

Liquid Insight

RBA preview: Biding time

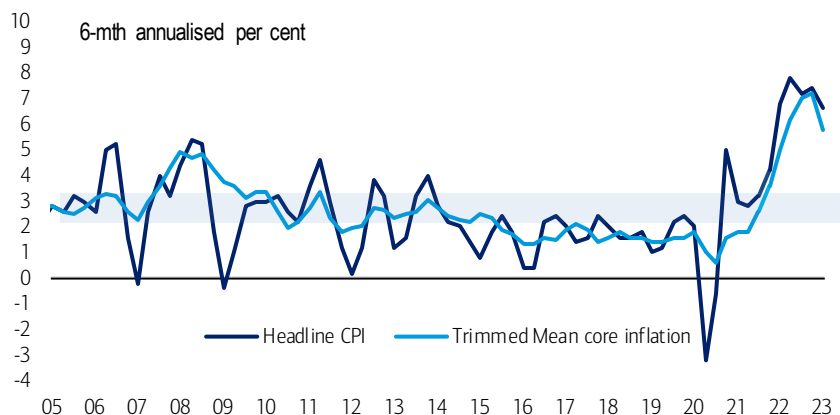
Key takeaways

- The 1Q CPI report confirmed that Australia's inflation peaked in 4Q22, with headline inflation slowing to 1.4% QoQ (7.0% YoY)
- Trimmed mean inflation, though still elevated, came in softer than expected at 1.2% QoQ, largely in line w/ the RBA's f'casts
- Given the RBA's reaction function, we think the bar for further hikes is high and continue to f'cast a pause at the 2 May mtg

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Chart of the day: Australia headline and trimmed mean core inflation

Inflation peaked in 4Q22 and is now decelerating



Source: Bloomberg, BofA Global Research

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1Q CPI “good enough” for a continued RBA pause

Australia's latest CPI report confirmed that inflation pressures had peaked in 4Q22, with headline inflation slowing to 7.0% YoY in 1Q23, from 7.8% in 4Q22. Meanwhile, trimmed mean inflation slowed to 6.6% YoY (1.2% QoQ), largely in line with the RBA's path implied by its projections in its February Statement on Monetary Policy (SMP).

Though still too high on an absolute basis, the latest CPI data should buy some time for the growth-sensitive RBA to assess the impact of its tightening. We continue to expect a hold at the Board meeting on 2 May, and think that the central bank will likely remain on an extended pause.

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Australia in focus

Australia's latest CPI report confirmed that inflation pressures had peaked in 4Q22, with headline inflation slowing to 7.0% YoY in 1Q23 (vs. consensus: 6.9%; BofAe: 7.0%; 4Q: 7.8%) (see [Chart of the day](#)). On a QoQ basis, headline inflation decelerated to 1.4% QoQ from 1.9% in 4Q, which was a touch higher than our and consensus expectations of 1.3%. The Australian Bureau of Statistics (ABS) noted that the quarterly rise is the lowest since December 2021.

Meanwhile, underlying inflation measures came in slightly weaker than our and consensus expectations as trimmed mean inflation rose 6.6% YoY (vs. consensus: 6.7%; BofAe: 6.7%; 4Q: 6.9%). The figure was largely in line with the path implied by the RBA's projections in its February Statement on Monetary Policy (SMP). On a sequential basis, trimmed mean inflation slowed from 1.7% QoQ in 4Q to 1.2% in 1Q (vs. consensus 1.4%; BofAe: 1.4%).

Goods disinflation offset by sticky services

Looking at the 1Q CPI on a more granular level, the picture is one of a sharper deceleration in goods while services inflation, although slowing sequentially, remains elevated (Exhibit 1).

