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Easy Money Policy

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Early this week, the Reserve Bank of Australia (RBA) announced a change in its monetary policy stance.

The RBA benchmark interest rate, known as cash rate, has been reduced from 3.25 percent to 3.0 per cent effective from December 5.

The cash rate is the rate at which commercial banks borrow from each other to tide over temporary shortage in funds, reflecting the tightness or otherwise. All interest rates charged by commercial banks and other financial sector institutions are expected revolve around this. A lower cash rate interest rate signifies an easier monetary policy stance of the central bank so that investors and consumers alike can take the cue that the economy has to move forward with greater investment and consumption.

The Reserve Bank of Fiji announced on November 29 that there is no change in its easy money policy stance adopted since October 2011. The RBF's benchmark interest rate is known as overnight policy rate. It would continue to remain the same at 0.5 percent.

RBA decision

The RBA decision to adopt an easier monetary policy was based on the after-effects of a fading mining boom on the mineral exports dependent Australian economy. Falling commodity prices have forced mining companies to retrench thousands of workers.

With a modest growth forecast in China and the slowing down of the global economy in the context of the unresolved euro zone crisis and the fiscal cliff stand-off between the executive and legislative wings in America, RBA is worried. An easy money policy would reignite demand in the weakening sectors including retail and manufacturing. The inflation outlook is benign. Hence, a poor global growth outlook forced RBA to take decision to become more accommodative.

Soon after the announcement of an easy money policy, three of the four big banks announced cuts in their rates only by 20 basis points. They do not allow a full pass through. The banks always play safe. For this particular reason, RBA had to announce larger cut in cash rate.

RBF decision

The RBF decision to continue its accommodative policy stance is based on the expectations of further deterioration in the global economy next year "as a result of possible fiscal tightening in the US and the degree to which austerity measures are undertaken within the Euro zone".

Fiji's economy is projected to grow in 2012 year by 2.5 percent, below the earlier 2.7 percent growth forecast. Since attractive interest rates are now offered by banks for loans for housing and consumer durables and the 2013 Budget has offered incentives, RBF decided to continue the monetary policy stance unchanged.

Although inflation rose to a lower-than-expected 4.1 percent in October from 3.7 percent in September, RBF is confident "price pressures are expected to moderate further due to the flow-on-effects of restrained growth in global demand. The year-end inflation forecast remains at around 3.5 percent with possible downward movement in the remaining months".

With Fiji's international foreign reserves being at a comfortable level of $1.6 billion, adequate for 6 months of imports, the decision to maintain monetary policy stance unchanged is consistent with global central bank behaviour.

"Ballooning Balance Sheets"

The world's leading central banks, the US Federal Reserve (the Fed), the European Central Bank (ECB) and the Bank of England (BOE) have all now low interest rates.

In fact the US Fed Funds rate is close to zero.

An IMF study says "the central banks found themselves in a policy quandary."

Since their rates are already low, they have difficulties in lowering policy interest rates further to fight recession and encourage investment. The only way open to them is to soak their economies with greater liquidity by purchasing private sector debt and sovereign debt, which are not normally done.

As they say, in war and love everything is fair.

The BOE by buying government securities since 2009 has added to money supply by 14 percent of GDP. The ECB has conducted a range of measures, including long-term financing operations and a limited securities market program for sovereigns. The Fed purchased both government bonds and mortgage-backed securities to reduce long-term yields, especially on residential mortgage rates.

The result: there has been a ballooning of all three central banks' balance sheets. Since the beginning of financial crisis in August 2007, the BOE's balance sheet has grown 380 percent; the ECB's went up by 241 percent; and the Fed's by 221 percent.

Low interest rates and excess liquidity have not moved the world economy. What else needs to be done?

The only thing that remains is: return of investor confidence.

Money cannot buy it!