June
2024

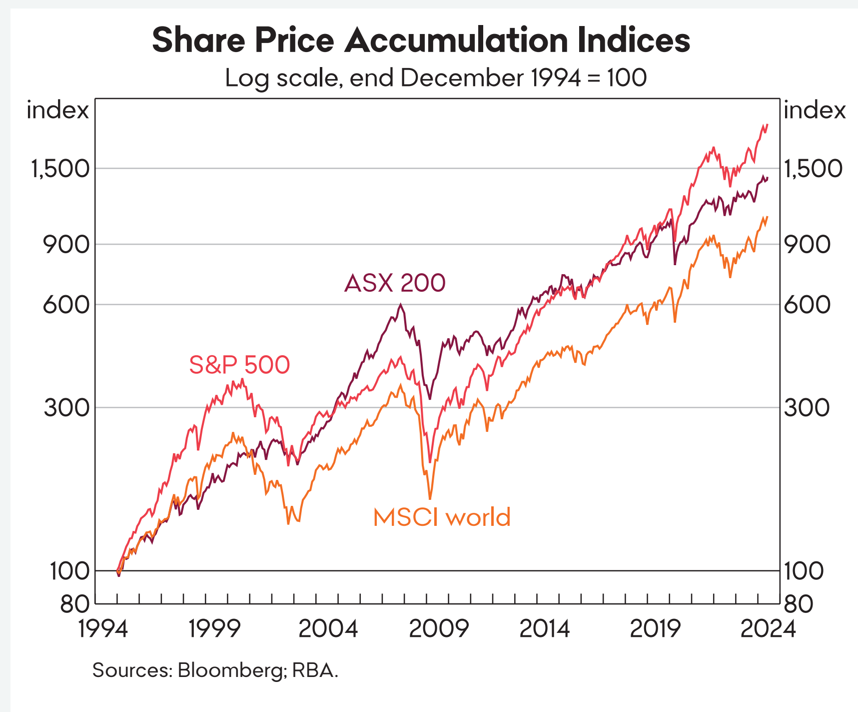
Economic and market update

Economic Overview – as at 20th June 2024

Global markets

The sequence of rate cuts from advanced economy central banks continues to take shape with the Bank of Canada and the ECB initiating their easing cycles in early June, following the Swiss National Bank in March and Sweden's Riksbank last month. While the depth of easing cycles ahead is looking shallower and in many countries being kicked down the road a little, easing biases greatly outnumber tightening at present (Japan the main outlier). Equity markets continue to be buoyed by the prospect of easier policy ahead and a number of indices are at record highs, in no small part driven by AI euphoria - evidenced by the recent elevation of Nvidia to the most valuable company in the world, overtaking Microsoft with a market cap of over US$3 1/3 trillion.

The timing of US rate cuts continues to be reassessed by markets and by Federal Reserve members themselves, with Fed officials earlier in the year implying three cuts in 2024 via their 'dot plot' forecasts, but now a mix of 2, 1 and even no rate cuts were flagged by Fed members this year. Markets are leaning to two cuts - one in September and another in December after the latest US inflation data showed a flat CPI in May and core inflation only up 0.2% m/m; but the Fed will want to see further evidence.



The US economy continues to decelerate based on soft retail sales data (only up 0.1% in May, and April's figure revised down to a 0.2% fall), declining consumer sentiment and the unemployment rate edging up to 4.0%, although labour markets remain fairly resilient.

The long-awaited first ECB rate cut was delivered on 6 June, the day after the Bank of Canada but expectations for further cuts have been pared back by more recent wages and price data. After a period of stagnation and recessions the euro-zone economy has picked up a little, and the EU are forecasting 1.6% growth in 2025 (presumably helped by several additional ECB cuts). Core inflation is still expected to continue to trend lower, although regional variances will complicate the outlook and the latest EU elections and resulting French snap election has triggered a sell-off in bond yields.

The Bank of Japan again disappointed markets with its unconvincing policy announcement last week. The lack of detail around its planned reduction in JGB (government bond) purchases was perplexing, and while Governor Ueda said the reduction would be 'substantial' and another BoJ rate hike was possible in July, the Yen weakened further towards ¥160. Japan's economy contracted by 0.5% in Q1, although the weaker Yen is supporting export markets and tourism is booming.

China's activity data for May showed a solid pickup in retail sales and export growth, although the lack of improvement in the property sector (despite recent policy support) suggests more People's Bank of China easing ahead. However like the Japanese Yen the recent weakness in the Chinese Yuan (approaching the 15 year low of 7.35 against the strong US Dollar) does complicate the task of the PBC, so much of the support may come via property specific support measures. Nevertheless China's 5% growth target for this year appears on track.

In summary, as outlined in the recent World Bank summary, global growth remains below trend and (while appearing resilient amid inflationary pressures and geopolitical tensions) is unlikely to recover for some years back to the pace of growth seen last decade. Southeast Asia remains the fastest growing region globally, and while North Atlantic economies have started to ease official rates the risks of rates remaining higher for longer continues - even if stock markets appear aloof to this risk.

