All Signal, No Noise

MARKET ANALYSIS

MNI RBA Preview - November 2022

Meeting Date: Tuesday 1 November 2022

Announcement Time: 14:30 AEST / 03:30 GMT

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

Contents

mni Central Bank Watch - RBA

Monday, October 31, 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	7.3	6.1	↑	5.1	↑					1.53
CPI Trimmed Mean (Q)	% y/y	6.1	4.9	↑	3.8	↑					1.73
Import Prices (Q)	% q/q	3.0	4.3	↓	5.1	↓					-0.03
Consumer Inflation Exp	% y/y	5.4	6.3	↓	5.2	↑					-0.31
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
AiG PMI	Index	50.2	54.0	↓	55.7	↓					-1.03
GDP (Q)	% y/y	3.6	3.3	↑	4.5	↓					0.20
Building Approvals	% y/y	-9.5	-19.8	↑	-7.5	↓					1.21
Trade Balance	AUD m	8324	14257	↓	6950	↑					-0.79
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	9.5	9.1	↑	8.0	↑					1.04
Private Capital Expend (Q)	% q/q	-0.3	0.4	↓	1.8	↓					-0.80
Commodity Prices	% SDR	30.6	42.9	↓	46.0	↓					-0.61
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	0.6	0.2	↑	1.6	↓					-0.07
Consumer Confidence	Index	83.72	83.79	↓	95.77	↓					-0.70
Employment Change	k	0.9	68.4	↓	35.8	↓					-0.73
Wage Price Index (Q)	% q/q	0.7	0.7	↑	0.7	↑					1.01
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	6837.1	6945.2	↓	7435.0	↓					-0.59
AUD 10-Year Yield	%	3.78	3.06	↑	3.13	↑					0.97
AUD Yield Curve (3s-10s)	bps	47.9	39.6	↑	41.8	↑					0.44
AUD TWI	Index	140.20	134.34	↑	133.37	↑					1.40

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

Business Address - MNI Market News, 5th Floor, 69 Leadenhall Street, London, EC3M 2DB

MNI POV (Point Of View): 25bp In November But Cycle Likely To Be Longer

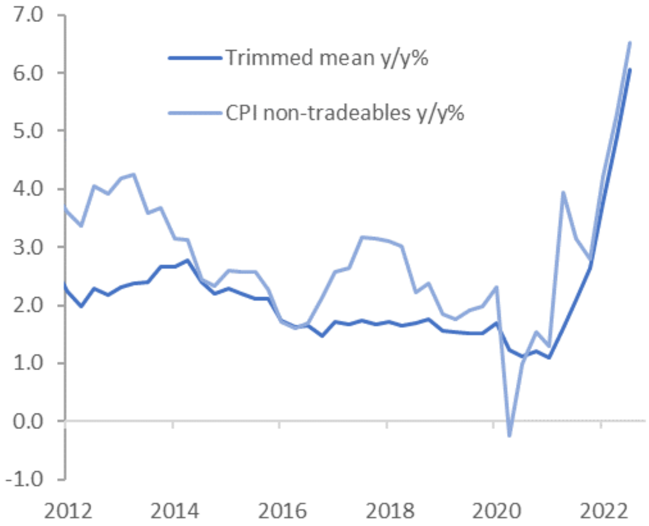
Despite the higher-than-expected Q3 CPI print and the pickup in underlying inflation, we expect the RBA to stick to its new 25bp hiking path at its meeting on November 1. Economists generally also expect 25bp with only 3 of the 26 surveyed by Bloomberg forecasting a return to 50bp. While its trimmed mean inflation forecast is likely to be revised up in the Statement on Monetary Policy published on November 4, recent RBA commentary gives many reasons why it is likely to raise rates 25bp again rather than going back to 50bp.

Many of the RBA's reasons for the surprise pivot to 25bp in October still hold. In the minutes, the Board said that one motive for slowing the pace of tightening was that it would be "drawing out policy adjustments" which could "help to keep public attention focused for a longer period" on the Board's determination to bring inflation back to target. Deputy Governor Bullock also commented recently that the RBA has more meetings than other central banks and so can do less per meeting but achieve the same result. The RBA has two meetings before the end of the year. Global and domestic uncertainties, the lags involved, considerable tightening this year and wages still consistent with the inflation target remain valid reasons to keep to 25bp hikes per meeting.

