HD Reserve Bank of Australia Dec minutes see likely period of stable rates

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Investing.com - The following are the **board** meeting minutes of the Reserve Bank of Australia for the December meeting released on Tuesday.

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Members Present

Glenn Stevens (Governor and Chair), Philip Lowe (Deputy Governor), John Akehurst, Roger Corbett AO, John Edwards, Kathryn Fagg, Martin Parkinson PSM (Secretary to the Treasury), Heather Ridout AO, Catherine Tanna

Others Present

Guy Debelle (Assistant Governor, Financial Markets), Christopher Kent (Assistant Governor, Economic), Alexandra Heath (Head, Economic Analysis Department), Anthony Dickman (Secretary), Peter Stebbing (Deputy Secretary)

International Economic Conditions

Members commenced their discussion of the international economy by noting that growth of Australia's major trading partners had been around its long-run average in the September quarter. Commodity prices, notably those for iron ore and oil, had continued to decline. Members noted that these price developments could be largely explained by increases in supply, although easing demand was also a factor. The fall in oil prices was expected to contribute to lower headline consumer price inflation in many of Australia's trading partners and, other things being equal, lower oil prices were likely to spur higher growth in many economies. Very accommodative financial conditions in the major economies continued to support global growth.

GDP growth in **China** in the September quarter was consistent with the authorities' objectives. Members observed that housing prices in **China** had fallen again in October but by less than in previous months. The ongoing weakness in housing markets had been reflected in a further easing in growth in investment and industrial production; lower growth in steel production had contributed to lower iron ore prices in recent months. Policymakers in **China** had responded to weakness in some sectors of the economy and this was expected to support growth in the near term. There were tentative signs that conditions in the housing market were stabilising.

In Japan, GDP fell in the September quarter against expectations of a small rise. Members noted that the weakness was spread across most components of expenditure. In contrast, recent indicators suggested that conditions in the labour market had remained tight. Output growth for the September quarter in the rest of east Asia had been around its average of recent years.

The US economy had grown at an above-trend pace in the September quarter and the unemployment rate had declined further. Core inflation had increased relative to a year earlier, but remained about ½ percentage point below the Federal Open Market Committee's goal of 2 per cent.

Members noted that the recovery in the euro area remained fragile. The unemployment rate had declined a little during 2014 but remained high, and inflation was well below the European Central Bank's target of close to, but below, 2 per cent. Members also observed that differences in growth across euro area countries could partly be explained by the different levels of national competitiveness.

Domestic Economic Conditions

Members noted that the data available at the time of the meeting had indicated that GDP growth was likely to be a bit below average in the September quarter. Resource exports had continued to grow strongly in the September quarter and further expansions in iron ore production were expected to continue supporting resource exports in the near term. Production of liquefied natural gas was also likely to start increasing gradually over the course of the next year. Mining investment looked to have declined in the September quarter and further substantial declines were expected. Fiscal consolidation at all levels of government in Australia was also expected to weigh on GDP growth for a time.

The available data suggested that dwelling investment was likely to subtract a little from growth in the September quarter. However, building approvals and other forward-looking indicators of **residential** building activity continued to suggest that dwelling investment would contribute to growth in coming quarters. Aggregate housing price growth had slowed a little and continued to display considerable regional variation, with housing price growth strongest in Sydney. Members noted that credit to owner-occupiers was growing at a pace only a little above that of income, but that growth in credit to investors was considerably higher.

Members noted that the strength in the housing market and data on retail sales, for example, indicated that household consumption growth was likely to have picked up a little from the pace recorded in recent quarters. However, they recognised that the labour market had remained subdued and that this was restraining growth in labour income. The unemployment rate had risen over the past six months, employment growth had been somewhat below the pace of population growth and wage growth had remained low in the September quarter. Forward-looking indicators also remained consistent with expected relatively moderate growth in employment over coming months.

Data from the ABS capital expenditure survey was consistent with expectations that non-mining investment would grow modestly in the current financial year. Members noted that a number of more timely indicators of activity in the non-mining business sector, such as the measure of business conditions from the NAB survey, recent data on business credit and growth in profits of the corporate non-mining sector, were consistent with this assessment.

Financial Markets

The **Board** discussed how financial markets over the past month had responded to the increasingly divergent outlooks for monetary policy in the major economies. In particular, members discussed the effects of recent policy announcements in Japan.

Members had been advised at the November meeting that the Bank of Japan (BoJ) had unexpectedly announced an expansion of its monetary easing program at its late October meeting, by increasing its rate of **purchases** of Japanese government bonds. These **purchases** were expected to result in a substantial increase in measures of ‘base money’. In gross terms, the BoJ's **purchases** would also account for around two-thirds of all new issuance of government bonds over the coming year, with **purchases** exceeding new issuance for bonds with a maturity of 5−10 years.

The **Board** assessed the prospect of an increase in the rate of **purchases** of offshore assets by Japanese residents following the recent easing in the monetary policy of the BoJ and the announcement by Japan's Government Pension Investment Fund (GPIF) that it would reallocate its portfolio more towards domestic equities and foreign assets and less towards domestic bonds. Members noted that the effect of these actions was expected to result in further sizeable capital outflows from Japan in the period ahead. While the bulk of these were likely to be to the United States, Australia would probably see some significant flows as well, with consequent effects on exchange rates.

