REST EASILY: INTEREST RATES WON'T RISE MUCH MORE

While crude-oil prices continue to rise, approaching record-high levels, and illustrious, organisations, such as The Asian Development Bank, are warning that the high price of energy could well have a very detrimental effect on the economies of quite a number of Asian countries (the People's Republic of China could see its **G**ross **D**omestic **P**roduct (GDP) fall by about one percent, India, by about 1.10 percent, and Thailand by about 1.80 percent), one notes that inflation, for the most part, has been well contained!

Last Thursday (May 4, 2006), the **E**uropean **C**entral **B**ank (ECB) determined to keep interest rates unchanged at 2.50 percent per annum for main refinancing operations, 3.50 percent per annum for marginal lending facilities, and 1.50 percent per annum for deposit facilities.

While senior officials of the ECB spoke of the potential for increasing interest rates in the near future in order to contain run-away prices, it was clear that, at present, there is no imminent danger of galloping inflation on the economic horizon in Europe.

In the US, The Federal Reserve has been steadily raising interest rates, during the past 15 sessions of its Open Market Committee Meetings, but each one of those interest-rate increases was for 25 basis points, only.

The Fed, also, does not appear to be too much concerned about inflation in the US, but it is, nevertheless, keeping the lid on simmering US economic soup … just in case.

One of the salient reasons that inflation in the US and the European Union has been contained for the most part is that labour has lost some of its bargaining power as managements of multinationals are able to outsource certain services to countries where labour costs are considerably lower than in the US and Europe.

India, immediately, springs to mind since, as a service centre, it is proving its worth for all of the complaints that one hears from time to time.

Stronger productivity growth, coupled with the fact that labour costs in the US and Europe have not kept abreast of that stronger productivity growth, has come to mean that demands of labour, which used to be able to crack the whip over the backs of management, have been undermined, considerably.

Coincidentally, the stronger productivity growth has, also, come to mean an increased supply of goods and services to the consumer in the High Street.

And the consumers of the industrialised countries of the world are lapping it up in the manner of a thirsty dog, making a mad dash for a drink of water on a hot day.

Increased supplies of goods and services to feed consumers are likely to increase apace even further in the near future, especially in respect of those economies which are able to take full advantage of integrating operations into the world economy.

Cheaper goods and services are going to mean that the consumer will have more spending power in the fullness of time.

As consumers look to spend that part of their disposable income, which is surplus to day-to-day needs due to the cheaper cost of traditionally purchased goods and services, those goods and services that are considered necessities, so industry will have to crank up the speed of their machinery in order to churn out those goods and services that are being demanded.

As demand for goods and services rise, so industry will try to keep the gravy train on the tracks, causing consumers to spend more for those goods that they covet.

And The Effects Are …

This will have the effect of holding down inflationary pressures – which will be to the delight of both The Fed and the ECB, no doubt, both of which organisations will take the credit for their well-reasoned, respective monetary policies.

Exports of cheaper-produced, Asian goods to the US and Europe, if anything, have helped to contain inflation in those areas of the world, too, regardless of protestations to the contrary.

Multinationals of the US and Europe are flocking to Asia in order to produce their goods for both the Asian marketplace and to transship them back to their home bases or where-ever else there is seen to be a market for those goods.

This increased mobility of international capital has, also, had the effect of undermining demands from labour in both the US and Europe – to the chagrin of many a labour union, the managements of which have found themselves unable to brandish the same stick of years of yore.

It is a well-known fact that, in a domestic economy, capacity expansion and new job creation do not go hand-in-hand although, on occasion, they do.

Investment determinations of today are based on an international bias where labour costs are often a determinant feature.

Demands by labour in the US and Europe face the threat that management may look more carefully with a view to export more jobs because, if they do not, their enterprises could well fall prey to international competitors, who are, always, nipping at their heels.

This threat – that more and more jobs could be exported if management cannot see its way clear to meeting the demands of labour – is keeping salaries and wages down in both the US and Europe and, obviously, helping to contain inflation.

What the above means is, inter alia:

1. Global exports will continue to expand;

2. Asian economies will continue to be the leaders in this global trade expansion;

3. The US, Europe and Japan are quite likely to be laggards in the expansion of trade on an international basis, and their respective currencies could well come under pressure (the US dollar translation rate against the Japanese yen has, already, lost about 2.50 percent of its value in the past week);

4. Capacity utilisation in Japan, Europe and the US, being only at an historic average, is likely to continue along that path as international demand for goods and services are satisfied by new capacities, generated in emerging markets;

5. Employment in Japan, Europe and the US is unlikely to expand very much in the coming few years and real wages are unlikely to increase materially, if at all; and,

6. Economic growth in these 3 areas of the world is unlikely to be much more than that of 2005 – at about 2.60 percent per annum.

In conclusion, the world, today, has undergone, and continues to undergo, rapid structural changes.

These changes are here to stay.

As the Internet has changed the lives of everybody on this planet, and these changes are permanent, to be sure, so the internationalisation of trade and investment has come to mean that the economic formulae of yesteryear no longer apply, at least, not in full.

Interest rates are unlikely to be increased much more although one may see some appreciation in the short term.

One other thing is absolutely certain and is very apparent: Central banks of the major economies of the world do not want to cut down the financial saplings before the fruit is ripe.

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