

Beware the cold winds from Central Banks

The Bank of England has pursued an energetic monetary tightening since the spring of 2017. Two interest rate hikes, a withdrawal of credit facilities to commercial banks and a major FPC tightening on car loans, some mortgages and consumer credit have helped slow the economy markedly. This has reinforced the fiscal squeeze, with higher taxes and a lower deficit, which is also pushing the economy into slow growth.

In the USA the government in contrast is keen to promote growth. It has done so by tax cuts for all and some state spending increases. As a result the US economy has accelerated well. This week the Chairman of the Federal Reserve Board declared war on this policy by letting us know that there will be more interest rate rises to come to brake the economy's progress.

Markets had been expecting a shallow rate cycle, with a peak official rate of around 3%. There is no undue inflationary pressure, and wages have been going nowhere in real terms despite the low levels of unemployment. The Fed now seem to be implying they think their current rate of 2.25% is "behind the curve" or too low. Markets were duly spooked. Longer term rates rose sharply, the cost of US government borrowing went to a new high for this cycle, and stockmarkets fell.

This icy blast will be felt around the world. There has been a general tendency to higher rates and monetary tightening all year, and that will now get worse. Most at risk are the badly run emerging economies with too much dollar and other foreign debt. We have seen big currency falls in places like Turkey, Argentina and Brazil, with falls by most currencies this year against a dollar buttressed by rising rates.

Central Banks should ease up a bit. Their ruinous policies caused the boom and bust in 2005-10. They have been rightly in atonement for their bad decision to deflate their credit bubble too quickly in 2008, keeping rates low and encouraging banks to rebuild damaged balance sheets to make the system more resilient. Moving too quickly to higher rates is a destabilising move which they should avoid. There is no "normal" higher rate they have to get to.

Debt is sustainable all the time the borrowers keep their jobs and all the time the interest charges stay around current levels. Pushing rates too high too quickly undermines both these conditions for sustainability.