May Monthly Economics and Markets Review

QUEENSLAND TREASURY CORPORATION

Overview

Domestic economy

The RBA surprised by increasing the cash rate by 25-basis points to 3.85 per cent at its May policy meeting, the highest the cash rate target has been since April 2012. Communication from the Bank continues to suggest that 'further tightening of monetary policy may be required to ensure that inflation returns to target in a reasonable timeframe'. The dataflow was mixed, with Q1 wages growth at its fastest in a decade, while employment declined in April.

International economy

A number of key central banks globally lifted rates further, though the outlook as to where policy rates may go from here is mixed. Conditions in the US banking sector appear to have normalised, though a fourth bank did fail during the month. There were concerns of US default, though these have eased with an agreement being reached to raise the US debt ceiling (though this still requires congressional approval).

Short-term interest rates

Short-term-end bond yields rose in May with the three-year Australian Government Bond yield finishing the month around 37 basis points higher at 3.36 per cent.

Long-term interest rates

The 10-year Australian Government Bond yield increased around 30 basis points to 3.61 per cent. Resilient labour markets and price pressures along with the gradual reduction in risk aversion following global banking concerns earlier in the year and concerns for the US debt situation all saw yields edge higher in May.

MATURITY	ISSUER	YIELD	1 MONTH BPS CHANGE	1 YEAR BPS CHANGE
3 Year	QTC	3.71	31	61
	Australian Government	3.36	37	51
	US Government	4.05	18	122
5 Year	QTC	3.74	29	39
	Australian Government	3.38	31	30
	US Government	3.75	12	84
7 Year	QTC	3.93	28	38
	Australian Government	3.48	28	27
	US Government	3.70	9	75
10 Year	QTC	4.23	27	49
	Australian Government	3.61	27	28
	US Government	3.64	7	74

AUSTRALIAN DOLLAR CROSSES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
AUD/USD	0.6472	-2.6%	-10.0%
AUD/EUR	0.6071	0.3%	-9.9%
AUD/GBP	0.5222	-1.7%	-9.2%
AUD/JPY	90.4242	-0.9%	-3.2%

MAJOR CURRENCIES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
EUR/USD	1.0661	-2.9%	-0.1%
GBP/USD	1.2395	-1.0%	-0.8%
USD/JPY	139.71	-1.8%	-7.5%
USD/CNY	7.1061	-2.8%	-6.4%

Prices sourced from Bloomberg & QTC and are correct at the time of publication

The tables above show yields on bonds issued by the Queensland, Australian and US Governments as well as values for the Australian Dollar against a range of currencies and US Dollar against major currencies. The change in yields and exchange rates over different time periods are also included.

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Domestic economy

SUMMARY:

The RBA surprised by increasing the cash rate by a further 25-basis points at its May policy meeting. Additional communication from the Bank through the month suggested policymakers are increasingly concerned about the persistence of inflation.

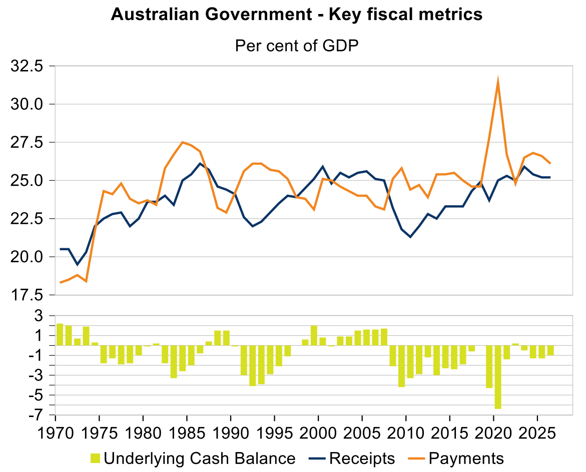
REVIEW:

