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Fund managers to Treasurer Josh Frydenberg: we need reform, not RBA interest rate cuts

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Anton Tagliaferro, investment director & founder of Investors Mutual. Picture: Ryan Osland

One of Australia's best-known active fund managers has slammed policymakers for using ultra-low interest rates to stimulate the economy and called on the federal government to consider tax and energy reforms and incentives to guide super funds into infrastructure and venture capital investment.

In a letter to federal treasurer Josh Frydenberg, Investors Mutual investment director Anton Tagliaferro and senior portfolio manager Hugh Giddy warn that manufacturing companies are at risk of going broke because of high energy prices, while super funds could be directed to help better use the country's water resources.

The fund managers, who oversee $9bn at IML, highlighted concerns about the long-term effects of using interest rates to stimulate the economy as well as their waning impact.

“We believe alternative policies need to be considered by your government if Australia is to extend the country’s 28 years of expansion,” the two write in a letter seen by The Australian.

The call came as the Bureau of Statistics said September quarter retail sales volume grew at the slowest pace since the last recession in 1991, leading economists to conclude rate cuts and tax relief since June have had little impact apart from lifting house prices.

The government has resisted calls to stimulate the economy, preferring to preserve a budget surplus forecast to arrive next year. But the lacklustre retail sales and other economic data have come despite rate cuts and the first stages of the government’s income tax cuts in July.

The Reserve Bank’s monthly board meeting today is widely expected to leave official interest rates at a record low of 0.75 per cent, after three cuts in five months, as governor Philip Lowe maintains there is a “gentle turning point” in the economy.

Tagliaferro and Giddy presented their case against further cuts in a paper to Lowe last week that said ultra low rates “aren’t necessarily working” and “may be counter-productive”. “We have had decades of money and credit growing much faster than output,” the paper to the RBA said.

“Inflation has trended down. Growth in output has trended down as interest rates, set by the government’s responsible authorities that we know as central banks, have trended down.”

But it had also created imbalances in the economy and increased income inequality that had fuelled the rise of nationalist and populist politics.

Rate cuts and quantitative easing — now being mooted for Australia — “in reality, have previously resulted in major imbalances and have frequently ended in crises, such as the technology boom and bust, the housing boom and mortgage financing bust in the US followed by a global financial crisis, and several other booms and busts such as those experienced in Iceland, Spain, and Ireland.

“The common theme in all these events is easy access to very cheap credit.”

Rather than further fuelling these forces, IML argued the Treasurer should implement energy and tax reforms and incentives and use public-private partnerships to fuel investment in infrastructure. “These high (energy) prices are now seriously threatening the long-term viability of many industries in Australia such as the smelting, fertiliser and packaging industries,” Mr Tagliaferro and Mr Giddy say in the letter.

“Having the highest electricity prices in the world is a nonsense when one considers Australia is a major exporter of LNG, uranium and coal to the rest of the world.”

Reduced restrictions on the extraction of coal-seam gas was one area that needed urgent review, with Victoria continuing to resist lifting a moratorium on onshore gas exploration.

IML also called for tax incentives to direct more of the $2.7 trillion in superannuation towards infrastructure and venture capital funding because they were “areas which can potentially create more sustainable, long-term wealth for the country”.

More incentives may be required to direct super money towards water extraction and irrigation infrastructure to make Australia’s land mass more productive and raise our long-term agricultural output.

Calls for super money to be directed into infrastructure development have previously been resisted on the grounds that super funds should focus on investment returns for members. However, super funds have been among the biggest players in building up holdings of established infrastructure projects that do not carry development risk and can provide long-term, steady returns suited to funding retirement income.

Mr Tagliaferro and Mr Giddy said interest rates cuts rewarded highly-geared consumers but penalised savers and were not leading companies to expand their productive capacity.

“As with many central banks overseas, the RBA seems to take little account of the fact that they are sending the wrong message to society at large,” the fund managers said.

As of October 2019, one-year term deposit rates were 1.6 per cent, meaning that to earn $20 (before tax) a day in interest, “which will hardly afford the holder a lavish lifestyle” an investor needed over $500,000 on term deposit”.

“As these savers seek higher-return alternatives, they are pushed up the risk curve and existing asset prices are pushed higher.”

In justifying lower rates Lowe recently argued that because of higher levels of household debt, the benefit of rate cuts to the broader economy outweighed the impact on savers.

But IML said that while higher prices for houses, shares and other assets benefited asset owners, they penalised people who did not own assets.

“In favouring debtors over savers and asset owners over people without assets, central banks are effectively redistributing income and widening the gap between the haves and the have nots.”

Cheap and plentiful credit was also allowing older and less efficient “zombie companies” to survive longer than they should, slowing renewal in the economy.

This could be seen in economies including Japan and Europe where years of sustained low interest rates had not produced the strong economic growth that was expected, Mr Tagliaferro and Mr Giddy said.