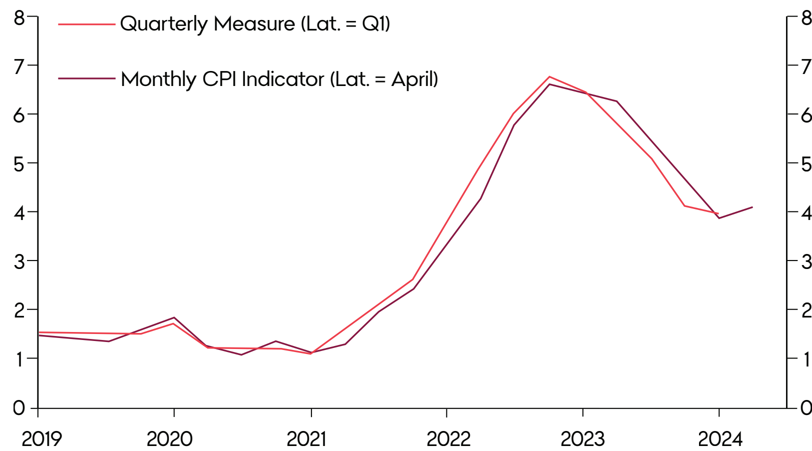
Domestic economy

The June RBA monetary policy on-hold decision was universally expected, however the frequency of references to 'uncertainty' in the statement was interpreted by some as an upside risk to interest rates, and Governor Bullock's press conference reiterated the lack of conviction the RBA (and markets) have for the path ahead. Another interpretation of this understandable uncertainty however is even more reason for the RBA to keep the cash rate on hold, given how unclear the outlook is for:

- Global markets and the geopolitical backdrop
- Labour markets (more on this below and in the appendix)
- The impact of the stage three tax cuts and 'cost of living support measures' on spending
- CPI and Core Inflation

As our Federal Budget summary last month opined, the rebates for energy bills will take some pressure off the utilities component of the Consumer Price Index, but beyond the stage three tax cuts (roughly $22 Bn in FY25) other cost of living support measures including state and territory budgets are now approaching $30 Bn in value. The degree to which this fiscal stimulus is spent vs saved, and therefore the risk that demand might exceed supply for even longer is a key unknown. It will take time for this to all become apparent, and the gap between headline CPI and core inflation may widen further, depending on household savings rates and discretionary spending ahead.

The latest monthly CPI indicator was a good example of this uncertainty with the uptick of 0.1% for consumer price inflation in April unwinding some of the recent progress, and with measures of underlying inflation also moving slightly higher - the trimmed mean (the RBA's preferred measure of core inflation) rising from 4.0% to 4.1%. The RBA remain far more focussed on the quarterly data (Q2 will be released on 31 July) than the monthly indicator, but the core reads have been fairly well correlated and the Q1 data was higher than previous forecasts, so the tolerance for another upside surprise would be low. Our basecase scenario below, which still includes no change for the official cash rate this year (up or down), has CPI and core inflation printing at 0.8% for Q2, but any read above 1% for the quarter would challenge the expectation that official rates here have peaked.



Sources: ABS, Refinitiv, Capital Economics.

The next RBA decision in early August will be most heavily influenced by the level of core inflation which is expected to be back below 4% by then, but another important factor for interest rates is labour markets, as new deputy governor Andrew Hauser discussed in a recent interview. The RBA dual mandate of managing inflation while preserving jobs can be considered a trade-off in many respects, and tolerating a slightly higher-for-longer path for inflation as a justification for a lower peak in the cash rate in the interests of protecting jobs, seems reasonable. However the latest fall in the unemployment rate to 4.0% and another 40k jobs added in May could be interpreted as too strong. As the charts in the appendix show, the underutilisation rate remains near the lowest level since the early 70's, although total hours worked has declined and forward-looking indicators (especially job vacancies) continue to suggest tightness in labour markets is easing.

Labour productivity was slightly more encouraging in the Q1 national accounts data (although is only marginally higher than 2016 levels) and unit labour costs eased but are still up 5.8% y/y.

The GDP data once again showed the per-capita recession is intact (for 5 consecutive quarters now) so our economy is mainly being supported by public spending and population growth, all of which adds to the case for no further RBA hikes. The timing of cuts however is clearly at the mercy of moderating inflation. Household income and spending were higher than expected in the quarter, but a methodology change on overseas spending complicated this outcome along with the ongoing surge in population. The new financial year should see a steadily improving position for households thanks to the impending tax cuts and moderating inflation - and eventually rate cuts.

The Australian Dollar continues to consolidate against the waning strength in the greenback and as RBA cuts continue to be pushed back together with firm commodity prices, but similar uncertainty around Fed rate cut expectations have capped the Aussie Dollar's gains. Cross rates remain firm with Aussie-Yen up at a 15-year high and the trade-weighted index at 63.5 is approaching a 3-year high.

Interest Rate Outlook

The Official Cash Rate is most likely at its cycle peak at 4.35%, although the case for another RBA hike is stronger than an imminent cut. A longer cycle (into 2025) as core inflation persists above 3% is still the basecase scenario outlined below, with no move up or down in 2024, while a number of North Atlantic advanced economies have initiated their easing cycles. Earlier RBA cuts are still possible but would require faster progress with inflation than forecast, or a sharper slowdown for our economy.

