Interest Rate Outlook

Tuesday, 19 March 2024

RBA Board Meeting

RBA Off The Field, To The Bench, BoJ Scores

- **The Reserve Bank (RBA) left the cash rate on hold at 4.35% for the third straight meeting. This decision was of no surprise to markets or economists.**
- **While the RBA Governor emphasised repeatedly that the Board haven't "ruled anything in or out", the changes in the statement suggest the threshold for another rate hike are high and moved higher still. The rate hike in November was very likely the last.**
- **The RBA have provided few clues to the timing of a rate cut. Their statement suggests they've come off the field and are watching the game of data play out as they sit on the bench and assess how the economy is unfolding.**
- **Financial markets are fully priced for a cut in September this year and the risks seem evenly balanced around this timing. The Stage 3 tax cuts occur from 1 July and the impact of these cuts will need to be assessed, as will any fiscal decisions in the Federal Budget in May.**
- **Across to Asia and the Bank of Japan (BoJ) hiked their cash rate for the first time in nearly 17 years – ending negative interest rate policy at a time when many major central banks around the world have finished or almost finished hiking.**
- **The BoJ moved their policy rate from -0.1% to a range of 0% and 0.1%. Japanese bond yields and the Japanese currency fell immediately after the decision, perhaps reflecting the BoJ's Governor's remarks that today's decision may not necessarily be accompanied by more rate hikes.**

Australia

The RBA left the cash rate on hold at 4.35% today. This surprised no one. Markets and economists alike expected this on-hold decision.

Last meeting the Reserve Bank inserted words in the final and most pertinent paragraph of their one-page statement that suggested they were not ruling out further rate rises – maintaining the tightening bias of the statement. This month, they removed those words. It suggests they've tilted more towards a neutral stance. The threshold for another rate hike would still be high in our view and the November rate hike the last in the hiking cycle.

The RBA has effectively come off the playing pitch and is now sitting on the bench watching the game (i.e. the data) and assessing whether they return to the pitch but with a rate-cutting psyche instead. This position is evidenced by the statement saying "the path of interest rates that will best ensure that inflation returns to target in a reasonable timeframe remains uncertain and the Board is not ruling anything in or out". The RBA Governor in the press conference also said there are "risks on both sides" and the risks are "finely balanced". She also repeated on numerous occasions that the Board “can’t rule anything in or out”.

The RBA is likely to continue to watch services inflation closely. The latest inflation report shows some early signs it is rolling over, but the RBA reiterated “services inflation remains elevated, and is moderating at a more gradual pace”. Bullock referred to services inflation being high overseas, likely a reference to the US where persistent price pressures remain a risk in the services sector.

During the press conference, the Governor was asked about the Fair Work Commission’s latest decision to grant aged care workers a further pay increase of up to 14% and the impact this might have on the RBA’s wages forecasts and services inflation. The Governor characterised the wage increases as being a worthy increase for a historically underpaid sector that is experiencing labour shortages. The Board will be watching for any potential spillovers to other sectors.

Financial markets are fully priced for rate cuts to start in September this year. The Group view matches this market view. With inflation progressing lower but remaining elevated, the RBA will want to be more convinced of inflation returning to its target band of 2-3% per annum before it comes off the bench to play in the rate-cutting field.

The RBA Governor continues to stress a cautious wait-and-see approach, suggesting rate cuts in the near term are not likely and that they would need to be much more confident of inflation coming back into the band before rate cuts are a serious consideration.

Bullock also took a leaf from the book of her predecessor, Philip Lowe, saying she was a firm believer that the Australian economy is “still on a narrow path”, suggesting engineering a soft landing for economic activity whilst bringing inflation back to the band remains in reach.

Japan

This week is marked by a high number of central bank meetings and today the BoJ made history. Japan’s central bank ended the most aggressive monetary easing program in modern history by scrapping its negative-interest-rate-policy (NIRP) along with its yield curve control (YCC) mechanism and purchases of exchange-traded funds (ETFs). The BoJ set a new policy rate range of between 0% and 0.1%, shifting from an interest rate of -0.1%. The BoJ said that financial conditions will remain accommodative, suggesting that today’s decision does not necessarily mean they’re embarking on an aggressive rate-hiking cycle.

It's the first hike from the BoJ in almost 17 years and comes as many major central banks around the world are ending or have ended their rate-hiking cycles and are instead considering when to begin cutting.

Financial markets expected a rate hike was a possibility today after the BoJ Governor in recent remarks suggested wages growth would be critical to the decision. On Friday, Rengo, Japan’s largest umbrella group for labour unions succeeded in an initial wage increase of 5.28% - the highest rise since the early 1990s – setting up the framework necessary for a potential rate hike today.

The initial market reaction has been for USD/JPY to appreciate (AUD/JPY has also lifted) – i.e. the yen slipped, perhaps due to the BoJ Governor suggesting the rate rise today may not mean the start of a hiking cycle. Japanese government bond yields – both at the shorter end and longer end – also pulled back.

RBA Governor Bullock was asked about the BoJ decision in her press conference. She wouldn’t be drawn into any specifics – simply stating that they had been facing the opposite issues to other countries and had become more encouraged that inflation and wages were heading in the right direction. However, she did remind us that their rates are still at zero! This is a far cry from the levels of rates that are currently in place across other developed economies.

United States

On Thursday morning, the outcome meeting of the US Federal Open Market Committee (FOMC) will be revealed. The Fed is likely to keep policy steady. What will garner much more attention will be the statement following the decision, the press conference from Fed Chair Jerome Powell, the updated “dot plot” – which shows members’ individual expectations of the path of the Fed funds rate, and updated economic projections.

There’s some risk that the dot plot and press conference comments may see markets push out the timing of the start of rate cuts, given the recent inflation data prints.

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