May Monthly Economics and Markets Review

QUEENSLAND TREASURY CORPORATION

Overview

Domestic economy

While the Federal Budget garnered a lot of attention during the month, there was a soft tone to data released this month. For example, this was evident in readings on the labour market (with the unemployment rate rising by more than expected and wages not increasing by as much as anticipated). It was also apparent in subdued business and consumer surveys. An exception might have been the monthly CPI for April which increased by more than expected, though the increases were not as large when referencing the series that have had the impact of seasonality removed.

International economy

There were further signs of the orderly moderation of US economic activity continuing in June. The Whitehouse raised tariffs on imports of selected Chinese products, including electric vehicles where the production of these has been an area of strength for the Chinese economy. This is at odds with soft conditions in China's property market and in terms of household spending. Key central bank policy rates were kept on hold during the month with US monetary policymakers pushing back on the idea that further rate hikes would be needed.

Interest rates

Yields dipped in the first half of the month due to an easing of US inflation, weaker-than-expected US retail sales and after Fed Chair Powell pushed back on the notion of rate hikes. In contrast, yields rose in the second half of the month following stronger than expected readings on conditions in the manufacturing and services sectors of key economies as well as firmer readings on US consumer confidence and Australian inflation. Overall, Australian Government yields were little changed on the month while those in the US fell.

MATURITY	ISSUER	YIELD	1 MONTH BPS CHANGE	1 YEAR BPS CHANGE
3 Year	QTC	4.42	-1	71
	Australian Government	4.05	2	68
	US Government	4.68	-13	54
5 Year	QTC	4.56	-1	82
	Australian Government	4.10	1	72
	US Government	4.51	-14	66
7 Year	QTC	4.81	3	88
	Australian Government	4.24	-1	76
	US Government	4.51	-13	73
10 Year	QTC	5.16	4	93
	Australian Government	4.40	-1	79
	US Government	4.50	-13	81

AUSTRALIAN DOLLAR CROSSES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
AUD/USD	0.6648	2.4%	0.5%
AUD/EUR	0.6122	0.8%	-0.7%
AUD/GBP	0.5221	0.5%	-1.5%
AUD/JPY	104.4423	2.0%	13.1%

MAJOR CURRENCIES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
EUR/USD	1.0858	1.6%	1.2%
GBP/USD	1.2732	1.9%	2.0%
USD/JPY	157.11	0.3%	-12.5%
USD/CNY	7.2420	0.0%	-2.3%

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:

While the Federal Budget garnered a lot of attention during the month, there was a soft tone to data released this month. For example, this was evident in readings on the labour market (with the unemployment rate rising by more than expected and wages not increasing by as much as anticipated). It was also apparent in subdued business and consumer surveys. An exception might have been the monthly CPI for April which increased by more than expected, though the increases were not as large when referencing the series that have had the impact of seasonality removed.

REVIEW:

- The RBA left the cash rate unchanged at its May meeting as expected. The Minutes to the meeting noted the Board chose to keep rates steady given recent data '*had not been sufficient to warrant a change in the stance of monetary policy*' and that keeping rates steady '*could also be an appropriate way to mitigate the risk that future demand growth turned out to be slower than envisaged*.'
- The forward guidance was broadly unchanged, noting that the Board '*agreed that it was difficult either to rule in or rule out future changes in the cash rate target*.' While noting '*the risks around inflation had risen somewhat*', the Minutes also noted risks around the broader forecasts were '*judged to be balanced*' and added that the Board wanted to '*avoid excessive fine-tuning*' of policy in response to '*short-term variation*' in inflation.
- The unemployment rate rose by more than expected in April, increasing to 4.1 per cent from an upwardly revised 3.9 per cent in March. Part of the increase could reflect ongoing shifting seasonal patterns and may partially unwind next month.
- The wage price index rose 0.8 per cent in Q1, slightly below economists' expectations for a 0.9 per cent increase. Annual wages moderated from 4.2 to 4.1 per cent.
- Consumer sentiment eased 0.3 per cent in May, a third consecutive monthly decline. Households remain concerned about high inflation and the possibility of interest rate increases. Westpac noted that the survey was in the field around the release of the Federal Budget. Sentiment amongst those surveyed pre-Budget was noticeably higher than those surveyed following the Budget.
- The *NAB Business Survey* showed that business conditions eased in April, with all three sub-components now back around their long-run average. The decline in the employment index is perhaps the most notable shift after a period of persistent out-performance.
- The ABS' monthly CPI rose 0.7 per cent in April to be 3.6 per cent higher over the year. This was above the previous outcome (+3.5 per cent) and analyst expectations (+3.4 per cent). The widely cited measure of core inflation in the monthly report (CPI excluding volatile items and travel prices) rose 0.4 per cent to be up 4.2 per cent over the year. Interestingly, when these series are seasonally adjusted a picture of slightly softer monthly inflation emerges with both the CPI and core CPI measures both increasing by only 0.2 per cent. For both this was the smallest rise since December.
- The 2024-25 Federal Budget featured a further near-term improvement in Australia's public finances, with firmer commodity prices supporting a forecast $9.3bn underlying cash surplus (0.3 per cent of GDP) for 2023-24. This is an improvement of $10.5 billion since the Mid-Year Economic and Fiscal Outlook and is the second straight surplus. However, the Budget balance is forecast to slip back into deficit thereafter, with cumulative deficits of approximately $95 billion over the three years 2026-27.
- These deficits largely reflect policy decisions, with some of the policies in the Budget including: the previously announced Stage 3 tax cuts, the Future Made in Australia strategy and various housing initiatives. There were also a number of policies aimed at cost-of-living, including the energy bill relief package, lower cost of PBS medicines, changes to the indexation for student debt, and wage increases in the aged-care and childcare sectors.

