Economics

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What Have Central Banks been doing?

The Bank of Japan announced a relatively smaller than expected dose of stimulus of ¥ 6 trillion (~ $ 60 billion) worth of exchange-traded stock funds annually compared with ¥ 3.3 trillion previously. This was a letdown considering that the markets expected more after the government had announced a fiscal stimulus plan earlier this week which included the pushing back of sales tax increase plan.

The Bank has pointed out three factors that were also factored in when taking this decision:

- Brexit,
- the slowdown in emerging economies, and
- Uncertainties around offshore growth.

The enhancement of monetary easing was necessary to prevent these uncertainties from leading to deterioration in business confidence and consumer sentiment as well as ensure smooth funding in foreign currencies by Japanese firms and financial institutions. The central bank will also increase the size of its lending program to support growth which will be $ 24 billion (about ¥ 2.5 trillion; double the previous size of 12 billion USD). These measures will provide funds to Japanese firms' overseas activities.

What does such limited action mean?

The limited stimulus being provided by BOJ is indicative of possibly the limitations of conventional monetary policy that have now been recognized as these measures which have been pursued by other central banks too have had a mixed result. It can hence be inferred that the Bank of Japan had already stretched its policy limits and nothing more could be done. Hence, this time BOJ does not talk of additional purchase of government bonds or lowering of the interest rate further in the negative region. The market did expect a bolder move to complement the recently announced government's spending plan and the concept of 'helicopter money' was being spoken of. The present measures will probably not have the desired effect on both the strengthening of the yen and changing the direction of inflation. BOJ has officially taken a stance that it will do everything to push inflation to 2%; but prices continue to decline as consumption remains weak.

What has Japan done to aid spending?

Japan has already announced a $ 266bn fiscal stimulus for the economy. Increased government spending on infrastructure including a magnetic-levitation train line connecting Tokyo and Osaka and construction is already under way on an initial leg of that route. The stimulus plan may also include direct payments to lower-income people.

What have other central banks done?

Federal Reserve

The Federal Reserve has been trying for months to raise interest rates and given indications that it would do so when it met this week. Such actions had been put on hold not just because of the domestic data but uncertainty on global events such as the Brexit. The FOMC had indicated in June that:

- the labor market was strengthening
- economic activity has been expanding at a moderate rate
- Payrolls and other labor market indicators point to some increase in labor utilization in recent months.
- Household spending has been growing strongly though business fixed investment has been soft.
- Inflation has continued to run below the Committee's 2% longer-run objective - partly reflecting earlier declines in energy prices and in prices of non-energy imports.

Against this backdrop, the Committee decided to maintain the target range for the federal funds rate at 1/4 to 1/2 percent.

European Central Bank

The ECB had left rates unchanged and would reassess conditions in September. ECB had left the interest rate on the main refinancing operations, marginal lending facility and the deposit facility unchanged at 0.00%, 0.25% and -0.40% respectively. The Governing Council continues to expect the key ECB interest rates to remain at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases.

Regarding non-standard monetary policy measures, the Governing Council has confirmed that the monthly asset purchases of € 80 billion would continue to run until the end of March 2017, or beyond, if necessary. It also sees a sustained adjustment in the path of inflation consistent with its inflation aim.

Bank of England

The Bank of England’s Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target and in a way that helps to sustain growth and employment. At its meeting earlier this month, the MPC voted by a majority of 8-1 to maintain Bank Rate at 0.5%, with one member voting for a cut in Bank Rate to 0.25%. The Committee voted unanimously to maintain the stock of purchased assets financed by the issuance of central bank reserves at £375 billion.

Concluding remarks

1. There are still no clear signs of a recovery in the developed world. USA may be the only exception, though the pace of growth will be moderate in the upward direction.
2. The fact that Bank of Japan has gone slow does indicate that there is now recognition that monetary policy has its limitations in terms of reviving the economy.
3. Globally commodity prices remain benign and as can be seen central banks are trying to push up inflation towards the 2% mark through the demand side as the supply picture is benign with low demand and higher output characterizing the situation.

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