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One reason I'm invited to speak on the political and economic outlook each year is that I can't do so without making some political predictions and, since I normally leave the economic forecasting to business economists, this is their chance to get their own back and have a laugh at my expense when, inevitably, some of my predictions prove badly astray. This year you've really set me up, holding your forecasting conference just 10 days before a very heavily contested federal election campaign.

But, like a good journalist with an eye to a good read, I'm going to lead with my chin and take my chances. I confidently predict Kevin Rudd will win comfortably and we'll see a change of government. I don't believe Labor's win will be narrow. Hesitant people are always predicting elections that 'go down to the wire' but, actually, such close calls are not common. Landslides are more common. Nor do I believe in trying to predict the outcomes of elections by counting the particular seats likely to be won or lost. There's an old saying that, if the swing is on, it's on. If the swing is on, the necessary seats will come - but not necessarily those the Mackerras pendulum says should come. It's like being asked where the jobs will come from in a recovery. When you've been around for a while, you learn not to make detailed predictions, just to be confident they'll come from somewhere. I always reply, ask me again in a few years time and I'll look up the figures for you.

Defeated Liberals' dire prospects

Almost everything that follows will be based on the assumption of a Labor win. That's mainly because pondering what life would be like under a Rudd government is the more interesting and potentially useful thing I could do. Life under a re-elected Liberal government - possibly without John Howard - would be little changed. Peter Costello's accession to the leadership - either immediately or after a year or so - is undoubted. His two main rivals - Tony Abbott and Malcolm Turnbull - have both had most unimpressive campaigns. Even so, Costello will survive one term at best. His chances of ever making it back into government are zilch. Being out of office in every state and territory as well as federally will leave the Libs in a terribly weakened and demoralised state, susceptible to much infighting. It will take them years to recover. Business will swing all its focus onto trying to influence and ingratiate itself with the Rudd government. Even so, the election of a Labor government at the federal level is the necessarily first step towards breaking Labor's stranglehold at the state level. The Australian voters' penchant for having an each-way bet at the federal and state levels is a potent force. The election of a few Liberal state governments will be a most healthy development and I look forward to the day, sorry only that it didn't start last March with the defeat of the Iemma government.

Why Rudd will win

If I'm right in predicting a Rudd win, the central question is why Howard was defeated at time when the economy was positively booming. It's true that - leaving aside the Left's regiment of Howard Haters - the public has not developed a dislike of Howard comparable to its loathing of Gough Whitlam or Paul Keating. I think it's mainly the It's Time factor. Howard is looking old and wizened - televising his morning walks doesn't do him any favours - whereas Rudd is young, good looking, obviously intelligent, well-spoken and capable of behaving with dignity on public occasions with presidents and the Queen. Equally importantly, unlike Howard - whose voice and visage we've grown tired of after his three decades in public life - Rudd has no track record. No list of broken promises to his name. It's important to understand that the flip side of cynicism is naivety and the electorate regularly flip-flops from one to the other. In short, Rudd's new face makes him someone in whom hope can spring eternal.

This election campaign is about personalities, not policies. Rudd keeps saying he stands for 'fresh ideas'. What is the fresh idea? It's Kevin Rudd. He's sold himself as a younger John Howard and that's what the public has been happy to buy. Rudd represents a change (which is nice) without change (which isn't). So the electorate's switch from Howard to Rudd is the ultimate act of consumerism: we've simply traded Howard in on the new model.

But I don't think it's quite as superficial as that. I think Howard has suffered a significant erosion of his credibility in the eyes of the electorate. With his non-core promises, his weapons of mass destruction, his children overboard, his Tampa, his mistreatment of David Hicks, his AWB scandal and his promise to keep interest rates at record lows, he's led us up the garden path one too many times. Every time Howard got caught misleading us, his minders would assure the press gallery that the public didn't really care. Case by case, that was true. But after 11 years of misbehaviour, all those cases leave a cumulative distaste in the electorate's mouth. At the time of the sudden discovery of an Aboriginal national emergency in the Northern Territory, I was struck when I heard John Laws ask his listeners whether this was Howard 'doing a Tampa'. I'm sure that, at the time of the Tampa, neither Laws nor any of his listeners thought Howard was merely pulling on a stunt to help him win an election. At this remove, however, Laws was sure his listeners would know that 'doing a Tampa' meant. With Howard's loss of credibility, the public stopped listening to him, just as they stopped listen to Keating in 1996.

