Weekly Economic Outlook

Monday, 7 March 2022

War Impacts Central Bank Expectations

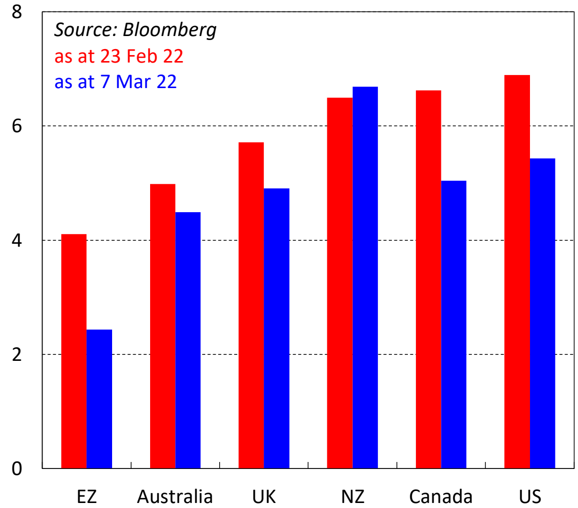
The terrible war in Ukraine continues to dominate headlines. The potential economic implications from the war and the economic sanctions imposed on Russia continue to drive volatility in global markets and are underpinning a shift towards safe-haven assets. Additionally, the war and fears on the impacts it may have on the global economic recovery have affected market pricing of central bank rate increases over 2022.

Russia is the third largest exporter of crude oil and petroleum products. Concerns over supply have led to oil prices increasing to their highest levels since July 2008. The West Texas Intermediate futures price spiked to above US$130 a barrel today and is currently trading around US$125. The price surged from around US$90 a barrel prior to the invasion.

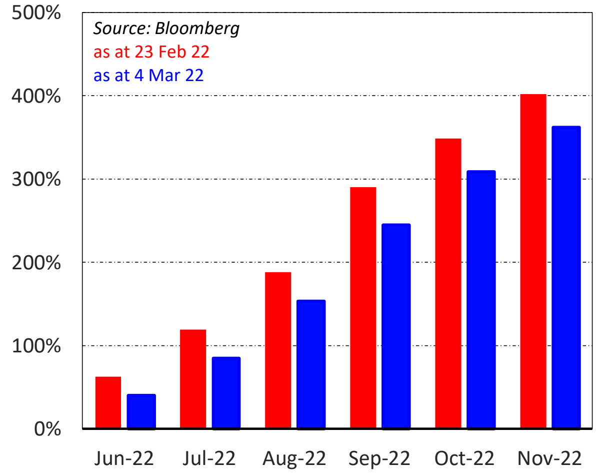
Higher oil prices have the potential to flow through into elevated global inflation and negatively impact global growth and the economic recovery. The possible economic fallout from the war creates a difficult situation for central bank policy makers, as they seek to support domestic and global growth, while also addressing growing inflationary risks.

This has contributed to the market reducing its expectations of interest rate increases by major global central banks over 2022. Prior to the Russian invasion of Ukraine, the market was expecting almost seven interest rate increases over 2022 by the central banks of the US, Canada, and New Zealand. This pricing has pulled back across almost all central banks over the past few weeks.

Number of Rate Hikes in 2022
(Pricing by Interest Rate Markets)



Market Pricing for a 25 Basis Point Rate Hike From the RBA



Europe is likely to be most heavily impacted by developments surrounding Ukraine. Reflecting this, markets are now pricing in only around two interest rate increases by the European Central Bank over 2022. This is down from over four increases on 23 February 2022, prior to the invasion.

In the US, market expectations of rate increases over 2022 and at the upcoming March Federal Open Market Committee meeting have also been pared back. The market was previously pricing in a reasonable probability of a 50 basis point increase at the March meeting. However, this has reduced significantly. The market is no longer expecting a 50 basis point move and is currently pricing in around a 90% chance of a 25 basis point increase in March. US Federal Reserve Chair Jerome Powell also sent a very strong signal last week in remarks to Congress that the first move would be 25 basis points. Over 2022, the number of expected interest rate moves in the US have fallen from almost seven to a bit over five.

In Australia, interest rate expectations have also been pulled back. The market is currently expecting around four interest rate increases over 2022, this is down from close to five prior to the outbreak of the war. The expected first rate hike has also been pushed back from June. The market is now expecting a 15 basis point move to come in July.

