

Monetary chiefs in historic harmony

Author: Guha, Krishna

[ProQuest document link](#)

Abstract (Abstract): By contrast, Ben Bernanke, Fed chairman, was sceptical that a Fed rate cut on its own, which was already priced into the market, would do very much to boost growth or ease market stress. Fourth, it reassured the markets that the world's central banks were operating in harmony, at a moment when governments around the world were adopting emergency actions - such as bank deposit guarantees or recapitalisation plans - that were plainly not co-ordinated and often had harmful spillover effects. Yesterday's joint action represents a globalisation of the Federal Reserve's strategy of using rate cuts to ease or at least offset what would otherwise be a tightening of financial conditions in order to reduce danger to the world economy from the credit crisis.

Full text: Central Banks ; Krishna Guha explains why the co-ordinated transatlantic cuts in interest rates make sense

Yesterday's interest rate cut by six central banks in North America and Europe is a historic move that attempts to produce for the first time a comprehensive international monetary policy response to the economic risks of the credit crisis.

The transatlantic move marks a recognition that growth had already weakened across the industrialised world even before the latest escalation of financial stress.

The combination of an increasingly global downturn, plus global financial stress, raises the likelihood of rising unemployment in leading economies and has already depressed commodity prices, making the inflation outlook less worrying.

Policymakers see the danger that the feedback loop between financial sector weakness and economic weakness that has menaced the US since the start of the credit squeeze may now be replicating at global level. Since the financial markets are global, the threat to growth is global, and falling commodity prices are global, it makes sense to address the economic risks through global monetary easing.

The Federal Reserve, Bank of Canada, European Central Bank, Bank of England, Swiss National Bank and the Swedish Riksbank would in any case have moved in convoy to ease rates in the coming weeks.

China's move - and the rate cut by the Reserve Bank of Australia this week - further strengthens the notion that this is a truly global effort. However, for the six central banks to act as one has a number of advantages.

First, by acting simultaneously, the central banks maximised the chance that their actions might shock the credit markets back to life and bolster collapsing confidence among households and businesses.

By contrast, Ben Bernanke, Fed chairman, was sceptical that a Fed rate cut on its own, which was already priced into the market, would do very much to boost growth or ease market stress.

Second, the co-ordinated nature of the move made it less embarrassing for central banks to U-turn on rates - particularly the ECB, but also the Bank of England and the Fed, which adopted a neutral balance of risks at its last policy meeting.

Third, it avoided the risk that one-at-a-time rate cuts would produce disorderly swings in currency markets. This was a particular concern for the Fed and the Bank of England, since the dollar and sterling have both suffered bouts of extreme weakness since the credit crisis began.

The ECB did not want to see the euro swing higher against the dollar even on a temporary basis following a Fed emergency rate cut.

Fourth, it reassured the markets that the world's central banks were operating in harmony, at a moment when governments around the world were adopting emergency actions - such as bank deposit guarantees or recapitalisation plans - that were plainly not co-ordinated and often had harmful spillover effects.

In particular, the central banks were signalling that there would be no "beggar-thy-neighbour" efforts at competitive devaluation.

Pulling this off was no mean feat.

Since the start of the credit crisis the world's central banks, in particular the Fed and the ECB, have appeared to take a different approach to dealing with the danger.

Yesterday's joint action represents a globalisation of the Federal Reserve's strategy of using rate cuts to ease or at least offset what would otherwise be a tightening of financial conditions in order to reduce danger to the world economy from the credit crisis.

It also respects the ECB separation principle, since the rate cuts are explicitly targeted at the economy rather than the financial system, and are justified by the change in inflation outlook.

People: Guha, Krishna

Publication title: Financial Times

First page: 9

Publication year: 2008

Publication date: Oct 9, 2008

Year: 2008

Section: GLOBAL FINANCIAL CRISIS

Publisher: The Financial Times Limited

Place of publication: London (UK)

Country of publication: United Kingdom

Publication subject: Business And Economics--Banking And Finance, Political Science

ISSN: 03071766

Source type: Newspapers

Language of publication: English

Document type: News

ProQuest document ID: 250129172

Document URL: <http://search.proquest.com/docview/250129172?accountid=17203>

Copyright: (Copyright Financial Times Ltd. 2008. All rights reserved.)

Last updated: 2010-06-12

Database: ProQuest Central

Contact ProQuest

Copyright © 2014 ProQuest LLC. All rights reserved. - [Terms and Conditions](#)