

# Weekly Economic Outlook

Monday, 9 May 2022

## Inflation & Hikes to Test Confidence

### Inflation and central banks

Over the past few weeks, inflation and central banks remained centre stage in Australia and around the world. Headline inflation in Australia surged to 5.1% over the year to the March quarter. This was the fastest pace in almost 21 years.

Inflationary pressures have also become more broad-based. Trimmed mean inflation, which strips out more volatile price movements and is a better measure of underlying inflation, jumped to a 13-year high of 3.7%.

Subsequently, the Reserve Bank (RBA) increased the cash rate for the first time in 11½ years last week. The cash rate was increased by 25 basis points, to 0.35%, beating market expectations for a 15 basis point hike.

Separately, last week the US Federal Reserve increased rates by 50 basis points, as widely expected. The Bank of England hiked rates by 25 basis points and projected very strong inflation, peaking above 10% this year, while slicing their growth forecasts for the UK economy.

Risk sentiment has deteriorated over recent months as investors worry about how aggressively central banks will need to hike rates to tame inflation. There is subsequently concern about the extent to which global growth will be hit by higher rates, alongside disruptions from the Ukraine war and renewed lockdowns in China.

Indeed, equity markets have taken a hit. Year to date, the S&P 500 is down more than 13% and the tech-heavy Nasdaq has fallen even further, by more than 22%. The ASX 200 is only down a bit over 4% year to date, partly reflecting the heavy weighing towards resource companies, which have outperformed alongside the surge in commodity prices.

Interest rate markets are expecting the RBA cash rate to increase to around 3.0% by the end of 2022. This is more aggressive than our own expectations. We expect a 40 basis point increase at the June meeting, with additional hikes over 2022, taking the cash rate to 1.75% by the end of the year.

### Confidence

Higher-than-expected inflation and the RBA kicking off the cash rate hiking cycle are likely to weigh on confidence. This week, we will receive an update on how businesses and consumers are feeling.

On Tuesday, the April estimate of business confidence will be published. The survey is typically undertaken during the last week or two of each month. Therefore, it is not expected to capture the RBA's cash rate increase, which occurred on Tuesday, 3 May. However, the survey is expected to partially capture the fallout from the stronger-than-expected inflation outcome, which was published on Wednesday, 27 April.

In March, businesses remained upbeat despite record price pressures, labour shortages and

ongoing supply-chain disruptions. Business confidence and conditions both increased to well above their long-run averages. In April, business conditions are likely to have remained robust despite rising inflationary pressures. The economy is growing strongly following the lifting of most restrictions around the country, which is supporting business conditions.

On Wednesday, the May Westpac-Melbourne Institute consumer sentiment survey will be published. This survey is typically undertaken around the first week of the month and will capture the impact of the RBA's interest rate hike. Consumer sentiment has been declining in recent months as households become more worried about the prospect of higher rates amid an environment of rising inflation. Other events, such as flooding across large parts of NSW and Queensland, and the war in Ukraine have also weighed on confidence. Sentiment is expected to have been dented further in May by the first interest rate hike in 11½ years.

### **Retail sales**

On Tuesday, we will receive the March quarter real retail sales outcome. This adjusts the nominal retail sales figures for changes in prices to indicate the volume of spending in the economy. This is an important input to understand how household consumption, and in turn GDP, has evolved. Despite some headwinds, including spiking case numbers due to the Omicron variant in January and flooding across large parts of NSW and Queensland, nominal retail sales were strong. Nominal sales grew by 2.9% over the quarter. However, inflationary pressures were elevated. Fuel prices spiked and supply-chain disruptions, in addition to strong demand, impacted prices of many goods and services. These factors are expected to result in a 1.2% increase in real sales over the quarter, which would lift the volume of retail sales to a new record high. This follows an 8.2% gain in the December quarter of 2021, when spending bounced back strongly as Delta-related restrictions lifted across the largest states.

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## Forecasts

End Period:	2022				2023		
	Close (6 May)	Q2 (f)	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)
<b>Aust. Interest Rates:</b>							
RBA Cash Rate, %	0.35	0.75	1.25	1.75	2.00	2.25	2.25
90 Day BBSW, %	0.92	0.95	1.45	1.95	2.20	2.45	2.45
3 Year Swap, %	3.36	3.25	3.15	3.10	3.00	2.90	2.80
10 Year Bond, %	3.51	3.30	3.15	2.90	2.65	2.50	2.40
<b>US Interest Rates:</b>							
Fed Funds Rate, %	0.875	1.375	2.125	2.625	2.625	2.625	2.625
US 10 Year Bond, %	3.07	2.90	2.80	2.60	2.40	2.30	2.20
<b>USD Exchange Rates:</b>							
AUD-USD	0.7125	0.74	0.75	0.76	0.77	0.78	0.79
USD-JPY	130.43	129	128	126	125	124	122
EUR-USD	1.0542	1.07	1.08	1.09	1.11	1.13	1.14
GBP-USD	1.2373	1.25	1.26	1.27	1.28	1.30	1.32
NZD-USD	0.6436	0.67	0.68	0.69	0.70	0.71	0.72
<b>AUD Exchange Rates:</b>							
AUD-USD	0.7125	0.74	0.75	0.76	0.77	0.78	0.79
AUD-EUR	0.6759	0.69	0.69	0.70	0.69	0.69	0.69
AUD-JPY	92.931	95.5	96.0	95.8	96.3	96.7	96.4
AUD-GBP	0.5759	0.59	0.60	0.60	0.60	0.60	0.60
AUD-NZD	1.1072	1.10	1.10	1.10	1.10	1.10	1.10

	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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