Economic commentary

The global economy

Core inflation in major developed economies has remained elevated and central banks have been increasingly concerned about inflation being ‘sticky,’ particularly core services inflation. However, most central banks view their current policy rates as restrictive and appear to be getting close to the end of their tightening cycles.

In the US, the Federal Reserve increased its policy rate by 25bps in May as it revised up forecasts for core inflation. The Fed’s preferred measure of inflation – the core Personal Consumption Expenditure (PCE) deflator – was stronger than expected in April, at 4.7% over the year. The labour market also remains tight, with the unemployment rate falling to 3.4% and non-farm payrolls again surprising to the upside in April. Although activity in the manufacturing sector has weakened, economic activity has been supported by a resilient services sector.

Hawkish commentary by several Fed officials that see the need for further interest rate rises has led investors to ascribe a higher chance of the Fed raising rates again in coming months. While lending standards tightened further in the March quarter, a key uncertainty for the Fed is the extent of credit tightening still to come and whether, or how much, this will reduce the need for further rate hikes. Concerns around the regional banking sector remain, even though they have diminished. Despite Fed officials also communicating that rates are likely to stay higher for the foreseeable future, investors still expect the Fed to start cutting interest rates at the end of this year.

The European Central Bank (ECB), the Bank of England and the Reserve Bank of New Zealand (RBNZ) also raised their policy rates by 25bps to combat stubbornly high core inflation. ECB officials continue to communicate the need for further interest rate rises, while the RBNZ indicated that rates might have peaked. Growth in the UK and euro area economies has been weak, at 0.1% in the March quarter.

Concerns around faltering growth momentum in China have increased as industrial production, investment and retail sales were weaker than expected in April and no further policy stimulus measures have been announced. Chinese economic data showed weaker activity in the manufacturing sector while the services sector grew at a modest pace.

The Australian economy

The Reserve Bank of Australia (RBA) raised its policy interest rate by 25bps in May, after pausing in April, which surprised many investors. The RBA’s priority is to return inflation to its target band within a reasonable timeframe, with the RBA forecasting inflation to fall to 3% by mid-2025. The RBA also views risks to inflation as skewed to the upside due to strong population growth, weak productivity growth and international experience that suggests services price inflation may be more persistent than expected. The monthly CPI indicator for April rose more than expected, to be 6.8% higher over the year driven by higher petrol prices and travel costs.

The labour market remains tight, though conditions appear to be loosening with the unemployment rate increasing to 3.7% and employment falling in April. Wages growth accelerated in the March quarter, with the Wage Price Index 3.7% higher over the year. Consumer spending has been slowing as households face a higher cost of living and higher interest rates, with retail turnover at a similar level to 6 months ago and retail sales volumes declining in the March quarter. While consumer confidence remains weak, business sentiment has been resilient.

Conditions in the established housing market continue to improve, with auction clearance rates and house prices moving higher in capital cities. Strong population growth and an under-supply of housing are supporting prices, with the supply of established properties for sale at its lowest level in over a decade. Building approvals continued to trend lower in April, though the pipeline of work remains large.

The Federal Budget released in early May showed the budget recorded a $4.2bn surplus in 2022-23 due to stronger than expected revenue. The 2023-24 Budget is expected to fall back to a deficit of around $14bn.

Financial market commentary

Developments on negotiations to raise the debt ceiling and an upward reassessment of the outlook for interest rates in the US dominated investor sentiment in May. These saw bond yields in the US and Australia rise and supported the US equity market.

Equity markets (performance in local currency, excluding dividends)

Most equity markets fell in May, except for the US and Japanese markets. The outperformance of mega-cap technology stocks supported US equities, with the S&P500 gaining 0.2% and Nasdaq rising by nearly 6%. Japanese equities outperformed in May, rising by 7%, to be around 20% higher in 2023 so far. Japanese stocks have been supported by the depreciation of the yen over this time and expectations that the Bank of Japan will leave their loose monetary policy settings in place for the foreseeable future.

The ASX200 fell by 3% in May – weighed down by financial, energy stocks and resources stocks – to be 0.7% higher in 2023 to date. However, Australian equities have underperformed most developed economy equity markets this year, except for the UK.

