

Weekly Economic Outlook

Tuesday, 26 April 2022

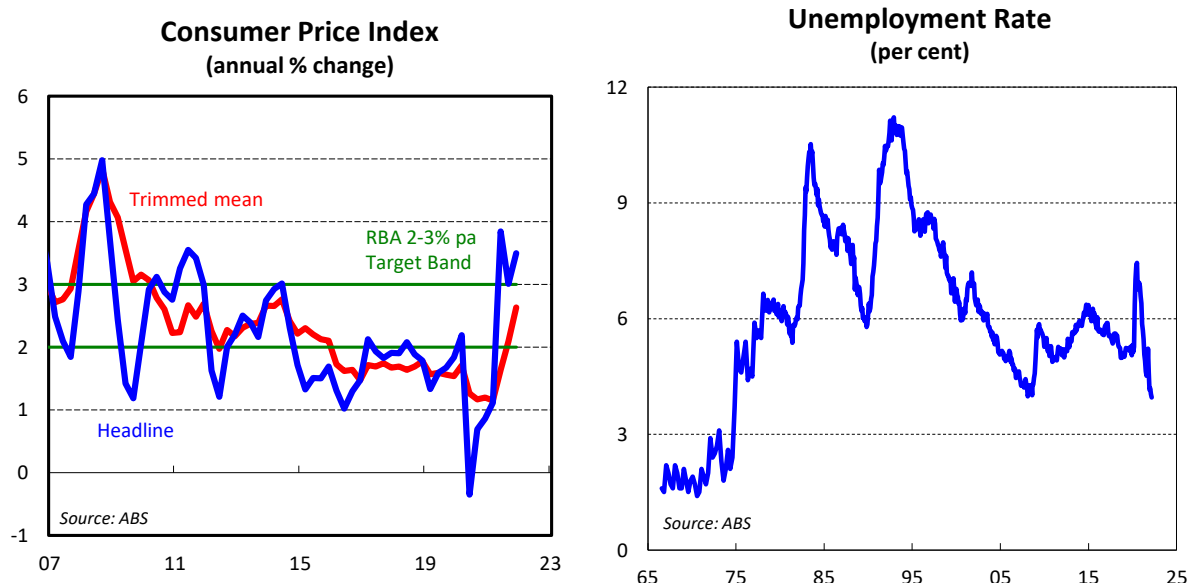
Price Surge Points to Larger Hike in June

Consumer price index preview

This week, all eyes are on the March quarter consumer price index (CPI), which will be published tomorrow.

The Reserve Bank (RBA) will be watching closely. In its statement earlier in April, the Board noted “over coming months, important additional evidence will be available” on inflation and labour costs. We expect the RBA wants to see this week’s CPI data and the next wage price index report (May 18). As a refresher, headline CPI rose 1.3% in the December quarter, taking annual inflation to 3.5%. Core inflation, measured by trimmed mean CPI, was up 1.0% in the quarter, to be 2.6% higher over the year.

We are expecting a whopper report for the March quarter, projecting a 2.0% quarterly increase in headline inflation, taking annual inflation to 4.9%. This would mark the largest quarterly jump in headline inflation since the September quarter 2000.



We anticipate this will partly reflect a lift in housing costs, alongside the expiry of COVID-related government support, such as HomeBuilder. Housing costs are also being pushed up by global supply-chain disruptions, which have increased the cost of building materials, and increasing labour costs as labour shortages become more pronounced. The Ukraine war has also contributed to price pressures via higher commodity and energy prices, and the flow-on effect to higher fuel prices.

However, importantly, we also expect to see a broader pick up in price pressures alongside solid domestic demand. We expect this will lead to 1.2% quarterly growth in core inflation – measured by the trimmed mean – taking annual core inflation to 3.4%. This result would be the strongest

quarterly growth in core inflation since September 2008, in the midst of the mining boom.

RBA likely to hike more aggressively

Such a strong CPI report is likely to unsettle the RBA.

Notably, at 3.4% annual trimmed mean inflation would be well above the 2–3% target band. The RBA technically targets headline inflation, but the Board pays close attention to the trimmed mean measure because it strips out more volatile price changes. The RBA forecast trimmed mean inflation to hit 3.25% in the June quarter of this year in its latest projections from February.

In addition, we expect the unemployment rate will fall under 4.0% in April (to be released on May 19). This would be the lowest unemployment reading since November 1974, when the unemployment rate was measured on a quarterly basis! On this backdrop, we expect a solid print on the wage price index in May.

