Reserve Bank says further rate cuts unnecessary

AAP

August 18, 2009 11:37am

- *Text size*
  - +
  - -
- Print
- Email
- Share

THE Reserve Bank (RBA) says the improvement in the global and domestic economies means further interest rate cuts are unlikely to be necessary.

Instead, if the improved prospects for economic growth prove accurate, the RBA says it will need to lift the cash rate from the current 49-year low of 3 per cent.

The minutes of the August 4 board meeting noted that the cash rate had already been reduced to its current "very low level in anticipation of very weak economic outcomes".

"In recent months, members had left open the possibility of further reductions in the cash rate should further downside risks to the economy emerge," said the minutes, published today.

"Given the recent improvement in the global and domestic outlooks, it now appeared unlikely that this would be necessary.

"In fact, if the economy evolved as anticipated in the forecasts, the Bank would in due course need to adopt a less expansionary policy stance."

The RBA board has kept the cash rate unchanged for the past four months, judging 3 per cent as "consistent with fostering sustainable growth and low inflation, while leaving adequate flexibility to respond to developments as needed over the period ahead".

But the timing any interest rates rises from the current "expansionary policy setting" involved balancing two risks, the minutes said.

First, there was the risk of keeping interest rates too low for too long in a recovering economy, "particularly when underlying inflation still needed to decline to reach the target".

Second, tightening monetary policy too early risked "choking off confidence and demand prematurely".

"A particular source of uncertainty was whether the recent growth in household spending was due mainly to the temporary fiscal measures, in which case it would probably soon fade, a more general decline in risk aversion, or the more persistent effects of lower interest rates," the minutes said.

The minutes noted that retail sales had fallen in June, reversing some of the earlier gains, and that the RBA's liaison with retailers suggested that spending in July "might be weaker than in earlier months".

Also, the minutes said business investment was expected to fall significantly as a share of gross domestic product (GDP) over 2009 and 2010, but would still remain quite high by historical standards.

The RBA's latest growth forecasts were published in its Statement on Monetary Policy, released on August 7. The central bank said it expected the domestic economy to post modest growth of about 0.5 per cent for calendar 2009, up from its previous forecast of a 1 per cent contraction.

The RBA minutes said "about half of this revision reflected the stronger-than-expected GDP data for the March quarter".

The upward revision also reflected the view that exports, business investment, household consumption and dwelling investment would all be stronger than expected, the minutes said.

The economy grew by 0.4 per cent in the March quarter.

"It was noted that the wide discrepancy in the various estimates of GDP suggested that this figure was subject to greater-than-usual uncertainty," the minutes said.