While the latest inflation data may not necessarily mean that the bank returns to 50bp, it probably indicates that its tightening cycle will be extended into 2023, as we discussed in MNI Insight: Australian Q3 CPI Beat Sees Tightening Cycle Extend Into 2023. In addition, the October federal government budget forecast of a 56% increase in power prices over the current and following financial years and the subsequent 0.75pp and 1pp contributions to inflation could also add to the duration of the RBA's hiking cycle, if there isn't any intervention in energy markets.

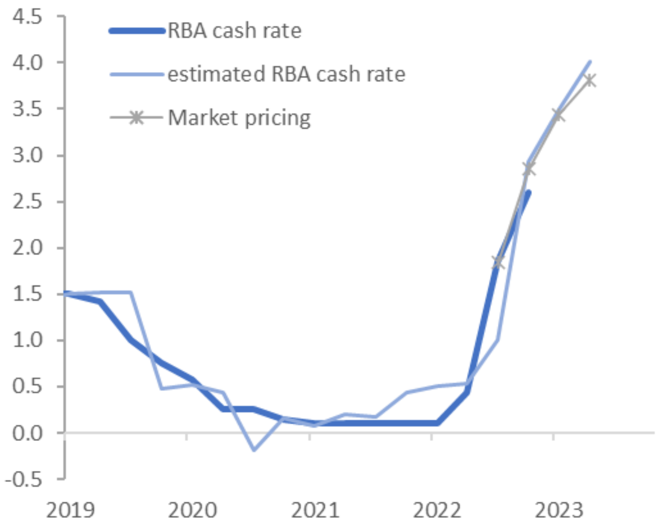
Q3 CPI rose to its highest annual rate since mid-1990 at 7.3% y/y after 6.1% y/y. The quarterly pace didn't ease as expected either. The underlying inflation measures were also very concerning. Trimmed mean rose to 6.1% y/y, above the RBA's year-end forecast, and the 1.8% q/q rise was a further pick up in pace. The newly established monthly data for September showed that core inflation only rose further at the end of the quarter. Non-tradeables prices increased a strong 2% q/q and 6.5% y/y, pointing to a concerning pick up in domestically-driven inflation (see Fig 1).

