

# CASH RATE OUTLOOK

## RBA Board Meeting: Cash Rate on hold at 3.50%

Tuesday, 3 July 2012

### Key Points

- The Reserve Bank of Australia (RBA) left its official cash rate unchanged at 3.50% following the meeting of its board today
- Economic growth has slowed in the US, Europe and China. Unlike some central banks, the RBA has room to move if the slowdown turns into a global recession.
- Domestically, the RBA seems to be treading cautiously around the recent run of positive economic data. Although the RBA notes that GDP Q1 was stronger than it anticipated and that labour market conditions had improved, the economy was still undergoing structural change and the housing market remains subdued.
- The RBA considers its stance as accommodative with lending rates mildly expansionary.
- We expect ongoing subdued inflation and moderating global growth will give the RBA room to cut its cash rate to 3.25% in August.

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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 3.50 per cent.

Growth in the world economy picked up in the early months of 2012, having slowed in the second half of 2011. But more recent indicators continue to suggest weakening in Europe and a slower pace of growth in China. Conditions in other parts of Asia have recovered from the effects of last year's natural disasters, but the ongoing trend is unclear and could be dampened by the effects of slower growth outside the region. The United States continues to grow at a modest pace. Commodity prices have declined, which is helping to reduce inflation and providing scope for some countries to ease macroeconomic policies. Australia's terms of trade have peaked, though they remain historically high.

**Our view:** *The RBA is pointing out that global economic has slowed and that economic conditions are fragile in the US and Europe. The RBA has scope to cut rates if global economic conditions deteriorate.*

**RBA Statement:** Financial markets have initially responded positively to signs of further progress towards longer-term sustainability in European financial affairs, but Europe will remain a potential source of adverse shocks for some time. While capital markets remain open to corporations and well-rated banks, low appetite for risk has seen long-term interest rates faced by highly rated sovereigns, including Australia, decline to exceptionally low levels. Share markets have remained volatile.

**Our view:** *We were pleased to see moves towards banking unity in Europe but would appreciate seeing the details of changes to arrangements for access to Europe's various stability funds. To date there has been much repackaging of earlier statements of intent, mostly in broad brush form.*

**RBA Statement:** In Australia, recent data suggest that the economy continued to grow in the first part of 2012, at a pace somewhat stronger than had been earlier indicated. Labour market conditions also firmed a little, notwithstanding job shedding in some industries; the rate of unemployment remains low.

***Our view:** The outcome for Q1 GDP was stronger than the RBA anticipated, with GDP rising 1.3% in the quarter. The RBA has also recognised some improvement in labour market conditions following solid gains in employment over the past few months, but notes the structural changes are having a negative impact on some industries.*

**RBA Statement:** There have been no changes to the Bank's outlook for inflation. Over the coming one to two years, and abstracting from the effects of the carbon price, inflation is expected to be consistent with the target. Maintaining low inflation over the longer term will, however, require growth in domestic costs to slow as the effects of the earlier exchange rate appreciation wane.

***Our view:** There has been little data to alter the RBA's outlook on inflation. A key data release however will be Q2 CPI which will be released on 25 July, and will precede the RBA's next meeting in August.*

**RBA Statement:** Interest rates for borrowers have declined, to be a little below their medium-term averages. Business credit has increased more strongly in recent months, though credit growth remains modest overall. The housing market remains subdued. The exchange rate has been volatile recently, but overall remains high.

***Our view:** Interest rates are in mildly expansionary territory, but have yet to have a significant impact on lending, notwithstanding a pickup in business credit. The RBA has also taken caution in reading too much into the latest RP Data house prices which revealed house prices rose 1.0% in June, and today's 27.3% surge in building approvals data. Indeed, housing market conditions are still fragile, and we would need to see further gains in house prices and a more convincing upward trend in building approvals before concluding a turnaround in housing is underway.*

**RBA Statement:** As a result of the sequence of earlier decisions, there has been a material easing in monetary policy over the past six months. At today's meeting, the Board judged that, with inflation expected to be consistent with the target and growth close to trend, but with a more subdued international outlook than was the case a few months ago, the stance of monetary policy remained appropriate.

***Our view:** The trend is the RBA's friend. Despite calls for further easing from those struggling under structural change and / or high levels of debt and calls for higher interest rates from those who fear the effects of the resources boom, the RBA has stood firm. On average, in their eyes and ours, the economy is travelling relatively well. This is not to deny the pain of structural change or the excess of the resources boom. We believe subdued inflation and moderating global growth will give the RBA room to cut in August.*

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