Rate cut to boost employment and economic growth

Reserve Bank Board meeting

- **The Reserve Bank has cut the cash rate by 25 basis points (quarter of a per cent) to a record low of 1.25 per cent. It is the first change in rates in 34 months (31 meetings).**

What has changed since the last meeting?

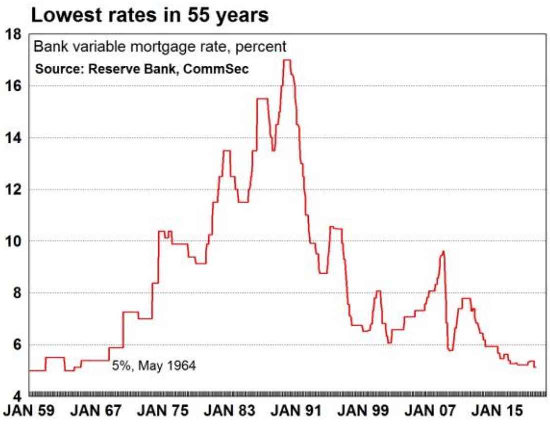
- The Coalition Government was returned to power at the Federal Election.
- The Australian jobless rate rose from 5.1 per cent to 5.2 per cent in April.
- Private sector wages rose by 2.4 per cent over the year to March.
- The CoreLogic national home price index fell by 0.4 per cent in May.
- The Federal Budget was broadly in balance for the 12 months to April.
- The annual total of dwelling approvals is close to the decade average.
- Annual credit growth stands at 3.7 per cent – the slowest rate recorded in 5½ years.
- The Australian ASX200 share index hit 11½-year highs after the Federal Election.
- The Australian dollar has held around US68-69 cents.
- There is uncertainty about whether a US-China trade agreement will be successfully concluded.
- The US Federal Reserve expects to leave rates on hold over 2019.

The assessment

- The Reserve Bank cut interest rates to a fresh record low 1.25 per cent today after an extended pause going back almost three years. Unemployment has edged higher, inflation remains anchored below the Reserve Bank's 2-3 per cent target and a deteriorating global growth backdrop is likely behind the move.
- In the final paragraph of the Reserve Bank's Statement, the Board emphasised that *"the decision to lower the cash rate….will assist with faster progress in reducing unemployment and achieve more progress towards the inflation target."* Clearly, Governor Philip Lowe is hoping that additional policy stimulus will reduce spare capacity in the economy, lower the jobless rate back towards 4-4.5 per cent and in-turn lift wages and stoke inflation.

Perspectives on interest rates

- The Reserve Bank cut the cash rate by 25 basis points (quarter of a per cent) to 1.25 per cent. The previous move was a rate cut on August 2 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?

- It is good news for first home buyers. Less positive news for those relying on interest income like self-funded retirees. But the hope is that lower rates and other stimulus measures like tax cuts cause consumers to spend. And, in turn, that businesses lift hiring and investment. There are good chances that these hopes will be fulfilled given the positive post-election

Ryan Felsman, Senior Economist
Twitter: @CommSec

environment. But if not, the Reserve Bank will cut interest rates further in August (after the next inflation data).

Comparing the two most recent statements

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

Media Release

No: 2019-11
Date: 7 May 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 outlook for the global economy remains reasonable, although the risks are tilted to the downside. Growth in international trade has declined and investment intentions have softened in a number of countries. In China, the authorities have taken steps to support the economy, while addressing risks in the financial system. In most advanced economies, inflation remains subdued, unemployment rates are low and wages growth has picked up.

Global financial conditions remain accommodative. Long-term bond yields are low, consistent with the subdued outlook for inflation, and equity markets have strengthened. Risk premiums also remain low. In Australia, long-term bond yields are at historically low levels and short-term bank funding costs have declined further. Some lending rates have declined recently, although the average mortgage rate paid is unchanged. The Australian dollar is at the low end of its narrow range of recent times.

The central scenario is for the Australian economy to grow by around 2¾ per cent in 2019 and 2020. This outlook is supported by increased investment in infrastructure and a pick-up in activity in the resources sector, partly in response to an increase in the prices of Australia's exports. The main domestic uncertainty continues to be the outlook for household consumption, which is being affected by a protracted period of low income growth and declining housing prices. Some pick-up in growth in household disposable income is expected and this should support consumption.

The Australian labour market remains strong. There has been a significant increase in employment, the vacancy rate remains high and there are reports of skills shortages in some areas. **Despite these positive developments, there has been little further progress in reducing unemployment over the past six months. The unemployment rate has been broadly steady at around 5 per cent over this time and is expected to remain around this level over the next year or so, before declining a little to 4¾ per cent in 2021. The strong employment growth over the past year or so has led to some pick-up in wages growth, which is a welcome development.** Some further lift in wages growth is expected, although this is likely to be a gradual process.

The adjustment in established housing markets is continuing, after the earlier large run-up in prices in some cities. Conditions remain soft and rent inflation remains low. Credit conditions for some borrowers have tightened over the past year or so. 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 over the past year. Mortgage rates remain low and there is strong competition for borrowers of high credit quality.

The inflation data for the March quarter were noticeably lower than expected and suggest subdued inflationary pressures across much of the economy. Over the year, inflation was 1.3 per cent and, in underlying terms, was 1.6 per cent. Lower housing-related costs and a range of policy decisions affecting administered prices both contributed to this outcome. Looking forward, inflation is expected to pick up, but to do so only gradually. The central scenario is for underlying inflation to be 1¾ per cent this year, 2 per cent in 2020 and a little higher after that. In headline terms, inflation is expected to be around 2 per cent this year, boosted by the recent increase in petrol prices.