Figure 1: Underlying inflation y/y%



Source: Source: MNI – Market News/Refinitiv

Figure 2: RBA reaction function with expectations

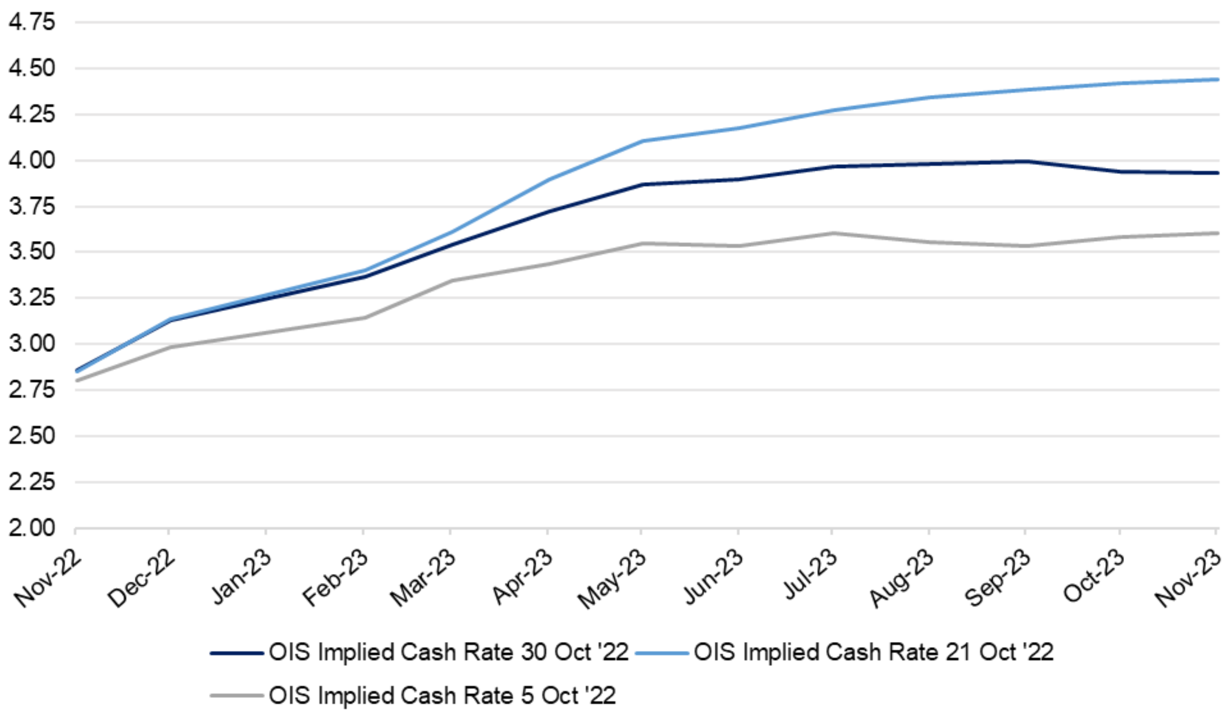


Source: MNI – Market News/Refinitiv/Bloomberg

The board is likely to have a difficult discussion at the November meeting, given the inflation surprise and the broadening of price pressures into more domestic-related sectors and that the outlook for consumers and the global economy remains uncertain. While a return to 50bp could provoke the markets and other economic participants to panic and impact the RBA's credibility, it continued to leave the door open at the end of the October statement by saying "The size and timing of future interest rate increases will continue to be determined by the incoming data…" So, there is a risk that the RBA decides to hike by 50bp in response to rising inflation.

AUD OIS pricing expects about 30bp from the RBA in November and a peak in rates around August of just under 4%. Our estimated policy reaction function is signalling 25bp rate hikes at the next six meetings based on actual and projected inflation and capacity measures, and is just above market pricing with an approximated average cash rate of 4.0% for Q2 2023 (see Fig 2 above and [MNI Insight: Economics Pointing To Rate Hikes Into 2023] for estimation details).

Fig. 3: The Recent Evolution Of Market Pricing Of The RBA Cash Rate (%)



While inflation was worryingly high in Q3 and the labour market remained tight in the latest data, surveys pointed to an upcoming slowing in domestic and global activity and a peak in cost pressures. As the RBA is data dependent, on balance the data over the last month point towards a 25bp hike at the November meeting but inflation indicates that there are upside risks to this expectation.

RBA October 4 2022 Meeting Statement

At its meeting today, the Board decided to increase the cash rate target by 25 basis points to 2.60 per cent. It also increased the interest rate on Exchange Settlement balances by 25 basis points to 2.50 per cent.

The Board is committed to returning inflation to the 2–3 per cent range over time. Today's increase in interest rates will help achieve this goal and further increases are likely to be required over the period ahead. The cash rate has been increased substantially in a short period of time. Reflecting this, the Board decided to increase the cash rate by 25 basis points this month as it assesses the outlook for inflation and economic growth in Australia.

As is the case in most countries, inflation in Australia is too high. Global factors explain much of this high inflation, but strong domestic demand relative to the ability of the economy to meet that demand is also playing a role.

A further increase in inflation is expected over the months ahead, before inflation then declines back towards the 2–3 per cent range. The expected moderation in inflation next year reflects the ongoing resolution of global supply-side problems, recent declines in some commodity prices and the impact of rising interest rates. Medium-term inflation expectations remain well anchored, and it is important that this remains the case. The Bank's central forecast is for CPI inflation to be around 7¾ per cent over 2022, a little above 4 per cent over 2023 and around 3 per cent over 2024.

The Australian economy is continuing to grow solidly and national income is being boosted by a record level of the terms of trade. The labour market is very tight and many firms are having difficulty hiring workers. The unemployment rate in August was 3.5 per cent, around the lowest rate in almost 50 years. Job vacancies and job ads are both at very high levels, suggesting a further decline in the unemployment rate over the months ahead. Beyond that, some increase in the unemployment rate is expected as economic growth slows.

