Central Banks Ready To Panic – Again

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This article was written by John Rubino and originally published at Dollar Collapse

Less than a decade after a housing/derivatives bubble nearly wiped out the global financial system, a new and much bigger commodities/derivatives bubble is threatening to finish the job. Raw materials are tanking as capital pours out of the most heavily-impacted countries and into anything that looks like a reasonable hiding place. So the dollar is up, Swiss and German bond yields are negative, and fine art is through the roof.

Now emerging market turmoil is spreading to the developed world and the conventional wisdom is shifting from a future of gradual interest rate normalization amid a return to steady growth, to zero or negative rates as far as the eye can see. Here's a representative take from Bloomberg:

> **Cheap Money Is Here to Stay**
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> For decades, central banks lorded over markets. Traders quivered at the omnipotence of monetary authorities — their every move, utterance and wink a reason to scurry for safe havens or an opportunity to score huge profits. Now, though, markets are the ones doing the bullying.
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> The Fed's Countdown
> Take New Zealand and Australia. Yesterday, the Reserve Bank of New Zealand slashed borrowing costs for the second time in six weeks even as housing prices continue to skyrocket. A day earlier, its counterpart across the Tasman Sea (already wrestling with an even bigger property bubble of its own) said a third cut this year is "on the table."

> Just one year ago, it seemed unthinkable that officials in Wellington and Sydney, more typically known for their hawkishness and stubborn independence, would join the global race toward zero. But with commodity prices sliding, China slowing and governments reluctant to adopt bold reforms, jittery markets are demanding ever-bigger gestures from central banks. Even those presiding over stable growth feel the need to placate hedge funds, lest asset markets falter. When this dynamic overtakes countries such as New Zealand (growing 2.6 percent) and Australia (2.3 percent), it's hard not to conclude that ultralow rates will be the global norm for a long, long time.
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> Indeed, the major monetary powers that are easing — Europe, Japan, Australia and New Zealand — have all suggested rates may stay low almost indefinitely. Those angling to return to normalcy, meanwhile — the Federal Reserve and Bank of England — are pledging to move very slowly. Even nations with rising inflation problems, like India, are hinting at more stimulus.
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> "As interest rates continue to fall across most of the globe, central banks are also united in their main message: Once rates have come down, they're likely to stay down," says Simon Grose-Hodge of LGT Bank. "And when they finally do tighten, the 'normal' rate is going to be a lot lower than it used to be."
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> Could the People's Bank of China be next? "With underlying GDP growth still looking weak, more monetary policy moves are likely," says Adam Slater of Oxford Economics. "And China may even face the prospect of short-term rates dropping towards the zero lower bound."

This is not how the Fed, ECB or Bank of Japan envisioned the year playing out. They see ultra-low rates as an emergency measure, temporary in nature and to be dispensed with asap. From MarketWatch:

> **Here's the real reason the Fed wants to raise rates**
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> Federal Reserve policy makers are hoping, even praying, that no unexpected domestic development or international crisis intervenes to prevent them from taking the first baby step to normalize interest rates at the Sept.16-17 meeting.
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> Why? Fed officials point to a number of reasons: the unnatural state of a near-zero benchmark rate; the potential risk of financial instability; an improving labor market; diminishing headwinds; and yes, expectations of 3% growth just over the horizon.
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> Fed Chairman Janet Yellen, usually considered a member of the Fed's dovish faction, sounded determined to act when she testified to Congress last week.
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> "We are close to where we want to be, and we now think that the economy cannot only tolerate but needs higher interest rates," Yellen said during the Q&A. "Needs," as in the patient needs his medicine.
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> What's the urgency with an economy chugging along at 2-something percent and low inflation? I suspect Fed officials are terrified of being caught with their pants down, in a manner of speaking. Should some unforeseen event come along to upend the economy, the Fed's arsenal would be dry. They'd like to put some space between their policy rate and zero.

That "unforeseen event" has arrived, leaving most central banks with a stark choice: Let the deflationary crash run its course at the risk of blowing up the quadrillion or so dollars of interest rate, credit, and currency derivatives hidden on bank and hedge fund balance sheets. Or push interest rates into negative territory pretty much across the developed world. Since option number one carries a statistically-significant chance of ending the modern financial era it is absolutely unacceptable to Goldman et al, and is thus a non-starter. Which leaves only option two: more of the same but bigger and badder.

So…the central banks will panic. Again. Countries that retain some control over their monetary systems will see their interest rates fall to zero and beyond, while those that don't will be thrown into some kind of new age hyperinflationary depression. Not 2008 all over again; this is something much stranger.

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