RBA Statement on Monetary Policy

Inflation Up But RBA Eyeing Soft Landing

- **The Reserve Bank (RBA) Governor's glass remains half full as the RBA still expects the economy to achieve a soft landing, even as inflation is expected to be higher for longer and risks continue to mount.**
- **This was outlined in today's quarterly Statement on Monetary Policy (SoMP). The document provides a full breakdown of the RBA's forecasts, some of which were previewed in the monetary-policy decision earlier this week.**
- **Without widespread jobs losses and following the largest inflationary shock in over 32 years, annual headline inflation is expected to fall to 3¼ per cent by the end of 2024, down from a peak of 8 per cent expected by the end of 2022. Importantly, this implies that inflation is not expected to fall into the 2-3% band until 2025, at the earliest.**
- **The unemployment rate is expected to tick up to 4¼ per cent by the end of 2024, after accommodating a significant increase in net overseas migration that was revealed in last month's Budget. This is well below the 5.5 per cent average unemployment rate recorded over the decade prior to the pandemic.**
- **At the same time the RBA expects the economy to lock in higher wages growth. The RBA expects wages to grow by close to 4.0 per cent in 2023 and 2024. This is a step up from the 3.1 per cent expected in 2022 and much stronger than the average growth of 2.7 per cent recorded over the decade prior to the pandemic.**
- **This contrasts with aggressive actions by global central banks, which are expected to generate sharp downturns. The challenge of achieving such an outcome should not be understated. There are many risks. If inflation remains elevated, the cash rate may need to go higher, likely leading to a sharper slowdown and more job losses.**
- **We expect the RBA has more work to do to sustainably bring inflation back down. However, we do not think that the RBA will need to hike to around 4 per cent by the end of 2023 as interest-rate markets are currently expecting.**

The RBA Board has now raised the cash rate by 275 basis points since May, the most rapid tightening cycle since 1994. The cash rate is now at 2.85 per cent, the highest rate since April 2013. The SoMP released today shows that the RBA is expecting this tightening to generate a slowdown in economic activity and reduce elevated inflation. Importantly, the RBA expects this to occur with the unemployment rate increasing to only 4¼ per cent, a still very low rate compared with the pre-pandemic 10-year average of 5.5 per cent.

Economic Growth

The economy is expected to grow solidly in the second half of 2022. Over the following two calendar years, the RBA expects economic growth to slow to below trend. Increasing interest rates, declining dwelling prices and ongoing cost-of-living pressures are expected to weigh on household spending and economic activity. The RBA forecasts economic growth to be 3 per cent over 2022 and then 1½ per cent over the 2023 and 2024 calendar years.

Compared with the RBA's August forecasts, the slowdown in economic activity is now expected to be more pronounced. The RBA revised down growth across all three calendar years (2022 to 2024) by around ¼ percentage point each year. The revision is likely due to higher-than-expected inflation leading to a higher assumed profile for the cash rate. In particular, the RBA's forecasts assume the cash rate reaches a peak of around 3.5 per cent in mid-2023, higher than the around 3.0 per cent peak assumed in the August SoMP.

Table 5.1: Output Growth and Inflation Forecasts[(a)]
Per cent

	Year-ended					
	June 2022	Dec 2022	June 2023	Dec 2023	June 2024	Dec 2024
GDP growth	3.6	3	2	1½	1½	1½
(previous)		(3¼)	(2¼)	(1¾)	(1¾)	(1¾)
Unemployment rate[(b)]	3.8	3½	3½	3¾	4	4¼
(previous)		(3¼)	(3½)	(3½)	(3¾)	(4)
CPI inflation	6.1	8	6¼	4¾	4¼	3¼
(previous)		(7¾)	(6¼)	(4¼)	(3½)	(3)
Trimmed mean inflation	4.9	6½	5½	3¾	3½	3¼
(previous)		(6)	(5)	(3¾)	(3¼)	(3)
	Year-average					
	2021/22	2022	2022/23	2023	2023/24	2024
GDP growth	3.9	4	3½	2	1½	1½
(previous)		(4)	(3½)	(2¼)	(1¾)	(1¾)

(a) Forecasts finalised 2 November. The forecasts are conditioned on a path for the cash rate broadly in line with expectations derived from surveys of professional economists and financial market pricing. Other forecast assumptions (assumptions as of August *Statement* in parenthesis): TWI at 62 (63); A$ at US$0.64 (US$0.69); Brent crude oil price at US$89bbl (US$94bbl). The assumed rate of population growth is broadly in line with the profile set out in the Australian Government Budget 2022–23. Forecasts are rounded to the nearest quarter point. Shading indicates historical data, shown to the first decimal point.
(b) Average rate in the quarter.

