Outlook Q3 2024 & Quarterly review

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Economic Outlook Q3

The Reserve Bank of Australia (RBA) kept the official cash rate unchanged for the seventh straight month in June and signalled that it was more at risk of rising than falling. The persistence of inflation continues to be a major headache for the RBA with the pace of the decline in inflation stalling in recent months. If rate hikes are indeed on the horizon, the RBA needs a trigger and that would be a high June quarter CPI (due on July 31). The RBA Board next meets on August 5-6, so they have the luxury of time. Overseas, the Federal Reserve System (Fed) are yet to commence their easing cycle but the Bank of Canada and European Central Bank (ECB) have recently cut rates with inflation now back inside their respective target bands.

The RBA took a more hawkish turn at the June Board Meeting but this arguably just reverses the ill-timed dovish pivot they adopted in Q1. Net-net it seems we are now at a 'neutral' stance with the recent RBA messaging more an attempt at jawboning consumers and the market. The RBA believes economic risks are evenly balanced, however, there are some hawkish elements such as the positive revisions to household spending and the ongoing upside risks to services inflation. This points to an expected strengthening of the economy into H2 24.

As mentioned above, while the Q2 CPI release could open the door to an RBA rate hike, the trajectory of inflation readings into late 2024 remains interesting. Looking ahead to the Q3 CPI release (30 October) government rebates will subtract sharply from headline CPI. As the prior year's subsidies unwind, they are more than offset by the new state and federal subsidies. There is an approximate 0.5% subtraction off headline inflation which likely means CPI will end 2024 back in the RBA's 2-3% target band. However, as the temporary effects of the subsidies roll off in 2025, and assuming they aren't extended again, the headline CPI will likely rise back above 3% in 2025. Governor Michele Bullock's recent observation that "a lot needs to go our way if we want to get inflation back to the target" might not be as difficult as it first sounds.

Although GDP growth will remain below trend through H2 24 a pick-up is expected from the current 1.1% p.a. pace. Stage 3 tax cuts and cost of living relief measures will add about 1% of GDP through 24/25. An expected uptick in consumer spending, along with expected solid growth in public final demand and business investment should see a modest increase in growth in H2 24. Governor Bullock noted at the June meeting the RBA staff would provide refreshed forecasts in August.

The labour market is also showing signs of weakness, but it remains tighter than is consistent with sustained full -employment and inflation at target. However, there is some optimism with softer hours worked and job vacancies declining. The latest data on wages growth was also positive being described by the RBA as "slower-than-expected". Consumer sentiment remains 'exceptionally weak'[1]. Personal and investor housing credit growth remains sluggish[2].

We are still of the view the RBA will hold the cash rate at the current level for an extended period. Their commentary is consistent with a preference to remain on hold if possible, but allow for some near-term tightening risk given lack of progress towards their inflation target. While financial conditions in Australia are thought to be restrictive enough for households, the RBA is sounding a lot more cautious and less patient now, noting "the narrow path is getting narrower" and that "a lot needs to go our way [to prevent the cash rate from increasing again]". The key takeaways heading H224 are that the official cash rate is not going down anytime soon and when the easing cycle commences it will be gradual and shallow.

Credit Outlook Q3

Credit continued to perform well through Q2 as the high demand for credit assets was met with a wall of supply from issuers more than willing to sell debt at tight spreads and in large volume. The underlying theme of investors' chasing relatively high outright yields persisted. The primary volumes in the local fixed income market are running well ahead of last year's run-rate which has led to noticeable improvements in secondary liquidity.

The macro backdrop is still conducive for high quality fixed income – government bonds and investment grade credit. Bonds usually exhibit relatively strong total returns in the lead up to, and immediately after, central banks commence cutting rates. This is the benefit of owning duration in a portfolio as that is where most of the return is generated from. As we see in the current environment, spreads have largely done their work by contracting to tight levels vs government bonds, hence the contribution from spreads will be much lower as we move forward.

We expect Australian credit spreads to remain largely range bound over the next 3 months. We have already started to see some signs of de-risking, or trimming, by investors' who have clearly been overweight credit during H1 24 and this has seen spreads drift a little wider. We expect the economy to hold up reasonably well and there to be little downwards rating pressure in the near term. Investors can continue to pick up carry in a relatively benign macro-outlook with a soft landing being the baseline case.

