Tuesday, 17 July 2018

Minutes of the July RBA Board Meeting

A Cautious Central Bank

The RBA minutes of the July board meeting did not suggest any major shift in the RBA's assessment of the domestic economy. The RBA remained broadly comfortable with the outlook for the domestic and global economies. However, more caution entered the RBA's rhetoric about the world economy. Moreover, the RBA seemed to indicate inflation would need to be closer to the midpoint before changing the cash-rate lever.

Recent data on the Australian economy had been consistent with the RBA's forecast for GDP growth to pick up to a bit above 3% over 2018 and 20-19.

The central bank's ongoing uncertainty around the outlook for consumption remained a theme, given that household income had continued to grow slowly and debt levels were high.

The RBA noted that leading indicators of labour demand pointed to above-average employment growth over the second half of this year. So RBA members expect some wage pressures to build in some parts of the economy. However, the RBA indicated wages growth remained low and some structural forces are at work.

The path of wages growth remains critical for the inflation outlook.

On inflation, the RBA appeared to raise the bar for a rate hike by referring to the "midpoint" of the inflation target when indicating they were in no rush to raise rates. The RBA expects progress towards a lower unemployment rate and an inflation rate closer to the midpoint to be "gradual" in nature. In prior minutes, the RBA only referred to the target band (i.e. 2-3%pa).

Considerable discussion was held on the high level of household debt in Australia with a special paper prepared for the meeting. The RBA continues to watch developments in this space closely.

The RBA noted that survey data revealed much of the household debt is owed by higher-income and middle-aged people, who tend to have more stable employment and often larger savings buffers. However, a material share of household debt is held by lower-income households, which generally have higher debt relative to their income.

Encouragingly, household assets are valued at around five times the value of household debt and assets exceed debt for most households. But the RBA warned that most household assets are housing and superannuation; both of these are illiquid.

The RBA noted that household with high debt levels are more vulnerable to economic shocks and so are more likely to lower consumption in the face of uncertainty about their future. Members also noted that changes in interest rates have a larger effect on disposable income for households with high debt levels.

On the international front, the RBA's optimism was tempered by worries about escalating trade tensions. These concerns echoed those of the International Monetary Fund. The RBA noted that non-tariff measures, such as administrative delays, might also widen. Further, the RBA noted that indicators of activity in the euro area in recent months had softened, suggesting a weaker near-term outlook for the euro area. The RBA also seemed more cautious about China.

On financial markets, we were eyeing comments on money-market spreads, which have widened recently and so increased the cost of borrowing for financial institutions in the short-term money market. The RBA noted that it was" uncertain" how persistent these pressures would be.

In the June meeting minutes, the RBA had dropped the reference that the next move in the cash rate would more likely be up. We were not concerned by this omission at that time because the RBA Governor in subsequent speeches was still suggesting the next move would be up. We are not then surprised that the RBA brought back in these minutes the signal that the next move will be higher. It noted "member continued to agree that the next move in the cash rate would more likely be an increase than a decrease". However, the RBA sees no strong case for a near-term adjustment in monetary policy.

We remain comfortable in expecting the RBA to take its time in starting a rate-hike cycle. We expect a live window to open in the second half of next year, but we do not expect the RBA to act until early 2020.

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