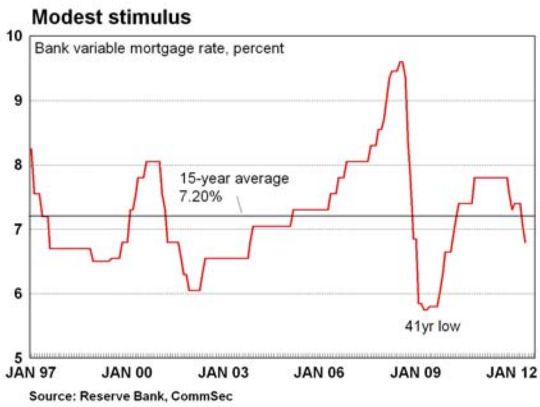
# Reserve Bank opts for actions over words

## Reserve Bank Board meeting

- **The Reserve Bank Board cut the official cash rate by 25 basis points (quarter of a percentage point) to 3.50 per cent. The cash rate is at the lowest level in 2½ years (December 2009). The next RBA Board meeting is on July 3 2012.**
- **The Reserve Bank summed up the decision quite neatly. "*with modest domestic growth and a weaker and more uncertain international environment, the outlook for inflation afforded scope for a more accommodative stance of monetary policy.*"**

### What does it all mean?

- The Europeans talk about doing what it takes to stabilise their economies and financial systems. The Reserve Bank prefers actions over words. Australia needs some insulating from global risks and the Reserve Bank is showing that it is prepared to do what it takes to keep the economy growing.
- This is a smart decision. This is an appropriate decision. And this is a decision that deserves support across all areas of the Australian community.
- This is where the Reserve Bank officials earn their money. Sometimes it is abundantly clear what should be done with interest rates. Other times – such as now – it gets a lot harder. In other words, monetary policy is more art, than science.
- The Reserve Bank could have left rates unchanged. But there would have been more risks associated with that decision and potentially more regrets. The economy is soft, inflation is low and the global economy has all manner of risks. The Reserve Bank may have cut rates by half a per cent. But there were risks in this strategy as well – the Bank doesn't want to use up all its ammunition.
- So a rate cut of a quarter of a per cent proves the happy medium. It is appropriate given soft domestic and international conditions. And a modest rate cut provides stimulus without putting up barriers to further action.
- The Reserve Bank would prefer not to cut rates again, but it has shown that it is prepared to do so. The problem with cutting rates too far is that you get too far away from "normal" and eventually you have to return to that happy place where the cash rate isn't slowing the economy down, and not speeding it up either. Importantly though, interest rates are only "a little below medium-term averages."
  In other words there is still plenty of firepower.
- CommSec believes that more rate hikes are possible over coming months and we have pencilled in another quarter per cent rate cut in August. Hopefully this rate cut won't be required. That is, the hope is that Greece opts to stay in the Euro; that the Spanish banking system is supported; that China acts to stimulate its economy; and that Aussie consumers start to spend, invest and borrow again.




### Interest rate decision and past cycles

- The Reserve Bank Board has cut the cash rate by 25 basis points (quarter of a percentage point) to 3.50 per cent. The previous rate cuts were in May (50 basis points) and November and December 2011 (each by 25 basis points).

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Prior to those moves the Reserve Bank had previously lifted rates seven times from October 2009 to November 2010 – a total of 1.75 percentage points, from 3.00 per cent to 4.75 per cent.

- In the last rate-cutting cycle the cash rate fell to a low of 3.00 per cent in April 2009. In the previous rate-cutting cycle the cash rate fell to 4.25 per cent in December 2001. In the two previous rate-cutting cycles, the cash rate fell to lows of 4.75 per cent.
- The Reserve Bank now looks more closely at the variable housing rate to gauge how close rates are to "normal". Currently the variable housing rates of major banks are around 7.05 per cent, slightly below the long-term average or "normal" rate of 7.20 per cent. The RBA says that "*interest rates for borrowers have declined to be a little below their medium-term averages."* In other words stimulus is still very modest.

