MNI RBA Preview - July 2022

Meeting Date: Tuesday 5 July 2022

Decision Time: 14:30 AEST/05:30 BST

Link To Statement: https://www.rba.gov.au/monetary-policy/int-rate-decisions/2022/

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mni Central Bank Watch - RBA

Monday, July 4, 2022

MNI RBA Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI (Q)	% y/y	5.1	3.5	↑	3.0	↑					1.53
CPI Trimmed Mean (Q)	% y/y	3.7	2.6	↑	2.1	↑					2.03
Import Prices (Q)	% q/q	5.1	5.8	↓	5.4	↓					1.00
Consumer Inflation Exp	% y/y	6.7	4.9	↑	4.8	↑					2.32
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
AiG PMI	Index	54.0	55.7	↓	48.4	↑					-0.15
GDP (Q)	% y/y	3.3	4.4	↓	4.1	↓					0.34
Building Approvals	% y/y	-20.9	-8.0	↓	-8.2	↓					-0.37
Trade Balance	AUD m	10495	12745	↓	10384	↑					0.35
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Home Loans	% m/m	1.4	-0.8	↑	-2.1	↑					0.84
Private Sector Credit	% y/y	9.1	8.0	↑	6.6	↑					1.36
Private Capital Expend (Q)	% q/q	-0.3	2.3	↓	-1.1	↑					-0.24
Commodity Prices	% SDR	24.3	45.0	↓	30.7	↓					-1.27
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% m/m	0.9	1.8	↓	7.1	↓					0.05
Consumer Confidence	Index	86.35	96.62	↓	104.28	↓					-1.69
Employment Change	k	60.6	97.6	↓	384.0	↓					-0.14
Wage Price Index (Q)	% q/q	0.7	0.7	→	0.6	↑					0.80
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	6634.0	7499.6	↓	7444.6	↓					-0.60
AUD 10-Year Yield	%	3.49	2.84	↑	1.67	↑					1.40
AUD Yield Curve (3s-10s)	bps	64.6	50.5	↑	75.7	↓					-0.38
AUD TWI	Index	135.03	138.81	↓	133.38	↑					0.22

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

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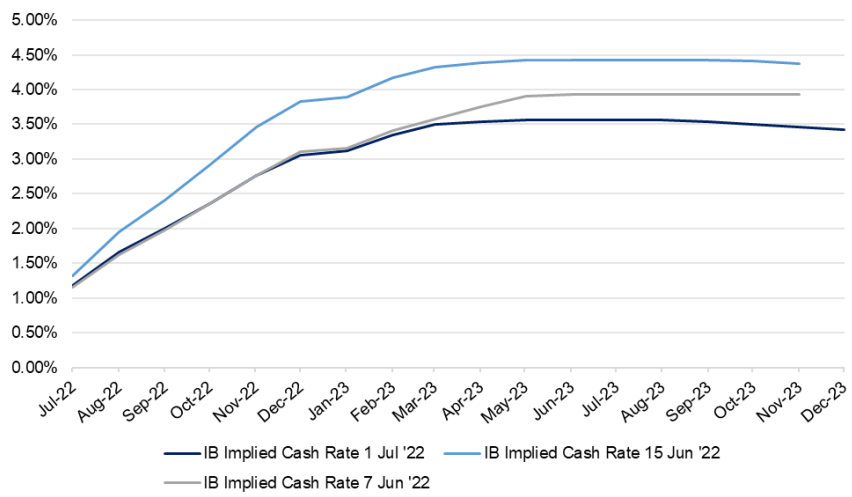
MNI POV (Point Of View): Everything Points To 50

The analytical community is unanimously behind the idea that the RBA will deliver further tightening at its July meeting, with 25 of the 26 surveyed by BBG looking for a 50bp hike and just one looking a 75bp step. The STIR space currently prices in ~43bp of tightening come the end of the Bank's July meeting, which equates to just under a 75% chance of a 50bp hike.

