

RBI Guv Raghuram Rajan warns of global assets crash

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Reserve Bank Governor Raghuram Rajan has warned that global markets are at the risk of a "crash" due to the lingering competitive loose monetary policies being followed by the developed economies.

Warning that the current build-up of financial sector imbalances may cause sudden price reversals and sharp spikes in volatility, Rajan said, "we are taking a greater chance of having another crash at a time when the world is less capable of bearing the cost".

In an interview to London-based 'Central Banking Journal' yesterday, he said, "unfortunately, a number of macro- economists have not fully learned the lessons of the great financial crisis. They still do not pay enough attention -en passant- to the financial sector. Financial sector crises are not as predictable. The risks build up until, wham, it hits you".

The Governor expressed fears that central banks "may be exhausting room on the financial side and creating a situation where there will be a discontinuous movement in the financial sector."

Discounting arguments from a section of economists that asset price hike is not due to credit growth, Rajan said problems do not appear to be arising from credit growth although this is an issue in some emerging markets.

"They (global investors) put trades on even though they know what will happen as everyone attempts to exit positions at the same time, there will be major market volatility," the RBI chief said.

Reiterating his warnings that emerging markets are especially vulnerable to big shifts in capital flows brought on by unprecedented monetary accommodation in rich nations, Rajan warned, "there will be major market volatility if such a crash occurs. True, it may not happen if we can find a way to unwind everything steadily. But it is a big hope and a prayer".

The former IMF chief economist, who famously predicted the 2008 financial meltdown - three years before at an event in US - from which the global economy is yet to recover fully, compared the current global markets to the 1930s which marked the worst recession in the financial history.

Stating that the Great Depression was due to a long period of competitive devaluation of national currencies, Rajan said, "we are back to the 1930s, in a world of competitive easing.

"Back then, it was competitive devaluation, but competitive easing could lead to competitive devaluation. If there were no consequences, to competitive easing, fine; but there are consequences."

The central banks of the rich nations are now engaged in ever more accommodative policies, he said, and called for more coordination between the major monetary authorities.

Rajan first made this demand early this year in Sydney during the BRICS finance ministers and central bankers summit. He repeated the same at the annual summit of the World Bank Group in Washington a few months later.

Calling for more policy co-ordination and research into effects of central bank policy spillover and spill-backs, he said monetary policy changes by the developed world central banks can cause "substantial levels of uncertainty" at a time that may suit the policy instigator but not be convenient for other central banks, especially in the emerging markets.

Welcoming the IMF recent statement that it would "examine" monetary policies of major central banks to check their net benefits, the Governor said this is a major change in the international organisation's stance.

"The sensitivity this kind of discussion raises in central banks will make them think about the value of policies and whether they are helpful elsewhere."

"I have no doubt that countries will still do what is largely in their interests. But over time we need a little more effort looking at the global interest. My sense is that once the debate is engaged, we will figure out a way to move in that direction," the ex-Chicago University professor said.

Expressing concerns about the impact of investors quitting emerging markets all at once after buying heavily into assets inflated by these loose central bank policies, he said continued failure of leading economies to comprehend the dangers of financial cycles pose significant risks to the global economy.

After May 24, 2013 tapering talk by the US Fed, India faced its worst crisis since the balance of payment issue of 1991. The rupee was one of the worst hit as current account deficit overshoot to close to 5 per cent of GDP as FIIs dumped Government debt and equities like hot coal.

On the continuing crisis in the Eurozone, the Governor said the common European currency is "too strong". Thus, the monetary union faces similar problems to emerging market economies, as it is affected by spillovers from ultra-loose monetary policies being pursued by the central banks such as the US Fed, Bank of Japan and Bank of England.

The Governor noted that Europe faces a disinflationary environment, close to deflation, despite pursuing a "very, very accommodative policy".

Eurosystem policy appears un-accommodative, he said, "because everyone else's policy is even more accommodative".

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