Highlights

- Economic indicators suggest the economy remains resurgent, which will quell the impact of the end of JobKeeper and HomeBuilder.
- Employment numbers indicate that employers have transitioned the bulk of workers receiving JobKeeper either into part time work or have let them go.
- Investor activity should keep housing related activity strong.
- The RBA updated their economic forecasts in the Statement on Monetary Policy for May.
- While the employment was significantly improved, the upgrades to growth and inflation were more muted.

Rates Recap

- There was a slight shift in rhetoric from the RBA towards increasing the cash rate prior to 2024.
- Resoundingly strong employment numbers are a key prompt in the shift.
- The lack of transmission to prices remains the barrier to a premature increase in the cash rate. So far there is no evidence prices have responded to the uplift in economic activity.
- The RBA will decide whether Yield Curve Control and Quantitative Easing will be extended in July, which will be the biggest factor effecting rates over the near term.

Key Market Moves

	Latest	1 Month Ago	Change
Cash Rate	0.10	0.10	0.00
3M BBSW	0.04	0.04	0.00
6M BBSW	0.11	0.09	0.02
1 Year Swap	0.07	0.08	-0.01
3 Year Swap	0.31	0.31	0.01
5 Year Swap	0.84	0.84	0.00
3 Year Futures	0.25	0.24	0.01
10 Year Futures	1.67	1.72	-0.05
AUD	0.78	0.76	0.02
ASX 200	7109	6995	114
US 2 year	0.15	0.15	-0.00
US 10 year	1.59	1.66	-0.07
US 30 year	2.31	2.33	-0.02
USD Index	90.28	92.16	-1.88
Dow Jones	34743	33801	942

Hot Economy Prompts Forecast Upgrades

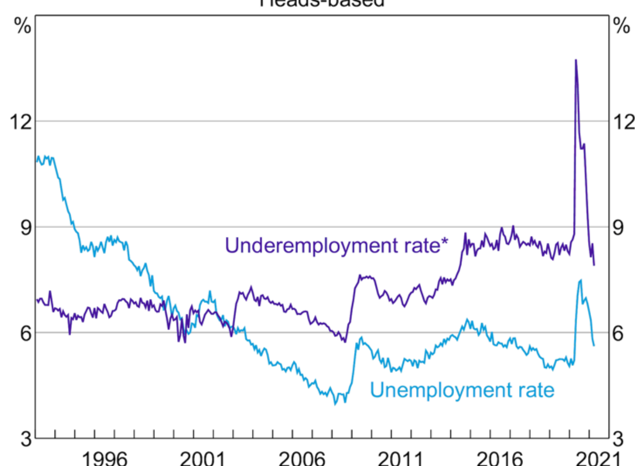
Economic indicators continue to show a resurgence in economic activity. It has prompted the RBA to upgrade their economic forecasts and fuelled more speculation about the cash rate rising sooner than expected.

March marked the end of JobKeeper and HomeBuilder, which had been supporting the economy since covid began. There has long been speculation these schemes would lead to a downturn in employment and housing activity; however, recent data updates suggest these fears will not eventuate.

Employment for March suggests employers have already transitioned much of their employees from the JobKeeper payment. Those employed but working zero hours fell from 106 000 to 61 000, which leaves it just higher than pre-Covid levels. This drop coincided with a rise in part time employment of 91 000 and a drop in full-time employment of around 20 000. The fall in full time employment and sharp rise in part time employment is contrasted to recent employment numbers which saw full time employment rise strongly and part time employment soften.

Labour Underutilisation Rates

Heads-based



* Full-time workers on reduced hours for economic reasons and part-time workers who would like, and are available, to work more hours

