Tuesday, 5 August 2014

# RBA Cash Rate held at 2.50%

- The RBA's statement following its August interest rate decision was almost a 'cut and paste' of its comments in June and July.
- A "period of stability in interest rates" was again repeated in today's statement, suggesting that the 12-month run of unchanged rates is set to continue for at least a few months longer.
- The commentary on the AUD was also unchanged, although the AUD lifted slightly after the statement. This is not the first occasion the Aussie has lifted on a lack of new commentary suggesting markets keep preparing for the RBA to "talk down" the currency.
- Much like policy makers in the US, the RBA highlighted the complacency of investors in the pricing of risk within financial markets.
- Positive business confidence, a recovery from a soft patch in consumer spending, healthy levels of residential construction and a boom in export volumes should see the economy grow close to trend this year.
- We expect that as the economy continues to improve, the need for record low interest rates will pass in time. We expect the RBA will leave rates on hold for the rest of this year before looking to raise them 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 remains generally in line with policymakers' objectives. Commodity prices in historical terms remain high, but some of those important to Australia have declined this year.

*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 grow 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 very low. Emerging market economies are 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, or other adverse event, over the period ahead.

*Our view: Despite the modest pick-up in global growth, longer-term interest rates remain very low. This stems from low inflation and the possibility of easier monetary policy in Europe. Unusually low volatility suggests investors are becoming complacent and not correctly pricing in risk. 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, growth was firmer around the turn of the year, but this resulted mainly from very strong increases in resource exports as new capacity came on line; 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 range of recent partial data is suggesting that the economy lost some momentum in the second quarter. Household consumption and net exports appear unlikely to provide large contributions to growth. We also think that falling mining investment could drag on growth significantly in coming years. However, we continue to expect that Australia's GDP growth will have a '3' in front of it for 2014, which would be close to trend. Low interest rates should see a recovery resume in consumer spending, the housing sector remains buoyant and businesses also appear more upbeat.*

RBA Statement: There has been some improvement in indicators for the labour market this year, but it will probably be some time yet before unemployment declines consistently. Recent data showed an increase in inflation, with both headline and underlying measures affected by the decline in the exchange rate last year. But growth in wages has declined noticeably and is expected to remain relatively modest over the period ahead, which should keep inflation consistent with the target even with lower levels of the exchange rate.

Our view*: Since the RBA's last meeting, the unemployment rate edged back up to a decade high of 6.0%, and (headline) inflation hit the top of its 2 to 3% per annum target band. However, the RBA's assessment on the labour market and inflation is unchanged, suggesting that these developments were in line with the RBA's expectations. The central bank continues to expect inflation will be "consistent with the target".*

RBA Statement: Monetary policy remains accommodative. Interest rates are very low and for some borrowers have continued to edge 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. The increase in dwelling prices has been slower this year than last year, though prices continue to rise. 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 the pace of house prices growth had slowed. 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 93 US cent range. The 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 93 US 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 being in the top half of the RBA's target band , 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.*

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