Tuesday, 15 October 2019

RBA Minutes of the October Meeting

Debunking the On Hold Case

- **The minutes of the Reserve Bank's (RBA) October board meeting provided greater insight into the decision to lower the cash rate to 0.75%. It was the third time the cash rate has been lowered this year.**
- **There was extensive discussion over the case for and against easing policy further. The RBA pointed out that unemployment and inflation outcomes were "likely to be short of the Bank's goals". Over the course of this year, we have been highlighting the risk that the unemployment rate would head higher, and that inflation is unlikely to return to the RBA's 2 to 3% target over the medium-term.**
- **The RBA provided counterveiling arguments against all the rationales for not moving interest rates. Consequently, the RBA concluded that the arguments against easing were insufficient.**
- **The RBA highlighted that it was the "level of interest rates" which was the key driver of demand rather than changes in interest rates, which supported the case for lower rates sooner rather than later in the face of increased downside risks.**
- **On the effectiveness of policy, the RBA recognised "the negative effect of low interest rates on the income and confidence of savers might be more significant", but noted the more positive impact on debt holders.**
- **The RBA's expectation for economic growth to pick up to a pace of growth close to trend remains unlikely. Moreover, the discussion against the case for leaving rates on hold in the October meeting suggests the RBA is open to lowering official interest rates again. We continue to expect that the RBA will lower the cash rate another 25 basis points. February remains the most likely timing but an earlier move cannot be ruled out.**

The minutes of the Reserve Bank's (RBA) October board meeting provided greater insight into the decision to lower the cash rate to 0.75%. It was the third time the cash rate has been lowered this year.

In these minutes, there was extensive discussion around the case for and against easing policy further.

The RBA pointed out that unemployment and inflation outcomes were "likely to be short of the Bank's goals". Over the course of this year, we have been highlighting the risk that the unemployment rate would head higher, and that inflation is unlikely to return to the RBA's 2 to 3% target over the medium-term. Moreover, the RBA also notes the weak run of data, which "had been on the softer side".

In the arguments against easing, the RBA noted that:

- Monetary policy was already expansionary and that the lower exchange rate was also supporting growth
- There was an argument for monetary stimulus to be kept in reserve to address future economic shocks
- There was strength in employment growth
- Policy stimulus might be less effective than in the past
- The housing market might be overinflated by lower interest rates

Nonetheless, there were counterveiling arguments against all of these points. Firstly, there were downside risks to the global growth outlook and questions around the impact of fiscal and monetary stimulus. The RBA also highlighted that it was the “level of interest rates” which was the key driver of demand rather than changes in interest rates.

In addressing the strength in employment, the board noted that all the strength in employment had been matched with higher participation, so there had been no reduction in spare capacity.

On the effectiveness of policy, the RBA recognised “the negative effect of low interest rates on the income and confidence of savers might be more significant”, but noted the more positive impact on debt holders and that “household interest payments exceeded receipts by more than two to one”. The RBA also once again referred to the transmission mechanism of lower rates on the exchange rate as working effectively.

Finally, the impact on asset prices was not “unlikely to represent a risk to macroeconomic and financial stability”. Higher asset prices also helped boost economic growth, as it assists in boosting household wealth and encourages home building.

Consequently, the RBA concluded that the arguments against easing were insufficient.

On the RBA’s assessment of economic conditions, there was a sombre assessment of the international economy, particularly in relation to the manufacturing sector and the impact of recent trade tensions.

In regards to the domestic economy, the RBA remained hopeful of an improvement in economic activity. The RBA pointed to its liaison program of a “mild pick-up in retail sales since July”. However, there was more pessimism among dwelling investment, in which the decline was “greater than had been expected a few months earlier”. The outlook for non-mining investment remained “favourable”.

The conditions which have led the RBA to lower official interest rates is expected to continue. There have been limited signs of a meaningful response to the recent stimulus, and we continue to see downside risks to the outlook.

The RBA’s expectation for economic growth to pick up to a pace of growth close to trend remains unlikely. Moreover, the discussion against the case for leaving rates on hold in the October meeting suggests the RBA is open to lowering official interest rates again.

We continue to expect that the RBA will lower the cash rate another 25 basis points. February remains the most likely timing but an earlier move cannot be ruled out.

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