Australian central bank cuts interest rate to record low

Nick Beams
6 May 2015

The Reserve Bank of Australia (RBA) yesterday cut its base interest rate for the tenth time in the past three and a half years, taking it to a record low of 2 percent. The rate is now a full percentage point below that set in 2009, amid the global financial crisis, described then as an "emergency" setting.

The decision was taken to try to counter deepening recessionary tendencies, chiefly the fall in investment following the end of the mining boom, and lower the value of the Australian dollar to boost export revenues. It will have little or no effect on either.

In a turbulent day on financial markets, the Australian dollar rose in value following the RBA move, in the belief that this would be the bank's last interest rate cut.

Financial analysts voiced concern, fearing the rate cut will inflate the property bubble in the country's largest market, Sydney, where the median price for a house is on the way to a million dollars, and destabilise the banks in the future as families take on unsustainable debt.

Fitch, the ratings agency, said the Australian banking system "could be undermined by further increases in property prices and household debt" and warned of growing risks in the housing market unless further "macroprudential scrutiny"—tighter controls on banking lending—was forthcoming. Barclays Bank economist Kieran Davies said debt levels could rise further and, while the decision would boost consumer spending, it "also increases the risk of further instability in the economy."

An *Australian Financial Review* editorial warned that the RBA, which it described as the most "credible financial institution" in the country, "risks embroiling itself in the currency wars and asset bubbles that have been the result of ever-loose monetary policy elsewhere in the world."

In the face of these concerns, the Abbott Liberal government's Treasurer Joe Hockey, was out spruiking like a dodgy used-car salesman after the decision was announced. "Now is the time to borrow and invest, whether you be a household or small business—now is the time to have a go," he said.

Hockey said there were "many green shoots" in the Australian economy and the decision was like "spreading fertiliser."

In fact, the Reserve Bank made the cut because the economic outlook is worsening. The fall-off in investment in mining has not been countered by increases in other areas of the economy, contrary to the scenario for a "recovery" outlined by the RBA and the Treasury. Unemployment is on the rise, officially at more than 6 percent, and youth unemployment is now at its highest level since the recession of the early 1990s.

The RBA is entrapped in the global vortex created by the deepening financial crisis and an international currency war. Its strategy has been based on the assumption that rate cuts in Australia, coupled with an expected upward movement of US interest rates starting later this year, would lift the American dollar, and lower the Australian currency. This would help counter the precipitous fall in commodity export prices, in particular iron ore, which has hit the Australian budget and the economy at large.

After falling to 75 cents to the US dollar—around the level considered suitable by Reserve Bank governor Glenn Stevens—the Australian dollar has risen in recent weeks and is now near 80 cents.

This is largely due to the fact that the first US interest rate rise since the onset of the global financial crisis, pencilled in for June, has been delayed to later in the year, and possibly not until next year, because of fears that a rising US dollar will hit the American economy.

The most recent US Federal Reserve statements on monetary policy have pointed to the impact of the US dollar's rise on exports and profits. While trade makes up only 13 percent of the US economy, export sales comprise around 25 percent of the profits of major US companies in hi-tech, computers and pharmaceuticals.

Well-known economist Nouriel Roubini noted in a syndicated column that until recently US policy-makers were not overly concerned about the rise of the US dollar because America's growth prospects were better than either

© World Socialist Web Site

Europe or Japan and domestic demand would be strong enough to support growth of 3 percent.

However, the rise in the value of the US dollar was faster than predicted and "strong domestic demand had failed to materialise" [US growth was flat in the first quarter, increasing by only 0.2 percent].

"As a result," Roubini wrote, "the US has effectively joined the 'currency war' to prevent further dollar appreciation. Fed officials have started to speak explicitly about the dollar as a factor that affects net exports, inflation and growth. And US authorities have been increasingly critical of Germany and the euro zone for adopting policies that will weaken the euro while avoiding those—for example, temporary fiscal stimulus and wage growth—that boost domestic demand."

The RBA's impotence in the mounting global turbulence has seen renewed pressure from financial markets for the Australian government to carry out major spending cuts, accompanied by warnings that unless it does so the country's AAA credit rating in international markets will be threatened.

Wall Street investment bank Goldman Sachs said the government was running out of time to start cutting the budget deficit and that the credit ratings agency Standard & Poor's could put Australia on a negative outlook within months.

That prospect has come closer with the latest budget predictions. Issuing his budget forecast on Monday, Chris Richardson of Deloitte Access Economics said that, while the iron ore price fall had been the focus of attention in determining the government's fiscal position, another factor was looming large.

Lower tax revenues as a result of slow wage growth—pay rises have flatlined over the past year—would "tear a new hole in the heart of the budget," he warned. The underlying cash deficit could be $45.3 billion for 2015–16, representing a $14.1 billion fall from the deficit forecast last December.

"We still see deficits as far as the eye can see, with the repair task getting harder both because of economics—commodity prices and wages—and because of politics," he said. "Politics" refers to the government's inability to secure the passage through the Senate of key spending cuts introduced in last May's budget, due to opposition from the Labor Party and the crossbenches, made up of Greens and independents.

The Labor Party is not opposed to cuts. Rather it is making an appeal to the financial elites that it is more able to secure their passage than the Liberals.

Labor's shadow treasurer, Chris Bowen, has insisted Labor is not averse to unpopular measures but will ensure that they are seen as "fair." In other words, Labor will make a better instrument for carrying through the attacks on the working class now being demanded.

That was the orientation of an address by Labor leader Bill Shorten to the McKell Institute at Sydney University on Monday.

Shorten ignored the clear signs of the deepening recessionary trends in the global economy—faltering growth in the US economy, Europe still not back to where it was in 2007, ongoing deflation in Japan, despite Abenomics, and slowing growth in China. He claimed that with the right policies, Australia was "uniquely placed" to take "the opportunities of the moment" because it was situated in the fastest growing region of the world.

Before indulging in windy rhetoric about those opportunities, Shorten gave a firm commitment to the finance houses.

"We hold a hard-won AAA credit rating from the three major ratings agencies, giving confidence and certainty to business and investors—and we must preserve it," he said.

Shorten criticised the Liberals' measures for not producing a "sustainable trajectory for improving the budget balance." He said the lesson of the Liberals' budget debacle was not to give up on "reform"—the code word for major cuts—but to "do reform right, make it fair."

In other words, the problem was not spending cuts as such, but the fact they provoked such hostility that Labor felt constrained to oppose some of the more egregious measures in the Senate.

Labor's strategy has been unveiled in recent weeks. It has proposed relatively minor measures to make multinational corporations pay higher taxes and force high-income earners to pay more tax on superannuation.

These measures are aimed at providing a cover for deep cuts in spending directed against the working class, in line with Labor's commitment, if returned to office, to ensure indefinite austerity by keeping spending below revenue for at least the next decade.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site