Members noted that the European Central Bank (ECB) had also reiterated its intention to expand its balance sheet by around 1 trillion back towards its previous peak in 2012 and had indicated a willingness to adjust the size and composition of its asset **purchases** further to achieve that objective.

Overall, members noted that the actions of the BoJ and ECB would result in total liquidity provided by major central banks increasing at a similar pace to that observed over recent years, notwithstanding the Federal Reserve's large asset **purchase** program having ended in October. Such an expansion could, however, occur against a backdrop of rising US interest rates.

Among other central banks, the People's Bank of **China** (PBC) announced the first reduction in its benchmark interest rates since mid 2012. In part, this was a further step on the path of financial liberalisation, but it also appeared to reflect a deliberate easing in monetary conditions. At the same time, members noted that the PBC continued to restrict credit provision in the shadow banking sector.

Turning to foreign exchange markets, members noted the 7 per cent depreciation of the yen against the US dollar, and on a trade-weighted basis, following the announcements by the BoJ and the GPIF. In addition to its marked appreciation against the yen, the US dollar had appreciated a little against most other currencies over November, to be 6 per cent higher on a trade-weighted basis since the middle of the year. Members noted that the Korean authorities had recently expressed concern about the depreciation of the yen, although the won had still depreciated significantly against the US dollar over November and also on a trade-weighted basis. The euro was little changed over the month and remained 5 per cent below its May 2014 peak on a trade-weighted basis. The Swiss franc had appreciated further against the euro over the month to be only marginally below the Swiss National Bank's ceiling. The Russian rouble declined sharply over the previous month to be around 20 per cent lower against the US dollar.

In part reflecting these exchange rate movements, over the past month the Australian dollar had appreciated by 5 per cent against the yen and 3 per cent against the won, but had depreciated to a four-year low against the US dollar. The Australian dollar had also depreciated against the renminbi (which continued to track recent movements in the US dollar) to be only slightly lower on a trade-weighted basis than at the beginning of the year, although members noted that the terms of trade and key commodity prices had fallen significantly further since that time.

Members noted that sovereign bond yields in the United States and Europe had generally declined over the course of November, with German yields reaching new lows. Australian government bond yields had also declined, with the yield on 10-year bonds falling below 3 per cent and the spread to US treasuries narrowing to its lowest level in eight years.

Equity prices in the advanced economies had increased over the past month, with the US and Japanese markets more than fully retracing the falls experienced over recent months to reach multi-year highs. Japanese equity prices had increased strongly following the announcements by the BoJ and the GPIF, while Australian equity prices declined over the month and were little changed over the year to date. The underperformance of the Australian market reflected the poor performance of equity prices of mining and energy companies, which were around 20 per cent lower in response to falls in iron ore, coal and oil prices.

Bond issuance by Australian banks in 2014 to date had been solid in both gross and net terms, although the overall funding mix of the banks was little changed. Members noted that conditions in the Australian **residential** mortgage-backed securities market were strong at present, with high levels of issuance and relatively tight pricing. Competition in the deposit market had continued to ease and interest rates on certain savings accounts had declined noticeably over the past year or so. Lending rates on the stock of outstanding housing and business loans remained at historically low levels.

Financial market pricing indicated that the **Board** was expected to leave the cash rate unchanged at the December meeting, with some chance of an easing in 2015.

Considerations for Monetary Policy

In assessing the stance of monetary policy in Australia, members noted that the outlook for the global economy was little changed over the past month, with growth of Australia's major trading partners forecast to be a little above average in 2014 and 2015. Commodity prices, particularly those for iron ore and oil, had declined over the year to date. Demand-side factors, such as the weakness in **Chinese property** markets, had played a role over recent months, though expansions in global supply appeared to have played a larger role earlier in the year. Global financial market conditions had remained very accommodative.

Domestically, the data that had become available over the month suggested that the forces underpinning the outlook for domestic activity were much as they had been for some time. GDP growth was still expected to be below trend over 2014/15 before gradually picking up to an above-trend pace towards the end of 2016. Mining investment was expected to decline sharply and resource exports were expected to grow strongly as the transition from the investment to the production phase of the mining boom continued. Very low interest rates had supported activity in the housing market, which in turn was expected to support consumption. However, members noted that subdued labour market conditions were likely to weigh on consumption growth and consumer confidence more generally. With spare capacity in labour and product markets likely to weigh on domestic inflationary pressures for some time, the inflation outlook remained consistent with the target of 2 to 3 per cent, notwithstanding some temporary upward pressure from the recent depreciation of the exchange rate.

Members noted that the current accommodative setting of monetary policy was expected to support demand and help growth strengthen at the same time as delivering inflation outcomes consistent with the target over the next two years. Despite the depreciation of the exchange rate, the Australian dollar remained above most estimates of its fundamental value, particularly given the significant declines in key commodity prices over recent months. Members agreed that further exchange rate depreciation was likely to be needed to achieve balanced growth in the economy. They noted that market expectations implied some chance of an easing of policy during 2015 and discussed the factors that might be producing such an expectation.

On the information available, the **Board** judged that the current stance of monetary policy continued to be appropriate for fostering sustainable growth in demand and inflation outcomes consistent with the target. Members considered that the most prudent course was likely to be a period of stability in interest rates.

The Decision

The **Board** decided to leave the cash rate unchanged at 2.5 per cent.

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