Economic Insights

Economics | July 5 2016

Reserve Bank keeps rates at record lows

Reserve Bank Board meeting

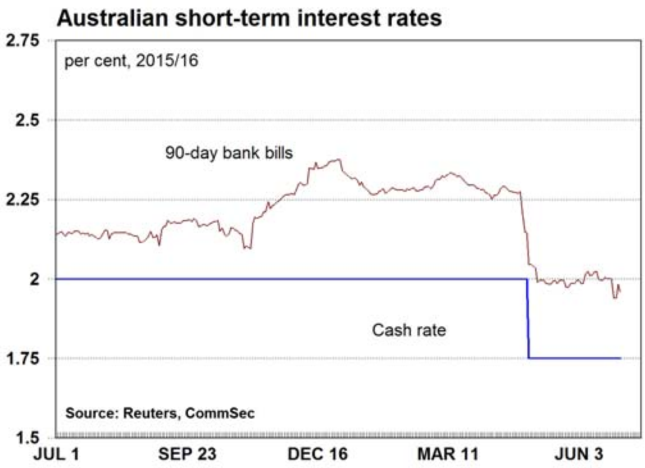
- **The Reserve Bank has left the cash rate at a record low of 1.75 per cent. The Reserve Bank has added in a slight easing bias. *"Over the period ahead, further information should allow the Board to refine its assessment of the outlook for growth and inflation and to make any adjustment to the stance of policy that may be appropriate"*.**

What does it all mean?

- The Reserve Bank has given no indication of an imminent rate cut. Rather policymakers have indicated that further time is needed to assess how the state of not just the Australian economy but also the recent shifts in the global economic landscape.
- Although the central bank did not comment on the Australian Federal election it is clear that the political uncertainty and the likely impact on economic activity will be watched closely in coming months. Particularly the effect that a minority government may have on non-mining business investment – the key ingredient missing in the economic recovery.
- You could argue that there is more risk to global growth than there was when the Reserve Bank last cut interest rates in May. The UK referendum to leave the European Union has added another dimension to risk. The uncertainty in the Euro zone has the potential to crimp growth and hurt exports from emerging economies to that region. The Reserve Bank statement summoned up the uncertainty on Brexi *"any effects of the referendum outcome on global economic activity remain to be seen and, outside the effects on the UK economy itself, may be hard to discern".*
- Interestingly central banks across the globe have vowed to provide stimulus if there is heightened volatility and a threat to financial markets, and the Reserve Bank is in the perfect position to also follow suit. Encouragingly the Reserve Bank has plenty of firepower to provide stimulus to the economy if it deems it necessary. And more importantly inflation remains well contained.
- The inflation landscape remains subdued. And if the June quarter inflation data (released on July 27) results in inflation remaining below the low end of the Reserve Banks 2-3 per cent target band, we would expect the central bank to cut the cash rate again in August.

Perspectives on interest rates

- The Reserve Bank left the cash rate at a record low of 1.75 per cent. The previous rate cut was in May 2016 (25 basis points), taking the cash rate to a record low of 1.75 per cent.
- There have been 11 rate cuts since November 2011.
- The Reserve Bank had previously lifted rates seven times from October 2009 to November 2010 – a total of 1.75 percentage points, from 3.00 per cent to 4.75 per cent.



Savanth Sebastian – Economist (Author)
(612) 9118 1805 (work); Twitter: @CommSec

What are the implications of today's decision?

- On balance rates still have scope to fall. It all depends on the Reserve Bank's assessment on how fast the economy can grow without generating inflation above the upper end of the 2-3 per cent target band.
- The accompanying statement had interesting observations on the labour market. The RBA notes a modest slowdown in employment. *"Labour market indicators have been more mixed of late, but are consistent with a modest pace of expansion in employment in the near term."* There is no doubt that activity levels have eased, with employment, housing and retail activity all noticing a marked slowdown in the first half of 2016. If the soft conditions persist over the next few months it will open the door for further rate cuts.
- We expect the Reserve Bank to cut rates again at the August meeting. At the August meeting the Reserve Bank will have digested the latest inflation data (released end July), as well as any further fallout from the UK Brexit decision, July US rate decision, and even a better understanding of the formation of Australian government.

Comparing the two most recent statements

- The statement from the June 2016 meeting is on the left; the statement from today's July 2016 meeting is on the right. Emphasis has been added to significant changes in the wording in the statements.

