Weekly Economic Outlook

Monday, 31 January 2022

RBA's QE on the Chopping Block

It is a chock-a-block week for economists.

All eyes are on the Reserve Bank (RBA) ahead of its meeting tomorrow, where the central bank will decide on the future of its bond buying program. Plus, on Wednesday the Governor will address the National Press Club and the quarterly Statement on Monetary Policy (SoMP) will be released on Friday.

The RBA flagged it would review its quantitative easing program at the February meeting, after tapering purchases to $4 billion per week, from $5 billion, in September.

In a speech in mid-December, Governor Lowe said three options were on the table: (1) tapering purchases further and concluding the program in May, (2) tapering purchases further and reviewing the program again in May or (3) ceasing purchases altogether in February. Lowe said the option they choose will "depend upon the news" they receive between now and when they meet in February.

Since then, headline inflation printed at 3.5% over the year to the December quarter – above the RBA's 2-3% target band. Underlying inflation was also strong at 2.6% – above the mid-point of the band. Added to that, the unemployment rate came in at 4.2% in December, its lowest level since 2008.

Separately, the Federal Reserve has accelerated its exit from its own quantitative easing program. This gives the RBA more room to pullback support faster without driving upwards pressure on the Australian dollar.

On the other hand, Omicron will temporarily delay the recovery, and could be seen as a reason to hold onto QE for a bit longer. But on balance, we see little reason for the RBA to persist with the bond-buying program given the strong underlying momentum in the economy.

Turning to the cash rate, our central view is that the rate-hike cycle will commence in August with a move of 15 basis points. We expect a 25 basis point hike to follow before the end of 2022 and further tightening in 2023, with the cash rate peaking at 1.75%.

The SoMP will include an updated set of forecasts, which will provide more colour on when the RBA expects to lift the cash rate. An upgrade to the forecasts is on the cards, with the RBA's latest forecasts from November out of date given the recent data prints. In November, the RBA expected underlying inflation to hold at 2.25% through to June 2023 and the unemployment rate to print at 4.75% in the December quarter.

There is also a swathe of economic data to be released.

We'll get a fresh read on the housing market with data on dwelling prices, housing finance and building approvals.

We expect dwelling prices rose 0.9% in January. The pace of dwelling price growth moderated into the end of 2021. It rose 1.0% in December, well down on the 2.8% peak in growth in March.

However, monthly growth remained well-above the 10-year average. In annual terms, prices grew by 22.1% over the year to December, the highest growth over a calendar year since the 1980s. A divergence across regions has emerged. Growth across the most expensive markets is slowing while growth in the more affordable cities of Brisbane and Adelaide has accelerated. Looking forward, we expect prices growth to continue to moderate over 2022.

We project housing finance approvals jumped 8.0% in December, consistent with the resurgence in sales coming out of the Delta lockdowns. This is off the back of a 6.3% jump in November. We expect investor loans rose 8.5% in the month, beating an expected 7.5% rise in lending to owner-occupiers. New lending will continue to be supported by low interest rates, robust housing demand and a recovering economy. However, affordability pressures and the prospect of higher interest rates are growing headwinds.

The housing update will be rounded out by dwelling approvals, which we forecast rose 3.0% in December. This reflects the end of the HomeBuilder unwind, which has dragged on housing approvals over the second half of 2021. The high volume of approvals over the past 12 months means levels are around those reached during the construction boom between 2015 and 2018. This has created a solid pipeline of construction activity which will bolster the economic recovery from the Delta lockdowns.

December retail sales data will be released on Tuesday. We expect a 2.0% pullback in the month following the blockbuster 7.3% jump in November alongside Black Friday sales and a bring-forward in spending ahead of the Christmas period. Partial indicators such as mobility and credit card data point to a drop in spending, as millions were forced into isolation and some households took more precautions to avoid contracting the virus. Staff availability and supply-chain disruptions have also impacted product availability and opening hours of some businesses during the holiday season and into January. However, the hit to spending from these ‘shadow lockdowns’ that have emerged alongside surging case numbers is likely to be captured more clearly in the January data.

Private sector credit data for December will be released this morning. We forecast a solid 0.5% rise in the month, following a 0.9% jump in November. Credit growth stepped up over the second half of 2021, reflecting the underlying strength in the economy. Omicron presents a fresh hurdle for households and businesses. While our customer liaison suggests there has been some uptick in businesses calling for relief, this is only in the short-term. But there are several factors that should continue to underpin business spending and the need for credit, including low rates, the economic recovery and generous government incentives.

Finally, trade data for December will also be released this week. We expect the trade surplus to narrow to $8.3 billion from $9.4 billion in November. Imports are likely to post further gains alongside higher prices and volumes. Meanwhile, export earnings are likely to have a more mixed picture.

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Forecasts

		2022				2023	
End Period:	**Close (28 Jan)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	0.10	0.10	0.10	0.25	0.50	0.75	1.00
90 Day BBSW, %	0.08	0.10	0.10	0.35	0.60	0.95	1.20
3 Year Swap, %	1.61	1.60	1.65	1.70	1.75	1.90	2.05
10 Year Bond, %	1.97	2.15	2.40	2.40	2.50	2.50	2.40
US Interest Rates:							
Fed Funds Rate, %	0.125	0.375	0.625	0.875	1.125	1.375	1.625
US 10 Year Bond, %	1.82	2.00	2.30	2.40	2.50	2.50	2.40
USD Exchange Rates:							
AUD-USD	0.7044	0.71	0.70	0.71	0.73	0.75	0.76
USD-JPY	115.41	116	116	117	117	118	118
EUR-USD	1.1156	1.10	1.08	1.09	1.10	1.11	1.12
GBP-USD	1.3404	1.36	1.37	1.38	1.38	1.37	1.37
NZD-USD	0.6582	0.67	0.66	0.67	0.69	0.70	0.71
AUD Exchange Rates:							
AUD-USD	0.7044	0.71	0.70	0.71	0.73	0.75	0.76
AUD-EUR	0.6314	0.65	0.65	0.65	0.66	0.68	0.68
AUD-JPY	81.295	82.4	81.2	83.1	85.4	88.5	89.7
AUD-GBP	0.5255	0.52	0.51	0.51	0.53	0.55	0.55
AUD-NZD	1.0701	1.06	1.06	1.06	1.06	1.07	1.07

	2020	**2021 (f)**	**2022 (f)**	**2023 (f)**
GDP, %	-0.8	3.2	5.5	2.7
CPI (Headline), %	0.9	3.5	3.1	2.8
CPI (Trimmed mean), %	1.2	2.6	2.8	2.8
Unemployment Rate, %	6.8	4.7	3.8	3.9
Wages Growth, %	1.4	2.3	3.1	3.2

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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