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AUSTRALIA: RBA policy held, easing bias emerging?

As was universally expected, the RBA decided to keep the Cash Rate unchanged at 4.25% at its meeting in April, a third-straight decision to hold policy, but all following two successive rate cuts at the end of 2011.

Stabilizing global economic outlook?

The statement by Governor Stevens following this meeting, however, showed some notable changes from the previous month. Beginning with the global economy, the RBA once again noted that recent information was consistent with projected below-trend growth this year but with nothing to suggest a deep downturn is occurring. Specifically, while many European countries are still expected to record very weak growth, the US is showing a continued moderate expansion and the Chinese economy is expected to remain at a more measured and sustainable pace of growth going forward.

Output deteriorates, inflation stable…

In terms of the domestic economy, the RBA highlighted the fastest domestic demand growth in four years in 2011, but with diverging performances between sectors and considerable structural changes occurring in the economy once again emphasized. However, new this month, the Bank also observed that the balance of recent information suggested that output growth was still somewhat below trend over the past year. Elsewhere, labor market conditions were seen as having been steady in recent months after the deterioration in mid-2011 while interest rates for borrowers remained close to their medium term average.

In regard to inflation, the RBA noted that core CPI inflation was around 2.5% in 2011, and that while the headline measure was higher, it was projected over fall over the next two quarters and to remain within the RBA's target range of 2-3% over the coming one to two years (abstracting from the effects of carbon prices).

Further easing in policy?

Meanwhile, the final paragraph of the statement began with an explanation that, in all subsequent meetings since the rate cut in late 2011, the Board had judged the setting of monetary policy to be appropriate, with growth expected to be close to trend, inflation close to target and lending rates close to average. However, the Board now judged the pace of output growth to be lower than earlier estimated. Having previously flagged a rate cut in the event of a material weakening in demand conditions, the RBA now appears to be leaning clearly towards a further easing in policy, with the decision to hold policy this month possibly only motivated by the RBA's preference to wait until the release of the next batch of labor market numbers and CPI data due later this month before actively considering any such move. Favorable base effects suggest CPI inflation could fall towards the lower end of the RBA target, thereby clearly creating at least scope for a rate cut.

(Chang Liu & Andrew Wroblewski)