

RBA keeps rates unchanged at 1.5%

The AUD is off its recent highs which, if maintained, will provide a window for some eventual RBA policy normalisation



Source: Crawford Forum

1.5%

 Cash rate

As expected

As widely expected, the Reserve Bank of Australia left monetary policy unchanged at the meeting today.

The common dilemma

The background for Australia is firming up though. Recent activity data was constructive, and much like its G-7 peers, the RBA faces the dilemma of how to respond to strong growth and a tight labour market when the currency is firm, and there is no inflation or wage pressure.

Markets are not fully pricing in an RBA hike until July 2018.

High and rising household debt is one reason to move rates higher, though that job has largely been delegated to the Australian Prudential Regulation Authority (APRA), which has been weighing on the mortgage lending market. Judging by the softening of house prices in the Sydney area, APRA seems to be having some success.

If that takes some of the pressure off the RBA to raise rates to bolster APRA's efforts, the absence of inflation is something that has been causing policymakers worldwide to scratch their heads.

RBA Governor, Lowe (pictured), has indicated that he thinks inflation has troughed. And on some of the RBA's trimmed inflation metrics, this appears to be the case. But inflation is still below 2.0% on all these measures, even if it is nosing slowly higher, and so it could be months before the mid-point of the RBA's 2-3% inflation target is threatened.

What next?

Markets are not fully pricing in an RBA hike until July 2018. This seems overly cautious to us even with low and slowly rising inflation. But with the Fed hiking in December in all likelihood, even if there is no strong reason for the RBA to follow suit (as Lowe himself made clear recently), higher US rates do provide some cover for a dovish RBA hike.

The AUD is off its recent highs, which if maintained, will also provide a window for some normalization. But today's statement gave no ground on the AUD, which was a verbatim copy of its September 5 statement.

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