
Weekly Economic Update

RBA on hold despite above-target inflation

The Reserve Bank probably should have raised interest rates for a fourth straight time on Tuesday. But, of course, it didn't, despite inflation being uncomfortably high and about to get worse as the fallout from the war in Iran lifts prices of everything from fertilizer to bitumen. Much of the secondary price impulse is still coming, yet core inflation already has been above the midpoint of the RBA's target for four years (see chart below)!

Moreover, our obsessively poll-driven Federal government is about to make inflation worse. On Wednesday, it announced a two-year extension to the multi-billion-dollar wage subsidy for private sector childcare workers. And the PM is poised to extend the fuel excise cut beyond 30 June. The latter temporarily will keep petrol prices down, but both measures will pump even more taxpayers' money into an economy with no spare capacity. Guess what happens to inflation?

So, why did the RBA balk this week? It seems officials want more clarity on everything from the budget's incentive-sapping tax proposals to the speed with which tankers resume traversing the now "open" Strait of Hormuz. Also, the economy almost certainly will shrink in Q2 as the real economy fallout from the Middle East spills into the GDP numbers. The RBA has been trying to engineer a slowdown, not a car crash.

So, the RBA is back in its happy place of "wait and see". Those hoping the cash rate may come down soon will have been disappointed in the RBA's language this week. The statement said the cash rate will rise if necessary, which economists say is a clear "tightening bias". Markets price a 50/50 chance of another hike this year. In other words, economists have no

idea whether the RBA hikes again or not. Choose your own adventure.

On the contentious budget measures, the Senate this week concluded its sham of an inquiry. What's been described as the most profound tax "reform" in a generation apparently deserved just two days of scrutiny, with carefully curated attendees. That's scandalous and means we'll end up with inferior policy. It's not the "wrecking ball" the NZ PM described a few weeks back, but the proposals already are crushing sentiment - ask anyone working at a non-tech start-up or a real estate agent.

In response to sustained pressure, the government did announce reversals on some contentious proposals, including exempting testamentary trusts from a minimum tax rate (neutralising the "death tax" claim made by some) and raising the turnover threshold for small businesses five-fold to \$10 million. These will help, but the whole package still raises nearly \$80 billion more tax!

Earlier this week, President Trump declared the end of military engagements in the Middle East and, this time, the Iranians agreed. But shipping companies indicated they're not yet ready to send their expensive vessels through the hot zone. And who can blame them? The President begged ships to "start your engines" but they'll be idling for a while yet.

Financial markets reacted to the positive news as would be expected. Shares rallied, including here in Australia, and government bond yields fell, although only modestly. Crude oil prices dived, although they remain well above where they were when the war started at the end of February. The AUD flat-lined at just above 70 US cents.

Finally, in other central bank action, the Bank of Japan lifted the cash rate again this week to the highest level in more than three decades. But the new chairman of the US Federal Reserve delivered "no change", despite inflation persisting above the Fed's 2% target.

The President has insisted his hand-picked candidate as Fed chair cut interest rates, but courageous Board members resisted. In fact, they signalled that the next move in the US could be a rate hike.

