

Reserve Bank of Australia makes room for adjustment

The latest statement from the Reserve Bank of Australia leaves the date of the forward guidance on the first hike in the cash rate unchanged at 2024. But it looks as if they are preparing the ground for an adjustment to this guidance and other policies to bring them more into line with Australia's strong economic fundamentals



Cut to the chase

Perhaps the most important part of this RBA statement is always contained in the last paragraph, which this time states. *"It (the RBA) will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. The Bank's central scenario for the economy is that this condition will not be met before 2024. Meeting it will require the labour market to be tight enough to generate wages growth that is materially higher than it is currently".*

This tells us a couple of things. One is that, unlike the US Federal Reserve, there has not yet been any clear change in the Reserve Bank of Australia's commitment to keeping the cash rate unchanged until 2024. However, the small details matter. The new forward guidance has lost the additional qualifier "at the earliest." It has also added the caveat that this is dependent on the "central scenario" being met. That was not present in the June statement. Both provide some

wiggle room.

We also get confirmation that it is changes in the labour market that are going to be pivotal to any future changes in policy. So we know what data we need to scrutinise. Even though we have known this for a while, this is confirmation.

So one could argue that though the 2024 commitment to an unchanged cash rate remains intact, the commitment is being softened up in preparation for a possible shift forward. Which, given the description of the economy that precedes it, is not at all surprising.

The economy is great - rates on hold?

Indeed, this commitment to keeping the cash rate on hold until 2024 looks increasingly strained relative to the description of the economy that the RBA provided earlier in its statement.

For example:

- *"The economic recovery in Australia is stronger than earlier expected and is forecast to continue".*
- *"The outlook for investment has improved and household and business balance sheets are generally in good shape"*
- *"National income is also being supported by the high prices for commodity exports."*
- *"The labour market has continued to recover faster than expected."*
- *"...more Australians have jobs than before the pandemic"*

The fact that wage and inflation outcomes remain "subdued" is also at least partly a function of the fact that this quarterly data comes out with a considerable lag. We don't get any new wages data for 2Q21 until 18 August, though CPI for 2Q21 is released a bit earlier on 28 July. Current justifications are being made with reference to some fairly dated figures.

Other decisions today

As flagged at the June meeting, the RBA made a decision on which bond to target with its 3Y yield curve control policy, and it has stuck to the April 2024 issue. This is in line with our prior thinking. You certainly wouldn't target a longer-dated issue if you were seriously considering shifting your first cash rate hike forward, conceivably to 2023. That would make it very hard to control. The rate for the yield curve control target was left at 0.1%. We were told that last month - this was never in doubt.

The RBA has also been quite clever with its asset purchase targets. Whereas previous policies aimed to purchase AUD100bn over a six month period, the latest plan to purchase AUD4bn per week represents about the same pace, though allows for a near-term adjustment at the November meeting.

Conclusion - markets being prepared for a shift to 2023 guidance - they are already there

Taking all of these small changes together, it looks to us as if the market is being softened up to accept a change in guidance on the cash rate at forthcoming meetings to a first hike during 2023, not 2024. If so, then the market was pretty much there already. It is also being conditioned to

accept an incremental lowering of the asset purchase pace over coming quarters. We could imagine an AUD3bn per week target in November, reducing to an AUD2bn target in February and so on.

Implied rates on the 3m bank bill future were at 0.95% on the December 2023 contract yesterday. They have risen only to 0.98% today following this statement. Consequently, we suspect any boost to the AUD or to Australian longer-dated bond yields that this statement will provide will be fairly modest.

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