Monday, 18 March 2024

Central Banks Take Centre Stage

A raft of central bank meetings are taking place this week and will take centre stage. Indeed, there are six central bank meetings we will be eyeing. The Reserve Bank (RBA) and the Bank of Japan (BoJ) will be the first cabs off the ranks – both delivering their decisions on Tuesday. These will provide an appetiser for the main meal in the middle of the week – the US Fed, who hand down their decision early Thursday morning, Australian time. The Bank of England (BoE) will be the dessert, with its decision due late on Thursday night. In between the Fed and BoE, the Swiss National Bank (SNB) and Norges Bank – Norway's central bank – will also make interest rate decisions – a palette cleanser before dessert, perhaps.

Federal Reserve

Economists and market participants will be watching the outcome of the Fed meeting with eagle eyes. The decision itself is not the focus – that will with near certainty be another on-hold decision. What will garner much more attention will be the statement following the decision, the press conference from Fed Chair Jerome Powell, the updated "dot plot" – which shows members' individual expectations of the path of the Fed funds rate and updated economic projections.

Over 2024, Fed officials have been singing a broadly similar tune regarding the outlook for monetary policy. In short, that is one noting that inflation was on its way back down to target, but that the Fed couldn't be confident enough yet that it would sustainably return to their 2% target to begin the process of cutting rates. The key for the Fed was waiting to receive more high-quality data to gain additional confidence before acting. It wasn't that the data so far wasn't showing positive signs of disinflation, but that they wanted to see more of it so as to increase their confidence levels.

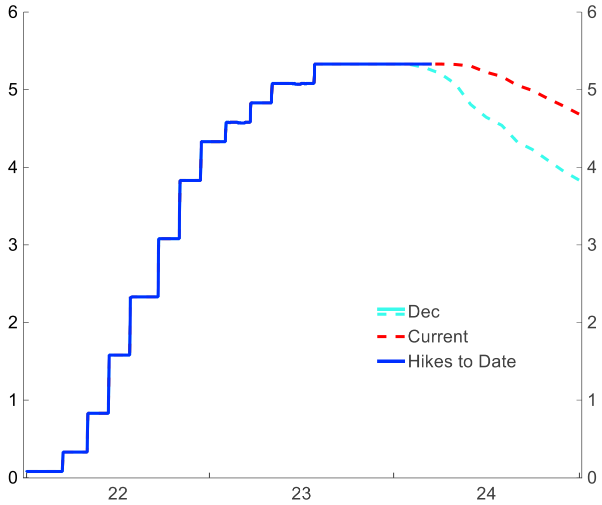
The reasoning is understandable. The US and most developed economies are coming out of a historic period where inflation surged to levels not seen in several decades. While inflation has pulled back materially, it is still above target across most developed economies. There are risks that inflation will take longer to get back to target and the Fed doesn't want to declare victory too early. Additionally, with a strong economy and robust labour market, they are afforded the luxury of waiting to see how things evolve before cutting.

Recent US inflation data has also surprised to the upside. Last week, both consumer and producer inflation for the month of February came in hotter-than-expected. Core CPI (excluding food and energy) was running at a monthly pace of 0.4% – unchanged from the January reading. This was above expectations for slower growth of 0.3%. This result took the annual pace of growth to 3.8% – down from the January reading of 3.9%, but above expectations for a more meaningful fall to 3.7%.

On the labour market side, a slowing is well underway but it has been orderly so far. The recent payrolls report was also stronger than consensus anticipated, although downward revisions to the back series make the release more complicated to interpret.

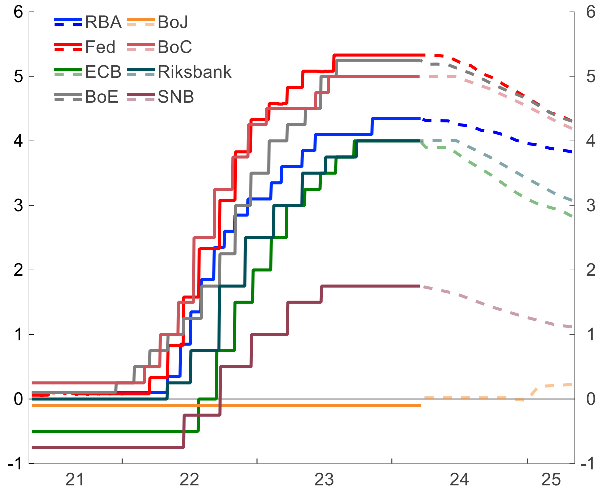
These factors underpinned the push back we've seen in market pricing for US rate cuts through 2024. Looking back, it appears that markets got ahead of themselves late last year and the pull back through 2024 was an unwinding of some of this exuberance.

