MNI RBA Preview - March 2023

Meeting Date: Tuesday 7 March 2023

Announcement Time: 14:30 AEST / 03:30 GMT

Link To Statement: https://www.rba.gov.au/monetary-policy/int-rate-decisions/2023/

Contents

- **Page 1-2:** MNI POV (Point Of View): 25bp In March, Guidance The Focus
- **Page 3:** Pre-Meeting RBA Dated OIS Pricing
- **Page 4:** RBA 7 February 2023 Meeting Statement
- **Page 5:** MNI RBA WATCH: 25bp Hike But Statement In Focus As Data Slows
- **Page 6-9:** Sell-Side Analyst Views

MNI POV (Point Of View): 25bp In March, Guidance The Focus

The RBA is widely expected to hike rates a further 25bp to 3.6% bringing the cumulative tightening this cycle to 350bp. The tone of the February statement was more hawkish with increased concerns regarding high inflation and stating that “further increases in interest rates will be needed” – plural. The Board’s inflation concerns were reiterated by Governor Lowe following the meeting, and in the minutes, but he said it was “unclear” how much further rates needed to rise. The disappointing data since the February meeting are highly unlikely to derail tightening in March and given elevated inflation the RBA is unlikely to change its mind about “increases”. Given the clear softening though, each decision from now will be even more data dependent than before.

As the Board is unlikely to surprise in March, the focus is going to be on the statement. It is probable that the softer activity and wages data will be acknowledged but also probable that the sentences regarding inflation concerns will be unchanged. The tightening bias is also likely to stay, as inflation is still “too high” and the labour market very tight, any change is likely to coincide with updated forecasts. The question though is whether the tone will be softened to December’s “the Board expects to increase interest rates further over the period ahead but is not on a pre-set course” from February’s “expects that further increases in interest rates will be needed over the months ahead”. The former keeps options open while reintroducing the possibility of a pause. There should also be more clarification when Governor Lowe speaks on March 8 and the minutes are published on March 21.

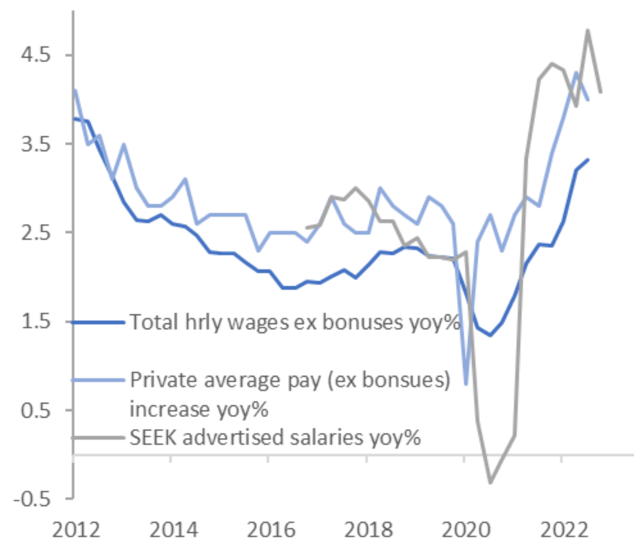
Q4 wages rose 3.3% y/y below the RBA’s 3.5% forecast but private sector wage increases received were still at 4%. SEEK advertised salaries also moderated to 4.4% y/y in January from 4.6%. Australia’s sticky multi-year bargaining system may be working in the RBA’s favour, which is likely to be a relief but it is still early days with changes to the bargaining system being implemented early this year. The Board is reassured that increases agreed for 2024 tend to be lower than for 2023. There are also early signs that tightness in the labour market is easing but special factors related to people taking time off between jobs in the summer have distorted the data. The February jobs data on March 16 should provide more insight.

Q4 CPI showed that inflation was “too high” at 7.8% but that domestically-driven price pressures were rising. This prompted the Board to state that it was concerned about inflation becoming “entrenched”. Apart from the wages data, there has been very little to alter this view. Governor Lowe told the Senate Economics Committee that high inflation is “damaging” and “dangerous” and the latest GDP data showed that high inflation weighed on Q4 domestic expenditure volumes.

