Weekly Economic Update

OPTIMAL ECONOMICS

20 March 2026

The RBA this week delivered a second quick-fire rate hike as just about every economist had expected and financial markets had all but fully priced. The surprise was that the decision was a close call, with four of the nine Board members opting to wait. The naysayers were outnumbered, of course, but only just. Under the Bank's new governance system, we know the tally of votes but not who voted for what, so we are left to speculate. Which is fun. The split decision hinted that another rate hike at the next board meeting in early May is not a done deal - market pricing plunged from 100% before the decision to 50% after the news of disagreement broke.

RBA Governor Michele Bullock indicated the split on the board was about timing rather than the direction of travel. She also indicated in her post decision press conference that the war in the Middle East pushing up energy prices was not the reason for this week's rate hike. Indeed, Australia had a domestic inflation problem before the bombs started falling on Iran. Later, Governor Bullock mentioned the "R word", saying a recession was "possible" if inflation persisted longer than feared and interest rates had to keep rising. Recession looks unlikely, but the message is the RBA will do whatever is necessary to squeeze inflation out of the economy – it is that destructive.

Don't be fooled by the rhetorical flourishes elsewhere - our inflation problem is mainly home grown, with global issues merely making things worse. The domestic economy has little or no spare capacity, so as private sector activity expands, even modestly, competitive pressures are ignited in labour and capital markets, pushing up prices.

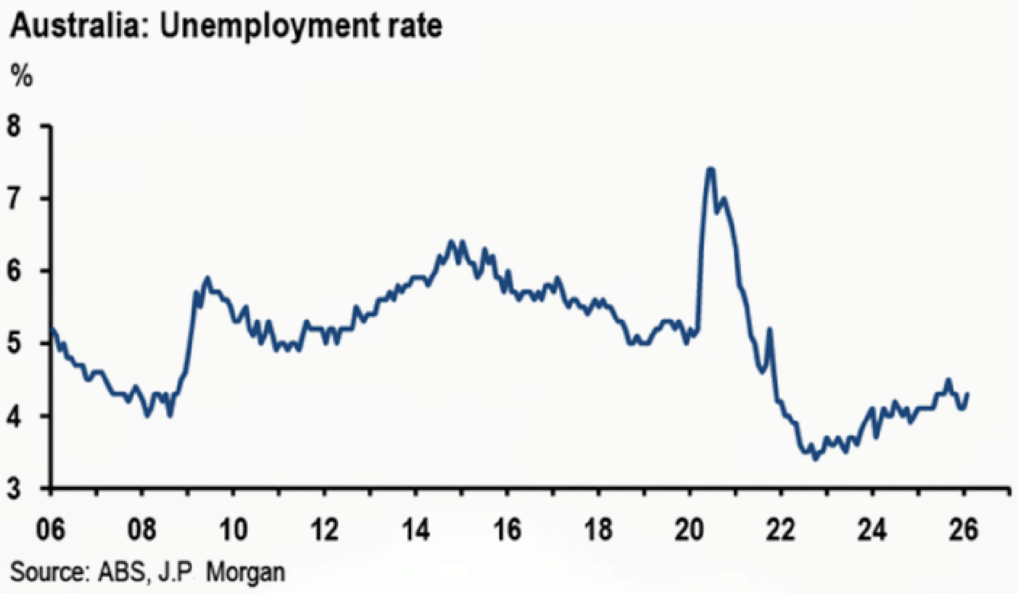
Also, public demand is surging, further increasing pressure on resources. It's true that the Bank's statement on Tuesday did not mention government spending as a cause, but it's a key element of aggregate demand, which is growing too quickly relative to supply.

Also, the labour market remains very tight, with jobs growth booming, the unemployment rate still low (see chart below from JPMorgan) and skill shortages widespread. This all adds upside pressure to wages when the vital link to productivity has been weakened by deliberate policy change. This week's monthly jobs report for February showed another big gain in jobs (nearly 50,000 positions), but a higher unemployment rate. The latter, though, was because more people started the search for work as the number of people losing their jobs actually fell. The report confirmed that the labour market remains in rude health.

The few economists who called for interest rate stability on Tuesday (alongside four RBA board members!) claim a global oil price shock damages economic growth and confidence. This certainly is true, but a more powerful, persistent and damaging force is the inflation pulse unleashed. Petrol prices in Australia have surged, soon to be followed by prices for food, fertilizers, plastics, airfares and packaged and transported goods (that is, everything else). In this environment, the RBA wants to re-anchor price expectations by sending a strong signal that interest rates will keep rising as needed. It sent this strong signal by deed and by word.

See over the page...

Finally, the US Federal Reserve left interest rates steady overnight, with other central banks likely to do the same tonight as officials await clarity on the Middle East war. The fact that the RBA is hiking while other central banks are not further confirms that Australia's inflation problem is mainly home grown.



Stephen Walters

Chief Economist,
Optimal Economics

Call us:
+61 2 0499 976 196

Email:
stephenwalters@optimaleconomics.com.au

Website:
https://optimaleconomics.com.au/