In terms of risks to credit the obvious concerns are geopolitical risk and increasingly election risks. The recent snap parliamentary election in France hit risk sentiment hard and the US election is drawing ever closer.

Currency Outlook Q3

The AUD was marginally firmer through Q2 spending the majority of the quarter in a US$0.66-0.67 cent range[3]. With the RBA adopting a more hawkish and determined posture, the AUD should find a fairly supportive interest rate backdrop. In contrast, US Fed Chair Powell appears to have an asymmetric easing bias, declining to entertain rate hikes and repeatedly emphasizing the need for more time. Given the potential paths for the Australian and US cash rates, i.e. a narrowing, the AUD should increasingly find a more durable downside floor.

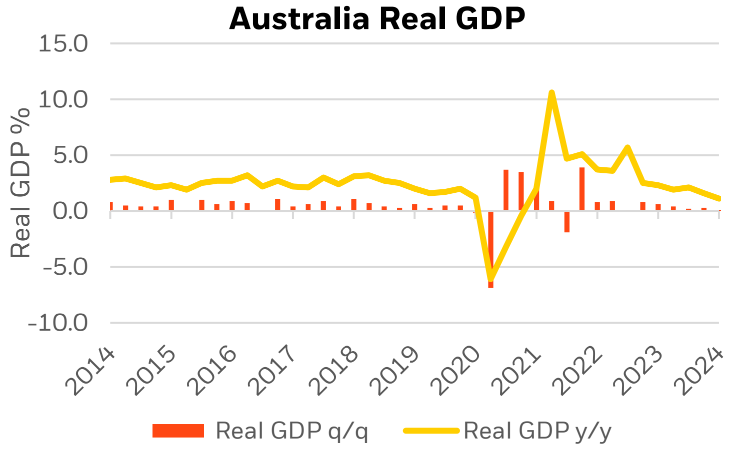
Iron ore prices have steadied to around US$100-110/t, however, China's economic recovery remains unbalanced, with steel mills and the property sector still struggling. The AUD remains sensitive to risk-off events like increasing US bond supply and weak Treasury auctions (and higher yields) sapping the AUD's bullish momentum. Pullbacks appear to be well supported around US$0.6480 level. Global geopolitical risks remain elevated, which is another reason to be somewhat cautious on the AUD.

Source: BlackRock as of 26/06/2024.
1. WBC 2. RBA 3. Bloomberg

GDP – Q1 2024

▲ QoQ GDP **grew 0.1%,** broadly **in line with** expectations.
▼ YoY GDP fell from **1.6%** to **1.1%**.

Australian Q1 2024 GDP rose +0.1% QoQ, the weakest quarter since Q3 2022. In per capita terms, GDP contracted by -0.4% QoQ /-1.3% YoY extending the per capita recession to 5 quarters. The weakness in growth reflected a broadening of the slowdown in the domestic economy beyond households and into investment, which also declined in Q1. Overall, growth is increasingly being supported by the public sector. Speaking just before the release of the data, RBA Governor Michele Bullock acknowledged that the economy was weak, but insisted that policy needed to be restrictive. We expect the governments supportive 2024-25 budget delivering cost of living relief and tax cuts to help boost consumption in H2 2024.