WHAT TO WATCH:

Given mixed signals on inflation and a desire to gather more data and obtain greater clarity on the current strength of price pressures, the RBA will be closely watching the next monthly CPI report from the ABS (26 June). The ABS' next labour force (13 June) report is likely to also be heavily scrutinised by the central bank who will be interested to see the extent to which the rise in the unemployment rate in April was driven by a weakening of labour market or was an artefact of statistical noise.

CHART 1: NON-SEASONALLY ADJUSTED SERIES GAVE A SENSE THAT PRICE PRESSURES WERE FIRMER IN APRIL IN AUSTRALIA THAN WHAT WAS IMPLIED BY THE SEASONALLY ADJUSTED SERIES

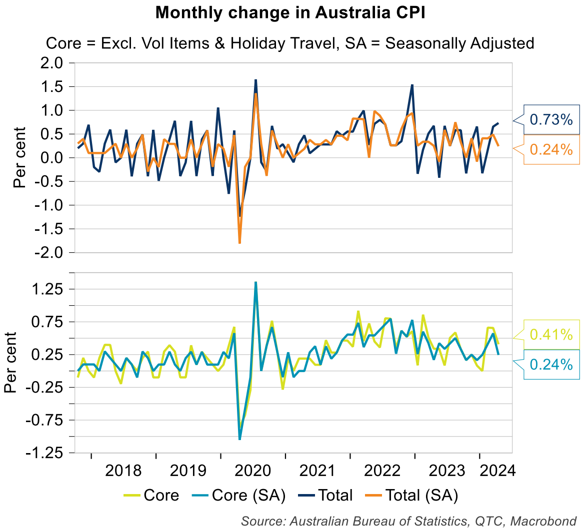


CHART 2: WAGE GROWTH EASED IN Q1. MOST ECONOMISTS BELIEVE WE HAVE PASSED THE PEAK IN ANNUAL GROWTH.

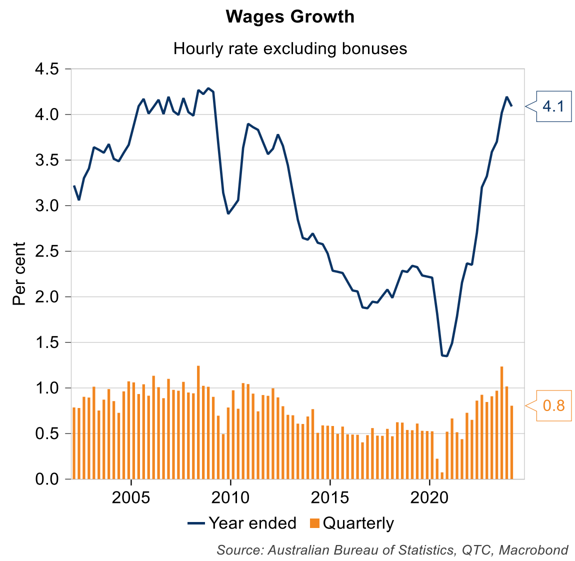
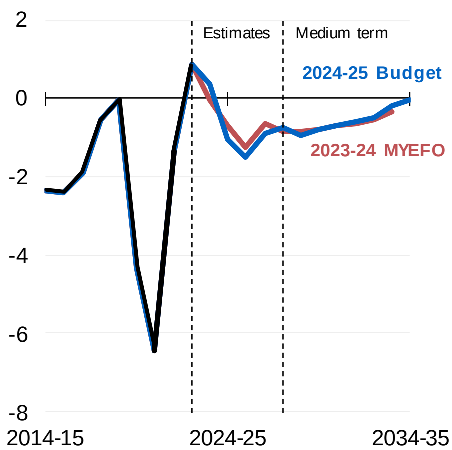


CHART 3: LOOKING BEYOND 2023-24, UNDERLYING CASH DEFICITS ARE EXPECTED TO PERSIST OVER THE NEXT DECADE



International economy

SUMMARY:

There were further signs of the orderly moderation of US economic activity continuing in June. The Whitehouse raised tariffs on imports of selected Chinese products, including electric vehicles where the production of these has been an area of strength for the Chinese economy. This is at odds with soft conditions in China's property market and in terms of household spending. Key central bank policy rates were kept on hold during the month with US monetary policymakers pushing back on the idea that further rate hikes would be needed.

