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RBA MONITOR : STATUS QUO WITH LOW INFLATION AND A STRONGER AUSSIE

Summary

The RBA is expected to leave the cash rate at 1.50% in February. Growth momentum has picked up with improving business sentiment and capital expenditure bottoming out. On the back of these developments, wage growth has finally begun to turn around, as employment growth expands. However, the recent strength of the Aussie could derail the ongoing economic transition, as the appreciation would reduce demand for tourism. Because inflation has remained below the 2-3% target range, the RBA can afford to keep the monetary policy accommodative.

The Reserve Bank of Australia (RBA) is anticipated to keep the cash rate at 1.50% in February, to further support the economic transition away from the mining sector.

Growth momentum has picked up with stronger business sentiment in major sectors. Business investments increased for the first time in more than four years, as non-mining investments have begun to stabilize. On the back of these developments, the labor market has improved with increasing employment growth and rising participation rate. Wage growth has also begun to show signs of bottoming out after decelerating for four years.

The recent appreciation of the Aussie could derail the ongoing economic transition **(Chart 1)**. In fact, tourism has been one of the bright spot of the economy. A stronger Aussie would reduce demand not only for tourism but also for commodities.

The RBA is anticipated to remain on hold at the February meeting. While a lower cash rate could weaken the Aussie, the RBA will be hesitant to provide additional monetary stimulus, as housing debt reached a record level of 137.5% in Q3-17. Instead, the Reserve Bank is anticipated to leave the cash rate at 1.50%, as further normalization by the Fed would weaken the Aussie. Because inflation remained below the 2-3% inflation target range in Q4-17, the RBA can afford to keep the monetary policy accommodative **(Chart 2)**.

Chart 1
Australia: Exchange Rate
(Jan 2nd, 2017=100)

Chart 2
Australia: Inflation (YoY, %)

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