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July Monthly Economics and Markets Review

QUEENSLAND TREASURY CORPORATION

Overview

Domestic economy

The RBA kept policy settings unchanged at its July meeting, as was expected by a major of economists and market pricing. Though despite this, the Bank did suggest that '*some further tightening of monetary policy may be required to ensure that inflation returns to target in a reasonable timeframe.*'

Data over the month were mixed, with inflation easing more than expected, while the labour market tightened further.

International economy

It was also a mixed story internationally, with some central banks increasing the pace of tightening, while others paused. The IMF revised up its growth expectations for 2023, while moderating its inflation forecast for this year.

Short-term interest rates

Front-end domestic bond yields fell over the month as the RBA held rates on-hold and the Q2 CPI inflation report came in below expectations. The three-year Australian Government Bond yield started the month at 4.05 per cent before hitting its highest level in 12 years (4.23 per cent). It then traded as low as 3.79 per cent before finishing the month at 3.87 per cent.

Long-term interest rates

Meanwhile longer-end bond yields rose alongside increases across the US and Europe. The ten-year Australian Government Bond yield finished the month around 36 basis points higher at 4.05 per cent.

MATURITY	ISSUER	YIELD	1 MONTH BPS CHANGE	1 YEAR BPS CHANGE
3 Year	QTC	4.15	-16	116
	Australian Government	3.87	-16	120
	US Government	4.52	4	173
5 Year	QTC	4.17	-9	103
	Australian Government	3.84	-11	104
	US Government	4.18	5	154
7 Year	QTC	4.35	-2	104
	Australian Government	3.94	-4	101
	US Government	4.08	10	146
10 Year	QTC	4.65	5	109
	Australian Government	4.05	3	100
	US Government	3.96	12	139

AUSTRALIAN DOLLAR CROSSES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
AUD/USD	0.6738	1.6%	-4.3%
AUD/EUR	0.6112	0.4%	-10.9%
AUD/GBP	0.5238	-0.3%	-8.7%
AUD/JPY	95.7272	-0.2%	3.1%

MAJOR CURRENCIES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
EUR/USD	1.1024	1.2%	7.3%
GBP/USD	1.2863	1.9%	4.7%
USD/JPY	142.07	1.8%	-7.8%
USD/CNY	7.1465	1.4%	-5.6%

Prices sourced from Macrobond & 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 held policy unchanged at its July meeting to give it time to assess the economy. However, it did suggest that some further tightening may be required.

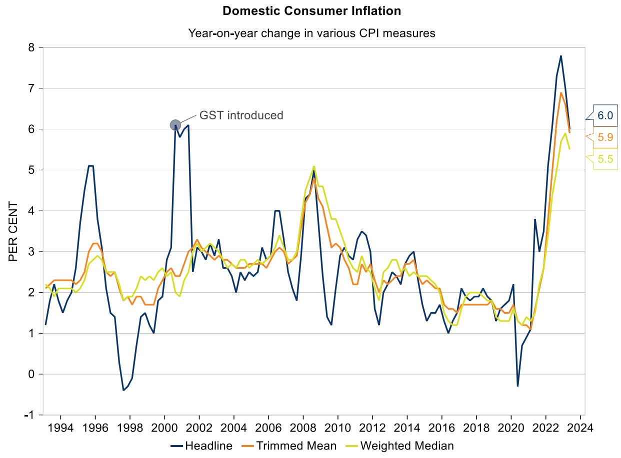
REVIEW:

