



## Statement on Monetary Policy Dude. Where's My Inflation?

- Today's *Statement on Monetary Policy* highlighted the uncertainties facing policymakers. It singled out China, wages and inflation as key concerns.
- The *Statement* noted that growth in China had moderated further, that growth in the United States had eased and that activity in Japan remained weak. The outlook was not off to a good start! Europe, it appears, is looking better with growth of 0.6% in the March quarter.
- A key uncertainty is the global outlook for China. Like Australia, China is in transition. In the case of China it's away from reliance on heavy industry and investment and towards services and consumption. We believe that China will slowly work through its issues but that the path will not be smooth. It is unlikely to lead to a further significant uplift in commodity prices. And this has implication for the AUD.
- The RBA's growth forecasts were unchanged from the previous *Statement* but the inflation forecasts have been dialled down significantly.
- The RBA remains cautious on global economic growth. Global inflation remains subdued with little prospect of short-term pick-up.
- Despite an unchanged outlook for domestic economic activity, the risk that wage growth and inflation will be weak leads us to acknowledge that interest rates in Australia can go lower. We now expect a further rate cut in August following the June quarter inflation results.

Forecasting is not for the feint hearted. Nor is it for those who cannot imagine different futures. Where are wages heading? What will happen to wages if the unemployment rate sinks to 5.5%? Which way will China turn and what will that mean for Australian economic growth?

Today's *Statement on Monetary Policy* highlighted the uncertainties facing policymakers. It singled out China, wages and inflation as key concerns.

The *Statement* noted that growth in China had moderated further, that growth in the United States had eased and that activity in Japan remained weak. The outlook was not off to a good start! Europe, it appears, is looking better with growth of 0.6% in the March quarter.

But a key uncertainty is the outlook for China. Like Australia, China is in transition. In the case of China it's transition is away from reliance on heavy industry and investment and towards services

and consumption. The problem is that stimulation of heavy industry and investment is easier in the short-term than lifting consumption and services activity and the most recent Chinese stimulus package was aimed at the older industries rather than the new industries. Will it work or will it lead to simply more debt and over supply? The answer is important for Australia.

We believe that China will slowly work through its issues but that the path will not be smooth. It is unlikely to lead to a further significant uplift in commodity prices. And this has implication for the AUD.

So what about wages? One can almost sense the torment in the *Statement*. There are so many possible paths. Which way do we jump? We expect wage growth to remain subdued. Yes the unemployment rate has declined in recent months but there does appear to be substantial spare capacity in the labour market. Add to this intense competition in the market place and the pressure placed on delivering returns, and it is difficult to see wages picking up anytime soon.

That brings us to inflation. The RBA's *Statement* forecasts inflation at or below its target of 2-3% for the remainder of 2016 and possibly remaining below the target band into 2018. This is despite the outlook for domestic economic looking reasonably positive. We appear to be set for reasonable economic growth but with low inflation. And that, in our view, is a call to action.

Australia's interest rate structure sits above those of other developed nations. Our economic outlook is good and we sit next to a region that continues to grow and develop. However, where is the inflation? Maybe it is time for rates to come down further.

### **Cash Rate Outlook**

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**Hans Kunnen, Chief Economist**  
Ph: 02-82534-8322

*The forecasts in full are detailed on the following page.*

**CURRENT FORECASTS FROM THE RBA, May 2016 SoMP****Table 6.1: Output Growth and Inflation Forecasts<sup>(a)</sup>**  
Per cent

	Year-ended					
	Dec 2015	Jun 2016	Dec 2016	Jun 2017	Dec 2017	Jun 2018
GDP growth	3	2½–3½	2½–3½	2½–3½	2½–3½	3–4
CPI inflation	1.7	1	1–2	1½–2½	1½–2½	1½–2½
Underlying inflation	2	1½	1–2	1½–2½	1½–2½	1½–2½
	Year-average					
	2015	2015/16	2016	2016/17	2017	2017/18
GDP growth	2½	2½	2½–3½	2½–3½	2½–3½	2½–3½

(a) Technical assumptions include A\$ at US\$0.75, TWI at 62.5 and Brent crude oil price at US\$47 per barrel; shaded regions are historical data  
Sources: ABS; RBA

**PREVIOUS FORECASTS FROM THE RBA, February 2016 SoMP****Table 6.1: Output Growth and Inflation Forecasts<sup>(a)</sup>**  
Per cent

	Year-ended					
	Dec 2015	Jun 2016	Dec 2016	Jun 2017	Dec 2017	Jun 2018
GDP growth	2½	2–3	2½–3½	2½–3½	2½–3½	3–4
CPI inflation	1.7	1½	2–3	2–3	2–3	2–3
Underlying inflation	2	2	2–3	2–3	2–3	2–3
	Year-average					
	2015	2015/16	2016	2016/17	2017	2017/18
GDP growth	2½	2–3	2–3	2½–3½	2½–3½	2½–3½

(a) Technical assumptions include A\$ at US\$0.72, TWI at 62 and Brent crude oil price at US\$35 per barrel; shaded regions are historical data  
Sources: ABS; RBA

## Contact Listing

### Chief Economist

Hans Kunnen

[kunnenh@bankofmelbourne.com.au](mailto:kunnenh@bankofmelbourne.com.au)

(02) 8254 8322

### Senior Economist

Josephine Horton

[hortonj@bankofmelbourne.com.au](mailto:hortonj@bankofmelbourne.com.au)

(02) 8253 6696

### Senior Economist

Janu Chan

[chanj@bankofmelbourne.com.au](mailto:chanj@bankofmelbourne.com.au)

(02) 8253 0898

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