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Weekly Economic Outlook

Monday, 28 October 2019

Sharpest Tool in the Shed

Monetary policy is again in the spotlight this week. On Wednesday night, the US Federal Open Market Committee (FOMC) is widely expected to cut the Federal funds rate to 1.50-1.75% from the current band of 1.75-2.00%. Closer to home, the Reserve Bank (RBA) has been easing policy since July with the cash rate now at a record low 0.75%. A policy rate near its effective lower bound has meant that the conversation has turned towards unconvential monetary policy.

US Federal Reserve Chair Jerome Powell and other FOMC members are still characterising the Fed rate cuts (of which there have already been two) as being "mid-cycle adjustments", or in other words, a nudge to keep the economic expansion going. The FOMC are betting that US consumer spending will remain strong, boosted by a solid labour market. We believe there is mounting evidence of a slowdown in the labour market, which should spur a rate cut in December, as well as two more next year. We expect each of these rate cuts to be 25 basis points in size.

Powell has made it clear that he will be guided by the data. In the face of lacklustre business investment and weakening exports, there have already been some signs that employment growth is softening. Closely-watched surveys of business confidence for US manufacturing and service-sector companies turned markedly weaker in September. With monthly payrolls growth already slowing from the peak struck in January this year, the committee's commitment to following the data could be tested in the months ahead.

In Australia, employment growth is also starting to show some signs of easing. The central bank is eyeing labour-market data closely. In addition, the RBA is no doubt taking note of below trend economic growth despite recent stimulus measures. The RBA cut the cash rate for the third consecutive time this year to 0.75% earlier this month. Following the Federal Government's tax offset for low and middle income earners for the 2018/19 financial year, there has been little evidence of an increase in economic activity. With limited space left for the RBA to cut before rates reach their effective lower bound, other options are being reviewed.

Over the weekend, a freedom of information request revealed some insight into the thinking of the Federal Treasury. Documents submitted for a Cabinet hearing in July gave a summary of options for unconventional monetary policy, including negative interest rates, quantitative easing and forward guidance. The Treasury notes that fiscal policy and quantitative easing are the preferred methods of supporting domestic demand when interest rates are low or even negative. It's reasoning is that bank profits are likely to come under pressure when rates are very low because of the reduced margin between borrowing and lending rates.

There is a swathe of domestic data released this week which will shed further light on the likelihood of policymakers having to pursue alternative policy measures. Consumer prices (i.e. inflation) data will be released on Wednesday and data for building approvals and privatesector credit on Thursday. Friday will provide further insight into the extent of the housing market recovery with updated data on dwelling prices for October published by CoreLogicConsumer prices (CPI)will be of particular importance, given that price growth in underlying terms has been below the RBA's target band of 2-3% for 3½ years. In underlying terms (i.e. trimmed mean), we expect a modest 0.3% gain in Q3, leaving the annual rate subdued at 1.5%.

Dwelling approvals for September are expected to record a modest 0.5% rise compared with a 1.1% decline in August. Despite the recovery in house prices, particularly in Sydney and Melbourne, construction activity is expected to continue to weaken as downside risks in the high-rise segment remain. Data on Friday should reveal another firm increase for dwelling prices nationally in October, led by Sydney and Melbourne where price increases in the month of 1% are likely.

Finally, we expect private-sector credit growth to remain muted at 0.2% in September.

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Forecasts

	2019		2020			
End Period:	**Close (Oct 25)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**
Aust. Interest Rates:						
RBA Cash Rate, %	0.75	0.75	0.50	0.50	0.50	0.50
90 Day BBSW, %	0.88	0.85	0.70	0.70	0.70	0.70
3 Year Swap, %	0.80	0.70	0.70	0.75	0.80	0.85
10 Year Bond, %	1.06	0.95	1.00	1.15	1.20	1.25
US Interest Rates:						
Fed Funds Rate, %	1.875	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	0.6823	0.67	0.66	0.66	0.67	0.67
USD-JPY	108.67	108	107	107	107	108
EUR-USD	1.1080	1.10	1.08	1.07	1.07	1.09
GBP-USD	1.2827	1.30	1.33	1.33	1.32	1.31
NZD-USD	0.6349	0.63	0.62	0.62	0.63	0.63
AUD Exchange Rates:						
AUD-USD	0.6823	0.67	0.66	0.66	0.67	0.67
AUD-EUR	0.6161	0.61	0.61	0.62	0.63	0.61
AUD-JPY	74.14	72.4	70.6	70.6	71.7	72.4
AUD-GBP	0.5322	0.52	0.50	0.50	0.51	0.51
AUD-NZD	1.0742	1.06	1.06	1.06	1.06	1.06

	2018	**2019 (f)**	**2020 (f)**
GDP, %	2.2	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, %	2.4	2.5	2.5

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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