Economic Analysis

RBA Update May 2024

The Reserve Bank of Australia (RBA) Board kept interest rates unchanged at the May meeting, 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.

A separate set of data showed that RBA bond holdings declined by A$21.0b to A$314.4b in April, mainly due to maturing of the Commonwealth Bond April 2024.

Post-meeting Statement

The post-meeting RBA Board statement was rejigged substantially, with the narrative being slightly more hawkish, stressing that:

- inflation is high and is falling slower than expected, mainly due to stickiness in services price inflation, with further disinflation likely to be bumpy;
- labour market conditions are stronger than expected, with wages growth, despite peaking, still too high given sluggish productivity growth;
- the outlook remains highly uncertain, given the lags in monetary policy transmission and global risks; and
- returning inflation to the target range remains a priority, with the Board being vigilant to upside risks and still not 'ruling anything in or out'.

The last point implies that the RBA has retained some tightening bias, with any future decisions remaining data-dependent.

Statement on Monetary Policy

The highlights of the updated economic projections included in the May Statement on Monetary Policy are as follows:

- inflation is still forecast to return to the target range in 2025 and to the mid-point of the target in 2026, despite an upward revision to the 2024 forecasts due to the recent stronger-than-expected inflation and employment data;
- the unemployment rate path was revised slightly downwards across the projection horizon, with the unemployment rate now expected to peak at 4.3% by mid-2025; and
- the 2024 GDP growth forecasts were revised slightly downwards, mainly reflecting a downgrade to household consumption.

Apart from updated projections, the Statement included insights from liaison, which suggested that, faced with subdued consumer demand, companies are finding it harder to increase prices. Business investment intentions have eased to around their long-run average, while housing construction is expected to decline further.

The RBA included its additional estimates showing that output gap is positive but closing, while the labour market is above full employment. Both pose an upside risk to inflation.

Press Conference

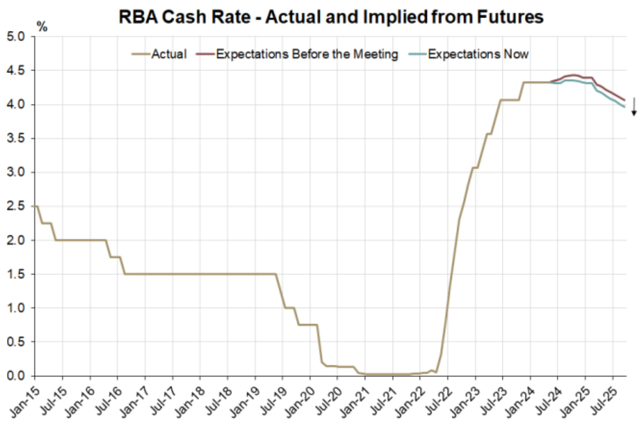
In the press conference, Governor Bullock reiterated all the above information, adding that:

- the RBA Board considered a rate hike at the meeting but reckoned it was not needed now, though they will not hesitate to tighten policy if needed;
- due to the rise in market cash rate expectations, the May projection assumed tighter monetary policy conditions than its February predecessor, which translated into lower inflation forecasts than there would have been if the rate path was unchanged; and
- the strong labour market conditions are partly due to intensive hiring in education and healthcare, with businesses continuing to have trouble finding suitable workers, and labour hoarding.

Market Impact

A cash rate hike was partly priced in for the meeting. With no rate increase and the Board signalling that, in its view, the cash rate is likely high enough to bring inflation back to target, there was unwinding of market pricing for a cash rate increase in the coming months and:

- a fall in 3-year Commonwealth bond yields from 4.03% to 3.92% at the time of writing;
- a decline in 10-year yields from 4.37% to 4.31%; and
- a fall in the AUD from US$0.6627 to US$0.6587.



Comment

At the May meeting, the RBA Board turned back to being a bit more hawkish and a rate hike was again discussed. However, this hawkish tilt was not as strong as feared by some, dealing a blow to those investors and market analysts that were positioning for more hikes.

While nothing is off the table, our main scenario remains for no more hikes and the start of a rate cutting cycle at the turn of 2024 and 2025. However, possible upward impacts of the near-term inflation stickiness on inflation expectations are a major risk to this scenario.

7 MAY 2024