The tightness of the labour market (as measured by the headline unemployment rate, alongside tumbling underemployment & underutilisation rates, as well as job vacancies data), coupled with a higher peak in inflation (Governor Lowe recently revealed that the RBA now expects inflation to hit 7% in Q422) and the fact that Governor Lowe recently pushed back against the idea of deploying a 75bp hike at the upcoming meeting, expressing his preference for a 25 or 50bp hike when questioned on the matter, leads us to favour a 50bp rate hike in July. The aforementioned factors, alongside the tightening witnessed in the likes of the U.S. and New Zealand and the RBA's focus on inflation psychology, mean that there is no reason for the RBA to ease off when it comes to the pace of tightening, at least in the very immediate term.

Looking ahead, markets continue to price a terminal rate that is above both the wider sell-side views and the ~2.50% that the RBA is hopeful that the cash rate will reach at some point. Still, note that pricing surrounding the cash rate at the end of the Bank's Dec '22 meeting has moderated in recent weeks, driven by a combination of market pricing surrounding the Bank's major global peers (as recessionary worry bites) and Governor Lowe's pushback against the idea of deploying a 75bp rate hike.

Fig. 1: The Recent Evolution Of Market Pricing Of The RBA Cash Rate



The degree of tightening priced into the markets continue to draw questions from economists, with some worry surrounding household debt evident (the RBA's measure of household debt to income moved past levels observed in '18 during Q122).

The window whereby the RBA has space to act is seemingly narrower than was perceived just a few months back, given wider recessionary worries (most notably in the U.S., Eurozone & UK), although the reopening of the Chinese cities of Beijing and Shanghai present some near-term economic tailwinds from closer shores, albeit with questions surrounding the wider trajectory of economic growth in Chinese remaining evident. House prices have started to correct, although that presents nothing in the way of surprise/headwinds to further tightening.

Elsewhere, externalities surrounding the aforementioned recession worry in some of the major global economies, coupled with the associated potential for shallower than previously perceived hiking cycles for some of the major global central banks continue to leave market pricing looking aggressive, even when the recent correction is considered. There is an argument to be made re: needing to deliver on the bulk of the tightening currently priced into markets to limit the extent that downside in AUD feeds through into higher inflation, although the AUD has been much more sensitive to wider swings in expectations surrounding broader growth and commodity prices than relative RBA pricing expectations.

Expect the Board to reiterate its guidance that it "expects to take further steps in the process of normalising monetary conditions in Australia over the months ahead." Q2 CPI data (due 27 July) is set to provide the next major yardstick when it comes to assessing the velocity of any future RBA tightening, while the minutes of the July meeting will be combed over for references to the level of stimulatory benefits provided by the post-July meeting cash rate setting.

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RBA 7 June 2022 Meeting Statement

At its meeting today, the Board decided to increase the cash rate target by 50 basis points to 85 basis points. It also increased the interest rate on Exchange Settlement balances by 50 basis points to 75 basis points.

Inflation in Australia has increased significantly. While inflation is lower than in most other advanced economies, it is higher than earlier expected. Global factors, including COVID-related disruptions to supply chains and the war in Ukraine, account for much of this increase in inflation. But domestic factors are playing a role too, with capacity constraints in some sectors and the tight labour market contributing to the upward pressure on prices. The floods earlier this year have also affected some prices.

Inflation is expected to increase further, but then decline back towards the 2–3 per cent range next year. Higher prices for electricity and gas and recent increases in petrol prices mean that, in the near term, inflation is likely to be higher than was expected a month ago. As the global supply-side problems are resolved and commodity prices stabilise, even if at a high level, inflation is expected to moderate. Today's increase in interest rates will assist with the return of inflation to target over time.

The Australian economy is resilient, growing by 0.8 per cent in the March quarter and 3.3 per cent over the year. Household and business balance sheets are generally in good shape, an upswing in business investment is underway and there is a large pipeline of construction work to be completed. Macroeconomic policy settings are supportive of growth and national income is being boosted by higher commodity prices. The terms of trade are at a record high.

The labour market is also strong. Employment has grown significantly and the unemployment rate is 3.9 per cent, which is the lowest rate in almost 50 years. Job vacancies and job ads are at high levels and a further decline in unemployment and underemployment is expected. The Bank's business liaison program continues to point to a lift in wages growth from the low rates of recent years as firms compete for staff in a tight labour market.

