Tuesday, 5 May 2015

Bank of Melbourne

RBA Cuts Cash Rate To 2.00%

- **he RBA cut the cash rate from 2.25% to 2.00% today. The cut was accompanied by one of the RBA's shorter statements. Presumably, further comments on the RBA's view of the world will come in Friday's quarterly Statement on Monetary Policy.**
- **In the RBA's justification for today's cut, it said that "the inflation outlook provided the opportunity for monetary policy to be eased further".**
- **The RBA is focusing on the outlook for demand and noted the weakness in overall business investment for both non-mining and mining investment. This is despite noting an improvement in consumer spending and the labour market.**
- **Has the RBA dropped its easing bias? An easing bias was not in the Governor's statement – but then again many things were missing from the governor's one page note. We suspect the easing bias has been put on the back burner but could be turned back on if need be.**
- **The RBA has stepped up its desire for a weaker Australian dollar. A decline in the Australian dollar is not only "likely" but also "necessary".**
- **We expect the RBA to remain on hold for the remainder of 2015 – unless domestic demand fails to pick up over the next 12 months or there is some global financial issue that it must respond to.**

RBA Statement: At its meeting today, the Board decided to lower the cash rate by 25 basis points to 2.0 per cent, effective 6 May 2015.

The global economy is expanding at a moderate pace, but commodity prices have declined over the past year, in some cases sharply. These trends appear largely to reflect increased supply, including from Australia. Australia's terms of trade are falling nonetheless.

Our view: *It appears as if the RBA is leaving its outlook comments for Friday's Statement on Monetary Policy. Nothing is said about the outlook for the United States, Europe or China.*

RBA Statement: The Federal Reserve is expected to start increasing its policy rate later this year, but some other major central banks are stepping up the pace of unconventional policy measures. Hence, financial conditions remain very accommodative globally, with long-term borrowing rates for sovereigns and creditworthy private borrowers remarkably low.

Our view: *Without doubt, global long-term borrowing rates are historically low. This may change when the US lifts its interest rate structure but the timing of any US rate hike remains unclear. The US Fed is treading carefully.*

RBA Statement: In Australia, the available information suggests improved trends in household demand over the past six months and stronger growth in employment. Looking ahead, the key drag on private demand is likely to be weakness in business capital expenditure in both the mining and non-mining sectors over the coming year. Public spending is also scheduled to be subdued. The economy is therefore likely to be operating with a degree of spare capacity for some time yet. Inflation is forecast to remain consistent with the target over the next one to two years, even with a lower exchange rate.

Our view: *Despite the decision today, the RBA's assessment on current domestic conditions was a touch more upbeat. The RBA cited the recent improvement in consumer spending and the better picture of health in the labour market. However, not surprisingly, the RBA is focusing on the outlook for demand and noted the weakness in overall business investment. Non-mining investment has been identified, in addition to mining investment.*

RBA Statement: Low interest rates are acting to support borrowing and spending, and credit is recording moderate growth overall, with stronger lending to businesses of late. Growth in lending to the housing market has been steady over recent months. Dwelling prices continue to rise strongly in Sydney, though trends have been more varied in a number of other cities. The Bank is working with other regulators to assess and contain risks that may arise from the housing market. In other asset markets, prices for equities and commercial property have been supported by lower long-term interest rates.

Our view: *The RBA continues to be encouraged by the pickup in business credit, which provides a positive sign of confidence. Nonetheless, it appears that other available information to the RBA continues to suggest that the non-mining investment outlook is weak. The RBA seems relatively relaxed about housing market developments given that lending growth has been steady. The RBA appears to be relying on APRA's measures to limit risks emanating from the housing market.*

RBA Statement: The Australian dollar has declined noticeably against a rising US dollar over the past year, though less so against a basket of currencies. Further depreciation seems both likely and necessary, particularly given the significant declines in key commodity prices.

Our view: *A decline in the Australian dollar is not only "likely" but also "necessary". The RBA continues to prefer stimulus come in the form of a weaker Australian dollar. At the announcement of today's cash rate decision, the AUD initially fell, but then rebounded higher.*

RBA Statement: At today's meeting, the Board judged that the inflation outlook provided the opportunity for monetary policy to be eased further, so as to reinforce recent encouraging trends in household demand.

Our view: *Has the easing bias gone or is the RBA simply being silent on the issue? We expect the RBA to maintain the cash rate at 2.00% for the remainder of the year, unless domestic demand fails to pick up over the next 12 months or global developments take a turn for the worse.*

Hans Kunnen, Chief Economist & Janu Chan, Senior Economist
Ph: 02-8254-8322

Contact Listing

Chief 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