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Opinions

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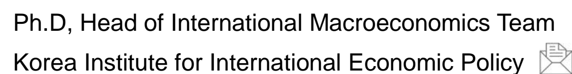
Facing Global Economic Instability

Dong-Eun Rhee



Ph.D, Head of International Macroeconomics Team
Korea Institute for International Economic Policy

The Great Moderation refers to the period between the mid-1980s and the outbreak of global financial crisis, when the world experienced noticeably low economic volatility. The rationale behind this Great Moderation is approached academically in various ways - with the stable operation of advanced countries' monetary and fiscal policies being one of them. In other words, it can be said that advanced nations' sound fiscal policy with greater fiscal discipline and effective monetary policy through strengthened central bank independence and introduction of inflation targeting eventually contributed to the reduction of global economic fluctuation in the period.

However, the global financial crisis changed such patterns of world economy completely. Advanced countries who previously led the Great Moderation are now epicenters of global economic instability, although it has been more than four years since the outbreak of the financial crisis. The expansionary fiscal policy was a necessary measure to cope with the crisis, but on the other hand this has greatly weakened the fiscal soundness of advanced nations and as a consequence, brought about the fiscal crisis in the Euro Area in addition to the fiscal cliff of the U.S.

Monetary policy is the remaining policy option for developed countries who have no more room for fiscal policies. However, traditional monetary policies also became unaffordable since near-zero interest rate continues and hence the only option left for expansionary monetary policy is unconventional monetary policy, which is represented by quantitative easing(henceforth QE). Recently, aside from countries such as the U.S. and U.K who have implemented QE since the beginning of the global financial crisis, Euro Area and Japan also started to try their hands in QE. It should be noted that QE is a transitory policy tool to ease financial conditions during crises and the return to a conventional interest rate policy is needed to accomplish the basic goal of monetary policy: inflation stabilization. In case of BOE (Bank of England), despite the fact that they have announced inflation targets, inflation exceeding their target level is still accepted and quantitative easing policy is maintained. If monetary authority fails to stabilize inflation, it would increase business cycle fluctuations.

The problem of advanced countries' economy eventually impacts the world economy. During the last few years, the global economy's predictability dropped to a very low level and its economic growth slowed down rapidly due to government debt crisis in PIIGS countries of the Euro Area and fiscal issues in the U.S. Moreover, quantitative easing of each country became the main factor of confusion in international financial and capital markets since it causes global liquidity expansion. Quantitative easing policy, on the surface, presents alleviation of domestic financial market as its objective. However, in the international community, suspicion arose that quantitative easing manipulates exchange rates by depreciating the currency value of a nation who implements such a policy. It is a well known fact that one nation's monetary expansion is a 'beggar thy neighbor policy' since it impacts another country's economy in a negative way.

One can acknowledge that expansionary macroeconomic policy prevented the spread of crisis and contributed to stabilizing the world economy in the beginning of the global financial crisis. Nevertheless, attempt to get out of the crisis depending only on

macroeconomic policy can be risky. The macroeconomic policy would not be effective in the long-run and such policy cannot become a fundamental engine for growth. More than four years has past since the global financial crisis occurred and the period where the economy could be stimulated by relying on macroeconomic measures is already behind us.

Hence, now that advanced economies moved out from the center of financial crisis, they need to get rid of the 'sugar-coated morphine' that is the expansionary macroeconomic policy and reach out for a more fundamental cure. They need to take care of the side effects from the overuse of macroeconomic policy during global financial crisis. Fiscal soundness should be recovered to avoid another economic crisis and an exit strategy to take back quantitative easing policy at a proper time need to be set up.

The world economy will become more multi-polar system after the global financial crisis. The stable growth of major developing countries such as China, Brazil, and India, who show rapid prosperity, is required for advanced nations' economy to recover from the current persistent recession. Advanced nations need to break out of unproductive argument such as the currency war and restore their perspective in comprehending the global economy, in order to regain the leading position. That is because within a globalized economy, the world economy just happens to be a group bound together by a common destiny.