Q4 inflation was elevated going into Q1 2023. The January data has tentatively signalled that Q4 2022 was the peak. January CPI data moderated more than expected to 7.4% y/y from 8.4%, but this series is still untested and the first month of the quarter has updates for only 62% of the basket with the rest being carried over from the

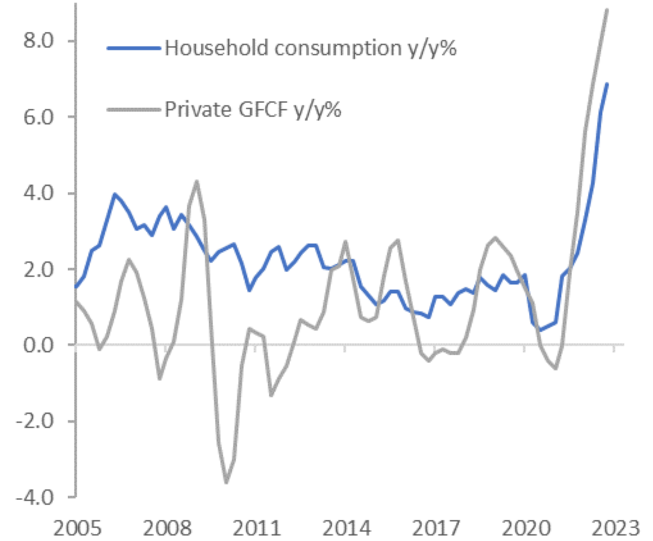
previous month, including utilities and restaurant meals, which have been rising. The January/February average of the Melbourne Institute's inflation gauge is currently at 6% y/y up from Q4's 5.7%. But MI consumer inflation expectations eased in February to 5.1%, the lowest since May 2022. They have been struggling to break through 5% but consumers seem to have faith that the RBA's tightening will bring inflation down. At this point it is difficult to determine if inflation has peaked but the RBA believes that it has.

Figure 1: Wages growth y/y%



Source: Source: MNI – Market News/ABS/SEEK

Figure 2: Implicit price deflators y/y%



Source: MNI – Market News/ABS

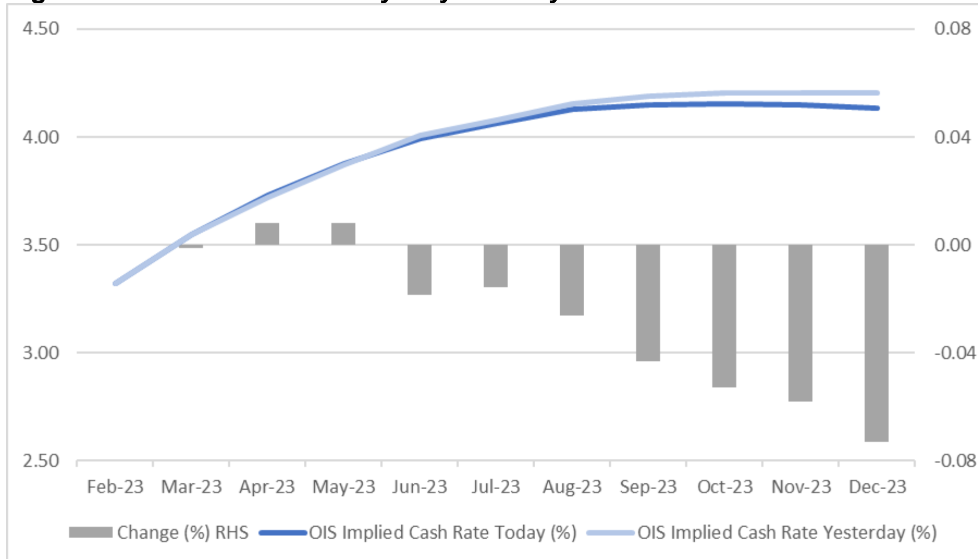
Activity data has generally been softer than expected but survey data has been improving. Q4 GDP showed that domestic demand didn't grow at the end of 2022, growth was due to the external sector and the savings rate dipped sharply. GDP rose 0.5% q/q and 2.7% y/y – in line with the RBA's forecast. This is concerning going into 2023 but it should also be a relief to the RBA that demand has eased and is moving more in line with supply. The house price correction paused in February, but lending and activity data still point to a significant slowdown in the sector. Retail sales have been volatile but January was in line with September's level, indicating that there hasn't been any growth since then. But February PMIs improved across the board indicating that growth may trough towards mid-year. Also, NAB January business conditions and confidence rose to more solid levels and employment intentions remained robust and the price/cost components ticked up.

