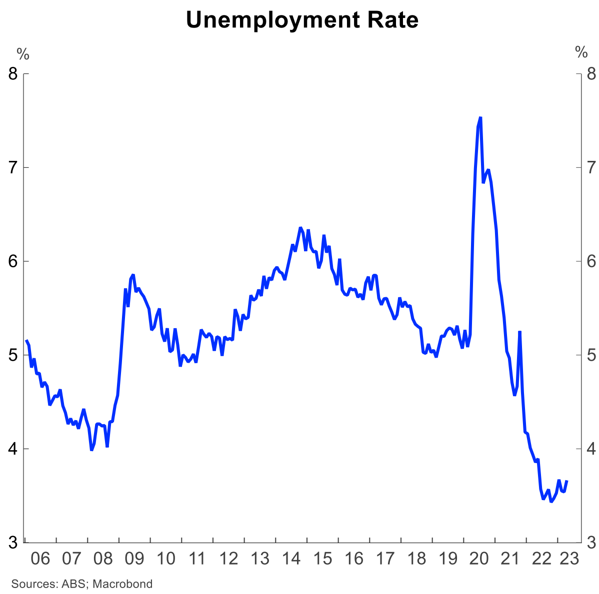
Data Likely To See RBA Pause In June

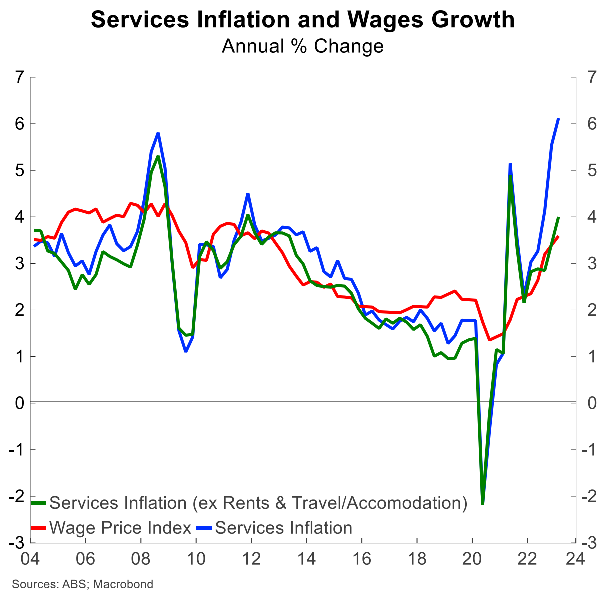
The top tier domestic data released last week confirmed that labour market conditions are starting to ease and there is limited evidence of a blowout in wages growth. This week we expect to see a further easing in retail spending over April. This combination should keep the Reserve Bank (RBA) Board on the sidelines for their next meeting in June, but it could be a close call.

The unemployment rate increased to 3.7% in April from 3.5% in March. The number of people employed declined by 4.3k over April, the first fall since December. A key question has been whether the labour market would be able to create enough jobs to absorb the record influx of overseas arrivals. Last week's data suggests we have reached the point where the growth in labour supply will outpace labour demand. This will help see conditions ease and the unemployment rate drift higher over 2023.

Why is this important? A tight labour market means there are more people employed earning income, spending, and adding to demand which the RBA is trying to slow. It also means that workers may be able to bargain for higher wages. In a high inflation environment, employers may be more willing to grant higher wages knowing it's easier to pass on higher costs to consumers.

We have seen this in other countries such as the US and the UK, where wages growth peaked at around 5½% and have now moderated to be growing closer to 5% per annum. Australia's Wage Price Index (WPI) confirmed that there is limited evidence of a blowout in wages growth. Over the March quarter, the WPI grew by 0.8% which is equivalent to around 3¼% in annual terms. The release of the WPI also showed the composition of wages growth is shifting in a way we anticipated - public sector wage growth has accelerated from low levels as more enterprise agreement are renegotiated. On the other hand, private sector wages growth has moderated.





