Tuesday, 19 April 2016

Bank of Melbourne

Minutes of the April RBA Board Meeting

Discontent Rising?

- On balance, the minutes of the RBA board meeting in April continued to suggest that the RBA remains satisfied regarding current monetary settings and does not seem poised to lower interest rates any time soon.
- The RBA was generally upbeat regarding developments in the domestic economy. Nonetheless, there were other concerns raised regarding global conditions and the stronger Australian dollar.
- The RBA still seemed confident that the necessary rebalancing was occurring. If anything, the RBA was more upbeat regarding the state of the domestic economy. The RBA would be even more encouraged by last week's labour force data, which confirmed that jobs were continuing to grow at a healthy pace.
- The major offsetting concern however for the RBA, was the level of the Australian dollar. The RBA has expressed some discomfort with the AUD at just above 75 US cents (at the time of the meeting) although commentary suggested that the RBA did not view the currency as being out of line with fundamentals. An AUD at 77.7 US cents at the time of writing this note could be even more disconcerting for the RBA, and we suspect they will be watching this development closely.
- We believe that there is little fundamental reason to expect the AUD will sustain at current levels, unless commodity prices rise further from here. An AUD seriously out of line with our forecast for a sustained period, without a corresponding move in commodity prices, would raise the likelihood of further monetary easing. However, barring such an event, we maintain our view that the economy will grow sufficiently for the RBA to leave rates on hold for the remainder of the year.

It was a mixed bag from the minutes of the RBA board meeting in April. The RBA was generally upbeat regarding developments in the domestic economy. Nonetheless, there were other concerns raised regarding global conditions and the stronger Australian dollar.

On balance, the minutes continued to suggest that the RBA remains relaxed regarding recent developments and does not seem poised to lower interest rates any time soon.

The much used phrase that "continued low inflation would provide scope to ease monetary policy further, should that be appropriate to lend support to demand" was again reiterated.

However, the RBA still seemed confident that the necessary rebalancing was occurring and that "there were reasonable prospects for continued growth in the economy". If anything, the RBA was more upbeat regarding the state of the domestic economy. The discussion surrounding past economic indicators including GDP, the labour market and dwelling investment were broadly positive. The RBA was unsurprisingly less positive on the outlook for business investment, but noted that the decline over the December quarter was "in line with expectations".

The RBA would be even more encouraged by last week's labour force data which confirmed that jobs were continuing to grow at a healthy pace.

The major offsetting concern however for the RBA, was the level of the Australian dollar. "Members noted that an appreciating exchange rate could complicate progress in activity rebalancing towards the non-mining sectors of the economy". Much like in the Governor's statement earlier in the month, the RBA explained the appreciation with the lift in commodity prices and expectations of a slower pace of tightening by the Federal Reserve. Therefore, while the RBA has expressed some discomfort with the AUD at just above 75 US cents (at the time of the meeting), it was not yet at a point where the RBA viewed the currency as being out of line with fundamentals. An AUD at 77.7 US cents at the time of writing this note could be even more disconcerting for the RBA, and we suspect they will be watching this development closely.

Of course, an appropriate level for the AUD would depend heavily on the outlook for commodity prices. On this front, the RBA has hinted at some doubt that the current level of commodity prices will be sustained, in particular the price of iron ore. The RBA noted that Chinese steel production had declined, and global supply was expected to increase.

The other concerns for the RBA regarded the risks to financial stability from China and some other emerging market economies. These were also raised in the RBA's financial stability review released last week. The RBA also noted softening economic activity in emerging economies, but that growth for Australia's major trading partners was as forecast.

Outlook for Monetary Policy

The RBA continues to be confident that the domestic economy is performing relatively well and suggests that a rate cut is unlikely anytime soon. However, the level of the exchange rate could cause the RBA some concern if it stays at current levels or it appreciates further, particularly without a corresponding increase in commodity prices.

We believe that there is little fundamental reason to expect the AUD will sustain at current levels, unless commodity prices rise further from here. An AUD seriously out of line with our forecast for a sustained period without a corresponding move in commodity prices would raise the likelihood of further monetary easing. However, barring such an event, we maintain our view that the economy will grow sufficiently for the RBA to leave rates on hold for the remainder of the year.

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