The overall picture is of an economy with inflation that is "too high" but that demand pressures are easing, and while the labour market remains tight wage pressures are contained. This view is highly unlikely to prevent the RBA going back on its forward guidance of "further increases" in rates on March 7 and so 25bp is expected. The central bank's 3% inflation forecast by mid-2025 assumed a 3.75% cash rate, implying at least two more 25bp hikes. The question has always been whether the post-March move would wait until after the Q1 CPI data on April 26. The February statement signalled that it wouldn't but the downward shift in the data is likely to make RBA decisions even more dependent on the "incoming data". Before the April meeting there is February employment, retail sales and CPI plus the usual surveys. The Board will have Q1 CPI for the May meeting and Q1 wages for June, whether inflation has become "entrenched" should be clearer by mid-year.

Pre-Meeting RBA Dated OIS Pricing

A 25bp hike from the RBA is almost a lock according to RBA-dated OIS with the market pricing a 92% chance. Beyond the March meeting, however, the market is less certain with a 72% chance of a 25bp hike in April priced and a cumulative 33bp of tightening priced by May. At the core of this uncertainty is the possibility that the RBA could change its policy guidance in the all-important last paragraph in response to the recent data.

Figure 3: RBA dated OIS today vs yesterday

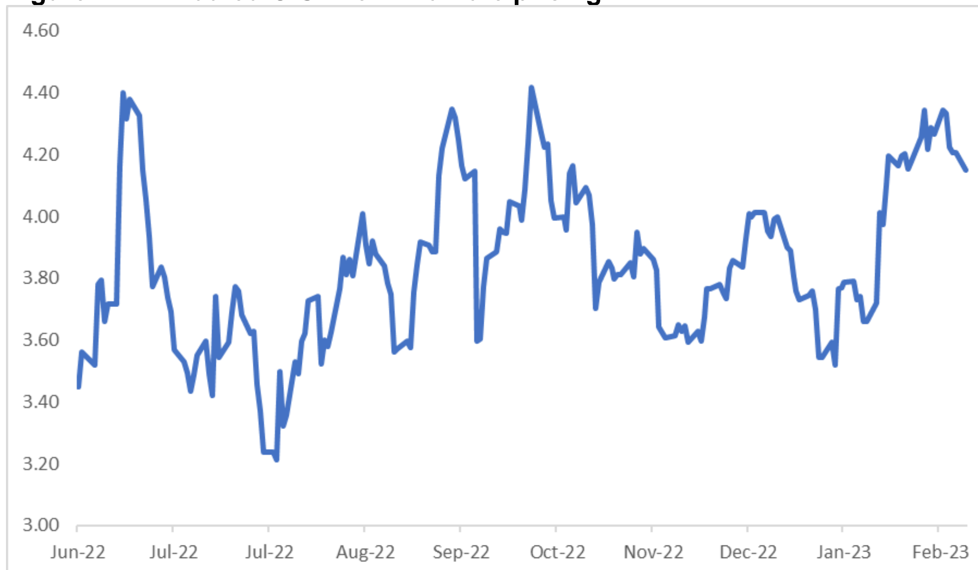


Source: Bloomberg / MNI - Market News

Looking beyond May, it has been a wild ride for terminal rate pricing since the February RBA meeting, with the market moving from a pre-RBA level of around 3.72% to a high of 4.35%, just shy of its cycle high of 4.42% (Oct-22), before moving back to its current level around 4.15%.

