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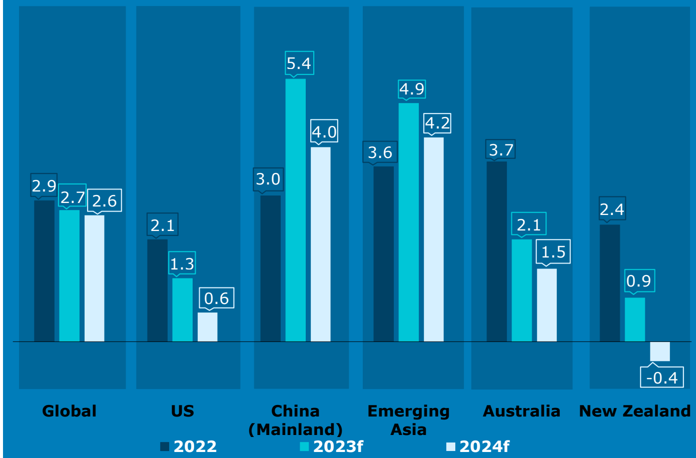
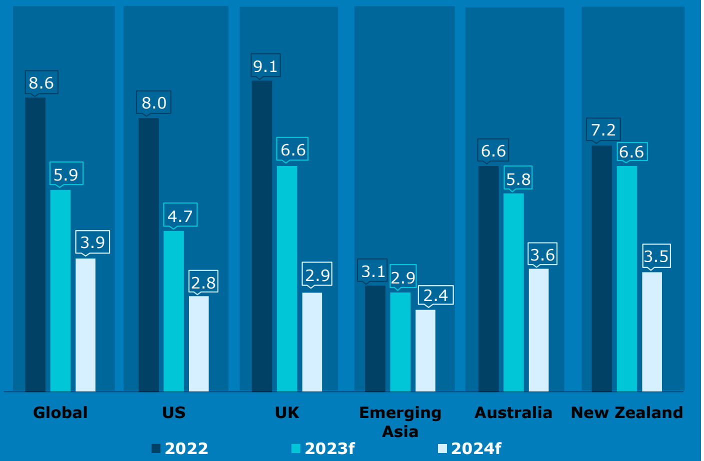
At a glance

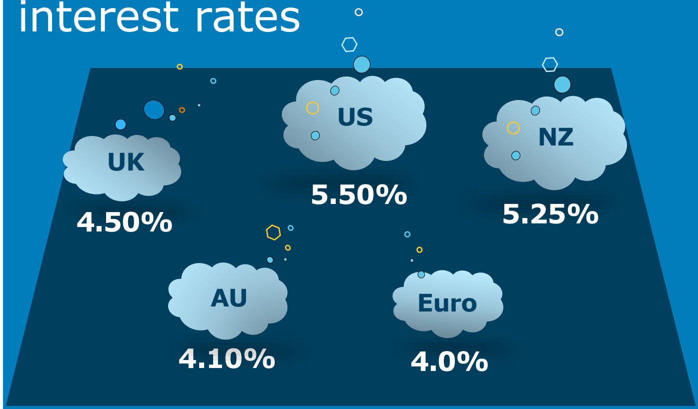
Slower growth but no global recession



Inflation still not tamed



Extended plateau in global interest rates



US bond yields have peaked

Financial fragility has probably confirmed the peak in US bond yields.

Further rate hikes, however, will support yields elsewhere.

The US yield curve is now in a steepening phase.

USD downtrend intact

The emergence of US financial instability has confirmed the downtrend in the USD.

Other parts of the world are much less affected, leaving the peak in US interest rates to weigh on the USD.

The BoJ’s pivot remains a key focus, even if a near-term policy shift is unlikely.

Asia is a safe harbour, and the AUD is our favoured commodity currency.

Commodities well supported

As commodity supply shocks fade, the traditional inverse relationship between commodity prices and the USD will return.

Sustained capex discipline and other supply challenges will be keeping market balances tight.

The global economy is likely to slow this year but avoid recession.

Energy shortages have eased, but inventories remain precariously low.

Bringing it all together

Passed peak liquidity

Richard Yetsenga

There is a low risk in our view that recent banking sector developments escalate into a broad, global, economic and financial crisis. They are likely to signal a peak in global USD liquidity conditions and complicate central banks' inflation challenge. Geographically, the implications for the US are most significant.

Duration risk is inherent in banking systems: banks hold deposits which can generally be withdrawn at short notice but lend that money for terms that are much longer. Ultimately confidence and trust are required for system stability. Even acknowledging the elusive nature of these qualities there are a range of reasons to think the worst outcomes are far from the most likely.

- The GFC is still a fresh memory and policymakers are being highly responsive to individual bank issues as they arise.
- To the degree it can, monetary policy is responding to what are, so far, localised issues. While several central banks have hiked rates recently and we expect further hikes over coming months, the risks around banking sectors are acknowledged and forward guidance has become less hawkish.
- The pockets of financial excess seem much narrower than during the GFC. BIS data, for instance, suggest this has been the least credit intensive US upswing in at least four decades (Figure 1). Regulation also tightened substantially following the GFC, and bank capital levels are much higher.
- Household sector balance sheets are in much better shape across a range of markets including the US, Australia, New Zealand and Korea.

Global slowdown, outside China, remains our central expectation for 2023, with only the UK and New Zealand experiencing recessions.

Private sector balance sheets are much stronger than during the GFC, limiting the risk of a crisis.

Recent developments suggest tighter USD liquidity, a peak in US bond yields and a steeper US yield curve.

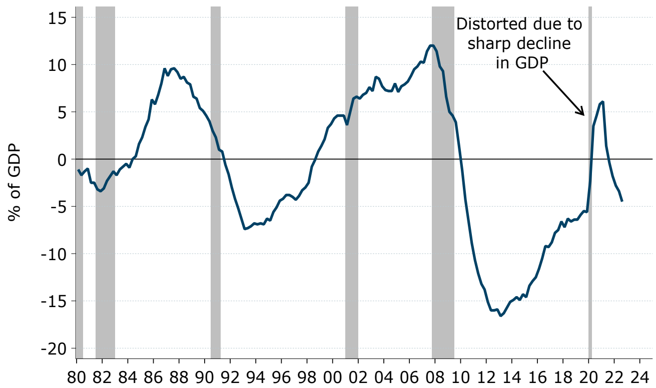
Outside the US, the implications are more modest, with further policy firming still likely, the USD weaker and commodity prices well supported.

Getting inflation down globally – from the 7–8% that many economies have seen to central banks' 2–3% targets – was likely to come with some stress, even if identifying the form and the timing was difficult. Central banks need to reduce demand to a level more balanced with supply. The idea that inflation would immaculately evaporate didn't seem well-founded.

The first substantial stresses have manifested themselves and we expect more to come as policymakers balance short-term financial stability considerations and longer-term inflation considerations. As such, despite the resilience that suggests a broad crisis is a low probability, we expect recent banking events to crystallise a trend of tighter USD liquidity and consequently greater sensitivity to further interest rate hikes.

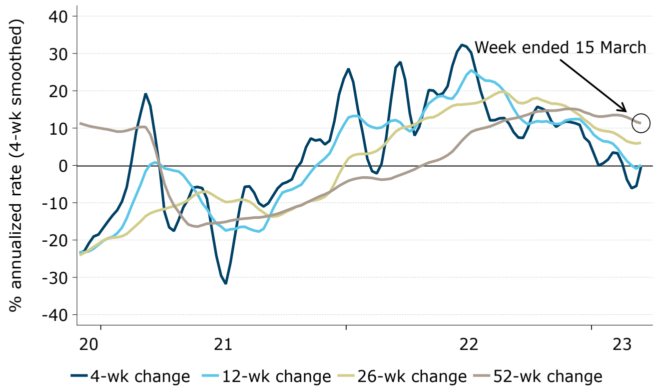
Coming into this period credit conditions were already tightening. Data show commercial and industrial lending growth slowing (Figure 2) and US money supply (M2) falling. The Fed's January 2023 Senior Officer Loan Survey indicates a net balance of 45% of US banks were tightening standards for commercial and industrial lending (Figure 3). This level of tightening has historically been associated with recessionary, or near recessionary, conditions. In February, a near record

Figure 1. US credit gap as a share of GDP



Source: BIS, Bloomberg, Macrobond, ANZ Research

Figure 2. US bank lending to commercial and industrial companies



Source: Fed, Macrobond, ANZ Research

of 56% of households say that credit availability is worse than one year ago. Both lenders and depositors have likely become more cautious after recent developments, which will tighten credit conditions further.

Recent events haven't affected conditions outside the US to the same degree in our view. Policy-makers have acted with sufficient vigour thus far to ensure few direct spillovers, US banks seem to be affected by some specific factors, excesses in emerging markets don't seem to be as prevalent, and commentators suggest bank regulations outside the US have been enforced more stringently.

As one example, foreign equity flows into Asia have been fairly resilient throughout the banking turmoil. In the week following the collapse of Silicon Valley Bank there were USD2.5bn of outflows from Asia ex-China equities. After the UBS takeover of CS equity inflows began to return.

Much like the more conservative position of US households and the US economy itself, Asian credit growth has been quite subdued in recent years. Domestic bank lending has been growing at single digit rates across much of the region (Figure 4). While not just confined to Asia, growth in USD credit outside the US has been similarly subdued.

Our view of a global slowdown but not a crisis requires policymakers to remain very active in the face of any further instability in individual institutions, and for those policy actions to ultimately bring a halt to further problems. In the GFC, inflation was low and central banks could consequently reduce interest rates as required. With inflation high at present central banks are constrained in their ability to respond to financial stress with lower interest rates.

Central banks to continue with the challenge of balancing both financial stability and price stability

Our views also require central banks to continue with the challenge of balancing both financial stability and price stability. The policy response to deal with the financial problems of today is to add more liquidity, even if only targeted to certain institutions. But if policymakers are successful there is at least some prospect this compound the inflation challenges of tomorrow.

In sum, while recent financial instability is potentially worrying, in our central case it doesn't imply substantial changes in the outlook. Most notably, developments have reduced the risk of the Fed tightening beyond our 5.5% peak forecast; a risk we raised in early March.

This leaves markets more eager to price the next easing cycle and is likely to mean lower bond yields relative to our previous expectations. So, we have revised our bond yield forecasts lower, with the result that our forecasts for the first time countenances that the peak in US 10-year bond yields may be behind us.

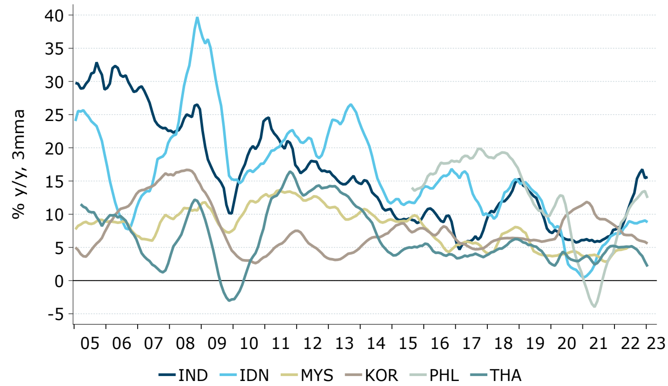
Beyond these changes, the broad thrust of our forecasts remains unchanged. We anticipate slower economic growth in 2023, outside China. With US exceptionalism priced into the USD and US macro developments on a poorer financial footing, the trend to USD weakness remains intact. A weaker USD also helps support commodity prices, which continue to face both resilient demand and constrained supply.

In Q3 2022 we suggested the flattening trend in the US yield curve had come to an end. That view was off base, as the 2/10 curve flattened more than 50bp further into the early months of 2023. With the market now more willing to price rate cuts, we are confident the curve has passed its flattest point.

Figure 3. Bank lending standards for C&I loans

Source: Fed, Macrobond, ANZ Research

Figure 4. Asia credit growth



Source: Macrobond, ANZ Research

US: financial ructions

Tom Kenny | Brian Martin

The near-term outlook for the US economy is highly uncertain as stress in the banking system leads to tighter lending conditions.

The BoJ's governor Kuroda stepped down after ten years at the helm. The new regime may look to fade out yield curve control.

The euro area is emerging from last year's energy crisis. However, too high inflation and the re-emergence of financial stability risks are hurdles.

The near-term outlook for the US economy is highly uncertain in the wake of the collapse of Silicon Valley Bank (SVB). History shows how quickly a problem in the banking sector, if not sorted, can undermine public confidence in healthy banks. This contagion risk could severely disrupt the stability of the financial system and the macroeconomy with adverse consequences for economic welfare.

A run on deposits occurred at SVB as depositors lost confidence in its viability. US authorities moved swiftly and decisively to limit the potential for contagion. All the uninsured deposits of over USD250k in the failed SVB have been made good. Treasury Secretary Yellen has indicated that the same action would be repeated for other banks if their failure posed a systemic risk. In addition, the Fed announced a measure to provide all banks access to emergency liquidity by creating the Bank Term Facility Program (BTFP). The BTFP assures "all banks have the ability to meet the needs of all their depositors". Banks can also continue to access the Fed's discount window to meet short-term liquidity needs as they arise. These actions have for the time being eased fears over a potential banking crisis.

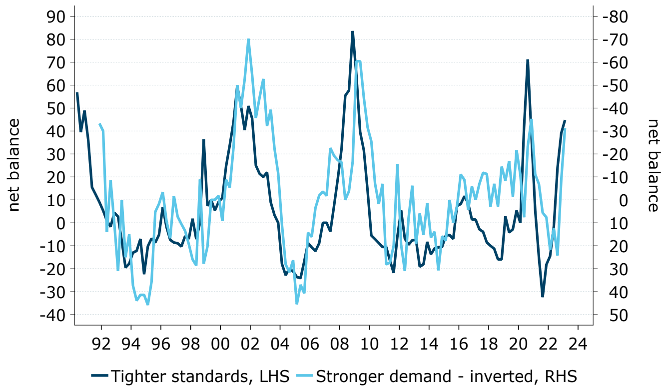
Despite these steps, anxiety over capital adequacy and deposit flows may persist, as counterparty risk is firmly in the spotlight. Not surprisingly this has prompted concerns that the flow of credit could slow sharply leading to disinflation and recession. Bank lending standards have already tightened significantly since late last year. This has contributed to lower demand for lending and in turn weaker activity. Tighter lending standards alongside higher interest rates have already contributed to a significant slowdown in housing investment.

We are monitoring closely deposit flows, credit, and lending conditions, especially at the small banks who rely more heavily on deposits to fund their lending. These data are high frequency so can provide an early indication of the stress facing banks and thus any potential adverse real-economy outcomes.

Momentum in the economy appeared to be accelerating with household consumption and employment picking up prior to the demise of SVB. The resilience in spending may be overstated owing to issues with seasonally adjusted data in the wake of the pandemic, while significant cost-of-living adjustments to social security payments provided a sizeable one-off boost to household incomes in January. Less disputable is the strength in the jobs market. Hiring trends are indicative of an economy growing well above trend. Layoffs remain very low and the demand for labour remains robust. As a result, the unemployment rate is hovering near a fifty-year low.

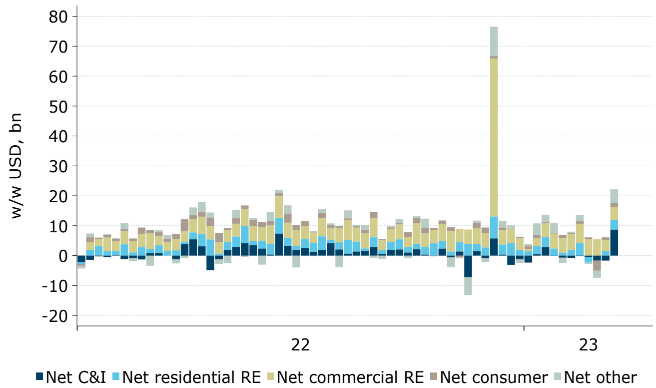
We are forecasting a notable slowing in US GDP in response to the Fed's rapid-fire tightening over the course of the past year. The recent stress in the banking sector will also weigh on growth as credit conditions tighten. We expect growth of 1.3% in 2023 and 0.6% in 2024. Our profile is consistent with a soft but bumpy landing, not one that meets the NBER's recession definition of a "significant decline in economic activity that is spread across the economy and that lasts more than a few months". There is a high degree of uncertainty around our projections, and we are cognisant there are many moving parts which could unravel in a non-linear fashion.

Figure 1. C&I lending conditions and demand



Source: Fed, Macrobond, ANZ Research

Figure 2. Net lending by small banks (w/w)



Source: Fed, Macrobond, ANZ Research

Price data early this year show inflationary pressures are more disconcerting than late last year. Our one-month Core CPI Diffusion Index jumped to above two standard deviations in January and February, the highest it's been since mid-2022. Such a reading implies price pressures are broad based and intense. This view is supported by the statistical core inflation measures of the trimmed mean and weighted median, both of which grew above 6% saar in the first two months of 2023. This is a long way above the Fed's 2% price stability target.

In addition, recent revisions to seasonal factors by the Bureau of Labor Statistics portray a less flattering inflation profile than was initially reported. The new factors resulted in inflation being a bit weaker in Q2 2022 and a tad stronger in Q4. We estimate the three-month saar in June 2022 was lowered from 7.6% saar to 6.8%, and the December 2022 three-month saar was boosted from 3.2% to 4.2%. This implies there was a much weaker easing in inflation over June to December: a 2.6ppt decline as opposed to a 4.4ppt fall as initially reported.

We forecast headline CPI to be 4.7% in 2023 and 2.8% in 2024

The outlook for inflation is largely dependent on core services-ex housing, given core goods inflation is easing and CPI housing rents should cool from around mid-year based on recent trends in new rental leases.

The major driver of core services ex-housing inflation is wages, as they represent the bulk of the cost of providing these services. One of the better wage measures for predicting inflation is unit labour costs (ULC). This measures the compensation of a worker adjusted by productivity. If a worker gets a pay increase without an offsetting increase in productivity, then this is inflationary. ULC are currently running at over 6% y/y, the highest in decades and well above levels consistent with 2% inflation. Our correlation analysis suggest ULC leads core CPI by three quarters. With ULC currently elevated, core services ex-housing inflation may stay high for some period.

We forecast headline CPI to be 4.7% in 2023 and 2.8% in 2024.

