ECONOMICS: AUSTRALASIAN PERSPECTIVES

EASING DOWN UNDER

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The global trend towards monetary policy easing in 2015 has also been reflected in Australia (rate cut) and New Zealand (return to neutral). Domestic developments suggest more easing to come from the Reserve Bank of Australia, while the Reserve Bank of New Zealand is likely to be more cautious.

RBA Joins Global Easing Party

The Reserve Bank of Australia (RBA) cut interest rates this week, reducing the overnight cash rate by 25 basis points to 2.25%.

By the time the RBA's policy meeting—the first for the year—rolled around, this was not a completely unexpected outcome. The market had been pricing almost two rounds of rate cuts since the second half of December, and the main uncertainty surrounded the exact timing.

And, of course, a conga line of central bankers was already in full swing at this year's easing party—a congregation which, importantly, included the commodity-sensitive Bank of Canada. So the RBA is treading on what has now become a well-worn path **(Display 1)**.

Long Shadow of Commodity Slump

But it would be a mistake to see the RBA's actions as purely a response to global developments—i.e., an extension of the so-called currency wars. Domestic developments were central in this decision.

We have been talking about policy easing in Australia as one of the key 2015 themes for a while now, and that was predicated on the continuing impact of the terms-of-trade slump. The downside of the commodity supercycle bust continues to cast a long shadow, causing sluggish domestic incomes, subpar economic growth and a continued drift higher in unemployment. These themes are set to become more visible as 2015 unfolds.

By and large, that's the line the RBA has now adopted, downgrading its growth outlook and expressing confidence that inflation will remain consistent with its target—even with a lower exchange rate, which was itself an explicit aim of the policy easing.

Wages and Housing in Focus

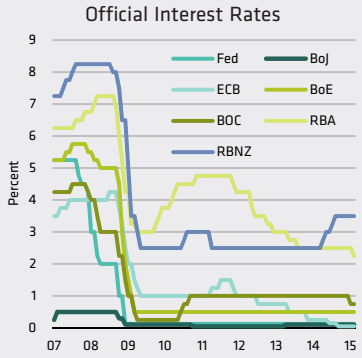
That confidence is in no small part down to subdued wages growth, a common global theme. And any concerns about rising house prices are batted away with macroprudential policy.

There's no explicit bias in the RBA's statement. But it would be unusual if this were to be the only move in this phase of the policy cycle. Pencil in at least one more rate cut, perhaps in March.

New Zealand: Same but Different

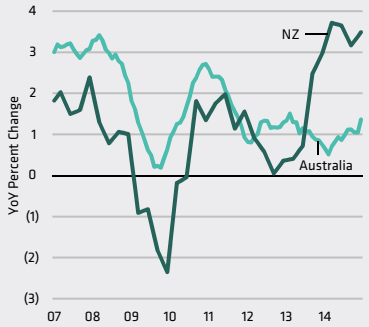
Across the Tasman, the Reserve Bank of New Zealand (RBNZ) has not been immune to this global policy reassessment either.

Display 1
RBA Joins Global Easing Party



As of February 6, 2015
Source: Reserve Bank of Australia and Reserve Bank of New Zealand

Display 2
NZ Still Better Looking Employment Growth



NZ data as of 4Q:2014, Australia data as of December 2014
Source: Reserve Bank of Australia and Reserve Bank of New Zealand

Its January monetary policy announcement emphasized neutrality in no uncertain terms, stating that "future interest rate adjustments, either up or down, will depend on the emerging flow of economic data." Governor Graeme Wheeler repeated that sentiment in a speech this week.

This is the first acknowledgment from the RBNZ that rate cuts are possible. Until now, the question was whether the bank will raise rates or not.

But, as with the RBA, domestic developments are key for the RBNZ. There are clear similarities—inflation and wages growth are low, and the slump in the country's key commodity price, dairy, is a concern (albeit for 2016, not now). But growth is still robust, with jobs growth running above 3% **(Display 2, previous page)**, and there's no slowing in the housing market momentum.

So while we wouldn't rule out rate cuts, the current market pricing for NZ looks a little overcooked—unless domestic economic data slow very abruptly in the next few months. ■