Monday, 29 May 2023

It’s a Deal As Investors Sigh In Relief

Investors breathed a collective sigh of relief over the weekend as US President Joe Biden and House Speaker Kevin McCarthy came together on a deal to raise the US debt ceiling. This removed a weight around the neck of markets as investor concerns receded around the potential grave ramifications to the US and global economy and markets if a deal wasn’t passed.

Looking at the details, the deal includes a range of measures, some of which should appease either side. Key for the Republicans, non-military spending growth will be limited and work requirements will be tightened for people to receive food aid support payments. Key for Democrats, climate and clean energy provisions from the Inflation Reduction Act would be maintained and exemptions from the work requirements noted above for certain vulnerable cohorts would be granted.

The debt ceiling currently stands at $31.4 trillion. The deal suspends this ceiling until January 2025, beyond the current term of US President Biden. Key spending changes include:

- Non-military spending: To be held roughly flat from this year through the 2024 fiscal year. Increases for the 2025 fiscal year to be capped at 1%.
- Military spending: Rising by 3% in the 2024 fiscal year, broadly in line with President Biden’s budget request.
- $20 billion shifted from the Internal Revenue Service (IRS) over 2024 and 2025 to other areas. This reallocates some of the $80 billion the IRS was granted over a decade to expand its capabilities and hire additional staff to increase tax enforcement.
- Clawback of funding raised for unused COVID-19 support measures.
- Increasing work requirements for individuals to receive government food aid support payments. This will be implemented through raising the age of people who must work to receive such payments from 49 to 54 until 2030. Exemptions for certain individuals, such as veterans or homeless people, will be expanded.
- Student loan payments to be restarted from the end of the summer, after payments were paused during the pandemic.
- Climate and clean energy measures from the Inflation Reduction Act to be maintained.

Next, the deal goes to Congress. A vote is expected to take place on Wednesday. The Republicans hold a majority in the House of Representatives, while the Democrats hold a slim majority in the Senate with the support of independents. Swift passage is not necessarily assured, with news reports emerging of many Republicans intending to vote against the deal. However, Congress doesn’t have much time to debate the details. Indeed, US Treasury Secretary Janet Yellen warned that the cash coffers would run dry by 5 June, updated from the 1 June deadline that had previously been estimated.

So, we're not quite out of the woods yet, but there is now a bright light at the end of the tunnel.

Global markets also had to contend with fresh data on US inflationary pressures. The US Federal Reserve focusses on the personal consumption expenditure (PCE) deflator as the key indicator when considering inflation. The core PCE deflator lifted in April to 4.7% year-on-year and has been stuck in a range of 4.6% to 4.8% for the past six months, suggesting some possible stickiness to US inflation. Markets reacted by shortening the odds for another rate hike from the US Federal Reserve when they meet next month.

Economic Data

Turning our focus to domestic matters, it's a big week for economic data this week. A range of partial economic indicators will be dropped ahead of the release of March quarter GDP numbers on Wednesday next week.

The releases will also be watched closely by the Reserve Bank (RBA) ahead of the June RBA Board meeting next Tuesday. However, the data would need to surprise materially to the upside to move the dial for the June meeting, as interest-rate markets and economists are all but convinced that a pause will be delivered. However, while financial markets expect a pause in June, another hike later down the line is certainly not off the table. Indeed, interest-rate markets are attaching a probability of almost 70% for another 25-basis-point hike by September.

April Monthly CPI

The March quarter consumer price index (CPI) report confirmed that inflation in Australia peaked in the December quarter of 2022. This was an encouraging sign for the RBA. However, the RBA does not expect inflation to return to the 2-3% band until mid 2025.

On Wednesday, the April monthly inflation indicator will be released. This will provide an important update on how the path of inflation is unfolding and how quickly inflation is moving down toward the RBA's target. For April, we expect that the monthly pace of inflation slowed from 0.6% in March, to 0.5% in April. While this represents a slowing in the monthly pace of inflation, due to base effects, the annual pace is expected to rise to 6.5% in April, from 6.3% in March.

