RBA rate cut to 'hurt recovery', savers

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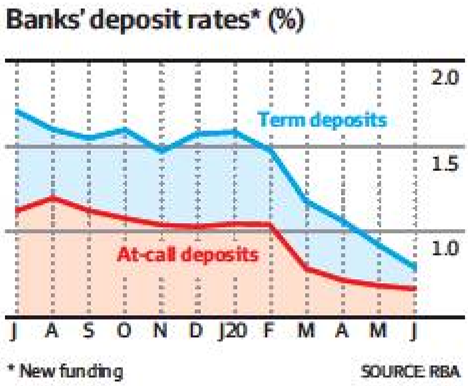

Former Reserve Bank board member Warwick McKibbin has warned that rate cuts and quantitative easing by the RBA this Melbourne Cup day would undermine the economic recovery and further squeeze savers.

The RBA is expected to cut the cash rate from 0.25 per cent to 0.10 per cent on Tuesday and announce as much as $163 billion in new bond purchases designed to reduce borrowing rates and stimulate the economy.

The big four banks' average conditional savings rate on deposits is now just 0.66 per cent, lower than the latest inflation reading of 0.7 per cent, indicating negative real interest rates or a situation where depositors are now virtually paying the bank to hold their money.

"Further rate cuts would be counterproductive to the economy," Professor McKibbin said. "Why keep cutting rates when we know it does nothing but redistribute wealth from lenders to borrowers?"

On Friday the Commonwealth Bank cut rates on savings deposits again – the third time in six weeks – as official figures showed tax cuts and government financial support had been placed into bank deposits that swelled $16.5 billion in September, pushing total deposits to over $1 trillion.

Wilson Asset Management fund manager Geoff Wilson also dismissed further rate cuts, saying the collapse in deposit rates would force people into even riskier investments.

"Unfortunately both cutting rates and QE [quantitative easing] are negative for self-funded retirees," he said. "It will just push people into equities and that means taking on much more risk and that's something that really concerns me.

"This has been happening for some time. Two years ago when rates were 2 per cent people were saying to me 'I really can't live on that' – so how will they live on zero per cent?" On Thursday, ANZ Banking Group chief executive Shayne Elliott said the bank was already flush with cheap funds and that further measures would hurt their profitability.

"People don't want it, borrowers don't want it, it becomes a burden for me because I end up having to buy government bonds or bank it with the RBA," he said.

Curve Securities' Peter Sheahan said "the excessive 12 per cent growth in deposits during October, totalling $16.5 billion, relative to a paltry 2 per cent growth in credit is a real challenge to our financial industry. The positive funding paradigm has emerged as the clearest and present danger of [banks] operating performance."

The Reserve Bank is not only expected to cut rates but to join other central banks in committing to buy bonds via quantitative easing.

In doing so it hopes to lower longterm bond rates and reduce the attractiveness of local assets, asserting downward pressure on the Australian dollar.

That in turn would ease the strain on exporters and support the economy. The dollar, which plunged to below 60¢ against the US dollar in March, has traded above 70¢ since early June and is still higher than it was on January 1 before the crisis.

But Professor McKibbin said: "QE would distort the financial system and should only be kept for market functionality."

Treasurer Josh Frydenberg declined to comment on the pressure of lower rates. However, Labor financial services spokesman Stephen Jones said further cuts should not be made.

"It's going to hurt self-funded retirees and it's not obvious that it's going to lead to any extra demand in the economy," he said.

"ANZ admitted as much yesterday, that self-funded retirees, especially those dependent on their deposits, would feel pain."

As the savings rates crash smaller banks, which depend more heavily on deposits to fund their balance sheets, will start to feel pain.

Newcastle Permanent group treasurer Brian Reid, who runs a home loan book with lower arrears than the big four banks, said further cuts and a QE program would create problems.

"It does impact quite significantly now especially if the deposits are their major source of income," Mr Reid said.

"It's a bigger problem for us than the big four because we tend to target lower levels of profitability because we want to push more value through to our deposit holders. "I think another cut and QE will just mean a transfer to borrowers from lenders."

Until mid-October, the Reserve Bank appeared reluctant to intervene in the bond market other than to restore order in times of dysfunction and to achieve its three-year yield target of 0.25 per cent.

But in his first public appearance since the pandemic began, governor Philip Lowe said the board noted that Australia's long-term bond rates were higher than anywhere else in the world, and it was considering whether it should bring them into line.

Those higher bond yields had helped the government to sell tens of billions of dollars of debt to local and foreign investors as it sought to finance the budget deficit.

The government's debt agency, the Australian Office of Financial Management, which recently held discussions over 80 buyers of the nation's bonds, said that some investors thought the central bank's unwillingness signalled a lack of support for the government bond market.

But the AOFM said "for many investors, the RBA being less active in the government bond market compared to other sovereigns was viewed favourably as this reflected less chance of 'distortion'".

Economists, including Warren Hogan and former RBA governor Ian Macfarlane, have pushed back on the need for quantitative easing, but former prime minister Paul Keating has encouraged it, suggesting the bank should have done it sooner.

The Reserve Bank is also expected to cut the rate paid on commercial bank deposits in exchange settlement accounts at the RBA to 0.01 per cent, from the current 0.10 per cent. That could result in negative nominal rates between big investors within months.

However, Westpac chief economist Bill Evans said such a situation should not be considered as a negative rate for retail depositors.

"What is certain is that markets should not interpret some slight negative deposit rates in the institutional space as a change in the Reserve Bank's strong resistance to negative policy rates," he said.

"We understand that a negative rate policy would put significant downward pressure on the Australian dollar but do not believe that the decision to cut the ESA rate to 1 basis point should be seen as some early commitment to negative rates."