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RBA Cash Rate Outlook

Cash Rate Lowered to 0.75%

- **Today, the Reserve Bank (RBA) lowered the official cash rate by 25 basis points to a new record low of 0.75%. This decision was in line with our forecast which we have had in place since July 24.**
- **A range of factors have supported the decision to lower official interest rates. Economic growth is running below trend and is at its slowest pace since 2009. Underlying inflation has held below the RBA's 2 to 3% target band for 3½ years. While there has been strong growth in employment, the unemployment rate has been propped up by a record high workforce participation, and is preventing prospects for wage growth to pick up from its slow pace.**
- **Adding to these domestic factors, the international environment has been increasingly uncertain. As trade tensions have persisted and dented investment intentions and trade flows for businesses, major central banks around the world have lowered interest rates. The RBA specifically noted that lower global interest rates was taken into account in today's decision.**
- **On the domestic economy, the RBA had some increased doubts in regards to the recovery, which was described as a "gentle turning point". This phrase was also used by Governor Lowe in a recent speech.**
- **The RBA is clearly hoping for an improvement in economic activity, which will lead to a falling unemployment rate. These outcomes will assist the RBA in achieving the broader goal of bringing inflation back towards its 2 to 3% target. Both domestic and international developments are frustrating the progress towards the RBA's aims.**
- **Without these further signs of improvement it would seem likely that the RBA would provide further monetary policy support. We are expecting another rate cut early next year, in February, to 0.50%.**

The Reserve Bank (RBA) lowered the official cash rate by 25 basis points today to a new record low of 0.75%. This decision was in line with our forecast which we have had in place since July 24.

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Indeed, in the accompanying Statement today, the RBA Board "took account of the forces leading to the trend to lower interest rates globally and the effects this trend is having on the Australian economy and inflation outcomes".

On the domestic economy, the RBA had some increased doubts in regards to the the recovery, which was described as a "gentle turning point". This phrase was also used by Governor Lowe in a recent speech.

Most notably, the language around the pick up in household incomes, was also more cautious. Households have received a boost to incomes from earlier rate cuts and tax rebates, but there is less confidence that these measures will boost spending as much as the RBA would like.

The outlook for consumption was still the "main domestic uncertainty" but was followed by "the sustained period of only modest increases in household disposable income continuing to weigh on consumer spending". Previously, "a pick-up in growth in household disposable income and a stabilisation of the housing market are expected to support spending".

For the outlook, the RBA continued to reiterate that "an extended period of low interest rates will be required", and that it is "prepared to ease monetary policy further if needed".

Of note, the RBA has also included "full employment" to its list of goals, in addition to "sustainable growth" and "the achievement of the inflation target over time". It highlights the importance of bringing down the unemployment rate closer to 4.5%, the RBA's estimate of the unemployment rate at full employment.

Implications and the Outlook

The RBA is clearly hoping for an improvement in economic activity, which will lead to a falling unemployment rate. These outcomes will assist the RBA in achieving the broader goal of bringing inflation back towards its 2 to 3% target.

Both domestic and international developments are frustrating the progress towards the RBA's aims.

Domestically, the key risk is the ongoing restraint in spending by the consumer, under the weight of slow wage growth and high household debt. There are few signs of a meaningful pick up in consumer spending to date, despite a boost to incomes from tax rebates and rate cuts from the middle of this year.

Internationally, uncertainty is lingering amid the ongoing trade conflict and other geopolitical risks. Expectations remain for central banks to ease monetary policy further.

Moreover, the current below trend rate of growth suggests that the unemployment rate continues to be at risk of moving higher, and further away from the RBA's estimate of full employment.

Without further tangible signs of improvement it would seem likely that the RBA would provide further monetary policy support. We are expecting another rate cut early next year, in February, to 0.50%. At this point, there will be increasing talk of other ways the RBA can support the economy, such as unconventional monetary policy measures. These could include quantitative easing (or bond purchases) to bring down long-term interest rates.

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