An overview on central banks' struggles to implement efficient monetary policies ...

Economics

The article examines the effects of the latest monetary policies proposed by the central banks in the U. S. and Japan as well as their role in the current slow-growth environments. As of September 22nd 2016, the Federal Reserve’s latest policy statements were to maintain the interest rate paid on required and excess reserve balances at 0. 50% and continue rolling over maturing Treasury securities, while the BOJ (Bank of Japan) decided to target the 10-year yield instead of the typical short-term rates, on the way to save its “ anemic” economy.

The author’s overall view of the current policies and actions by the central banks is, in short, negative. He/she ridicules the central banks’ objectives while pointing out how the banks have failed to attain the latters and stimulate the economy throughout the past few years implementing the controversial policy that is “ quantitative easing”. One of the points strongly supported by the author is that the better option for the Fed right now is to stop reinvesting in their maturing bonds before raising the rates as planned. In other words, the Fed should shrink its balance sheet, before tightening (normalize the rate), as unwinding its massive holding of long-term bonds might cause volatility in long-term rates. Furthermore, the author claims that the central banks are not being efficient enough as well as fulfilling their role as the “ economic saviors” since they have not yet deliver their promises concerning the economy’s recovery from stagnation, such as the inflation target of 2%. Even though the author’s opinion on the issues and happenings resemble that of the majority of the public, it lacks some meat and contains too much negativity and disappointments toward the banks and their efforts.

First of all, since the Fed should be concerned with both the rates level as well as the shape of the yield curve, it is not surprising that the recent flattening of the U. S. yield curve gave the public a good reason to urge the Fed to sell their assets (Treasury bonds) before raising the rates. However, that may not be the only way for the Fed’s to keep up with its agenda and calming the public at the same time. Maybe the author should have considered other options, such as a mixed strategy that consist of utilizing both the rate and balance sheet tools simultaneously. As a matter of fact, according to Curdia and Woodford (2011), balance sheet tools and interest rate policies can be used simultaneously and “ independently” to pursue the dual mandate as they might note induce any tradeoffs between the financial stability and price stability. Since the balance sheet tools were first implemented, they have led to benefits that were not available from only relying on the federal fund rate. Other arguments laid out by Benjamin Friedman back in June 2014 (Financial Times) highlighted the fact that the Fed, as well as other central banks, should “ permanently maintain the balance sheet tool (in terms of both size and composition)” after a thorough evaluation of the optimal monetary strategy. Most importantly, if the author proposed to stop rolling over the bonds, to what point should it stop? The author did not give adequate justification and precisions to back up his opinion, such as the optimal size of the balance sheet. If it is up to the Fed to establish their own agenda and define the optimal size of their balance sheet, it is very likely that most of us will lack insights to grasp their logic. As a result, once the FED has decided on a long-run plan to use its balance sheet tools, it make sense that the central bank design and follow a reinvestment strategy that is consistent with the use of these tools and maintain the balance sheet’s current size and composition to attain the dual mandate as well as financial stability objectives, especially over the long run. Of course, this should only happen while the costs do not outweigh the benefits (of using the balance sheet tools) and there is no sign of imminent counter-effect or irreversible undesirable outcome.

As for the author’s assertion that “ the recovery from stagnation that the central bankers promised has not been materialized”, due to the gravity of the previous recession followed by a multitude of tricky situations, it is not unreasonable to have more hope in the Fed and the economy. Meanwhile, the unemployment rate has been decreasing since 2009 (9. 8% Sep 2009 – 5. 0% Sep 2016) and new jobs have been created, as shown by a model developed by Federal Reserve Bank of San Francisco chief John Williams in 2010 suggesting “ the Fed’s second round of bond-buying – $600 billion worth – generated700, 000 additional jobs” (Reuters, 2011). Additionally, inflation rate has been through some ups and downs but mainly an overall increase from 0. 1% in December 2008 to 1. 1% as of August 2016. Regarding the suggestion to halt the use of balance sheet tools, “ quantitative easing has shown positive effect in the past, as the first two rounds of QE raised economic activity by 3% and increase private sector jobs by 2 million” (compared to what would have happened without it), according to the former Fed Chairman Ben Bernanke. Considering the low that the Fed was put into in 2008, there have been some improvements worth noticing. As for the case in Japan, with the 10-year yield trading at an all-time low of -0. 3% in July, the decision to switch focus on the 10-year yield curve control in order to bring the rate back to 0% and above without putting aside the 2% inflation target rate makes sense and shows that the BOJ does know what they are doing. Finally, if the banks seem to be unable to make further progress, it is probably time for the government to step in and lend a hand with its fiscal policy.

The central banks were created for a reason and there is no doubt that they have been fixing issues in the economy. The author, in this case, seemed to be pessimistically realistic, which led him/her to become too impatient to wait for the central banks to delivered their promises. However, one's perception of the banks' unsatisfying efforts and results should not hinder one's willingness to explore more solutions to the problems. Instead of blaming the waning of the economy on the Fed, the author should dig into the mechanics of the fiscal policy and also examine the roles of the Congress and POTUS, in terms of what other policies they can implement to support the Fed's effort. On the other hand, internally, the Fed is more or less a mess at the moment and they should come together to give more clarity on what they planning to do in order to boost the public's confidence in the future. And if the people are concerned about the way the Fed is managing its policy, then here is a good reason for the Fed to take their opinions into account and re-review their policies.