The other point to make in explaining the switch to Rudd is that one policy really did affect a lot of votes: Work Choices. It worries workers who perceive themselves to have little personal bargaining power and others who worry their children may be adversely affected. There's circumstantial support for this proposition in the big swings to Labor among young people and women. In any case, Howard tacitly acknowledged Work Choices was hurting electorally with his major watering down of the policy and reintroduction of a fairness test, the attempt to abandon the name Work Choices and the huge advertising campaign. But this backdown has come too late to register on the public's consciousness. I'll bet Howard lies awake a night wishing he'd never touched Work Choices.

Me tooism

One of the most widely remarked features of this campaign is the way Rudd has said 'me too' to so many of the Government's policies. But though this may be the most extreme example we've seen, it's by no means the first. As you recall, Howard tried to make himself a 'small target' when he beat Keating in 1996. He promised 'never ever' to introduce a GST, abandoned a lifetime of opposition to Medicare and played down any plans he had to reform industrial relations. Me tooism is a strategy that appeals to oppositions. In any argument over policy, government's have an inbuilt advantage because they enjoy the authority of office. It's the government that's best able to introduce policies it hopes will 'wedge' its opponents, dividing them internally. Howard wedged Labor so successfully over the years that it has learnt to protect itself by instantaneously agreeing to every policy Howard proposes.

But me tooism is best seen as one way of competing, with clues to what's happening coming from Hotelling's law. Labor has sought to make its product indistinguishable from the Liberals' in areas where the Libs are perceived by voters to be more capable (such as the economy, defence and security), but sought to differentiate its product in areas where Labor's perceived to be more capable (education, health, the environment and industrial relations). So Labor has not said me too in these areas, but has sought to focus the election debate upon them. But me too is a game for both sides. Consider all the respects in which Howard sought to narrow the gap with Labor because he was fighting on Labor territory and wanted to shift debate back to his own territory: he has heavily modified Work Choices by restoring a safety-net, completely reversed his scepticism on climate change and opposition to an emissions trading scheme, suddenly discovered a belief in symbolic reconciliation, gone cold on nuclear power and stumped up big bucks for water, tertiary education, hospitals and child care.

What kind of a man is Rudd?

Australian election campaigns have become more presidential and so have the day-to-day operations of government - that is, more centred on the personality and preferences of the prime minister. That's been true of Howard; it will be truer of Rudd. The Libs have always been a leader-calls-the-shots party, whereas Labor has been more democratic, with caucus having the final say. Rudd seems more self-willed in the style of a Liberal prime minister, as revealed by his unilateral announcement that he, not caucus, will decide who gets into cabinet. The question is whether, once Labor is safely back into government, the rest of the parliamentary party is still willing to stifle their differing preferences in the way they have been in their efforts to defeat the cleverest politician of our age, John Howard. My guess is they won't be, and that Rudd will face a fair bit of internal dissent.

With all of Rudd's me tooing, there is a suspicion in many people's minds that, once he's installed, he'll be revealed to be something other than he presented himself as before the election. Liberal supporters fear he'll reveal himself as a closet socialist; Labor supporters hope he'll reveal himself as any kind of socialist. I suspect both sides will be surprised - that, with Rudd, what you see is what you get. He really is just the younger version of John Howard he's portrayed himself as. I believe he's a very conservative man, with views on foreign affairs, defence, national security and

terrorism that are little distinguishable from Howard's (even on Iraq), and views on economic issues that aren't far from Howard's, either. Despite the Libs laughable attempt to portray him as a tool of the union movement (like Bob Hawke was, d'ya mean?) and imaginary claim that he would return us to centralised wage-fixing, the changes he'll make to the now heavily modified Work Choices are quite cautious.

