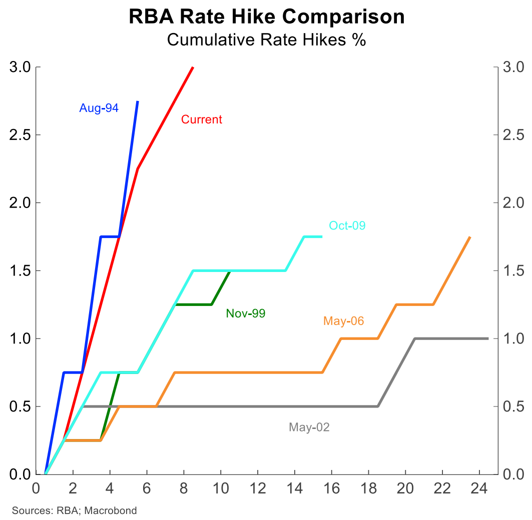
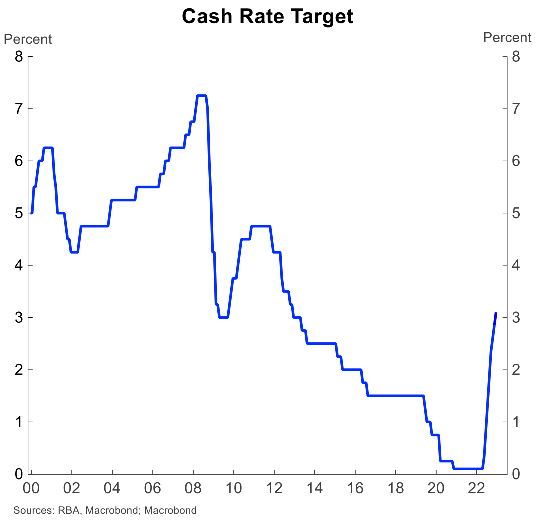
Tuesday, 6 December 2022

RBA Board Meeting

The RBA Makes it 8 in a Row

- **The Reserve Bank's fight against inflation continued with another rate hike today of 25 basis points, taking the cash rate to 3.10% - the highest rate since November 2012.**
- **Today's rate hike is not the last in this cycle. The RBA continued to flag that they expect to "increase interest rates further over the period ahead".**
- **Today's decision was widely expected by economists, but not by interest rate markets. Rate traders had a 40% possibility attached to a pause today.**
- **The language today arguably was more hawkish around the RBA's resolve to contain inflation, including the RBA stressing its priority was to "re-establish low inflation" and describing the damages to the economy of high inflation.**
- **But interestingly, the RBA added that policy was "not on a pre-set path". The last and only time it has included that in this cycle was in September. And September was the month before the RBA pivoted, that is, stepped down to rate hikes of 25 basis points to those of 50 basis points.**
- **Is the re-insertion of these words another signal for a critical change in policy? It will depend on the data, especially the quarterly inflation report released in late January. The labour market data will also be critical.**
- **By February, the RBA will also have the benefit of understanding the shape of intervention from the Federal Government in the electricity market, which adds to the uncertainty around household response to higher rates and could have flow on implications to inflation. Speculation suggests possible options are subsidies or electricity price caps.**





The Reserve Bank delivered another rate hike of 25 basis points to take the cash rate to a decade high of 3.10%. It takes the cumulative tightening over the past eight months to 300 basis points – the most tightening in an eight-month window since inflation targeting began in the early 1990s.

What to next for the RBA?

The most important take out from the RBA's statement was that the Board did not step away from suggesting more tightening was on the way. In fact, they continued to flag that the "Board expects to increase interest rates further over the period ahead". The message is clear - today's rate hike is not the last in this cycle.

Our Group view is the cash rate will rise to a peak of 3.85% next year. We have previously flagged the risk that the peak could be lower at 3.35% or 3.60%. Today's statement downplayed such a risk, but leaves it in place.

One of the more "hawkish" aspects of the statement was the addition in the statement that the RBA's "priority is to re-establish low inflation and return inflation to the 2–3 per cent range over time". The phrase "re-establish low inflation" was a new addition in this month's statement. In that same paragraph, the RBA said high inflation "damages" the economy and "makes life more difficult for people".

Today's decision came as no surprise to us or consensus among economists, however, interest-rate markets were toying with the possibility of a pause. Economists won out and the pause did not materialise.

The RBA has a natural pause in January – a month it does not traditionally meet. The RBA's next board meeting is scheduled for 7 February 2023.

Is a pause possible as soon as February?

Well, on the one hand, the RBA statement has critically inserted that it expects to raise rates further, "but it is not on a pre-set course". The last and only time the RBA had the words "not on a pre-set course" in its statement this cycle was in September. September was the month before the RBA stepped down from hiking in 50 basis point steps to 25 basis point steps. So, is this deliberate addition of the words "not on a pre-set course" another signal that there is a change coming? Could that change be a pause as soon as February? Much will depend on the economic data between now and early February.

It is perhaps why, the statement also suggests that uncertainties around policy lags, the path of household spending and the outlook for the global economy means "there are a range of potential scenarios".

The RBA will have to be guided by the data. If data gives them the room to pause, they will. Importantly, in January the quarterly inflation report is published. The monthly inflation indicator last week showed a surprise pull back in annual inflation, but one month's numbers is not enough to constitute a trend. Also, the monthly inflation measure is not identical to the quarterly inflation measure that the RBA focusses on, although it has been giving a reliable guide.

The RBA will be eyeing very closely wages growth and the labour market in its assessments of the inflation trajectory. In the latest numbers, the unemployment dropped to a near-50-year low and growth in the wage price index showed signs of an acceleration.

We remain of the view that inflation will peak in this current quarter, the December quarter, at around 8%. Over 2023, inflation should gradually move lower, but inflation is likely to stay elevated and above the RBA's 2-3 per cent target band for some time. It means that there is little, if any, wiggle room for the RBA and that the bias remains towards further tightening.

By early next year, the RBA should have the benefit of knowing the Federal Government's policy around reducing the cost of electricity for households. This adds to the uncertainty around household response to higher rates and could have implications for inflation. Federal Treasurer Jim Chalmers has indicated that the Government intends to provide support in a "temporary, responsible and meaningful way". There is speculation some of the interventionist options include targeted subsidies to households or price caps on electricity prices.

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