PRO-POL SHADOW RBA BOARD – COMMENTS

MAY 2012

From March 2012, each Shadow Board member was invited (but not obliged) to provide a personal comment on monetary conditions. Neither the comments nor the probabilities constitute financial advice. The views of the Shadow Board members are not those of CAMA. Any individuals utilizing these comments, or the probabilities, do so at their own risk.

PAUL BLOXHAM

With underlying inflation in the lower part of the RBA's target band and growth a bit below trend, there is room for the RBA to cut rates at the next meeting and I would recommend a 25bp cut. I would be prepared to discuss a 50bp cut but think that actually cutting by 50bp would require more information than is currently available, particularly given recent improvements in labour market and business conditions indicators. I would recommend waiting for further information on the labour market trends -- in early May -- before considering further easing beyond a 25bp cut this month. In the medium term the distribution of outcomes remains bifurcated. Global risks remain to the downside, which could see rates lowered. On the other hand, purely domestic conditions may require further tightening by the RBA as weak productivity growth means the medium term inflation risks are to the upside.

MARK CROSBY

No comment.

MARDI DUNGEY

The continuing poor performance in the Australian regions which are being reinforced by tight fiscal budgets in regional and local governments, and the lessened evidence of immediate inflationary pressure provide some room for the RBA to lower rates. Conditions in Europe have worsened over the past month, creating substantial risk of further negative conditions from the international community, and particularly tightening in international financial markets as banks deleverage. The risks suggest that looser monetary policy is likely to be justified.

SAUL ESLAKE

No comment.

BOB GREGORY

Monetary policy needs to be focused on the likely outcomes in the economy twelve to eighteen months hence – current commentary on employment and inflation outcomes is too focused on the short term. Forecasts are extremely uncertain at the moment. My best guess is that the economy will remain fairly subdued with moderate growth. All the risk is on the downside, especially with tight fiscal policy and limited short run impacts of RBA lower interest rates on real outcomes. I see virtually no prospect of any interest rate increase over the next eighteen months.

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WARWICK MCKIBBIN

The RBA has room to cut by 25 basis points to alleviate political pressure. This however will do little for the sectors under structural adjustment pressure. The problem for monetary policy is that the price of non-traded goods continues to rise at around 3.5% and it is imported inflation partly through a strong exchange rate that is holding down the CPI. Too deep a cut in interest rates will just bring down the currency and worsen inflation further and raise domestic demand even further unleashing an inflation shock. It is unlikely that another interest rate cut would be wise given the underlying conditions in the overall economy. A crisis in Europe would change this completely. Rather than fiscal policy being arbitrarily tightened so that monetary policy can expand, the stance of policy should be focussed on microeconomic adjustment to a large shift in relative prices globally and the RBA should keep focussed on doing the very good job it is doing.

JAMES MORLEY

Inflation Anchored, Real Activity Close to Balanced, and Policy Close to Neutral:

Year-on-year inflation is at 1.6% (Source: ABS), a bit below the target range of 2-3%. However, this is clearly due to the predictable reversal of the effects of the 2010-2011 Queensland floods on certain food prices. The “underlying” measure of inflation that removes volatile food and energy prices is currently at 2.2%, which is comfortably within the RBA’s target band of 2-3%. This situation suggests relatively low risks of inflationary pressures over the medium term, allowing more flexibility for policy to respond to any deterioration in real economic conditions.

On the real side of the economy, the current aggregate situation remains fairly balanced, with the unemployment rate holding steady at 5.2% in March (Source: ABS). The net risks are slightly negative, given some weakness in the domestic retail sector and the fact that any slowdown in China would be more directly harmful than a continuing recovery in the United States would be helpful. However, the overall uncertainty in global conditions and the potential impact on Australia is clearly less pronounced than it was six months ago. Specifically, even though the European debt crisis remains unresolved, it no longer appears to represent an imminent risk for Australia or Asia.

The slight negative balance of risks to the real side of the economy is addressed by the fact that the target cash rate is slightly below (albeit close to) its neutral level given close-to-average output growth and anchored inflation expectations.

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JEFF SHEEN

With first quarter 2012 CPI inflation relatively weak, coupled with a low outcome for GDP growth in 4th quarter 2011, there is an increased risk that Australia is having a 'double-dip' slowdown (in contrast to recession in many other countries). However the inflation numbers suggest that much of the weakness is due to food and weather (particularly bananas) plus the lower prices of imports with the strong exchange rate. Though inflation is low, many price levels may actually now be nearly right. Further the labour market is showing (minor) positive signals, with employment up, unemployment steady, and participation up.

With low output growth comes the structural problem of the booming mining sector plus the flagging rest. Much of the needed structural adjustment ought to be accomplished by fiscal policy, but that is now sub-optimally constrained by political compromises. Thus in 2012-13, the economy faces unnecessarily tight fiscal policy with the government's commitment to achieve a surplus. Given the likely slow recovery of the global economy, this may force a tight fiscal - easy monetary policy mix. The latest data indicates that the monetary part of this mix may need to start sooner rather than later.

There remains reasonable probability that Australia and its trading partners will trade their way back to normal growth by 2013-14 in which case the cash rate will need to be returned to its higher neutral level.

MARK THIRLWELL

No comment.