Putting the Data in Data-Dependent

The central banks of the US, UK and Europe held their nerve last week and pressed on with rate hikes despite turmoil in the banking sector and considerable financial market volatility. These developments themselves tighten financial conditions and led to speculation that central banks could pause rate hikes. In fact, some estimates suggest that the recent tightening of financial conditions in the US banking sector is equivalent to 25-50 basis points of rate hikes.

Despite this, monetary authorities concluded that inflationary pressures remained too high, and that further tightening was necessary. However, it was acknowledged that the future path of interest rates may be lower than previously anticipated, depending on the ultimate impact of banking developments on financial conditions.

Crucially, central banks segregated the task of reigning in inflation from maintaining financial stability and concluded that the actions taken to shore up liquidity were sufficient to press ahead with rate hikes.

Next week, the Reserve Bank (RBA) Board will convene for its April policy meeting and will face its own policy dilemma. In March, the Board recognised the need to pause rate hikes to assess the ongoing impact of rate hikes to date on the real economy. In particular, the RBA Board sighted the recent string of softer than expected economic data which suggested the Australian economy had reached a turning point in the December quarter.

However, the RBA has made it clear that the decision of when to pause will ultimately be informed by the incoming data. Governor Lowe flagged four key data releases due in the intermeeting period which would determine whether a pause is appropriate in April. The first two, the February business and labour force surveys, have already been released. They confirmed that while conditions remained solid in February, an underlying slowdown is underway. The remaining two releases, retail sales and the monthly CPI indicator for February, are due out this week.

We expect these data releases to follow much in the same vein. We expect retail sales advanced 0.5% in February, following a strong 1.9% rise in January. However, this will not be enough to unwind the massive 4.0% fall in retailing in December and will represent a deepening of the slowdown underway in household spending. Remember that monthly retail trade data is released in nominal terms, so when stripping out the impact of higher prices, spending growth would be even weaker in real terms.

The monthly inflation indicator will be released on Wednesday. Despite the measure's volatility, it is useful for determining turning points and identifying new trends. In January, the indicator fell to 7.4% from 8.4% in December. We expect a further moderation to around 7.2% in February, providing further evidence that inflation peaked in the December quarter. The RBA is likely to focus on the sub-components, especially services categories which are driving much of the stickiness in inflation observed overseas.

The recent developments in the US and Swiss banking sectors are also expected to play into the RBA's decision. Although, the decision from other central banks to press ahead with rate hikes likely waters down this consideration. Given the Australian banking system remains robust and is at very low risk of contagion, the developments are likely to factor into the RBA's decision through two key channels.

Firstly, through a potential tightening in domestic financial conditions. When the RBA increases the cash rate, it tightens financial conditions. However, higher interest rates are not the only driver of financial conditions and other market developments also play a significant part. In the wake of the SVB collapse and Credit Suisse merger we have seen big swings in financial markets, including falling equity prices, higher credit spreads and fluctuating foreign exchange rates. These make for tighter financial conditions, which may mean that the RBA has less to do to achieve the appropriate tightening in total financial conditions. However, this relies on these market impacts being permanent, which is difficult to determine and will depend on how the situation in the banking sector continues to unfold.

The second is through weaker global growth. The developments in the banking sector have highlighted a monetary policy trade-off which was not previously apparent. The need to increase interest rates to tame inflation vs the risk higher interest rates undermine financial stability. So far, central banks have been able to manage this trade-off by providing liquidity to the banking sector while continuing with their interest rate crusade. It is unclear exactly how this trade-off will evolve but one thing is almost certain. The presence of this trade-off has increased the risk of a recession in the US and likely in Europe. Lower global growth is a positive for the inflation outlook and may mean that the RBA can hike a bit less than previously thought. In fact, late last year the RBA tabled a slower global growth outlook as a potential reason to pause rate hikes.

Based on our expectations for the upcoming data and the implications from the global banking sector, we expect the RBA to press the pause button in April. If this is the case, the RBA be the second major central bank to pause, following the Bank of Canada. Interest rate markets agree and believe the RBA's next policy move will be a cut rather than a hike. A 25-basis point cut is currently fully priced for August.

Other Domestic Data

Thursday will feature the release of job vacancy data for the three months to February. This will provide a key insight into how labour demand is reacting to early signs of an economic slowdown. And additionally, whether recent gains in employment have made a dent in the long list of businesses looking for staff.

To cap off the week we will receive private sector credit numbers for February. A gradual slowdown in lending activity is underway alongside sharply higher interest rates and we expect this continued through February. The pace of business credit growth will be of particular interest and will serve as a sign of whether businesses are moving forward with investment plans, or potentially scaling back in anticipation of weaker conditions ahead.

Both data releases will be closely watched by the RBA but are unlikely to carry as much weight as the retail and inflation releases.

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Group Forecasts

End Period:	Close (27 Mar)	2023 Q2 (f)	2023 Q3 (f)	2023 Q4 (f)	2024 Q1 (f)	2024 Q2 (f)	2024 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, %	3.70	3.95	3.95	3.97	3.72	3.47	3.22
3 Year Swap, %	3.31	3.65	3.60	3.50	3.40	3.20	3.00
10 Year Bond, %	3.22	3.60	3.40	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, %	3.38	3.70	3.50	3.30	3.10	2.90	2.80
USD Exchange Rates:							
AUD-USD	0.6645	0.69	0.72	0.74	0.75	0.76	0.76
USD-JPY	130.73	131	130	129	128	127	126
EUR-USD	1.0760	1.09	1.10	1.11	1.12	1.13	1.14
GBP-USD	1.2233	1.22	1.23	1.24	1.25	1.26	1.27
NZD-USD	0.6203	0.64	0.66	0.67	0.68	0.68	0.68
AUD Exchange Rates:							
AUD-USD	0.6645	0.69	0.72	0.74	0.75	0.76	0.76
AUD-EUR	0.6176	0.63	0.65	0.67	0.67	0.68	0.67
AUD-JPY	86.862	90.4	93.6	95.5	96.0	96.5	95.8
AUD-GBP	0.5432	0.57	0.59	0.60	0.60	0.60	0.60
AUD-NZD	1.0714	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	3.0
CPI (Trimmed mean), %	2.6	6.9	3.6	3.1
Unemployment Rate, %	4.7	3.5	4.6	5.1
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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