THE POLITICAL AND POLICY OUTLOOK IN AUSTRALIA

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With the federal election not far behind us, this isn't a bad time to be examining the political and policy outlook, though I have to warn you up-front that it's not a particularly cheery outlook for people with the policy preferences I suspect you have. The first bad sign is that this was the first election in many years (since the Vietnam-war election in 1966, I think) where economic issues - the state of the economy and micro reform – weren't dominant. Rather, the dominant issues were the boatpeople and 'security' – which suited John Howard down to the ground. He may now be ashamed of the way he stooped to pressing xenophobic and possibly racist buttons, but there is simply no denying the overwhelming emphasis on the boatpeople issue in his advertising – particularly in the final week – and even in the signs his people strung up around polling places. It suited Howard to promote this mighty distraction from the public's economic discontents: the high price of petrol (until the last month or two), all the complaints from people who perceive themselves to be losers from globalisation or national competition policy, and, above all, all the lingering whinges about the GST package.

The Labor Party chose not to fight on macro issues, adopting the Government's policies on the inflation target and the independence of the Reserve Bank, and on the medium-term fiscal strategy. It even matched Howard and Costello's stupid – but clearly premeditated – promise to keep the budget in surplus throughout the next term. Both sides chose not to mention unemployment, even though it's risen by a percentage point over the past year. The Government tried to hide its stated intention to sell the rest of Telstra. In the end the parties were not far apart on Labor's preferred issues of education and health (neither side was promising the kind of sweeping changes to funding arrangements – and funding sources – that are needed to bring genuine improvement to these areas). And, most surprising of all, in the one policy area where the parties did have significant, ideologically driven differences – industrial relations – both sides had their own reasons for not wanting to raise it. The conclusion is inescapable: neither side wanted to talk about economic issues in this campaign. And that fact does not augur well for further economic reform in the Government's third term.

How Howard won

It's important to understand how Howard won the election and why Labor lost. Early this year, after the West Australian and Queensland state elections and the Ryan federal by-election, Howard had been written off by everyone but himself. His back-to-the-wall survival strategy had two stages. The first stage was to remove all the negatives – all the reasons people wanted to vote against him; the second stage was to find a positive reason for them to vote <u>for</u> him. The first stage involved, in particular, doing something to mollify each of the various interest groups with gripes about the GST. Thus we had: the changes to the BAS, the cut in petrol excise and the abolition of indexation, the cut in the beer excise, the temporary increase in the first-home owners grant, the $300 handout to pensioners, the extra tax rebate for the self-funded retirees and the backdowns on various unpopular aspects of business tax reform, such as taxing family trusts as companies and the abuse of personal service income. As you well know, this Rollback and various spending programs appropriated most of the prospective budget surpluses for this and the next three financial years. The second stage of Howard's strategy involved seizing on the Tampa incident and exploiting it for all it was worth. In that sense, this issue involved less good luck than 'good' political manipulation. Howard well knew how unpopular the boatpeople were with most Australians, he was on the look out for an issue to use as a diversion from the public's economic discontents and he had the quick wittedness to see the Tampa's potential and exploit it shamelessly. Howard's use of the boatpeople was an example of the timeless effectiveness of the oldest trick in the leaders' handbook: using a threat from outside to unite your team. But it also had something else: whereas Howard's own version of GST Rollback had been about the removal of negatives, Tampa gave people a <u>positive</u> reason for voting for him. They'd been reminded of an issue they really cared about – the need to repel the alien interlopers – and been shown the perfect man for the job.

What role did September 11 play in the election result? Did it make people feel insecure and anxious about what the future might hold, and thereby force them back into the arms of the incumbent? Yes, I guess it did to some extent and Howard was certainly quite blatant in the way he sought to fan uncertainty. But I don't think it was nearly as big an issue as the boatpeople. And, by its depiction of alien and threatening Arabs and Muslims, it served to reinforce the boatpeople threat. What's more, first Peter Reith and then Howard himself sought to link the two issues with the disingenuous statement that he couldn't be sure there were no terrorists among the boatpeople.

