

Monday, 19 December 2022

Rate Hikes to Take a Toll in 2023

We wish you a very safe and happy festive season. Thank you for your readership this year. This is the last Weekly Economic Outlook for 2022. This report will return on 23 January 2023.

2022 was a year unlike most in the world of economics and markets. What was slated to be a year of repair and recovery as the pandemic became endemic, turned out to be somewhat different. Marked by elevated volatility, global supply disruptions, and tight labour markets, 2022 quickly became the year high inflation returned to the fore after a multi-decade hiatus. This heralded the end of 'cheap money' as central banks unwound emergency policy settings and started to apply the economic brakes. Russia's invasion of Ukraine was a humanitarian and economic shock unseen in modern times, displacing millions and sending commodity and energy markets into turmoil.

In Australia, inflation hit a more than 32-year high of 7.3% in the September quarter, the unemployment rate fell to a near 50-year low of 3.4% and the Reserve Bank (RBA) hiked the cash rate 300 basis points – its most aggressive tightening since inflation targeting began in the 90s.

But as we near the end of 2022 and look ahead to the future, it is likely 2023 will look different again. The start of 2023 is set to sound familiar; the key question will be how much higher central banks need to take interest rates to get inflation back in check and relatedly, how quickly inflation will subside. The structural vs transitory inflation debate will again be in vogue. However, as the year progresses and rate hikes take a toll, discussion will shift to the size and length of the global downturn which will likely be in prospect. For some economies, this will mean a recession, while others, such as Australia, are expected to avert recession but experience a sharp slowdown in growth. Weaker growth will ignite debate about when rate cuts will be appropriate, this will differ across the globe but will likely hinge on how rapidly inflation normalises.

This Week's Data

Bringing the attention back to the present, we are set for a quiet economic calendar to round out the year. The minutes from the RBA's December meeting will be released tomorrow and are the key item on the agenda this week. The December meeting featured a 25-basis point hike and included commentary which seemed deliberately vague but decidedly balanced. The RBA left every option on the table. A focus on the Bank's resolve to tackle inflation and elevated attention to the damages from high inflation appeared more hawkish. However, the addition of the words "not on a pre-set path" opened the door for a potential pause at a future meeting. Ultimately, the message was clear, the RBA expects to "increase interest rate further over the period ahead", but the path to get there may not necessarily be a straight one. The minutes tomorrow may give us more information on what that path might look like.

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Forecasts

End Period:	2023				2024		
	Close (16 Dec)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)
Aust. Interest Rates:							
RBA Cash Rate, %	3.10	3.60	3.85	3.85	3.85	3.60	3.35
90 Day BBSW, %	3.19	3.97	4.05	4.05	3.97	3.72	3.47
3 Year Swap, %	3.67	3.80	3.75	3.70	3.60	3.55	3.50
10 Year Bond, %	3.46	3.20	3.10	3.00	2.90	2.80	2.70
US Interest Rates:							
Fed Funds Rate, %	4.375	4.875	4.875	4.875	4.875	4.375	3.875
US 10 Year Bond, %	3.48	3.40	3.30	3.20	3.10	2.90	2.70
USD Exchange Rates:							
AUD-USD	0.6685	0.69	0.70	0.72	0.74	0.75	0.76
USD-JPY	136.60	136	135	134	132	130	128
EUR-USD	1.0586	1.06	1.07	1.09	1.11	1.12	1.13
GBP-USD	1.2148	1.22	1.22	1.23	1.24	1.25	1.26
NZD-USD	0.6373	0.64	0.65	0.66	0.67	0.68	0.68
AUD Exchange Rates:							
AUD-USD	0.6685	0.69	0.70	0.72	0.74	0.75	0.76
AUD-EUR	0.6316	0.65	0.65	0.66	0.67	0.67	0.68
AUD-JPY	91.329	93.8	94.5	96.5	97.7	97.5	97.3
AUD-GBP	0.5510	0.57	0.57	0.59	0.60	0.60	0.60
AUD-NZD	1.0485	1.08	1.08	1.09	1.10	1.11	1.13

	2021	2022 (f)	2023 (f)	2024 (f)
GDP, %	4.6	2.6	1.0	2.0
CPI (Headline), %	3.5	7.5	3.9	3.0
CPI (Trimmed mean), %	2.6	6.7	3.6	3.0
Unemployment Rate, %	4.7	3.3	4.6	5.1
Wages Growth, %	2.3	3.6	4.5	3.5

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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