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Editorial: Could They? Should They?

RBA: Policy Decision, Statement on Monetary Policy.

Australia: Q1 real retail sales.

NZ: GlobalDairyTrade auction, ANZ commodity prices, manufacturing PMI.

China: CPI, PPI, trade balance, current account, M2 money supply.

UK: BoE Policy Decision, Decision Maker Panel, Q1 GDP.

US: Senior Loan Officer Opinion Survey, consumer credit, UoM consumer sentiment.

Key economic & financial forecasts.

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 3 MAY 2024.

WESTPAC INSTITUTIONAL BANK

Could They? Should They?

With the inflation surprise in the March quarter and some further upside possible in the June quarter, the outlook for rate cuts in Australia has been pushed out. The timing of expected rate cuts in the United States has also been pushed out.

One body of opinion goes further, though, holding that rate hikes are necessary and likely in Australia. The reasoning seems to be that, because the RBA raised rates less than the Federal Reserve, it has (by definition) not done enough and will therefore end up having to do more. The unstated presumption behind this reasoning is that both countries face the same shock and the same context, and therefore the appropriate stance of policy is the same (and produced by the same level of the policy rate). Another unstated assumption in this line of argument is that the feasible rate of unemployment is well described by past averages or minimums, and therefore current rates are too low.

In our view, these presumptions are unjustified. As we have noted in the past, the United States is something of an outlier among peer economies. Domestic demand growth is outstripping that in peer economies; headline inflation is stabilising not still falling; and consumption per capita consistently rising. Both countries have tight labour markets, but our assessment is that next year will see labour market slack emerge in Australia.

More broadly, the two countries are facing very different fiscal contexts, which helps explain why domestic demand growth remains strong in the United States and weak in Australia.

This different fiscal context is in part shaped by the actual and perceived interest-sensitivity of the Australian household sector. Nowhere else in the advanced world is the discourse so aghast at the idea that fiscal policy might add to demand, thereby slowing the hoped-for disinflation and delay (or even reverse) the hoped-for rate cuts. Likewise, nowhere else in the world is the fiscal policymaker so incentivised to avoid a further rate hike.

Recall that while tax cuts are coming, these mostly give back recent bracket creep and are necessary to achieve even the small improvement in growth we expect over the second half of this year. They are also already in everyone's forecasts. So they cannot be used as a reason to hike rates unless and until evidence emerges that the consumption (and so inflation) response to the tax cuts is larger than anticipated. That evidence, if it were to emerge, will not do so until late this year or early next year. In the here and now, retail spending and consumption more broadly are weak, and consumer sentiment remains extremely subdued.

A reasonable counter to this view is that the state governments are adding to demand. There are also longer-term issues around the structural budget balance. That is a separate issue from macroeconomic management over the cycle, though. State governments are in any case showing themselves to be sensitive to the need to be seen not to add to measured inflation. This week's announcement by the Queensland government of an increase to electricity rebates is a case in point. Actual electricity bills will be lower, and so measured CPI inflation will be slightly lower, in the second half of the year as a result of that announcement.

Another line of argument for a rate hike hangs off the surprise in the March quarter inflation and labour force data. And maybe that argument is compelling to some of the decision-makers in Chifley Square. The nagging doubt around that course of action is that this was what happened last November, only to see a significant downside surprise in the December quarter inflation and real-side data. The result was that the RBA's February 2024 forecast for trimmed mean inflation over 2025 reversed the upward revision in the November 2023 forecast round. Past surprises are most relevant for what they say about the future. There is no point warning that the disinflation journey could be bumpy if you then treat every bump as a change in trend.

There is a state of the world in which the RBA would need to raise rates. Consider a scenario where services inflation fails to decline further, the federal Budget later this month is more expansionary than expected, and the Fair Work Commission hands down a decision for an increase in the minimum wage not much below last year's outsized result, even though inflation is much lower one year on. None of these outcomes seem likely given the atmospherics, but it is understandable that policymakers might want to see the actual results, and a bit more progress on inflation, before even thinking about cutting rates.

Could they hike? Not yet, and probably not given the current run of data. The language following next week's meeting could be more hawkish. In the end, though, the Board will and should remain forward looking. We continue to expect the next move to be a cut, down the track.

Luci Ellis, Chief Economist Westpac Group

In Australia, partial updates on consumption came in on the softer side. Growth in nominal retail sales turned negative in March, down –0.4% (0.8%yr), the decline broad-based across sectors, with food retailing the only segment to record a gain. Downward revisions to prior months also weighed on Q1's nominal result, leaving it materially below expectations at just 0.2%. Based on data from the Q1 CPI, prices look to be offering nominal growth less support, with outright price declines observed across clothing and several consumer durables in recent months.

