

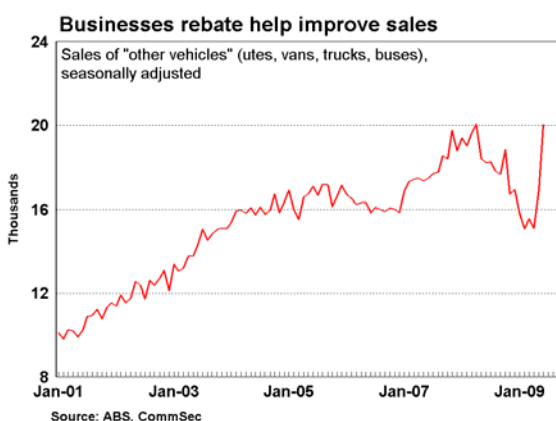
# Reserve Bank Board: Reluctant rate cutters

## RBA Board minutes; Car sales

- Reserve Bank Board members agreed the current level of interest rates was supporting growth while ensuring inflation remained under check. They noted the significant improvement in economic conditions in domestic and global economies.
- Board members highlighted the effect of the significant stimulus injected into the Australian economy over recent months: Members commented on the substantial boost to retail sales, improvement in household balance sheets and the sharp pickup in consumer sentiment.
- Car sales rose by a substantial 5.7 per cent in June, marking the best monthly increase in 4½ years. Sales of other vehicles (utes, buses and trucks) rose by 18.3 per cent in June – the biggest monthly increase in over nine years.

### What does it all mean?

- It is pretty clear from the minutes of the latest Reserve Bank Board meeting that the Board believes that interest rates are at the perfect level to foster growth while ensuring inflation remains relatively low over the mid-term. Essentially the Reserve Bank Board has indicated that the Australian economy has been front loaded with more than enough ammunition to combat the current downturn. However if the domestic economy does take a turn for the worse the Reserve Bank is in a position to inject further stimulus.
- A quiet confidence is perceived in the Board minutes with members adding to the positive rhetoric from the June statement. Members noted that that the global economy is showing signs of having passed through the worst of the downturn, while the domestic economy is noticing a significant improvement in confidence level, retail spending, housing activity and even a pick up in house prices.
- Board members were decidedly more optimistic on the strong initial recovery recorded in China. Noting an improvement in conditions across an array of indicators. Importantly for Australia, the Reserve Bank expects domestic demand in China to play a bigger role in driving the Chinese growth expansion in coming years.
- A qualitative assessment of the Reserve Bank Board by CommSec highlights the more optimistic tone of the meeting. Only 10 per cent of the statement highlighted a negative viewpoint while a resounding 60 per cent of the



### Assessing the stance of policy\*

#### RBA July Board Minutes

<b>International Economic Conditions (7)</b>		
Positive (4)	Negative (0)	Neutral (3)
<b>Domestic Economic Conditions (8)</b>		
Positive (5)	Negative (2)	Neutral (1)
<b>Financial Markets (15)</b>		
Positive (9)	Negative (1)	Neutral (5)

\* Paragraph from the statement that are assessed as positive, negative or neutral

Source: CommSec

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statement was more positive.

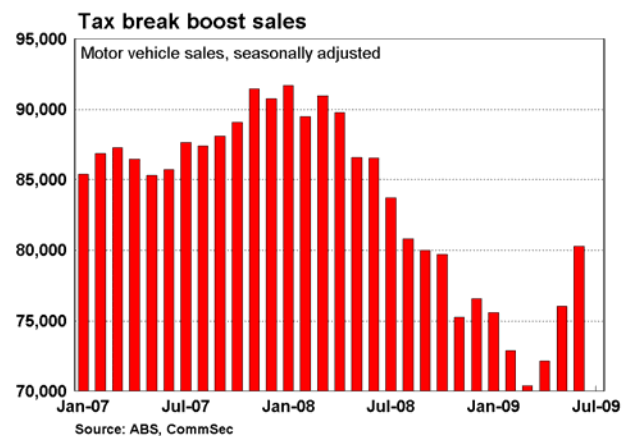
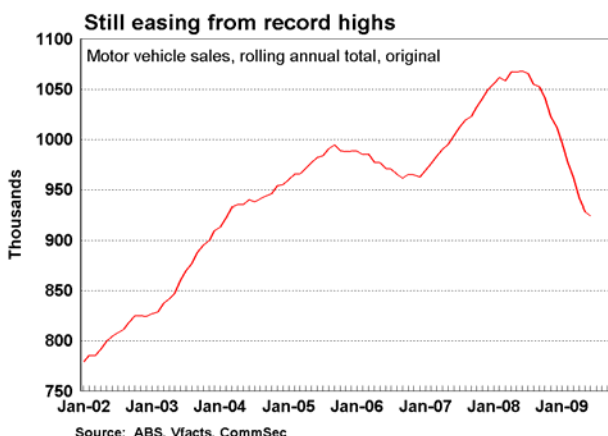
- The Board clearly believed that with interest rates at 49 years lows and significant fiscal stimulus currently been undertaken, it was having an expansionary effect on the Australian economy, however concerns over inflationary expectations has seen the Reserve Bank temper any further rate cuts.
- It is looking more likely that Reserve Bank has decided the low point for interest rates is the current cash rate of 3 per cent. Any further rate cuts would only be if the domestic economy took a turn for the worse. At this stage the Reserve Bank looks likely to keep rates on hold in up coming months. However CommSec is not ruling out the possibility of another rate cut of 25 basis points over the last quarter of this year.
- The sharp increase in car sales over June has confirmed that the domestic car industry has turned the corner. Vehicle sales have jumped by a substantial 5.4 per cent, marking the best result in 4½ years.
- As we have commented on over the last couple of months, the government tax rebate on business investment has been the driving factor behind the sharp increase in sales. Sales of business vehicles like commercial trucks, vans, buses and utes recorded the biggest monthly increase in nine years. And in annual terms sales of businesses vehicles are now up almost 10 percent on a year ago. It is likely that the business sector will support the car industry over the next few months with the tax rebate deadline extended to the end of the year for small businesses.
- Passenger car sales have also continued to improve, recording the third consecutive month of gains. It should be noted that while passenger car sales have improved over the last couple of months it is coming from a very low base and as such the economic landscape will play a key factor in sales over coming months. Car retailers are more likely to continue discounting and offering incentives to ensure that sales targets are reached.

