“Strong” jobs market keeps Reserve Bank sidelined

Reserve Bank Board meeting

- The Reserve Bank has left the cash rate at a record low of 1.50 per cent for the 30th straight month (27th meeting). The last rate change was a quarter percent rate cut on August 2, 2016.

What changed since the last meeting?
- The Australian economy grew by 0.3 per cent in the September quarter to stand 2.8 per cent higher over the year.
- The Australian jobless rate fell to a 7½-year low at 5 per cent in December.
- The key underlying inflation measure was 1.75 per cent in 2018, below the Reserve Bank’s 2-3 per cent target.
- The CoreLogic national home price index fell by 5.6 per cent over the year to January 2019.
- Building approvals are down by 22.5 per cent over the year to December.
- Annual credit growth stands at 4.3 per cent – the slowest rate recorded in 5 years.
- The rolling annual budget deficit has fallen to 9½-year lows at $1.6 billion or 0.1 per cent of GDP.
- Australian business conditions fell by 8.4 points in December – the biggest monthly decline since October 2008.
- The iron ore price has risen by US$19.40 or 28.7 per cent to US$87.00 a tonne.
- The Australian dollar has fallen by around 1 per cent to US72.50 cents.
- The IMF has downgraded its global growth forecast from 3.7 per cent to 3.5 per cent in 2019.
- Chinese economic growth slowed to 6.6 per cent in 2018 – the slowest annual growth rate in 28 years.
- The US Federal Reserve lifted the federal funds rate by 0.25 per cent to 2.25-2.50 per cent in December.

The assessment
- The Reserve Bank remains patient. Continued job market strength remains critical to the economic and interest rate outlook. The Board has described the labour market as “strong” with “a further decline in the unemployment rate to 4¾ per cent expected over the next couple of years.” It expects “the improvement in the labour market should see some further lift in wages growth over time” as “the vacancy rate is high and there are reports of skills shortages in some areas.” While the Reserve Bank acknowledges that the “main domestic uncertainty remains around the outlook for household spending and the effect of falling housing prices in some cities”, it is hoping that ongoing solid jobs growth will cushion Aussie consumers from the property downturn. Of course, the ‘wildcards’ remain China and the banks/regulators’ response to the Hayne Royal Commission, particularly due to the tightening in credit availability. Chinese policy stimulus could boost demand for Australia’s resources. And the Australian Federal government and opposition Labor Party could both announce further stimulatory tax cuts and infrastructure spending in the lead up to the election, given Australia’s improving fiscal position.

Perspectives on interest rates
- The Reserve Bank has left the cash rate at 1.50 per cent. The previous move was a rate cut in August 2016 (25 basis points). There have been 12 rate cuts since November 2011, with the Reserve Bank cutting rates from 4.75 per cent to 1.50 per cent.
- The Reserve Bank had previously lifted rates seven times from October 2009 to November 2010 from 3.00 per cent to 4.75 per cent.
What are the implications of today's decision?

The Reserve Bank is walking a tight rope on interest rates, but remains on the sidelines for now. On one hand, jobs growth is strong and economic growth is at long-run trend levels. Wages growth is the strongest in three years with unemployment rates in NSW and Victoria the lowest since 1978. But falling home prices, tighter credit availability, slowing global growth and the potential impact of political uncertainty on business investment all present downside risks. We expect the Reserve Bank to adjust its growth and inflation forecasts in Friday's Statement of Monetary Policy. Governor Philip Lowe will likely lay the groundwork in a speech tomorrow.

Comparing the two most recent statements

The statement from the December 2018 meeting is on the left; the statement from today's February 2019 meeting is on the right. Emphasis has been added to highlight key points in the wording in the statements.

Media Release

No: 2018-31
Date: 4 December 2018

Statement by Philip Lowe, Governor:
Monetary Policy Decision

At its meeting today, the Board decided to leave the cash rate unchanged at 1.50 per cent.

The global economic expansion is continuing and unemployment rates in most advanced economies are low. There are, however, some signs of a slowdown in global trade, partly stemming from ongoing trade tensions. Growth in China has slowed a little, with the authorities easing policy while continuing to pay close attention to the risks in the financial sector. Globally, inflation remains low, although it has increased due to the earlier lift in oil prices and faster wages growth. A further pick-up in core inflation is expected given the tight labour markets and, in the United States, the sizeable fiscal stimulus.

Financial conditions in the advanced economies remain expansionary but have tightened somewhat. Equity prices have declined and credit spreads have moved a little higher. There has also been a broad-based appreciation of the US dollar this year. In Australia, money-market interest rates have declined, after increasing earlier in the year. Standard variable mortgage rates are a little higher than a few months ago and the rates charged to new borrowers for housing are generally lower than for outstanding loans.

