Week in Review

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Central Banks

RBA Minutes (18.07.23)[2]

- Members noted that **inflation in Australia remained very high,** despite a decline in prior months, and was currently **not expected to return to the top of the target range until mid-2025.**
- **The housing market had stabilised,** with housing prices rising once again. The tightening of monetary policy was still working its way through the economy, including as fixed-rate loans matured.
- **Members discussed two options for monetary policy at this meeting: increasing the cash rate by a further 25 basis points; or holding the cash rate unchanged.**
- **Case for a hold:** inverted yield curve, lags in transmission of monetary policy, demand for labour also responds with a lag.
- **Case for a 25 bps hike:** inflation was forecast to remain above target for an extended period, weak productivity was contributing to strong growth in unit labour costs, tight labour market, policy rate in Australia was still lower than elsewhere, other countries' experiences with upside risks to inflation.
- **Members agreed to hold the cash rate steady and reassess the situation at the August meeting.**
- Members agreed that **some further tightening of monetary policy may be required** to bring inflation back to target within a reasonable timeframe

Highlights from the Minutes below:

Domestic economic conditions

Turning to the domestic economy, members noted that economic growth in Australia had slowed considerably, reflecting the impact of higher interest rates and high inflation. GDP increased by 0.2 per cent in the March quarter and growth was expected to be similar in the June quarter; output growth was well below the estimated rate of increase in the population over the same period. The slowdown in activity had had only a modest effect on the labour market, with conditions remaining tight. Employment growth had continued to be robust and measures of spare capacity remained near multi-decade lows. Inflation had eased from its peak but remained too high. Market measures of short-term inflation expectations had declined from their peaks but also remained high; however, survey measures suggested that households expected the current high inflation rate to be mostly temporary.

Timely indicators pointed to a gradual easing in inflation over the first half of 2023. The monthly CPI indicator for headline inflation had eased to 5.6 per cent in year-ended terms in May. Across most components of the basket, the year-ended rate of inflation had eased over the preceding three months. Members observed that measures of underlying inflation had remained high in May at 6.4 per cent, excluding volatile items and travel. Food inflation remained high; while the 2022 flood-related effects on fresh food had unwound, the reversion in global food prices was yet to be seen in domestic prices. Furthermore, the increased likelihood of an El Niño event in 2023/24 and an associated downgrade for agricultural production could put upward pressure on some food prices over the coming year.

1 Clickable to navigate within the document

2 https://www.rba.gov.au/monetary-policy/rba-board-minutes/2023/2023-07-04.html

Considerations for monetary policy

In turning to the policy decision, members noted that inflation in Australia remained very high, despite a decline in prior months, and was currently not expected to return to the top of the target range until mid-2025. Services price inflation, in particular, continued to be high. There was little spare capacity in the economy or the labour market, and the level of economic activity was high relative to some years prior. Further, the housing market had stabilised, with housing prices rising once again. At the same time, output growth had slowed materially. Consumer spending had been weak in the first half of 2023 because of the effect of higher inflation, increased tax payments and higher interest rates on households' real disposable incomes. The tightening of monetary policy was still working its way through the economy, including as fixed-rate loans matured. Core inflation had proved stickier than anticipated in many advanced economies and several central banks had tightened policy unexpectedly or by more than expected in preceding months. Market expectations for the peak in policy rates in most advanced economies had also continued to rise.

Members discussed two options for monetary policy at this meeting: increasing the cash rate by a further 25 basis points; or holding the cash rate unchanged.

The case to increase the cash rate further was centred on the observations that inflation was forecast to remain above target for an extended period and there was a risk that this timeframe would be extended without further monetary policy tightening. Members noted that several CPI categories for which inflation was typically quite persistent already had too high inflation, including rent and services prices more broadly. They also observed that weak productivity was contributing to strong growth in unit labour costs. Furthermore, electricity prices had risen substantially on 1 July; while this was expected and had been incorporated in the staff forecasts for some time, there was a risk that the wider effects on inflation had not been fully captured.

