Interest Rate Outlook

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RBA Board Meeting Minutes

August Forecasts Key To Future Decisions

- **The Reserve Bank (RBA) Board left the cash rate unchanged at 4.10% at its July meeting. Rapid increases in the cash rate to date and downside risks to economic growth tipped the scales towards a pause, but inflation risks and the case for additional tightening remain.**
- **Uncertainty around the economic and inflation outlook is high. The Board took the view to pause and wait for additional data before making another decision on whether additional monetary policy tightening is required.**
- **The economy is slowing, and the RBA Board clearly acknowledged there was a risk that growth could be weaker than forecast given that policy was clearly restrictive at the prevailing cash rate. References to traversing a "narrow path" were removed, suggesting the Board thinks the probability of downside risks to growth has increased compared to previous months.**
- **The Board will receive updates of key information ahead of the August meeting. The most important of these will be a full set of updated economic forecasts from the RBA staff in the August Statement on Monetary Policy (SoMP). This will show whether the Board's intended path of returning inflation to the top of the 2-3% target band by mid-2025 remains intact.**
- **Other key releases ahead of the August Board meeting include the June quarter inflation report, and updates on the labour market and consumer spending.**
- **In our view, the data to date and our forecasts suggest that further hikes are needed to get inflation sustainably down to the 2-3% band in a reasonable timeframe and guard against risks of inflation expectations rising.**
- **The balance the Board places on its objectives of maintaining price stability and full employment remains key. The updated forecasts from the August SoMP are likely to be the deciding factor on where this balance lands.**

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

Going into the July meeting, economists were split over whether the RBA would hike or keep the cash rate unchanged. 14 of 27 economists survey by Bloomberg expected a pause, and the remaining 13 expected a 25-basis-point hike.

As with recent meetings, the Board discussed two options: "increasing the cash rate by a further 25 basis points; or holding the cash rate unchanged." This wording was broadly unchanged from the June meeting minutes. However, the result was different this time around following the Board's deliberations.

Pausing to gather more information

The minutes noted that inflation remained too high, and it was "currently not expected to return to the top of the target range until mid-2025" (emphasis added). The RBA updates their economic forecasts on a quarterly basis in the Statement of Monetary Policy (SoMP). The next SoMP is due in August and the Board will have the benefit of an updated set of forecasts at that meeting.

The decision statement in July noted that the Board would be looking at the "forecasts for inflation and the labour market" going forward. The minutes confirmed the Board would like to see these updated inflation and economic forecasts, the latest suite of economic data releases, and "a revised assessment of the risks" before deciding whether additional hikes are needed.

Case for a pause stronger

The minutes suggest the Board placed more weight on the downside risks to economic growth at the July meeting versus the June meeting, which emphasised the upside risks to inflation.

It was noted that the cash rate had already risen rapidly and that "the stance of monetary policy was clearly restrictive at the prevailing cash rate". The RBA points to the inversion of the yield curve as an indicator of policy being restrictive. An inverted yield curve suggests that the market expected the cash rate to be higher in the near term than it would be over the longer term, consistent with a contractionary monetary policy stance. Mortgage interest payments were already around record highs and would rise further as the stock of fixed rate loans rolls onto higher rates and previous cash rate hikes are passed through.

The economy is slowing and there was a risk growth could be weaker than forecast. Following the July decision, we flagged that it was notable that the Governor's statement removed any references to keeping the economy on an "even keel" or being on a "narrow path". This was echoed in the minutes, as references to traversing a "narrow path" were removed. This suggests the Board thinks the probability of downside risks to growth eventuating has increased compared to previous months.

The minutes flag that: "The Board recognised the strength of both sets of arguments but judged that the case to hold the cash rate unchanged at this meeting was the stronger one." This differs from the previous meeting, where the arguments were "finely balanced". This implies that perhaps the decision at the July meeting wasn't quite as finely balanced as the June meeting, and that the bar for further hikes may have been lifted.

Ultimately, the large degree of uncertainty and the significant cash rate hikes to date were viewed as strong reasons to support a pause at the meeting, to gather more information and review the case for further hikes at the August meeting.

Upside risks to inflation still exist

While there is uncertainty around the economic outlook, the upside risks to inflation remain and there is also uncertainty around how quickly and sustainably inflation will subside. The Board is aware of this and flagged that the case for further hiking "centred on the observations that inflation was forecast to remain above target for an extended period and there was a risk that this timeframe would be extended without further monetary policy tightening".

Services inflation continues to be flagged as an area to watch, as does weak productivity and elevated unit labour costs. The impact of surging electricity prices, and the continued tight labour market, which has only showed early signs of easing, were also noted.

Evidence of sticky inflation overseas and the risk of this happening here remains on the radar, as does the fact that policy rates in Australia are lower than comparable countries.

Outlook

The minutes noted that "Members agreed that some further tightening of monetary policy may be required to bring inflation back to target within a reasonable timeframe, but that this depended on how the economy and inflation evolve."

Words suggesting that additional hiking may be necessary have been a feature of most meeting minutes for some time. However, in June, these words were surprisingly removed. The reinsertion of these words in July adds weight to views that the hiking cycle is not necessarily finished. The minutes also confirmed the Board would like to wait for updated forecasts for inflation and the economy before deciding whether additional hikes are necessary.

In our view, the data to date and our forecasts suggest that further hikes are needed to get inflation sustainably down to the 2-3% band in a reasonable timeframe and guard against risks of inflation expectations rising. This is expected to place a toll on the economy and we predict growth to be very weak in 2023 and 2024.

The balance the Board places on its objectives of maintaining price stability and full employment remains key. The updated forecasts from the August SoMP are likely to be the deciding factor on where this balance lands. Other key releases ahead of the August Board meeting include the June quarter inflation report, and updates on the labour market and retail spending.

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