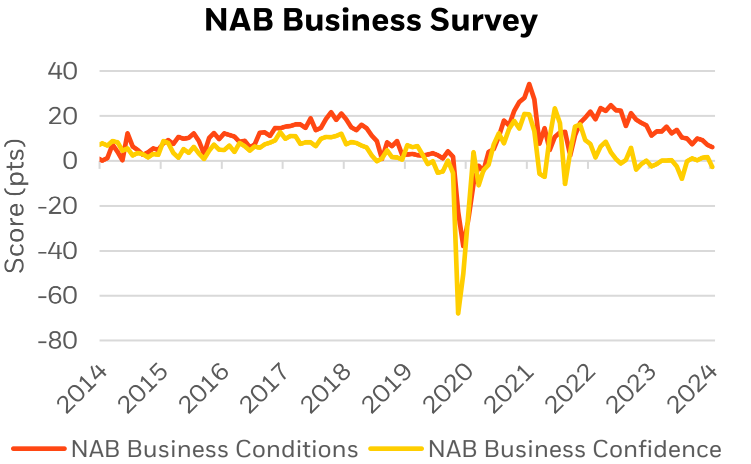


Source: ABS, Bloomberg, BlackRock as of 26/06/2024

Business Conditions – May 2024

▼ **Conditions fell by 1pt** from +7pts (April) to +6pts (May)
▼ **Confidence fell by 5pts** from +2pts (April) to -3pts (May)

In line with the slowdown in the economy, the May NAB business survey saw business conditions soften, moving just below the long-run average of +7pts. Trading conditions and profitability fell by 3pts each while the employment index rose 3pts to +5pts. Business confidence also remained weak and fell back into the negative. While forward orders rose by 1pt to -6pts, they continued to remain negative, particularly for retail, wholesale and construction. Capex fell 4pts to +4pts and capacity utilization rose to 83.3%, remaining above average suggesting that there continues to be an imbalance between supply and demand.

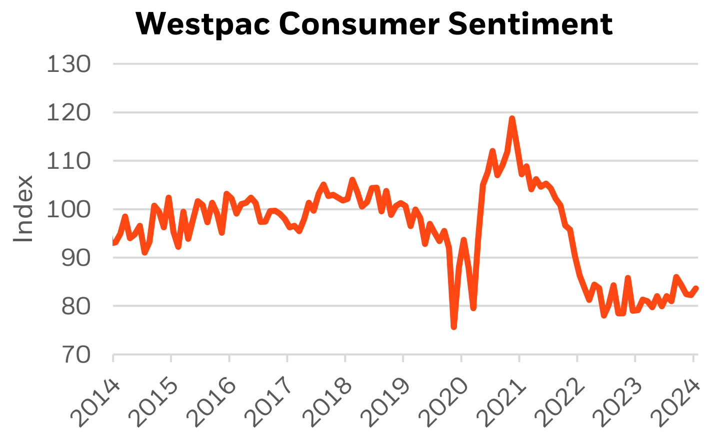


Source: NAB, Bloomberg, BlackRock as of 26/06/2024

Consumer Sentiment – June 2024

▲ The Westpac-M.I. Index of Consumer Sentiment **rose 1.7% MoM** from 82.2 in May to **83.6 in June**.

While consumer sentiment improved in June, rising by +1.7%, the index results remain pessimistic and well below the neutral level of 100. The sub-index tracking the 'economic outlook for the next 12 months' fell -5.7% MoM to 78.5, the lowest since October 2023. Of the 5 subcomponents of the consumer sentiment index, 'economic conditions next 5yrs' is the only one higher than its lifetime average at 94.1 vs 92.0. In comparison 'time to buy a major household item' is currently 44.7pts below its lifetime average of 124.4. The survey also indicates that the positive impacts of fiscal support measures are being counterbalanced by heightened worries about inflation and outlook for interest rates. 'Inflation' continues to dominate the news cycle, and this month 'budget & tax' also stood out.

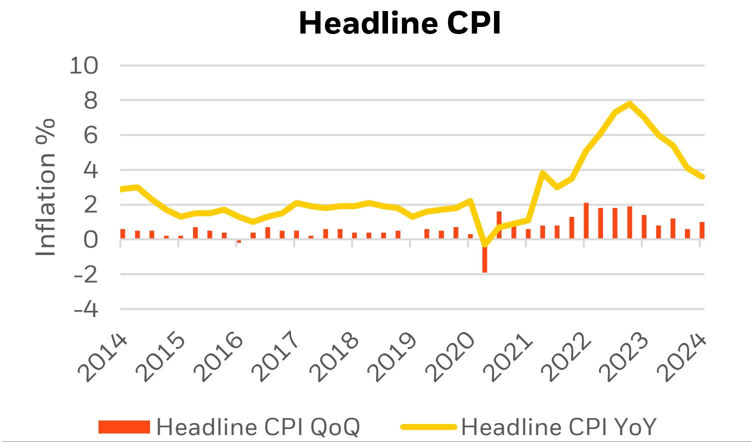


Source: Westpac, Bloomberg, BlackRock as of 26/06/2024

Inflation – Q1 2024

▲ Headline CPI **increased** by **1.0% QOQ** from 0.6%.
▼ Annual inflation **fell 0.5%** from to 4.1% to **3.6%**.

