MNI RBA Preview - May 2023

Meeting Date: Tuesday 2 May 2023

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

Link To Statement: https://www.rba.gov.au/monetary-policy/int-rate-decisions/2023/

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MNI POV (Point Of View): RBA On Hold, But Close Call

The RBA paused its tightening cycle in April for the first time since it began in May last year in order to "gather more information" on the economic outlook and allow time for policy to be felt. But Governor Lowe made it very clear at his speech the following day that the pause didn't "imply that interest rate increases are over" but that it's also not 100% certain that they will need to rise again – it will depend on the data. This tells us that the Board will look at the information gathered in April including updated forecasts and consider that in the context of material tightening to date and the "long and variable lags". Thus, the meeting decision is likely to be very close but given that inflation has peaked and that April was the first pause, rates are likely to be left unchanged at 3.6% on May 2. Lowe will speak in the evening following the meeting, which gives him the opportunity to add more clarity on the decision.

Bloomberg consensus generally expects the RBA to be on hold in May but of the 30 analysts surveyed 9 are projecting a 25bp hike, including local bank CBA. While forecasts are clearly in favour of a pause, they are not unanimous and highlight that the decision is likely to be close and that the discussion will probably be around a pause or a 25bp rate increase.

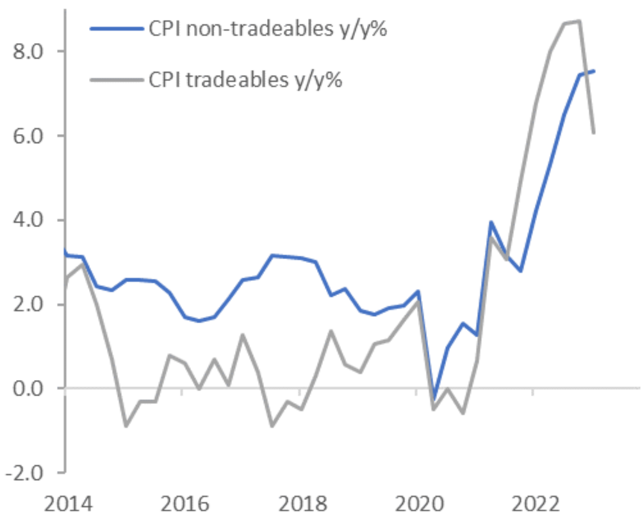
In his speech following the April meeting, Governor Lowe made it clear that the RBA will hike rates again if it needs to and that it remains "resolute" in bringing inflation back to target. The meeting statement also said that the Board "expects that some further tightening" will be needed, which was toned down from March. But Lowe made clear during the Q&A that it is "way to early" to talk about rate cuts. The expectation that inflation is unlikely to return to target until mid-2025 was discussed at the April meeting and noted that "it would be inconsistent with the Board's mandate for it to tolerate a slower return to target". The message from RBA communication over the last month is that decisions will be made each month and determined by the data. Thus, the outcome of the May 2 meeting is far from certain, and the statement guidance is likely to be little changed from April and continue sounding tough on inflation while stating that it has peaked but keeping the Board's options open, which will probably be reiterated in Lowe's speech that day. Also, Assistant Governor (Economics) Ellis speaks on May 3 about the economic outlook.

The meeting statement will also include some indication of the updated forecasts, which will be published in full in the Statement on Monetary Policy on May 5. Forecasts are unlikely to be revised significantly from February. Following Q1 CPI data, headline inflation projections may be revised down a bit near-term with the trimmed mean likely to be unchanged. The focus will probably be on when inflation returns to the top of the target band, which should remain mid-2025. If it is pushed out, then a further rate hike becomes much more likely. Growth projections could be revised up due to population growth being higher than the RBA expected. The unemployment rate is likely to remain unchanged.

The May statement should reiterate that "inflation has peaked in Australia" following the Q1 CPI data. Headline CPI eased to 7% y/y from 7.8% and the trimmed mean to 6.6% from 6.9% with the quarterly rise slowing for both but remaining above 1% and the historical average. Importantly, the domestically-driven components were stronger with non-tradeables rising 1.9% q/q and 7.5% y/y, a new series high, and services rising 1.7% q/q and 6.1% y/y, the highest since 2001. Prices in these sectors have a large wage component. Cost of living pressures also remain acute with non-discretionary inflation above headline at 7.2% y/y. An argument can be made from the CPI data for both a pause and a hike. See Inflation Easing But Domestic Components Could Push RBA To Hike.