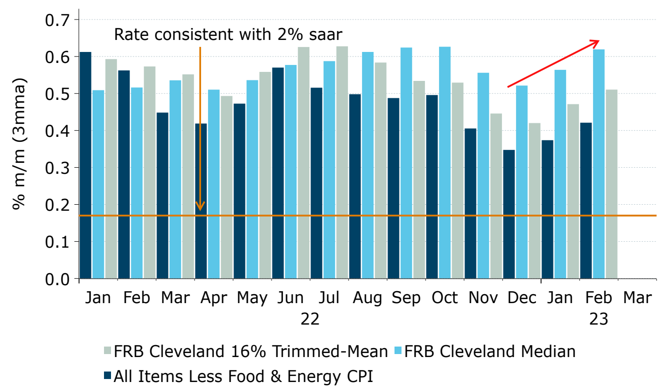
At its 21-22 March meeting the Fed raised the federal funds rate (FFR) by 25bp and turned more dovish on its guidance for future rate hikes. The FOMC toned down its guidance on future rate hikes to "some additional policy firming may be appropriate" from "the committee anticipates ongoing increases of the target range will be appropriate." Chair Powell acknowledged that there is much uncertainty over how recent stress in the banking sector will affect economic activity.

The Fed left its view of the terminal FFR at 5.1% unchanged. Prior to this meeting several Fed officials, including Powell, had indicated that they would revise up their expectation of terminal FFR at this meeting. Powell explained that the reason the view didn't shift was because many FOMC members felt tighter credit conditions were doing the work of higher rates. He indicated that the view on terminal could again shift higher if this current bout of uncertainty abates soon. He added that rate cuts are not part of the committee's base case projection for policy this year, pushing back on market expectations of around 100bp of cuts. The Fed revised up slightly its expectation for the effective FFR at the end of 2024, which has now three and half 25bp rate cuts compared to four previously.

The forecasts in latest Summary of Economic Projections (SEP) have a heightened degree of uncertainty attached to them as is evident by the elevated readings of the uncertainty diffusion indices and from Powell's post meeting comments. The Fed's clear concern is that bank lending conditions could tighten meaningfully and that this could persist. For now, it is too early to make an insightful comment around this view.

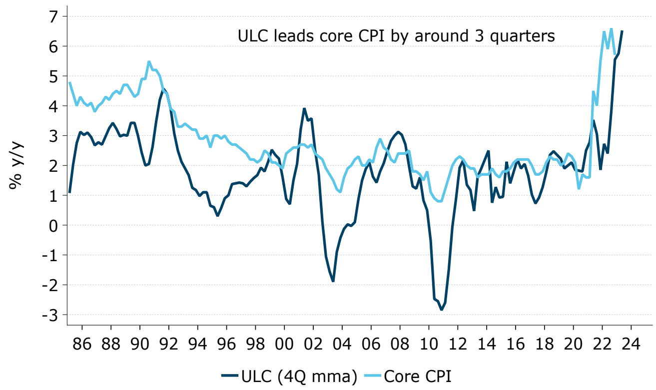
We maintain our FFR terminal call of 5.50% and will continue to monitor credit data and related developments. There is no evidence yet that either cyclical or sticky-price inflation is turning lower. If the turmoil currently besetting the banking sector is resolved soon, we think there are upside risks to our FFR profile.

Figure 3. Core CPI accelerating



Source: BLS, Federal Reserve Bank of Cleveland, Macrobond, ANZ Research

Figure 4. ULC and inflation



Source: BLS, Macrobond, ANZ Research

Japan: passing the baton

Japan's economy was flat in Q4 2022, which meant that GDP in 2022 was 1% higher on the previous year. Consumer spending and exports made solid contributions to GDP in the last quarter of 2022. Government measures aimed at boosting domestic tourism supported spending in multiple service-related industries, while spending on goods was driven by a recovery in auto production. Exports benefited strongly by a substantial rebound in tourist arrivals after the government ended restrictions on foreign arrivals.

Japan's economy should benefit from the government's decision to reclassify COVID-19 under the Infectious Diseases Act from class II to class V. This will take effect on 8 May. A disease classified as class II allows authorities to stop infected persons from working. It also gives the government the power to declare a state of emergency, which happened several times during the pandemic, which restricted the operations of many face-to-face service industries. COVID-19 will now be treated like the seasonal flu, which means the government can no longer stop sick people from working or declare a state of emergency.

We forecast GDP at 1.5% for 2023 and 1.0% for 2024

Pent-up household demand should be a notable contributor to growth in 2023. Spending on services remains some way below its pre-pandemic level and households continue to hold a sizeable pool of excess savings courtesy of government transfers during the pandemic. The outlook for household income is positive given the demand for labour is strong and unions are pushing for the highest wage increase in decades. That said, with inflation high, real wages are trending negative.

The latest Tankan survey shows corporate profits and margins are elevated across industries. Sound profitability along with labour shortages is underpinning a buoyant capex outlook. In recent times a substantive amount of capex has been directed toward, labour saving-related technology, and logistics facilities. We expect this to continue.

Our GDP forecasts are 1.5% for 2023 and 1.0% for 2024.

The Diet has approved Kazuo Ueda to be the next governor of the BoJ after Haruhiko Kuroda finishes his term in April. Kuroda has spent the past decade at the helm of the central bank trying to achieve its 2% inflation target. He did so by adopting aggressive monetary policy easing. The initial strategy was an asset purchase program called Quantitative and Qualitative Monetary Easing (QQME). The easing policy framework has evolved over time until its current iteration of QQME with Yield Curve Control (YCC) was introduced in September 2016.

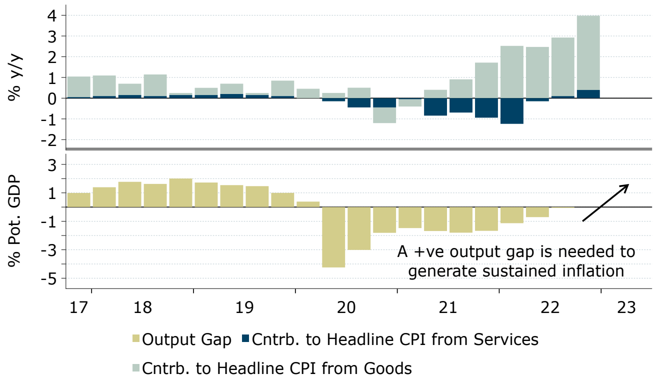
Although some core CPI measures are above 2%, much of this is driven by JPY weakness and cannot be sustained. Thus, Kuroda fell short of his goal. He acknowledges the price stability objective won't be achieved until there is a more meaningful pick-up in wages. We would also add that there remains a sizable negative output gap which will take time to close. Until this happens its unlikely that there can be a sustained pick-up in inflation.

Kuroda's easing strategy has come at a substantial monetary cost and is also posing a threat to overall financial stability.

- The size of Japan's balance sheet as a share of GDP has ballooned to around 130%, which is about four times the US Fed's balance sheet.
- Functioning of the JGB market is reportedly at an all-time low, with liquidity levels poor given the sizable (around 50% of total) share of outstanding bonds held by the BoJ.
- YCC is harming bank profitability by shrinking the spread between borrowing and lending rates, this also undermines incentives to lend.

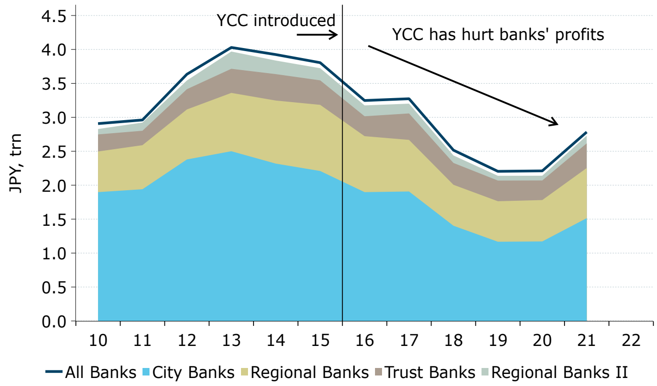
Ueda seems keen to continue with substantive easing to reach the price stability goal. However, he has in the past been circumspect about the efficacy of YCC. A review of the central bank's monetary framework is likely to take place soon. This could set out an exit strategy from YCC. The first stage might be to shorten the duration of the intended JGB yield target from 10yr to 2yr. This would mean less bond buying for the BoJ and improved bank profitability.

Figure 5. Inflation and the output gap



Source: BoJ, MIAC, Macrobond, ANZ Research

Figure 6. Japan banks' profits



Source: JBA, Macrobond, ANZ Research

Euro area: recession avoided, growth recovering

The euro area has avoided recession over the winter. Owing partly to a mild winter and voluntary gas reductions, energy supply was adequate, prices fell sharply and a deeper energy shock did not occur. Having flatlined in Q4, activity is recovering. PMI data are pointing to a strong rebound in service sector growth, which accounts for 70% of GDP. Job creation is strong and consumer confidence is recovering.

> We expect the governing council to raise rates another 50bps in Q2 to 4.0%

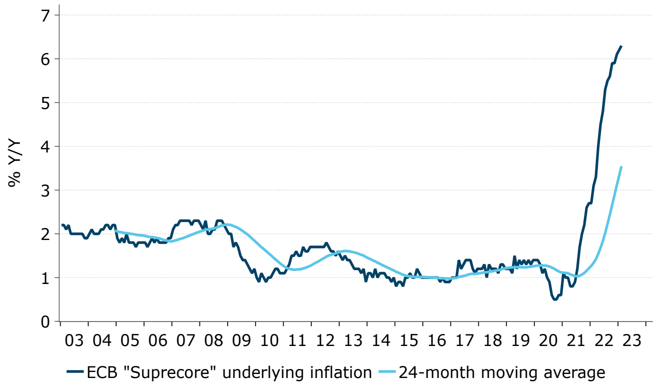
A major shock to the economy last year following Russia's invasion of Ukraine was the collapse in the terms of trade. This has corrected in recent months as commodity prices have receded. Monthly current account data have returned to surplus and are running above their long run average. Elsewhere, fiscal policy is supporting investment in climate and digitalisation. The drivers of EA growth are diversified. We forecast that GDP will rise 1.2% this year.

One area of uncertainty, however, is the impact that recent stress in the European and US banking sectors may have on credit provision. The early evidence from surveyed PMI data is that economic confidence is holding up well despite recent financial sector volatility. But it will take time to observe how the flow of credit and the strength of bank intermediation is affected. The longer volatility and uncertainty continue, the greater the chance that credit growth will slow as banks' lending standards tighten.

Headline inflation is receding as energy costs fall, but outside of that, inflationary pressures are intense. Core inflation is running at a record high (5.6% y/y) and the ECB's estimate of cyclical inflation, supercore, is 6.3% y/y. Record high inflation is broad based across both service and core goods sectors.

The ECB faces the challenging twin task of bringing inflation back to a sustainable path towards target and underpinning stability in the financial system. A keen focus on both economic data and the financial system is needed. But the best way the ECB can guarantee economic and financial stability is to ensure price stability.

Figure 7. Euro area cyclical inflation way too high



Source: ECB, Macrobond, ANZ Research

Whilst a tightening in credit provision, if it emerges, would help to reduce inflation, we expect that the ECB will tighten further and hold rates at peak levels into 2024. The strength of spring wage settlements will also be important in assessing the path for inflation and policy rates.

> Monitoring the credit data and possible emergence of fragmentation will be of heightened importance in coming months. Annual rates of credit growth have been slowing as pandemic related liquidity programs and emergency borrowing recede. We will watch to see if the sequential flow of credit deteriorates beyond the normalisation that existed pre the recent banking volatility. The ECB can easily introduce a new TLTRO for banks if additional liquidity is required.

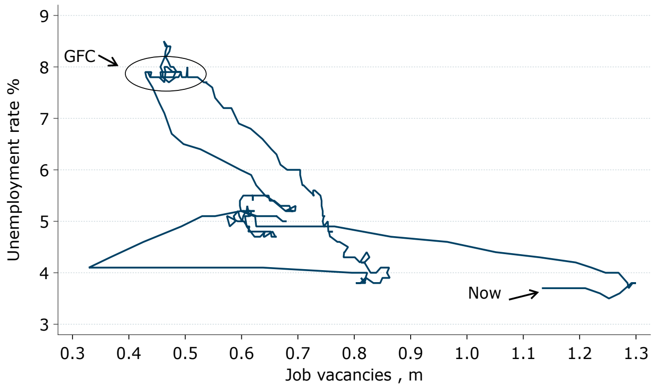
Our baseline is that further rate increases are appropriate, and we expect the governing council to raise rates another 50bp in Q2 to 4.0%

UK: economy proving resilient

Contrary to expectations of a protracted, shallow recession, the UK economy has proved resilient in the face of multi-decade high inflation. In the first two months of this year, 140k jobs have been created, retail sales volume growth has been strong (+2.4%) and consumer confidence is recovering. Whilst the early 2023 pace of jobs growth and spending is above the economy's long run average potential, the resilience is positive and should be further underpinned by new fiscal support for households.

Inflation, nevertheless, remains a significant threat to the growth outlook. The BoE has raised the bank rate to 4.25% and the risks are still skewed towards higher rates. Owing to wholesale gas price falls and index base effects, annual rates of inflation should fall quite sharply from Q2, providing some comfort to households. But service price inflation remains too high (6.6% y/y) and tightness in the labour market (unemployment rate 3.7%) can sustain high levels of wage growth. Average weekly wages ex-bonuses are running at 6.5% y/y compared with 3.7% a year earlier. The employment rate is at 75.7%, high, but still 0.8% below pre-pandemic levels. That is adding to inflationary pressures given strong demand for labour. The government is taking fiscal measures to encourage re-entry to the labour force.

Figure 8. UK labour market very tight



Source: ONS, Macrobond, ANZ Research

Financial centralisation

Raymond Yeung

China considers job creation a top economic target. High youth unemployment raises social stability concerns.

The policymakers will focus on boosting domestic consumption and investment. Urbanisation will quicken.

The Party will supervise the financial system closely. More restructuring and personnel appointments will be announced.

China's economic performance has improved since authorities reopened for business last December. In the first two months of 2023, retail sales returned to positive growth (3.5% y/y) following consecutive contractions in the last three months of 2022. Consistent with February's impressive manufacturing PMI print (52.6) – its highest point since 2012 – industrial production rose to 2.4% y/y over the same period after December's 1.3%. Fixed asset investment also rose 5.5%, beating the market expectation of 4.5%.

Indeed, the end of the zero-COVID regime released a significant amount of latent activity. Domestic travel and in-city traffic are back to normal. In some cases, metro traffic has largely returned to pre-COVID levels (Figure 1). Based on our local knowledge, we found that airlines and hotels have lifted prices in response to pent-up demand. We are also seeing many conferences and events in business hotels, which were rare in 2022. In major urban areas, people are queueing to get into restaurants. International travellers are also returning. Social activity is normalising.

External demand remains weak. Exports contracted 6.8% ytd y/y in the first two months of 2023, following December's 9.9%. And imports dropped 10.2%. The trade data echoes those of neighbouring economies: Korea and Taiwan both reported large contractions in exports. For the latter, December's exports fell 17.1% in February, the largest since 2008's GFC. Hong Kong's exports shrank by 36.7% in January to the lowest figure since 1953 during the Korean War. Activity relating to electronics supply chains is experiencing a downturn as fears of a global recession increase.

This economic environment prompted the government to set a prudent GDP target of "about 5%" at the National People's Congress (NPC). At the same time, it vowed to create 12m urban jobs, up from last year's 11m.

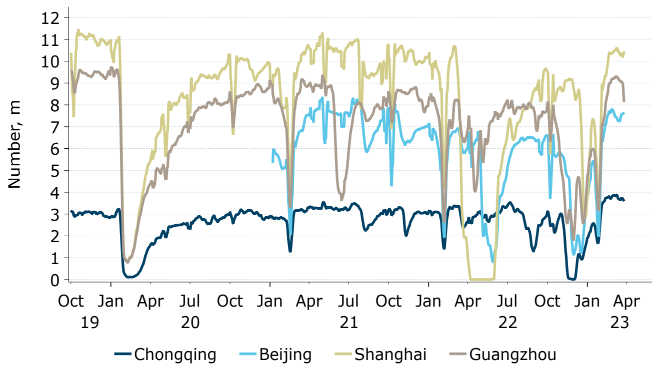
The number of new graduates will reach 11.6m, a record high. As the growth target is lower than last year's 5.5%, a structural shift within the economy would be needed so that more jobs can be created for every yuan of GDP expansion.

Indeed, the government is counting on domestic demand to shore up growth. Notably, it plans to utilise urbanisation to not only boost growth but to upgrade people's standard of living. Statistically, each 1ppt increase in urbanisation will add 1.8% to China's overall consumption. China faces mounting youth unemployment (February: 18.1%) (Figure 2), and the government will continue to quicken the pace of urbanisation to help relieve that too.

The leadership stresses on stability

At the 2023 NPC press conference, the newly appointed Premier Li Qiang reiterated the policy ambition to stabilise growth, prices and employment. The government recognises a pressing need to maintain growth momentum at a steady pace as it needs a constant flow of jobs in the labour market. It recognises the need to restore confidence in the private sector, including tech and e-commerce, which provide numerous opportunities for young people. He praised the contribution of private entrepreneurs and reassured them that their involvement would lead to a promising future.

Figure 1. Metro traffic has normalised



Source: Metro Chongqing, Metro Beijing (Subway), Metro Shanghai, Metro Guangzh Bloomberg, Macrobond, ANZ Research

Figure 2. China urban jobless rate age 16-24

Source: China National Bureau of Statistics, Bloomberg, Macrobond, ANZ Research

The government aims to avoid massive swings in the economic cycle. Overall, its policies will remain growth supportive. However, the authorities will still be cautious in managing the doses of policy stimulus. Notably, they will not opt to 'flood' the economy with massive monetary injections. Instead, the key is to unlock the potential of social resources in supporting the economic recovery. According to our estimates, CNY7trn of extra household deposits is sitting in the banking system. The question is how to turn the non-state resources into effective demand.

Policymakers have urged commercial banks to support property lending, and builders have received funds to complete projects on hand. There are also signs that property prices have bottomed. In the first two months of the year, prices of newly built residential real estate rose on a month-on-month basis (February: 0.3%), ending 16 months of falls since September 2021. Benefiting from the end of COVID lockdowns, property sales rose mildly, at 3.5% y/y, in January-February.

China treasures stability as global uncertainty intensifies

This explains why the People's Bank of China opted in March to lower the reserve requirement ratio by 25bp. Credit expansion was stronger than expected in February, with Total Social Financing hitting CNY3.2trn (Figure 3). Interbank funding is relatively tight. By lowering the RRR, authorities can inject long-term funding to stabilise the market interest rate at the target level (7-day repo rate of 2.00%).

Since the government will unlikely slash interest rates much, as the PBoC prefers policy stability, a massive upswing of the property sector is also unlikely. In our view, China's property sector will need a full recovery to sustain cyclical growth momentum through 2023. Local authorities are now allowed to set mortgage interest rates more flexibly, and do not need to observe the standard reference to 5y Loan Prime Rate. But the average rate for first home buyers is still high at around 4.04%, limiting the upside of the property recovery.

