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Economic Analysis RBA Monetary Policy Decision July 2023

At its meeting today, the Reserve Bank of Australia (RBA) decided to keep interest rates on hold. The cash rate target remains at 4.10% and the interest rate on Exchange Settlement balances at 4.00%.

The market analysts were split 50-50 in their expectations, with a 25bps hike less than 50% priced in.

A separate dataset shows that the RBA's bond holdings were roughly unchanged at A$337.1b in June.

Justification of the Decision

In the post-meeting statement, RBA Governor Philip Lowe explained that the decision to leave the rates on hold was to provide more time to assess the impacts of the interest rate hikes to date and the economic outlook. He highlighted that the RBA had increased its interest rates by 400bps so far in this cycle and that the economic outlook remains uncertain.

While assessing price developments, Governor Lowe observed that inflation has passed its peak and the monthly CPI indicator pointed to a further decline. However, he underscored that inflation is still too high. The reference to increased upside risks to price growth was removed from the statement, though Governor Lowe continued to point to the risks associated with the de-anchoring of inflation expectations.

Turning to economic and labour market conditions, Governor Lowe also referred to the slowdown in GDP growth and the slight easing in labour market tightness. He continued to judge that wages growth is consistent with the inflation target of 2-3%, as long as productivity picks up.

According to Governor Lowe, the RBA Board expects the Australian economy to continue to grow as inflation returns to the target, but again stressed that "the path to achieving this balance remains a narrow one". He sees large uncertainty around the outlook for household consumption since the impacts of cost-of-living increases are unevenly distributed among households.

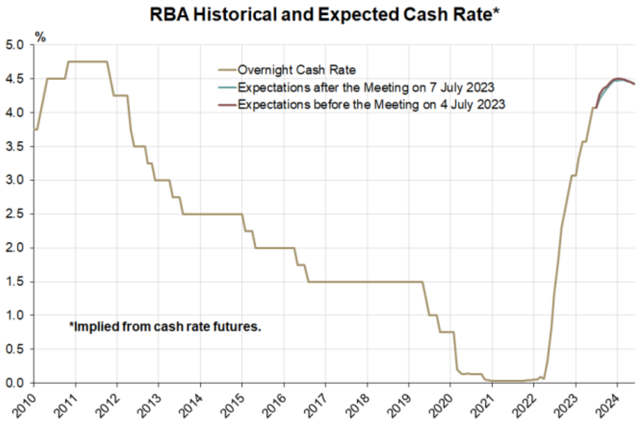
The forward guidance was unchanged, with the Board still expecting that some further tightening may be required.

Governor Lowe stressed that decisions ahead would remain data-dependent, focussing on the global economic outlook, household spending, inflation and labour market conditions. The RBA Board will also pay particular attention to the evolution of labour costs and price-setting behaviour of companies.

Market Impact

The RBA's decision to keep the interest rates on hold was a surprise to some market participants. As a result of this, there was some reaction in the financial markets:

- 3-year Commonwealth bond yields dropped from 4.07% to 4.00% after the decision, before rising slightly to 4.01% at the time of writing,
- 10-year yields declined from 4.04% to 4.00%, having briefly reached 3.98%,
- the AUD/USD dropped from $0.6680 to $0.6653,
- the ASX 200, which was trading at 7,236 just ahead of the decision, closed at 7,279.



Comment

The RBA's decision to pause was a surprise to some market participants, who expected another 25bps hike. However, other market participants anticipated such a move, particularly after the recent downside surprise to the monthly CPI indicator.

The pause in July buys the RBA time to look at the less volatile and more complete quarterly inflation figures, as well as gauge the impacts of the "mortgage cliff", as many households are transitioning from very low fixed mortgage rates to higher variable rates. In addition, at the next meeting, the RBA will have the new inflation projection, which will be crucial to their decision.

In the post meeting statement, Governor Lowe continued to stress that the RBA Board remain "resolute" in their determination to bring down inflation. As a result, the market continues to expect further interest rate increases, with a peak of around 4.50% priced in for early 2024 at the time of writing.

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