

RBA hikes rates - market reaction is curious

Although the RBA hike was expected by the majority of the forecast community, markets were not completely sold on the idea, which is why it is curious that the AUD weakened on the decision and that bond yields fell



4.35%

RBA Cash rate target

up 25bp

As expected

RBA hikes but AUD softens

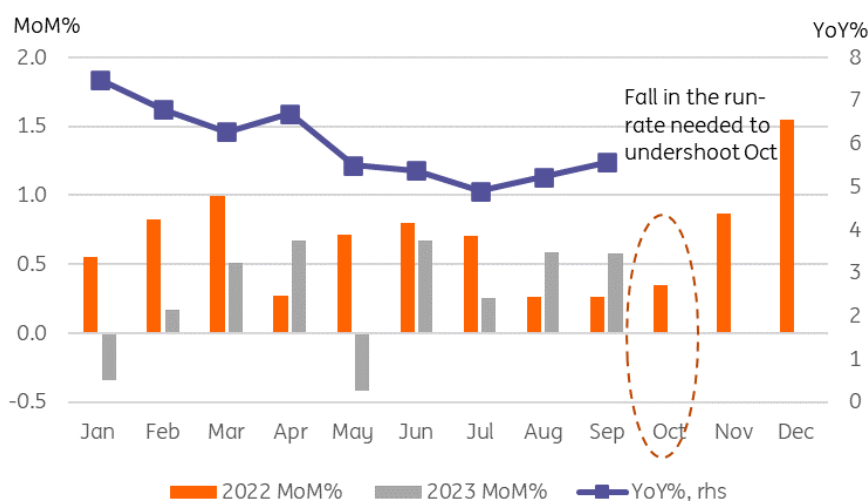
It was no surprise that the RBA hiked the cash rate by 25bp today. Only three of the Bloomberg consensus expected the RBA to hold rates steady today. We were not among them. However, the market pricing was more circumspect, with only about a 59% probability of a hike priced in to today's meeting.

All of which makes the subsequent market reaction quite strange.

The AUD made a very brief run stronger on the announcement, but almost immediately fell back, dropping to about 0.643 from about 0.652 prior to the announcement.

Australian government bond yields also declined. 10Y government bond yields fell from about 4.76% to 4.70% and yields on 2Y government bonds fell from 4.37% to 4.31%. There was a slight decline in US Treasury yields at the same time, which may have influenced things, but it isn't a particularly satisfactory explanation.

Inflation may not have stopped rising yet



Source: CEIC, ING

RBA statement was reasonably hawkish

This market reaction cannot either be put down to [the accompanying statement by the RBA](#), which in our view leaned in a hawkish direction. The justification the RBA gave for today's hike was the slow progress being made towards their target inflation range, the arrival at which was put back to late 2025. The RBA also judged that the weight of information received since the previous meeting raised the chances that inflation would remain higher for longer.

The RBA's statement also kept the door open to the possibility of further hikes, saying that *"Whether further tightening of monetary policy is required to ensure that inflation returns to target in a reasonable timeframe will depend upon the data and the evolving assessment of risks"*.

Thanks to base effects, next month's inflation data will probably show another increase (see chart above). However, we don't think the RBA will respond again so soon if inflation does indeed rise. After that, when the November and December figures are released, absent the floods and energy shortages of last year, we should see inflation resume its downward trend, which may be enough to cement the view that this was the last hike this cycle after all.

The risk to this view comes from the current run rate for inflation. For the last 2 months, the CPI index has risen by 0.6% MoM. This isn't consistent with an inflation rate between 2-3% but rather one closer to 7%. So this also needs to slow down considerably over the coming months. If it doesn't, then instead of the rate cuts that we expect could be on the radar by mid-2024, we might

still be looking at some further tightening before we can call this rate cycle truly over. As the RBA notes in their statement, "*There are still significant uncertainties around the outlook*".

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