Interest Rate Outlook

Tuesday, 6 August 2013

BankSA

Cash Rate lowered to 2.50%

- **The Reserve Bank of Australia (RBA) cut the cash rate to 2.50% at its meeting today as widely expected.**
- **There were frustratingly few clues to future monetary guidance in its accompanying statement, and very little change to its statement from July. However, the final sentence, "The Board will continue to assess the outlook and adjust policy as needed to foster sustainable growth in demand and inflation outcomes consistent with the inflation target over time" would suggest that the RBA may have softened its easing bias.**
- **Despite further depreciation in the Australian dollar, the RBA continues to hint that it expects the AUD to weaken further.**
- **On Friday, the RBA will release its quarterly Statement on Monetary Policy. The Statement should shed some light on the RBA's stance and its updated forecasts. Growing concern about weakening mining investment suggest that the RBA's growth forecasts may have been downgraded.**
- **Low inflation did provide some scope to ease the cash rate. Has all that 'scope' now been used up? Our position has been that the stimulus provided by today's cut plus the stimulus from the lower AUD will foster growth over time. We are wary of a possible rise in traded goods inflation and that may restrain the RBA from further cuts.**

Below is the Governor's statement interspersed with our views.

RBA Statement: At its meeting today, the Board decided to lower the cash rate by 25 basis points to 2.5 per cent, effective 7 August 2013.

Recent information is consistent with global growth running a bit below average this year, with reasonable prospects of a pick-up next year. Commodity prices have declined but, overall, remain at high levels by historical standards. Inflation has moderated over recent months in a number of countries.

Our view: This paragraph is virtually identical to last month! We note that growth in China has slowed but remains at a solid pace of around 7% per annum. In the US, jobs are being created but at a pace that might be described as modest. Europe continues to struggle although recently business sentiment has picked up. Low interest rates and inch by inch reform should see better outcomes for Europe in 2014. Despite 'money printing' by some central banks we agree with the RBA that inflation is not a major concern around the globe at present.

RBA Statement: Globally, financial conditions remain very accommodative, though the recent reassessment by markets of the outlook for US monetary policy has seen a noticeable rise in sovereign bond yields, from exceptionally low levels. Volatility in financial markets has increased and has affected a number of emerging market economies in particular.

Our view: *Despite speculation surrounding the 'tapering' of US Fed bond purchases, monetary policy is 'easy' across the globe. Today's decision by the RBA adds to those supportive conditions. Long-term bond yields have risen around the globe as a result of US 'tapering' speculation and this has lifted the borrowing costs of those nations seeking to borrow long-term funds.*

RBA Statement: In Australia, the economy has been growing a bit below trend over the past year. This is expected to continue in the near term as the economy adjusts to lower levels of mining investment. The unemployment rate has edged higher. Recent data confirm that inflation has been consistent with the medium-term target. With growth in labour costs moderating, this is expected to remain the case over the next one to two years, even with the effects of the recent depreciation of the exchange rate.

Our view: *There was little change in this paragraph, other than the confirmation that recent Q2 inflation data was consistent with the RBA's 2 to 3% per annum band. We would have liked to have seen some insight into the RBA's forecasts which are due to be published this Friday in the RBA's quarterly Statement on Monetary Policy. The more downbeat assessment on mining investment and concerns about a potential big decline seem to have weighed more heavily on the RBA according to the last RBA minutes published in July and Governor Stevens' speech last week, and would suggest that the RBA's forecasts have been downgraded.*

The RBA is perhaps now more confident that the weaker Australian dollar will not pose a significant risk to inflation than it was in July.

RBA Statement: The easing in monetary policy over the past 18 months has supported interest-sensitive spending and asset values, and further effects can be expected over time. The pace of borrowing has remained relatively subdued, though recently there are signs of increased demand for finance by households.

Our view: *There has been little to change the RBA's assessment on the impact on monetary policy. Data today and last week, has supported the view that house prices are recovering further. However, consumption growth and credit growth remain at a subdued pace.*

RBA Statement: The Australian dollar has depreciated by around 15 per cent since early April, although it remains at a high level. It is possible that the exchange rate will depreciate further over time, which would help to foster a rebalancing of growth in the economy.

Our view: *The Australian dollar has weakened a further 1.8% against the US dollar and 2.8% in trade weighted terms since the RBA's last meeting in July, however the RBA's assessment has remained the same. The RBA continues to hint that it expects further depreciation in the Australian dollar.*

RBA Statement: The Board has previously noted that the inflation outlook could provide some scope to ease policy further, should that be required to support demand. At today's meeting, and taking account of recent information on prices and activity, the Board judged that a further decline in the cash rate was appropriate. The Board will continue to assess the outlook and adjust policy as needed to foster sustainable growth in demand and inflation outcomes consistent with the inflation target over time.

Our view: *Low inflation did provide some scope to ease the cash rate. Has all that 'scope' now been used up? Further detail on the RBA's views will be released in Friday's Statement on Monetary Policy. Our position has been that the stimulus provided by today's cut plus the stimulus from the lower AUD will foster growth over time. We are wary of a possible rise in traded goods inflation and that may restrain the RBA from further cuts. Bring on Friday's Statement.*

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