Monetary Policy Recommendation Statement

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Recommended Target (X=4.75%)	
target rate	probability
X+75bp	0
X+50bp	0.1
X+25bp	0.3
X	0.35
X-25bp	0.05
X-50bp	0.15
X-75bp	0.05

Policy Rate Distribution

Because there are lags between the implementation of a monetary policy and its effects on real economic activity and inflation, policy should be forward looking and responsive to changes in forecasts of economic conditions.

Uncertainty about future economic conditions and the length of time between implementation and effect of policy suggests that a policy recommendation can be usefully expressed as a distribution of possible policy rate settings. The weights on the different policy rates should reflect the strength of belief that a given policy rate will guide the economy towards the desired outcomes of stable and low inflation and full employment of economic resources in the face of a particular set of economic conditions emerging over the time it takes for current policy to affect future conditions. Full weight on a single policy rate would be inappropriate if beliefs accommodate the possibility of different economic conditions and/or different possible effects of a given policy rate.

Main Risks for Near-Term Economic Conditions

The near-term outlook for inflation is mixed. Headline inflation is running above the target range, but should be expected to fall back into range within the next year as the large increases in food prices due to the Queensland floods ease. Also, the large increase in world oil prices has eased somewhat in recent months. At the same time, the low unemployment rate suggests limited slack in labour markets and only a small downside risk for underlying inflation.

The near-term outlook for real economic activity is dominated by the strong growth of exports to fast-growing Asian economies and the concomitant investment boom in the mining sector. The high Australian dollar somewhat mitigates the overall upside risk of an export-led boom. Also, consumer sentiment and retail sales have shown some recent weakness, which can be expected to persist over the near term. There is also a small, but non-negligable risk that debt crises in the United States and Europe will have contagious effects for the entire world economy, including for Australia. A recent rise in unit labour costs (wages relative to productivity) suggests some upside risks for the impact of real-economic activity on inflation.

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