RBA Observer Update

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Economics

Pivot delivered, with a 25bp hike

Australia

- The RBA lifted its cash rate by 25bp to 2.60% (our central case, but not consensus), which was a pivot from its previous four 'super-sized' 50bp hikes
- The RBA is seeking to deliver both lower inflation and a soft landing for growth, with these dual priorities motivating today's pivot to a smaller hike
- The statement noted that more hikes are likely and we expect 25bp moves at the next two meetings to 3.10%, and then see the cash rate held steady

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Facts

- The RBA lifted its cash rate by 25bp (as expected by 7 of 28 economists in the Bloomberg survey, including HSBC).

Implications

The RBA surprised the market today with a smaller-than-expected cash rate move, driving large moves in bond market pricing and the currency. The RBA's decision reflects that it sees the balance of risks around its key challenges as a little different to many other central banks at present.

Many others have turned very hawkish recently, having shifted to an almost 'one-eyed' focus on getting inflation down. Others are facing pressure to 'follow the Fed'. The RBA is, to some degree, mapping its own pathway. As today's decision reminded us, the RBA is hoping it can keep the economy on a 'even keel' and traverse what it describes as a 'narrow pathway' of bringing inflation back to target, while avoiding an economic recession. Clearly this is the goal for other central bank's too, but for some the pathway may have become too narrow to traverse.

Australia may be able to achieve this, because some aspects of the economic story are a bit different, at least at this stage. This includes that wages growth is still picking up more slowly in Australia than in many other advanced economies, as the RBA noted today. The later arrival of the inflationary impulse to Australia -- it arrived in 2022, rather than 2021 -- has also meant it has had less time embed itself in inflation expectations. And, the global downturn that is now underway may deliver a disinflationary impulse at just the right time -- Australia may get a little lucky on the timing of the inflation outbreak.

Another aspect that may influence the RBA's approach is that it has had 'flexible inflation targeting' from the beginning of the inflation targeting regime in 1993. This may make it a bit more comfortable than other central banks to accept an extended period of above target inflation, as long as it deems that inflation is headed in the right direction. Today's statement reminded us that the RBA's forecast is for inflation to be 7.75% over 2022, falling to 'a little above 4%' over 2023 and around 3% in 2024.

This strategy is not without risks, but it appears to be the approach the RBA is taking at this stage.

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Today's decision also acknowledged that, having increased the cash rate 'substantially in a short period of time' the board slowed the pace of hikes in part to 'assess' their impact on the inflation and growth outlook (which we have highlighted in previous notes). And that there was considerable uncertainty across many dimensions, including the outlook for the global economy and about the local monetary transmission mechanism.

Finally, as the statement noted, 'the board expects to increase interest rates further over the period ahead'. We agree that further rate rises are likely. Our central case is for 25bp moves at each of the November and December board meetings, taking the cash rate to 3.1%, before we expect the cash rate to be held steady.

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