Reserve Bank of Australia raises rates again

Australia's Reserve Bank raised its cash rate target a further 50bp to 2.35% at its meeting today. Rates may now increase at a slower pace over the remainder of the year, and AUD may struggle to recover amid external challenges

The Reserve Bank of Australia today hiked rates by 50bp

2.35%

Cash rate target

+50bp

As expected

A hike today was never in doubt

Today's 50bp hike in the cash rate target to 2.35% was comfortably the median expectation of forecasting analysts, though there were still a few who thought the Reserve Bank of Australia (RBA) might deliver a smaller 25bp hike. The logic for the smaller rate hike view stemmed from the language in the previous meeting's statement that there was no predetermined path for rates, though as it turned out, while that is probably true, it was not code to indicate a slowdown in the pace of tightening.

Now what?

But now we are at 2.35%, which by some reckoning is close to a "neutral" rate that neither stimulates nor restricts the economy, there is a greater chance that rates may now continue to be raised at a slower pace.

The latest statement to accompany today's decision repeats much of the text from the pivotal paragraph from August's meeting on future rate decisions. Namely: "The Board expects to increase interest rates further over the months ahead, but it is not on a pre-set path. The size and timing of future interest rate increases will be guided by the incoming data and the Board's assessment of the outlook for inflation and the labour market." This doesn't give much away and is essentially no change from August.

But one factor that may enable the RBA to tighten at a more moderate pace from now on is the fact that unlike some other central banks, such as the US Federal Reserve, the RBA meets monthly, so 25bp hikes at each of the remaining meetings this year will still take policy rates to the lower end of a restrictive setting by the year-end. And given the lags from policy changes to the real economy and inflation, tightening in 25bp increments from now on may be viewed as prudent and limiting the risks of over-tightening and damaging the economy unnecessarily. Such an approach would give more time for the economy to show signs that it is beginning to respond to the RBA's tightening "medicine", though of course, if the economy and inflation do not respond satisfactorily, there is nothing to stop further 50bp hikes.

AUD remains vulnerable

The RBA policy has not been a major driver of AUD moves since the start of the year and today's quite muted reaction to the 50bp rate hike is another case in point. Incidentally, a switch to 25bp rate increases from now on may force some dovish re-pricing in the RBA rate expectation curve.

As external factors – in particular risk sentiment and China's outlook – remain key for the AUD outlook in the near term, downside risks are still quite elevated. Our forecasts for AUD/USD still embed a small recovery by year-end but are mostly justified by USD seasonal weakness in December and any rally may still struggle to go far beyond the 0.70 mark.

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