- The RBA increased the cash rate target by 25-basis points to 3.85 per cent at its May meeting. This came as a surprise to both markets and economists as the RBA pause in April was to see further information and the most material news to emerge over the past month was softer than expected inflation. The Bank acknowledged the easing of price pressures as being welcome but seems to be growing uncomfortable with the time that inflation is expected to be above target. The post-meeting statement highlighted that some 'further tightening of monetary policy may be required to ensure that inflation returns to target in a reasonable timeframe'.
- RBA Governor Lowe spoke following the RBA decision and, as per the more detailed minutes to the May meeting, acknowledged that this months' decision was 'finely balanced'. He justified the hike on account of extra information received over the period including the unemployment rate remaining very low, house prices beginning to rise again, the AUD declining and worryingly persistent services inflation overseas.
- In its May Statement on Monetary Policy the RBA reiterated that 'some further tightening of monetary policy may be required to ensure that inflation returns to target in a reasonable timeframe', but that any tightening 'will depend upon how the economy and inflation evolve'. The forecasts featured downgrades to the near-term inflation outlook, though medium-term expectations were unchanged with inflation expected to the top of its target band by June 2025.
- In other RBA news, it was widely reported that during a closed-door session with members of the federal parliament's economics committee RBA Governor Lowe struck a relatively pessimistic tone in stating that he had no tolerance for lingering inflation and would do what was needed to bring it down.
- The Federal Budget forecasts a surplus of $4.2 billion for 2022-23. This is a material change from the deficits expected in the October 2022 ($36.9 billion) and March 2022 ($78 billion) budgets. The upward budget balance revisions were driven by better-than-expected economic conditions seeing higher revenue and lower expenses as well as policy decisions to raise revenue more than offsetting new policy spending initiatives.
- On the domestic data front:
  - The April Labour Force Survey disappointed expectations with employment declining 4,300. The softer outcome may reflect that it followed strong employment growth in Q1 (averaging 39,000 a month) and could in-part be the product of seasonal issues with `the survey period coinciding with the Easter holiday. Soft jobs growth saw the unemployment rate increase to 3.7 per cent (from 3.5 per cent) despite a slight dip in the participation rate.
  - The Wage Price Index rose 0.8 per cent in Q1 to a decade-high of 3.7 per cent. This was broadly in line with consensus expectations and the latest RBA forecasts.
  - The annual pace of the monthly headline CPI gauge accelerated by five-tenths to +6.8 per cent year-on-year (notably above the +6.4 per cent median expectation). Compositionally, the upside surprise was driven by a strong rebound in holiday travel & accommodation, but there was also an acceleration across durable goods as well as services. The ABS also resumed publishing a monthly trimmed-mean measure, which accelerated two-tenth to +6.7 per cent year-on-year.

WHAT TO WATCH:

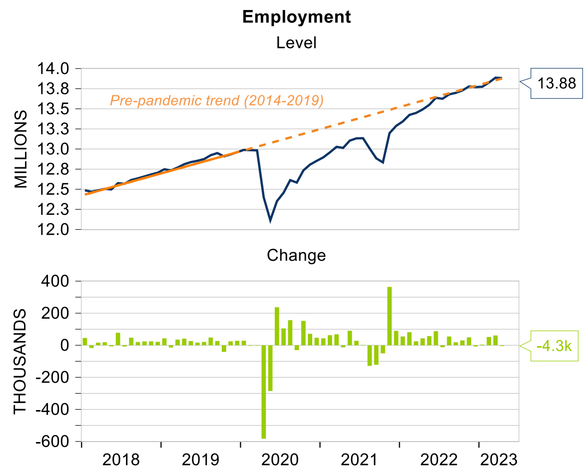
The Fair Work Commission's minimum and award wage decision (2 June), GDP (6 June), CPI (26 July) as well as labour market data for May and June (released mid-month) will be the key releases ahead of the most likely possible occasion for a rate rise (RBA meeting on 1 August).

