Monetary Policy Update

NAB now expects the RBA to hike in September

Key points

- We now expect the RBA to increase the cash rate by 25bp in September to 4.6%.
- July CPI data showed inflation running hotter than the RBA expected in early August, and the RBA has repeatedly signalled in recent weeks that the Monetary Policy Board would act if upside risks to inflation were realised.
- The risk is biased towards an additional hike in November, especially if activity data shows resilience in coming months.
- A more restrictive stance is needed for now. We expect a gradual normalisation back towards a more neutral setting of monetary policy from August 2027.

Detail

After yesterday's stronger than expected inflation data, we are changing our view on the RBA and now expect a 25bp rate hike at the September meeting. That would take the cash rate to a new cycle high of 4.6%.

The 0.5% mom reading on trimmed mean inflation was broad-based and our early read through suggests a Q3 quarterly trimmed mean print of 1.0%-1.1%, materially higher than the RBA's August forecast of 0.83%; see our data note for more detail.

If our upwardly revised 3Q core CPI forecast is broadly correct, then the annual rate of core inflation as of 3Q will be no lower than it was in Q2, reflecting a more challenging starting point and implying that the return to the 2-3% target band may take even longer than forecast earlier this month. This will not be an acceptable outcome for the RBA, not least because it implies lower real short rates, all else equal, at a time when the RBA policy rate is at a level it considers only "somewhat restrictive".

RBA officials have been very clear in recent months that firstly, risks to their inflation forecast were tilted to the upside; and secondly, that if those risks were realised then the Board would respond with a rate hike. The minutes from the August Board meeting earlier this week reinforced this messaging. In our view, yesterday's data crystallise upside risks to inflation and thus a hike in September is more likely than not. We think it unlikely that activity data between now and the September board meeting will be weak enough to deter the Board from hiking.

The risk to a near-term hike is that the Board decides to wait for more inflation data. The August monthly inflation data is published the day after the September Board meeting, with the full Q3 data available ahead of the November meeting. In this instance, the November Board meeting would be the natural opportunity for a hike.

However, the mention of pre-emption in this week's Board meeting minutes underscores that there is very limited tolerance for higher-than-forecast inflation outcomes. Having opted against the argument that tightening policy pre-emptively could be appropriate to manage upside risks in August, the Board may now feel a sense of urgency. The RBA were wrong footed last year by a resurgence in inflation, and this has left them with little or no flexibility with respect to inflation outcomes. Indeed, the August Board meeting minutes noted that "*Several members judged that it was quite possible that the upside risks to the inflation forecast would crystallise, requiring some further tightening*."

Will one hike be enough? Or will the RBA need to hike in September and November? At this stage, we look for one hike to a cash rate peak of 4.6%. With policy already "somewhat restrictive", another hike will take the overall policy setting more clearly into restrictive territory. And with growth already slowing, and the RBA explicitly attuned to downside risks to the labour market and from the housing market, we see one further tightening as the most likely outcome. However, risks are biased to a follow up hike, especially if resilience in activity data emerges ahead of the November meeting.

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