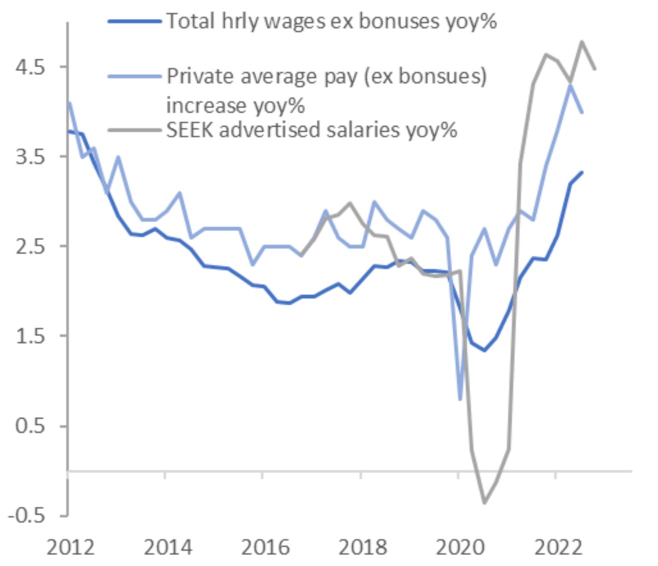
The RBA pointed out in its April meeting statement that it is concerned about both the pace of rental and utilities increases. Governor Lowe said following the last meeting that the current rate of population growth had caught the central bank by surprise and could result in higher inflation, "… the net effect of a sudden surge in population growth could be somewhat inflationary for a period." He noted that near-term population figures would need to be upgraded. He also said that it was putting pressure on the housing stock and that it will take time for supply to respond and until then rents and house prices will be higher. He also noted that domestic supply-side factors were an important contributor to high energy prices. These could be reasons for a further rate hike in the months ahead.

Figure 1: Domestic inflation continued rising in Q1



Source: Source: MNI – Market News/Refinitiv/ABS

Figure 2: SEEK wages have stayed elevated in 2023



Source: MNI – Market News/ABS/SEEK

Data since the last meeting showed that the labour market remains very tight and poses a risk to wages, thus keeping rate hikes on the agenda. March jobs data was stronger than expected with employment rising 53k driven by the full-time component and the unemployment rate staying at 3.5% (see Labour Market Remains Tight, Keeping Rate Hikes On Agenda). The March SEEK advertised salaries index rose 0.4% m/m to be stable at 4.7% y/y (see SEEK Salaries Another Signal That Labour Market Remains Tight). Offered wages remain elevated signalling that demand for labour is strong. Governor Lowe warned that it is important that wages don't follow prices, but the RBA has noted "increased risk of larger wage increases" from the tight labour market and the public sector. A pause in May allows the Board to wait for Q1 WPI released on May 17 and indications of the size of minimum/award wage hikes. Wage growth has been sticky in response to the tightening of the labour market but that means they could also be sticky on the upside when unemployment rises.

In other data, house prices have begun rising again, business conditions remain robust, consumer confidence responded positively to the tightening pause but remains depressed, business price/cost indicators eased and PMI services rose into expansionary territory again. The global economic outlook is basically unchanged.

The RBA is likely to keep rates at 3.6% in May, although it is a close call. The labour market, house prices, rents, energy, services inflation and population growth point to another hike. Easing Q1 trimmed mean inflation, lags, difficulty in communicating a hike straight after a pause, material tightening to date, consumption slowdown, RBA erring on the dovish side in previous meetings, and time to wait for wages and fiscal information all point to another pause. If there is another pause in May, then upside surprises to inflation and/or wages are likely to be needed for the tightening cycle to resume, and there is the risk that wages and core inflation could be sticky. With expectations that inflation will only return to the top of the target band in mid-2025, the tightening bias is likely to be maintained for now and rate cuts in 2023 appear unlikely.

