Quiet panic behind drive for Aussie QE

In the face of the oncoming financial tsunami, the US Federal Reserve and European Central Bank have declared they will do whatever it takes to provide liquidity to sagging markets, using rate cuts and new rounds of quantitative easing (QE) as required, while Australia's Reserve Bank is under growing pressure to prevent its deflating housing bubble from crashing.

The RBA "has extreme stimulus measures on standby", wrote John Kehoe in the *Australian Financial Review* (*AFR*) on 11 June. In December 2018 RBA Deputy Governor Guy Debelle foreshadowed a series of rate cuts and suggested that "Quantitative easing is a policy option in Australia, should it be required". He admitted the RBA was paying close attention to the plunge in house prices: "This is not a situation we have seen before—it is uncharted territory", he told the annual Australian Business Economists dinner. In early June 2019 the RBA cut the cash rate to 1.25 per cent, its first adjustment in nearly three years—not due to any "deterioration in the economic outlook", claimed RBA head Philip Lowe in a 20 June speech, but because "we could do better" by boosting disposable incomes, lowering the cost of finance, etc. He foreshadowed further cuts and suggested the government utilise fiscal policy, such as spending on infrastructure, to help stimulate credit flow.

JPMorgan Australia expects rates to go as low as 0.5 per cent. Citi's chief Australian economist Paul Brennan recently called on the government to make "government cash handouts to households for spending, financed by a permanent increase in RBA money supply", an extreme form of quantitative easing known as helicopter money. The RBA considered such approaches in a 2016 study of unorthodox approaches to monetary policy.

Now Dr Stephen Kirchner, from the United States Studies Centre at the University of Sydney, has recommended measures that would have the same impact as cutting the cash rate 2.5 percentage points below zero. In his new paper "Lessons from quantitative easing in the United States: A guide for Australian policymakers", released 18 June, he advocates a combination of both interest-rate cuts and QE. He suggests that the US Fed didn't go hard enough with its easing policy during the global financial crisis. What they did is the "lower bound of what's possible", he stated. "There is no in-principle limit to how much QE a central bank can do, it is always possible to do more…."

The impact of central banks creating money to purchase government bonds or high-quality debt is equivalent in terms of liquidity to a cut in rates, says Kirchner, which impact continues after rates hit zero. RBA purchases of some 1.5 per cent of the value of Australia's GDP (about $30 billion) would be equivalent to a 0.25 per cent rate cut, Kirchner says.

According to an ABC report, JP Morgan chief economist Sally Auld and KPMG analysts support Dr Kirchner's call. Bloomberg reported on the paper in a 24 June article, "Australia Is Finally Debating QE, Even If Its Central Bank Isn't", which also cites ANZ economist Hayden Dimes saying that if the global outlook worsened the RBA may "provide additional stimulus" which would "almost inevitably need to be quantitative easing". Westpac chief economist Bill Evans agreed, on the proviso that the policy "only be adopted when a credit crisis has emerged", rather than as a form of stimulus. The report said that after his Adelaide speech, hanging on to his view that Australia's economy is still "quite reasonable", Lowe told the Q&A session: "I am very hopeful that we will not need to go, certainly into negative territory, or to these very low interest rates that the Federal Reserve and the Bank of Canada got to."

While it didn't enter the market directly to purchase government bonds, the RBA did conduct a version of QE in the post-2008 period, John Kehoe wrote in the 11 June *AFR*. It expanded its balance sheet by 50 per cent to more than $150 billion. The bank also expanded its Open Market Operations to provide greater liquidity. This is the process where it buys and sells government bonds or enters into repurchase agreements (the same thing but with an agreement to repurchase at a later date) to manage day-to-day liquidity in the financial system. The collateral it accepts for its operations was expanded during the GFC to include virtually any security with a AAA-rating, a feature which has been maintained since. The government also lent its AAA credit rating to the banks during the crisis to enhance their borrowing capacity.

The disastrous US model

"QE has been road tested", Kirchner said, and "We've little to fear from it". Kehoe affirmed the "RBA has experience" using more extreme monetary tools. The 2008 model should hardly be regarded as a successful one, however, since we are facing a new bubble worse by every measure than the last, and are again discussing extreme measures to deal with it.

Despite this, Fed Chairman Jerome Powell, speaking at a 4 June Fed conference in Chicago, said the Fed was ready "to help sustain the recovery with whatever is necessary". Referring to a potential return to QE, he said, "Perhaps it is time to retire the term 'unconventional' when referring to tools that were used in the crisis. We know that tools like these are likely to be needed in some form in the future." In May, former chair of the US Federal Deposit Insurance Corporation (2006-11) Sheila Bair had insisted that emergency measures used in the crisis must not be turned into standard operating practice. What is required instead, she said are "fundamental reforms of the financial system", including Glass-Steagall bank separation.

Rather than resurrecting the real economy, the QE bonanza went to the world's biggest banks to continue building speculative bubbles. Bankers who should have gone to jail went straight back to the activity that got us in trouble. Debt ballooned due to cheap credit; asset bubbles boomed again—including housing. On the other hand, thousands of small banks went bust. The real economy was neglected and austerity policies—supposedly to clear out the debt—destroyed the lives of millions of poor and middle-class citizens.

Here in Australia, we are now face to face with the consequences of these policies—and they will not be solved by throwing more money at them. Only radical surgery, to rid all commercial banks of speculation, allowing investment banks to crash when the system fails, and creating a national credit bank to direct funds into the productive economy can work.

Australian Alert Service 26 June 2019