The labour market remained very tight, notwithstanding some easing in conditions in the preceding month or so. While nominal wages growth appeared to have stabilised recently, members assessed that the environment would remain conducive to above-average increases in prices and wages under such levels of labour market tightness.

Members observed that inflation in advanced economies was proving to be more persistent than expected and that central banks had responded to this with unexpected or larger-than-expected monetary policy tightening over the preceding month. The policy rate in Australia was still lower than in many comparable economies and the recent experience of those countries highlighted the upside risks to inflation and the outlook for interest rates.

Members then turned to the option of holding the cash rate unchanged.

Members noted that monetary policy had been tightened considerably and rapidly over the prior year and the stance of monetary policy was clearly restrictive at the prevailing cash rate. The inversion of the yield curve signalled that the market expected the cash rate to be higher in the near term than it would be over the longer term, consistent with a contractionary monetary policy setting. In addition, mortgage interest payments (as a share of household disposable income) were around a record high in May and would rise further as fixed-rate loans continued to mature, even if the cash rate was not increased further. Members noted that the lags in the transmission of monetary policy through the economy meant that the full effects of the policy tightening that had occurred over the preceding year were yet to be observed. They acknowledged that it takes time for households and businesses to adjust their spending and investment plans, and that there were still significant resets of low fixed-rate loans ahead. Similarly, demand for labour typically responds with a lag, which implied that the current tightness in the labour market might also ease.

Members acknowledged that inflation was now declining, albeit from a high level, and that this would help mitigate the risk of a rise in medium-term inflation expectations. Members noted that global developments over prior months – in particular, the fall in commodity and shipping prices – had reduced upstream cost pressures for goods. More broadly, the slowing in economic growth was working to bring demand and supply into closer alignment, which, over time, would work to lower inflation.

Members also discussed the risk that output growth slows by more than expected. They noted that the slowing in economic activity in general, and consumption in particular, had been consistent with what could reasonably have been expected given trends in household income and wealth. However, members observed that there was considerable uncertainty about the resilience of household consumption and that the squeeze on many households' finances could result in consumption slowing more sharply than implied by the current forecasts. Higher interest rates could also be expected to encourage households to save more, which would affect consumption. If that were to occur, the demand for labour would slow and the unemployment rate would be likely to rise beyond the rate required to ensure inflation returns to target in a reasonable timeframe.

The Board recognised the strength of both sets of arguments but judged that the case to hold the cash rate unchanged at this meeting was the stronger one. Noting both the uncertainty around the outlook and the significant increase in interest rates to date, members agreed to hold the cash rate steady and reassess the situation at the August meeting.

Members agreed that some further tightening of monetary policy may be required to bring inflation back to target within a reasonable timeframe, but that this depended on how the economy and inflation evolve. At the August meeting, 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. Members reaffirmed their determination to return inflation to target within a reasonable timeframe and their willingness to do what is necessary to achieve that outcome.