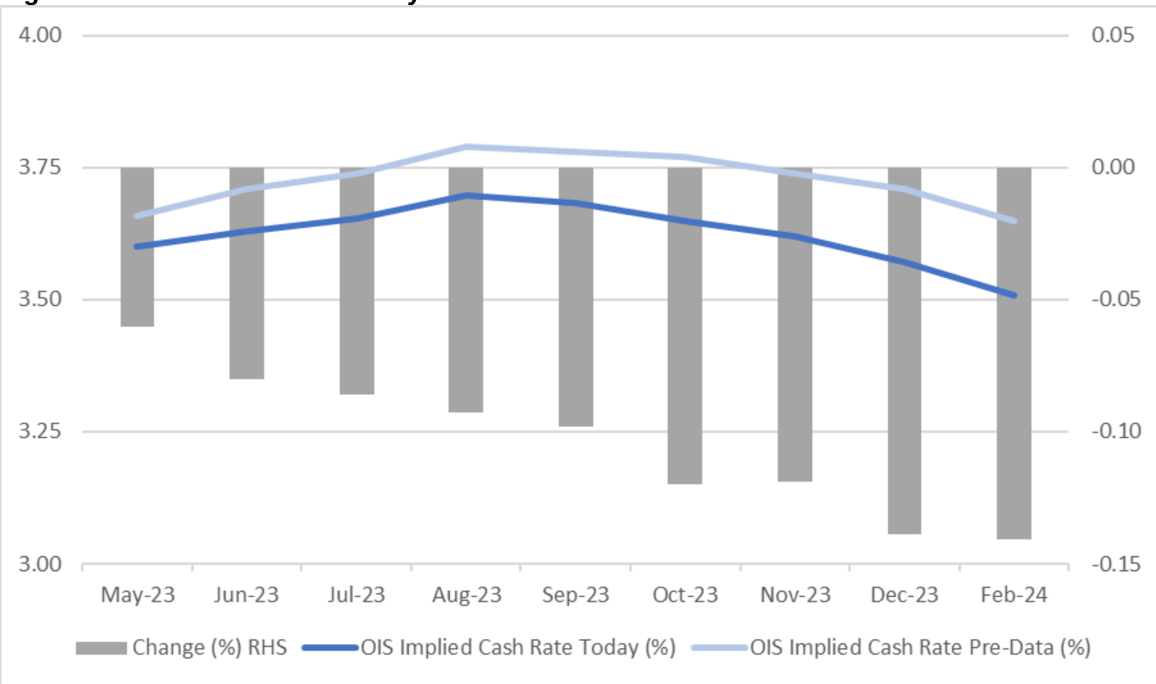
Pre-Meeting RBA Dated OIS Pricing

The RBA is expected to remain on hold at its policy decision meeting tomorrow, taking advantage of the Q1 core CPI undershoot to assess the impact of the 350bp of tightening that has been delivered to date. RBA dated OIS is currently attaching only a 10% chance of a 25bp hike versus 36% ahead of Q1 CPI data.

Terminal rate expectations, which have centred on the August meeting, have also been scaled back with current pricing at 3.71%, 14bp of cumulative tightening, versus 3.79% pre-CPI data.

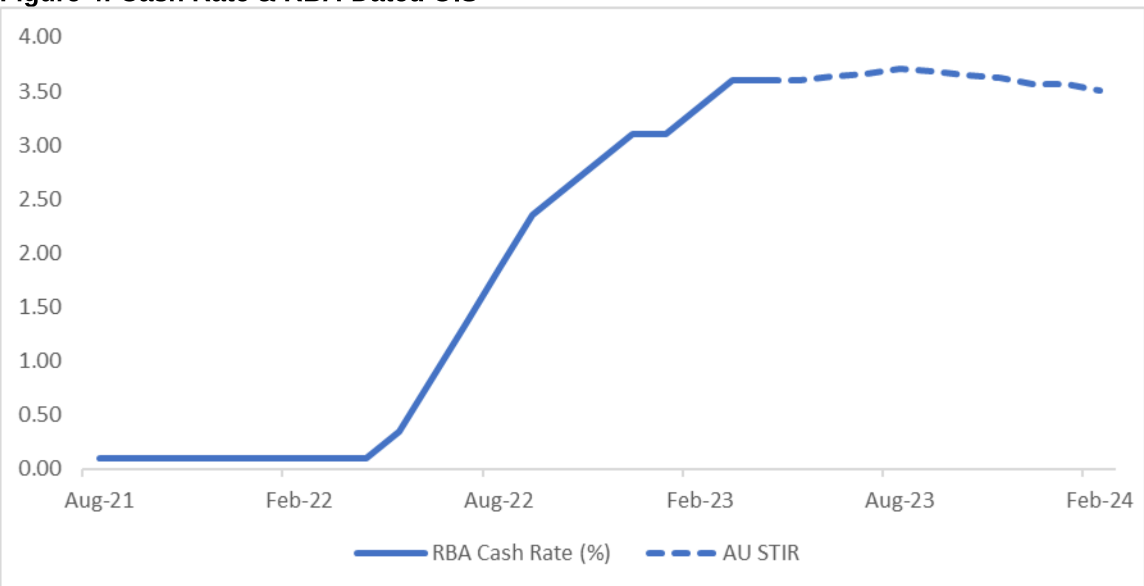
AU STIR continues to price in policy easing by year-end. Easing expectations currently sit at 14bp versus 8bp ahead of the CPI data.

Figure 3: RBA-Dated OIS – Today Vs. Pre-CPI Levels



Source: Bloomberg / MNI - Market News

Figure 4: Cash Rate & RBA-Dated OIS



Source: Bloomberg / MNI - Market News

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RBA 4 April 2023 Meeting Statement

At its meeting today, the Board decided to leave the cash rate target unchanged at 3.60 per cent and the interest rate on Exchange Settlement balances unchanged at 3.50 per cent.

This decision follows a cumulative increase in interest rates of 3½ percentage points since May last year. The Board recognises that monetary policy operates with a lag and that the full effect of this substantial increase in interest rates is yet to be felt. The Board took the decision to hold interest rates steady this month to provide additional time to assess the impact of the increase in interest rates to date and the economic outlook.

Global inflation remains very high. In headline terms it is moderating, although services price inflation remains high in many economies. The outlook for the global economy remains subdued, with below-average growth expected this year and next. The recent banking system problems in the United States and Switzerland have resulted in volatility in financial markets and a reassessment of the outlook for global interest rates. These problems are also expected to lead to tighter financial conditions, which would be an additional headwind for the global economy.

