Commentary on reserve bank board interest rate decision - 24 September

Under Pressure

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The RBA left rate on hold again at 4.35%.

Michele Bullock, Governor of the Reserve Bank of Australia (RBA), is feeling the pressure. Rates are falling elsewhere, even across the ditch in New Zealand. Comments from the Treasurer and a former Labor treasurer show the government's dissatisfaction with current economic conditions. The Australian Greens are even calling for the Treasurer to overrule the RBA and to cut rates using a never-before-used power - it is unlikely to happen.

The Governor is committed to putting the inflation genie back in the bottle so interest rates need to stay restrictive for now. Some consumers are hurting but it could be much worse as the labour market remains strong. Despite hyperbole from the politicians, the RBA remains on its narrow path between inflation and employment.

What the RBA's Statement said

"Taken together, the latest data do not change the Board's assessment at the August meeting that policy is currently restrictive and working broadly as anticipated."

"Some central banks have eased policy, although they note that they are removing only some restrictiveness and remain alert to risks on both sides, namely weaker labour markets and stronger inflation."

"The most recent projections in the August SMP show that it will be some time yet before inflation is sustainably in the target range. Data since then have reinforced the need to remain vigilant to upside risks to inflation and the Board is not ruling anything in or out."

Statement by the Reserve Bank Board: Monetary Policy Decision, 24 September 2024.

https://www.rba.gov.au/media-releases/2024/mr-24-18.html

What the Governor said at the press conference

“Overall the information since the August meeting has not materially altered the outlook, the key judgements, and risks the Board sees.”

“... getting underlying inflation down has slowed and it’s likely to be slow in the September quarter.”

“We judge that the level of demand is still above the economy’s ability to supply goods and services but that gap is closing.”

“Wages growth is past its peak but remains high relative to productivity growth which has been weak for some time.”

‘Weak productivity growth weighs on the economy’s supply capacity compared to a scenario where productivity is stronger. Weak productivity growth means it takes longer for the gap between demand and supply to close and therefore longer for inflation to return to target.”

“June quarter national accounts and other recent data suggest a slightly softer outlook for the economic activity in the near term than we were expecting in August.”

“I will stay out of the politics of it ... My only comment would be that we are doing what we think is best to maintain this path of bringing inflation back down because it's still too high at the moment … we are still on that path where we are managing to do that without a large increase in the unemployment rate.”

“... that’s the most important thing we can do to ease pressures on people is to bring inflation back down.”

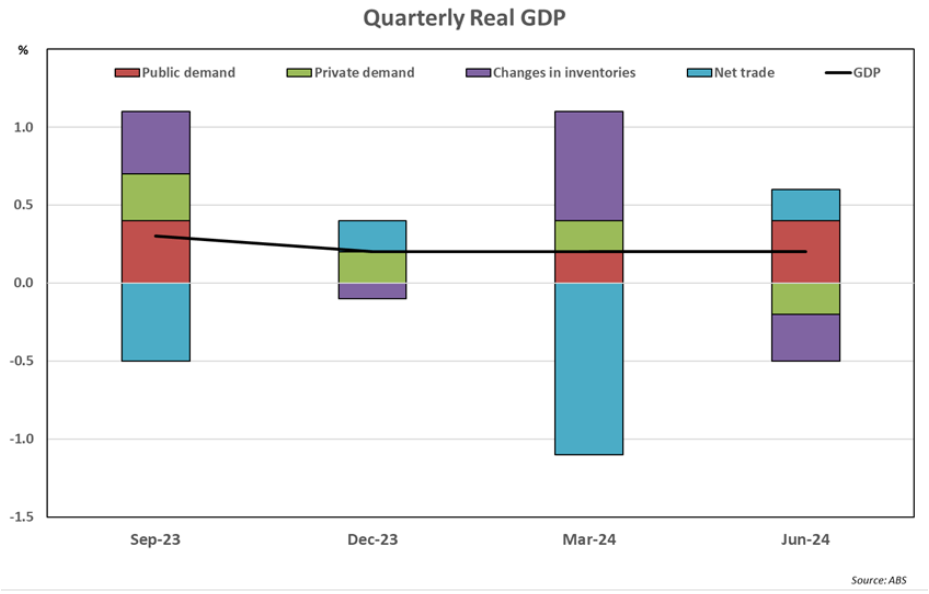
“Economic circumstances here are a little different than they are overseas. … We're restrictive but they are more restrictive than us.”