Economic Data

Monday, 17.07.23

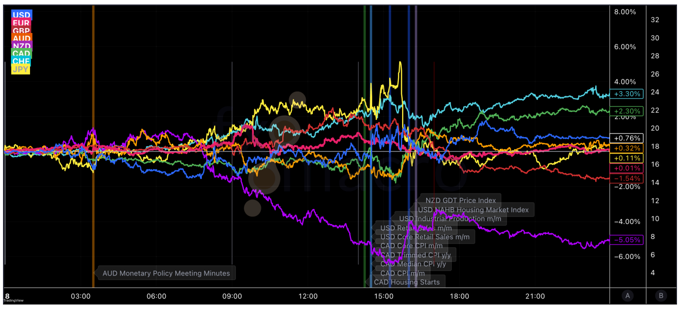
data via forexfactory.com

Date	FRA	LON	NYC	Cncy	Data	Act.	Exp.	Prev.	Forecast Range Low	Forecast Range High	Reaction
Mon 17.07.23	**00:30**	23:30	18:30	NZD	BusinessNZ Services Index	50.1		53.3			NZD eventually lower
Mon 17.07.23	**04:00**	03:00	22:00	CNY	GDP q/y	6.3	7.1	4.5			AUD lower
Mon 17.07.23	**04:00**	03:00	22:00	CNY	Industrial Production y/y	4.4	2.6	3.5			
Mon 17.07.23	**04:00**	03:00	22:00	CNY	Retail Sales y/y	3.1	3.4	12.7			
Mon 17.07.23	**04:00**	03:00	22:00	CNY	Fixed Asset Investment ytd/y	3.8	3.4	4.0			
Mon 17.07.23	**14:30**	13:30	08:30	USD	Empire State Manufacturing Ind	1.1	0.2	6.6			USD higher

Tuesday, 18.07.23

data via forexfactory.com

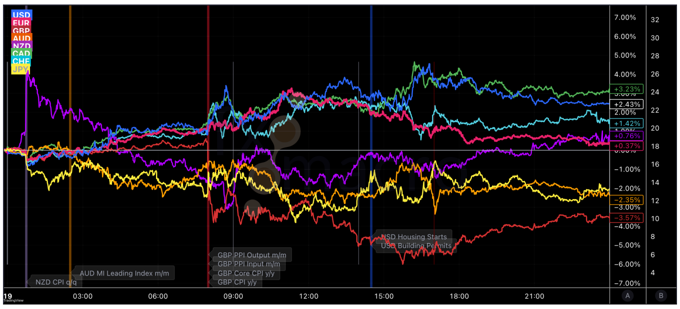
Date	FRA	LON	NYC	Cncy	Data	Act.	Exp.	Prev.	Forecast Range Low	Forecast Range High	Reaction
Tue 18.07.23	**03:30**	02:30	21:30	AUD	Monetary Policy Meeting Minute						AUD sideways overall
Tue 18.07.23	**14:15**	13:15	08:15	CAD	Housing Starts	281	221	202			CAD stronger
Tue 18.07.23	**14:30**	13:30	08:30	CAD	CPI m/m	0.1	0.3	0.4			CAD initially lower but subsequently higher
Tue 18.07.23	**14:30**	13:30	08:30	CAD	Median CPI y/y	3.9	3.7	3.9			
Tue 18.07.23	**14:30**	13:30	08:30	CAD	Trimmed CPI y/y	3.7	3.6	3.8			
Tue 18.07.23	**14:32**	13:32	08:32	CAD	Core CPI m/m	-0.1		0.4			
Tue 18.07.23	**14:30**	13:30	08:30	USD	Core Retail Sales m/m	0.2	0.4	0.1			USD higher
Tue 18.07.23	**14:30**	13:30	08:30	USD	Retail Sales m/m	0.2	0.5	0.3			
Tue 18.07.23	**15:15**	14:15	09:15	USD	Industrial Production m/m	-0.5	0.0	-0.2			USD sideways
Tue 18.07.23	**16:00**	15:00	10:00	USD	NAHB Housing Market Index	56	56	55			USD lower
Tue 18.07.23	**16:17**	15:17	10:17	NZD	GDT Price Index	-1.0		-3.3			CAD sideways