Financial oversight is centralised

The government is still wary of property bubbles that may hinder the quality driven development of the nation. For decades, China's growth has been riding a positive property cycle. Local governments used to rely on land sales to fund local activities. Their implicit guarantees to Local Government Financing Vehicles expanded the financial leverage of their affiliated entities as well as many local state-owned enterprises. China's central government is now determined to clean up hidden debts and financial risks at the local level.

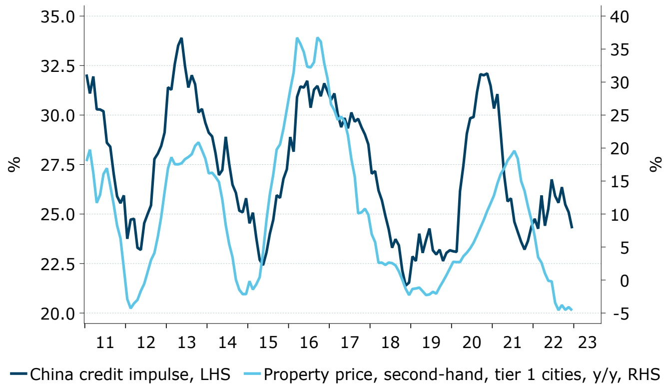
Against this backdrop, the political leadership began a financial overhaul. The regulatory functions of the China Banking and Insurance Regulatory Commission will expand and be renamed the State Administration for Financial Regulation.

Financial authorities at local government level will be trimmed. Regional branches of the PBoC will close, and provincial branches will report directly to headquarters. More importantly, the Financial Stability and Development Commission at the state council level will be replaced by the Central Financial Affairs Commission at the party level. This suggests authorities want a firmer grip on the financial system.

China is taking financial stability very seriously at a time when the global financial market is challenged by the failure of individual banks. In fact, the global issues may have reinforced China's belief in a heavy-handed approach to financial supervision.

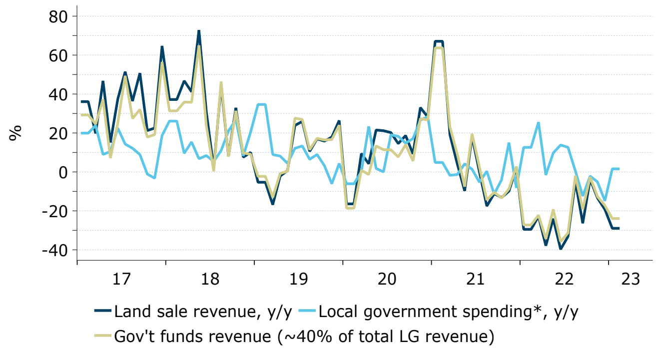
Domestically, policymakers are moving to de-risk the financial system. Local governments' explicit debts have increased 16% y/y over the past five years and their implicit debts may have reached CNY60trn, or half of China's GDP, according to our estimates. Since local fiscal positions have deteriorated due to property woes (Figure 4), the financial overhaul signals authorities will use a top-down approach to tighten the financial system more aggressively.

Figure 3. China's credit impulse and property prices



Source: NBS, Bloomberg, Macrobond, ANZ Research

Figure 4. Local fiscal condition deteriorates due to poor land sales



Note: Local government spending refers to spending under both the general budget and government fund budget.
Source: MoF, Macrobond, ANZ Research

Australia

Rates to rise further and stay high

Felicity Emmett

RBA on track to deliver two more rate hikes, given the resilience in demand, strength in the labour market and sticky inflation.

Australia should avoid recession given strong population growth, a tight labour market, resilient consumers and a large pipeline of construction.

We don't expect a quick reversal of rate hikes. Monetary policy will need to remain restrictive until late-2024.

While there are risks to the timing of the next couple of rate hikes, we are comfortable with our view that a solid domestic economy and a slow return of inflation to the target will see the cash rate eventually peak at 4.1%.

Moreover, an extended period of restrictive rates will be required to bring inflation back to target, notwithstanding a slowing growth trajectory. We see the cash rate on hold at 4.1% until late-2024.

Banking sector wobbles of the past few weeks have created more uncertainty about the broader economic outlook, despite swift action from central banks. Concerns that the fallout from the recent issues could tighten financial conditions will likely linger.

The inflation beast has not yet been tamed in Australia, but the RBA has been clear in its recent communications that it is getting close to pausing the rate hike cycle. With around 15% of mortgage debt rolling off from very low fixed rates (around 2%) to much higher variable rates (5.5–6%) through this year, the RBA is keen not to overtighten. Signs of softer growth and confirmation that we have passed the peak in annual inflation suggest rates are beginning to bite and the much-anticipated slowdown in activity is starting.

We're not so sure. While we don't doubt that the economy is slowing, the softness in Q4 GDP seems overstated. It's not consistent with the strength in business surveys or the rise in hours worked. We expect Q1 to look a little better. And, like the RBA, we're conscious of the experience in the US and Europe, where a patch of soft data mid-last year was reversed, with core inflation picking up in recent months.

Labour market still tight

The labour market picture we get from the hard data, surveys and bank customers supports our view that the economy remains resilient. The March quarter ACCI Survey of Industrial Trends showed that businesses see labour as the tightest constraint on output in the six-decade-history of the survey.

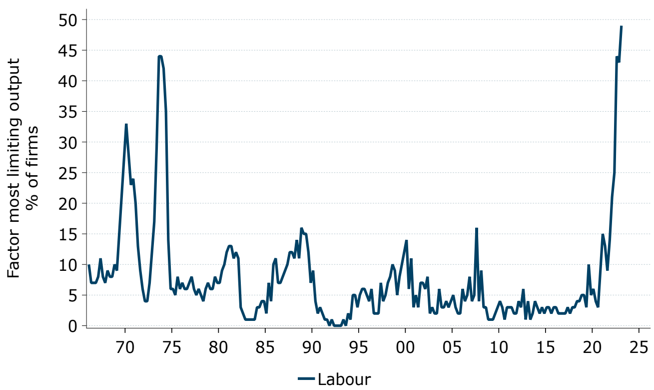
At the same time, orders, as a constraint on output, fell to their lowest level since the early 1970s. Demand remains solid. Supply is still the bigger problem.

The recovery in labour market data in February is telling. Unemployment fell back to 3.5%, while underemployment dropped back to its recent low. At 9.4%, overall labour market underutilisation is only just off the trough of 9.3% recorded in November.

The excess demand for workers (reflected in a very high level of job vacancies) will limit the rise in the unemployment rate. We see it staying in the mid-3s through most of this year before rising to 4.3% by the end of 2024.

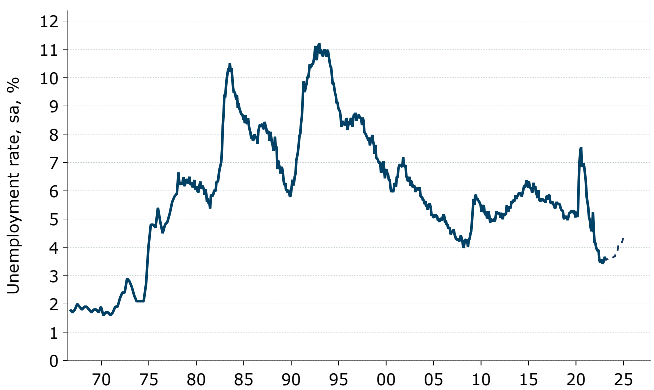
Importantly for the RBA, the tight labour market is not feeding into sharply higher wages growth. At least not yet. Growth in the Wage Price Index has accelerated but remains moderate at 3.3% y/y, while the broader measure of labour costs favoured by the RBA, average non-farm hourly earnings, grew only 2.5% y/y in the December quarter. While these benign outcomes have reduced concerns about a possible price-wage spiral, ongoing labour market tightness is likely to keep the RBA watchful. Our own view is that wages growth continues to accelerate, reaching 4.4% y/y by early 2024.

Figure 1. Labour is the key constraint on output



Source: Australian Chamber of Commerce & Industry, Macrobond, ANZ Research

Figure 2. Unemployment to rise only moderately



Source: ABS, RBA, Macrobond, ANZ Research

Improving wage growth will help households manage the challenges ahead. While the household saving rate has fallen to pre-COVID levels, large savings buffers built up through the pandemic will help to cushion the impact of higher mortgage rates and the higher cost of living. The willingness of households to run down these savings will have an important influence on the trajectory for consumer spending and overall demand.

While the slowdown in consumer spending in the Q4 national accounts looks exaggerated, ANZ-observed spending data for March suggest that the long-anticipated consumption slowdown may be starting to come through. That said, travel and other services spending remains very elevated.

Rising house prices suggest consumer resilience

Evidence of household strength is apparent in the resilience in house prices. While prices at the national level fell nearly 10% in the period from May 2022 to February 2023, the pace of declines has moderated sharply. Prices fell just 0.2% in February after a 1.1% fall in January, while Sydney prices rose 0.1%. Daily data suggest the trend continued into March, with Sydney prices up around 1% on a rolling-28-day basis, and Melbourne prices also back in positive territory. This is a surprising development and suggests considerable upside risk to our forecast for a 10% decline in prices in 2023.

An extended period of restrictive rates will be required to bring inflation back to target

But, stepping back, if the most interest rate sensitive sector of the economy is staging a comeback, more hikes may be necessary to dampen demand and hence inflation.

Underlying inflation likely to be sticky

Easing global supply-side pressures will help drive annual headline inflation down to 4.5% by year-end. But we continue to expect trimmed mean inflation to be slightly stickier. After peaking at 6.8% in the December quarter, we're expecting only a gradual decline to 4.8% by end-23 and 3.0% by end-24. This is a long period to have inflation running so far above target and raises the risk of high inflation becoming entrenched through higher expectations from both households and businesses.

Global developments will be important for the domestic outlook, in terms of both inflation and activity.

A recovery in China will be a positive. Services will be the biggest beneficiary with Australia's tourism and education exports getting a sorely needed boost from the easing of COVID restrictions and reopening of international borders in our biggest trading partner.

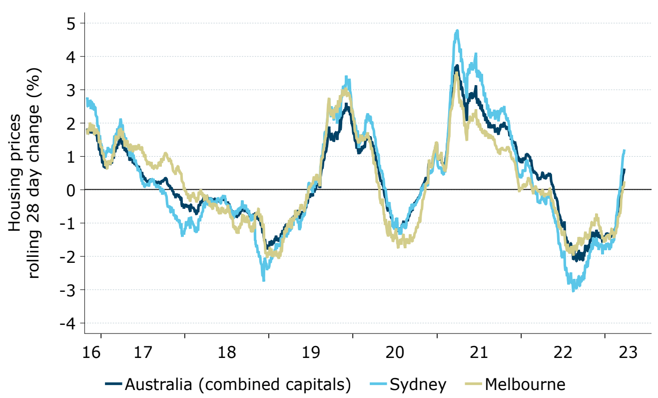
Somewhat offsetting that, shallow recessions in the US and Europe will weigh on global growth in 2023. But the bigger wildcard is the banking sector and any financial contagion that may develop.

Strong population growth will also support the Australian economy. Since the opening of international borders early last year, overseas migration has surged to record highs, boosting overall population growth well above our (and the government's) earlier expectations.

Our central case is that a tight labour market, resilient consumers, population growth and a large pipeline of construction will help the Australian economy avoid recession over the next couple of years. But this resilience will translate to persistently high inflation, and a vigilant RBA.

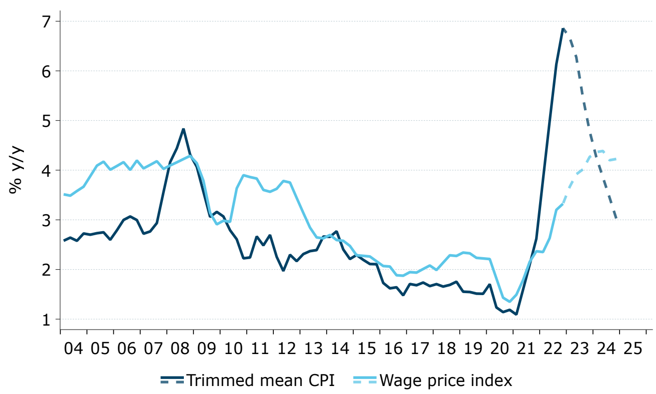
Rates will need to remain in restrictive territory for some time, and our view remains that the first rate cut will not be delivered until November 2024.

Figure 3. Housing prices are now rising



Source: CoreLogic, Macrobond, ANZ Research

Figure 4. Wages growth to accelerate



Source: ABS, Macrobond, ANZ Research

New Zealand

Turning

Sharon Zollner

The **NZD** sometimes trades as a proxy for global risk. Might it fall out of bed, boosting inflation?

The **labour market** is gradually becoming less tight – how quickly will wage pressures fall?

The fall in **house prices** has been very orderly so far, and helpful for taking heat out of the economy. Could strong **migration** turn it around?

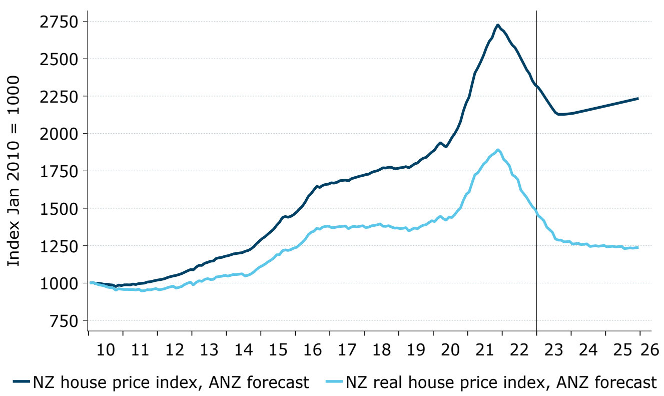
Like many economies around the world, New Zealand finds itself in a transition phase. Sharply tighter monetary policy is starting to have clear impacts, most dramatically on house prices but also on retail spending. But the labour market remains extremely tight, and forecasts that CPI inflation will fall off its 7% plateau remain just that for now – forecasts. And in the meantime, a succession of supply shocks, primarily weather-related, are unhelpfully keeping inflation for some key goods elevated, particularly fresh fruit and vegetables. Fiscal policy is under opposing pressures: to ease the cost of living, to reduce deficits, and now, to organise and fund a significant rebuild programme after Cyclone Gabrielle damaged roads and bridges around the North Island.

Monetary policy is gaining traction. And that's not surprising, given the Official Cash Rate (OCR) has been lifted from 0.25% in mid-2021 to 4.75%. Home prices have fallen 16% on their way to a fall of 22% from their November 2021 peak, based on our forecasts. Remarkably, that can be considered a soft landing, given that house prices jumped 45% in two years during the COVID period. Such a fall will still leave house prices higher than pre-COVID in nominal terms, and slightly below, in wage-adjusted terms (Figure 1). That's a pretty benign outlook, on the whole, amid a broad societal acceptance that house prices need to fall in order to make home ownership a realistic goal for younger generations.

That's not to say that such a fall is pain-free. A small number of borrowers are in negative equity. Making money through property development is clearly a riskier proposition in a world where construction costs continue to rise but the price of the finished product is going backwards, and consents are falling markedly. But overall, it's a case of 'so far so good' in what has been a very orderly adjustment. Heavily leveraged households are facing a sharp shock as their fixed mortgage rates roll over, and in some cases have more than doubled. But the overall level of household debt relative to income is not as high as one might think, given the turbo-charged housing cycle New Zealand experienced in recent years (Figure 2). That's because both employment growth and wage growth have been very high, offsetting the debt increase.

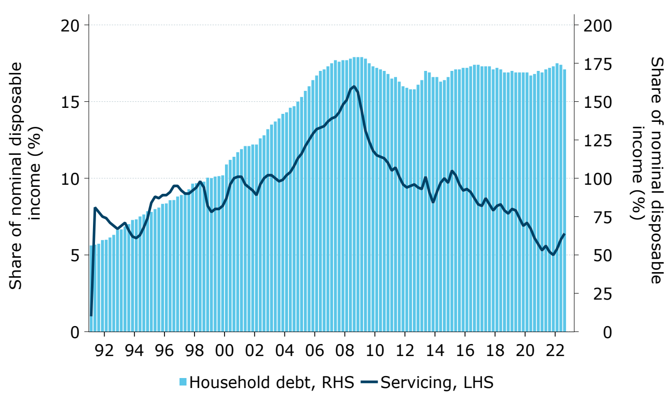
Bank lending has also been much more prudent than in the years preceding the Global Financial Crisis. Accordingly, based on our forecast that the OCR will peak at 5.25%, the proportion of household disposable income that is being used to pay interest on debt will peak a little over 10%. That's a doubling from its trough and not to be sneezed at, but it's a lot lower than the 16% peak seen in 2008. Household debt is not the cap on the OCR that one might assume. That's not to say all borrowers will be able to handle the sharp lift in mortgage rates without difficulty. But monetary policy is concerned with the average household. Financial stability policy focuses on the tails. And so far, indicators of mortgage stress, while rising, are only back around pre-COVID levels.

Figure 1. ANZ nominal and real house price forecasts



Source: Stats NZ, REINZ, Macrobond, ANZ Research

Figure 2. Household debt and debt servicing



Source: RBNZ, Macrobond, ANZ Research

Still, more money is being sucked out of consumers' pockets. That is showing up in lower retail volumes, albeit not as weak as consumer confidence data suggest (Figure 3). Weaker retail spending is, a theme we expect to continue, reinforced by unemployment which is expected to lift towards 5% as the economy slows. With CPI inflation running at 7.2%, the increase in the cost of living is also dampening spending power. However, with private sector average hourly earnings up 8.1% y/y, the minimum wage rising 7.2% and benefits to be lifted by a similar magnitude, the extra burden on that mythical 'average' household needs to be thought about in net terms. Compensation for high inflation is happening.

While only fair and reasonable, from an inflation-targeting point of view this represents a degree of 'normalisation' of high inflation that has the potential to become persistent – hence the urgency with which the OCR has been raised. Are people starting to build higher wage expectations into their borrowing decisions? Has the perception of a 'good' mortgage rate changed? Are firms starting to assume that passing on costs won't be difficult because everyone will be doing it? A recession will put paid to that view; hence the RBNZ's admission that the mild recession they (and we) are forecasting for this year is entirely deliberate.

