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RBF policy actions and what it means

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This week there were developments of significance on the central banking front.
There were no changes in monetary policy stance. No change is also of significance!

First on July 30, Reserve Bank of Fiji decided to maintain the same policy rate of interest at the lowest ever, 0.5% which is prevailing since November 2, 2011.

The RBF was aware that the much expected global recovery and growth have yet to get fully materialized. Global inflationary conditions continue to remain subdued giving relief to consumers and investors in small open economies including Fiji and Pacific island countries which are dependent on critical imports ranging from food to fuel and investment goods.

Domestically speaking, Fiji's growth outlook, according to RBF is strong despite fall in government expenditure and adverse effects due to weather disturbances on sugar cane production. This is ascribed to better performance by tourism and rising demand as reflected in improved business climate and growing bank credit.

With low inflation at 0.8% and foreign reserves at $1.9 billion, adequate to cover around 5 months of imports, RBF does not want to change policy stance. The RBF is confident that Fiji would be able to reach the targeted growth rate at 4.3% for 2015.

RBA action

The same degree of cautious optimism is seen in the monetary policy statement of Reserve Bank of Australia issued on August 4, when it decided to maintain the same bench mark interest rate known as official cash rate at 2%, which is the rate since May 2, 2015. The RBA statement notes moderate growth rate of expansion of global economy. It also recognizes key commodity prices are much lower than a year ago due to increased supply from Australia itself and resultant fall in Australia's terms of trade hurting growth prospects.

Despite these developments, RBA is optimistic because of low borrowing costs all over the world as well as stronger growth of employment and a steady rate of unemployment over the past year. With the economy operating with a degree of spare capacity for some more time and as domestic inflationary pressures are low, RBA decided that monetary policy "needs to be accommodative."

Business is happy. Any increase in exchange rate following a hiking of interest rate would hurt exporters. Present conditions are favourable to business as the Australian goods are more competitive. The Aussie dollar has already lost its value by 9 per cent against major currencies since 2014.

Businesses have noted that RBA's latest statement did not any longer refer to the need for "further depreciation" in Aussie dollar. It simply stated that "the Australian dollar is adjusting to the significant decline in key commodity prices".

The analysts have drawn the conclusion that there may not be any cut at all in the interest rate.

The contribution to maintenance of competiveness of exports for a much longer time, not only of Australia but also of the rest of the world, including New Zealand would come from elsewhere.

That is the United States.

The US to raise interest rate?

The US Federal Reserve is likely to raise its interest rate, if not now, at least in September. There are three more policy meetings in 2015. The first one is slated in September and the next two are in October and December.

This follows from a strong report on U.S. service-sector growth; and from the comments of the Fed Bank of Atlanta President Dennis Lockhart last Wednesday. The economic data reveal that unemployment rate is 5.3%, much below the high of 10% in 2009. Job gains have averaged 208,000 a month this year. The Fed Bank of Atlanta President Dennis Lockhart said an interest rate hike is certain and he would not put too much weight on new data that emerges in the next few weeks unless it is especially weak.

So a hike in interest rate is imminent.

If it materializes, the US dollar will soar to new heights. Increase in the US Fed's interest rate will signal to the reset of the world that US returns to normalcy. With absence of capital controls in the industrialized world, hot money from Europe and Australia and New Zealand and Japan will flow into USA, besides the usual demand for US bonds and securities. In countries under flexible exchange rate regimes, bilateral exchange rates will change in their favour. Currencies of the world will fall.

Appreciation of US dollar would thus effectively transfer demand from the U.S. economy to rest of the world. This will be welcomed by all economies, including Australia, Japan and others especially emerging nations in Asia and Europe, who depend on exports for domestic growth.

Australia and others do not have to worry about further cuts in interest rates.