Interest rates

Movements in global bond yields were mixed in May, with US and Australian 10-year yields rising while German and Japanese yields were little changed. In the US, yields rose on growing optimism that a deal to raise the debt ceiling will be reached between the Democrats and Republicans and hawkish commentary by several Fed officials that led investors to ascribe a higher chance of a Fed rate hike in June. US 2-year bond yields rose by 44bps in May and 10-year yields increased 22bps. US 10-year yields have now retraced around two-thirds of the fall experienced in March after the collapse of Silicon Valley Bank.

Australian bond yields followed US yields higher in May, with 3-year yields rising 37bps and 10-year yields increasing by 27bps. Australian 10-year yields have generally traded within a 3-4% yield range for the past year. TCorp bond yields also moved higher in May, alongside the moves in Australian Government bond yields.

Currency and commodity markets

The Brent crude oil price fell by 8.6% in May, continuing the trend decline over the past year, as concerns about slowing global growth dominated. The Australian dollar depreciated by 2.1% against the US dollar in May, temporarily falling below US$0.65 – it's lowest level since October 2022. The broad-based strength in the US dollar in May reflects the upward assessment of interest rate expectations following hawkish commentary by Fed officials.

Financial market performance

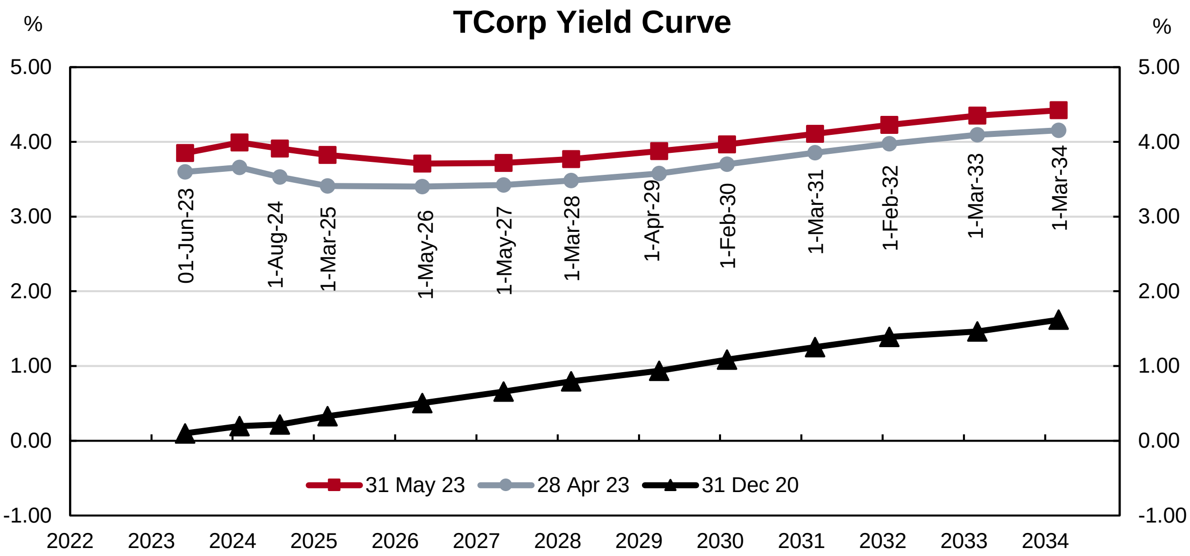
Currency markets May 2023	Previous month close	Month high	Month low	Month close	Month change
AUD/USD	0.662	0.679	0.648	**0.648**	-2.1% ▼
AUD/EUR	0.600	0.617	0.603	**0.607**	1.1% ▲
AUD/JPY	90.16	91.95	89.75	**90.69**	0.6% ▲
AUD/GBP	0.526	0.537	0.524	**0.524**	-0.5% ▼
AUD/BRL	3.300	3.404	3.255	**3.275**	-0.7% ▼
AUD/INR	54.13	55.58	53.59	**53.59**	-1.0% ▼
AUD/CNY	4.577	4.698	4.595	**4.605**	0.6% ▲

