Wednesday, 20 August 2019

RBA Minutes of the August Meeting

Global Economy Moves into the Spotlight

- **The minutes of the RBA board meeting in August were published today. They revealed an RBA more confident about the outlook for the domestic economy, leaving aside the near-term outlook, and more worried about the global economic outlook.**
- **The RBA has shifted to give greater weight to global economic developments in setting cash-rate policy. In the conclusion of the minutes, the RBA noted "the Board judged it appropriate to assess developments in the global and domestic economies before considering further change in the setting of monetary policy". This paragraph is in contrast to recent statements where the emphasis was on the labour market.**
- **On jobs, the RBA noted "there appeared to have been more spare capacity in the labour market than previously appreciated".**
- **However, while the RBA concerns around the labour market have risen, the RBA seems more hopeful and confident on the real economy. The RBA stated "risks around the outlook were more balanced than they have been for some time".**
- **This more balanced expectation about the domestic economic outlook was underpinned by a boost to incomes from tax cuts and a signs of recovery in some housing markets.**
- **The RBA continues to expect growth to recover to trend in 2020 of 2.75% and lift to 3% in 2021. We expect growth will fall short of these expectations, making it hard for the unemployment rate to move to the desired rate and challenging for inflation to move back into the RBA's target band.**
- **Therefore, we continue to expect two more rate cuts from the RBA – one in October and one early next year.**
- **Monetary policy becomes a blunter instrument at these lower levels. So the possibility of the RBA having to pursue unconventional policies as they take the cash rate from 0.75% to 0.50% or after taking the cash rate to 0.50% is a growing risk.**
- **The RBA minutes noted the board members reviewed the experience of other advanced economies with unconventional policy measures. The minutes noted one key lesson from the international experience was that the effectiveness of these measures depended upon the specific circumstances facing each economy and the nature of its financial system. Further, "a package of measures tended to be more effective than measures implemented in isolation".**

A short time ago, the Reserve Bank (RBA) published minutes from its board meeting on August 6.

The RBA seemed more confident about the outlook for the domestic economy, leaving aside the near-term outlook, and more worried about the global economic outlook.

Recent trade tensions have deteriorated and deepened the downside risk to the global economic outlook. Global-supply chains have been disrupted, business confidence is fragile in the major economies and there are signs business-investment decisions are being negatively impacted in the major economies also.

Understandably, the RBA has become more concerned about the global outlook. The RBA noted "trade and technology disputes had increased the downside risks to the global outlook", "uncertainty around trade policy had already had a negative effect on investment in many economies" and "a number of central banks had reduced interest rates this year and further monetary easing was widely expected".

This board meeting had been held in the wake of US-Sino trade tensions taking a turn for the worse on August 1 when US President Trump tweeted tariffs were to be applied to a further US$300 billion of Chinese imports. China's currency depreciated against the US dollar, breaking a key level on August 5, which followed with Trump labelling China a currency manipulator. These developments highlighted the deterioration in underlying trade tensions. Risk aversion around the world heightened around the world as a result and remains elevated.

The RBA appears to now be giving greater weight to global economic developments in setting cash-rate policy. In the conclusion of the minutes, the RBA noted "the Board judged it appropriate to assess developments in the global and domestic economies before considering further change in the setting of monetary policy". This is in contrast to the RBA's recent statements where the RBA instead emphasised the labour market in its concluding paragraph.

The global economic outlook is a variable outside of the RBA's control and one that comes with considerably uncertainty, given the tit-for-tat nature of the trade war so far. The global economy in our view continues to be one of the key swing factors determining how far the cash rate is lowered and if unconventional policies are adopted.

The labour market is unlikely to have paled in significance. However, the RBA has moved global economic conditions more into the spotlight.

On the labour market, the RBA noted "there appeared to have been more spare capacity in the labour market than previously appreciated". Further, there is "a more subdued outlook for wages than three months earlier". Indeed, members also noted "the outlook for the labour market was one of the key uncertainties for the forecasts".

However, while the RBA concerns around the labour market have risen, the RBA seems more hopeful and confident on the real economy. RBA members noted in the minutes that "although the outlook for consumption remained uncertain, the risks around the outlook were more balanced than they have been for some time". This more balanced expectation was underpinned by a boost to incomes from tax cuts and a signs of recovery in some housing markets.

These expectations no doubt underpinned the RBA's recently updated forecasts. The RBA continues to expect growth to recover to trend in 2020 of 2.75% and lift to 3.00% in 2021. We expect growth will fall short of these expectations, making it hard for the unemployment rate to move to the desired rate of 4.5% and challenging for inflation to move back into the RBA's 2-3% per annum target band. Therefore, we continue to expect two more rate cuts from the RBA – one in October and one early next year.

Monetary policy becomes a blunter instrument as the cash rate falls to these lower levels. It makes the possibility of the RBA having to pursue unconventional policies as they take the cash rate from 0.75% to 0.50% or after taking the cash rate to 0.50% a growing risk.

The RBA minutes noted the board members reviewed the experience of other advanced economies with unconventional policy measures. The main idea behind most unconventional policies is to lower lending rates and lift loan volumes, helping to foster faster growth in the economy.

The minutes noted that one key lesson from the international experience was that the effectiveness of these measures depended upon the specific circumstances facing each economy and the nature of its financial system. The minutes also noted that members noted that "a package of measures tended to be more effective than measures implemented in isolation" and it was "important for the central bank to communicate clearly and consistently about these measures".

The toolbox of unconventional policies is large and the RBA minutes appeared to suggest members would favour purchasing government bonds.

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