RBA Leaves Cash Rate At 1.50%

- The RBA left its cash rate at 1.50% following its September board meeting having reduced it by 25 basis points in both May and August. The accompanying Statement by the RBA Governor was little changed from the previous month. There was no implicit bias to ease.
- The Statement ended with the view 'that holding the stance of policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time.' While we expect economic growth to be close to trend in the year ahead, we are less certain that the RBA's inflation targets can be reached under current conditions.
- We do not disagree with the bulk of the RBA's analysis. The economy is growing despite the fully anticipated decline in mining investment. Exports are playing their part in economic growth and jobs continue to grow.
- Missing from today's Statement was the RBA's previously stated belief that 'the likelihood of lower interest rates exacerbating the risks in the housing market has diminished.' The growth in the supply of apartments on the eastern seaboard is noted but given the low interest rate environment and the ongoing increase in the population, housing continues to be sold quickly and at higher prices.
- Given our doubts regarding a pick-up in inflation, we expect the RBA to cut its cash rate in November – unless there is a turnaround in underlying economic conditions or housing regains stronger momentum than expected. A substantially lower AUD could be one of those changes in underlying conditions.

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Missing from today's Statement was the RBA's previously stated belief that "the likelihood of lower interest rates exacerbating the risks in the housing market has diminished." It will take several months before we can be sure of the impact of the August rate cut but we note that auction clearance rates in August were firm and prices headed higher in most capital cities.

The Statement ended with the view "that holding the stance of policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time." While we expect economic growth to be close to trend in the year ahead, we are less certain that the RBA's inflation targets can be reached under current conditions. Given these doubts, we expect the RBA to cut its cash rate later this year – unless there is a turnaround in underlying economic conditions.

The underlying conditions keeping inflation subdued, and below the RBA's targets, include low wage growth, ongoing competitive pressure in the retail sector, ongoing savings levels across the household sector and the reduced spending power of those reliant on their savings income. The RBA also notes that "the global economy is continuing to grow, at a lower than average pace", suggesting little inflationary impetus from offshore.

We do not disagree with the bulk of the RBA's analysis. The economy is growing despite the fully anticipated decline in mining investment. Exports are playing their part in economic growth and jobs continue to grow.

The growth in the supply of apartments on the eastern seaboard is noted in the Statement but given the low interest rate environment and the ongoing increase in the population, housing continues to be sold quickly and at higher prices.

Outlook for Monetary Policy

Tomorrow will provide news on the underlying pace of economic growth. We expect GDP growth of 0.5% for the quarter and 3.2% for the year. These would be creditable outcomes but they do disguise the fact of considerable variation across the States and Territories. The headline GDP figures also hide the squeeze in nominal incomes resulting from lower prices.

We expect the RBA will need to cut its cash rate again in the current cycle in order to lift underlying inflation towards its target of 2-3% over the course of the economic cycle. Unless there are changes to underlying economic conditions, we expect the cash rate to fall to 1.0% by mid-2017. We expect the first cut to occur in November - unless there is a turnaround in underlying economic conditions or housing regains stronger momentum than expected. A substantially lower AUD could be one of those changes in underlying conditions.

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

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