- The RBA kept the cash rate steady at 4.1 per cent at its July meeting, with the Bank noting this decision *'provides the Board with more time to assess the state of the economy and the economic outlook and associated risks.'* Despite pausing this month, the RBA reinstated previous forward guidance which had been removed from the June Minutes that *'some further tightening of monetary policy may be required to ensure that inflation returns to target in a reasonable timeframe, but that will depend upon how the economy and inflation evolve.'* The post-meeting statement removed commentary that the Board was *'seeking to keep the economy on an even keel'* and that the path to a soft landing was *'a narrow one'*. In its place the release noted that the Board is *'still expecting the economy to grow'* but the path to achieving *'this balance is a narrow one.'* This change is hard to interpret but could suggest that the Bank is more confident in the resilience of the economy and is comfortable tilting its actions more towards containing inflation than shoring up growth.
- Released later in the month, the Minutes to the RBA's July meeting highlighted that there was a debate by members on the merits of hiking versus pausing, but ultimately the Board elected to keep rates steady so members could *'reassess the situation at the August meeting'* given *'both the uncertainty around the outlook and the significant increase in interest rates to date'*.
- In a speech titled *'The Reserve Bank Review and Monetary Policy'* RBA Governor Lowe provided a ten-point plan for the Bank moving forward. This included reducing the number of Board meetings each year to eight from 11 (though making those meetings last longer) and introducing a post-meeting press conference held by the Governor to help explain the decision. Lowe also suggested the Board was open to the publication of a vote count, Board members making public appearances and the establishment of an advisory group to the Board, though he believes these should be considerations by the next RBA Board in 2024.
- In other RBA news, current RBA Deputy Governor Michele Bullock will become the Bank's next Governor when Philip Lowe's term ends on 17 September 2023.
- It was also a busy month for data:
  - Consumer inflation surprised to the downside in the June quarter:
    - Headline CPI rose +0.8 per cent in Q2 to be +6.0 per cent higher over the year. These outcomes were below both market expectations and RBA forecasts as well as being the slowest pace of quarterly and annual inflation since Q3 2021 and Q1 2022 respectively. Meanwhile the trimmed-mean (which is the RBA's preferred gauge) rose +0.9 per cent in Q2 (the slowest quarterly pace since Q3 2021) with the annual rate of growth eased seven-tenths to +5.9 per cent year-on-year, slightly below the consensus expectation and RBA's latest forecast of +6.0 per cent.
    - The downside surprise was largely driven by goods disinflation, which eased to +0.9 per cent in Q2 (the slowest pace since Q3 2021), with the annual rate falling 1.8 percentage points to +5.8 per cent. Meanwhile, services inflation dipped to +0.8 per cent on the quarter, though the annual rate rose two-tenths to +6.3 per cent (the highest since 2001). The increase in services inflation was driven by higher prices in a range of categories including rents, restaurant meals, holiday travel and insurance. On housing, quarterly rents growth rose the most since the late 1980s, though this was partially offset by easing inflation across new housing and utilities.
  - The Labour Force Survey was stronger than expected for a second consecutive month in June. Total employment rose by 32,600, with strong full-time employment growth (+39,300), offsetting a slight decline in part-time work (-6,700). The boost in employment and a one-tenth decline in the participation rate (to 66.8 per cent) saw the unemployment rate fall one-tenth to 3.5 per cent (though unrounded it was 3.46 per cent, just above the October 2022 cycle low of 3.4 per cent).
  - The *Westpac-Melbourne Institute Consumer Sentiment Index* rose marginally in July, despite the RBA not hiking rates this month, with the level of sentiment still notably below the long-run average. Meanwhile, the *NAB Business Survey* for June showed conditions were stable at levels above the series long-run average, while business confidence rose slightly (though remain subdued relative to history).

WHAT TO WATCH:

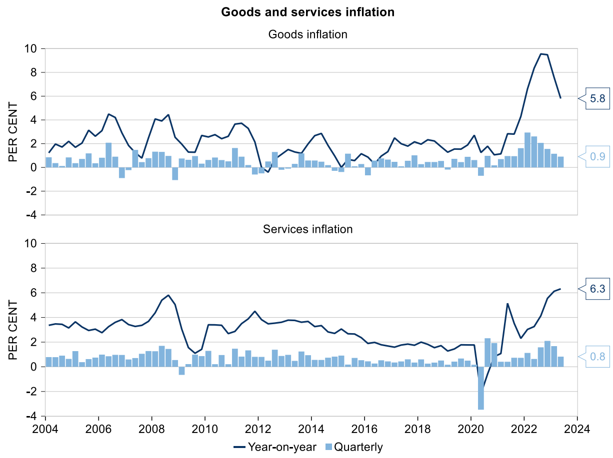
The RBA's next policy meeting on 1 August (today) will be key to understanding the Board's appetite for future rate hikes, particularly given then softer Q2 CPI release yet firm June Labour Force Survey.