In their efforts to minimise retrospectively the central role played by the Tampa issue, Liberal functionaries have argued that the Government's good economy management and the good state of the economy were major factors in its win. It's true the public perceived the Libs to be much better economic managers than Labor (with a strength of belief few economists would share) and that Howard and Costello exploited this perception brilliantly in their strategy of keeping Labor boxed in. But, even so, it's important that economists don't fall for this line. The aphorism to remember is that no-one votes out of gratitude – as Jeff Kennett, Winston Churchill and many other politicians have discovered. The politics of economic management isn't symmetrical: bad management can get you tossed out, but good management can't, by itself, get you re-elected. At best, it's the removal of a negative. To me, the proof that the state of the economy didn't figure largely in Howard's re-election is that it wasn't a lot different between March (when Howard had been written off) and November (when he won). Interest rates were a bit lower; unemployment was a bit higher. Back in March, the good state of the economy wasn't sufficient to outweigh the whole range of people's economic complaints – about petrol, globalisation, competition policy and the GST – but by November petrol prices had fallen, much had been done to mollify the GST whingers and, above all, Howard had managed to divert everyone's attention to a (perceived) non-economic issue.

Why Beazley lost

Why did Labor lose? Because, once Howard had played his masterstroke, the whole emptiness of Labor's election strategy, its policies and its leadership was revealed. Kim Beazley tried to get himself elected the same way Howard got elected: by making himself a small target so that all the focus was on the public's dissatisfactions with the Prime Minister as a person and with his policies, notably the GST. Unfortunately for Kimbo, Howard was no Paul Keating. It was an appropriate strategy for Beazley, a man with no particularly strong convictions about economics, no personal reform agenda, and no burning desire run the country much differently from Howard. Labor hit on two genuinely important issues for the positive centrepiece of its campaign – education and health – but it revealed little understanding of the structural problems involved, nor any desire to tackle them. It just wanted to exploit public discontent about education and health by promising to spend more money on them. But the real rock on which Labor's strategy was built was the unpopularity of the GST. It thought it was on to a winner but, as things turned out, the GST proved a fatal distraction. As we've seen, Howard had mollified much of the unhappiness with the tax package and then powerfully diverted attention to the treat from terrorist boatpeople. In the process, however, he'd done something else important in defusing the GST as an election issue: he'd emptied the till. Labor <u>could</u> have won plenty of votes with a big program of Rollback, but the money just wasn't there for anything more than a laughably token effort. So, for Labor, the GST ended up being a distraction, and the distraction proved fatal. Without the GST issue, Labor was reveal as having few feathers to fly with. I have to say that, on this, Labor got its just deserts – from Day 1, its position on the GST was cynical, opportunist and devoid of principle. It's also worth noting that it was a good thing for the long-term future of reform in general, and tax reform in particular, to have the Government comfortably re-elected. Had it lost, tax reform would have got the blame – from both sides. This isn't a huge amount of comfort, however, because the Libs' conclusion from the episode would be that the GST brought them a mighty lot closer to the abyss than they ever want to be again, and they'll make sure they never take on any reform even half so unpopular.

Labor under Crean

Before we move from politics to policy, I should say a little about the new Labor leader, Simon Crean. Crean is unelectable and everyone knows it – his party knows it and the talkback callers know it. He got the job because there was no-one remotely better, but this won't protect him from recurring leadership rumblings whenever he's judged to be faltering. Fortunately, Crean is under no illusion that he's regarded as unelectable and that he'll get only one crack at the prime ministership – if that. This is why he's trying so hard to be the new broom and everything that Beazley wasn't. Labor will have plenty of well-developed, alternative policies this time around. Like his deputy, Jenny Macklin, Crean has an economics degree. But he's no economist. The Canberra press gallery keeps marvelling at how 'dry' he's become since he became shadow treasurer, but this doesn't prove much. The gallery wouldn't know a genuine dry if it saw one. One thing it means is that Crean saw no alternative but to wear the fiscal straitjacket that Peter Costello so cunningly fashioned for him with all his silly talk of perpetual surpluses. But that was mainly about being seen to have politically correct views on fiscal issues. The other thing it means is that Crean is what Labor politicians call 'pro-business'. He wants business – big as well as small – to see him as pro-business and he really is pro-business in the sense that, when business lobbyists are on the make for a new tax break or handout, Crean will be very keen to talk turkey. He was dead keen for Labor to be seen to be co-operating with Costello to get the Ralph business tax reforms through the Senate. Unlike many of his colleagues, he had no problem going along with the halving of capital gains tax, only requiring that the Government ensure the total package was revenue neutral by including some anti-avoidance measures (most of which it subsequently dropped when the going got tough). What Crean is and always will be is a full-on believer in industry policy: special deals for manufacturing, tarted up by reference to the latest fashionable enthusiasm – R&D, IT, the New Economy, whatever. At the centre of his industry policy is always a tripartite deal between government, unions and business. And at the centre of the tripartite deal is always the great deal-maker and ringmaster, Captain Handout himself, Simon Crean.

