

RESERVE BANK BOARD MINUTES

A Higher Hurdle

Tuesday, 21 February 2012

- The minutes from the Reserve Bank board meeting on February 7 do not suggest that the RBA feels any pressing need to change the cash rate.
- Indeed, as per the accompanying statement from February 7, it appears that any further easing will need demand conditions to weaken “materially”. This word materially continues to suggest to us that the hurdle for a rate cut in coming months is higher, especially as sentiment towards the European crisis continues to improve.
- The domestic data and global economic developments since the RBA last met give us little reason to believe the hurdle has shifted. However, the Aussie dollar has appreciated a little further and average variable mortgage rates have risen slightly.
- On balance, we think that a near term rate cut is less likely and the RBA will be on hold over the next few months.
- We now expect the timing of the next rate cut to be May. Moreover, for a May rate cut to become reality it will require a further intensification of the problems in European and/or a material deterioration in the domestic economy.

The minutes from the Reserve Bank (RBA) board meeting on February 7 do not suggest that the RBA feels a pressing need to change the cash rate. Indeed, as per the accompanying statement from February 7, it appears that any further easing will require demand conditions to weaken “materially”. This word materially continues to suggest to us that the hurdle for a rate cut in coming months is higher, especially as sentiment towards the European crisis has improved.

The RBA notes that “global economic and financial market developments had been somewhat more positive over the past month or so”, but does note too “further measures would be required to bring about a comprehensive solution”. Liquidity measures in mid December from the European Central Bank helped mitigate the risk of a liquidity shortage and have led to a lift in risk appetites and confidence. Further, a second bailout of Greece has just been struck.

The run of domestic data since February 7 and global economic developments suggest the hurdle has not shifted much since these minutes were formulated. But the AUD has appreciated a little further and average variable mortgage rates have risen slightly. These are factors among many that the RBA needs to take into account when making its cash rate decision.

On balance, we think that a near term rate cut is less likely and the RBA will be on hold over the next few months. We expect the timing of the next rate cut is now May and it will require a further intensification of the European crisis and/or material deterioration in the domestic economy.

The RBA expects Australia to grow at “an around-trend pace over 2012 and 2013” and sees a “disorderly resolution of the sovereign debt problems in Europe as the major downside risk for the global and domestic economies”. In our view, the ECB and euro-zone leaders have bought some valuable time by mitigating bank liquidity issues but genuine progress towards resolving Euro zone’s fundamental shortcomings is still needed. Further, there remains the risk that Greece fails to implement what it has agreed to do in austerity measures. So the downside risks from Europe remain and with that the risk of another easing remains.

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