March Quarter Construction Work Done

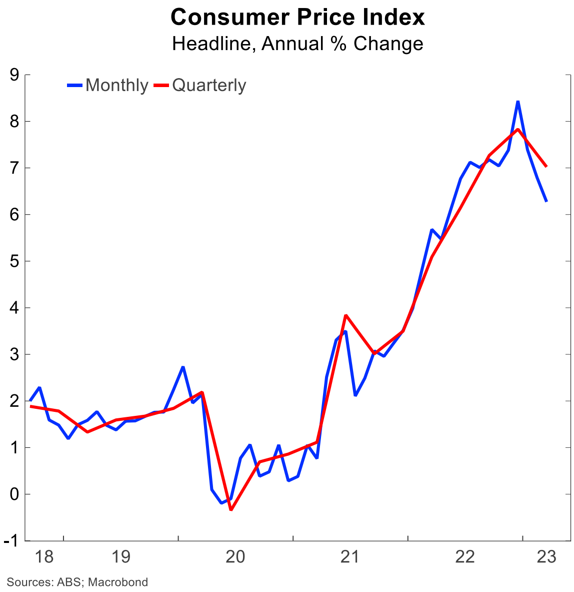
On Wednesday, the Australian Bureau of Statistics (ABS) will release the March quarter construction work statistics. These will provide important information on construction work over the quarter across residential, commercial, and public construction, including housing and infrastructure. Construction work rose but was volatile over 2022, as a range of headwinds impacted construction firms. Despite a strong pipeline of construction projects, surging material prices and challenges sourcing the right kind of labour significantly impacted the sector. Weather-related effects impacted the amount of work that could be done. Indeed, we have seen these factors contributing to the rise in insolvencies across the construction sector.

We expect that construction work expanded by 1.2% over the March quarter, following a 0.4% decline in the December quarter. The outcome reflects an expectation that public and private infrastructure work expended in the quarter. Despite building approvals have declined sharply over recent months, a large pipeline of housing remains to be worked through over time. That is expected to support housing construction in the near term (over the next 6-12 months). However, other factors, including weakness in renovation work, are likely to contribute to some volatile in the housing segment.

March Quarter Capital Expenditure (Capex)

On Thursday, the ABS will release the March quarter capex survey. Capacity utilisation has been very elevated throughout the second half of 2022 and into 2023 as the economy rebounded from COVID-19. Businesses hit up against existing capacity due to the resurgence in demand. This contributed to stronger expansion and investment plans as businesses looked to increase their capacity. Additionally, inflation has also contributed to stronger capex expenditure and plans, which are reported in nominal terms. For the March quarter, we expect capex spending expanded by 1.0%, following 2.2% growth in the December quarter.

Additionally, the March quarter capex release will include the second estimate for capex expenditure in 2023-24. We expect economic growth to be quite weak in 2023. As the economy slows, businesses typically reduce their capex plans as they expect demand to be weaker going forward. However, there is a question of whether these reductions in spending plans would be full captured in the second estimate. On balance, we expect that the second estimate to be 3.0% above the second estimate from last year. However, there is a risk that future estimates underwhelm as the slowing is more fully captured in expectations.



April Private Sector Credit

The pace of credit growth shifted down a gear from late 2022 as rapid cash rate hikes negatively impacted borrowing capacity and an expected slowdown in the economy contributed to weaker demand for credit from businesses. Monthly business credit growth slowed to 0.4% in March, from a peak of 1.5% in September 2022. In annual terms, business credit growth slowed from a 14-year high of 13.8% over the year to October 2022, to 10.6% over the year to March 2023. Housing credit has also slowed from its peak, but not quite to the same extent as business credit growth given growth didn't reach the same levels during the upturn.