Wages growth is continuing to pick up from the low rates of recent years, although it remains lower than in other advanced economies where inflation is higher. Given the tight labour market and the upstream price pressures, the Board will continue to pay close attention to both the evolution of labour costs and the price-setting behaviour of firms in the period ahead.

Price stability is a prerequisite for a strong economy and a sustained period of full employment. Given this, the Board's priority is to return inflation to the 2–3 per cent range over time. It is seeking to do this while keeping the economy on an even keel. The path to achieving this balance is a narrow one and it is clouded in uncertainty.

One source of uncertainty is the outlook for the global economy, which has deteriorated recently. Another is how household spending in Australia responds to the tighter financial conditions. Higher inflation and higher interest rates are putting pressure on household budgets, with the full effects of higher interest rates yet to be felt in mortgage payments. Consumer confidence has also fallen and housing prices are declining after the earlier large increases. Working in the other direction, people are finding jobs, gaining more hours of work and receiving higher wages. Many households have also built up large financial buffers and the saving rate still remains higher than it was before the pandemic.

Today's further increase in interest rates will help achieve a more sustainable balance of demand and supply in the Australian economy. This is necessary to bring inflation back down. The Board expects to increase interest rates further over the period ahead. It is closely monitoring the global economy, household spending and wage and price-setting behaviour. The size and timing of future interest rate increases will continue to be determined by the incoming data and the Board's assessment of the outlook for inflation and the labour market. The Board remains resolute in its determination to return inflation to target and will do what is necessary to achieve that.

MNI RBA WATCH: Hot Inflation Means 25bp Hikes Into 2023

By Robert Guy

MNI (Perth) - The Reserve Bank of Australia is expected to deliver a 25bp hike to 2.85% at its Nov 1 meeting after a red-hot September quarter inflation print triggered the pricing in of additional hikes and a terminal rate above 4%. A seventh consecutive increase in rates will lift them to their highest level since April 2013, but the most aggressive tightening cycle in three decades is expected to push into 2023 after the September quarter CPI rose at a 7.3% y/y pace. The higher-than-expected inflation prompted some economists to call for a 50bp hike next Tuesday.
(See MNI INSIGHT: Economics Pointing To Rate Hikes Into 2023)

The decision to downshift to a 25bp hike at the October meeting - and wrong-foot consensus calls for 50bp - was "finely balanced" according to the meeting's minutes, with the bank acknowledging in its post-meeting statement that inflation was expected to rise "over the months ahead". The decision to slow the pace of hikes reflected the fact that rates had "increased substantially" since the RBA started tightening in May from a low of 0.1%. (See MNI STATE OF PLAY: RBA Taps Brakes, Sees Slower Pace of Hikes)

The RBA has been wary of a shift in inflation psychology should it trigger a change in wage and corporate price setting behaviour. Feeding those concerns has been tight labour supply, but September jobs data suggested steam may be coming out of the market. Only 900 new jobs were added, compared to a forecast 25,000, and the unemployment rate remained steady at 3.5%. NAB's September Business Survey showed signs of easing labour and purchase cost growth.

INFLATION FIGHTING CREDENTIALS

Despite the CPI shock, the RBA is expected to use its monthly meetings to keep tightening in 25bp increments. Deputy Governor Michele Bullock said on Oct 18 that its ability to meet 11 times a year - there is no meeting in January - is an "advantage in uncertain times", adding the RBA "can potentially move much faster than overseas central banks." (See MNI BRIEF: RBA Can Move As Fast As Other Banks - Bullock).

A backflip to a 50bp hike after one month could also be viewed as a reputational blow at a time when a Treasury-backed review of the central bank's board composition, forecasting, policy implementation and communication is in full swing (See MNI BRIEF: RBA Review To Leave No Stone Unturned). However, some economists believe it could burnish the RBA's inflation fighting credentials.

It's been a bruising 12 months for Martin Place after it abandoned its yield curve control policy last November, upsetting mortgage borrowers who believed rates would be held at 0.1% until 2024. This was followed by a mea culpa from Governor Philip Lowe in September when he acknowledged the Bank's "very large forecast miss" in assessing the inflation risk. (See MNI: RBA's Lowe Says Case For Slower Hikes Becoming Stronger)

Lowe will provide additional insight into the Bank's thinking when he presents a speech on the evening of Nov 1. The RBA will release its Statement on Monetary Policy on Nov 4.

