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## Another crash is coming?

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Last week, the US Federal Reserve (the Fed)'s action not to raise interest rate calmed down the stock markets. But it was only for a short while.

The market is now volatile.

Before the US Fed's policy decision on March 18, investors used to low interest rate since 2008, (the starting year of recession) were nervous.

The Fed decided against the rise in interest rate on two grounds: low inflation due to low energy price; and the US economy was just recovering with much scope remaining for growth in job numbers, especially quality jobs.

The target rate of inflation is still below 2 percent and so there is some leeway for stimulating growth through a low interest rate environment.

However for the first time, the Fed indicated it would raise the interest rate when needed. Does it mean it is waiting for inflation to be close to 2 percent?

We have clear indications of recovery of the US economy. As an economy picks up, prices of raw materials and inputs tend to go up; wages would rise; and costs of production would increase.

As jobs and incomes register increases, demand for consumer goods would also be up: all will be reflected in the rising price level.

### **Growth without inflation**

The latest US data reveal, although consumer price index rose by 0.2 percent in February, it remained unchanged from a year earlier.

The negligible rise in February is just after three successive months of falling price level. The price drop was 0.7 percent in January. We see no inflationary conditions yet so far.

Is it all due to oil price shock: low energy price?

Linda Yueh, BBC's chief business correspondent reminds us of the similarity to another strange phenomenon: stagflation.

The 1970s all over the world experienced high inflation while output was stagnant, just "the opposite of what is happening today".

It is "against normal economic relationships".

The reason then was oil price shock of opposite kind: high energy price.

High oil prices due to conflicts in the Middle East raised inflationary pressures which were beyond control of US and UK, which along with other poor countries without any oil resources had to face domestic inflation in the midst of recession.

Today, when the economies recover, no pressures on price level: coexistence of growth and low or no inflation!

### **UK's zero inflation**

News is on hand, inflation in UK fallen to zero for the first time.

The consumer prices index dropped in February. Steep oil price slump and supermarket price wars brought down fuel prices by 17 percent over the year, and food prices by 3 percent.

### **But stock prices soar!**

While the real economy is yet to be on a growth path, we are witnessing bubbles in the financial markets: false boom!

The European and US markets are now surging: Late last week, London's Financial Times Stock Exchange Index went up past the 7000 mark in history and so too the European indices.

On the exchange rate front, the euro recovered from its lowest rate of US\$1.05 against the American currency in 12 years to US\$1.10, a big rise in a single day last Friday; and so too the Chinese currency.

### **Australian economy**

The latest news as I write this is the Australian dollar rose against the US dollar. It is US\$0.79, certainly affecting export prospects.

Another interest rate cut next month, instigating a currency war?

Already with a low interest environment triggered by interest rate cut last month to 2.25 percent, has pushed property prices up.

Rise in bank lending is now seen to encourage speculative activity. Lending has gone up by 150 percent in housing sector.

Reserve Bank of Australia (RBA) notes any strong speculative demand would only amplify the run-up in housing prices.

RBA warns: “prices might fall significantly later on”, which would eventually “reduce wealth and dampen spending for the broader household sector, particularly for those households with significant housing debt”.

### **Stocks & speculation activities**

“The stock market boom is driven by fear rather than by euphoria”, says Nobel Laureate, Professor Robert Schiller of Yale University.

In his March 22 interview with a German newspaper, he observed “We are not seeing any optimism”.

Private sector optimism is necessary for investment in real sector.

Cheap money leads to investment in financial assets and speculative activities.

Although he refrained from criticizing the central banks for what they are doing in the current circumstances, he laid the blame on global pessimism.

What is the alternative: a greater role for public sector?

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