“We are expecting the demand for services to come back into line with the supply of those services over the next year or so.”

Political pressure on the RBA

Bullock made it clear during her press conference that the Board is solely focused on bringing inflation down while minimising increases in unemployment and is not letting itself get distracted by comments from politicians. The Board can only control what it can control and that is the single blunt lever of monetary policy.

Interestingly, the June quarter GDP figures show that public expenditure was the main driver of economic growth in the quarter (see chart below). Everyone wants to avoid a recession if possible but is the government doing enough, with its many policy levers, to reduce inflation? Governments like to keep central banks accountable but central banks usually refrain from giving it back.

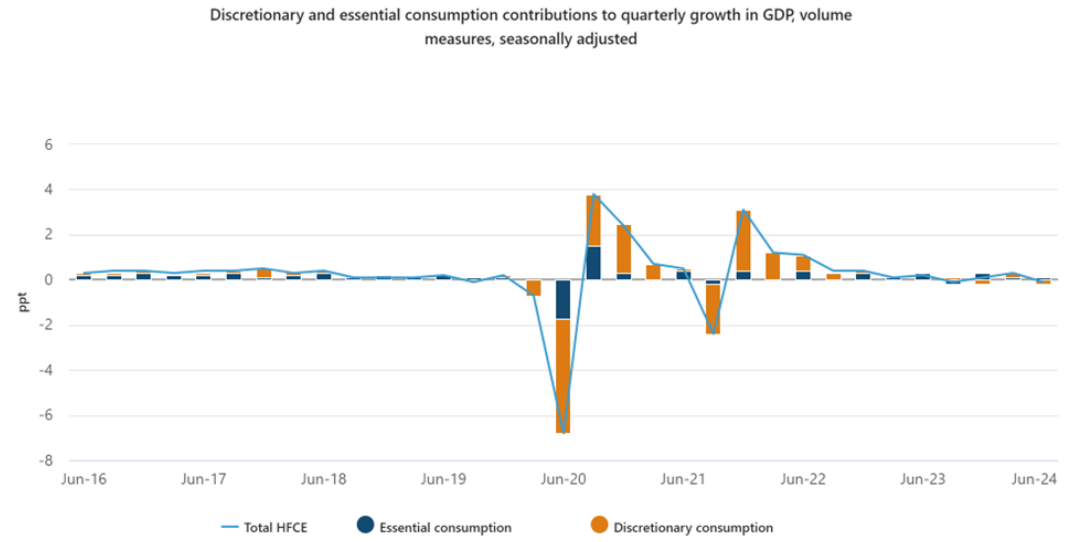


Slowing consumption

The June GDP figure also showed that both discretionary and non-discretionary consumer spending slowed in the quarter (see chart below). This has carried over into July according to the monthly household spending indicator which also showed a continuing decrease in spending on services such as recreation and hospitality, The RBA will be hoping that this continues.

However, Bullock did indicate that it expects consumption to tick up a little in the second half of the year as real wages rise and homeowners feel the positive wealth effect or raising house prices.

Overall, while demand is slowing and it may slow even further in the second half of the year, Bullock pointed out that there is still a gap between aggregate demand and aggregate supply which is keeping inflation higher than it otherwise would be. This is where the RBA would really like to see some movement.