CHART 1: THE FEDERAL GOVERNMENT'S BUDGET BALANCE HAS SEEN A SIGNIFICANT IMPROVEMENT WITH THE FIRST SURPLUS SINCE 2007-08



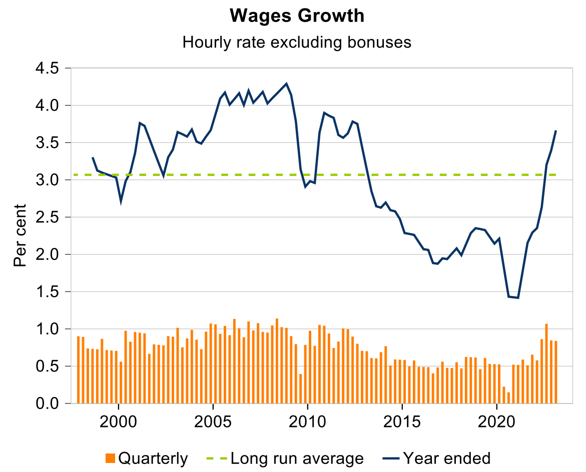
Source: Australian Department of the Treasury, QTC, Macrobond

CHART 2: JOBS GROWTH HAS SLOWED, WITH THE LEVEL OF EMPLOYMENT NOW AROUND THE PRE-PANDEMIC TREND



Source: Australian Bureau of Statistics, QTC, Macrobond

CHART 3: DOMESTIC WAGES GROWTH PICKED UP TO THE FASTEST PACE SINCE 2012



Source: Australian Bureau of Statistics, QTC, Macrobond

International economy

SUMMARY:

Several key central banks globally lifted rates further in May, though there is a mixed outlook on where policy may go from here.

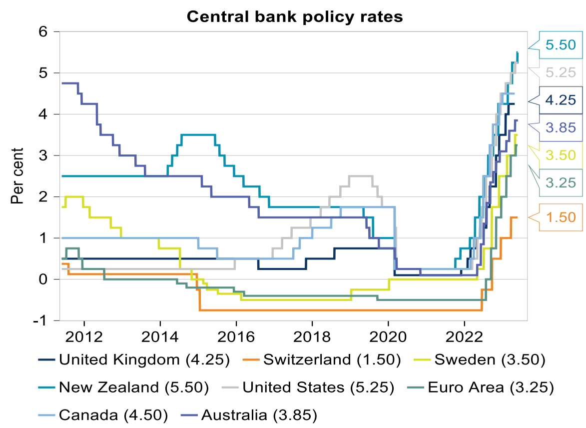
REVIEW:

- US fiscal policymakers reached a tentative deal to raise the US debt ceiling and avoid a US default. The deal is subject to congressional approval before it can be signed by President Biden. This comes just days before the US Treasury is set to run out of funds to meets its existing obligations (known as the X-date and estimated to be on 5 June).
- In central bank news:
  - The US Federal Open Market Committee, the policymaking body of the US Federal Reserve, increased the Fed Funds target rate by 25-basis points to 5.0 to 5.25 per cent as widely expected. The post-meeting statement removed the comment that 'the committee anticipates that some additional policy firming may be appropriate', a move seen as a hint that a possible pause in the hiking cycle may soon be coming and one which the Fed Chair Powell described as a 'meaningful change'. However, in the weeks since the meeting there has been mixed commentary from various Fed officials, with some suggesting rates needed to be higher, others implying they should remain on-hold and another cohort undecided and waiting for more data ahead of the next meeting on 15 June.
  - The ECB lifted rates by 25-basis points, which while expected, was a slower pace of rate hikes than seen in recent months. That said, with inflation risks still skewed to the upside, it seems as though policy tightening is not yet done with the Governing Council acknowledging that it had 'more ground to cover' and that it would cease re-investing maturing securities in July thus speeding up the process of balance sheet shrinkage.
  - The Bank of England lifted rates by 25 basis points to 4.5 per cent given a firmer outlook for both economic activity and inflation as well as a desire to reduce the risks of inflation remaining uncomfortably high. Further rate hikes remain on the table, though will depend on evidence of inflation persistence.
  - The Reserve Bank of New Zealand lifted the policy rate by 25-basis points to 5.5 per cent at its May meeting. While in-line with consensus expectations, some had expected a 50-basis point hike. The post-meeting statement struck a dovish tone, with policymakers discussing the merits of a 25-basis point hike or keeping rates on-hold. Policymakers failed to reach a consensus and opted to put the policy decision to a vote for the first time; five members voted for the 25-basis point hike while two voted to keep rates unchanged.
- While a fourth US bank collapsed at the start of May (First Republic Bank who were subsequently acquired by JP Morgan), news for smaller regional banks was more muted through the month. The one positive development was Western Alliance Bancorp reporting deposits had increased notably over recent weeks.
- On the international data front:
  - Business activity across many advanced economies (as measured by the S&P Global PMIs) was mixed in May with conditions in the manufacturing sector moderating while those in the larger services sector continues to improve.
  - US headline inflation eased further, while the annual pace of the Fed's preferred measure of inflation rose. The US labour market remains strong with employment rising above and the unemployment rate declining to 3.4 per cent.
  - UK data was generally disappointing, with inflation higher than anticipated and GDP contracting in Q1 as labour strikes and bad weather constrained output.
  - Germany entered a technical recession over winter with Q1 23 GDP revised down from flat to -0.3 per cent, this followed the -0.4 per cent Q4 22 print.