Source: ABS

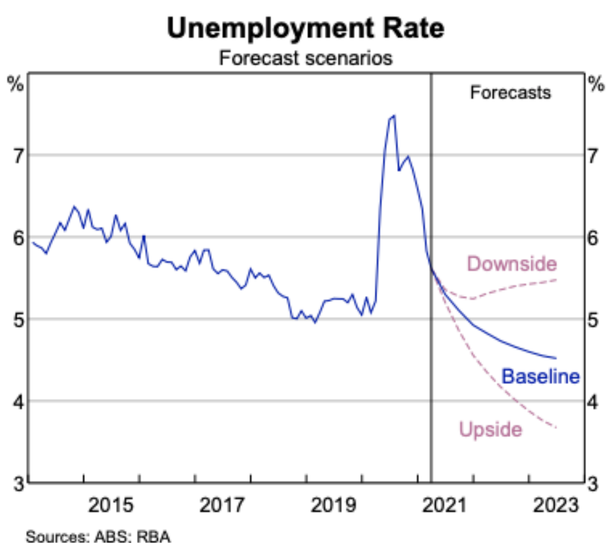
The numbers can be interpreted as a large portion of JobKeeper recipients being transitioned to part time employment rather than being let go. Although there is evidence of people losing their jobs with the fall in full time employment. Given job ads were up again over April by 4.7% and extremely positive employment index figures in business surveys, unemployment is expected to continue its decline beyond this month.

Similar to the end of JobKeeper, the end of Homebuilder was expected to have a marked effect on housing activity. Recent numbers suggest dwelling approvals will be the only indicator to decline, due to the shift in housing activity to investors rather than owner occupiers. For two consecutive months, investors have led finance approvals, with investor loans up an astounding 12.7% for the month. Overall housing finance approvals are now up 55% on last year.

The shift to investor activity is significant, as first home buyers and owner occupiers had been spurring housing activity. It was speculated this was due to HomeBuilder. With investors now active in the market, they should continue to spur activity over the next few months. House prices are already up 7.5% in 2021 and credit growth recorded a 0.4% rise in March. Dwelling approvals though are expected to be hit in April. They are 63.6% higher than last year, so the end of HomeBuilder should prompt a sharp fall.

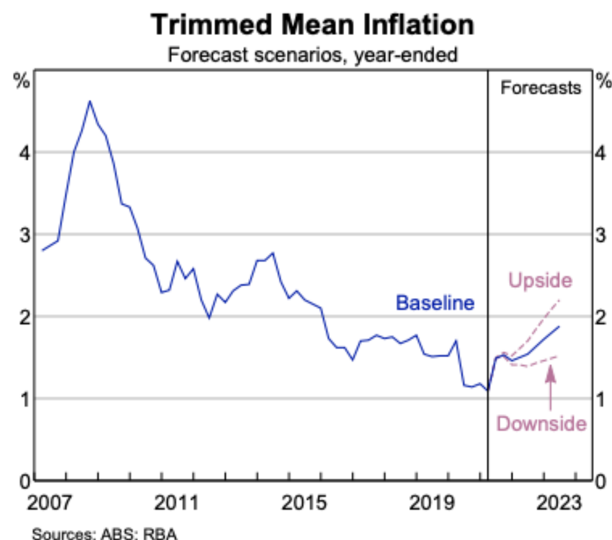
The resurgent economy has prompted the RBA to upgrade their economic forecasts in their latest quarterly Statement on Monetary Policy. In particular their outlook for employment has been drastically improved.

In February's statement, the upside scenario had unemployment at 4.75% by the end of 2022. Now the base scenario has unemployment at 4.5% by this time. In addition, unemployment is now expected to be 5% by the end of the year and 4.5% by June 2023, upgraded from February's forecast of 6% and 5.25% respectively. The upside scenario has unemployment at 4.5% by the end of the year and 3.75% by June 2023.

