Data Snapshot

Tuesday, 2 July 2013

Bank of Melbourne

Cash Rate unchanged at 2.75%

- The Reserve Bank of Australia (RBA) left the cash rate unchanged at 2.75% at its meeting today as widely expected.
- The commentary noted that the lower AUD will help rebalance the economy. It will do this by encouraging exports and possibly dampening demand for imports.
- The RBA is looking for a pickup in global economic activity in 2014 following an extensive period of low interest rates and monetary stimulus. The RBA also expects the AUD to fall further.
- We believe the RBA will cut its cash rate to 2.50% in August and then leave it at that level for the remainder of the year. The weaker AUD should boost domestic demand and, as yet, we have not seen the full impact of earlier cuts to the cash rate.

Below is the Governor's statement interspersed with our views.

RBA Statement: At its meeting today, the Board decided to leave the cash rate unchanged at 2.75 per cent.

Recent information is consistent with global growth running a bit below average this year, with reasonable prospects of a pick-up next year. Commodity prices have declined further but, overall, remain at high levels by historical standards. Inflation has moderated over recent months in a number of countries.

Our view: The US is growing below trend as its debt issues restrain government spending. However, low energy costs, low interest rates and relatively cheap labour are reinvigorating the manufacturing and housing sectors. Activity in Japan has picked up but Europe remains in the doldrums. Growth in China remains robust but recent attempts to restrain credit growth have generated some uncertainty regarding short term economic growth. We agree that inflation is not a major concern around the globe at present.

RBA Statement: Globally, financial conditions remain very accommodative. However, a reassessment by the market of the outlook for monetary policy in the United States has seen a noticeable rise in sovereign bond yields from exceptionally low levels. Volatility in financial markets has increased and there has been some widening of credit spreads.

Our view: The US is healing itself following the GFC but the pace of growth is modest. The US Federal Reserve is of the view that it can 'taper' its monetary stimulus but has been purposely vague about the timing of such a move. This has created volatility in the AUD and in global markets. It is highly probable that the period of very low bond yields is over.

RBA Statement: In Australia, the recent national accounts confirmed that the economy has been growing a bit below trend over the recent period. This is expected to continue in the near term as the economy adjusts to lower levels of mining investment. The unemployment rate has edged higher over the past year and growth in labour costs has moderated. Inflation has been consistent with the medium-term target and is expected to remain so over the next one to two years, notwithstanding the effects of the recent depreciation of the exchange rate.

Our view: The national accounts data which was released the day after the RBA's last meeting in June revealed growth in the March quarter was consistent with the RBA's forecasts. The RBA makes no mention of the decline in domestic demand. While the weakness in domestic demand remains concerning for the outlook, we can't ignore the traded sector, which contributed a full 1 percentage point to growth in the March quarter. The RBA doesn't seem too concerned about the potential inflationary impact of the weaker Australian dollar.

RBA Statement: The easing in monetary policy over the past 18 months has supported interest-sensitive spending and asset values and further effects can be expected over time. The pace of borrowing has remained relatively subdued, though recently there are signs of increased demand for finance by households.

Our view: There is very little change to this paragraph in comparison to the RBA's previous Statement. Over the past month, there has been further evidence of a recovery in housing. House prices have risen across the country and home loan demand is picking up, particularly among investors. It would be encouraging to see a pickup in non-resource related capital expenditure in the months ahead.

RBA Statement: The Australian dollar has depreciated by around 10 per cent since early April, although it remains at a high level. It is possible that the exchange rate will depreciate further over time, which would help to foster a rebalancing of growth in the economy.

Our view: The RBA has become unusually explicit in its expectations for the Australian dollar. After already witnessing a significant depreciation of the AUD , the RBA is hinting that it wants the Australian dollar to fall further. This is not too surprising, given the RBA expects the terms of trade to also fall.

RBA Statement: At today's meeting the Board judged that the easier financial conditions now in place will contribute to a strengthening of growth over time, consistent with achieving the inflation target. It decided that the stance of monetary policy remained appropriate for the time being. The Board also judged that the inflation outlook, as currently assessed, may provide some scope for further easing, should that be required to support demand.

Our view: *The RBA has left the door open for a further cut in its cash rate. We believe this will occur in August following the next set of inflation numbers. Domestic demand in the last national accounts was relatively soft and is in need of a touch more support. The lower AUD is likely to assist domestic demand but in the meantime a further rate cut would be welcome.*

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The Detail

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