Tuesday, 5 March 2013

Cash Rate on Hold at 3.00%

- **The Reserve Bank of Australia (RBA) left its cash rate unchanged at 3.00%.**
- **The Statement in March was little changed from its accompanying Statement in February, although there were very minor signs the RBA has been encouraged by developments over the past month. This included the lift in spending intentions for non-mining investment, although there was recognition that actual spending remained subdued.**
- **The RBA also seemed slightly more relaxed regarding risks surrounding the global growth outlook and encouraged by the lift to financial market sentiment.**
- **The concerns surrounding the high Australian dollar combined with a subdued inflation outlook and low demand for credit indicate that the RBA maintains an easing bias, but will want to wait on the sidelines. The Statement again reiterated that "inflation outlook, as assessed at present, would afford scope to ease policy further, should that be necessary to support demand".**
- **We continue to expect the RBA has room to cut rates once more by 25 basis points given there remain pockets of weakness in the domestic economy. However, we believe that the RBA will need a bit more time to assess how earlier rate cuts are taking effect. Additionally, while the run of data has been mixed, it isn't likely to be alarming enough to convince the RBA into action for the next few months. We expect the RBA will delay cutting rates until June.**

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 lessened over recent months. The United States is experiencing a moderate expansion and financial strains in Europe are considerably reduced compared with the situation through much of last year. 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 of stabilisation. Commodity prices are little changed recently, at reasonably high levels.

Our view: The RBA appears to be a touch more comfortable surrounding the risks to the global outlook, which have now "lessened over recent months" while previously they had "abated, for the moment at least". It appears more encouraged by the developments in the US with data continuing to point to modest growth. In our opinion, fiscal policy remains a significant risk to the US outlook.

RBA Statement: Sentiment in financial markets is much improved compared with the middle of last year. Risk spreads have narrowed and funding conditions for financial institutions are 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 risen substantially from their low points. However, the task of putting private and public finances on sustainable paths in several major countries is far from complete. Accordingly, as seen most recently in Europe, financial markets remain vulnerable to occasional setbacks.

Our view: Recent developments in Italy have provided a reminder that underlying problems remain for the euro zone, which the RBA has continued to highlight as a downside risk. That said, the improvement in sentiment and support to share markets will provide a positive effect on wealth and the outlook for demand.

RBA Statement: In Australia, most indicators available for this meeting suggest that growth was close to trend over 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: Recent capital expenditure data has changed little to the RBA's expectations on the outlook for mining investment. Although mining investment is expected to remain at very high levels, it will unlikely add as much to growth as in recent years.

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, is relatively subdued, though recent data suggest some prospect of a modest increase during next financial year. Dwelling investment appears to be slowly increasing, with higher dwelling prices and rental yields. Exports of natural resources have been strengthening, though recent bad weather is affecting some shipments at present. Public spending, in contrast, is forecast to be constrained.

Our view: The RBA has been looking to non-mining investment to pick up. Recent capital expenditure data has provided some tentative evidence that this may be occurring, at least sectors other than manufacturing. The RBA however, has recognised that actual spending outside of mining remains subdued and business conditions remain soft. Meanwhile, recent housing data has been mixed - demand for new home loans have lost some momentum but house prices have continued to rise.

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, as was confirmed in the most recent data. Moreover, businesses are 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: Annual growth in wages softened to the lowest since 2010, reflecting a soft labour market. The data further confirmed that inflation remains well contained and there has been little to change the RBA's outlook on inflation.

RBA Statement: During 2012, there was a significant easing in monetary policy. Though the full impact of this will still take more time to become apparent, there are signs that the easier conditions are having some of the expected effects. 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 paragraph above is virtually identical to the RBA's previous Statement suggesting that the RBA is still waiting to assess developments and the impact of earlier rate cuts. It continues to highlight concern about the level of the Australian dollar. Recent commentary has suggested that while the RBA does not think it can influence the currency's value, it could lower interest rates to help mitigate any tightening effect of the high AUD.*

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: Again, the RBA is keeping the door open for another easing reiterating "inflation outlook, as assessed at present, would afford scope to ease policy further, should that be necessary to support demand".

We continue to expect the RBA has room to cut rates once more by 25 basis points given there remain pockets of weakness in the domestic economy. However, we believe that the RBA will need a bit more time to assess how earlier rate cuts are taking effect. Additionally, while the run of data has been mixed, it isn't likely to be alarming enough to convince the RBA into action for the next few months. We expect the RBA will delay cutting rates until June.

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