Tuesday, 20 June 2017

Minutes of the June RBA Board Meeting

Growth set to improve but inflation to stay low

- **A theme in today's Reserve Bank minutes from the June meeting was one of a central bank cautiously optimistic about the outlook for economic growth, but one that also saw few signs of wage or inflation pressures. It is a combination that leaves the RBA on hold.**

- **Risks to economic growth were centred on the rise in household indebtedness and weak incomes growth such that the growth of the former is now outpacing the latter. This trend poses risks to household spending at a time when retailing conditions are characterised as challenging by the RBA.**

- **Employment growth was expected to continue, but slack remained in the jobs market, judged by the number of employed people who would like to work more hours.**

- **Housing is the other implicit risk to the growth outlook. On this front, the RBA noted that for Sydney and Melbourne, the two cities on the radar, there had been some tentative signs of easing in housing conditions. The RBA notes that it would take some time for the full effects of the latest prudential supervision measures to flow through to the housing lending data.**

- **Some positive aspects to the growth outlook worth noting from the minutes is that the RBA's assessment that the drag to the economy from the transition to lower levels of mining investment (after the mining boom) was "almost complete".**

- **Moreover, Board members further noted that surveyed business conditions and business investment in those parts of the economy not directly affected by the drop in mining investment had improved.**

- **Global economic conditions are continuing to improve and encouragingly are showing some signs of flowing through to business investment, a necessary condition for a more self-sustaining dynamic in the world economy.**

The minutes of the June board meeting covered a lot of ground. It presented a central bank that was cautiously optimistic of an improvement in economic growth over time but one that also expected inflation to remain low. Wages growth is expected to stay "low" and core consumer prices (which strip out the prices of volatile items) is expected to remain subdued.

The combination leaves a central bank that is unlikely to shift the cash rate any time soon. We expect the cash rate to stay on hold at 1.50% for the foreseeable future.

While economic growth is projected to improve, it is clear that there are risks to this outlook. In particular, from the rise in household indebtedness; growth in household debt is now growing faster than income growth. This trend poses risks to household spending. This risk was underscored by the RBA's assessment of conditions in the retailing sector, which accounts for a large share of overall household spending.

Retailing conditions were characterised as "challenging", according to liaison and survey data and this is even before the potential arrival of Amazon and Alibaba to Australia.

Employment growth, which is a critical determinant of household spending and also of wages pressures, had picked up over this year. The RBA indicated that forward-looking indicators of labour demand suggested that this recent pace of employment growth was likely to continue. But while the unemployment rate had fallen, the number of people who would like to work more hours had not declined. It indicates that some slack in the labour market remains. At last month's board meeting (May), the RBA spent time explaining why the distinction between part-time jobs growth and full-time jobs growth had become less important over time in assessing conditions in the jobs market. Assessing the additional hours workers were willing and able to contribute as well as the number of unemployed should give a more comprehensive picture.

Housing is the other risk to the growth outlook; the RBA was not explicit about this risk, but the devotion to financial stability considerations and their bearing on monetary policy decisions implicitly suggests this to be the case.

Residential building activity is expected to remain high over the forecast period, but the pipeline of work to be done was likely to decline.

In terms of housing markets in Sydney and Melbourne, the two cities on the radar, the RBA notes there had been some tentative signs of easing in housing conditions. Specifically, housing price growth and auction clearance rates in both cities had decline.

The RBA notes that it would take some time for the full effects of the latest prudential supervision measures introduced by the Australian Prudential Regulation Authority (APRA) to flow through to the housing lending data.

Some positive aspects to the growth outlook worth noting from the minutes is that the RBA's assessment that the transition to lower levels of mining investment after the mining boom was "almost complete". This statement indicates that the drag on economic activity from this transition is set to lesson.

The RBA further notes that surveyed business conditions and business investment in those parts of the economy not directly affected by the drop in mining investment had improved. The capital expenditure survey published by the Australian Bureau of Statistics (ABS) continued to imply subdued growth in non-mining investment for the next year or so. However, members of the Board noted that this survey covers only around half of non-mining investment and excludes investment in areas such as health & education, and intangible assets, such as software, for which investment growth had been strongest in recent years.

The global economic outlook was viewed as underpinning economic growth in Australia. Board members noted that Australian economic growth was (still) expected to increase gradually over the next couple of years to a little over 3% per annum. The RBA notes again that global economic conditions had continued to improve in 2017. Steady and solid consumption growth in the world economy was viewed as having underpinned growth in the world economy. The improvement in global economic conditions had been evident in strong growth in goods trade and industrial production and there are now “some signs” that this strength was flowing through to business investment. A more broadly-based strengthening in business investment would be encouraging because it would help in generating a self-sustaining positive dynamic in the world economy.

Similar to Australia, core inflation in the key advanced economies was subdued.

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