Tuesday, 17 May 2022

RBA Board Meeting Minutes

RBA Keeps Options Open

- **The Reserve Bank (RBA) hiked the cash rate for the first time in more than a decade on 3 May. The minutes from were released today. They provided more colour on a few key considerations: wages, the size of changes in the cash rate and the RBA's balance sheet.**
- **The size of future cash rate moves remains an open question. The RBA has avoided locking itself into any particular-sized moves on a backdrop of heightened uncertainty. The Board considered lifting the cash rate by 15, 25 or 40 basis points at the May meeting.**
- **The RBA will allow the bonds it purchased under its quantitative easing program to mature, instead of reinvesting the proceeds or selling the bonds. The minutes note that selling the bonds would have a "modest" effect compared to hiking the cash rate.**
- **The minutes reiterate that the central bank is increasingly relying on its business liaison program for information on wages, which is more timely than the lagged wage price index that the RBA has traditionally examined.**
- **The Governor has stressed the importance of getting "back to business as usual". These remarks suggest the RBA might favour a "standard" sized move of 25 basis points next month, but stronger employment and wages data might mean the RBA has to move the cash rate by more.**
- **We expect the Reserve Bank will continue hiking the cash rate to 1.75% by the end of 2022.**

The RBA hiked the cash rate for the first time in more than a decade on 3 May. The minutes from this meeting were released today.

We've heard a lot from the RBA in recent weeks. Alongside the usual monetary policy announcement, there was also a press conference, as has followed significant policy announcements in recent years. Plus, the RBA published an updated set of forecasts in its Statement on Monetary Policy.

The minutes today provided a little more colour on a few key considerations for the central bank: wages, the size of the May cash rate hike and the RBA's balance sheet.

Wages

The RBA has been at pains to underscore the importance of seeing a pick up in wages growth before it was willing to lift the cash rate. Historically, the RBA has focused on the wage price index as the key measure of wages growth in Australia. Indeed, as recently as April, the RBA had suggested it was looking to evidence "over the coming months" on labour costs, alluding to the wage price index release due out tomorrow.

However, inflationary pressures have picked up faster than the RBA expected. This meant the RBA could no longer be 'patient' in waiting for more data before lifting the cash rate.

The minutes spell out that the Board "considered whether it was necessary to wait for March quarter data on the Wage Price Index and broader measures of wages growth from the national accounts to be published. They agreed that this information would be helpful; however, the recent evidence on wages growth from the Bank's liaison and business surveys was clear".

This reiterates the messaging from recent RBA communications that the central bank is increasingly relying on more timely wages information from its business liaison program. The liaison program has found "labour costs were rising at a faster pace and that this was likely to continue" and that labour shortages are impacting many firms.

The size of cash rate moves

Historically, the RBA has moved in increments of 25 basis points (e.g. 25, 50, 75 basis points etc). This changed during the pandemic when the RBA was nearing the zero lower bound and cut the cash rate by 15 basis points to 0.10% in November 2020.

The size of future cash rate moves remains an open question as the RBA has avoided locking itself into any particular-sized moves. The minutes note the Board considered lifting the cash rate by 15, 25 or 40 basis points at the May meeting.

The Board decided 15 basis points was not the preferred option given "policy was very stimulatory and that it was highly probable that further rate rises would be required". It was also noted that a "15 basis point increase would also be inconsistent with the historical practice of changing the cash rate in increments of at least 25 basis points".

The Board agreed 25 basis points was the preferred option because it would signal a return to "normal operating procedures". This echoes the Governor's remarks in the press conference, where he emphasised the importance of getting "back to business as usual". At the same time, the minutes also flagged a case for "an increase of 40 basis points could be made given the upside risks to inflation and the current very low level of interest rates".

The balance sheet

The RBA's balance sheet tripled to around $640 billion during the pandemic alongside the central bank's unconventional monetary policy programs, most notably, quantitative easing. The RBA announced it will allow the bonds it purchased under its quantitative easing program to mature, instead of reinvesting the proceeds or selling the bonds. The Governor said in his speech that we can think of the balance sheet as on "autopilot". This will place upward pressure on longer-term interest rates and is a form of monetary policy tightening.

The minutes provide more colour on the options the RBA considered for unwinding its balance sheet. The minutes explain the Board considered reinvesting the bonds as they matured, which "would maintain the stimulus associated with the stock of bonds held by the Bank, but would be inconsistent with the strength of the economy and the high level of inflation". The minutes also note that the effect of selling bonds, which would remove the stimulus associated with the balance sheet more quickly, would be "modest compared with the effect of increases in the cash rate".

The minutes reiterated the message following the Board meeting, that the RBA does not "currently plan" to sell government bonds and will allow the balance sheet to run down in a "predictable way". This is consistent with the RBA's use of the cash rate as its primary monetary policy tool.

Monetary policy

The RBA's forecasts point to persistent, elevated price pressures and a tight labour market. The central bank projects inflation will peak around 6% and won't return to the top of the target band until 2024. Plus, the RBA forecasts the unemployment rate will continue to fall to around 3½ per cent next year.

Uncertainty remains elevated, and much will hinge on the evolution of the labour market and inflation. The easing of global supply disruptions, in addition to developments surrounding the war in Ukraine and China's zero-COVID strategy will also be key.

Another critical question is how household spending will evolve over the coming year. On one hand, higher interest rates, the hit to spending power as inflation outruns wages growth and slower growth in household wealth (alongside declining dwelling prices) will weigh on consumption. But at the same, the very strong jobs market and elevated savings will continue to support spending.

On this backdrop, we expect the RBA will look to quickly unwind the emergency settings implemented during the pandemic. We are expecting another rate hike next month. The wages, employment and national accounts data ahead of the June meeting will determine the size of the move. The Governor has stressed the importance of getting "back to business as usual" and the minutes suggest the central bank is keen to signal a return to "normal operating procedures".

These remarks suggest the RBA might favour a "standard" sized move of 25 basis points next month, but stronger employment and wages data might mean the RBA has to move the cash rate by more. Interest rate markets are expecting at least a 25 basis point hike. A 25 basis point hike is 120% priced.

We expect the Reserve Bank will continue hiking the cash rate to 1.75% by the end of the year.

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