

Vital Signs: The one thing holding back an RBA rate cut

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Vital Signs is a weekly economic wrap from UNSW economics professor and Harvard PhD Richard Holden ([@profholden](#)). Vital Signs aims to contextualise weekly economic events and cut through the noise of the data affecting global economies.

This week: what is the new normal for economic growth? And why the RBA is still waiting to raise rates.

In a radically unsurprising decision on Tuesday the Reserve Bank of Australia left official interest rates unchanged at 1.5%. [In their announcement](#) there was plenty of what amounts to copy-and-paste from previous rate decisions. For instance:

“Employment grew strongly over the past year and the unemployment rate declined... Notwithstanding the improving labour market, wage growth remains low. This is likely to continue for a while yet, although the stronger economy should see some lift in wage growth over time.”

And on inflation it's still low with the consumer price index (CPI) and underlying inflation (inflationary pressures in the economy that are predominantly due to market forces like supply and demand), below 2%.

These are the key factors that make raising rates unlikely. Indeed, perhaps the only thing preventing a cut in rates is the fear of a housing bubble.

On that front the RBA seemed to report progress, saying:

“[the Australian Prudential Regulation Authority] APRA's supervisory measures and tighter

credit standards have been helpful in containing the build-up of risk in household balance sheets, although the level of household debt remains high.”

Little wonder that markets are not predicting an increase in rates this year.

On the labour market front, [the ANZ job advertisements survey](#) revealed that the strong growth in ads from previous months was largely maintained. Although for the month of February ads were down 0.3%, the robust growth in previous months means that ads are still up 13.3% on the previous 12 month period. It seems that the strong employment growth from last year is set to continue, but there is still no real sign of this translating into wage growth.

The global puzzle of why employment growth is strong while wages growth is weak endures. And, as the RBA comments reveal, it is weighing on the minds of central bankers.

The volatile [building approval data](#) jumped around again in January, with approvals up 17.1% in January, following a 20% fall in December. Approvals for apartments jumped a massive 42.2% in January. That’s an interesting figure for two reasons.

The strong growth in supply of apartments is one factor that is (slowly) helping housing affordability. In cities like Sydney, with geographic constraints on all sides, the only place to go is up in terms of building new dwellings.

And less happily, sharp increases in supply are typically how bubbles burst. An important question is who is going to buy all these new apartments, and how speculative are those purchases.

There is scant evidence on this point, but [plenty of anecdotal fears](#) about people purchasing off the plan with significant leverage in the hope of flipping at a quick profit. The apartment market is a key indicator to watch in 2018.

[National accounts data](#) showed the Australian economy grew at the same rate in 2017 as it did in 2016, with GDP growth coming in at 2.4%. This points to one of the big, unresolved macroeconomic questions of our time.

Is the “new normal” for economic growth something like 2% ? (This would put GDP growth per capita well below that.) Or was the great recession a damaging and long, but ultimately a temporary lull, and that we will return to 3%-plus growth sooner or later. I have consistently said I think it's the former, but again it is too early to tell.

[International trade data](#) released Thursday showed Australia's trade balance at A\$1.1 billion, up slightly from the previous month.

Speaking of trade, the biggest economic news of recent weeks was [the Trump administration's announcement](#) that it would impose significant steel and aluminium tariffs (25% and 10% respectively). This has the potential to trigger a global trade war and tank economies around the world, although such a cataclysm is a fair way off yet.

Make no mistake, this is terrible policy. The worry is that it's not just another cunning and cynical move by Trump, but that he actually believes in it. He has railed against trade deficits for 20 years, revealing the poverty of his understanding of economics.

For now it's wait-and-see, but the fact that National Economic Council director Gary Cohn resigned in the wake of the announcement suggests that Trump might not flip-flop on this issue - and that there is more bad news to come.

Richard Holden does not work for, consult, own shares in or receive funding from any company or organisation that would benefit from this article, and has disclosed no relevant affiliations beyond their academic appointment.

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