



RBA Statement on Monetary Policy

A Quietly Confident RBA

- The Reserve Bank (RBA) appears to be increasingly confident that the Australian economy is evolving as expected as suggested in the RBA's quarterly Statement on Monetary Policy (SoMP).
- The RBA is painting a story of an economy growing at a bit above estimates of potential growth, but inflation pressures remaining muted.
- The RBA forecasts the unemployment rate to reach around 5 percent by the end of 2020, as flagged earlier this week. The indication of reaching an unemployment rate of 5.0% is important as it provides an explicit expectation by the RBA that the economy will approach full employment.
- Despite expectations of strength in the domestic economy and the labour market, inflation is not expected to reach the middle of the RBA's 2 to 3 percent per annum target band over the RBA's forecast period, until at least the end of 2020.
- One of the most noticeable changes in today's SoMP is the RBA's inflation forecasts. The RBA has downgraded its near-term forecasts for inflation, although it has left its medium-term forecasts unchanged.
- The RBA continues to indicate that the next move in the cash rate will be higher, which is consistent with the view of an economy growing a bit above potential, and a falling unemployment rate. Nonetheless, ongoing low inflation and slow wage growth suggests little need to raise interest rates any time soon. We continue to expect the RBA will leave rates on hold for some time.

There were few surprises in the RBA's quarterly Statement on Monetary Policy (SoMP) released today.

However, the RBA appears to be increasingly confident that the Australian economy is evolving as expected. The RBA opened the Statement with the comment: "The Australian economy remains on track to achieve lower unemployment and higher inflation over time". The RBA is painting a story of an economy growing at a bit above estimates of potential growth, but inflation pressures remaining muted.

The RBA forecasts the unemployment rate to reach around 5 percent by the end of 2020, as flagged on Tuesday following the RBA's policy decision. The indication of reaching 5.0% is important as it provides an explicit expectation by the RBA that the economy will approach full employment.

That being said, inflation is not expected to reach the middle of the RBA's 2 to 3 percent per annum target band over the RBA's forecast period, till at least the end of 2020. Despite the ongoing improvement in the labour market, there is little expectation for a meaningful pickup in wage growth and inflation.

Moreover, given the experience in overseas economies, there is the likelihood that the unemployment rate could fall and sit below 5.0% without wages and inflation picking up for some time. In a speech earlier this week, RBA Governor Lowe highlighted this risk saying that an unemployment rate of between 4.5%-5.0% could be consistent with inflation at 2.5%, although Lowe later seemed to play down this risk.

There were some tweaks to the RBA's growth and inflation forecasts, although the medium-term outlook was broadly unchanged.

Growth in the year to June 2018 was upgraded from 2.75% to 3.0%, largely reflecting a stronger-than-expected GDP outcome in the March quarter. Growth in the year to the June quarter was revised down from 3.5% to 3.25%, but average growth over 2018 was revised upwards from 3.0% to 3.25%.

One of the most noticeable changes in today's SoMP is the RBA's inflation forecasts. The RBA has downgraded its near-term forecasts for inflation, although it has left its medium-term forecasts unchanged.

The downgrade is due to government initiatives which have brought down the price of services in the current September quarter. These price declines include child care (reflecting government changes to the subsidy packages), electricity & gas prices in some states, TAFE fees and car registration fees in NSW.

These declines in administered prices are expected to impact headline inflation more than underlying prices.

Headline inflation is now expected to grow by 1.75% in the year ended December quarter 2018, compared with 2.25% previously. Over the same time period, underlying inflation growth is now expected to be 1.75%, from 2.00% previously.

If these forecasts come to fruition, then this calendar year will be the fifth year in a row that headline inflation has printed below the 2-3% target band and the third year running underlying inflation has been under this target band.

These declines in administered prices will have a one-off impact to the inflation rate. So while they have impacted the year-ended inflation forecasts for 2018, they have not affected the year-ended inflation forecasts for 2019. The latter forecasts remain at 2.25% per annum for headline and 2.00% per annum for underlying.

The inflation profile has been extended to the end of 2020 and inflation (both in headline and underlying terms) still is not projected to reach the middle of the target band in the forecast periods.

The RBA noted the downside risks to the global economy from trade tensions. Additionally, there were concerns over the outlook for China given financial risks and slowing growth. However, described the global outlook as remaining "positive". The RBA also adds that the growth in the US

could be “stronger than expected”.

Cash Rate Outlook

The RBA continues to indicate that the next move in the cash rate will be higher, which is consistent with the view of an economy growing a bit above potential, and a falling unemployment rate. Nonetheless, ongoing low inflation and slow wage growth suggests little need to raise interest rates any time soon. The RBA today has said that “holding the cash rate steady at 1½% would support the gradual progress being made on unemployment and inflation, with steady monetary policy promoting stability and confidence. Higher interest rates are likely to be appropriate at some point, if the economy continues to evolve as expected.” However, the RBA also reiterated that there was not a “strong case to adjust the cash rate in the near term”. We continue to expect the RBA will leave rates on hold for some time.

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The RBA’s forecasts in full are detailed on the following page.

CURRENT FORECASTS FROM THE RBA, August 2018 SoMP**Table 5.1: Output Growth and Inflation Forecasts^(a)**

Per cent

	Year-ended					
	Jun 2018	Dec 2018	Jun 2019	Dec 2019	Jun 2020	Dec 2020
GDP growth	3	3¼	3¼	3¼	3	3
Unemployment rate ^(b)	5.5	5½	5¼	5¼	5¼	5
CPI inflation	2.1	1¾	2	2¼	2¼	2¼
Underlying inflation	2	1¾	2	2	2¼	2¼
	Year-average					
	2017/18	2018	2018/19	2019	2019/20	2020
GDP growth	2¾	3¼	3¼	3¼	3¼	3

(a) Technical assumptions include A\$ at US\$0.74, TWI at 64 and Brent crude oil price at US\$73 per barrel; shaded regions are historical data

(b) Average rate in the quarter

Sources: ABS; RBA

PREVIOUS FORECASTS FROM THE RBA, May 2018 SoMP**Table 5.1: Output Growth and Inflation Forecasts^(a)**

Per cent

	Year-ended					
	Dec 2017	Jun 2018	Dec 2018	Jun 2019	Dec 2019	Jun 2020
GDP growth	2.4	2¾	3¼	3½	3¼	3
Unemployment rate ^(b)	5.5	5½	5½	5¼	5¼	5¼
CPI inflation	1.9	2	2¼	2¼	2¼	2¼
Underlying inflation	1¾	2	2	2	2	2¼
	Year-average					
	2017	2017/18	2018	2018/19	2019	2019/20
GDP growth	2.3	2¾	3	3¼	3¼	3¼

(a) Technical assumptions include A\$ at US\$0.75, TWI at 62 and Brent crude oil price at US\$71 per barrel; shaded regions are historical data

(b) Average rate in the quarter

Sources: ABS; RBA

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The Detail

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