Monday, 5 June 2023

Yield Curve Inverts for 1st Time Since '08

We kicked off this week with news that the Australian 2-10-year generic government yield curve inverted at the close on Friday for the first time since 2008. An inverted yield curve historically has been an indicator of forthcoming recessions. However, a sustained and extended inversion is usually required.

The Reserve Bank (RBA) Governor has said that they are treading a narrow path in attempting to bring down inflation whilst keeping the economy on an even keel. The inversion suggests the path has become narrower. The Governor fronted the Senate estimates last week and during the hearing he suggested that they're prepared to veer off this narrow path if required to bring inflation back into its target band.

Reserve Bank Board Meeting

All eyes will be on the RBA board decision tomorrow at 2:30pm AEST. The decision has become a close one after the monthly inflation report and minimum wage decision last week. Interest-rate markets are attaching a probability of around 30% to a rate hike tomorrow and are more than fully priced for a rate hike by August. A recent survey of 30 economists reveals the median expectation is for the cash rate to remain unchanged at 3.85% tomorrow and rise to 4.10% at the RBA's July meeting. Our Group view remains unchanged; that is, no further rate hikes are expected in this cycle. But the odds of further tightening have certainly shortened considerably.

We cannot rule out more central-bank tightening, particularly with inflation well above the target band and the RBA not anticipating a return to the target band until mid 2025 (when the RBA expects it to touch 3%).

The monthly inflation report provided some mixed signals. It showed that the headline inflation unexpectedly stepped up to an annual rate of 6.8% in April, from 6.3% in March. This higher-than-expected outcome was significantly impacted by distortions from the halving of the excise fuel tax between the end of March and September of last year. When adjusting for volatile items and holiday travel, the seasonally adjusted inflation measure showed a 6.5% increase, down from 6.9% in March. But the annual trimmed measure, which dampens the impact of bigger price movements, increased to 6.7% in April, from 6.5% in March.

The minimum wage decision was also higher than anticipated by policy makers and suggests some upside risk to inflation.

Around 2.6 million persons on a minimum wage, award or enterprise agreement tied to an award will receive a minimum 5.75% increase in their wages from 1 July 2023. This is higher than last year's decision, which was a 5.2% rise for the minimum wage and a 4.6% rise for the award wages.

If we allow for the FWC shifting up the minimum wage to the higher award rate, the effective rise in the minimum wage is 8.6% (not 5.75%). It impacts only a small number of workers directly, that is, around 184k or less than 1% of the workforce. But it could encourage other workers in the labour market to use it as an anchor to bargain for a larger wage increase.

We estimate it could add up to 0.4 percentage points to the growth rate in the Wage Price Index (WPI) in the September quarter of 2023 compared to the September quarter of last year. This could bring the growth rate up to as much as 1.5% over the quarter and 4.2% in annual terms.

Our view is that the boost to purchasing power from the decision is higher than last year's decision, will generate a greater spending impulse and see wages growth remain higher. Our Group view is unchanged at a 4.1% peak in the WPI. But we see a strong risk that wages growth could rise to a peak of up to 4.25% before next year's minimum wage decision. Wages warming up will add to inflationary pressures and mean a slower return to the inflation target.

The RBA Governor at Senate Estimates last week appeared very concerned about nominal wage growth during a period of weak productivity growth. So, in our opinion, tomorrow's decision has become a very close call, especially as the slowing in retail spending and rise in the unemployment rate (from 3.5% to 3.7% in the latest report) must also be considered.

National Accounts; Partial Indicators for the National Accounts

The RBA board decision comes just ahead of the release of the March quarter national accounts data on Wednesday. These accounts will give us an update on the pace of economic activity in the March quarter. Our central forecast is that GDP rose by 0.2% in the March quarter, but given the weakness from the trade sector and household consumption, there's a risk of a fall. The range of estimates is currently -0.2% to 0.5% for the quarter.

A rise of 0.2% in GDP would send the annual growth rate of GDP to 2.3%, from 2.7% in the previous quarter. An annual pace of 2.3% is modestly below the trend rate of growth in the economy.

Before GDP is published, there are a range of partial economic indicators to be released. These include business indicators today (includes updates on profits and inventories) and both the balance of payments (net exports contribution) and government statistics tomorrow.

International Trade

To round out the week, the trade balance is out this Thursday. Australia has continued to achieve a sizeable monthly trade surplus– averaging $11.7 billion during 2022. The surplus has continued to trend up and has climbed towards a record high of $15.3bn in the latest report for March. For April, a correction from this elevated level is in prospect, with the surplus likely to print at $11.8bn. Export earnings are expected to pull back sharply because of lower commodity prices and lower volumes. Imports are also expected to soften, but by a more modest amount, due to a softening in underlying consumer demand.

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Group Forecasts

		2023			2024		
End Period:	**Close (5 Jun)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	3.85	3.85	3.85	3.85	3.60	3.35	3.10
90 Day BBSW, %	4.02	3.95	3.95	3.97	3.72	3.47	3.22
3 Year Swap, %	3.88	3.60	3.50	3.40	3.30	3.10	2.90
10 Year Bond, %	3.64	3.40	3.30	3.20	3.00	2.80	2.70
US Interest Rates:							
Fed Funds Rate, %	5.125	5.125	5.125	4.875	4.375	3.875	3.375
US 10 Year Bond, %	3.69	3.50	3.40	3.30	3.10	2.90	2.80
USD Exchange Rates:							
AUD-USD	0.6610	0.69	0.72	0.74	0.75	0.76	0.76
USD-JPY	139.92	132	130	128	127	126	125
EUR-USD	1.0708	1.11	1.11	1.12	1.13	1.14	1.15
GBP-USD	1.2453	1.25	1.25	1.26	1.26	1.27	1.28
NZD-USD	0.6067	0.64	0.66	0.67	0.68	0.68	0.68
AUD Exchange Rates:							
AUD-USD	0.6610	0.69	0.72	0.74	0.75	0.76	0.76
AUD-EUR	0.6171	0.62	0.65	0.66	0.67	0.67	0.66
AUD-JPY	92.47	91.1	93.6	94.7	95.3	95.8	95.0
AUD-GBP	0.5306	0.55	0.58	0.59	0.60	0.60	0.59
AUD-NZD	1.0891	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	4.0	3.1
CPI (Trimmed mean), %	2.7	6.9	3.7	3.1
Unemployment Rate, %	4.7	3.5	4.2	5.0
Wages Growth, %	2.3	3.4	4.1	3.3

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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