

DATA SNAPSHOT

RBA Board Minutes for the Mar-10 Meeting

Tuesday, 16th March 2010

- The RBA explained that the March decision to lift rates (from 3.75% to 4.00%) was part of the ongoing move towards more “normal levels” in interest rates.
- Further, at this meeting, it was considered “timely to take another step in that direction” given recent evidence on economic and financial developments.
- While the RBA acknowledged the chance of European fiscal problems reviving turmoil in financial markets and inhibiting growth, it balanced this by stating that such an outcome “was not the most likely one” and policy should be based on the “most likely outcome”.
- Today’s minutes did not contain elements, which were notably different from the tone of recent RBA rhetoric. So it leaves us comfortable with our ‘rates on hold’ view for April.
- However, we also acknowledge that, given the rate of progress in the Australian economy, the risk of near-term rate hikes remains ‘live’. So while we see reasons for the RBA to pause in April, every meeting is still a live possibility.

In the final paragraph of today’s minutes to the March meeting, the RBA stated: “On balance, members concluded that the evidence that had become available recently had confirmed that it remained appropriate for interest rates to move gradually towards normal levels, and that it was timely to take another step in that direction”.

The “evidence” that they refer to here include; recent developments in economic activity, i.e. ongoing strength in the Asian economies, despite softness in the major western economies (which are not as high up in Australia’s export destination ladder). Meanwhile domestically, most economic indicators also continued to show strength in activity with consumption spending holding up reasonably well, significant and ongoing gains in house prices and evidence that the construction boom is indeed underway. The mining sector is also expected to provide a “significant boost” to the Australian economy over a number of years. Amid such developments, employment conditions have continued to improve. While the RBA also noted that hours worked had not yet reversed earlier falls experienced during the crisis (i.e. cut in work hours by firms to save costs), last Thursday’s employment figures provided an early sign that this could be starting to come through.

The RBA also highlighted that in the lead up to the meeting, they had revised up their forecast for Q4 GDP to 0.75% - 1.0% q/q. This was later confirmed the following day after the meeting to be +0.9% q/q, i.e. in the middle of their forecast range. The outcome, in turn, especially given it was not in the lower end of the forecast range, could be argued to support the RBA’s day-earlier decision to lift rates. Importantly, it was also noted that, “some recent indicators suggested that growth might already have been running at or close to trend for a few months”. This could suggest that rates should be taken up “sooner rather than later” to more normal levels given this stronger-than-expected economic impetus.

On the financial sector the RBA states ongoing resilience in Australian financial conditions with early signs of credit to business becoming easier. Australian banks and other authorised deposit-taking institutions remained well capitalised (reflecting ongoing profitability and recent equity raisings) and had also bolstered their holdings of liquid assets.

The RBA also made a reference to the debt-problems in Europe in explaining its decisions. They highlighted that the exposure of Australian banks to European government debt was “minimal”. Moreover, while they acknowledged that unsatisfactory resolution of the European fiscal problems could spillover to financial markets and growth and have implications for Australia, they said that such an outcome was “not the most likely one”. Accordingly, the RBA stated that “the appropriate course was to set policy as required by the most likely outcome”.

The language in today’s minutes was not notably different from recent RBA thinking. Along, with last Thursday’s soft employment outcome, it leaves us comfortable with our ‘rates on hold in April’ forecast. However, if the inflow of economic data does not take a turn for the worse, we acknowledge that there is still the risk of the RBA bringing forward the bulk of its future rate hikes. In other words it could decide to ‘act sooner rather than later’ in lifting rates to be more in line with the expected

growth path, thus preventing a potential inflation outbreak. It would, in turn, allow the central bank greater flexibility to pause later on if needed once rates are back up to a more normal level.

Indeed in reference to this 'greater flexibility later' option, today the RBA indicated that its "prompt start" to the policy unwinding process last October was a key factor that allowed it to pause in February. So the chances are that the central bank could take this option of lifting rates now instead of later to pave way for greater flexibility later. Accordingly, although our core view is that the RBA will leave rates on hold in April, the chances of them moving are still "live".

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