

Inflation leaves RBA open to further rate rises if required, minutes reveal

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Key points

- RBA Board members unanimously backed September's 25 basis point rate rise.
- Higher oil prices, AI investment and stronger domestic inflation added to concerns.
- The Board says rates could rise further if needed.

The Reserve Bank of Australia believed it could be costly to wait for more evidence that inflation pressures were building before raising interest rates in September, minutes from its latest meeting show.

The RBA's Monetary Policy Board unanimously raised the cash rate by a quarter of percentage point to 4.60% at its 28 to 29 September meeting, after concluding several risks identified only a month earlier had either materialised or intensified.

Inflation remained too high, while the board saw growing evidence that domestic capacity pressures may be greater than previously thought. July inflation data was stronger than expected, GDP growth had been slightly stronger, and businesses continued to report widespread cost pressures.

The board said it would continue to do what was necessary to achieve its inflation and employment goals, "including increasing the cash rate target further if required".

Commonwealth Bank Head of Australian Economics Belinda Allen said the minutes were "decisively hawkish, as you would expect given the unanimous decision to hike the cash rate".

Board discussions were heavily weighted towards inflation and upside risks to the outlook, while giving relatively little attention to downside risks to growth, Allen said.

Allen said the tone contrasted with RBA Governor Michele Bullock's press conference comments following the September meeting, which focused more heavily on the delayed impact of previous rate rises and the hope that the four increases delivered so far would be enough.

Why did the RBA raise rates?

The minutes show the board considered three main arguments for lifting rates.

First, several inflation risks identified at its August meeting had become more pronounced.

Allen said the RBA had seen inflation risks grow on three fronts: the escalation of the Middle East conflict and higher commodity prices, demand from the AI data centre build-out and evidence that domestic capacity pressures may be greater than previously thought.

The board's assessment that July's inflation surprise was more likely to reflect domestic capacity pressures than stronger-than-expected pass-through from the Middle East conflict was "a clear signal that the board is still worried about domestically driven inflation pressure", Allen said.

Secondly, board members also judged that acting promptly would better balance its inflation and employment objectives.

Allen said the minutes showed a shift in the Board's approach, with a greater willingness to accept slower growth and employment if persistent supply constraints continued to keep inflation high.

The board also believed waiting for more confirmation could be costly, because inflation had already been above target for an extended period, the minutes revealed. The Board was also concerned that medium-term inflation expectations among businesses could be starting to rise.

Board members' third consideration was the possibility that the existing cash rate may no longer have been restrictive enough to bring demand and supply back into balance within a reasonable timeframe.

The RBA said indications of a higher global "neutral" interest rate could mean a 4.35% cash rate was less restrictive than it had been two years earlier.

Only a brief discussion of the case to leave rates on hold

The board only briefly considered the arguments to leave the cash rate on hold.

The main arguments downside risks to growth and employment could prove larger than expected. A weaker housing market could suppress spending more than expected, the Middle East conflict and related uncertainty could weigh on demand more than expected and the effects of tightening of policy to date might provide larger than forecast.

Allen said the minutes suggested the board was relatively unconcerned about weakness in some recent data and gave little weight to the potential flow-through from lower housing prices to household spending.

"Quite surprisingly, there was no mention of the lags to monetary policy, which was a key point made by the Governor as a reason to be more patient," Allen said.

Could interest rates rise again?

The minutes show the board left open the possibility that more interest rate increases could be required.

The inflation outlook would depend on the Middle East conflict, global demand, domestic capacity pressures and how cost increases flowed through to prices and inflation expectations, the board believed.

Members said they would remain focused on returning inflation to target while preserving as many employment gains as possible, but acknowledged more persistent global supply shocks could require slower growth in both demand and employment.

CBA economists continue to expect the cash rate to remain on hold from here, but Allen said "the clear risk is another rate hike" with November "very much live".

Markets were pricing about a 30% chance of a November rate rise when CBA published its analysis.

Attention will now turn to RBA Deputy Governor Andrew Hauser's comments on 21 October and September-quarter inflation data on 28 October.

CBA expects trimmed mean inflation to rise 1.0% over the September quarter and Allen said the hurdle for another rate increase appeared lower than CBA had judged after the RBA's September press conference.

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