Monetary policy is gaining traction

It's important to note that it isn't merely inflation that is making the case that consumers need to "cool their jets" in the words of RBNZ Governor Adrian Orr. New Zealand's current account deficit has blown out to 8.9% of GDP – the highest since the official data started in 1987 (Figure 4). This represents:

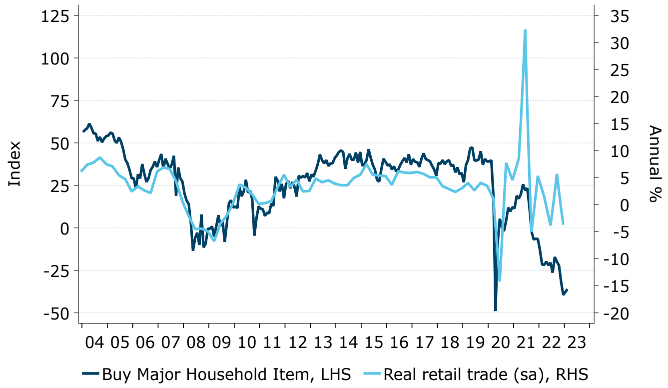
- a goods trade deficit as a result of both strong consumer and government spending and weather-impacted exports;
- a services trade balance due to the closed border having abruptly stopped tourism (previously a major foreign exchange earner); and
- an income deficit – as a net debtor nation, New Zealand is a loser when interest rates rise.

In all, the picture is of an economy that has been living beyond its means for some years, and which needs to get onto a more sustainable path.

Recent global events imply a risk that this path could be bumpier and less on our own terms than we might prefer. New Zealand banks are very well capitalised with sound liquidity positions. But at the end of the day, New Zealand is a small, open economy with a large current account deficit, heavily exposed to global growth and China in particular. If risk gets repriced, New Zealand may face higher costs to fund itself offshore. In addition, the NZD has long been a favourite proxy for traders punting on a weak global growth outlook. A sharply weaker currency would be inflationary, potentially putting the RBNZ in a tricky situation if there is a second-round impact on inflation expectations.

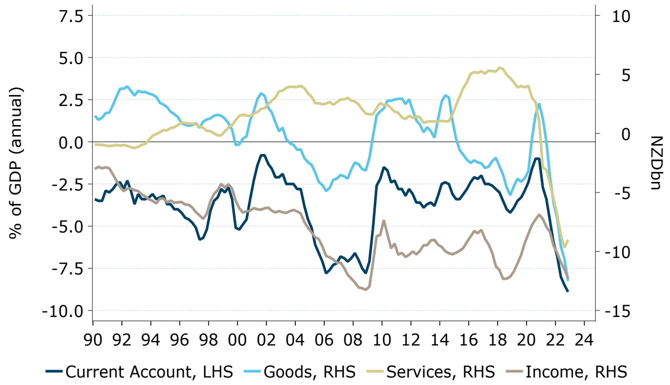
Overall, we see risks on both sides of our forecast that inflation will fall steadily from here back to 2%, but with the upside risks dominant. The economy is clearly slowing, and is at risk of a sharper slowdown if the global outlook deteriorates. That could see inflation fall faster than expected. But there is also a risk of unhelpful upward shocks to inflation from offshore (geopolitics, supply chain rethinks, central banks struggling to do what's needed to tame inflation in the face of financial stability risks, the NZD) and onshore (inflation expectations and sticky wage growth). Sluggish growth but sticky inflation would represent an unappealing set of policy options for the RBNZ.

Figure 3. Retail volumes and 'Good time to buy a major household item?'



Source: Stats NZ, Macrobond, Roy Morgan, ANZ Research

Figure 4. Current account deficit components



Source: Stats NZ, Macrobond, ANZ Research

Asia (ex-Mainland China)

A 'garden variety' slowdown

Sanjay Mathur

We anticipate the current slowdown to be of a 'garden variety,' as the region does not suffer from deep imbalances.

Near-term domestic demand may even be selectively better than anticipated and help to overcome weak exports.

Lower energy prices and a revival in tourism inflows portend stronger current account positions for most economies.

Inflation is receding unevenly across the region.

Broadly unchanged from our previous assessment, our 2023 GDP forecast of 4%[1] reflects the net balance of resilient domestic demand and prolonged weakness in exports. Also embedded in the forecast is our view that apart from possible near-term weakness in cross border flows, the Asia (ex-mainland China) region will be largely immune to changing financial conditions in developed markets.

Household consumption, though slowing, has held up better than anticipated. Labour markets, encompassing both employment and wages, remain firm, whereas monetary policy tightening has not made any meaningful dent in select ASEAN economies or India. The latter largely reflects the incomplete transmission of higher policy rates to lending and deposit rates. The structure of bank deposits is still skewed towards lower interest-bearing demand and savings deposits, credit demand has not materially strengthened and liquidity remains generous by historical standards, so banks in several economies have not yet felt compelled to pass on higher policy rates to lending rates. Only in Malaysia have lending rates risen in lockstep with policy rates. In India, Indonesia and the Philippines, lending rates have risen by less than half that of the policy rate.

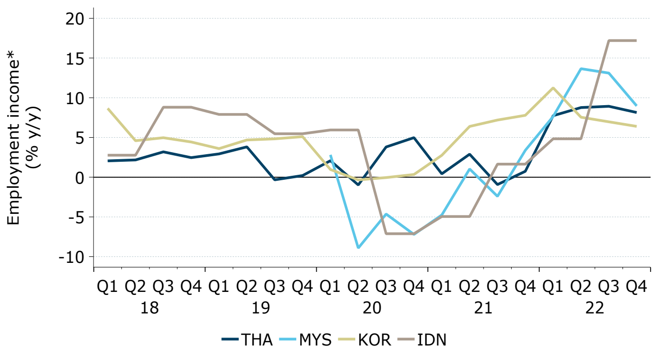
Cumulatively, labour market strength and incomplete policy transmission portend stronger than previously anticipated resilience in household consumption in some economies in the near term. This combination is particularly evident in Malaysia and the Philippines. Though policy transmission has been complete in the former, the rise in the policy rate has been mild amounting to 100bp. We have, accordingly, upped our 2023 GDP forecast for these two economies to 5.8% and 4.2% from 5% and 4% previously. Malaysia's growth should also benefit from a step-up in public development spending. For India, we have maintained our FY24 GDP forecast of 6% despite a cumulative 250bp increase in the policy rate.

We are however, cognisant that incomplete policy transmission offers only near-term upside to growth. As growth becomes more leveraged and excess liquidity normalises, lending rates will rise more aggressively. Developments in South Korea provide useful forward guidance. Its business and credit cycles advanced earlier than those in ASEAN and India and accordingly, lending and deposit rates also recalibrated to the policy rate much earlier.

Even so, it helps to offset weak exports, for which the global backdrop is less than encouraging for three reasons: 1) the services-oriented bias of economic activity in developed economies, 2) on-going pressure on the global tech cycle and 3) the focus of mainland China's policymakers on internal demand to drive growth. Validating point three was the nearly 21% y/y fall in mainland China's imports from Asia in January-February. This suggests the main benefit of its re-opening will be regional tourism as opposed to goods exports. It also underscores our relative optimism on Thailand's growth.

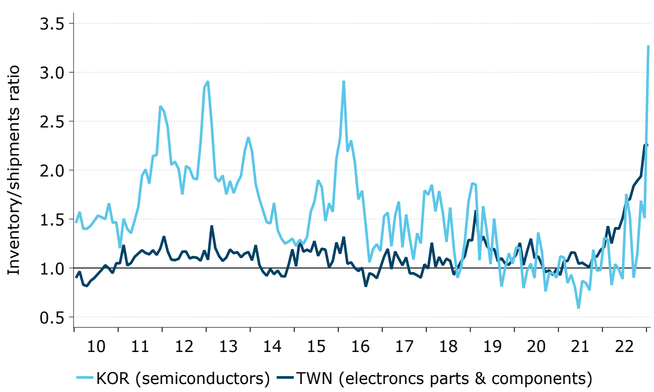
[1] Asia (ex-Mainland China) not shown in forecast tables at end of report.

Figure 1. Robust income growth



Source: National sources, Macrobond, ANZ Research
*Calculated as employment x average wage.
Note: MYS based on available manufacturing and services data.

Figure 2. Soaring tech inventories



Source: Macrobond, ANZ Research

On the weakness in the global tech cycle, exports from Singapore, South Korea and Taiwan have fared poorer than the others and the new export orders sub-component of their manufacturing PMIs remains well below the neutral mark of 50. Furthermore, South Korea's and Taiwan's inventory-shipment ratio for this sector is running at a multi-year high, the unwinding of which is likely to be time consuming. As such, we are still midway in the downturn of the global tech cycle that typically lasts 13-16 months.

Weaker exports notwithstanding, we foresee better current account positions for most economies in the region. Headwinds that had adversely impacted current account positions in 2022 are abating. Food and energy prices, supply chain disruptions and tourism flows are turning more supportive. We anticipate the largest improvement in Thailand where the current account should swing back into surplus. This is despite weak outturns in January 2023. In fact, for Thailand, we forecast the current account to improve from a deficit of 3.4% of GDP to a surplus of 2.3%, marking a positive swing of around 5.7% of GDP.

Near-term resilience in domestic demand should offset weak exports

We had also anticipated a return of portfolio flows this year, thereby allowing for a stronger improvement in the overall balance of payments. The risk around this expectation has, however, widened following the rise in volatility in global financial markets.

Turning to monetary policy, we think that price stability will remain the key near-term anchor for monetary policy and more so, as the US Fed is now close to completing its own tightening cycle. On this premise, central banks in Malaysia, South Korea and Taiwan have concluded their tightening cycles. We anticipate one more hike of 25bp each in India, the Philippines and Thailand.
We also anticipate further calibration of the slope of the S$NEER band in April. Meanwhile, the slowdown in the construction and real estate sector has prompted the State Bank of Vietnam to cut its policy by 100bp.

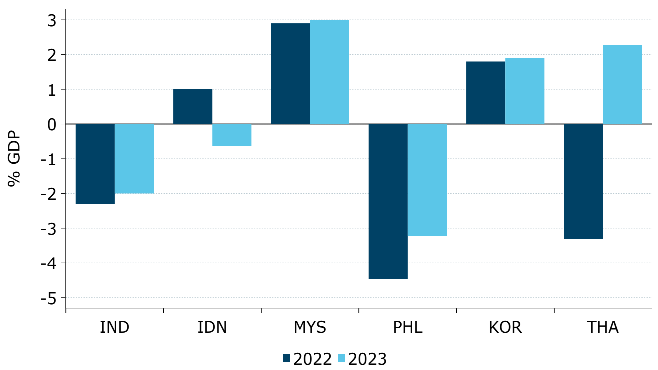
The inflation outlook is quite varied across economies. Overall, as food and energy prices – as opposed to domestic demand – have been the main sources of price pressure, their retreat should be unambiguously favourable for inflation in the region. However, for idiosyncratic reasons, the path is proving to be non-linear in India and the Philippines. Market inefficiencies in the Philippines are preventing a decline in food prices whereas in India, inflation expectations now appear to be feeding through core inflation. It is unlikely that inflation can gravitate back into the official target range of 2-4% before Q4 2023 in the Philippines. It is also likely to stay above the mid-point of the official range in India for a prolonged period.

The path of inflation is also unclear in Malaysia where the new administration has reiterated its intention of moving to targeted fuel subsidies. As the contours of this shift have yet to be tabled, we have retained our earlier CPI forecast of 3.1% for 2023. Singapore's inflation is also set to remain elevated owing to the 1% hike in the GST this year.

Finally, we wish to stress that the region is well positioned to manage any financial market stress emanating from developed economies. We note that banking systems are well capitalised and asset price valuations including equities and property prices are generally not stretched. Credit, though improving is far from excessive.

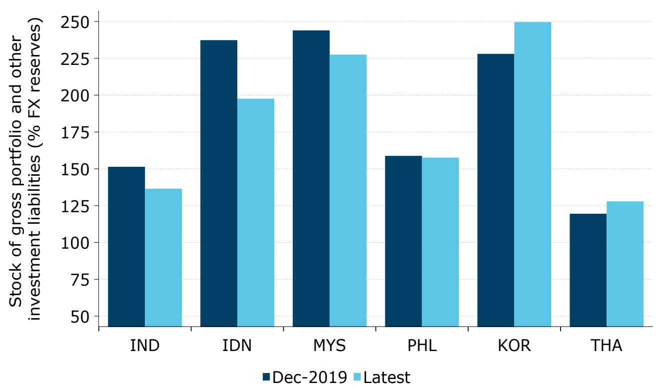
Improving current account positions and generally stable vulnerable external liabilities (portfolio capital and 'other investment' as a share of FX reserves further add to resilience. In all likelihood, the oncoming slowdown should be of a 'garden variety' as opposed to a protracted one.

Figure 3. Current accounts on the mend



Source:Bloomberg, Macrobond, ANZ Research
India: fiscal year starting April

Figure 4. Stable to improving share of vulnerable liabilities



Source: Macrobond, ANZ Research

PNG's agribusiness potential

Kishti Sen

The agriculture sector is vital to Papua New Guinea (PNG) as it accounts for 16% of GDP, constitutes 12% of total export earnings, and supports around 80% of the population. And last year was a good year for PNG's rural commodity exports as it yielded substantial returns to millions of farmers. Coffee and palm oil farmers had a particularly good year as high prices saw production and export receipts easily outperform the previous two years.

Coffee prices were at record levels through 2022, trading at a high of USD0.242/lb in August and averaging USD0.210/lb (USD4,629/mt) for 2022 (PGK16,500/mt). This was 27.3% higher than 2021. This encouraged farmers to pick their coffee and sell it, especially from the more remote areas where transport costs, both road and air freight costs, can make it uneconomical to move coffee to market. Higher coffee prices meant farmers could sell their beans at commercial levels and earn a decent return.

We estimate PNG produced about 840,000 (60kg) bags of coffee last year which equates to 50,400 tonnes. At PGK16,500/mt, PNG received PGK831.6m through coffee exports last year (+42.7% on 2021) (Figure 1). Palm oil was another standout performer for rural commodity exports for PNG. Export volumes climbed 10% in 2022. With prices up by 11.8% on 2021, total palm oil exports jumped 18.2% to PGK2.7bn in 2022. Strong receipts from rural commodity exports boosted household income and supported consumer purchases last year.

Commodity volumes to stay high in 2023

Industry anecdotes suggest coffee flowerings and weather patterns have been encouraging and indicate good volumes for 2023. The coffee market is expected to hold up well this year and prices are expected to improve into 2024. If all goes to plan, PNG could be looking at exporting about 870,000 60kg bags of coffee this year, a 3.6% increase on 2022.

PNG's food and beverage sector is seeing the benefits of solid population growth and household income growth, both of which boost consumer purchases.

The prospects for this sector are bright. Employment is expected to surge on the back of an expected upswing in construction, while retreating supply chain constraints should reduce pressure on manufacturers too.

Longer term, PNG can elevate rural commodity volumes and exports by improving market access under potential Free Trade Agreements.

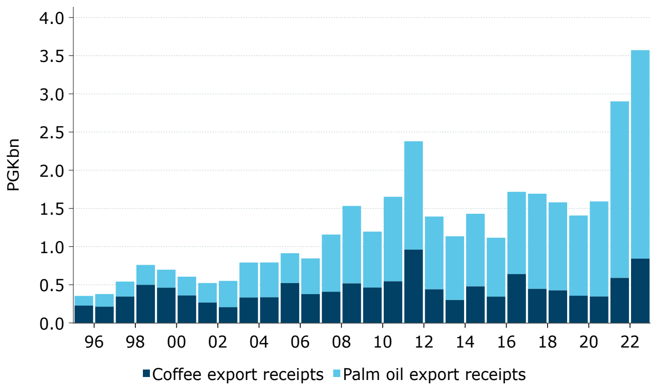
Cocoa is another crop expected to do well. There are expectations of a bumper crop in 2023, with volumes anticipated to be up 25−50% on last year. Industry liaison suggests the recent drought helped reduce the crop's exposure to the cocoa pod borer disease, which in 2006 halved PNG's cocoa production to 30,000t.

Agri output can lift with right support

Global production and consumption of rural commodities has grown in line with population growth, but PNG's market share is small and declining (Figure 2). However, there is strong demand for PNG's niche products, so there is scope for PNG to upscale and increase its share in global trade.

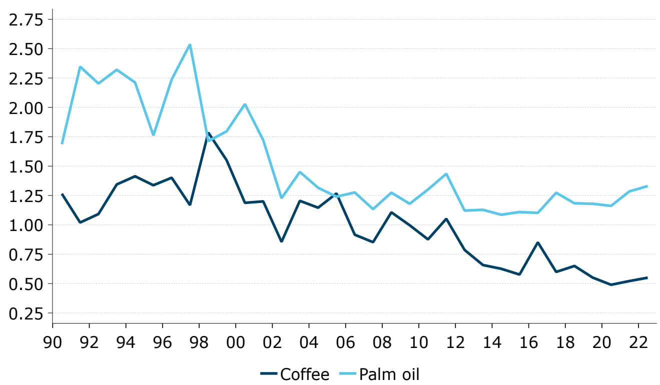
At present, only about 15% of crop smallholders are producing at maximum yield. Most have land that is underutilised. Easier access to new planting material and training on plant care could increase the number of farmers achieving optimal yields. New planting can be augmented with qualitative inputs, such as training on care and rehabilitation of existing gardens to lift yield. Government support for smallholder farmers to optimise cropping on land holdings would go a long way to maximising yields.

Figure 1. PNG's rural commodity exports



Source: BPNG, Macrobond, ANZ Research

Figure 2. PNG's share of global rural commodity exports



Source: USDA, Macrobond, ANZ Research

Foreign exchange

US dollar declines

Mahjabeen Zaman | Khoon Goh | John Bromhead | Felix Ryan

Year-to-date, the US dollar has been whipsawing from positive to negative on the back of multi-sigma moves in the rates markets. This is due to hawkish rhetoric from the US Federal Reserve over the first two months of the year as well as better-than-expected US activity data. However, the onset of the banking crisis in early March reversed the sell-off in US Treasuries, with 2Y yields retreating from a high of more than 5% to current levels of over 3%, with a series of rate cuts now priced in for the second half of the year.

There has been a concerted effort by regulators, central banks, and the banking sector to preserve financial stability via liquidity injections from multiple banks to First Republic Bank. The US Fed also set up the Bank Term Funding Program to provide liquidity to financial institutions. Such moves have apparently averted a bigger crisis, for now.

This has been one of the contributing factors why the Fed, BoE, ECB and SNB continued to raise interest rates to rein in inflation despite an uncertain environment.

We do not think the volatility in rates market and its impact on FX will subside anytime soon. There is limited data available to evaluate the impact of the banking stresses in the US and Europe on overall economic conditions. Therefore, market sentiment will remain fragile.

