

Monday, 22 January 2024

Soft Landing In Sight, Risks Remain

In our last weekly economic update for 2023 we noted that household finances were under immense pressure, but that this pressure will ease as we work through 2024. Moderating inflation is one of the reasons we expect the pressure valve to gradually open. This view was supported by the monthly inflation outcome for November. This showed that inflation had moderated more quickly than expected to 4.3% in annual terms, from a peak in the monthly indicator of 8.4% in December 2022. This was the softest monthly inflation read since January 2022.

Last week we continued to see signs that labour market conditions are softening. The number of people employed declined by 65.1k over December. This was broadly matched by a decline in the number of people that are actively participating in the labour market, which saw the unemployment rate remain steady at 3.9%. While it's hard to get a clear monthly read on key labour market variables given shifting seasonality as consumers adjust spending patterns because of Black Friday sales, employment growth is clearly slowing – over the first half of 2023 employment grew on average by around 43k each month, over the second half employment grew on average by only 21k each month.

With labour market conditions easing and inflation coming down we expect the Reserve Bank (RBA) will be able to cut the cash rate in the second half of this year – most likely starting in the September quarter. This will also help household finances, particularly liquidity constrained households with variable rate mortgages.

However, there are risks to this soft landing. Over the summer we saw shipping costs spike as Yemen's Houthis attacked commercial vessels in the Red Sea. Tensions have increased further as the US and its allies have responded to the attacks. As a result, the costs of freight that pass through the Red Sea have more than doubled and in some instances increased by close to 300%. For example, the Shanghai to Genoa container rate has increased by close to 300% since mid-December. This spike in prices could impact the significant share of global trade that passes through the Red Sea – around 30% of global container trade, or around 12% of global trade. Alternate routes take longer, adding to costs and generating other difficulties such as spoiling of perishable foods.

Notwithstanding the sharp increase in shipping costs, these costs remain lower than the pandemic peaks. However, if they remain elevated for an extended period, businesses will have to pass on these higher costs to consumers, adding to inflationary pressures. If this is the case, central banks may be forced to respond to ensure expectations remain well anchored.

This week will be relatively quiet on the domestic data front. On Tuesday, we will receive an updated read on business confidence and conditions. Business conditions have started to ease, particularly in consumer facing industries. This has led to a deterioration in business confidence. The next instalment will give us a read on whether this dynamic continued over December.

Group Forecasts

End Period:	2024				2025		
	Close (19 Jan)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)	Q1 (f)	Q1 (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	4.55	4.47	4.22	3.97	3.72	3.47
3 Year Swap, %	4.06	4.15	4.10	4.05	4.00	3.90	3.70
10 Year Bond, %	4.29	4.35	4.30	4.20	4.15	4.10	4.05
US Interest Rates:							
Fed Funds Rate, %	5.375	5.125	4.875	4.625	4.375	4.125	3.875
US 10 Year Bond, %	4.12	4.25	4.20	4.15	4.10	4.05	4.05
USD Exchange Rates:							
AUD-USD	0.6597	0.67	0.68	0.69	0.70	0.71	0.72
USD-JPY	148.12	145	144	141	138	135	132
EUR-USD	1.0898	1.09	1.11	1.13	1.14	1.15	1.16
GBP-USD	1.2703	1.26	1.27	1.28	1.29	1.30	1.30
NZD-USD	0.6113	0.62	0.62	0.62	0.63	0.63	0.63
AUD Exchange Rates:							
AUD-USD	0.6597	0.67	0.68	0.69	0.70	0.71	0.72
AUD-EUR	0.6054	0.61	0.61	0.61	0.61	0.62	0.62
AUD-JPY	97.72	97.2	97.9	97.3	96.6	95.9	95.0
AUD-GBP	0.5194	0.53	0.54	0.54	0.54	0.55	0.55
AUD-NZD	1.0789	1.08	1.11	1.11	1.11	1.13	1.14

	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	4.5
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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