Tuesday, 1 July 2014

RBA Cash Rate held at 2.50%

- **The RBA's statement following its July interest rate decision was almost a 'cut and paste' of its comments in June. However, it appeared to have a slightly more positive tone than the minutes of the June meeting.**
- **The statement noted that growth was only a little below trend and that exports made a solid contribution to the March quarter GDP results. The RBA also acknowledged the modest pick-up in credit growth to business as well as firm conditions in the housing construction sector.**
- **One can almost feel the sense of frustration within the RBA regarding the relative strength of the AUD. A lower AUD would assist the economy rebalance itself as resource investment subsides. The AUD is lower than it was two years ago but the recent move back above $US 94 cents is limiting its support for the economy.**
- **The RBA's outlook for inflation is benign with inflation expected to stay broadly within the 2-3% range. Weak wage growth should keep inflation for domestically produced goods and services under control and the risk of elevated imported inflation has fallen with the resilience of the AUD.**
- **Monetary policy remains accommodative. We expect the RBA will leave rates on hold for the rest of this year before looking to raise them late in the first quarter of 2015.**

RBA Statement: At its meeting today, the Board decided to leave the cash rate unchanged at 2.5 per cent.

Growth in the global economy is continuing at a moderate pace, helped by firmer conditions in the advanced countries. China's growth slowed a little earlier in the year but remains generally in line with policymakers' objectives. Commodity prices in historical terms remain high, but some of those important to Australia have declined.

Our view: *We concur with the RBA. Global growth is moderate. The US is recovering on the back of low interest rates and cheaper energy. It has also created more jobs in the past few years than were lost during the GFC. China continues to growth at a solid pace but commodity prices have fallen at a time when export volumes are increasing. Slow, synchronised global growth is a positive for the Australian economy.*

RBA Statement: Financial conditions overall remain very accommodative. Long-term interest rates and risk spreads remain low. Emerging market economies are once again receiving capital inflows. Volatility in many financial prices is currently unusually low. Markets appear to be attaching a very low probability to any rise in global interest rates over the period ahead

Our view: *Despite the modest pick-up in global growth, longer-term interest rates remain low. This stems from low inflation and the possibility of easier monetary policy in Europe. Rises in official interest rates in the US and mainland Europe are still some way off although it appears as if the UK is set to lift rates before the end of the year. It will require stronger growth in the US and Europe for official rates to increase but a tightening of US policy cannot be ruled out in the first half of 2015. The risk remains that longer term rates could move up as US growth takes hold.*

RBA Statement: In Australia, recent data indicate somewhat firmer growth around the turn of the year, but this resulted mainly from very strong increases in resource exports as new capacity came on stream; smaller increases in such exports are likely in coming quarters. Moderate growth has been occurring in consumer demand. A strong expansion in housing construction is now under way. At the same time, resources sector investment spending is starting to decline significantly. Signs of improvement in investment intentions in some other sectors are emerging, but these plans remain tentative as firms wait for more evidence of improved conditions before committing to significant expansion. Public spending is scheduled to be subdued. Overall, the Bank still expects growth to be a little below trend over the year ahead.

Our view: *The RBA appears more upbeat than last month about conditions in the first half of 2014. The firm March quarter GDP numbers showed a strong contribution to growth from exports, a result that may not be replicated in the second quarter. The negative impact of lower public spending is again noted but growth remains positive, even though it is a little below trend. This language does not suggest that the RBA is likely to cut rates in the near term.*

RBA Statement: There has been some improvement in indicators for the labour market in recent months, but it will probably be some time yet before unemployment declines consistently. Growth in wages has declined noticeably. If these and other domestic costs remain contained, inflation should remain consistent with the target over the next one to two years, even with lower levels of the exchange rate.

Our view: *The RBA remains relatively upbeat on the labour market. Its note on wages growth suggests that inflation will remain subdued. We believe the unemployment rate could edge a little higher as domestic demand remains below trend and that inflation will be within the RBA's comfort zone.*

RBA Statement: Monetary policy remains accommodative. Interest rates are very low and for some borrowers have edged lower over recent months. Savers continue to look for higher returns in response to low rates on safe instruments. Credit growth has picked up a little, including most recently to businesses. Dwelling prices have increased significantly over the past year, though there have been some signs of a moderation in the pace of increase recently. The exchange rate remains high by historical standards, particularly given the declines in key commodity prices, and hence is offering less assistance than it might in achieving balanced growth in the economy.

Our view: *Low interest rates are doing what they can to support the economy. There is growing evidence of risk-taking by investors, rising asset prices and a pickup, albeit gradual, in credit growth. The RBA particularly noted that credit growth to business had picked a little. The lower AUD (in a medium term context) will help the economy over time but the impact has been partly nullified by the move of the AUD back up into the $US 94 cent range. AUD still appears high given recent downward moves in commodity prices. We expect the AUD to remain elevated over the next* *few months and finish the year around $US 93 cents.*

RBA Statement: Looking ahead, continued accommodative monetary policy should provide support to demand and help growth to strengthen over time. Inflation is expected to be consistent with the 2–3 per cent target over the next two years.

Our view: *The RBA expects low interest rates to do their job of supporting demand. But it is a slow process. Despite inflation likely to be in the top half of the RBA's target band in Q2 , the RBA seems relaxed about the outlook for inflation.*

RBA Statement: In the Board's judgement, monetary policy is appropriately configured to foster sustainable growth in demand and inflation outcomes consistent with the target. On present indications, the most prudent course is likely to be a period of stability in interest rates.

Our view: *This paragraph is exactly the same as last month. We expect the RBA will leave rates on hold for this year before looking to raise them in the early months of 2015. The ongoing relative strength of the AUD is restraining growth in Australia but not to the point of further reducing the official cash rate.*

Hans Kunnen, Senior Economist
Ph: 02-8254-8322

Contact Listing

Chief Economist

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

Senior Economist

Hans Kunnen
kunnenh@bankofmelbourne.com.au
(02) 8254 8322

Senior Economist

Josephine Horton
hortonj@bankofmelbourne.com.au
(02) 8253 6696

Economist

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