Appendix – 4 questions for '24

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4 questions for '24

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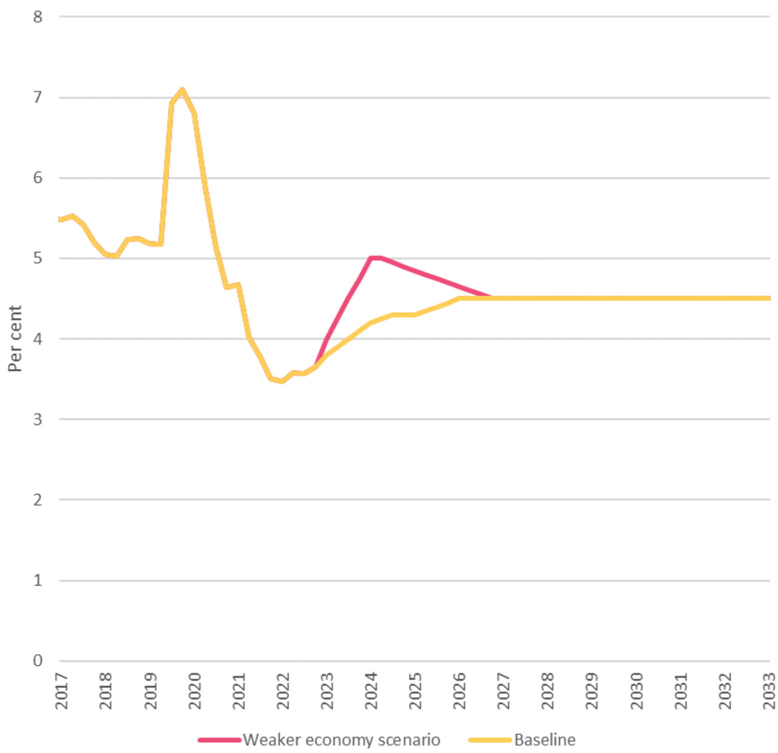
This appendix includes analysis as to how key economic variables might evolve under different scenarios related to the question of what it would take for inflation to head toward the middle of the RBA's target band by the end of its forecast horizon. This was one of the questions in *4 questions for '24*. The baseline scenario in this analysis corresponds to forecasts or assumptions from the RBA's November *Statement of Monetary Policy* (SoMP). The alternate scenarios are set out below. Moody's Analytics' Global Macroeconomic Model was used for this analysis.

Weaker economy scenario

In this scenario the economy weakens by more than expected following previous interest rate increases. Here the unemployment rate increases to five per cent in the first half of 2025 (Graph A1). This is higher than forecast in the November SoMP. More subdued economic conditions lead to inflation slowing to 2.4 per cent by the end of the RBA's forecast horizon in December 2025 (Graph A2). Seeing that inflation is moderating in line with softer economic conditions, the RBA responds by lowering the cash rate by more than currently anticipated (Graph A3).[1]

Graph A1 – Unemployment rate under different scenarios



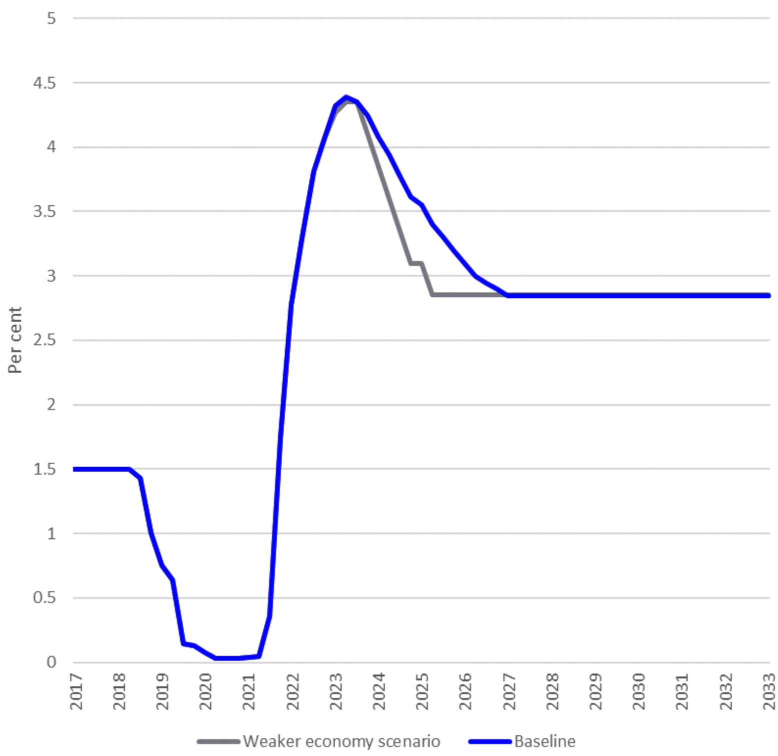
Source: Moody's Analytics, QTC Economic Research

1 The technical assumption the Bank uses in preparing its forecasts is that the cash rate moves broadly in line with economist expectations and market pricing