Also, of note since the February meeting has been the pricing out of virtually all chance of an easing this year. The day after the February meeting the market was pricing slightly more than a 50% chance of a 25bp easing this year. That has declined to a 12% chance currently.

Figure 4: RBA dated OIS – terminal rate pricing



Source: Bloomberg / MNI - Market News

RBA February 7 2023 Meeting Statement

At its meeting today, the Board decided to increase the cash rate target by 25 basis points to 3.35 per cent. It also increased the interest rate on Exchange Settlement balances by 25 basis points to 3.25 per cent.

Global inflation remains very high. It is, however, moderating in response to lower energy prices, the resolution of supply-chain problems and the tightening of monetary policy. It will be some time, though, before inflation is back to target rates. The outlook for the global economy remains subdued, with below average growth expected this year and next.

In Australia, CPI inflation over the year to the December quarter was 7.8 per cent, the highest since 1990. In underlying terms, inflation was 6.9 per cent, which was higher than expected. Global factors explain much of this high inflation, but strong domestic demand is adding to the inflationary pressures in a number of areas of the economy.

Inflation is expected to decline this year due to both global factors and slower growth in domestic demand. The central forecast is for CPI inflation to decline to 4¾ per cent this year and to around 3 per cent by mid-2025. Medium-term inflation expectations remain well anchored, and it is important that this remains the case.

The Australian economy grew strongly over 2022. The central forecast is little changed from three months ago, with GDP growth expected to slow to around 1½ per cent over 2023 and 2024. The recovery in spending on services following the lifting of COVID restrictions has largely run its course and the tighter financial conditions will constrain spending more broadly.

The labour market remains very tight. The unemployment rate has been steady at around 3½ per cent over recent months, the lowest rate since 1974. Job vacancies and job ads are both at very high levels, but have declined a little recently. Many firms continue to experience difficulty hiring workers, although some report a recent easing in labour shortages. As economic growth slows, unemployment is expected to increase. The central forecast is for the unemployment rate to increase to 3¾ per cent by the end of this year and 4½ per cent by mid-2025.

Wages growth is continuing to pick up from the low rates of recent years and a further pick-up is expected due to the tight labour market and higher inflation. Given the importance of avoiding a prices-wages spiral, the Board will continue to pay close attention to both the evolution of labour costs and the price-setting behaviour of firms in the period ahead.

The Board recognises that monetary policy operates with a lag and that the full effect of the cumulative increase in interest rates is yet to be felt in mortgage payments. There is uncertainty around the timing and extent of the expected slowdown in household spending. Some households have substantial savings buffers, but others are experiencing a painful squeeze on their budgets due to higher interest rates and the increase in the cost of living. Household balance sheets are also being affected by the decline in housing prices. Another source of uncertainty is how the global economy responds to the large and rapid increase in interest rates around the world. These uncertainties mean that there are a range of potential scenarios for the Australian economy.

The Board's priority is to return inflation to target. High inflation makes life difficult for people and damages the functioning of the economy. And if high inflation were to become entrenched in people's expectations, it would be very costly to reduce later. The Board is seeking to return inflation to the 2–3 per cent range while keeping the economy on an even keel, but the path to achieving a soft landing remains a narrow one.

The Board expects that further increases in interest rates will be needed over the months ahead to ensure that inflation returns to target and that this period of high inflation is only temporary. In assessing how much further interest rates need to increase, the Board will be paying close attention to developments in the global economy, trends in household spending and the outlook for inflation and the labour market. The Board remains resolute in its determination to return inflation to target and will do what is necessary to achieve that.

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MNI RBA WATCH: 25bp Hike But Statement In Focus As Data Slows

By Robert Guy

(MNI) Perth - The Reserve Bank of Australia is expected to hike rates 25 basis points to an almost 11-year high on Tuesday as inflation remains well above target, though softer-than-expected price and growth data will ensure a sharp focus on any tweaks to February's hawkish tone.

