CPG Research & Advisory Pty Ltd

**ECONOMIC & MARKET COMMENTARY**
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# RBA Reform

*The government has indicated support for the recommendations of its review into RBA governance. As they have bipartisan support, the creation of a Monetary Policy Board (MPB) is now locked in. We examine the more important changes, and contemplate some implications.*

There were many, many recommendations[1] from the review of the RBA, intended to take effect for FY25 – there is a little over a year to legislate the required changes. Many do not require Parliament and can be phased in earlier. We examine the key ones:

- **Monetary Policy Board**

**Delegation of monetary policy to a separate expert committee** – this leaves the Board to concentrate on traditional governance responsibilities. The RBA Board is said to have less monetary policy experience than other central bankers, and spend less time on it.

The proposal appears modelled on the **Bank of England's** Committee. But the BoE is the prudential regulator of UK banks. In Australia, this was spun out and combined with the Insurance and Superannuation Commission to form **APRA in 1998**.

It remains to be seen whether appointments are narrowly targeted at monetary economists or **whether political interests are represented**.

We are **sceptical about academics (too theoretical), but also of private sector practitioners (conflicts)**.

***Is there one group consistently correct?*** They would need to match the 29 year record of the independent RBA: Been as good at anticipating inflation moves in 2008, 2016 and 2020, as quick to respond to extreme events (2007, 2020) <u>and</u> then not kept policy too loose in mid 2021. Many would have got <u>one</u> call right. Being right for 29 years and then flipping to the exact opposite in 2021's nascent inflation is a high hurdle.

We note that **in the GFC, the government and Treasury were promoting disinflationary austerity policy months after the global inflation cycle flipped** to the greatest deflation threat in a lifetime. It was the RBA that publicly renounced "fight inflation" talk in mid-2008, but USA had been in recession since the previous year!

- **Dual mandate**: Price stability and full employment, **<u>equally</u> weighted** (but removing "currency stability," reimagined as price stability since its float).

This is a radical reform, **reversing 30 years of the primary mandate being inflation targeting**.

The **inflation target was affirmed at 2½%**.

- **Transparency**: How long are divergences from objectives expected?
- **Collaboration with Treasury** on aligning monetary and fiscal policy

In theory a great idea – our greatest macroeconomic policy disasters have come when the two are run in contradictory directions. In practice, does this subordinate the RBA to Treasury (which ultimately answers directly to the voters and is a political operator)?

[1] The full report is found at https://rbareview.gov.au/final-report

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- **Advising APRA** on use of macroprudential tools

Again, risking politicising a regulator, at the worst time.

- **Legislated independence**

Conversely, the review proposes removing the power of the Treasurer to override decisions (to "pull the levers," as a Treasurer once said). For decades, using that power has been unthinkable outside Turkey.

It went horribly wrong when Pres Erdogan did it, and even Russia with a quite…centralised power structure respects central bank independence. **The government has realised having the power attracts its share of blame when rates rise.**

The **Treasury Secretary must also forget that they are a government employee** when on the RBA Board, and proposed MPB. They must not be directed by the Treasurer in that capacity, and act independently.

- **Consider climate change, but not in setting monetary policy**

One wonders how, given the RBA doesn't do anything else!

- **Management Changes**

A Chief Operations Officer. A Chief Communications Officer. Press conferences. Publication of papers after 5 years.

- **Payments System Board**

Yet another Board.

- **Increase modelling capabilities –** fiscal policy and supply-side economics

This reflects broader integration with other policymakers.

- **More detailed information –** the MPB to receive more detailed papers and briefings from RBA economists

This reflects broader integration with other policymakers.

- **Diversity of thought**

Diversity targets, external hiring, welcoming alternative views to limit "groupthink."

It is generally agreed that *if it's not broken, don't fix it*. **The changes proposed are radical enough to suggest the government believes the RBA Board is, in fact, broken.** It is a near certainty that Gov Lowe will not be offered another term.

In fact, the report criticised the failure to achieve target inflation from 2016-19, having averaged 1.6% rather than 2-3%. The real policy error was since 2021, of course.

There are solid arguments that the Board (to become the Governance Board) has many governance responsibilities that have little to do with monetary policy. And being a competent director is quite a different skillset from being an expert monetary economist.

***On balance, we consider the MPB objective to be a good one***, and acknowledge that it has bipartisan support. We expect little pushback from Parliament.

***The other changes risk watering down the independent, inflation-first central bank that is widely considered best practice.*** There is a strong correlation between independence and inflation outcomes[2]. The review did not adopt the craziest suggestions, and it could have been much worse. But ***we expect a more dovish institution over the very long term.***

[2] https://www.rba.gov.au/speeches/1994/images/sp-gov-231194-graph1.gif

**Leading Markets**

Stocks rallied while bonds were mixed in a quiet month. The US Dow Jones, S&P500 and NASDAQ gained +2.6%, +1.6% and +0.1%. MSCI World ex-AUS rose +1.4% in local terms.

Emerging Markets eased -1.1% in $US. Asia fell but Europe and MENA rose. Frontier Markets added +1.1%.