Sources: ABS; RBA

A more subdued global outlook also contributed to the downward revision. The RBA noted that global interest rates are now expected to peak at a higher level on the back of stronger than expected inflation. Coupled with skyrocketing energy prices in Europe and ongoing weakness in key sectors in China, slower growth in our major trading partners will also impact on domestic activity through lower international trade.

Labour Market

The labour market has remained incredibly tight since the RBA's last SoMP in August. The unemployment rate continues to hover around a 50-year low of 3.5%. Job vacancies remain near a record high and job ads are also at elevated levels. Other measures of labour market slack, such as the underemployment and underutilisation rates, also point to a continued tight labour market.

However, in recent months, there have been some tentative signs of a cooling in this hot market. Employment growth has begun to slow and measures of job advertisements and vacancies have stabilised or declined slightly from elevated levels. This suggests that the unemployment rate may not have much further to fall before it begins to rise.

Indeed, this is the RBA's expectation. In its August SoMP, the RBA expected the unemployment rate to fall further to 3¼ per cent in December 2022. However, it now expects the unemployment rate to remain around the current low level of 3½ per cent.

The unemployment rate is forecast to gradually rise over the forecast period as economic growth slows. The RBA expects the unemployment rate to rise from around 3½ per cent in December 2022, to 3¾ per cent in December 2023. Looking into 2024, the RBA expects the unemployment rate to continue to rise to 4¼ per cent. The unemployment rate has been revised higher since the August SoMP by ¼ of a percentage point in both December 2023 and December 2024.

It should be noted that this is still a very low unemployment rate and would be within the vicinity of the RBA's estimates of full employment, which are for an employment rate in the 'high 3s to the low 4s'.

Employment growth is also expected to slow in line with weaker economic growth. However, despite the slowing in employment growth and a rise in the unemployment rate, the overall labour market is expected to remain relatively tight.

The tightness of the labour market is expected to flow through to an increase in nominal wages growth, as measured by the Wage Price Index (WPI). Annual wages growth is expected to accelerate to 3.1 per cent in 2022, and 3.9 per cent in 2023 and 2024. This compares with the 3.0 per cent in 2022, 3.6 per cent in 2023, and 3.9 per cent in 2024 expected in the RBA's previous SoMP in August.

While nominal wages growth is expected to increase, as inflation is predicted to remain elevated over the forecast period, real wages growth (i.e. adjusted for inflation) is expected to remain negative until 2024.

Inflation

Headline inflation surged to a more than 32 year high of 7.3% over the year to the September quarter. This stronger-than-expected outcome was one of the contributors to the RBA now expecting inflation to remain higher for longer.

Headline inflation is expected to peak at 8.0 per cent in the December quarter of 2022. This is up from the 7¾ per cent expected in the August SoMP. Looking further forward, the RBA expects inflation to gradually decline to 4¾ per cent over 2023, and 3¼ per cent over 2024. This inflation profile has been revised higher from 4¼ per cent over 2023 and 3 per cent over 2024 at the August SoMP.

Additionally, trimmed mean inflation, which provides a better measure of underlying inflationary pressures by excluding categories with large movements in prices, is also expected to remain elevated. The RBA expects trimmed mean inflation to peak at 6½ per cent in 2022, before gradually declining to 3¾ per cent over 2023 and 3¼ per cent over 2024.

Inflation is high and broadly based. International factors such as the global imbalance between supply and demand for goods and the impact of the war in Ukraine were the initial drivers of strong inflation. However, as international factors have begun to gradually unwind, domestic drivers of inflation have become more prominent.

Domestic disruptions such as flooding across large parts of the country have added to inflationary pressures and are expected to continue to impact prices in the near term. Retail gas and electricity prices are also expected to increase by 20-30 per cent in 2023 and have contributed to a higher inflation profile that the RBA previously expected.

Importantly, despite a slowing economy, higher interest rates, and the gradual unwind of global supply-chain disruptions, the RBA does not expect inflation to get back to within the 2-3% band in the forecast period (to the end of 2024). Instead, the RBA expects inflation to be around the top of its target band by the end of 2024. This implies that inflation is not expected to be within the band until 2025, at the earliest.

Monetary Policy Outlook

The SoMP released today shows that the RBA still expects to achieve a soft landing, even though inflation is expected to be higher for longer. By the end of 2024, the RBA expects inflation to have fallen to just above the top of its target inflation band of 2-3%, while locking in higher wages growth and keeping the unemployment rate well below its pre-pandemic average.

There are risks, however. Inflation has surprised on the upside, with the outlook for inflation revised higher. This has led to a higher assumed path for the cash rate and a slightly more pronounced downturn in the economy. If inflation continues to be stronger than expected, the cash rate may need to go higher for longer, likely leading to a more pronounced economic downturn with more job losses.

We expect the RBA has more work to do to bring inflation back down. However, we do not think that the RBA will need to hike to around 4 per cent by the end of 2023 as interest-rate markets are currently expecting.

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