Graph A2 – Inflation under different scenarios

Source: Moody's Analytics, QTC Economic Research

Graph A3 – Cash rate under different scenarios

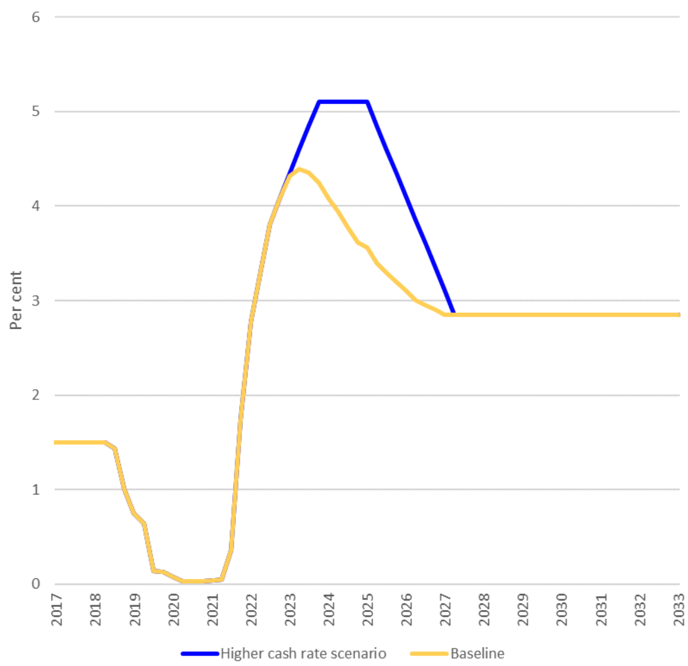


Source: Moody's Analytics, QTC Economic Research

Tighter policy scenario

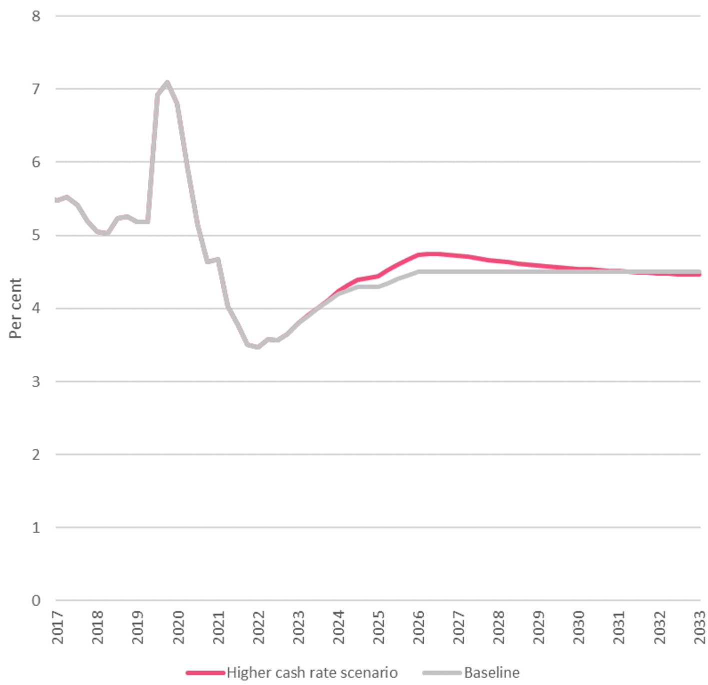
In this scenario the RBA delivers three further 25 basis point rate rises to combat sticky domestic services-based inflation (Graph A4). In response, economic activity softens and the unemployment rate rises more quickly than under the baseline scenario (Graph A5) and inflation moderates (Graph A6). However, it takes until mid-2026 to get back to the middle of the band. While this is not achieved by the end of the RBA's forecast horizon, delivering more than three further rate increases to get inflation a few tenths of a percentage point lower a few quarters earlier might not be considered an appealing trade-off. Further, when the RBA's forecast horizon is extended a further six months in August 2024, inflation will be within the target band under this scenario.

Graph A4 – Cash rate under different scenarios



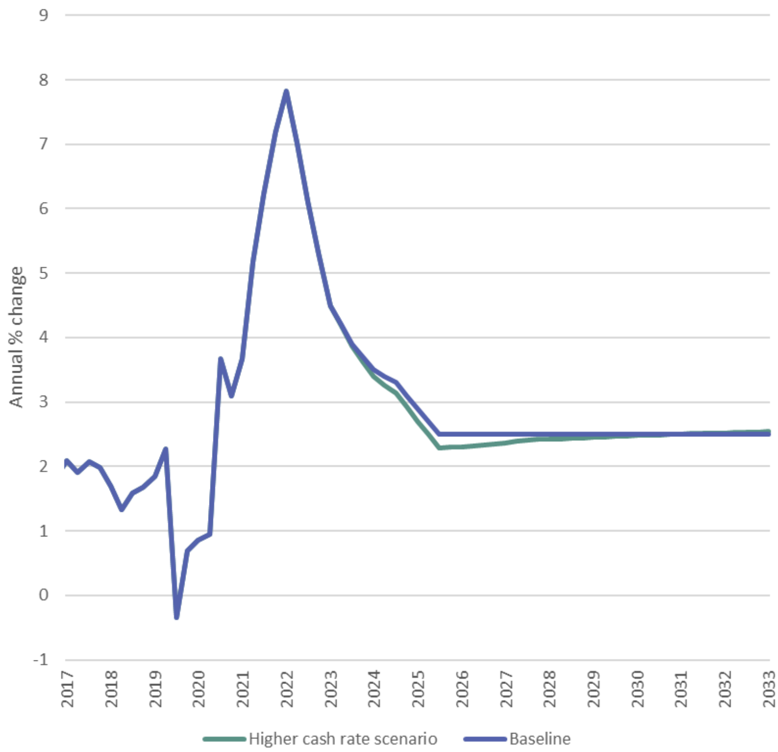
Source: Moody's Analytics, QTC Economic Research

Graph A5 – Unemployment rate under different scenarios



Source: Moody's Analytics, QTC Economic Research

Graph A6 – Inflation under different scenarios



Source: Moody's Analytics, QTC Economic Research

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