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Economic Analysis — RBA Monetary Policy Decision Nov 2023

The Reserve Bank of Australia (RBA) Board decided to raise interest rates by 25 basis points, increasing:

- the cash rate to 4.35%, and
- the interest rate on Exchange Settlement balances to 4.25%.

The decision was in line with market expectations, with the futures market pricing in a 70% probability of a 25bps hike prior to the meeting.

Justification of the Decision

The post-meeting statement highlighted the RBA's concerns over the increased risk that inflation will be 'higher for longer'.

This is because:

- underlying inflation, particularly for services, has been stronger than forecast in the August projection,
- economic growth in the first half of 2023, while below trend, was stronger than expected, and
- the unemployment rate forecasts have been revised downwards compared to the August projection.

Inflation forecasts have been revised slightly upwards from August figures, with the RBA now expecting CPI inflation to be around 3.5% by the end of 2024 and only 'at the top of' the target range of 2-3% by the end of 2025.

At the same time, Governor Bullock continued to assess that wages growth is consistent with the inflation target, provided productivity growth accelerates. She also cited multiple risks to the outlook, such as the behaviour of services price inflation, households' reaction to tightening, lags in monetary policy transmission, the uncertainty over the Chinese economic outlook and geopolitical risks.

Unsurprisingly, the RBA's forward guidance in the all-important final paragraph continues to signal that it is ready to increase interest rates further to ensure inflation returns to target in a reasonable timeframe.

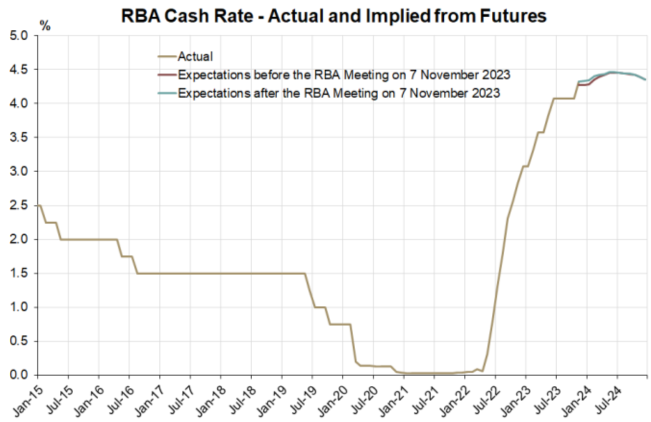
The RBA will remain data dependent in its deliberations, but there was a small watering down of thereference to the possibility of further tightening from 'some further tightening of monetary policy may be required' to 'whether further tightening (…) is required'.

The list of conditions was broadened, to focus on domestic demand rather than household consumption alone. Governor Bullock again underscored that the RBA Board remains 'resolute' in doing whatever is necessary to return inflation to its target.

Market Impact

The RBA's decision to increase the interest rates was widely expected by the markets. Despite the slightly watered-down tone of the forward guidance, cash rate expectations are roughly the same as before the statement was released. At the same time, however:

- 3-year yields dropped from 4.32% to 4.23% just after the decision, before rising to 4.25%,
- 10-year yields declined from 4.76% to 4.71%, with some volatility on the way,
- the AUD/USD weakened from US$0.6489 to US$0.6437, and
- the ASX 200, which dipped to 6952 points at the time of the decision, eventually closed at 6977 points, to be down 0.3% for the day.



Comment

The RBA's decision to deliver a hike after an extended pause came as no surprise given the recent data confirming that disinflation is occurring at a slower rate than hoped for some time ago, while the household sector and housing market remain resilient.

While the new projections are to be released on Friday, the RBA has already revealed that inflation forecasts were revised upwards, while the unemployment rate forecasts were downgraded.

Given these revisions, the softening of the forward guidance appears a bit surprising and should not be overinterpreted. The RBA Board retains a clear tightening bias, with further decisions being data-dependent.

Currently, the market is pricing in a 30% probability of a final 25bps hike in February, following the Q4 CPI report in late January. This is when the RBA will update its economic projections again, to have more certainty on whether inflation will return to target over the medium term, with the current level of the cash rate.

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