However, we expect US growth to slow in the aftermath of the above events, which reinforce our view of a weaker dollar this year. Despite having retreated from its highs last September, the US Dollar Index (DXY) remains over-valued based on our fair value models.

Our view of a weaker dollar into year-end is based on some of the following factors. The energy risk premium embedded in the euro has subsided, and activity data in Europe is turning positive as seen in the PMIs and improving consumer confidence. We also expect the Bank of Japan (BoJ) to exit its yield curve control in H2 2023, which will be bullish for the JPY. Assuming the banking crisis remains contained within the US, safe haven buying will be routed towards JPY and CHF instead of USD. A steeper yield curve tends to correlate with a weaker dollar, especially as interest rate cuts are now being priced in.

We expect a slowdown in US growth on the back of recent events which reinforce our view of a weaker dollar this year.

A steeper yield curve tends to correlate with a weaker dollar, especially as interest rate cuts are now being priced in.

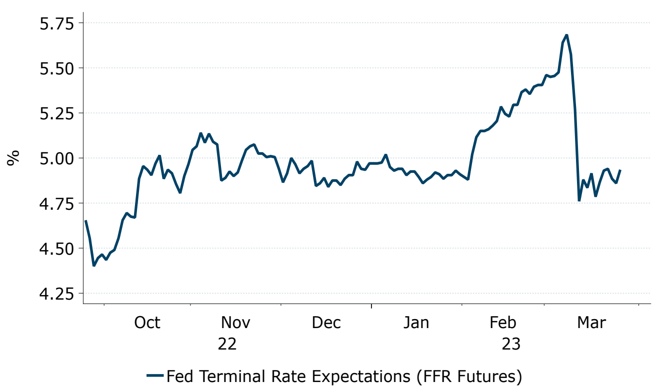
We forecast the DXY to end the year lower at 98.

The US debt ceiling has not yet been reset; in the event of a government shutdown in the second half of the year, the risks surrounding US sovereign debt will lead to concerns on its credit standing.

The Fed has acknowledged that they may not have to push interest rates significantly higher due to tighter financial conditions after the recent bank failures. Thus, incoming data will help markets evaluate the Fed's next steps and rate moves. This will also have an impact on the USD though its slide will be non-linear amid various uncertainties.

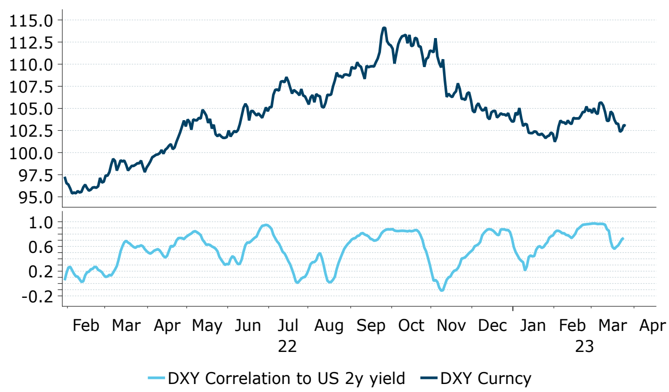
In the coming weeks, there will be more hard data which will reveal the impact on in credit growth from the US banking crisis. We do expect some impact on growth though some of it may already be priced in via market expectations of rate cuts in the second half of the year. Furthermore, the Fed is providing open-ended liquidity support via its discount window and the Bank Term Funding Program (BTFP). Liquidity conditions and households and businesses are also in much better shape than that in previous cycles. Our year-end forecast for the dollar index is 98.

Figure 1. Fed terminal rate expectations plummet



Source: Bloomberg, Macrobond, ANZ Research

Figure 2. DXY correlation to US 2Y bond yields



Source: Bloomberg, Macrobond, ANZ Research

EUR: ECB remains hawkish

The ECB has kept a hawkish posturing after raising interest rates by 50bps in March despite the unfolding of recent banking events in the US and Switzerland. ECB President, Christine Lagarde has committed to getting euro inflation back on target and has said that there is no trade-off between price stability and financial stability. We forecast the EUR/USD to be at 1.14 at year-end as the ECB's hawkish stance will provide a tailwind for the euro.

Relative fundamentals are positive for the EUR vs the USD

Furthermore, given that the ECB started raising interest rates after the US Fed, there is a likelihood that the ECB may still be raising interest rates well after the Fed has paused. The market is pricing in 90bps of rate cuts by the Fed, but none for the ECB. The euro remains under-valued based on our fair value models and as interest rates between the ECB and FED Fed narrow, we expect the EUR to outperform.

The average PMI for Q1 is in expansionary zone at 52.1, well above the 50 mark. This signals resilience in activity despite a rising rate environment. On a fundamental basis, the euro area's current account surplus increased in March as positive interest rates are attracting capital back to Europe. The improving economic momentum adds pressure on the ECB to continue to hike interest rates. This is a positive for the EUR.

Finally, markets are fragile given the recent banking developments in US regional and Swiss banks. While we do not see risks of contagion at this stage to European banks, it is important to note that EU banks are governed by a relatively more stringent stronger regulatory framework. as opposedthan to US banks. In addition, European banks are required to regularly stress test any impact on liquidity from changes in interest rates. On a relative basis, US banks have also been underperforming European bank equities since October 2022. Therefore, while the EUR/USD pair might experience volatility due to the vulnerabilities in the global banking sector, we believe relative fundamentals are positive for the EUR vs the USD.

GBP: things are looking up

The sterling has remained in a range of 1.19-1.24 in Q1. We think there is further upside and forecast GBP/USD to rise to 1.26 at end-2023.

In the March meeting minutes, the Bank of England (BoE) noted that the UK GDP in Q2 2023 is expected to "increase slightly" rather than their previous forecast of a 0.4% contraction as per their February report.

UK retail sales have rebounded to pre-pandemic levels while PMI data is well above 50, with new orders increasing. This optimism is also mirrored in an improving consumer confidence index. Consumption will receive a boost with the arrival of the spring and summer months, when there is reduced demand for heating, implying more disposable income for households.

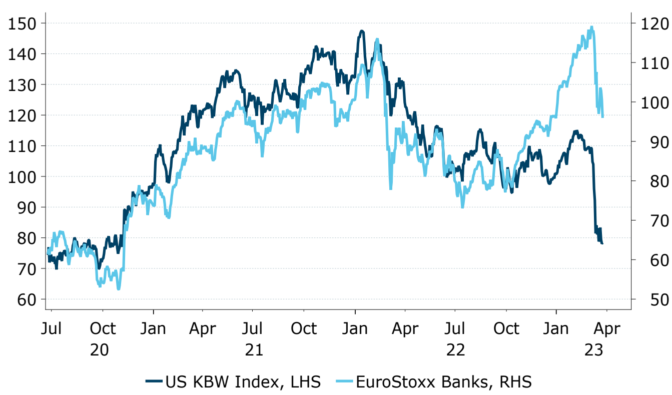
Furthermore, the deal on the Northern Ireland Protocol and EU may lead to an increase in investment and capital inflows to the UK. This development has also been a driver of the upward momentum seen in the GBP.

While a recession may be avoided, UK inflation remains at multi-decade highs. Headline CPI in March was reported at 10.4%, with core CPI at 6.2%. Therefore, higher interest rates are expected to be a feature of BoE meetings ahead.

JPY: BoJ pivot still a key focus

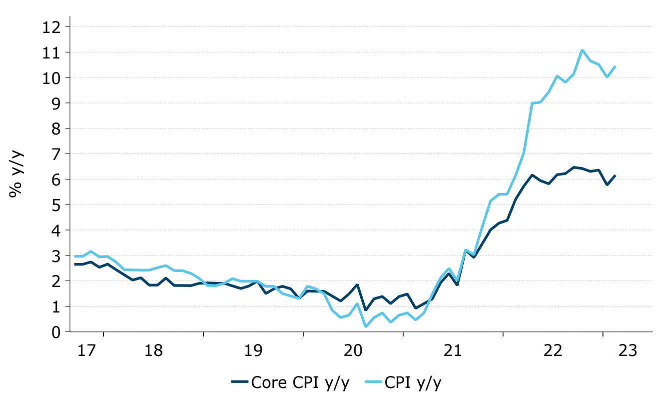
The concerns of financial instability saw an influx of safe haven buying for currencies such as the JPY, shifting attention away from the speculation of a potential surprise policy shift as BoJ Governor Kuroda's term ended in March. Such a speculation stemmed from the BoJ's surprise widening of the YCC band on JGB 10Y yields to 0.5% from 0.25% at the end of December 2022.
It caused elevated volatility in USD/JPY in subsequent months. Additional pressure on a policy shift comes from rising inflation and wages in Japan, despite government measures to cap utility prices for households.

Figure 3. US regional banks underperform EU banks



Source: Bloomberg, Macrobond, ANZ Research

Figure 4. UK inflation rebounds in February



Source: ONS, BoE, Macrobond, ANZ Research

Yet in the immediate term a policy shift looks unlikely. Incoming Governor Kazuo Ueda (whose term will start from 9 April), has publicly supported ultra-loose monetary policy even before his nomination. In his speech before the Diet on 17 February, he described the BoJ's current settings as "appropriate". If a policy shift does materialise, which we anticipate being after Q2 this year, the JPY will rally on more favourable yield differentials. We forecast USD/JPY to fall progressively to 124 by the end of the year.

CHF: safe haven status not much help

Despite being classed as a "safe haven" currency, the CHF has weakened against most G10 currencies in the wake of headlines concerning Credit Suisse, although the franc rebounded in subsequent sessions after Credit Suisse and UBS entered into a merger agreement.

Credit Suisse's collapse hasn't curbed the SNB's hawkish resolve

The SNB has reiterated its commitment to FX intervention as part of its broader strategy of managing inflation. SNB President Thomas Jordan emphasised that the Bank's approach to achieve price stability includes both interest rate hikes and currency intervention, with recent data confirming that the central bank sold more than USD24bn (CHF22.3bn) worth of forex during Q4 2022.

Although a strong CHF has helped to keep Swiss inflation below that of its G10 peers, inflationary pressures have rebounded in 2023. Overall inflation remains too high for the SNB's liking. With the labour market still robust, the SNB will likely remain more hawkish, as evidenced by their 50bp hike in March meeting. Furthermore, President Jordan made it clear that measures taken by the Swiss government, regulators and the SNB have put a comprehensive halt to the Credit Suisse turmoil. As such, Credit Suisse's collapse has not curbed the SNBs hawkish resolve.

Overall, while the CHF has struggled in recent weeks, sound domestic fundamentals and a hawkish, activist central bank affords the currency the potential to recover after the dust settles. We see USD/CHF moving to 0.90 by year-end.

CAD: BoC's pause will pay off

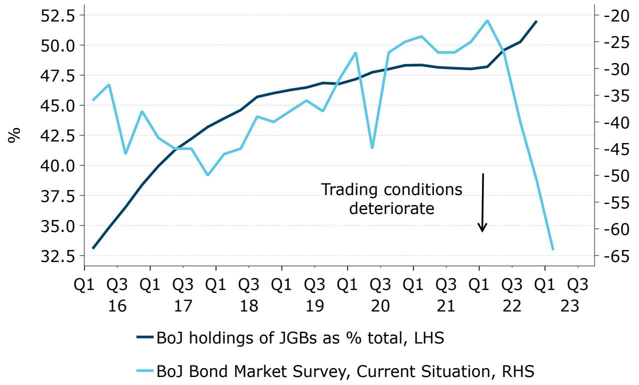
The CAD has struggled amid a stronger DXY in the first half of Q1, and its woes were compounded by the Bank of Canada's (BoC) apparent succession to the local tightening cycle.

Although the BoC's pause might be causing short term pain for the CAD, the decision certainly seems to be in line with the direction of local data. CPI data for both January and February have demonstrated declines in both key goods and services metrics.

However, the Canadian labour market has remained astoundingly resilient, with January's employment data showing 150,000 new jobs, exceeding expectations 10-fold, while unemployment remains near a record low of 5%.

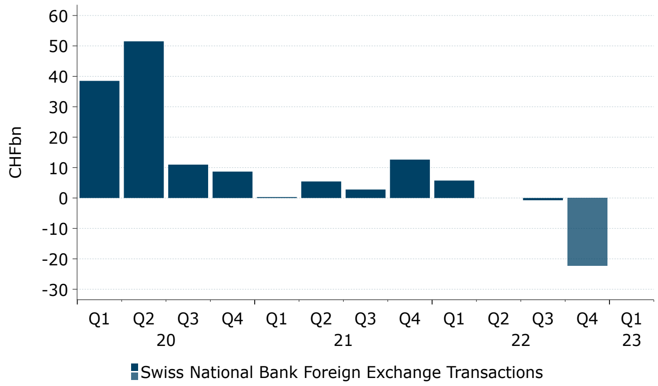
If CPI continues to slip towards the BoC's expectations of 2.6% y/y by year-end, the pause in the current monetary policy tightening cycle may bring about a rebound in broader economic data later in the year, leading to tailwinds for the CAD as the DXY declines and oil prices rise as per our forecasts. In the near term, CAD underperformance will continue, but we believe that USD/CAD will gradually fall to 1.29 by December this year.

Figure 5. BoJ Kuroda's legacy – a poorly functioning Japanese bond market



Source: BoJ, Bloomberg, Macrobond, ANZ Research

Figure 6. The SNB sold more than USD24bn in forex during Q4 2022



Source: Bloomberg, Macrobond, ANZ Research

AUD: vulnerable on crosses

Headwinds have gathered momentum through the first half of 2023, unwinding initial gains. The nearly 7% fall since the end of January is a function of both global and domestic factors.

On the domestic front, economic data have weakened considerably. Combined with global financial stability concerns, this has catalysed an extreme reaction from rates markets (Figure 7). Despite labour market data printing above expectations in February, the market sees next adjustment to interest rates from the RBA (after a pause) as down. This is a significant shift from just a month ago when the policy rate was forecast to peak at 4.3%.

To us, there is a signal in this message from rates pricing - Australia's economic momentum is insufficient to close the policy gap with the rest of the world. We think this will restrict the AUD's upside potential against cyclical currencies with higher rates structures.

However, we see the AUD finishing the year higher against the USD. This is mostly a function of a valuation unwind in the USD, which is still commanding a premium of more than 10% to our measure of fair value. This adjustment process won't be linear, however, and the lower interest rate structure leaves the AUD vulnerable on cross exposures. We expect downward pressure on the AUD/JPY as defensive flows and continued expectations of a policy reset will drive JPY higher.

We maintain our year-end forecast of 0.75 for AUD/USD but acknowledge that in the short term, fears about a global banking crisis are unlikely to inspire strong risk appetite, which may keep a lid on any upside.

AUD upside through 2023 driven by USD weakness

NZD: late cycle dynamics

Much like other cyclical pairs in the G10, the NZD has largely been a pro-risk, anti-USD trade through the first half of Q1 2023. Since the middle of February, it has traded within a relatively tight range between 0.61 and 0.63.

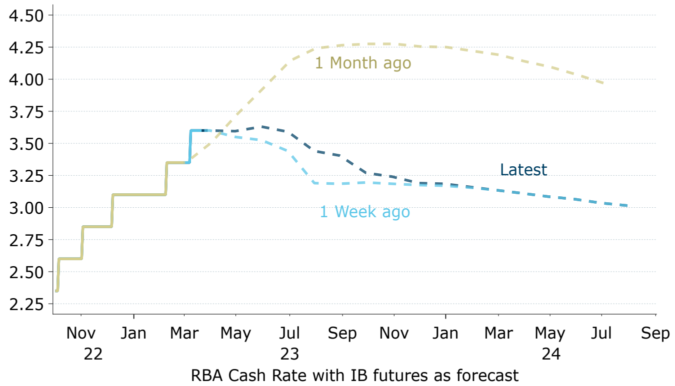
Forward-looking economic indicators are holding up better than expected, despite a soft Q4 GDP print. The New Zealand economy contracted 0.6% q/q in Q4 on a seasonally adjusted basis, weaker than the 0.3% contraction we forecast, and much weaker than the RBNZ's February MPS forecast of +0.7% q/q. However, this is unlikely to materially move the dial for the central bank which is seeking clear evidence that the current extreme mismatch between labour supply and labour demand has turned the corner.

We still see the RBNZ hiking the OCR to a peak of 5.25% by May 2023 and holding it there until at least the end of 2024. But the tight labour market and uncertain impact of the recent cyclone pose upside risks to the outlook for both inflation and the OCR. The growing divergence from Australian rates is a major headwind for AUD/NZD (Figure 8) and upward momentum will be hard to maintain while the RBA remains more dovish.

While global risk appetite has waned in recent weeks, we believe the NZD's higher rate structure presents some downside protection. US and European investment desks, looking for exposure to the Asia Pacific and China re-opening narrative, can do so via the high-yielding NZD.

Overall, our forecasts have the Kiwi appreciating mildly further over the course of 2023, but imbalances like the current account deficit are weighing on sentiment. We see the NZD finishing the year at 0.66.

Figure 7. Expectations for peak RBA cash rate have collapsed



Source: Bloomberg, Macrobond, ANZ Research

Figure 8. Australian less New Zealand 2-year swap spread, near historic lows

Source: Bloomberg, Macrobond, ANZ Research

Asia: a safe harbour

The banking stresses in the US, triggered by the collapse of Silicon Valley Bank, are specific to the US at this stage. Even the issues plaguing Credit Suisse which resulted in its takeover by UBS, have had limited spill-over effects into Asia.

Due to the limited direct exposure of Asian banks to US regional banks and to Credit Suisse, we see the former as well placed to absorb any potential contagion effects.

Asia is well placed to absorb any potential contagion effects

The macroeconomic impact will likely be the bigger effect on Asia. Even if confidence is restored, the ensuring tightening in lending standards in the US will intensify downside growth risks. With Asian exports already declining significantly due to weakness in external demand, the export outlook looks set to remain muted for some time. This will be a drag on the region's growth.

However, Asia does have a tailwind, thanks to China's economic rebound after its reopening. The turnaround in local home prices could be important if it heralds the start of the property sector's recovery. The surprise RRR cut by the PBoC on 17 March shows that policymakers are keen to boost confidence and push the recovery along.

In addition, expectations of a peak in the terminal fed funds rate have been scaled back, with rate cuts by year-end priced in. US Fed actions are an important consideration for Asian central banks when setting monetary policy. If the Fed signals a pause in its hiking cycle, it will provide Asian central banks the cover to maintain policy settings, or for some of them, limit how much more hikes to deliver.

The fact that equity outflows from Asia ex-China have been manageable throughout the banking turmoil, with China receiving inflows via the Stock Connect scheme, highlights broad investor comfort over the impact on the region.