US 10-year bonds firmed to 3.42% (-7bp tighter). The 2-10 inversion was little changed at -60bp, signalling recession. High yield firmed marginally to 453bp spread (-5bp).

**Other Highlights**

Markets stabilised as strong systemic support followed a series of bank rescues. However, First Republic became another statistic.

Global COVID19 reported deaths (ex-China) fell under 500/day for the first time since early March 2020 with the 684m reported cases (ex-China) also growing at the slowest rate then.

US Q1 GDP was estimated at +1.1%, easing from Q4's +2.6% p.a. as manufacturing contracted since October.

Unemployment eased to 3.5% (-0.1%) in March as Non-farm Payrolls beat expectations with +236k *vs* a revised +326k. Participation rose to 62.6% (+0.1%). Youth unemployment dived to 7.5% (-0.6%).

Headline inflation slowed to 5% YoY (-1%) after a +0.1% month. Core CPI rose to 5.6% (+0.1%) on a +0.4% month. Retail sales slowed -0.6% after February was revised down to -0.7%.

Eurozone inflation was 6.9% in March, *vs* 8.5%. Core CPI rose to 5.7% (+0.1%). Q1 GDP of +0.1% followed a flat quarter. During the month, the CY22 fiscal outcome was confirmed at -3.6% of GDP. Individual outcomes ranged from -8% (Italy) to balance (Netherlands).

Chinese GDP grew +2.2% in Q1's reopening. Inflation fell to 0.7% (-0.3%) YoY as prices fell -0.3% in March.

Japan's prices rose 0.3%, but saw YoY inflation at 3.32% (-0.1%). Retail sales recovered +0.6%. UK inflation remained in double digits at 10.1% (-0.3%).

**Domestic**

The April RBA meeting saw the RBA pause, but retaining an upward bias. The Board is set to lose interest rate decisions to a separate Monetary Policy Committee. The futures market prices a long pause, with cuts to start at year end.

Tax revenue increased +15.2% in FY22.

Bonds weakened, ignoring offshore leads to tighten their spread through US bonds. 2-year bond yields closed 3.08% (flat), 5-year at 3.01% (+5bp) and 10-year at 3.27% (+5bp).

COVID19 deaths rose to 17/day from a post-omicron low of 9/day.

The ASX200 gained +1.9%, with the Small Ordinaries +2.8%.

CoreLogic reported a +0.7% national housing gain in April with only Darwin down. Hobart units and Sydney houses lead YoY falls with -12 to -13%.

Inflation data series fell to 7% YoY *vs* 7.8% in Q4. Prices rose 1.3% in Q1. The core equivalents were 6.6% and 1.2%, and Producer Price Index 5.2%. Electricity dominated the price drivers.

Unemployment was steady at 3.5%, with unchanged participation at 66.7%. Employment added +53k (f/t +30k). Underemployment increased to 6.1% (+0.3%). Hours worked eased -0.2%.

February's trade surplus grew to $13.87bn (+19%). Retail sales grew +0.2% in February to be +6.4% YoY (slightly below CPI).

Building approvals gained +4% in February, after January's -27% took them to a decade low. Commencements fell -22% in CY22, with -34% in units.

Consumer sentiment rebounded to 86 (+9%).

**Commodities and Currency**

WTI oil firmed to $US76.78 (+1.5%) on large OPEC+ cuts. Gold rose to $US1984 (+0.7%). Iron ore dived to $US104/t (-18%).

Base metals were mixed, with Nickel +1.6%, Tin +1.1% and Aluminium +0.2% but Copper -4.1% and Zinc -7.8%.

$A eased to 66.07 US (-1.2%).

## KEY FINANCIAL MARKET DATA – AS AT 30TH APRIL 2023 (UNLESS SPECIFIED)

**Interest Rate Markets**

| Index Performance | 1 month | 3 months | 6 months | 1 year | 2 year p.a. | 3 year p.a. | 5 year p.a. |
|---|---|---|---|---|---|---|---|
| Bloomberg AusBond Bank | 0.30% | 0.83% | 1.60% | 2.37% | 1.19% | 0.81% | 1.11% |

| Key Rates | Apr-23 | Mar-23 | Feb-23 |
|---|---|---|---|
| Australian Cash Rate | 3.60% | 3.60% | 3.35% |
| 90 day BBSW | 3.68% | 3.72% | 3.56% |
| 3 Yr Commonwealth Bonds | 2.93% | 2.94% | 3.57% |
| 10 Yr Commonwealth Bonds | 3.27% | 3.22% | 3.87% |
| CDX North American 5 Yr CDS | 78bp | 78bp | 76bp |
| iTraxx Europe 5 Yr CDS | 83bp | 88bp | 80bp |
| iTraxx Australia 5 Yr CDS | 89bp | 92bp | 87bp |
| US Fed Funds Rate | 4.75-5.00% | 4.75-5.00% | 4.50-4.75% |
| US 10 Yr Bond Rate | 3.42% | 3.49% | 3.91% |

