

# Why it's getting harder to dismiss the possibility of rate hikes in Australia

Sticky inflation means the Reserve Bank of Australia will struggle to justify rate cuts this year – indeed, the chance of a further increase in rates is growing



Inflation's not only proving sticky in Australia, it's actually on the rise again - and we're not convinced the path to getting it fully under control is going to be smooth sailing

## After a good start, inflation is now going back up

Much like the Federal Reserve, expectations for easing from the Reserve Bank of Australia (RBA) were strong at the beginning of this year. But after an initially impressive decline from the 8.4% year-on-year December 2022 peak, progress in getting inflation lower has ground to a halt and even reversed in recent months. As it has done so, market expectations for rate cuts have evaporated.

Following the latest set of inflation data for April – where the CPI index rose 0.7% month-on-month, lifting the inflation rate from 3.5% to 3.6% YoY – we also bit the bullet and chopped out our last remaining rate cut forecast for 2024.

What has concerned us is the lack of any apparent slowdown in the run-rate for inflation in Australia, without which any prospect of inflation dropping back within the RBA's 2-3% target range looks elusive. A reasonable question is, did the RBA ever raise rates far enough to bring inflation back to target? At 4.35%, Australia's cash rate target is more than 100bp lower than the equivalent US rate. While at its peak, Australian inflation was not much lower than that in the US

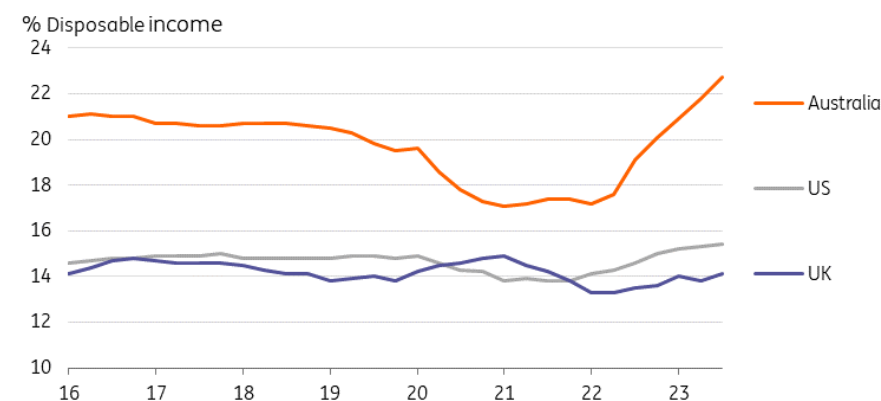
(US inflation peaked at 9.1% YoY in June 2022).

## The arguments for a lower peak rate in Australia are good...

Differences in the mortgage structure between the US and Australia (in particular, shorter fixed-rate mortgage products) may mean that Australian households have less insulation against policy rate hikes than their US counterparts. If so, that should show up as a larger increase in debt service costs, justifying lower peak policy rates.

This is certainly confirmed by evidence from the Bank for International Settlements (BIS), which shows a much sharper rise in debt service costs for Australian households than either their US or UK counterparts. It is also reflected in a much weaker profile for Australian household spending in GDP data since rates started to go up than in the US, where consumer spending has been the bulwark of GDP growth until recently.

### Debt service costs (% disposable incomes)



### ... but inflation is still rising

Still, despite weaker growth, Australian inflation is not only sticky, but rising again. The CPI price level increases in the last three months have averaged more than 0.5% MoM – more than twice what is needed to bring inflation back within the RBA's target. May data could get some help from lower crude oil and retail gasoline prices, which could weigh on the price level. But the May 2023 price level change was -0.4% MoM, and undershooting that is going to be very hard. So a further increase in inflation next month looks possible even with lower oil prices.

With little evidence that the momentum of CPI is slowing enough, or even at all, whatever the debt service data and household spending show, it is becoming harder and harder to dismiss the possibility that rates in Australia may not have peaked after all.

We removed the final rate cut from our 2024 forecast this month. A further increase in inflation next month may force us to consider adding in an additional rate hike and pushing back the start date of the easing cycle much later into 2025.

In fairness to the RBA, it has been clear that it did not see inflation returning to target until later in 2025. Nevertheless, even with a very slow adjustment to target, you'd be hard pressed to argue that the central bank will be content seeing inflation moving higher for much longer.

## Author

### Robert Carnell

Regional Head of Research, Asia-Pacific

[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).