

Monday, 16 September 2019

Oil Spike Overwhelms Trade Worries

Trade tensions have taken a back seat to oil tensions. Global oil prices surged early Monday after an attack on two Saudi Arabian oil facilities over the weekend. These facilities deliver more than half of Saudi Arabia's oil exports and account for around 5% of global supply.

London's Brent oil futures jumped almost US\$12 a barrel (or 19.5%) after the open today to reach an intraday high of US\$71.95 a barrel; it is the biggest intraday advance in dollar terms since they were launched in 1988.

The unexpected and unprecedented move in oil reverberated in other financial markets. Safe-haven assets, including gold, government bonds and the Japanese yen, lifted on concern over the geopolitical risks from the attacks.

For oil markets, it is the single worst sudden disruption on record, even surpassing the loss of Kuwaiti and Iraqi petroleum supply in August 1990 when Saddam Hussein invaded his neighbour.

The US have indicated it is "ready to deploy resources from the Strategic Petroleum Oil Reserves". Meanwhile, officials in Saudi Arabia have indicated it will take weeks to resume full production and that it may call on other OPEC countries to increase supply to compensate for the shortfall.

Turning to the domestic market and this week there are two major events on the economic calendar. They are the minutes of the Reserve Bank board meeting on September 3 (tomorrow) and labour force data for August (Thursday).

The statement that accompanied the RBA board meeting earlier this month failed to incite expectations of a near-term rate cut. Indeed, the probability of a 25 basis point rate hike fell from 74% before the board meeting to stand at just 24% today.

The final paragraph of the RBA's statement made it clear that the key areas of focus for the RBA were global developments and the domestic labour market.

On Thursday, the Australian Bureau of Statistics will deliver August data for the labour force. This data will be crucial in determining whether the RBA cuts in October or keeps its powder dry for a little longer.

We anticipate jobs expanded by only 7k in August, after an outsized 41.1k gain in July. We expect the unemployment rate to edge up to 5.3% in August from 5.2% in July and for the participation rate to hold steady at a record high. Employment growth has remained robust; employment grew by 2.6% in the year to July and the three-month-moving average in July stood at 28k. Some slowing in employment growth from the current solid rate is likely with the risk the unemployment rate will move further away from the RBA's desired target of 4.5% (i.e. the RBA's estimate of full employment).

In financial markets, the sell off in global bond markets has continued (i.e. bond yields have continued to rise). In Australia, the three-year government bond yield has moved 29 basis points

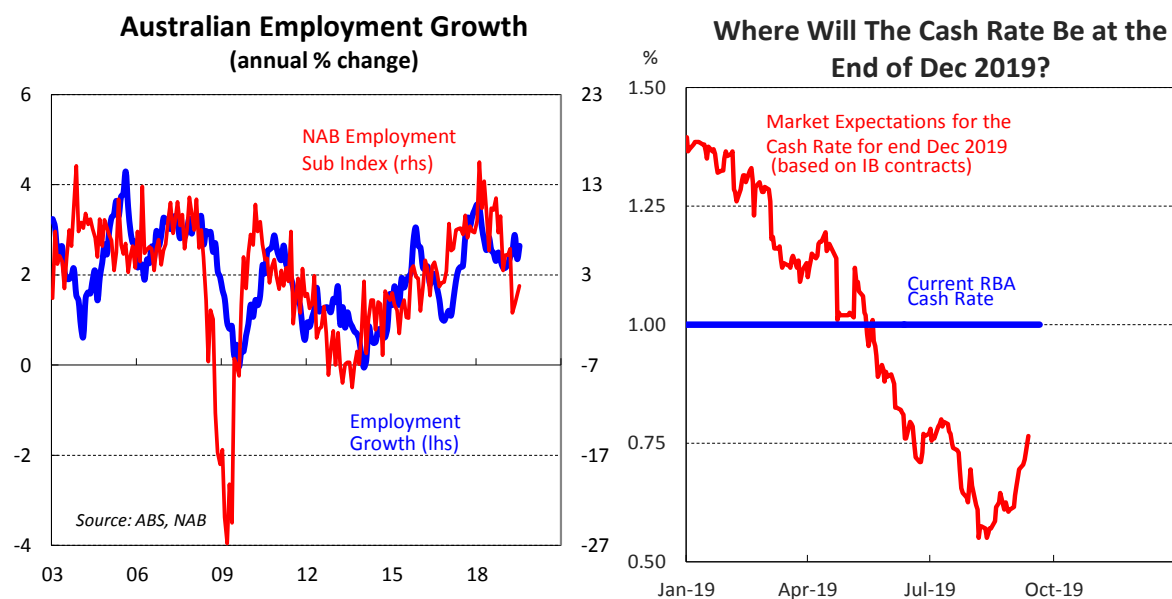
from a record low of 0.63% on August 26 to a high of 0.92% today. Australian 10-year yields have risen 36 basis points from 0.85% in mid August to 1.21% today. Recent positive developments on the US-China trade front together with some recent upbeat data in the US have helped spur the bond sell off. Brexit has also moved further away from a no-deal Brexit and the European Central Bank (ECB) delivered stimulus to the euro area economy, taking a 5-pronged approach. The approach included a cut of 10 basis points in the deposit facility rate, upgraded forward guidance, and the restart of asset purchases.

