CAMA RBA SHADOW BOARD – COMMENTS

JUNE 2015

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

No comment.

MARK CROSBY

Further signs that the economy is not weakening further, so that the case for a cut or cuts in the near future does not seem to be as strong as in past months. Still uncertainty on the global front, with the ever present possibility that Greece may finally default. But does not seem that would have longer term effects on global economies. As a result the longer term outlook would be for a start towards rate normalisation within 12 months.

MARDI DUNGEY

The RBA decision to ease monetary policy in May for which the timing was partly decided in order to meet the "challenges of communication" (RBA Minutes of Board Meeting for May 2015) associated with the timing of the Federal Budget is a gamble that accommodative monetary policy can overcome the problems of the inactive role fiscal policy is currently playing in macro policy making. As there seem to be few signs of improvement on the fiscal front, the RBA is taking a risk that looser monetary policy can fill part of this role and not cause structural problems elsewhere. The Board meeting minutes make clear that most domestic conditions are if anything only a little weaker than in previous months; and there is considerable uncertainty as to whether consumption will respond similarly to that experienced in pre-crisis conditions – given the rather nasty scare experienced by many in the economy, it seems unlikely we will see this type of response to lower rates. More likely is that looser credit will inflate house prices – an area where the fiscal reform agenda could make substantial improvements by removing a number of incentives to overinvest in housing. Given the hand that the RBA has been played, it is not unreasonable that they chose to move rates. However, if all arms of policy were playing a role in active economic management this would not be the path I would recommend. For that reason, my recommendations are based on the presumption that monetary policy cannot reasonably be expected to manage single-handed and that it is able to follow its usual best-practice course in setting policy in partnership with other arms of policy making, in which case I recommend that a higher policy rate should have been maintained.

BOB GREGORY

No comment.

GUAY LIM

No comment.

WARWICK MCKIBBIN

Continued weakness in nominal GDP growth in Australia implies that the neutral policy interest rate continues to fall. However, evidence of rising asset prices particularly in the housing markets of Sydney and Melbourne makes the setting of interest rates increasingly complex. From the point of view of short term macroeconomic factors, low interest rates in Australia could be justified, however, the distortion this is causing in asset markets is worsening. This highlights the difficult tradeoff between short term growth and medium term vulnerability. My judgement is that the damage caused by a painful adjustment in the housing market and the high levels of leverage by households in an environment of a downward adjustment in trend economic growth is a dangerous mix that loose monetary policy and even more financial leverage cannot solve. Add to this situation, the move to normalize interest rates in the US and there are many bad scenarios for Australia that are plausible. I recommend leaving interest rates unchanged (indeed I would not have lowered them to the current level). Monetary policy should be focused on medium term stability especially if it has little prospect of solving the problems that cause weak short term demand. There is strong evidence that a point have been reached where monetary policy cannot offset the core problems caused by uncertainty about economic and political prospects in the Australian economy. The lack of substantial policy assistance from fiscal rebalancing or substantive economic reform generally, is increasingly backing the Reserve Bank into a corner. It appears that many politicians do not appreciate the risks that now face the Australian economy. No wonder investment is weak and uncertainty is damaging economic prospects in Australia. It may be that the optimistic projections in the recent federal budget turn out to be correct, however, the vulnerabilities within the Australian economy are growing and lower interest rates without any other policy response makes this situation worse.

JAMES MORLEY

The relatively stimulative federal budget and the recent lower level of the Australian dollar mean that the RBA has scope to hold the policy rate steady this month and even start raising it back to its neutral level over the medium term.

JOHN ROMALIS

No comment.

JEFFREY SHEEN

In my opinion, the cut in the cash rate to 2% in May was the right move. My expectation is that it should remain at this level until at least early 2016.

The net saving glut in Australia continues to be a problem. Consumption growth is unlikely to contribute much to growth normalization because of the relatively high levels of household debt. Growth recovery will have to come largely from business investment, which unfortunately shrank badly in the March quarter and continues surprisingly in waiting mode, despite low interest rates. The proposed federal budget in May 2015 turned less austere than anticipated, reducing one obstacle to the return to normal growth. The 20% trade-weighted exchange rate depreciation over the last 24 months will help growth recovery by boosting non-mining exports, but this boost should continue for a while to be more than cancelled by the falling value of mining exports. Overall, upside inflation risk remains minimal since wages growth is modest and energy prices are unlikely to rise much. The outlook for Greek debt negotiations looks grim, with possible negative ramifications for global asset markets. Therefore, the Australian economy needs its current monetary policy push to remain for some time yet, and needs a stronger fiscal push.