OPINION

Is the Monetary Tightening Cycle Over?

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Table Inflation and Key Interest Rates (in percent)

	Three Advanced Economies						Emerging Economy		Pacific Island Economy		
	USA Inflation (Y to Y) (%)	USA Interest Rate (%)	UK Inflation (Y to Y) (%)	UK Interest Rate (%)	EURO zone Inflation (Y to Y) (%)	Interest Rate (%)	India Inflation (Y to Y) (%)	India Interest Rate (%)	Fiji Inflation (Y to Y) (%)	Fiji Interest 0PR (%)	Fiji Minimum Lending Rate (%)
2021 Dec	7.00	0.25	4.80	0.25	4.96	0	5.56	4.00	3.0	0.25	0.50
2022 Jan	7.50	0.25	4.40	0.25	5.11	0	6.01	4.00	2.7	0.25	0.50
Feb	7.90	0.25	5.00	0.50	5.87	0	6.07	4.00	1.9	0.25	0.50
March	8.50	0.50	6.20	0.75	7.44	0	6.95	4.00	4.7	0.25	0.50
April	8.30	0.50	7.80	0.75	7.44	0	7.79	4.00	4.7	0.25	0.50
May	8.60	1.00	9.10	1.00	8.05	0	7.04	4.40	5.0	0.25	0.50
June	9.10	1.75	9.40	1.25	8.64	0	7.01	4.90	5.1	0.25	0.50
July	8.50	2.50	10.10	1.25	8.87	0.50	6.70	4.00	5.2	0.25	0.50
Aug	8.30	2.50	9.90	1.75	9.14	0.50	7.00	5.40	5.4	0.25	0.50
Sept	8.20	3.25	10.10	2.25	9.93	1.25	7.41	5.90	4.7	0.25	0.50
Oct	7.70	3.25	11.10	2.25	10.62	2.00	6.77	5.90	4.8	0.25	0.50
Nov	7.10	3.75	10.70	3.00	10.05	2.00	5.88	5.90	4.7	0.25	0.50
Dec	5.00	4.00	10.50	3.50	9.20	2.50	5.72	6.25	3.1	0.25	0.50
2023 Jan	6.40	4.25	10.10	3.50	8.64	2.50	6.52	6.25	2.5	0.25	0.50
Feb	6.00	4.50	10.40	4.00	8.50	3.00	6.44	6.50	1.5	0.25	0.50
March	5.00	4.75	10.10	4.25	6.88	3.50	5.66	6.50	2.0	0.25	0.50
April	4.90	5.00	8.70	4.25	6.96	3.50	4.70	6.50	NA	0.25	0.50
May	4.00	5.25	8.70	4.50	6.10	3.75	4.25	6.50	NA	0.25	0.50
June	TBA	5.25	TBA	NA	TBA	4.00	TBA	6.50	TBA	0.25	0.50

Notes TBA : to be announced
NA: Not Available
Y to Y: year to year
June inflation data will be available in mid July.

Sources: Websites of US Federal Reserve St Louis, Trading Economics
Bank of England, European Central Bank,
Reserve Bank of India and Reserve Bank of Fiji

The decision on June 14, 2023 by US Federal Reserve Bank (the Fed) to leave the policy interest rate unchanged at 5.25 per cent, which was set last month is a major step. It finally snapped up a string of 10 consecutive rate hikes since July 2022 for fighting "the country's worst outbreak of inflation in 40 years".

In his defense at a Press meet on May 4, after effecting a rise by 25 bps (a quarter of one percentage point) and increasing the interest to 5.25 per cent, the Fed chair Jerome Powell observed that despite a fall in inflation from a historically high rate of inflation at 9.1 per cent in June 2022, to 4.9 per cent in April 2023 (Table), inflation still remained a global issue. The markets expected a reduction in interest rate, as steady fall in inflation has been displaying downward trend from early 2023 (6.4 per cent in January, 6.0 per cent in Feb, 5 per cent in March and 4.9 per cent in April). It did not happen. On the other hand, he warned further monetary tightening would result in "a mild recession". Nobody wanted a recession.

