NAB Monetary Policy Update 26 June 2024

NAB pushes out first rate cuts to May 2025 as "lower for longer" strategy plays out

NAB Economics

Key points

- We now expect the RBA to remain on hold for longer, with a first rate cut now unlikely until May 2025 (previously November 2024). From there we see a steady profile of one cut per quarter back to 3.10%, now reaching that point in mid-2026.
- Economic growth has slowed significantly over the past year as the effects of monetary policy have flowed through, and the labour market has started gradually easing. However, progress on inflation has been slower than we (and the RBA) had expected with the May Monthly CPI indicator signalling upside risk pointing to our expectation for a Q2 trimmed-mean print of 0.9% q/q and 3.9% y/y.
- The mix of slow growth and gradual progress on inflation reflects the RBA's decision to embrace a "lower for longer" approach – a lower rate peak compared to other advanced economies, resulting in a longer period at that peak. It is possible the Board will change course and raise rates at its August meeting (especially if the Q2 print exceeds expectations) but with the labour market easing we don't believe their hand will be forced.
- Instead, we expect the Board will remain on hold with inflation still likely to slow in H2 alongside further easing in the labour market. However, we believe it will be some time before the Board has the confidence to begin to ease policy settings – likely only after several quarters of inflation annualising around the top of band. This may be in hand by February but we see May, after the Q1 2025 CPI, as most likely.
- Inflation should continue to moderate towards the mid-point of the RBA's target range through 2025 and 2026, though the path will likely be uneven. This will see the focus shift back towards growth and the labour market, leading the RBA to continue bringing the cash rate back towards a more neutral level, which we see as around 3%. A slower pace of cuts, or higher end point, remains possible.

Slow progress on inflation despite soft growth.

The recent Q1 National Accounts showed growth slowed to 0.1% q/q and 1.1% y/y – the slowest growth in decades outside of major recession events. The labour market has also eased around 0.5ppts over the past 12 months as the pace of employment growth has fallen marginally below the pace of population growth, though the unemployment rate remains very low at 4.0%.

These outcomes have played out broadly in line with our (and the RBA's) forecasts, reflecting the moderately restrictive stance of monetary policy with the Board seeking to slow the pace of demand growth and bring supply and demand into better balance without causing an economic downturn.

Nonetheless, progress on inflation is proving slower than we (and the RBA) had expected. The May Monthly CPI provided tentative evidence of some slowing in still too hot market services components that suggest domestic inflation pressures are past their peak. However, housing components remain a persistent source of strength, and there has been little further disinflation impulse from goods and food prices.

On balance, the monthly data signals upside risk to our expectation for a Q2 trimmed-mean print of 0.9% q/q. At 3.9% y/y, this would already be 0.2ppts above our forecast at the start of the year (when we last revised our monetary policy call) and 0.1ppt above the RBA's forecast in the May Statement of Monetary Policy (SoMP). This is not necessarily a catastrophic forecasting miss but shows that inflation is proving stubborn.

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Longer period of restrictive rates a consequence of RBA strategy.

The RBA's strategy of taking rates to a lower level than compared to the more restrictive levels seen in most other advanced economies – has been driven by an understandable desire to limit the risk of a significant labour market deterioration. However, the quid-pro-quo of this approach has always been that rates may need to remain restrictive for longer to bring inflation back to target.

In effect, the Board has embraced a "lower for longer" approach – a lower rate peak but a longer period at that peak. That trade-off is now becoming clearer with inflation remaining well above target some two years on from the beginning of the RBA's hiking cycle and rate cuts looking more distant at a time when some other central banks have already begun easing.

Governor Bullock has repeatedly stated that the Board is not "ruling anything in or out" and with another strong print in Q2, they will have the option of adjusting their strategy and raising rates at the August meeting. Indeed, as recently as January we saw 4.6% as the likely rate peak. However, with 9 months elapsed since the last hike a August move would represent a significant course correction late in the cycle. Unless inflation deviates more considerably from the forecast path, we expect the Board to stick to their existing approach.

Sufficient evidence on inflation now at least six months away.

How long rates will remain on hold will ultimately depend on the flow of data. We expect some gradual further easing in the labour market over the coming months, which will begin to put some countervailing pressure on the Board, but with such a low starting point for the unemployment rate the focus will remain on inflation.

We believe the Board will want to see several underlying CPI prints annualising around the top of the target band before it has the confidence to begin to ease policy settings. With a 0.9% q/q print likely for Q2, the Q3, Q4 and Q1 prints may all be needed to meet that criterion. We expect these to print in the range of 0.7-0.8% q/q, providing the Board with sufficient evidence for a first cut ahead of its May 2025 meeting.

From there, and provided inflation continues to track at an acceptable pace, our expectation remains that a gradual process of normalising policy will be the RBA's preference. We see GDP growth picking up in 2025 – but only to around a trend rate – and the unemployment rate stabilising around 4½%, consistent with a more neutral stance of monetary policy.

Risk remains that "lower for longer" drags deeper into 2025.

Our view that the RBA will be in a position to cut by May is dependent on inflation moderating in H2 as the weakness in activity data continues to flow through to prices. If inflation instead persists at its currently elevated rate – whether because goods prices rebound or services fail to soften – the scope for cuts would quickly evaporate and the RBA would instead likely remain on hold deeper into 2025.

Against this, there remain some downside risks on the economy. Our forecasts (and the RBA's) are in part predicated on a pickup in consumption growth in H2 as households benefit from easing inflation and the impact of tax cuts. Were this not to materialise (for example, if households choose instead to increase savings rates) the period of very slow economic growth would continue and there would likely be a more rapid deterioration in the labour market. These risks are clearly front of mind for the Board but given the challenges on inflation, cuts in the very near term are highly unlikely.

Table 1: Updated cash rate profile

	2024				2025				2026			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Cash Rate	4.35	4.35	4.35	4.35	4.35	4.10	3.85	3.60	3.35	3.10	3.10	3.10

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