The rise in the Cash Rate to 3.6%, the highest since June 2012, will underscore the hawkish shift revealed at the February meeting as it struggles to steer inflation back to the 2-3% target despite 325bp of cumulative tightening over nine meetings since May 2022. Overnight indexed swaps have largely priced in a fifth consecutive 25bp hike. (See MNI RBA WATCH: Hawkish Shift Puts 25bps On Table In March)

Since adopting a more hawkish tone in February, data over the past week has highlighted both slower growth and a waning of inflationary pressures. Attention will focus on whether the statement reiterates language adopted in February that guided towards more rate hikes "over the months ahead" compared to "over the period ahead" in December.

Coupled with continued housing market weakness, the softer data has prompted traders to pull back pricing on the RBA's peak rate. Overnight indexed swaps point to a peak of around 4.2% later this year, from 4.4% priced in earlier in the week.

January's monthly Consumer Price Index, released on Wednesday, eased to 7.4% y/y from 8.4% y/y, confirming the RBA's view that it likely peaked in Q4. However, inflation remains far too high, with the February Statement on Monetary Policy forecasting a fall to only 4.75% by the end of the year and a return to the top end of the target range by mid-2025.

SOFTER GROWTH

Fourth-quarter GDP, also released Wednesday, disappointed as well, with an increase of 0.5% q/q, the second straight quarter of slower growth as higher rates and elevated inflation weigh on consumers. Household spending rose 0.3%, the weakest quarterly rise since Q3 2021, with discretionary spending slowing to 0.4%, almost in line with essential spending growth of 0.3%. The year-on-year GDP rise of 2.7% matched RBA forecasts.

However, the GDP data underscored the RBA's inflation problem. The domestic final demand implicit price deflator rose 1.4% q/q and 6.6% y/y, the largest year-on-year increase since Q1 1990, and services inflation remained strong amid a tight jobs market. RBA Governor Philip Lowe has been concerned about risks of a wage-price spiral, but recent pay data has fallen short of expectations. The Wage Price Index rose 3.3% y/y in Q4, a modest increase over the 3.2% y/y pace in Q2.

Further insight into the RBA's thinking will come on Wednesday when Governor Lowe delivers a keynote speech at a high profile business summit.

Sell-Side Analyst Views

ANZ (+25bp):

- The Q4 national accounts showed activity, prices and wages were more subdued than we expected. GDP details suggest the economy was already slowing under the weight of higher prices and interest rates in late 2022.The benign wages outcome was particularly surprising. Annual growth in average non-farm earnings per hour (the RBA's preferred measure of broader labour costs) was reported at just 2.9%. The RBA, who make some adjustments to the ABS data, subsequently reported this number as an even lower 2.5%. That's almost half the 4.7% y/y growth the Bank forecast in its February Statement on Monetary Policy. While this low outcome is somewhat consistent with the moderation in quarterly growth in the Wage Price Index, it's at odds with business surveys, the RBA's own business liaison, and measure of labour market tightness.
- While the weak wages result raises the risk the RBA may feel able to pause in its tightening cycle earlier than we currently think, we still expect another 25bp hike at the March board meeting. The monthly CPI showed that inflationary pressures remain strong, albeit with signs of moderation. The nascent recovery in housing prices would suggest that rate hikes have not yet quelled demand enough to be confident that inflation will move back into the target band in a reasonable time frame. Global indicators have been almost uniformly strong.
- We'll be watching the post-meeting statement for the RBA's take on the wages data. It will be difficult for the March statement to repeat the comments from last month: Wages growth is continuing to pick up from the low rates of recent years and a further pick-up is expected due to the tight labour market and higher inflation. The Board's interpretation of the wages data will give us a guide on what might be ahead.

Bank of America (+25bp): There are early signs of the economy softening, however the labour market is still strong. We expect the labour market resilience is likely to keep the RBA on its hiking path and we expect it to hike by 25bps in its March meeting.