One source of uncertainty about the economic outlook is how household spending evolves, given the increasing pressure on Australian households' budgets from higher inflation. Interest rates are also increasing. Housing prices have declined in some markets over recent months but remain more than 25 per cent higher than prior to the pandemic, supporting household wealth and spending. The household saving rate also remains higher than it was before the pandemic and many households have built up large financial buffers. While the central scenario is for strong household consumption growth this year, the Board will be paying close attention to these various influences on consumption as it assesses the appropriate setting of monetary policy.

The Board will also be paying close attention to the global outlook, which remains clouded by the war in Ukraine and its effect on the prices for energy and agricultural commodities. Real household incomes are under pressure in many economies and financial conditions are tightening, as central banks withdraw monetary policy support in response to broad-based inflation. There are also ongoing uncertainties related to COVID, especially in China.

Today's increase in interest rates by the Board is a further step in the withdrawal of the extraordinary monetary support that was put in place to help the Australian economy during the pandemic. The resilience of the economy and the higher inflation mean that this extraordinary support is no longer needed. Given the current inflation pressures in the economy, and the still very low level of interest rates, the Board decided to move by 50 basis points today. The Board expects to take further steps in the process of normalising monetary conditions in Australia over the months ahead. The size and timing of future interest rate increases will be guided by the incoming data and the Board's assessment of the outlook for inflation and the labour market. The Board is committed to doing what is necessary to ensure that inflation in Australia returns to target over time.

MNI STATE OF PLAY: RBA To Hike Again And Push Rates Over 1%

By Lachlan Colquhoun

SYDNEY (MNI) - The Reserve Bank of Australia meets this week with few doubts that the interest rate hikes it began in May will continue as it moves to normalise monetary policy with a careful eye on inflation risks.

The RBA's overnight cash rate currently stands at 0.85% after a surprisingly large 50 basis point increase in June, and the bank is likely on Tuesday to consider either a 25 or 50 basis point increase at the board meeting to take rates through the 1% threshold.

A 75 bps increase is considered unlikely following comments by RBA Governor Philip Lowe at a Bank of International Settlements event earlier this month, when he largely ruled out the chances of the bigger hike, (See: MNI INSIGHT: 75 Basis Points Hike Unlikely For RBA).

FORWARD GUIDANCE AND DATA

He said the fact that the RBA meets monthly means that it can increase rates in smaller increments than other central banks. The RBA has abandoned forward guidance and now says it will be data driven, although there have not been any significant data releases from the Australian Bureau of Statistics since the last meeting in June.

Building approvals data from the ABS on Monday showed a seasonally adjusted 2.4% fall in May dwelling approvals, suggesting that rising interest rates are already putting the brakes on the economy. Retail trade, international trade and payroll data is due later this week, but the next ABS inflation data is not until July 27.

OTHER SOURCES

The RBA's own data, released last week, showed a different picture in that credit demand remained steady in May and is growing at an annualised 9%.

The central bank has been relying more on its liaison research programmes, which deliver more time sensitive data, and wages data gleaned from the source was used to justify the May rate hike.

The RBA's current stance is that it will do all it can to combat inflation, which is currently at 5.1% against the 2 to 3% target range. Underlying inflation, the bank's preferred measure, is at 3.7%.

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Sell-Side Analyst Views

AMP Capital: The RBA is expected to increase the cash rate again on Tuesday by another 0.5% taking it to 1.35%. This is already the fastest tightening cycle since 1994 and reflects the surge in inflation and the RBA wanting to underline its commitment to getting inflation back to 2-3% on the grounds that this will help avert the need for even more aggressive rate hikes later. RBA Governor Lowe has indicated that a 0.25% or 0.5% hike is on the table for the July meeting. With interest rates still being too low given the tight jobs market, inflation on its way to 7%yoy and the RBA needing to keep inflation expectations down – particularly after the roughly 5% minimum wage and minimum award wage increases - we expect another 0.5% move. A 0.75% hike as undertaken by the Fed last month is possible but unlikely given that the RBA meets more frequently than the Fed. The RBA will probably hike again by 0.5% in August but thereafter we expect more gradual moves as economic data slows with the cash rate expected to rise to 2.1% by year end with a peak around 2.5% in the first half of next year, ahead of rate cuts in the second half of next year.

