In 2015 many policy changes are expected

Much commentary has already been delivered at the start of this year over the disparate directions macroeconomic policy is projected to go in 2015. Already in the first two weeks of this year, the Swiss National Bank surprised markets by jettisoning its self-imposed peg to the Euro, hence shocking financial markets and causing an intense increase in foreign exchange volatility. The Federal Reserve (FRB) in the US has widely telegraphed its intention that they will begin to tighten monetary policy this year. In contrast, the European Central Bank (ECB) is widely forecast to ease its monetary policies (perhaps more than once), and the Bank of Japan (BOJ) will probably continue to pursue more stimulative policies.

Macro policy in China is thought to move in many different directions this year. Lastly, the Monetary Authority of Singapore (MAS) is expected to maintain its macro-prudential policies. With these prospective diverse policies in mind for this year, it begs the question as to whether existing macroeconomic policies have produced the desired results, and were they appropriate.

Macroeconomic policy is more than just monetary policies

Macroeconomic policy is more than interest rate manipulation and engaging in quantitative purchases of outstanding securities. It also includes the actions of governments’ fiscal policies (changes in taxation, public spending, and welfare programs) and microprudential policies that target specific sectors of the economy.

Macro policies finally worked in the US

In the US both fiscal and monetary policy has been heavily involved in affecting US economic outcomes over the past several years. As all who are conscious knows, US
monetary policy has been heavily engaged in purchasing outstanding government-backed securities for the past five years. The FRB announced the cessation of their purchase program at the end of 2014 after having acquired US$3.7 trillion of securities. The FRB has also kept its official policy rate near zero for most of that period.

Have their policies helped the economy recover from the ‘great recession’? Undeniably they have. The expansion of the FRB balance sheet helped clean up several large near (corporate) bankruptcies, re-liquifed the banking system, and slowly propelled the economy back close to full employment and healthy economic growth. Furthermore, these positive developments have been achieved without creating any inflation.

Fiscal policy in the US has also been quite active during the past several years. At the height of the ‘great recession’, the government’s fiscal policies expanded the federal budget deficit in fiscal 2009 by nearly 9 times to pump money into a contracting economy. Subsequently, the budget deficit shrank down to US$506 billion in fiscal 2014 from a peak deficit of US$1.4 trillion, creating several years of massive fiscal drag and prolonging the hoped-for economic recovery.

Were the macro policy measures taken good or bad? Given the present healthy shape of the US economy, we must describe the public policies as very good. In 2015 fiscal policy will probably remain relatively neutral: fiscal drag is nearly finished and the FRB will gingerly begin to raise official policy rates.

Singapore: another example of successful policy

In Singapore, official policy rates have been kept relatively low to stimulate credit creation and facilitate economic growth. However, the MAS did adapt a set of macroprudential policy measures to address the explosion in home prices. These unusual measures have been highly effective in reducing demand, lowering home prices, and controlling property speculation. The MAS has already indicated that they intend
to maintain these micro prudential policies throughout 2015.

Broad macro policies, however, may have to change if economic growth in 2015 slows more than expected. Consequently, because the macroprudential policies have effectively deflated the property bubble, one must assign these policies to the good category.

**Bad economic policies**

Bad macroeconomic policies can unequivocally be assigned to the European Union (EU). Inadequate monetary policy and inappropriate fiscal policy both contributed to the dismal performance of the EU economy over the past 5 years.

The ECB did ease monetary conditions in their initial response to the global debt crisis in 2009, but they prematurely raised official policy rates before the EU economy and the world economy recovered. Then belatedly and reluctantly they embarked upon a stimulative policy that lacked effectiveness. At the start of this year, another year of zero growth at best, the ECB has finally formally embraced a one trillion Euro commitment to quantitative easing. However positive the ECB announcement is, it will not be sufficient to pull the EU economy from its economic slump: fiscal policy is needed to provide an incentive.

Moreover, EU fiscal policy has applied austerity measures upon all member countries including those countries buried in recession. This lamentable policy dug the economic grave deeper, creating massive unemployment and, consequently, risking widespread social unrest. In addition, Government-mandated, politically-inspired economic sanctions designed to reduce the flow of trade between EU member economies and one of their biggest counterparties, Russia, have deepened the economic crisis for all of the EU economies. Consequently, the macroeconomic policies carried out by the EU were an abject failure, and highly qualify for the bad pile.