Real retail sales (due May 7) are expected to again be weak, up a forecast 0.1%qtr. Further, our Westpac Card Tracker, including transaction data through to late-April, suggests the nominal spending pulse remained poor at the start of Q2. Our latest Red Book provides an in-depth assessment of the current health of the Australian consumer.

On housing, in April tension remained between the official unadjusted CoreLogic's home value index and Westpac's seasonally adjusted equivalent, a reported 0.6% gain moderated to just 0.2% once seasonality is accounted for. Annual growth is strong at 9.4% but is moderating. Conditions also differ by city, with Sydney and Melbourne experiencing soft growth as the smaller capital cities continue to post robust gains.

Additionally, the underlying trend for dwelling approvals remains uncertain. Volumes are holding in line with the cycle-lows of last year, and there is a material risk of a further deterioration. The 'front-end' of Australia's residential project pipeline has shrunk materially and will have a long lasting effect on construction activity.

Finally, a note on trade. Australia's goods trade surplus surprisingly shrunk to a three-year low of $5.0bn in March, extending the trend narrowing since November's surplus of $11.5bn. The chief culprit was imports which surged 4.2% higher in March after a 4.4% gain in February, with the gains broad based across capital, intermediate and consumer goods. Meanwhile, export earnings were flat in the month, the recovery in iron ore volumes from Cyclone Lincoln offset by a moderation in commodity prices.

Offshore, the big event was the FOMC's May meeting. Overall, a balanced view of the outlook was given. Risks to the inflation outlook were highlighted, the Committee noting that in "recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective". However, Chair Powell's Q&A emphasised the FOMC still expect inflation to ease towards target over the remainder of the year, with the policy stance viewed as "sufficiently restrictive". All together this points to the question being when (not whether) to cut. The starting point for the labour market and economic activity gives the FOMC scope to take their time assessing inflation risks. This week's ECI and JOLTs surveys again pointed to a fully employed labour market, though the ISM manufacturing survey employment index again warned of a loss of momentum in job creation. As long as activity growth only slows to around trend and employment growth remains positive, we expect the FOMC to hold off on the first cut until September. Beyond that event, lingering inflation risks and the robust health of the US economy is anticipated to result in the FOMC only slowly easing policy, one 25bp cut forecast per quarter until a mid-2026 low of 3.375%, a terminal rate we regard as modestly contractionary.

Inflation in Europe remained at 2.4%yr in April, with services inflation down a tad to 3.7%yr from 4.0%yr the prior three months. Activity growth meanwhile recovered to 0.3%qtr in Q1, more than reversing the contraction suffered during the technical recession of H2 2023. While there are upside risks for inflation, progress continues to be seen. And there are also downside risks to growth from trade and credit conditions. This sets the stage for the ECB to deliver their first cut at the June meeting.

China's NBS manufacturing PMI was broadly consistent with long-term average levels in April, the price sub-component an exception – 2 points below the 5-year pre-COVID average. This is consistent with overcapacity in many existing factories and industry's drive to continue expanding. The services sector remains challenged, but the 'expectations' component 5-point gain points to optimism returning. The Government's growth aim being achieved without aggressive policy stimulus likely helping matters.

Week ahead & data wrap

Slow progress.

New Zealand's labour market is clearly softening, and we're likely to see further rises in unemployment as the economy remains sluggish. At the same time, there are still worrying signs that the higher inflation of the last few years could be difficult to dislodge.

This week's Household Labour Force Survey (HLFS) showed the unemployment rate rising from 4.0% to 4.3% in the March quarter. That was slightly higher than the 4.2% that market forecasters and the Reserve Bank had been expecting. The softening in the labour market has been a fairly drawn-out one so far – unemployment reached a record low of 3.2% in early 2022, and has risen by just over a percentage point in the two years since then.

That gradual rise reflects the fact that job creation has continued over the last couple of years – it's just not fast enough to keep up with population growth. The working-age population has grown by more than 3% over the last year, driven by record levels of inward migration (and migrants themselves are largely coming to work). But in a cooling economy, there are no longer enough new jobs to go around. The HLFS figures on transitions suggest that while there has been some pickup in job losses, the more significant change has been that people who are out of employment are finding it harder to get in.