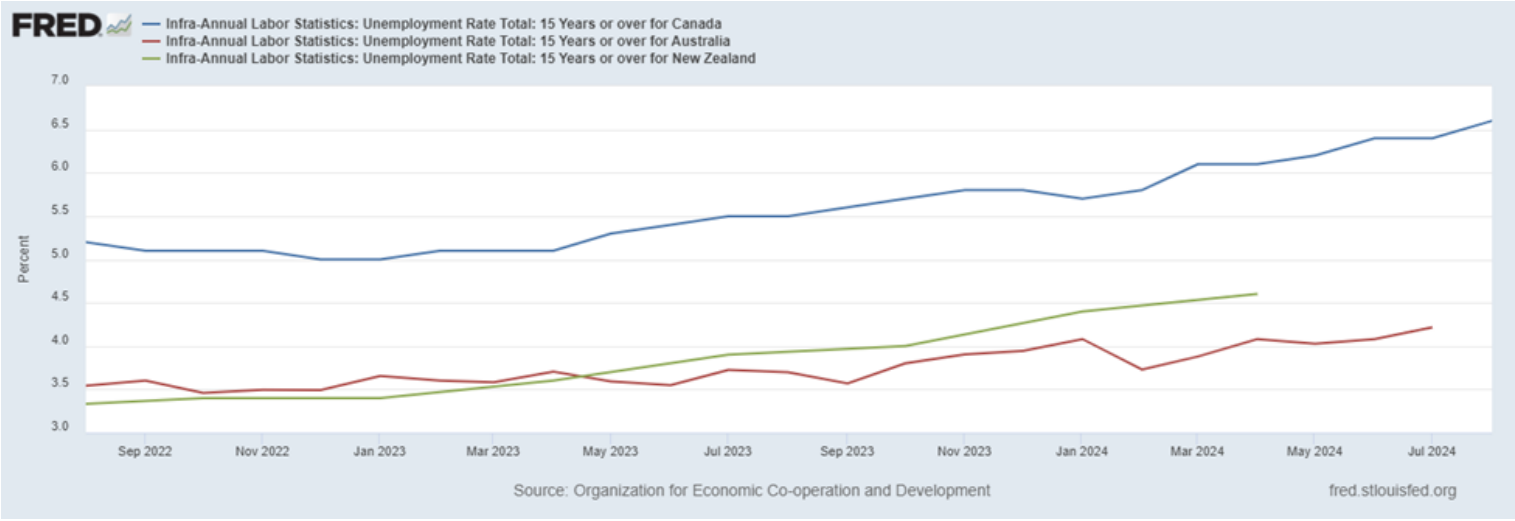
Source: Australian Bureau of Statistics, Australian National Accounts: National Income, Expenditure and Product June 2024

The RBA chose a different path

It is because aggregate demand is still higher than aggregate supply that Australia is following a different path to other developing economies. In countries like Canada and New Zealand, demand has fallen below supply and unemployment has sharply increased (see chart below).

Australia also did not raise interest rates as early nor as high as other developing economies. So Bullock argues that although some of these other economies have now started to cut interest rates, their monetary policy still remains more restrictive than Australia.

On the flip side, with Australia's demand and employment in a better space and our monetary policy less restrictive, inflation is taking longer to come down than is the case elsewhere. This is the narrow path the Board chose under previous governor Philp Lowe and is continuing with Bullock. So far, the Australian economy remains balanced on that narrow path.



Productivity: where did you go?

Bullock once again mentioned that the RBA is keeping close tabs on productivity growth and the lack thereof since the end of the pandemic (see chart below). A productivity rebound, as has happened in the US, would have seen aggregate supply catch up to aggregate demand faster thereby reducing inflationary pressure in Australia.

The RBA would like to see future wage growth driven by increases in productivity. Wages can't continue to go up indefinitely just because prices are - that way lays the dark side of a price-wage spiral.

Bullock once again also pointed to the importance of rising productivity for raising living standards.

Surely, productivity should be near the top of the government's agenda. When was the last time someone dared to speak the phrase "microeconomic reforms" in parliament? Certainly not this decade.

What happens next?

Australian consumers are set to feel more pain before relief comes. The RBA is waiting for consumers and businesses to cut back on demand and for labour shortages in certain industries to improve. Only as demand and supply come closer together will the RBA feel comfortable about underlying inflation. In the meantime, they are hoping that there is no sudden change in employment.

Impact on the Australian Private Debt Market

The Australian economy remains robust and with rates not coming down anytime soon, it remains an attractive market for investors.

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