Thursday, 2 April 2015

Bank of Melbourne

Cash Rate Outlook – April Odds Shorten

- **The odds of a rate cut from the Reserve Bank as soon as next week have shortened.**
- **Falls in bulk-commodity prices and a still stubborn currency could tilt the RBA to cut the cash rate next week rather than wait until May.**
- **If the RBA does not slice rates next week, a May rate cut is a near certainty.**

The Reserve Bank (RBA) meets next week on Tuesday. Policymakers last cut the cash rate on 3 February. In March when they met, the RBA adopted a bias to ease rates and left rates unchanged.

As we have highlighted for some time, we expect the Reserve Bank will slice the cash rate a second time this year by 25bp, taking the cash rate to 2.00%.

We've had a slight preference over May for the timing, but noted that April was still a live date. Certainly, more recently the odds appear to have shortened for a rate cut as soon as next week. In our opinion, April is now the more likely timing but it remains a close call.

The prices of our bulk commodities have witnessed sharp falls recently, hurting further our terms of trade and thereby incomes. The Australian dollar versus the US dollar has failed to fall by as much.

Moreover, in trade-weighted terms the Australian dollar has failed to provide more stimulus to the economy; it is higher than where it sat when the RBA last cut the cash rate on 3 February.

The business spending plans, released on 26 February in the capital expenditure survey, was also disappointing. The survey implied that non-mining investment would remain subdued for some time yet and for longer than had been previously expected. The capex data was not enough to push the RBA to cut in March, but when we add recent developments in commodities and the Australian dollar it might be enough to push the RBA over the line in April.

Confidence remains an issue for activity in the non-mining economy; it is fragile across both consumers and businesses. While consumer confidence received a boost in the wake of the February rate cut, the lift was not fully sustained. Meanwhile, business confidence deteriorated in February in spite of the rate cut.

If the RBA decide to sit tight next week, a May rate cut is almost certain. A rate cut in May would be followed with the quarterly Statement on Monetary Policy, which would give the RBA room to explain its decision in detail. A May rate cut would also provide the RBA with the benefit of seeing another inflation report before it meets to decide interest-rate settings. However, we do not expect the RBA needs to wait to see another set of inflation figures because inflation is unlikely to stand in the way of further easing.

Financial markets (using interbank cash-rate futures as a proxy) are attaching a 75% chance of a 25bp rate cut next week. This probability is a significant lift from a probability of 47% only two weeks ago.

Besa Deda, Chief Economist
Ph:02-8254-3251

Contact Listing

Chief Economist

Besa Deda
dedab@bankofmelbourne.com.au
(02) 8254 3251

Senior Economist

Hans Kunnen
kunnenh@bankofmelbourne.com.au
(02) 8254 8322

Senior Economist

Josephine Horton
hortonj@bankofmelbourne.com.au
(02) 8253 6696

Senior Economist

Janu Chan
chanj@bankofmelbourne.com.au
(02) 8253 0898