CAMA RBA SHADOW BOARD – COMMENTS

OCTOBER 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.

BEGOÑA DOMINGUEZ

Today (29 Sept 2022) Australian Bureau of Statistics (A.B.S.) released the monthly CPI indicator for Australia. This is a very welcome innovation from the A.B.S. that will facilitate the work of the Reserve Bank of Australia (R.B.A.) as well as many academics, public and private sector economists, and policymakers. Dr David Gruen AO said that "The monthly CPI indicator saw annual inflation of 6.8 per cent in August compared to 7.0 per cent in July and 6.8 per cent in June". Dr Gruen also indicates that the slight fall from July to August was mainly due to a decrease in fuel prices. These numbers clearly show that annual CPI is well above target. However, inflation has slowed down in August. In my opinion, at this point, this is just one observation rather than an established trend. Global factors and in particular the war in Ukraine could lead to further increases in energy prices over the coming months and even years (due to the need for transition to greener energy).

Dr Gruen also states that inflation of food and non-alcoholic beverages increased to 9.3 %, with very large increases particularly in the fruit and vegetables category. This is very concerning as these are essential products that will particularly affect families in modest income brackets.

In the last few days A.B.S. has also released additional data that shows that retail trade remains strong (rose 19.2% from August 2021 to August 2022), but job vacancies have started to decrease (2.1 % from May to August 2022) particularly in the private sector (3.1 % fall in the same period). So the economy remains strong but there are signs that it could start cooling down.

The R.B.A. has the difficult task of bringing down this inflation to its target while maintaining full employment. With inflation at 6.8 % and the cash rate target at 2.35%, I believe the R.B.A. should continue with its monetary policy tightening, respond strongly, and increase the cash rate in this monthly meeting. However, over the following coming months, it should start considering a more gradual approach to minimise the risk of recession (i.e. to engineer a soft-landing). That will involve paying close attention to the distribution and trends of inflation and expectations of inflation (to ensure these are well anchored) as well as to indicators of the real economic activity.

SARAH HUNTER

Australia's economy continues to look more resilient to the current headwinds facing the global economy, with household spending and construction activity holding up better than in other developed economies. But there are now clear signs that the economy is running into capacity constraints, with employment total hours worked holding broadly steady since May (after a sustained period of strong growth post-Delta lockdown).

With demand still running stronger than supply, further domestic inflationary pressures are likely to be generated through wages and price setting behaviour, and it is appropriate that the RBA board continue to raise the cash rate to contain these. But given the extent of monetary tightening that has already been implemented, now is the time for the Board to slow the pace and assess the impact of what has already been put in place. Furthermore, the deterioration in the global environment will weigh on external demand.

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A potential complication through the next twelve months will be developments in global currency markets, particularly the AUD:USD bilateral rate. While the AUD has outperformed most developed economy currencies this year (against the USD), import contracts are typically priced in USD, and a further sharp depreciation of the AUD would lead to further upward pressure on prices via imported inflation. But elevated prices for key commodities (particularly coal and natural gas) will provide support for the AUD, and a further normalisation of supply chains and shipping costs will also help to cool import prices. Overall then, inflation in Australia is still likely to peak at around 7.5%, well below other developed economies.

MARIANO KULISH

No comment.

GUAY LIM

No comment.

WARWICK MCKIBBIN

The RBA finds itself in a difficult position given domestic and international circumstances are contradictory. Over the coming months, major economies will likely be in recession (Europe probably already is in recession). A significant global economic slowdown implies that the RBA will likely not have to continue quite so aggressively with the current tightening cycle as slow global growth due to tight monetary policy and the energy crisis coincide with falling global inflation. Given current information, interest rates in Australia need to rise above a neutral nominal rate of 3.5% to bring inflation back to target. However, inflation is likely already falling due to adjustments in the global economy. Thus there is considerable uncertainty about the appropriate policy rate over the next year, but it is probably significantly higher than at the end of September.

JAMES MORLEY

No comment.

JOHN ROMALIS

No comment.

PETER TULIP

The consensus outlook is for underlying inflation to remain above the RBA’s target range and unemployment to remain below the NAIRU throughout the forecast horizon. Policy tightening is being offset by foreign developments, so the exchange rate is not appreciating as desired. A higher path of interest rates than currently anticipated would move both inflation and unemployment closer to their targets, so is unambiguously preferable.