Rate Cut Wrong in an Era of High Debt

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The reduction in per head GDP in the last two quarters has produced many explanations and predictions of possible future outcomes, including by Reserve Bank governor Lowe down-playing the seriousness of any softness in the national accounts ("Drumbeat for rate cut gets louder", 7 March).

As a Treasury officer in the 1980s I argued unsuccessfully that the RBA then needed higher official interest rates to help combat inflation and to reduce the growth in credit, which reached an astonishing annual rate of 20 per cent between end 1983 and mid-1989.

The RBA however also rejected my argument that monetary policy should also take greater account of high debt levels.

Over the last few years the household saving ratio has progressively fallen, from 10 per cent in 2008-09 to just over 5 per cent today, reaching the lowest since the GFC. This has evidently been accompanied by higher levels of household debt and an increased tendency to reduce spending rates on consumption and housing. One possible explanation is that monetary policy allowed interest rates at relatively low levels for too long, resulting in higher borrowings and excessive debt levels.

This suggests it would be inappropriate if the RBA now further lowered official interest rates. The banking system should be told to have much greater regard to borrowers' capacity to service debts and to stop no interest loans.

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