We previously flagged that we expect the RBA will begin hiking in June. Given our refreshed forecasts for very strong inflation and wages data, we expect the Reserve Bank will hike by 40 basis points in June, up from our previous expectation of a 15 basis point hike. We expect further 25 basis point hikes will follow in July and August.

It remains a possibility the RBA may take a more cautious approach and instead opt to hike by 25 basis points in June and then 40 basis points in July. The RBA could be concerned that starting off with a 40 basis point hike could damage confidence. Confidence could take a hit if there is a perception that the central bank is worried it has been too slow to clamp down on inflation.

Regardless, we expect further hikes over the remainder of the year will take the cash rate to 1.5% by the end of 2022, instead of 1.25% previously. We continue to expect the cash rate will peak at 2.0% in 2023.

Markets are fully priced (112%) for a 40 basis point rate hike in June. A 25 basis point hike in June is 180% priced. Some participants are betting on a hike in May, although we do not expect this will materialise.

The actions of other central banks also have important implications for the RBA – in particular the US Federal Reserve. The Fed already kicked off its hiking cycle with a 25 basis point move in March. Markets are fully priced for two consecutive 50 basis points hikes at the next Fed meetings in May and June. The Bank of Canada and Reserve Bank of New Zealand also recently implemented 50 basis point hikes. This will give the RBA more leeway to hike the cash rate faster without putting unwelcome upwards pressure on the Australian dollar.

Credit data

The week will be rounded out with private sector credit data for March. We expect a solid 0.6% increase in the month and 8.0% growth over the year. In February, credit growth rose 0.6% in the month to hit 7.9% over the year, its fastest annual pace in more than 13 years.

We anticipate that momentum in business lending has remained robust, alongside the uplift in economic activity as we adapt to living with covid. Business confidence is elevated despite staff shortages, supply disruptions and inflationary pressures. Meanwhile, there may be tentative signs of a slow-down in housing lending. Consumer confidence has been dampened by elevated inflation and the prospect of rising rates, while stretched affordability has pushed some buyers out of the market. There is a risk that weak consumer confidence could flow onto dampen business confidence, if for example, there were concerns about a slowdown in consumer spending.

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Forecasts

| End Period: | 2022 | | | | 2023 | | |
|------------------------------|----------------|--------|--------|--------|--------|--------|--------|
| | Close (22 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, % | 0.46 | 0.70 | 1.20 | 1.70 | 1.95 | 2.20 | 2.20 |
| 3 Year Swap, % | 2.97 | 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, % | 2.94 | 2.90 | 2.80 | 2.50 | 2.40 | 2.30 | 2.20 |
| USD Exchange Rates: | | | | | | | |
| AUD-USD | 0.7336 | 0.74 | 0.75 | 0.76 | 0.77 | 0.78 | 0.79 |
| USD-JPY | 128.28 | 124 | 123 | 122 | 121 | 120 | 119 |
| EUR-USD | 1.0845 | 1.10 | 1.11 | 1.12 | 1.13 | 1.14 | 1.15 |
| GBP-USD | 1.3023 | 1.33 | 1.34 | 1.35 | 1.36 | 1.37 | 1.37 |
| NZD-USD | 0.6694 | 0.69 | 0.70 | 0.71 | 0.72 | 0.72 | 0.73 |
| AUD Exchange Rates: | | | | | | | |
| AUD-USD | 0.7336 | 0.74 | 0.75 | 0.76 | 0.77 | 0.78 | 0.79 |
| AUD-EUR | 0.6764 | 0.67 | 0.68 | 0.68 | 0.68 | 0.68 | 0.69 |
| AUD-JPY | 94.106 | 91.8 | 92.3 | 92.7 | 93.2 | 93.6 | 94.0 |
| AUD-GBP | 0.5633 | 0.56 | 0.56 | 0.56 | 0.57 | 0.57 | 0.58 |
| AUD-NZD | 1.0959 | 1.07 | 1.07 | 1.07 | 1.08 | 1.08 | 1.09 |

| | 2020 | 2021 | 2022 (f) | 2023 (f) |
|-----------------------|------|------|----------|----------|
| GDP, % | -0.8 | 4.2 | 5.5 | 2.7 |
| CPI (Headline), % | 0.9 | 3.5 | 4.9 | 2.3 |
| CPI (Trimmed mean), % | 1.2 | 2.6 | 3.8 | 2.9 |
| 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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