Typically during periods of risk aversion, the USD tends to benefit from safe-haven demand. Not this time. The initial trigger for the banking turmoil was US-specific, and though Credit Suisse got caught in the turbulence, the stresses are still contained largely within the US regional banking system. Hence, the sharp repricing lower of US rates dominated, hurting the USD.

Given our view that the impact on Asia will be limited, particularly through the financial channel, we see scope for some Asian currencies to outperform.

China's economic cycle is going in the opposite direction of the US. The growth recovery has further to run, and importantly China's financial system is not seeing any of the pressures faced by US banks. The changed US monetary policy outlook and pressure on the USD should benefit CNY, especially on the back of increased conversion of export receipts. Cross border flows have been supportive for CNY and we expect a rebound in bond and equity inflows to help firm the yuan.

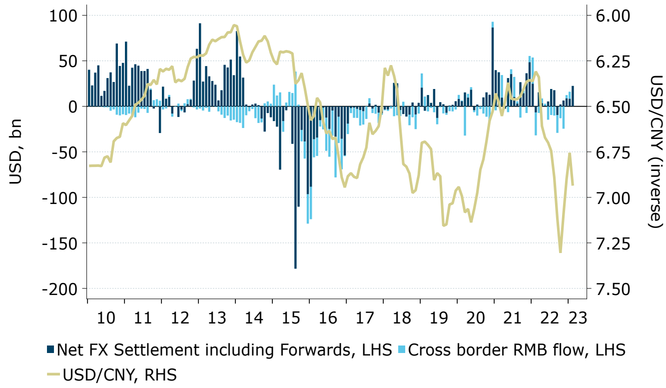
We see SGD strengthening from further policy tightening by the Monetary Authority of Singapore. Inflation pressures remain acute in Singapore as ongoing labour market tightness and the passthrough of accumulated business costs look set to keep inflation at very elevated levels for some time. A stronger appreciation path should see the S$NEER rise to record highs.

IDR remains our preferred high yield currency in the region. Indonesia's banking sector is far removed from the troubles plaguing US and European banks. Economic growth remains robust, and high coal prices have helped underpin positive export growth, contrary to the weakness seen in other countries in the region. This has seen Indonesia's trade surplus holding up well. Potential for more exporter conversion could also give the rupiah a lift.

Figure 9. Asia is well placed to absorb any potential contagion effects

Source: Bloomberg, Macrobond, ANZ Research

Figure 10. Cross-border flows supportive for CNY



Source: SAFE, PBoC, CCS, Bloomberg, Macrobond, ANZ Research

Global rates

Risks mount, but higher rates for now

Jack Chambers | Jennifer Kusuma | Zhaopeng Xing
David Croy | Gregorius Steven

We have seen the peak in UST yields in the current cycle.

The market is under-estimating RBA hikes, which will likely see 3Y ACGB yields rise in the next quarter.

For NZD rates, markets will look through high inflation and look for RBNZ cuts.

Asia LCY bonds have behaved as safe havens amidst weakening global risk sentiment.

10Y CGB yields will trade in a narrow range.

Developments in the global banking sector, particularly for mid-size US banks, put an abrupt halt to the rise in global interest rates which started around 18 months ago. Central banks and other authorities have acted swiftly to minimise the fallout from the banking issues. At this point, it looks like this has been successful and the banking issues will not become systemic.

Even if the most negative scenarios don't come to pass, we are unlikely to return to the previous highs in rates. At the very least, we expect the recent events to slow credit creation, which will in turn dampen growth later in the year. The effects are similar to that of additional Fed monetary policy tightening. The recent moves also highlight that underlying fragilities can be exposed when central bank raise rates as quickly as they have in the current cycle. With these risks in mind, terminal Fed pricing will struggle to return to its previous highs. In addition, markets are likely to continue to price in cuts into 2024 due to expectation that policy will need to turn around at some point.

This all means that we have likely seen the cyclical high in 2Y and 10Y UST yields. But, in the near term we believe that rates can still rise a little further. Presently markets are pricing in around 75bp of Fed cuts by the start of 2023. Unless the issues with the banking sector prove to be much worse, it's difficult to see the central bank making this fast of a shift when the US labour market remains strong and with inflation still too high. So, even if credit creation slows as we anticipate, it will take time for this to translate into conditions which are consistent with the Fed's pause, let along rate cuts.

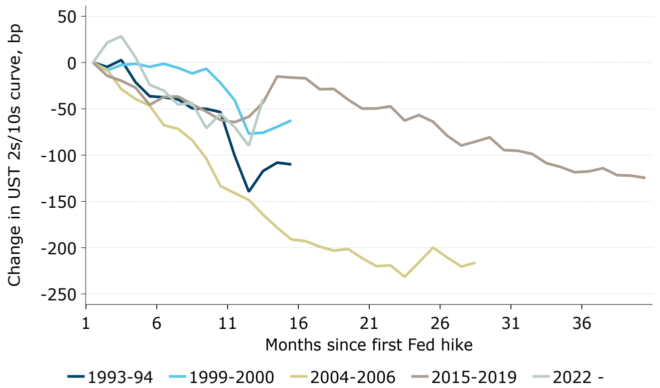
Therefore, in the near term, we believe some of the pricing for cuts can be pushed out and terminal rate expectations can move higher. This implies that the UST yields will rise, particularly at the front end of the curve.

We expect 2Y UST yields to get to 4.5% and 10Y to 3.75% by mid-2023. This implies that the 2s10s curve will flatten to 75bp.

In the second half of 2023 though, we expect bond yields to fall. By this point, activity will be slowing more quickly and inflation will be sliding close to the Fed's target. This will allow for markets to more definitively price in cuts. This will also steepen the UST 2s10s curve, as is typical at the end of a hiking cycle. These moves will continue into 2024 as the Fed starts to cut.

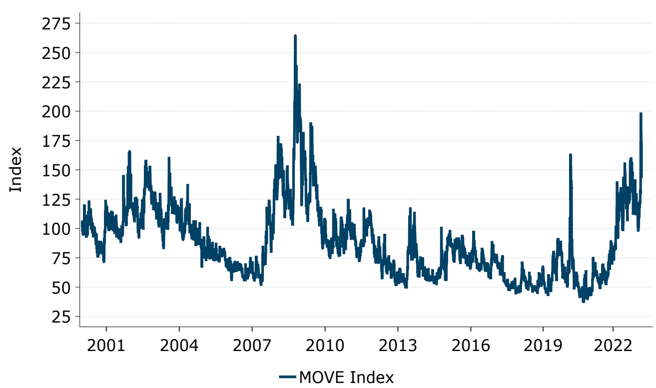
All of this is our central view. But we should emphasise that there is more uncertainty at the moment than typical. There is a chance that the issues in the banking sector are much worse than currently thought. This implies that interest rates will fall sharply from current levels and curves steepen. Alternatively, if the recent issues have only a minor impact on credit creation, then we may be underestimating the magnitude of the sell-off into mid-year.

Figure 1. UST 2s/10s curve across hiking cycles



Source: Bloomberg, Macrobond, ANZ Research

Figure 2. Annual changes in 10Y UST yield



Source: Bloomberg, Macrobond, ANZ Research

AUD: room to price in more hikes

Directionally, AUD rates have followed the global moves in the first quarter of the year. To start with, rates moved higher as USD rates rose and as the RBA provided further hawkish messaging. However, since then, the combination of the global banking issues and softer domestic data has taken ACGB yields lower.

We are sceptical that the recent fall in yields can continue. At present the market is not pricing in any more RBA hikes with any significant probability. Instead, the Bank is priced to be cutting by the end of the year. In our view, this sort of turnaround in pricing will require some sort of global shock. Although the risk can't be ruled out, it is not our baseline case. And domestically, the macro backdrop is still strong, with the unemployment rate very low and inflation still strong. This will compel the RBA to hike further from here.

The 10y ACGB/UST spread will move higher over time

So, if some of the acute concerns about the offshore banking sector start to fade, the domestic realities are likely to push up market pricing for terminal RBA rate and push out expectations of cuts later in 2023 or into 2024. This will push up 3Y ACGBs from current levels. However, it's also likely that we have already seen the peak in 3Y ACGB yields in the current cycle, since broader global concerns will still weigh on how far the RBA is expected to go.

For the 10Y ACGB/UST spread, we now expect it to average around -10bps over the next couple of quarters. This is slightly higher than our previous forecast, reflecting that the recent banking issues will have a larger impact on expectations around the Fed than RBA, so AUD rates won't sit as low relative to USD rate anymore. Over time, we expect this spread to drift higher as the Fed enters its easing cycle earlier.

Meanwhile, the unwind of one of the RBA's key policies – the Term Funding Facility – will come into closer view in the coming months. Domestic banks have been preparing for this by buying other forms of High Quality Liquid Assets – particularly semis. This trend is likely to accelerate in the coming months. This, and the associated hedging flows, will see some outperformance of semis and swap spreads stay wide.

Figure 3. AUD rates rally

Source: Bloomberg, Macrobond, ANZ Research

NZD: markets focussed on global financial instability rather than inflation

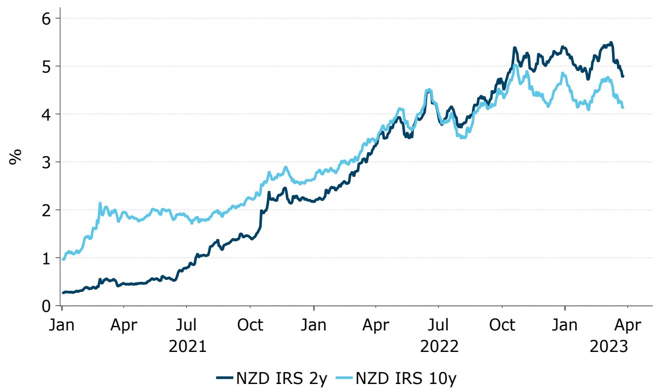
We expect the RBNZ to deliver two more 25bp hikes in this cycle, taking the OCR to 5.25%. However, uncertainty is extremely elevated as markets mull the impact of financial instability on the economy.

Last quarter, we wrote about expecting volatility to trump directionality as the global policy cycle matured, higher interest rates bite, and economies started to skirt, or fall into, recession. What happened in March is an example of the stresses we expected to emerge, even if how and where they arose (and how quickly they did so) wasn't specifically anticipated.

New Zealand's inflation remains too high and in the absence of recent turmoil, we'd have said the risks to the OCR were shaded to the topside, given rising global inflation in 2023. However, the tightening in global financial conditions may lead to more rapid slowing in demand, reducing the need for OCR hikes. Although that is the prevailing market narrative, it is likely too soon for the RBNZ to count on this, especially given New Zealand's remoteness from global financial contagion, as well as peculiar domestic factors such as post-cyclone rebuilding. We believe this will make April's OCR decision (where we expect a 25bp hike) more assured.

Beyond that, things are less certain, and markets may well be right in their view that cuts will come not long after the next one or two hikes. Our forecasts assume markets will continue to look through high inflation and continue to "gun" for cuts, hence our expectation of lower short end rates and a steeper (or less inverted) 2Y-10Y yield curve in 2024. Our NZ rate view is less challenging of market pricing than our Australian rates view. However, we note that near term New Zealand market pricing is similar to our forecasts. Additionally, RBNZ not only hiked more rapidly than the RBA this cycle, they also got started sooner and now have an OCR that is 1.15ppts higher than the RBA rate.

Figure 4. NZD rates off the highs



Source: Bloomberg, Macrobond, ANZ Research

Asia: local drivers to provide an anchor

Investors in local currency (LCY) bond markets need to consider two key external developments. Recent bank failures in major economies are a reminder that the synchronised and rapidly rising interest rates over the last year could give rise to more episodes of global financial markets disturbances in the near term. The US Fed has also hiked its policy rate above most Asian peers, in the process removing any yield pick-up (at least on the front end of the curve) emerging Asian markets had offered over the US. The immediate implication is increased uncertainty over the local rates outlook, as cross-border (portfolio) flow volatility increases and global drivers are likely to remain a key driver of market outlook.

Asia LCY bonds have behaved as safe havens

Yet LCY bonds have behaved as safe havens amid weakening global risk sentiment in recent weeks, suggesting that local dynamics have extended support in the current episode of portfolio outflows (rather than adding to the stress as often the case in past occurrences). To illustrate, higher-yielding 10Y IDR, PHP and INR yields fell by 13-50bps between 8 and 24 March (vs over 60bps in 10Y UST yields) or broadly in step with the decline in lower and middle-yielding Asia LCY yields.

We expect continued support from local market dynamics and view valuations as broadly fair across curves. Firstly, Asian LCY curves are steep vs the UST and most emerging market peers, with the bond curve carry remaining positive across all middle and higher-yielding markets. Secondly, the region does not suffer from any deep imbalances. We expect improving y/y current account positions to help mitigate any FX and liquidity risks stemming from increased cross-border flow volatility. The more benign growth-inflation mix (with the exceptions of India and the Philippines) has enabled local central banks to diverge from the US Fed's tightening stance year-to-date (with Vietnam notably cutting its policy rates by 100bps on 14 March). We assessed that the 2023 bond supply-demand dynamics* will be broadly neutral – with a constructive outlook for the IDR, KRW and SGD markets - and expect a potential supply indigestion to remain a risk only in the INR market.

China rates: limited upside risk

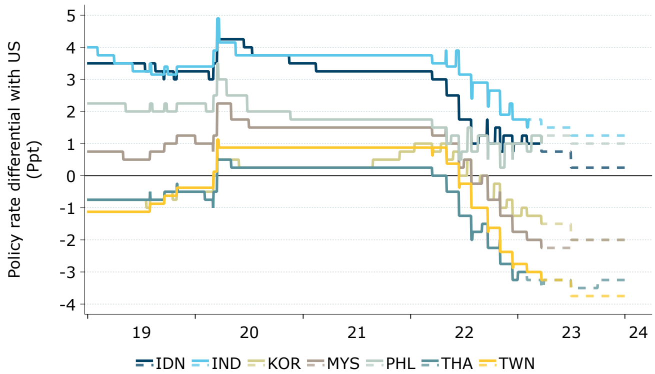
CGB yields will price in two risks in Q2: net supply and growth momentum. On one hand, net CGB supply will increase significantly owing to reduced maturities. On other hand, China's growth momentum will likely ease from the immediate rebound seen after its reopening while weak domestic demand remains the biggest challenge. The 5% GDP target, below the market consensus, suggests there will be no big stimulus going forward. As a result, there will be limited upside risk for the 10Y CGB yield. We expect it to trade in a narrow range of 2.85-2.95% in Q2.

Policy wise, we do not expect any big change to the People's Bank of China (PBoC) monetary policy stance, with the benchmark funding cost (daily repo rate DR007) staying around 2.00%. The PBoC cut the reserve requirement ratio (RRR) following news of bank failures in the US and Europe. However, it should not be perceived as a policy reversal to easing. In our view, China's monetary policy will adhere to a "targeted and forceful" stance, with the PBoC keeping key policy rates on hold while adding long term liquidity mainly through the medium term lending facility (MLF) and other targeted tools.

Supply risks will rise. Total CGB maturities in Q2 will be CNY320bn less than that in Q1. As a result, the net supply of CGB will likely increase by more than CNY1trn from Q1. The good news is that demand from commercial banks will remain strong because CGB yields look attractive. The risk-adjusted return on bank loans is now at 2.70%, still lower than the risk-free 10Y yield.

Our view will be challenged by a sustained recovery in the property sector. Backed by the government's rescue plan, property data have improved in the first two months of the year, with a 3 5% y/y rise in new home sales. However, it looks more like inventory offloading because supply remains contractionary, as evidenced by a 9.4% fall in the floor space of newly-started houses at the same time. We believe that the government's priority is to ensure developers' debt repayment instead of expanding new housing projects. Therefore, the property sector may help lift near-term growth but is unlikely to be a long-term driver.

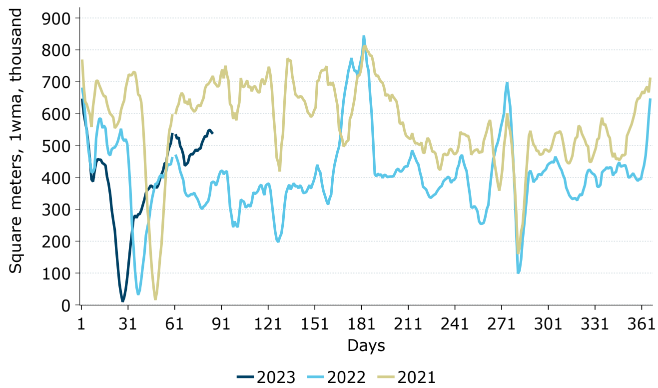
Figure 5. Compressed Asia-US rate differentials



Source: Bloomberg, Macrobond, ANZ Research

** Registered users can access at research.anz.com*

Figure 6. China: new home sales in 30 largest cities



Source: Wind, Macrobond, ANZ Research

Commodity markets

Hitting turbulence

Daniel Hynes | Soni Kumari

The likely return of the traditional inverse relationship between commodity prices and the US dollar has important market implications. As global inflation eases, a weaker USD will be a tailwind for the sector. With most international prices denominated in US dollars, a weaker USD means commodities become less expensive. This will stimulate demand for commodities to some extent in 2023.

Yet when the USD rallied more than 30% from the start of 2021 to September 2022, commodity prices also spiked, as supply shocks stemming from sanctions on Russian oil nullify this inverse relationship. Crude oil prices hit USD120/bbl, while copper breached USD10,000/t for the first time since 2011.

The rally in the USD was mainly due to the US Federal Reserve's aggressive monetary policy tightening to tame rising inflation, widening interest rate differentials between the US dollar and other currencies. At the same time, investors built positions in commodities to hedge against inflation.

Indeed, commodity markets are increasingly becoming an asset class of interest for investors, just like stocks and bonds. But the proliferation of commodity investment products will also expose the sector to the whims and fancies of global capital, whose impact is magnified by the growing popularity of automated trading and active allocation strategies.

Despite the macro headwinds in recent weeks, investor positioning has become more bullish. In the Brent crude futures market, non-commercial players have significantly slashed short positions, while long positions are climbing.

Macro backdrop, including a weaker USD should become increasingly supportive for commodities.

Weak oil demand in advanced economies is offsetting a strong recovery in China.

Energy shortages have eased; however, the risk of further issues in coming months remains high.

