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LOOSE MONETARY POLICIES MAY RESULT IN INSTABILITY, SAYS IMF

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The loose monetary policies of global central bankers may end up hurting the prospects of a recovery, towards which these same policies are targeted. The International Monetary Fund (IMF) has raised a warning that central banks need to reverse policies in a timely manner to avoid this.

Central banks from the US to Japan have kept policies ultra-loose, pumping in liquidity in the years before the pandemic struck. The liquidity has found its way into markets and signs of asset price inflation are visible across markets. The fund pointed out that leverage on corporate balance sheets and households had increased to all-time high levels before the pandemic. While a part of this increase can be explained through the loss of output, some of it is mainly due to the liquidity glut that accommodative central banks have created. Leverage on corporate balance sheets has increased further after the pandemic.

eriods of high leverage are followed by periods of fall in output, the fund added. Ergo, the recent increase in leverage does not augur well for the expected economic recovery. “Policymakers need to be mindful of the financial stability risks stemming from high leverage in the post-pandemic environment and should stand ready to tighten macroprudential policies as the recovery takes hold," the IMF said in its global financial stability report on 29 March.

The IMF said central banks in advanced and emerging market economies need to “lean against the wind" and tighten policies once the first signs of economic recovery are visible. “Considering the possible lags between implementation and full impact, policymakers should take early action to tighten selected macroprudential tools to address rising non-financial sector vulnerabilities," it said.

The IMF’s warning comes even as a different kind of leverage trouble is building amid global banks. Block trades to dump shares by Archegos Capital Management, a private investment firm, led to banks like Nomura and Credit Suisse suffering huge losses. Archegos did a fire sale of shares of firms following margin calls from its brokers after shares of some firms that it held began to fall. Given the leverage associated with the firm, global banks are staring at huge losses. Easy liquidity has prompted several leveraged financial products to fund equity purchases.

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