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Two central banks: two different actions

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China and Australia are experiencing one common ailment: decline in economic activities. Both resorted very recently to the same old remedy of an easy monetary policy. That is the quicker of the two, the other being the fiscal policy, which is a blunt tool with slow impact.

Reduction in interest rate has another advantage. In the globalized world with absence of controls on movements, capital flows out to countries with higher interest rates. They would automatically decrease exchange rates of countries with lower interest rates. Depreciation of currencies makes exports more attractive.

China, the second largest economy has been on the decline since last quarter, triggering fall in demand for imports and consequently commodity prices of raw materials, including iron ore. The effects spread to Australia, the source country of mineral imports. Australia’s mineral boom ended.

Easy money policy

Last December, China's central bank cut its interest rate. Australia followed on February 3, this year.

Size of cuts was small, as they were waiting for the largest economy, the United States (US) to raise its interest rate to ward off inflationary potential, an offshoot of the recovery process. As capital flows were expected to stage a reverse flow back to US from the rest of the world, all major currencies would fall against the American dollar. Hopes lingered exports to US, both mineral and non mineral, would pick up.

That did not happen.

On February 25, the US Fed Chair told the US Congress that no rate increase is on cards for some time.

China

With no alternative, on March 1 China announced another reduction in interest rate, second time in three months. In the context of deflationary trend due to weakening external demand, China is turning to new policies: re-balancing. That is, domestic demand should be stepped up, lessening dependence on exports. With a revised, lower growth rate target of 7.4 per cent, China has to do all it can.

In February, house prices in China's major cities fell by 4 per cent. The middle class who had borrowed to finance their dream homes would be hit hard, if asset prices are allowed to plunge. China preferred a further rate cut for stepping up demand to prevent a deflationary spiral.

Different Conditions in Australia

The latest Reserve Bank of Australia (RBA)'s press release of March 3 recognizes that "growth is continuing at a below-trend pace, with domestic demand growth overall quite weak, with unemployment rate increasing over the past year. Under conditions of low inflation with subdued growth in labour costs, a more aggressive expansionary policy with another cut was eagerly awaited. However, RBA which reduced interest rate only last month for the first time since August 2013 to a record low of 2.25 percent resisted all temptations to effect another cut in interest rate.

RBA is cautious. They are aware of risks associated with further growth in credit for housing. Housing prices have already risen sharply since February in Sydney; and so too prices for equities and commercial property as a result of the easy money policy resulting in decline of long-term interest rates.

RBA prefers to wait until it contains risks that may arise from the housing market, before acting further in the next few months.

RBA wants a decrease in the value of Australian dollar against a rising US dollar. It feels it Aussie dollar is above its fundamental value, particularly given the significant declines in key commodity prices.

Thus, RBA's indications are clear: it has an easy money policy bias.

As I write this, the news is on hand that the Reserve Bank of India has cut its interest rate by 0.25 percent.

More on that next week.

Impact on Fiji

Aussies will wait for another month.

On the other hand, crashing property prices in China would force its investors to look outside, including Fiji. In the absence of financial assets, which are perfect and desirable substitutes to those of the rich countries, the Chinese will be attracted only to by Fiji's property sector.

If the Chinese attention is only on existing houses, prices will sky rocket. But if funds flow in new construction, commercial development and housing, the locals will not be priced out of the market. It will be a boost to growth as well.

Another boom period is waiting for owners of existing houses and vacant lands, in rural areas.

Of course, for the mushrooming real estate agents too, who have picked up enough Chinese language skills!

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