Inflation fall opens door to rate cut

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The Reserve Bank of Australia's preferred measure of underlying inflation has dipped below 3 per cent for the first time in more than three years, opening the door to a probable interest rate cut in May after the federal election.

But inflation over the past three months was a bit higher than the market expected and picked up from a low point in the December quarter, prompting economists to warn that the RBA would be cautious about unleashing a flurry of rate cuts this year.

Approaching the end of a cost-of-living election, Treasurer Jim Chalmers said the decline in both headline and underlying inflation to inside the RBA's 2 per cent to 3 per cent target range was proof of economic progress after inflation peaked at 8 per cent in 2022.

He pointed to money markets pricing in at least four more rate cuts by the RBA this year, after its initial rate reduction in February.

Larger price rises for housing, education and food were partly offset by price falls for furniture, household equipment and recreation activities in the March quarter, the Australian Bureau of Statistics reported yesterday.

The annual consumer price index rose 0.9 per cent in the three months, to hold steady at 2.4 per cent over the year.

The RBA's more closely watched underlying measure of inflation, which trims out the most volatile price movements and discounts the artificial impact of temporary government subsidies, moderated to 2.9 per cent. It rose 0.7 per cent for the three months.

This was broadly in line with RBA forecasts, but above expectation of market economists for underlying inflation of 0.6 per cent for the quarter and 2.8 per cent in annual terms.

It was the first time since the December 2021 quarter trimmed mean annual inflation has been in the RBA's target band of 2 per cent to 3 per cent.

It sets up the RBA for a probable second cut this year to the 4.1 per cent cash rate at its monetary policy board meeting on May 19-20, a bit over two weeks after Saturday's federal election.

IFM Investors chief economist Alex Joiner said there appeared to be enough progress towards the 2.5 per cent midpoint of the RBA's inflation target range for the central bank to lower interest rates in May.

"But it will remain cautious and data-dependent, which suggests a follow up cut in July is not guaranteed," Joiner said. "August seems a more likely option for it to deliver further easing as further clarity on the global economic environment emerges."

Money markets imply a 98 per cent chance of a standard 0.25 of a percentage point cut to 3.85 per cent at its next policy meeting, down from 113 per cent before the inflation data. They imply a total of 116 basis points of cuts over the next year, down from 122 basis points before the CPI print.

JPMorgan economist Tom Kennedy said the RBA was on track to ease the cash rate in May, but the modest upside surprise to quarterly inflation meant the market was pricing in too many rate cuts this year.

EY senior economist Paula Gadsby said the RBA had an opportunity to loosen monetary policy at its May meeting. "Further cuts to bring the cash rate closer to a more neutral position are likely this year," she said.

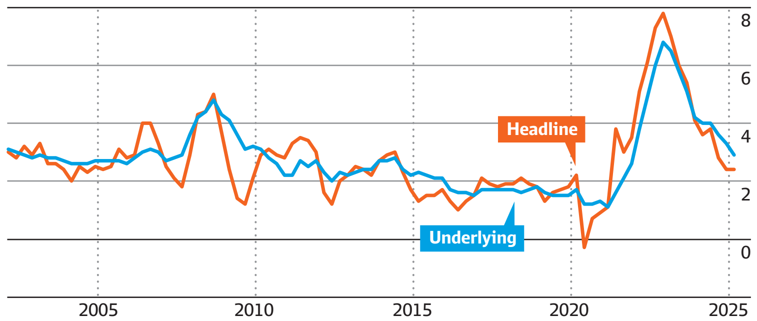
"The Reserve Bank will need to be alert to unfolding global trade developments which tilt the balance of risks for growth to the downside, especially if uncertainty causes a pause in consumer and business activity."

Chalmers said he was happy with the result three days out from the election.

"This means both headline and underlying inflation is within the Reserve Bank's target band for the first time since 2021. I don't predict or preempt decisions taken independently by the Reserve Bank, but the market is expecting somewhere between four and five additional interest rates this year. And if that eventuated, that would deliver hundreds of dollars every month to Australians with a mortgage."

On target

Annual inflation (%)



SOURCE: ABS, RBA