**What do the figures show?**

**Minutes from the May Reserve Bank Board meeting**

**Key Comments:**

- *“Turning to the recently released data for specific economies, members noted signs that the rate of deterioration in the United States had slowed and that the economy may be reaching a turning point..”*
- *“Recent data on the Chinese economy had been positive, with all major components of industrial production recording gains over the past few months. Members expected that, over time, domestic demand was likely to play a more important role in driving growth in the Chinese economy than had been the case over the past couple of decades.”*
- *“There had been some improvement in business sentiment in Europe and the United Kingdom in the past month or so, but the data on production and spending were still weak.”*
- *“The GDP outcome for the March quarter had been surprisingly strong. Members noted the unusually large difference between the various measures of GDP. If the result was combined with the December quarter outcome, the picture was that the economy had contracted slightly over the six months to March.”*
- *“Members also noted that, according to a range of private-sector measures monitored by the staff, house prices had increased in almost all areas over recent months. Auction clearance rates in Sydney and Melbourne were also high, though the number of sales by auction was not particularly high. Housing loan approvals were strong, and while existing borrowers had increased their loan repayments, overall housing credit had recorded solid growth”*



- **Retail sales:** *“Looking at consumption, members noted that retail sales had increased strongly in May and were 7 per cent higher than in September, a considerably stronger outcome than in comparable countries. The staff’s liaison with retailers suggested that this strength had continued into June. Members noted that the fiscal transfers had helped support retail sales, as had the stimulus for indebted households from lower interest rates.”*
- **Business investment:** *“Turning to the business sector, investment had fallen by 6 per cent in the March quarter, which was nonetheless stronger than the outcome in many other countries. While members noted that further falls in investment were likely, business sentiment had improved recently. Members also noted that car sales to businesses had increased significantly over the past couple of months, stimulated by tax incentives, notably for small businesses..”*
- **Exports:** *“Members noted Australia’s remarkably strong export performance over the December and March quarters. Over this period, export volumes had increased by almost 2 per cent, whereas in other countries, export volumes had typically fallen by 10–20 per cent, with much larger falls being recorded in some cases. While the depreciation of the Australian dollar had been helpful to exporters, the strong performance of the Chinese economy was particularly important.”*
- **Financial markets:** *“Members noted that the conditions in financial markets had been mixed during the month. The general improvement in credit markets had continued, though the rise in share prices had lost momentum. Some of the earlier rise in government bond yields had been reversed.”*
- *“Members noted that conditions in money markets around the world had continued to improve, with spreads now at the levels prevailing prior to the collapse of Lehman Brothers. In Australia, short-term money market spreads were now around the lowest levels in the period since the onset of the financial crisis..”*
- **Outlook:** *“In assessing the stance of monetary policy, members observed that the early and substantial easing of both monetary and fiscal policy had been effective in supporting demand, which, if anything, had been more resilient than expected. The full effects of policy measures would still be coming through for some time.”*
- **Policy decision:** *“Accordingly, members judged the current stance of monetary policy to be consistent with fostering sustainable growth and low inflation, while leaving adequate flexibility to respond to developments as needed over the period ahead.”*
- In seasonally adjusted terms, **motor vehicle sales** rose a substantial 5.7 per cent in June – the best monthly increase in 4½ years. Despite the increase in sales are still down 7.2 per cent on a year ago.
- Sales of passenger cars rose by 1.6 per cent in June. Sales of sports utility vehicles (SUVs or four-wheel drive vehicles) were up by 3.2 per cent. Sales of “other” vehicles (including utes, vans, trucks and buses) rose by 18.3 per cent – the best result since December 2000. Sales of “other” vehicles are up 9.9 per cent on a year ago.
- In the year to June 924,693 vehicles were sold, down 13.4 per cent on the year to June 2008 – the biggest annual decline in the 14 year history of the series.

### What is the importance of the economic data?

- The Reserve Bank releases minutes of its monthly Board meeting a fortnight after the event. The minutes give a guide to Reserve Bank thinking on interest rate settings.
- The Australian Bureau of Statistics (ABS) provides monthly estimates of car sales in seasonally adjusted and trend terms after receiving the actual sales data from the car industry. The figures highlight the strength of consumer spending as well as conditions facing auto & components companies.

### What are the implications for interest rates and investors?

- CommSec is pencilling in a small 25 basis point rate cut later in the year – just in case. In the current environment it looks more likely that rates will be left on hold. Still, with longer term interest rates and funding costs for banks remaining elevated above “normal “ levels, the potential for one further rate cuts is on the cards.
- The latest improvement in car sales adds further weight to the economic recovery, and also suggests that the household consumption component will be relatively strong in the June quarter growth figures. It is looking more likely that the Australian economy recorded an expansion over the June quarter.

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