BerkeleyLaw
UNIVERSITY OF CALIFORNIA

Berkeley Center for Law,
Business and the Economy

University of California, Berkeley
School of Law
2850 Telegraph Ave, Suite 500
Berkeley, CA 94705-7220

Ph: 510.642.0532 – Fax: 510.643.7095
E-mail: BCLBE@law.berkeley.edu
http://www.law.berkeley.edu/bclbe.htm

Stimulus: The Beginning of an End

By Prashant Kadam, LL.M. Candidate 2018 | November 20, 2017

The Global Financial Crisis (GFC) forced the central banks in major economies across the world to resort to unconventional monetary policies. One of the unconventional policy measures was to prescribe policy interest rates near zero or even below zero, as seen in some European economies.

By prescribing near zero policy rates in the beginning of the crisis, and even negative rates at subsequent stages, the central bankers communicated that commercial banks are supposed to use available resources to lend, and not earn small returns by depositing that money with the central bank.

The signs of economic recovery and increasing domestic demand have prompted the central bankers to take stock of the situation. Though the U.S. Federal Reserve has signaled that it is beginning to withdraw its stimulus program of allowing the government bonds to mature in October 2017 without any replacement, the other major central banks are not likely to follow suit any time soon.

In the wake of the GFC, the U.S. has seen huge volumes of liquidity being pumped into the economy with near zero policy rates, but unlike Europe and Japan, it did not breach the zero barrier. This difference can be attributed to two factors: first, the U.S. has faster recovery than Europe and Japan; second, the saturation of interest rate reduction policy where any further reduction in rates is not likely to improve the domestic demand.

However, the access to near zero credit has stabilized the banking system and set off a boom in the financial assets market. This boom has been further strengthened by the flight of safety to dollar-denominated assets by financial asset managers and the simultaneous appreciation of the dollar. The recent Federal Open Market Committee statement released on November 1, 2017 gives clear indications of recovery in the economy, highlighting the low unemployment rate and expansion of economic activity at a moderate pace, irrespective of an anticipated temporary increase in inflation due to recent natural calamities.

While the U.S. has set its course on withdrawing its economic stimulus, Europe and Japan are not likely to do so in the near future. One of the factors adding to the uncertainty of withdrawal of stimulus by European Banks and Japan is that head chiefs of four major central banks are nearing end of term and may be replaced soon: namely, Mario Draghi, Chairman of European Central Bank; Janet Yellen, Chair of U.S. Federal Reserve; Haruhiko Kuroda, Governor of Bank of Japan; and Zhou Xioachuan, Governor of People’s Bank of China. However, the fears of this uncertainty are allayed to a certain extent after taking into consideration that their probable successors would continue to tread on expected lines and consider the withdrawal of stimulus as the economies show signs of recovery.