Interest Rate Outlook

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RBA Minutes of the December Meeting

February Rate Cut Still Looms Large

- **The Reserve Bank (RBA) met in December and kept the cash rate at a record low of 0.75%.**
- **The minutes reveal that the case for another rate cut remains solid.**
- **The RBA is waiting for now to assess how the economy evolves. It is clear that the assessment so far has not improved sufficiently to move away from an easing bias.**
- **Data published since the RBA board met in December has not shown an improvement in economic conditions.**
- **The RBA continues to rank and monitor labour market data prominent among all data releases. The RBA's liaison contacts revealed employment intentions had "generally been moderate".**
- **The minutes outline a soggy wages profile, making inflation returning the RBA's target band challenging. The RBA also noted it would make returning consumption growth to trend hard.**
- **The RBA conceded in these minutes the negative effects lower interest rates can have on savers and confidence, but resolved that "the impact of these effects was unlikely to outweigh the stimulus to the economy of lower interest rates".**
- **On the global front, the RBA viewed downside risks as having receded a little.**
- **We continue to anticipate two more rate cuts next year from the RBA – in February and June – and do not rule out quantitative easing later next year.**

The RBA met on December 3 and kept the cash rate at a record low of 0.75%. The minutes for the December board meeting do not dissuade us from expecting another rate cut in February next year.

The minutes reveal that the case for another rate cut remains solid. The RBA is waiting for now to assess how the economy evolves, but it is clear that the assessment so far has not improved sufficiently to rule out more easing. It is also clear that data published since the RBA board met in December has not shown an improvement in economic conditions.

These minutes were published before the GDP data for the September revealed an economy still languishing. The GDP outcome did not provide the concrete evidence of a "gentle turning point" in Australian economy referred to by the RBA.

The RBA minutes said economic growth and the unemployment rate were broadly consistent with the RBA's forecasts, but a deterioration in the outlook would be "concerning".

Furthermore, the RBA has outlined that it expects to "reassess" the economic outlook in February. The data outcomes between December's board meeting and February, therefore, take on added importance. In that time, retail sales and GDP have disappointed. This Thursday's labour force data will be keenly watched.

The RBA continues to make labour market data prominent among all data releases. It noted it remained "an area to monitor". The RBA's liaison contacts revealed employment intentions had "generally been moderate". We continue to expect the unemployment rate to move higher by mid year 2020, from the current level.

More importantly, the RBA minutes also highlighted that the "current rate of wages growth was not consistent with inflation being sustainably within the target range…nor was it consistent with consumption growth returning to trend". The minutes described wages growth has having "levelled out in recent quarters following its gentle upward trend of the previous couple of years". The RBA's liaison program revealed that a larger share of firms expected wages growth to be "stable in the year ahead".

Weak wages growth clearly remains a big concern for the central bank. Moreover, this evidence outlined in the minutes suggests wages growth is likely to remain soggy, which means getting underlying inflation back to the RBA's target band is likely to continue to be challenging, sustaining the case for another rate cut.

The RBA also noted soft wages growth would make returning consumption growth to trend hard. Consumer spending continues to sag with the latest retail spending figures showing no growth, despite three rate cuts from the RBA and tax rebates from the Federal government.

The RBA conceded in these minutes the negative effects lower interest rates can have on savers and confidence, but resolved that "the impact of these effects was unlikely to outweigh the stimulus to the economy of lower interest rates".

The recovery in housing prices was pointed out as a channel in which lower interest rates had been effective. However, while the RBA acknowledged the upturn in the housing market to be a positive development, it also said it "could become a source of concern if borrowing were to run too quickly ahead of income growth".

The RBA minutes on global economic developments were more positive. It described downside risks as "receding a little". Since the December meeting, the phase one trade deal between the US and China has been inked and uncertainty around Brexit has lessened.

We continue to anticipate two more rate cuts next year from the RBA – in February and June – and do not rule out quantitative easing later next year from occurring. This week's labour force data remains important.

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