Equity markets* May 2023	Previous month close	Month high	Month low	Month close	Month change
MSCI World ex Australia	2904	2914	2845	**2870**	-1.2% ▼
MSCI Emerging Markets	977	989	959	**959**	-1.9% ▼
S&P/ASX200	7309	7335	7091	**7091**	-3.0% ▼
S&P/ASX Small Ordinaries	2898	2926	2802	**2802**	-3.3% ▼
S&P500 (US)	4169	4206	4061	**4180**	0.2% ▲
FTSE 100 (UK)	7871	7871	7446	**7446**	-5.4% ▼
Stoxx600 (Europe)	467	469	452	**452**	-3.2% ▼
DAX (Germany)	15922	16275	15664	**15664**	-1.6% ▼
CAC 40 (France)	7492	7492	7099	**7099**	-5.2% ▼
Nikkei 225 (Japan)	28856	31328	28950	**30888**	7.0% ▲
Hang Seng (HK)	19895	20297	18234	**18234**	-8.3% ▼
Shanghai Composite (China)	3323	3395	3201	**3205**	-3.6% ▼
Bovespa (Brazil)	104432	110906	101797	**108335**	3.7% ▲
IPC (Mexico)	55121	55535	52736	**52736**	-4.3% ▼
S&P/BSE Sensex (India)	61112	62969	61054	**62622**	2.5% ▲

*Returns are in local currency, and exclude dividend payments

Bond markets (%) May 2023	Previous month close	Month high	Month low	Month close	Month change
RBA Official Cash Rate	3.60	3.85	3.60	**3.85**	0.25 ▲
90 Day Bank Bill	3.68	3.98	3.67	**3.98**	0.30 ▲
180 Day Bank Bill	3.86	4.17	3.83	**4.17**	0.32 ▲
1 Year Term Deposit Rate	3.20	3.20	3.20	**3.20**	0.00 –
3 Year CGS Bond	3.00	3.44	2.96	**3.37**	0.37 ▲
10 Year CGS Bond	3.34	3.73	3.30	**3.61**	0.27 ▲
10 Year US Bond	3.42	3.82	3.34	**3.64**	0.22 ▲
10 Year German Bond	2.31	2.54	2.19	**2.28**	-0.03 ▼
10 Year Japanese Bond	0.39	0.44	0.37	**0.44**	0.04 ▲

TCorp bonds (%) May 2023	Previous month close	Month high	Month low	Month close	Month change
08-Feb-24	3.66	3.99	3.70	**3.99**	0.33 ▲
20-Aug-24	3.53	3.92	3.57	**3.91**	0.38 ▲
20-Mar-25	3.41	3.87	3.41	**3.83**	0.42 ▲
20-May-26	3.40	3.78	3.35	**3.71**	0.31 ▲
20-May-27	3.42	3.78	3.37	**3.72**	0.29 ▲
20-Mar-28	3.48	3.85	3.43	**3.77**	0.29 ▲
20-Apr-29	3.58	3.96	3.54	**3.88**	0.30 ▲
20-Feb-30	3.70	4.06	3.65	**3.97**	0.27 ▲
20-Mar-31	3.85	4.21	3.80	**4.11**	0.25 ▲
20-Feb-32	3.97	4.34	3.93	**4.23**	0.25 ▲
08-Mar-33	4.10	4.47	4.06	**4.35**	0.26 ▲
CIB 2.75% 20 Nov 25	0.28	0.70	0.30	**0.63**	0.36 ▲
CIB 2.50% 20 Nov 35	1.79	2.04	1.82	**1.94**	0.15 ▲



Source: TCorp

Commodity markets (US$) May 2023	Previous month close	Month high	Month low	Month close	Month change
Brent Oil (per barrel)	79.5	79.3	72.3	**72.7**	-8.6% ▼
Iron Ore (per tonne)	116.1	108.5	102.3	**105.1**	-9.5% ▼

TCorp forecasts	June-23	Dec-23	June-24	Dec-24
RBA Official Cash Rate	3.85	3.85	3.85	3.85
90 Day Bank Bill	4.00	4.00	4.00	4.00
10 Year CGS Bond	3.75	3.75	3.75	3.75

About New South Wales Treasury Corporation (TCorp)

TCorp provides best-in-class investment management, financial management, solutions and advice to the New South Wales (NSW) public sector. With A$107 billion of assets under management, TCorp is a top 10 Australian investment manager and is the central borrowing authority of the state of NSW, with a balance sheet of A$152 billion. It is rated Aaa (Stable) by Moody's, AAA (Stable) by Fitch, and AA+ (Stable) by S&P.

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