Sell-Side Analyst Views

ANZ: The Q3 acceleration in CPIs expected to see the RBA lift its forecast for headline inflation for the full 2022 year to more than 8%. We think the equivalent forecast for trimmed mean inflation will lift to around 6.6% y/y. This shifts the narrative about Australia being on a different inflation pathway from other developed countries.

- The shift in this narrative has caused us to adjust our policy expectations for the RBA, noting that we already had a further 100bp of tightening before the Q3 CPI was published. We have pushed that up to another 125bp, with the RBA no longer expected to pause in December. After consecutive 25bp rate hikes next week and December, we see a further 75bp of tightening over the first half of 2023 which will take the cash rate target to a revised peak of 3.85% in May (up from 3.6%).
- Absent a sharp negative external shock, we don't think the RBA will be in a position to ease policy for some time. We have 50bp of rate cuts penciled in for H2 2024.
- The inflation backdrop all but guarantees that next week's RBA communication will be hawkish.

Bank of America: The Reserve Bank of Australia (RBA) surprised markets by slowing its pace of hikes and raising the cash rate by 25bp to 2.6% at its October meeting. The minutes of the meeting noted that the argument for a stepdown to a 25bp hike rested on concerns over global and domestic growth. Monetary policy operates with a lag, and the RBA is mindful of downside risks to consumption and housing activity from higher interest rates. Inflation was still "too high," but the Board expressed comfort at the fact that medium-term inflation expectations remained well anchored and wage growth had not reached levels that would be inconsistent with the inflation target. Finally, the Board noted, in an uncertain environment, there was an argument to slow the adjustment of policy for a time to assess the effects of the significant rise in interest rates to date. Given above-target inflation, further hikes were needed in the months ahead, but at a gradual pace.

Barclays: The RBA will continue to hike by 25bp increments after pivoting last month due to growth risks. We expect growth risks to outweigh the still high inflation print last week as the RBA has already taken higher prices until the end of the year into account.

CBA: We expect a 25bp hike to 2.85%, but note there is a non-trivial risk the RBA opt for larger 50bp hike. We ascribe a 60% chance to a 25bp hike and a 40% chance to a 50bp hike (we consider the risk of any other move immaterial). These are the same probabilities we assigned to the cash rate decision at the October Board meeting. The RBA will publish their full suite of updated economic forecasts in the November 2022 Statement on Monetary Policy (SMP) on Friday. We expect the RBA to upwardly revise their peak for underlying and headline inflation in Q4 22 which will mechanically lift their inflation forecasts for 2023. We expect forecasts for wages growth and the unemployment rate to be left largely unchanged. Our central scenario for the RBA has the Board delivering two further 25bp rate hikes in November and December which would take the cash rate to 3.10% (our expectation for the peak in the cash rate). The risk sits with a higher terminal rate, but we continue to look for rate cuts in H2 2023 and favour 50bps of easing towards the end of 2023.

Goldman Sachs: Since October's meeting, the domestic macro data have remained fairly robust. The RBA is likely to revise up its forecasts for underlying inflation in November's Statement on Monetary Policy.

- Against this backdrop, we expect the RBA to hike +25bp to 2.85% in November and maintain forward guidance that "the Board expects to increase interest rates further over the period ahead". That said, we are mindful that the stronger-than-expected 3Q2022 inflation data could see the Board pivot back to hiking in +50bp increments, particularly given the unemployment rate remains low. Specifically, we put a 30% chance of the Board hiking by +50bp to 3.1% in November.
- However, we lean towards a +25bp increase in November as the base case given the argument outlined in October's Minutes remain in place, including deteriorating global growth, the notion that there are lags to monetary policy and the fact that the RBA meets more frequently than its peers. There have been incrementally dovish pivots from several peer central banks over the past few weeks.
- Further ahead, we expect the RBA to continue to hike +25bp in December, February and March, reaching a terminal rate of 3.6%. We see upside risks to this terminal rate, particularly if inflation continues to

accelerate over 1H2023 and/or base wages growth (currently <3%yoy) rises above 'sustainable' levels of 3-4%yoy. This would likely see a more elongated hiking cycle over 2Q2023.