An unemployment rate of 4.3% is not particularly high compared to history – indeed, it's broadly in the range of what we would consider to be a 'neutral' level over the long run. But its rise isn't going to end here; we expect it to peak above 5% sometime next year. High interest rates are continuing to suppress economic activity, and the labour market tends to respond to this with a lag.

Moreover, the risks around the near-term outlook for the economy are turning to the downside. While business surveys showed some signs of improvement at the start of this year, the mood has definitely soured again. The manufacturing and services PMI surveys were both below 50 in March, consistent with negative growth (the next releases will be on 10 and 13 May). And the ANZ business confidence survey fell for the third straight month in April, effectively giving back all of the gains it had made since late last year.

A net 20% of firms reported that their trading activity had declined compared to a year ago. That's the weakest result we've seen since the pandemic. There has also been a widespread fall in the number of businesses who expect that their trading activity will improve over the coming months. Consistent with those trends, fewer businesses are planning to take on more staff or increase their capital spending.

With the potential for conditions to change quickly, it remains important to keep an eye on high-frequency measures of the economy such as the Monthly Employment Indicator (MEI). Because this is drawn from tax data, it is a near-complete record of employment in this country, and is far more stable than surveys which can suffer from sampling error. The March report, released on Monday, showed that the number of jobs is still rising modestly, but not enough to match population growth.

The other aspect of the labour market that we're watching is wage growth. Inflation in New Zealand remains stubbornly elevated, and increasingly is being driven by the services sectors, where labour makes up the largest share of their costs. Taming the pressure on pay rates is key to bringing overall inflation back to the Reserve Bank's 1-3% target range.

On that front, this week's news wasn't all that encouraging. The Labour Cost Index (LCI) saw a 0.9% increase for the March quarter – only slightly slower than in previous quarters, and the annual growth pace of 4.1% hasn't fallen far from its cyclical peak of 4.3%.

In part, wage growth is being held up by government pay agreements for teachers, nurses and the public service, which were agreed last year and staggered over several periods. (This has also affected the private sector wage measures, as parts of the health and education sectors are privately-run but publicly-funded.) Looking past this effect, it's clear that there has been some progress in bringing wage growth down – but perhaps not as much as expected, given the extent to which the tightness in the labour market has eased over the last year.

The ANZ business survey also showed that the number of firms planning to raise their prices has effectively stalled at a high level over the last nine months, despite the continued cooling in the economy. The need to pass on rising costs has been an ongoing theme.

We expect the Reserve Bank to hold off on cutting interest rates until early next year. But we remain open to the idea that the coming months could force them off this path in either direction – a sharper economic slowdown could prompt them into earlier rate cuts, or a lack of progress in bringing inflation down could bring further rate hikes back into discussion. Our latest "Hawks, doves and kiwis" briefing shows that there is plenty of ammunition right now for both views.

Michael Gordon, Senior Economist

Round-up of local data released over the last week

Date	Release	Previous	Actual	Westpac f/c
Mon 29	Mar employment indicator	0.1%	0.4%	0.2%
Tue 30	Apr ANZ business confidence	22.9	14.9	–
Wed 1	Q1 employment	0.4%	-0.2%	0.4%
	Q1 unemployment rate	4.0%	4.3%	4.2%
	Q1 LCI wage inflation (pvte, ordry time)	1.0%	0.8%	0.7%
Thu 2	Mar building permits	15.9%	-0.2%	-5.0%

DATA PREVIEWS

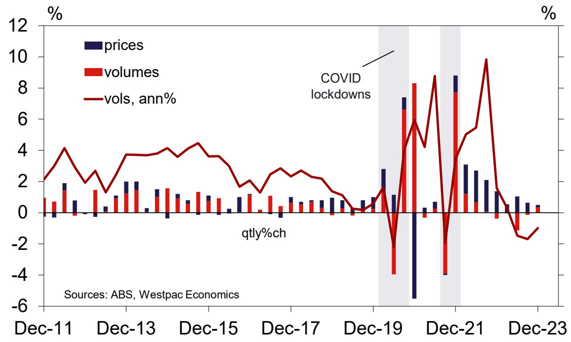
Aus Q1 real retail sales (%qtr)

May 7, Last: 0.3%, WBC f/c: 0.1%
Mkt f/c: –0.3%, Range: –0.4% to 0.3%

Real retail sales rose 0.3% in Q4, breaking a run of four successive quarterly declines but with sales volumes still down 1%yr – a large 3.5%yr fall in per capita terms.