Federal Funds Rate Market Pricing
Fed Funds Rate Futures



Sources: New York Fed, CME Group, Macrobond

Central Banks Policy Rates
Historical & Market Expectations, %

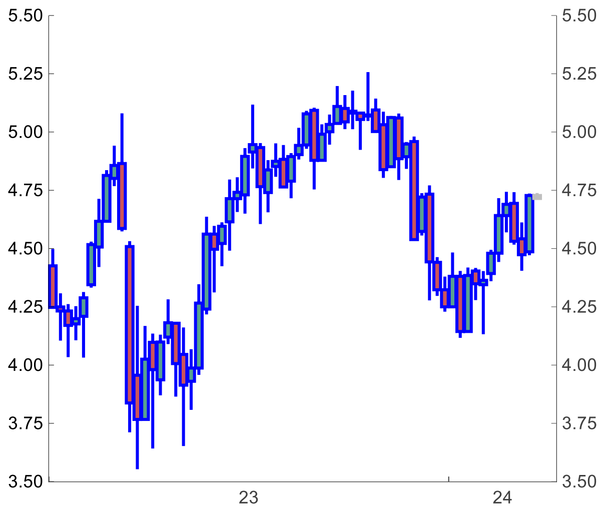


Sources: RBA, ASX, New York Fed, CME Group, ECB, ICE, BoE, BOJ, TFX, BoC, TMX, Riksbanken, Nasdaq OMX Nordic, SNB, Macrobond

For example, in late 2023 and early 2024, interest-rate markets were pricing around 160 basis points of cuts (i.e. over six 25-basis-point cuts) from the Fed by the end of 2024. This is now sitting at around 85 basis points (i.e. between three and four 25-basis-point cuts).

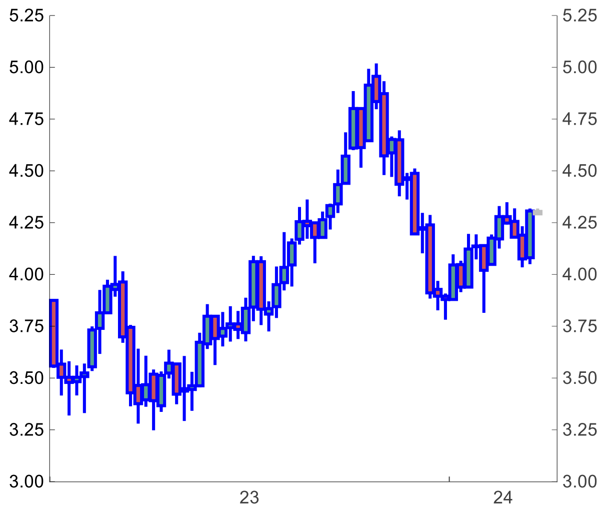
US bond yields have also moved higher and are trading near their highest levels for 2024 so far.

US Generic Govt 2-Year Yield
Weekly, %



Sources: Bloomberg, Macrobond

US Generic Govt 10-Year Yield
Weekly, %



Sources: Bloomberg, Macrobond

How the Fed is interpreting the latest run of data is something that financial markets will be trying to ascertain from Chair Powell's press conference. The dot plots will be another key indicator. Should the median number of cuts in 2024 based on the dot plot fall to two (from three currently), volatility could spike and shorter-dated bond yields would likely jump as markets reprice Fed expectations.

Powell has previously emphasised that the dot plot is not a forecast or projection of where the Fed expects to take policy. Rather, it is a representation of the median expectation of Fed members themselves. If the median projections were to fall based on the updated dot plot, Powell could use these points in the press conference to calm markets and provide reassurance that policy is still expected to be eased if the data continues to show meaningful progress on inflation.

Reserve Bank

Domestically, economists universally expect the RBA to remain on hold – as do we. The focus again will be on any changes to the statement and Governor Bullock's press conference after the meeting. The RBA's forecasts are updated once a quarter. As the forecasts were updated in February, the Board will not receive updated forecasts at this meeting. However, the data that has been released since the February meeting has largely evolved as expected by the RBA and demonstrated that economic growth and inflation are both slowing – i.e. the economy currently remains on track for a soft landing. This suggests that the forecasts would be little changed even if they were updated.

The RBA is likely to maintain some form of tightening bias in its communication, or at least continue to note that it remains ready to hike if it turned out to be necessary. It will likely wait until it is more confident that inflation is sustainably back to the 2-3% target band and closer to the band before it shifts to an explicit cutting bias. We continue to expect that a cutting cycle will begin from September 2024.

Bank of Japan

The BoJ meeting may be a wildcard this week.

