RBA Minutes of the September Meeting

Catch-22

- **The minutes today gave the impression the RBA retained its easing bias, while appearing content with current monetary policy settings.**
- **The RBA's "on hold" stance seems to be relying on the delayed impact of lower interest rates on the domestic economy, and hopes that further declines in the Australian dollar will assist in supporting growth.**
- **The recent lift in the Australian dollar over the past few weeks puts the RBA in a Catch-22 scenario. In part, the AUD has lifted due to rising expectations the RBA is done cutting rates. However, a high AUD will keep the door open for another rate cut, because a stronger currency tightens financial conditions.**
- **While monetary stimulus has evidently impacted the housing market, the flow on effect to the broader economy has been limited to date. Consumption growth has been subdued, and there is little sign of a pickup in non-mining business investment.**
- **The still high Australian dollar and the weakness in the labour market and non-mining investment suggest that a rate cut remains a possibility. We continue to expect the RBA to cut the cash rate when it meets in November.**

There was little new information in today's minutes of the September board meeting. The minutes gave the impression the RBA retained its easing bias, while appearing content with current monetary policy settings. This sentiment was spelled out in the sentence: "Members agreed that the Bank should again neither close off the possibility of reducing rates further nor signal an imminent intention to reduce them".

The commentary however, surrounding current domestic conditions was downbeat, particularly in regard to business investment and the employment outlook. The concerns about declining mining investment remained. The RBA was also quite pessimistic on non-mining investment, expecting it "would remain restrained". In regards to the labour market conditions, the RBA described them as "subdued", and the RBA noted the rise in the unemployment rate, and softening wage growth.

On the global front, the RBA appeared a bit more relaxed about the outlook for China, given that some of the downside risks have eased. The RBA expects growth would be close to 7.5% this year, which is near consensus estimates and the authorities' growth target. The RBA noted the growing concerns in emerging economies, notably Brazil, India, Indonesia and Turkey, which have had large capital outflows and sharp falls in their respective currencies. However, the RBA saw these emerging economies much better placed than in similar situations in the past, given that foreign exchange reserves were larger and they are holding relatively less foreign currency-denominated debt.

The RBA's "on hold" stance seems to be relying on the delayed impact of lower interest rates on the domestic economy, and hopes that further declines in the Australian dollar would assist in supporting growth.

While monetary stimulus has evidently impacted the housing market, the flow on effect to the broader economy has been limited to date. Consumption growth has been subdued, and there is little sign of a pickup in non-mining business investment. Consumer and business confidence has improved post-election, but there is some uncertainty as to whether this can be sustained long enough to have a profound impact on spending.

The RBA further reiterated its hopes for the Australian dollar to weaken and assist in supporting the economy by remarking that "some further decline in the exchange rate would be helpful". Since the RBA has softened its easing stance, expectations of another rate cut from the RBA by the end of the year have significantly lowered in recent weeks. Market pricing (according to IB interest rate futures) is placing a 36% chance of another 25 basis point cut by the end of the year, well down from an 86% chance in late August.

These expectations and among other factors has seen a lift the Australian dollar, which puts the central bank in a catch-22 scenario. The AUD has risen a touch over 2 cents since the September meeting to be at 93 US cents today. However, a higher Australian dollar will help keep open the possibility of another rate cut from the RBA.

The Australian dollar remaining at elevated levels, the weakness in the labour market and non-mining investment suggest that a rate cut remains a possibility. We continue to expect the RBA to cut the cash rate when it meets in November.

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