Exhibit 1: Australia CPI: Goods vs. services QoQ growth

Services moderating slower than goods

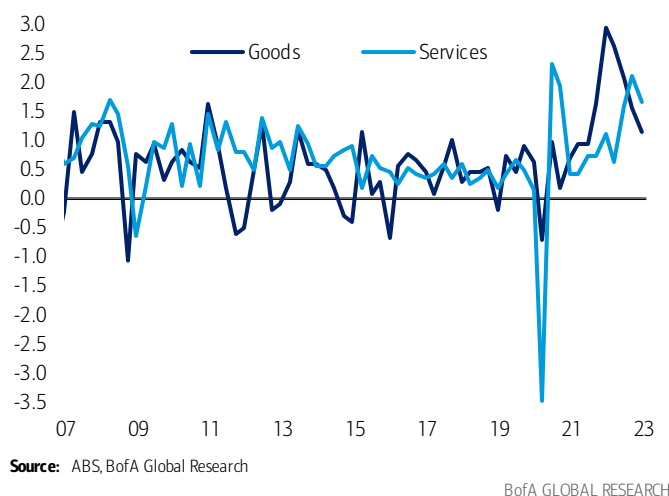
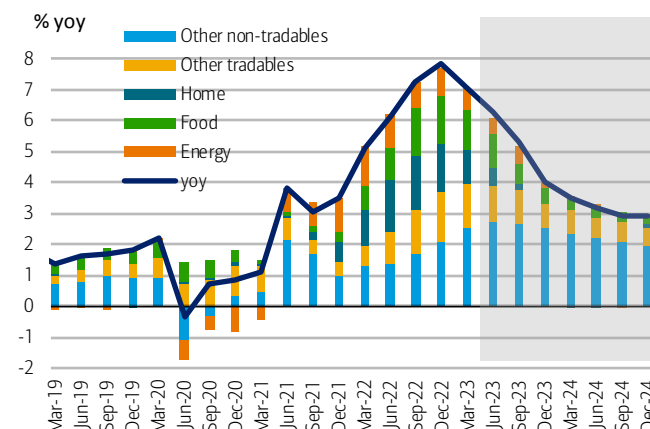


Exhibit 2: Contribution to AU headline CPI inflation & BofA forecasts (%YoY, ppt)

Slowing goods inflation should help drive headline inflation CPI in 2023, but elevated services inflation should make the RBA cautious about early cuts



In sequential terms, goods inflation slowed for the fourth quarter running, rising 1.2% QoQ in 1Q23 vs. 1.6% in 4Q22. On a YoY basis, goods inflation softened to 7.6% (vs. 9.5% in 4Q22). The slowdown was primarily driven by a fall in prices of furniture, household appliances, and clothing. Easing fuel costs (-0.8% QoQ) further dampened the pace of goods inflation.

Services inflation also decelerated on a sequential basis, rising 1.7% QoQ in 1Q23 vs. 2.1% in 4Q22. However, with six-month annualized momentum running at 7.6%, it still remains elevated. The most significant contribution to services inflation came on the back of medical and hospital services (4.2% QoQ), tertiary education (9.7% QoQ), and domestic holiday travel and accommodation (4.7% QoQ). Meanwhile, there was a sharp decline in international travel and accommodation (-8.2% QoQ) as the strong seasonal gains of 4Q22 were reversed.

Given that the 1Q CPI results were largely in line with our expectations, we keep our projections unchanged. Looking ahead, we expect price pressures to ease over 2023 and

see headline inflation slowing from 7.0% YoY in 1Q23 to 4.1% YoY in 4Q23 (Exhibit 2; Exhibit 3).

Exhibit 3: BofA AU forecasts vs consensus

%yoy, average

	2022	2023	2024
GDP	3.7	1.8	1.4
Consensus	3.7	1.7	1.6
Headline CPI	6.6	5.6	3.1
Consensus	6.6	5.5	3.1
Wage price index	2.8	3.7	3.3
Consensus	2.9	3.8	3.8
Unemployment rate	3.7	3.9	4.3
Consensus	3.7	3.8	4.4

Source: Bloomberg, BofA Global Research

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May RBA preview: We expect a continued pause

Though still too high on an absolute basis, we think the latest CPI data should buy some time for the growth-sensitive RBA to assess the impact of its tightening. We continue to expect a hold in May and an extended pause from the central bank (see our report [RBA review: Headed for an extended pause](#), 4 April 2023).