A question we have attempted to answer in several research pieces is why wages growth has remained contained, notwithstanding the tightest labour market conditions in almost 50 years. Over the past year, if we remove the September quarter which was heavily influenced by the Fair Work Commission's (FWC) minimum wage decision, quarterly wages growth averaged 0.8%. This is consistent with Australia's inflation target and in stark contrast to the experience in other advanced economies. We have outlined several reasons for this outcome including the inertia in our wage setting system due to a higher share of workers covered by collective bargaining agreements, and higher labour supply firstly from higher participation and more recently, from the record influx of overseas arrivals.

Wages growth is important because it feeds into the prices of services (i.e. haircuts, medical services). Services inflation remains elevated in other comparable countries, largely due to strong wages growth. In Australia, the RBA is cognisant of the risk that as more enterprise agreements are renegotiated and the FWC sets the minimum wage for 2023-34, we see an acceleration in wages growth. Once services inflation becomes elevated it tends to be sticky and the only way to bring it down is by causing unemployment and job losses.

In the RBA's May Minutes the Board noted that the "high rate of services price inflation in the March quarter consumer price index (CPI) pointed to upside risks." Services inflation grew by 6.1% over the year to the March quarter. However, a large part of this growth reflects rents and domestic/international travel and accommodation. Rising rents have been underpinned by an imbalance in the housing market and there is little the RBA can do to address the drivers of rental inflation. Additionally, the surge in travel and accommodation prices appear temporary and have already started to moderate after spiking over the summer break. <u>Stripping away these factors, services inflation is running at 4.0% per annum – a much more palatable figure for the RBA.</u>

This week will be quiet on the domestic data front. We will receive retail trade numbers for April on Friday. Unlike labour market conditions and inflation which are lagging indicators, spending is a leading indicator – that is when spending slows, we expect to see demand for labour slow and inflation ease, with a lag. Recall that the underlying trend for spending has been soft as elevated cost of living continues to weigh on household income. In fact, we saw retail spending per capita, adjusted for inflation, fall by 1.3% in the March quarter - this was the largest quarterly fall in over 13 years (ex. COVID). <u>We expect retail spending continued to ease over April, falling by 0.2%. This is consistent with the RBA's own expectations.</u> In the RBA Board's May Minutes, it was noted that "liaison contacts pointed to a further modest decline in retail spending in April."

We continue to expect that the RBA will go on pause again in June and leave the cash rate unchanged at 3.85% for the remainder of the year. Labour market and wages growth data were broadly consistent with the RBA's forecasts. Retail spending is expected to continue to underwhelm. Over the next few weeks, we will receive partial economic indicators that will feed into the March quarter GDP estimates for Australia. <u>Given available information, we expect activity over the March quarter to be soft, with a chance that we may even record a negative quarter of economic activity.</u>

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Group Forecasts

		2023			2024		
End Period:	**Close (19 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, %	3.93	3.95	3.95	3.97	3.72	3.47	3.22
3 Year Swap, %	3.70	3.60	3.50	3.40	3.30	3.10	2.90
10 Year Bond, %	3.59	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, %	3.67	3.50	3.40	3.30	3.10	2.90	2.80
USD Exchange Rates:							
AUD-USD	0.6651	0.69	0.72	0.74	0.75	0.76	0.76
USD-JPY	137.98	132	130	128	127	126	125
EUR-USD	1.0805	1.11	1.11	1.12	1.13	1.14	1.15
GBP-USD	1.2445	1.25	1.25	1.26	1.26	1.27	1.28
NZD-USD	0.6283	0.64	0.66	0.67	0.68	0.68	0.68
AUD Exchange Rates:							
AUD-USD	0.6651	0.69	0.72	0.74	0.75	0.76	0.76
AUD-EUR	0.6154	0.62	0.65	0.66	0.67	0.67	0.66
AUD-JPY	91.72	91.1	93.6	94.7	95.3	95.8	95.0
AUD-GBP	0.5344	0.55	0.58	0.59	0.60	0.60	0.59
AUD-NZD	1.0593	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, %	2.4	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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