

Monday, 3 April 2023

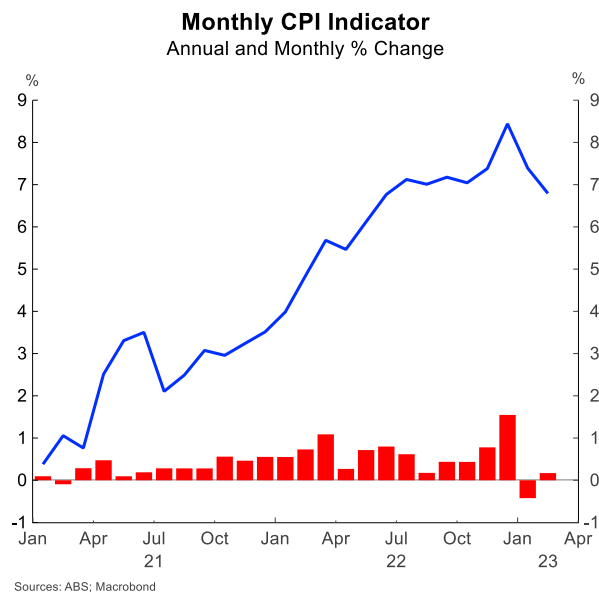
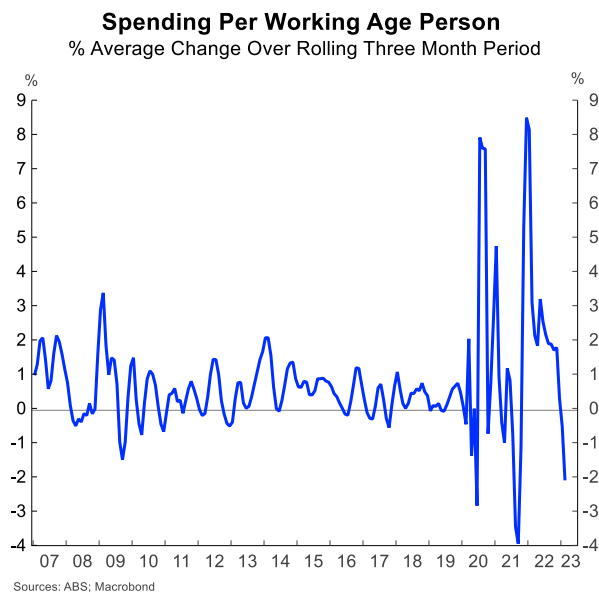
Pause Could Spell The End Of This Cycle

Interest rate markets are pricing in no chance of a rate hike at tomorrow's Reserve Bank (RBA) Board meeting. Economists generally agree - 16 of 27 economists surveyed by Bloomberg are expecting a pause at tomorrow's meeting.

We expect the RBA Board to pause tomorrow and for the Policy Statement to remain hawkish, signalling that the Board will be data dependent and ready to hike if necessary. The RBA Governor will give a speech on Wednesday at the National Press Club in Sydney, likely reinforcing the message that inflation remains the RBA's priority and that the Board will be prepared to hike if the data warrants, and inflation accelerates.

However, there is a growing chance that the incoming data will continue to point to an economy that is slowing and slowing quickly. If this is the case, we may have already seen the last hike of this cycle. The retail trade and inflation data released last week, two of four key indicators the RBA Governor was watching ahead of tomorrow's meeting, point to a sharper than anticipated fall in spending and inflationary pressures.

The retail trade release confirmed that spending is falling. Looking through the seasonal volatility, over the three months to February spending declined by 1.5% compared with spending over the previous three months. On a per person basis, spending was 2.1% lower over the three months to February – the largest fall on record outside of COVID, even larger than the Global Financial Crisis. Remember retail trade records the amount of money spent. As such, these falls would be larger after correcting for inflation. When you consider that only around 50% of the rise in the cash rate to date has likely been passed through to total scheduled mortgage payments, we expect the softness in spending to continue over 2023.



The monthly inflation gauge showed that inflation had fallen from 8.4% over the year to December 2022, to 6.8% over the year to February 2023. This suggests that inflation in Australia has now peaked and is on its way down. On the current trend, it is possible that underlying inflation comes in around 6.2% over the year to the March quarter. An underlying inflation rate of 6.2% is the RBA's forecast for the June quarter. In other words, it is possible that inflation has eased at double the rate the RBA expected just a few months ago in November.

A softer than expected March quarter inflation read will reduce the need for further hikes. We think the outcome could be softer based on fall already seen in the monthly inflation and, as we have previously flagged, because the December quarter inflation report was held up by temporary factors. The unwinding of the cut of the fuel excise, electricity subsidies and HomeBuilder, or similar state based subsidises, all contributed to the higher-than-expected December quarter outcome. The other upside surprise to hit the December quarter, travel and accommodation cost, has also started to fall, and fall sharply – by 7.2% in January and 14.6% in February.

