

More rate cuts... the only question is when

RBA Board minutes

- **The Reserve Bank Board debated the possibility of further rate cuts at the March meeting before deciding to keep rate on hold. The board believes generational low interest rates and fiscal stimulus is having an expansionary effect on the Australian economy, however it is too early to judge the extent of the expansion.**
- **The Board has indicated that the speed and scale of the deterioration in the global economy will result in an unavoidably weak level of domestic activity in the short term.**
- **CommSec expects the Reserve Bank to cut interest rates at the April meeting and reassess the situation in subsequent months following more timely economic data.**

What does it all mean?

- It is pretty clear from the minutes of the latest Reserve Bank Board meeting that the Board debated further rate cuts before deciding to keep rates on hold. The Reserve Bank Board has indicated that the Australian economy has been front loaded with more than enough ammunition late last year to combat the current downturn, but the speed and scale of the deterioration in the global economy will no doubt see near term domestic activity unavoidably weak.
- A quiet confidence is perceived in the Board minutes with members keeping rates on hold at the March meeting despite noting that the December quarter GDP number would show a slight contraction. The resilience of the Australian economy, strength of the financial sector and the fact that the “monetary policy transmission process” still worked, would help to see an improvement in economic activity over the longer term.
- The Board clearly believed that with interest rates at 45 years lows and significant fiscal stimulus currently been undertaken, it was having an expansionary effect on the Australian economy. However gauging the size and extent of recovery was the difficult part. As a result the Reserve Bank decided the more prudent course was to keep rates on hold.
- The Reserve Bank Board certainly hasn’t closed the door to further rate cuts. But neither is it flagging that another significant rate cut is on the agenda. A raft of positives were noted across sectors from retail spending, government stimulus, double digit growth in business investment and the pick up in the housing activity. For the Reserve Bank it becomes a matter of timing the rate cuts to ensure maximum “bang for the buck” and also having enough ammunition left to feel comfortable about future outlook.

- The Reserve Bank noted that policy interest rates had been reduced to almost zero across several advanced economies and quantitative easing had become the alternative stimulus policy. Buying commercial debt, shares and agency paper in the hope of increasing money supply and in turn economic activity were having mixed results over the last few months. Quantitative easing will no doubt be an avenue that the Board will want to avoid considering the longer term ramifications.
- Future rate cuts will all depend on the state of financial markets and global economic at the time of each Reserve Bank Board meeting. At some point the Reserve Bank is likely to call a low for interest rates with money markets expecting it to be around 2 -2.5 per cent.
- CommSec is factoring in the possibility of another rate cut of 50/75 basis points over the next few months. At this stage the Reserve Bank looks likely to cut rates once again in April and reassess the situation in subsequent months.

What do the figures show?

Minutes from the February Reserve Bank Board meeting

Key Comments:

- *“Members were informed that, with the national accounts for the December quarter scheduled for release the day after the meeting, the partial data available to date indicated a small fall in output in the quarter... Recent indicators suggested that economic activity had remained subdued in the early part of the March quarter.”*
- *“Business conditions, while also having fallen, were fluctuating around levels similar to those seen during the slowdown early in the current decade. Slowing business activity had led to further declines in capacity utilisation, which had fallen noticeably from the peak levels reached a year or so earlier..”*
- *“...retail spending had increased sharply in December, after a run of weak readings in previous months. This produced a rise in spending in inflation-adjusted terms in the December quarter, following three quarters in which sales had been relatively flat. Data released during the meeting showed that the higher level of December sales was maintained in January, with sales rising by a further 0.2 per cent.”*
- *“Members noted that real household disposable income had been boosted towards the end of 2008 by lower lending interest rates, lower petrol prices and government transfer payments. Members recognised that these effects were not evenly spread across households and that for households which are interest receivers there had been a loss of income from that source. But for the household sector as a whole, the net effect had been a significant addition to disposable income..”*
- *“Declines in house prices in the past few months had mainly been in the more expensive suburbs, with prices in other suburbs appearing to level out. In a sign of increased demand for housing, patterns of housing finance indicated an increase in housing loan approvals of about 10 per cent over*

the past few months, partly spurred by the increased incentives for first home buyers to enter the market.”

- *“Further signs of an increased level of activity in the secondary housing market were significant rises in auction clearance rates in both Sydney and Melbourne in February, and a component of the Westpac-Melbourne Institute consumer sentiment survey indicated that current conditions were conducive to buying a dwelling.*
- *“Looking at government finances, the Australian Government’s fiscal package announced in February would provide significant stimulus to the economy over the next two years.”*
- *“Conditions in the labour market had continued to soften, with no growth in monthly trend employment in January. The unemployment rate to date had risen relatively gradually from its low of 4 per cent, though members noted that significant deterioration was forecast”*

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.

What are the implications for interest rates and investors?

- The global economy has shown no key signs of bottoming out. And the recent weakness of Chinese economic data is yet a further sign that domestic rate cuts remain on the agenda. The expected rise in unemployment and paring back of domestic growth in the short term will keep the Reserve Bank deliberating on when to deliver further rate cuts.
- The flow of more timely economic data in the next few weeks will give the Reserve Bank a better gauge on the current domestic situation. CommSec expects another reduction of 50/75 basis points to be delivered at the April Reserve Bank Board meeting.

Source Craig James, Chief Equities Economist, [CommSec](#)