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U.S. Monetary Policy Normalization, Concerned Effects

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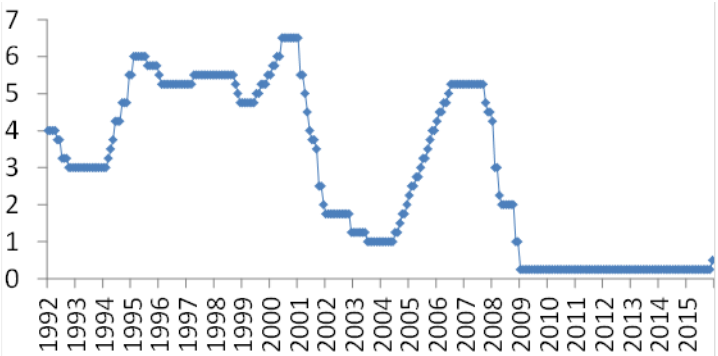
On Dec. 16th The U.S. Federal Reserve System (FED) announced their decision to raise its target range for the federal fund rate to 0.25% - 0.50%, following the two day meeting of the Federal Open Market Committee (FOMC). The virtually zero interest rate policy which began seven years ago had come to an end (See Chart). In the background, there is the continuous recovery of the economy including the labor market and the FED's confidence that the inflation rate will rise over the medium term to its 2% objective. The FOMC statement notes that "Given the economic outlook, and recognizing the time it takes for policy actions to affect future economic outcomes", they have decided the rate hike.

Meanwhile, there are strong cautions as to the effects of the normalization of U.S. monetary policy will have on the international financial market and the global economy. One specific concern is the increase in debt of emerging countries corporates, as have been mentioned by BIS, IMF and World Bank. In a number of emerging countries, private sector (households, corporates) debt increased after the global financial crisis and in some countries there was the increase of U.S. dollar-dominated corporate debt. If the U.S. rate hike causes funds to flow out of the emerging countries to the U.S., interest rate will rise from the ultra-low level, the dollar will see further appreciation, and thus increase the debt burden of these private sectors. If the number of defaults cases increase it may develop into financial unrest. Shocks from a few emerging countries will spread to the entire emerging countries through the international financial market and may affect the pace of FED's interest hikes.

The IMF's Oct. 2015 Global Financial Stability Report advises the regulators of the emerging countries to monitor risk vulnerable sectors and systemically important firms as well as other sectors such as banks that are closely linked to them, deploy micro and macro-prudential policies to help limit excessive increase in foreign currency debt and leverage and, if necessary, reform corporate insolvency processing systems.

The FED is projected to raise the interest rate slowly and maintain an accommodative monetary policy for some time. If the market takes in these factors and a sudden outflow of funds from emerging countries are avoided, it would buy time for these countries to response to these problems of increasing debt.

Chart: Federal Funds Target Rate (%)



(Data) Thomson Reuters