Interest Rate Outlook

bankSA

Tuesday, 2 August 2016

RBA Cuts Cash Rate to 1.50%

- **The RBA lowered the official cash rate to 1.50% at its August board meeting by 25 basis points, stating that "prospects for sustainable growth in the economy, with inflation returning to target over time, would be improved by easing monetary policy at his meeting". It follows a 25 basis point cut at its May board meeting two months ago.**
- **It appears that slower lending growth for housing was a factor behind the decision. Additionally, the low inflation outlook was the other major factor.**
- **The question everyone is asking is "will this rate cut make a difference?" In helping to bring inflation back to target, the answer is probably not a lot! Rate cuts at this stage of the cycle may mean a lower exchange rate than otherwise. However, there are global factors which are helping to keep down inflation and there appears to be no impediments to obtaining financing to those who want to borrow.**
- **It also appears that one of the hurdles which had been preventing the RBA from cutting rates – a strong housing market – has moderated. If housing continues to moderate and with not much prospect for inflation or domestic growth to pick up sufficiently, there remains a risk that the RBA is not done cutting rates in this cycle.**

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It appears that slower lending growth for housing was a factor behind the decision. The RBA stated that "the likelihood of lower interest rates exacerbating risks in the housing market has diminished". Additionally, the low inflation outlook was the other major factor. The RBA stated that "recent data confirmed that inflation remains quite low".

The balanced, but cautious view of previous commentary was largely repeated. On the domestic economy, the RBA saw that growth was "continuing at a moderate pace, despite a very large decline in business investment". Labour market indicators were "somewhat mixed, but consistent with a modest pace of expansion in employment in the near term".

There was no mention of an update to the RBA's growth or inflation forecasts. We will have to wait until Friday when the RBA publishes its Statement on Monetary Policy to gauge the outlook for economic growth and inflation.

Outlook for Monetary Policy

The question everyone is asking is "will this rate cut make a difference?" In helping to bring inflation back to target, the answer is probably not a lot! Rate cuts at this stage of the cycle may mean a lower exchange rate than otherwise and this may contribute towards lifting the prices of imported goods and services. However, there are global factors which are helping to keep down inflation and there appears to be no impediments to obtaining financing to those who want to borrow.

This could mean one of two things for the RBA cash rate outlook. Firstly, the RBA believes that there is not much more that it can do to boost growth and inflation and will avoid lowering official interest rates unless there is a strong case to do so. Alternatively, the RBA could continually keep cutting rates with little impact on the domestic economy, but keeping in step with other central banks. After cutting official interest rates today, the latter appears like the more likely scenario.

On a more optimistic note, we are seeing signs that non-mining activity has continued to improve, and prospects that the labour market will be strong enough to see the unemployment rate remain broadly steady.

However, for inflation to pickup, we may need to see a further reduction in the unemployment rate, and a pickup in wages. This would require a sustained period of above trend economic growth.

It also appears that one of the hurdles which had been preventing the RBA from cutting rates- a strong housing market – has moderated. If housing continues to moderate and inflation remains well below target, there remains a risk that the RBA is not done cutting rates in this cycle.

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

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