RBA Still in Neutral, We Expect Rate Cuts

The Reserve Bank (RBA) left the cash rate unchanged at 1.50% after its Board meeting today. This decision was widely expected. The RBA has not shifted the cash rate since August of 2016.

We expected the accompanying statement to be more cautious than the previous one published on Feburary 5 because in a speech to the National Press Club on February 6 the RBA Governor adopted a neutral bias. Governor Lowe explained that the RBA could now envisage scenarios where the cash rate might go up and scenarios where it might go down with the risks evenly balanced around these scenarios. We did not get as strong a sense of this rhetoric in today's statement. Indeed, the changes to today's statement were minimal.

In explaining the change in bias in February, Lowe indicated that downside risks to the global economy and domestic economy had increased.

Today, on the global economy the RBA statement repeated that the global economy slowed in the second half of this year, but added that "the slower pace of growth has continued into 2019". The statement added that "the outlook for the global economy remains reasonable, although downside risks have increased". The trade tensions were highlighted as a source of uncertainty for the world economy.

Earlier today, we received news that the Chinese government cut its growth forecast to 6.0-6.5% for this year. Last year, the economy grew by 6.6%. Forward-looking indicators of Chinese economic activity, such as the purchasing managers' indices, suggest slower growth is indeed in store for China.

On the domestic front, the RBA maintained employment in the spotlight. Indeed, the favourable language on employment growth was stepped up today with the RBA adding "there has been a significant increase in employment". The RBA continues to expect a further decline in the unemployment rate to 4¾% over the next couple of years. Employment is a lagging economic indicator. Our softer growth forecast for this year compared with the RBA's forecast means we think it will be harder to sustain the employment pace required for the unemployment rate to sustainably reach 4¾%.

The RBA continues to expect the improvement in the labour market to see some further lift in wages growth over time, although the RBA concede this is still expected to be a "gradual process". The recent wages data published suggests the recovery in wages growth is still akin to a grind.

The RBA proceeded to note that other indicators suggest the Australian economy slowed over the second half of 2018. We expect tomorrow's GDP data will vindicate this slowdown. For the December quarter, we expect a modest lift in growth, taking annual GDP growth to below trend. The data should show that the Australian economy lost considerable momentum in the second half of this year, as the housing downturn deepened and impacted economic activity.

The RBA is still expecting growth this year of around 3% as its central scenario. We see this RBA growth forecast as too optimistic and expect the RBA will need to revise down its growth forecasts in coming months.

The RBA reiterated that the main domestic uncertainty continues to be household consumption, especially in the context of weak growth in household income and falling house prices in some cities. In the past, it has been unclear as to whether the RBA sees falling dwelling prices as a significant threat to consumer spending. With the RBA tying the uncertainty in household consumption to falling house prices, the RBA seems to be admitting there is an impact and they're considering this effect more intently.

On the housing market, the RBA also noted that credit conditions for some borrowers have tightened a little further over the past year or so. The RBA also describes housing conditions as remaining soft.

Our weaker growth outlook and the downside risks we attach to the consumption outlook coming from the slowdown in housing amid subdued wages growth means we expect the RBA to cut the cash rate later this year.

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