

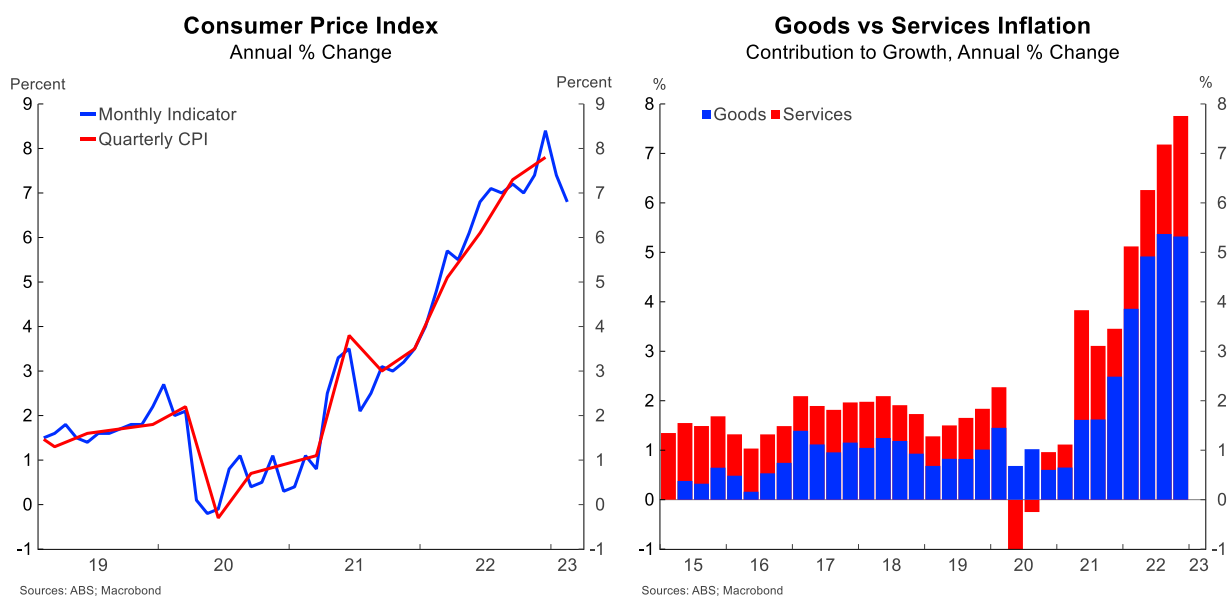
Inflation to Determine RBA’s Next Move

After a quiet week for domestic economic data, this week will prove to be more eventful with the much-awaited release of the March quarter Consumer Price Index (CPI) on Wednesday. The CPI will be the last piece of the puzzle for the Reserve Bank’s (RBA) May meeting. Markets have priced in a 20% chance of a 25-basis point hike when the RBA Board meets next week.

Partial indicators, including the Australian Bureau of Statistics’ (ABS) monthly inflation gauge, suggest that inflation peaked in the December quarter 2022. One-off factors, such as the unwinding of state electricity subsidies and the fuel excise cut, led to an increase in the December quarter inflation outcome. As these factors dissipate, inflation will mechanically fall.

As such, the RBA will not only be looking to confirm that inflation has peaked, but also that “core inflation” is showing signs of decelerating. Core inflation strips away categories recording large increases and decreases in prices to measure the underlying inflationary pulse. Core inflation increased by 6.9% over the year to the December quarter – the fastest pace in more than 30 years.

The RBA’s latest forecasts have core inflation decelerating to an annual rate of 6.2% by the June quarter. An annual reading below December quarter’s 6.9% is likely to satisfy the RBA that inflation is on its way down. The closer the March quarter outcome is to the RBA’s June forecast of 6.2%, the more likely the RBA Board will be satisfied that they have done enough tightening to ensure inflation is on track to decline to the target band of 2 – 3% at the desired pace.



We expect core inflation to be around 6.7% over the year to the March quarter. However, there are risks. On the upside, the record surge in overseas migration has increased demand for goods and services. This may provide a signal to sellers that demand remains strong and that there is scope to pass through higher costs or expand margins. We are seeing this in the rental market -

advertised rents have accelerated, and this will feed through to the stock of all rents with a lag. The incredibly tight labour market is also increasing the risk that wages growth accelerates. If realised, this may fuel a further acceleration in services inflation to levels that are inconsistent with the RBA's target. However, in our view this risk is contained. We saw services inflation accelerate and increase by 2.2% over the December quarter. This was largely driven by international/domestic travel and accommodation and rents. Stripping away these drivers to derive a "super core" measure of services inflation, suggests that growth was 1.1% over the December quarter – a rate the RBA Board would be less concerned about. While rental pressures remain, partial indicators suggest that the prices of international/domestic travel and accommodation have come down considerably since December.

On the downside, the record surge in overseas migration means there are more working age persons in Australia, adding to potential labour supply. This will help address skills shortages and ultimately reduces the upward pressure of wages growth and services inflation.

Finally, the disinflationary impulse from the resolution of supply chain disruptions and the fall in freight costs will also put downward pressure of goods inflation. The RBA Governor recently noted that we are yet to see the impact of this powerful disinflationary force in the domestic price data.

Other domestic data

This week we will also receive data on private sector credit growth. Credit growth has decelerated alongside sharply higher interest rates, and we expect this to continue as we go forward. However, we will be looking out for any signs of stabilisation or even a recovery in housing credit. Recently, house prices have stabilised and, in some parts, recorded increases. It will be interesting to see whether an increase in credit growth has fuelled this price action.

As a result of the recent stabilisation in house prices, we're now expecting the peak to trough fall in prices to be around 10%. Indeed, given the record pace of overseas migration and the lack of housing supply, we are expecting average house prices to be flat across 2023, which is a significant upward revision from the fall of 7% previously expected. We are also expecting average house prices to increase by 5% in 2024, up from the increase of 2% previously expected.

International data

On the international front, the key data release will be US employment cost index and the core personal consumption expenditure deflator. Both sets of data will be released Friday night. 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 meeting.

We will also receive the March quarter preliminary estimates for economic activity in the US. Markets are expecting economic activity to be soft and well below average or trend economic growth.

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Group Forecasts

End Period:	2023				2024		
	Close (21 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, %	3.68	3.95	3.95	3.97	3.72	3.47	3.22
3 Year Swap, %	3.57	3.65	3.60	3.50	3.40	3.20	3.00
10 Year Bond, %	3.46	3.40	3.30	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, %	3.57	3.50	3.40	3.30	3.10	2.90	2.80
USD Exchange Rates:							
AUD-USD	0.6692	0.69	0.72	0.74	0.75	0.76	0.76
USD-JPY	134.16	130	129	128	127	126	125
EUR-USD	1.0986	1.10	1.11	1.12	1.13	1.14	1.15
GBP-USD	1.2432	1.23	1.24	1.25	1.26	1.27	1.28
NZD-USD	0.6139	0.64	0.66	0.67	0.68	0.68	0.68
AUD Exchange Rates:							
AUD-USD	0.6692	0.69	0.72	0.74	0.75	0.76	0.76
AUD-EUR	0.6089	0.63	0.65	0.66	0.67	0.67	0.66
AUD-JPY	89.751	89.7	92.9	94.7	95.3	95.8	95.0
AUD-GBP	0.5379	0.56	0.58	0.59	0.60	0.60	0.59
AUD-NZD	1.0898	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), %	2.6	6.9	3.7	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.

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