**More bad policy decisions**

Another government snatched defeat from the arms of victory, and in the process relegated their macroeconomic policy to the bad pile. It all started hopefully when newly-elected Prime Minister Shinzō Abe initiated his ‘Abenomics’ policies. The stock market soared, the Yen depreciated, and the economy rebounded. There was even hope that the Japanese economy would escape
from nearly two decades of deflation. However, the foolish imposition of a consumption tax in 2014, and the promise of another increase in the following year, undid all the positives and goodwill from Abenomics, and subsequently threw the Japanese economy into reverse and recession: Abenomics, rightfully, should be rebranded as ‘Abatenomics’.

The Abe government, with whatever little macroeconomic wisdom left, responded by withdrawing the promised second consumption tax increase, by enacting more fiscal spending and by instigating more vigorous monetary policy stimulus. In sum, the effect of their economic policy efforts must be considered bad, perhaps even foolish, since they should have known from past experience, 16 years earlier to be exact, what negative effects could be expected from imposing a consumption tax on a reviving economy.

**Policies still in progress**

The final set of macroeconomic policies considered for this informal reality show scoring scheme, is from China. Economic growth in China has been slowing significantly in the past few years however, that has been a byproduct of their recent policy objectives and the successful maturing of the Chinese economy. The new Chinese government determined in 2013 that structural reform should take precedence over pursuing more rapid economic growth. Consequently, the government resisted using traditional macro policy stimulus to counter their decelerating economic growth.

Last year they made minor changes in policy, relaxing monetary conditions when interbank credit suddenly froze. Nevertheless, they continued to reign in commercial bank lending to state-owned enterprises, and eradicate corruption at the expense of promoting economic growth. Their goal of raising the contribution of consumption to growth relative to investment continues to be their primary economic focus.

The verdict is yet to be ascertained if China will be successful, or not, in their present pursuits, and whether the costs of their present macro policy mandate outweigh the expected benefits. The world, in the meantime, watches with bated breath.

**Conclusion**

Many economies are expected to endure macro policy changes this year as global economic growth is predicted to slow, and deflation is threatening in a number of important economic regions. Nevertheless, some large economies are improving and will require contra policies to the rest of the developed world. Already financial markets have been affected by policy changes, especially foreign exchange rates, which will probably reflect the most volatility as a result of expected further policy changes. Foreign exchange rates are being used as a
policy weapon. Emerging markets will therefore be buffeted by opposing effects. For more information, please contact camri@nus.edu.sg
# KEY INDICATORS TABLE (AS OF 23 JANUARY 2015)

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*Source: Bloomberg*

# APPENDIX

**GLOSSARY OF KEY TERMS (Source: Bloomberg, with tickers in parenthesis. In US$ where applicable)**

**S&P500**: capitalization-weighted index of the prices of 500 US large-cap stocks (SPX)

**FTSE**: capitalization-weighted index of the prices of the 100 largest LSE-listed stocks (UKX)

**NIKKEI**: capitalization-weighted index of the largest 225 stocks of the Tokyo Stock Exchange (NKY)

**HANG SENG**: capitalization-weighted index of companies from the Hong Kong Stock Exchange (HSI)

**STI**: cap-weighted index of the top 30 companies listed on the Singapore Exchange (FSSTI)

**EUR**: USD/EUR exchange rate: 1 EUR = xx USD (EUR)

**YEN**: YEN/USD exchange rate: 1 USD = xx YEN (JPY)

**CMCI**: Constant Maturity Commodity Index (CMCIPI)

**Oil**: West Texas Intermediate prices, $ per barrel (CLK1)

**3MO LIBOR**: interbank lending rate for 3-month US dollar loans (US0003M)

**10YR UST**: 10-year US Treasury yield (IYC8 – Sovereigns)

**10YR BUND**: 10-year German government bond yield (IYC8 – Sovereigns)

**10YR SPG**: 10-year Spanish government bond yield, proxy for EU funding problems (IYC8 – Sovereigns)

**10YR SGS**: 10-year Singapore government bond yield (IYC8 – Sovereigns)

**US ISM**: US business survey of more than 300 manufacturing firms by the Institute of Supply Management that monitors employment, production inventories, new orders, etc. (NAPMPMI)

**EU PMI**: Purchasing Managers’ index for the 17 country EU region (PMITMEZ)

**JP TANKAN**: Bank of Japan business survey on the outlook of Japanese capital expenditures, employment and the overall economy, quarter index (JNTGALLI)

**CHINA IP**: China’s Industrial Production index, with 1-month lag (CHVAIOY)

**LC**: Local Currency

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