

CAMA RBA SHADOW BOARD – COMMENTS

NOVEMBER 2023

Each CAMA RBA Shadow Board member is invited (but not obliged) to provide a personal comment on monetary conditions. Neither the comments nor the probabilities constitute financial advice. The views of the Shadow Board members are not those of CAMA. Any individuals utilizing these comments, or the probabilities, do so at their own risk.

SALLY AULD

No comment.

BESA DEDA

The inflation report for the September quarter revealed upside inflation risks are materialising. Indeed, inflation could take longer to come down as a result. Headline inflation showed growth of 1.2% in the quarter, much faster than the 0.9% growth rate that the current forecasts from the RBA imply. In a recent speech, Bullock emphasised that the RBA would not tolerate a later return to the target band, which means the higher-than-expected inflation result has implications for the next policy decision on 7 November.

Bullock, the recently appointed Governor of the RBA, also took to the stand today before the Senate Legislative Committee. Bullock said services prices were still higher than the RBA was “comfortable with”.

The inflation report followed a recent update on the jobs market, which revealed a tick down in the national unemployment rate to close to a 50-year low of 3.6% in September. Whilst job vacancies are off their post-covid peaks, they are still elevated and some businesses are still struggling with shortages. It’s hard to find strong evidence that the unemployment rate is set to move above the rate consistent with full employment over the coming six months at least.

The low unemployment rate reflects the resilience of the economy. Households are tightening their belts and consumer spending growth is slowing, leading the weaker activity in the economy. However, strong population growth is injecting a layer of resilience.

These mix of factors and data leaves the November board meeting as a live decision. In fact, we are left in no doubt that the Board will need to discuss a rate hike at the meeting. The discussion will boil down to whether they leave the cash rate unchanged or tap the brakes by 25 basis points to fine tune policy settings and ensure that inflation returns to the band in a timely manner.

The RBA will need to weigh up the slowdown in consumer spending growth against ongoing resilience from businesses and determine how much of the surprise outcome in inflation was due to temporary factors versus permanent drivers. In our opinion, there were more permanent drivers at play. For example, around 75% of prices economy-wide are growing at an annual rate that is faster than the midpoint of the RBA’s inflation target band. This share has come down from the peak, but remains high and progress lower appears to have stalled.

Since the rate-hike cycle began in May of last year, one variable has ranked consistently high on the RBA’s watch list. That variable is inflation expectations, especially over the medium term. The RBA wants to ensure that inflation expectations do not become de-anchored. Higher than expected prints on inflation can contribute to a flare up in inflation expectations. There is some evidence in recent weeks that medium-term inflation expectations have begun to tick up, suggesting the RBA may need to lean in to arrest the trend.

Reflecting the changing balance of risks, we believe the odds have shortened considerably for a rate hike on Melbourne Cup Day. Is this one hike and done? Quite possibly, but the high uncertainty attached to forecasts in the current environment means further tightening in the next six months cannot be fully ruled out. The incoming data remains key.

BEGOÑA DOMINGUEZ

No comment.

MARIANO KULISH

The RBA should increase the cash rate at its next meeting. As I said in August 2023, monetary policy, while less expansionary than before, remains expansionary. This remains true today. With underlying inflation running above 5 per cent, the real cash rate remains negative. Real rates for households and businesses are at historically low levels as well. The labour market continues to be tight. The exchange rate remains weak as expectations of future monetary policy in the United States incorporated the higher-for-longer message of the Federal Reserve. A weak exchange rate add to the ability of foreign inflation to turn into domestic inflation. The RBA should put more weight on the risks associated with doing too little, in particular the risk of inflation taking a long time to return to its target. At the moment, giving current inflation, low productivity growth, a weak exchange rate, very high services inflation and historically low real rates, increasing the cash rate, in my view, is required.

GUAY LIM

No comment.

WARWICK MCKIBBIN

No comment.

JAMES MORLEY

The latest inflation report confirms that we are past the peak and inflation looks like it will gradually return to the RBA's 2-3% target range. However, there are enough components of inflation that surprised on the upside in the report and the RBA will want to ensure longer-term inflation expectations remain anchored at low levels despite another spike in volatile energy prices that is hopefully less persistent than with the War in Ukraine. Also, more robust global economic conditions and domestic financial conditions both suggest the risk of recession is receding. Thus, the RBA has room to raise rates at the next meeting in response to inflationary pressures while still likely achieving a soft landing.

My recommendation puts a bit more weight on raising than holding steady, but the rise in geopolitical uncertainty means that risks of a global recession have not completely evaporated. Also, domestic demand is likely to continue to weaken given the past increases in interest rates. It is just that an upside surprise in the level of inflation should be met with a response to ensure real interest rates have their effects in cooling inflation and to help bring the level back to the target range. It will be important to monitor global inflation and demand conditions as well going forward as these appear to have an influence on Australia's inflation. The RBA should not ignore components of inflation that are beyond their immediate control, but should offset them in whatever way necessary to ensure total headline inflation returns to the target range.

JOHN ROMALIS

No comment.

PETER TULIP

With underlying inflation accelerating, despite large fiscal subsidies, the economy appears to be operating beyond its sustainable capacity. The outlook for inflation, under unchanged policy, would be for a prolonged return towards the target. If the RBA signals acquiescence with that, inflation expectations will increase, leading to more unemployment in future. So further tightening is needed.