

Monday, 9 September 2019

Central Banks Ready to take Action

The warning lights are still flashing amber according to economic developments over the weekend. The run of data is suggesting that the trade tensions are increasingly impacting the global economy.

Take Chinese trade data released on Sunday. Chinese exports were disappointing and contracted 1.0% in the year to August. The weak result was despite the fact that the yuan depreciated over the month and despite the fact demand was expected to be brought forward ahead of US tariff hikes. Moreover, weak imports further suggest weakness in the Chinese domestic economy.

The US economy is also facing headwinds. The uncertainty over tariffs and trade developments has not been conducive for business investment and hiring decisions. The downturn in business confidence has translated into a weaker pace of hiring; the run of job gains this year has been consistently below the heady pace of last year. While the current rate of job growth is still sufficient to prevent the unemployment rate from rising, jobs growth is likely to weaken further. Indeed, the softer pace of employment growth is likely to impact the US consumer, which has been resilient to date.

Consequently, it seems increasingly likely that the 25 basis point rate cut delivered by the Federal Reserve will not be the only one. US Federal Reserve Chair Powell has said that the rate cut was a “mid-cycle adjustment”, but the comments preceded the escalation in the trade conflict over recent weeks and further indications that economic growth is losing momentum.

The increasing risk that US economic growth will slow to a pace below trend suggests the Federal Reserve will implement rate cuts at every meeting for the remainder of this year and twice more next year, taking the Fed funds rate to 0.875% by mid-2020.

The Federal Reserve is not the only central bank looking to provide monetary policy support. Just last Friday, the People’s Bank of China (PBoC) lowered its reserve requirement ratio (the amount of funds that banks have to hold in reserve) for the third time this year, which will be its lowest since 2007.

Additionally, on Thursday, we expect the European Central Bank (ECB) to lower its deposit rate by 10 basis points and announce a new round of quantitative easing to be implemented by the end of the year.

Unlike the financial shocks that have resulted in global recessions in the recent past, the current risks seem more like a kettle slowly coming to the boil rather than being thrown into the fire. However, as RBA Governor Lowe recently highlighted, “political shocks are turning into economic shocks”. The long-running trade tensions continue to suggest that the risk to the outlook are skewed towards the downside.

Forecasts

End Period:	2019		2020			
	Close (Sep 6)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)
Aust. Interest Rates:						
RBA Cash Rate, %	1.00	0.75	0.50	0.50	0.50	0.50
90 Day BBSW, %	1.00	0.85	0.70	0.70	0.70	0.70
3 Year Swap, %	0.82	0.70	0.75	0.80	0.85	0.90
10 Year Bond, %	1.09	0.95	0.90	0.95	1.00	1.05
US Interest Rates:						
Fed Funds Rate, %	2.125	1.375	1.125	0.875	0.875	0.875
US 10 Year Bond, %	1.56	1.45	1.40	1.45	1.50	1.55
USD Exchange Rates:						
AUD-USD	0.6846	0.67	0.66	0.66	0.67	0.67
USD-JPY	106.92	105	104	104	106	108
EUR-USD	1.1029	1.07	1.05	1.06	1.07	1.09
GBP-USD	1.2283	1.17	1.18	1.20	1.22	1.24
NZD-USD	0.6421	0.64	0.63	0.63	0.64	0.64
AUD Exchange Rates:						
AUD-USD	0.6846	0.67	0.66	0.66	0.67	0.67
AUD-EUR	0.6210	0.63	0.63	0.62	0.63	0.61
AUD-JPY	73.20	70.4	68.6	68.6	71.0	72.4
AUD-GBP	0.5573	0.57	0.56	0.55	0.55	0.54
AUD-NZD	1.0671	1.05	1.05	1.05	1.05	1.05

	2018	2019 (f)	2020 (f)
GDP, %	2.4	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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