

Australia: Reserve Bank surprises with 25bp hike

Despite falling inflation, Reserve Bank of Australia (RBA) Governor Philip Lowe justified the latest hike by saying it would take time to bring inflation down and hinted that more hikes might be necessary



Reserve Bank of Australia Governor Philip Lowe

Source: Shutterstock

3.85%

Cash rate

Hiked by 25bp

Higher than expected

The 'pause to assess' seems to have ignored the improvement in inflation

At its previous meeting in April, the RBA left rates unchanged "...to provide additional time to assess the impact of the increase in interest rates to date and the economic outlook..." In our view, the most relevant data since then was the March inflation print, which showed annual inflation

dropping to 6.3% year-on-year, well below the 8.4% December peak. We anticipate further quite rapid declines in inflation over the coming months, as high base effects from last year drop out, and as the boost to inflation from rents subsides as it has already started doing. That said, the April inflation data might drift sideways before the next leg down recommences.

Meanwhile, the rate of wage-price increases remains very benign at 3.3%YoY, and the latest statement's reference to "...unit labour costs are also rising briskly, with productivity growth remaining subdued" seems to be confusing the cyclical slowdown in growth and its negative impact on productivity (which is simply a residual of growth and labour inputs) with something that is structurally inflationary, which we don't believe is the case.

Governor Lowe has a very different perspective to us, and also it appears to the majority of other forecasters who were also looking for no change in rates at this meeting. The accompanying statement that came alongside the RBA's decision says of its forecasts that "...it takes a couple of years before inflation returns to the top of the target range; inflation is expected to be 4.5% in 2023 and 3% in mid-2025". We would be very surprised if it took anything like this long. History will show whether we or Lowe are right, and in our view, sooner than the RBA might imagine.

Australian CPI inflation and ING forecasts



Source: CEIC, ING

Forward guidance lacks consistency

Not only did today's hike take markets by surprise, but the comment that "...some further tightening of monetary policy may be required to ensure that inflation returns to target in a reasonable timeframe", also seems to be at odds with the decision to change to that wording at the March meeting, downgrading the previous wording from "...further increases in interest rates will be needed over the months ahead". At the time, this change was widely understood to mean that from multiple anticipated hikes, only one more hike was then expected. Now we have had that one, but it still sounds as if the RBA is looking to deliver more, despite progress on inflation. It certainly feels as if whatever message the RBA is trying to convey, it isn't getting it across very effectively.

Markets had to do quite a lot of adjusting to take on board the RBA's shock decision. The Australian

dollar (AUD) shot back up over 67 cents and 2Y Australian government bond yields rose more than 26bp with a smaller 13.7bp rise in 10Y government bonds.

What to do with our forecasts?

We had been on the verge of reducing our previous cash rate forecast peak rate from 3.85% to 3.6%. But following today's decision, we will no longer need to do so. The question remains, should we push this higher to 4.1% or above?

Our inclination right now is not to do so. This latest hike didn't look necessary to us in order to bring inflation down, and the forward guidance contained in the latest statement is also not particularly convincing. Like the RBA, we will watch the data before making any further decisions. And the April inflation print might not be too helpful to our case – we expect it may go sideways in year-on-year terms before moving lower again thereafter.

But beyond the very short-term, our base expectation remains that the rate hikes that have already been implemented will be enough to continue to deliver progress on inflation. And if we get more, then it reduces the chances of achieving a soft landing, and we may begin to see that reflected in lower longer tenor bond yields if the RBA follows through on its latest hawkish guidance.

Author

Robert Carnell

Regional Head of Research, Asia-Pacific
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 <http://www.ing.com>.