Bank of Melbourne

Tuesday, 7 March 2023

RBA Board Meeting

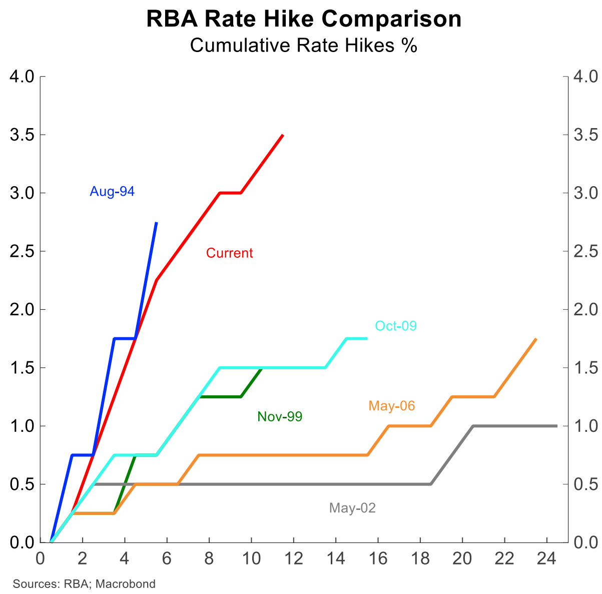
Readying for a Possible Pause?

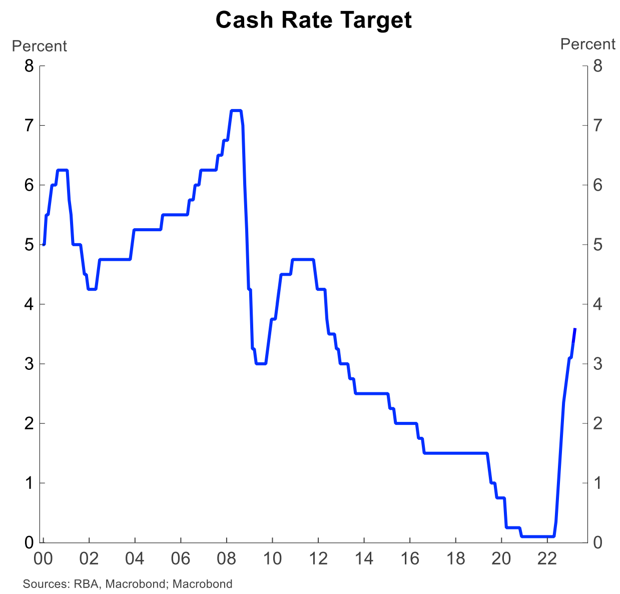
- **The Reserve Bank (RBA) Board delivered another 25-basis-point hike today, taking the cash rate to 3.60% – the highest level since May 2012.**
- **It takes the number of consecutive rate rises to ten and the cumulative tightening since May to 350 basis points (or 3.5 percentage points) – the most aggressive tightening cycle since before the 1990s.**
- **The rate hike was widely expected. But the tone of the statement was not. There was a noticeable shift in the statement this month with the commitment to another rate hike next month toned down. We've previously flagged this possibility because of the recent run of underwhelming economic data.**
- **Importantly, the RBA dropped its explicit reference to "further increases in interest rates will be needed over the months ahead." They replaced it with the "Board expects that further tightening of monetary policy will be needed to ensure that inflation returns to target."**
- **Last month's statement seemed like the Board was on a pre-determined course to hike the cash rate at least twice more, but today's statement is indeterminate around timing and how much more tightening is needed.**
- **It appears policy makers have recognised the risk of overtightening, as evidenced by the run of soft data, and today's language was centred on giving themselves more options to respond to the data flow in future meetings.**
- **The RBA appears to view the balance of risks as lying to more tightening down the track, but it has opened up the idea that they may be closer to the peak and/or closer to a pause.**
- **Their assessment of the inflation outlook is also consistent with this – they noted the monthly Consumer Price Index (CPI) indicator suggests "inflation has peaked", floated the idea that some demand for services was temporary and so perhaps services inflation would not be pesky, and they remarked that there are lower risks around a wage-price spiral.**
- **In assessing when and how much further to raise rates, the RBA will be paying close attention to developments in the global economy, spending, inflation, and jobs market.**
- **The Group view remains that the cash rate will need to increase to 4.10% in this cycle, including with a rate hike next month. However, there's a risk that the peak falls shy of this level and/or takes longer to get to this level. We cannot rule out a pause next month.**
- **The Governor gives a keynote address tomorrow where more clues around the cash-rate outlook may be deciphered.**

What did the Reserve Bank (RBA) Board decide?

As was widely expected, the Reserve Bank (RBA) Board delivered another 25-basis-point hike today, taking the cash rate to 3.60% – the highest level since May 2012. Today's hike was the tenth consecutive increase, taking the cumulative tightening to 350 basis points since May.

The pace and scale of hikes make this cycle the most aggressive in the inflation targeting era. Since the early 1990s there have been 5 hiking cycles (excluding the current cycle) which have delivered an average of 180 basis points of tightening over an 18-month period.





Did the RBA Board's forward guidance shift?

While the outcome was widely expected, economists and investors were looking for any shifts in the RBA Board's forward guidance.

We've previously flagged the possibility that the run of underwhelming economic data since the February Board meeting may lead to a shift away from the RBA's pre-determined course to hike the cash rate at least twice more.

This was indeed the case. The RBA replaced "further increases in interest rates will be needed over the months ahead" to "the Board expects that further tightening of monetary policy will be needed to ensure that inflation returns to target."

The other change in the final paragraph was the addition of the word "when" in the sentence referring to the factors the Board would consider in assessing the need for additional hikes. Specifically, "in assessing when and how much further interest rates need to increase, the Board will be paying close attention to developments in the global economy, trends in household spending and the outlook for inflation and the labour market."

These may seem a minor changes but in central bank speak, they are key updates. So, what does it mean?

It appears policy makers have recognised the risk of overtightening, as evidenced by the run of soft data, and today's language was centred on giving themselves more options to respond to the data flow in future meetings.

The RBA appears to view the balance of risks as lying to more tightening down the track. This is because inflation remains elevated, and the labour market remains tight.

However, the RBA has opened up the idea that they may be closer to the peak and/or closer to a pause and has clearly stated that its next move will be determined by paying close attention to developments in the global economy, spending, inflation, and jobs market.

What does this mean for our interest rate outlook?

We continue to expect that the cash rate will need to increase to 4.10% to contain inflationary pressures and ensure inflation expectations remain well anchored. Stronger-than-expected activity in the global economy as well as sticky global inflation also supports this view.

However, given the shift toward a more data dependent policy approach, there is now significant risk that deteriorating economic conditions may mean the RBA does not reach this level. It may also mean that the RBA may pause earlier. But a pause may not necessarily mean the end of the cycle and further hikes may be needed down the track.

While this remains uncertain, what is certain is that the RBA has taken notice of the underwhelming economic data since the February meeting and will decide future moves based on developments in the global economy, spending, inflation, and the labour market.

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