Two points about the Government before we leave politics for policy. There will be two recurring political themes in the Government's third term. First, after the new Senate is installed in July and for as long as the Libs look strong in the polls, we'll have the Government trying to get its way with a recalcitrant Senate by threatening a double dissolution – something that would be guaranteed to reduce the Democrats numbers.

Second, Howard is supposed to be retiring two years into this term, but he's made no firm promises (public or private) and the ability to quit while you're ahead seems incompatible with the ego required to be a successful prime minister. Knowing all this, Costello and, just as importantly, his parliamentary supporters, will be as twitchy as hell until the changeover is effected. You may know that there is no love lost between the two men. So the welling of tensions to the surface will be a recurring theme and the gallery will be on the lookout for them. Since such reports are usually unsourced and often formally denied by the parties, there's a temptation for Liberal sympathisers back in Sydney to see them as products of the gallery's overactive imagination. Not so. Stories of leadership tensions have a high ratio of signal to noise and are often borne out by a subsequent formal challenge. They're usually well-founded because the journalists have politicians whispering in their ears.

Howard's third-term agenda

As everyone realised as soon as the election was over, John Howard had managed to get himself re-elected without a third-term agenda of any consequence. This is typical of politicians. When you've got your back to the wall, you fight to preserve your political life and only once you've succeeded do you worry about what you'll do next. By now, however, Howard does see the need for an agenda. Quote: ‘It would be a terrible mistake if in this term we thought everything had been accomplished and no more reform was necessary because we a need to have an activist reform agenda’. And now his cabinet has been appointed, he’s told them their first job is to think up a list of things that need doing.

But despite his fine words, I don’t hold much hope for genuine economic reform, for five reasons. First, campaigning on the slogan ‘Keep Australia in safe hands’ doesn’t get you off to a very daring start. Second, Howard’s long-held personal ‘conviction’ agenda – which was set in concrete while he was Treasurer in the Fraser Government – has only two major items, both of which have been ticked off (even if they haven’t been finished properly): reform industrial relations and introduce GST. Third, what Howard really meant by that quote is that governments are expected to keep busy. They can’t be seen to be resting on their laurels, but must always have some big new projects on the go. It doesn’t follow, however, that all the big new projects have to be economic. I suspect that, from now on, a lot more of the Government’s appearance of busyness will come from non-economic endeavours such as defence and ‘security’ and a federal government’s version of the law-and-order agenda, such the war on drugs. Fourth, if the economic downturn proves deeper and longer than all of you guys expect – as I suspect it may – the public’s economic focus (and, hence, the Government’s focus) will switch back from micro reform issues to all the old issues of macro stabilisation: what’s the Government doing about creating jobs to reduce unemployment and, much later, what’s the Government doing to rein in the Budget deficit?

Fifth, I fear there’s a micro-reform price to be paid for the cleverness of the boatpeople ploy. John Edwards (in my opinion the only business economist with a good feel for politics) reminded us during the campaign that no party was running in support of globalisation. Not a good start towards a courageous third-term agenda, but I fear it’s worse than that. Part of the cleverness of the boatpeople issue was that it diverted people’s attention away from their discontents about globalisation, the effects of national competition policy on the regions, and suchlike. People were so stirred up by the threat posed by the boatpeople that they forgot their worries about globalisation etc. You could argue that this is a good thing: the Libs managed to get re-elected without being punished for the perceived evils of globalisation. But I fear it works the other way. There’d be a close overlap between the people stirred up about globalisation and the people stirred up about boatpeople. Why? Because the boatpeople issue is merely a novel dimension of globalisation. Like the opposition to globalisation, the boatpeople issue is about resistance to change, fear of foreigners, protectionism (build up border barriers to keep the threatening world at bay) and about mercantilism (it’s OK for us to plunder other countries’ skilled workers, but it’s a terrible loss for our brains to go abroad). Shifting the focus from scientists to ordinary workers, it’s a fair bet that much of the fear of invading boatpeople arises from a fear they will ‘take our jobs’.

