Weekly Economic Outlook

Bank of Melbourne

Monday, 2 May 2022

Say Goodbye to Ultra-Cheap Money

Spearheading a jam-packed week of economic data is the Reserve Bank's (RBA) May monetary policy decision, due tomorrow. At its last meeting the RBA outlined a script for a near-term rate rise, suggesting that the Board was keen to see the March quarter inflation report (published last week) and the March quarter wages report (out on May 18) before raising rates. However, last week's inflation report blew the RBA's most recent forecasts out of the water. Headline inflation hit 5.1%, its fastest annual rate in more two decades, while underlying inflation surged to a 13-year high of 3.7%. Both outcomes were well above the RBA's latest projections and, critically, much higher than the RBA's inflation target band of 2-3%.

The blisteringly strong inflation print, combined with a robust recovery in economic activity and the unemployment rate falling to near a 50-year low, means the RBA cannot wait any longer to raise rates. Inflation is notoriously difficult to reign back in once the genie gets out of the bottle and last week's data is a sign the inflation genie is rearing its head.

We expect the RBA to hike the cash rate for the first time in more than a decade at its Board meeting tomorrow. The first hike is likely to be a 15 basis point move, followed by a further 25 basis point hike in June. However, there is some risk the RBA will elect to go with an out-sized 50 basis point jump at its June meeting, after moving by 15 basis points at its May meeting. The RBA may be influenced by other global central banks recently moving in 50 basis point increments (the Reserve Bank of New Zealand and the Bank of Canada) or being expected to do so soon (the US Federal Reserve). Following a swift reversal of the 65 basis points of emergency rate cuts implemented at the outset of the pandemic, we expect the RBA to continue to hike the cash rate higher, reaching 1.50% at the end of the year. We expect further increases in the cash rate until mid-2023. By that time, the current era of ultra-cheap money will be well and truly behind us, at least until future economic downturns.

Interest rate markets have attached a 78% probability of a 15 basis point move in the cash rate tomorrow and are aligned with our central view that the cash rate will hit 50 basis point in June. However, the market is pricing a much more aggressive hiking profile from there. The market expects the RBA to hike the cash rate to 2.50% by the end of 2022, representing a 240 basis point jump from its current level and is 100 basis points above our current expectations.

Regardless of the result, tomorrow's monetary policy decision will likely be the most closely followed in some time, and not just by economists. Households will be keeping a close eye on the outcome and what it means for their mortgage repayments, while the Federal Government will be staring down the barrel of the first rate hike during an election campaign since 2007, when the Rudd campaign toppled the incumbent Howard Government.

Housing Market

A slew of housing market data will also be scattered throughout this week.

CoreLogic kicked off proceedings this morning with April's dwelling price figures. These showed a continuation of recent trends in the housing market. Overall, momentum continued to slow in the capital cities, led by further weakness in the most expensive markets of Sydney and Melbourne. Both markets recorded their first 3-month fall in prices since the extended lockdowns of 2020. Prices continue to grow strongly in the remaining capital cities, especially in Adelaide, Brisbane and Canberra, although the peak appears to be behind us. We expect momentum to continue to slow as interest rates rise.

On Wednesday, the ABS will release housing finance data for March. We expect to see the value new of loan commitments decline by 3.5% in March. This would be the second consecutive monthly decline, alongside a broader slow-down in the housing market and the recent decline in sales turnover. We expect the decline in lending to be skewed towards owner-occupiers, although investor loans are also expected to take a hit.

And to cap it off, we will get an update on building approvals for March on Thursday. There has been an extraordinary amount of volatility in building approvals over the start of 2022, masking an underlying softening trend. We expect this softening to continue in March, in line with the broader market trend, with a 4% decline in the month.

