Weekly Economic Outlook

Tuesday, 28 January 2020

Inflation and US Fed in Limelight

In the week ahead, Australian inflation data and the US Federal Reserve Open Market Committee (FOMC) meeting are in the limelight. But these two events are unlikely to generate any sparks.

Australia inflation data should continue to show a soft underlying trend. We expect headline consumer prices rose 0.6% in the December quarter, taking the annual rate from 1.7% in the September quarter to 1.8% in the December quarter. A rise in tobacco and auto fuel prices is likely to boost the headline result. The impact from the drought is also likely to prevail in food prices. The impact of the bushfires should reveal itself more so in the March quarter.

The focus will be on the trimmed mean measure of underlying inflation because this measure attempts to account for volatile prices. For this measure, we expect a rise of 0.4% in the December quarter, which leaves the annual rate at a soggy 1.5%.

The likelihood of a soft inflation result leaves us comfortable with our forecast of more easing from the Reserve Bank (RBA) later this year. At its meeting next week we think the RBA will wait for now and not cut the cash rate until April. The RBA cut the cash rate three times last year and it will wish to hold on to its firepower for as long as it can. With the last two data releases on jobs upbeat and a recovery underway in dwelling prices, the RBA can bide its time for now.

The US Federal Reserve meets tomorrow night. We expect the Fed to leave its benchmark federal funds target rate unchanged at 1.50-1.75%. Economic data has continued to show a resilient US jobs market and whilst there is some evidence of vulnerabilities creeping in to the US consumer, US consumer spending is still resilient. Global economic risks, notwithstanding the new coronavirus, also have receded.

On the data calendar for the rest of this week, we receive an update on business confidence and conditions today and private-sector credit on Friday.

Business sentiment and business conditions are likely to have stayed sluggish in December and remain below their 10-year averages. A continued malaise in business sentiment suggests that business investment is unlikely to increase significantly in coming months, despite the very low interest-rate environment.

Lending to the private sector is likely to have picked up just 0.2% in December, after 0.1% growth in November. Lending for housing is improving, but lending growth to businesses and for other purposes remains soft. The soft pace of credit growth remains consistent with economic activity travelling at a sub-par pace in Australia. It also keeps the prospect of more easing from the RBA in play.

Aside from the data, investors will remain on edge this week as the new coronavirus spreads. Investors are concerned also about the economic impact on the world's second largest economy, China. These lingering concerns could see downward pressure on the Australian dollar and global bond yields remain.

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Forecasts

		2020				2021
End Period:	**Close (Jan 27)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**
Aust. Interest Rates:						
RBA Cash Rate, %	0.75	0.50	0.50	0.25	0.25	0.25
90 Day BBSW, %	0.89	0.95	0.70	0.45	0.45	0.50
3 Year Swap, %	0.68	0.70	0.60	0.50	0.55	0.60
10 Year Bond, %	1.09	1.05	0.95	0.90	0.80	0.80
US Interest Rates:						
Fed Funds Rate, %	1.625	1.625	1.375	1.125	0.875	0.875
US 10 Year Bond, %	1.68	1.65	1.50	1.45	1.40	1.45
USD Exchange Rates:						
AUD-USD	0.6761	0.68	0.66	0.67	0.67	0.68
USD-JPY	108.90	107	106	105	105	106
EUR-USD	1.1019	1.09	1.10	1.11	1.12	1.13
GBP-USD	1.3057	1.33	1.32	1.32	1.31	1.31
NZD-USD	0.6548	0.66	0.66	0.66	0.66	0.66
AUD Exchange Rates:						
AUD-USD	0.6761	0.68	0.66	0.67	0.67	0.68
AUD-EUR	0.6136	0.62	0.60	0.60	0.60	0.60
AUD-JPY	73.62	72.8	70.0	70.4	70.4	72.1
AUD-GBP	0.5177	0.51	0.50	0.51	0.51	0.52
AUD-NZD	1.0327	1.03	1.00	1.02	1.02	1.03

	2018	2019 (f)	2020 (f)
GDP, %	2.1	2.1	2.1
CPI (Headline), %	1.8	1.8	1.7
CPI (Trimmed mean), %	1.8	1.5	1.9
Unemployment Rate, %	5.0	5.2	5.5
Wages Growth, %	2.3	2.3	2.3

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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