The annual pace of inflation declined to 3.6%, slightly higher than market expectations of 3.5% YoY. This marked the fifth consecutive quarter of lower annual inflation, down from the peak of 7.8% in the December 2022 quarter. A closely watched measure of core inflation, the trimmed mean, slowed to an annual pace of 4% against expectations of 3.8%. Key contributors to rising prices in Q1 were tertiary education (+6.5%), secondary education (+6.1%), medical and hospital services (+2.3%), and rents (+2.1%). Moderation in inflation was led by clothing and footwear (-1.1%), communication (-0.3%), furnishings, household equipment and services (-0.1%), and recreating and culture (-0.1%).



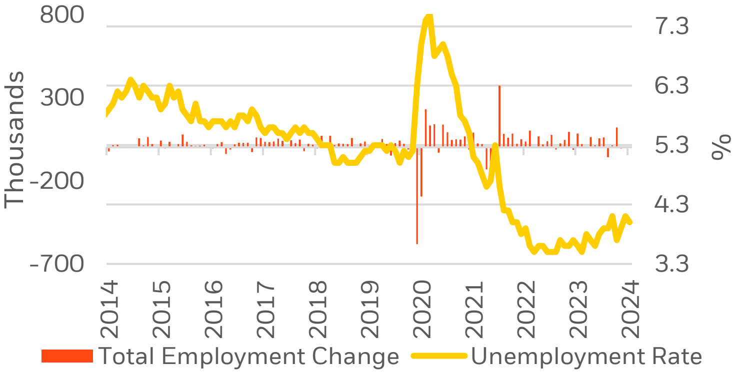
Source: ABS, Bloomberg, BlackRock as of 26/06/2024

Labour Market – May 2024

- ▲ Employment data saw 39,700 **new jobs gained**, above forecasts of 30,000.
- ▼ The unemployment rate **fell 0.1% MoM** from 4.1% to **4.0%**, in line with estimates.

Australian employment outpaced expectations in May, as net employment rose 39,700, above forecasts of 30,000, led by a jump in full-time employment. Employment growth was driven by full-time workers rising +26.2k, whilst part time increased by +12.5k. The unemployment rate also eased to 4.0%, while the participation rate remained steady at 66.7%. Whilst seasonal adjustment issues have made month to month data volatile, it appears that supply of labour (~38k per month) is stronger than demand for labour (~30k per month) leading to a gradual uptick in the unemployment rate.

Monthly Employment Change & Unemployment Rate



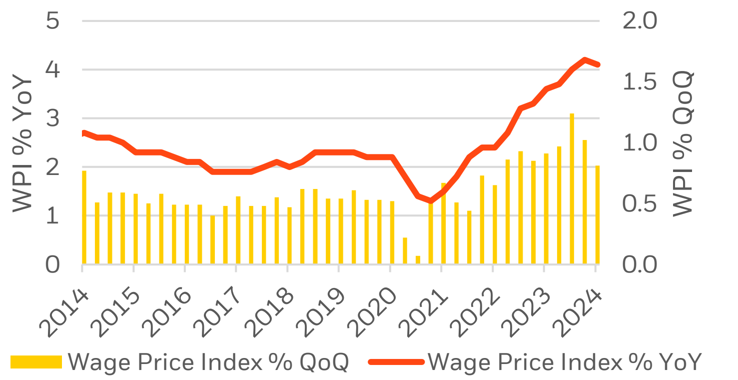
Source: ABS, Bloomberg, BlackRock as of 04/04//2024

Wage Price Index – Q1 2024

- ▲ Wages **increased by 0.8%** over Q1. This was **slightly below** the market consensus of 0.9%.
- ▼ Annual wage growth **fell 0.1%** to **4.1%**

In Q1, Australian Wage Price Index increased by 0.81% QoQ following an upwardly revised 1.02% increase in Q4 2023. This was the equal slowest rate since Q1 2022. The annual rate fell from 4.2% to 4.1%, 0.1% below the RBA's forecast. Private sector wages grew by 0.8% QoQ and 4.1% YoY. The public sector wages grew by a more modest 0.5% and 3.8% YoY, following a record high of 1.4% in Q4 2023. Fair Work commission (FWC) minimum wage increase for 2024-25 was set at 3.75%. Enterprise agreements had a smaller impact on overall wage growth compared to the same period last year. This is partly due to fewer new enterprise agreements being established this quarter.