HSBC: In early October, the RBA delivered a pivot in its cash rate pathway, surprising markets for the most part although this was in line with our view. This decision appeared to reflect two key factors. First, that the RBA had already tightened policy quickly. Second, although inflation has risen sharply and is high, the pick-up in wages growth has been more sluggish. The recent CPI inflation figures for Q3 suggest that inflation remains high with CPI inflation up 7.3% y-o-y in Q3. But the pulse of inflation may have passed its peak with a new monthly CPI indicator showing a slowdown in the q-o-q pace. On the jobs market, there are some early signs that the momentum in the pace of tightening has slowed. The reopened border is also improving labour supply. We expect a 25bp hike in November, lifting the cash rate to 2.85%.

J.P.Morgan: Though the 3Q CPI report was stronger than expected, we do not think it is sufficient to disrupt the tapering plan set in place at the last RBA decision, and expect another 25bp hike.

- We expect the RBA's headline forecasts to be unchanged in next week's SoMP, while near-term core inflation (trimmed mean) forecasts will be boosted. In explaining the lack of response to higher core forecasts, Governor Lowe is likely to emphasize policy lags, and the RBA's meeting frequency which allows time to catch up later if required (i.e., a longer string of 25bp moves).
- Our forecast remains for the RBA to hike 25bp in December as well before entering a pause, with this week's upside adding potential for the string to continue early next year. Of course, that departure vs. our baseline scenario won't be tested for another three months, and there will be more monthly CPI indicators to gauge momentum in the interim.
- The RBA will also publish updated macro forecasts in the upcoming Statement on Monetary Policy. Following, it appears the Bank's headline CPI forecast is tracking and we don't expect any significant changes with inflation still anticipated to peak at 7.75% this quarter. In contrast, trimmed mean inflation (6.1%oya) is now above the RBA's projected peak (4Q22: 6%oya) and we expect the Bank to raise the near-term profile by 25bp-50bp.
- The real GDP and labour forecasts appear to be tracking and are unlikely to change materially. The RBA expects wage growth to finish the year close to 3%oya, a forecast which is unlikely to change and broadly aligns with our own.

Morgan Stanley: We expect the RBA will hike the cash rate 25bps at its November meeting next week. Inflation forecasts will rise on the Q3 beat, but near-term re-acceleration in hiking pace is unlikely. We keep our 3.6% terminal rate forecast – with declining inflation and rising unemployment key for a pause.

- Commentary from the RBA since the October meeting suggests they are focussed on the lagged impact of prior hikes, but absent a sharp deterioration in conditions they still see further hikes likely - supported by their central neutral rate estimate of ~3.1%. The comment that "The Board expects to increase interest rates further over the period ahead" is likely to be retained.
- This meeting also corresponds with the quarterly update of RBA staff forecasts and Statement of Monetary Policy. We expect near-term inflation forecasts will be upgraded on the back of the Q3 beat, offset by a modestly weaker GDP and unemployment path. This demand downgrade will be important to still have inflation return to the top of the target band by end-24.
- An upgrade to the inflation outlook sits uncomfortably with the RBA slowing the pace of hikes at the prior meeting – but we think a near-term re-acceleration of tightening is unlikely.
- To be clear, we do think there is some upside risk to the RBA path from the stronger Q3 inflation print - but that this is more likely to be in the form of a more extended tightening cycle, rather than re-acceleration in pace this year.
- A pause would require confidence from the RBA that they have moved into restrictive territory. We think by the end of 1Q23 it will be clearer - hence our forecast terminal rate of 3.6% reached in March.

NAB: The RBA's November meeting comes a month after the RBA opted to downshift the pace of hikes in October to 25bp to acknowledge the lagged effect of tightening so far, uncertainty around households' response to the real income squeeze from higher rates and inflation, and a darkening global outlook. The Minutes reflected the decision was finely balanced, those considerations won out over the capacity constrained activity and labour market backdrop and clear evidence of domestic inflation pressure. With Q3 CPI data having demonstrated inflation is high, broad-based and present in domestically sensitive parts of the basket, the RBA is likely to revise higher their underlying and headline forecasts by ½ppt or more.