## What are the implications of today's decision?

- With each rate cut, savers are presented with more choices. It may have been safe to leave money in the form of cash, but is it still the smart decision? The rate cut is great news for a residential property sector that some describe as being in recession. Today's rate cut should boost demand for property by investors and owner-occupiers alike. Fundamental demand for property is strong and supply isn't keeping up.
- The rate cut is unlikely to put downward pressure on the Aussie dollar. In fact the currency rose in response to the decision. While Aussie businesses would have preferred a weaker currency, they will have to learn to live with a dollar near parity against the greenback.
- Retailers have reason to be hopeful. Consumer spending power has been boosted, but we all have to learn to actually spend again rather than keep the dollars in our pockets.
- There have been three rate cuts, but so far the impact on the economy appears negligible. Eventually we will get to the point where rate cuts work to stimulate growth. But it may prove a little like stretching a rubber band – at some point there will be a snap where consumers and businesses bounce back into action.
- Smart investors will be asking where the opportunities are, and be focussing on the medium-term rather than the short-term.

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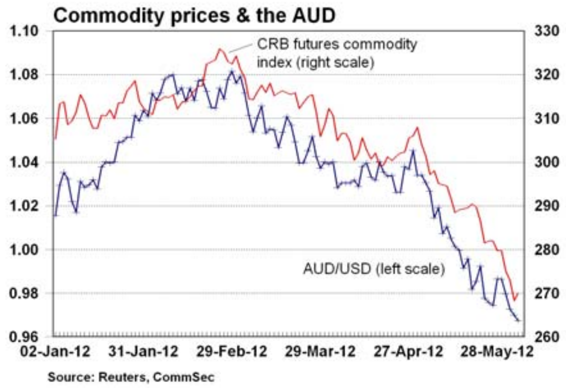


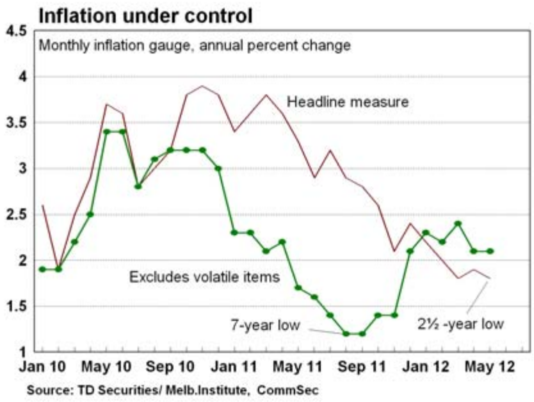


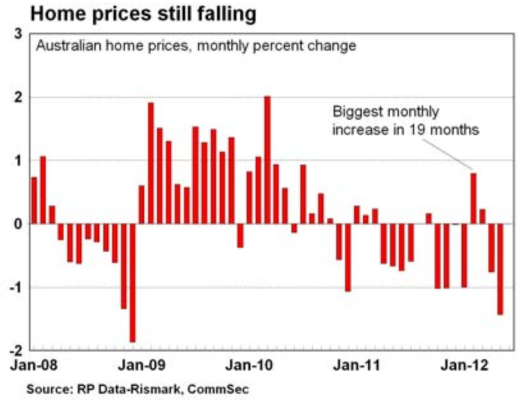


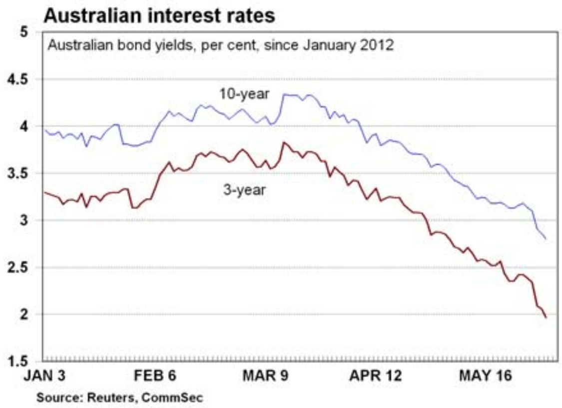

## Comparing the two most recent statements

- The statement from the May meeting is on the left; the statement from today's June 2012 meeting is on the right. Emphasis has been added to significant changes in wording in the recent statement.

## MEDIA RELEASE

**No:** 2012-10
**Date:** 1 May 2012
**Embargo:** For Immediate Release

### STATEMENT BY GLENN STEVENS, GOVERNOR MONETARY POLICY

At its meeting today, the Board decided to lower the cash rate by 50 basis points to 3.75 per cent, effective 2 May 2012. This decision is based on information received over the past few months that suggests that economic conditions have been somewhat weaker than expected, while inflation has moderated.

