Outlook Q2 2024 & Quarterly review

BlackRock

Produced by BlackRock Australia Fixed Income

Economic Outlook Q2

The Reserve Bank of Australia (RBA) kept the cash rate unchanged over Q1'24 and signaled in the March meeting that the prospect of further rate hikes from here on is diminishing. Their preference is naturally to not rule anything in or out given the level of uncertainty around services inflation, in particular. The greater than expected resilience in the US economy and several large emerging market economies along with fiscal support measures in China would no doubt be adding an extra layer of caution to the RBA's current thinking.

Australian inflation has eased considerably and broadly in with the RBA's own estimates. The decline in inflation has been broad based highlighting a weakening consumer and labour market falling back into balance. While the RBA's growth and inflation forecasts have been revised lower, they retain a clear sensitivity towards inflation threats. The RBA still characterize the overall inflation mix as indicative of an economy with excess demand and the labour market being tighter than "sustainable" levels. Rents remain "sticky" which may keep services inflation risks elevated.

Wages growth was solid in Q4'23 rising by 0.9% (4.2% y/y). This put annual wages growth at the highest since Q1'09 and highlighted significant wages growth in the public sector. Despite this the RBA retains the view that wages growth is currently around its peak for the cycle but is not expected to decline quickly.

GDP for Q4'23 was positive at 0.2% (1.5% y/y) and in line with the RBA's assumption. The data reflected that Government spending and private business investment remained the main drivers of GDP growth supported by a large pipeline of construction and public infrastructure work. Household consumption remains weak due to ongoing cost-of-living pressures, higher interest rates and higher taxes weighing on disposable income. GDP will remain sub trend in 2024 but should improve over the course of the year due to falling inflation, scheduled income tax cuts, and government rebates/subsidies.

National house price growth remains strong with annual growth remaining resilient at 9.7% y/y. Expectations are for prices to ease due to record poor affordability levels and slowing population growth. However, building approvals and construction weakness is set to continue through the year.

Our thinking had been the RBA would hike a final time in Q1'24 tightening financial conditions a little more and instilling the bank with more confidence around hitting their 2-3% inflation target. However, the RBA thinks overall financial conditions in Australia are restrictive enough for households.

It now feels like a very high hurdle to get the RBA hiking again. Accordingly, we expect the cash rate to be held at the current level for an extended period, at least until Q4'24. The risks to our view are that cuts are delayed into 2025 due to ongoing "sticky" services inflation. Conversely, an unexpected weakening in the labour market could bring about an earlier than expected cut in interest rates.

Credit Outlook Q2

The demand for credit was extremely strong in Q1'24 with investors' chasing the relatively high outright yields on offer. 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. It seems the global 'carry' trade is in full swing now that economic growth, while muted, looks OK, inflation continues to fall and global central banks shift their rhetoric towards prospective rate cuts in 2024.

Credit spread tightening has been fairly consistent and forwardlooking total returns still look relatively attractive. However, falling interest rates will be an important driver of total returns in credit.

The main risk to ongoing positive investor sentiment is the timing and magnitude of rate cuts in 2024. Any delays will make it a challenge to support spreads at their current very tight levels. Geopolitical risks also abound and there is a busy global election calendar later in the year.

Currency Outlook Q2

The AUD continued to trade in a remarkably tight US\$0.65-0.66 cent range in Q1'24. Despite the dovish rate outlook from the major global central banks the AUD has consistently failed to benefit. This is a worrying sign and likely points to concerns around the China growth outlook and some general investor risk aversion.

The RBA's recent pivot to more dovish language in response to softer-than-expected data will make it a challenge for the AUD to test recent highs. Local economic data or events that cause the market to price more RBA easing will see the AUD trend lower, albeit in a tight trading range.

Global commodity prices are lower year-to-date and the lack of policy support by Chinese policy officials to stimulate the economy continues to weigh on iron ore prices. Geopolitical developments, including developments in the Red Sea, and the Middle East and Russia-Ukraine conflicts, continue to influence commodity prices.

Any opinions, forecasts represent an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation. Source: BlackRock as of 04/04/2024.

GDP – Q4 2023

- ▲ QoQ GDP grew 0.2%. This was in line with expectations.
- YoY GDP fell from 2.1% to 1.5%.

Despite the overall slowdown to GDP over 2023, the increase in growth marked the ninth straight rise in quarterly GDP. However, YoY GDP growth was the lowest since Q4 2020, highlighting the impact of elevated rates. The largest contribution to growth was net exports due to a -3.4% fall in imports driven by weakness in consumption goods. The weakness in real household disposable income has continued to underpin the weakness in consumption. Household spending remained subdued increasing by +0.1% QoQ, with a rise in spending on essentials offset by a fall in discretionary spendings. Economic growth this year was also supported by public and private investment which is expected to continue.

