



Perennial Perspective



April 2015

Rate watching

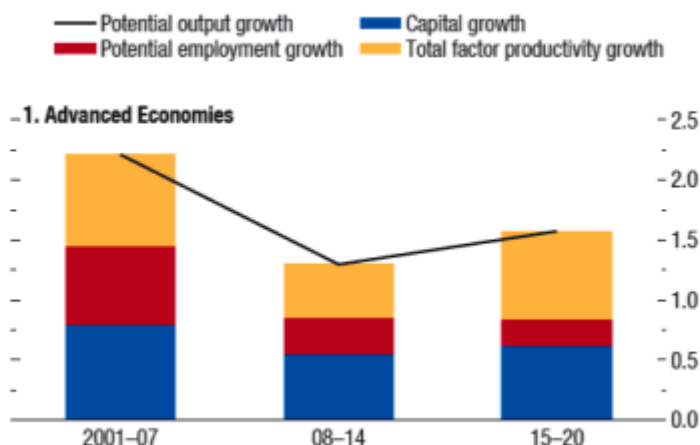
The Reserve Bank of Australia (RBA) caught markets offside again in April leaving the cash rate unchanged at 2.25% and maintaining an easing bias. Markets were leaning towards an easing but it looks like the RBA will make haste slowly at a time when the cash rate is at an historical low. Our fixed interest team expect that the release of the March quarter CPI in late April will provide the trigger for a May easing. The combination of lower oil prices and building slack in the economy should be enough to generate a subdued inflation outcome. With growth below trend and the inflation outlook subdued in the near term, the RBA has little option but to edge the cash rate lower. However, as the RBA has pointed out recently, monetary policy is not a panacea for all of the challenges the economy faces. Given ongoing falls in commodity prices, there is scope for the currency to depreciate further and this should help with the re-balancing task. However, while a lower exchange rate and lower interest rates can help lift non mining investment out of the doldrums, greater policy vision certainty at a Federal and State level would be just as, or even more helpful, in lifting “animal spirits”.



Brian Thomas
Head of Retail Funds Management

Driving with the handbrake on

The lack of so called “animal spirits” and lower growth outcomes post the financial crisis are not unique to our economy but appear to be part of a broader and more global phenomenon. This theme was picked up in April’s release of the IMF’s World Economic Outlook where they decompose the drivers of potential output growth. They note that into the lead up to the financial crisis, advanced economy potential growth rates were already slowing due to declining productivity rates. The opposite held for emerging market economies. However, unlike previous episodes of financial crisis, the most recent episode was associated with both a reduction in the level of output and also with a reduction in the rate of growth. On the plus side, advanced economies potential growth rates are expected to lift over the next five years, though their analysis suggests that we should not expect growth rates to get back to pre-crisis levels, given the impact of the ageing population on employment growth.



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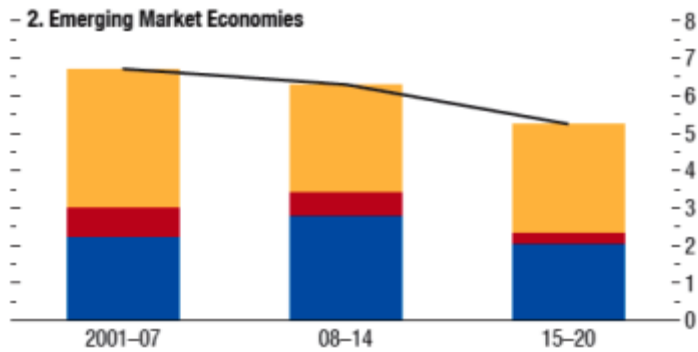
Economic monthly update

by: [Frank Uhlenbruch](#)
The world economy continues to enjoy support from highly accommodative monetary policy settings, the net stimulatory effects of lower oil prices and lessening fiscal drag. To read Frank's Economic monthly update, please [click here](#).

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Source: IMF staff estimates.

Taking the handbrake off

This IMF report brings into stark reality the perplexing outlook facing investors and policy makers. For investors, a slight lift in potential growth rates in advanced economies is good news and is needed to justify equity market valuations. Compared to earlier periods though, the outlook suggests lower equilibrium real interest rates. While this should limit the extent to which nominal yields can rise in a cyclical recovery, it also shows how bare the central bank cupboard is should another negative shock evolve. For governments, the onus is on implementing structurally unpopular policies to both stabilise and improve structural fiscal positions and reform product and labour markets. The greater the success in these areas, the more the handbrake comes off, allowing an economy's potential growth rate to speed up.

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