Tuesday, 5 September 2023

RBA Board Meeting

Lowe's Job Done – Next Move Cuts in '24

- **The Reserve Bank (RBA) Board left the cash rate unchanged at an 11-year high of 4.10% today for the third straight month.**
- **Philip Lowe goes out in his last Board meeting as Governor with the rate-hiking job done. The RBA has now paused in 4 of its last 6 meetings, including today's meeting, providing more evidence that the cash rate may now be at its peak.**
- **Whilst we are of the core view that the cash rate has peaked and rate cuts will start in the second half of next year, the RBA is unlikely to drop its warning around the possibility of further tightening. It cannot afford to drop the tough talk whilst inflation remains high.**
- **The RBA's accompanying statement and its changes from the previous statement were mostly unremarkable in nature with a few key exceptions. These exceptions centred on inflation, the labour market and China.**
- **On inflation, the tweaks to the language suggest the RBA is more convinced inflation has peaked and is declining, although it flags inflation will stay high for some time yet. The RBA still appears on alert for sticky services inflation.**
- **On the labour market, the RBA watered down the description of the labour market from "very tight" to "tight", perhaps also an implicit suggestion that wages growth is nearing its peak.**
- **Finally, there was the insertion of the uncertainty clouding the outlook globally coming from China and the ongoing stresses in its property market. This presents a downside risk to Australia's growth outlook and, ultimately, inflation outlook, as growth and inflation are irrevocably tied.**

Today's meeting marks the last board meeting for Philip Lowe as Reserve Bank Governor. Michele Bullock will be the Governor at the time of the next Board meeting on 3 October.

As widely anticipated, the cash rate stayed on hold at an 11-year high of 4.10%, marking the third consecutive month of no move. The RBA has now paused in four of its last six meetings, including today's meeting, providing more evidence that we may well now be at a peak. We see the timing of rate cuts as the second half of next year.

The RBA's accompanying statement and its changes from the previous statement were mostly unremarkable in nature with a few key exceptions. The key changes are around inflation, the labour market and China and reinforce our view that the cash rate has peaked.

The tweaks to the language around inflation appear to strengthen the case that inflation has peaked and is declining, although the RBA has continued to point out that "inflation is still too high" and added "it will remain so for some time yet". The RBA calls out the risks around services inflation by stating that the prices of many services are rising briskly. Moreover, the statement continues to reiterate that services price inflation has been surprisingly persistent overseas and flagging the same could occur in Australia. It is clear, the RBA remains on high alert for possible stickiness in inflation relating to the prices of services.

On the labour market, the language used to characterise the labour market has been watered down from "very tight" to "tight", reflecting we think the decline in job vacancies and ads, and the recent pick up in the unemployment rate to 3.7% in July, from 3.4% in June. The slight change in language may also implicitly suggest (quarterly) wages growth is at or nearing a peak, once the Fair Work Commission's 2023-24 award and minimum wage decision flow through into pay packets in the September quarter.

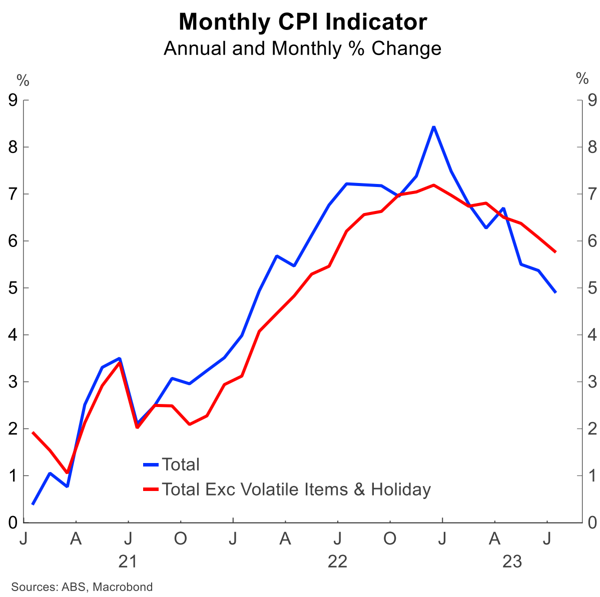
The third key change is the insertion of increased uncertainty globally around the outlook for the Chinese economy due to ongoing stresses in the property market. It follows fresh developments with Evergrande and China's largest private property developer, Country Garden.

China is experiencing its longest property downcycle in history after the liquidity crisis in the sector began to unfold in the second half of 2021. The dust has not yet settled on China's property market and the property market is likely to continue to be a brake on the pace of growth that can be achieved in the economy.

Lowe leaves the Reserve Bank as Governor with the economy still on its narrow path. Whilst the RBA statement avoided using the precise words "narrow path", it certainly described the narrow path: inflation coming down, the labour market staying strong, the economy operating at a high level of capacity utilisation and growth having slowed.

It leaves us with the idea that the RBA remains intent on sticking to this narrow path by trying to finagle a slowdown in inflation to the target band whilst keeping growth away from a hard landing through sustaining gains in the labour market.

Whilst we are of the view that the cash rate has peaked and the next move will be down, we are also of the view that the RBA will not be dropping its tough talk around possible further tightening any time soon. It cannot afford to drop the tough talk whilst inflation remains elevated and well above the band, even if the trend is heading the right way now – down! And so, the final statement, maintained a mild tightening bias, that is, it said "some further tightening of monetary policy may be required'. The data and the evolving assessment of risks will remain critical to the policy outlook.



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