Tuesday, 15 November 2022

RBA Board Meeting Minutes

Consistency Rules Supreme

- **In November, the Reserve Bank (RBA) Board raised the cash rate by 25 basis points to 2.85% – the highest rate since April 2013.**
- **The decision followed a stronger-than-expected September quarter inflation report where annual headline inflation surged to 7.3% – its highest level in over 32 years.**
- **As in October's board meeting, the RBA Board again considered a 25 or 50-basis-point move. While the minutes note that "there were arguments in favour of both courses of action", it appears the decision was not quite as "finely balanced" as in October.**
- **Consistent with October, the minutes show that the key arguments in favour of a 25-basis-point move "rested largely on the fact that the cash rate had been increased materially in a short period of time and that there were lags in the operation of policy".**
- **The RBA decided not to do a U-turn on its pivot from October. A key reason given was that another 25 basis points would provide consistency to the Board's actions and this was important in giving confidence in the monetary policy framework. There's a whiff of the RBA's decisions not being guided predominantly by the data.**
- **The RBA is still seeking to walk a 'narrow path' to achieve a soft landing of reducing inflation over time without producing a hard downturn. However, this strategy is not without its risks. The key risk being a rise in inflation expectations.**
- **It also places the RBA somewhat at odds with other central banks who are more willing to aggressively hike rates to ensure inflation falls back toward their targets. The minutes noted that "many major central banks had been raising policy rates quickly and were more likely to err on the side of doing too much rather than too little".**
- **The RBA expects further interest rate increases will be necessary as it tackles high inflation. Interest-rate markets expect the cash rate to peak at 3.90% by late 2023.**
- **However, some entertainment of a pause in the cash rate was introduced for the first time in these minutes.**

At its policy meeting earlier this month, the Reserve Bank (RBA) Board raised the cash rate by 25 basis points to 2.85% – the highest level since April 2013. Today, the minutes from the RBA's November Board meeting were released. The minutes provide further insights into the November decision, along with some additional colour on the assessment of the global and domestic economic landscape.

The decision to increase the cash rate by 25 basis points followed a stronger-than-expected

September quarter inflation report where annual headline inflation surged to 7.3% – its highest level in over 32 years. Underlying inflation also jumped, increasing to 6.1% – the highest in the history of the series dating back to 2002.

During the November meeting, the RBA Board again considered the merits of raising rates by 25 or 50 basis points, as it did at the October board meeting.

During the October meeting, the arguments for either decision were “finely balanced”. At the November meeting, the minutes note that “there were arguments in favour of both courses of action”, however, it appears that perhaps the decision was not quite as finely balanced as it was at the October meeting.

Long and variable lags

The key argument in favour of a 25-basis-point move was the long and variable lags that exist in the transmission of monetary policy. In fact, the minutes noted that the arguments “rested largely on the fact that the cash rate had been increased materially in a short period of time and that there were lags in the operation of policy”.

Prior to the November meeting, the cash rate had been increased by 250 basis points since May – the most aggressive hiking cycle since 1994. Importantly, households were not yet feeling the full effect of those increases. It takes an average of two to three months for households to start paying higher (variable) mortgage repayments after a cash rate increase. This reflects the notice period that banks provide their customers when increasing interest rates.

Additionally, a higher-than-average number of households are on fixed rate mortgages and will not feel the effects of higher interest rates until their fixed rate period ends. The RBA expects 62% of these households will roll off fixed rates by the end of 2023.

The cash rate increases have had a more immediate effect on consumer sentiment and the housing market. However, there continues to be a lag on the impact on consumer spending. The RBA continues to monitor the disconnect between what consumers say and do. It is expected that spending will gradually decline as the full impact of cash rate hikes flows through.

Other factors supporting a 25-basis-point move included that “wages growth had not reached levels that would be inconsistent with the inflation target” and that there was “evidence of some easing in global supply-chain issues and a decline in some commodity prices”.

Consistency of Board actions a factor

In October, the Board pivoted from 50-basis-point hikes to a 25-basis-point move. In our communication ahead of the November meeting, we noted that there was a risk that the Board may not do a U-turn on its pivot so quickly, despite the upside surprise to inflation.

