

Unexpected pause by the RBA but August meeting still in play

The RBA surprised markets by holding the cash rate steady at 3.85%, citing the need for greater confidence in the inflation outlook. Our CPI estimates suggest the August meeting remains live, with a potential rate cut still on the table. AUD/USD jumped on the announcement, but its short-term outlook remains strictly tied to tariff and Fed news



In a surprising decision, the Reserve Bank of Australia held the cash rate steady at 3.85% today, defying both market consensus and our expectations. The vote was split, with six of the nine monetary policy board members supporting the move.

While we had anticipated a rate cut given the recent softness in headline CPI inflation - now aligning more closely with the RBA's 2-3% target - the central bank emphasised the need for further confirmation that "inflation remains on track to reach 2.5% on a sustainable basis."

This outcome appears to reflect a matter of timing rather than a shift in policy direction. The RBA will closely monitor upcoming quarterly inflation and monthly employment data ahead of its next meeting in August. Governor Michele Bullock also flagged concerns around rising costs in home construction and durable goods, which will be key areas to watch in the next CPI release.

We continue to expect a moderation in trimmed CPI inflation in 2Q, keeping the door open for a potential rate cut next month. The RBA also placed particular emphasis on global developments and trade-related risks, and how these may affect domestic conditions - factors that should become clearer by the time of the next meeting.

AUD/USD back to being driven by US factors soon

The Australian dollar jumped on the surprising hold and is trading 0.8% above yesterday's close vs USD. We are, however, quite wary when drawing FX conclusions beyond the very near term after this RBA meeting. Despite a roughly 10bp jump in front-end AUD swap rates, the market's baseline scenario should remain an August cut, followed by at least another cut by year-end, capping the room for more hawkish repricing.

Most importantly, developments in the US should have a much bigger say in where AUD/USD is heading. Should Trump go ahead with a fully fledged re-escalation in trade tensions - which markets are still treating with caution - then USD should bear a bigger brunt than AUD. Australia was hit with only 10% tariffs in April, and China has a separate deal that should keep it insulated from new tariffs in July, making AUD incidentally more shielded than other high-beta currencies. If Trump ultimately de-escalates his tariff threats again, then it will be up to US data to set the tone for AUD/USD. On that, we think AUD/USD risks are more on the downside as we think hot inflation could prompt markets to price out a September cut from the Federal Reserve.

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