

Monday, 23 September 2019

## Stage Being Set for Lower Interest Rates

Over the course of last week, expectations for further monetary easing by the RBA have ramped up. Interest rate futures are now pricing in a near 80% probability of a 25 basis point rate cut at the RBA's next meeting in October, up from just a 24% chance priced in a week ago. Markets are now placing a 91% probability of 25 basis point rate cut to occur by the end of the year, up from 69% a week ago. The Australian dollar is also lower, back below 68 US cents, although elevated geopolitical risks are likely adding downward pressure on the AUD.

What may have occurred to shift expectations? Firstly, the RBA released the minutes of its September meeting on Tuesday. While the RBA did not change the language on its guidance on monetary policy, there was an increasing tone of caution on international developments and the impact of trade tensions.

Secondly, labour force data on Thursday continued to provide a mixed picture. Jobs growth remained very strong, but as far as the RBA is concerned, its focus is on what it means for wages and inflation. Strong population growth, growing workforce participation and an upward trending unemployment rate is pointing to spare capacity not only persisting, but gradually increasing in the labour market.

The uncertainty within the global economy and the risk that the unemployment rate is moving away from the RBA's full-employment estimate of 4.5%, is further laying the groundwork for another cut to the official cash rate. We maintain our view that the RBA will lower official interest rates at its next October board meeting.

We could gain further clues into the RBA's thinking on Tuesday, when RBA Governor Lowe delivers a speech entitled "An Economic Update". Since the turn of the year, there have been strong signals in the Governor's speeches to communicate the RBA's stance on policy. Lowe's comments will therefore be closely watched for signs of whether the RBA will consider lowering interest rates in October.

It follows the Federal Reserve's decision last Wednesday to lower official interest rates by 25 basis points, for the second time in this cycle. China also cut its one-year benchmark lending rate for the second month in a row by 5 basis points, and followed a lowering of the reserve requirement ratio (cash required by banks to hold as reserves) earlier in the month.

The wave of monetary easing by central banks around the world highlight the range of risks continuing to face the global economy. The key challenges continue to be the impact of political shocks on the broader economy, reflecting ongoing uncertainty amid global trade tensions and elevated political risks in the Middle East.

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## Forecasts

End Period:	2019	2020				
	Close (Sep 20)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)
<b>Aust. Interest Rates:</b>						
RBA Cash Rate, %	1.00	0.75	0.50	0.50	0.50	0.50
90 Day BBSW, %	0.92	0.85	0.70	0.70	0.70	0.70
3 Year Swap, %	0.80	0.70	0.85	0.90	0.95	1.00
10 Year Bond, %	1.02	0.95	1.00	1.15	1.20	1.25
<b>US Interest Rates:</b>						
Fed Funds Rate, %	1.875	1.375	1.125	0.875	0.875	0.875
US 10 Year Bond, %	1.78	1.45	1.40	1.45	1.50	1.55
<b>USD Exchange Rates:</b>						
AUD-USD	0.6766	0.67	0.66	0.66	0.67	0.67
USD-JPY	107.56	105	104	104	106	108
EUR-USD	1.1017	1.07	1.05	1.06	1.07	1.09
GBP-USD	1.2478	1.17	1.18	1.20	1.22	1.24
NZD-USD	0.6258	0.63	0.62	0.62	0.63	0.63
<b>AUD Exchange Rates:</b>						
AUD-USD	0.6766	0.67	0.66	0.66	0.67	0.67
AUD-EUR	0.6141	0.63	0.63	0.62	0.63	0.61
AUD-JPY	72.78	70.4	68.6	68.6	71.0	72.4
AUD-GBP	0.5422	0.57	0.56	0.55	0.55	0.54
AUD-NZD	1.0810	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), %	1.9	1.5	1.8
Unemployment Rate, %	5.0	5.4	5.6
Wages Growth, %	2.3	2.5	2.6

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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