Growth in the world economy slowed in the second half of 2011, and is likely to continue at a below-trend pace this year. A deep downturn is not occurring at this stage, however, and in fact some forecasters have recently revised upwards their global growth outlook. Growth in China has moderated, as was intended, and is likely to remain at a more measured and sustainable pace in the future. Conditions in other parts of Asia softened in 2011, partly due to natural disasters, but have recently shown some tentative signs of improving. Among the major countries, conditions in Europe remain very difficult, while the United States continues to grow at a moderate pace. Commodity prices have been little changed, at levels below recent peaks but which are nonetheless still quite high. Australia's terms of trade similarly peaked about six months ago, though they too remain high.

Financial market sentiment has generally improved this year, and capital markets are supplying funding to corporations and well-rated banks. At the margin, wholesale funding costs have declined over recent months, though they remain higher, relative to benchmark rates, than in mid 2011. Market sentiment remains skittish, however, and the tasks of putting European banks and sovereigns onto a sound footing for the longer term, and of improving Europe's growth prospects, remain large. Hence Europe will remain a potential source of adverse shocks for some time yet.

In Australia, output growth was somewhat below trend over the past year, notwithstanding that growth in domestic demand ran at its fastest pace for four years. Output growth was affected in part by temporary factors, but also by the persistently high exchange rate. Considerable structural change is also occurring in the economy. Labour market conditions softened during 2011, though the rate of unemployment has so far remained little changed at a low level.

Recent data for inflation show that after a pick-up in the first half of last year, underlying inflation has declined again, and was a little over 2 per cent over the latest four quarters. CPI inflation has also declined, from about 3½ per cent to a little over 1½ per cent at the latest reading, as the weather-driven rises in food prices in the first half of last year have, as expected, now been fully reversed. **Over the coming one to two years, and abstracting from the effects of the carbon price, inflation will probably be lower than earlier expected, but still in the 2–3 per cent range.**

**As a result of changes to monetary policy late last year, interest rates for borrowers have been close to their medium-term averages over recent months, albeit tending to increase a little as lenders passed on the higher costs of funding their books.** Credit growth remains modest overall. Housing prices have shown some signs of stabilising recently, after having declined for most of 2011, but generally the housing market remains subdued. The exchange rate remains high even though the terms of trade have declined somewhat.

Since it last changed the cash rate in December, the Board has maintained the view that the setting of policy was appropriate for the time being, but that the inflation outlook would provide scope for easier monetary policy, if needed, to support demand. The accretion of evidence over recent months suggests that it is now appropriate for a further step in that direction.

**In considering the appropriate size of adjustment to the cash rate at today's meeting, the Board judged it desirable that financial conditions now be easier than those which had prevailed in December.** A reduction of 50 basis points in the cash rate was, in this instance, therefore judged to be necessary in order to deliver the appropriate level of borrowing rates. .

## MEDIA RELEASE

**No:** 2012-13
**Date:** 5 June 2012
**Embargo:** For Immediate Release

### STATEMENT BY GLENN STEVENS, GOVERNOR MONETARY POLICY

At its meeting today, the Board decided to lower the cash rate by 25 basis points to 3.50 per cent, effective 6 June 2012.

Growth in the world economy picked up in the early months of 2012, having slowed in the second half of 2011. But more recent indicators suggest **further weakening in Europe and some further moderation in growth in China.** Conditions in other parts of Asia have largely recovered from the effects of last year's natural disasters, but the ongoing trend is unclear and could be dampened by slower Chinese growth. The United States continues to grow at a moderate pace. Commodity prices have declined lately, though they are mostly still high. Australia's terms of trade similarly peaked about six months ago, though they remain historically high.

**Financial market sentiment has deteriorated over the past month.** The Board has noted previously that Europe would remain a potential source of adverse shocks. Europe's economic and financial prospects have again been clouded by weakening growth, heightened political uncertainty and concerns about fiscal sustainability and the strength of some banks. Capital markets remain open to corporations and well-rated banks, but spreads have increased. Long-term interest rates faced by highly rated sovereigns, including Australia, have fallen to exceptionally low levels. Share markets have declined.