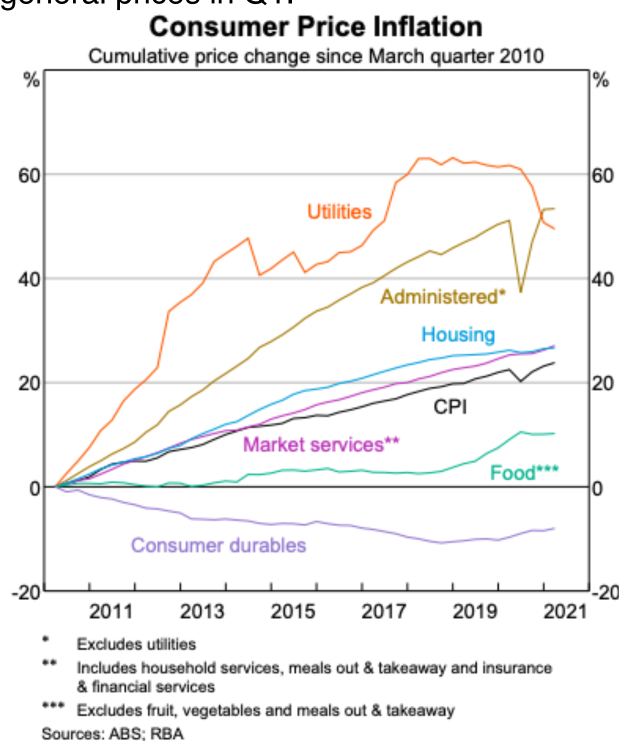


Growth and inflation on the other hand are only slightly improved. Annual output is expected to reach lofty levels by the middle of the year, with 9.25% forecast for GDP by June 2021. This is expected to fall back to 4% by June 2022 and 3% by June 2023. This is slightly higher than the February forecasts.

Inflation forecasts were improved only slightly. After an expected 3.25% rise in Q2, inflation is expected to fall back to 1.5% by December 2022, before increasing to 2% by June 2023. Apart from Q2 this year, the trimmed mean is expected to largely follow the headline number. Also, the upside scenario for inflation shows only a slightly higher inflation number, with trimmed mean inflation only 0.25% points higher in mid 2023.



The slight upward adjustments followed underwhelming Q1 inflation. Inflation was expected to rise 0.9% but instead rose 0.5%. Apart from a temporary spike in annual inflation expected next quarter as the Covid lows drop out of the annual figure, expectations for inflation remain subdued. HomeBuilder grants completely offset rises in other housing prices in Q1 and is expected to lag on prices due to an extension in April of 12 months for when construction can begin. Apart from fuel prices and health costs, there was no other suggestion of an uplift in general prices in Q1.



Outlook for Interest Rates

The lack of transmission of a low unemployment rate to wages and inflation is the primary reason the RBA have stuck to their outlook of the cash rate not rising until 2024 at the earliest. This outlook is in spite of the RBA's emphasis on unemployment in determining their decisions, which pre-Covid was highlighted far less. In a speech last week, Debelle said the RBA will not increase the cash rate until there is a *'lower unemployment rate and a return to a tight labour market'*. So a low unemployment rate is a necessary but not a sufficient condition to increase the cash rate.

There is very little evidence of economic activity leading to a rise in the overall price level currently. This is not necessarily surprising, given inflation tends to lag the economy. It is for this very reason that the RBA before Covid used forecast inflation to determine their policy decisions rather than actual inflation. Because the RBA will wait for actual inflation to hit the target band then the RBA will be slower to increase the cash rate than usual.

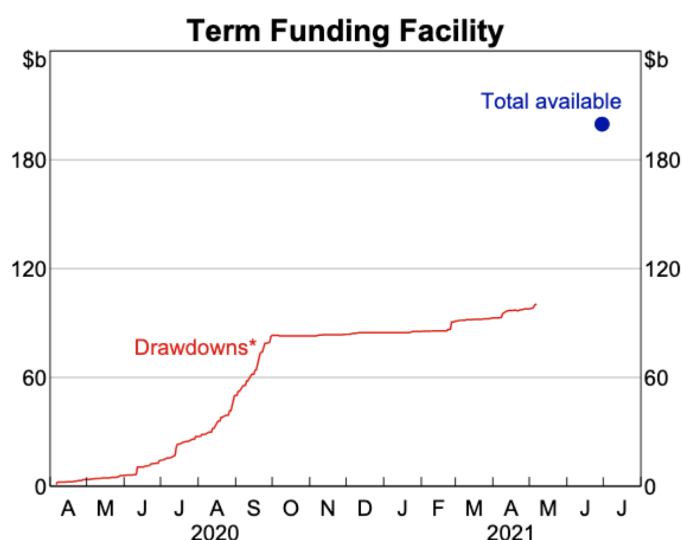
Over the past month though, there was a subtle change in rhetoric that suggests the RBA are at least cognisant that they may have to move earlier than expected. In the Policy decision for May, the RBA said of the cash rate rising that they consider it *'unlikely to be until 2024 at the earliest'*. This is different wording to prior statements, which stated that *'the Board does not expect these conditions to be met until 2024 at the earliest'.* Some analysts have interpreted the change in wording as enabling the RBA to change its opinion should economic conditions improve faster than expected.

In addition, Debelle spoke last week and said the key for the cash rate to rise is *'the state of the economy… not the calendar'.* Again, this emphasises the RBA can change their opinion should economic conditions dictate.

