RBA Update December 2024

The Reserve Bank of Australia (RBA) Board kept interest rates unchanged at the December 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. However, the post-meeting statement was significantly more dovish than in November.

Post-meeting Statement

The post-meeting statement continued to stress that underlying inflation is too high and underscore the commitment to returning inflation sustainably to the mid-point of the target range of 2-3%.

However, the document also stated (twice) that the RBA Board is gaining confidence that inflation is declining in line with the November projection, which had forecast a sustainable return to the mid-point of the target range in 2026.

The RBA Board also said that some of the upside risks to inflation appear have eased and removed the word 'vigilant', which was used to describe the alertness to these risks.

Another new dovish element was the observation that wages growth in Q3 was slower than expected in the projection released a little over a month ago. That said, the RBA cautioned that the slower-than-expected wages growth should be viewed against sluggish productivity gains.

The RBA highlighted ongoing soft GDP growth that saw the annual growth rate fall to just 0.8% in Q3. However, while the output gap continues to close, the level of aggregate demand remains above the economy's supply capacity.

While the recovery in household consumption is slower than forecast, the central bank continues to expect household consumption to start picking up in the coming quarters, with tentative signs of improvement already emerging.

The RBA Board also drew attention to ongoing solid labour market conditions as well as recent declines in youth unemployment and underemployment rates.

The document continued to cite multiple uncertainties about the economic outlook, both internal and external.

The Board made some notable changes to its forward guidance, removing the reference of not ruling anything 'in or out' as well as its comment that that policy will need to remain 'sufficiently restrictive' until the Board is confident inflation is moving sustainably towards the target.

Notwithstanding all the above, the RBA Board remains 'resolute' in their determination to return inflation sustainably to target.

Press Conference

During the press conference, RBA Governor Michele Bullock justified the changes in the statement. She stressed that removing the phrase on not ruling anything 'in or out' was deliberate. It was intended to acknowledge the softer data and increased confidence that inflation will evolve in line with the RBA's November projection.

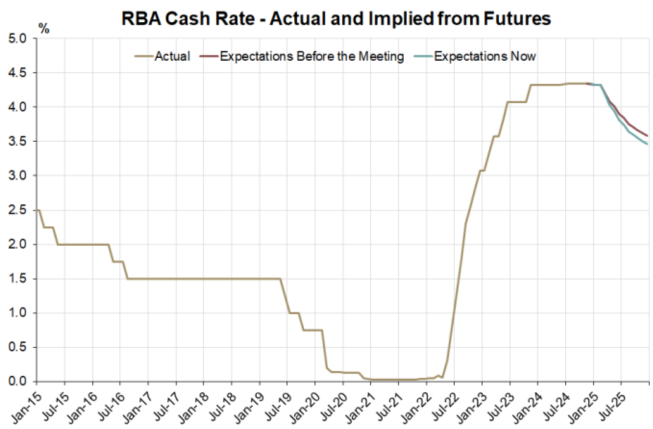
On three separate occasions, Governor Bullock declined to give a clear indication of the timing of a rate cut, but did not completely rule out such a move in February. She also confirmed that a rate change was not 'explicitly' discussed at the December meeting.

Market Impact

The dovish post-meeting statement caused a slight intensification in cash rate cut expectations. The first reduction is still not fully priced in before April, but the probability of a cut in February increased to 67% from 54% before the RBA decision.

A decline in cash rate expectations dragged Commonwealth bond yields lower. 3-year yields fell from 3.80% to 3.72%, while 10-year yields declined from 4.22% to 4.15%.

The AUD/USD dropped below US$0.64 and is trading at US$0.6392 at the time of writing. The ASX 200 closed 0.4% lower but was down 0.6% before the decision.



Comment

While it would be an exaggeration to call communication around the December RBA meeting a dovish pivot, a change in sentiment in favour of considering the start of monetary policy easing is clear. This is not surprising given the meagre Q3 GDP figures, disappointing Q3 wages growth and decline in underlying inflation.

That said, while tightening is off the table for now, the RBA remains uncomfortable with the current level of underlying inflation and will hold off with rate cuts until they are fully convinced that the target will be met. We continue to view a cut as more likely in Q2 than in Q1.

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