

CAMA RBA SHADOW BOARD – COMMENTS

FEBRUARY 2022

Each CAMA RBA Shadow Board member is invited (but not obliged) to provide a personal comment on monetary conditions. Neither the comments nor the probabilities constitute financial advice. The views of the Shadow Board members are not those of CAMA. Any individuals utilizing these comments, or the probabilities, do so at their own risk.

SALLY AULD

No comment.

RENÉE FRY-MCKIBBIN

No comment.

SARAH HUNTER

The omicron wave has created significant short term challenges for the economy, with both consumer confidence and domestic supply chains taking a knock. But as has been seen in other parts of the world, the impact is likely to be temporary and the economy will be able to bounce back; domestic supply chain challenges are already easing (although they remain stretched), and the weekly consumer confidence and spending indices are now recovering.

The policy settings remain very supportive. Traditional fiscal supports (spending on infrastructure, the increase in the instant asset tax write-off for businesses, additional government spending on healthcare etc) are still feeding through and although market rates have risen and there is increased volatility, monetary conditions remain relatively loose. Together with further increases in consumer spending, that are likely to materialise as people become used to living with COVID, the outlook for growth this year remains brisk.

With economic activity and employment now pushing beyond pre-COVID levels (meaning the spare capacity in the economy has largely been absorbed), domestic inflationary pressures are building, as highlighted in the latest CPI data for Q4 2021. While some of the contributions to headline inflation will ease (particularly fuel, where the pace of increase is already moderating), core inflation has picked up and is likely to run further. Wage increases are now driving rises in the cost of home construction, childcare and gardening services amongst others, and many businesses are reporting that they will have to raise their final output prices in response to significant increases in their cost base.

Given the current position of the economy, it is appropriate for the RBA to move decisively away from the emergency pandemic settings - they have done their job and are no longer needed - and back towards 'business as usual'. It would be appropriate for the RBA to end its QE program in the very near term, and to begin raising the cash rate in the second half of 2022.

MARIANO KULISH

No comment.

GUAY LIM

No comment.

WARWICK MCKIBBIN

No comment.

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JAMES MORLEY

Headline year-on-year inflation of 3.5% has led to some calls for the RBA to start a raising cycle for its policy interest rate this year. However, this would be premature.

Underlying measures of inflation are closer to the midrange of the target (e.g., trimmed mean = 2.6%). But more importantly, it is entirely predictable that inflation will fall to lower levels now that the base effects of the initial Covid shock to the CPI have run their course. Also, the recent high quarterly inflation was primarily driven by large increases in new dwelling prices and petrol prices. Mechanically, these effects on inflation will disappear or possibly push inflation back below the target range if these prices do not continue to increase at the same rate or even reverse (likely with petrol prices).

The 10-year break-even inflation expectations measure is back up to 2.3%, which is welcome news for the RBA in trying to achieve its inflation target. But this financial market expectation is predicated on the RBA sticking to keeping rates “lower for longer” (i.e., not raising rates until the second half of 2023 at the earliest) and could fall back below the target range if the RBA adjusts its forward guidance policies too drastically.

Global indicators of supply chain pressures also may be peaking (<https://www.bloomberg.com/news/newsletters/2022-01-05/supply-chain-latest-new-global-supply-chain-gauge-shows-pressure-has-peaked>).

All in all, the latest data suggest the RBA is on course to bringing inflation sustainably into its target range. But it is important that the RBA stays the course in its forward guidance policies to ensure inflation expectations remain aligned with the inflation target and, as frequently noted by the RBA, these expectations translate more strongly into sustained (real) wage growth.

JOHN ROMALIS

No comment.

JEFFREY SHEEN

With inflation having been below the RBA's target range for almost 6 years and having now only just reached into the range, the RBA should reject pressure to raise the cash rate too soon. The US Federal funds rate will have to start rising this year given the excessive fiscal and monetary policy accommodation in place there, and this will tighten financial conditions even in Australia. But the RBA needn't match the Fed, and can afford to allow some weakening in the currency. Assuming the unwinding of health and supply chain shocks by 2023, the time to think about normalising the cash rate is in 2023.