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Economic Analysis RBA Monetary Policy Decision Sep 2023

In Governor Philip Lowe's last meeting at the helm, the Reserve Bank of Australia (RBA) kept interest rates on hold. The cash rate target remains at 4.10% and the interest rate on Exchange Settlement balances at 4.00%.

The decision was in line with cash rate futures pricing for no change, while only three out of 32 participants in the Bloomberg survey expected a 25bps increase.

Justification of the Decision

The wording of the post-meeting statement was largely unchanged from the previous meeting, again citing:

- substantial monetary policy tightening to date;
- inflation having passed its peak; and
- uncertainty surrounding the economic outlook.

On the first point, Governor Lowe repeated that interest rates had increased by 400bps in this cycle, in an effort to work towards a 'more sustainable balance between supply and demand', but again stressed that monetary policy operates with a lag.

On the second point, Governor Lowe underscored that:

- Inflation has declined, led by slower growth in goods prices.
- Labour market conditions remain tight, but they have 'eased a little', and wages growth, while faster, is still consistent with the inflation target, provided productivity growth accelerates.
- The central RBA forecast is for inflation to return to the 2-3% target range in late 2025.

On the third point, the RBA Governor citied risks to the inflation central forecast, most notably:

- Services price inflation, which remains 'brisk' could be as persistent as in other advanced economies.
- Despite the recent slowdown, the economy continues to operate at high levels of capacity utilisation.
- The outlook for private consumption is uncertain due to the uneven distribution of the effects of tightening across households, with some benefiting from rising house prices, savings buffers and higher interest income.

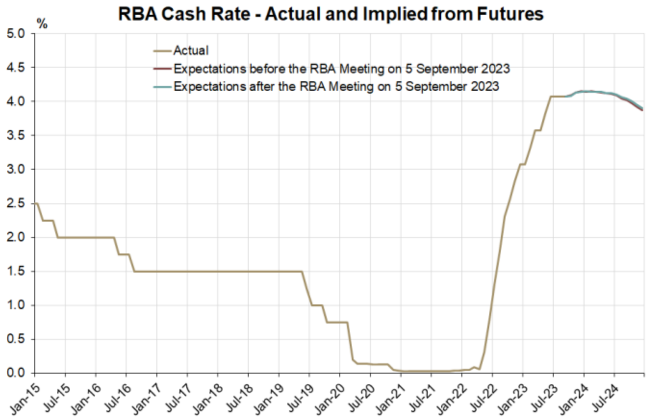
At the same time, Governor Lowe stressed that household consumption and dwelling investment growth are weak, and that the Chinese economy and its property market are an additional source of uncertainty.

Looking forward, he continued to underscore that some further tightening may be required. However, future decisions would remain data-dependent, focussing on the global economic outlook, household spending, inflation, and labour market conditions.

Market Impact

The RBA's decision to keep the interest rates on hold was widely expected by the markets and the language of the statement did not bring major surprises. As a result, cash rate expectations are virtually unchanged after the post-meeting statement, with another 25bps only partially priced in. In addition:

- 3-year Commonwealth bond yields dropped from 3.83% to 3.80%, before rising to 3.81%.
- 10-year yields ebbed from 4.14% to 4.13%.
- The AUD/USD fell from US$0.6425 to be currently just below US$0.64.
- The ASX 200, which was trading at 7,297 just ahead of the decision, ticked up to 7,314.



Comment

The RBA's decision to pause was expected by most traders after the recent downside surprises to wages, employment and the monthly CPI indicator.

It was taken despite the upward trend building up in house prices, amid ongoing solid demand and structural undersupply.

It appears that, despite inflation remaining elevated, the RBA is increasingly confident that, absent of materialisation of upside risks, inflation will return to the 2-3% target range over the medium term.

In the post meeting statement, Governor Lowe continued to stress that the RBA Board remain 'resolute' in their determination to bring down inflation. Despite this the market is pricing in only a relatively small chance of another interest rate hike.

Tomorrow's data on Q2 national accounts will be important for monetary policy outlook in the coming months, likely confirming that the impacts of RBA tightening are slowly sinking into the economy, which will eventually see in inflation decline back to its target.

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