Central Banks can be Anti-Globalists Too

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When the price of certain goods and services is rising, the old but reliable law of supply and demand has an explanation. This means either or both of two things happen:
a) Fast growth in demand relative to their supply due to increase in consumers' income, change in their tastes and preferences, other reasons; and/or
b) Shrank or decreased supply (both local and global supply) relative to stable or increased demand due to natural disasters that wiped out harvests, big fires/terrorist attacks that destroyed the production plants, and other reasons.

These temporary "market failures" also create market solutions. A rise in the price of certain goods and services would invite entrepreneurs and businessmen to go and supply those commodities to cash in potentially high profits, even temporarily.

Now come central banks (Federal Reserve, Bangko Sentral, etc.) and their inflation-targeting policies and philosophies. When a central bank rushes in to "control inflationary pressure" in the economy, it has lots of tools in its wings that it can manipulate: reduce money supply by raising overnight rates of commercial banks, raise their required reserves (RRs), among others. When this happens, this also squeezes short-term credits to entrepreneurs who would have otherwise put up new firms, or expand existing companies' operations, to supply certain goods and services that experience supply gap or reduction, whether temporarily or permanently.

It is possible to have hyper-inflation (very high rise in prices) in some commodities and deflation (reduction in prices) in other commodities, all happening at the same time. For instance, a hyper-inflation in school supplies (say the 2 largest manufacturing plants and suppliers were gutted by fire) and a deflation in burgers, pizza and softdrinks (say Coke, Pepsi, McDonald, Burger King, Jollibee, dozen other companies engaged in a sudden and fierce price war). In this case, there is no need for national government or central bank interventions to stabilize prices.

Recently, the Bank for International Settlements (BIS), also known as central bankers' bank (not the IMF), cautioned central banks around the world to prepare to raise interest rates due to (i) rising global inflationary pressure, and (ii) vulnerability to "bang" in market turbulence. Let's take these one by one.

The main drivers of global inflationary pressure are (a) high and volatile oil prices, and (b) still insufficient trade liberalization across countries. There aren't much the world can do on (a) partly because some poor countries have experienced fast economic growth (think of China and India alone) and their people are buying vehicles and boats and appliances left and right. Oil refineries are also not catching up fast enough (no thanks to hurricanes Katrina and others) to supply big demand. There are other reasons for the high world oil prices.

On (b), many countries, or more appropriately, politicians and trade negotiators of those countries, would only blame their counterparts in other countries, that is why they are closing off a big portion of their economies from foreign imports of certain commodities. That is, they are depriving their citizens of more options. These imported commodities (which are just surplus production in the exporting countries, are cheaply produced there) could have reduced inflation, even result in temporary deflation, for the sectors/commodities of the importing countries if only they allowed those goods to enter. Again, no need for national governments and central banks to come and intervene.

Central banks, the BIS and US Fed particularly, think they must make borrowers poorer by raising their cost of borrowing; by making the cost of money for business expansion that should help boost supply that should fight inflationary pressure, more expensive. After all, they are waging a holy war against global inflationary pressures.

If asset prices are surging high, if trade imbalances between some countries (between US and China in particular) is going even larger, artificially raising interest rates through central bank intervention is not the answer. The reason why the US has huge trade deficit with China, as well as Japan, Germany, and other countries, is mainly because US citizens are searching for bargains, a very rational consumer behavior. If China-made rubber shoes are sold just half or a third of US-made rubber shoes, then American consumers will buy those shoes from China. While exchange rate manipulation by the Chinese government and central bank is partly to blame for this low price of China products, the even bigger explanation is the low cost of labor, low cost of power, low cost of office and land rental, low cost of transportation, of goods in China than in the US.

One remedy that the US and other rich countries can do to bring down their production cost aside from mechanization, is to allow migrants who are willing to work long and dirty tasks at low wages. Another remedy is to cut business taxes and/or business registration procedures, other things that will help bring down entrepreneurs' operating costs.

Businessmen and consumers of the US, Europe, Asia and the rest of the world, will be better off if there will be low interest rates and low inflation rate at the same time. Raising interest rates to fight inflationary pressure that was created by trade protectionism, immigration paranoia, and other structural problems in the production sectors, are not the way to help the consumers that the central banks say they want to protect.