ANZ: We see the RBA tightening by 50bp. The accompanying statement will likely repeat June's wording that "the Board expects to take further steps in the process of normalising monetary conditions in Australia over the months ahead." This is a clear signal of future rate hikes. We expect that at its August meeting the Board will again choose between an increase of 25 or 50bp, though this time we expect the choice to be 25bp. But a big upward surprise in Q2 inflation may force the RBA's hand to another 50bp.

Bank of America: RBA Governor Lowe has effectively ruled out the possibility of 75bp hikes at upcoming meetings. Similar to the June meeting, the Bank would decide between 25bp and 50bp next week, depending on the economic data available at the time. Domestic data have been sufficient to support our view for a 50bp hike next week. Labor market outcomes for May suggest there is scope for unemployment to fall further below 4%. Importantly, inflation is far from peaking, where we see headline rising to 9.2% by the year-end vs. the RBA's 7%. Yet, fiscal policy is set to remain stimulatory across AU states despite the risk of fueling inflation even further, especially after the 5.2% lift to minimum wages.

Barclays: The RBA is likely to raise the cash rate aggressively until the OCR reaches 2.0%, a level last seen in early 2016. The bank is likely to place less emphasis on data until that level is reached. In light of continued increase in inflation, we expect a 50bp hike**.**

CBA: On balance, we favour a 50bp hike in July. The RBA now appears intent on front loading the tightening cycle despite the Governor stating in his 21 June speech that, "I want to emphasise though that we are not on a pre-set path." The market prefers consistency in policy communication and action. That does not mean the market requires forward guidance. Indeed maintaining rigid forward guidance when the facts change is very much want the market does not like. However, it does not make sense to chop and change between a series of 25bp and 50bp hikes over coming months. Indeed we believe that once the RBA drops back to a 'business as usual' 25bp rate hike at any near term monthly Board meeting the probability of then delivering a larger 50bp hike at a future meetings in this tightening cycle would be very low. Put another way, a potential sequence of rate hikes of 25bp in May, 50bp in June, 25bp in July and 50bp in August would be unwelcome. It is much better to move by 50bp in July and make a judgement around 25bp or 50bp in August based on the evolution of the data and the outlook for both inflation and the economy.

Goldman Sachs: On balance, we continue to expect the RBA to hike by 50bp in July, followed by 50bp hikes in August and September. In terms of risk, we now only assign a 20% chance of a 75bp hike in July given Governor Lowe's recent comments. However, given the rising inflation outlook, we continue to assign a ~35% chance that the RBA hikes rates by 75bp in August (following the Q222 CPI data). We expect the RBA's official forward guidance to remain fairly vague and data dependent. Further ahead, our base case remains that RBA will hike by 25bp per meeting over Q422, reaching a terminal rate of 3.1% by end 2022 - around 50bp above our estimate of 'neutral'. While headline inflation is likely to come down quite quickly over H123 as food and fuel prices ease, we expect the RBA to keep policy settings 'contractionary' over 2023 to generate a modest increase in unemployment and prevent an ongoing overshoot of underlying inflation in 2024 and 2025.

ING: It is pretty clear that despite being a little slow to pick up the inflation threat, the RBA is now fully on board with its determination to bring inflation down. Rates are going up. The only question is, how fast? Well, we haven't had any particularly helpful data since the last meeting. We don't for example have any further inflation data to react to, though Melbourne Institute inflation expectations did move sharply higher. The lack of new hard data is probably why Governor Philip Lowe ruled out a 75bp hike when asked earlier this month. The choice is therefore between 25bp and 50bp. What may tip the balance in favour of the bigger hike is how far the RBA needs to go in order to get rates even to neutral. That suggests not hanging about. They can step up the pace if needed once they have sight of the Q2 inflation print. So it's 50bp now, and 75bp in September, if the inflation data paints an ugly enough picture. If not, they can ease back a bit and revert to 25bp or 50bp hikes.

