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24 September 2020

'We're all fiscalists now' but Keating is still wrong on the RBA

It is perhaps an apocryphal story, but back in the 1960s, former US President Richard Nixon was attributed the phrase, "we're all Keynesians now".

Others attribute it to former Nobel laureate Milton Friedman not as a prescription, but rather as a descriptive criticism of the prevailing macroeconomic policy orthodoxy in the late 1960s and early 1970s.

In the present circumstance that phrase might be adapted to "we're all fiscalists now".

The singularly most important message coming from central bank communication in the last week is not only that it needs fiscal help, but that fiscal policy needs to be the primary macro policy tool. It is a clear and consistent message from Jerome Powell to Christine Lagarde to Philip Lowe and Guy Debelle here in Australia.

And it is one governments need to heed (with of course the important proviso that those fiscal measures be intelligently crafted).

The lack of any fiscal follow-through has been a big factor in the recent unnerving of markets.

It is still probably the case that any central banker asked the question about running out of monetary ammunition would respond in the negative, but it is hard to escape the conclusion that they might do so with only tepid conviction levels.

Federal Reserve chairman Powell at the most recent FOMC meeting, which included the long-awaited move to flexible inflation targeting, announced a series of policy measures best described as more of the same.

Locally, Reserve Bank deputy governor Debelle insisted there was a range of monetary options the RBA could exercise should it judge a further easing of monetary conditions was warranted.

But those options essentially consisted of a tweaking of current tools. Dr Debelle (rightly) expressed some scepticism on the efficacy of negative rates.

In pointing out the limitations to monetary policy I am not seeking to decry the efforts of central bankers. Former Prime Minister Paul Keating has levelled some sharp criticism of the RBA approach – harshly in my view.

The world's central banks, including the RBA, have acted with alacrity in addressing the issues associated with the pandemic and their responses have proved pivotal in mitigating the negative consequences. However, there is only so much central banks can do.

Where Mr Keating may have a point is that fiscal policy should now assume a primary role.

However, for the most part Mr Keating's criticisms of the RBA are wide of the mark, or, at the very least exaggerated.

In the first instance, I think the RBA has been a vocal advocate of fiscal expansion and its measures to date have supported the ability of the government to go down that path.

Australian 10-year bond rates at 0.8 per cent are hardly a brake on the government's ability to fund fiscal expansion and it is difficult to ascertain what incremental value would result from direct purchases by the RBA of government bonds.

The Australian government has by and large met the immediate fiscal challenge, even if it may be that more (intelligently crafted) fiscal help is needed. There is a sense that states could do a little more to mitigate the economic damage wrought by border restrictions.

That Australia's public debt is relatively low by international standards means there is plenty of fiscal room should the government wish to do more. That is a testament to the frugality of past governments on both sides of politics.

Elsewhere, governments have been tardy in offering central banks the requisite support.

In the US, the political wrangling between Congress and the Trump administration on the size and structure of any fiscal support factor has seen delays in fiscal support that is beginning to unnerve risk markets.

Washington dysfunction is a large and growing theme, particularly as the presidential contest looks tight, and markets digest the implications of a potential regulatory regime focused on oligopolistic privilege.

The exhortations of central bankers for governments to provide fiscal support therefore face significant challenges, raising the prospect of a further roiling of global markets.

The year 2020 has been challenging on many levels. The success or otherwise in meeting the fiscal challenge may well be the pivotal factor driving markets as we seek to put behind us a year that many would like to forget.

Published in The Australian Financial Review, 24 September 2020

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