In Australia, available indicators suggest modest growth continued in the first part of 2012, with significant variation across sectors. Overall labour market conditions firmed a little, notwithstanding job shedding in some industries, and the rate of unemployment remains low. **Nonetheless, both households and businesses continue to exhibit a degree of precautionary behaviour, which may continue in the near term.**

There have been no new data for inflation since the previous meeting. Over the coming one to two years, and abstracting from the effects of the carbon price, inflation is expected to be in the 2–3 per cent range. In the near term, it is likely to be in the lower part of that range, though maintaining low inflation over the longer term will require growth in domestic costs to slow as the effects of the earlier high exchange rate wane.

As a result of earlier changes to monetary policy, interest rates for borrowers have declined to be **a little below their medium-term averages**. Business credit has increased more strongly in recent months, though credit growth remains modest overall. Housing prices had shown some signs of stabilising around the turn of the year, but have recently declined again. Generally, the housing market remains subdued. The exchange rate has declined over recent weeks, reflecting lower commodity prices, heightened risk aversion and expectations of lower interest rates.

At today's meeting, the Board judged that, with modest domestic growth and a weaker and more uncertain international environment, the outlook for inflation afforded scope for a more accommodative stance of monetary policy.

## Implications for home buyers

- If the rate cut is passed on, the following table highlights the impact on mortgages.

MORTGAGE CALCULATOR (Monthly repayments, 25 years)

| Mortgage | | Change in Interest Rates | | | | | |
|---|---|---|---|---|---|---|---|
| | | -0.25% | -0.50% | -0.75% | -1.00% | -1.25% | -1.50% |
| | 7.05 | 6.80 | 6.55 | 6.30 | 6.05 | 5.80 | 5.55 |
| $100,000 | $709.97 | $694.07 | $678.33 | $662.76 | $647.36 | $632.13 | $617.08 |
| $150,000 | $1,064.96 | $1,041.11 | $1,017.50 | $994.15 | $971.04 | $948.20 | $925.62 |
| $200,000 | $1,419.94 | $1,388.14 | $1,356.67 | $1,325.53 | $1,294.72 | $1,264.26 | $1,234.15 |
| $250,000 | $1,774.93 | $1,735.18 | $1,695.84 | $1,656.91 | $1,618.40 | $1,580.33 | $1,542.69 |
| $300,000 | $2,129.92 | $2,082.22 | $2,035.00 | $1,988.29 | $1,942.08 | $1,896.39 | $1,851.23 |
| $350,000 | $2,484.90 | $2,429.25 | $2,374.17 | $2,319.67 | $2,265.76 | $2,212.46 | $2,159.77 |
| $400,000 | $2,839.89 | $2,776.29 | $2,713.34 | $2,651.05 | $2,589.45 | $2,528.53 | $2,468.31 |
| $450,000 | $3,194.87 | $3,123.32 | $3,052.51 | $2,982.44 | $2,913.13 | $2,844.59 | $2,776.85 |
| $500,000 | $3,549.86 | $3,470.36 | $3,391.67 | $3,313.82 | $3,236.81 | $3,160.66 | $3,085.39 |
| | | Change in repayments per month | | | | | |
| $100,000 | | -$15.90 | -$31.64 | -$47.21 | -$62.61 | -$77.84 | -$92.89 |
| $150,000 | | -$23.85 | -$47.46 | -$70.81 | -$93.92 | -$116.76 | -$139.34 |
| $200,000 | | -$31.80 | -$63.27 | -$94.42 | -$125.22 | -$155.68 | -$185.79 |
| $250,000 | | -$39.75 | -$79.09 | -$118.02 | -$156.53 | -$194.60 | -$232.24 |
| $300,000 | | -$47.70 | -$94.91 | -$141.63 | -$187.83 | -$233.52 | -$278.68 |
| $350,000 | | -$55.65 | -$110.73 | -$165.23 | -$219.14 | -$272.44 | -$325.13 |
| $400,000 | | -$63.60 | -$126.55 | -$188.83 | -$250.44 | -$311.36 | -$371.58 |
| $450,000 | | -$71.55 | -$142.37 | -$212.44 | -$281.75 | -$350.28 | -$418.03 |
| $500,000 | | -$79.50 | -$158.19 | -$236.04 | -$313.05 | -$389.20 | -$464.47 |

Source: CommSec