The Australian banking system is strong, well capitalised and highly liquid. It is well placed to provide the credit that the economy needs.

A range of information, including the monthly CPI indicator, suggests that inflation has peaked in Australia. Goods price inflation is expected to moderate over the months ahead due to global developments and softer demand in Australia. Meanwhile, rents are increasing at the fastest rate in some years, with vacancy rates low in many parts of the country. The prices of utilities are also rising quickly. The central forecast is for inflation to decline this year and next, to around 3 per cent in mid-2025. Medium-term inflation expectations remain well anchored, and it is important that this remains the case.

Growth in the Australian economy has slowed, with growth over the next couple of years expected to be below trend. There is further evidence that the combination of higher interest rates, cost-of-living pressures and a decline in housing prices is leading to a substantial slowing in household spending. While some households have substantial savings buffers, others are experiencing a painful squeeze on their finances.

The labour market remains very tight. The unemployment rate is at a near 50-year low and underemployment is also low. Many firms continue to experience difficulty hiring workers, although some report an easing in labour shortages and the number of vacancies has declined a little. As economic growth slows, unemployment is expected to increase.

Wages growth is continuing to increase in response to the tight labour market and higher inflation. At the aggregate level, wages growth is still consistent with the inflation target, provided that productivity growth picks up. The Board remains alert to the risk of a prices-wages spiral, given the limited spare capacity in the economy and the historically low rate of unemployment. Accordingly, it will continue to pay close attention to both the evolution of labour costs and the price-setting behaviour of firms.

The Board's priority is to return inflation to target. High inflation makes life difficult for people and damages the functioning of the economy. And if high inflation were to become entrenched in people's expectations, it would be very costly to reduce later, involving even higher interest rates and a larger rise in unemployment. The Board is seeking to return inflation to the 2–3 per cent target range while keeping the economy on an even keel, but the path to achieving a soft landing remains a narrow one.

The Board expects that some further tightening of monetary policy may well be needed to ensure that inflation returns to target. The decision to hold interest rates steady this month provides the Board with more time to assess the state of the economy and the outlook, in an environment of considerable uncertainty. In assessing when and how much further interest rates need to increase, the Board will be paying close attention to developments in the global economy, trends in household spending and 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: Jobs Caution, Inflation Set Up Rates Coin Flip

By Daniel O'Leary

The Reserve Bank of Australia's decision to raise or pause the cash rate at the May 2 board meeting will be a coin flip, with the Bank wary of triggering labour market pain as it tackles inflation persistently well over the 2-3% target.

A further pause – the RBA snapped a chain of 10 consecutive increases at its April 4 meeting, leaving rates at 3.6% (See: MNI RBA WATCH: Rates on Hold, Bank Charts Cautious Path) – would play into the Bank's aspiration of keeping unemployment between 4-4.5% while still returning inflation to target by 2025. (see: MNI POLICY: RBA Eyes Mid-25 Target Return, Unemployment 4-4.5%). But a 25bp increase would placate some of the Bank's critics and address the issue of sticky inflation, especially among non-tradables.

While CPI for the March quarter printed below market expectations – trimmed mean CPI rose 1.2% q/q compared to the expected 1.4% – annual CPI proved sticky, printing at 7%, above the expected 6.9%. While the market expects no change next week, bank analysts are divided and the overnight index swap rate has nixed the chance of a rate cut by year's end, illustrating the growing view that rates will hold elevated for longer and the cash rate has likely reached its peak.

RBA VIEW
Governor Philip Lowe has said further increases were possible following April's pause, with the rental market, high immigration and electricity price growth noted as key issues that could lead to more tightening.

Housing rental inflation also remains elevated, though MNI understands that an internal debate among RBA economists is underway on how exactly monetary policy – and further hikes – could impact rent.

Population growth has also surprised the RBA, which had expected a slower return to normal. The Federal Government this week unveiled reforms to Australia's immigration system, though the impact on net population inflows has not been determined.

Lowe also expects further energy price rises this year, targeting a 15% y/y increase by year's end, up from 2022's 12% gain.

WAGES & LABOUR
The goal to maintain high levels of employment – which currently sits at 3.5% – drove the RBA's thinking on rates in April. The Bank said its pause was consistent with its desire to assess the full impact of the swift pace of past rises, but it also wants to see what further wage gains a tight labour market could produce before higher rates stoke unemployment.

To date, Australia has not experienced rapid wage inflation as noted overseas. But this could change as various state Labor governments move forward with public sector wage increases that had been curtailed during the pandemic years. The Fair Work Commission could also lift the country's minimum wage by mid-year, with the country's peak union body pushing for a 7% increase.

Former RBA staffers have told MNI the Reserve's pauses are overly optimistic and that the Bank is walking a fine line that could imbed inflation expectations. Some believe the cash rate must rise above 4% to bring down inflation over a reasonable timeframe.

