CAMA RBA SHADOW BOARD – COMMENTS

OCTOBER 2013

Each CAMA RBA Shadow Board member is 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

This month brought more signs that monetary policy is getting traction, with the local housing market continuing to lift and sentiment improving. There are also signs that growth in the Asian economies is picking up, led by Australia's two largest trading partners: China and Japan. An improvement in conditions in Asia has also been part of the reason why the Australian dollar has risen in the past month. While local growth remains below trend at the moment and inflation is near the lower bound of the target band, the risks to the growth and inflation outlook have shifted further to the upside in the past month. Rising housing prices and a pick up in new lending also mean that financial stability concerns should start to play a bigger role when considering whether the cash rate should be cut any further. As I noted last month, cutting rates further from here may entail increased risks of asset price misalignments and while in the short run rising asset prices are likely to support growth, they may cause other problems in the medium term. Despite the recent rise in the AUD, I recommend that the cash rate is left unchanged this month.

MARK CROSBY

Ongoing uncertainty not helped by the Fed decision not to taper, though in general international conditions continue to surprise on the upside. It is surprising that the RBA is hosing down talk of a housing bubble when experience of the early 2000s suggests that the RBA can be wise to jawbone down the housing market, while Greenspan's claims of "localised froth" proved to be folly.

MARDI DUNGEY

No comment.

SAUL ESLAKE

No comment.

BOB GREGORY

No comment.

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WARWICK MCKIBBIN

There is clear evidence that loose monetary policy in Australia is driving the demand for assets (especially housing) suggesting that that asset prices are inflating relative to fundamentals. The resolution of political uncertainty will likely improve confidence in the economic outlook and thus stimulate the economy. A stronger outlook for China will also reduce concerns over the outlook for the Australian economy. Low interest rates are likely to be misallocating capital in the Australian economy and to avoid the US experience during 2001 to 2004 when rates were too low for too long a move to more normal interest rates would be advisable. A greater burden on structural adjustment should be borne by fiscal policy, particularly infrastructure spending.

Globally emerging markets are being stressed through a reallocation of global capital flows as the Fed edges closer to the end of quantitative easing. The recent surprise announcement of a continuation of bond purchases by the Fed was unwelcome news in many economies. The growing gap in the US between the data and the forward guidance by the Fed is becoming a problem for the global economy.

JAMES MORLEY

Focus on stable financial conditions more than a specific growth rate for economic activity:

The unemployment rate has continued to creep up, reaching 5.8 percent in August. This reflects economic growth being somewhat below potential. However, monetary policy is already quite accommodative, with the ability of policymakers to fine tune the economy to the extent of hitting a particular growth rate being very limited at best. Thus, any future decrease in the policy rate would only be appropriate if there were clear signs of a significant deterioration in the level of overall economic activity.

The RBA should continue to monitor conditions in the housing market and be ready to “take away the punch bowl” if it continues to boom in the midst of a somewhat weak economy. In particular, households should not assume that such low real interest rates will persist over the long term when making decisions about debt-financed purchases.

JEFFREY SHEEN

No comment.