We expect the RBA to be less aggressive in their rate hike trajectory than anticipated by markets. We remain comfortable with our view that the first rate hike will come in August, with another hike before the end of 2022.

Downside risks to the economic outlook are growing. However, in Australia, the economic recovery remains on track. The economy sprung back by 3.4% over the December quarter of 2021, following the impacts of the Delta lockdowns. At the end of 2021, the economy was 3.4% larger than prior to the pandemic. Despite various challenges, this positive momentum has continued into 2022. Consumer spending is supporting the recovery, the labour market is strong, and unemployment is expected to fall below 4% over 2022. Household and business balance sheets remain robust, monetary policy continues to be supportive, and wages are expected to continue to pick up over 2022, as the labour market tightens.

Turning to this week's upcoming economic data, we will receive an update on how the war in Ukraine and other developments have impacted consumer and business confidence.

On Tuesday, business confidence for the month of February will be published. In January, business confidence rebounded to around average levels of +3. This followed a plunge of 25 points in December as case numbers surged due to the Omicron outbreak. The rebound in confidence in January supported our view that the Omicron outbreak would not derail the economic recovery.

Confidence in February is likely to remain relatively stable. A recovering economy will be negated by the conflict in Europe. The survey is generally undertaken in the last two weeks of the month. Russia invaded Ukraine on 24 February. This means that the full-scale outbreak of war will only be captured in responses towards the end of the period.

Consumer sentiment for the month of March, published by the Melbourne Institute and Westpac, will be released on Wednesday. In February, sentiment declined by 1.3%. The pullback appeared to reflect rising cost-of-living pressures and growing prospects of interest rate increases on the horizon. These overshadowed falling case numbers and a positive economic outlook. Despite declining over recent months, sentiment remained around 100, indicating that optimists and pessimists were broadly evenly weighted.

Sentiment in March might be impacted by the rise in uncertainty from the war in Ukraine. Additionally, Australia also faced its own difficulties as flood waters rose across many parts of Queensland and New South Wales, devastating many rural communities and impacting residents across both states. These factors are likely to negatively drag on confidence in the month.

Jarek Kowcza, Senior Economist
Ph: 0481 476 436

Forecasts

		2022			2023		
End Period:	**Close (4 Mar)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	0.10	0.10	0.25	0.50	0.75	1.00	1.25
90 Day BBSW, %	0.08	0.10	0.35	0.60	0.95	1.20	1.45
3 Year Swap, %	1.88	1.75	1.80	1.90	2.00	2.10	2.20
10 Year Bond, %	2.23	2.40	2.40	2.50	2.50	2.40	2.30
US Interest Rates:							
Fed Funds Rate, %	0.125	0.875	1.125	1.375	1.625	1.875	1.875
US 10 Year Bond, %	2.02	2.30	2.40	2.50	2.50	2.40	2.30
USD Exchange Rates:							
AUD-USD	0.7308	0.70	0.71	0.73	0.75	0.76	0.77
USD-JPY	115.33	117	117	118	118	119	119
EUR-USD	1.1018	1.11	1.12	1.13	1.14	1.15	1.15
GBP-USD	1.3327	1.37	1.38	1.38	1.38	1.37	1.37
NZD-USD	0.6792	0.65	0.66	0.68	0.69	0.70	0.71
AUD Exchange Rates:							
AUD-USD	0.7308	0.70	0.71	0.73	0.75	0.76	0.77
AUD-EUR	0.6633	0.63	0.63	0.65	0.66	0.66	0.67
AUD-JPY	84.283	81.9	83.1	86.1	88.5	90.4	91.6
AUD-GBP	0.5484	0.51	0.51	0.53	0.54	0.55	0.56
AUD-NZD	1.0789	1.08	1.08	1.08	1.09	1.09	1.09

	2020	2021	2022 (f)	2023 (f)
GDP, %	-0.8	4.2	5.5	2.7
CPI (Headline), %	0.9	3.5	3.3	2.5
CPI (Trimmed mean), %	1.2	2.6	3.3	2.9
Unemployment Rate, %	6.8	4.7	3.8	3.9
Wages Growth, %	1.4	2.3	3.2	3.5

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
(02) 8254 3251

Economist
Matthew Bunny
matthew.bunny@bankofmelbourne.com.au
(02) 8254 0023

Senior Economist
Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
0481 476 436

Associate Economist
Jameson Coombs
jameson.coombs@bankofmelbourne.com.au
0401 102 789