More on the Reserve's thinking will be known when Governor Lowe delivers a speech at a Board dinner following the May 2 decision. An updated set of economic forecasts will also be published in the May Statement on Monetary Policy next Friday.

Sell-Side Analyst Views

ANZ (unch): With the Board having taken the decision to pause in April and the Q1 CPI data either consistent or lower than the Bank's expectations, we expect another pause in May. That does not mean that the cycle is over, however. Not only will the decision in front of the Board be close, but the likely persistence of services inflation suggests another interest rate increase will ultimately be necessary.

- The Q12023 CPI showed trimmed mean inflation running lower than we, the market and we think the RBA expected. Headline CPI was a touch higher than our expectations, but the 1.4% q/q / 7.0% y/y print was, in our view, either consistent or even little better than what the RBA was anticipating (based on its February forecasts). With the Board having taken the decision to pause in April and the Q1 CPI data either consistent or lower than the Bank's expectations, we expect another pause in May. That does not mean that the cycle is over, however. Not only will the decision in front of the Board be close, but the likely persistence of services inflation suggests another interest rate increase will ultimately be necessary.
- The coming Board meeting will receive new forecasts from the RBA staff which will be published in Friday's Statement on Monetary Policy (SoMP). . On the forecasts to be published in the SoMP, we expect upgrades to the GDP growth forecasts, largely reflecting faster population growth and little change to the inflation forecasts.
- It will also be the first Board meeting since the release of the RBA review. In his response to the review Governor Lowe noted that: The Review includes a number of recommendations for how the Board works, including the frequency of meetings and the approach to communication...The Board will consider these issues over coming meetings...We will publish a detailed response later this year after the necessary work has been completed

Bank of America (unch): The 1Q23 CPI print was closely watched as a key input for the RBA ahead of its May policy meeting. The report confirmed that Australia's inflation peaked in 4Q22, with both headline and trimmed mean inflation slowing and largely in line w/ the RBA's f'casts as implied in the Feb SMP. We thus think the bar for re-starting hikes is high and expect the central bank to remain on an extended pause.

CIBC (+25bp): We expect the RBA to hike the cash target rate by 25 bps to 3.85% next week (May 2nd at 00:30 EST). We anticipate that this will be the resting spot.

- With regards to the statement, we see the RBA highlighting the need to arrest domestic inflationary pressures still present in the labour market and services sector as the main reasons behind the increase in the cash target rate. Note that the unemployment rate at 3.5% is already 0.5 p.p. below its previous cyclical low, while the rise in services inflation is showing that domestic inflation may be more persistent.
- However, we recognize that the odds of an on-hold RBA have increased as March's trimmed mean CPI comes in lower than expected. While the market focused on the recent downside miss in trimmed mean inflation, we believe that there is more nuance behind the inflation numbers. Specifically, the decline in CPI is being driven by declining goods inflation, while services inflation is still increasing. The decline in goods inflation shows that the global inflationary impulse is wavering. However, the rise in services inflation is showing that domestic inflation may be more persistent.
- Housing has been a stubbornly large contributor to CPI, with rents continuing to increase. Hence, combined with increasing migration, this continues to pose upside risks to inflation.
- The tightness of the labour market is also showing up in wages, which have been on an upwards trend through 2022, and have yet to come off. These pressures are likely to continue showing up in the services inflation momentum.
- Risks: The RBA already signalled strongly that it was close to a pause in its last statement. It may use the deceleration in the last CPI headline as a reason to stand pat again. Updated forecasts that highlight downward pressure on wages and looser labour markets into H2 2023 (as immigration increases), could lead the RBA to forecast a return to inflation target sooner than mid-2025.

Citi (unch): Citi Economics expects no change to the cash rate at 3.60%. The bar for rate hikes is high given latest soft CPI prints. We watch for any suggestions of dovishness, especially with regards to inflation coming down. Governor Lowe's speech at 12:20 BST should echo similar sentiments in his remarks.

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CBA (+25bp): We retain our call for the RBA to increase the cash rate by 25bp to 3.85% at the May Board meeting (our forecast for the peak in the cash rate). It's a very close call

