

Monday, 11 December 2023

Major Central Banks Round Out the Year

If the pandemic taught policymakers anything it was the importance of co-ordinating both monetary and fiscal policy. When these two tools are calibrated in tandem, they are an incredibly powerful tool for managing the economy.

The Reserve Bank (RBA) left the cash rate on hold at 4.35% last week, locking in monetary policy settings until February next year. The subsequent National Accounts data solidified our view that this is likely to be the peak in the cash rate as the economy begins to show more concrete signs it is slowing.

This week, we expect the Federal Government to release its Mid-Year Economic and Fiscal Outlook (MYEFO) which will provide an update on the Budget position and fresh economic forecasts. Comments from the Treasurer suggest we are unlikely to see much in the way of new policy announcements, particularly on the cost-of-living front which are more likely to come in next year's official Budget (if at all). In the May Budget, Treasury estimated a \$13.9 billion underlying cash deficit for the 2023-24 financial year. Big upsides on the revenue side stemming from resilient commodity prices and a rapidly growing tax take from households is likely to see this number revised higher. Indeed, over the first four months of the 2023-24 financial year, total revenue is already tracking \$8.4 billion above what was expected back in May when the Government published its Budget, while payments are \$0.8 billion lower than expected. We think there is a good chance the Government could print a second consecutive budget surplus for the 2023-24 financial year. However, the Government is likely to keep the numbers conservative.

The economic data calendar is relatively quiet this week. Consumer and business sentiment will be released tomorrow. The large divergence in business and consumer sentiment is likely to continue but could narrow somewhat. The huge pressure on household incomes demonstrated in last week's National Accounts stands as a stark reminder for why consumer sentiment has been stuck in the doldrums and is unlikely to drift meaningfully higher anytime soon. If the gap between household and business confidence is to close, it will more likely be coming from the business side. Surging overseas migration has underpinned resilience in business conditions, helping hold on to some optimism. But this tailwind is likely to wane over the period ahead as much of the rebound in student arrivals has run its course. We still expect population growth to be strong, but the boost from the reopening of borders will not be repeated.

The other critical piece of data out this week is the release of the November labour force survey on Thursday. The labour market is slowly turning as labour supply growth outstrips demand, but this dynamic has been slower than initially expected. In 2024, we expect this process to accelerate but for the loosening in the labour market to remain orderly. Much of the adjustment in conditions is expected through hours of work rather than headcount, partly explaining why we expect employment growth to continue in 2024, just at a slower pace. We see the unemployment rate drifting higher, to around 4½% by the end of next year - a low level by historical standards.

This week's data will provide another update on how this dynamic is progressing.

International

Offshore this week is a frenzy of central bank policy meetings from the US Fed, European Central Bank (ECB) and the Bank of England (BoE). The RBA set the tone last week, leaving rates on hold for their final meeting of 2023 and we expect much the same at each of these meetings. The accompanying commentary, not the decision will again be the primary interest.

But before that, the US consumer Price Index (CPI) will drop on Tuesday night (AEDT). Headline inflation in the US has slowed to 3.2%, while underlying inflation is sitting at 4.0%. This is still double the Fed's 2% inflation target (in underlying terms) but recent data has been encouraging. Economists aren't expecting the narrative to shift much this week, forecasting a marginal step down in headline inflation, to 3.1%, and an unchanged reading for core inflation.

The Fed will announce its policy decision early on Thursday morning (AEDT). It's widely expected the fed funds rate will remain on hold at 5.25% to 5.50%. It will instead be the updated 'dot plots' (economic and interest rate forecasts from Fed committee members) and Jerome Powells speech which will garner the most attention. Markets have recently moved sharply to price in rate cuts in 2024, there are currently 100 basis points of rate cuts fully priced in for next year. Of most importance will be whether Jerome Powell pushes back against aggressive rate cut expectations and the associated loosening in financial conditions which has accompanied the move. Either way, we can expect some volatility in markets come Thursday morning.

The ECB and the BoE will follow on Thursday night. Both are expected to leave rates firmly on hold. Again, speculation will be centred more on expectations for rate cuts, rather than the chance we will see further hikes. Economic growth, particularly in Europe, is looking weak and inflation progress has been encouraging. As in all jurisdictions, the question of rate cuts squarely sits with the rate of inflation progress.

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Group Forecasts

| End Period: | Close (01 Dec) | 2023 | 2024 | 2025 | | | |
|------------------------------|----------------|--------|--------|--------|--------|--------|--------|
| | | Q4 (f) | Q1 (f) | Q2 (f) | Q3 (f) | Q4 (f) | Q1 (f) |
| Aust. Interest Rates: | | | | | | | |
| RBA Cash Rate, % | 4.35 | 4.35 | 4.35 | 4.35 | 4.10 | 3.85 | 3.60 |
| 90 Day BBSW, % | 4.37 | 4.55 | 4.55 | 4.47 | 4.22 | 3.97 | 3.72 |
| 3 Year Swap, % | 4.18 | 4.50 | 4.40 | 4.30 | 4.20 | 4.10 | 3.90 |
| 10 Year Bond, % | 4.49 | 4.70 | 4.60 | 4.50 | 4.40 | 4.30 | 4.15 |
| US Interest Rates: | | | | | | | |
| Fed Funds Rate, % | 5.375 | 5.375 | 5.125 | 4.875 | 4.625 | 4.375 | 4.125 |
| US 10 Year Bond, % | 4.20 | 4.80 | 4.70 | 4.60 | 4.50 | 4.40 | 4.20 |
| USD Exchange Rates: | | | | | | | |
| AUD-USD | 0.6675 | 0.66 | 0.67 | 0.68 | 0.69 | 0.70 | 0.71 |
| USD-JPY | 146.82 | 149 | 147 | 144 | 141 | 138 | 135 |
| EUR-USD | 1.0884 | 1.08 | 1.09 | 1.11 | 1.13 | 1.14 | 1.15 |
| GBP-USD | 1.2710 | 1.23 | 1.24 | 1.25 | 1.26 | 1.27 | 1.28 |
| NZD-USD | 0.6209 | 0.60 | 0.61 | 0.62 | 0.62 | 0.62 | 0.63 |
| AUD Exchange Rates: | | | | | | | |
| AUD-USD | 0.6675 | 0.66 | 0.67 | 0.68 | 0.69 | 0.70 | 0.71 |
| AUD-EUR | 0.6133 | 0.61 | 0.61 | 0.61 | 0.61 | 0.61 | 0.62 |
| AUD-JPY | 98.01 | 98.3 | 98.5 | 97.9 | 97.3 | 96.6 | 95.9 |
| AUD-GBP | 0.5252 | 0.54 | 0.54 | 0.54 | 0.55 | 0.55 | 0.55 |
| AUD-NZD | 1.0750 | 1.09 | 1.10 | 1.11 | 1.11 | 1.12 | 1.13 |

| | 2021 | 2022 | 2023 (f) | 2024 (f) |
|-----------------------|------|------|----------|----------|
| GDP, % | 4.6 | 2.7 | 1.2 | 1.6 |
| CPI (Headline), % | 3.5 | 7.8 | 4.6 | 3.4 |
| CPI (Trimmed mean), % | 2.6 | 6.8 | 4.4 | 3.3 |
| Unemployment Rate, % | 4.7 | 3.5 | 3.8 | 4.7 |
| Wages Growth, % | 2.4 | 3.3 | 4.1 | 3.2 |

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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