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HD RBA October board meeting minutes repeat period of stability

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Investing.com - The following is the full-text statement released Tuesday of the board meeting minutes from the Reserve Bank of Australia's October rate decision.

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Members Present

Glenn Stevens (Governor and Chair), Philip Lowe (Deputy Governor), John Akehurst, Roger Corbett AO, John Edwards, Kathryn Fagg, Heather Ridout AO, Catherine Tanna

Jenny Wilkinson (Acting Executive Director (Domestic), Macroeconomic Group, Treasury) attended in place of Martin Parkinson PSM (Secretary to the Treasury) in terms of section 22 of the Reserve Bank Act 1959.

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

The global data released over the past month suggested that Australia's major trading partners had continued to grow at around their long-run average pace over the past year, although there had been quarterly volatility in growth in some of the major economies through the year. Inflationary pressures had remained contained across all major regions.

In China, some indicators of economic conditions had softened a little. Members were briefed that the Chinese authorities had scope to ease policy if needed to support GDP growth. In the property market, conditions had continued to soften and the government had announced policy changes designed to support the market. After discussing the potential impact of these changes on the housing cycle in China, members noted that the flow of overall non-bank financing had eased further, possibly reflecting recent additional regulatory measures aimed at limiting this type of finance. They also noted that the authorities' target for employment growth in 2014 as a whole was already close to being achieved.

In Japan, economic activity appeared to have picked up only a little following the decline in the June quarter, which had been due to the effect of the increase in the consumption tax earlier in the year. Overall, prospects for growth remained unclear, even though labour market conditions had been relatively tight, with average labour earnings having increased a little over the past year. Members observed that growth in output in the rest of east Asia had been a bit below its decade average in recent quarters. East Asian trade had grown steadily and remained relatively stable as a share of world trade.

The US economy looked to have been growing at around, or even a little above, trend, with business investment picking up noticeably and labour market conditions improving further. The unemployment rate had continued to decline, reflecting solid growth in payrolls in recent months, though members noted the low participation rate and relatively elevated measures of underemployment.

In the euro area, there had been little change in output in recent months and inflation remained well below the target of the European Central Bank (ECB). In response, the ECB had announced further stimulatory measures at its September meeting.

Members noted that iron ore prices had declined further over the past month, reaching their lowest level since September 2009. The decline over the past year had reflected a combination of increased Australian and global supply and, more recently, some softening in the growth of **Chinese** demand for steel, perhaps resulting in part from weaker conditions in the housing market. Members observed that most Australian iron ore production remained profitable at these lower prices and that increased pressures on global higher-cost mines would be expected, in time, to lead to reductions in their production. The prices of other commodities had declined a little over the past month in SDR terms, but were little changed in Australian dollar terms given the depreciation of the exchange rate.

Domestic Economic Conditions

The June quarter national accounts had been released the day after the September **Board** meeting. The accounts showed an increase in real GDP of 0.5 per cent in the quarter and a little more than 3 per cent over the year, in line with the forecasts published in the August Statement on Monetary Policy. Members noted that a decline in resource exports in the June quarter had followed very strong growth in the previous two quarters, which meant that resource exports had made a significant contribution to year-ended growth. Consumption recorded moderate growth in the first half of 2014. Over the year to June 2014, consumption had grown faster than real disposable income, resulting in a further decline in the savings ratio. Growth in dwelling investment had been strong, whereas mining and non-mining business investment in aggregate had fallen over the year.

More recent data and liaison had suggested that moderate growth of consumption had continued into the September quarter. The two key measures of consumer sentiment had diverged, with one around average levels and the other still a bit below average. Members noted that consumption was also likely to be supported by the ongoing strength in the housing market.

Dwelling investment had increased by more than 8 per cent over the year to the June quarter, and continued strength in building approvals and other indicators pointed to further growth in coming quarters. House price growth had been a little slower, on average, over 2014 than in late 2013, but remained consistent with strong conditions in the established housing market. Over the previous six months, overall housing credit growth had been steady at around 7 per cent in annualised terms, but members noted that growth of investor credit had increased to close to 10 per cent.

Mining investment increased slightly in the June quarter, but was still expected to decline significantly over the course of 2014/15. Non-mining business investment was little changed over the year to the June quarter, but members noted that data from the capital expenditure survey indicated that this component of business investment was likely to increase moderately in 2014/15. Measures of business conditions and confidence had remained around, or a little above, their long-run averages. Information from liaison indicated that the cost and availability of finance did not appear to have been restraining business investment.

Members recognised that historically slow wage growth outcomes were consistent with spare capacity in the labour market. They also noted that the recent labour force data had been quite volatile, suggesting the possibility of some measurement problems. The unemployment rate in August had retraced the sharp rise recorded in July to be close to 6 per cent, around the average of the monthly unemployment rate over the year to date. Employment had reportedly increased substantially in August, driven by an exceptionally strong rise in part-time employment. Looking at a broader range of data, members concluded that labour market conditions remained subdued, although they appeared to have stabilised somewhat over the course of 2014 to date. Forward-looking indicators had picked up a little, but still pointed to only modest employment growth over the coming months.

