RBA Still Playing the Waiting Game

- **At the RBA's August board meeting today, the RBA left the cash rate unchanged at 2.0%, as expected. Again, the RBA remained vague on guidance of monetary policy stating that it will assess economic and financial developments in the period ahead to determine the stance of policy. The RBA continues to play a waiting game.**
- **While any bias towards shifting rates continues to be towards easing, the tone of the accompanying statement suggests that if anything, the RBA is less inclined to ease than in previous months. The surprising strength in the labour market and the fall in the Australian dollar have slightly shifted the pendulum away from further monetary policy easing.**
- **Most notable in today's statement was a stronger recognition that the labour market has improved and was despite the pace of economic growth at "below longer-term averages". The RBA has recently outlined possible reasons for this phenomenon.**
- **Another notable change in the language of today's Statement was the comments on the Australian dollar, and could suggest that the Australian dollar is now closer to where the RBA considers as fair value.**
- **We should receive further clues in the RBA's Statement on Monetary Policy which will be released on Friday.**
- **It is likely the RBA will continue to assess developments for a little while longer. There are a few tentative signs of improvement in the non-mining sector, but it remains uncertain whether it will offset further significant falls in mining investment enough and if the domestic economy will pick up sufficiently for the RBA next year. A further reduction to the cash rate cannot be fully ruled out, but we continue to expect the RBA to keep rates on hold until late 2016.**

At the RBA's August board meeting today, the RBA left the cash rate unchanged at 2.0%, as expected. Again, the RBA remained vague on guidance of monetary policy stating that it will assess economic and financial developments in the period ahead to determine the stance of policy. The RBA continues to play a waiting game.

We continue to view that any bias towards shifting rates will be towards easing – the RBA maintains that monetary policy needs to be accommodative, inflation remains well-contained and that the economy is operating with a degree of spare capacity.

However, the tone of the accompanying statement suggests that if anything, the RBA is less inclined to ease than in previous months.

Most notable was a stronger recognition that the labour market has improved. The RBA continued to note that economic growth was "below longer-term averages" but that it was "associated with somewhat stronger growth of employment and a steady rate of unemployment over the past year".

The combination of below trend growth and a broadly steady unemployment rate has been somewhat of a puzzle. In recent commentary, RBA governor Stevens has hinted that this could be due to a lower potential rate of growth – thus the rate of growth that is neither inflationary or disinflationary could be lower than previously thought. If the RBA board takes this view, it would lower the benchmark for economic growth and limit the likelihood of lowering the cash rate further. The concept of lower potential growth is not new and not unique to Australia and has been raised many times in other developed economies.

Other possible reasons for low growth combined with a relatively strong labour market could include greater flexibility in wage growth, that GDP data is underestimating the true pace of economic activity or that recent labour market data has been overstated.

Another notable change in the language of today's Statement was the comments on the Australian dollar. The remark that "further depreciation seems both likely and necessary" has now been omitted from today's Statement. The RBA now states that the Australian dollar is "adjusting to the significant declines in key commodity prices". This could be interpreted to mean that the Australian dollar is now closer to where the RBA considers as fair value. Our long-held AUD forecast for end 2015 is 73 US cents, although this forecast is partly contingient on commodity prices not falling significantly further. The Australian dollar bounced from 72.9 US cents prior to the RBA release to 73.5 US cents at the time of writing.

The RBA appears unsurprised by recent inflation data, which confirmed that "inflation pressures have been contained."

Outlook for Monetary Policy

The surprising strength in the labour market and the fall in the Australian dollar have slightly shifted the pendulum away from further monetary policy easing. How much so will depend on the RBA's reasoning behind low growth and a steady unemployment rate. We should receive further clues in the RBA's Statement on Monetary Policy which will be released on Friday.

It is likely the RBA will continue to assess developments for a little while longer, and will hold off from moving rates. There are a few tentative signs of improvement in the non-mining sector, but it remains uncertain whether it will offset further significant falls in mining investment, and if the domestic economy will pick up sufficiently for the RBA next year. Another reduction to the cash rate in this cycle therefore cannot be fully ruled out.

We continue to expect the RBA to keep rates on hold until late 2016, unless the domestic economy fails to pickup sufficiently as expected, or international developments take a turn for the worse.

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

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