

# THE CASH RATE OUTLOOK

## Rate Cut Odds Shorten for Melbourne Cup Day

Tuesday, 4 October 2011

- The sentence that stole the limelight in today's RBA media release is that "an improved inflation outlook would increase the scope for monetary policy to provide some support to demand, should that prove necessary". While it does not mean that a rate cut is a lay down misère, it does suggest the RBA is now open to cutting rates and, further, that the probability of a rate cut has lifted.
- The RBA could well tap on the accelerator as soon as Melbourne Cup day, but it is conditional on the next inflation report giving the RBA sufficient breathing space. And any rate cut decision as soon as November will be a close call.
- Any rate cut might also rely on hard-data evidence that developments in Europe are negatively impacting the Asian region.
- Any easing from the RBA we feel would be modest in size and not necessarily the start of a marked easing cycle. But the heightened uncertainty in the global economy means that there is greater variability than usual around forecasting.

The deterioration in global markets, the weakening global economy and the possibility that the rise in underlying inflation will be contained has shortened the odds of a rate cut from the Reserve Bank. Our long-held view for some time has been for rates to stay on hold. We now believe that recent global developments have shortened the rate-cut odds significantly such that a rate cut cannot be ruled out later this year.

We believe the earliest a rate cut could be delivered is Melbourne Cup Day (on November 1), but it is conditional on the next inflation report (released October 26) giving the RBA enough comfort that the rise in inflation is contained. And any rate cut decision as soon as November will be a close call.

The sentence that stole the limelight in the statement is that "an improved inflation outlook would increase the scope for monetary policy to provide some support to demand, should that prove necessary". The Board is now entertaining the possibility that the path for inflation may now be more consistent with the 2-3% per annum target range for 2012 and 2013. It is entertaining this thought because the Board appears more confident that the rise in inflation would be contained by weaker than expected conditions, due to both local and global factors, including the financial turmoil and related effects on confidence.

This does not mean that a rate cut is a lay down misère. But it suggests the RBA is open to cutting rates, which is very different to just a few months ago when the RBA was still considering tightening rates. It underscores the fact that global economic conditions have deteriorated and markedly in a short space of time.

We believe that any rate cut is conditional on inflation and also global economic developments. The RBA has suggested it wants to see hard-data evidence that the turbulence in Europe and the US is impacting economic activity in China and the rest of the Asian region. To date, there has been little evidence. It might take some time for this evidence to show up, but we believe slower growth in the US and Europe will impact negatively on Asian exports. Asia did not de-couple from the Europe and US during the GFC and it is difficult to see that a de-coupling will occur now in what is still the aftermath of the GFC. However, China and Asia are likely to be relatively more resilient to the ructions in markets and this is not a repeat of the GFC but part of the aftermath.

The RBA highlighted in their statement today the increasing uncertainty about both the prospects for resolution of the sovereign debt and banking problems in Europe, and the outlook

for global economic growth.

However, it has meant the Australian dollar is now below parity and combined with a decline in some housing and business loans, financial conditions have eased somewhat. The RBA then remains in wait-and-see mode but with an increasing bias it appears towards easing.

Any easing from the RBA we feel would be modest in size and not necessarily the start of a marked easing cycle. But the global backdrop means that there is greater variability than usual around forecasting

Besa Deda, Chief Economist

Ph: (02) 9320-5854

## Contact Listing

---

Chief Economist	Besa Deda	<a href="mailto:dedab@stgeorge.com.au">dedab@stgeorge.com.au</a>	(02) 9320 5854
Senior Economist	Josephine Heffernan	<a href="mailto:heffernanj@stgeorge.com.au">heffernanj@stgeorge.com.au</a>	(02) 9320 5751
Economist	Janu Chan	<a href="mailto:chanj@stgeorge.com.au">chanj@stgeorge.com.au</a>	(02) 9320 5892
State Manager SA	Mark Goldsmith	<a href="mailto:goldsmithm@banksa.com.au">goldsmithm@banksa.com.au</a>	(08) 8424 5597

The information contained in this report (“the Information”) is provided for, and is only to be used by, persons in Australia. The information may not comply with the laws of another jurisdiction. The Information is general in nature and does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and is not an invitation to take up securities or other financial products or services. No decision should be made on the basis of the Information without first seeking expert financial advice. For persons with whom BankSA has a contract to supply Information, the supply of the Information is made under that contract and BankSA’s agreed terms of supply apply. BankSA does not represent or guarantee that the Information is accurate or free from errors or omissions and BankSA disclaims any duty of care in relation to the Information and liability for any reliance on investment decisions made using the Information. The Information is subject to change. Terms, conditions and any fees apply to BankSA products and details are available. BankSA or its officers, agents or employees (including persons involved in preparation of the Information) may have financial interests in the markets discussed in the Information. BankSA owns copyright in the information unless otherwise indicated. The Information should not be reproduced, distributed, linked or transmitted without the written consent of BankSA.

Any unauthorised use or dissemination is prohibited.

Neither BankSA - A Division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ACL 233714, nor any of Westpac’s subsidiaries or affiliates shall be liable for the message if altered, changed or falsified.