The Month Ahead – May 2023

Global equity markets were relatively subdued in April with most share markets ending the month with modest gains. In the US, the S&P 500 Index ended 1.1% higher, while the NASDAQ 100 Index rose about 0.5%. It was the tightest trading ranges for the two indices in many months. The NZX 50 Index also had a relatively subdued month, ending April up about 1%.

After some slower-than-expected inflation data in the US and New Zealand, this month the focus shifts back to central banks and how they will respond to falling inflation rates. Elsewhere, we take a look at the looming debt ceiling debate in the US.

Breaking this down is ANZ Investments' May Month Ahead.

Inflation slows, but central banks expected to hike—perhaps for the last time

Economic data in April showed inflation rates in both the US and New Zealand continue to slow, signs that the cumulative interest rate hikes are starting to temper demand and bring inflation down.

Inflation in the US fell to 0.1% in March, which dropped the annual rate to 5%, the ninth-consecutive fall in annual inflation, and the lowest level since mid-2021. Meanwhile, annual inflation in New Zealand fell to 6.7% in the first quarter of 2023, which was below forecasts.

For US policymakers, the good sign was that food prices were flat over the month, while shelter inflation, which has been a significant source of US inflation over the past 12 months, recorded its smallest gain since November. In New Zealand, some concerns still remain around non-tradeable inflation, which is proving 'sticky', but on the whole, the fall in prices was a relief.

Despite the drop in inflation rates, it is expected that both the US Federal Reserve and the Reserve Bank of New Zealand (BRNZ) will lift policy rates once again (each by 25 basis points), and perhaps for the last time in this tightening cycle. As of 29 April, interest rate markets are pricing in about an 80% chance of a hike for each central bank.

US debt ceiling negotiations set to continue

In the US, lawmakers will continue negotiations on the debt ceiling, the maximum amount the federal government can borrow to cover spending obligations. Periodically, the ceiling is lifted because the spending obligations are greater than the money received from taxes.

Historically, the debt ceiling debate has come and gone without any fuss, but with a divided Congress (Republicans control the House, while Democrats control the Senate and the White House) and a hostile political environment, the debate, and potential fallout, is starting to flow into financial markets with fears a default on the government's debt is a possibility.

Although the probability of a default is unlikely (it has never happened before) the consequences are far-reaching. A default would likely send the country into a recession, leading to widespread job losses, suspension of Medicare and social security payments and other public service obligations.

"A default on our debt would produce an economic and financial catastrophe". That's how Treasury Secretary, Janet Yellen, described the ramifications of a debt default earlier in April.

House Speaker, Republican Kevin McCarthy, has agreed to lift the ceiling by US$1.5 trillion if the government commits to about $4.5 trillion in spending cuts, however, President Joe Biden has, so far, said he is not willing to negotiate spending cuts on money that has already been signed into law.

At this stage, estimates have the government running out of money by June at the earliest, while it could be as far out as September, depending on tax intake over the next few months. So while there is still time, the fact both parties are so far apart might make for an anxious month ahead.

New Zealand retail data could confirm an economic slowdown

In May, retail sales figures for the first quarter of 2023 will indicate just how resilient New Zealander consumers have been in the face rising household expenses and higher mortgage payments, as borrowers roll off low fixed rate mortgages.

The RBNZ has made it clear that one way to bring down inflation is to temper demand, and should we see a slowdown in retail spending, it would likely assist the RBNZ's quest to get inflation back to target levels. However, there is a fine line. A significant slowdown could signal a recession is near (something the RBNZ has predicted) making the prospect of a soft landing more unlikely. For the RBNZ, it will be hoping to see a mild slowdown in spending, but not to a level that sees spending fall off a cliff.