Wednesday, 19.07.23

data via forexfactory.com

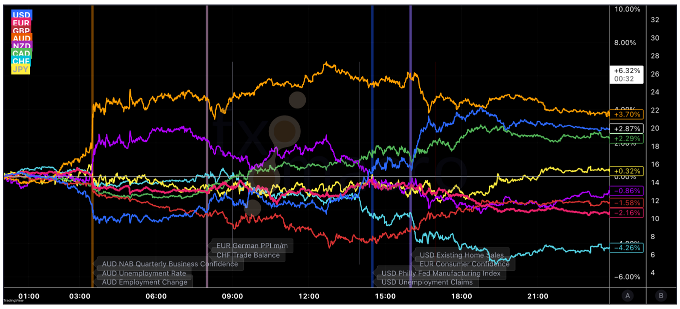
Date	FRA	LON	NYC	Cncy	Data	Act.	Exp.	Prev.	Forecast Range Low	Forecast Range High	Reaction
Wed 19.07.23	**00:45**	23:45	18:45	NZD	CPI q/q	1.1	0.9	1.2			NZD up but then weaker
Wed 19.07.23	**02:30**	01:30	20:30	AUD	MI Leading Index m/m	0.1		-0.3			AUD weaker
Wed 19.07.23	**08:00**	07:00	02:00	GBP	CPI y/y	7.9	8.2	8.7			GBP sharply lower
Wed 19.07.23	**08:00**	07:00	02:00	GBP	Core CPI y/y	6.9	7.1	7.1			
Wed 19.07.23	**08:00**	07:00	02:00	GBP	PPI Input m/m	-1.3	-0.3	-1.5			
Wed 19.07.23	**08:00**	07:00	02:00	GBP	PPI Output m/m	-0.3	-0.3	-0.5			
Wed 19.07.23	**14:30**	13:30	08:30	USD	Building Permits	1.43	1.48	1.49			USD sideways
Wed 19.07.23	**14:30**	13:30	08:30	USD	Housing Starts	1.44	1.47	1.63			



Thursday, 20.07.23

data via forexfactory.com

Date	FRA	LON	NYC	Cncy	Data	Act.	Exp.	Prev.	Forecast Range Low	Forecast Range High	Reaction
Thu 20.07.23	**03:30**	02:30	21:30	AUD	Employment Change	32.6	15.4	75.9			AUD kneejerk higher
Thu 20.07.23	**03:30**	02:30	21:30	AUD	Unemployment Rate	3.5	3.6	3.6			
Thu 20.07.23	**03:30**	02:30	21:30	AUD	NAB Quarterly Business Confide	-3		-4			
Thu 20.07.23	**08:00**	07:00	02:00	CHF	Trade Balance	4.82	4.23	5.48			CHF sideways
Thu 20.07.23	**08:00**	07:00	02:00	EUR	German PPI m/m	-0.3	-0.4	-1.4			EUR stronger
Thu 20.07.23	**14:30**	13:30	08:30	USD	Unemployment Claims	228	239	237			USD stronger
Thu 20.07.23	**14:30**	13:30	08:30	USD	Philly Fed Manufacturing Index	-13.5	-10.1	-13.7			
Thu 20.07.23	**16:02**	15:02	10:02	EUR	Consumer Confidence	-15	-16	-16			EUR unchanged
Thu 20.07.23	**16:00**	15:00	10:00	USD	Existing Home Sales	4.16	4.21	4.30			USD stronger



Friday, 21.07.23

data via forexfactory.com

Date	FRA	LON	NYC	Cncy	Data	Act.	Exp.	Prev.	Forecast Range Low	Forecast Range High	Reaction
Fri 21.07.23	**01:01**	00:01	19:01	GBP	GfK Consumer Confidence	-30	-25	-24			GBP unchanged
Fri 21.07.23	**01:30**	00:30	19:30	JPY	National Core CPI y/y	3.3	3.3	3.2			JPY briefly higher
Fri 21.07.23	**08:00**	07:00	02:00	GBP	Retail Sales m/m	0.7	0.2	0.3			GBP stronger
Fri 21.07.23	**14:30**	13:30	08:30	CAD	Core Retail Sales m/m	0.0	0.2	1.3			CAD weaker
Fri 21.07.23	**14:30**	13:30	08:30	CAD	Retail Sales m/m	0.2	0.5	1.1