

Monday, 18 November 2019

Deal Inching Closer

The trade deal between the US and China. It's coming, they say.

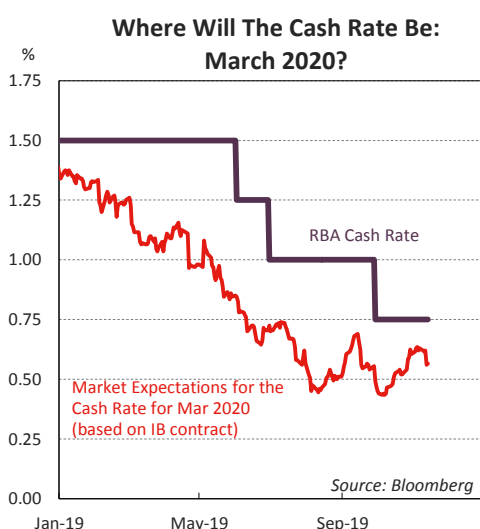
Talks are “constructive” and it appears that the US and China are closer to a deal than they have been for some time. Equity markets are hopeful – US share indices hit new record highs last week.

In Australia, markets are not so optimistic. Despite the positive developments globally on trade, a disappointing jobs report locally last week has kept the Australian dollar under downward pressure. The Australian dollar is sitting at 68.2 US cents, down from 69.2 US cents earlier in the month.

Markets are now pricing in a nearly 60% chance that the RBA will lower official interest rates by February next year, up from a 43% chance a week ago. Bond yields are also lower than this time last week, reflecting the increased odds the RBA will lower official interest rates soon.

For some time, we have warned that employment growth would soften. The pace of jobs growth over the past year or so has been surprisingly strong given the weak pace of economic growth. It reflects our expectation that the unemployment rate could rise further. This expectation is reinforced by the fact that high workforce participation is also propping up the unemployment rate.

For the RBA, it means that spare capacity is here to stay, and that full-employment (which the RBA estimates to be at an unemployment rate of 4.5%) remains elusive.



That further suggests that wage growth is likely to go nowhere, and makes it difficult to see how inflation will lift to the RBA's 2 to 3% target band. Underlying inflation has been below the RBA's target band for over 3½ years.

It supports our view that the RBA will need to once again provide further support, and lower official interest rates to 0.50%. We continue to think February is the most likely timing. Indeed, it will further strengthen calls for stimulus via other means, including fiscal stimulus and non-conventional monetary policy.

Ahead this week, we will look for some further insights into the RBA's thinking in the minutes of the November meeting to be released tomorrow. Otherwise it is a rather quiet week on the data calendar.

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Forecasts

End Period:	2019		2020			
	Close (Nov 15)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)
Aust. Interest Rates:						
RBA Cash Rate, %	0.75	0.75	0.50	0.50	0.50	0.50
90 Day BBSW, %	0.89	0.85	0.70	0.70	0.70	0.70
3 Year Swap, %	0.80	0.75	0.70	0.70	0.80	0.85
10 Year Bond, %	1.16	1.10	0.90	0.90	1.00	1.10
US Interest Rates:						
Fed Funds Rate, %	1.625	1.625	1.375	1.125	0.875	0.875
US 10 Year Bond, %	1.83	1.70	1.50	1.45	1.40	1.50
USD Exchange Rates:						
AUD-USD	0.6817	0.67	0.66	0.66	0.67	0.67
USD-JPY	108.80	108	107	106	105	105
EUR-USD	1.1051	1.09	1.09	1.10	1.11	1.12
GBP-USD	1.2897	1.30	1.33	1.32	1.32	1.31
NZD-USD	0.6404	0.63	0.62	0.62	0.63	0.63
AUD Exchange Rates:						
AUD-USD	0.6817	0.67	0.66	0.66	0.67	0.67
AUD-EUR	0.6170	0.61	0.61	0.60	0.60	0.60
AUD-JPY	74.19	72.4	70.6	70.0	70.4	70.4
AUD-GBP	0.5285	0.52	0.50	0.50	0.51	0.51
AUD-NZD	1.0647	1.06	1.06	1.06	1.06	1.06

	2018	2019 (f)	2020 (f)
GDP, %	2.2	2.3	2.4
CPI (Headline), %	1.8	1.7	1.9
CPI (Trimmed mean), %	1.8	1.6	1.9
Unemployment Rate, %	5.0	5.3	5.6
Wages Growth, %	2.4	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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