Interest Rate Outlook

Tuesday, 20 February 2018

Bank of Melbourne

Minutes of the February RBA Board Meeting

The RBA Assesses Progress

- **There were not many surprises in the minutes of the Reserve Bank (RBA) Board meeting in February given the wide range of RBA commentary over the past few weeks.**
- **It was however, a broadly positive statement, and one gets the sense that the RBA is becoming more confident in the Australian economy, particularly in comparison to the end of last year. There was use of the word "progress" twice in the final paragraphs of the minutes in reducing unemployment and bringing inflation closer to target.**
- **The increased optimism was obvious with the global economy, where "global GDP growth in 2017 had exceeded expectations of most forecasters". The RBA board also notes that global growth could "continue to surprise on the upside, given the synchronised nature of the current upturn".**
- **Domestically, the RBA continues to be more upbeat with regards to the outlook for business investment and the labour market, but continues to highlight downside risks to household consumption.**
- **The RBA also notes the "stronger than expected" indicators on the labour market, but that spare capacity would remain.**
- **There is "progress" in achieving the RBA's inflation outlook and reducing spare capacity over time. However, given that spare capacity is expected to persist for some time, and the uncertainty around how the labour market, wages and inflation will respond suggests the RBA is not close to raising rates any time soon.**
- **The responsiveness of wage and inflation pressures to strength of the labour market will be key factors in determining when and how fast the RBA starts its tightening cycle. We continue to expect that the RBA will leave rates unchanged for all of 2018.**

The minutes of the Reserve Bank (RBA) Board meeting in February was mostly a repeat of the sentiment expressed in a range of commentary over the past few weeks.

It was however, a broadly positive statement, and one gets the sense that the RBA is becoming more confident in the Australian economy, particularly in comparison to the end of last year. There was use of the word "progress" twice in the final paragraphs of the minutes in reducing unemployment and bringing inflation closer to target.

The increased optimism was with the global economy, where "global GDP growth in 2017 had exceeded expectations of most forecasters." The RBA board also notes that global growth could "continue to surprise on the upside, given the synchronised nature of the current upturn".

Domestically, the RBA is becoming increasingly more upbeat for business investment, noting that "prospects for private non-mining investment were more positive than they had been for some time".

The uncertainties surrounding spare capacity, wages and inflation that was raised in recent RBA commentary over the past few weeks continued to be evident in the minutes today.

The RBA also continued to highlight downside risks to household consumption, given weak growth in household incomes. Indeed, we view household spending as one of the key risks to the domestic growth outlook.

The RBA also notes the "stronger than expected" indicators on the labour market, but that spare capacity would remain. Members did note that "uncertainty remained about how employers would respond as spare capacity in the labour market diminished. Indeed, it was possible that ongoing strength in the demand for labour might result in wage growth picking up by more than anticipated, both in Australia and abroad".

Despite the more positive outlook for the global economy, the RBA states that "terms of trade were still expected to decline over the following two years, partly reflecting prospective increases in low-cost supplies of bulk commodities".

Implications

We have had a range of commentary from the RBA in recent weeks. Today's minutes confirm that the RBA is increasingly upbeat regarding the international economy and elements of the domestic outlook.

Business investment and public sector investment remain supportive factors, but household spending remains a downside risk.

There is "progress" in achieving the RBA's inflation outlook and reducing spare capacity over time. However, given that spare capacity is expected to persist for some time, and the uncertainty around how the labour market, wages and inflation will respond suggests the RBA is not close to raising rates any time soon.

The responsiveness of wage and inflation pressures to strength of the labour market will be key factors in determining when and how fast the RBA starts its tightening cycle. We continue to expect that the RBA will leave rates unchanged for all of 2018.

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

Contact Listing

Chief Economist	Senior Economist	Senior Economist
Besa Deda	Josephine Horton	Janu Chan
dedab@bankofmelbourne.com.au	hortonj@bankofmelbourne.com.au	chanj@bankofmelbourne.com.au
(02) 8254 3251	(02) 8253 6696	(02) 8253 0898