

Reserve Bank of Australia Eases Monetary Policy

- **The Reserve Bank of Australia (RBA) lowered its benchmark cash rate by 25 basis points (bps) to 1.25% on the back of muted inflationary pressures and rising concerns about the economy.**
- **The RBA refrained from providing explicit guidance on future policy directions but indicated that labour market developments would determine next steps.**

Today's policy step was widely anticipated. The central bank increasingly communicated a dovish bias in the lead up to the decision. The rate cut takes Australia's policy rate to a new record low (chart) with the last reduction in August 2016.

The RBA's decision to lower the benchmark interest rate was justified. Australia's economy is showing signs of moderation with an opening of the output gap; employment gains are expected to slow in the coming quarters (albeit from above average levels); and inflation is persistently low. Headline inflation hovers below the RBA's 2–3% target with prices rising by only 1.3% y/y in the first quarter 2019 on the back of lower fuel prices, muted housing-related price gains, and soft wage gains. We estimate that base effects will take headline inflation back toward the 2% mark in early 2020.

RBA policy makers underscored risks related to both the domestic and global economy. Global uncertainties would increasingly weigh on private sector investment in Australia, while slowing demand in China would impact its external sector. However, Australia's improved terms of trade—the ratio of export prices to import prices—would offset some of the adverse impact. With economic growth expected to be carried by consumer spending, authorities also flagged uncertainties pertaining to muted wage growth, moderating employment gains, high household debt, and cooling housing markets. Nevertheless, a still-robust labour market provides a reasonable counterbalance.

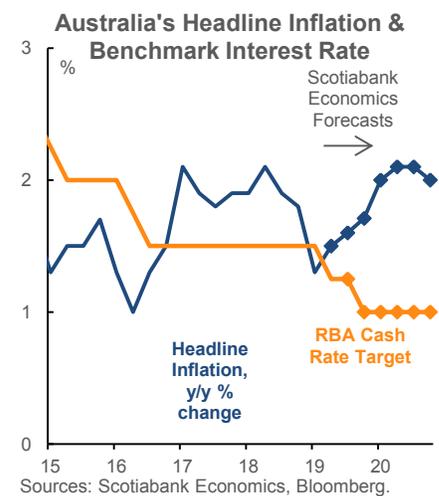
The central bank has indicated that it stands ready to ease monetary policy further if needed. RBA Governor Philip Lowe pointed out that labour market developments would play a key role in directing future decisions. While we find the RBA's communications regarding future policy direction rather cautious, assuming labour markets do not strengthen materially in the coming months, we expect another 25 bps cut is likely to follow sooner rather than later, most likely in the second half of 2019. The RBA will only communicate its intentions shortly before a critical policy meeting.

Nevertheless, we point out that today's rate reduction is largely symbolic in nature, given that the impact of looser monetary conditions will be mostly limited to boosting confidence. The policy action's transmission to the real economy is set to be fairly small on the back of already low interest rates in the economy, high household debt, and the ongoing residential housing price correction. There are growing calls on policy makers to deploy additional stimulative measures to revive Australia's economy.

CONTACTS

Tuuli McCully, Head of Asia-Pacific Economics
 65.6305.8313 (Singapore)
 Scotiabank Economics
tuuli.mccully@scotiabank.com

Chart 1



This report has been prepared by Scotiabank Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

These reports are provided to you for informational purposes only. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap or any other transaction. The information contained in this report is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap within the meaning of U.S. Commodity Futures Trading Commission Regulation 23.434 and Appendix A thereto. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a “call to action” or suggestion that you enter into a swap or trading strategy involving a swap or any other transaction. Scotiabank may engage in transactions in a manner inconsistent with the views discussed this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

Scotiabank, its affiliates and any of their respective officers, directors and employees may from time to time take positions in currencies, act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to securities or related derivatives. As a result of these actions, Scotiabank may receive remuneration. All Scotiabank products and services are subject to the terms of applicable agreements and local regulations. Officers, directors and employees of Scotiabank and its affiliates may serve as directors of corporations.

Any securities discussed in this report may not be suitable for all investors. Scotiabank recommends that investors independently evaluate any issuer and security discussed in this report, and consult with any advisors they deem necessary prior to making any investment.

This report and all information, opinions and conclusions contained in it are protected by copyright. This information may not be reproduced without the prior express written consent of Scotiabank.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotiabank, together with “Global Banking and Markets”, is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including, Scotiabanc Inc.; Citadel Hill Advisors L.L.C.; The Bank of Nova Scotia Trust Company of New York; Scotiabank Europe plc; Scotiabank (Ireland) Limited; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Scotia Inverlat Casa de Bolsa S.A. de C.V., Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank group and authorized users of the Scotiabank mark. The Bank of Nova Scotia is incorporated in Canada with limited liability and is authorised and regulated by the Office of the Superintendent of Financial Institutions Canada. The Bank of Nova Scotia is authorised by the UK Prudential Regulation Authority and is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia's regulation by the UK Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorised by the UK Prudential Regulation Authority and regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority.

Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., and Scotia Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Not all products and services are offered in all jurisdictions. Services described are available in jurisdictions where permitted by law.