Interest Rate Outlook

bankSA

Tuesday, 3 July 2018

RBA's Benchwarmers

- **The Reserve Bank (RBA) left the cash rate unchanged at 1.50% at its board meeting today as widely expected.**
- **In the accompanying statement there was recognition of some rising downside risks.**
- **Globally, the RBA highlighted the uncertainty with regards to international trade policy and also strains in emerging market economies.**
- **There was also acknowledgement of the weaker housing conditions, particularly in Sydney and Melbourne. The RBA notes that "lending standards are tighter than they were a few years ago" and also makes mention of the increase in short-term wholesale interest rates in recent months.**
- **There was however, a slightly more upbeat tone on the labour market – the RBA states that the outlook "remains positive". The RBA points to the high vacancy rate and elevated forward-looking indicators. Indeed, job ads and vacancies suggest strong employment growth over coming months, and support the view that the unemployment rate will fall over time**
- **The RBA has continued to highlight the importance of the labour market in its interest-rate-setting decisions. Expectations that job growth will be sufficient to bring down the unemployment rate, albeit slowly, continues to suggest that the next move in the cash rate will be higher. However, spare capacity is likely to continue for some time, and suggest limited upward pressure on wages.**
- **There are increasing downside risks emanating from the global economy and domestically, from the housing sector. Moreover, the risk of a tightening of lending standards and recent upward pressure on wholesale funding costs highlighted by the RBA today further points to a risk that a rate hike will be later rather than sooner. We expect the RBA will leave rates on hold for an extended period.**

The Reserve Bank of Australia (RBA) board left the official cash rate on hold at 1.50% as widely anticipated. Unsurprisingly, the language of today's statement did not suggest any shift to the RBA's stance that the cash rate is unlikely to move any time soon. Again, the RBA reiterated that progress would be "gradual" in reducing unemployment a return for inflation back to target.

In the accompanying statement there was recognition of some rising downside risks.

Globally, the RBA highlighted the uncertainty with regards to international trade policy and also strains in emerging market economies. Its assessment on the global economy also shifted slightly - the RBA characterises the global economic expansion as "continuing" instead of having "strengthened over the past year" in its previous statement.

There was also acknowledgement of the weaker housing conditions, particularly in Sydney and

Melbourne. The RBA notes that “lending standards are tighter than they were a few years ago” and also makes mention of the increase in short-term wholesale interest rates in recent months.

There was however, a slightly more upbeat tone on the labour market – the RBA states that the outlook “remains positive”. The RBA points to the high vacancy rate and elevated forward-looking indicators. Indeed, job ads and vacancies suggest strong employment growth over coming months, and support the view that the unemployment rate will fall over time. In addition, while the RBA references some employers finding it difficult to hire skilled workers in its previous statement, the RBA today notes that there are “increasing reports” of skill shortages in some areas”.

The RBA remained upbeat on domestic economic growth more broadly, noting that recent data had continued to be “consistent with the Bank’s central forecast for GDP growth to average a bit above 3 per cent in 2018 and 2019”.

On the Australian dollar, the RBA dropped the comment that “an appreciating exchange rate would be expected to result in a slower pick-up in economic activity and inflation than currently forecast”. This might suggest the RBA is less concerned with a potential appreciation in the Australian dollar given its depreciation over recent months.

Outlook and Implications

The RBA has continued to highlight the importance of the labour market in its interest-rate-setting decisions. Expectations that job growth will be sufficient to bring down the unemployment rate, albeit slowly, continues to suggest that the next move in the cash rate will be higher. However, spare capacity is likely to continue for some time, and suggest limited upward pressure on wages.

There are increasing downside risks emanating from the global economy and domestically, from the housing sector. Moreover, the risk of a tightening of lending standards and recent upward pressure on wholesale funding costs highlighted by the RBA today further points to a risk that a rate hike will be later rather than sooner. We expect the RBA will leave rates on hold for an extended period.

Janu Chan, Senior Economist
Ph: 02-8253-0898

Contact Listing

Chief Economist	Senior Economist	Senior Economist
Besa Deda	Josephine Horton	Janu Chan
dedab@stgeorge.com.au	hortonj@stgeorge.com.au	chanj@stgeorge.com.au
(02) 8254 3251	(02) 8253 6696	(02) 8253 0898