Barclays (+25bp): The hawkish turn at the February meeting suggests that the RBA will hike at this meeting by 25bp, despite the downside surprise in growth last week. However, we expect the bank to flag the risks around household consumption, which has started to decrease, especially with the savings rate also having dropped below pre-COVID levels.

CBA (+25bp): We expect the RBA to raise the cash rate at the March Board meeting by 25bp to 3.60%. We consider the risk of any other move to be immaterial.

- The focus will be on the Governor's Statement – a hiking bias and hawkish tone will be retained.
- Key domestic economic data over the past month has largely printed softer than consensus and RBA expectations, but the Board is unlikely to change their tone or assessment on the economic outlook just yet.
- That said, the Governor may soften the line a touch from the February Statement that "the Board expects further increases in interest rates will be needed over the months ahead". Specifically that line could be tweaked to, "the Board expects to increase interest rates further over the period ahead".
- The Governor will deliver a speech at the AFR Business Summit on Wednesday 8 March (8.55am AEDT) – the speech will fully flesh out the RBA's latest thoughts on the economic and monetary policy outlook.

Goldman Sachs (+25bp):

- Since February's meeting the macro data have been mixed, with local activity and inflation data generally surprising to the downside, but global data surprising to the upside. That said, the downside surprises in the local data have also been difficult to interpret given an unusual amount of post-COVID volatility in the December/January holiday period.
- On balance, while there are some signs the domestic data are slowing, the significant uncertainty around seasonal noise and ongoing hawkish developments offshore mean the RBA is likely to remain fairly hawkish in March. We expect the Board to raise the cash rate +25bp to 3.6% and reiterate that it "expects that further increases in interest rates will be needed over the months ahead." This would be consistent with our forecast for additional +25bp hikes in April/May to a terminal rate of 4.1%. We expect Governor

Lowe to highlight the RBA's focus on reducing inflation in his post-meeting speech on Wednesday, reiterating his view that not tightening rates high enough in the near term could risk even higher rates and a possible recession down the track.

- We are mindful that the RBA could hike by +25bp to 3.6% but switch to a more 'data dependent' forward guidance given the recent volatility in the labour and inflation data. Indeed, in his recent testimony before parliament Governor Lowe noted that another weak employment report could 'complicate the outlook' for rates. While this is not our base case, we see risks marginally skewed in this direction. We continue to put a low chance on a return to +50bp rate hikes (GSe: 10% probability), given the RBA has repeatedly noted its scheduled monthly meeting means it can hike in smaller increments compared to other central banks.
- Further ahead, we see risks in both directions around our terminal rate forecast for 4.1%, with upside risks from ongoing global inflation and rate hikes from peer central banks (putting downward pressure on the AUD) and downside risk from the domestic housing market. On balance, we see risks as skewed to a higher terminal rate, with the potential for a more elongated tightening cycle beyond May.

ING (+25bp): Following the larger-than-expected decline in January's inflation figures, coupled with a slowdown in GDP growth in the fourth quarter, we expect that the upcoming RBA meeting is going to be much more interesting than has been the case recently.

- Although the January inflation rate had dropped a full percentage point, inflation still stands at 7.4% year-on-year – way higher than the RBA will be comfortable with. The RBA will want to see confirmation of a downward trend in inflation, not just a reversal of seasonal spikes to even consider pausing its current 25 basis point per meeting tightening strategy.
- The softer-than-expected 4Q22 GDP number was encouraging but we would need to see confirmation from other data to conclude that a slowdown is underway, and of a sufficient magnitude to see inflation fall back within the RBA's 2-3% target range.

JP Morgan (+25bp): We look for the RBA to hike the cash rate 25bp to 3.60% at this week's decision.

- The leadership started the year in more hawkish fashion than it ended 2022. At the end of last year, the board had been entertaining a pause, and noted the "size and timing" of future increases would be data dependent. In February, though, reference to timing was dropped, suggesting a front-loading of remaining hikes, and a less certain terminal point.
- In combination with a relatively unchanged forecast set, the impression was that the recent CPI result had resulted in a loss of patience, and more myopic reaction function. Since then, however, data on wages, monthly CPI, the labour market and GDP have all landed softer than expected, showing evidence of policy traction.
- There is still some remaining conditionality in the guidance, which was amended from the board "expects to increase interest rates further" to expecting that further hikes "will be needed" given the data/outlook. The language in the March statement, and more so, Governor Lowe's speech the following day, will provide further colour on how recent data are being interpreted, and the degree of data dependence that decisions demonstrate near term.

