Tuesday, 4 October 2016

RBA Leaves Cash Rate At 1.50%

- **The RBA left its cash rate at 1.50% at its October meeting as widely expected by financial markets. It followed reductions in the cash rate by 25 basis points in both May and August.**
- **It was the first statement by the newly instilled RBA Governor Lowe. While there was more detail, the overall tone was broadly similar to the Statement in September – that conditions are uneven and inflation remains low.**
- **Over recent months, the RBA has repeatedly emphasised flexibility around the 2-3% inflation target band. This would suggest that the RBA is not inclined to excessively reduce rates. However, there is still a mandate to keep inflation within its target "over time". We continue to have doubts that inflation would feasibly return to its target before end 2017, at the earliest.**
- **The RBA remains relatively sanguine regarding the housing market, although price growth in "some markets have strengthened recently". If the RBA wanted to lower rates further, these comments suggest that at present, financial stability concerns are not a major hurdle.**
- **A pickup in inflation would likely require a further reduction in the unemployment rate, a pickup in wages and a sustained period of above trend economic growth. Global conditions also continue to be conducive to a very low inflation environment. These conditions may force the RBA to reduce interest rates further and as such, we expect the RBA will lower the cash rate to as low as 1.0% by mid next year.**
- **The timing of when the RBA will lower rates is however, a bit uncertain. This month's Statement did not highlight the importance of the CPI release as they did in July prior to the August decision to cut rates. However, we view the CPI data as still a critical piece of information ahead of the November decision, which will be released on 26 October.**

The RBA left its cash rate at 1.50% at its October meeting as widely expected by financial markets. It followed reductions in the cash rate by 25 basis points in both May and August.

It was the first statement by the newly instilled RBA Governor Philip Lowe. While there was more detail, the overall tone was broadly similar to the Statement in September – that conditions are uneven and inflation remains low. The Statement was open regarding a signal on near-term rates.

Of interest was the comment that "inflation remains below most central banks' targets". The RBA appears to be highlighting that low inflation is a global phenomenon. Australia is not the only country where inflation is running below the central bank's target, and the statement might be emphasizing that Australia's 2-3% per annum target is flexible.

On economic conditions, the RBA remained mostly cautious. Australian economic growth was growing at "a moderate rate". Positives were in "residential construction, public demand and exports". The statement was more downbeat on household consumption which "appears to have slowed a little recently".

The labour market continued to be "mixed", recognising that the unemployment rate had fallen, but that there was "considerable variation in employment growth across the country".

The RBA remained relatively sanguine regarding the housing market, noting that "growth in lending has slowed" and turnover had declined. Price growth was "lower than it was a year ago, although some markets have strengthened recently". If the RBA wanted to lower rates further, these comments suggest that at present, financial stability concerns are not a major hurdle.

On the Australian dollar, there was an added comment that "the lower exchange rate since 2013 had been helping the traded sector". The note that "an appreciating exchange rate could complicate this" remained.

Outlook for Monetary Policy

The RBA has repeatedly emphasised flexibility around the 2-3% inflation target band over recent months. This would suggest that the RBA is not inclined to excessively reduce rates even though headline inflation is at an annual pace of 1.0% and underlying inflation stands at 1.5%.

However, there is still a mandate to keep inflation within its target "over time". We continue to have doubts that inflation would feasibly return to its target anytime soon, and may not occur until the end of 2017, at the earliest.

A pickup in inflation would likely require a further reduction in the unemployment rate, a pickup in wages and a sustained period of above trend economic growth. Global conditions also continue to be conducive to a very low inflation environment.

These global conditions may force the RBA to reduce interest rates further and as such, we expect the RBA will lower the cash rate to as low as 1.0% by mid next year.

The timing of when the RBA will lower rates is however, uncertain. This month's Statement did not highlight the importance of the CPI release as they did in July prior to the August decision to cut rates. However, we view the CPI data, which will be released on 26 October, as still a critical piece of information ahead of the November decision.

The one page text of the Governor's Statement can be found at http://www.rba.gov.au/

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