The subdued performance looks to have carried into early 2024. Nominal retail sales posted a 0.2%qtr gain in Q1, down from a 0.6%qtr gain in Q4 (see here fore more details). Much of that moderation looks to be price-related, the CPI detail showing near-flat results for basic food, clothing, household goods and hospitality (the stronger than expected Q1 result driven by health, education, motor vehicles and insurance which are all outside the scope of the retail survey). As such we expect real retail sales to post a feeble 0.1% gain for the quarter.

Quarterly retail volumes and prices



Aus RBA policy decision

May 7, Last: 4.35%, WBC f/c: 4.35%
Mkt f/c: 4.35%, Range: 4.35% to 4.60%

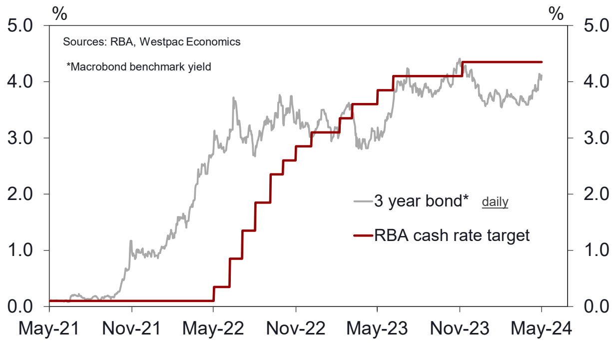
At the May Board meeting, Westpac anticipates that the RBA will leave the cash rate unchanged at 4.35%.

The Board will meet to discuss recent economic data. That includes the Q1 CPI, which reported slower progress on disinflation than what the RBA was anticipating, based on our assessment of its June 2024 forecasts from February. Additionally, the data flow on the labour market points to a lower starting point for labour market slack.

Given these developments, the language in the Board's decision statement, Governor Bullock's press conference and the Statement on Monetary Policy – may be more hawkish. Nuances on the balance of risks will be in focus. We continue to expect the next move to be a cut in November.

For more detail, see Page 2.

RBA cash rate and 3 year bonds



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For the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
Mon 06					
Aus	Apr MI inflation gauge %yr	3.8%	–	–	Provides a general view of risks.
	Apr ANZ job ads %mth	–1.0%	–	–	Moderation persists, but at a slightly slower pace.
NZ	Apr ANZ commodity prices	–1.3%	–	2.0%	Improved prices for meat and dairy, weaker for logs.
Chn	Apr Caixin services PMI	52.7	52.5	–	Optimism building?
Eur	May Sentix investor confidence	–5.9	–	–	Confidence recovery persists as rate cuts near.
	Mar PPI %yr	–8.3%	–	–	Upstream prices still falling, but not as much as last year.
US	Fedspeak	–	–	–	Barkin, Williams.
	Senior Loan Officer Opinion Survey	–	–	–	Likely to reflect tight credit conditions.
Tue 07					
Aus	Q1 real retail sales %qtr	0.3%	–0.3%	0.1%	Nominal sales up just 0.2% in Q1. Retail prices about flat.
	RBA policy decision	4.35%	4.35%	4.35%	To remain on hold and wary of domestic inflation pressures…
	RBA Statement on Monetary Policy	–	–	–	… views on the balance of risks will be closely scrutinised.
Eur	Mar retail sales %mth	–0.5%	–	–	Restrictive policy is keeping spending low.
US	Mar consumer credit $bn	14.1	16.5	–	Showing resilience, aided by labour market and savings.
	Fedspeak	–	–	–	Kashkari.
Wed 08					
NZ	GlobalDairyTrade auction (WMP)	0.7%	–	–	Futures prices down about 5% since the last auction.
US	Mar wholesale inventories %mth	–0.4%	–0.4%	–	Final estimate.
	Fedspeak	–	–	–	Cook.
Thu 09					
Chn	Apr trade balance US$bn	58.55	81.35	–	Asian demand is keeping surplus healthy.
	Apr M2 money supply %yr	8.3%	8.3%	–	Money supply growth is decelerating.
UK	BoE Policy Decision	5.25%	5.25%	5.25%	Sticky services inflation is preventing a step down.
	BoE Decision Maker Panel	–	–	–	An update on price and wage expectations.
US	Initial jobless claims	–	–	–	Low for now.
Fri 10					
NZ	Apr manufacturing PMI	47.1	–	–	Businesses continue to report sluggish demand.
Jpn	Mar household spending %yr	–0.5%	–2.3%	–	Consumption remains in a delicate position.
Chn	Q1 current account balance US$bn	56.2	–	–	Strong exports are supporting a surplus.
UK	Q1 GDP %qtr	–0.3%	0.4%	–	Rebounded expected.
US	May Uni. of Michigan sentiment	77.2	77.0	–	Updated inflation expectations key.
	Fedspeak	–	–	–	Bowman, Goolsbee, Barr.
Sat 11					
Chn	Apr CPI %yr	0.1%	0.1%	–	Price pressures remain weak as consumers hold back…
	Apr PPI %yr	–2.8%	–2.3%	–	… and excess capacity remains.