J.P.Morgan: We expect the RBA to hike the cash rate target and IOER by 50bp at this week's meeting, taking the target to 1.35%. The minutes and the Governor's most recent speeches indicate that decisions are currently motivated by the still low level of rates, and reaching a destination of 2.5% "over time". This suggests that for now, each monthly move in the recalibration of policy is not particularly tethered to the flow of incoming data and so can be quite brisk, until rates get closer to 2%. Recent communications also suggest the board is tossing up between 25bp and 50bp moves, with 75bp off the table for now.

- Guidance has not exactly been iron-clad in recent years, but for the coming meeting, we see this as credible. The board's messaging is that nothing about the normalization process is locked in stone, but to the extent this is true, it is stating the obvious and probably is directed at the public, rather than markets. In our view the leadership does have a path/destination in mind for the next six months or so given that inflation is likely to remain strong, and only a very sharp weakening in the activity data would be sufficient to stop this. Last week's retail and vacancy data were firm and suggest household spending will hold up in the opening leg of the tightening process, despite weaker housing/sentiment. In our view this should be decisive for a 50bp move this week.

Morgan Stanley: The RBA has moved inflation concerns to the fore, and we expect another 50bp hike in July. The impact of tightening is emerging in sentiment and housing, but broader slowing of jobs and inflation won't be felt until late this year, keeping H222 rate hikes on track, even as risks grow for 2023. In a speech the Governor noted that its rate decision would be influenced by: 1) global developments; 2) labour costs; 3) how spending is responding to higher rates. We think all three of these factors point to a larger hike in July - particularly given the continued upside surprises to inflation outcomes and central bank responses globally, as well as the minimum wage increase of 4.6-5.2% in June. With the Governor taking a 75bp hike off the table, we think this implies 50bps is the most likely outcome. The tightening impact is already evident in the more sensitive areas of the economy. Consumer sentiment has declined to recessionary levels and house prices are falling sharply. Importantly though - while discretionary areas of spending are likely to come under pressure (from elevated levels), broader consumer spending should hold up OK during H222, with labour market weakness only coming through early next year. Inflation optics are likely to stay poor for some time - we expect a peak in inflation in Q4 at 7.4% - which (given quarterly inflation prints) means it would not be until the May '23 meeting that the RBA receives the first data confirming a peak in inflation.

NAB: The RBA surprised markets with a 50bp hike in June and we expect another 50bp hike in both July and August. The communication since the June meeting has made it clear that the 50bp move was based on an "upward revision to the inflation outlook and the recognition that interest rates were still very, very low for an economy that was experiencing high inflation and had such low unemployment." Data since then has been on the strong. Central banks globally are almost singularly focussed on the risk of high and variable inflation entrenching for longer should inflation expectations de-anchor and wages growth accelerate more sharply. For its part, the RBA is emphasising the need to chart a 'credible' path back to at-target inflation. In that environment, the risk is that the RBA opts to push rates more clearly into restrictive territory. NAB pencils in 50bp rises in July and August and a cash rate of 2.1% by year-end. The risk is the RBA will feel compelled to continue to hike rates relatively aggressively after August given what we expect to be a very strong Q2 CPI print and no let up of labour market tightness on the back of very strong labour demand indicators

RBC: Another hike in the policy normalization cycle is a done deal this week with the only uncertainty around the size. Like the last meeting, RBA communication suggests that the deliberation will be over whether to move by 25bp or 50bp. Since the board last met on 7 Jun, global central banking policy (+75bp Fed, +50bp SNB, hawkish ECB, BoE), domestic wage and inflation developments (5.2% minimum wage increase, surging wholesale gas, rising inflationary expectations) and the still very low level of cash suggest a 50bp hike on Tuesday is warranted. We look for another 50bp move this week and, a statement that confirms a focus in returning inflation back to target and need to keep inflationary expectations anchored. We expect the tone to err hawkish, consistent with not only further hikes but the likelihood of further 50bp moves with a desire to get into the neutral cash rate range of 2-3% sooner rather than later.