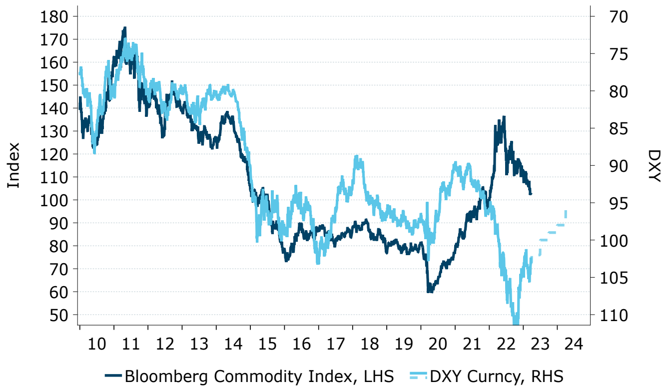
Inventories remain precariously low, leaving the sector vulnerable to price spikes should demand rebound as monetary tightening eases.

Gold's negative correlation with the US dollar remains strong given that the former is considered an alternative currency. USD weakness has encouraged central banks to diversify their foreign exchange reserves over the past year. In 2022, central banks' net purchases totalled 1,136t, marking the second consecutive year-on-year increase and the highest annual demand since 1950.

Industrial metals are generally driven by the global growth pulse, especially when economic growth outside the US is strong and a weaker USD. So, any weakness in the USD should support industrial metals. Fundamentals remain supportive, in part driven by China's reopening.

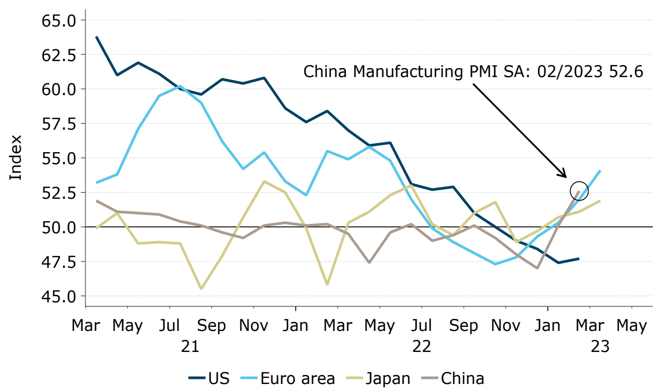
More recently, factors such as easing inflation and the USD have had a greater impact on commodity prices. At its peak in September 2022, the DXY was more than three standard deviations above fair value. Since then, the DXY has declined over 10%, yet it remains over-valued based on our fair value models. Markets are also pricing in a pause in rate hike and the possibility of cuts in the second half of this year. Thus, the USD's dominance is expected to moderate.

Figure 1. Commodities vs currencies



Source: ICE, PBoC Bloomberg, Macrobond, ANZ Research

Figure 2. PMIs



Source: Bloomberg, Macrobond, ANZ Research

However, risks remain. Recent US economic data have been resilient, with the latest CPI numbers showing higher core services inflation. Auxiliary measures of inflation, including various regional Fed measures of CPI, support this message.

In addition, global PMIs have improved, with services PMIs advancing to expansionary levels above 50. As the pandemic eases, consumers have shifted spending to services such as travel, restaurants and recreation, and this has been amplified by China's re-opening and its government's focus on boosting domestic consumption.

Growth in China's demand will underpin tight oil markets

Energy

Crude oil has faced headwinds this year as central banks remain steadfast to their goal of reducing inflation. The aggressive rate hike cycle undertaken by the US Federal Reserve has raised concerns about a weaker growth outlook for the world's biggest consumer of oil.

The crude oil market came under further pressure following the failure of Silicon Valley Bank (SVB). This was followed by a lack of investor confidence about Credit Suisse. Brent crude recently fell below USD75/bbl for the first time in more than 14 months. The potential risks to the US banking sector and the broader economy drove a broad risk-off tone across markets and weighed heavily on sentiment.

This has also increased uncertainty around the Fed's monetary policy. The bank collapses have raised concerns about whether the US financial system can withstand further monetary tightening. Market expectations of further rate hikes have fallen substantially. However, central banks are apparently committed to taming inflation.

We believe that the near-term risks to oil will remain to the downside. Nevertheless, this is transitory and crude oil will become increasingly driven by much stronger fundamentals.

Crude oil demand in China appears to be rebounding quicker than expected. Mobility indicators are showing a rise in travel, even after stronger-than-expected volumes over the Lunar New Year holiday period. Road congestion in cities saw a moderately strong start to February, implying higher demand for oil.

In addition to transport, rising economic activity should support oil demand. The Purchasing Managers Index (PMI) for manufacturing activity in China rose to 50.1 in January, indicating an expansion (Figure 4).

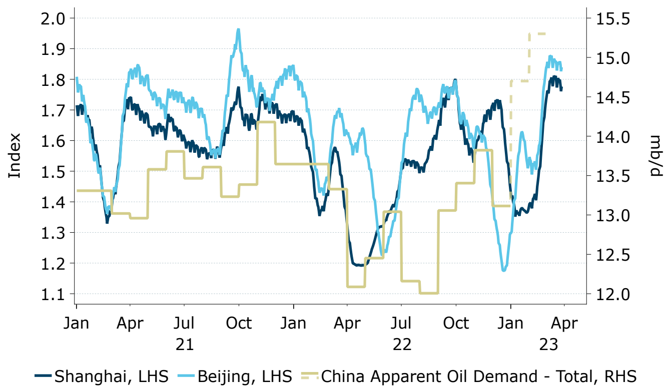
The tightening of the spread between Brent and Dubai suggest demand in Asia is incrementally stronger than Europe. This is backed by the rising costs of shipping crude to Asia. After falling from record highs late last year, the daily rate for coal production from the Arab Gulf to China has risen more than 400% this year to nearly USD100,000/day.

Overall, we expect China's oil consumption to increase by around 1.0mb/d this year. The pick-up in growth has already commenced; however, the bulk will emerge in the following three quarters.

Elsewhere we are seeing improved trends in travel in developed economies. Global road traffic activity shows a positive trend, with North America and Europe recovering to pre-pandemic levels. Passenger flight schedules for March imply global jet fuel demand will continue to grow strongly.

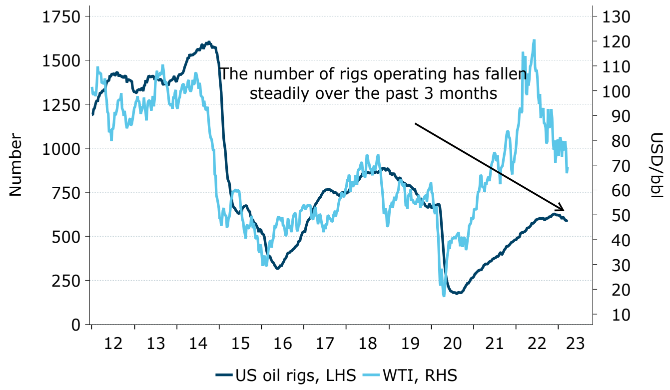
Combined with strong demand growth from less developed economies, we expect global demand to rise by 2.5mb/d in 2023.

Figure 3. China crude oil demand



Source: MoT, China National Health Commission, Macrobond, ANZ Research

Figure 4. US oil rigs vs WTI crude oil



Source: Baker Hughes, Bloomberg, Macrobond, ANZ Research

There are ongoing supply-side issues due to uncertainty surrounding Russian supply. Sanctions have had a significantly smaller impact than expected, with Asian buyers snapping up volumes lost to Europe. However, the sanctions on Russian diesel imports may be harder to offset.

Growth from the US shale industry remains subdued. 2023 started with the drill rig count falling again, partly due to the uncertain US economic outlook. Some US shale regions are also aging. At the same time, US shale lease operating costs climbed from around USD5/bbl to USD9.5/bbl in Q4 2022, a 100% increase. A tight labour market and issues with equipment availability are also constraining activity.

Fears of supply shortages have eased in coal and LNG markets

Amid the uncertainty, we expect OPEC to maintain its production cuts announced in late 2022. Markets have assumed that the lower output quotas will likely be lifted as demand rebounds over the course of the year. However, the recent sell-off suggests this probability is diminishing quickly.

We expect those production cuts to remain in place until the expiry of the current agreement (December 2023). With market supply tightening from the second quarter, we expect crude oil prices to push above USD100/bbl in the second half of the year.

The current pullback in **LNG** prices is expected to be short-lived, with the market expected to see fierce competition for cargo as it prepares for the next heating season.

A mild winter in Europe and Asia subdued demand. China's reopening also occurred during a seasonally weak period for natural gas consumption. Nevertheless, China's gas demand will likely rise in Q2 as industrial activity picks up. Overall, we expect it to import 71 million tonnes (mt) of LNG this year, up 13% y/y.

In Europe, the spectre of a gas shortfall lingers. We are concerned that lower gas prices could slow the reduction in consumption required to offset the fall in Russian supply. Ultimately, Europe will be forced to rely even more on the LNG market. While panic buying is not expected, increased competition for LNG is likely to see North Asian prices trend higher in the second half of the year. We have an end-of-year target of USD25/MMBtu for spot LNG prices.

The sharp fall in gas and LNG prices has dragged **thermal coal** lower. This has been exacerbated by subdued demand in Asia after an unusually warm winter. Nevertheless, we expect China's reopening to stoke industrial demand.

China's growth in electricity consumption hit 4.3% y/y in 2022 and is expected to rise further this year as economic activity rebounds post-lockdown. China is likely to increase electricity generation via coal, with construction starting on 50GW of capacity last year. This could exert more pressure on international coal markets, given increased safety inspections could curtail domestic output.

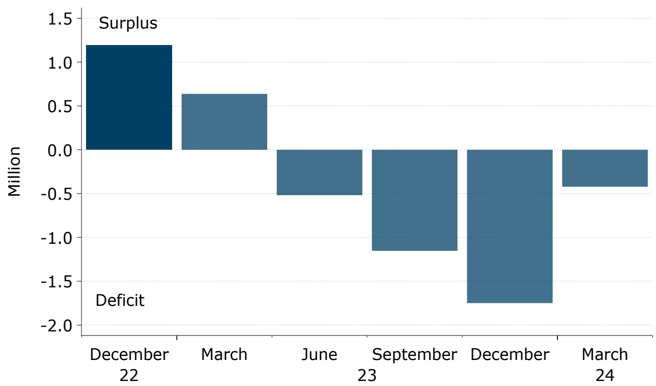
Industrial metals

Market sentiment could mask underlying strong fundamentals in the short term, so we believe depleted global inventories, constrained supply and improving demand from China should keep industrial metals relatively resilient.

With construction season kicking in, green shoots of demand have started emerging from China. **Copper and aluminium** inventory drawdowns are taking place at a quick pace, suggesting downstream demand is picking up.

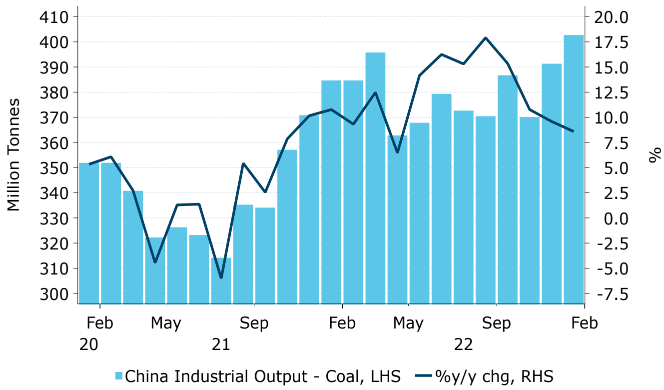
This is being reflected in recovering spot premiums for these two major metals.

Figure 5. World LNG supply-demand



Source: Bloomberg, Macrobond, ANZ Research

Figure 6. China domestic coal production



Source: NBS, Bloomberg, Macrobond, ANZ Research

China's state grid investments will cost CNY520billion (or USD77bn) in 2023, rising 4.5% y/y after a subdued patch since 2016. The accelerating pace of renewable energy deployments continue to provide structural support against a cyclical slowdown.

Operating rates for copper and aluminium are improving ahead of seasonal demand. According to SMM, copper production increased to 7% y/y to 908kt in February, or 6.4% m/m (ie 18% m/m on a daily adjusted basis). The agency estimates an increase of 4-5% m/m in March due to the ramp-up of new smelting capacity to 10.8mt in 2023. Copper concentrate stocks were sufficient to feed additional smelting capacity despite renewed supply issues in South America.

China's infrastructure push will bolster demand for metals in 2023

We acknowledge that new copper projects will be ramped up in 2023 and 2024. Nevertheless, the ongoing protest and political changes in Chile and Peru makes it challenging to achieve actual supply growth in spite of the expansion plans. Continued supply challenges and demand growth should see copper trading above USD10,000/t towards the end of the year.

Supply curbs continue in the **aluminium** market this year as well. European smelter suspended nearly 1mt of smelting capacity due to the energy crisis in 2022.

Although the power shortages have eased and energy prices have normalised, smelters are reluctant to restart production amid the ongoing geopolitcal situation which keeps energy prices volatile.

The recent decline in aluminium prices is also disincentivising restarts. Nord Hydro has been keeping its suspended production offline. China has been experiencing hydo power shortages due to drought since late 2022, impacting aluminium output. According to SMM, smelters in Yunnan reduced their production capacities by 780kt due to power shortages in February.

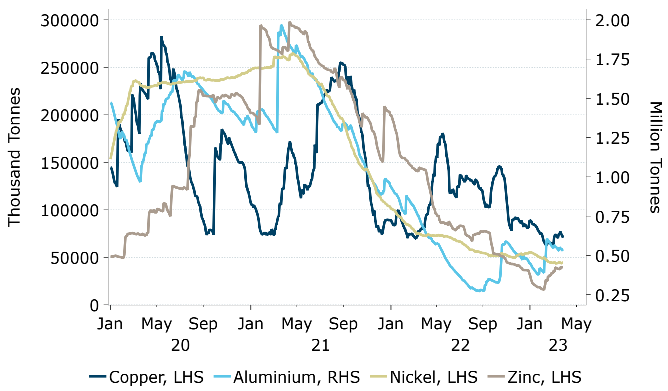
Downstream demand in China is picking up thanks to measures to support the property market and the GDP growth target of 5% in 2023. We expect aluminium to trade above USD2,500/t in the remaining quarters of the year.

Nickel prices have fallen nearly 25% year-to-date amid easing supply tightness and lacklustre demand from the stainless steel sector. While this was largely in line with our view of Indonesian supply growth keeping the market well supplied, we expect prices to find a floor soon.

The accelerated pace of energy transition and related government policies in the US and Europe will keep nickel demand from battery sector strong. To incentivise battery grade nickel production, prices have to remain above USD20,000/t. In addition, making nickel production less carbon and energy intensive also adds to the cost. We expect nickel prices to recover towards USD25,000/t.

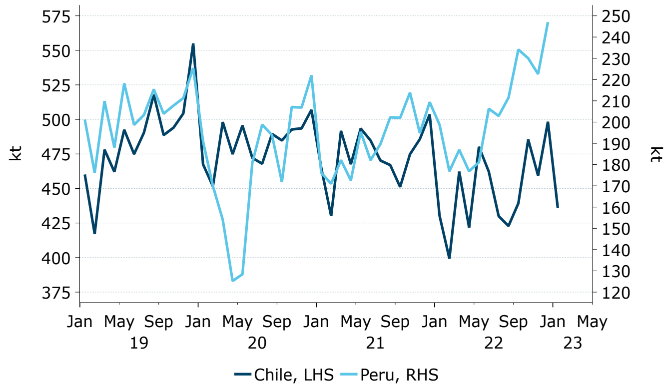
The **zinc** market was also impacted by Europe's energy crisis. Although Europe's supply is coming back online, the market is likely to remain tight as China's construction activity rebounds. We thus expect prices to trade above USD3,400/t by year-end.

Figure 7. LME base metal inventories



Source: LME, Bloomberg, Macrobond, ANZ Research

Figure 8. Chile and Peru copper production



Source: Bloomberg, Macrobond, ANZ Research

Precious metals

The ongoing banking crisis has swiftly turned things in favour of bullion. We believe US recessionary fears, easing inflationary pressure and dovish monetary policy will drive gold's performance.

Slowing economic growth and increasing prospects of rate cuts are setting the stage for gold's outperformance this year. Meanwhile, falling US Treasury yields and the weakening USD are adding to price momentum in the short term.

Gold supported by weaker USD and easing inflationary pressures

The inverse relationship of gold with US real yields improved in Q1 after a weakening in the past few years. With the DXY softening in recent weeks, the US yield has become the key driver of gold prices of late.

The focus has shifted from sticky inflation and strong labour market data to the banking turmoil and a hard landing later in the year. Although the Fed raised interest rates by 25bps at its latest meeting, it has turned more dovish on future rate hikes.

Furthermore, the regulators do not see any contagion risk from the recent collapse of SVB. If this holds true, investors could book profits, weighing on gold prices in the short term.

Another short-lived headwind is upside inflation surprises. Nevertheless, this does not sway our bullish view on gold; we believe the cumulative effects of aggressive interest rate hikes will have negative implications on growth later in the year.

The USD will likely continue to face downward pressures in 2023. Aside from a possible pause or even cut in US interest rates, the better performance of other major economies against the US will weigh on the US dollar. Improving fundamentals in other major economies could limit the greenback's upside.

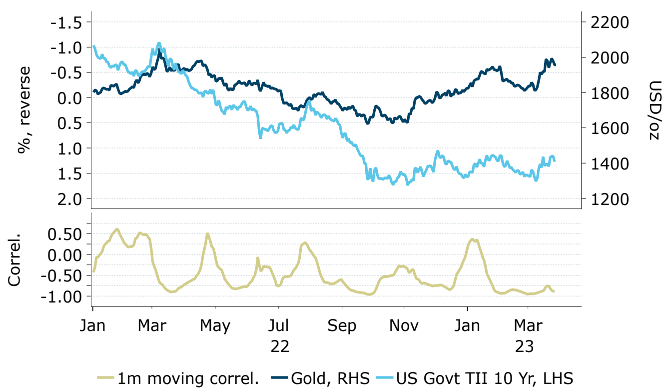
Gold is reasserting its safe haven appeal amid the US banking crisis, with investment demand picking up even as physical demand may ease. Gold ETF holdings are increasing after 10 consecutive months of outflows until February. Fresh long gold positions and short covering are also increasing. If the banking crisis worsens, investment inflows to gold are likely to increase. On the contrary, higher gold prices could dampen physical offtake. In addition, spot gold prices are at a discount in many consumer markets; dealers in India are offering discounts of up to USD33/oz over official domestic prices. We expect India's demand easing in 2023. The prospects of below-normal monsoon rains will also dampen demand for gold.

While central banks' gold buying spree will continue in 2023, the pace will likely slow from last year. Turkey has paused its gold purchases recently. Nonetheless, investment demand will help offset some of these demand losses.

