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The RBA Puts Its Faith in Jobs

- **In a highly anticipated decision, the Reserve Bank left the cash rate unchanged today at 1.50%.**
- **We maintained our forecast that the RBA would wait to cut the cash rate until the second half of this year (which is our forecast since February), but conceded it would be a close decision.**
- **The RBA's accompanying statement made it clear the RBA has put its faith in jobs. Today's on-hold decision was heavily steered by the firm trend in jobs growth.**
- **For some time the RBA has faced a conundrum. On the one hand, there has been a slowing of economic momentum since the middle of last year and inflation has remained subdued. But, amid this backdrop, jobs growth has stayed very strong. The RBA is likely trying to assess which scenario reflects more truly the underlying state of the economy.**
- **The flavour of the statement suggests the RBA believes the unemployment rate will decline over time. It has a forecast for the unemployment rate for 2021 of 4¾%, although this year and over next year the central bank expects the jobless rate to remain broadly around 5%.**
- **Looking ahead, the RBA continues to expect inflation "to pick up", but to do so only gradually". Underlying inflation has been running under the RBA's 2-3% per annum target band for over three years. The risk is it continues to take longer to get back in the band.**
- **The RBA today cut its inflation projections for this year and next year.**
- **Whether the RBA cuts the cash rate in coming months will boil down to the jobs market. In the final paragraph, the RBA said it needs further improvement in the labour market for inflation to be consistent with target. However, its broadly steady unemployment rate forecast until 2021 suggest a higher risk that a rate cut will be warranted.**
- **We continue to expect the RBA's next move in the cash rate to be a cut and in the second half of this year.**

Today's decision from the Reserve Bank (RBA) was highly anticipated. Interest-rate futures attached a 50% chance to a 25 basis point rate cut today. We maintained our forecast that the RBA would wait to cut the cash rate until the second half of this year (which is our forecast since February), but conceded it would be a close decision. In the event, the RBA left the cash rate unchanged at 1.50% and its accompanying statement made it clear the RBA was steered by the firm trend in jobs growth in keeping rates steady.

For some time the RBA has faced a conundrum. On the one hand, there has been a slowing of economic momentum since the middle of last year and inflation has remained subdued. But, amid this backdrop, jobs growth has stayed very strong. While employment is a lagging indicator of activity, some signs of slowing should have shown up by now.

The RBA is likely trying to assess which scenario reflects more truly the underlying state of the economy. The flavour of the statement suggests the RBA believes the unemployment rate will decline over time. It has a forecast for the unemployment rate for 2021 of 4¾%, although this year and over next year the central bank expects the jobless rate to remain broadly around 5%. The current unemployment rate stands at 5.0%.

The RBA highlighted again today that the "main domestic uncertainty continues to be the outlook for household consumption". Household consumption is being impacted by low income growth, high household debt and declining house prices. However, the RBA expects "some pick-up in growth in household disposable income" and this pick up "should support consumption". Today's data on retail-sales volumes shows household consumption remains soft; retail-sales volumes have shown no growth in six months.

The recent weak set of inflation numbers for the March quarter were addressed in the statement. The RBA noted that inflationary pressures are "subdued" across much of the country. The RBA explained that lower housing-related costs and a range of policy decision affecting administered prices both contributed to this outcome.

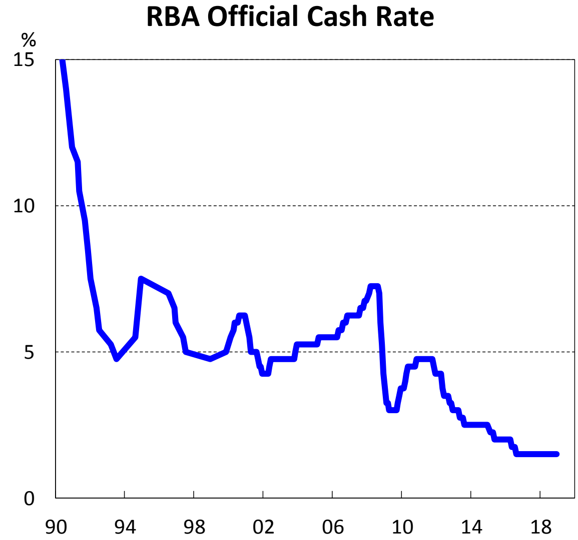
Looking ahead, the RBA continues to expect inflation"to pick up", but to do so only gradually". Underlying inflation has been running under the RBA's 2-3% per annum target band for over three years. The risk is it continues to take longer to get back in the band.

The RBA today cut its inflation projections. This year, the RBA now expects underlying inflation (i.e. trimmed mean measure) to be 1¾%, which is down from their previous forecast. For next year, the RBA cut their underlying inflation forecast from 2.1% to 2.0%. Headline inflation is expected to be higher this year at around 2%, boosted by higher petrol prices.

The RBA has maintained its existing GDP growth forecasts of 2¾% for this year and next year, which is broadly in line with trend. We are forecasting weaker growth than these forecasts and see potential for the unemployment rate to creep higher.

Whether the RBA cuts in coming months will boil down to the jobs market. So labour market releases take on added importance. In the final paragraph, the RBA said it needs further improvement in the labour market for inflation to be consistent with target. However, its broadly steady unemployment rate forecast until 2021 suggest a higher risk that a rate cut will be warranted.

RBA Official Cash Rate



We continue to expect the RBA's next move in the cash rate to be a cut and in the second half of this year.

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