30 March 2023

RBA Board to pause next week

The Reserve Bank Board meets next week on April 4.

We confirm the forecast we released on March 17 that the Board will decide to pause at the April meeting.

That move is unlikely to see the end of the tightening cycle since we expect a final 25 basis point increase at the May Board meeting.

The Minutes from the March Board meeting included the unusual: “Members agreed to reconsider the case for a pause at the following meeting, recognising that pausing would allow additional time to assess the outlook for the economy.”

Signalling aspects of the decision process at the upcoming meeting is something I have not seen in previous Board Minutes. This approach indicates that there is arguably a preference for pausing.

And note that this “preference” was revealed prior to the developments in the global banking system. The Board meeting was on March 7 and the authorities took control of Silicon Valley Bank on March 10.

Some argue that the decision by the Federal Open Market Committee to still lift the Federal Funds Rate by 25 basis points on March 22 indicated that central banks were looking through the financial sector disruptions to focus specifically on inflation.

But it is important to compare the starting point of the two central banks.

Before the banking sector disruptions, the FOMC was favouring a 50 basis point increase in contrast to the RBA Board that was considering a pause at the next meeting.

In response to the financial sector developments the FOMC scaled the increase back to 25 basis points and changed the guidance from “ongoing increases in the target range will be appropriate “to “some additional policy firming may be appropriate”.

This was a significant change in stance from the FOMC and would have had an impact on the Board’s thinking.

We also ask ourselves why there was such a turnaround between the February and March Board meetings.

Recall that the Minutes to the February meeting sent a clear message to markets to expect two consecutive rate increases; “further increases in interest are likely to be needed over the months ahead.”

The December quarter national accounts would have shocked the Board. Domestic demand stagnated in the December quarter largely due to a slowdown in consumer spending growth from 1% in the September quarter to 0.3% in the December quarter. Dwelling investment and new business investment both contracted, while the 0.5% growth in the quarter was entirely due to a boost from net exports.

Quarterly growth in the Wage Price Index surprised to the downside indicating to the Governor that “lower risk of a cycle in which prices and wages chase one another.”

The Board also derived some encouragement that inflation had peaked from the January Inflation Report where annual inflation slowed from 7.8% to 7.4%, including a fall of 0.4% in the month of January.

The Governor responded with, “The monthly CPI indicator suggests that inflation has peaked in Australia.”

While we think the Governor has a preference for pausing, the Board Minutes set out a path for the decision at the April meeting; “they agreed that upcoming releases on employment, inflation, retail trade, and business surveys would provide important additional information, as would developments in the global economy.”

The February Employment Report was strong with new jobs printing 64,600 and the unemployment rate falling from 3.7% to 3.5% (a fall of 0.13% to the second decimal point from 3.67% to 3.54%).

This result would not have come as a major surprise to the RBA. The Governor pointed out to the House of Representatives Economics Committee that seasonality issues in January were significant and 100,000 respondents were reported by the ABS to have been outside the workforce in January but had secured jobs for February.

The NAB Survey of Business Conditions showed a sharp fall of 10 points to –4 in Business Confidence – firmly in pessimistic territory. Business Conditions held firm at +17 but clearly off the highs of September 2022 when they reached +24.

The February Retail Sales Report showed a muted increase of 0.2%. Following the 4% fall in December, and the partial rebound of 1.9% in January, this means that retail sales over the three months from December are 1.5% down on the previous three months. Our Card Tracker is pointing to a likely fall in real retail sales in the March quarter.

The February CPI Indicator rose 0.2% in February following the fall of 0.4% in January. Annual inflation fell from 7.4% in January to 6.8% in February. We now see downside risks to our current forecast for headline inflation in the March quarter.

Overall, these domestic data points do not provide a sufficiently convincing case for a Board whose prior, we believe, is to pause in April to change course.

Note that the global economy also figures in the Board’s check list. While markets have stabilised the clear risk of credit tightening in the US and Europe as US regional banks deal with increased regulation and deposit instability in both US and Europe lowers the outlook for global growth.

Given these issues the appropriate policy for the Board is to pause to await clearer information.

When central banks are faced with high inflation the priority must be to move policy into contractionary territory. The Board acknowledges that policy is now contractionary so the urgency to move policy at every meeting passes.

The RBA Board, with more meetings per year than any other central bank, can now take that break.

By the May meeting the Board will have the benefit of refreshed forecasts from the staff, including the time required to return to the 2-3% target zone for inflation which we think is likely to remain at a distant mid–2025.

But of most importance will be a refreshed measure of underlying inflation – the Trimmed Mean. The monthly Indicators do not provide a measure of the Trimmed Mean. It was the surprise lift in the Trimmed Mean Inflation rate from the expected 6.5% to 6.9% in the December quarter that prompted the hawkish response in the February Minutes.

Westpac is forecasting the Trimmed Mean inflation to slow from 6.9% to 6.5%.

In an economy with full employment that is still too high and we expect a final 0.25% lift in the cash rate will be required.

Much better to make that decision with the benefit of a true indication of the inflation challenge along with the other benefits of another month of data, including around global developments, than needing to move in April.

Conclusion

We confirm our forecast from March 17 that the RBA Board will pause in April prior to one final move in May.

Bill Evans, Chief Economist (WestpacGroup)

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