Tuesday, 4 November 2014

BankSA

Groundhog Day at the RBA

- The cash rate was kept on hold at 2.50%– yet again. The RBA is not concerned about inflation or the overall direction of global economic growth. It expects that its current policy settings will sustain demand and economic growth into 2015.
- China is showing signs of slower growth and the downturn in its property market will require some management. However, growth in China is expected to remain robust, close to official targets and well above growth in the United States, Europe and Australia.
- The RBA continues to wonder if financial markets are asleep. Are world financial markets really as ‘riskless’ as market pricing suggests. Volatility has picked up. It’s time to be alert. If rates rise in the US, markets could react badly.
- We continue to expect that Australia’s GDP growth will be a touch above 3% for 2014, in comparison to the RBA’s 3% forecast. We will see an update to the RBA’s forecast in its Statement on Monetary Policy this Friday.
- We expect the RBA will lift the official cash rate in 2015, but the patchy recovery in the domestic economy suggests that the earliest this could happen is most likely in June.

RBA Statement: At its meeting today, the Board decided to leave the cash rate unchanged at 2.5 per cent.

Growth in the global economy is continuing at a moderate pace. China's growth has generally been in line with policymakers' objectives, though weakening property markets there present a challenge in the near term. Commodity prices in historical terms remain high, but some of those important to Australia have declined further in recent months.

Our view: Concerns regarding the Chinese economy remain, particularly the risks from the downturn in its property market. However, the RBA still maintains that growth will be close to the target of the Chinese authorities of 7.5%.

RBA Statement: Volatility in some financial markets has picked up over the past couple of months. Overall, however, financial conditions remain very accommodative. Long-term interest rates and risk spreads remain very low. Markets still appear to be attaching a low probability to any rise in global interest rates or other adverse event over the period ahead.

Our view: The RBA has continued to hint that financial markets might be too relaxed about the possibility of higher interest rates or other adverse events in the future. This is despite the recent appreciation of the USD, and the recent lift in volatility in financial markets.

RBA Statement: In Australia, most data are consistent with moderate growth in the economy. Resources sector investment spending is starting to decline significantly, while some other areas of private demand are seeing expansion, at varying rates. Public spending is scheduled to be subdued. Overall, the Bank still expects growth to be a little below trend for the next several quarters.

Our view: The battle to fill the gap left by declining resources sector investment continues. It remains uncertain as to how much residential construction, non-mining investment and consumer spending can help offset the sharp decline in mining investment. We continue to expect that Australia's GDP growth will be a touch above 3% for 2014, in comparison to the RBA's 3% forecast. We will see an update to the RBA's forecast in its Statement on Monetary Policy this Friday.

RBA Statement: Recent data on prices confirmed that inflation is running between 2 and 3 per cent, as expected, and this is likely to continue. Although some forward indicators of employment have been firming this year, the labour market has a degree of spare capacity and it will probably be some time yet before unemployment declines consistently. Hence, growth in wages is expected to remain relatively modest over the period ahead, which should keep inflation consistent with the target even with lower levels of the exchange rate.

Our view*: Recent data revealed that Q3 inflation was largely in line with the RBA's forecast and is well-contained. The soft conditions in the labour market, notwithstanding the difficulty in reading recent ABS data, suggests that inflation should remain within the RBA's 2 to 3 per cent target band over the near-term.*

RBA Statement: Monetary policy remains accommodative. Interest rates are very low and have continued to edge lower over the past year or so as competition to lend has increased. Investors continue to look for higher returns in response to low rates on safe instruments. Credit growth is moderate overall, but with a further pick-up in recent months in lending to investors in housing assets. Dwelling prices have continued to rise.

Our view: *This paragraph is almost identical to last month's statement. It continues to note the increase in credit for housing investment and rising house prices. The RBA and APRA have stated that they will make further comments on home lending before the end of the year.*

RBA Statement: The exchange rate has traded at lower levels recently, in large part reflecting the strengthening US dollar. But the Australian dollar remains above most estimates of its fundamental value, particularly given the further declines in key commodity prices in recent months. It is offering less assistance than would normally be expected in achieving balanced growth in the economy.

Our view: *The RBA has acknowledged the recent fall in the AUD but makes the point that it remains above most estimates of fundamental value. We tend to agree and expect the AUD to move lower over time but not too significantly. The RBA appears frustrated by the apparent overvaluation of the AUD.*

RBA Statement: Looking ahead, continued accommodative monetary policy should provide support to demand and help growth to strengthen over time. Inflation is expected to be consistent with the 2–3 per cent target over the next two years.

Our view: *The RBA remains relaxed about the outlook for inflation. Given weak growth in wages and the relative strength of the AUD, this view is reasonable.*

RBA Statement: In the Board's judgement, monetary policy is appropriately configured to foster sustainable growth in demand and inflation outcomes consistent with the target. On present indications, the most prudent course is likely to be a period of stability in interest rates.

Our view: *There is once again little change to the RBA's view of the economy and hence no change in its stance of monetary policy. The modestly lower Australian dollar should provide some needed support for the Australian economy, and help offset the significant drag on growth from declining mining investment. We continue to expect the RBA will lift the official cash rate in 2015, but the patchy recovery in the domestic economy suggests that the earliest this could happen is most likely in June.*

Hans Kunnen & Janu Chan, Senior Economists
Ph: 02-8254-8322

Contact Listing

Chief Economist
Besa Deda
dedab@stgeorge.com.au
(02) 8254 8322

Senior Economist
Josephine Horton
hortonj@stgeorge.com.au
(02) 8253 6696

Senior Economist
Janu Chan
chanj@stgeorge.com.au
(02) 8253 0898

State Manager
Hans Kunnen
kunnenh@stgeorge.com.au
(02) 8254 8322

State Manager
Mark Goldsmith
goldsmithm@banksa.com.au
(08) 8424 5597