It is a far cry from imminent rate hikes though, not least because yield curve control (YCC) and QE need to be unwound first. The RBA confirmed they will decide whether to extend YCC and QE in July. Market pricing still indicates the yield curve target is expected to end, with the November 2024 government bond trading at a yield above 0.30%. This fell following the underwhelming Q1 CPI data, but only slightly. Whether QE will be extended is less clear, but analysts suggest it will be extended.

The decision on both will be consequential for rates. Should both be unwound, then it paves the way to potentially raise the cash rate before 2024. If one or both are extended then the cash rate going up will not even be considered, likely until the rest of the year.

Independent of the RBA's decisions though, downward pressure on rates will remain. Debelle in his speech referenced the large



amounts of TFF still to be drawn down by ADIs. His view was the TFF *'will continue to provide low-cost funding to the banking system and keep downward pressure on borrowing rates for businesses and households throughout the next three years until the funds are repaid'*. Add to this the RBA still have some $80 billion of bond purchases remaining and the prospect for further purchases.

The end of the TFF should result in an uptick in rates. But how much higher and how quickly this will occur is unclear. It is difficult to imagine rates being lower at the end of the year than they will be over the next few months unless the RBA throw a spanner in their policy. But unless there is a premature increase in the cash rate, it is hard to see rates drastically higher. A sooner than expected increase in the cash rate will be subject to transmission to prices, but there is no evidence of this yet.

Australian Economic Insights

- **Growth** in Australia continues to rebound into the end of the year positing a second consecutive increase above 3% in the Q4. The recovery in growth continues to be driven by consumption, which was also the hardest hit component of growth during the Covid downturn. GDP is expected to return to pre-Covid levels by the middle of the year and grow by 3 ½ per cent in 2021 and 2022.
- **Inflation** underwhelmed in Q1, up only 0.6% when 0.9% was expected. It leaves the annual rate at 1.1%, which will spike next quarter as the drop over Q2 last year induced by Covid is removed from the annual figure. HomeBuilder grants over Q1 contributed to subdued Q1 prices and is expected to wane on the index for some time as grants are received as projects begin.
- March **employment** numbers seemed to be heavily impacted by the end of JobKeeper. Employment overall was still strong, with 35 000 jobs added. However, in contrast to recent months, the gains were driven by part time employment, which was up over 91 000 jobs. Full time jobs on the other hand were down 20 000. It seems that employers, in anticipation of the end of JobKeeper, shed part of their staff but also kept a lot on in part time work. Those working zero hours but still employed fell to 61 000 from 107 000, which leaves it just above pre-Covid levels.
- **ANZ Job ads** rose for an eleventh straight month, up 4.7% in April. This leaves them significantly higher than pre Covid levels at 27.8% above last year. Job ads are a leading variable for employment, so will be relevant to seeing whether the RBA's revised employment forecasts are likely to under or overshoot.
- **Business confidence and conditions** for April broke the new records from March. Conditions are at 32 from 24 in March and confidence is at 26 up from 17 in March, which is staggeringly high. The employment index again improved, up to 22, which bodes well for minimising the impact of the end of JobKeeper. Evidence of prices increasing remains minimal though.
- **Consumer confidence** continues to defy expectations, up 6.2% to 118.8, which is the highest level in eleven years. The unemployment index did rise though, which may be due to the end of JobKeeper. Time to buy a dwelling was also down 7.9%, which likely reflects the recent run up in house prices.
- **Retail sales** remain strong, up another 1.3% over March. This leaves them still at elevated levels compared to pre Covid.
- **Housing finance** approvals recovered over March, up 5.5% after a fall of 0.4% in February. Investor loans again led the gains, up 12.7%, the highest in 18 years. Investor loans are now up 54.3% on last year and owner occupied up 55.6%. Investor led growth in new loans may offset the impact of the end of HomeBuilder grants.
- Australia's **trade surplus** declined for a second consecutive month, down by $2 billion to $5.6 billion. Imports were up 4.3%, with the Easter period seemingly spurring demand. Exports on the other hand were down 1.7%. Gold exports were down 25% and coal down 11%, with the latter affected by flooding in NSW.

- The end of the HomeBuilder contributed to a 17.4% rise in **dwelling approvals** for March. Detached houses, which have led the high approval rates, were up only 0.1%, whereas unit approvals were up an astounding 63.6%. Sharp falls should be expected now HomeBuilder has ended.

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