Interest Rate Outlook

bankSA

Tuesday, 2 April 2019

RBA Puts Us on Notice

- **The Reserve Bank left the cash rate unchanged at 1.50% after its Board meeting today**
- **The changes in the final paragraph suggest the RBA is putting us on notice for a potential shift in the cash rate in the near future.**
- **The RBA acknowledges the dichotomy between weaker GDP growth and stronger labour market outcomes.**
- **The central bank also conceded more loudly the negative impact on household consumption from the adjustment in housing markets.**
- **The downside risks to the world economy combined with the uncertainty and profusion of risks to the consumer-spending outlook in Australia suggests the next move from the RBA is a cut.**
- **Our preferred timing for rate cuts this year is August and November.**

The Reserve Bank (RBA) left the cash rate unchanged at 1.50% after its Board meeting today. This decision was widely expected. The RBA has not shifted the cash rate since August of 2016. However, the time may be approaching for the RBA to shift the gears.

Indeed, it appeared the RBA may be putting us on notice for a potential shift in its stance. In the final paragraph, the statement said “the Board judged that it was appropriate to hold the stance of policy unchanged at this meeting”. This sentence stopped here whereas previously this sentence continued to explicitly link this with being consistent with sustainable growth in the economy and achieving the inflation target over time”. It is a subtle change, but we feel that it is a very important and critical one; it is a hint to financial markets that they are on hold for now, but perhaps not for much longer.

Moreover, the RBA added that “it will continue to monitor developments”, suggesting to us that the policy outlook has become more uncertain, data dependent and open to near-term change.

We continue to expect rate cuts in the second half of this year.

The other major changes were largely reserved for the paragraph on the Australian economic growth outlook, which starts with the RBA acknowledging the dichotomy between weaker GDP growth and stronger labour market outcomes. This dichotomy is interesting and is what currently divides the economists in the rate-cut camp from those in the on-hold camp. But employment growth is a lagging economic indicator, as it takes time for firms’ hiring decisions to respond to economic conditions.

The RBA then proceeds to state that GDP rose by just 0.2% in the December quarter to be 2.3% higher over 2018. The RBA also omitted its “central scenario” for the “Australian economy to grow by around 3% this year”. The inclusion of a weak growth outcome combined with the deletion of the above-trend growth forecast is significant, suggesting the RBA is less encouraged by the Australian economic outlook.

This paragraph on growth was also interesting because the RBA conceded more loudly the negative impact on household consumption from the adjustment in housing markets. For much of 2018, RBA rhetoric suggested they were of the view the impact from weaker dwelling prices would have only a minimal impact on household consumption.

Also noteworthy is that where the RBA described the factors supporting growth, it described private investment as being in an “upswing” rather than “rising” as it did previously. It suggests the RBA is more confident of the business investment outlook, despite the fragile sentiment expressed in business surveys.

On inflation, the RBA repeated the central scenario is for underlying inflation to be 2% this year and 2¼% in 2020. In the near term, the RBA continues to expect headline inflation to decline, but today the RBA inserted that it expects “underlying inflation…to remain broadly stable”.

In its characterisation of the world economy, the RBA added that growth in international trade has declined and investment intentions have softened in a number of countries. This addition suggests the downside risks to the global economy have grown in the mind of RBA policymakers.

The downside risks to the world economy combined with the uncertainty and profusion of risks to the consumer-spending outlook in Australia suggests the next move from the RBA is a cut. Our preferred timing for rate cuts this year is August and November.

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