Financial Markets

Members opened their discussion of financial markets with the observation that central banks were the main focus of attention in September and volatility had picked up a little from very low levels, predominantly in currency markets.

The US Federal Reserve had maintained its guidance in September that the federal funds rate was likely to remain unchanged for a ‘considerable time’ and thereafter rise only gradually. There were small upward shifts to Federal Open Market Committee (FOMC) members' projections for the federal funds rate for 2015, with individual members' projections continuing to diverge substantially.

In contrast, the ECB had unexpectedly reduced by a further 10 basis points both its policy rate, to 5 basis points, and its deposit rate, to -20 basis points, in September. The ECB had also announced that from

October it would purchase 'simple and transparent' euro area asset-backed securities, including residential mortgage-backed securities, and covered bonds. While no explicit target was set, the ECB's intention appears to be to expand its balance sheet back to its crisis peak, which would be around 1 trillion euros larger than at present, through a combination of targeted long-term refinancing operations (TLTROs) and asset purchases. The ECB conducted the first of the TLTROs during September, with the take-up being lower than expected.

The decisions of the FOMC and the ECB were followed by sizeable movements in exchange rates, with the US dollar appreciating across the board, including against the Australian dollar. While an appreciation of the US dollar had been anticipated for some time, the exact timing of the appreciation was difficult to explain. The appreciation was associated with an increase in volatility in the main currency pairs, albeit only back towards typical levels. The euro had depreciated by 9 per cent since early May to be at its lowest level against the US dollar in two years, while emerging market currencies had generally depreciated against the US dollar as well. The notable exception was the Chinese renminbi (RMB), which had been little changed against the US dollar and had appreciated in trade-weighted terms by 5 per cent over the preceding year.

Members noted that the Australian dollar had depreciated by 4 per cent in trade-weighted terms over September. This was primarily a 6 per cent depreciation against a rising US dollar (and the RMB), although weaker-than-expected Chinese economic data and further declines in key commodity prices had contributed to some additional softening of the Australian dollar. The recent depreciation followed a period when the Australian dollar had held up against the US dollar more than most other currencies, and meant that the Australian dollar was now around its January low against the US dollar but remained a little higher on a trade-weighted basis than earlier in the year.

Members observed that US sovereign bond yields had fluctuated over September, with German, UK and Australian bond yields generally tracking the moves in US yields.

Share prices in the developed economies had declined over the past month, with the exception of Japan, where share prices had risen strongly in conjunction with a sizeable depreciation of the yen. Australian share prices had underperformed equity markets in other developed economies in September; concerns about the pace of economic growth in China and falls in commodity price had adversely affected the share prices of domestic resource companies, and the share prices of banks had also weakened.

Members concluded their discussion of financial markets by observing that lending rates in Australia continued to edge down marginally in September. Financial markets continued to expect that the cash rate would be unchanged at the October meeting and over the following 12 months.

Considerations for Monetary Policy

Growth in the global economy was continuing at a moderate pace. Commodity prices, in particular iron ore prices, had declined over the past month. This was consistent with both the ongoing increase in iron ore supply and further weakening of the Chinese property market, which is an important source of demand for steel. Global financial conditions remained very accommodative and the Australian dollar had depreciated somewhat, largely reflecting a broad-based appreciation of the US dollar.

As expected, the domestic economy had grown moderately in the June quarter, following a strong March quarter result. The outcome was supported by strong growth in dwelling investment and steady consumption growth. Members noted that more timely indicators suggested that moderate growth overall had continued into the September quarter.

Faced with volatility in the labour force survey results, members based their assessment of the labour market on a range of indicators. These suggested that conditions in the labour market remained subdued but had stabilised somewhat this year. While forward-looking indicators pointed to modest employment growth in the months ahead, there was a degree of spare capacity in the labour market and it would probably be some time before the unemployment rate declined consistently. Wage growth was expected to remain relatively slow in the near term, which should help to maintain inflation consistent with the target even with lower levels of the exchange rate.

Members noted that the current setting of monetary policy was accommodative, with lending rates remaining very low and continuing to edge lower over recent months as competition to lend had increased. In this context, members discussed the importance of lenders maintaining strong lending standards and the ongoing dialogue between the Bank and APRA on the matter.

Continued accommodative monetary policy was expected to support demand and help growth to strengthen over time. To date, this had been most apparent in the housing market, where dwelling investment had picked up and was expected to remain strong following the rapid rise in housing prices and high levels of approvals. Credit growth had remained moderate overall, but in recent months there had been a further pick-up in lending to investors in housing. Despite the easing in financial conditions associated with the depreciation of the Australian dollar, the exchange rate remained high by historical standards - particularly given recent declines in key commodity prices - and was offering less assistance than would normally be expected in achieving balanced growth in the economy.

Given the information available, the **Board**'s judgement was that the current stance of monetary policy continued to be appropriate for fostering sustainable growth in demand and inflation outcomes consistent with the target over the period ahead. 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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