Gearing Up For GDP

Today kicks off a huge week for economists – there is no less than ten major data releases out. The biggest in the bag locally is the national accounts data on Wednesday where we receive an important update on the pace of economic activity at the end of 2023. This data could have important implications for the timing of rate cuts. The market remains fully priced for rate cuts to start in September. There is one rate cut fully priced in by the end of this year and the risk of a second is sitting at a probability of around 75%, but this could change after the data deluge.

The Group view expects gross domestic product (GDP) was unchanged in the December quarter, after growing by 0.2% in the September quarter. Such an outcome would lead to a deceleration in the annual growth rate from 2.1% to a three-year low of 1.4%, as the impact of higher interest rates and elevated inflation takes a toll.

But where do the risks lie? Consensus forecasts would suggest to the upside. Indeed, there's some upside risk that private demand, especially business investment, shows some ongoing resilience. Outside of private demand, the trade sector should add marginally to economic activity in the quarter.

Inventories could be the biggest drag on GDP for the quarter. The rundown in inventories in the final quarter of 2023 could lop as much as 1.0 percentage point off GDP.

The risks to the GDP number may ultimately boil down to whether the population explosion has been enough to inject some resilience into aggregate demand. This has been the case of recent quarters and has kept growth running uninterrupted for eight straight quarters. At the end of the June quarter 2023, the population increase was running at an annual total and a record of over 600,000.

Hours worked has dropped considerably and traditionally can provide a reliable guide to broader patterns in economic activity, but we have seen exceptions before, such as during the GFC.

In the lead up to Wednesday, there are partial economic indicators that help economists round out their forecasts for GDP. These include business indicators data today, of which inventories and gross company profits garner the most attention, balance of payments (tomorrow) and government statistics (tomorrow).

The current account is likely to return to surplus whilst government spending and demand is likely to have supported growth in the quarter.

Amid the GDP deluge, we also receive updates on the labour market, trade and housing.

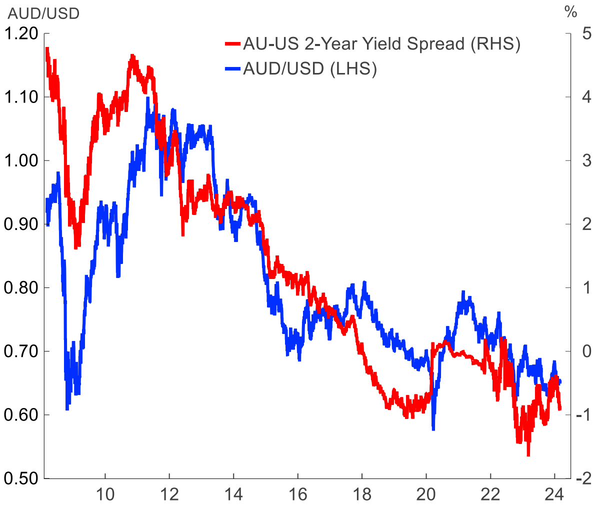
Job advertisements (released today) showed a fall of 2.8% in February, suggesting employment growth is likely to let up from the current rate and that the unemployment rate will continue to gradually lift higher. The labour market remains tight nationally and across individual states and territories, but has moved from 'white hot' to 'red hot' and turning to 'hot'.

Housing data this week is two pronged – building approvals today and housing finance on Thursday. The trends in both are likely to continue to add to the housing challenge facing Australia – that is, too little supply for underlying demand against a backdrop of slowing residential construction. Building approvals fell 1.0% in January – representing the third consecutive monthly fall and a contraction of 44.5% from the cyclical peak in early 2021. Meanwhile, housing finance should expand by 1.0% in January, reversing some of the 4.0% decline in December related to the Reserve Bank's (RBA) cash-rate hike the month before. The longer running trend in housing finance will be heavily influenced by how soon the RBA cuts rates.

The RBA is keeping an eye on US inflation developments. The US is expected by interest-rate markets to cut before the RBA, in July. There have recently been big movements in shorter dated bond yields in the US as data has suggested perhaps there is more persistent price pressures than the Federal Reserve would like. The US 2-year government yield surged from a closing low of 4.14% in mid January to a high of 4.72% at the time of this Weekly last Monday (26 February). Shorter dated bond yields in the US have since retreated to 4.55%, but the retreat in Australian 2-year yields has not been as deep.

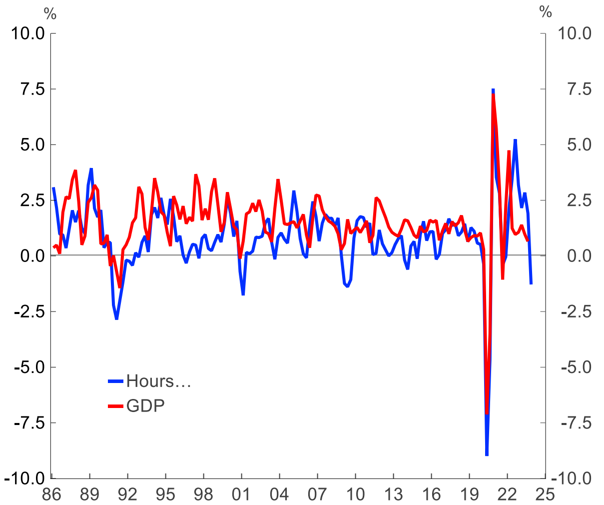
The narrowing of the short-term interest rate spreads between Australia and the US gave the AUD/USD a kick higher – it rose from near the 0.6330 handle to a three-week high of 0.6595 on February 22 before pulling back ahead of a big data week here and with payrolls pending release on Friday in the US. For almost a year, the AUD/USD has stuck to a trading range in broad terms of 0.6300-0.6900. We can't see the AUD/USD sustainably lifting and breaching the top side of this range until the Fed starts cutting and provided the Fed cuts deeper and faster than the RBA. The market is betting on this to be the case with 6 rate cuts priced in for this year for the Fed and just shy of 2 for Australia, but the data run will be vital.

AUD vs AU-US 2-Yr Yield Spread
Daily



Sources: Macrobond, RBA, U.S. Treasury; Macrobond

GDP and Hours Worked
% change over two quarters



Sources: ABS, Macrobond

Besa Deda, Chief Economist
Ph: +61 404 844 817

Group Forecasts

	2024					2025	
End Period:	**Close (01 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, %	3.90	4.05	3.95	3.85	3.75	3.65	3.60
10 Year Bond, %	4.14	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, %	4.18	4.15	4.00	3.90	3.80	3.85	3.90
USD Exchange Rates:							
AUD-USD	0.6527	0.66	0.68	0.69	0.70	0.71	0.72
USD-JPY	150.12	147	144	141	138	135	132
EUR-USD	1.0837	1.09	1.11	1.13	1.14	1.15	1.16
GBP-USD	1.2655	1.26	1.27	1.28	1.29	1.30	1.30
NZD-USD	0.6107	0.62	0.63	0.64	0.64	0.64	0.65
AUD Exchange Rates:							
AUD-USD	0.6527	0.66	0.68	0.69	0.70	0.71	0.72
AUD-EUR	0.6020	0.61	0.61	0.61	0.61	0.62	0.62
AUD-JPY	97.97	97.0	97.2	97.3	96.6	95.9	95.0
AUD-GBP	0.5157	0.52	0.53	0.54	0.54	0.55	0.55
AUD-NZD	1.0687	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	3.1

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