Interest Rate Outlook

Tuesday, 6 October 2015

Bank of Melbourne

RBA – Steady As She Goes

- **At the RBA's October board meeting today, the RBA left the cash rate unchanged at 2.0%, as expected.**
- **The broad message of the Statement was very similar to those of previous months - the RBA will continue to assess economic and financial conditions and appears comfortable with the pace of both domestic and global economic growth. This suggests to us that the cash rate will be on hold well into 2016.**
- **Financial markets may be pricing in a rate cut by March 2016 but we disagree on the basis of our outlook for global and domestic economic activity.**
- **The RBA board noted that house prices in Melbourne as well as Sydney have risen strongly over the past year. However, actions taken by APRA appear to have constrained the risks arising out of these heated housing markets.**
- **Financial markets functioned well during September despite considerable volatility. Financial market conditions did not tighten significantly.**
- **The foreign exchange market was encouraged by the RBA's Statement and pushed the AUD higher. This suggests that the foreign exchange market was positioned for a more 'doveish' commentary from the RBA.**

At the RBA's October board meeting today, the RBA left the cash rate unchanged at 2.0%. With the decision widely expected, the focus was on the commentary surrounding the decision.

The broad message of the Statement was similar to that of the past two months. The RBA will continue to assess economic and financial conditions and appears comfortable with the pace of both domestic and global economic growth. This suggests to us that the cash rate will be on hold well into 2016.

Financial markets may be pricing in a rate cut by March 2016 but we disagree on the basis of our outlook for global and domestic economic activity.

The few changes to the RBA's accompanying statement dealt with the ongoing functioning of financial markets in the face of volatility; house prices in Melbourne and the impact of regulatory measures to contain risk arising from the housing market.

House prices have risen strongly in Melbourne as well as in Sydney over the past year. Given the increase in debt associated with much of these increases, the RBA and APRA have been concerned about the potential risks to the financial system if house prices were to drop sharply. The move by APRA to reduce risk by constraining lending to housing investors is, in the eyes of the RBA board, beginning to have an impact.

In our view, the housing market will not prevent the RBA from moving its cash rate should the need to change it arise over the next twelve months.

The volatility seen in equity markets around the globe in the past month was unsettling for many investors but the RBA noted that financial markets continued function, mostly unimpaired. There was no cause for panic nor for wholesale adjustments to forecasts of global economc growth.

Outlook for Monetary Policy

The RBA remains in a "wait and see" mode despite some recent volatility in global financial markets.

The US economy continues to grow, Europe and Japan continue to stimulate their economies via quantitative easing and China has the firepower to stimulate its economy should it feel the need.

The domestic economy continues to undergo a slow and difficult transition from mining investment to growth driven by other sectors of the economy. Nonetheless, there are tentative signs of improvement. 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/

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