Monday, 26 February 2024

Domestic Data Unlikely to Make a Splash

Global markets have been fixated on when, and by how much, the US Fed will cut rates in 2024. These expectations naturally ebb and flow with the release of new data. However, since the start of the year expectations for aggressive rate cuts in the US have been watered down significantly. At times in January there were more than six 25-basis point rate cuts priced in for 2024 and in December 2023 the market was fully pricing the first Fed cut to be in March.

At Friday's close expectations for the first rate cut have been pushed back to July and there are now just a little over three cuts expected by the end of the year. That's a significant adjustment in a very short space of time.

Central to this repricing in interest rate expectations has been the resilience of the US economy. The labour market remains tight, and activity has surprised meaningfully to the upside. Accompanying the impressive economic data has been a chorus of central bank officials who have adopted a mantra of patience as they remain wary of the risk inflation could reaccelerate on the back of a strong economy. They are pleased with the progress on inflation, but they are cautious of cutting too early without more evidence that this progress can be sustained.

Complicating this dynamic is the fact that on a six-month annualised basis the Fed has already hit its inflation target. The case for maintaining restrictive monetary policy becomes less convincing when inflation appears on course for the Fed's 2% target. It was this surprisingly quick progress on inflation which underpinned the markets initial optimism of imminent and significant rate cuts.

Given the extent to which inflation and growth dynamics have been distorted by the disruptions of the pandemic and the subsequent unwind, it makes sense to tread carefully.

There are plenty of compelling arguments for rates to remain at current levels for longer; higher productivity, larger fiscal deficits, expanding potential aggregate supply to name just a few. Most of these explanations involve the argument that the 'neutral' policy rate, the so-called 'r-star', is higher than previously thought and that the current level of interest rates might not be as restrictive as perceived. But there is also a simple case to be made that outright deflation in the goods and energy components of inflation, underpinned by the unwinding of supply shocks, may be flattering the inflation outcomes.

However, there are equally as captivating arguments in favour of a fairly prompt easing in monetary policy. Leading economic indicators point to a broad softening in economic activity, mixed signals on the labour market could be masking underlying weakness and softening wage pressures are reducing the risk of a reacceleration in inflation.

Given the uncertainty, and the lack of consensus on the outlook, sizeable swings in market expectations for Fed rate cuts are likely to remain the norm for a while yet.

At home, rate expectations have been more stable. Although, the number of cuts expected for

2024 has been pared back alongside the moves in the US. Currently, markets are expecting just one rate cut from the Reserve Bank (RBA) in 2024 and there is around a 70% chance of a second cut by year-end. Markets are expecting the first rate cut to come at the RBA's September meeting.

The dispersion in the timing of expected rate cuts in the US and Australia is explained simply by the fact that we have trailed the US in this cycle because of differences in when each economy reopened from the pandemic. The forces driving divergent expectations on the number of cuts in each economy are more nuanced but a big component here is just that the US hiked rates further, so there is further to ease to return to neutral.

Domestically, the flow of data ramps up this week in the lead up to the December quarter National Accounts which are due out next Wednesday. In contrast to the US, we are not expecting to see strong economic data which would warrant significantly re-evaluating the expected path of interest rates. If anything, the risks are tilted towards the other side.

On Wednesday, we will receive an update on inflation in January from the monthly consumer price index (CPI) indicator. The indicator only updates part of the CPI basket each month. This means it should be treated as a signal, but not as gospel. Being the first month of the quarter, the January update will see a large share of goods prices updated, with limited updates on the prices of services. This presents considerable scope for a soft number come Wednesday. However, this is likely to be accompanied by a jump in the measure as we progress through the quarter and receive more updates on the prices of services. More important than the headline number will be unpicking specific dynamics within the inflation basket.

December quarter updates on construction activity and private capital expenditure (CAPEX) will give us a glance at the real side of the economy. We expect construction activity expanded 0.8% in the December quarter, slowing after very strong growth in activity over the past year-or-so. We expect CAPEX growth to be flat in the quarter but note that the level of capital spending is expected to remain elevated. The key question will be whether recent strength in spending intentions carried through into the December quarter.

We will also get some more timely data on the consumer and household sector. January retail sales are due out on Thursday. Shifting spending patterns have made retail data difficult to interpret around the end/beginning of the calendar year. After a 2.7% fall in December, we are expecting are modest 0.3% rise in retail turnover in January.

February's release of CoreLogic's dwelling prices data will cap off the week. Based off the daily indicator we expect dwelling prices rose 0.6% in February, extending recent gains. Strength is again expected to be concentrated in the Perth, Adelaide, and Brisbane markets, where the stock of advertised supply remains particularly low.

Jameson Coombs, Economist
Ph: +61 401 102 789

Group Forecasts

		2024				2025	
End Period:	**Close (23 Feb)**	**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, %	4.20	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, %	4.25	4.15	4.00	3.90	3.80	3.85	3.90
USD Exchange Rates:							
AUD-USD	0.6562	0.66	0.68	0.69	0.70	0.71	0.72
USD-JPY	150.51	147	144	141	138	135	132
EUR-USD	1.0821	1.09	1.11	1.13	1.14	1.15	1.16
GBP-USD	1.2672	1.26	1.27	1.28	1.29	1.30	1.30
NZD-USD	0.6197	0.62	0.63	0.64	0.64	0.64	0.65
AUD Exchange Rates:							
AUD-USD	0.6562	0.66	0.68	0.69	0.70	0.71	0.72
AUD-EUR	0.6066	0.61	0.61	0.61	0.61	0.62	0.62
AUD-JPY	98.78	97.0	97.2	97.3	96.6	95.9	95.0
AUD-GBP	0.5179	0.52	0.53	0.54	0.54	0.55	0.55
AUD-NZD	1.0592	1.06	1.07	1.08	1.09	1.11	1.11

	2022	**2023 (f)**	**2024 (f)**	**2025 (f)**
GDP, %	2.3	1.4	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	3.0

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

Contact Listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
+61 404 844 817

Senior Economist
Pat Bustamante
pat.bustamante@bankofmelbourne.com.au
+61 468 571 786

Senior Economist
Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
+61 481 476 436

Economist
Jameson Coombs
jameson.cooombs@bankofmelbourne.com.au
+61 401 102 789

The Detail

The information contained in this report ("the Information") is provided for, and is only to be used by, persons in Australia. The information may not comply with the laws of another jurisdiction. The Information is general in nature and does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and is not an invitation to take up securities or other financial products or services. No decision should be made on the basis of the Information without first seeking expert financial advice. For persons with whom Bank of Melbourne has a contract to supply Information, the supply of the Information is made under that contract and Bank of Melbourne's agreed terms of supply apply. Bank of Melbourne does not represent or guarantee that the Information is accurate or free from errors or omissions and Bank of Melbourne disclaims any duty of care in relation to the Information and liability for any reliance on investment decisions made using the Information. The Information is subject to change. Terms, conditions and any fees apply to Bank of Melbourne products and details are available. Bank of Melbourne or its officers, agents or employees (including persons involved in preparation of the Information) may have financial interests in the markets discussed in the Information. Bank of Melbourne owns copyright in the information unless otherwise indicated. The Information should not be reproduced, distributed, linked or transmitted without the written consent of Bank of Melbourne.

Any unauthorised use or dissemination is prohibited. Neither Bank of Melbourne- A Division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ACL 233714, nor any of Westpac's subsidiaries or affiliates shall be liable for the message if altered, changed or falsified.