

Tuesday, 21 April 2015

## Minutes of the April RBA

### Board Meeting

#### A Sobering Read

- The minutes of the RBA's April board meeting are a sobering read. Frequent reference to 'below trend', 'below average' and 'subdued' punctuate the text leaving the reader with the impression of an economy struggling to gain momentum. In this context, the easing bias is well and truly maintained and leads us to expect a rate cut in May.
- The RBA board noted the ongoing weakness of bulk commodity prices and the need for a lower AUD to help rebalance the economy. Each of these supports the case for an easing sooner rather than later.
- The sobering outlook for economic activity rests with the ongoing spare capacity in the economy, the reluctance of non-mining businesses to invest and the ongoing decline in mining investment. Under these circumstances only modest employment growth can be expected.
- Commentary on China focussed on weakness in its property market and the flow-on effect for the demand for steel and iron ore. The RBA noted that iron ore exports to China had in fact increased in recent times but at lower prices. The Governor in his speech last night noted that growth in the order of 6-7% in China would continue to contribute significantly to global economic growth.
- The relationship between lower interest rates and the responses of consumers and businesses at a time of very low interest rates is described as 'unusually uncertain'. This gives the impression that the cash rate is close to its nadir. Maybe it is time for other policy to begin some of the heavy lifting. We expect a rate cut in May but cuts beyond that are also unusually uncertain and will depend on both global and domestic developments.

#### International Economic Conditions

The key observation is that monetary policies remained very accommodative. China is dealing with number of imbalances but the growth of 6-7% targeted for 2015 will continue to contribute significantly to global economic growth and demand.

Modest recovery in Japan continues and the Asia-Pacific region is witnessing an average pace of growth but with regional variations. The US economic recovery also continues but had moderated in recent months. Labour markets had improved but wage growth in the US remained subdued and hence held back growth in consumption.

The European economy remains troubled and inflation is well below the European Central Bank's target.

## **Domestic Financial Conditions**

The RBA board noted that public demand has made little contribution to growth over the year. Is this a veiled call for fiscal policy expansion or simply a description of the state of play? The board noted that public demand in NSW and Victoria was making a positive contribution towards economic activity in those States.

There is an expectation with the RBA board that dwelling investment will remain elevated in the quarters ahead but the outlook for non-mining business investment was grim with the board noting the possibility of a decline over the next year or so. This would come on top of the 13 per cent decline in mining investment in 2014 and further declines in such investment during 2015. The lack of business investment comes despite fairly static unit labour costs over the past three years.

## **Financial Markets**

The RBA board discussed the 'unusual trading' in the AUD immediately prior to the Board's rate decision in March but 'had not identified any evidence of procedural lapses or conduct that could have led to the early release of relevant information'. Illiquidity in the market had contributed to movements in the AUD at that time combined possibly with 'algorithmic trading strategies'.

Tension between Greece and its creditors was noted as well as the expectation by the US FOMC that it would begin its interest rate normalisation process sometime in 2015.

The board noted that the ECB's bond purchasing programme was contributing to record low long-term interest rates in many jurisdictions, including Australia.

## **Considerations for Monetary Policy**

Growth below trend and businesses investment levels remaining subdued for longer than had been expected form the basis for the RBA board's easing bias. They note that 'further easing of policy may be appropriate over the period ahead to foster sustainable growth in demand and inflation consistent with the target'.

The RBA is expecting the AUD to decline given reductions in commodity prices. While the AUD has fallen against the USD, the decline on a trade weighted basis (TWI) is not as pronounced.

## **Our Outlook for Monetary Policy**

We expect the RBA to cut the cash rate to 2.00% at its May meeting and then to remain on hold throughout the remainder of 2015 unless there are significant global developments that threaten Australia's economic growth path or non-mining business investment does fails to pick up. Unwelcome global developments could include further significant falls in commodity prices or disruptions to markets flowing from Greece's debt situation.

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