Morning Report

Tuesday, 3 September 2013

Bank of Melbourne

RBA Cash Rate held at 2.50%

- **The Governor's Statement was essentially a 'cut and paste' from the August Statement with the exception of the final paragraph and some minor wording. This month, the Board kept the cash rate on hold.**
- **The message that inflation is well contained both in Australia and overseas was loud and clear. The RBA's aim here might be to dispel fears that quantitative easing or 'money printing' in the US and elsewhere is creating widespread inflation. It isn't.**
- **The RBA's view is that even the decline in the AUD is unlikely to add substantially to Australian inflation given that growth in labour costs is moderating.**
- **The full impact of past cuts to the RBA cash rate have yet to be felt but there is scope to cut rates further if demand weakens or inflation moves well below target.**
- **We expect the cash rate to be cut by 25 basis points in November and then most likely left alone. The data will determine the final outcome.**

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 2.5 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 from their peaks, but generally remain at high levels by historical standards. Inflation in most countries remains well contained.

Our view: *This paragraph is a re-run of last month, but making the point that commodity prices have peaked. Commodity prices will not be going back to the levels seen a few years ago.*

RBA Statement: Overall, global financial conditions remain very accommodative, though the recent reassessment by markets of the outlook for US monetary policy has seen a noticeable rise in sovereign bond yields, from exceptionally low levels. Volatility in financial markets has increased and has affected a number of emerging market economies in particular. Notwithstanding the higher volatility, Australian institutions have ample access to funding markets.

Our view: *Talk of the US Fed 'tapering' its quantitative easing program has unsettled markets. Despite this, Australian institutions are able to access markets due to their solid credit standing. The greatest impact of 'tapering speculation' has been felt by emerging markets some of whom have have seen their currencies decline sharply and their bond yields rise.*

RBA Statement: In Australia, the economy has been growing a bit below trend over the past year.

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. Inflation has been consistent with the medium-term target. With growth in labour costs moderating, this is expected to remain the case over the next one to two years, even with the effects of the recent depreciation of the exchange rate.

Our view: *The Australian economy is growing but at a very sluggish pace – as witnessed by today's subdued retail sales figures. Investment in mining set to decline but investment in housing is picking up. To-date we have not seen the impact of the lower AUD on the broad measure of inflation. Maybe it is yet to come but most likely competition will keep most prices in check.*

RBA Statement: The easing in monetary policy since late 2011 has supported interest-sensitive spending and asset values, and further effects can be expected over time, including from the declines in rates seen over recent months. The pace of borrowing has remained relatively subdued, though recently there are signs of increased demand for finance by households.

Our view: *The recent building approval figures, combined with a firm sharemarket and rising house prices suggest that interest sensitive sectors of the economy are indeed moving. House prices are rising, but nationwide we are far from a housing bubble.*

RBA Statement: The Australian dollar has depreciated by around 15 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 lower AUD will aid economic growth as will the recent cuts in the RBA cash rate. Rebalancing an economy is painful for some as resources move from one area to another. Jobs will be lost in some industries and created in others. We look for the lower AUD to aid exporters and those who compete against imports. Low (and possibly lower) interest rates will assist the building industry and retailers over time.*

RBA Statement: At today's meeting, the Board judged that the setting of monetary policy remained appropriate. The Board will continue to assess the outlook and adjust policy as needed to foster sustainable growth in demand and inflation outcomes consistent with the target.

Our view: *We believe the RBA will need to cut one more time in order to foster sustainable economic growth. Inflation remains well contained.*

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