

Tuesday, 21 November

## RBA Board Meeting Minutes Home Grown Inflation Headache

- Slower than expected progress on inflation and greater economic resilience underpinned the Reserve Bank's (RBA) decision to hike the cash rate by 25 basis points in November.
- The minutes from the RBA Board meeting, released earlier today, showed that the Board's assessment of risks to the inflation and growth outlook has shifted from a global supply to a domestic demand focus. The Board is growing concerned that a stronger economy could prolong the inflation fight and is less alarmed about the lagged impacts of monetary policy slowing the economy too far.
- In particular, the minutes noted that "strength in demand was allowing firms to pass on higher costs". This was contributing to "growing signs of a mindset among business that any cost increases could be passed onto consumers". Clearly, the Board is concerned that inflation expectations may be drifting higher, a scenario they are committed to avoiding.
- This commitment was supported by scenario analysis undertaken by RBA staff which "illustrated that even a modest further increase in inflation expectations would make it significantly more challenging and costly to return inflation back to target within a reasonable timeframe". Indeed, the decision to hike in November was made partly to protect against this risk.
- On the other side of the ledger, the RBA is more confident in the resilience of the domestic economy. In particular, the Board highlighted that many households had rolled off fixed rate mortgages on to much higher variable rate loans "without a noticeable adverse effect on their ability to service their loans". Reinforcing this assessment, the minutes noted that "overall debt-servicing costs were estimated to be lower than the previous peak".
- The minutes also spelled out the RBA's latest forecasts assumption of "one to two" additional rate hikes. The importance of this is two-fold. Firstly, if the RBA had remained on hold in November, the leeway for achieving a return to the inflation target by the end of 2025 would be even slimmer and potentially at risk.
- Secondly, the interest rate assumptions do not imply another rate hike is 'baked in' to the forecasts, nor that the RBA expects further hikes will be needed. This is consistent with our view that it will take a further upside inflation surprise for the RBA to pull the trigger again.
- However, given the growing concern around inflation expectations and the domestic forces underpinning the recent inflation surprise, only a relatively small upside surprise could be enough to force the RBA's hand on rates.

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