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## Getting ahead of the curve

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Early this month, one news item went unnoticed by local media. Maybe it was considered relevant, only to advanced countries.

Advice or research finding emanating from any part of the world in area of concern is important in a global village. For example, a finding that frequent and indiscriminate use of antibiotics to treat common illnesses for an extended time or in large doses is bad is of universal health concern.

The Bank of International Settlements (BIS) in its annual report released on June 30, cautions central banks against the continued use of low interest rates for providing monetary stimulus.

The BIS advice is also relevant to Fiji and other Pacific island countries which have independent currencies and central banks with monetary policy tools.

The BIS based in Basel, Switzerland was established in 1930 with a membership of 60. They include central banks of the US, UK, Japan and China and European Central Bank and other major countries.

Although known as central banks' central bank, BIS does not lay down policies. It only provides a forum for central bankers to exchange views on global economic issues.

### **Disconnect between two sectors**

Low interest rates helped increase demand for higher risk investments in stock markets, in property and corporate bonds markets. However, there is a "puzzling disconnect between the markets' buoyancy and underlying economic developments".

BIS warns: “Over time, policies lose their effectiveness and may end up fostering the very conditions they seek to prevent”.

While stock market and property prices have skyrocketed, economic growth is low and slow, with weak increases in jobs and household incomes. The US Federal Reserve’s low interest at 0.25 percent ever since 2008; other central banks’ similar low rate regimes (Bank of England with 0.50 percent; ECB’s 0.15 percent; Japan’s 0.10 percent) have not resulted in higher real growth.

Apparently, monetary policy transmission mechanism has failed.

Global growth despite its recovery at 3 percent during first quarter of January of 2014 is weaker than the 3.9 percent growth rate between 1996 and 2006. On the other hand, stock markets are “euphoric”, despite political rife in Ukraine and in the Middle East.

With the upturn, BIS wants reduction in emphasis on monetary stimulus. Any postponement or delayed action could have potentially damaging consequences by encouraging investors to take too much risk.

It is better to be ahead of the curve.

### **Pacific region**

Two central banks have been quite conscious of the need for using monetary policy to meet the changed circumstances. Australia was the country to increase the interest rate in 2009 in the midst of recession in the rest of the world, as domestic economy showed signs of recovery. New Zealand which kept the interest rate low at 2.50 percent for five years (2009-2014) started raising the rate since March: 2.75 percent in March, 3 percent in April and to 3.25 percent in June.

On July 1, RBA noted that accommodative policy has helped credit growth and dwelling prices have increased significantly over the past year.

In Fiji, benchmark interest is low at 0.5 percent since 2010, which has contributed to growth in net domestic credit by 18 percent over last three years. This is driven by higher credit to the private sector. Bank loans for building and construction and real estate, including property development rose from F\$ 518 million in 2010 to F\$689 million in 2013. The increase is 33 percent. For real estate and property development, loans were F\$316 million in 2010 and F\$429 million in 2013. The growth is 36 percent.

### **Housing bubble**

The credit growth for real estate and property development is fuelled by overseas investors’ readiness to buy built up properties. This has encouraged domestic agents and builders and construction companies to buy first, and only to sell later to overseas investors at an opportune

time. Under the pretext of property renovation and development, they also borrow from banks and wait for overseas investors.

Anecdotal evidence shows that properties, which were bought with a view to selling them later for capital gains were held for a very short period. Bank loans are now seen contributing to formation of housing bubble.

With Fiji on an expansion path (3.6 percent in 2013 with positive growth rates for past three years) and with increasing consumption demand for both tradables and nontradable during the election period, Reserve Bank of Fiji is watching.

A former Chairman of the US Federal Reserve, William McChesney Martin once remarked: “The Federal Reserve's job is to take away the punch bowl just as the party gets going.”