Tuesday, 5 April 2022

RBA Board Meeting

Odds Shorten for a Hike as Soon as June

- **The cash rate was unchanged at 0.10%, as widely expected.**
- **There were critical changes to the Reserve Bank's statement, including dropping the word "patient", which sow the seeds for a rate hike in the coming months.**
- **The next inflation and wages reports, due later this month and in May, respectively, will be important in determining the timing of the next move.**
- **Rate hikes are coming soon. It is just a question of when. Today's statement suggests the odds have shortened on a rate hike occurring as soon as June.**
- **Interest-rate markets have moved to price in a cash rate at the end of this year of nearly 2%.**

The cash rate was left on hold at 0.10% as widely expected. However, the Reserve Bank (RBA) made several critical changes to the statement which point to a rate hike in the coming months.

The changes in tone suggest the RBA is sowing the seeds for a rate hike in coming months, and possibly as soon as June. Our house view remains August, but the odds of a rate hike as soon as June have shortened significantly, making June a close call.

The last paragraph is always the most important of the statement and in the last paragraph there were four key changes. It is the last paragraph where the most critical changes were made.

First, the word "patient" was dropped. Previously, the RBA repeatedly pledged patience around raising rates. It especially wanted further evidence of a pick-up in wages growth to be assured inflation would be sustained in its 2-3% per annum target band. Additionally, the RBA no longer stated that it is "too early to conclude" that inflation is sustainably within the band. Instead, it said that inflation has picked up and that a further increase is expected.

Second, the RBA dropped the sentence "there are uncertainties about how persistent the pick-up in inflation will be", suggesting perhaps it's more convinced about the upward trajectory of inflation.

Third, the three new words "over coming months" sends an important signal around the possible timing of the first rate hike in this cycle. The RBA underscored that "over coming months, important additional evidence will be available to the Board on both inflation and the evolution of labour costs… the Board will assess this and other incoming information as it sets policy…" These new sentences are a nod to the fact that a rate hike is coming soon – it will only be a matter of months – but the RBA still wants to see more data. We anticipate the RBA wants to see another consumer prices report (April 27) and wage price index (WPI) report (May 18).

Finally, the RBA dropped the reference to being "committed to maintaining highly supportive monetary conditions", further indicating that a change in these highly accommodative settings is on the horizon.

In beginning a rate-hike cycle, developments in the labour market and with wages remain top of mind. Over recent months, the RBA acknowledged it was considering broader measures of wages than just the WPI. These 'broader measures' such as bonuses are more responsive to changing conditions and are expected to identify a pick-up in wages earlier than the WPI. The WPI is typically slow to respond to changes in economic conditions, due to the inertia that exists within enterprise bargaining and award wage setting practices. However, the WPI would still be a key measure in the RBA's consideration of the whole wages picture.

On wages, the RBA made a key tweak and said there are "some areas where larger wage increases are occurring". In addition, and more importantly, the RBA tweaked its outlook on wages to state "a further pick-up in aggregate wages growth and broader measures of labour costs is in prospect". The words "in prospect" are stronger language than in the previous statement.

We expect the WPI to lift to 2.5% in Q1 and rise to nearly 3% in Q2 of this year. There is evidence of bonus payments increasing, and retention payments and jobs turnover are also rising. Amid a 13½-year low in the unemployment rate, an economy growing at a solid clip and elevated inflation pressures, the RBA risks waiting too long to raise rates.

Underlying inflation is already in the top half of the RBA's band. We expect it will move above the band when data for Q1 is released later this month. The RBA continues to expect a further lift in inflation over coming quarters and has added that "rising prices are putting pressure on household budgets".

This is a central bank with not a lot of wiggle room to wait in raising rates, given commodity prices are elevated and global-supply chain disruptions are ongoing.

The US Federal Reserve meets next month and the outcome of that meeting could also be important for the RBA. There are rising risks the Fed will hike by 50 basis points. Such a move could make the RBA feel more comfortable about moving as soon as June, given the implications for the Australian dollar.

The AUD/USD jumped sharply in the wake of the RBA's statement, from around 0.7540 just before its release to a high of 0.7626 at the time of writing this report. The level of 0.7610 was a key resistance level for the AUD/USD; the clean break above it suggests the AUD/USD rally has now resumed.

The Australian 3-year swap yield rose from around 2.55% to a high of 2.74% before edging back slightly. The lift in this key benchmark reflects the market shortening its odds of a rate hike sooner rather than later. At the time of writing, cash-rate futures remain fully priced for the first rate hike to occur in June and now have a cash rate at the end of the year of nearly 2% priced in.

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