Interest Rate Outlook

Tuesday, 19 March 2019

Bank of Melbourne

RBA Minutes of the March Meeting

The minutes of the Reserve Bank (RBA) board meeting held in March elaborated on the commentary in its accompanying Statement earlier in the month. Additionally, in early February, RBA Governor Lowe noted that there were scenarios in which an increase in the cash rate would be appropriate- and other scenarios where a decrease would be appropriate. The risks around whether the cash rate would next go up or down were considered to be evenly balanced by Lowe. These sentiments were echoed in today's minutes.

There was a sense of greater caution surrounding the outlook, recognising the softening momentum in the economy over the second half of 2018. In particular , the RBA saw there was uncertainty in regards to the outlook for consumer spending given the downturn in the housing market and it was highlighted that the decline in dwelling investment could be "sharper than currently expected".

However, the RBA continues to be more optimistic than conditions would suggest in our view. The RBA is still pointing to a central scenario of GDP at "around 3 per cent over 2019" and a further decline in the unemployment rate.

Note, that these minutes would have occurred a day prior to the release of GDP growth in the December quarter, which was well below the RBA's implied forecast for GDP growth. The RBA will more than likely need to revise down its growth forecasts again at its next update in May.

A key feature in today's minutes is that the RBA appeared at odds with the weakening outlook for domestic growth and the strength of the labour market. The labour market has continued to post solid job gains over the past year or so. Meanwhile, a range of indicators, including GDP growth, has pointed to a softening in economic activity. Indeed, the RBA referred to these conflicting signals between the labour market and economic activity as being "tensions". The RBA states that the board "assessed that it would be appropriate to hold the cash rate steady while new information became available that could help resolve the current tensions in the domestic economic data". It would suggest that while the labour market is continuing with its strength, the RBA would be unlikely to move interest rates and also highlights the importance of the labour market in determining the future path of monetary policy.

The RBA refers to a phenomenon occurring around the world in which GDP growth has been weak, but labour markets have remained strong, stating that "tension in a number of economies between slower GDP growth and resilient labour markets". The US is a prime example.

However, the labour market tends to lag economic activity. We expect employment growth to moderate given the recent weakness in economic growth, and that we expect that this weakness will convince the RBA to cut the official cash rate later this year.

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