Tuesday, 7 April 2015

RBA Leaves Cash Rate Unchanged at 2.25%

- **The RBA continues to hold its breath having left its cash rate on hold at 2.25%. The door has been left wide open for a further cut but the RBA will wait for further data to come in. We expect a rate cut to be announced in May.**
- **Nothing was said about economic conditions in Europe or about the risks facing the Chinese economy. These risks are real but manageable. Modest global economic growth will support economic activity in Australia.**
- **Non-mining investment remains the main source of weakness in the domestic economy. The question marks over the recovery in non-mining investment, the soft labour market and below trend pace of growth continue to suggest that another rate cut is likely.**
- **The RBA appeared more relaxed about developments in the housing market, noting that lending has not been "picking up further at present". That would suggest that the housing market is unlikely to be an impediment to cutting rates next month.**
- **An easing bias has been left in place. At the RBA's next meeting in May, the board will have the benefit of inflation data and the RBA's revised growth and inflation forecasts ahead of its quarterly Statement on Monetary Policy.**

RBA Statement: At its meeting today, the Board decided to leave the cash rate unchanged at 2.25 per cent.

Moderate growth in the global economy is expected in 2015, with the US economy continuing to strengthen, even as China's growth slows a little from last year's outcome.

Our view: *While the US economy has picked up, recent data has shown some loss of momentum. The US Fed seems intent on raising its Fed funds rate this year but the market and ourselves remain uncertain about the timing. June appears to be most likely. China's growth of close to 7% will continue to see demand for Australian product rise. While demand has fallen for iron ore, education services and tourism demand continue to pick up. Europe is still struggling but hopes its 'money printing' program will provide positive results.*

RBA Statement: Commodity prices have declined over the past year, in some cases sharply. The price of oil in particular is much lower than it was a year ago. These trends appear to reflect a combination of lower growth in demand and, more importantly, significant increases in supply. The much lower levels of energy prices will act to strengthen global output and temporarily to lower CPI inflation rates. Prices for key Australian exports have also been falling and therefore Australia's terms of trade are continuing to decline.

Our view: *Weaker commodity prices are hurting corporate earnings and the labour market. Royalties from minerals have declined and have dented some State government coffers. A lower AUD is providing some cushion for earnings but weaker commodity prices are a drag on the Australian economy. Lower oil prices are a mixed blessing. Fuel costs are lower but prices received for energy exports are likely to be lower.*

RBA Statement: Financial conditions are very accommodative globally, with long-term borrowing rates for several major sovereigns at all-time lows. Financing costs for creditworthy borrowers remain remarkably low.

Our view: *Global interest rates in the major economies are at or close to all time lows. German ten-year government bonds yield just 0.19% while in the US they sit at 1.9%. Our ten-year government bond yield, at just 2.30%, would have been unthinkable five or ten years ago. While the US seems likely to lift official short-term rates, bond yields are set to remain low as the ECB and the Bank of Japan engage in bond purchase programs.*

RBA Statement: In Australia the available information suggests that growth is continuing at a below-trend pace, with overall domestic demand growth quite weak as business capital expenditure falls. As a result, the unemployment rate has gradually moved higher over the past year. The economy is likely to be operating with a degree of spare capacity for some time yet. With growth in labour costs subdued, it appears likely that inflation will remain consistent with the target over the next one to two years, even with a lower exchange rate.

Our view: *The RBA's overall assessment on the economy is similar to last month, but this time, the RBA has singled out business capital expenditure as a source of weakness. The latest ABS capex survey, released in late February, suggested that the recovery in non-mining investment will stall. The RBA also conducts is own liason surveys with firms to assess their investment plans. The soft outlook for non-mining investment continues to support the case for another rate cut, along with ongoing weakness in the labour market.*

RBA Statement: Credit is recording moderate growth overall. Growth in lending to investors in housing assets is stronger than to owner-occupiers, though neither appears to be picking up further at present. Lending to businesses, on the other hand, has been strengthening recently. Dwelling prices continue to rise strongly in Sydney, though trends have been more varied in a number of other cities. The Bank is working with other regulators to assess and contain risks that may arise from the housing market. In other asset markets, prices for equities and commercial property have risen, in part as a result of declining long-term interest rates.

Our view: *The RBA appears more relaxed about developments in the housing market and noted that lending has not been "picking up further at present". That would suggest that the housing market is unlikely to be an impediment to cutting rates further. The RBA continued to note that it is working with "other regulators to assess and contain risks".*

Nonetheless, the RBA is encouraged by the recent pickup in lending to businesses, which could signal an improvement in confidence and translate into a lift in hiring and investment plans.

RBA Statement: The Australian dollar has declined noticeably against a rising US dollar over the past year, though less so against a basket of currencies. Further depreciation seems likely, particularly given the significant declines in key commodity prices. A lower exchange rate is likely to be needed to achieve balanced growth in the economy.

Our view: *The RBA remains unhappy with the level of the Australian dollar, but it has omitted the comment that the AUD "remains above most estimates of its fundamental value". Since the RBA's last meeting, the Australian dollar is marginally lower against the greenback, but has fallen 2.8% against a basket of currencies (trade-weighted terms). The RBA maintains that "a lower exchange rate is likely to be needed to achieve balanced growth in the economy." The fall in prices of key commodities, in particular the drop in iron ore prices in recent days, suggest that there remains downside risks to the Australian dollar.*

RBA Statement: At today's meeting the Board judged that it was appropriate to hold interest rates steady for the time being. Further easing of policy may be appropriate over the period ahead, in order to foster sustainable growth in demand and inflation consistent with the target. The Board will continue to assess the case for such action at forthcoming meetings.

Our view: *The RBA has left the door well and truly open for a further rate cut. We expect the RBA will cut the cash rate in May. Beyond that, rate movements will depend on how the data pans out.*

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