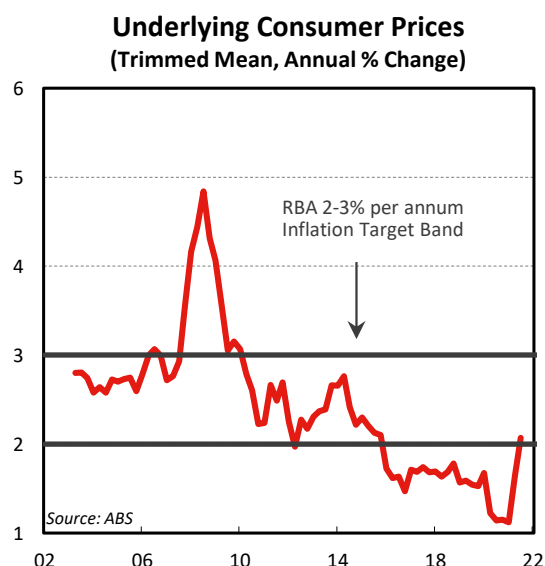


Interest Rate Outlook

Tuesday, 7 December 2021

RBA Board Meeting RBA Shrugs Off Omicron Fears

- The Reserve Bank (RBA) left key policy settings unchanged this month, as widely expected.
- The RBA remains upbeat on the outlook for growth, noting that the economy is recovering from the Delta lockdowns. In fact, the RBA brought forward when it expects the economy to return to its pre-Delta growth path to the first half of 2022 (previously mid 2022).
- The RBA flagged that a new source of uncertainty is the emergence of the Omicron strain, although “it is not expected to derail the recovery”.
- The RBA was notably more upbeat on the jobs market, although continued to emphasise it only expects a gradual pick up in wages and inflation.
- Today's meeting was the last until February 2022 when the bond buying program will be reviewed. The statement reiterated that the future of the program will depend on several factors, including the actions of other central banks.
- Several US Federal Reserve officials have suggested the Fed needs to taper faster. If this materialises, it may open the door for the RBA to end its own bond-buying program sooner.
- Our core expectation, for now, remains that the RBA will announce a further reduction in the rate of bond purchases in February, before it is wound up by the middle of next year.
- The RBA repeated that it “is prepared to be patient”. We stand by our view the cash rate will first increase in early 2023. Markets are fully priced for the first hike to occur in September 2022, which has been pushed back from July 2022 just two weeks ago.



The Reserve Bank (RBA) left key policy settings unchanged this month, as widely expected. Last month, the RBA made major changes by dropping the yield curve control program and the guidance that the cash rate would not lift until 2024. The RBA had previously flagged that it would review the bond-buying program in February 2022.

Economic Growth and Omicron

The RBA opened its statement with optimism. It remains positive on the outlook for growth, noting that the Australian economy is recovering from the setback caused by the Delta outbreak. In fact, the RBA brought forward when it expects the Australian economy to return to its pre-Delta growth path to the first half of 2022 (previously mid 2022). The statement flagged a strong rebound in household consumption is underway and the outlook for business investment has improved.

The RBA noted that a new source of uncertainty is the emergence of the Omicron strain. However, it stated “it is not expected to derail the recovery”.

Labour Market

One of the features of the statement that stood out was the language used to describe the labour market – it was notably more upbeat. Last month, the RBA said data on jobs ads suggested that many firms were hiring, which would boost employment over coming months. Today, the RBA noted that leading indicators “point to a strong recovery in the labour market”. The RBA added that job ads are at a “historically high level and there are reports of firms finding it difficult to hire workers”.

Despite their optimism on jobs, the RBA still appears languid around their expectations for wages growth, although it was not without caveats. These caveats could suggest upside risk to the forecasts.

Inflation and Wages

The RBA is expecting a further pick-up in wages growth as the labour market tightens, but they expect this pick-up to be “only gradual”. However, they did highlight that there is uncertainty about the behaviour of wages as the unemployment rate declines to historically low levels. This implies that wages growth may pick up faster than the RBA’s central forecast.

