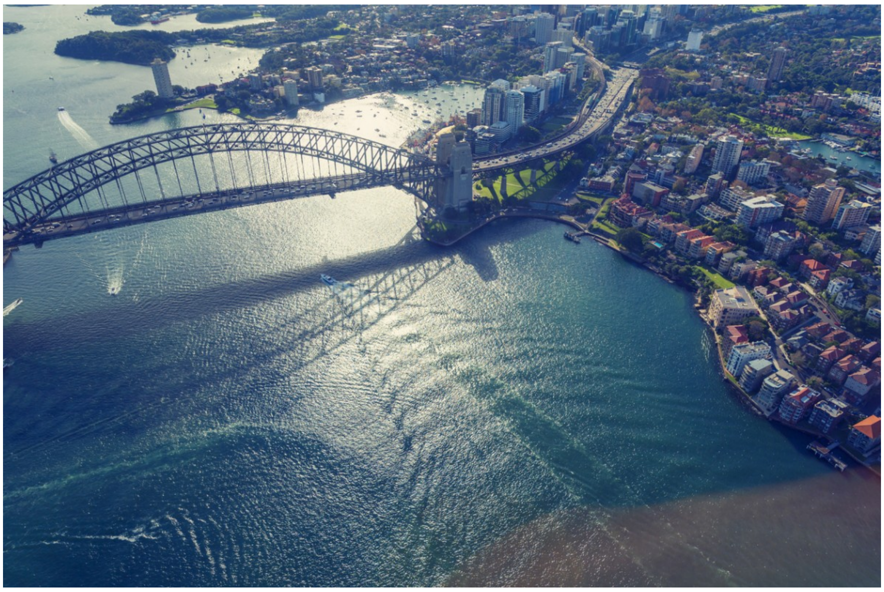
Australian 2Q19 CPI takes pressure off Reserve Bank

Despite recent dovish remarks from Reserve Bank (RBA) Governor Lowe, the improved CPI figures for 2Q19 take the pressure off any need for an imminent follow-up to recent back-to-back easing.



1.6%YoY

2Q19 inflation

Up from 1.3% in 1Q19

Higher than expected

Higher inflation, but still way below target

Australia's Central Bank (the Reserve Bank, RBA) has a tougher job than most central banks around the world, given that it targets an inflation range with a mid-point half a percentage point above most other developed-market central bank inflation targets .

So today's rise in the headline inflation rate to 1.6% in 2Q19, represents a welcome directional shift given the steep drop to 1.3% in 1Q19, but leaves a still substantial gulf to be filled to get inflation closer to the medium-term target.

RBA outlook - nothing for now

So what does this mean for RBA policy?

In the short term, it means that the back-to-back cuts, with the most recent at this July's meeting, are probably enough for now. The government's tax cut package passed parliament this month too, which will deliver a tax rebate of AUD255 to AUD1,080 for many earners on tax returns now being filed. That should provide a lift to spending, and hopefully, in time, employment, wages and inflation. That said, these transmission channels are a lot weaker than they used to be, so the full extent of the outcome remains uncertain.

The RBA has not been silent on its view that fiscal policy needs to do its share of the heavy lifting to bring economic growth, employment and inflation back to a more reasonable path, and whilst it waits to see how this pans out, there seems little prospect that the RBA will need to provide any further monetary stimulus.

Longer term - possibly another cut

We still have a further cut penciled in for 4Q19. This isn't a particularly strong conviction call, especially in terms of the timing. But recent dovish comments by Governor Lowe indicate that the RBA may not have quite finished its easing yet. While we wait for the impact of the earlier monetary easing and the forthcoming tax rebates, we will retain a cautious outlook for policy, though it may be that we end up shifting this cut back into 2020, or even removing it entirely if the economic backdrop improves sufficiently.

Markets are still fully pricing in a further rate cut by the year-end, with a further cut of the cash rate to 0.5% partly priced in. This sounds too much for us.

Author

Robert Carnell
Regional Head of Research, Asia-Pacific
robert.carnell@asia.ing.com