Fiji Sun Paper | Online | Mobile
Saturday, May 9 2015

Three central bank actions

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This week, three central banks announced their monetary policy decisions.

Two of them, Reserve Bank of Fiji (RBF) and Reserve Bank of New Zealand (RBNZ) decided against any change. On the other hand, Reserve Bank of Australia (RBA) decided to cut its interest rate to a historical low: 2 percent.

The RBF decision on April 30 to maintain its benchmark interest rate at 0.5 percent was not a surprise. With growth projections for 2015 revised upwards from 4.0 percent to 4.3 percent, RBF decided to continue the current accommodative policy stance, effective since November 2011. The press release said:“Twin objectives of monetary policy, namely low inflation until now and adequate foreign reserves level ($1,857 million, sufficient to cover 4.6 months of retained imports) considered to remain comfortable over the near term.”

However, RBF made it clear that the monetary authorities are conscious that inflation rose to 2.4 percent in March, from 2.1 percent in February, due to higher food, alcoholic beverages and tobacco prices. Although there are expectations that the “recent reduction in domestic fuel prices would ease inflationary pressures in the months ahead”, it is indicated that any change to monetary policy will be guided by developments on the outlook for foreign reserves.

Further, the recognition that the pressure on foreign reserves “remains as given Fiji’s growing import demand for consumption and investment related goods”, as evidenced in the rising current account deficits, would lead to an indication that continuance of the accommodative monetary policy stance cannot be taken for granted.

Reserve Bank of New Zealand (RBNZ)

On April 3, RBNZ too decided to maintain its policy rate, which has been effective from July 2014, at 3.5 percent. Factors which influenced the decision were fall in oil prices and a strong kiwi dollar, which reduced inflation to 0.1 percent in the first quarter, the lowest in 15 years. The inflation is below target rate of 2 percent. Crude oil prices are almost 50 per cent below their July 2014 level. Together with fall in fuel prices, low interest rates since last year, high net immigration and construction activity contributed to growth at an annual rate of 3 per cent.

Because of low policy interest rates by central banks with uncertainties in Europe, China and in US about the timing of much expected interest rate adjustment, RBNZ took the decision to persist with accommodative policy. RBNZ made a clear statement that any “appreciation in the exchange rate, while our key export prices have been falling, is unwelcome since lower dairy incomes, lingering effects of drought, fiscal consolidation, and the high exchange rate are weighing on the outlook for growth”.

Reserve Bank of Australia

In Australia, both the mining sector and the non-mining sectors investment are sliding. Unemployment rate is around 6 percent, worse than what it was during the financial crisis of 2008-09. While the weaknesses in the Australian economy can be traced to low commodity prices affecting mining sector, there are decreases in private investment (except in housing) and public investment due to government’s own fiscal restraint. With public spending expected to remain subdued, RBA had to act, as it did before. It cut 10 times since 2011. Each cut turned out to be less effective than it used to be.

It cut the policy rate to record low 2.0 percent from 2.25 percent. In its decision a benign inflation outlook “provided the opportunity for monetary policy to be eased further, so as to reinforce recent encouraging trends in household demand”.

The decision to boost economic activities has a high risk: it is feared it would only add fuel to the fire in the hot Sydney and other “burning” urban property markets. The fear is the speculators would jump in. It is predicted that home loan rates would dip below 4 per cent, which will be the lowest on record.

Fear of another bubble

Cheaper credit would only lead to creation of a bubble. That is the last thing RBA would like to have.

The RBA might be happy to see housing construction pick up some of the slack left by the sharp decline in investment. But there is every concern at the rate of property inflation in Sydney; currently running at more than 10 per cent a year.

The RBA has to rely on macro-prudential tools – direct controls on bank lending – to avert any build-up in systemic bank risk, through Australian Prudential Regulation Authority (APRA).

The policy rate of Fiji (0.5 percent) now compares with RBNZ rate of 3.5 percent, 0-0.25 percent in the United States, 0-0.1 percent in Japan, 0.5 percent in the euro zone, and 2.00 percent in Australia.