June 4, 2019

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 it's 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.

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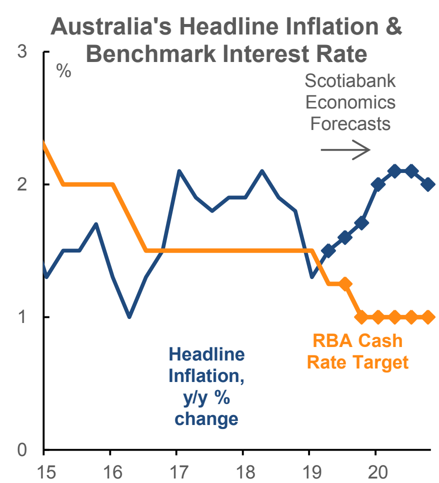
Chart 1



Sources: Scotiabank Economics, Bloomberg.