Central banks also take centre stage this week. The Federal Reserve (Thursday morning AEST), Bank of Japan (Thursday), Bank of England (Thursday) and the Swiss National Bank (Thursday) are due to meet and make policy decisions.

Among these central bank meetings, the limelight will shine the brightest on the Federal Reserve meeting and subsequent press conference by Chair Jerome Powell. The consensus expectation and our own expectation is for a rate cut of 25 basis points to be handed down by the Fed. It follows a 25 basis point rate cut in July, which was the first rate cut since 2008.

In the press conference that followed the July meeting, Powell described the cut as a “mid-cycle adjustment”, suggesting this rate-cut cycle would be modest. However, it preceded the escalation of the trade war. Investors are pricing in the probability of another 50 basis points of easing from the Federal Reserve this year (including this week’s cut) and a further 50 basis points next year. Expectations for the depth of the easing cycle had been more aggressive during August, but has settled in recent weeks with some positive developments in the US-China trade war.

In terms of the Australian dollar, in recent weeks it has echoed the improvement in risk sentiment and rise in global bond yields. The AUD/USD exchange rate has appreciated from a low of US\$0.6688 on September 3 to a high of US\$0.6895 last Thursday. The Australian dollar appears to be consolidating in a range of US\$0.6850-0.6895 for now. The Federal Reserve meeting and labour force data will be important factors in determining if the AUD/USD can break outside of this consolidation range.



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Forecasts

End Period:	2019		2020			
	Close (Sep 13)	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, %	1.03	0.85	0.70	0.70	0.70	0.70
3 Year Swap, %	0.96	0.70	0.75	0.80	0.85	0.90
10 Year Bond, %	1.16	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, %	1.77	1.45	1.40	1.45	1.50	1.55
USD Exchange Rates:						
AUD-USD	0.6879	0.67	0.66	0.66	0.67	0.67
USD-JPY	108.09	105	104	104	106	108
EUR-USD	1.1073	1.07	1.05	1.06	1.07	1.09
GBP-USD	1.2501	1.17	1.18	1.20	1.22	1.24
NZD-USD	0.6377	0.64	0.63	0.63	0.64	0.64
AUD Exchange Rates:						
AUD-USD	0.6879	0.67	0.66	0.66	0.67	0.67
AUD-EUR	0.6213	0.63	0.63	0.62	0.63	0.61
AUD-JPY	74.37	70.4	68.6	68.6	71.0	72.4
AUD-GBP	0.5503	0.57	0.56	0.55	0.55	0.54
AUD-NZD	1.0788	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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