

## Second-quarter inflation sets up Reserve Bank of Australia for a 50bp hike

Second-quarter CPI rose 1.8% quarter-on-quarter, taking the inflation rate to 6.1% year-on-year. While a steep rise from the first quarter, the RBA has time to respond and doesn't need to speed up the rate of tightening at its coming meeting. The monetary policy channel should continue to be a secondary one for AUD/USD, as external drivers remain dominant



Governor of the Reserve Bank of Australia, Philip Lowe

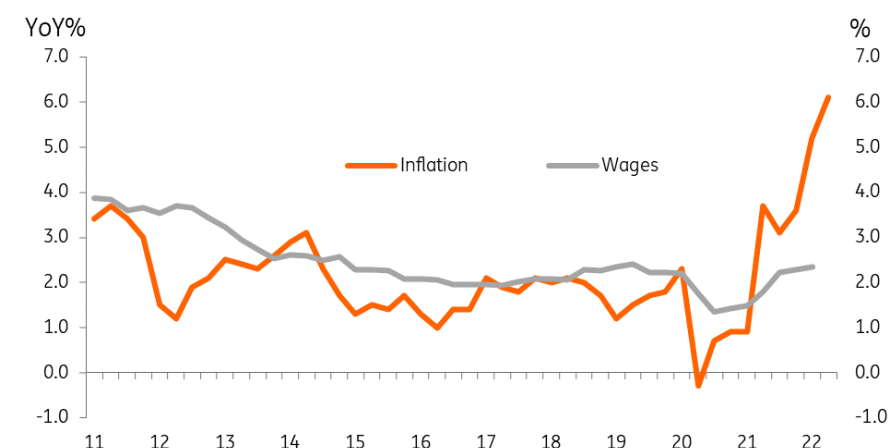
# 6.1%YoY

Headline inflation rate

Up from 5.1%

Lower than expected

## Australia wages and inflation



Source: CEIC, ING

## 50bp or 25bp?

There is no question that the Reserve Bank of Australia (RBA) will hike rates at its meeting next week (2 August). The latest inflation data were the most important set of numbers since the last meeting when it hiked the cash rate by 50bp to 1.35%, and since the last labour report which set a new all-time low in the unemployment rate. The July RBA meeting was considered a 25bp or 50bp choice, and the coming meeting looks like a similar discussion and probably a similar outcome (50bp).

The market is no longer fully pricing in a 50bp rate hike following these inflation figures as it was before the inflation release. The consensus view had been for a slightly higher 1.9% outcome, and now only 44bp of tightening is priced in by futures markets. But as we heard from RBA Governor Philip Lowe at a recent speaking engagement, "[the neutral nominal rate is at least 2½%. It would be higher than this if medium-term inflation expectations were to shift higher](#)". So a 50bp hike next week will still leave the RBA with quite a lot of work to do to get rates even to neutral, and more when you consider that in all likelihood, rates will have to be raised to a moderately restrictive level, so something around 4% or higher. Doing only 25bp raises the prospect that inflation expectations will drift higher, which it doesn't sound as if Governor Lowe is keen to risk.

In the RBA's favour, it meets each month, unlike the US Federal Reserve. So a 50bp hike in August will prime the RBA to consider what additional action is warranted following the 2Q22 Wage Price Index later in August and also following the next set of labour data. A further 50bp in September will take rates to a level close to, but still slightly lower than, neutral (2.35%), and thereafter the RBA might consider that further moves can be done at a more leisurely pace depending on the run of data. So, although all moves are to an extent "data dependent", by then there will be much less of a "catch-up" component to the tightening process.

## AUD: RBA still playing a secondary role

The Aussie dollar has been the most resilient G10 currency (along with CAD) to the USD appreciation in the past month, and our short-term fair value model shows that AUD/USD is currently showing no mis-valuation. By comparison, EUR/USD is currently trading around 2% below its fair value.

This means that markets have probably priced out some degree of the risk premium that was previously embedded into AUD and could have been related to fears about China's outlook, and it appears that AUD is now factoring in a more sanguine view on China.

In all this, the RBA continues to play a secondary role for AUD/USD, and we expect any post-announcement reaction on 2 August to prove short-lived and be rapidly out-shadowed by external factors. In the current unstable market environment, risks to the 0.67-0.68 area in the pair remain material, even though our baseline scenario is still a gradual appreciation back above 0.7000 in the fourth quarter.

## Author

**Francesco Pesole**

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).