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ASIA HOT TOPICS

WRITTEN BY



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RBA's pause supported by the FED but also a weaker Australian economy

Notwithstanding the Reserve Bank of Australia (RBA)'s Governor Bullock hawkish stance based on inflation and tighter labor market, the RBA has decided to pause today. There are two main reasons for that. Firstly, a sea-change in the market prediction of the way forward for the FED, with as much as 100bp in cuts as a consensus for in 2024 (150 basis points in the case of NATIXS research. Secondly, the Australian economy is clearly decelerating with slowing retail sales.

Although inflation has been on a downward trend with the CPI falling from +5.6% YoY in September to +4.9% YoY in October, the RBA has been concerned with the speed of the decline. Despite of an aggressive hike of 425 bps since early 2022, the October CPI is still well above the 2-3% target range (**Chart 1**). While the weak Aussie lifted goods prices, services prices have been sticky on the back of a tight labor market with the unemployment rate below the natural rate. With this background, the decline in the underlying inflation measured by trimmed mean was limited from +5.4% YoY in September to +5.3% YoY in October.

At the same time, the Reserve Bank would need to manage the delicate balance between inflation and growth. Mortgage payments have surged to about 9% of household's disposable income on the back of rapid RBA's tightening, weakening private consumption. With declining households' purchasing power, nominal retail sales have slowed from +2.0% YoY in September to +1.2% YoY October (**Chart 2**). Hence, a further rate hike could possibly trigger a recession.

At the December meeting, the RBA remained on hold with the cash rate at 4.35% to see how fast inflation will fall, after a 25-bps rate hike in November. Going forward, a stronger Aussie could further contain inflation, as market expectations of Fed rate cuts increase. However, because the tight labor market is likely to keep services inflation sticky, our view is that the RBA will hike by 25 bps next February.

Chart 1
Australia: Inflation (YoY, %)

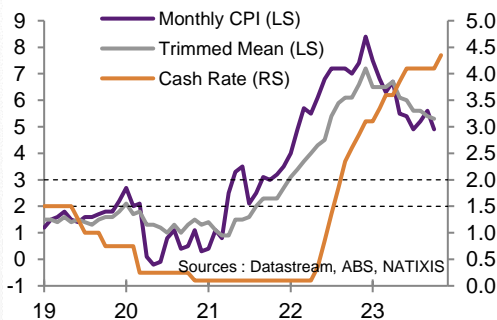
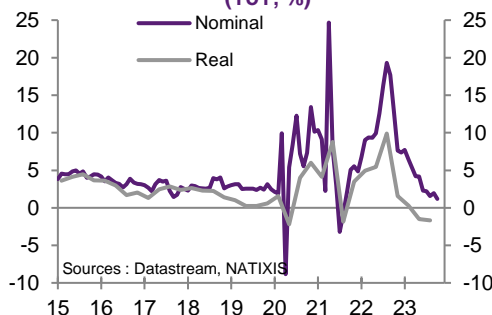


Chart 2
Australia: Retail Sales (YoY, %)



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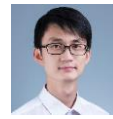
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