- We ascribe a 55% chance to a 25bp rate increase and a 45% probability to no change (we consider the risk of any other move immaterial).
- Governor Lowe will deliver a speech at the RBA Board dinner on Tuesday 2 May. And an updated set of economic forecasts will be published on Friday in the May Statement on Monetary Policy (SMP).
- We expect the RBA to retain their forecast for headline and underlying inflation to only return to the top of the target band by mid-2025 despite the Q1 23 CPI printing a little softer than the RBA's implied profile from the February SMP.
- The RBA considers the stronger-than-anticipated lift in population growth to be inflationary and we expect this factor to offset the slightly lower starting point for the RBA's inflation profile.
- We expect the RBA to leave their forecast profile for the unemployment rate unchanged.
- The case to keep the cash rate on hold in May:
    - The Q1 23 CPI confirmed that the annual rate of headline and core inflation peaked in Q4 22. And more importantly from a policy perspective, the trimmed mean came in a little below market and RBA expectations in Q1 23. Monetary policy works with the well documented 'long and variable lags'. And inflation itself is a lagging indicator.
    - There is a growing body of evidence that indicates aggregate demand is slowing in the economy. And given there has been an incredible amount of tightening in a short space of time there is merit in extending the pause in the tightening cycle to further assess trends in spending and the outlook for inflation and the labour market.
- The case to raise the cash rate in May:
    - We do not expect the RBA to downwardly revise their forecast profile for core inflation in the upcoming SMP despite the slightly lower–than-anticipated Q1 23 outcome. We arrive at this view because population growth has been stronger than the RBA expected. The RBA views higher population growth as inflationary.
    - If the RBA does not lower their inflation forecasts and considers monetary policy will need to be tightened a little further to see inflation to return to the target range only by mid-2025 then they are likely to hike the cash rate in May.
    - The labour market data will also feed into the May interest rate decision. The RBA will remain somewhat concerned about a potential wage price spiral while the unemployment rate has a 3 handle and inflation is sitting well above target.
    - The recent lift in home prices will also feed into the RBA's thinking given the impact of a negative wealth effect looks to have run its course, which would mean stronger household spending than would otherwise be the case.

Goldman Sachs (unch): Our base case is the RBA will keep the cash rate unchanged at 3.6% and leave its forward guidance broadly unchanged. An ongoing pause is consistent with our view that the 1Q2023 inflation data likely came in a bit below the RBA's prior expectations and the Board will want to give itself more than one month to "assess" the lags of monetary policy after pausing in April (consistent with the historical precedent). The RBA will also likely want to assess the macro impacts of any major announcements in the Government's Budget on 9 May.

- That said, we view it as a fairly close call, and assign a 30% chance that the RBA hikes by +25bp to 3.85%. The argument for hiking +25bp May would be ongoing above-target inflation and tightness in the labour market, as well as recent data pointing to a surge in overseas migration in early 2023. We have argued that higher migration is providing a material boost to rents growth and house prices in Australia and could see the RBA revise up its medium-term inflation forecasts.
- Looking beyond May's meeting, our base case is that the RBA will ultimately hike +25bp in July and August to a terminal rate of 4.1%, after accumulating sufficient evidence about the impact of prior tightening and observing a strong outcome in the Fair Work Commission's FY2023/24 minimum/award wage determination. We think an ongoing rebound in house prices will also make the RBA increasingly uncomfortable, as it will effectively loosen financial conditions in Australia and make it more difficult to keep inflation on a downward trajectory.

ING (unch): After pausing at its April meeting to gather more information and assess the impact of its tightening so far, the main point of note for the Reserve Bank of Australia (RBA) will have been the much lower inflation numbers in March than in February. These figures not only point to an extension of the pause but could also be viewed as raising the likelihood that 3.6% marked the peak in the cycle for cash rates.

- We would also not rule out there being some easing of rates before the end of this year, as by then we believe inflation will have fallen to a level that is only just above the upper bound of the RBA's 2-3% inflation target.

JP Morgan (unch): 1Q CPI was close to expectations, though a little softer on trimmed mean, and relative to interpolated RBA forecasts. This has consolidated the impact of last week's global rally on AUD OIS pricing, leading markets to assign little probability of a hike next week. With no push-back having (so far) occurred through the conventional RBA messaging channels, we push out our call for a final RBA hike from May, to August. The transmission of policy is playing out swiftly, though on-schedule and importantly, the RBA's approach has incorporated nuances in the local economy's policy transmission all along. Given this, the tightening to date seems appropriately calibrated and with the end quite near, discretion affords a slightly longer period of assessment.

- We still expect the guidance regarding "when and how much further interest rates need to increase" or words to that effect will be maintained next week. After the RBA's pause last month we noted that a consistently unfulfilled policy bias would not usually have a very long shelf-life, but today's unusual inflation dynamics would help to extend it. The board is already compromising on the inflation mandate to some extent by pursuing a gradual return to target.
- The CPI details – particularly, the handover from goods to services inflation – suggest some degree of stickiness which means the return to target is not yet guaranteed. Services are more wage-driven than goods. Previous research shows that while the WPI is slow to respond to labour market conditions, those same long-cycle properties also drive persistence, once there is momentum in the system. Outcomes in the 3-4% range should be quite persistent even as unemployment starts to rise, making full return to the inflation target a fairly protracted affair.

Morgan Stanley (unch): We expect the RBA will keep rates on hold at its May meeting while still flagging a tightening bias. Updated forecasts are expected to show a soft landing but an extended path to get inflation back to the target midpoint. We retain hikes in August and September to a terminal rate of 4.1%.

