Liquid Insight

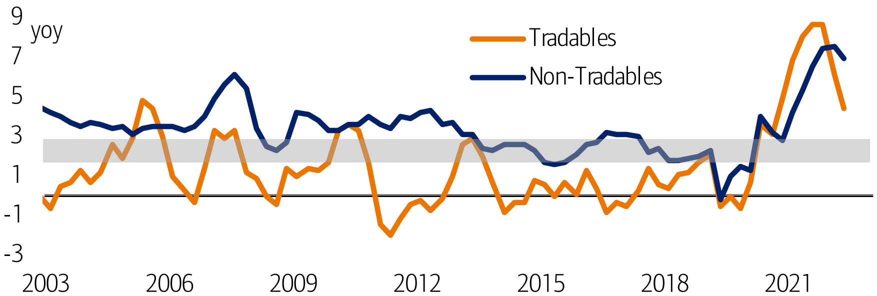
RBA preview: one more hike, just in case

Key takeaways

- We expect one last 25bp RBA hike in August to take the cash rate to 4.35%. Risk is for another pause as 2Q CPI softened.
- The labour market is very tight, inflation is still too far above target and expectations for an extended pause boost housing
- An RBA forecast update is due after the meeting. The Bank aims to reach target by mid-2025. A new Governor takes over in Sep.

By Micaela Fuchila & Adarsh Sinha

Chart of the day: Non-tradables (domestic) inflation is too far above target
Tradables show a clear peak



Source: ABS, Macrobond

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New Governor, terminal rate and new forecasts all in sight

We think one more hike to take the cash rate from 4.1% to 4.35% would be the RBA's best option to continue to provide support to the very resilient labour market as well as ensuring inflation continues to move towards the top of the target. Should our view for a further hike in August materialize, we would expect rates to remain on hold for the rest of the year as the RBA assesses traction from higher rates.

While 2Q CPI data reflected softer than expected outcomes, domestic pressures remain elevated and improved demographics increase uncertainty around the outlook for growth and inflation. Importantly, rent inflation recorderd the largest increase since 1988 and housing activity and prices have picked up as we approach the end of the hiking cylcle. Following the Board meeting, the RBA will provide the last round of forecasts update under Phil Lowe's leadership in the Statement on Monetary Policy (due on Aug 4). We expect modest changes to the growth and labour market assumptions, but focus will be on the inflation measures. The slightly larger decline in CPI in 2Q means the Bank could now reach the top of the target by Dec-24 vs Jun-25.

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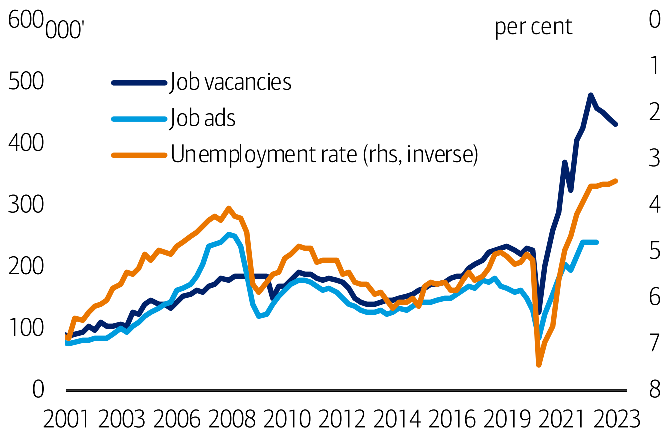
Mixed current conditions make the rate hike a close call

Since the RBA's uncomfortable pause in July, the data has not provided a clear picture of current economic conditions. This has seen increased divergence around economists and the market's views on the outlook for the cash rate. For instance, while economists' consensus has now shifted towards our call for a hike in August, market pricing implies only a 20% chance of further tightening tomorrow.

Price pressures are clearly peaking, though it seems to be driven by tradables as demand-driven inflation remains persistent. The RBA could take the opportunity to pause again on the back of softer inflation outcomes, but we think one slightly softer CPI report will not be enough to gain confidence that inflation and inflation expectations will stabilize at target. See: Australia Economic Watch: CPI review: Softer but persistent 26 July 2023

Labour market data remains strong, with the most recent report showing unemployment at 3.5%, which is a multi-decade low. Indeed, full-time work drove these outcomes. Leading indicators are showing early signs of easing, but not yet a confirmation that the labour market has turned (Exhibit 1).

Exhibit 1: Leading indicators for employment move sideways
Unemployment is ultra low



Source: ABS, Macrobond

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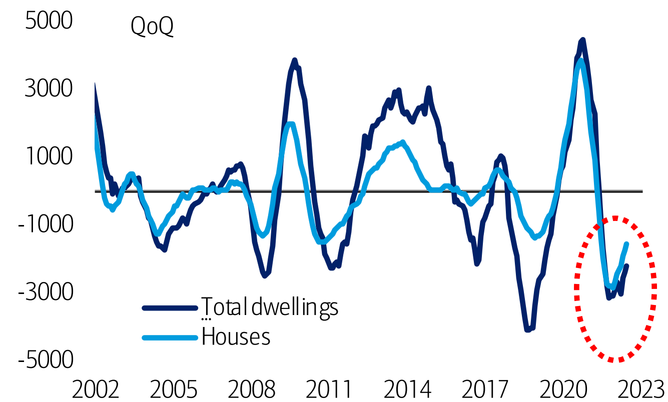
Exhibit 2: Housing activity shows signs of a pick up
As we approach the end of the hiking cycle



Source: ABS, Macrobond

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Economic activity has also been mixed. Consumer spending continues to weaken with a retail sales report that suggests the high cost of living is placing significant pressure on consumers. Though, the volatility of this release makes it difficult to conclude that one soft month (after a strong May) is the beginning of a new trend.