Part of the genius of Howard’s identification of the potency of the boatpeople issue is that it redefined the globalisation issue in a way that allowed him to get out in front of the mob as the leading <u>opponent</u> of globalisation – to provide the very kind of leadership that people in the regions and One Nation voters had been craving – <u>without</u> incurring the ire of the business and economic supporters of globalisation. He found the one exception to the globalisers' rule: countries should be open to the free flow of all goods, services, ideas, technology, capital and executive and highly skilled labour, but tightly limiting the inflow of common-or-garden labour is AOK.

But what's the opportunity cost of this cleverness? Now the Libs have experienced the huge political benefits of setting themselves at the head of the anti-globalisation crowd, are they really going to want to alienate that crowd by returning to a pro-globalisation agenda? What price the business community's push for a much bigger immigration program? And what about the remaining islands of tariff protection? In its first term, the Howard Government reviewed the post-2000 arrangements for the tariffs on motor vehicles and textiles, clothing and footwear. It decided to freeze the 2000 rates for four years, but then to catch up with the deferred reductions on the day after the freeze. In this term, the Government's challenge is to stick with its rather daring back-end loading, resisting industry pressure to review the post-2004 arrangements and further postpone the reduction. What do you reckon are the chances of it going to the barricades in defence of free trade?

The unfinished agenda

The one area where Howard <u>has</u> made clear his determination to push on with reform is industrial relations: exempting small business from the unfair dismissal law, further limiting union access to workplaces, tightening the prohibition on secondary boycotts, requiring secret ballots before strikes and banning unions from charging non-union freeriders a fee for negotiating a collective agreement in their workplace. Most of these measures have been blocked frequently in the Senate by Labor and the Democrats. The chances of them changing their minds in this term are slim. So what's Howard on about?

He's playing politics, trying to knacker Crean from the start in the same way he so successfully knackered Beazley. Howard and Costello made so much fuss about Beazley's $10 billion budget black hole that he was branded for all time as a bad economic manager. Labor developed an inferiority complex about macro management, it lived in fear of being asked 'where's the money coming from?' and was never really game to take the fight up to the Libs on the weaknesses in their economic performance. This is why, once the Libs had raided the fiscal cookie jar, Labor was snookered. It could see no alternative to standing up in the campaign and promising to splash out sixpence on Rollback, sixpence on education and sixpence on health. Howard believes Crean's Achilles' heel is his union background. So he's bowling up the IR legislation as a (quote) 'test of whether Mr Crean has really freed himself from union domination'. Crean being Crean, he will try to find some compromise on which they can do a deal. But Howard won't be buying. He's not on about getting whatever IR reform he can, he's on about stigmatising Crean in the eyes of the public and getting the drop over him from the off.

I believe Howard will add few if any new items to the reform agenda. There are many unfinished items on the agenda, but I fear little progress will be made.

Telstra: has reached stalemate. Much as Howard and Costello would like to complete its privatisation, this is unlikely. Labor and the Democrats retain control of the Senate and their opposition is implacable. In any case, even the National Party is unlikely ever to agree to it; the bush would never understand. For all intents and purposes, the era of privatisation – federal and state – has come to an end.

Business taxation: many loose ends remain but, after all the angst of the past two years, there'll be little enthusiasm for tying them up, either from the Government or business. Howard has promised to examine company tax arrangements affecting Australian multinationals and is sure to do something. This <u>could</u> come under the heading of tax reform, but is more likely to involve a few grudging, piecemeal concessions intended to shut the Business Council up till next time. On another matter, if you're still dreaming of a cut in the top tax rate, dream on.

