Central Bankers looking for fresh tools to tackle fears of a global recession

With the World's monetary policy makers all congregating last week at Jackson Hole, Wyoming for the annual summer gathering at the economic policy symposium; it was interesting to read that the title of this year's event was; Challenges for Monetary policy. I'd suggest that most policy makers have been thinking long and hard about two main problems which sing true to the event's title. The first being, despite dropping interest rates, in some cases below zero, central banks in developed economies still cannot meet their inflation targets. The second problem is a more recent encounter, that being, the uncertainty created by trade disputes and the negative consequence it is having on global growth, even in America! Central banks are now becoming progressively more uncertain about the tools at their disposal, as they may need to use them sooner than they had first anticipated with the current economic backdrop being its most interesting since the global financial crisis ('GFC').

All ears were on the early scheduled key note speaker Jay Powell, US Federal Reserve Chairman, who commented on such matters:

"The current era has been characterized by much lower neutral interest rates, disinflationary pressures, and slower growth. We face heightened risks of lengthy, difficult-to-escape periods in which our policy interest rate is pinned near zero. To address this new normal, we are conducting a public review of our monetary policy strategy, tools, and communications—the first of its kind for the Federal Reserve. We are evaluating the pros and cons of strategies that aim to reverse past misses of our inflation objective. We are examining the monetary policy tools we have used both in calm times and in crisis, and we are asking whether we should expand our toolkit. In addition, we are looking at how we might improve the communication of our policy framework."

This follows Mr Powell's comments in June, where he pointed out that the Fed's rate, then at 2.5%, was already close to zero, leaving little room to make a difference in the next economic down-turn. Having said that, the Fed is not alone. Since the GFC, central banks in other developed countries have dropped short-term rates; many are now below zero. They have also been buying bonds to try to drag long-term rates down, a tactic that was once considered a heresy, with the Japanese central bank going one step further and buying equities to prop-up risk assets.

But after a decade of accommodative policies, central banks have been unsuccessful in meeting their inflation targets and now are left with low or negative rates; as a result, economists are on the pursuit for alternative measures.

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In the past, some former policymakers have proposed that governments of developed economies should have clearly defined fiscal spending projects ready for a downturn, paid for with debt bought by their central bank. The reason for such radical measures is simple – it is very difficult to envisage stimulus in the next recession coming from pushing rates lower than they already are and having the same effect as they have done in the past, especially in light of the recent path change and sentiment, with quite a few central banks already having eased in the last six months on the back of slowing growth especially in China and Germany.

Unfortunately for Mr Powell, the dilemma is that the US data points are not as bad as that for other countries: industrial output has slowed but is not shrinking, while unemployment remains at levels not seen since the late 60s. Meanwhile, the US 'power-house' consumer is continuing to spend.

As a result, it will be interesting to see what new 'radical' policies are put forward and whether fiscal policies will have a greater role to play in the next recession – all of which we are keeping a close eye on.

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