Societe Generale: We expect the RBA to increase the cash rate target from 0.85% to 1.35% at its July policy meeting, which would mark a back-to-back 'big-step' policy rate hike after the one announced in June.
The RBA already demonstrated its hawkish stance at its June meeting by announcing a surprising 50bp rate hike and using wording such as "still very low level of interest rates," "take further steps in the process of normalising monetary conditions over the months ahead" and "committed to doing what is necessary to ensure that inflation returns to target over time." Accordingly, we made the call for the RBA to make another 50bp rate hike in July right after the June meeting.

- The events and data releases that have occurred since the June policy meeting largely support a 50bp hike in July. Above all, the US Fed's 'giant-step' hike of 75bp on 16 June should clearly affect global central banks including the RBA. Governor Lowe's speech on 21 June basically reiterated the hawkish stance already seen in the June meeting, although the effective upward revision of the Q422 headline inflation forecast from 5.9% to around 7% would be another excuse for a big-step hike. The minutes to the June meeting explain that a 50bp hike is needed to control inflation expectations. The latest economic data also favour aggressive monetary tightening. The May employment data contains various signs of tight labour market conditions, including a record-low unemployment rate, a record-high participation rate, a shift from parttime to full-time workers, and the significant increase in hours worked. Continued strength in retail sales would be evidence of both a resilient consumption recovery and higher inflation.
- We maintain our base scenario that the policy rate will reach a 'terminal' level of 2.50% at the end of this year after a few more big-step hikes. Further hikes are unlikely given the likely decline in inflation from early next year and concern about the impact that higher interest rates will have on growth and the housing market. We acknowledge that these two factors have already taken on board by the policymakers.

TD Securities: Governor Lowe made it clear that the Board will discuss either a 25bps or 50bps hike next week. Given the strong data prints and upside inflation risks, we expect the RBA to take decisive action and hike by 50bps. However, we see a low likelihood of the RBA sounding more hawkish in the statement after the Governor's successful attempt in paring back aggressive OIS pricing.

Westpac: We expect the Board will decide to lift the cash rate by 50 basis points from 0.85% to 1.35%. We assess the neutral zone for the cash rate at 1.5-2.0%. Consequently, even after that move the cash rate will still be below the "neutral zone" and in stimulatory territory. The impotence of a predictable, steady sequence of 25 basis point moves was demonstrated during the housing bubble period in the US. Between June 2004 and May 2006 Chairman Greenspan's FOMC raised the federal funds rate at every meeting by 25 basis points. That steady, predictable policy did little to dissuade speculators about the FOMC's commitment to maintaining stability. My interpretation of the "uncertain environment" is that in due course, when rates are higher, that consideration will be relevant. Once policy is near the top of the "neutral zone" the impact of policy on the economy does become more uncertain and caution is warranted. The other benefit of the 50 basis point move at the June meeting was seen to be "there is a heightened risk of persistently high inflation, especially if expectations of higher inflation become entrenched." That concern around inflationary expectations stands out as a key consideration not only for the RBA but also for all central banks. A "steady" path of 25 basis points would certainly have much less "shock effect" on the assessment of the commitment of the RBA to containing inflationary pressures. So, now that the Board has clarified its position on the best approach to policy it would seem quite clear that with the cash rate at only 0.85% a second decisive move of 50 basis points is the appropriate policy.

- The Governor's Statement following the Board meeting and the associated Minutes which will print on July 19 will provide some guidance as to whether the Board believes the cash rate is still stimulatory at 1.35% We think the need to contain those inflationary expectations in the face of another outsize inflation print and the assessment that policy is still stimulatory will indicate to the reader that the Board is open to a third 50 basis point move in August. We would be very surprised if the Statement indicates a commitment to scale back the rate hikes to that "steady" 25 basis point process for the remainder of the year. In fact, our view is that a better policy would be to raise the cash rate by 50 basis points in August and then pause in September so that the unprecedented cumulation of four consecutive meetings totalling 175 basis points can be assessed. There will be no indication of that strategy in July. We will have to await the August Statement to see whether the pause is favoured by the Board.
- We will be particularly interested in any guidance the Governor may provide about the August meeting, where we expect a third consecutive 50 basis point move prior to a pause in September. The June quarter inflation data, to be published on Wednesday July 27, will be a key update a little less than a week prior to the August Board meeting.