

PRO-POL SHADOW RBA BOARD – COMMENTS

JULY 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

I would recommend the RBA stay on hold this month. Having cut rates by a total of 75bp in the past two months, the RBA should now sit still to assess the impact that these rate cuts have had on the economy. Local conditions still look to be fairly solid, with employment growing strongly in May and GDP for Q1 an upside surprise. There is a clearly a risk that things have slowed down since then, with business and consumer surveys weakening, and the downside risks from abroad rising. But some part of this risk has already been accounted for in last month's cut. Rates are now clearly stimulatory. With the AUD no longer appreciating, upside risks to inflation are also building. A discussion about cutting this month could be had around global risks, but I would not recommend a cut this month, having just gone last month.

Looking further out, much is dependent on the global outlook. How the European debt crisis resolves is clearly key in this regard. Assuming the euro muddles through, with only a modest recession but no sharp financial shock, rates are likely to stay unchanged, or be cut only modestly from here in the next six months. In this fairly benign euro scenario, there would be an increasing chance that rates will need to be lifted over a twelve month horizon. If the euro situation deteriorates further, however, rates may need to be cut more aggressively. There are also risks due to the China slowdown, though these seem much less concerning at this point than those emanating from Europe.

MARK CROSBY

No comment.

MARDI DUNGEY

Despite the relief of the outcomes of the Greek elections the situation in European markets is far from resolved. Progress (or not) towards a feasible plan for structuring the fiscal and monetary future of the Euro Area will be critical to outcomes in both the immediate and prolonged future. This makes for a great deal of uncertainty as an abrupt change in confidence could occur at almost any time. While domestic conditions are stable, there is a significant threat from reduced international demand, and it is unclear how much of this may be realised. With fiscal austerity being practiced at State level in many jurisdictions monetary policy should err on the side of caution- the risk for the short-term economic outlook is almost entirely on the downside. In the longer term, there is a great deal of uncertainty as to whether domestic inflationary or recessionary concerns will dominate.

SAUL ESLAKE

Noting that last month's decision to cut rates was 'finely balanced' (according to the minutes), and since then we've had the second Greek elections (the outcome of which has lowered the near-term probability of a disorderly Greek exit from the euro), and much stronger Q1 GDP and May labour force survey data, I think there's zero chance that the RBA Board should do anything other than leave rates on hold at this week's meeting.

The six-month view (and my 12-month view) reflects a view that there are (broadly speaking) two plausible monetary policy scenarios - one, with 80% probability, that there isn't another major global financial shock, and that the Australian economy slows from its Q1 pace (with unemployment riding towards 6%), prompting one (or possibly two) 25bp reductions in the cash rate; and a second, with 20% probability, that there is another major global financial shock, prompting a more aggressive easing from the RBA.

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BOB GREGORY

No comment.

WARWICK MCKIBBIN

No comment.

JAMES MORLEY

Slow adjustment back to neutral, but always ready for quick response to unusual developments in inflation or financial conditions:

After cuts in the policy rate over the past few months, monetary policy is currently in an accommodative stance. This provides some insurance against any possible deterioration in the domestic economy or spillovers from continuing problems in the rest of the world. However, in the absence of a full-blown financial crisis in the Eurozone, the main focus of policy should be on the appropriate timing to return to a more neutral stance over the next six to twelve months. This timing will depend in part on the inflation outlook, with the current outlook allowing for a fairly gradual adjustment.

As always, monetary policy should be ready to respond immediately to a new global financial crisis. But it should not do so preemptively unless the likelihood of a full-blown crisis rises substantially before the next policy meeting.

JEFF SHEEN

The cash rate was cut last month, which was a move that I did not support, but does constrain what I recommend now. Since then, the March quarter national accounts data have come out, showing real GDP growth at 4.3%, well above normal. This may well be revised downward later, but not by enough to justify any further pessimism about the overall Australian economy. The source of expenditure growth was not only (mining) investment, but also consumption, which broadens the base for the recovery. In addition, employment growth (particularly, full-time) in May was positive, as was participation (which actually meant unemployment rose a little, but is still very low). Though the trend growth and level of productivity remains a concern, this is not something monetary policy can properly address. Global risks have declined following the outcome of the Greek election, and then the agreement by European leaders to allow direct recapitalisation of troubled banks and to encourage stimulus policies as well as a closer economic union in the longer run. Disaster would seem to be averted, but it's hard to see ailing Europe as anything but the new Japan in the medium term.

MARK THIRLWELL

No comment.