

Monday, 15 July 2019

Uncertainty Lingerin

Federal Reserve Chairman Powell's message was loud and clear last week. It was expected that there would be ongoing growth in the US economy, but Powell emphasized uncertainty, particularly around trade and investment, and that the Fed would "act as appropriate". In addition, Powell downplayed the stronger-than-expected jobs data released in the previous week. Importantly, Powell did not attempt to shift market expectations, which has fully priced in a 25 basis point rate cut at the Fed's next meeting on July 30-31. His comments have cemented expectations that the Fed will lower official interest rates, and another 25 basis point cut is fully priced in by the end of the year. US share markets have once again cheered, lifting to a new record high. Bond yields however, are still up from their lows, reflecting a reassessment of conditions. Powell did emphasize that the economy was "in a good place". Inflation outcomes have also slightly exceeded expectations and the labour market has remained quite tight.

Rate cut expectations are weighing on the US dollar, and consequently helping to prop up the Australian dollar. The AUD appears to have found a new range over the last few months, between 68.3 US cents and 70.5 US cents. While the AUD is gaining support from the resilience of commodity prices and expectations of easier monetary policy from the Fed, lower interest rates are also expected in Australia. Moreover, we continue to see risks for the AUD to be tilted towards the downside given that the uncertainty facing the global economy is likely to linger.

This uncertainty is certainly evident in China. Chinese GDP for the June quarter, along with other key activity indicators, will be released today. PMI surveys have pointed to a loss of momentum in the Chinese economy, suggesting a weakening pace of growth over the June quarter. There will remain the usual skepticism regarding the reliability of Chinese economic data, but further weakness will likely encourage further stimulus from Chinese authorities.

At home, the RBA minutes of its July meeting to be released tomorrow will be gleaned on for further clues into the future for monetary policy. While the RBA has signalled that further easing in monetary policy "if needed", ongoing signs of weakness in the economy suggest that a rate cut will be possibility at every meeting from now.

No doubt, the labour market will continue to be a key focus for the central bank. Thursday will see the labour force release for June. We are still waiting for a slowing in employment growth, as suggested by job vacancies, business surveys and the weak pace of economic growth.

Forecasts

End Period:	2019			2020			
	Close (Jul 12)	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)
Aust. Interest Rates:							
RBA Cash Rate, %	1.00	1.00	0.75	0.75	0.75	0.75	0.75
90 Day BBSW, %	1.13	1.10	1.00	1.00	1.00	1.00	1.00
3 Year Swap, %	1.04	1.00	1.05	1.15	1.20	1.25	1.30
10 Year Bond, %	1.44	1.30	1.40	1.45	1.60	1.70	1.75
US Interest Rates:							
Fed Funds Rate, %	2.375	2.125	1.875	1.875	1.875	1.875	1.875
US 10 Year Bond, %	2.14	2.00	2.05	2.10	2.20	2.25	2.30
USD Exchange Rates:							
AUD-USD	0.7020	0.68	0.68	0.66	0.66	0.67	0.67
USD-JPY	107.91	106	105	107	108	109	110
EUR-USD	1.1270	1.14	1.14	1.13	1.13	1.12	1.12
GBP-USD	1.2572	1.26	1.25	1.26	1.27	1.29	1.30
NZD-USD	0.6693	0.65	0.65	0.65	0.66	0.66	0.66
AUD Exchange Rates:							
AUD-USD	0.7020	0.68	0.68	0.66	0.66	0.67	0.67
AUD-EUR	0.6228	0.60	0.59	0.59	0.59	0.60	0.60
AUD-JPY	75.77	72.1	71.2	70.8	71.5	73.0	73.7
AUD-GBP	0.5583	0.54	0.54	0.53	0.52	0.52	0.52
AUD-NZD	1.0490	1.05	1.04	1.02	1.01	1.01	1.01

	2018	2019 (f)	2020 (f)
GDP, %	2.4	2.2	2.5
CPI (Headline), %	1.8	1.8	1.6
CPI (Trimmed mean), %	1.8	1.4	1.8
Unemployment Rate, %	5.0	5.2	5.5
Wages Growth, %	2.3	2.5	2.5

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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