I suspect Rudd is big on tactics, but weak on strategy. You can see that in his decision to adopt 90 per cent of Howard's tax cuts. As a political tactic, this was smart: he knew the Libs' advantage on taxation meant he couldn't win a comparison of rival tax cuts, so by matching the Libs he removed taxation as an election issue. As a strategy, however, it left much to be desired. He claimed that the hugely expensive areas education and health were his highest priorities but, at the first opportunity to spend \$31 billion on cutting tax rather than fixing education and health, he seized it. Nor was he prepared to use a refusal to match Howard's tax cut to demonstrate his superior credentials as an economic manager and economic conservative.

Rudd is highly ambitious and I suspect his ambition outweighs his commitment to Labor values. If so, he'll be good at winning elections, but not at knowing why he wants to win apart from the obvious. He'll survive for a long time, but achieve surprisingly little. He's not a class warrior nor highly ideological, but he is a control freak, who looks set to expand the role of his own department. He's self-willed, a tough boss, a hard worker and a detail-man.

Rudd as an economic manager and reformer

This is not a good election to win. The longstanding pattern is for federal governments to be tossed out only after they've presided over a recession. That's true of the Whitlam, Fraser and Hawke/Keating governments. But the Howard government will be the exception to the rule: it presided over 11 years of strong economic growth, low inflation and falling unemployment, all the time grinding into the public's consciousness its claim that Labor was a hopeless economic manager. The Rudd government is unlikely to be as lucky as the Howard government. With the expansion phase now in its 17th year, the chances of recession occurring some time in the next three years would have to be high. And in the meantime, of course, the Reserve will be grappling with a runaway economy, possibly raising rates a fair bit further. So there's a fair chance the Howard government will go down in history as an exemplary economic manager, whereas Labor's reputation as hopeless economic manager will be confirmed for a generation. Added to this we have a government that said me too to pretty much all of the Howard government's now clearly inappropriate three years of tax cuts and general spending spree. It's standard practice for incoming governments to use their first budget to change the direction of their pre-election rhetoric and also clean out a lot of the favourite spending programs of their predecessors. Labor has announced spending cuts it says are worth \$3 billion and also made noises about establishing a razor gang. The press gallery has treated these announcements with scepticism; if it knew a bit more economic history it wouldn't.

I think that when economists look back on the economic record of the Howard government they'll conclude it had such good luck it didn't have to try very hard and, in fact, didn't try very hard. They spent so long telling us what good managers they were they came to believe their own bull-dust. Paradoxically, Labor's reputation as a

hopeless economic manager means it knows it must always try hard on economic policy if it wants to survive in government. Similarly, when you're a Liberal you can afford to take the business community for granted, but when you're Labor you always have something to prove. Rudd Labor will be seeking legitimacy and will try hard to establish good relations with business. Labor is likely to listen more closely to Treasury, and Treasury stands a good chance of giving Rudd and Wayne Swan something to believe in and fight for, just as it did Keating. Between Treasury and Professor Ross Garnaut, I expect Labor's implementation of the tradable emissions regime to be quite sensibly done. It wouldn't be realistic to expect a Rudd government to be as committed to micro reform as Treasurer Keating was - the days of continuous reform are gone - but I do think there's a good change it will be more interested in reform than the Howard government was.

Labor will not, of course, have control of the Senate. But nor are the Libs likely to retain control - certainly not after the new senators take their places in July. The balance of power is likely to be held by the Greens, which raises a novel circumstance. In the past, having the Australian Democrats holding the balance of power acted as a brake on Labor implementing some of its more radical policies, probably no bad thing. But now with the Greens in may be that Labor has to make some of its policies more radical to get them through.