The Board judged that it was appropriate to hold the stance of policy unchanged at this meeting. **In doing so, it recognised that there was still spare capacity in the economy and that a further improvement in the labour market was likely to be needed for inflation to be consistent with the target. Given this assessment, the Board will be paying close attention to developments in the labour market at its upcoming meetings.**

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Media Release

No: 2019-15
Date: 4 June 2019

Statement by Philip Lowe, Governor: Monetary Policy Decision

At its meeting today, the Board decided to **lower** the cash rate **by 25 basis points to 1.25 per cent. The Board took this decision to support employment growth and provide greater confidence that inflation will be consistent with the medium-term target.**

The outlook for the global economy remains reasonable, although the downside **risks stemming from the trade disputes have increased.** Growth in international trade **remains weak and the increased uncertainty is affecting** investment intentions in a number of countries. In China, the authorities have taken steps to support the economy, while addressing risks in the financial system. In most advanced economies, inflation remains subdued, unemployment rates are low and wages growth has picked up.

Global financial conditions remain accommodative. Long-term bond yields and **risk** premiums are low. In Australia, long-term bond yields are at historically low levels. **Bank funding** costs have also declined further, with money-market spreads having fully reversed the increases that took place last year. **The Australian dollar has depreciated a little over the past few months and is at the low end of its narrow range of recent times.**

The central scenario **remains** for the Australian economy to grow by around 2¾ per cent in 2019 and 2020. This outlook is supported by increased investment in infrastructure and a pick-up in activity in the resources sector, partly in response to an increase in the prices of Australia's exports. The main domestic uncertainty continues to be the outlook for household consumption, which is being affected by a protracted period of low income growth and declining housing prices. Some pick-up in growth in household disposable income is expected and this should support consumption.

Employment growth has been strong over the past year, **labour force participation has been increasing**, the vacancy rate remains high and there are reports of skills shortages in some areas. Despite these developments, there has **been little further inroads into the spare capacity in the labour market of late**. The unemployment rate had been steady at around 5 per cent for some months, **but ticked up to 5.2 per cent in April.** The strong employment growth over the past year or so has led to a pick-up in wages growth in the private sector, although overall wages growth remains low. A further gradual lift in wages growth is expected and this would **be a welcome development. Taken together, these labour market outcomes suggest that the Australian economy can sustain a lower rate of unemployment.**

The recent inflation outcomes have been lower than expected and suggest subdued inflationary pressures across much of the economy. Inflation is still however anticipated to pick up, and will be boosted in the June quarter by increases in petrol prices. The central scenario remains for underlying inflation to be 1¾ per cent this year, 2 per cent in 2020 and a little higher after that.

The adjustment in established housing markets is continuing, after the earlier large run-up in prices in some cities. Conditions remain soft, **although in some markets the rate of price decline has slowed and auction clearance rates have increased. Growth in housing credit has also stabilised recently.** Credit conditions have been **tightened** and the demand for credit by investors has been subdued for some time. Mortgage rates remain low and there is strong competition for borrowers of high credit quality.

Today's decision to lower the cash rate will help make further inroads into the spare capacity in the economy. It will assist with faster progress in reducing unemployment and achieve more assured progress towards the inflation target. The Board will continue to monitor developments in the labour market closely and adjust monetary policy to support sustainable growth in the economy and the achievement of the inflation target over time.

Implications for home buyers

- The following table shows current monthly repayments on a range of mortgages and projections if rates are cut by major lenders in response to the lower cash rate.

MORTGAGE CALCULATOR (Monthly repayments, 30 years)

Mortgage		Change in Interest Rates					
		-0.25%	-0.50%	-0.75%	-1.00%	-1.25%	-1.50%
	5.37	5.12	4.87	4.62	4.37	4.12	3.87
$100,000	$559.66	$544.18	$528.90	$513.84	$498.99	$484.36	$469.95
$150,000	$839.49	$816.27	$793.36	$770.76	$748.49	$726.54	$704.93
$200,000	$1,119.32	$1,088.36	$1,057.81	$1,027.68	$997.98	$968.72	$939.90
$250,000	$1,399.15	$1,360.45	$1,322.26	$1,284.60	$1,247.48	$1,210.90	$1,174.88
$300,000	$1,678.98	$1,632.54	$1,586.71	$1,541.52	$1,496.97	$1,453.08	$1,409.85
$350,000	$1,958.81	$1,904.63	$1,851.17	$1,798.44	$1,746.47	$1,695.26	$1,644.83
$400,000	$2,238.64	$2,176.72	$2,115.62	$2,055.36	$1,995.96	$1,937.44	$1,879.80
$450,000	$2,518.47	$2,448.81	$2,380.07	$2,312.28	$2,245.46	$2,179.62	$2,114.78
$500,000	$2,798.30	$2,720.90	$2,644.52	$2,569.20	$2,494.95	$2,421.80	$2,349.76
		Change in repayments per month					
$100,000		-$15.48	-$30.75	-$45.82	-$60.67	-$75.30	-$89.71
$150,000		-$23.22	-$46.13	-$68.73	-$91.00	-$112.95	-$134.56
$200,000		-$30.96	-$61.51	-$91.64	-$121.34	-$150.60	-$179.42
$250,000		-$38.70	-$76.89	-$114.55	-$151.67	-$188.25	-$224.27
$300,000		-$46.44	-$92.26	-$137.46	-$182.01	-$225.90	-$269.13
$350,000		-$54.18	-$107.64	-$160.37	-$212.34	-$263.55	-$313.98
$400,000		-$61.92	-$123.02	-$183.28	-$242.68	-$301.20	-$358.83
$450,000		-$69.66	-$138.40	-$206.19	-$273.01	-$338.85	-$403.69
$500,000		-$77.40	-$153.77	-$229.10	-$303.35	-$376.50	-$448.54

Source: CommSec