Stamford Capital
AUSTRALIA


## Interest Rate Outlook

Every day appears somewhat like Groundhog Day, when reviewing the RBA setting of its targeted cash rate. That's not to say that there isn't market volatility in the yield curve and fixed rates and we have certainly witnessed significant volatility in the AUD currency.

So in reviewing the current market conditions and value opportunities, should we become apathetic that for a significant period there won't be any official interest rate change? We shall answer this rhetoric later on.

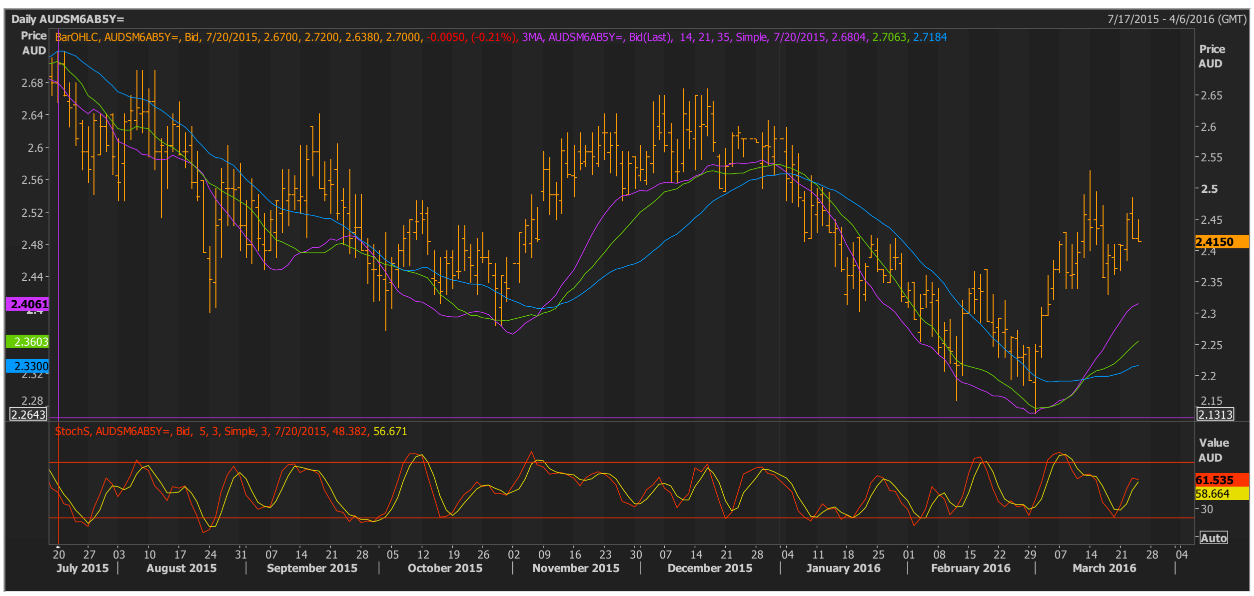
Perhaps we can start the analysis by reviewing the A$ movements as indicated by the chart below.


In January of this year the A$ touched a low point of .6824c and hit a triple bottom. This significantly provided the strong base of support that has literally shanghaied the currency to its recent peak of .7680, a move of nearly 8.5 cents. Historical movements have typically averaged around 15-20c so will this continue and create further concern for the central bank?

In his speech on Tuesday 22nd March, Glenn Stevens commented that the 'currency is ahead of itself' and would clearly be one part of the financial system structure that is creating a concern. This follows on from the RBA's consistent jawboning around rates potentially going lower, thereby at least attempting to see a lower AUD. Stevens theme of discussion was around shocks to markets, good or bad, and how to adapt and respond to those shocks.

By definition, events which are shocks are generally not perceived or forecast by the vast majority, so are dealt with as and when they occur. The simulation of say a Monte Carlo probability outcome of 10,000 random simulations, typically assumes a shock event once in every ten years. History demonstrates that shocks have occurred much more frequently and the naysayers having been forecasting a housing price correction shock. History will judge if they are accurate in their forecasts.
Meanwhile, the yield curve and wholesale fixed rates continue to bounce around as highlighted in the 5 year swap chart below.

Again we can identify a mid - swap rate low in early March of 2.27% with a recent high of 2.53% as the market have abated their view of a reduction in official rates.




Dr Luci Ellis of the RBA, recently delivered a talk and discussion paper on 'Boom, Bust, Cycles and Risk Appetite'. One of her comments was she wouldn't '*regard the last 25 years as a period of entirely uninterrupted expansion, the downturns that did occur were brief and shallow'*. This clearly needs to be read in context with the comparison of remainder of her speech, but is one point to highlight the financial systems relative stability over the journey.

So where does this leave the RBA on policy:-

We notice that a number of forecasters whom have previously placed some bold calls out in the market, have now quietly retracted those views. Ie, two further rate cuts this year are now, no change.

Interpreting RBA speak can be a challenge in attempting to identify its next move. What does appear clearly articulated is that the RBA has capacity and conviction to move, should it be required. There should be a view that unless a change in policy has impact, then there is little point of adjusting it as there may be a time when it is really needed in either direction. Slower growth may translate to lower rates, but should the RBA see headwinds of concern they may very well move ahead of the time.

Whilst our view remains consistent with no change to the cash rate for a sustained period, the risks and shock could actually come from an unexpected downward policy adjustment. After all, that is what is consistently discussed at each RBA monthly meeting. Ongoing monitoring of the local and global economy will determine the RBA's next move.

Regards,

Russell