Weekly Economic Outlook

Monday, 3 May 2021

Limelight Shines More Brightly on Housing

Housing never really leaves the limelight but the limelight on dwellings shines even more brightly than usual this week. Fresh data will be published on prices, lending and buildings approvals. The Reserve Bank (RBA) also meet tomorrow. The central bank is keeping a close eye on lending standards amidst the surge in house prices.

An update on dwelling prices data from CoreLogic was released earlier this morning. It showed the frenetic pace of growth in recent months might be slowing, likely partly due to affordability becoming stretched. There has also been a lift in fresh listings although they are being snapped up so quickly that the housing supply still remains low. Dwelling prices rose 1.8% in April, which is very robust, but lower than the gains in March. March's increase was the largest in 32 years, so growth was unlikely to continue at this pace.

Housing finance approvals tomorrow should show a rise of 2.0% for March, after the huge 76% gain since the low in May of last year. The upturn has been driven by owner-occupier lending, which has been underpinned by the Federal government's HomeBuilder scheme. This scheme ended on 31 March and in coming months we should see the unwinding of the pull-forward effect related to the program. Investors are starting to come back to the table, lifting growth in investor housing finance.

On Wednesday, we get data covering another part of the housing pipeline – this time, building approvals. We expect approvals will rise 3.0%, after leaping 21.6% in February. The HomeBuilder scheme should still be supporting approvals in March. Building approvals are elevated, suggesting the boom in house prices is spilling over into approvals, which will deepen the upturn forming in residential construction activity. Approvals for housing are high, but approvals for units are lagging. This residential construction upturn may not be dominated by high-rise apartments as it was in the previous cycle before the pandemic.

The Reserve Bank Board meets on Tuesday. A warning about the importance of sound lending might feature again in its statement. We are not anticipating any change to policy settings. Last week's inflation data showed that the inflation dragon remained afflicted by lethargy. Indeed, the widely anticipated lift in inflationary pressures failed to materialise in a meaningful way.

But in the coming months, the inflation dragon is set to stir. Base effects from last year's falls in consumer prices and the cessation of some government support schemes will boost inflation in the June quarter. Pent-up demand, accommodative policy settings and an easing of restrictions will also help drive inflationary pressures over the coming period. However, policymakers expect this lift in inflation will be transitory and policymakers will look through temporary effects. The statement should confirm this.

The expected path of inflation leaves us comfortable with our view around future policy settings. We do not expect a hike in the RBA's cash rate before 2024. The yield-curve control (YCC) program will be be directed from the April 2024 bond to the November 2024 bond, but we might not get this direction from the RBA until August's board meeting. To recap, the YCC involves the RBA buying bonds to hold the 3-year government bond yield around 0.10%. We also expect an extension of the quantitative easing (QE) program (or bond-buying program) for government bond maturities of 5 to 10 years. The second tranche of the RBA's $100 billion QE program is due to end in late August 2021. We expect a third tranche of $100 billion and a fourth and final tranche of $50 billion.

After the RBA board meeting, we will also be eyeing RBA Deputy Governor Debelle's speech on Thursday titled "Monetary Policy during Covid". One of my favourite speeches by Debelle was when he linked his speech to albums he loved listening to. This speech may not be linked to albums, but it will have financial markets listening very carefully for clues about future policy settings.

To wrap up an RBA-jam-packed week we have the RBA's quarterly Statement on Monetary Policy (SoMP) on Friday. This SoMP will contain updated economic forecasts. But we do not think these forecasts will cause us to change our view around future RBA policy settings.

The most important revisions in the SoMP will be to the unemployment rate forecast. The RBA last published its SoMP in February when the most recent read on unemployment was for December 2020 at 6.8%. Fast forward and the unemployment rate was 5.6% in March and likely to be lower still by the end of this year. Forward-looking indicators of employment are encouraging and suggest the impact from the expiry of JobKeeper in March will be a modest speed hump. Prior to JobKeeper's expiry, we projected 60,000-140,000 would be lost due to the conclusion of the program. Recent data suggests it might be on the smaller side of this range.

We anticipate the RBA will cut its forecast for the unemployment rate from 5.25% to 4.5% for June 2023, the end of the forecast horizon.

Other forecasts that will come under scrutiny will be GDP, inflation and wages. There may be some tweaks to the inflation and wage growth forecasts alongside the adjustment to the unemployment forecast. But these tweaks are not likely to be enough to alter the path of future policy settings.

Lastly, the Australian Bureau of Statistics publishes data on trade tomorrow. Australia's trade account has been in surplus for 38 consecutive months, from the start of 2018. The surplus has ballooned from $23 billion for 2018 to $75 billion in 2020. In January 2021, the surplus hit a record high of $9.6 billion, then eased to $7.5 billion in February. It is forecast to narrow to $6.3 billion in March on a flood of imports ahead of the Easter-holiday period. Export earnings continue to go from strength to strength on higher commodity prices, particularly iron ore.

The increase in commodity prices, and the speedy recovery in the labour market, have materially reduced the government's budget deficit for 2020/21. The exact size of the improvement will be apparent in the Federal Budget handed down on May 11.

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Forecasts

		2021			2022		
End Period:	**Close (30 April)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW, %	0.04	0.05	0.07	0.09	0.10	0.10	0.10
3 Year Swap, %	0.33	0.40	0.40	0.45	0.60	0.80	0.90
10 Year Bond, %	1.75	1.85	1.95	2.10	2.20	2.30	2.40
US Interest Rates:							
Fed Funds Rate, %	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond, %	1.63	1.75	1.85	2.00	2.10	2.20	2.30
USD Exchange Rates:							
AUD-USD	0.7716	0.79	0.80	0.82	0.85	0.85	0.84
USD-JPY	109.31	109	110	111	112	111	111
EUR-USD	1.2020	1.20	1.21	1.23	1.25	1.26	1.27
GBP-USD	1.3822	1.40	1.40	1.41	1.41	1.41	1.42
NZD-USD	0.7162	0.72	0.73	0.74	0.76	0.76	0.75
AUD Exchange Rates:							
AUD-USD	0.7716	0.79	0.80	0.82	0.85	0.85	0.84
AUD-EUR	0.6412	0.66	0.66	0.67	0.68	0.67	0.66
AUD-JPY	84.3	86.1	88.0	91.0	95.2	94.4	93.2
AUD-GBP	0.5582	0.56	0.57	0.58	0.60	0.60	0.59
AUD-NZD	1.0770	1.10	1.10	1.11	1.12	1.12	1.12

	2019	**2020**	**2021 (f)**	**2022 (f)**
GDP, %	2.2	-1.1	4.5	3.0
CPI (Headline), %	1.8	0.9	3.1	2.2
CPI (Trimmed mean), %	1.5	1.2	2.0	2.0
Unemployment Rate, %	5.2	6.8	5.0	4.7
Wages Growth, %	2.2	1.4	1.8	2.0

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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