Morgan Stanley (+25bp): We expect the RBA will hike the cash rate 25bp in March to 3.6%. Communication last month signalled multiple further hikes with reduced data dependence – a key focus will be on whether the messaging around "months" of further tightening is retained. We expect the RBA to hike through until May, reaching a 4.1% terminal rate.

NAB (+25bp): The RBA meets on Tuesday and a 25bp increase looks penned in. All analysts in the Bloomberg Survey look for a 25bp hike and markets are 88% priced. Of more interest will be the guidance.

- After including a pause in the list of options in December, a pause was off the table in February alongside the reassessment of the extent of the domestic inflation backdrop.
- The RBA's more hawkish rewrite last month implied at least two more hikes. With one of those hikes set to occur in March, all focus will be if this tone is repeated. If it is, then the RBA is set to hike in April and May.
- Markets currently price a peak of 4.2% by September but allow a very high chance of the RBA pausing in the next couple of months. Just 39bp are priced by April and 55bp by May.
- Given the run of data has been on the softer side, we doubt the RBA would want to pre-commit as heavily and we would expect a step back in language more akin to November and December when the Board

expected "to increase interest rates further over the period ahead". WPI and National Accounts showed a wages backdrop in Q4 that while far from benign, is not adding to worries of a price-wage spiral. Last week's GDP data also showed household consumption growth slowing, with growth of just 0.3% q/q.

- January Monthly CPI fell from 8.4% y/y to 7.4% and while supportive of NAB's and the RBA's expectation that inflation has peaked, will not do much to shift the RBA's assessment that further tightening is needed.
- NAB's view remains that the extent of inflation pressure, the still tight labour market, and the overall resilience of domestic demand continue to make the case for further hikes from the RBA. NAB continues to expect increases in March, April and May to 4.1%. Given the competing risks in the outlook, there is a strong case for an extended pause to assess the evolution of the incoming data.
- As well as the decision and Statement on Tuesday, Governor Lowe is delivering the Keynote at the AFR Business Summit on Wednesday morning. Key will be the extent to which Governor Lowe takes comfort in the softer-than-expected Q4 earnings updates and whether the evolving inflation picture merely supports their existing expectation that Q1 inflation will have eased from Q4 or whether it gives them more confidence in the outlook.

Societe Generale (+25bp): We expect the RBA to increase the cash rate target from 3.35% to 3.60% at its 7 March policy meeting, which would mark its fifth consecutive 'baby-step' hike of 25bp since October last year. Most market participants also seem to expect a 25bp hike at the March meeting.

- We believe that recent signs in the macroeconomic data, such as the decline in inflation, the rebound in unemployment rate, relatively lukewarm wages growth and the confirmation of consumption slowdown all support a 25bp hike in March. They also support our base scenario of a terminal policy rate at 3.85%, despite the financial market's more hawkish expectation on US Fed policy.
- The slowdown in consumption was finally confirmed by the 4Q22 GDP data, as qoq growth fell from 1.0% to 0.3%. The rather steep decline in the household savings rate from 7.1% to 4.5% suggests that the 'savings buffer' on consumption has mostly been used up. Note that policymakers have long worried about the consumption slowdown, which is partially a result of the RBA's ongoing tightening campaign.
- We believe that the recent macroeconomic indicators endorse the RBA's view that inflation will decline, and GDP growth will slow led by consumption in 2023. As a result, it would be natural to think that the RBA's own assumption of the terminal policy rate at 3.75% will materialise. We don't think that the RBA will follow the Fed if the Fed extends the rate-hike drive into the summer season. Note that the RBA has not explicitly considered the Fed policy as its driver of monetary policy of late.

