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End of cheap money

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Nearly a decade of easy money policy is over.

The US Federal Reserve reduced its benchmark interest rate (known as Federal Funds rate) of 5.25 percent in September 2007 to a range of zero-0.25 percent in December 2008 to fight the Great Recession.

The Federal Funds rate is the interbank lending rate, which reflects the market tightness or otherwise at which banks borrow from each other.

In addition to the unprecedented benchmark interest rate of near zero percent, the US Central bank began pumping money each month totaling nearly four trillion for maintaining the liquidity at a very high level.

Finally, the suspense of nearly two years also ended.

The suspense began with the announcement in late 2013, when an off the cuff remark was made by the former US central bank chair that the monthly addition of money supply would end soon hinting a sooner than anticipated return to normalization of monetary policy. The signs were clear. The unemployment rate was falling gradually, although inflation was never higher than one percent and much less than the target rate of 2 percent.

Beginning of taper tantrum

That in a way prepared the emerging economies, including Brazil, India, China and South Africa) which enjoyed unprecedented inflows of capital seeking higher returns to get ready for an increase in the US interest. Some began to reassess their economic conditions in the light of

likely impact on imports from US becoming more expensive and debts incurred in US dollars posing problems of servicing their repayments.

But the Fed blinked in 2015, as data dependent Fed Chair hesitated.

There were months when the additions to jobs varied. When finally in July 2015 the unemployment rate fell below 5 percent, it was expected the US central bank would raise interest rate in August. The unexpected devaluation of the Chinese currency hinted a new crisis developing in the world, spelling doom and gloom. That forced the Fed to postpone its decision.

Added to the Chinese economic slowdown, the European and the Japanese economies had some setbacks too. The IMF took the opportunity to tell the US central bank to consider postponing any return to normalcy so soon and wait for the New Year.

The concerns were genuine.

An increase in the rate would spell disaster, as the rise in the interest rate would make the US dollar stronger. External debts of all economies, which are denominated in US dollars make them go up in terms of domestic currencies, rendering the servicing charges more expensive and setting apart more local resources.

The Fed took the plunge finally. The latest annualized growth rate for the quarter ending November is 2.1 percent. So the return to normalcy is justified.

The Fed Open Market Committee's decision was unanimous.

Winners and Losers

The Fed action can be seen as a measure to prevent any possible heating up of the economy. Its decision was guided by experiences drawn from the previous episodes of recovery. They were often seen accompanied by an inflationary phase. The Fed is keen to reduce consumer borrowing and discourage bubbles in the housing market and other assets.

However, there are firms with high level of debts. They took advantage of cheap interest rates.

There are oil fracking companies which are losing in the face of falling oil prices. They have heavily borrowed will find things tough going, as they now face interest rate rising.

Households who have borrowed for housing at fixed rates would not lose. Further, the household debt has generally come down since 2008.

There will be less borrowing in several markets: autos, credit card usage and housing.

On the other hand, US exporters will be unhappy too. Their exports will become more expensive to developing countries, as the US dollar strengthens. The manufacturing US companies located

overseas will be losing when they repatriate their profits in dollars as they will lose while converting them into US currency.

American tourists will feel happy, as they would see their dollars will buy more foreign goods; and hotels and food costs will be less than before.

The losers will be emerging economies.

There will be fresh outflows of funds, although the outflows have already begun. The currencies will fall in value. Import costs will go up. The current account deficits will widen again.

Already some countries have begun to raise their interest rate reducing interest rate differential gap. With the falling commodity prices, mineral exporting industries which are hurt already will be facing higher borrowing costs.