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Reflections ahead of Philip Lowe's last speech

Philip Lowe's last speech as RBA Governor is scheduled for Thursday lunchtime. Ahead of this, it is worth reflecting on the highs and lows during his leadership and some lessons learnt that might assist future RBA Governors.

Low inflation and financial stability are the RBA's key goals

Many groups call on the RBA to take action to advance their vested interests. The brutal reality is that the RBA Cash Rate isn't a plaything that can be targeted at reducing unemployment, encouraging wage growth, making housing affordable or addressing environmental issues amongst a myriad of competing demands. The RBA's primary goal is to maintain low inflation and changes in the Cash Rate are primarily targeted at that goal. The secondary goal of ensuring a stable financial system is assisted by avoiding a low Cash Rate. The full employment aim is a red herring as many factors beyond the RBA's remit (e.g. welfare, migration levels, international economic circumstances) have a stronger influence than the Cash Rate.

Low interest rates are unproductive

Cutting interest rates pulls forward demand and promotes speculative economic activity. Low interest rates have a two-fold impact; cheap debt encourages investors to leverage their assets and it discourages them from pursuing lower risk investments where prospective returns have been forced down. The activities of speculative investors rarely increases productivity. The limited short-term stimulus from low interest rates inevitably reverses as normalising interest rates unwinds those impacts, which often results in a recession.

Politicians are more enemy than friend

Politicians are acutely focussed on winning the next election and have formed the view that there are more votes in lower interest rates than higher interest rates. This perspective may change as an ageing population and growing superannuation base demand decent long term returns on low risk investments. Politicians are also focussed on delivering positive economic news (life is prosperous when we are in government), even when economic data points to a cautious outlook being warranted. The embarrassing joint press conference with Josh Frydenberg in 2019 was a clear example of the supposedly independent RBA being co-opted for government spin.

The RBA, along with the Productivity Commission, occupy vitally important positions. As bodies stacked with economists and intended to be independent from politics, they are well placed to hold politicians to account. Over the last fifteen years governments have avoid productivity reform, tax reform and fiscal equilibrium. Philip Lowe deserves credit for frequently raising the need for productivity reform. However, the failure to mention the need for fiscal restraint when excessive government spending has put upward pressure on already high inflation is a glaring error.

Quantitative easing (QE) was a mistake

By the RBA's own estimates, QE lowered Australian government bond yields by a measly 0.30%. That's profoundly underwhelming for a program that bought $280 billion of medium and long term bonds and is set to lose tens of billions in taxpayer dollars. QE also stoked inflation, assisted governments in their profligacy and undermined the fundamental concept of sound money. QE should be written into the central bank textbook as a failed experiment, never to be tried again, alongside its close relative modern monetary theory.

The term funding facility was a mistake

The term funding facility was supposed to provide cheap loans that would stimulate investment and economic growth. The most obvious and immediate outcome was a surge in house prices, as Australians rushed to buy property using

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the cheapest debt they had ever been offered. Now that the cheap debt party is over, borrowers are facing the dual hangover of higher repayments and lower house prices.

Taxpayers have been stung for billions of dollars, with banks lending the cheap funds back to the RBA at a much higher interest rate. The term funding facility was also a major tilt of the playing field in favour of banks. It gave them cheap funding to steal market share away from non-banks, who were deliberately left out. The awful implementation of this policy demonstrates again that the RBA lacks financial markets expertise.

There were numerous communication mistakes

Many will remember the RBA encouraging people to borrow by stating its view that interest rates wouldn't rise until 2024. While this was a misunderstanding that can be blamed on both the speaker and the listener, several factual errors have tarnished the RBA's reputation. The repeated claim that lower interest rates didn't lead to higher house prices was immediately disputed by many outside the RBA and was eventually and embarrassingly refuted by RBA economists. Another claim, that households are net borrowers, was a statistical sleight of hand.

Philip Lowe tied himself in knots trying to make the case that low inflation was a problem in need of a solution. He should have said that low inflation is a desirable outcome and that the inflation target minimum of 2% was the problem. Instead, he bumbled along arguing that if inflation expectations are set too low then low inflation would become entrenched (what a blessing that would be) and would be difficult to get back to the target range.

Another economic communications error was the claim that a glut of savings caused low interest rates. This is an economist's version of gaslighting given central banks control the interest rate paid on overnight deposits. Rather than a glut of savings, there was a glut of quantitative easing, flooding financial markets with excess liquidity.

Lessons for future RBA Governors

Arguably the most significant lesson from Philip Lowe's time as RBA Governor will be that future Governors should intervene with monetary policy far less than he did. By attempting to solve problems that monetary policy isn't well suited for, productivity has been depressed and taxpayers are paying an enormous price. The RBA's independence should be used assertively to say "no" far more often. Instead of intervening with monetary policy, the RBA's platform should be used to explain the necessary solutions and to call on others, primarily governments, to fulfill their roles to increase the economic prosperity and welfare of the people of Australia.

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