Royal Bank of Canada (+25bp): We assume the bank will hike another 25bp in March (which is our call, and almost universally expected). The odds of no move are, in our view, vanishingly small, with a greater (but still very small) chance of a 50bp hike.

- Assuming the move is +25bp, the next thing markets will be looking for is whether the statement will repeat the line "further increases in interest rates will be needed over the months ahead". If it does, that would signal terminal at 4.10% or higher and prompt a bearish reaction in markets. If the line is moderated or made more ambiguous, (.e.g. in Dec: "The Board expects to increase interest rates further over the period ahead" or "we expect further tightening") then that signals at least the possibility of only one more, taking cash to a terminal of 3.85%. This would be taken bullishly by markets. In fact it is difficult to imagine a statement which doesn't elicit any market reaction.
- Either way, we expect some acknowledgement of the weakening evident in household consumption in Q4 amid a squeeze on incomes by rising interest payments and taxes. This may give the RBA scope to slant their language a little dovish, but we wouldn't expect them to signal an imminent pause. We also expect statements around the need to get inflation down will probably stay largely intact.

Scotia: Consensus unanimously expects the Reserve Bank of Australia to hike its cash rate target by another 25bps on Tuesday. Markets are a little less sure with almost 80% odds of a 25bps hike priced into futures markets.

- Key may be forward guidance albeit that the RBA is between forecast cycles and has already indicated that further hikes are ahead. Markets are pricing cumulative rate hikes of between ¾% and 1% from the present 3.35% target rate.
- The RBA had embraced somewhat of a more moderate bias toward the end of 2022 only to return with a further 25bps hike in February with a hawkish bias that followed hot inflation and wage readings. The dangers of prematurely halting hike cycles only to have to return with more later offer a common parallel between the RBA and the BoC.

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TD Securities (+25bp): The focus will be on whether the RBA softens its language in light of recent weaker data. On the back of the widening breadth and persistence of inflation, the cash rate in Australia remaining below comparable G10 economies, and the Australian economy more likely to benefit from China's reopening, we expect the RBA to push on with hikes in Apr and May.

Westpac (+25bp): We expect the Board will decide to lift the cash rate by a further 0.25% from 3.35% to 3.6%. Most interest will be in the guidance the Governor provides in his Statement announcing the decision.

- The issue will be whether the Board chooses to revert back to language that accommodates a possible pause in April or decides to confirm the guidance from February ("further increases in interest rates") with a statement like, "The Board expects to increase interest rates further over the period ahead." (The December statement without the "not on a pre-set path"). Such an approach would be consistent with the "further increases" wording in February.
- A further hike in April, which is Westpac's view, seems the logical extension of the February statement. But since the February Board meeting, we have seen downside surprises on both the Wage Price Index and economic activity. A sharp deterioration in productivity saw unit labour costs surge by 7% for the year – highlighting the risk from wages growth for inflation.
- In the Parliamentary hearings the RBA Governor attended recently he emphasised the importance of a steady policy approach. Having signalled multiple rate hikes at the February Board it seems that the prudent approach for the Board at the March meeting will be to remain consistent with that guidance while certainly not committing to a move in May. The best way to achieve that will be for the Governor to simply note that "The Board expects to increase interest rates over the period ahead." That will send a clear signal for April while keeping options open for May. Any policy change to take the recent data into account should be contemplated for May.
- National Accounts raise alarm bells about the household balance sheet. The national accounts that printed this week for the December quarter highlighted the risks associated with the narrow path. The household sector faced some extraordinary pressures during the December quarter. The fall in real wages contributed to a record (outside the volatile pandemic period) fall in real disposable income of 2.2%.
- We have lowered our already very modest forecasts for consumer spending growth from 1% to 0.7% in 2023 and 2% to 1.5% in 2024. Those adjustments see our GDP growth forecast hold at 1% for 2023 and trimmed to 1.5% for 2024 (marked down from 2%).
- Note that we have not changed our RBA call that the cash rate will peak at 4.1% in May while the easing cycle will begin in the March quarter 2024.