The Australian economy is performing well. The central scenario is for GDP growth to average around 3½ per cent over this year and next, before slowing in 2020 due to slower growth in exports of resources. Business conditions are positive and non-mining business investment is expected to increase. Higher levels of public infrastructure investment are also supporting the economy, as is growth in resource exports. One continuing source of uncertainty is the outlook for household consumption, which is normalised in household income remains low, debt levels are high and some asset prices have declined. The drought has led to difficult conditions in parts of the farm sector.

Australia’s terms of trade have increased over the past couple of years and have been stronger than earlier expected. This has helped boost national income. Most commodity price indicators have softened, however, depressingly, with oil prices falling significantly. The Australian dollar remains within the range that it has been in over the past two years on a trade-weighted basis.

The outlook for the labour market remains positive. The unemployment rate is 5 per cent, the lowest in six years. With the economy expected to continue to grow above trend, a further reduction in the unemployment rate is likely. The vacancy rate is high and there are reports of skilled shortages in some areas. The stronger labour market has led to some pick-up in wages growth, which is a welcome development. The improvement in the economy should see some further lift in wages growth over time, although this is still expected to be a gradual process.

Inflation remains low and stable. Over the past year, CPI inflation was 1.9 per cent and in underlying terms inflation was 1¼ per cent. Inflation is expected to pick up over the next couple of years, with the pick-up likely to be gradual. The central scenario is for inflation to be 2¼ per cent in 2019 and a bit higher in the following year.

Conditions in the Sydney and Melbourne housing markets have continued to ease and nationwide measures of rent inflation remain low. Credit conditions for some borrowers are tighter than they have been for some time, with some lenders having a reduced appetite to lend. The demand for credit by investors in the housing market has slowed noticeably as the dynamics of the housing market have changed. Growth in credit extended to owner-occupiers has eased to an annualised pace of 5–6 per cent. Mortgage rates remain low, with competition strongest for borrowers of high credit quality.

The low level of interest rates is continuing to support the Australian economy. Further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual. Taking account of the available information, the Board judged that holding the stance of monetary policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time.

Media Release

No: 2019-01
Date: 5 February 2019

Statement by Philip Lowe, Governor:
Monetary Policy Decision

At its meeting today, the Board decided to leave the cash rate unchanged at 1.50 per cent.

The global economy grew above trend in 2018, although it slowed in the second half of the year. Unemployment rates in most advanced economies are low. The outlook for global growth remains reasonable, although downside risks have increased. The trade tensions are affecting global trade and some investment decisions. Growth in the Chinese economy has continued to slow, with the authorities easing policy while central banks pay close attention to the risks in the financial sector. Globally, headline inflation rates have moved lower due to the decline in oil prices, although core inflation has picked up in a number of economies.

Financial conditions in the advanced economies tightened in late 2018, but remain accommodative. Equity prices declined and credit spreads increased, but these moves have since been partly reversed. Market participants no longer expect a further tightening of monetary policy in the United States. Government bond yields have declined in most countries, including Australia. The Australian dollar has remained within the narrow range of recent times. The terms of trade have increased over the past couple of years, but are expected to decline over time.

The central scenario is for the Australian economy to grow by around 3½ per cent this year and by a little less in 2020 due to slower growth in exports of resources. The growth outlook is being supported by rising business investment and higher levels of spending on public infrastructure. As is the case globally, some downside risks have increased. GDP growth in the September quarter was weaker than expected. This was largely due to slower growth in household consumption and income, although the consumption data has been volatile and subject to revision over recent quarters. Growth in household income has been low over recent years, but is expected to pick up and support household spending. The main domestic uncertainty remains around the outlook for household spending and the effect of falling housing prices in some cities.

The housing markets in Sydney and Melbourne are going through a period of adjustment, after an earlier large run-up in prices. Conditions have weakened further in both markets and rent inflation remains low. Credit conditions for some borrowers are tighter than they have been. At the same time, the demand for credit by investors in the housing market has slowed noticeably as the dynamics of the housing market have changed. Growth in credit extended to owner-occupiers has eased to an annualised pace of 5½ per cent. Mortgage rates remain low and there is strong competition for borrowers of high credit quality.

The labour market remains strong, with the unemployment rate at 5 per cent. A further decline in the unemployment rate to 4½ per cent is expected over the next couple of years. The vacancy rate is high and there are reports of skills shortages in some areas. The stronger labour market has led to some pick-up in wages growth, which is a welcome development. The improvement in the labour market should see some further lift in wages growth over time, although this is still expected to be a gradual process.

Inflation remains low and stable. Over 2018, CPI inflation was 1.8 per cent and in underlying terms inflation was 1¼ per cent. Underlying inflation is expected to pick up over the next couple of years, with the pick-up likely to be gradual and to take a little longer than earlier expected. The central scenario is for underlying inflation to be 2 per cent this year and 2¼ per cent in 2020. Headline inflation is expected to decline in the near term because of lower petrol prices.

The low level of interest rates is continuing to support the Australian economy. Further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual. Taking account of the available information, the Board judged that holding the stance of monetary policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time.