**Equity Markets**

| Domestic | 1 month | 3 months | 6 months | 1 year | 2 year p.a. | 3 year p.a. | 5 year p.a. |
|---|---|---|---|---|---|---|---|
| S&P/ASX 200 TR | 1.85% | -0.80% | 8.71% | 2.83% | 6.43% | 13.99% | 8.26% |
| S&P/ASX Small Ordinaries TR | 2.78% | -1.74% | 5.77% | -9.43% | -3.45% | 9.22% | 3.90% |
| S&P/ASX 200 A-REIT TR | 5.29% | -2.11% | 7.38% | -9.90% | 1.82% | 10.71% | 4.94% |

| International | 1 month | 3 months | 6 months | 1 year | 2 year p.a. | 3 year p.a. | 5 year p.a. |
|---|---|---|---|---|---|---|---|
| US: S&P 500 ($US) | 1.56% | 2.72% | 8.63% | 2.66% | 1.43% | 14.52% | 11.45% |
| US: NASDAQ ($US) | 0.07% | 5.78% | 11.80% | 0.02% | -5.69% | 12.08% | 12.60% |
| MSCI World Acc. (Local Currency) | 1.60% | 2.49% | 9.47% | 3.16% | 1.51% | 13.51% | 8.85% |
| MSCI World Acc. (AUD) | 3.12% | 9.16% | 8.63% | 10.95% | 7.87% | 12.75% | 11.05% |
| FTSE 100 (£) | 3.41% | 2.63% | 13.01% | 8.17% | 10.24% | 14.08% | 4.88% |
| MSCI Emerging Markets ($US) | -1.13% | -4.74% | 16.36% | -6.51% | -12.62% | 4.33% | -1.05% |

**Fixed Interest Markets**

| Bonds | 1 month | 3 months | 6 months | 1 year | 2 year p.a. | 3 year p.a. | 5 year p.a. |
|---|---|---|---|---|---|---|---|
| Bloomberg Global Agg TR AUD | 1.79% | 6.81% | 5.39% | 5.05% | -0.12% | -4.21% | 1.74% |
| Bloomberg AusBond Composite | 0.19% | 1.99% | 4.23% | 2.06% | -2.82% | -2.28% | 1.38% |
| ICE BofA US High Yield TR USD | 0.97% | 0.78% | 5.88% | 1.04% | -2.01% | 4.87% | 3.12% |

| Data* | Current Period | | Previous Period | |
|---|---|---|---|---|
| *Employment Data* | | | | |
| Employment Growth | March | 53,000 | February | 64,600 |
| Unemployment Rate | March | 3.50% | February | 3.50% |
| Participation Rate | March | 66.70% | February | 66.60% |
| *Lending Finance* | | | | |
| Housing Finance | February | -0.90% | January | -5.30% |
| Personal Finance | February | 1.10% | January | 0.50% |
| Business Construction | February | 62.20% | January | -2.50% |
| *Other* | | | | |
| Balance on goods and services | March | 15,269m | February | 14,151m |
| Retail Sales | March | 0.40% | February | 0.20% |
| Building Approvals | February | 4.00% | January | -27.60% |

*All data is seasonally-adjusted.

| Median Fund Manager Returns (Morningstar) | 1 month | 3 month | 6 month | 1 year | 2 year p.a. | 3 year p.a. | 5 year p.a. |
|---|---|---|---|---|---|---|---|
| Australian Equity Large Cap | 1.90% | -0.35% | 7.34% | 2.16% | 5.82% | 14.00% | 7.10% |
| Australian Equity Small Cap | 2.68% | -0.50% | 5.35% | -6.75% | -1.11% | 13.75% | 5.77% |
| Global Equity Large Cap | 2.80% | 7.94% | 9.96% | 10.73% | 5.52% | 11.45% | 9.26% |
| Global Equity Small Cap | 0.77% | 2.84% | 5.95% | 6.30% | -1.30% | 10.30% | 7.01% |
| Australian Fixed Income | 0.20% | 1.96% | 4.48% | 1.94% | -3.10% | -2.24% | 1.21% |
| Global Fixed Income | 0.34% | 0.40% | 4.02% | -2.58% | -5.00% | -2.83% | 0.22% |
| Australian Listed Property | 5.06% | -2.14% | 7.14% | -10.01% | 1.65% | 10.68% | 4.62% |
| Australian Cash | 0.29% | 0.82% | 1.59% | 2.28% | 1.17% | 0.83% | 1.09% |
| Conservative[1] | 0.44% | 0.89% | 3.62% | 1.22% | -1.06% | 0.97% | 1.44% |
| Moderate[2] | 0.83% | 1.22% | 4.32% | 1.07% | 0.08% | 2.87% | 2.61% |
| Balanced[3] | 1.21% | 1.36% | 5.45% | 1.72% | 1.24% | 5.64% | 4.13% |
| Growth[4] | 1.51% | 1.56% | 6.25% | 1.58% | 1.74% | 7.68% | 5.06% |
| Aggressive[5] | 1.84% | 1.72% | 7.35% | 2.13% | 2.88% | 10.21% | 6.30% |

[1] Growth Assets 0% - 20%
[2] Growth Assets 21% - 40%
[3] Growth Assets 41% - 60%
[4] Growth Assets 61% - 80%
[5] Growth Assets 80%+

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