CHART 1: DOMESTIC CONSUMER PRICE INFLATION CONTINUED TO EASE IN THE JUNE QUARTER…



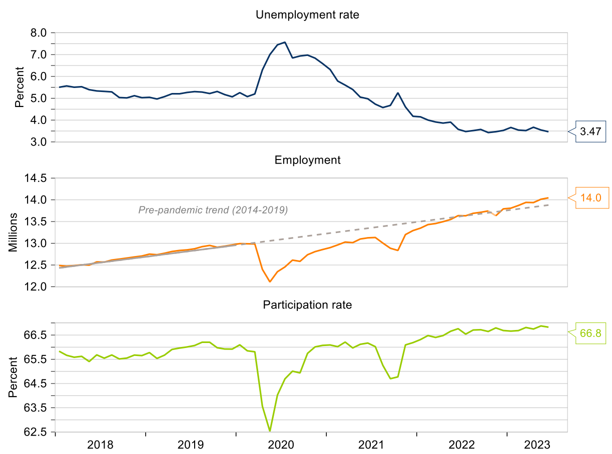
Source: Australian Bureau of Statistics, QTC, Macrobond

CHART 2: WHILE GOODS INFLATION HAS SLOWED NOTICEABLY, SERVICES INFLATION APPEARS TO BE EASING MORE SLOWLY



Source: Australian Bureau of Statistics, QTC, Macrobond

CHART 3: THE DOMESTIC LABOUR MARKET REMAINS RESILIENT, WITH EMPLOYMENT AT A NEW RECORD, THE UNEMPLOYMENT RATE NEAR ITS CYCLE LOW AND THE PARTICIPATION RATE HISTORICALLY ELEVATED…



Source: Australian Bureau of Statistics, QTC, Macrobond

International economy

SUMMARY:

It was a particularly busy month for central banks globally, with some delivering further rate hikes, others pausing and one even loosening policy.

REVIEW:

- Policy decisions from major central banks were mixed in July:
  - The FOMC lifted rates by 25-basis points to 5.25-to-5.50 per cent, as widely expected. The only adjustment to the post-meeting statement was an upgrade to the Committee's characterisation of economic growth to *'moderate'* from *'modest'*. In the press conference Chair Powell said the full impact of prior rate increases have yet to be felt, although there was evidence in some sectors; that policymakers have not committed to an *'every other meeting'* approach and will remain data dependent; that Fed staff economists no longer anticipate a recession; and that, when rate cuts do come, the could still continue to shrink its balance sheet.
  - The ECB raised interest rates by 25-basis points as expected. However, guidance from its Governing Council (GC) and President indicated that the Bank may be close to done with tightening policy. For example, previously President Lagarde indicated that the Bank had *'more ground to cover'* in lifting interest rates but now noted that incoming data would dictate *'whether and how much'* rates would be lifted. Similarly, the GC previously noted that rates would need to be *'brought to'* restrictive levels but now says rates would be *'set at'* these levels, implying that they may now be there.
  - The Reserve Bank of New Zealand left rates on-hold at 5.5 per cent, marking the first policy pause since it started raising rates in October 2021. The forward guidance was unchanged and continued to suggest the cash rate *'will need to remain at a restrictive level for the foreseeable future'*.
  - The Bank of Canada lifted its policy rate by 25-basis points to 5.0 per cent, marking the second consecutive rate rise after the Bank had paused policy earlier in the year. The forward guidance suggested the Bank would remain data dependent with no indication given that it was at the end of its hiking cycle (as had been signalled earlier in the year).
  - While keeping policy rates and targets unchanged, the Bank of Japan did slightly alter its Yield Curve Control framework. Given heightened actual inflation and rising inflation expectations, the Bank will now allow flexibility for the yield on the ten-year Japanese Government Bond (JGB) to rise up to one-per cent (which if achieved will be the highest rate for the ten-year JGB since early-2012).
  - Following recent soft data, officials from the People's Bank of China (PBoC) pledged to utilise policy to support the economy and suggested there was room for a further reduction in bank lending rates. However, despite this, the PBoC held the Medium-Term Lending Facility Rates Loan Prime Rates unchanged, though did announce it would increase cross-border funding for companies and financial institutions.
- On China, the Politburo of the Chinese Communist Party said the economy faced *'new difficulties and challenges'* given insufficient demand and a *'complex and severe external environment'*. There was some apparent support for the troubled property sector with it vowing to *'adjust and optimise real estate policy in a timely manner.'* Also, notably absent from the post-meeting statement was the prior comment that *'housing is for living and not for speculation'*.
- The IMF revised up its global growth forecast for 2023 to +3.0 per cent (from +2.8 per cent in April), with growth in 2024 still expected at +3.0 per cent. The Agency also its lowered expectations for global inflation in 2023 down two-tenths to +6.8 per cent, but increased its forecast for 2024 to +5.2 per cent (from +5.0 per cent) as it projects underlying inflation to persist and decline more gradually.
- Inflation data over the month were relatively positive, with headline inflation easing across the US, euro area, UK, Japan and New Zealand, though core inflation remains more sticky. Despite some weakness, labour markets globally remain historically very tight.