- Messaging in the accompanying statement should be little changed - the RBA will keep its tightening bias but emphasize the value in waiting and assessing the lagged impact of prior rate hikes.
- Data over the past quarter has been mostly consistent with prior RBA forecasts. The biggest change we expect is a significant uplift in population growth assumptions - which is likely to modestly support the GDP growth forecast. We expect some mark to market near-term downgrades to headline inflation, but over the following quarters this should be offset by two upside risks the RBA flagged in its April Minutes - the migration surge being inflationary on net, and potential for stronger wage growth over 2H23. Combining these factors, we expect the inflation path to still get back to the top of the target band by mid-2025.

NAB (unch): When the RBA paused in April it was still with a clear hiking bias. The decision to pause and the surrounding communication made clear that the RBA is comfortable with a slower return of inflation to target than some peers. The April Minutes made clear that the RBA's intention of returning inflation to 3% by mid-2025 was testing the limits of its 2-3% flexible inflation target, and that a slower return than this would be inconsistent with their mandate. Since then, an added complication is the RBA Review recommended changes to make clear the RBA should target the mid-point of the 2-3% band.

- We expect the RBA to be on hold on Tuesday and for this to be the top of the cycle. Data over the month has been broadly supportive of the RBA's aim of returning inflation to 3% by mid-2025.
- After the RBA Board Meeting on Tuesday, we hear from Governor Lowe, speaking from Perth at 9:20pm AEST, and Assistant Governor for Economic Group, Luci Ellis, speaking on the economic outlook on Wednesday. The full forecast update and outlook will not be published until the SoMP on Friday, but much of the detail will be known through the week.
- Although we see the RBA on hold throughout 2023, the risk remains that the RBA may not be done at 3.6%. Inflation, while having peaked, remains much too high and measures of domestically generated and labour-cost sensitive inflation are elevated. The early gains seen so far on disinflation have come from lower-hanging fruit with some goods prices seeing outright declines and New Dwelling Costs inflation having slowed sharply. For the outlook, the key will be wages data with WPI data on 17 May, along with other wage outcomes around minimum and award wages and public sector agreements.
- For the RBA, it will ultimately come down to whether they are comfortable forecasting inflation returning to target. We don't expect the May forecast profile to show a slower return to target than the RBA forecast in February, even if the profile is conditioned on a peak around the current cash rate, vs the February assumption of a peak of 3.75%. But with rents inflation still accelerating, ongoing energy cost inflation, a

still tight labour market and ongoing acceleration in more inertial public and award wages, risks of more persistent pressures remain.

- Q4 GDP data was a little softer than the RBA had pencilled in, and they have interpreted household spending momentum as soft, but higher population growth will be supporting the growth outlook. We would expect that to net to a broadly unchanged growth outlook.
- Employment growth forecasts will likely be revised higher alongside the population assumption, but the unemployment rate track is not likely to shift materially.
- The inflation outlook will hinge on wages. The starting point for the inflation forecast will be revised lower based on the Q1 CPI. Less certain is what happens to the forecasts further out, which depend much more on resilience inactivity, the labour market and earnings, than they do the near-term outlook for disinflation from fading pandemic dynamics. We see little need to change those forecasts given the RBA in February was reasonably conservative about the path of goods and construction disinflation.

Natwest (+25bp): We expect the RBA to hike the cash rate by 25bp next week. This week's inflation data showed signs of cooling, however trends in some of the domestic factors like food and rent suggests the decline in inflation to be gradual. A Statement on Monetary Policy will be released next week, and we don't expect any major changes to the forecast. However, considering the slowing inflation, a pause next week cannot be ruled out.

- The overall economy remains robust with strong labour market. Even though RBA has downplayed concerns of wage-price spiral recently, we think wages data for Q1'23 and employment growth in the next couple of months will be key for policy direction. Considering the risk/reward between pause and a 25bp hike, we think it's better for the policy rate to be raised earlier than later since inflationary pressures driven by domestic factors like food, rent and wages are high.
- In our view, inflation has peaked in Q4'22 but the surge in food inflation and rents increases concerns of sustained inflationary pressures. On balance, we expect the fall in inflation to be gradual in the coming quarters.

Societe Generale (unch): We expect the RBA to hold the cash rate target at 3.60% at its 2 May policy meeting after a similar decision in April. The policy statement for the April meeting clearly outlined the factors affecting the interest rate decision: developments in the global economy, trends in household spending and the outlook for inflation and the labour market. We believe that those factors support a decision to keep rates on hold again.