National competition policy: this is the progressive review of all anti-competitive state and federal legislation. It's meant to be micro reform on automatic pilot. But it's grinding along very slowly, without that fact disturbing the Howard Government or any other. The Nats made various promises to throw further sand in the gears.

Review of Trade Practices Act and the ACCC: This election promise was intended to <u>look</u> anti-Fels, but whether it ends up clipping his wings or adding to his feathers remains an open question. The Prof gets up a lot earlier than his big-business detractors. Howard made no bones about the purpose of the review: 'It's time we had another look at whether the competition laws of this country preserve the right balance between large and small within our community but, equally, allow for the development of sufficient critical mass amongst our larger corporations that they can fully participate in a globalised economic environment.' Doesn't sound like reform to me – more like special rates for business mates. We'll see how much eventuates. But there's no doubt about the future of the Four Pillars policy – it will still be standing inviolate in three years time.

Ageing policy: a nice, post-election idea to take this issue more seriously, but unlikely to lead to any controversial policy measures. Howard may yield to the financial services lobby's pressure for a thorough review of superannuation – its adequacy and tax arrangements – but I doubt it. His election promises on super would actually add to the mess and amount to little more than the introduction of super tax concessions for rich single-income families.

Fiscal policy

Turning now to fiscal policy, it won't surprise you to hear that I'm not much impressed with the way it's been conducted in recent years. A key element in the Government's re-election strategy was to spend virtually all of the prospective budget surpluses, so as to win votes by doing so and, just as important, so as to deny Labor the chance to do so. Particularly in the latter objective, it succeeded brilliantly. Despite all the warning it had, Labor was totally wrong-footed. With little to spend it had little policy to offer and little to say about anything economic. If you fear, as I do, that the economy may be a lot weaker next financial year than the Government's forecasts imply, then a case can be made for a discretionary increase in government spending, even to the point where it takes the budget into deficit. But that case wasn't made – either by the Government or by Labor – and the new spending measures weren't of an appropriately immediate, finite, pump-priming nature.

We've been through five fat years in which the budget outcome has invariably come in above budget – often well above. But I suspect that, between the raid on the surplus and the economy's move into what could be several years of slower growth, we may be entering a period of lean years where budget outcomes come in below budget. In other words, the underlying cash balance may well drop into deficit, as the fiscal balance already has, to the turn this financial year of more than $3 billion.

But both Howard and Costello kept promising to keep the budget in surplus throughout their new term. So, does this say we're in for a tough, post-election budget next May to haul the balance back into surplus? Not a snowball's chance in hell. There's a far higher chance that, by then, the Government will see a need to supplement easy monetary policy with further discretionary fiscal stimulus. But, even if we don't reach that point, I reckon it won't be long before Costello has to do a lot of climbing down about the importance of keeping the budget in perpetual surplus.

John Howard is inordinately proud of his achievement in 'bringing the budget back to surplus'. But Paul Keating used to be just as proud of his own, similar achievement. What Keating discovered, however – much to his disillusionment - is that 'bringing the budget back to surplus' isn't a 'reform' – it isn't something that needs to be fixed and then, once fixed, stays fixed. It's a chore to be repeated once-a-cycle. By the time he realised that, despite his earlier labours, the budget had unfixed itself and needed to be 'brought back to surplus' a second time, Keating had little stomach for the task. His interests had moved on; been there, done that. It was his failure to re-apply his shoulder to the budgetary wheel that left such a damaging inheritance for Beazley as Labor's next leader. The Beazley black hole crippled Labor for 5 _ years, robbing it of economic credibility and budgetary flexibility. But the point is that the ultimate test of fiscal heroism is the second-time-around test. We've yet to see whether Howard does any better on that test than Keating did.

We know already, however, that the Government's fiscal performance isn't nearly as impressive as it pretends. It's much-trumpeted Charter of Budget Honesty has fallen well short of expectations. It's a flawed document, open to manipulation for political purposes, which Costello has not hesitated to do. Despite its efforts to obfuscate the facts, we know from John Edwards's calculations that this Government's levels of spending and taxation as a proportion of GDP are remarkably high, and give the lie to its small government/low tax pretensions. Nor does its much-boasted 'fiscal framework' live up to its billing. Its medium-term fiscal strategy (to balance the budget on average over the cycle) is admirable in principle but, since the Government's reversal of its decision to publish estimates of the structural budget balance, is unmeasurable in practice. We now have a fiscal framework that is honoured by nothing more than bald assertion.

