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Headline: Major economies should coordinate policy measures

The combination of a rising US dollar and a falling yen may be ambiguous as a strong greenback is good while a falling Japanese yen is bad for the eurozone. PHOTO: REUTERS

Major economies should coordinate policy measures

Discrepant decisions by Fed, ECB and BOJ point to economic warfare that will make all of them losers with disastrous consequences for the economies.

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DECISIONS by the US central bank (Fed), the European Central Bank (ECB), and the Bank of Japan infer a currency war unless central banks somehow contrive to find a way out of the blind alley that they have chosen to manoeuvre themselves into.

The US dollar seems bound to strengthen considerably against the Japanese yen (already at a seven-year low against the greenback), less so but up against the euro with China successfully resisting an appreciation of the renminbi. Many emerging market and developing economies (EMDE) currencies are falling vis-à-vis the US dollar, reinforcing its appreciation.

Compounded by a lower oil price, the global economy is clearly out of sync with current account imbalances among the US, China, and the eurozone, and the age-old Japanese surplus is dwindling fast.

Perennial national deficits and debts (public and private sectors) haunt policy makers. These imbalances will deepen and stick with us for the foreseeable future, jeopardising attempts to get the global economy back on track.

End-October delivered some good news, indicating that growth in the US swinging into a higher gear, from a little bit above 2 per cent in 2014 to maybe 3 per cent in 2015. Figuring in the expected currency movements and oil price dips, this now seems overly optimistic.

Admittedly foreign trade may not be much more than a quarter of gross domestic product (GDP), but the repercussions from a higher US dollar are by no means negligible and the much talked about process of bringing manufacturing and jobs back to the US may slow down, connoting a psychological blow. The positive impact of lower oil prices, so welcome a decade or two ago, will be small due to the rise in US domestic supply of energy. Almost certainly, it will put a crimp in shale gas & oil exploration and extraction.

The Fed's changed stance on monetary policy may be warranted analysing liquidity, but sets in at a moment where the upturn is precarious to say the least. Up to date figures disclose a slightly rising US real wage, which in principle should boost consumption, but consumer spending for September was disappointing.

The combined result of these elements is discouraging: higher current account deficit, probably rising deficit on the federal budget in the slipstream of growth below forecasts plus higher net interest rate burden as the Fed's policy inevitably hikes interest rates. In short: growing internal imbalances threatening sustainable growth.

Japan and the eurozone shift the burden of adjusting to higher growth to the American economy, forcing it onto a lower growth trajectory. The inevitable question: Will the US allow this to happen? The surmise is that the Fed does not change back so there are not many cards left except tit for tat on the currency market (manipulating the US dollar down) and/or threatening semi-protectionist measures.

The eurozone economy seems likely to be the putative winner though not much is due to its own policies. As a large net importer of energy, it gets a tangible boost from a lower oil price, especially of the amount seen over the last two months (25-30 per cent).

The combination of a rising US dollar and a falling yen may be ambiguous as a strong greenback is good while a falling Japanese yen is bad for the eurozone, but in view of trade structure, the overall result will help the eurozone towards higher growth albeit its strength may not be so evident.

Signals about the state of the eurozone are mixed, but news that credit conditions eased in the third quarter of 2014 and demand for loans among companies strengthened by the most since 2011 do support feelings that the underlying growth pattern is better than anticipated. The relatively low household debt may form the background for a pickup of private consumption. Fiscal tightening has largely run its course, turning fiscal policy to neutral from contractionary.

The Japanese economy should benefit most of all. A low oil price and a falling yen constitute a very strong boost and leveraging on it for a genuine recovery may have spurred recent policy changes of an unexpected scope by the Bank of Japan. There is, however, little reason to be carried away. Japanese manufacturers are officially in recession. Household spending and real wages are falling. The preceding 25 years have exposed the structural weaknesses of the Japanese economy, preventing it from taking off. It is therefore more likely than not that what economic theory describes as strong stimulus will prove less strong when applied to a Japan unfortunately struck with a lethargic economy.

The global economy has been so mired in low growth and imbalances over the past decade or so, poor expectations have set in among the major players, who seem unable to figure out that the only way ahead is coordinated policy measures. Monetary policy pursued by major central banks are discrepant, threatening a kind of economic warfare about who can outmanoeuvre who – ultimately making all of them losers with disastrous consequences for the economies that they should shield and protect.

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