Other

The March retail sales result will be released on Wednesday. After a strong start to the year over January (+1.6%) and February (+1.8%), we expect retail sales to take a backwards step in March, with a projected 1% decline. Cost-of-living pressures associated with surging petrol prices and broader inflationary pressures likely weighed on retail spending. Extreme weather events in the month including severe flooding across large parts of NSW and Queensland were also likely to drag on sales. Despite the monthly decline, sales are expected to stay elevated, following a near-record high in February.

Updated trade balance data for March will be released on Thursday. Australia's trade surplus is expected to increase to around $10.7 billion in March. This follows a $7.5 billion surplus in February. Exports are expected to strengthen, and imports likely declined in the month.

Enough RBA for One Week?

If you haven't had enough of the RBA for one week - economists will argue there can never be too much – the week will be capped off with the RBA's quarterly Statement on Monetary Policy (SoMP) on Friday.

The SoMP will include the RBA's most recent economic forecasts. These will no doubt look very different to the last set of projections from February, after some very strong data over the period, not least, last week's inflation print. Economists will be taking a close look at the SoMP for any clues on the RBA's thinking around the path of interest rates and importantly, the Bank's plans for its supersized balance sheet.

The SoMP will also provide further insights into how the RBA expects the Australian and global economies to react to the continued war in Ukraine and its associated impacts on the energy and commodities markets.

A Look Offshore

The RBA isn't the only central bank meeting this week. The US Federal Reserve (Fed) convenes its two-day meeting tomorrow night, and the outcome will be released in the early hours of Thursday morning.

It is widely expected that the Fed will increase the federal funds rate by 50 basis points, following a 25 basis point move at the March meeting. Several Fed officials, including Chairman Jerome Powell, have recently made comments supporting a 50 basis point rate hike, as the Bank moves quickly to return interest rates to a 'neutral' level as inflation surges. Inflation hit an annual rate of

8.5% in March, its highest level since December 1981. The extraordinary inflationary pressures mean there is some risk of a larger 75 basis point rate hike, although this is not our expectation.

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Forecasts

		2022			2023		
End Period:	**Close (29 Apr)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	0.10	0.50	1.00	1.50	1.75	2.00	2.00
90 Day BBSW, %	0.71	0.70	1.20	1.70	1.95	2.20	2.20
3 Year Swap, %	3.06	3.00	2.90	2.85	2.75	2.65	2.55
10 Year Bond, %	3.15	3.20	3.10	2.80	2.65	2.50	2.35
US Interest Rates:							
Fed Funds Rate, %	0.375	1.375	1.875	2.375	2.375	2.375	2.375
US 10 Year Bond, %	2.82	2.90	2.80	2.50	2.40	2.30	2.20
USD Exchange Rates:							
AUD-USD	0.7102	0.74	0.75	0.76	0.77	0.78	0.79
USD-JPY	130.87	130	128	126	124	122	120
EUR-USD	1.0497	1.07	1.10	1.12	1.13	1.14	1.15
GBP-USD	1.2459	1.28	1.30	1.32	1.34	1.36	1.37
NZD-USD	0.6511	0.69	0.70	0.71	0.72	0.72	0.73
AUD Exchange Rates:							
AUD-USD	0.7102	0.74	0.75	0.76	0.77	0.78	0.79
AUD-EUR	0.6766	0.69	0.68	0.68	0.68	0.68	0.69
AUD-JPY	92.944	96.2	96.0	95.8	95.5	95.2	94.8
AUD-GBP	0.5700	0.58	0.58	0.58	0.57	0.57	0.58
AUD-NZD	1.0945	1.07	1.07	1.07	1.08	1.08	1.09

	2020	2021	2022 (f)	2023 (f)
GDP, %	-0.8	4.2	4.5	2.5
CPI (Headline), %	0.9	3.5	5.6	2.6
CPI (Trimmed mean), %	1.2	2.6	4.4	3.0
Unemployment Rate, %	6.8	4.7	3.2	3.4
Wages Growth, %	1.4	2.3	3.4	4.0

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

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

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