RBA Inflation Twist Suggests Economy Can Run Hotter on Low Rates
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By Michael Heath

(Bloomberg) -- Australian central bank chief Philip Lowe's move to emphasize current inflation rates rather than projections suggests the economy will be allowed to run hotter with interest rates staying lower for longer.

Lowe conceded that assessing the outlook is problematic when inflation dynamics aren't well understood and the world is so uncertain.

"We will now be putting a greater weight on actual, not forecast, inflation in our decision-making," Lowe said, outlining the RBA's latest thinking on prices in a speech on Thursday that hinted at further easing to come.

Annual inflation has averaged 1.7% since Lowe took the helm at the Reserve Bank of Australia in 2016, versus a target of 2%-3% over time, and has now dropped below zero.

Low inflation has been a key concern of the past decade for major central banks. The worry is that it morphs into deflation -- a downward spiral of prices and wages that has historically wrecked economies. Japan, the poster boy for deflation, has responded by pumping trillions of dollars worth of currency into the financial system, with only limited success.

Lowe's U.S. and European counterparts already started reviewing their price-growth strategies before the pandemic. The Federal Reserve has resolved to try to overshoot its goal for periods of time. The European Central Bank is likely to examine a similar approach.

The RBA governor's comments on his latest stance on prices "have a 'Jackson Hole' feel about them, coming, not coincidentally, a few months after Chairman Powell signaled a more patient approach to the inflation target," said Bill Evans, chief economist at Westpac Banking Corp. "The conclusion from both speeches is that we can expect policy to remain stimulatory for even longer."

Australia's central bank cut its cash rate to 0.25% and set the same target for the three-year government bond yield during the height of Covid market uncertainty in March. The aim was to lower borrowing costs across the economy and signal to households there would be no policy tightening before 2023.

The RBA is now signaling it's prepared to do more, and economists forecast a cut in rates to 0.10% and bond buying of longer-dated maturities, potentially in the 5-10 year range.

Catherine Mann, global chief economist at Citigroup Inc., reckons the world has changed to such an extent that inflation is unlikely to return.

"We don't see a closing of the global output gap," she said Thursday in an Asia Briefing Live event. "We don't see that happening ever."

Mann was speaking in the context of U.S. unemployment having dropped to a 50-year low in September last year without a major increase in inflation, before the pandemic struck.

"If we think about inflation being generated by wage demands or firms being able to pass through costs and having pricing power, you don't see that if you're in an environment where unemployment is higher than it was in January," she said.

"If you're going to start worrying about inflation, you have to go out long after I will retire."

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