Wages growth is a key driver of inflation. And indeed, the RBA remains of the view that there will be a further, but only gradual, pick-up in inflation. The RBA’s central forecast is for underlying inflation to reach 2.5% by the end of 2023. In comparison, we expect underlying inflation to hit 2.8% by the end of next year. Our expectation for a faster pick-up in inflation underpins our view that the RBA will lift the cash rate in early 2023.

Housing Market

What happens to rates will impact dwelling prices. Whilst dwelling prices continue to grow, they are growing at a slower rate. The RBA acknowledged today that some of the steam has come out of the housing market. The statement noted the rate of dwelling price growth has “eased over recent months” and that the “value of home loan commitments has declined from high levels”.

Monetary Policy

Turning to the outlook for policy, there were no gamechangers in today's statement. This is to be expected given the significant policy shifts made at the last meeting.

This month, markets were watching closely for any clues on the future of quantitative easing. Today's meeting was the last until February 2022, when the bond buying program will be

reviewed. But the RBA is keeping their cards close to their chest and gave away no new information on this front. The statement reiterated that bond purchases will continue at \$4 billion per week and what happens with these purchases will depend on “the actions of other central banks; how the Australian bond market is functioning; and, most importantly, the actual and expected progress towards the goals of full employment and inflation consistent with the target”. The RBA likely wants to keep wiggle room for bond purchases to observe how the recovery evolves over the coming months and to wait for more information on Omicron.

Of other central banks, it is the actions of the US Federal Reserve that will be the most important. The Federal Reserve started tapering its bond-buying program last month. We expect the Fed will conclude purchases by March next year. Recent remarks from several Fed officials have flagged that tapering perhaps needs to quicken given the extent of inflationary pressures in the US. If the Fed does indeed taper faster, the door might open for the RBA to conclude its bond-buying program sooner.

Our core expectation, for now, remains that the RBA will announce a further reduction in the rate of bond purchases in February 2022, before it is wound up by the middle of next year.

The forward guidance on the path of the cash rate was unchanged. The RBA continued to emphasise that “the Board is prepared to be patient”. The statement again highlighted that inflation remains low and the price pressures are less significant than in other countries.

We also stand by our long-held view that the cash rate will first increase in early 2023. There is a wide range of opinions on when the RBA will start raising rates. Interest rate markets are fully priced for the first rate hike to occur in September, followed by another before the end of next year. A third rate hike in 2022 is now only partially priced in. Two weeks ago, before the emergence of Omicron, interest rate markets were pricing in the first rate hike in July with two rate hikes to follow before the end of 2022.

Besa Deda, Chief Economist

Ph: 0404 844 817

&

Matthew Bunny, Economist

Ph: (02) 8254 0023

Contact Listing

Chief Economist

Besa Deda
dedab@banksa.com.au
(02) 8254 3251

Economist

Matthew Bunny
matthew.bunny@banksa.com.au
(02) 8254 0023

Senior Economist

Jarek Kowcza
jarek.kowcza@banksa.com.au
0481 476 436

Associate Economist

Jameson Coombs
jameson.coombs@banksa.com.au
0401 102 789

The information contained in this report (.the Information.) is provided for, and is only to be used by, persons in Australia. The information may not comply with the laws of another jurisdiction. The Information is general in nature and does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and is not an invitation to take up securities or other financial products or services. No decision should be made on the basis of the Information without first seeking expert financial advice. For persons with whom BankSA has a contract to supply Information, the supply of the Information is made under that contract and BankSA's agreed terms of supply apply. BankSA does not represent or guarantee that the Information is accurate or free from errors or omissions and BankSA disclaims any duty of care in relation to the Information and liability for any reliance on investment decisions made using the Information. The Information is subject to change. Terms, conditions and any fees apply to BankSA products and details are available. BankSA or its officers, agents or employees (including persons involved in preparation of the Information) may have financial interests in the markets discussed in the Information. BankSA owns copyright in the information unless otherwise indicated. The Information should not be reproduced, distributed, linked or transmitted without the written consent of BankSA.

Any unauthorized use or dissemination is prohibited. Neither BankSA- A Division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ACL 233714, nor any of Westpac's subsidiaries or affiliates shall be liable for the message if altered, changed or falsified.