

RESERVE BANK RATE DECISION

It's a Material World

Tuesday, 7 February 2012

- The RBA took markets by surprise today by leaving the cash rate unchanged at 4.25%.
- While the material girl stole the world stage on Monday with her performance at the US Super Bowl, today the word “materially” stole the market’s attention in the RBA’s statement.
- The RBA has left the door open for further rate cuts but has attached any further easing to demand conditions weakening “materially”. The word materially suggests to us that the hurdle for a rate cut in coming months is now higher.
- Between now and the next RBA meeting on March 6, there will be a considerable flow of domestic economic indicators, including the partial economic indicators for Q4 GDP.
- We continue to expect a rate cut in March, but we think it is now a close call and the data flow between now and March will be critical in the RBA’s decision. This data flow includes international developments, where considerable uncertainty remains.

The material girl stole the world stage on Monday with her performance at the US Super Bowl. Today, the word “materially” stole the market’s attention in the Reserve Bank statement accompanying its very unexpected decision to leave rates unchanged at 4.25%.

A recent survey taken on Friday 3 February of 27 institutions revealed 24 of these 27 institutions expected a rate cut today, including ourselves. Financial markets were also almost fully priced for a cut.

The RBA has left the door open for further rate cuts but has attached any further easing to demand conditions weakening “materially”. The word materially suggests to us that the hurdle for a rate cut in coming months is now higher. Moreover, that domestic economic conditions need to deteriorate markedly from here for the RBA to cut as soon as next month.

We still think another easing is likely this year, but when remains the more open-ended question.

Will the case for a rate cut be strong enough between now and the next meeting on March 6? Possibly, but we suspect it will be a very close call. Between now and the next RBA meeting, there will be a considerable flow of domestic economic indicators – including the partial indicators for Q4 GDP. This data includes retail spending and employment.

Of course, global economic conditions could also push the RBA over the line to cut rates next month. The RBA still characterises risks as skewed to the downside in Europe but recent improved data from the US has likely helped offset some of the concerns about the global economy.

On Friday, the RBA’s Statement on Monetary Policy will give us a more detailed view of the RBA’s analysis of economic conditions and give us a better handle on when the timing of the next rate move will be. For now, we continue to expect a rate cut in March, but we think it is now a close call and the data flow between now and March will be critical in the RBA’s decision. This data flow includes international developments (especially European ones), where considerable uncertainty remains.

On Europe, the RBA notes that “the acute financial pressures on banks in Europe were alleviated considerably late in 2011 by the actions of policymakers” although with “risks still skewed to the downside”.

On the Australian economic growth outlook, the RBA’s comments were broadly similar to that published after the December rate decision, namely that they see growth as “close to trend”.

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