Last week, Rengo – Japan's largest union group – announced average pay increases for its members of 5.28% so far. This was the initial estimate, which captures large employers. This is below the 5.85% initially sought by the unions, but is well above historical wage increases. For example, it easily eclipsed the 3.8% increase from last year and was the strongest annual wage increase for Rengo members since the early 1990s. Of note, final wages agreed are always below the initial expectations from unions and the gap in the most recent rounds has been smaller than most other periods in history.

BoJ's Governor Ueda and other members have consistently flagged a revival in wage growth as a key ingredient they are looking for to become confident that inflation will be sustainably at their 2% target. The BoJ is looking for base pay to increase to above 3%. In the 2023 financial year (to April 2023), base pay grew by 2.12% and the 2024 financial year is on track to eclipse 3%.

The stronger-than-expected wage growth data has added to market expectations that the BoJ may end its long-standing policy of negative interest rates at this week's meeting or next month's meeting. News reports have also emerged of some traders positioning for an end of negative interest rates by shorting Japanese bonds. This 'widow-maker' trade has caught many investors off guard, as previous expectations of an end to the negative interest rate policy have proven to be premature.

However, entrenched expectations of below-target inflation have been difficult to break for the BoJ. This supports a view of standing pat to assess more data and gather more confidence that this time can be different. After decades of interest rates around zero or below zero, the BoJ doesn't necessarily need to be in a hurry to move from its current stance.

Markets are currently attaching a 47% probability of a 10 basis point hike – which would see the rate increased to 0.00% from the current -0.10%. Economists are less convinced. Of the 36 economists recently surveyed by Bloomberg, only six expect a move at this week's meeting. Four expect a 10 basis points hike, and two are expecting a 20 basis point hike to 0.10%. The remaining 30 expect rates to remain unchanged. Given markets have roughly 50/50 odds attached, a market reaction is likely no matter the outcome.

Economic data

Looking to the domestic data calendar for this week, updated labour force data for the month of February will be the key release. January data again presented us with some volatility in the numbers. Changing seasonal patterns continue to impact the January numbers. Specifically, there are changes to the way people take leave around the end of the year and in the number of people that have jobs to go to in January but were classed as unemployed or not in the labour force in the data. While these patterns always impact the December/January period to a degree, the changes are larger than in previous years, leading to impacts to the seasonally adjusted figures.

For February, we expect the patterns to return to a more normal level. However, we don't expect the rebound from the January weakness to be as large in February 2024 as previous years. This reflects the continued expected easing of the labour market. Our expectation is that employment grew by 40k in February, following the broadly flat result of 0.5k in January. We expect the participation rate to remain unchanged at 66.8%, which would result in the unemployment rate ticking down to 4.0%, from the 4.1% January read.

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Group Forecasts

		2024				2025	
End Period:	**Close (15 Mar)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	4.35	4.35	4.35	4.10	3.85	3.60	3.35
90 Day BBSW, %	4.34	4.40	4.37	4.12	3.92	3.67	3.47
3 Year Swap, %	3.96	4.05	3.95	3.85	3.75	3.65	3.60
10 Year Bond, %	4.13	4.20	4.05	3.95	3.85	3.90	3.90
US Interest Rates:							
Fed Funds Rate, %	5.375	5.375	5.125	4.625	4.375	4.125	3.875
US 10 Year Bond, %	4.31	4.15	4.00	3.90	3.80	3.85	3.90
USD Exchange Rates:							
AUD-USD	0.6560	0.66	0.68	0.69	0.70	0.71	0.72
USD-JPY	149.04	147	144	141	138	135	132
EUR-USD	1.0889	1.09	1.11	1.13	1.14	1.15	1.16
GBP-USD	1.2736	1.27	1.27	1.28	1.29	1.30	1.30
NZD-USD	0.6085	0.62	0.63	0.64	0.64	0.64	0.65
AUD Exchange Rates:							
AUD-USD	0.6560	0.66	0.68	0.69	0.70	0.71	0.72
AUD-EUR	0.6026	0.61	0.61	0.61	0.61	0.62	0.62
AUD-JPY	97.77	97.0	97.2	97.3	96.6	95.9	95.0
AUD-GBP	0.5151	0.52	0.53	0.54	0.54	0.55	0.55
AUD-NZD	1.0781	1.06	1.07	1.08	1.09	1.11	1.11

	2022	**2023 (f)**	**2024 (f)**	**2025 (f)**
GDP, %	2.4	1.5	1.6	2.5
CPI (Headline), %	7.8	4.1	3.0	2.7
CPI (Trimmed mean), %	6.8	4.2	3.1	2.8
Unemployment Rate, %	3.4	3.8	4.5	4.6
Wages Growth, %	3.3	4.2	3.2	3.1

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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