The macro backdrop will also remain supportive, so any price dips should be short lived, prompting opportunistic buying. We target gold at USD2050/oz towards year-end.

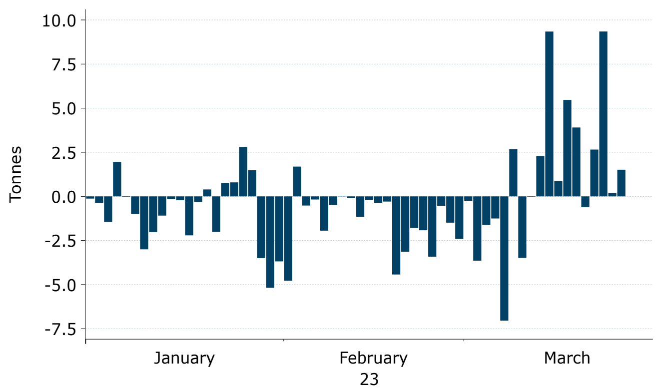
We expect **silver** to outperform gold in a rising price environment.

Figure 9. Gold vs real yields



Source: Bloomberg, Macrobond, ANZ Research

Figure 10. Gold ETF net flows



Source: Bloomberg, Macrobond, ANZ Research

PGM fundamentals are looking constructive due to supply issues. Local power shortages in South Africa will trim the rebound in last year's production losses to less than 1% y/y in 2023. Sanctions against Russia also add to supply risks, particularly for palladium.

Improving auto sector growth, higher loadings and substitution away from palladium are likely to benefit platinum. Auto catalyst demand is likely to grow 5% y/y to 2,767koz this year. Constrained supply and robust demand could shift the market into a deficit of 145koz. This should push platinum prices to USD1,250/oz towards year-end.

Steel and iron ore

Beijing is reverting to tried-and-tested methods to support the economy after the lifting of COVID-19 restrictions. Policies designed to support infrastructure growth, in particular the property sector, have been implemented this year.

Underlying issues with China's property sector will limit upside in iron ore

This has already boosted sentiment across the steel and iron ore markets. China's steel PMI rose to 52.17, in February the highest level since May 2021. Beijing's campaign to support economic growth via an infrastructure investment will boost demand for steel. Accordingly, we have revised higher our forecast of China's steel production, expecting a rise of 2.5% to 1,050mt in 2023.

Output and inventories are reflecting increased activity. The average daily output of crude steel from key enterprises has surged in the weeks after the Lunar New Year holiday period in January.

Steel inventories normally build up quickly in the first three months of the year, ahead of the most intense construction period in Q2. This stockpiling has distinctly slowed, indicating demand is rising.

The improving backdrop and low inventories have lifted steel prices. After hitting an 18-month low of CNY1,816/t in November last year, prices are up nearly 16%, improving producers' margins. Profitability for China's blast furnace steel producers has breached CNY300/t after staying in negative territory at the end of last year.

Against such a backdrop, we expect China's steel output to continue to increase in the coming months, as the industry restocks to meet pent-up demand. Yet this strength may not persist till the end of the year as underlying issues in the property sector limit further upside. We also expect supply issues to ease gradually as the year progresses.

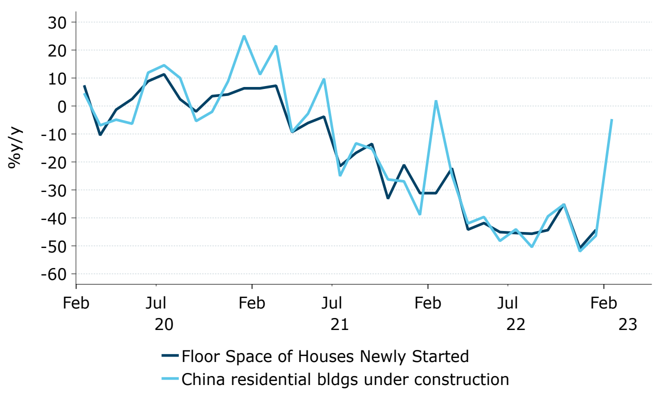
China's property sector policies are intended to prevent massive defaults and any further deterioration rather than to stimulate investment demand for property. In addition, the government's 'common prosperity' mandate, which views property as for housing not for investment, looms over market sentiment.

Thus, the policies should allow the resumption of unfinished residential construction projects, which will bolster demand for raw materials and reduce the risk of a hard landing. However, a sustained pick-up in growth is unlikely while new housing starts and new construction activity remain subdued (Figure 8).

Supply issues are expected to ease over the year. The commissioning of new mines in Australia, particularly Rio Tinto's Koodaideri and FMG's Iron Bridge, will add to global supply. Brazil's output is also expected to improve.

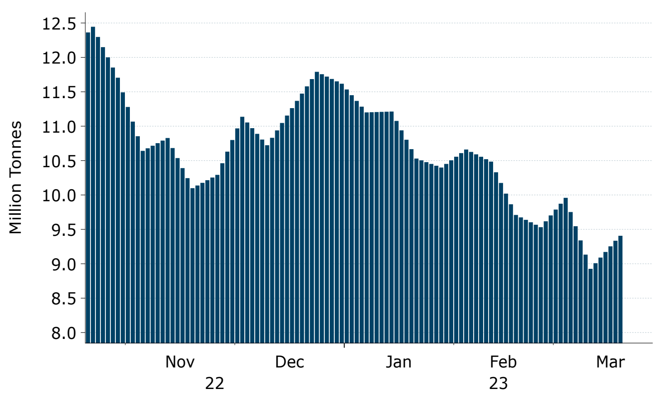
Overall, we see the deficit in the iron ore market easing in 2023. As pent-up demand dissipates, this should weigh on sentiment, ultimately pushing prices back below USD100/t by year-end.

Figure 11. China housing



Source: Bloomberg, Macrobond, ANZ Research

Figure 12. Australian iron export exports



Source: Bloomberg, Macrobond, ANZ Research

Forecasts

Gross domestic product (year-average % change)

	1998-2007 average	2008-2017 average	2018	2019	2020	2021	2022	2023f	2024f
United States	3.1	1.5	2.9	2.3	-2.8	5.9	2.1	1.3	0.6
Euro area	2.6	0.8	1.8	1.6	-6.1	5.3	3.6	1.2	1.6
United Kingdom	2.7	1.2	1.7	1.6	-11.0	7.5	4.2	-0.1	1.0
Japan	1.0	0.5	0.6	-0.4	-4.3	2.2	1.0	1.5	1.0
China (Mainland)	10.0	8.3	6.7	6.0	2.2	8.4	3.0	5.4	4.0
India*	7.2	7.1	6.5	3.9	-5.8	9.1	6.8	6.0	6.5
South Korea	5.2	3.2	2.9	2.2	-0.7	4.1	2.6	1.0	1.8
Taiwan	5.1	2.9	2.8	3.1	3.4	6.5	2.5	1.9	2.5
Indonesia	2.8	5.5	5.2	5.0	-2.1	3.7	5.3	4.7	5.0
Thailand	3.9	3.1	4.2	2.2	-6.2	1.5	2.6	3.9	4.0
Hong Kong	3.9	2.7	2.8	-1.7	-6.5	6.3	-3.5	3.2	2.7
Malaysia	4.3	4.8	4.8	4.4	-5.5	3.1	8.7	4.2	4.7
Singapore	5.5	4.7	3.7	1.1	-4.1	7.6	3.6	1.9	2.5
Philippines	4.2	5.7	6.3	6.1	-9.5	5.7	7.6	5.8	5.0
Vietnam	6.8	6.0	7.1	7.0	2.9	2.6	8.0	5.0	6.0
Emerging Asia	7.5	6.9	6.0	5.0	0.1	7.6	3.6	4.9	4.2
Asia (ex-Mainland China, India)	4.5	4.0	4.0	3.2	-2.3	4.5	3.8	3.0	3.4
Australia	3.5	2.6	2.8	1.9	-1.8	5.2	3.7	2.1	1.5
New Zealand**	3.5	2.2	3.6	3.1	-1.5	6.1	2.4	0.9	-0.4
World	4.2	3.4	3.6	2.8	-2.2	5.6	2.9	2.7	2.6

*Fiscal years, eg 2017 is year-ending March 2018. New GDP base year is 2011-12

**NZ GDP numbers are production based GDP(P)

Source: Bloomberg, Macrobond, IMF, ANZ Research

Forecasts

Consumer price index inflation (year-average)

	1998-2007 average	2008-2017 average	2018	2019	2020	2021	2022	2023f	2024f
United States	2.6	1.7	2.4	1.8	1.2	4.7	8.0	4.7	2.8
Euro area	2.0	1.4	1.8	1.2	0.3	2.6	8.4	5.5	3.3
United Kingdom	1.6	2.4	2.5	1.8	0.9	2.6	9.1	6.6	2.9
Japan	-0.2	0.3	1.0	0.5	0.0	-0.2	2.5	1.7	1.0
China (Mainland)	1.1	2.6	2.1	2.9	2.5	0.9	2.0	2.2	2.0
India*	5.3	7.9	3.4	4.8	6.2	5.5	6.7	5.2	4.6
South Korea	3.2	2.3	1.5	0.4	0.5	2.5	5.1	3.2	2.0
Taiwan	0.9	1.1	1.3	0.6	-0.2	2.0	2.9	2.2	1.4
Indonesia	14.9	5.7	3.2	2.8	2.0	1.6	4.2	4.5	3.3
Thailand	2.8	1.9	1.1	0.7	-0.8	1.2	6.1	2.6	2.0
Hong Kong	-0.8	3.2	2.4	2.9	0.3	1.6	1.9	1.9	2.1
Malaysia	2.4	2.6	1.0	0.7	-1.1	2.5	3.4	3.1	1.7
Singapore	0.7	2.3	0.4	0.6	-0.2	2.3	6.1	4.9	4.0
Philippines	5.2	3.5	5.2	2.4	2.4	3.9	5.8	5.9	3.2
Vietnam	4.8	8.4	3.5	2.8	3.2	1.8	3.2	3.5	2.9
Emerging Asia	3.0	3.4	2.3	2.7	2.5	1.7	3.1	2.9	2.4
Asia (ex-Mainland China, India)	4.6	3.1	2.1	1.3	0.7	2.2	4.5	3.5	2.5
Australia	2.8	2.4	1.9	1.6	0.8	2.9	6.6	5.8	3.6
New Zealand**	2.1	1.9	1.6	1.6	1.7	3.9	7.2	6.6	3.5
World	4.6	3.8	3.6	3.5	3.0	5.1	8.6	5.9	3.9

*Fiscal years. Eg 2017 is year-ending March 2018

Source: Bloomberg, Macrobond, IMF, ANZ Research

Forecasts

Foreign exchange rates

	Current*	Jun 23	Sep 23	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24
DXY Index	102.5	101	99	98	96	95	94	93
EUR/USD	1.08	1.10	1.12	1.14	1.16	1.18	1.20	1.20
USD/JPY	132	130	127	124	122	120	118	116
GBP/USD	1.23	1.24	1.25	1.26	1.28	1.29	1.30	1.30
EUR/GBP	0.88	0.89	0.90	0.90	0.91	0.91	0.92	0.92
EUR/CHF	1.00	1.00	1.01	1.03	1.03	1.05	1.07	1.07
USD/CHF	0.92	0.91	0.90	0.90	0.89	0.89	0.89	0.89
USD/CAD	1.36	1.34	1.32	1.29	1.27	1.27	1.27	1.27
AUD/USD	0.67	0.70	0.72	0.75	0.77	0.78	0.79	0.80
NZD/USD	0.63	0.63	0.64	0.66	0.67	0.67	0.68	0.68
AUD/NZD	1.07	1.11	1.13	1.14	1.15	1.16	1.16	1.18
USD/CNY	6.89	6.70	6.60	6.55	6.50	6.45	6.40	6.40
USD/IDR	15088	14,900	14,500	14,200	14,100	14,000	13,950	13,900
USD/INR	82.27	81.50	81.00	80.00	79.80	79.50	79.30	79.00
USD/KRW	1299	1,250	1,210	1,190	1,180	1,175	1,170	1,165
USD/MYR	4.40	4.38	4.30	4.22	4.18	4.16	4.14	4.12
USD/PHP	54.44	54.40	54.20	54.00	53.80	53.60	53.50	53.40
USD/SGD	1.33	1.315	1.300	1.290	1.285	1.280	1.275	1.270
USD/THB	34.31	33.50	33.00	32.30	32.10	32.00	31.80	31.60
USD/TWD	30.41	30.00	29.50	29.20	29.00	28.80	28.60	28.40
USD/VND	23493	23,550	23,400	23,250	23,200	23,150	23,100	23,050
USD/HKD	7.85	7.80	7.78	7.76	7.76	7.76	7.76	7.76
PGK/USD	0.2842	0.2833	0.2828	0.2841	0.2858	0.2875	0.2892	0.2909
FJD/USD	0.4513	0.4616	0.4658	0.4683	0.4726	0.4759	0.4791	0.4814

*Current as of 29 March 2023

Source: Bloomberg, ANZ Research

Forecasts

Monetary policy rates

	Current*	Jun 23	Sep 23	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24
United States[1]	5.00	5.50	5.50	5.50	5.25	5.00	4.75	4.50
Euro area	3.00	4.00	4.00	4.00	3.75	3.50	3.25	3.00
United Kingdom	4.25	4.50	4.50	4.50	4.50	4.00	3.75	3.50
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
China (Mainland)[2]	2.00	2.00	2.00	2.00	1.90	1.90	1.80	1.80
Australia	3.60	4.10	4.10	4.10	4.10	4.10	4.10	3.85
New Zealand	4.75	5.25	5.25	5.25	5.25	5.25	5.25	5.25
Hong Kong	5.25	5.75	5.75	5.75	5.50	5.25	5.00	4.75
India	6.50	6.75	6.75	6.75	6.75	6.75	6.75	6.75
Indonesia[3]	5.75	5.75	5.75	5.75	5.50	5.25	5.00	5.00
Malaysia	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75
Philippines[4]	6.25	6.50	6.50	6.50	6.25	5.75	5.75	5.75
South Korea	3.50	3.50	3.50	3.50	3.25	3.00	2.75	2.50
Taiwan	1.875	1.875	1.875	1.875	1.875	1.875	1.875	1.875
Thailand	1.50	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Vietnam	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50

1. For the US, the rate is the ceiling of the Fed Fund's rates corridor
2. 7-day reverse repo
3. 7-day reverse repo
4. Overnight reverse repurchase (RRP) facility

*Current as of 29 March 2023

Source: Bloomberg, Relevant Central Banks, ANZ Research

Forecasts

Bond yields

	Current*	Jun 23	Sep 23	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24
US								
Fed funds rate[1]	5.00	5.50	5.50	5.50	5.25	5.00	4.75	4.50
2-year	4.07	4.50	4.00	3.75	3.50	3.25	3.00	2.75
10-year	3.56	3.75	3.75	3.75	3.50	3.50	3.50	3.50
Europe								
Policy rate	3.00	4.00	4.00	4.00	3.75	3.50	3.25	3.00
UK								
Bank rate	4.25	4.50	4.50	4.50	4.50	4.00	3.75	3.50
Japan								
Target rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
China (Mainland)								
10-year bond	2.85	2.95	2.85	2.75	2.7	2.7	2.65	2.65
Australia								
RBA cash rate	3.60	4.10	4.10	4.10	4.10	4.10	4.10	3.85
90-day bank bills	3.70	4.29	4.31	4.31	4.31	4.31	4.23	4.06
3-year bond	2.92	3.25	3.00	3.00	3.00	2.75	2.75	2.75
10-year bond	3.29	3.65	3.65	3.65	3.60	3.60	3.60	3.60
3s10s bond curve (bps)	37	40	65	65	60	85	85	85
AU-US 10-year spread (bps)	-27	-10	-10	-10	10	10	10	10
New Zealand								
NZ OCR	4.75	5.25	5.25	5.25	5.25	5.25	5.25	5.25
90-day bills	5.19	5.35	5.35	5.35	5.35	5.35	5.35	5.35
2-year bond	4.50	4.65	4.35	4.10	3.97	3.87	3.80	3.74
10-year bond	4.13	4.15	3.75	3.50	3.50	3.75	4.00	4.00
NZ-US 10-year spread (bps)	57	40	0	-25	0	25	50	50

1. For the US, the rate is the ceiling of the Fed Fund’s rates corridor

Bond yields are on government-issued securities at constant maturity

*Current as of 29 March 2023

Source: Bloomberg, ANZ Research

Forecasts

Commodities

	Unit	Current*	Jun 23	Sep 23	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24
Base metals									
Copper	USD/t		9,500	10,000	10,500	11,000	10,000	10,200	10,500
Aluminium	USD/t		2,600	2,700	2,600	2,700	2,600	2,550	2,500
Nickel	USD/t		25,000	24,500	24,000	23,000	22,000	20,000	19,500
Zinc	USD/t		3,300	3,500	3,400	3,300	3,200	3,000	3,200
Lead	USD/t		1,950	2,000	2,000	2,050	2,050	2,000	2,100
Precious metals									
Gold	USD/oz		1,900	1,950	2,050	2,080	2,100	2,120	2,100
Silver	USD/oz		22.35	22.94	23.84	27.73	28.00	28.27	28.00
Platinum	USD/oz		1,150	1,200	1,250	1,250	1,220	1,250	1,300
Palladium	USD/oz		1,600	1,650	1,650	1,650	1,620	1,600	1,550
Energy									
Brent crude	USD/bbl		90.0	102.0	105.0	105.0	105.0	105.0	105.0
WTI crude	USD/bbl		89.0	101.0	104.0	104.0	104.0	104.0	104.0
Bulks**									
Iron Ore	USD/t		120	100	95	95	95	95	95
Coking coal	USD/t		350	300	275	250	140	140	140
Thermal Coal	USD/t		250	325	325	300	320	300	250
Agriculture									
Corn	USc/bu		690	640	620	620	630	590	590
Wheat	USc/bu		670	700	730	750	720	700	710
Soybeans	USc/bu		1,490	1,470	1,410	1,340	1,260	1,250	1,290
Cotton	USc/lb		79	78	82	80	79	78	82
Sugar	USc/lb		19.6	19.0	20.0	20.0	18.6	18.1	19.0
Live cattle	USc/lb		167	163	172	168	162	156	160
Carbon									
European carbon	EUR/t		90	85	90	100	100	105	105
ACCU	AUD/t		50	48	45	42	50	55	60

Agriculture forecast are period averages, all others are end-period

*Current as of 29 March 2023

**Iron ore is spot price (62% fines) including freight to Qingdao Port, China

** Coking coal is Australian coking coal free on board price. Thermal coal is Newcastle futures contract

Source: Bloomberg, ANZ Research

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