This month, in June, the Fed Chair did not want to commit another "error in judgment", as inflation data released on June 13, showed a further fall: inflation in May was 4 per cent, decreasing from 4.9 per cent. There have been a series of serious errors beginning from late 2021. The inflation target of the Fed is 2 per cent which was exceeded consistently each month from mid 2021 (Table). The Fed which initially attributed the rising price level to transitory factors and they would vanish away, had to stop alluding to the imaginary factors, when inflation rose to a new high at 8.5 per cent in April 2022. The Russia-Ukraine conflict, which began in late February 2022 became a shooting war, which is still on-going, caused supply chain disruptions leading to shortages of availability of both petroleum crude and food grains. As inflation reached 9.1 per cent in June 2022, the highest in two decades, the Fed mounted a more aggressive monetary tightening policy.

As US inflation is now 4.0 per cent, confirming the downward trend, the Fed's decision to pause the rate change and keep the rate unchanged at 5.25 per cent shows it cannot ignore the worldwide trend in central bank interest rates. Amongst the world's 147 central banks, 95 central banks have maintained status quo, 43 have increased and 9 have decreased the policy interest rate. That is a relief for the rest for the world, which does not want a recession to result from monetary tightening. Although in recent years, the US shares of world's GDP and trade have shrunk, one should also be aware that the world GDP as well as world trade have also shrunk. These caused severe setbacks to globalization efforts, giving rise to fears of return to an era of protectionism with hurdles to movement of capital and labour across continents.

Europe and UK

However, inflation is still ravaging the advanced countries: United Kingdom and the Eurozone. The accompanying Table shows inflation is still above the inflation target of 2 per cent and the anti-inflationary measures have not ceased. As the inflation in UK was 10.4 per cent on March 23, the Bank of England (BOE) raised its policy rate by a further quarter of a percentage point (25 basis-point) increase from 4 per cent to 4.25 per cent. That was its 11th consecutive increase beginning from December 21, 2022, four months earlier than the Fed. On May 11, BOE again raised it to 4.5 per cent, which is the 12th consecutive increase. The European Central Bank (ECB) which increased its interest rate to 3.75 per cent in May has just raised it to 4 per cent on June 16. The rate setting committee member from Belgium was worried: "We are waiting for wage growth and core inflation to go down first, along with the headline inflation down before we can arrive at a pause".

> With decreasing inflation, one set of nations is worried about recovery and return to normalcy, more importantly growth. The other set of nations are still fighting inflation.

Other economies

Among the emerging economies, India has paused the interest rate change for the second time on June 8, as inflation went down further to 4.25 per cent. The interest rate stands at 6.5 per cent. It is noteworthy both the Fed and Reserve Bank of India ignored the rising inflationary trend in late 2021 on the ground that factors causing inflation were transient. Almost together, they resorted to anti inflationary measures of steady increase in interest rate from the second quarter of 2022.

As regards Pacific Island countries, our observations are economic issues of any country, big or small are size-neutral. However, if a country has a fixed exchange regime with restrictions on mobility of capital flows, monetary policy is more effective than those in countries which have fully convertible currencies and flexible exchange rate regimes with perfect mobility of capital. However, studies have brought out findings, with poorly developed financial markets, monetary policy is less effective than fiscal policy. The latter directly influences aggregate demand .

In Pacific island countries (PICs), imported inflation plays a major role. Most of the inflation stems from rise in prices of critical imports, such as food (grains, wheat flour and edible oil) and fuel (petrol, diesel and kerosene) and imported construction material for housing and infrastructural works in the public sector.

In Fiji, as a leading PIC, we note inflation has been brought under control through expenditure control of government. Further, fall in incomes due to disruption in tourism earnings have kept inflation down. Interest rate adjustments have been negligible as a low interest policy accommodative monetary stance, which was consistently kept with an eye on housing and other investment at household levels, has proved beneficial on the domestic front.

An ambiguous answer

Foregoing discussion opens up a new subject which centers around the recent and very unique occurrence: the concerted and coordinated action in two phases by all nations, which was witnessed in the fight against the COVID-19 pandemic; and close to its heels against inflation, caused by excess liquidity, originally stemming from measures to save the world economy from financial crises; and later to rescue the world economy from fall in output due to loss of lives and livelihoods following the pandemic. The era of coordinated action is coming to an end.

We have come to a new situation: cThe policies will now differ. Even among nations there are some, which seem to have conquered inflation have been worried about return of inflation or inflation would be staying elevated for a longer period than previously expected, as there are continuing geopolitical tensions.

So , the answer to the question: "Is the cycle of monetary tightening over?" remains at best ambiguous.

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