Observations on monetary policy

Over the past couple of years the Reserve Bank has developed a clear modus operandi in which it waits for the quarterly CPI release, revises its inflation forecast on the basis of the new information and then adjusts the stance of policy if necessary at the board meeting about two weeks later. This says rates are most likely to be adjusted at the February, May, August and November meetings. This established MO has many attractions for the Reserve. For a start, the timing of the quarterly Statement on Monetary Policy has been adjusted to come soon after those board meetings and also come shortly before the half-yearly appearances before the parliamentary committee. This means that, whether or not the board decides to move, only a few days pass before the Reserve is able to provide a highly detailed exposition of its reasoning. A late draft of the SoMP would be available at the time of the meeting. It's always difficult for central bankers to make a detailed public statement - or worse, be subjected to detailed public questioning by their parliamentary masters - when the case for a rate change has become apparent, but before they've had a chance to put it into effect. They always want to be in a position to assert that, in present circumstances, the current policy setting is 'about right'. So the beauty of this alignment of meeting, SoMP and hearing is that it maximises the chance of the central bankers been able to report publicly after they've acted, not before.

Another advantage of this MO is that it focuses attention on inflation and the prospects for inflation. Rate rises are never popular, but neither is inflation, and this alignment - acting so soon after the release of the CPI - highlights the Reserve's justification for its unpopular action. When you're trying to control inflation expectations, it's important to keep reminding the public that you're obsessive about controlling actual inflation and about achieving your target. But it's worth remembering - as we were reminded by Glenn Stevens's statement last week - that while inflation is the end result we're worried about, it's excessive growth that's the

cause of the result, so it's growth that interest rates work on to get to the result. A simple point, but one the politicians were happy to dissemble in the election campaign, with their eulogising of growth in one breath and their pious expressions of concern about inflation in the next.

A further advantage of this MO is that it makes it easier for the financial markets and business economists to form more accurate expectations about future rate movements. It's a very clear signalling device. The Reserve has nothing to gain and a little to lose by catching the markets out. The downside of catching the market with its rates down is that it makes embarrassed economists more likely to want to cover their embarrassment by arguing that the rate rise is unjustified. It's a mistake to imagine that being an independent central banks means you can do as you please. In a democracy, no public institution can do as it pleases. If it becomes too unpopular, eventually it will have its wings clipped. The consequence is that independent central banks have to do their own worrying about politics. And one consequence of this is that, when you're doing unpopular things like raising rates, it helps to have a chorus of market and business experts calling for and predicting a rate rise, thereby giving the rise an air of legitimacy as well as softening people up.

Finally, when you're tightening rates in a heavily indebted economy, this MO allows you to proceed cautiously, responding to the flow of incoming evidence as you go ever higher - something that's important if you believe, as most central bankers seem to, that rate rises aren't linear. That eventually you hit a point where the penny drops and behaviour really starts to change.

But there are a couple of qualifications to be made to this happy story. First, making one potential move a quarter is fine provided it allows you to move fast enough. It may not. As you know, the Reserve probably would have tighten at its September meeting after seeing the June quarter national accounts, had it not been for the sub-prime turmoil. Second, this as an MO for a tightening cycle. It doesn't make as much sense for an easing cycle - rate cuts are never unpopular - and, particularly if you thought the economy was slowing sharply, you might want to move a lot faster than once a quarter. The moral of the story is that, no matter how entrenched the quarterly MO becomes, the Reserve will always reserve the right to make changes in other months if it judges that to be necessary. Were that to happen and were you to be caught out, there'd be no point feeling aggrieved and claiming the bank had broken an unwritten convention. This MO will last only as long as it suits the Reserve.

Looking to next year, some economists think they can see two, even three more rate rises coming. They may prove right but, if you're in this camp, just remember that you're making a pure forecast. That is, you're getting ahead of the game. The Reserve has no game plan that calls for two or three more rises. While it clearly has a bias to tighten, it will take things a month at a time, responding to the data as it rolls in. That data includes the national accounts and the labour price index, not just the CPI, of course. Remember, too, that the need for further rises in the cash rate will be affected by the likelihood of the major banks instituting a mortgage rate rise of their own and by the possibility of a further slowing in the world economy, particularly the Asian end of it.