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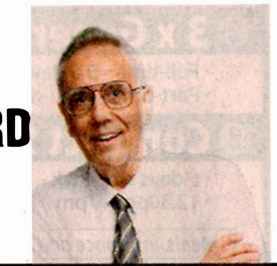
THE LAST WORD



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A quick and easy guide to the world's economy

IT was only six years ago (in 2008 to 2009) that fast action by governments pulled the world from the jaws of another Great Depression. Here is an update of where we are headed now.

1) Question: Quantitative Easing (QE) is the new buzzword. Will it really make us prosperous?

Answer: QE is also called "printing money" and it has increased the US money supply from US$1 trillion (S$1.36 trillion) to US$3 trillion over the past six years. It's huge.

Now, the US is winding down its QE while Europe is starting its own, which will begin tomorrow and add 1.1 trillion Euros (S$1.67 trillion) over 18 months. It works by sending newly created money to banks, which lend it to consumers and businesses, who spend and stimulate the economy. If all goes well, then "Yes, it will make us prosperous."

2) Question: Are there risks?

Answer: Sure. First, adding so much money could generate massive inflation, like 100 per cent per year. If you asked before the recession that occurred from 2008 to 2009, economists would have said: "Yes, this could happen". Economists were surprised it didn't and inflation has remained subdued at an annual rate of around two per cent, which is not too high and not too low. It's perfect. It makes you wonder: "Are these guys really good or are they just lucky?"

A second risk is banks could receive the new money and it would just sit there. No one would borrow. It's like throwing a party and no one comes. This would be embarrassing, but it does no harm and only means QE didn't work this time.

3) Question: Why use a new and untried tool like QE in the first place?

Answer: True, it is experimental. But there is no choice since countries had used all their ammunition fighting the great recession of 2008 to 2009. Printing money was the only tool left and it has worked better than expected.

Now, Europe has said: "Us too!" So, tomorrow it will embark on the same QE path as the US. Its goal is to stimulate the sleepy European economies where unemployment rates are as high as 25 per cent (in Greece) and 50 per cent for persons under 25 (in Spain). In contrast, Singapore's unemployment rate is 2 per cent.

QuickQuote

"I've got all the money I'll ever need if I die by four o'clock this afternoon."

Henny Youngman, comedian, 1906 to 1998

4) Question: What does "no more ammunition" mean?

Answer: It means the old reliable way to boost an economy was to borrow and spend on infrastructure like roads, parks and trains. Governments also cut taxes and the combination would boost the economy.

Now, however, countries have spent so much money pulling themselves out of the last great recession that government debt is at all-time highs. In some countries – like the US – the debt equals an entire year's GDP. Greece is in worse shape with debt that is 175 per cent of GDP. Japan is the world champion with debt at 220 per cent of GDP. As a result, most countries have no appetite for more, which means the old borrow-and-spend model is out.

5) Question: Was it a mistake to borrow and spend so much in 2008 to 2009?

Answer: Probably not. A bold move by governments was needed and without it, the world could have easily entered another 1929-style depression.

6) Question: Is there any other way to stimulate an economy?

Answer: One that is free and easy is for the country's Central Bank to lower interest rates, which makes borrowing less expensive and makes big-ticket items, like homes and cars, more affordable. The problem is this bullet has also been shot because the world's interest rates are at or near zero.

To go lower would make interest negative, which a few countries have tried, like Denmark and Switzerland, where the base interest is minus 0.6 per cent. Most countries are cautious since no one knows where it will lead. Does negative interest mean banks will pay customers to borrow money? It sounds too incredible to be true, but the answer is: "Yes, that is what negative interest means."

7) Question: Are any more tools left?

Answer: There is one. A country can boost exports by lowering the price of everything in the country. It's happening now as nations devalue their currencies, each trying to outdo the other. The most extreme is the Russian ruble which has dropped a whopping 60 per cent in six months although in that case, more than stimulating exports was involved.

Devaluation would work brilliantly except for one thing: It's a zero-sum game, so if one currency is undervalued, it means another is overvalued. Suppose the Singapore dollar declines by 10 per cent against the US dollar, then the US dollar appreciates by 10 per cent against the Singapore dollar. It is easy to see that every country cannot be cheaper than the others.

Only a few nations, like the US and Switzerland, sit back and say, "Go ahead. Sell down your currency while pushing ours higher. We can't be bothered!"

8) Question: (i) Borrow and spend is out, (ii) lowering interest rates is out and (iii) currency devaluation is out. All that's left is to use QE and print more money, which seems to work but no one is sure why. How's that for a summary?

Answer: Perfect.

An adjunct professor at SMU, Dr Haverkamp contributes this column weekly to help our readers understand money matters better.