This turned out to be a factor the Board considered. The November minutes note that “members also discussed the value of the Board acting in a consistent manner”.

The Board appears conscious of the risk that doing a U-turn on its pivot in such a short space of time may negatively impact the credibility of the RBA. The Board agreed that “acting consistently would support confidence in the monetary policy framework among financial market participants and the community more broadly.”

Elevated inflation environment and upside risks key arguments for 50-basis-point hike

The arguments in favour of a 50-basis-point hike were similar to those at the October meeting, including:

- Current elevated inflation environment and upside risks from the labour market, rents and energy costs
- The potential for any unexpected supply shocks pushing inflation even higher
- The potential for wage growth to pick up in a tight labour market
- Rising inflation expectations and changing price- and wage-setting behaviour
- Interest rates still being fairly low in a historical context

Other central banks going harder

We have previously noted that the RBA continues to walk a ‘narrow path’ as it seeks to engineer a soft landing – getting inflation down over time without an undue impact to growth.

However, other central banks have taken a firmer approach and have emphasised their willingness to materially impact growth to ensure that inflation falls back towards their targets. The approach taken by the RBA is not without its risks. The key being that inflation expectations among businesses and consumers increase, price- and wage-setting behaviour adjusts, and inflation becomes more embedded in the system. This would make it more difficult to get inflation back towards the RBA 2-3% target band and would likely result in the cash rate needing to be higher for longer.

The stronger actions of other central banks were an argument in favour of a 50-basis-point hike. The minutes noted that “many major central banks had been raising policy rates quickly and were more likely to err on the side of doing too much rather than too little”.

Not on a pre-set path

Despite the Board appearing to be somewhat hesitant to do a U-turn on its pivot so quickly, the RBA has not ruled out accelerating the pace of hikes in the future. The minutes note that “acknowledging the uncertainty, members did not rule out returning to larger increases if the situation warranted.”

While future interest rate increases are expected, the Board is also “prepared to keep rates unchanged for a period while it assesses the state of the economy and the inflation outlook”. This is the first time that the prospect of pausing has been discussed in the RBA minutes, after the Governor discussed the prospect of the RBA pausing, if necessary, at a speech following the November decision. This suggests the Board thinks that it is closer to a cash rate setting that is sufficiently restrictive to gradually return inflation to target and that a pause may be one of the options considered in future meetings.

Importantly, the minutes again emphasise that “interest rates are not on a pre-set path”.

Monetary Policy Outlook

The RBA Board is cognisant that monetary policy acts with a lag and that the cash rate has been increased rapidly in a short space of time. These increases have not yet fully flowed through to households. While spending is still holding up, it is expected to gradually slow, helping to create a better balance of supply and demand and reduce inflationary pressures over time.

The Board is trying to engineer a soft landing, where inflation reduces but growth is not hit too hard, and the unemployment rate doesn’t rise too quickly or too far.

This is the RBA’s ideal outcome.

Other central banks, notably the Federal Reserve, have also recently discussed the potential of slowing the pace of hikes as interest rates move higher and into contractionary territory.

However, global central banks appear more willing to hike rates into contractionary territory and hold them there for a time to ensure that inflation falls back towards their targets. This has the potential to have a larger impact on growth in those economies.

The RBA's strategy is not without its risks. The key one being that inflationary expectations increase, and the RBA has some catching up to do in the future.

Further interest rate hikes are expected and we expect the cash rate to be well into the 3s in 2023. Interest-rate markets are currently expecting the cash rate to increase to 3.90% by the end of 2023.

A 25-basis-point hike remains the most likely outcome at the December meeting. However, the RBA Board has raised the prospect of a pause in the near future as it assesses the impact the hikes to date have had on the economy.

Jarek Kowcza, Senior Economist
Ph: 0481 476 436

Contact Listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
(02) 8254 3251

Senior Economist
Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
0481 476 436

Senior Economist
Pat Bustamante
pat.bustamante@bankofmelbourne.com.au
0468 571 786

Economist
Jameson Coombs
jameson.coombs@bankofmelbourne.com.au
0401 102 789