Interest Rate Outlook

Tuesday, 3 November 2015

Bank of Melbourne

RBA Rate Cut Scratched

- At the RBA's November board meeting today, the RBA left the cash rate unchanged at 2.0% as we had expected.
- The RBA emphasised improving economic conditions and these appeared to be a key factor in keeping interest rate settings unchanged. The RBA cited the improvement in business surveys and continued to be encouraged by developments in the labour market.
- The low inflation outlook has lowered the hurdle for another cut. The RBA has suggested that inflation forecasts have been downgraded, and leaves room for further easing if necessary.
- A further reduction to the cash rate cannot be ruled out given the inflation outlook and current below trend pace of growth. However, we expect that there are enough signs of improvement in the domestic economy for the RBA to hold off from lowering the cash rate any further. Interest rates are already at very low levels, and the lower Australian dollar is providing support. We continue to expect the RBA to keep rates on hold until late 2016.

At the RBA's November board meeting today, the RBA left the cash rate unchanged at 2.0% as we expected.

We had nonetheless, expected a close call in today's decision given weak inflation data last week. Markets had been anticipating a high probability that the RBA would cut rates today.

There was something for both the hawks and the doves in today's statement.

The RBA emphasised improving economic conditions in its final paragraph, and this appeared to be a key factor in keeping interest rate settings unchanged. However, the RBA opened the door a little wider for further monetary easing given the lower inflation outlook. The RBA said that "the outlook for inflation may afford scope for further easing of policy, should that be appropriate to lend support to demand".

The RBA indicated that inflation forecasts have been downgraded - "Inflation is forecast to be consistent with the target over the next one to two years but a little lower than earlier expected".

Interestingly, there was no mention of the RBA's GDP growth forecasts, which are scheduled to be published on Friday. However, the RBA cited the improvement in business surveys and continued to be encouraged by an improvement in the labour market.

The RBA was generally dismissive of recent tightening in conditions for lending, stating that "while the recent changes to some lending rates for housing will reduce this support slightly, overall conditions are still quite accommodative". We had expected that the risks regarding financial stability surrounding the housing market would mean that changes in lending rates would not be unwelcome for the RBA.

On the global economy, the RBA omitted "China and east Asia" and instead referenced the "Asian region" where conditions had softened. In contrast, the RBA highlighted "continuing US growth" and "a recovery in Europe", despite ongoing slow growth for the EU region.

Outlook for Monetary Policy

The downgrade in the RBA's inflation forecasts suggests that the hurdle for a further easing in monetary policy has now been lowered. Nonetheless, the improvement in the domestic economic conditions suggests that there may not be a need to reduce interest rates any further. This will depend on how the economic outlook evolves in coming months.

The odds of another cut to the cash rate have increased with the low inflation outlook. Moreover, the domestic economy continues to undergo a slow and difficult transition from mining investment to growth driven by other sectors of the economy. This suggest that a further reduction to the cash rate cannot be ruled out. However, we expect that there will be enough signs of improvement in the domestic economy for the RBA to hold off from lowering the cash rate any further. Interest rates are already at very low levels, and the lower Australian dollar is providing support. We continue to expect the RBA to keep rates on hold until late 2016.

The one page text of the Governor's Statement can be found at http://www.rba.gov.au/

Janu Chan, Senior Economist
Ph: 02-8253-0898

Contact Listing

Chief Economist	Senior Economist	Senior Economist
Hans Kunnen	Josephine Horton	Janu Chan
kunnenh@bankofmelbourne.com.au	hortonj@bankofmelbourne.com.au	chanj@bankofmelbourne.com.au
(02) 8254 8322	(02) 8253 6696	(02) 8253 0898