Quantitative Easing: A Desperate Move With No Clear End Game

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The Reserve Bank of Australia's decision to engage in quantitative easing is a desperate move with no clear end game.

While QE has been precipitated by the public health response to coronavirus, the radical nature of the response is a result of a weakening economy on the back of more than a decade of failed monetary policy.

After cutting the cash rate from 0.75 per cent to 0.5 per cent earlier this month, last week the RBA made a rare unscheduled announcement to further the cut to 0.25 per cent and begin QE. The QE measure will involve the RBA buying 3-year Government bonds in a bid to control longer-term interest rates and inject more money into the economy. The RBA has committed to holding these measures in place until progress is made towards full-employment and achieving the inflation target of between two and three per cent. In addition, the RBA will set up a $90 billion lending facility to incentivise bank lending to small and medium-sized business.

The inevitability of QE was apparent long before the current coronavirus response. RBA Governor Philip Lowe clearly flagged a likely round of QE last year saying, "QE becomes an option to be

considered at a cash rate of 0.25 per cent." This was always only a matter of time. The RBA has consistently been cutting the cash rate since November 2011, with a rapid acceleration toward 0.25 per cent beginning in June last year.

The RBA's decade long experiment with record low interest rate policy has been a failure that has resulted in an economy that is dependent on an increasing supply of easy money.

Despite appearances of economic strength and a host of rosy wage growth forecasts, the RBA has been unable to return rates to normal.

This predicament has been faced by central banks around the world over the last decade. The US Federal Reserve for example, has repeatedly indicated an intention to raise interest rates, only to reconsider when the stock market dropped in response.

With no easy way out, the RBA has doubled down on a commitment to easy monetary policy that has produced damaging results. Asset prices have been inflated at the expense of those outside of the housing and stock markets, and interest income has been slashed at the expense of savers who are forced into greater risk exposure in search of a decent return. Further harm to savers will continue to occur through the erosion of the real value of savings through higher price inflation.

In addition, extended low interest rates have driven Australia's debt bubble by encouraging higher levels of both public and private debt making Australia extremely susceptible to economic shocks. Australia's household debt is 120 per cent of GDP, the second highest rate in the OECD.

The danger of failing to normalise interest rates is now being faced by the RBA. The longer the RBA maintained record low interest rates the more they increased the likelihood of having no room to move in the event of an economic crisis. The prevailing 0.75 per cent rate last month left the RBA with nothing but unconventional options to continue their monetary expansion.

In a speech last Thursday Philip Lowe referred to the RBA's interventions as "building [a] bridge to the time when the recovery takes place". But resorting to radical policies such as QE is a easy short term response that lacks a sustainable long term vision. There is no guarantee that the RBA will be able to maintain control of Australian financial markets. Should markets lose confidence in the Australian economy, the Australian dollar will continue to crumble and the cost of debt will rise despite monetary intervention.

The wisdom of doubling down with a strategy with no end game must be questioned. If the RBA could not normalise monetary policy over the last ten years of economic expansion, it is unclear what economic circumstances will be required to do so in the future.

The unfortunate reality is that Australia is likely to experience a painful recession. The solution cannot be to continually blow more air into an unsustainable bubble. The present circumstances call for bold action in the long term interest of Australia.

In the field of monetary policy, this means reversing the monetary expansion that causes harmful economic distortions, limits sustainable growth, and ultimately leads to a dead end.

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