BULLETIN

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Minutes to RBA's August meeting strike a more optimistic tone

The minutes of the Reserve Bank Board's August meeting show a further evolution consistent with policy being more firmly on hold.

As in May, June and July, the Board again considered two options for policy: to hold the cash rate steady or to increase it by 25bps. The cases for each option were again fairly similar but the key wording around the judgement saw another discernible change.

In May and June, the meeting minutes described the decision to raise rates as "finely balanced".

In July, this phrasing was dropped but the decision to leave rates unchanged came with a clear rider – that the pause was to "reassess the situation at the August meeting", when "the Board would have the benefit of additional data on inflation, the global economy, the labour market and household spending, as well as an updated set of staff forecasts and a revised assessment of the risks."

In August, the decision to leave rates unchanged had no 'temporary' elements to it. The monthly data updates were seen as encouraging, signalling that "the economy was still on the narrow path in which inflation returns to target while employment and the economy continue to grow" – a path that the staff's revised forecasts still saw as the central case outlook. While there were clearly still risks, members noted "these were broadly balanced" albeit asymmetric in terms of cost, particularly "if a sustained period of high inflation led to higher inflation expectations".

The June quarter inflation update looks to have been most influential, the lower-than-expected result described as "reassuring", albeit without showing a material slowing in services, which remains a central concern.

The Board was also unperturbed – at least for now - by the continued resilience in labour markets, noting "there were some signs that the labour market was at a turning point, including a small rise in the underemployment rate", and that interest rate rises were clearly impacting demand, noting weak retail sales results.

In weighing up, the case for a further rate rise rested on the risk of persistent high inflation – a 'stitch in time' rate rise now "mitigating the risk" of potentially having to make more damaging moves later on.

It was also noted that while the staff's forecasts were largely unchanged from May, these were "conditioned on a further increase in the cash rate". The recovery in house prices could also be a "signal that financial conditions were not as tight as they had assessed."

The case for remaining on hold centred on the view that the significant tightening to date was "working as intended", was impacting on consumption and, more tentatively, labour markets, with the full effects yet to be seen.

The bottom line was that members "observed that there was a credible path back to the inflation target with the cash rate staying at its present level", hence the convincing argument to leave the cash rate unchanged.

As with the Governor's decision statement, the language on prospective further tightening was also tweaked in the minutes – "it was possible that some further tightening of monetary policy may be required" a somewhat milder variation on July's "some further tightening of monetary policy may be required".

The checklist is the same: the data-flow data and the evolution of risks with a specific eye on the global economy, trends in household spending, and the outlook for inflation and the labour market. However, the language around it sounds a little more assured.

Conclusion

The minutes to the August meeting reaffirm the message from the Governor's decision statement and other communication that show the Board is now more confident about achieving its inflation objective of getting inflation back below 3% by the end of 2025, and more firmly on hold.

While the data flow and evolution or risks remain important, these are unlikely to constitute a strong enough case for a further hike in September. Indeed, the surprisingly soft June quarter wage cost index result out today likely further entrenches the Board's 'on hold' position.

The July monthly CPI indicator, due out at the end of August, may provide a surprise and might undo some of the encouraging progress on inflation but, even then, is likely to have some 'wrinkles', particularly around energy price increases, that could be viewed as transitory. The July labour force report due out later this week could also question the tentative turning point around jobs – albeit the minutes seem to imply some patience on this front.

All-up, the data-flow is unlikely to build a compelling case for a hike at the Board's next meeting on September 5. Beyond that the key data release will be the June quarter national accounts, due out a day later. This will include updates on the productivity and unit labour cost measures that the RBA has singled out as being particularly critical to achieving a return to low inflation over the medium term. But it will also give a much clearer picture of the weakening in activity – particularly around consumer spending. With inflation updates expected to show a further slowing, the mix is likely to preclude any further need for higher rates.

We reaffirm our view that the current cash rate of 4.10% will be the peak of the 2022-23 tightening cycle and that the next move in rates will be lower with the first cut in the cycle coming in the September quarter of 2024.

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