

## 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

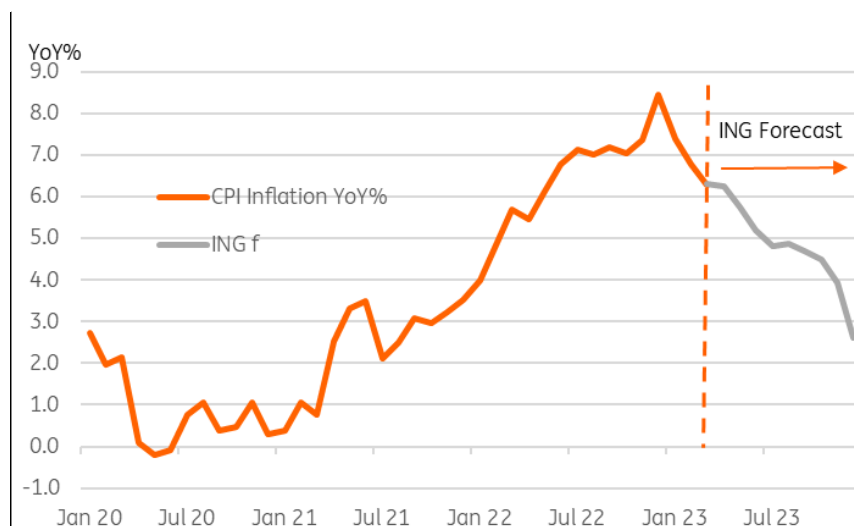
At its previous meeting in April, the RBA left rates unchanged "...to provide additional time to assess the impact of the increase in interest rates to date and the economic outlook..." In our view, the most relevant data since then was the March inflation print, which showed annual inflation

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.

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