Labour Market in Focus for the RBA

The Reserve Bank of Australia (RBA) board met today and left the official cash rate on hold at 1.50%. The RBA is unlikely to move the cash-rate lever any time soon and the language in today's statement said very little to suggest otherwise.

What leapt off the page in today's statement was the commentary on the labour market and China. The RBA stepped up its optimism on the labour market, but dialled down its optimism on China's economy.

We had flagged that we would be looking at the commentary on the labour market in particular. Between the last RBA board meeting in July and today, employment data surprised on the strong side of expectations. Employment jumped nearly 51k in June, well above consensus expectations and well outside of the range of consensus forecasts.

On the labour market, the RBA said "employment growth continues to be faster than growth in the working-age population". This sentence is a reference to the employment-to-population ratio, which is another measure of the health of the labour market. The employment-to-population ratio rose to 62.1 in June 2018 – a higher rate has not been recorded since March 2011. This ratio has the benefit of ignoring the participation rate, which has been trending higher over recent years. The lift in the participation rate has meant job gains have had to be greater to cause a fall in the unemployment rate.

Secondly on the labour market, the RBA said it expects a gradual decline in the unemployment rate over the next couple of years and in today's statement gave us an end forecast for this period for the first time – 5%. This forecast is 0.4 percentage points lower than the current unemployment rate of 5.4%.

Wages will be a key factor in determining the inflation outlook. The RBA continues to expect the improvement in the labour market and economy to bring a lift in wages growth over time. But that wages growth remains low and this "is likely to continue for a while yet".

Since the last Board meeting, the RBA also received an update on consumer prices. It showed headline inflation edged up to 2.1% per annum, but underlying inflation remained under the RBA's 2-3% target band at 1.9%.

The RBA notes that the latest inflation data was in line with its expectations and that the central forecast is for inflation to be higher in 2019 and 2020 than it is currently. This is not very different from its previous statement where the central forecast was noted as a a bit above 2% for 2018.

However, the RBA stated today that in the interim, once-off declines in some administered prices in the September quarter are expected to result in headline inflation a little lower than earlier expected, at 1.75%.

On economic growth, the RBA has also kept its central forecast unchanged. GDP growth is expected to average a bit above 3% in 2018 and 2019. The RBA has added today that "the drought has led to difficult conditions in parts of the farm sector".

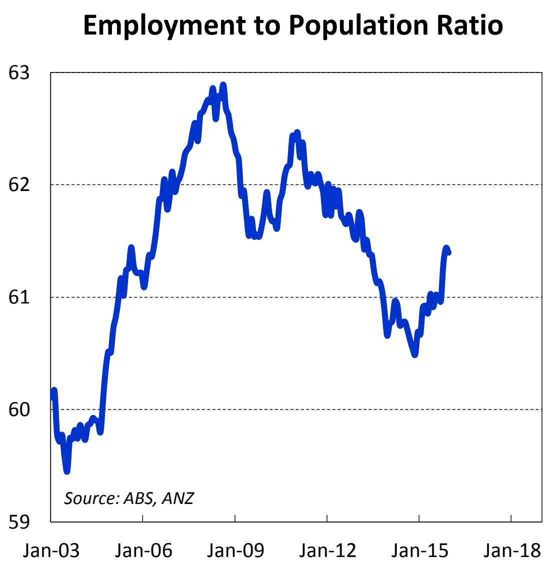
The RBA also devoted more room to a discussion on money-market interest rates. These are elevated (causing short-term funding premiums to be wide), although they have declined modestly since the end of June. The RBA notes that these higher money-market rates have not fed through into higher interest rates on retail deposits. Further, it has caused some lenders to increase their mortgage rates by small amounts, although the average mortgage rate paid is lower than a year ago.

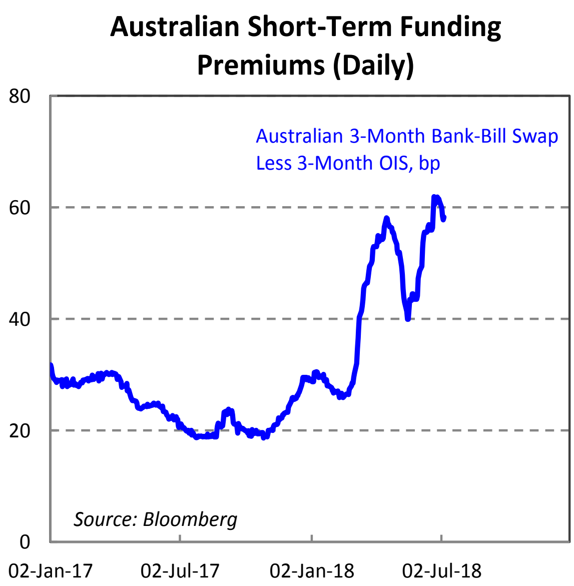
On the global front, some pessimism entered the fray with the RBA characterising growth in China has having "slowed a little". This description is a downgrade from the July statement where Chinese growth was characterised as continuing to "grow solidly".

The RBA repeated that the global economic expansion is continuining and that one uncertainty regarding the global outlook stems from the direction of international trade policy in the US.

Tomorrow, the Reserve Bank Governor will give his annual speech at the Anika Foundation lunch. The title of his speech is Demographic Change and Recent Monetary Policy. This speech will conclude with a questions-and-answers session. On Friday, the quarterly Statement on Monetary Policy will follow.

By the end of this week, we expect the message to be the same. This message is that the next move in the cash rate will be up, but not for some time to come. We expect the window will be live from the middle of next year, but for the RBA to wait until early 2020 to hike.





Besa Deda, Chief Economist
Ph: 02-8254-3251

Contact Listing

Chief Economist	Senior Economist	Senior Economist
Besa Deda	Josephine Horton	Janu Chan
dedab@bankofmelbourne.com.au	hortonj@bankofmelbourne.com.au	chanj@bankofmelbourne.com.au
(02) 8254 3251	(02) 8253 6696	(02) 8253 0898

The Detail