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Another round of downward revision of growth rates?

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Here we go again!

The IMF Chief Christine Lagarde has warned of another round of downward revision in world economic growth forecasts. Only eight weeks ago, the October 2015 forecasts were revised downwards to 3.4% in 2016 and 3.6% in 2017.

Yet another call to all central banks and finance ministries was made by IMF managing director at Frankfurt's Goethe University. Referring to the loss of growth momentum, caused by disappointing economic performance in Europe and Japan, and slowing growth in China, she alerted 188 member countries. The central bank governors and government leaders will meet next week in Washington to attend the annual Spring Meeting of IMF and World Bank.

They will have to consider the IMF’s yet another renewed call for structural reforms, removing the rigidities in labour markets, increased government spending and continuing the accommodative monetary policy aimed at cheaper credit for business.

IMF chief knows very well that most of the advanced countries have unprecedented low interest rates for past several years. Only last December the US central bank attempted to get out of the trap by raising the seven year old low policy rate (known as federal funds rate) from 0.0-0.25 % to 0.25-0.5%. Japan’s policy rate since 2010 has been 0.0-0.10%; UK’s rate since 2009: 0.50%; Canada since 2015: 0.50%; and Eurozone since March 2016: 0%

Structural reforms

The IMF knows the risk of additional measures such as pumping in money supply would only run the risk of creating asset bubbles, which were the cause of the US financial crisis. So IMF is now turning to other two: structural reforms and fiscal policies.

In her Goethe University address, Lagarde asked America to raise the national standard minimum wage rate of US$7.25 per hour. Labour market reforms and expansionary fiscal policy measures are expected to increase domestic consumption, the most important component of aggregate spending. China calls it “rebalancing the growth”, instead of continuing reliance on exports which target consumption overseas for its goods and services.

IMF Chief also urged Europe to improve job training; and emerging economies to cut fuel subsidies; and boost social spending. To all advanced economies, her advice is to provide greater research and development (R& D) investments as there is evidence that a 40 percent increase in R&D spending would result in a 5% rise in GDP over 20 years.

India

As IMF renewed its call for fresh measures to speed up the recovery process from the 2009 global financial crisis, we got the announcement from the Reserve Bank of India (RBI). Its lending rate known as repo rate was reduced to 6.5% from 6.75%, which is noted by Indian economists as the lowest in five years.

Governor Rajan has been known as an inflation fighter. He resisted to cut policy rate and incurred the wrath of the private sector. His move to adopt an accommodative monetary policy seems to be based upon careful considerations of key factors. One is a forecast of normal monsoon; and the other falling consumer price level. Indian economy, still dominated by its agricultural sector and millions of small farmers, is influenced more by monsoon than monetary policy changes or any policy changes. The oil price stubbornly low has also been a contributing factor to keep inflation at bay

The RBI has indicated that monetary policy stance will remain "accommodative", giving rise to possibilities of more rate cuts in the future if inflation continues to come down.

Governor Rajan is aware that RBI’s cuts in interest rates in the past were not passed on to borrowers by banks, a general tendency, which has been observed in all countries including Australia. RBI has introduced mechanism which forces banks to revise their lending rates in accordance with the revisions in policy rate. The new mechanism is the marginal cost of funds lending rate (MCLR) method to arrive at individual bank’s benchmark lending rate. MCLR will be calculated after factoring in banks' marginal cost of funds (largely, the interest at which banks borrow money), return on equity (a measure of banks' profitability), negative carry on account of cash reserve ratio (the cost that banks incur on account of keeping reserves with the RBI), operating costs and tenure premium (longer the loan term, higher the interest/premium). The actual lending rate will be MCLR plus the spread determined by banks after taking into account credit risk of the borrower, among other things. The new mechanism would ensure reduction in policy rate which would result in passing on the rate cut to borrowers more than before.

Nearer Home

New Zealand, another economy with agriculture dominating the economic activities, a month ago cut its policy rate known as Official Cash Rate (OCR) by 25 basis points to 2.25%. Reasons are the same: weaker growth in China and other emerging markets, and slower growth in Europe. Domestically, the dairy sector faces difficult challenges. Added to this, exchange rate had appreciated by more than 4 percent, hurting kiwi exports. So a lower interest rate is expected to weaken the exchange rate, thereby promoting the competitiveness of exports.

On Tuesday, Reserve Bank of Australia (RBA) decided to leave its policy rate known as cash rate unchanged at 2.0%, which has been in operation since March 2015. The RBA in its monetary policy statement notes that although commodity prices have increased little recently, “terms of trade are still lower than they had been in recent years”. Since inflation is low thanks to low oil prices, RBA considers continuing low accommodative monetary policy as appropriate.

Fiji’s monetary policy

Conditions in Fiji are different. Extraordinary circumstances created by cyclone Winston of February and the recent flooding caused by cyclone Zena have posed great challenges. Monetary policy stance will continue to be accommodative with the policy rate unchanged at 0.5%, which is in effect since November 2011. Reconstruction and rehabilitation works initiated with external assistance and diversion of budgeted funds towards recovery efforts would provide impetus to growth. Remittances and aid funds would keep up the comfortable level of foreign reserves for a while so there will be no pressure on exchange rate, a situation which has caused considerable concern in Papua New Guinea.

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