Australian central bank cuts rates as economic downturn accelerates

Nick Beams
4 February 2015

The Reserve Bank of Australia (RBA) yesterday cut its base interest rate by 0.25 percentage points in a move that reflects both the intensifying global currency war and the rapidly worsening state of the Australian economy.

The RBA's cash rate is now at an historic low—even below the level recorded in the depths of the 2008–2009 financial crisis. The Australian dollar fell to just above 76 US cents, its lowest point for more than five years, on the back of the news, amid predictions that further interest rate cuts will be made in coming months.

The RBA decision points to the deepening global downturn. In little more than a month since the start of the year, some 12 countries have now taken action, whether by cutting rates or other measures, to try to lower the value of their currencies as the struggle for markets intensifies and global growth declines.

Australia has been heavily impacted because of precipitous falls in commodity prices, most notably the halving of the price of iron ore, its leading export earner. The terms of trade, a measure of the relative value of exports compared to imports, have fallen by 25 percent over the past three years, leading to a contraction in real gross domestic income over the past half year. Real wages have contracted for the first time since 1991–92.

Having not experienced an official recession—defined as two consecutive quarters of negative growth—for almost a quarter of a century, Australia is now being sucked into the vortex created by the ongoing breakdown of the global economy that began in 2008.

Announcing the decision, RBA governor Glenn Stevens, who has advocated a lower Australian dollar in order to try to boost growth, pointed to two key motivating factors.

He said that while the Australian dollar had declined "noticeably against a rising US dollar in recent months," its fall against a basket of major currencies was much less marked and it remained "above its fundamental value." This is particularly significant because other central bankers have insisted that their rate cuts have not been aimed at reducing the value of their currency—such a policy being condemned as an expression of the beggar-thy-neighbour measures that characterised the 1930s.

Bank officials have generally tried to cover their tracks by citing the need to prevent the emergence of deflation. But with the inflation at or near 2 percent in Australia no such obfuscation was available to Stevens. He had to admit that the rate cut was specifically aimed at reducing the value of the Australian currency.

Stevens' statement pointed to the rapidly worsening position of the Australian economy. Growth remained at "below trend pace, with domestic demand growth overall quite weak." The major component of the weakness is the downturn in domestic investment as businesses anticipate stagnant or contracting markets.

Stevens said output growth would remain below trend and unemployment, now at 6.3 percent, would continue to rise.

This is in marked contrast to RBA forecasts made as recently as last November. Then it said that 2015 was likely to bring a recovery with growth rising from its level of 2.3 percent to 3.5 percent and possibly reaching 4.25 percent by the end of 2016.

As *Business Spectator* columnist Alan Kohler noted: "Taken at face value, the RBA has made a total reassessment of its view of the economy and concluded that things are not going that well—worse apparently than the statistics are telling us."

He said the RBA had decided to "don the camouflage suit and tin hat and race out into the currency war battlefield, guns blazing."

The RBA's "total reassessment" is an expression of the ongoing downward assessment of the state of the global economy. According to Australian Treasurer Joe Hockey, the International Monetary Fund is about to release fresh forecasts on global growth expressing "further concern about some of the headwinds we are facing." Just two weeks ago the IMF downgraded its forecast for global growth from 3.8 to 3.5 percent, but it now appears that even that was too optimistic.

Hockey's warnings about IMF growth revisions made total nonsense of his claim that the RBA cut was "good news for families and small businesses" and "good news for the economy and … good news for jobs."

In fact, the only beneficiaries will be the financial speculators—share prices rose to their highest levels since the financial crisis of 2008 following the RBA announcement—and real estate and property investors. In other words, the major economic outcome of the decision will not be real growth but ever-increasing financial parasitism and the further enrichment of the super-rich, together with widening social inequality.

Contrary to Hockey, the decision was made because RBA considers that, having held interest rates steady for the past 18 months, the economic outlook is now rapidly worsening, a downturn which has firmly taken hold since its assessment barely two months ago.

Hockey's bizarre remarks are an indication of the underlying economic forces driving the growing political crisis which has gripped the Abbott Liberal government. On the one hand, it is faced with demands from the corporate elites, articulated in numerous editorial comments, especially in the Murdoch press, that, under worsening economic conditions, it press ahead with an austerity program aimed at lowering the living standards of the working class.

On the other hand, these attacks have produced a growing wave of opposition which last weekend led to the ousting of the Queensland state Liberal National Party government. Premier Campbell Newman, who lost his own seat in the debacle, had exhibited exactly the kind of "strong" leadership advocated in the editorial columns, casting a pall of doubt over the future of the federal government.

In an attempt to deflect growing criticism of his leadership, Abbott used his National Press Club address on Monday to assure the corporate elites that he was remaining firm, while warning his opponents within the party that any attempts to remove him would make the position of the government even worse. His stand, however, has so far failed to end the leadership turmoil.

A measure of the mounting frustration in ruling circles over the worsening economic position and the increasing difficulty of securing their agenda through parliamentary forms of rule was the editorial published in today's *Financial Review* criticising the RBA decision.

"Fiscal policy is off the rails," it declared. "Politics is a mess, with the instability of the Rudd-Gillard years infecting the Abbott government. There has been no major productivity-enhancing policy reform since the GST [the regressive goods and services tax] a decade and a half ago. Our national prosperity is receding as iron ore and coal prices slump. And now, the one upright institution—and the one credible and coherent policy lever—monetary policy—are bending under the pressure of policy failure elsewhere."

The response of the working class to this deepening economic and political crisis must be to begin to advance its own independent program, based on socialist internationalism, and the building of a new leadership to fight for it.