Interest Rate Outlook

Bank of Melbourne

Tuesday, 19 May 2015

Minutes of the May RBA Board Meeting

Reading Between the Lines

- In the minutes of the RBA board meeting in May, the RBA outlined its case for a cut to the cash rate to 2.00%. As discussed in the RBA's recent Statement on Monetary Policy, the weaker outlook for non-mining investment and a downgrade in the RBA's growth and inflation forecasts was behind the decision.
- The RBA continued to be opaque regarding the outlook for monetary policy. However, reading between the lines, the RBA seemed to remain open to the possibility of rate cuts down the track. The soft growth outlook means the economy could do with more support.
- That said, there appears to be a high hurdle for another rate cut any time soon. On balance, we continue to expect the RBA to leave the cash rate on hold throughout the remainder of 2015.
- The depreciation in the Australian dollar was again highlighted as "likely and necessary" for more balanced growth. The RBA also tied the exchange rate to non-mining investment, stating its importance for investment decisions.
- Although the strong conditions in the housing market did not prevent the RBA from reducing the cash rate in May (or February), it remains a consideration. Any pickup in investor lending would be quite concerning for the RBA.

In the minutes of the RBA board meeting in May, the RBA outlined its case for a cut to the cash rate to 2.00%.

The weaker-than-expected outlook for non-mining investment, as indicated by the ABS capex survey and the RBA's own business liaison was the major driver for a downgrade to the RBA growth forecasts, and hence the RBA's inflation forecasts. Much of the assessment of the domestic economy was as outlined in the RBA's Statement on Monetary Policy. As in previous commentary, the longer time for a pickup in growth was the key reason for the cut to the cash rate.

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Outlook for Monetary Policy

The key focus is what the minutes mean for future official interest rates.

The RBA continued to be opaque regarding the outlook for monetary policy. "Members agreed that, as at the time of the reduction in the cash rate in February, the statement communicating the decision would not contain any guidance on the future path of monetary policy".

Following the decision to cut interest rates at the May meeting, some financial markets participants saw the omission of any interest rate guidance as a sign that the RBA had dropped its easing bias. However, the minutes added that "Members did not see this (lack of interest rate guidance) as limiting the Board's scope for any action that might be appropriate at future meetings", suggesting that the RBA remains open to the possibility of rate cuts down the track.

The Australian dollar, which has edged higher against the US dollar and in trade-weighted terms since the RBA's meeting also likely to keep concerning the RBA. The soft growth outlook means the economy could do with more support.

Nonetheless, there appears to be a high hurdle for another rate cut any time soon.

We learn that the RBA considered delaying the decision to cut rates by another month, which would allow obtaining details of the Federal Budget. However, the RBA opted to cut in May, given the benefit of communicating its reasons in the Statement of Monetary Policy, released a few days after. The consideration to delay the cut to the cash rate suggests that the RBA isn't looking to cut rates again in a hurry.

Additionally, the concerns regarding the "imbalances" within housing market remain. While they did not prevent the RBA from cutting in May, it continues to be a consideration for monetary policy. The rate cut in May suggests there is a risk that housing demand will be boosted further. Any pickup in home lending for investors would be quite concerning for the RBA.

On balance, we continue expect the RBA to leave the cash rate on hold throughout the remainder of 2015.

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