Opinion

# Historic change sees RBA leave the dog days behind

**Ross Garnaut**
*Contributor*

Apr 11, 2021 – 12.35pm

The RBA governor's statement after Tuesday's board meeting would have been remarkable before late 2019 for its reference to full employment. It would have been remarkable before the first half of 2020 for its commitment to interest rates near zero for cash and out along the yield curve. It would have been remarkable until recently for its acceptance of RBA purchases of large quantities of government bonds.

There has been a historic change in the basic stance of monetary policy since the beginning of the pandemic and especially since early February. The change gives Australia a chance of achieving full employment for the general run of citizens for the first time in the working lives of most Australians.

Covid-19 has forced governor Philip Lowe to change the RBA's monetary policy stance. **Alex Ellinghausen**

The Australian economy performed poorly in the seven years (2013-19) between the China resources boom and the pandemic recession. Australians experienced slower growth in output per person than other developed countries, including Japan. There was no growth at all in real household income per capita. There was persistently high unemployment (while the US went from much higher to much lower unemployment than Australia), and inexorably increasing underemployment. These were the dog days.

My book *RESET: Australia After the Pandemic Recession* attributes the stagnation to several causes, and gives a central place to monetary policy being tighter than the rest of the developed world even when our economy was weaker.

Stephen Grenville, former deputy governor of the RBA, says that *RESET* misses the real culprit: the government's fiscal austerity. Yes, given the restrictive monetary policy, commonwealth budgets were too tight for full employment and maximum sustainable growth. However, the focus on reducing budget deficits quickly would not have been so far out of line with our economic circumstances if monetary policy had been closer to other developed countries.



*RESET* says that a judicious balance between fiscal and monetary policy is necessary to achieve the combination of Australian dollar exchange rate and domestic expenditure that produces full employment with the right amount of foreign debt. Running tighter monetary policy than the rest of the developed world in the dog days kept the exchange rate too high.

**The RBA is now unequivocally committed to keeping interest rates low and bond purchases high until full employment is achieved.**

Grenville asserts that we had an "equilibrium" exchange rate in the dog days and that easing monetary policy to push it lower would have given us "beggar thy neighbour" competitive advantages over other countries. He says that the US would have challenged such improvements in Australian competitiveness.

There are many "equilibrium" exchange rates – one for every combination of fiscal and monetary policy settings. The "equilibrium" exchange rate that we should be seeking is that associated with the combination of fiscal and monetary policy that gives us full employment with the right amount of debt.


**Sign up for our Opinion newsletter here.**

The exchange rate can fall 20 per cent or more from the giddy heights of late 2011 and still be far too high for full employment with the right amount of debt. Interest rates can be "spectacularly low" and monetary policy can still be too tight for full employment with the right amount of debt. *RESET* explains how tendencies towards increases in savings' share of income and in investment's share of expenditure in the 21st century have transformed the relationships between interest rates and full employment. Restoring Australia after the pandemic recession requires us to run policy for conditions as they are in the 2020s, and not as they once may have been.

"Beggar thy neighbour" monetary policies? We let other developed countries beggar us through the dog days. Not that it should matter, but we would still have run a big bilateral trade deficit with the US if our monetary policies had been as expansionary as theirs. There is no risk that the US would have hit back against Australian monetary policies that were similar to their own.

It is good news that the Reserve Bank is now looking to its statutory obligations, setting cash rates not far above the average for developed countries, and purchasing almost as many bonds as governments are issuing. The RBA is now unequivocally committed to keeping interest rates low and bond purchases high until full employment is achieved. It is now appropriately defining full employment as the labour market conditions in which labour scarcity is lifting wages in the market place enough to achieve the inflation target on a continuing basis. Governor Phillip Lowe at the Australian Financial Review's Business Summit on March 10 said for the first time that at full employment, the unemployment rate may have a three in front of it.

**RELATED**

**Historic change sees RBA leave the dog days behind**

**RELATED**

**The RBA unveils its financial risk score**

We are still running tighter monetary policy than the rest of the developed world. Half of developed country GDP is in countries with negative cash rates, and we continue to eschew them. Recent IMF commentary says that a fall of interest rates into the negative when the economy is weak does roughly as much good and little harm as the same reduction to low positive rates. Sovereign bonds held on the Reserve Bank's balance sheet are a half or third as large as a proportion of GDP as in other developed countries.

But we are getting closer to what is required for full employment and rising incomes after the pandemic recession. Hold the recent gains, and monetary policy won't be the main cause if we fail in the post-pandemic restoration of Australian prosperity.

**Ross Garnaut** is professorial research fellow in economics at the University of Melbourne.



READ MORE

Monetary policy +
Opinion +
RBA +
Philip Lowe +

LATEST STORIES

Governance
Australia Post names Woolworths executive Paul Graham as new chief
21 mins ago

Travel
One tiny country accounts for a third of global cruise travellers
33 mins ago

Greensill Capital
Cameron breaks silence on Greensill, defends lobbying
57 mins ago

Live Coronavirus pandemic
Morrison dumps vaccine rollout date
1 hr ago

## LATEST IN ECONOMY

Population

### What the world's biggest census means for Australia

Apr 11, 2021 | Matthew Cranston

JobKeeper

### Employers face staff shortages post-JobKeeper

Apr 11, 2021 | Finbar O'Mallon and Natasha Boddy

Company tax

### US political battle lines form on Biden global tax plan

Apr 11, 2021 | James Politi and Aime Williams

**Analysis** Federal budget

### Vaccine bungle is an economic setback, not a disaster

Apr 10, 2021 | John Kehoe

**Exclusive** Federal budget

### Vaccine setback won't derail budget or recovery, says Frydenberg

Apr 10, 2021 | John Kehoe and Tom McIlroy

## MOST VIEWED IN POLICY

1 **Bob Katter's big power line a family affair**

2 **Employers face staff shortages post-JobKeeper**

3 **Mining off OECD global tax agenda**

4 **WA residents told to evacuate as Cyclone Seroja intensifies**

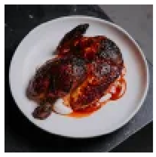
5 **What the world's biggest census means for Australia**

6 **Historic change sees RBA leave the dog days behind**

## The Australian Financial Review Magazine

### How to cook restaurant's smoking-hot harissa chicken dish at home

Jill Dupleix



**Nick Molnar's runaway success starts with style**

**The man behind some of world's most authentically feminine fashion**

## BOSS

### The five questions directors need to ask about cyber security

Sally Patten

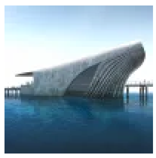
**Why this top Atlassian executive loves performance reviews**

**Boards brace for 'say on climate' resolutions**

## Life & Leisure

### The 'blue economy' heats up with bold new marine architecture in WA

Ute Junker



A flight of imagination in McLaren's grand tourer

Grape growers and winemakers find strength in new alliances

## RICH LIST

### Canva wants to be design platform of choice

Miranda Ward

Canva founders among 10 wealthiest Australians after $93m raise

Rich Listers add historic Fairburn farm to beef empire



**MY ACCOUNT**

**SUBSCRIBE**

**ABOUT US**

**CONTACT**

**MAGAZINES**

**COLUMNS**

**MARKETS DATA**

**LISTS**

**EVENTS**

**OUR NETWORK**

**TERMS AND CONDITIONS**



Site Map