Wage Price Index



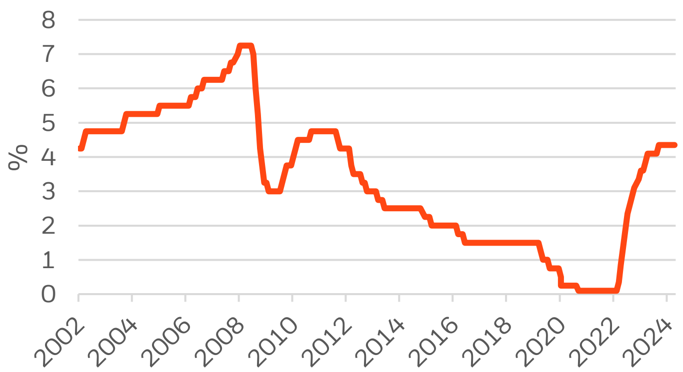
Source: ABS, Bloomberg, BlackRock as of 26/06/2024

RBA Policy Rate – June 2024

▶ The RBA left the cash rate **unchanged at 4.35%** during the quarter.

The RBA left cash rate unchanged at 4.35%, as widely expected. Given upside risks to inflation, the Board debated whether to raise rates, but decided to stay the course while signaling that further tightening is still possible. In the accompanying statement, the RBA emphasized the "need to remain vigilant" as recent data has been mixed, and that "a further increase in interest rates cannot be ruled out". The press conference that followed saw RBA Governor Bullock commenting that "a lot needs to go our way" to get inflation back to target. Despite the more hawkish stance, markets still imply that the chance of another rate hike is low as the bar for hikes remain high; but did pare back the probability of a December cut.

RBA Cash Rate Target

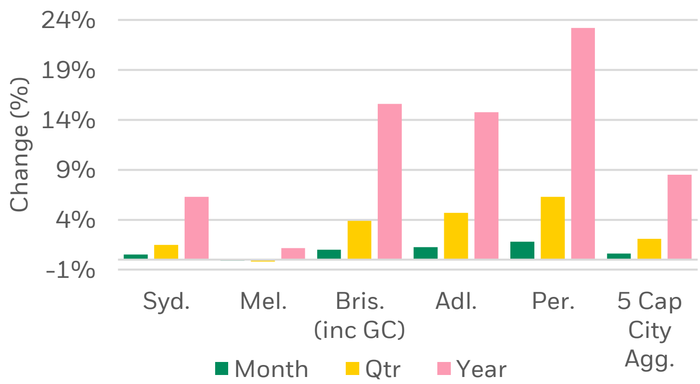


Source: RBA, Bloomberg, BlackRock as of 26/06/2024

House Prices – Q2 2024

- ▲ The CoreLogic national HVI **rose 2.1% in Q2**
- ▲ The CoreLogic national HVI **increased 8.5% over the year**

House prices in Q2 maintained their upward trajectory, but at a more moderate pace compared to mid-2023 wherein home values experienced a significant increase of 3.0% QoQ. Over the quarter there have been distinct variations in performance across different capital cities for both price growth and turnover with Melbourne (-0.2%) and Sydney (+1.5%) growing at a slower rate than Brisbane (+3.9%), Adelaide (+4.7%) and Perth (+6.3%). The availability of both 'on-market' and physical housing stock remains scarce. Dwelling prices are being supported by a supply and demand imbalance. Strong immigration has supported demand whilst supply remains challenged due to labour shortages, and material bottlenecks creating uncertain economic outcomes for property developers.



Source: CoreLogic, Bloomberg, BlackRock as of 26/06/2024

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