Hike odds have risen, but not odds-on

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When we last updated our rates view on 29 July, we said that the risk of a rate hike in November could not be ruled out, but it was no longer the base case.

The strong July monthly CPI does raise the chance of an RBA hike in November. But we do not think this one data point is enough to rush all the way to the other side of boat and lock in a hike. The RBA has emphasised that the monthly data are noisy, and their short history means seasonal patterns are unclear. The new financial year is a time when many businesses re-price, with subsequent months more moderate. This has been a pattern in the data in the past and might be again this year.

Recall also that the earlier data flow broke the other way. Labour market and wages data, as well as the Q2 CPI were all softer than RBA had been forecasting. Consumer spending has been more resilient recently, but we do not think the RBA will read “not outright contracting” as a sign of upside inflation risks crystallising.

Our earlier expectations for near-term hikes centred on concerns about outsized pass-through of higher fuel costs. Risks from this source have faded. If the RBA does raise the cash rate in the near term, it would more of an insurance hike, reflecting unease about a slow pace of return of inflation to target.

The timing of the September meeting is awkward for policymakers considering an early hike. The August CPI is released the following day. If it surprises on the downside or is simply moderate, the Monetary Policy Board (MPB) could look premature if it hiked the day before. (For anyone wondering, the RBA does not receive CPI data ahead of the market. A small number of ministerial staffers get an embargoed release a couple of hours early, but not the RBA.)

For this reason, a November hike is more plausible than September. In our view, November timing would still require confirmation from the intervening data.

Whatever the next few meetings bring, split decisions are a distinct possibility. If the minutes are any guide, some MPB members seem to be leaning towards the idea of pre-emptive hikes as insurance against future price spikes. The post-Review personnel changes have added a more academic – and potentially more activist – perspective to the MPB. Its proponents could be less inclined to wait out monetary policy’s transmission lags when inflation is half a percentage point above the target range.

But other members are likely to differ from the staff about the level and trend growth in supply capacity, particularly labour supply (see this note from Ryan Wells in May for more background). A September hike would certainly involve dissents. Depending on Q3 inflation and the rest of the data flow between now and then, a November hike could easily involve a split vote as well.

Bottom line: there are near-future states of the world which will lead us to change our call and expect a hike in November. As we said at the time of the August MPB meeting, we believe that investors should allow for some risk of a hike later this year. But one monthly CPI print is not enough evidence to price in a hike fully. We will be particularly attentive to the labour market and national accounts in coming weeks, as well as the August CPI.

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