Tuesday, 17 September 2019

RBA Minutes of the September Meeting

RBA Consumed by Consumption

- **The minutes from the September Reserve Bank (RBA) board meeting were published today. Overall, the tone was tentative in the wake of escalating trade tensions between the US and China and signs of a weakening global growth outlook.**
- **The RBA was tight-lipped about the timing of the next move, saying only that they would consider further cuts to the cash rate if it was needed to support growth and achieve its 2-3% per annum inflation target.**
- **The effects of the trade war were referenced by a drop in global trade volumes, slowing growth in global industrial production and below-average conditions in the global manufacturing sector. The RBA added that "recent indicators suggested trade-related activity would remain weak for some time".**
- **The RBA explained that Australian businesses had not appeared to have been affected by the weak trade environment to the same extent as businesses in other advanced economies.**
- **On the labour market, the RBA noted that "forward-looking indicators had continued to suggest that employment growth would moderate over the following six months". It added that information from the central bank's liaison program suggested employment intentions had remained weak in the residential construction sector but positive among services firms.**
- **Domestically, the key uncertainty continued to be the outlook for consumption. Through its liaison with retailers, the bank found little evidence of increased spending following the tax cuts for low and middle income households. Members took a more optimistic view on the sluggish response in spending by noting that even if consumers were holding onto their tax cuts in order to pay debts, it would still bring forward the point at which households would increase their spending.**
- **The odds of another cut by the end of year shortened after the release of the minutes. Financial markets have now fully priced in a third rate cut by December.**
- **We expect the RBA to make two more cuts in the current easing cycle. We favour October and early next year as labour market outcomes remain soft and global uncertainties take a further toll on business and consumer confidence.**

Earlier today the Reserve Bank (RBA) published minutes from its board meeting on September 3. At this meeting, the RBA left the cash rate at an all-time low of 1.00% after easing by 25 basis points in both June and July.

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The board meeting took place in the wake of the escalation of the US-China trade war during August and considerable discussion in the minutes was devoted to the trade tensions and their impact. The discussion on the trade war and external environment leaves the reader with the impression of a more pessimistic RBA on the global environment. On the domestic economy, the RBA was more mixed.

Global growth was no longer described as remaining reasonable in the August meeting minutes. Further, the labour markets in the major economies were no longer characterised as “strong”. Instead, employment growth was described as remaining robust but having eased a little in recent months.

The RBA noted that US inflation has increased in recent months and recent and prospective tariffs could lift consumer price inflation in the US by ¼-½ percentage points over the next few years.

The RBA underscored the effects of the trade war by explaining that global trade volumes have dropped and weak external demand had been reflected in slowing growth in global industrial production and below-average conditions in the global manufacturing sector. The RBA added that “recent indicators suggested trade-related activity would remain weak for some time”.

More importantly, the RBA minutes highlighted “growth in China had eased further”, indicators were pointing to output growth slowing in India and “weak global trade had continued to weigh on growth in east Asia”.

Trade developments have largely been calmer since the board meeting, but we see a risk of re-escalation.

The RBA explained that Australian businesses had not appeared to have been affected by the weak trade environment to the same extent as businesses in other advanced economies.

On the labour market, the RBA noted that “forward-looking indicators had continued to suggest that employment growth would moderate over the following six months”. The RBA added that information from the central bank’s liaison program suggested employment intentions had remained weak in the residential construction sector but positive among services firms.

GDP growth was expected to be 0.5% in the June quarter and in the event, it was 0.5%, in line with the RBA’s expectations.

In making its September decision, the RBA considered three key developments on the domestic front. The first was the labour market. While employment growth had continued to grow strongly, the unemployment rate had held steady at around 5.2% over recent months. The RBA Governor in speeches has indicated 4.5% is the desired rate of unemployment rate, as it is consistent with full employment.

The RBA’s outlook for wages was soggy. The minutes noted that “wages growth had remained low” and, critically, “there were few indications that wage pressures were building”. Underscoring the importance of labour market developments, the minutes then include "…a further gradual lift in wages growth would be a welcome development."

Second, the recent stabilisation in housing markets was acknowledged. It was noted that house prices in Sydney and Melbourne were recovering. There was some discussion about how the weakness in dwelling investment could "sow the seeds of an upswing in the housing price cycle"; a possible clue that the RBA is wary about the impact of further cuts on asset prices. Balancing this hawkish tone was the observation of low sales turnover and subdued credit growth, despite mortgage rates being at record low levels. Soft demand for credit from investors, as well as tight borrowing conditions for businesses were also flagged.

Third, the outlook for GDP growth was outlined. Supporting factors were the mining sector, the low level of interest rates, recent tax cuts and house price growth. Growth in the second quarter was boosted by exports and public demand, both of which had a temporary element through high iron ore prices and the rollout of the National Disability Insurance Scheme (NDIS).

Finally, the key uncertainty continued to be the outlook for consumption. From its current low base, the RBA expects household consumption to rebound, as disposable income picks up and improvements in the housing market encourage spending.

Retail sales volumes have been weak, despite the recent tax cuts for low and middle income households. Through its liaison with retailers, the bank found little evidence of increased spending following the cuts. Members took a more optimistic view on the sluggish response in spending by noting that even if consumers were holding onto their tax cuts in order to pay debts, it would still bring forward the point at which households would increase their spending.

The September minutes provide confirmation that the RBA sees downside risks to growth, particularly in the external environment. Overall, there remains considerable focus on the low level of interest rates both domestically and abroad, while the outlook for domestic growth remains mixed.

Given the lack of progress in reducing spare capacity in the labour market and persistently low inflation, further easing seems highly likely. On the question of timing, there were few clues about the precise month of the next cut. How the path of monetary policy proceeds from here depends a lot on consumption. The RBA expects a rebound, noting that it remains a key uncertainty. If spending remains subdued, it will add further impetus for more easing, and potentially the introduction of unconventional policies.

We expect the RBA to make two more cuts in the current easing cycle, in October and early next year as labour market outcomes remain soft and global uncertainties take a further toll on business and consumer confidence.

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