Tuesday, 1 May 2018

RBA Gets Comfy on the Sidelines

The Reserve Bank of Australia (RBA) board met today. As universally expected, the RBA Board left the cash rate on hold at 1.50%. It is the 22nd consecutive month that the cash rate has stayed at this level. The accompanying statement suggests that settings will remain on hold for the rest of this year.

The accompanying statement remains cautiously optimistic about the economic outlook, however, the RBA retained that some risks have arisen, especially in global financial markets. These risks relate to volatility, partly because of concerns about the direction of international trade policy in the US.

There were only a few changes to the statement today from the one published after last month's meeting.

The first change is that the RBA noted that the oil price and prices of base metals had risen recently. The RBA still expects the terms of trade to decline over the next few years, but this recent rise in commodity prices suggests the trajectory of the decline in the nearer term will be softer.

The second change related to the forecast for Australian economic growth. In February, the RBA had moved away from an explicit projection for growth, giving the perception to some market participants that perhaps the RBA had lowered its GDP forecasts. This month, the RBA returned to providing a more explicit projection. The RBA said that its central forecast was "for growth to pick up, to average a bit above 3 per cent in 2018 and 2019". The RBA further notes that this sort of growth should see "some reduction in spare capacity in the economy". As spare capacity is reduced, the pressures on inflation generally grow. The next move in the cash rate should still be up as a result and these economic projections are consistent with this view.

The third change was an acknowledgement from the RBA that employment growth had "slowed over recent months" after strong growth over the past year. The RBA reiterated this month that various forward-looking indicators continue to point to solid growth in employment in the period ahead, with a further gradual reduction in the unemployment rate expected.

Finally, the RBA also acknowledged the depreciation in the Australian dollar in recent times. Indeed, the Australian dollar has depreciated by 9.4% against the US dollar and by 8.6% in trade-weighted terms since its peak earlier this year. However, the RBA noted that on a trade-weighted basis, the Aussie dollar remains within the range that it has been over the past two years.

We continue to expect the RBA to leave the cash rate on hold this year. Overnight-indexed swap (OIS) pricing suggests financial markets also hold this view. The OIS market has a probability of 32% attached to an RBA rate hike of 25bp before the end of this year. This probability compares to 91% just six months ago.

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