Tuesday, 15 March 2022

RBA Board Meeting Minutes

Energy Market Turmoil Complicates Policy

- **The Reserve Bank (RBA) left policy settings unchanged at the March meeting, as widely expected. The minutes were released today. The most significant development in the lead up to the meeting was the emergence of the devastating Ukraine war.**
- **The RBA acknowledged Russia's invasion is an "adverse supply shock that would result in lower growth and higher inflation". However, the economic impact will depend on the "scale and duration of the conflict" and the extent of any second-round effects.**
- **The minutes note the Australian economy was resilient throughout the Omicron outbreak and had strong momentum ahead of the temporary disruption. The RBA understands activity and hours worked began to recover from late January as case numbers declined.**
- **Russia's invasion complicates the job of policymakers. The disruption to energy markets will weigh on global growth and push up inflation, materially increasing the risk of stagflation. Policymakers will need to balance supporting economic activity and taming inflation.**
- **We continue to expect that the RBA will commence the hiking cycle in August. However, we cannot fully rule out a move in June or July, particularly in the context of the additional inflationary pressures underpinned by the Ukraine conflict.**
- **Separately, last week Deputy Governor Guy Debelle surprised the economics community by announcing his resignation. Debelle was widely pinned as the next Governor. Speculation is rife over who will fill Debelle's shoes.**

The RBA left policy settings unchanged at the meeting on 1 March, as widely expected. The minutes from this meeting were released today.

The most significant development in the lead up to the March meeting was the devastating emergence of the Ukraine war. The minutes provide more colour on the central bank's thinking around the implications for Australia and the global economy.

Russia-Ukraine conflict

The RBA acknowledged Russia's invasion added to uncertainty over the global outlook. The conflict is an "adverse supply shock that would result in lower growth and higher inflation". However, the economic impact will depend on the "scale and duration of the conflict" and the extent of any second-round effects. The conflict is a significant setback for Europe's economic recovery via the disruptions to energy markets, which have pushed up prices. Russia is the world's largest exporter of natural gas and the third largest exporter of crude oil and crude products. Europe is particularly reliant on Russia for natural gas.

The RBA also noted the surge in the price of energy and other commodities would "redistribute income from energy-importing countries to energy-exporting countries". Regardless, the war will result in lower global output than otherwise.

Indeed, retail fuel prices in Australia have jumped to an average rate of 183.9 cents per litre in the week ending 6 March 2022, up 3% since the war began. The increase reflects the recent surge in oil prices. When the latest data is published, the price average is likely to be higher still, as many consumers are paying above $2 a litre.

The conflict will also exacerbate supply-chain disruptions. The minutes noted that ahead of the invasion of Ukraine, developments in supply chains had been mixed. It was flagged that supply chains for some goods had deteriorated further alongside robust demand, while pressures had eased in other areas. In particular, the minutes highlighted that supplier delivery times had edged lower, semiconductor prices had declined and motor vehicle production was recovering.

Economy resilient in face of Omicron

The minutes note the Australian economy was resilient throughout the Omicron outbreak and had strong momentum ahead of the temporary disruption. The RBA expects that activity and hours worked began to recover from late January, as case numbers declined. This is consistent with timely spending data and information from the RBA's liaison program.

The outlook for business investment remains solid. Business liaison suggests investment intentions remain "at or above average levels". The minutes also flag that "around half of firms were experiencing supply-chain disruptions" but these disruptions were generally only having a "small effect on business operations".

Labour market conditions "were the tightest since 2008" and forward-looking indicators point to a further tightening in the period ahead. Job mobility has increased, although not as much as in some other countries.

The minutes noted that wages growth had picked up, but only to its pre-pandemic level. However, members acknowledged that risks to the outlook for wages were tilted to the upside. At the same time, they continued to underscore uncertainty in the behaviour of wages at historically low levels of unemployment.

Meanwhile, inflationary pressures are widespread, but particularly pronounced in goods-importing industries. The RBA's liaison suggests firms were willing to pass these costs onto consumers – notably in construction, manufacturing, and retail – where "upstream cost pressures had been the most acute". However, the RBA also continued to emphasise that domestic inflation remained lower than in many other countries.

Surprise resignation

Deputy Governor Guy Debelle surprised the economics community by announcing his resignation last week to take up a position as Chief Financial Officer at Fortescue Futures Industries. Debelle has worked at the RBA for 25 years and was widely pinned as the next Governor.

Treasurer Josh Frydenberg has indicated he wants to install a new Deputy Governor before the May Federal election. Speculation is rife over who will fill Debelle's shoes.

The RBA has a history of promoting insiders – Bernie Fraser, who was appointed in 1989, is the only RBA Governor to come from outside the bank. RBA Assistant Governors Michele Bullock, Luci Ellis and Chris Kent are candidates in the running. However, reports have also flagged external names including Treasury Deputy Secretaries Jenny Wilkinson and Meghan Quinn.

The implications for the voting balance on the board are unclear since the RBA does not publish the votes of its members, unlike other central banks. In other words, we won't know if the change will tilt the opaque voting structure more hawkish or dovish.

Regardless, as one of the most influential public policy roles in the country, there will be plenty of focus on whoever fills the role.

Monetary policy

While inflationary pressures are heating up and the unemployment rate is at its lowest level in more than a decade, the RBA has underscored the need to be patient before lifting the cash rate. Prior to the invasion of Ukraine, this reflected two key factors. Firstly, uncertainty around inflation particularly in relation to how long global supply-chain disruptions will persist. And secondly, uncertainty over the path of wages growth. The RBA is concerned about inertia in wage setting practises.

Russia's invasion of Ukraine complicates the picture for policymakers. The supply shock will weigh on growth and push up inflation, especially via the disruptions to energy markets, materially increasing the risk of stagflation. Policymakers will need to balance supporting economic activity and taming inflation.

We continue to expect that the RBA will commence the hiking cycle in August with a 15 basis point move. However, cannot fully rule out a move in June or July, particularly in the context of the additional inflationary pressures underpinned by the Ukraine conflict. We expect a second 25 basis point hike in November. Markets have priced a more aggressive cash rate profile, suggesting the RBA will start hiking in June and lift the cash rate to 1.25% by the end of the year.

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