Interest Rate Outlook

bankSA

Tuesday, 3 May 2016

RBA – Will This Help?

- **The RBA lowered the cash rate by 25 basis points to 1.75% following its May board meeting.**
- **The accompanying Statement highlighted lower than expected inflation, some softening in the outlook for the global economy and the mixed labour market data of late, as reasons for their decision.**
- **In the past, concern over strong growth in housing prices appears to have restrained the RBA from cutting the cash rate. Those concerns have now been dampened.**
- **While the rate cut has the potential to take some pressure off those holding variable rate debt, one could question its ability to lift business investment – the missing link in the adjustment process.**
- **The immediate impact of the rate cut was to send the Australian dollar from 77.06 US cents just prior to the announcement, to 75.57 US cents a minute later. Unless commodity prices rally or the US Federal Reserve rules out further rate hikes, it is difficult to see the AUD regaining the levels seen in mid-April.**
- **We expect the RBA will hold fire for the next few months. The Governor's Statement provided no future guidance. Given its concerns regarding the global and domestic economies and its expectations for inflation, we expect that the RBA will wait to see what emerges from the data. A further rate cut remains possible but most likely not at the next meeting. By July, the RBA will have seen new data on the labour market, the national accounts and inflation.**

The RBA lowered the cash rate by 25 basis points to 1.75% following its May board meeting.

While we expected the RBA to remain on hold, the RBA argued that the reduction would improve the prospects for sustainable growth in the economy.

The accompanying Statement highlighted the impact on their thinking of lower than expected inflation, some softening in the outlook for the global economy and the mixed labour market data of late. The RBA also reiterated that the firmer Australian dollar over the past few months was a factor complicating the economy's adjustment following the end of the mining investment boom.

In the past, concern over strong growth in housing prices appears to have restrained the RBA from cutting the cash rate. With some moderation in house price growth, following measures taken by authorities, those concerns have been dampened and helped pave the way for today's rate cut.

While the rate cut has the potential to take some pressure off those holding variable rate debt, one could question its ability to lift business investment – the missing link in the adjustment process. Will the rate cut really stimulate demand or is monetary policy in Australia approaching the limits of its effectiveness? We fear this may be the case.

How will today's Statement be perceived by the wider public? Is it a sign that the Australian economy is in trouble and in need of assistance? Should we be concerned that unemployment will take a turn for the worse? Should we be lifting our precautionary savings? None of these things would be helpful in generating sustainable growth. Hopefully, tonight's Budget will provide a positive jolt to business and consumer confidence.

The immediate impact of the rate cut was to send the Australian dollar from 77.06 US cents just prior to the announcement, to 75.57 US cents a minute later. Unless commodity prices rally or the US Federal Reserve rules out further rate hikes, it is difficult to see the AUD regaining the levels seen in mid-April.

With inflation, or the lack of it, apparently at the heart of today's decision, the next few CPI results will take on even greater significance. The RBA appears to expect that core inflation will remain weak. Low wage growth supports this view and we eagerly await Friday's Statement on Monetary Policy which will provide more detail on the RBA's forecasts for both inflation and economic growth.

Outlook for Monetary Policy

We expect the RBA will hold fire for the next few months. The Governor's Statement provided no future guidance. Given its concerns regarding the global and domestic economies and its expectations for inflation, we expect that the RBA will wait to see what emerges from the data.

A further rate cut remains possible but most likely not at the next meeting. By July, the RBA will have seen new data on the labour market, the national accounts and inflation.

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