

EconoMag

Low-rate World©

by Alex Hurst



Hello from EnglishWaves Radio, and welcome to Economag, where we talk about everything economics. That was the chorus of one of the...err, nerdier rap battles of all time. A lyrical take on the ageless economics debate between Frederik Hayek and Milton Keynes.

Last week, we dug into interest rates set by central banks - what they are, how they work, and why central banks adjust them. So this week, let's take a closer look at what exactly is going on *now*, in what economists and financial reporters call our "low-rate world." Even if you don't pay attention to central banks, you've probably noticed this yourself; the money in your savings account is earning almost nothing, because interest rates are close to zero.

When the financial crisis hit, one of the biggest shocks was that credit dried up. Banks stopped lending money, and overall demand for goods and services in the economy decreased as firms postponed investments and consumers stopped spending. On a micro level, those are good individual decisions; but on the level of the economy as a whole, all that individual virtue became one giant vice. So central banks responded as they have time and time again when the economy needs to be spurred - by lowering interest rates and creating lots of new money they used to buy bonds.

In the sense that the world avoided another Great Depression, monetary policy was a success. But it ran into a problem - even with interest rates at or near zero for *years*, inflation has still been low nearly everywhere. Monetary policy reached what Paul Krugman calls the "zero-lower bound." There is debate in the economics world over the impact of keeping interest rates low, and what raising them might mean.

Left wing economists, like Krugman, argue that the Fed should hold off on raising rates until inflation has very clearly arrived. More center-right analyses, like the kind found in the British magazine, *The Economist*, put more weight on how long-term low interest rates have skewed the market. But the one thing that center-right and center-left do seem to agree on, is that raising interest rates will cause a big stock-market selloff in the short term, and depress overall demand in the long term. That is of course why central banks raise interest rates, to avoid overheating and to combat inflation.

So is there a way forward? One answer lies with governments. So far the US Federal Reserve, the European Central Bank, the Bank of Japan, the Bank of England...none of

them have been in a hurry to raise interest rates. But if they did, the job they are currently doing to stimulate the economy could be handed over to governments, which would directly spend. In effect, the government would be directly increasing demand, while central banks enacted policies that tempered demand.

You've been listening to Economag from EnglishWaves radio. Join us next time for more economics news broken down.