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RBA Minutes
Wait-and-See Mode

- **The Reserve Bank (RBA) Board met on 4 May and left policy settings unchanged. The minutes for the meeting were released today, although they did not contain a lot of new information. Our expectations for RBA policy are unchanged.**
- **At this meeting, the Board received an updated set of forecasts, which showed that the economy has bounced back faster than expected. The RBA is now forecasting GDP growth to be 4.75% over 2021, well above trend and up from 3.5% previously. The unemployment rate is expected to decline to 5.0% by the end of the year, down from its current level of 5.6%, and well below the previous forecast of 6.0%.**
- **Despite the considerable improvement in the economic outlook, there was not a material shift in the RBA's forward guidance.**
- **There were subtle shifts in communication reflecting that the risk of a cash rate hike before 2024 has increased slightly, alongside the faster-than-expected economic recovery. However, our central expectation is still that the RBA will not hike the cash rate before 2024.**
- **The Board will discuss whether to extend yield curve control and quantitative easing at its July meeting. Our view is that both policies will be extended.**
- **The RBA is uncharted waters. Unwinding the unprecedented monetary policy stimulus implemented in response to COVID-19 will be a delicate exercise. But for now, they are in wait-and-see mode.**

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At this meeting, the Board received an updated set of forecasts from the Reserve Bank's economists, reflecting that the economy has bounced back faster than expected. The RBA is now forecasting GDP growth to be 4.75% over 2021, well above trend and up from 3.5% previously. The unemployment rate is expected to decline to 5.0% by the end of the year, down from its current level of 5.6%, and well below the previous forecast of 6.0%.

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The minutes, like the statement following the meeting, note the **cash rate** is 'unlikely' to be lifted before 2024. This represents a slight tweak in language to acknowledge the slight possibility of a rate hike before 2024. In the past the RBA had said it 'did not expect' conditions to be met to hike the cash rate until 2024.

The minutes also acknowledge that some market participants expect the cash rate to begin increasing in 2023, in contrary to the RBA's guidance. This expectation is reflected in the increase in yields on some three-year financial instruments since the start of 2021, like swaps.

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The minutes reaffirmed our expectations that **yield curve control** (YCC) and **quantitative easing** (QE) will be extended. Both of these policies are due to be discussed at the July meeting. There is ongoing debate about whether these measures will be extended and in what form. In reference to these policies, the minutes note that 'monetary policy would likely need to be highly accommodative for some time yet'. This language certainly does not appear to suggest that YCC or QE will be winding down any time soon.

The minutes also provided some colour on the risks to the forecasts. It is flagged that there is considerable uncertainty about household saving behaviour, and this could have material implications for economic growth. Households accumulated large saving buffers in the past year, and the extent to which households draw down on these savings will significantly impact consumption.

The RBA's central view is that consumption will be supported by the lifting of restrictions on services, further jobs growth, wealth effects from higher house prices and reduced uncertainty. However, the minutes note that if households instead opt to continue strengthening their balance sheets, including by paying down debt, this could soften growth relative to the baseline forecast.

The minutes also provided a little more colour on the debate raging around inflation with a discussion of the risks to the inflation profile. Central banks argue the coming pick up in inflation will transitory, while some market participants worry the increase will be sustained. On one hand, it is possible that price pressures could be slow to build because of inertia in wage- and price-setting practices. On the other hand, higher commodity prices, supply chain bottlenecks and labour shortages due to border closures could mean that wages growth and inflation pick up more rapidly than expected. We agree with the RBA and expect the increase in inflation will be transitory.

Finally, the minutes continued to emphasise the importance of sound lending standards amidst the boom in house prices. They also noted that some construction firms in the RBA's liaison program have reported cost pressures and delays to construction timelines due to difficulties in securing materials and labour.

The RBA is uncharted waters. Unwinding the unprecedented monetary policy stimulus implemented in response to COVID-19 will be a delicate exercise. But for now, they are in wait-and-see mode.

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