RBA cuts rates 25bp to 1.0%

The Reserve Bank of Australia (RBA) has cut rates in line with the consensus forecast - but the market seems to be backing away from earlier aggressive rate cut projections

1.0%

RBA Cash rate target

Cut from 1.25%

As expected

Prospects of aggressive easing receding

Where their first rate cut seemed to provide the affirmation bias that a string of further easing was on its way, the latest rate cut does not seem to have had such an effect. At the end of last week (29 June), the probability that rates would have fallen to 0.75% by next month's meeting on 6 August, was 26.7%. Today, it is only 21.0%, and the probability does not rise to 30% until the following month. Mid-June (14th), the likelihood of rates falling as low as 0.25% was a non-negligible 6.5%, and the overall chance of rates being cut to 0.5% or lower was about 27%. Today, these implied probabilities have declined to 4% and 23.9% respectively.

Reality check

The net result of this is that rather than depreciate on the rate cut news, the AUD has found some resilience. The AUD sell-off had already happened to a large extent. And more recently, it had been under pressure from a US Fed, that seems destined to match all the easing the RBA has now done. The main difference between these two markets is that the US money market futures still seem to be fired up with rate cut fever, whilst the Australian market is having a spell of clearer thinking.

Statement says little

The RBA statement said that the easing "will support employment growth and provide greater confidence that inflation will be consistent with the medium-term target". And that "The central scenario for the Australian economy remains reasonable, with growth around trend expected".

There are few substantive changes to the statement that was submitted at the time of the June cut. Governor Lowe speaks later at a press briefing and may provide more for markets to digest.

Contrary to our assumption before this meeting, the RBA seems to be taking the view that with ammunition limited and ineffective, it is better to use it aggressively to have any effect at all, not to ration it out. Consequently, it seems reasonable to view another rate cut in the coming months as probable, and we are amending our forecast for a further 25bp cut to 0.75% by the year-end, with the next cut sometime in 4Q19, though more than this, and earlier, is clearly the main risk to this new forecast.

Lessons for the Fed?

It's not clear that the Australian market can provide any lessons for US markets and the Fed, though the situations are broadly similar. One observation is in terms of market pricing, where successively more easing has been priced out of the Australian market as the RBA has actually delivered. This has prevented the AUD from taking more of a beating. A similar story could prevent a bigger USD sell-off and keep the EURUSD within the 1.10-1.15 ranges that our FX strategists have referred to in their recent publications.

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