Media Release

No: 2016-16
Date: 7 June 2016
Embargo: For Immediate Release

**Statement by Glenn Stevens, Governor:
Monetary Policy Decision**

At its meeting today, the Board decided to leave the cash rate unchanged at 1.75 per cent.

The global economy is continuing to grow, at a lower than average pace. Several advanced economies have recorded improved conditions over the past year, but conditions have become more difficult for a number of emerging market economies. China's growth rate moderated further in the first part of the year, though recent actions by Chinese policymakers are supporting the near-term outlook.

Commodity prices are above recent lows, but this follows very substantial declines over the past couple of years. Australia's terms of trade remain much lower than they had been in recent years.

In financial markets, conditions have generally been calmer for the past several months following the period of volatility early in the year. Attention is now turning to some particular event risks. Funding costs for high-quality borrowers remain very low and, globally, monetary policy remains remarkably accommodative.

In Australia, recent data suggest overall growth is continuing, despite a very large decline in business investment. Other areas of domestic demand, as well as exports, have been expanding at a pace at or above trend. Labour market indicators have been more mixed of late, but are consistent with continued expansion of employment in the near term.

Inflation has been quite low. Given very subdued growth in labour costs and very low cost pressures elsewhere in the world, this is expected to remain the case for some time.

Low interest rates have been supporting domestic demand and the lower exchange rate overall is helping the traded sector. Over the past year, growth in credit to businesses has picked up, even as that to households has moderated a little. These factors are all assisting the economy to make the necessary economic adjustments, though an appreciating exchange rate could complicate this.

Indications are that the effects of supervisory measures have strengthened lending standards in the housing market. **Separately, a number of lenders are also taking a more cautious attitude to lending in certain segments**. Dwelling prices have begun to rise again recently. But considerable supply of apartments is scheduled to come on stream over the next couple of years, particularly in the eastern capital cities.

Taking account of the available information, and having eased monetary policy at its May meeting, the Board judged that holding the stance of policy unchanged at this meeting would be consistent with sustainable growth in the economy and inflation returning to target over time.

Media Release

No: 2016-17
Date: 5 July 2016
Embargo: For Immediate Release

**Statement by Glenn Stevens, Governor:
Monetary Policy Decision**

At its meeting today, the Board decided to leave the cash rate unchanged at 1.75 per cent.

The global economy is continuing to grow, at a lower than average pace. Several advanced economies have recorded improved conditions over the past year, but conditions have become more difficult for a number of emerging market economies. China's growth rate has moderated further, though recent actions by Chinese policymakers are supporting the near-term outlook.

Commodity prices are above recent lows, but this follows very substantial declines over the past couple of years. Australia's terms of trade remain much lower than they had been in recent years.

Financial markets have been volatile recently as investors have re-priced assets after the UK referendum. But most markets have continued to function effectively. Funding costs for high-quality borrowers remain low and, globally, monetary policy remains remarkably accommodative. Any effects of the referendum outcome on global economic activity remain to be seen and, outside the effects on the UK economy itself, may be hard to discern.

In Australia, recent data suggest overall growth is continuing, despite a very large decline in business investment. Other areas of domestic demand, as well as exports, have been expanding at a pace at or above trend. Labour market indicators have been more mixed of late, but are consistent with a modest pace of expansion in employment in the near term.

Inflation has been quite low. Given very subdued growth in labour costs and very low cost pressures elsewhere in the world, this is expected to remain the case for some time.

Low interest rates have been supporting domestic demand and the lower exchange rate since 2013 is helping the traded sector. **Financial institutions are in a position to lend and credit growth has been moderate.** These factors are all assisting the economy to make the necessary economic adjustments, though an appreciating exchange rate could complicate this.

Indications are that the effects of supervisory measures have strengthened lending standards in the housing market. Separately, a number of lenders are also taking a more cautious attitude to lending in certain segments. Dwelling prices have risen again in many parts of the country over recent months. But considerable supply of apartments is scheduled to come on stream over the next couple of years, particularly in the eastern capital cities.

Taking account of the available information, the Board judged that holding monetary policy steady would be prudent at this meeting. **Over the period ahead, further information should allow the Board to refine its assessment of the outlook for growth and inflation and to make any adjustment to the stance of policy that may be appropriate**.