Data Snapshot

Tuesday, 5 February 2013

Bank of Melbourne

Cash Rate on Hold at 3.00%

- **The Reserve Bank of Australia (RBA) left its cash rate unchanged at 3.00%.**
- **Despite global downside risks abating, the US and Europe still have much work to undertake on their debt positions.**
- **Unsurprisingly, the RBA was more upbeat about the improving global backdrop, rising share markets and higher house prices. It appeared more encouraged about the impact of stimulatory policy to date, and now perceives the easing to date as being "significant".**
- **Indeed, for much of the Statement, one would get the impression that the RBA was less inclined than in December to cut rates again if it weren't for one sentence: "The inflation outlook, as assessed at present, would afford scope to ease policy further, should that be necessary to support demand". The RBA seemed more confident that risks to inflation had eased.**
- **The notes of concern regarding non-mining investment, low demand for credit and the high exchange rate remained, with very little new data to change the RBA's view.**
- **The surge in capital spending on resource projects will come to an end but the precise timing of this is still unclear. Recent improvements in some commodity prices may have delayed the date.**
- **We remain comfortable with our view that the RBA will cut its cash rate to 2.75% in April by which time the economy is likely to be in need of a little more support.**

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 3.0 per cent.

Global growth is forecast to be a little below average for a time, but the downside risks appear to have abated, for the moment at least. The United States has so far avoided a severe fiscal contraction and financial strains in Europe have lessened considerably over recent months. Growth in China has stabilised at a fairly robust pace. Around Asia generally, growth was dampened by the earlier slowing in China and the weakness in Europe, but again there are signs recently of stabilisation. Some commodity prices have firmed over recent months.

Our view: The RBA has noted that the downside risks to the global economy have abated. This is apparent via movements in equity and bond markets. Bond yields in nations such as Spain and Italy are lower than they were for most of the December quarter, despite a setback last night. We believe China's growth is structural and will remain at a robust pace for several more years at least. Both Europe and the United States still have work to do on their budgets.

RBA Statement: Sentiment in financial markets has continued to improve, with risk spreads narrowing and funding conditions for financial institutions becoming more favourable. Long-term interest rates faced by highly rated sovereigns, including Australia, remain at exceptionally low levels. Borrowing conditions for large corporations are very attractive. Share prices have made further gains. However, the task of putting private and public finances on sustainable paths in several major countries is far from complete and, accordingly, financial markets remain vulnerable to setbacks in these areas.

Our view: Access and pricing for large Australian corporations has improved. This will keep their debt costs down, lifting earnings and shareholder dividends. This should further support the domestic equity market.

RBA Statement: In Australia, most indicators available for this meeting suggest that growth was close to trend in 2012, led by very large increases in capital spending in the resources sector, while some other sectors experienced weaker conditions. Looking ahead, the peak in resource investment is approaching. As it does, there will be more scope for some other areas of demand to strengthen.

Our view: No one can be certain when capital spending in the resource sector will peak. The recent rise in some commodity prices may have pushed that date a little further into the future. When it does finally arrive it will weaken economic growth unless there is a substantial pickup in capital spending elsewhere in the economy.

RBA Statement: Present indications are that moderate growth in private consumption spending is occurring, though a return to the very strong growth of some years ago is unlikely. The near-term outlook for non-residential building investment, and investment generally outside the resources sector, remains relatively subdued. Public spending is forecast to be constrained. On the other hand, there are indications of a prospective improvement in dwelling investment, with dwelling prices moving higher, rental yields increasing and building approvals higher than a year ago. Exports of natural resources have been strengthening, though recent bad weather is affecting some shipments.

Our view: There have been few new developments to change the RBA's view on the strength of domestic demand. It appears that consumption is set to grow modestly, and the RBA has recognised that the housing sector is slowly on the mend. A recent lift in house prices has been encouraging and building approvals remain on an upward trend. Today's trade data also confirmed that exporters are benefiting from a recovery in commodity prices, although the RBA noted weather-related disruptions will impact shipments in the short-term.

RBA Statement: Inflation is consistent with the medium-term target, with both headline CPI and underlying measures at around 2¼ per cent on the latest reading. Looking ahead, with the labour market softening somewhat and unemployment edging higher, conditions are working to contain pressure on labour costs. Moreover, businesses are likely to be focusing on lifting efficiency under conditions of moderate demand growth. These trends should help to keep inflation low, even as the effects on prices of the earlier exchange rate appreciation wane. The Bank's assessment remains that inflation will be consistent with the target over the next one to two years.

Our view: Following a subdued CPI reading in Q4, the RBA seems more reassured about the outlook for inflation. Recent data has also confirmed that labour market conditions were soft. It also seemed more confident that businesses were looking to lift productivity, and lessen any risk of *inflationary pressures.*

RBA Statement: During 2012, there was a significant easing in monetary policy. Though the full impact of this will still take further time to become apparent, there are signs that the easier conditions are having some of the expected effects: the demand for some categories of consumer durables has picked up; housing prices have moved higher; there are early indications of a pick-up in dwelling construction; and savers are starting to shift portfolios towards assets offering higher expected returns. On the other hand, the exchange rate remains higher than might have been expected, given the observed decline in export prices, and the demand for credit is low, as some households and firms continue to seek lower debt levels.

Our view: *The RBA is now describing the easing over the past year as "significant" as opposed to just "more accommodative" in its December statement. This change in language highlights the RBA's view that it has already done a lot to stimulate the economy. It has been encouraged by the impact to date, although it remains concerned about the high Australian dollar and noted the low demand for credit.*

RBA Statement: The Board's view is that with inflation likely to be consistent with the target, and with growth likely to be a little below trend over the coming year, an accommodative stance of monetary policy is appropriate. The inflation outlook, as assessed at present, would afford scope to ease policy further, should that be necessary to support demand. At today's meeting, taking into account the flow of recent information and noting that there had been a substantial easing of policy as a result of previous decisions, the Board judged that it was prudent to leave the cash rate unchanged. 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 over time.

Our view: We believe the RBA will cut its cash rates in April. By then inflation should still be under control and demand will likely need a little more support.

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