Australia Real GDP 15.0 10.0 5.0 0.0 -5.0 -10.0 $20^{12} 20^{12} 20^{14} 20^{15} 20^{16} 20^{17} 20^{19} 20^{19} 20^{17} 20^$

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

Consumer Sentiment – Mar 2024

The Westpac-M.I. Index of Consumer Sentiment decreased by 1.8% from 86.0 in February to 84.4 in March.

While consumer sentiment improved in February, rising by +6.2%, this month's survey shows that progress remains slow with renewed concerns about the economy's near-term outlook. Inflation continues to dominate the news cycle, but the cost-of-living crisis is becoming less acute, with news recall levels dropping to 43% from last year's 60%+ highs. Consumers are still wary of the potential for more rate rises with 40% still expecting mortgage rates to move higher over 2024. Sentiment among those surveyed prior to the RBA decision was stronger at 94.9 compared to 79.3 post-decision, suggesting that many consumers hoped for a more positive message on inflation and the interest rate outlook. Safe-haven assets continue to remain the preferred choice for savings.

Westpac Consumer Sentiment

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

BlackRock.

FOR WHOLESALE CLIENTS ONLY - NOT FOR DISTRIBUTION TO RETAIL CLIENTS.

Business Conditions – Feb 2024

Conditions rose by 3pts from +7pts (Jan) to +10 pts (Feb)

Confidence fell by 1pt from 1pt (Jan) to Opts (Feb)

The February NAB business survey saw business conditions rise 3pts to +10pts, driven by conditions and profitability rising by 4pts each while the employment index remained broadly unchanged. The survey signaled that the economy remained resilient in the new year and that inflation is still a challenge despite slowing growth. While business conditions strengthened to be marginally above the long-run average, business confidence remained weak and below the long-run average. Notably, retail price growth jumped to 1.4% from 0.9% previously. This reversed some of the easing seen towards the end of 2023, a sign that further progress on inflation is unlikely to be smooth over the months ahead.

NAB Business Survey

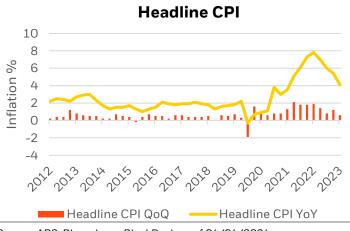


Source: NAB, Bloomberg, BlackRock as of 04/04/2024

Inflation – Q4 2023

- ▲ Headline CPI **increased by 0.6%** QoQ. This was **0.2% lower** than market consensus.
- Annual inflation fell 1.3% from to 5.4% to 4.1% YoY.

The annual pace of inflation declined to 4.1%, slightly lower than market expectations of 4.3% YoY. This marked the fourth consecutive quarter of lower annual inflation, down from the peak of 7.8% in December 2022. Annual inflation is now at its lowest level since December 2021. Key contributors to rising prices in Q4 were housing (+1.0%), alcohol & tobacco (+2.8%), and insurance and financial services (+1.7%). Price falls were recorded only for education (-0.1%), transport (-0.2%) and furniture and household equipment (-1%). Inflation is expected to continue to ease, however service inflation may prove to be sticky in 2024 particularly if subsidies roll off.



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

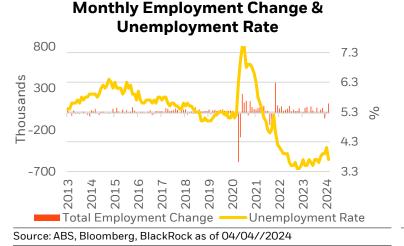
2

NM0424U-3514700-2/4 FIH0424A/S-3492389-2/4

Labour Market – Feb 2024

- ▲ Employment data saw 116,500 **new jobs gained**. This was **76.500 more** than market consensus.
- ▼ The unemployment rate **fell 0.4%** from 4.1% to **3.7%**.

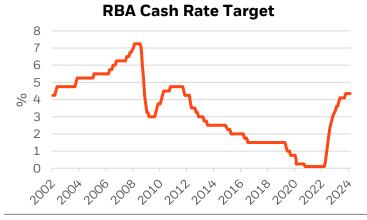
Australian employment surged in February, surprising again to the upside with 116.5k new jobs added. Employment growth was driven by full-time workers rising +78.2k, whilst part time increased by +38.3k. The unemployment rate also declined to 3.7% from a two-year high of 4.1%, while the participation rate fell to 66.7%. The ABS stated that "The large increase in employment in February followed larger than usual numbers of people in December and January who had a job that they were waiting to start or return to." Falling hours worked, rising parttime employment and underutilisation are all symptomatic of an easing in the tightness of the labour market.