- Despite the upside surprise on inflation, our expectation is that the RBA will not re-accelerate to a 50bp increment on Tuesday, but 50bp will be considered and in our view the risk the RBA opts for the larger move is larger than the 20% market pricing currently implies. Stepping back up the pace would however be an awkward communication challenge for the RBA, and surely the prospect of wrongfooting market pricing 2 meetings in a row and in different directions would give them some pause. Reflecting on the October decision Bullock said that "In part, this reflects our particular economic circumstances. But it is also relevant that the Board meets more frequently than most of our peer central banks."
- NAB last week updated our monetary policy call and see the RBA extending their hiking cycle into 2023. We expect the RBA will raise the cash rate by 25bp at each of the next 4 meetings to reach 3.6% in March.
- Ordinarily, a large forecast revision to the inflation outlook in either direction, would lead to a policy response. The downshift last month complicates the picture, though it's easy to contemplate a finely-balanced decision to a larger rate rise in November.

RBC: It may be another close decision and the RBA may well be regretting not hiking by 50bp at its last meeting but, on balance, we continue to expect another 25bp hike this Tuesday. As a moderation in growth comes more sharply into focus, we expect downward revisions to the RBA's GDP forecasts (which have been above our own for some time) for both 2022 and 2023 (by ½-1%). A higher starting point for inflation, however, will highlight the difficult balancing act, and coupled with higher flood induced prices will likely see a lift in its inflation forecasts (by ¼-½%). Inflation will remain well above the ceiling of the 2-3% target throughout most of the forecast horizon.

Scotiabank: The RBA delivers another policy decision on Tuesday that is widely expected to raise the target rate by another 25bps to 2.85%.

- It's unlikely that either the Australian Budget or the mild upside surprise to Q3 'core' inflation were enough to motivate the central bank to go back on its downshifting toward smaller rate hike increments at the last meeting by renewing preference for bigger moves. Further, the cash rate target is pushing into the range that Governor Lowe has guided to be his preference.
- Still, Lowe has guided that further data dependent hikes lay ahead. The next test may come when Q3 wage growth arrives on November 15th and could further inform the risk that wages could reinforce inflation risks within the context of a very tight Australian labour market marked by a record low unemployment rate, record high labour force participation rate and record high hours worked.

Societe Generale: We expect the RBA to increase the cash rate target from 2.60% to 3.10% at its 1 November policy meeting, which means that it is likely to return to the 50bp pace of tightening implemented from June to September after a one-off 25bp hike in October. The upside surprises in the 3Q22 inflation data should be the main driver for the likely 50bp hike, overwhelming other factors like the slowdown in employment and the stabilisation of global financial market conditions. The policy statement should continue to say that the RBA is resolute in its determination to return inflation to target while keeping the economy on an even keel. Meanwhile, we stick to our 'terminal' policy rate forecast of 3.60% at this juncture. We believe that the RBA will implement a 50bp hike based on the following sentence: "the size and timing of future interest rate increases will be determined by the incoming data."

TD Securities: The RBA made a judgment call in October and reduced the size of its rate hikes. However, the upside surprise in Q3 CPI cast doubt on the pivot, though we think this adds upside risk to our terminal rate call rather than a return to 50bps hike next month. The RBA will provide new forecasts and we expect downward revisions to growth and upgrades to its inflation forecasts.

Westpac: At the November Board meeting, Westpac anticipates that the RBA will lift the cash rate by 50bps, to 3.10%. This is a non-consensus view – most commentators anticipate a move of 25bps. In October, the RBA slowed the pace of tightening, raising rates by 0.25% after four consecutive moves of 0.50%. With rates arguably back in the neutral zone, the RBA felt that it was time to pivot. At the same time, the RBA kept its options open, with the decision statement indicating: "the size and timing of future interest rate increases will continue to be determined by the incoming data ...". It is significant then that Q3 inflation data on October 26 was much higher than anticipated. The 1.8%qtr, 6.1%yr increase in trimmed mean inflation was a shock result. It demands a more urgent response from the RBA. With inflation higher for longer the concern is that a strong inflationary psychology may become entrenched.