Bank of Melbourne

Tuesday, 17 October 2023

RBA Board Meeting Minutes

RBA More Alert But Not Yet Alarmed

- **The Reserve Bank (RBA) left the cash rate unchanged at 4.10% at its October meeting – the first meeting for new RBA Governor, Michele Bullock. This was the fourth consecutive meeting where interest rates had been left unchanged.**
- **Data dependency remained the name of the game. The Board concluded that "there had not been sufficient new information over the preceding month from economic data or financial markets to necessitate an adjustment in the stance of monetary policy".**
- **A range of data will be available ahead of the November meeting, including on "economic activity, inflation and the labour market, as well as a set of revised staff forecasts". The September quarter inflation report and the updated set of RBA staff forecasts are the main acts when it comes to next meeting's decision.**
- **Despite the pause, the RBA maintained a hiking bias and added that "the Board has a low tolerance for a slower return of inflation to target than currently expected" – which didn't appear in the September meeting minutes or October statement. This suggests that an additional hike may be forthcoming if the RBA's goal of getting inflation back to the 2-3% target by the end of 2025 is placed in jeopardy.**
- **The Board considered both a 25-basis-point hike and a pause at the meeting. The arguments around a hike centred on "the outlook for inflation and the associated risks" while the case for a pause was supported by the usual reference to the long and variable lags in monetary policy.**
- **While risks remain and additional monetary policy tightening cannot be ruled out, we continue to expect the RBA to remain on hold from here. The tightening to date, in addition to the substantial lags in monetary policy should see inflation continuing to move gradually lower, allowing the Board to maintain its position.**

The Reserve Bank (RBA) left the cash rate unchanged at 4.10% at its October meeting – the fourth consecutive meeting where interest rates had been left unchanged. The minutes from that meeting were released today and provide further insights into the decision and the outlook for interest rates.

The October meeting was the first as Chair for new RBA Governor, Michele Bullock. The post-meeting statement made only very minor changes from the September statement. Indeed, it was close to a carbon copy from the previous statement, with changes largely reflecting the passage of time. This approach suggests that the new Governor had preferred to hold the line and maintain the status quo as there wasn't sufficient evidence to change the policy approach at the October meeting.

Steady path as RBA Board remains data dependent

Data dependency is a term we have heard numerous times throughout this tightening cycle and the October minutes reaffirmed this approach from the RBA.

The final, and most closely watched, section of the minutes noted that "there had not been sufficient new information over the preceding month from economic data or financial markets to necessitate an adjustment in the stance of monetary policy".

This demonstrates the importance being placed on the incoming data and suggests that the onus is on the data to make the case for additional hikes. It also explicitly makes clear that the Board is monitoring financial market developments closely, in addition to what is happening in the real economy. This sentence adds weight to our expectation that the Board will remain on hold. However, risks remain that could place the RBA's trajectory of getting inflation back to the 2-3% band by 2025 under threat.

Looking forward, the minutes emphasised that the Board would receive a range of data ahead of their November meeting. This included "additional data on economic activity, inflation and the labour market, as well as a set of revised staff forecasts". The September quarter inflation report, due 25 October, and the updated set of forecasts from the RBA staff are the main acts when it comes to this additional data and will be most important for the November decision.

But tightening bias still evident and strengthened

Despite the RBA remaining on hold, a clear tightening bias remains. If anything, the minutes from the October meeting slightly strengthened that tightening bias. An additional sentence in the final paragraph was added, noting that "the Board has a low tolerance for a slower return of inflation to target than currently expected". This is new and didn't appear in the September meeting minutes or the October statement.

This firmer language suggests that that criteria for a further hike is centred on the 2025 inflation goal. This places the November RBA staff forecasts at the top of the pile and suggests the November meeting may be live if the September quarter inflation report surprises to the upside.

Familiar arguments and a familiar result

Underscoring the continued tightening bias, both a 25-basis-point hike and a pause were considered at the meeting – as has been the case for many meetings now. The arguments in support of either action were also similar to what we have seen in previous meetings.

The case for a hike

Specifically, the case for additional hikes "centred on the outlook for inflation and the associated risks". There remains a risk that services inflation proves to be somewhat sticky, as has been the case overseas and that higher petrol prices may flow through to higher inflation expectations for households. Given the length of time that inflation is expected to be above target, these risks were considered a "significant concern" by the Board.

Other arguments supporting a hike included "the implications of developments in asset prices", specifically, housing prices. The RBA doesn't explicitly target dwelling prices and the minutes reaffirmed this point. However, housing (and other asset) prices are considered from the perspective of household wealth and the impact this has on household spending, and thus inflation. The minutes also noted rising dwelling prices may give some clue to how tight monetary policy is relative to the neutral rate and that it may not be as tight as previously thought. However, they also tempered this by stating that there are other indicators that suggested the current monetary policy stance was tight.

Finally, the depreciation of the exchange rate was mentioned as another upside risk to inflation. However, the minutes also noted that “on a trade-weighted basis, the Australian dollar was only slightly lower than at the start of the year” and that “the trade-weighted exchange rate is the relevant measure for imported inflation in Australia”.

The case for a pause

Arguments supporting a pause centred on the fact that monetary policy had been tightened rapidly in a short period of time and that the full effects of this tightening were still working their way through the economy.

Inflation had fallen from its peak, household spending has slowed – indeed, real per capita household consumption has gone backwards for three consecutive quarters, and incomes were still under pressure from a range of factors, including elevated inflation, higher tax payments, and higher interest rates. Importantly, the RBA noted that the labour market had “reached a turning point” alongside a gradual easing in labour market pressures.

International developments also added weight to the case for a pause. In particular, “challenges in the Chinese economy could lead to slower growth in Australia if not contained”.

These factors all mean that risks remain two sided.

Financial stability

As this meeting preceded the publication of the biannual Financial Stability Report (FSR), the minutes included a section on financial stability. While financial stability risks were high, the international banking system remained well placed to deal with these risks.

Stress in China’s property sector is a key risk for the global economy. Other risks included a potential “further substantial tightening in global financial conditions” and the outlook for the commercial property sector. Domestically, while the uneven impact of monetary policy was acknowledged, “most households and businesses were managing to adjust”. However, some sectors were feeling the pain more than others. Notably, the rise in insolvencies across the construction, and arts & hospitality sector was noted as these industries deal with constrained profit margins and weakening demand.

The Australian banking system is strong and the minutes noted that the initial phase of the roll-off of funding from the term funding facility (TFF) had proceeded smoothly.

Outlook

The RBA Board maintained and strengthened its tightening bias. However, it’s data-dependent approach ensured the Board is alert but not yet alarmed by the risks to the economic outlook.

Going forward, the onus of proof appears to be on the data to make the case for additional hiking. The September quarter inflation report and the updated RBA staff forecasts will form the key pieces of the puzzle leading into the November meeting.

While risks remain and additional monetary policy tightening cannot be ruled out, we continue to expect the RBA to remain on hold from here. The tightening to date, in addition to the substantial lags in monetary policy should see inflation continuing to move gradually lower, allowing the Board to maintain its current stance.

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