RBA Policy Rate – Mar 2024

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

The RBA left cash rate unchanged at 4.35% as expected but moved from a mild tightening bias to a neutral one where "the Board is not ruling anything in or out" vs previous "a further increase in interest rates cannot be ruled out". The new guidance whilst not new language has more symmetry around the evolving risks that the RBA foresee. The RBA notes the progress on inflation despite the ongoing uncertainty but there is a note of caution with a new reference to continued high unit labor costs and uncertainty over the recent improvement in productivity. The RBA see the macro-economic environment as highly uncertain and is keeping all options open.



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

BlackRock

FOR WHOLESALE CLIENTS ONLY - NOT FOR DISTRIBUTION TO RETAIL CLIENTS.

Wage Price Index – Q4 2023

- Wages increased by 0.9% over Q4. This was in line with market consensus.
- Annual wage growth rose 0.2% to 4.2%

The annual wage growth is at its highest since Q1 2009, with the public sector rising 4.3% YoY, slightly above the private sector's 4.2%. Public sector wages also had the highest quarterly increase in 15yrs, increasing by +1.3% QoQ. Higher growth in the public sector was primarily due to newly implemented enterprise bargaining agreements (EBA's) for essential workers in the Health care and social assistance, and Education and training industries. WPI is likely to remain elevated due to lagged effects of new EBA's rolling onto larger increases putting a floor under WPI. The significant increase in net overseas migration will help cap the upside as it eases tightness in the labour market.



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

House Prices – Q1 2024

- The CoreLogic national HVI rose 1.6% in Q1
- The CoreLogic national HVI increased 10.1% over the year

House prices continued to rise over Q1, though the quarterly growth has halved compared to mid last year when home values rose 3.3% QoQ. Softer housing conditions since then were caused by rate hikes, cost of living pressures, and worsening housing affordability. Despite these challenges, undersupply relative to demand continues to exert upward pressure on home values. Perth's housing market experienced the highest growth, with values increasing by 1.9% over the month, followed by Adelaide and Brisbane increasing by 1.4% and 1.1% respectively. The remaining capitals showed much lower rates of change, with Melbourne being the only capital city to record a negative quarterly movement, decreasing by -0.2% over the first three months of the year.

Core Logic Australian Home Value Index



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

3

Want to know more?

blackrock.com/au | clientservices.aus@blackrock.com | 1300-366-100

IMPORTANT INFORMATION

Issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975, AFSL 230 523 (**BIMAL**) for the exclusive use of the recipient, which warrants by receipt of this material that it is a wholesale client as defined under the Australian Corporations Act 2001 (Cth).

This material provides general information only and does not take into account your individual objectives, financial situation, needs or circumstances. Before making any investment decision, you should assess whether the material is appropriate for you and obtain financial advice tailored to you having regard to your individual objectives, financial situation, needs and circumstances. Refer to BIMAL's Financial Services Guide on its website for more information. This material is not a financial product recommendation or an offer or solicitation with respect to the purchase or sale of any financial product in any jurisdiction.

Information provided is for illustrative and informational purposes and is subject to change. It has not been approved by any regulator.

This material is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation. BIMAL is a part of the global BlackRock Group which comprises of financial product issuers and investment managers around the world. BIMAL is the issuer of financial products and acts as an investment manager in Australia.

BIMAL, its officers, employees and agents believe that the information in this material and the sources on which it is based (which may be sourced from third parties) are correct as at the date of publication. While every care has been taken in the preparation of this material, no warranty of accuracy or reliability is given and no responsibility for the information is accepted by BIMAL, its officers, employees or agents. Except where contrary to law, BIMAL excludes all liability for this information.

Any investment is subject to investment risk, including delays on the payment of withdrawal proceeds and the loss of income or the principal invested. While any forecasts, estimates and opinions in this material are made on a reasonable basis, actual future results and operations may differ materially from the forecasts, estimates and opinions set out in this material. No guarantee as to the repayment of capital or the performance of any product or rate of return referred to in this material is made by BIMAL or any entity in the BlackRock group of companies.

No part of this material may be reproduced or distributed in any manner without the prior written permission of BIMAL.

© 2024 BlackRock, Inc. All Rights reserved. BLACKROCK, BLACKROCK SOLUTIONS, iSHARES and the stylised i logo are registered and unregistered trademarks of BlackRock, Inc. or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.

BlackRock.