Interest Rate Outlook

bankSA

Tuesday, 6 August 2019

RBA Cash Rate Outlook

The RBA on Standby

- **The Reserve Bank (RBA) left the official cash rate unchanged at 1.0% at its August meeting after back-to-back cuts over June and July. The decision was widely expected by markets.**
- **The RBA has reiterated that it would "continue to monitor developments in the labour market closely and ease monetary policy further if needed." The RBA remains on standby, continuing to leave the door open for more easing.**
- **There was only a small acknowledgement of the rapid deterioration in trade tensions between the US and China over the past few days. The RBA notes that there was "increased uncertainty" in regard to trade and technology disputes and it adds that "risks to the global economy remain tilted to the downside".**
- **In regards to the Australian economic outlook, the RBA's language suggests it is seeing the glass as half full. The RBA states economic growth is expected to "strengthen gradually". It references "lower interest rates, recent tax cuts, ongoing spending on infrastructure, signs of stabilising in some housing markets and a brighter outlook for the resources sector" as factors supporting the economic outlook.**
- **The RBA's growth forecasts of 2.5% in 2019 and 2.75% in 2020 suggest economic growth running at a below-trend pace this year, and returning to trend in 2020. We will gain further detail into the RBA's thinking and forecasts in its quarterly Statement on Monetary policy, which will be released on Friday, after the Governor delivers his semi-annual testimony.**
- **The RBA may be on the pause button for easing monetary policy, but we do not think it will be there for long. The support to economic growth is unlikely to be enough to drive a turnaround in the labour market sufficient to bring the unemployment rate down. The events over the past couple of days on trade further suggest increased downside risks to the global outlook.**
- **The RBA is continuing to indicate that it would lower official interest rates again "if needed". A softening in employment conditions and the deteriorating global growth outlook suggests the RBA could see this need within the next few months. We continue to favour October as the timing for the next rate cut, but could not rule out September, particularly if employment disappoints and the global environment continues to deteriorate.**

The Reserve Bank (RBA) left the official cash rate unchanged at 1.0% at its August meeting after back-to-back cuts over June and July. The decision was widely expected by markets.

The RBA has reiterated that it would "continue to monitor developments in the labour market closely and ease monetary policy further if needed." The RBA remains on standby, continuing to leave the door open for more easing.

The RBA also inserted the forward guidance that "it is reasonable to expect that an extended period of low interest rates will be required". A similar phrase was stated by Lowe in a speech last month.

There was only a small acknowledgement of the rapid deterioration in trade tensions between the US and China over the past few days. The RBA notes that there was "increased uncertainty" in regard to trade and technology disputes instead of "uncertainty" previously, and it adds that "risks to the global economy remain tilted to the downside".

In regards to the Australian economic outlook, the RBA's language suggests it is seeing the glass as half full. The RBA states that economic growth is expected to "strengthen gradually". It references "lower interest rates, recent tax cuts, ongoing spending on infrastructure, signs of stabilising in some housing markets and a brighter outlook for the resources sector" as factors supporting the economic outlook.

Nonetheless, the RBA's growth forecasts of 2.5% in 2019 and 2.75% in 2020 suggests economic growth running at a below-trend pace this year, and returning to trend in 2020.

Moreover, we continue to see downside risks, particularly given the ongoing uncertainty with regards to trade tensions and the loss of momentum in the global economy.

Without the economic growth strengthening to a pace above trend, it is difficult to envisage an unemployment rate falling by enough to support wage growth and inflation returning back to the RBA's 2 to 3 percent target band any time soon.

Indeed, the RBA points to "little inroad into the spare capacity in the labour market recently" but there doesn't seem to be much reassurance to how the RBA's central scenario would result in the unemployment rate to "decline over the next couple of years to around 5 per cent", as the RBA has forecast.

We will gain further detail into the RBA's thinking and forecasts in its quarterly Statement on Monetary policy which will be released on Friday, after the Governor delivers his semi-annual testimony to Parliament.

On the housing market, the RBA remains cautious, noting that overall housing conditions "remained soft" but "there are some signs of a turnaround, especially in Sydney and Melbourne".

Outlook and Implications

The RBA may be on the pause button for easing monetary policy, but we do not think it will be there for long. The growth outlook, particularly for consumer spending, does look better from the second half of 2019. But this improvement is coming from a very low starting point – retail spending (volumes) grew at their slowest annual pace since 1991, when the economy was in recession.

The support to economic growth is unlikely to be enough to drive a turnaround in the labour market in order to bring the unemployment rate down.

The events over the past couple of days in trade developments further suggest increased downside risks to the global outlook.

The RBA is continuing to indicate that it would lower official interest rates again "if needed". A softening in employment conditions and the deteriorating global growth outlook suggests the RBA could see this need become a reality within the next few months. We continue to favour October as the timing for the next rate cut, but could not rule out September, particularly if employment disappoints and the global environment continues to deteriorate.

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

Contact Listing

Chief Economist

Besa Deda
dedab@banksa.com.au
(02) 8254 3251

Senior Economist

Janu Chan
chanj@banksa.com.au
(02) 8253 0898

BankSA Financial Markets

(08) 8424 4305