REVIEW:

- In the US:
  - The US CPI report for April provided a small but welcome relief for the Federal Reserve. Core CPI rose 0.3 per cent in April, which saw annual inflation ease two-tenths to 3.6 per cent. The details of the report were encouraging, with primary rents reaching a 31-month low and new and used car prices declining.
  - US core retail sales were weaker than expected in April, declining by 0.3 per cent against consensus expectations for a 0.1 per cent increase. Headline spending remained unchanged, below consensus expectations for a moderate increase.
  - Non-farm payrolls increased by 175k in April, which was 65k lower than economists' expectations and the lowest outcome in six months. The unemployment rate edged higher and average hourly earnings increased at the slowest annual pace since May 2021.
  - The White House announced tariff hikes on a various goods imported from China, including electric vehicles, batteries, solar cells, chips, ship-to-shore cranes, and certain types of steel, aluminium, critical minerals and medical supplies. The tariff increases ranged from 25 to 100 per cent and will take effect in 2025 or 2026.
- In China, economic conditions remain patchy with ongoing weakness in household spending and the property sector being partly offset by a strong uplift manufacturing output. Retail sales growth eased to its slowest pace since December 2022 in April, while new home prices fell at their fastest annual pace in over nine years. China's fixed asset investment growth also slowed in April, largely reflecting slower infrastructure investment growth. In contrast, industrial production rose 6.7 per cent over the year to April, accelerating from 4.5 per cent in March. High-end manufacturing output has been particularly strong, with large increases in the production of electric vehicles.
- The S&P Global PMIs for May revealed that a pick-up in the rate of improvement in conditions across the manufacturing and services sectors in the US and euro area to the fastest rate since April 2022 and May 2023 respectively. In contrast, conditions in the UK's manufacturing sector improved at the fastest pace since June 2022 while those in the services sector eased from an 11-month high. This saw a decline in the composite measure across both sectors.
- In central bank news,
  - The monetary policymaking arm of the US Federal Reserve, the Federal Open Markets Committee (FOMC), kept rates steady at 5.25 per cent to 5.50 per cent. The post-meeting statement acknowledged a '*lack of further progress toward the Committee's 2% inflation target*' but noted risks to achieving employment and inflation goals '*have moved towards better balance over the past year*'.
  - In the post-meeting press conference, FOMC Chair Powell indicated that he sees current interest rate settings as sufficiently restrictive given the cooling off in labour demand and the softness in interest-sensitive spending. Furthermore, Powell considers that it is unlikely the next policy move will be a rate hike unless compelling evidence emerged that the current policy stance is not restrictive.

WHAT TO WATCH:

Incoming inflation and labour market data will be critical to get a sense of the timing and magnitude of the global monetary policy easing cycle. This has been delayed due to resilient readings on both in recent months. There are tentative signs beginning to emerge, including in the US, that things are starting to turn on these fronts.

CHART 4: US NON-FARM PAYROLLS POSTED ITS SMALLEST INCREASE SINCE OCTOBER 2023

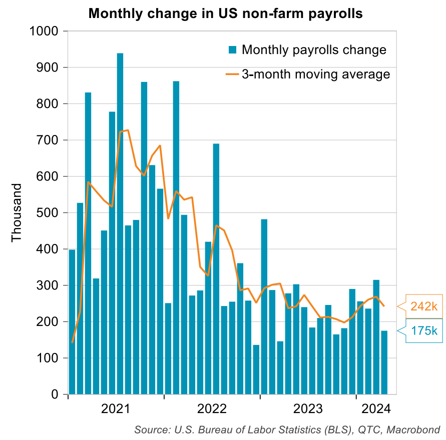


CHART 5: US AVERAGE HOURLY EARNINGS GROWTH EASED TO ITS SLOWEST PACE SINCE MAY 2021

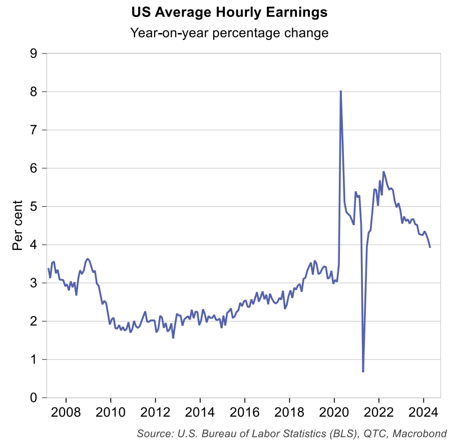


CHART 6: MANUFACTURING IN CHINA IS STRONG AT PRESENT, BUT THIS IS NOT THE CASE FOR PROPERTY