

Rate hike will remove uncertainty & distortion, says JP Morgan chairman

There has been too little debate about the cost of staying too long with negative real interest rates

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THERE is too much public debate about the cost of exit from a zero interest rate policy and too little debate about the cost of staying too long with negative real interest rates, according to Jacob Frenkel, chairman of JP Morgan Chase International.

Delivering the keynote address at the second Asian Monetary Policy Forum on Friday, Dr Frenkel pointed out that prolonging ultra-low interest rates would distort the allocation of resources and encourage asset price bubbles. "The fear of normalisation (of monetary policy) should be balanced against the fear of the lack of normalisation," he said.

Dr Frenkel – who formerly served as governor of the Bank of Israel, director of research at the International Monetary Fund (IMF) and chairman of Merrill Lynch International – pointed to a number of "abnormalities" in current monetary policy in the developed world:

➡ Interest rates are near zero in the US, the eurozone and Japan, and real interest rates (nominal interest rates adjusted for inflation) are negative.

➡ Central banks' balance sheets have expanded massively – the size of the US Federal Reserve's balance sheet is about five times greater than what it was before the global financial crisis (GFC) in 2007, while the balance sheets of the European Central Bank (ECB) and the Bank of Japan are two to three times greater.

➡ Normally, central banks maintain only the highest quality assets (such as Treasury bonds) on their balance sheets, but this changed after the GFC. The Fed took on a lot of less liquid mortgage-backed se-

curities on its balance sheet. The composition of the balance sheets of the ECB and the Bank of Japan also changed.

Dr Frenkel pointed out that since the GFC, a lot of deleveraging has taken place in developed economies. Households as well as the corporate sector – and especially the financial sector – have reduced their debts.

At the same time, governments have increased their leverage. In the US, overall debt to gross domestic product (GDP) ratios have declined, but this is not so in the eurozone or Japan.

As for growth, Dr Frenkel pointed out that 2015 will be the first year since the GFC during which the US, the eurozone and Japan will all have positive growth. But when it comes to unemployment, the picture is mixed. He noted that while in the US, unemployment has come down to 5.4 per cent from close to 10 per cent in 2008/09, this needs to be qualified by the fact that much of the decline in unemployment is not the result of more jobs being created but of more people dropping out of the labour force. In the eurozone, unemployment remains elevated at 11.3 per cent.

Overall however, and despite the picture being uneven since the GFC, "the world economy has not been in a better situation than it is now", Dr Frenkel noted. In particular, the financial sector is much stronger, with banks being better capitalised and less leveraged.

"In this regard, the world is ready for (monetary policy) normalisation," he said. A rate increase "would remove a fundamental source of uncertainty and distortion".

Attended by about 100 central bank officials, economists and financial market participants, the Asian Monetary Policy Forum was jointly organised by the Asian Bureau of Finance and Economic Research, the Chicago Booth School of Business, the Monetary Authority of Singapore and the NUS Business School.