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RBA Board Meeting Minutes

Paused But Still Case For Future Hike

- **At its April policy meeting the Reserve Bank (RBA) Board decided to leave the cash rate unchanged, at 3.60%. This was the first pause in 11 meetings. Two options were considered, a 25-basis-point hike, or a pause.**
- **The arguments for a hike included inflation being too high; the labour market being very tight; inflation being sticky overseas; pressures in housing and electricity markets impacting the pace of disinflation; and inflation only being forecast to return to the top of the 2-3% band by mid-2025.**
- **The arguments supporting a pause centred largely on the fact that the cash rate had already been raised by a significant amount in a short space of time and that monetary policy was already restrictive. For example, the minutes noted that home loan repayments as a share of income were forecast to rise to their highest level on record.**
- **The minutes provided some insight on how the RBA may approach policy going forward, stating they would not be comfortable with a return to the target beyond the mid-2025 forecast. This is consistent with comments from the Governor at his Press Club address where he noted a return to target much earlier would put in jeopardy the job gains recorded over the past few years.**
- **The meeting took place after the banking concerns in the US and Europe. Members "agreed that the strength of the Australian banking sector meant that financial system resilience was not a consideration in the decision to pause at this meeting".**
- **The May decision remains a close call. The RBA will be watching key economic data to determine whether to hike or pause again, including developments in the global economy, trends in household spending and the outlook for inflation and the labour market. The March quarter inflation report will likely tip the scales one way or the other.**

At its April policy meeting the RBA Board decided to leave the cash rate unchanged, at 3.60%. This was the first pause in this rapid interest rate hiking cycle in 11 meetings. Today, the minutes from that meeting were released, providing further insights into the RBA's policy deliberations and guidance for future meetings.

The April Board meeting took place after the banking concerns in the US and Europe and following significant changes in expectations for future interest rate hikes from central banks. Importantly, the minutes note that members "agreed that the strength of the Australian banking sector meant that financial system resilience was not a consideration in the decision to pause at this meeting".

Options considered by the RBA Board

In April, the Board considered two options for monetary policy, a 25-basis-point hike, or a pause.

This contrasts with the March meeting, where only a hike was considered.

25 basis point hike

The arguments supporting a further hike were broadly similar to those outlined in minutes from previous meetings, however, there were a few key additions, which included:

An upgrade to near-term projections for population growth, following the record surge in migration over 2022 and 2023. This has placed upward pressure on rents and is likely to flow through to upward pressure on other prices across the economy. Population growth increases both supply and demand, but the interaction of these factors is important. Rapid population growth can place pressure on various goods and services, given many supply-side factors take time to respond, such as housing supply, and are essentially fixed in the short term. The minutes note that "the net effect of a sudden surge in population growth could be somewhat inflationary for a period".

The other factor discussed was an increased risk of stronger wages growth across certain sectors later in 2023. This includes lower paid industries and the public sector. This reflects changes to wage bargaining policy settings in NSW and Victoria and the stated support from the Federal Government for an increase in the minimum wage which was in line with inflation.

Other arguments supporting a hike included:

- Inflation still being too high and the labour market being very tight.
- Overseas experience which showed that inflation has been stickier than previously expected.
- Imbalances between demand and supply in housing and electricity markets potentially impacting the pace of disinflation.

Members noted that these factors supported further hikes. They also added that the Board could cut rates in the future if it turned out that policy had been tightened too much.

Pause

The arguments supporting a pause centred largely on the fact that the cash rate had already been raised by a significant amount in a short space of time. Remember, the cash rate had been hiked by 350 basis points in the space of 10 meetings. This was the fastest hiking cycle since before the early 1990s, when inflation targeting began.

Pausing would allow the RBA to gather additional information on the state of the economy and assess how the cash rate hikes to date were flowing through to households, businesses, and ultimately, inflationary pressures.

Additionally, at their next meeting, the Board would have the benefit of receiving new economic forecasts from RBA staff. This would help the Board better understand the current state of the economy and the expected trajectory over the next few years.

The minutes also noted that a pause during a hiking cycle was "consistent with the typical pattern of policymaking before the pandemic".

Forward guidance

There were a few key insights from the minutes for the future path of monetary policy. The minutes noted that members would like to have additional data and an updated set of forecasts "before again considering <u>when and how much</u> more monetary policy would need to be tightened to bring inflation back to target within a reasonable timeframe" (emphasis added). This phrasing suggests that the board thinks that at least one more hike is likely to be necessary but that they want to wait for the data before confirming that view.

Importantly, in discussing the path of inflation in the future, the minutes noted that the latest forecasts from the RBA only had inflation getting back into the top of the 2-3% band by mid-2025. Additionally, these forecasts assumed a cash rate which was higher than the current level of 3.60%. This implies that further cash rate hikes would be required if the economy evolved broadly as expected by the RBA at its February forecasts.

The minutes also noted that “it would be inconsistent with the Board’s mandate for it to tolerate a slower return to target”.

These statements become more insightful if we pair them with comments from the RBA Governor at his Press Club speech, which was the day after the April meeting. In that speech the Governor noted that one of the reasons why interest rates were lower in Australia compared to other major economies was that the RBA was more willing than other central banks to tolerate a slower return to target to “preserve many of those job gains that have been delivered in the last few years”. This approach contrasts with getting inflation down more quickly but potentially having a larger impact on the economy.

Additionally, the Governor in his speech stated that “we're committed to making sure that inflation returns to the 2-3% range and to do that by mid-2025”.

What do these statements imply for the RBA’s tolerance of having inflation outside of the band for a prolonged period of time?

Together, they suggest that the RBA is comfortable with targeting a return to the top of the 2-3% band by mid-2025, but not later. Additionally, they are not targeting an earlier return either as they seek to maintain gains in the jobs market.

This suggests that if economic data unfolds in a way which supports achieving that target without further rate hikes, they will likely pause for longer. However, if the data suggests that mid-2025 would be missed without further hikes, the Board will likely raise the cash rate further.

Monetary policy outlook

For some time, the RBA has been emphasising the large degree of uncertainty around the current economic outlook and that it will remain data-dependent in its approach to setting policy. A pause allows the Board to gather more data and assess how much of an impact the rate hikes to date are having on the economy.

Ahead of the May meeting, the Board will be looking at a range of key indicators, including monthly updates on business confidence and conditions, the labour market, and the March quarter inflation report.

Updates to date on business conditions and the labour market suggest that the labour market remains very tight and that business conditions are still robust, despite a slowing trend continuing. Together, they support the need for a further hike at the May meeting.

But the decision remains a close call. The March quarter inflation report, due next week, will likely tip the scales one way or the other.

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