WHAT TO WATCH:

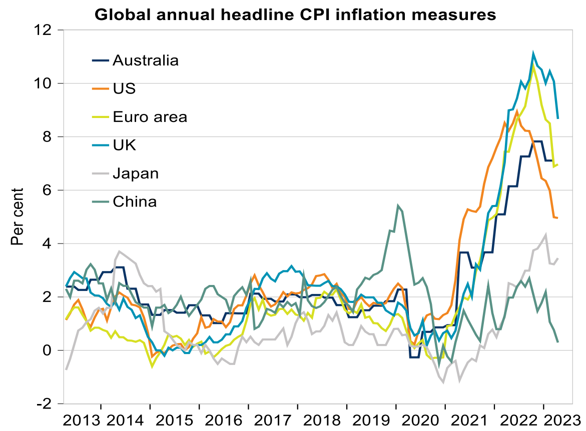
There are some signs of a moderation in global price pressures, though these are not uniform as to their size, composition, and geography. Until further evidence is available that inflation is on a clear downwards trajectory the possibility of further rate hikes remains. That said, central banks appear to be on the home stretch when it comes to inflation with focus likely to turn towards assessing the impact of hikes on the economy.

CHART 4: WHILE MANY CENTRAL BANKS HAD SLOWED THE PACE OF RATE HIKES, OR SEEMINGLY PAUSED, PERSITENT INFLATION SUGGESTS THEY MAY HAVE MORE TO DO



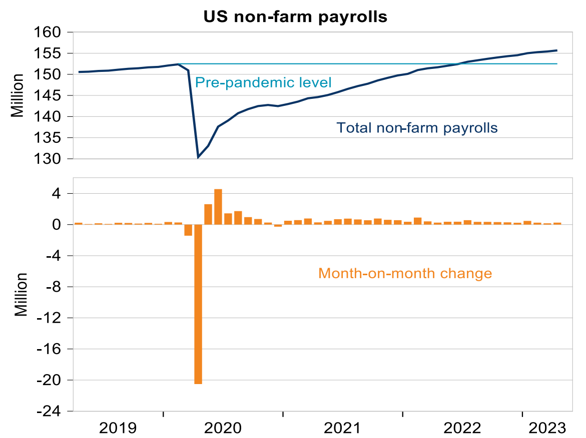
Source: QTC, Macrobond

CHART 5: HEADLINE INFLATION APPEARS TO HAVE PEAKED, THOUGH UNDERLYING INFLATION REMAINS STICKY



Source: QTC, Macrobond

CHART 6: US PAYROLLS ROSE FOR A 28TH CONSECUTIVE MONTH IN APRIL AS THE US LABOUR MARKET REMAINS TIGHT



Source: U.S. Bureau of Labor Statistics (BLS), QTC, Macrobond

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