Tuesday, 21 July 2015

Minutes of the July RBA Board Meeting

Positive Slant Suggests 'No Change'….but…

- The minutes of the RBA board meeting in July, gave the impression that the Australian economy is easing its way through an economic transition.
- The positive tone of the minutes focussed on improvements in the labour market, improvements in business sentiment, a lift in consumption, ongoing low inflation, expanded exports, solid housing investment and growth in job vacancies.
- Weaknesses in the Australian economic landscape noted in the minutes included spare capacity in the labour market, a currency stronger than preferred and a lack of non-resource related business investment.
- Recent changes to official rates in Canada and New Zealand must keep us alert to the possibility of changes in Australia. We expect the RBA's cash rate to remain on hold until late 2016 but if the data changes and the RBA becomes discontent with the trajectory towards stronger growth then it reserves the option to act.
- Inflation is under control with income growth well contained. Tomorrow sees the latest CPI results.
- As noted in the Governors' Statement and again in the minutes, "the decline in the Australian dollar had been more modest in terms of a basket of currencies. Members noted that the exchange rate had thus far offered less assistance than would normally be expected in achieving balanced growth in the economy and that further depreciation seemed both likely and necessary." We have been warned. Our forecast is for the AUD to sit at US 73 cents at the end of 2015.

The minutes of the RBA board meeting in July, gave the impression that the Australian economy is easing its way through an economic transition. While there is more 'hurt' to come, a reasonable global backdrop supported by low interest rates and a softer AUD will see the Australian economy continue to expand.

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With all this positive news, why would you want to or need to reduce the cash rate?

Is everything good? Clearly not. There is spare capacity in the labour market, the AUD appears to be too strong for the RBA's liking (despite a 20% decline from its peak in TWI terms), and non-resource related business investment remains well below par.

Given this mix of conditions and its outlook, a steady cash rate was the outcome of its meeting and is our expectation for many months to come?

There are risks attached to this view. Recent moves by the Bank of Canada and the Reserve Bank of New Zealand set the scene. The Bank of Canada recently surprised markets by cutting it official rate. The reason given was a downward revision to its forecasts for domestic economic growth. New Zealand also recently cut its overnight cash rate as the fall in its terms of trade impacted upon national income. Could we follow suit? We doubt it, but the risk still exists.

Of note in the RBA Board's discussion was the impact of slower population growth on the labour market. Despite below par economic growth in recent months, the unemployment rate has remained stable. Weaker population growth (mostly via reduced net migration) can help keep the unemployment rate steady but it can also lead to slower economic growth. Could the RBA 'do' a Bank of Canada and spring a surprise rate cut in August or September? We doubt it given the positive slant in the board minutes but surprises do happen.

Outlook for Monetary Policy

The positive slant in the minutes today suggest to us that, barring major changes to its outlook for economic growth, the RBA will maintain its historically low cash rate and not adjust it in either direction until late 2016. We must remain alert to factors that might cause the RBA to step back from its current view of the trajectory towards stronger economic growth.

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