- Conditions in the global economy have not much changed from a month ago.
- For household spending, the key monthly retail sales data are scheduled for release on 3 May, a day after the May RBA meeting.
- The main data point supporting our forecast for no rate hike is 1Q23 CPI, which confirmed the peaking of inflation according to the quarterly, trimmed mean figures. While policymakers have already mentioned the decline in monthly headline inflation, the RBA's inflation-targeting system still officially focuses on underlying (i.e., trimmed mean) inflation.
- March labour force data showed sustained tightness in labour market conditions with strong employment growth. But we don't think that the RBA will hike rates only on the back of this after opting for a pause in April amid a 'very tight' labour market even then. Note that the RBA does not officially expect a near-term rebound in the unemployment rate.
- In addition, policymakers will likely want to avoid giving the impression that the tightening cycle has already terminated. The RBA implicitly endorsed the consensus view of a terminal policy rate at around 3¾% (i.e., 3.85%) in the Statement on Monetary Policy in February, which has been maintained in our view. If the RBA were to raise the policy rate to 3.85%, most market participants would think that the hiking cycle has really ended given a lack of reasons to revise the terminal rate up from 3.85%.

Scotia: Most within consensus expect the Reserve Bank of Australia to hold its cash rate target unchanged at 3.6% on Tuesday. A minority of economists expect a 25bps hike. Futures markets are priced for no change and so clearly a hike would be a surprise. That indicates that while incremental price pressures at the margin have eased, they are still sticky—as is the case in Canada. What the minority may be going with is that jobs and PMIs have been strong of late and Australia is closer to the lift from China than other central banks, but a continued pause is likely to be accompanied by leaning against cut pricing with a mildly hawkish bias and with an eye on wages.

RBC (unch): We expect another close decision at the May meeting this Tuesday, but on balance we expect this pause in the tightening cycle to be extended this month. Domestic data have been mixed, including the key Q1 CPI, which is probably not enough to push the dovish RBA to hike. A clear tightening bias will remain, and indeed, we expect the RBA to repeat that "monetary policy may need to be tightened" in the future, consistent with an uneasy pause.

- The quarterly SoMP will provide more detail, but we do not expect any material changes to the RBA's key macro forecasts including core inflation not returning to target until mid-25 although there may be some modest upward revision of GDP if stronger population estimates are incorporated.
- The Governor's board meeting dinner address that evening and AG Luci Ellis's speech on 3 May will provide additional colour. We expect both to confirm a moderating economy that is responding to higher rates, inflation that has peaked but is still uncomfortably high with uncertainty around service sector inflation, and the door remaining open to further tightening.

TD Securities (unch): The RBA hit the pause button last month, and we expect it to leave the cash rate target unchanged again as the Bank would prefer more time to assess the effects of the rapid rate hikes to date. The continued moderation in monthly CPI prints and lower Q1 trimmed mean (RBA's core inflation measure) give room for the Bank to head for an extended pause.

- A single month is also unlikely enough time for a comprehensive RBA assessment, and a hike after pausing adds more confusion to the RBA's communication. We will also have a fresh set of economic forecasts on the 5th May, which may reflect a lower inflation trajectory and suggest that monetary policy is sufficiently restrictive to tame inflation.
- Overall, we don't expect a surprise from the RBA at the May meeting though we expect them to retain a hawkish tone to drive home the message that the Bank's tightening cycle is not over.
- In Q1, 74% of CPI components are above 3%, down from the 85% in the previous quarter, which should encourage the Bank that its rapid rate hikes are working. In summary, we think the March/Q1 inflation data should prompt the RBA to take a cautious approach and opt for an on-hold decision in May.
- In the Statement accompanying Tuesday's decision, the RBA will provide an update of its key economic forecasts, mainly on GDP, CPI, unemployment and wages- the full set of forecasts will be published on Friday 5th May in its Statement on Monetary Policy (SoMP).

Westpac (unch): Following the release of the March quarter inflation report Westpac now expects the Board to extend the pause it instigated at its April meeting to the May meeting. This decision will be despite the likelihood that the FOMC will announce the decision to lift the federal funds rate by 0.25% to 5.125% two days after the RBA meeting. We have always argued that May would likely be the peak of the RBA tightening cycle so we are now lowering our forecast cash rate peak from 3.85% to 3.6%.

- Given the uncertainty around the current outlook and a need to contain inflation expectations, the Board is almost certain to maintain its clear tightening bias. However, as we move through the remainder of 2023 the credibility of that bias is likely to fade.
- It seems very unlikely that the staff's refreshed forecasts, which will be supplied to the Board at the May meeting, will indicate that the timing of the achievement of the inflation target needs to be pushed out further – a change that would require an immediate policy response from the Board. Instead, it seems likely that the staff's forecasts for household spending and GDP growth in 2023 will be lowered somewhat, supporting the view that there is scope to pause.
- With the inflation result in line with the Bank's forecast path for eventually achieving its inflation target, the Board can take time to allow a further assessment of the cumulative impact of 350bps of tightening
- The inflation report is in line with the Board's path to achieving its stated objective of having inflation back at the top of the 2–3% target by mid-2025. This provides the Board with further scope to extend the pause we saw in April. The Board will still retain its tightening bias but given that the next 'live' meeting is likely to be in August (following the release of the June quarter inflation report) and that the need for further tightening will have eased further by then, the cash rate appears to have peaked at 3.6%.