WHAT TO WATCH:

There are some signs of a moderation in global price pressures, though these are not yet uniform as to their size, composition, and geography. Greater uniformity in this will be likely needed for central banks to feel comfortable that interest rates have increased sufficiently.

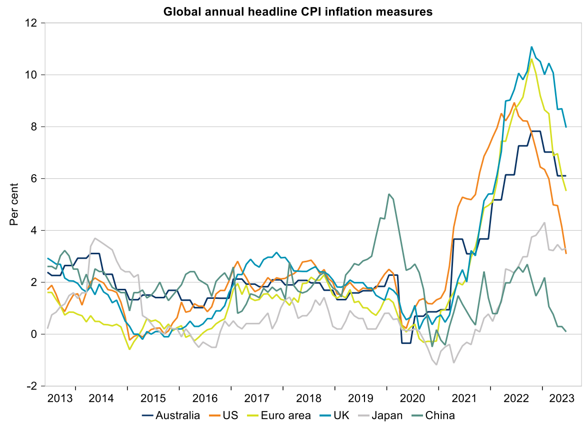
CHART 3: THE IMF UPGRADED ITS GROWTH OUTLOOK AND DOWNGRADED THAT FOR INFLATION FOR THIS YEAR

Overview of the IMF World Economic Outlook Projections

		Estimate		Current projection		Forecast revision from April 2023	
		2021	**2022**	**2023**	**2024**	**2023**	**2024**
Output	Global Growth	6.3%	3.5%	3.0%	3.0%	0.2%	0.0%
	Advanced Economies Growth	5.4%	2.7%	1.5%	1.4%	0.2%	0.0%
	Developing Economies Growth	6.8%	4.0%	4.0%	4.1%	0.1%	-0.1%
Prices	Global Inflation	4.7%	8.7%	6.8%	5.2%	-0.2%	0.3%
	Advanced Economies Inflation	3.1%	7.3%	4.7%	2.8%	0.0%	0.2%
	Developing Economies Inflation	5.9%	9.8%	8.3%	6.8%	-0.3%	0.3%

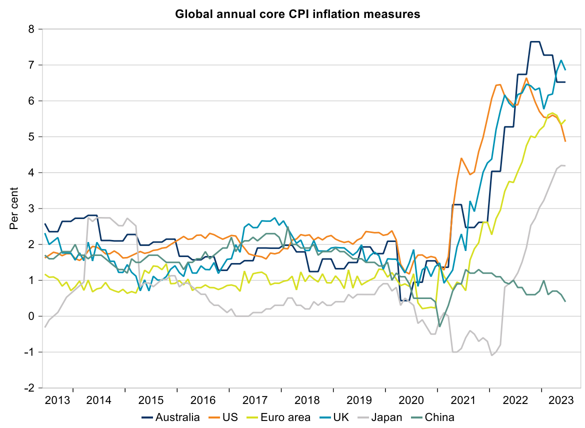
Source: *International Monetary Fund World Economic Outlook Update (July 2023 Update) & QTC*

CHART 4: HEADLINE INFLATION APPEARS TO HAVE PEAKED GLOBALLY…



Source: Australian Bureau of Statistics, U.S. Bureau of Labor Statistics (BLS), Eurostat, U.K. Office for National Statistics (ONS), Japanese Statistics Bureau, Ministry of Internal Affairs & Communications, China National Bureau of Statistics (NBS), QTC, Macrobond

CHART 5: … WHILE CORE INFLATION REMAINS STICKIER



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