WESTERN AUSTRALIAN
TREASURY CORPORATION

Economic Analysis RBA Monetary Policy Decision Dec 2023

The Reserve Bank of Australia (RBA) Board kept interest rates unchanged, with the cash rate target remaining at 4.35% and the interest rate on Exchange Settlement balances staying at 4.25%. The decision was in line with market expectations.

Justification of the Decision

In the post-meeting statement, RBA Governor Michele Bullock said keeping interest rates on hold would allow the RBA Board time to gauge the impact of the previous interest rate increases on demand, inflation and labour market conditions.

Governor Bullock again explained the decision to increase the interest rates in the previous month was due to the slower-than-expected progress in inflation returning to target.

When assessing developments since the previous meeting, Michele Bullock stressed that information was 'limited', but 'broadly in line with expectations':

- the October monthly CPI indicator suggested further disinflation, mainly in the goods sector,
- labour market conditions continued to ease, but remained tight, and
- the pick-up in wages growth in Q3 had been expected due to the minimum and award wage hikes.

The RBA Governor judged that inflation expectations 'overall' remained in line with the inflation target, as did wages growth, provided productivity growth accelerates.

However, Governor Bullock cautioned that the October monthly CPI indicator provided limited information about price developments in the services sector, which had surprised to the upside in Q3.

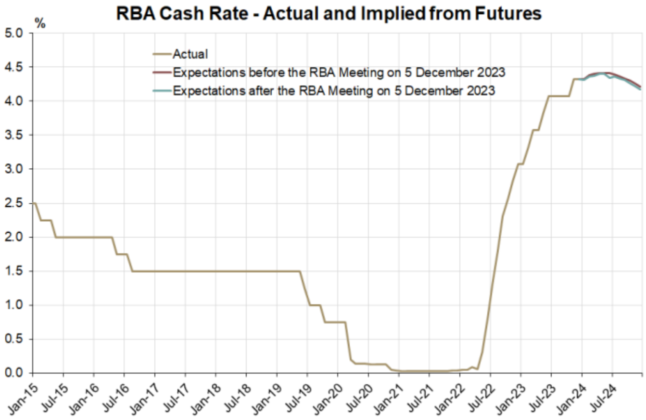
The Governor cited elevated uncertainty regarding the economic outlook. She put more emphasis on global uncertainties, including the Chinese economy and the impacts of the military conflicts abroad. Domestically, she again discussed the variable lags in monetary policy transmission, uncertain wage and price decisions given the still-tight labour market and the behaviour of households, which continue to be unevenly affected by cost-of-living pressures and higher interest rates.

The RBA's forward guidance in the all-important final paragraph was unchanged from the previous month, including the first sentence, which had been watered down in November. It will remain data-dependent as to whether further tightening will be required, but Governor Bullock again stressed that the RBA remained 'resolute in its determination' to bring inflation down to its target range of 2-3%.

Market Impact

The RBA Board's decision to keep the interest rates unchanged at the December meeting was widely expected. However, traders appeared surprised with the wording of the statement, which was less hawkish than the previous one with the watered-down forward guidance kept in place. In consequence, probability of a cash rate hike in February fell to below 10%. This triggered some slight adjustments in the markets:

- 3-year Commonwealth bond yields fell from 4.05% to just below 4% at the time of writing,
- 10-year yields slipped from 4.45% to 4.41%,
- Australian dollar depreciated from US$0.6608 to US$0.6581, and
- the ASX 200 closed at 7,062 points after trading at 7,051 points just prior to the decision and briefly hitting 7,074 points, to be still down 0.9% for the day.



Comment

The RBA's decision to leave the rates unchanged was no surprise, with the monthly CPI indicator suggesting a further decline in inflation, consumer demand again showing signs of weakness and the labour market cooling. It appears that, if these trends continue, there will be no need for the RBA to increase the interest rates further, but the tightening bias clearly remains in place.

Following the less alarming December post-meeting statement, expectations for any further cash rate hikes largely disappeared, but rate cuts are not priced in, at least to any significant extent, until late 2024. The next RBA Board meeting will be in February, the first under the new system of eight two-day meetings a year and will follow the release of the Q4 CPI figures in late January.

This will also be the meeting when the RBA Board releases its updated quarterly economic projections, which will be key to determining the RBA monetary policy outlook, at least for much of the first half of 2024.

5 DECEMBER 2023

Head Office: Level 12, 225 St Georges Terrace, Perth WA 6000
Postal Address: PO Box 7282, Perth Cloisters Square WA 6850
Phone: (+61) 8 9235 9100
Facsimile: (+61) 8 9235 9199
Email: watc@watc.wa.gov.au
Website: www.watc.wa.gov.au