Data Snapshot

Tuesday, 6 May 2014

Bank of Melbourne

RBA Cash Rate held at 2.50%

- **The RBA once again signalled a "period of stability in interest rates", suggesting that it intends to keep the cash rate on hold for quite some time.**
- **There was a balance of both optimism and concern in the Statement. On the positive side was the noted pick-up in US economic, the ongoing growth in China and the moderation of inflation among non-traded or domestically sourced goods and services.**
- **On the negative side the Board noted the ongoing reluctance of the non-resources sector to invest. Perhaps the Budget next week will bring them the necessary certainty to turn improved optimism into real activity. Another negative was the recent rise in the AUD. While the AUD is still lower than a year ago, its recent rise will dampen the impact on economic activity of the earlier decline.**
- **The RBA's outlook for inflation is benign with inflation expected to stay broadly within the 2-3% range. A lower AUD threatens to push up import prices but weaker inflation for domestic goods and services should balance that out.**
- **The RBA notes that the AUD is still high by historical standards. It also points out that the prices of several of Australia's major commodity exports have fallen. This suggests downside risk for the AUD over time.**
- **Monetary policy remains accommodative and we remain comfortable with our long-held view that the RBA will be on hold for most of 2014, before beginning to raise the cash rate towards the end of the year. That said, longer-term interest rates are at the mercy of global markets and could rise before the end of the year.**

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 was a bit below trend in 2013, but there are reasonable prospects of a better outcome this year, helped by firmer conditions in the advanced countries. China's growth appears to have slowed a little in early 2014 but remains generally in line with policymakers' objectives. Commodity prices in historical terms remain high, though some of those important to Australia have softened further of late.

Our view: *The RBA appears a little more optimistic on the US economy and remains confident in China's growth prospects. We concur. Even Europe is beginning to show modest signs of growth.*

RBA Statement: Financial conditions overall remain very accommodative. Long-term interest rates and most risk spreads remain low. Equity and credit markets are well placed to provide adequate funding.

Our view: *The official cash rate not is not going anywhere for quite some time. Longer term interest rates, however, could be affected by the tapering of the US Fed's Quantitative Easing program and by events in the Ukraine. If the US economy recovers strongly and if the situation in the Ukraine is resolved amicably, then longer term rates could rise.*

RBA Statement: In Australia, the economy grew at a below-trend pace in 2013. Recent information suggests moderate growth is occurring in consumer demand and foreshadows a strong expansion in housing construction. Some indicators of business conditions and confidence have improved from a year ago and exports are rising. But at the same time, resources sector investment spending is set to decline significantly and, at this stage, signs of improvement in investment intentions in other sectors are only tentative, as firms wait for more evidence of improved conditions before committing to expansion plans. Public spending is scheduled to be subdued.

Our view: *Despite a lift in business confidence it has not translated into real investment activity within the non-resources sector. It seems unlikely that lower interest rates would change the situation. If the upcoming Federal Budget provides some certainty then it is possible that business investment will lift. Thankfully exports are picking up and will add to economic growth over the year ahead.*

RBA Statement: The demand for labour has been weak over the past year and, as a result, the rate of unemployment has risen somewhat. More recently, there has been some improvement in indicators for the labour market, but it will probably be some time yet before unemployment declines consistently. Growth in wages has declined noticeably and this has been reflected more clearly in the latest price data, which show a moderation in growth in prices for non-traded goods and services. As a result, inflation is consistent with the target. If domestic costs remain contained, that should continue to be the case over the next one to two years, even with lower levels of the exchange rate.

Our view*: We believe the unemployment rate could edge a little higher as economic growth is still below trend. Recent job growth has been encouraging and jobs ads appear to be picking up. We will have to wait and see what impact the Budget has on hiring intentions and on consumer confidence.*

RBA Statement: Monetary policy remains accommodative. Interest rates are very low and savers continue to look for higher returns in response to low rates on safe instruments. Credit growth has picked up a little, while dwelling prices have increased significantly over the past year. The decline in the exchange rate from its highs a year ago will assist in achieving balanced growth in the economy, but less so than previously as a result of the rise over the past few months. The exchange rate remains high by historical standards.

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.*

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 that its current policy settings will achieve its goals of economic growth and inflation within its target band. At present growth is below trend. Low interest rates will encourage economic growth but it is taking longer than we might like.*

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 as is our comment. We continue to expect the RBA will leave rates on hold for most of this year before looking to raise them before year's end.*

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