Other Domestic Data

This week we get house price data for the month of March and forward indicators for residential construction, including building approvals and new housing finance. House prices have fallen since the start of the RBA's hiking cycle – by almost 10%. However, over the past few months house prices have started to stabilise, particularly in the capital cities. What's unique about this cycle is that international arrivals are increasing at a record pace and the rental market remains extremely tight. This is supporting higher demand for housing at the time demand should be falling on the back of higher interest rates. Households have also stayed on the sidelines and are waiting for conditions to improve before testing the market.

The increase in demand from external sources and limited supply has provided a floor for prices. However, as rate hikes continue to pass through to households with mortgages, particularly fixed rate mortgages, it is possible that supply will increase, and we may see further house price falls.

Forward indicators for housing construction, most notable building approvals and new housing finance for construction have also trended lower since the start of the hiking cycle. We expect to see this continue until it becomes clear that the hiking cycle has come to an end.

International Data

On the international front, several global Purchasing Managers' Indices will be released providing a read on economic conditions in March. However, the key global data release will be US payroll data to be released this Friday. Solid wages growth on the back of a tight labour market has seen services inflation become sticky in the US. The Fed will be watching developments closely, with the state of the labour market likely to be the key consideration in the Fed's upcoming May meeting.

Pat Bustamante, Senior Economist

+61 468 571 786

Group Forecasts

End Period:	2023				2024		
	Close (03 Apr)	Q2 (f)	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)
Aust. Interest Rates:							
RBA Cash Rate, %	3.60	3.85	3.85	3.85	3.60	3.35	3.10
90 Day BBSW, %	3.72	3.95	3.95	3.97	3.72	3.47	3.22
3 Year Swap, %	3.35	3.65	3.60	3.50	3.40	3.20	3.00
10 Year Bond, %	3.30	3.60	3.40	3.20	3.00	2.80	2.70
US Interest Rates:							
Fed Funds Rate, %	4.875	4.875	4.875	4.875	4.375	3.875	3.375
US 10 Year Bond, %	3.47	3.70	3.50	3.30	3.10	2.90	2.80
USD Exchange Rates:							
AUD-USD	0.6685	0.69	0.72	0.74	0.75	0.76	0.76
USD-JPY	132.86	131	130	129	128	127	126
EUR-USD	1.0839	1.09	1.10	1.11	1.12	1.13	1.14
GBP-USD	1.2337	1.22	1.23	1.24	1.25	1.26	1.27
NZD-USD	0.6258	0.64	0.66	0.67	0.68	0.68	0.68
AUD Exchange Rates:							
AUD-USD	0.6685	0.69	0.72	0.74	0.75	0.76	0.76
AUD-EUR	0.6166	0.63	0.65	0.67	0.67	0.68	0.67
AUD-JPY	88.773	90.4	93.6	95.5	96.0	96.5	95.8
AUD-GBP	0.5420	0.57	0.59	0.60	0.60	0.60	0.60
AUD-NZD	1.0684	1.08	1.09	1.10	1.11	1.13	1.13

	2021	2022	2023 (f)	2024 (f)
GDP, %	4.6	2.7	1.0	1.5
CPI (Headline), %	3.5	7.8	3.9	3.0
CPI (Trimmed mean), %	2.6	6.9	3.6	3.1
Unemployment Rate, %	4.7	3.5	4.5	5.0
Wages Growth, %	2.4	3.3	4.0	3.2

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

Contact Listing

Chief Economist

Besa Deda
dedab@bankofmelbourne.com.au
+61 404 844 817

Senior Economist

Pat Bustamante
pat.bustamante@bankofmelbourne.com.au
+61 468 571 786

Senior Economist

Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
+61 481 476 436

Economist

Jameson Coombs
jameson.coombs@bankofmelbourne.com.au
+61 401 102 789

The Detail

The information contained in this report (“the Information”) is provided for, and is only to be used by, persons in Australia. The information may not comply with the laws of another jurisdiction. The Information is general in nature and does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and is not an invitation to take up securities or other financial products or services. No decision should be made on the basis of the Information without first seeking expert financial advice. For persons with whom Bank of Melbourne has a contract to supply Information, the supply of the Information is made under that contract and Bank of Melbourne’s agreed terms of supply apply. Bank of Melbourne does not represent or guarantee that the Information is accurate or free from errors or omissions and Bank of Melbourne disclaims any duty of care in relation to the Information and liability for any reliance on investment decisions made using the Information. The Information is subject to change. Terms, conditions and any fees apply to Bank of Melbourne products and details are available. Bank of Melbourne or its officers, agents or employees (including persons involved in preparation of the Information) may have financial interests in the markets discussed in the Information. Bank of Melbourne owns copyright in the information unless otherwise indicated. The Information should not be reproduced, distributed, linked or transmitted without the written consent of Bank of Melbourne.