

THE CASH RATE OUTLOOK

Glenn Stevens' Testimony to Parliament

Friday, 24 February 2012

- Glenn Stevens' testimony to Parliament was a balanced assessment of the economy and its outlook. The RBA seems satisfied with current monetary policy setting. Stevens also seemed comfortable with the current level of commercial lending rates.
- On the Australian dollar, Stevens commented that the currency's strength was "a bit odd" given that the terms of trade had peaked and was now falling. Stevens said that the RBA had not intervened to hold down the Australian dollar, but he did not rule out any future intervention.
- Given that the RBA is expecting growth near trend, inflation consistent with their target and its assessment of risks roughly balanced, the RBA continues to provide little sense of urgency in cutting rates. We expect that the RBA will keep rates on hold until May.

Glenn Stevens' Testimony to parliament continued to present a balanced assessment of the economy and its outlook. It was very similar in tone to recent commentary in its February Statement on Monetary Policy.

Stevens confirmed that he was satisfied with current monetary policy setting saying that, "with growth near trend, inflation consistent with the target, interest rates about average and an outlook suggesting more of the same, the setting of policy was about right for the moment." Stevens also seemed comfortable with the current level of commercial lending rates despite these rising in recent weeks. He expressed surprise that lending rates were fully passed on after the RBA cut rates in December by 25 bps.

Stevens commended the actions of the European Central Bank (ECB) in its efforts to stabilise financial conditions and removed "questions over the funding of European banks." But he also recognised that problems in Europe will be around for some time.

On the outlook for the global economy in general, Stevens said that the RBA was expecting global growth below average, but was generally quite positive on the US and China.

Stevens also placed emphasis on the positives facing the domestic economy. These include the fact that Australia was in a long upswing, unemployment was low, government finances are strong and our banking sector was healthy.

On the Australian dollar, Stevens commented that the currency's strength was "a bit odd" given that the terms of trade had peaked and was now falling. Stevens said that the RBA had not intervened to hold down the Australian dollar, but he did not rule out any future intervention. That said, the RBA has previously justified the Australian dollar's current strength as being due to offshore purchases of Australian sovereign debt.

On employment, the Reserve Bank (RBA) expects that the unemployment rate will rise to a around 5.5% over the course of this year before declining. This reflects some caution by businesses in hiring. Meanwhile, the pace of wage growth was in line with the RBA's expectations, but Stevens said he would be "a bit uncomfortable if it materially accelerates."

Rates Outlook

Given that the RBA is expecting growth near trend, inflation consistent with their target and its assessment of risks roughly balanced, the RBA continues to provide little sense of urgency in cutting rates. As in recent commentary, the RBA is quite comfortable with the current setting of monetary policy and therefore we expect that the RBA will keep rates on hold until May.

Janu Chan, Economist
Ph: (02) 9320-5892

Contacts List

Contacts List

Economics Group

Chief Economist	Besa Deda	dedab@bankofmelbourne.com.au	(02) 9320 5854
Senior Economist	Josephine Heffernan	heffernanj@bankofmelbourne.com.au	(02) 9320 5751
Economist	Janu Chan	chanj@bankofmelbourne.com.au	(02) 9320 5892

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