Finally, we have the Government introducing accrual accounting, converting its measures and targets to an accrual basis (which, it assured us, was the superior measure), then quietly switching them back to underlying cash when the going got tough. Even more remarkable, it's done so virtually without a peep from business economists who, if they've even noticed, don't seem to care. The fact that this year's premature MYEFO revealed a fiscal deficit of $3.1 billion for this financial year and $1.3 billion for next year prompted no-one to cast aspersions on the whole bipartisan election-campaign farce of manfully struggling to ensure that promises didn't push the underlying cash balance into even a million of deficit. It's clear that business economists, as well as being weak on politics, are weak on accounting. Someone in Treasury told them the cash measure is more apposite for macroeconomic purposes, and they inquired no further. What that someone didn't both to tell them is that the cash measure is much easier to falsify than the accrual measure. Few business economists realise the truth that the budget is already in deficit.

Monetary policy

The market is still having a fair bit of trouble reading signals from the Reserve Bank. The reason for that is simple: the Reserve is not very good at signalling. A big part of the trouble is that the two institutions – the Reserve and the market – have quite different objectives and don't make adequate allowance for the other side's different approach. So there's a lot of failed communication and, as every (successful) journalist understands, that has to be the Reserve's fault, not the market's. Why? Because it's the Reserve that's initiating the communication. If I write a column that's misunderstood by thousands, it's idle for me to tell myself I'm surrounded by idiots. I attempted to communicate, but failed. If I don't like it, the only alternative is to lift my game.

The market assumes that every formal announcement from the Reserve – every statement accompanying a policy move, every quarterly statement on monetary policy (SOMP) – contains a signal about the Reserve's future intentions. Sorry, it's not that easy. The confusing thing is that sometimes SOMPs contain a signal and sometimes they don't. Sometimes it suits the Reserve to signal and sometimes it doesn't. When it doesn't suit to signal, the Reserve doesn't bother. On those occasions, all the signal-like remarks in the statement are merely backward-looking justifications of past decisions. The market is so fanatically forward-looking that it's incapable of recognising a backward-looking statement when it sees one. What it forgets is that central bankers are bureaucrats, and bureaucrats are obsessed by justifying their actions. They're highly defensive animals. So that's our first culture clash.

Why would the Reserve not want to signal? Because it's common for statements to be issued at times when it doesn't know what it plans to do at the next meeting. It will be awaiting developments and reacting to them. When you break down the conduct of monetary policy to its meeting-to-meeting moves, it's a highly subjective business; it's artistry, not science. Should we go now or wait a month? Should we do 25 or make it 50? Such decisions are the stuff of the monthly meeting, but they'll be made on the flimsiest of grounds. They're not strategy, merely tactics. Often, the tactical decision will be based on the question: which alternative would have the more helpful effect on confidence? Often, the answer to that question will come from the governor's gut-feel. Certainly, such decisions will be made very late in the peace. And, without wishing to shock you too deeply, it's always possible that such tactical decisions will be finally determined in the board meeting itself. (Which raises another issue: how would the board feel if the outcome of its deliberations was regularly and clearly signalled a month before hand?)

So, while the Reserve has no desire to catch the market out, it simply can't clearly signal its detailed intentions in every formal statement because it doesn't know what they are. And here's another major culture clash to be aware of. The Reserve is well aware that, whether it waits a week or a month or even a few months to make its next move – whether it does two 25s in a row or one 50 up-front – makes no discernable difference to ultimate macro outcomes. In contrast, those distinctions mean everything to the markets. I fear this difference of interest means the Reserve will never feel a need to keep the market as well signalled as it would like to be.

A reality with which the Reserve needs to grapple more successfully, however, is this. Though the Reserve may have times when it wants to <u>send</u> a signal and times when it doesn't, both the media and the markets have vested interests in <u>receiving</u> a signal every time. So they'll always <u>find</u> a signal, whether or not one's been sent. That being the case, it behoves the Reserve to do more to ensure that at least they don't walk away with a wrong signal. When the Reserve has no message to send and is merely boring away justifying past actions, it should try harder to ensure it doesn't inadvertently mislead people as to its future intentions. It should at least leave people with the right impression as to whether it retains a bias to tighten/loosen.

