

# Reserve Bank Board Meeting Minutes – September 2010

**ECONOMIC ALERT****21 SEPTEMBER 2010**

## KEY POINTS

The key points from the minutes of the latest RBA Board meeting on 7 September 2010 are as follows:

- The Australian economy appears to be growing at around trend pace, and the RBA expects growth to continue at trend, or a bit above, over the next few years.
- Growth in the world economy was solid in the June quarter 2010, though has moderated somewhat in recent months. The US economy appears to be losing momentum, and the RBA expects that economic growth will be quite subdued over the next few quarters. Growth in Asia has also moderated, though remains solid, while recent data from Europe has been better than expected. Looking ahead, however, the medium-term outlook for Europe remains weak given the public debt problems in a number of countries.
- Chinese steel production has fallen over the past few months, though steel and iron ore prices have held up quite well. More broadly, Australia's terms of trade rose by 12.5 per cent in the June quarter 2010, to be slightly above the elevated levels reached in 2008. The RBA expects Australia's terms of trade to increase again in the September quarter, before declining modestly towards the end of the year.
- There is some evidence to suggest that the cautious approach to household spending seen over recent times could be starting to wane, with retail spending picking up in the past few months and the national accounts measure of consumption growing strongly in the June quarter. This is an interesting development because the RBA recently noted that one of the main upside risks to their forecasts was if the current cautiousness in household spending did not persist. If this risk is realised, it is likely to lead to inflationary pressures building up more quickly than the RBA currently expects.
- The latest capital expenditure survey suggests that business investment will grow strongly over the coming period, and help to offset the reduction in public stimulus spending. The outlook for mining investment is particularly strong, and the RBA expects that this investment will help to stimulate activity in other parts of the economy, even though there is a significant imported component to many LNG projects.

## Policy implications

- If the economy continues to grow as the RBA expects, then interest rates will need to be raised in order to help curb inflation. Nonetheless, the global economy still poses risks to economic activity in Australia.
- Since the RBA Board meeting on 7 September, financial markets have become more confident that the RBA will raise interest rates by the end of the year.
- As of yesterday, the interbank futures suggested that there is close to a 25 per cent chance that the RBA will increase rates at their next meeting on October 5, and an 80 per cent chance of an interest rate rise by the end of the year. Following the release of the minutes today, some analysts are even predicting successive interest rate rises over the next two months.
- Looking further ahead, a recent poll of industry analysts by *Reuters* showed that most analysts expect interest rates will have risen above 5 per cent by the middle of 2011.