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A topsy-turvy business world

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It was truly a topsy-turvy week in the business world.

After a month of stock market rally in the United States (US) and Japan, there was a sudden tumble last week.

It caused a big scare.

Japanese stock market fell by 7 percent, the worst decline since the tsunami of March 2011. Until May 22, world stock markets were soaring despite the news on faltering economies of China and Korea.

Central bank actions

The world stock market performance was due to increases in money supply by central banks in US and England and by European Central Bank. They were joined by Bank of Japan in April.

The US Federal Reserve (the Fed) chairman Ben Bernanke started it all in 2008.

Under the name of quantitative easing (QE), the Fed began to soak the economy with additions to money supply by purchasing government debt and the mortgages of banks.

Under two phases of QE, the Fed added more than one trillion US dollars. Despite the benchmark interest rate being close to zero, the real economy was not moving. So the Fed decided to pump in US$85 billion each month until unemployment rate falls below 6.5 percent. As there is no target date, this is called QE Infinity.

Inflation expectations were low. Since the bench mark interest rate was close to zero percent, switching to stock was a better investment option.

That was the reason for the soaring equity price index. It is not due to better performance of companies or profits. Holding shares was the best alternative, as gold does not bring in any return. All asset markets including asset markets were dull.

The scare

The scare in the stock markets resulted from an answer by Bernanke to a question by the Joint Committee of the US Congress on May 22.

Earlier, in his prepared testimony to the committee, he hailed the success of QE.

He warned that "a premature tightening of monetary policy could lead interest rates to rise temporarily, but would also carry a substantial risk of slowing or ending the economic recovery and causing inflation to fall further."

In his reply to a question, he said money injections may slow in the next few months if employment rate improves. It would depend on fresh data.

That was clear and direct.

The markets reacted. Indications about the end of QE3 led to the fall in stock prices all over the world. Japanese government bonds suffered a steep fall, taking yields to their highest level. The fear about the end of QE 3 means end of falling yen, damaging Japanese export recovery prospects.

Better to keep markets guessing?

That brings us to the famous "Greenspeak". Professor Blinder calls it as "a turgid dialect of English, intentionally wordy, vague and ambiguous statements".

Alan Greenspan, who was the Fed chairman for 19 long years, was known for strategy of obfuscation. His utterances, called "Greenspeak" were one of "'mumbling with great incoherence". They often prevented financial markets from overreacting to his remarks.

He once famously told a US Congressman during a hearing:

"Mr. Congressman, I guess I should warn you, if I turn out to be particularly clear, you've probably misunderstood what I've said."

Some good, some bad news

On Tuesday, there was some good news about the real economy. One is about U.S. home prices and the other is on consumer confidence. Home prices posted their strongest gains since 2007. The consumer confidence index also surged to a five-year high in May, the highest reading since February 2008. The stock market, which was inspired by real economy, reacted with gains. That is the way it should be.

On Thursday, the news came that eurozone would shrink by 0.6 percent. The good news on the US recovery was more than offset by overwhelmingly bad news. The stock market gains of Wednesday were wiped out on Thursday.

It is too premature to call an end to the rally. There were occasions when stocks sharply went down and they rose again. Investors take advantage of fall in prices just to get back into the market.

To prove the point, as I write this on Friday, investors have ignored previous day bad reports The Dow-Jones, S&P 500, and the Nasdaq ended with gains between 0.2 percent and 0.7 percent. These three indices are now up between 16 percent and 18 percent this year.

In the midst of these topsy-turvy trends, small economies including Fiji have to keep floating. On Thursday, Reserve Bank of Fiji announced to maintain the policy stance without any change in its benchmark interest rate at 0.5 percent.