PRO-POL SHADOW RBA BOARD – COMMENTS

JUNE 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 low inflation the RBA has scope to consider further rate cuts, although the extent of this scope could be more limited than a month ago, as the recent AUD depreciation will put some upward pressure on inflation over the coming period. Domestic indicators remain firm for the Australian economy, particularly with employment continuing to grow and the unemployment rate low. The 50bp cut by the RBA last month has yet to feed through the economy and almost all of the currently available economic indicators pre-date the May cut. Global downside risks have clearly increased, particularly the risk of a further negative financial shock from Europe. But, at this stage, the path for the euro area remains highly uncertain, as much depends on political decisions. China's slowdown continues, though the easing has largely been at a pace that Chinese authorities had intended. I would countenance a discussion about a further cut this month, but would recommend waiting for more evidence of the impact of last month's 50bp cut and for further news from Europe before possibly making further cash rate cuts.

In the medium-term, the distribution of outcomes remains bifurcated. The probability of a financial disaster in Europe, potentially involving a partial euro break-up, has increased. If this were to come to pass, global output would be substantially weaker, motivating further significant cuts by the RBA. On the other hand, if the European situation stabilises, which is likely to reflect further support from policymakers, then Australian monetary policy will not be need to provide additional support for the economy, particularly as the local economy still has momentum from the ongoing mining boom.

MARK CROSBY

No comment.

MARDI DUNGEY

No comment.

SAUL ESLAKE

Current:

Although markets are convinced there will be a cut of at least 25bp at the June meeting, I think the $2.5bn of government cash is enough stimulus for this month, and they can afford to wait at least another month (although they may well draw up contingency plans for an inter-meeting cut depending on the outcome of the Greek elections on 17 June and anything else that could go wrong in Europe before the July meeting).

Long term:

Market pricing of a 2.5% cash rate or less would be justified if events in Europe resulted in another Lehman-type shock to the global financial system and global economy. But at the moment I don't think that's the most likely outcome.

BOB GREGORY

No comment.

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WARWICK MCKIBBIN

No comment.

JAMES MORLEY

Policy should avoid being seen as targeting asset prices:

After an aggressive 50-basis point cut last month, monetary policy should focus on slowly returning to neutral over the near term under the baseline scenario of unemployment remaining low and inflation remaining within the target range. There are some risks to this baseline scenario, with some caution about raising rates too quickly being warranted given uncertainty about how effective policy stimulus will be in China. However, it is also important that the RBA not be seen to be targeting housing prices on their way down, especially given that they were not targeted on the way up. The inflation-targeting mandate implies a need to focus on a broad basket of consumer goods, not on particular asset prices. Even with falling house prices, deflation remains a remote risk for the Australian economy. However, if the risk of deflation were to rise, an aggressive response would be necessary, with the current level of interest rates leaving room for such a response.

JEFF SHEEN

The Australian economy is performing better than most others, but the overall recovery remains patchy and weak. The most recent data shows that the mining investment boom is the only real contributor to growth recovery. Building approvals have been falling significantly particularly in VIC and SA. However new motor vehicle sales have done well over the year (7% growth). Retail sales are flat (though not for food and restaurant spending). Employment has been rising (albeit slowly) everywhere but NSW and TAS; hours worked is more robust; and unemployment is down to 4.9%. The risks from Europe, China and the US have worsened marginally over the last month. Dubious pessimism has led to significant stock price falls, which will impact on wealth and perhaps consumption, but the exchange rate continues to depreciate, which will help Australian exporters. Put together, my strongest case is for the cash rate to remain unchanged now, given the unexpectedly large cut in the previous month.

Over the next year, I consider the highest probability to be for the global and local recovery to proceed (slowly and variably), and so the cash rate should gradually begin to return towards its higher neutral level.

MARK THIRLWELL

Recent weeks have seen a marked deterioration in the outlook for the global economy, with risks now tilting even more sharply to the downside.