WESTERN AUSTRALIAN
TREASURY CORPORATION

Economic Analysis RBA Monetary Policy Decision Mar 2023

At its meeting today, the Reserve Bank of Australia (RBA) decided to lift its interest rates by 25 basis points, increasing:

- the cash rate target to 3.60%, and
- the interest rate on Exchange Settlement balances to 3.50%.

The decision was in line with the market expectations.

A separate dataset shows that the RBA's bond holdings were broadly unchanged at A$350.5b in February.

Justification of the Decision

The post-meeting statement was again altered from the previous month, striking – for a change – a more dovish tone.

First, on inflation, Governor Philip Lowe stressed that the monthly CPI indicator suggested inflation has peaked in Australia. However, he added that, while goods price inflation is to moderate in the months ahead, services price inflation remains high due to strong demand.

Second, Governor Lowe cited the slowdown in GDP growth in Q4, pointing to sub-trend growth ahead. He underscored that the slowdown is due to softer household spending growth and a decline in house construction, while the outlook for business investment remains positive.

Third, Governor Lowe assessed that labour market conditions have eased but still but remain very tight. Wages growth has picked up but remains consistent with the inflation target. He stressed that, while the recent data suggests the risk of a wage-price spiral has declined, the Bank remains alert to the risk.

Last, looking ahead, the RBA Board expects that "further tightening" will be needed. "When and how much" interest rates need to increase further will be decided based on the global economy and household spending, as well as inflation and the labour market outlook.

This is slightly softer language compared to the previous statement, which may imply that the Board is considering the possibility of a near-term pause in tightening in the next couple of meetings.

Nevertheless, the Governor retained the paragraph stressing it is the Board's priority that inflation returns to target, even elaborating more on the risks of high inflation feeding through to expectations. He stressed that, if this was to materialise, it would imply even higher interest rates and a larger rise in unemployment.

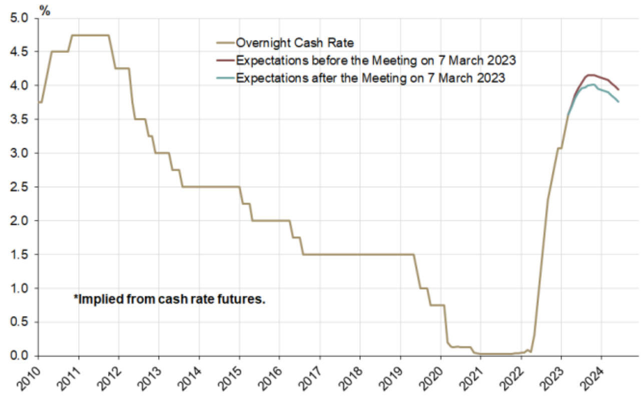
Governor Lowe also kept the paragraph talking about the lags in monetary policy, as well as risks around growth, most notably regarding household spending in reaction to weaker balance sheets. The Board still seeks to return inflation to the target band while keeping the economy balanced ("on an even keel").

Market Impact

The 25bps hike was expected by the markets, but the dovish tone of the statement meant that the cash rate expectations fell, and traders shifted to the risk-on mode:

- the AUD/USD dropped from 0.6743 before the decision to 0.6713 just after the announcement and then 0.6698 around 20 minutes later, before partly recovering to 0.6708 at the time of writing,
- the ASX 200, which had been trading flat at 7329 before the decision, surged to 7365 at the close,
- 3-year Commonwealth bond yields dropped 15 basis points to 3.368%, a level unseen since 9 February,
- 10-year yields fell 9 basis points to 3.687%, which is also the lowest level since the first half of February.

RBA Historical and Expected Cash Rate*



Comment

As expected, the RBA decided to deliver another 25bps rate increase. This was the 10th rise in a row, which took the cash rate to 3.60%, which is the highest level since May 2012.

However, after taking a hawkish turn in the previous month's statement, Governor Lowe softened the language in reaction to softer data on GDP growth and CPI inflation. The statement implies that the RBA is laying the groundwork for a pause in cash rate increases, possibly as early as April.

Following today's statement, pricing for the next 25bps hike is split between April and May, with some chance of a further increase beyond 4.0% priced in for the second half of the year.

We also continue to expect a 25bps hike in April, but with less confidence. The likelihood of an April pause has become stronger, with the outcome likely to depend heavily on the monthly CPI indicator and labour force reports for February. Beyond that, the meeting in May will come hot on the heels of the Q1 CPI report, which will be released on 26 April as well as the May projection.

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