To get down to practicalities (and at the risk of stating the obvious), when you're scrutinising a statement in search of signals, there should be two items on your checklist: one, what does it say about the balance of risks on inflation and, two, what does it say about the balance of risks on activity? The answers to those two questions should tell you as much as is being signalled about the Reserve's intentions.

If we take last month's SOMP as a case study, it did carry two signals. The first came in the way the Reserve laid it on so thick about international conditions being 'at their weakest for many years', with synchronicity being 'all the more cause for concern' and how global growth had 'turned out to be a good deal weaker than previously thought'. Got that – or would you like some more? The second signal came with the announcement that, at its November meeting, the board had 'elected not to change the stance of policy for the present'. This, I suspect, is the first time the Reserve has announced a non-decision. What you had to work out was why. Taken a face value (and ignoring the extent of the carry-on about the world economy), you could conclude that the Reserve was pretty happy with the stance of policy by November 6, and only if there were more bad news between then and now would it be likely to cut at its December meeting. But you had to be able to supply a word that would never cross an independent central banker's lips – a word that started with 'e' and ended with 'lection'. You had to know Ian Macfarlane is too proud to admit that only in the most extreme circumstances would the

Reserve risk getting itself embroiled in the political fray by adjusting rates during an election campaign. Most market participants knew that, but some – being so weak on politics – hadn't followed the logic through properly and wondered if the board had made a decision at its November meeting and was waiting til after the election to announce it. As John Edwards pointed out, you only have to think about that proposition for a minute to realise that such behaviour would get the Reserve into at least as much trouble with the pollies as changing rates during the campaign. But that was all the Reserve's second signal amounted to: if you were one of the mugs expecting a cut a day or two after the election, forget it. There are some matters so sensitive that they're written in invisible ink, and you have write them in yourself. One was the Reserve's attitude to elections, another was the role of the GST in the Reserve's decisions to tighten policy in the run up to July 2000.

Now for my call, which comes in five points. First, the Fed may have further to go than the markets imagine. It will be prepared to cut further if it's not confident that recovery is on the way. It will regard the whole 200 basis points as available to be used and, as we learnt last week, sees no need to keep its power dry.
Second, if the Fed eases more, the Reserve will ease more – though, as we've seen, not to the same extent.
Third, our economy can't go into recession unless consumer spending actually falls, which isn't likely. The downside risk that could produce such a fall is a savage bout of cost-cutting and layoffs by big business as propitiation to the god of Shareholder Value.
Fourth, the big test for our economy should come mid-year, when housing has finished its run. Will the US cavalry have perked up in time to rescue us? That's the base-case hope, but I have my doubts. Even if we are left in the lurch, however, that should mean weak growth rather than negative growth. By the time the non-arrival of the US recovery had become apparent, the Reserve would presumably have been easing further in anticipation (as the Fed would have, too). By then there would be more serious consideration of the need to supplement monetary stimulus with discretionary fiscal action.
Fifth, unless we're very unlucky, at some point in the first half of next year both the Fed and the Reserve will reach the end of what they need to do (though uncertainty means they're unlikely to signal clearly that this point has been reached). What happens then? This is where our last culture clash arises. Central banks are perfectly happy to live with protracted periods of inactivity, but the market (and the media) has a vested interest in movement. So the easing phase isn't over for five minutes before markets are bracing themselves for the tightening phase. To rationalise this compulsive behaviour, the market has already started telling itself how worried the central bankers will soon be about rampant inflation. This conveniently overlooks the evident structural change in inflation and productivity, as well as the central bankers' track record in the sitting-on-their-hands department. Consider our Reserve's record. It held the cash rate steady at 4.75 per cent for more than a year between July 1993 and August 1994, then held it at 5 per cent for 16 months between July 1997 and December 1998 and at 4.75 per cent for a further 11 months to November 1999.

So here's my call: most of you guys will spend most of next year anticipating a rise in rates that never eventuates.