RBA – Steady As She Goes

- **The RBA left the cash rate unchanged at 2.0% as widely expected at its April board meeting today. Moreover, the accompanying Statement provides a slightly more positive tone than seen in March.**
- **The positive tone of the Statement extended to the domestic economy. Like us they believe there are 'reasonable prospects for continued growth in the economy.'**
- **The RBA's comments on the AUD were eagerly anticipated. It settled for noting that the recent rise in the AUD 'could complicate the adjustment under way in the economy.' They did not say they expected the AUD to fall or that it was out of step with fundamentals. We would have said that the rise in the AUD was unhelpful, but it amounts to roughly the same sentiment.**
- **Low interest rates are supporting demand and the RBA's concerns over rapidly rising house prices seem to be abating following supervisory measures by APRA. Business borrowing has picked up and inflation remains low. Yes, the economy could be in better shape, but considering the trauma in the manufacturing sector and the decline in mining investment, the economy is in reasonable shape.**
- **There was little to suggest that the RBA has changed its stance in monetary policy. We continue to expect that the RBA will leave rates on hold throughout 2016. We do not believe that the RBA would cut the cash rate simply to target the AUD but a rise in the AUD without a corresponding rise in commodity prices would give them pause for thought. A run of consistently weak data would increase the risk of a rate cut but this is not our base case.**

The RBA left the cash rate unchanged at 2.0% as widely expected at its April board meeting.

The accompanying Statement was broadly positive on the outlook for the global and the domestic economies. One could almost sense the RBA's relief that the early 2016 market turbulence has abated and that financial market sentiment has improved.

That does not mean that it's 'all good'. The policy settings of the 'major jurisdictions' are described as 'remarkably accommodative'. Negative interest rates in Japan, quantitative easing in Europe and a very cautious approach from the US Fed leaves the RBA and other observers wondering how the low interest rate environment will play out. How would markets react to a second US rate hike?

The RBA's comments on the AUD were eagerly anticipated. It settled for noting that the recent rise in the AUD 'could complicate the adjustment under way in the economy.' They did not say they expected the AUD to fall or that it was out of step with fundamentals. We would have said that the rise in the AUD was unhelpful, but it amounts to roughly the same sentiment.

We expect the AUD will struggle to move higher again. Much will depend upon commodity prices and the path of US interest rates. At some stage we expect the US Fed to lift its rates which in turn should put some downward pressure on the AUD. Further rises in commodity prices would most likely require stronger global growth than currently expected or an unexpected and severe disruption to supplies.

The positive tone of the Statement extended to the domestic economy. Like us, the RBA believes there are 'reasonable prospects for continued growth in the economy.'

Low interest rates are supporting demand and the RBA's concerns over rapidly rising house prices seem to be abating following supervisory measures by APRA. Business borrowing has picked up and inflation remains low. Yes, the economy could be in better shape, but considering the trauma in the manufacturing sector and the decline in mining investment, the economy is in reasonable shape.

If activity slows significantly, the RBA could step in and cut the cash rate. Unlike other jurisdictions, the RBA still has 200 basis points to play with. This, however, is not our base case. In the current environment little would be achieved by cutting 25 basis points. It also risks sending the wrong message regarding the health of the economy.

Outlook for Monetary Policy

We continue to expect that the RBA will leave rates on hold throughout 2016. We do not believe that the RBA would cut the cash rate simply to target the AUD but a rise in the AUD without a corresponding rise in commodity prices would give them pause for thought. A run of consistently weak data would increase the risk of a rate cut but this is not our base case.

Unhelpful global developments would pose a downside risk but markets appear to have overcome their early 2016 jitters and real economic activity continues to point to modest but positive growth.

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

Hans Kunnen, Chief Economist
Ph: 02-8254-8322

Contact Listing

Chief Economist	Senior Economist	Senior Economist
Hans Kunnen	Josephine Horton	Janu Chan
kunnenh@stgeorge.com.au	hortonj@stgeorge.com.au	chanj@stgeorge.com.au
(02) 8254 8322	(02) 8253 6696	(02) 8253 0898