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Why is economic growth stagnating?

T.K. JAYARAMAN

Last weekend, there was disturbing news from America. New jobs created in March were only 120,000 compared to high numbers of monthly additions exceeding 200,000 monthly for 12 months in a row. The February figure was higher: 295,000.

Is US slowing down again? Discussions on recovery and hype about raising interest rate are too premature?

With successful US-Iran talks on nuclear deal, fears of rise in oil prices have vanished for now. With signs of assurance of low inflation at least in the near future, the accommodative near zero interest rate policy (ZIRP) is not likely change in the near future in US.

Australia's decision

Reserve Bank of Australia (RBA) has decided against any cut from benchmark interest, 2.25 percent. Many expected a cut. Prevailing conditions of low inflation and high unemployment, and reminders from RBA that the overvalued Australian dollar has been hurting competitiveness, all hinted a rate cut on April 7.

It did not materialize.

Fears of the housing bubble bursting any time took priority over concerns for jobs.

The question then remains the ineffectiveness of the much hailed biggest interest rate cut in 18 months by RBA in February to 2.25 percent, the lowest since the 1960s. What is holding back investment and consumption?

That is also the question haunting the world's largest economy.

So too the third largest economy, Japan's experience: Two years of Abenomics with central bank purchases of assets, known as "a bazooka of ultra-lavish monetary easing", have not yielded results.

Businesses have no incentive to invest and hire more labour in an economy of falling prices.

Stagnant growth

Economists have an explanation. They turn to the traditional answer that there is a need for lowering the cost of borrowing relative to the expected return on real capital, known as Wicksellian natural rate, named after Austrian economist: Wicksell.

It is argued if the so called Wicksellian rate decreases, the only way to stimulate investment is to reduce the cost of borrowing further.

How far can one go, if the natural rate of return goes down further and further?

Why is the natural rate of return going down? Poor optimism or absence of “animal spirits” of Lord Keynes?

It is not fashionable these days to advocate a larger role for government.

More acceptable now is monetarism, which has led to bulging balance sheets of central banks of US and others. The quantitative easing by US Fed under chairman Ben Bernanke involved purchase of assets for liabilities of US$3.5 trillion of US government debt and bonds created out of home loans or mortgages. With poor growth and slow rise in jobs, ZIRP has failed

Thesis of secular stagnation, a contribution of Alvin Hansen in 1950s, gained currency again, when Lawrence Summers of Harvard University, a former Secretary of the Treasury for President Clinton and Chairman of Council of Economic Advisers for President Obama, spoke about two years ago at IMF’s 14th Annual Research Conference.

Secular stagnation refers to a condition of no growth when there is an absence of long term investments in growth-sustaining areas including education, technological innovations and research, and infrastructure. When investments decline, per capita incomes would decline. That would result in fall in per capita savings. A reduced saving rate converging with reduced investment leads to stagnation.

Lawrence Summers had a point.

Coming as it did from a former official of Clinton and Obama, it received attention but was rejected as a Keynesian remedy

Ten days ago, secular stagnation thesis became popular again, when Bernanke, now with Brookings Institute’s Economic Studies Program entered into the blogosphere with his three part inaugural blog.

In his blog “Why are interest rates so low”, former Fed Chair took issue with Summers’ claim. Rejecting the secular stagnation hypothesis, Bernanke said “low growth in advanced countries today was a reflection of temporary headwinds and that normal growth rates would return when those headwinds abated”.

Summers replied: “I would like nothing better than to be wrong, as Alvin Hansen was, with respect to secular stagnation”. He added “But throughout the industrial world the vast majority of the revisions in growth forecasts have been downwards for many years now.”

IMF report

IMF’s latest *World Economic Outlook* released on April 7 supports the secular stagnation thesis, as policy makers gather for spring meetings in Washington.

Advanced economies’ growth is predicted to be below pre-crisis rates of 2.25 per cent. Emerging market economies would decline from an average of about 6.5 per cent to 5.2 per cent a year in next five years.

IMF says world is in the grip of “secular stagnation”.

Living standards of future generations will be much lower than expected.