

Investment markets research – Economic note

7 July 2009

“Hold the Line” - RBA stays at 3.0%

- The RBA holds the official cash rate at 3.0%, as widely expected by markets.
- The RBA retains a clear easing bias, based on declining inflation expectations, but the overall tone of today’s statement is a little more positive, suggesting that the most likely outlook is for the cash rate to remain unchanged at 3.0% in the months ahead.
- Global economic developments, inflation, employment and access to credit for households and businesses will remain the key factors for the RBA in assessing policy over H2 2009.

At today’s Board meeting, the Reserve Bank of Australia (RBA) decided to leave the official cash rate at 3.0%. This outcome was widely expected in markets. The RBA statement notes that **“the Board’s current view is that the outlook for inflation allows some scope for further easing of monetary policy, if needed”**. So the RBA retains a clear easing bias, but it does seem that **the overall tone of today’s statement from the RBA is slightly more positive than in June** and, given this, the near-term outlook is likely for the RBA to continue to hold the official cash rate steady at 3.0%. This view is clearly reflected in markets, with expectations for the cash rate at 2.995% in 1 month’s time, 2.92% in 6 months and 3.05% in 12 months.

Some of the highlights from today’s statement from the RBA are as follows:

- In June the RBA stated that “evidence has continued to emerge that the global economy is stabilising”. Now the RBA is much more emphatic, simply stating that **“the global economy is stabilising”**.
- Specifically the RBA noted that “conditions in global financial markets (are) improving and action to strengthen balance sheets of key financial institutions is underway.”
- In terms of the different economic regions, the RBA noted that “growth in China has strengthened considerably” and “there is tentative evidence that the US economy is approaching a turning point, but conditions in Europe are still weakening.”
- On the downside, however, the RBA also noted that “credit conditions remain tight and the effects of economic weakness on asset quality present a challenge. While the considerable economic policy stimulus in train around the world should support recovery, it is likely to be slow at first. For it to be durable, continued progress in restoring balance sheets is essential.”
- Turning to Australia, the RBA makes the significant statement that **“economic conditions in Australia have to date not been as weak as expected a few months ago.”**
- They also note, however, “output has been sluggish and capacity utilisation has fallen back to about average levels, with some further decline likely over the rest of the year. Weaker demand for labour is leading to lower growth in labour costs. **These conditions should see inflation continue to abate over the period ahead.”**
- We would also note that the Australian Fair Pay Commission today announced the decision to hold the minimum wage rate at \$A543.78 per week. While the trade union movement had asked for an \$A21 increase, +3.9%, employer groups were after an increase between zero and \$A8 (0% and +1.5%). The decision to hold the minimum pay rate steady was based on the Commission’s concerns about the impact of rising unemployment rates and that an increase in wages could further “reduce employment and working hours”. The Commission also stated that “recent fiscal stimulus packages have provided real increases to disposable income ... enabling the safety net to be maintained.” Today’s minimum wage decision will likely, therefore, provide **some downside bias to wage and inflation rates in the year ahead.**
- In today’s statement the RBA specifically noted that “a pick-up in housing credit demand suggests stronger dwelling activity is likely later in the year. House prices are tending to rise.”
- Turning to the corporate sector, the RBA notes that “business borrowing, on the other hand, has been declining, as companies postpone investment plans and seek to reduce leverage in an environment of tighter lending standards.” Reflecting recent equity market activity, the RBA also stated that “large firms have had good access to equity capital, which is assisting in strengthening their financial structures.”
- It is a little surprising, however, that the RBA did not follow this statement with a recognition that the access to funding for small and medium-sized businesses is much tighter.

- The RBA then repeats the point it has made several times over recent months, stating that “monetary policy has been eased significantly” and that “market and mortgage rates are at very low levels by historical standards, despite recent small increases. Business loan rates are below average. The effects of these changes will still be coming through for some time yet. Fiscal measures are also providing considerable support for demand.”
- The concluding statement from the RBA that **“the outlook for inflation allows some scope for further easing of monetary policy, if needed”, is almost a repeat of the June conclusion, but, as noted, the overall tone from the RBA is marginally more positive.**

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