Tuesday, 21 May 2019

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RBA Meeting Minutes & Governor Speech

RBA Prepares to Take Rate Action in June

- **We have been forecasting two rate cuts for this year since February 21. At the time, these forecasts were non-consensus. We are now bringing forward the timing of our rate cuts to June and August, from August and November previously.**
- **We did not expect the RBA to have cut in May, but we conceded it would be a close call. In recent weeks, we have highlighted that June is a live date. Both the board meeting minutes and Lowe's speech today have clearly spelt out a rate cut is on the way in June.**
- **Two paragraphs stood out in the minutes. The first paragraph included a statement that "members considered the scenario where there was no further improvement in the labour market in the period ahead, recognising that in those circumstances a decrease in the cash rate would likely be appropriate". Since the April board meeting, data showed a rise in the unemployment rate to an eight-month high of 5.2%, despite ongoing firm jobs growth.**
- **The minutes emphasised the RBA's growth and inflation forecasts were based on the assumption that the cash rate followed the path implied by market pricing. At the time the forecasts were prepared, market pricing implied a cut in the cash rate to 1% over the next year. Indeed, the RBA said "without an easing in monetary policy over the next six months, growth and inflation outcomes would be expected to be less favourable than the central scenario". However, the RBA's growth and inflation forecasts are hardly anything to write home about; the growth and inflation forecasts are sub par for 2019.**
- **The RBA has faced an unusual situation over much of the past year where the economy has lost momentum since the second half of last year, but the labour market has continued to show ongoing surprising strength. RBA Governor Lowe in this afternoon's speech to a Brisbane audience suggested they are not expecting the labour market to surprise on the upside, as it has done in recent months.**
- **Lowe indicated that we can have a lower unemployment rate that is consistent with the inflation target and should have an unemployment rate that is lower and monetary policy would help achieve these outcomes.**
- **From an inflation angle, Lowe said it will take a long time to get inflation back to the target band and the target remains the RBA's "north star", again implicitly suggesting monetary policy might need to help lead inflation back to the band.**

The RBA appears to be increasingly preparing for a move down in the cash rate. In the minutes of the Reserve Bank's (RBA) board meeting in May, two key paragraphs stood out as highlighting their bias to lowering the official cash rate.

The RBA Governor Lowe then gave a speech following the minutes titled "the economic outlook and monetary policy" to a Brisbane audience. His speech and remarks in the questions-and-answers session further cemented our expectations that a rate cut is on its way.

The first paragraph that stood out in the minutes stated that "members considered the scenario where there was no further improvement in the labour market in the period ahead, recognising that in those circumstances a decrease in the cash rate would likely be appropriate".

Since the April board meeting, we received labour market data for April. This data showed a lift in the unemployment rate to an eight-month high of 5.2%, despite ongoing firm jobs growth. The increase in the unemployment rate was mostly as a result of stronger workforce participation, also a signal of confidence in the labour market. However, the overall impact on inflation is deflationary because it suggests greater spare capacity (or greater availability of workers).

The second paragraph of note was the discussion about the assumptions of the RBA's forecasts. There was an explicit recognition that the central forecasts for growth and inflation were based on the technical assumption that the cash rate would follow market pricing. At the time the forecasts were prepared, market pricing implied that the cash rate was expected to decline by 50 basis points to 1% over the next year. Indeed, one rate cut of 25 basis points by July was fully priced and another rate cut before the end of this year almost completely priced in.

The RBA says "without an easing in monetary policy over the next six months, growth and inflation outcomes would be expected to be less favourable than the central scenario". However, the RBA's growth and inflation forecasts are hardly anything to write home about! The detailed RBA forecasts were contained in the recent Statement on Monetary Policy (published May 10). For 2019, GDP growth was forecast at 2.6% and underlying inflation growth at 1.75%, lifting to growth of 2.75% and underlying inflation of 2% in 2020. The 2019 forecasts are below trend for growth and below the bottom of the 2-3% per annum target band for underlying inflation.

RBA Governor Lowe concluded his speech with a key sentence. The sentence highlighted that in two weeks' time when the board meets, they "will consider the case for lower interest rates".

The RBA had faced an unusual situation where the economy has lost momentum since the second half of last year, but the labour market has continued to show ongoing surprising strength. RBA Governor Lowe in this afternoon's speech to a Brisbane audience suggested they are not expecting the labour market to surprise on the upside. Lowe said that while they can't rule out the possibility, "the recent flow of data makes it less likely". These remarks suggest that the RBA believe the slowing in GDP growth is giving the better signal to the outlook for the economy, again cementing the likelihood that the RBA is likely to cut the cash rate in the near term.

In the question-and-answer session that followed Lowe's speech, he explained that this year they have progressively reassessed how far the unemployment rate can fall whilst still being consistent with the RBA's inflation target. The RBA has seen evidence accumulate, including data in recent weeks, that the unemployment rate could move under 5% (currently at 5.2%) and still be consistent with the inflation target. Further, Lowe said monetary policy can help the unemployment move lower and we should want it go lower.

Lowe also confirmed that the RBA still targets inflation and described the inflation target band of 2-3% per annum as its "north star". In an answer to Westpac's Rory Robertson's question around an easing bias, Lowe responded "it is fair enough to say we have an easing bias", but refused to use the colourful language of "a red hot easing bias" put forward by Rory. Lowe in this same answer said to get inflation back to the band it would take a long time and so implicitly suggested that monetary policy would need to help inflation to do so.

We have been forecasting two rate cuts for this year since February 21. At the time, these forecasts were non-consensus. We are now bringing forward the timing of our rate cut projections to June and August, from August and November previously.

We did not expect the RBA to have cut in May, but we conceded it would be a close call. In recent weeks, we have highlighted that June is a live date. Both the board meeting minutes and Lowe's speech today have clearly spelt out a rate cut is on the way in June.

Once the RBA delivers on June 4, debate is likely to heat up around whether the RBA will take the cash rate under 1% in this easing cycle, but we will leave this discussion for another day.

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