Forecasts

Interest rate forecasts

Australia	Latest (3 May)	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Cash	4.35	4.35	4.35	4.10	3.85	3.60	3.35	3.10
90 Day BBSW	4.41	4.37	4.37	4.17	3.92	3.72	3.55	3.30
3 Year Swap	4.24	4.10	4.00	3.90	3.80	3.70	3.60	3.50
3 Year Bond	4.04	3.90	3.80	3.70	3.60	3.50	3.40	3.30
10 Year Bond	4.41	4.35	4.30	4.25	4.20	4.10	4.00	4.00
10 Year Spread to US (bps)	-17	-15	-10	-5	0	0	0	0
US								
Fed Funds	5.375	5.375	5.125	4.875	4.625	4.375	4.125	3.875
US 10 Year Bond	4.58	4.50	4.40	4.30	4.20	4.10	4.00	4.00
New Zealand								
Cash	5.50	5.50	5.50	5.50	5.25	5.00	4.75	4.50
90 day bill	5.63	5.60	5.60	5.50	5.25	4.95	4.75	4.50
2 year swap	5.00	5.10	5.00	4.75	4.55	4.30	4.15	4.00
10 Year Bond	4.81	4.80	4.70	4.60	4.50	4.40	4.35	4.25
10 Year spread to US	23	30	30	30	30	30	35	25

Exchange rate forecasts

Australia	Latest (3 May)	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
AUD/USD	0.6573	0.66	0.66	0.67	0.68	0.69	0.70	0.71
NZD/USD	0.5972	0.60	0.60	0.61	0.62	0.63	0.64	0.65
USD/JPY	152.88	156	156	154	150	146	143	140
EUR/USD	1.0733	1.08	1.09	1.10	1.11	1.12	1.13	1.14
GBP/USD	1.2551	1.26	1.27	1.28	1.29	1.30	1.31	1.31
USD/CNY	7.2411	7.20	7.15	7.10	7.05	7.00	6.90	6.80
AUD/NZD	1.1014	1.10	1.10	1.10	1.10	1.10	1.09	1.09

Australian economic growth forecasts

	2023			2024				Calendar years			
% change	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f	2022	2023	2024f	2025f
GDP % qtr	0.5	0.3	0.2	0.3	0.3	0.4	0.5	–	–	–	–
%yr end	2.1	2.1	1.5	1.3	1.1	1.3	1.6	2.4	1.5	1.6	2.5
Unemployment rate %	3.6	3.7	3.9	3.9	4.0	4.2	4.3	3.5	3.9	4.3	4.6
Wages (WPI)	1.0	1.3	0.9	0.9	0.9	0.8	0.5	–	–	–	–
annual chg	3.7	4.1	4.2	4.2	4.2	3.7	3.2	3.3	4.2	3.2	3.1
CPI Headline	0.8	1.2	0.6	1.0	0.9	0.6	0.8	–	–	–	–
annual chg	6.0	5.4	4.1	3.6	3.7	3.0	3.2	7.8	4.1	3.2	2.8
Trimmed mean	0.9	1.2	0.8	1.0	0.7	0.8	0.8	–	–	–	–
annual chg	5.8	5.1	4.2	4.0	3.7	3.4	3.5	6.8	4.2	3.5	2.8

New Zealand economic growth forecasts

	2023			2024				Calendar years			
% change	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f	2022	2023	2024f	2025f
GDP % qtr	0.5	-0.3	-0.1	0.2	0.2	0.2	0.2	–	–	–	–
Annual avg change	3.0	1.3	0.6	0.2	-0.2	0.1	0.4	2.4	0.6	0.4	1.6
Unemployment rate %	3.6	3.9	4.0	4.3	4.6	4.9	5.2	3.4	4.0	5.1	5.4
CPI % qtr	1.1	1.8	0.5	0.6	0.6	1.0	0.4	–	–	–	–
Annual change	6.0	5.6	4.7	4.0	3.6	2.8	2.7	7.2	4.7	2.7	2.3

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