For April, we expect that credit expanded 0.3% in the month, unchanged from the 0.3% monthly gain in March. This would see the annual rate slowing to 6.4% in April, from 6.8% in March. This releases will also be available on Wednesday.

Housing-related releases

In addition to the flurry of economic data, a string of housing-related releases will also be published. Building approvals will be published on Tuesday, dwelling prices on Thursday, and housing finance on Friday.

April Building Approvals

Building approvals have declined sharply from their peak earlier in the cycle. Indeed, building approvals are down around 46% from their March 2021 peak and are running at their slowest pace since May 2012 on a three-month moving average basis. The unwind of the bring-forward induced by the HomeBuilder policy, spikes in building costs, material shortages, challenges sourcing the right kind of labour, and interest rate hikes have all impacted approval numbers.

Volatility has also been a key theme of the results in recent months, as large month-to-month fluctuations in private sector multi-density approvals impact the numbers.

For April, we expect volatility has likely continued, as leading indicators suggest that private sector house approvals should be positive, while multi-density approvals are likely to remain volatile. We expect a 2.0% gain in April, following a 0.1% decline in March.

May Dwelling Prices

Despite another interest rate hike in May, dwelling prices continued to rise in the month. We expect that capital city dwelling prices rose 1.4% in May. Nationally, dwelling prices have been rising since March this year. Several factors have contributed to prices stabilising and beginning to rise in 2023. This includes existing listings (i.e. the stock) and new listings (i.e. the flow) remain low and well-below their respective five-year averages, a surge in migration adding to demand, and a spike in rents contributing to people who are in a position to do so accelerating their purchase plans to exit the rental market. The renewed strength in the housing market is also evident in auction clearance rates. The preliminary auction clearance rate lifted to 75.9% in the latest weekend – its highest levels since early November 2021.

April Housing Finance

As dwelling prices have begun to rise again, new finance approvals have also increased – in a sign that demand has contributed to the recent stabilisation in prices, in addition to supply-side factors like continued low listings. In March, the value of new housing finance excluding refinancing rose 4.9%, ending a 13-month run of declines. This reflected increases across both owner-occupied and investor loans. With dwelling prices continuing to rise in April, it is expected that new finance approvals will follow suit and increase 3.0% in the month.

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Group Forecasts

		2023			2024		
End Period:	**Close (26 May)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	3.85	3.85	3.85	3.85	3.60	3.35	3.10
90 Day BBSW, %	3.95	3.95	3.95	3.97	3.72	3.47	3.22
3 Year Swap, %	3.79	3.60	3.50	3.40	3.30	3.10	2.90
10 Year Bond, %	3.73	3.40	3.30	3.20	3.00	2.80	2.70
US Interest Rates:							
Fed Funds Rate, %	5.125	5.125	5.125	4.875	4.375	3.875	3.375
US 10 Year Bond, %	3.80	3.50	3.40	3.30	3.10	2.90	2.80
USD Exchange Rates:							
AUD-USD	0.6517	0.69	0.72	0.74	0.75	0.76	0.76
USD-JPY	140.60	132	130	128	127	126	125
EUR-USD	1.0723	1.11	1.11	1.12	1.13	1.14	1.15
GBP-USD	1.2344	1.25	1.25	1.26	1.26	1.27	1.28
NZD-USD	0.6051	0.64	0.66	0.67	0.68	0.68	0.68
AUD Exchange Rates:							
AUD-USD	0.6517	0.69	0.72	0.74	0.75	0.76	0.76
AUD-EUR	0.6076	0.62	0.65	0.66	0.67	0.67	0.66
AUD-JPY	91.65	91.1	93.6	94.7	95.3	95.8	95.0
AUD-GBP	0.5279	0.55	0.58	0.59	0.60	0.60	0.59
AUD-NZD	1.0771	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), %	2.7	6.9	3.7	3.1
Unemployment Rate, %	4.7	3.5	4.5	5.0
Wages Growth, %	2.3	3.4	4.1	3.3

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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