To be clear, the RBA has been careful to stress that it would be looking to tighten further if the data points to an even longer return to target.

In addition, the RBA flagged two new potential sources of upside risks to the inflation outlook in the minutes of its April Board meeting: 1) the possibility that stronger-than-expected immigration could put significant pressure on housing, which would in turn manifest in higher consumer prices; and 2) increased risk of larger wage increases in parts of the economy, including the public sector, later in the year.

However, the RBA gave itself a lot of wiggle room with its inflation projections in the February SMP: it expects headline inflation to slow to 6.7% in 2Q23, 4.8% in 4Q23, and sees it falling below the upper-end of its target only in 2Q25.

With 1Q headline inflation coming in slightly softer than the central bank's implied forecast path, the RBA should not face the pressure to revise up its near-term inflation forecasts in its upcoming SMP, even if it incorporated some of the aforementioned upside risk factors.

Note also that, albeit volatile, the ABS' monthly CPI index showed headline inflation decelerating further to 6.3% YoY in March, well below the RBA's 6.7% 2Q23 forecast.

"Higher for longer" the most likely scenario

Although some market participants have interpreted the "hawkish" April policy statement and minutes to imply a restart of tightening in May, we think the rhetoric was more about 1) taking out insurance against the risk of an upside surprise in 1Q CPI (which did not materialize), and 2) deterring markets from pricing in premature cuts.

By pausing in April despite projecting a very slow return of inflation back to target, the RBA has already demonstrated that it is willing to accept some long-term inflation risks if that meant avoiding a recession ("keep the economy on an even keel"). It already sees policy rates as being restrictive and wants time to assess the impact. We think this will likely require at least a few more months, by which point the growth and inflation data would likely have turned further.

We thus think the bar for re-starting hikes is high and expect the central bank to remain on an extended pause. That said, the RBA's preference for a soft landing also implies reduced risks of a crash in growth and labor markets, making underlying inflation slow to come down. We thus think early cuts are unlikely and have none penciled in through 2024.

Exhibit 4: Australia: Upcoming key releases

We expect the RBA to extend its pause at its upcoming Board meeting, to be held on 2 May.

2-May RBA Cash Rate decision (May)

3-May Retail Sales (Mar)

5-May RBA Statement on Monetary Policy (May)

9-May 2023 Federal Budget

16-May RBA Minutes (May)

17-May Wage Price Index (1Q)

18-May Employment (Apr)

26-May Retail Sales (Apr)

31-May Monthly CPI (Apr)

6-Jun RBA Cash Rate decision (Jun)

7-Jun GDP (1Q)

15-Jun Employment (May)

20-Jun RBA Minutes (Jun)

28-Jun Monthly CPI (May)

29-Jun Retail Sales (May)

4-Jul RBA Cash Rate decision (Jul)

18-Jul RBA Minutes (Jul)

20-Jul Employment (Jun)

26-Jul Quarterly CPI (2Q)

28-Jul Retail Sales (Jun)

1-Aug RBA Cash Rate decision (Aug)

4-Aug RBA Statement on Monetary Policy (Aug)

Source: Bloomberg, BofA Global Research

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Notable Rates and FX Research

- **Global Rates, FX & EM Year Ahead 2023 – [Year Ahead 2023: Pivot ≠ Peak](#)**, 20 Nov 2022
- [A year of many narratives](#), **Global FX Weekly**, 28 Apr 2023
- [Are we there yet](#), **Global Rates Weekly**, 28 Apr 2023
- [EURUSD & NZD selling, mixed JPY & NOK](#), **Liquid Cross Border Flows**, 24 Apr 2023

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[Global FX weekly: A year of many narratives 28 April 2023](#)

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