Interestingly, housing conditions have continued to improve lately. House prices have risen over the last five months while leading indicators for future activity in the dwelling sector are starting to rise in response to a slower pace to policy tightening (Exhibit 2). While this is a welcome development from the activity and labour market perspective, financial stability risks could increase.

In our view, there is a case for a pause as well and the RBA Board is likely to consider both scenarios as was the case last month. However, we think there would be a choice to deliver an "insurance hike" before an extended pause as we expect economic conditions to decline further. This will make it difficult to deliver any further tightening later. In our view, guidance is likely to remain on the hawkish side to ensure inflation expectations don't rise materially. Should the RBA choose to pause, we think an opportunity to deliver a hike could be after 3Q CPI data that is expected to print strong due to seasonal factors. See: Australia Economic Watch: CPI preview: Inflation sticks to the peak 20 July 2023.

New forecasts, new Governor, new meeting dates

We have previously discussed the changes to the RBA that are expected from next year along with the new Governor that is due to take over just after the September Board meeting here: [Australia Economic Watch: RBA overhaul long time coming 14 July 2023.]

Following The Australian Government's Review of the Reserve Bank of Australia, the RBA Board will, from next year, meet eight times a year rather than eleven to set monetary policy (Exhibit 3). The Board meetings will be longer, but less frequent to have more time to assess economic conditions in between meetings. Press conferences will follow every monetary policy decision and will complement current communication channels.

August is the second last meeting with Governor Lowe as the leader of the RBA. The Bank will also provide an update to their forecasts and views in the Statement on Monetary Policy. While we do not expect material changes to the forecasts, focus will be on mark-to-market changes to the inflation numbers (**Error! Reference source not found.**). Notably, these changes mean the Bank could reach the top of the target six months earlier than previously anticipated. Indeed, flagging an early than anticipated return to target supports our view that the terminal rate is in sight.

Exhibit 3: New RBA meeting dates
RBA set to meet 8 times a year from 2024

Month	Current	SMP meeting	2024 calendar
Jan			
Feb	x	x	x
Mar	**x**		**x**
Apr	x		
May	x	x	x
Jun	**x**		**x**
Jul	x		
Aug	x	x	x
Sep	**x**		**x**
Oct	x		
Nov	x	x	x
Dec	x		x

Source: ABS, RBA

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Exhibit 4: SMP Forecasts update
Our best guess. Focus on inflation

Year-Ended %	Jun 2023	Dec 2023	June 2024	Dec 2024	Jun 2025	Dec 2025
GDP	1.50	1.00	1.25	1.50	1.75	2.00
May-23	*1.75*	*1.25*	*1.50*	*1.75*	*2.00*	*-*
Unemployment	3.50	3.75	4.00	4.25	4.50	4.50
May-23	*3.50*	*4.00*	*4.25*	*4.50*	*4.50*	*-*
CPI	6.00	4.25	3.25	3.00	3.00	2.75
May-23	*6.25*	*4.50*	*3.50*	*3.25*	*3.00*	*-*
Underlying CPI (Timmed Mean)	5.90	4.50	3.50	3.25	3.00	2.75
May-23	*6.00*	*4.00*	*3.25*	*3.00*	*3.00*	*-*
Wages	3.7	3.50	3.25	3.00	2.75	2.75
May-23	*3.75*	*4.0*	*3.3*	*3.1*	*2.9*	*-*

Source: RBA

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After the August Board meeting

Monthly inflation data for July will be the first gauge for price pressures in 3Q. This is due for release on Aug 31st. Also, an update to wages growth will be out on Aug 15 for 2Q and should reflect public sector rises. Monthly labour force, confidence measures, house prices and credit growth will be closely watched as well as some partial data for 2Q GDP due for release on Sep 6.

AUD: US-China divergence to narrow later this year

The AUD trade weighted index has risen to the stronger end of its multi-year range, recently supported by lower-than-expected US CPI data (weaker USD), raising hope for a soft landing (risk on) and expectations for further policy easing in China (better China sentiment). All seem somewhat premature, in our view – while our year-end forecast of 0.69 is consistent with improvement in China sentiment by year-end, this may take longer to materialize given the lead-lags associated with stimulus. Meanwhile, we retain our broader constructive view on USD.

China's property sector (commodity demand) and service imports (tourism and education) will be the primary channels to watch for Australia. There were signs of green shoots in China's property sector in March, but recent data show deceleration in home sales. That said, home prices continue to rise and property easing measures may support demand in 2H. Meanwhile, a recovery in flight capacity would also boost Australia's service sector over time.

Rate hikes have supported AUD at the margin. At the same time, domestic policy rates remain less restrictive than elsewhere. Australia may have a better chance of avoiding a recession relative to its G10 peers, which should be a medium-term positive, especially when global central banks enter an easing cycle, likely in 2024.

Notable Rates and FX Research

- **Global Rates, FX & EM Year Ahead 2023 –** Year Ahead 2023: Pivot ≠ Peak, 20 Nov 2022

- Don't underestimate central bank commitment to 2% inflation **Global FX Weekly**, 28 July 2023

- Goldilocks and the 3 banks **Global Rates Weekly**, 28 July 2023

- Ahead of major central bank meetings, **Liquid Cross Border Flows**, 24 July 2023

Rates, FX & EM trades for 2023

For a complete list of our open trade recommendations, as well as our trade recommendations closed over the past 12 months, see the reports below:

Global FX Weekly: Don't underestimate central bank commitment to 2% inflation 28 July 2023

Global Rates Weekly: Goldilocks and the 3 banks 28 July 2023

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