Tuesday, 02 September 2014 11:47

Africa at Jackson Hole

Written by Christopher Wood

Photo © Karen bullock photography / flickr

The Jackson Hole summit (officially the Federal Reserve Bank of Kansas City's Economic Symposium, held 21-23 August 2014), was one of the more subdued in recent memory. Every comment coming out of the annual retreat of the world's top central bankers has been closely scrutinised over the last few years, as nervous markets searched for clues on how regulators would manage the financial crisis and the ensuing recovery. But even with markets returning to something resembling normality, the macro-economy once again crashed the party.

The topic of this year's conference – 'Re-evaluating Labour-Market Dynamics' – is one that sits uncomfortably with more conservative central bankers, whose overwhelming priority has been keeping inflation at bay. If the labour-market matters to central banks, it is usually as a risk – if interest rates are kept too low, too many people could be employed by cheap finance, causing the economy to overheat and inflation to spiral.

But central banks live in a post-financial crisis world, in which the focus of monetary policy has been on stimulating a badly depressed economy. Inflation rates have been negligible or negative in the developed world, giving central bankers ample scope to crank up their monetary stimulus and throw their weight behind economic growth and job creation.

In the language of finance, this year's topic is actually about what role Central Banks should play as the crisis moment draws to an end. The financial crisis strikingly highlighted the role that central bank monetary policy plays in ensuring the health of the real economy – it demonstrated that employment matters as much as inflation. This poses two questions. First, should central bankers focus on employment even in good times? And second, have the good times arrived? Do economies require more monetary stimulus to fully recover, or should attention turn to containing the spectre of inflation?

Divergent Paths

The answer really depends on who you ask. The main event of the conference was the double act by Janet Yellan and Mario Draghi, the heads of the US Federal Reserve and the European Central Bank respectively. The drastic contrast between the two speeches highlights the divergent fortunes of two of Africa's biggest trading partners.

Yellan's speech served to highlight that all was proceeding according to plan. Concern over the end of the Fed's stimulus has subsided as markets have mostly priced-in the shift and, with the taper set to conclude in October, attention has now turned to when interest rates should begin to rise. The US has had a run of positive jobs data, with unemployment dropping from a high of 10% in 2009 to 6.2% as of the last report in August. The Fed had previously committed to maintain interest rates in the low band of between 0% and 0.25%, so long as unemployment remained above 6.5% and future inflation below 2.5%. But with the 6.5% mark lapsed and replaced with a new, vaguer pledge to 'maximise employment', uncertainty reigns over when the Fed will start to raise interest rates.

If the quickly improving unemployment rate reflected a real shift in the fortunes of the American economy, there would be little doubt that the Fed would raise interest rates to keep inflation in check. But the recession didn’t just depress employment, it altered the functioning of labour markets, bringing into question the core usefulness of traditional measures of unemployment. Commentators have consistently noted that while unemployment has been shrinking, discouraged labour has remained high – reflecting a population resigned to unemployment and thus removed from the official figures. While there was no clear resolution to the debate over when the Fed starts to raise interest rates, the general consensus seems to be that it can’t be too far away.

The opposite is true for the European Union. Throughout the crisis, the European Central Bank (ECB) has been an adherent of the German-backed line of the need for structural realignment – often meaning austerity – as the route out of the crisis. The ECB did have their own stimulus plan – in the form of long-term refinancing operations (LTRO) – but has generally shied away from the type of explicit quantitative easing used by the United States. But in the face of continually sluggish Eurozone economy, Mario Draghi appears ready to bow to pressure to use ECB monetary stimulus to revive the Eurozone economy. What that means, however, remains uncertain.

The ECB has already put in place negative interest rates and direct funding-for-lending programmes. An explicit programme of quantitative easing might help, but debate rages over whether this would have any effect at all in the face of the zero-lower bound: the point at which interest rates are so low that monetary policy stops being effective. Fiscal policy might prove a more effective tool to revive the Eurozone, and Draghi made a limited call for the use of government spending to stimulate the economy, but this message will only be well received by member states who already believed it.

The Africa Connection

All this matters for Africa. The unprecedented optimism around African growth has at least in part been driven by post-financial crisis stimulus in key economies – particularly the US, EU, and China – which kept credit cheap and returns low in the advanced world. As stimulus begins to dwindle, questions will no doubt be raised on whether the heights of the African Rising boom of the last five years is a lasting phenomenon, or a passing moment of abnormal monetary policy.

The divergent paths of the world’s biggest economies (and their central banks) pose risks and opportunities for African economies, which feel the impacts via two mechanisms: trade and the cost of finance. Both mechanisms are at play today. If stimulus in the Eurozone revives the EU economy, it could spark a recovery in trade with one of Africa’s biggest partners, while also keeping return-seeking investment flowing away from Europe and into the emerging world.

On the other hand, if the Fed opts to raise US interest rates, and this slows the American recovery, then Africa’s trade links could be hit both directly with the US, and through the US’s role in driving growth in emerging countries like China. Higher interest rates, coupled to a US economy revived by the shale gas revolution, could also mean the US starts soaking up some of the investment that had found its way into African economies.

For now the news remains positive: the Fed looks unlikely to do anything to derail the US recovery, and the ECB seems to be getting serious about taking a proactive role in reinvigorating European growth. The lasting unknown is how committed the new generation of central bankers are to standing by safeguarding affordability – a broader target that encompasses a balanced concern for both inflation and employment. Standing by employment promotion is easy now, when inflation remains low, but as its spectre grow progressively large, central bankers will need to be bold to stand by their commitment to protecting jobs.

Christopher Wood is a researcher in the Economic Diplomacy programme at the South African Institute of International Affairs.