Monetary Policy Recommendation Statement

30 April 2012

James Morley

Recommended Target (X=4.25%)	
target rate	probability
X+75bp	0
X+50bp	0
X+25bp	0.2
X	0.55
X-25bp	0.2
X-50bp	0.05
X-75bp	0

Inflation Anchored, Real Activity Close to Balanced, and Policy Close to Neutral

Year-on-year inflation is at 1.6% (Source: ABS), a bit below the target range of 2-3%. However, this is clearly due to the predictable reversal of the effects of the 2010-2011 Queensland floods on certain food prices. The "underlying" measure of inflation that removes volatile food and energy prices is currently at 2.2%, which is comfortably within the RBA's target band of 2-3%. This situation suggests relatively low risks of inflationary pressures over the medium term, allowing more flexibility for policy to respond to any deterioration in real economic conditions.

On the real side of the economy, the current aggregate situation remains fairly balanced, with the unemployment rate holding steady at 5.2% in March (Source: ABS). The net risks are slightly negative, given some weakness in the domestic retail sector and the fact that any slowdown in China would be more directly harmful than a continuing recovery in the United States would be helpful. However, the overall uncertainty in global conditions and the potential impact on Australia is clearly less pronounced than it was six months ago. Specifically, even though the European debt crisis remains unresolved, it no longer appears to represent an imminent risk for Australia or Asia.

The slight negative balance of risks to the real side of the economy is addressed by the fact that the target cash rate is slightly below (albeit close to) its neutral level given close-to-average output growth and anchored inflation expectations.

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