Economic Analysis

RBA Update August 2024

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

Post-meeting Statement

The post-meeting statement was revised significantly compared to the previous month, but the key hawkish themes were maintained:

- inflation remains above target, falling ‘very little’ over the past year and remaining ‘too high’ in underlying terms, and the disinflation process overall is proving ‘slow and bumpy’;
- the outlook remains ‘highly uncertain’, particularly for inflation, given the still-strong labour market conditions and upward revisions to consumption figures; and
- returning inflation to the target range is RBA’s priority, with the Board still not ruling anything ‘in or out’.

The post-meeting statement contained a new sentence highlighting that monetary policy needs to remain restrictive until the RBA Board is confident that inflation is moving sustainably towards the target range.

Given the longer timeframe for returning to the range envisaged in the updated projections, this implies interest rates will remain elevated for some time.

Statement on Monetary Policy

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

- headline inflation is forecast to return to the target range in late 2026, compared to late 2025 in the previous projection (this partly reflects the impacts of the household electricity bill relief);
- trimmed mean inflation is not expected to approach the mid-point of the target range until late 2026, half a year later than envisaged in May;
- the unemployment rate forecasts were revised slightly upwards, with the peak expected at 4.4%;
- the near-term GDP growth projection path was revised slightly upwards, reflecting higher consumption forecasts.

Apart from the updated projections, the Statement included two boxes, with insights from the RBA business liaison, with one of the key takeaways being that cost and price pressures remain elevated.

The RBA also provided a broad review of inflation expectations, concluding that they remain anchored over the longer run, despite bond market investors demanding slightly higher compensation for increased inflation risk.

Press Conference

During the press conference, RBA Governor Michele Bullock adhered to the hawkish message, with the highlights being:

- a rate hike was not only discussed at the meeting, but was given ‘a very serious consideration’;
- rate cuts in near term (specified as around six months) are not on the agenda and do not ‘align’ with the RBA Board’s thinking; and
- the RBA needs to ‘stay on the course’ with the inflation fight, by ‘slowing the growth in demand’.

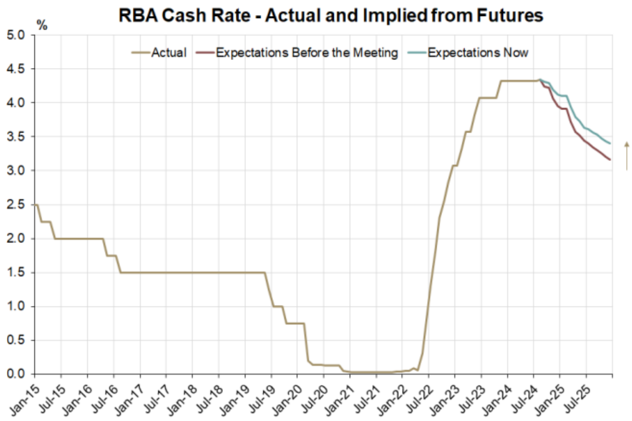
Market Impact

Cash rate expectations picked up a little during the press conference, with the first cut fully priced in for February 2025, rather than November.

Despite this, the broader market reaction to all the above events was quite calm, with:

- a rise in 3-year Commonwealth bond yields from 3.56% just before the decision to 3.61% at the time of writing; and
- an uptick in 10-year Commonwealth bond yields from 3.99% to 4.00%.

The Australian dollar has been bouncing around US$0.6510 after the decision, temporarily reaching US$0.6528 during the press conference.



Comment

With inflation remaining above the target and expected to return to it later than previously thought, the RBA needs to maintain a hawkish tone at this stage.

Similarly to other advanced economies, Australia is currently experiencing slower disinflation. However, there are several factors that will support the disinflation process over time, including the positive output gap and deteriorating global economic outlook. Given this, the next step from the RBA will be a cut, even if it is looking like it will not occur for several months.

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