CAMA RBA SHADOW BOARD – COMMENTS

MAY 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

Underlying inflation is steady and, at around 2.4%, it is still comfortably in the target band, albeit in the lower half. This suggests that demand has held up relative to supply in the economy, although growth is probably still a bit below trend. At the same time, a number of indicators of domestic economic conditions have lifted in the past month, including retail sales and employment, suggesting that the domestic momentum may be picking up, rather than slowing. Local asset prices have also remained buoyant and Sydney housing price growth still appears excessive. The AUD has appreciated over the past month, but this partly reflects rising commodity prices. On balance, the economic information that has arrived over the past month has been more positive for Australia. There also remains a key question about whether further easing of monetary policy could over-inflate asset prices, particularly given the continued exuberance in parts of the housing market. I recommend the cash rate is left on hold at 2.25% this month.

MARK CROSBY

With the markets anticipating delays in increased official rates in the US it would seem wise for the RBA also to stay lower for longer, with raises in the rates risking appreciation of the dollar and further weakening the economy. At the 12 month horizon there still seems to be a strong case for raising rates closer to neutral.

MARDI DUNGEY

No comment.

BOB GREGORY

No comment.

GUAY LIM

No comment.

WARWICK MCKIBBIN

The RBA faces a difficult choice. Cutting interest rates will likely further inject a bubble into asset markets which will lead to high economic costs when the policy unravels. Ultra low interest rates are not a substitute for dealing with the structural adjustment that the Australian economy needs to undertake. The longer that economic reform is postponed through political stalemate the more difficult the job of monetary policy will become. The ultimate questions for the RBA are: what is the objective of the current policy and what will be the most likely ultimate outcome of continually lowering interest rates in the current economic environment? Is the goal to drive the economic adjustment to the commodity price decline or is it to buy time by artificially stimulating asset values in the economy to sustain demand until the politicians that are blocking needed economic reform realize the folly of their actions? It may be possible for the RBA to drive the adjustment but it is more likely that it can only postpone a structural slowdown. Creating a significant misallocation of capital in an economy that will ultimately need major structural adjustment, while perhaps attractive in the short term, will likely create a proliferation of problems that will converge at some point in the not too distant future. My view is the RBA should hold its ground and focus attention on highlighting the fundamental economic problems that other policies need to address. Perhaps with luck, ultra-low interest rates might bridge the policy vacuum created by parliament. But the more likely outcome is that cutting interest rates further without other policy support, will ultimately create another painful economic adjustment that Australia did not need to have.

JAMES MORLEY

Despite the recent fall in headline inflation to 1.3%, underlying inflation remains within the target range at 2.3%. Meanwhile, the latest unemployment rate is 6.1%, which is down from its recent peak at 6.4%.
These conditions suggest that the RBA should hold the policy rate steady at the very low level of 2.25%, with concerns about an overstimulated housing market implying a tightening bias going forward.
The recent partial recovery of the Australian dollar largely reflects better external conditions for the export sector. Therefore, the RBA should not lower the policy rate to drive the dollar down.

JOHN ROMALIS

No comment.

JEFFREY SHEEN

I am marginally in favour of a cut in the cash rate because of the relatively weak outlook. My focus this month is on the following:
- Commodity prices remain depressed, and this problem will not change soon.
- The Commonwealth budget in May is likely to feature consolidation proposals.
- The US economy has temporary slowed its growth in the winter quarter, and the Federal Reserve is unlikely to raise its funds rate until at least later this year.
- The increasing risk of failure of the negotiations on Greek sovereign debt is a threat to financial market stability in Europe and beyond.
- CPI inflation in Australia for the March quarter is (temporarily) very low at 1.3% largely due to falling fuel costs.
- Wages, vacancy and employment growth remain modest in Australia.
- House price inflation may be a risk (mainly in Sydney), but this is investor-led and thus likely to encourage construction activity.

Overall, I think the RBA has the scope to cut the cash rate this month, and possibly again later in the year. If next year's circumstances warrant it, normalization of the cash rate can then begin from a lower base.