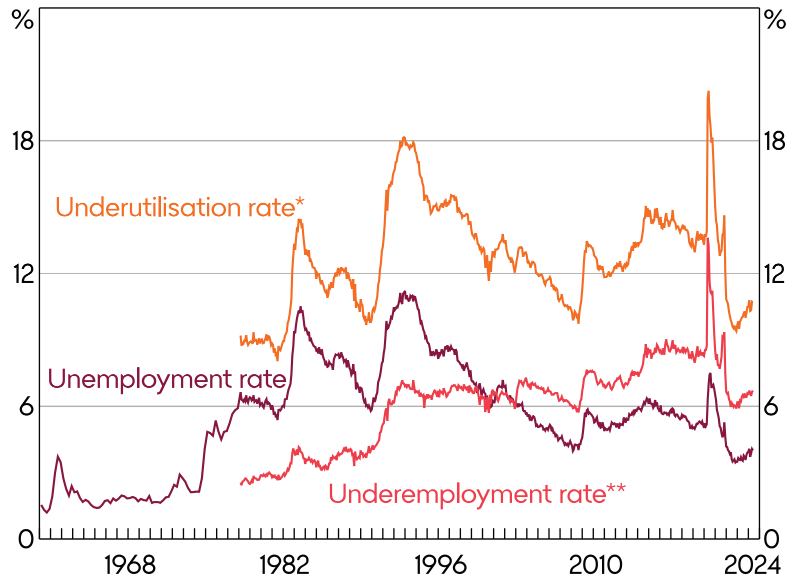
Economic Forecasts: basecase scenario

	2023				2024				2025		
% (actual, forecast)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q4
GDP q/q	0.6	0.4	0.2	0.3	0.1	0.2	0.4	0.4	0.5	0.6	0.8
GDP y/y	2.3	1.9	2.1	1.6	1.1	0.8	1.0	1.1	1.5	1.9	2.3
Unemployment	3.5	3.5	3.6	3.9	3.9	4.1	4.3	4.5	4.7	4.9	5.2
CPI (q/q)	1.4	0.8	1.2	0.6	1.0	0.8	0.8	0.5	0.6	0.9	0.8
CPI (y/y)	7.0	6.0	5.4	4.1	3.6	3.6	3.4	3.1	2.7	2.8	2.9
CPI (core y/y)	6.6	5.9	5.2	4.2	4.0	3.8	3.4	3.2	2.9	3.0	2.9
RBA cash rate	3.6	4.1	4.10	4.35	4.35	4.35	4.35	4.35	4.1	3.85	3.35
AUD / USD	.669	.666	.6435	.682	.6515	.67	.69	.73	.74	.75	.77

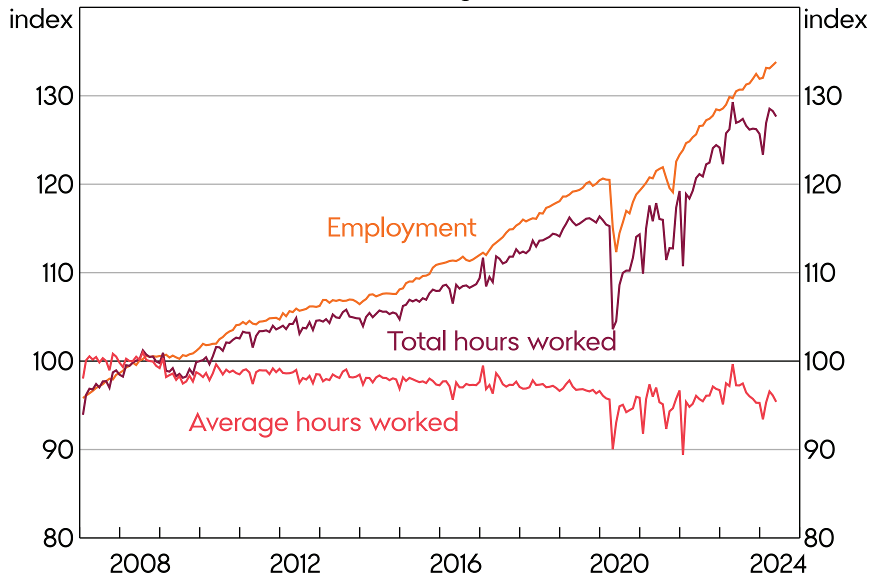
Benchmark rates

	30 / 4 / 23	30 / 4 / 2024	31 / 5 / 2024	20 / 6 / 2024
90-day bills	3.67%	4.41%	4.35%	4.38%
3-year swap	3.43%	4.25%	4.21%	4.08%
5-year swap	3.57%	4.42%	4.41%	4.20%
AUD/USD	.6615	.6475	.6655	.6670
ASX 200	7 309	7 664	7 702	7 769
Credit Index (iTraxx- 5 yr)	88.3	71.7	65.4	69.8

Appendix: Labour markets

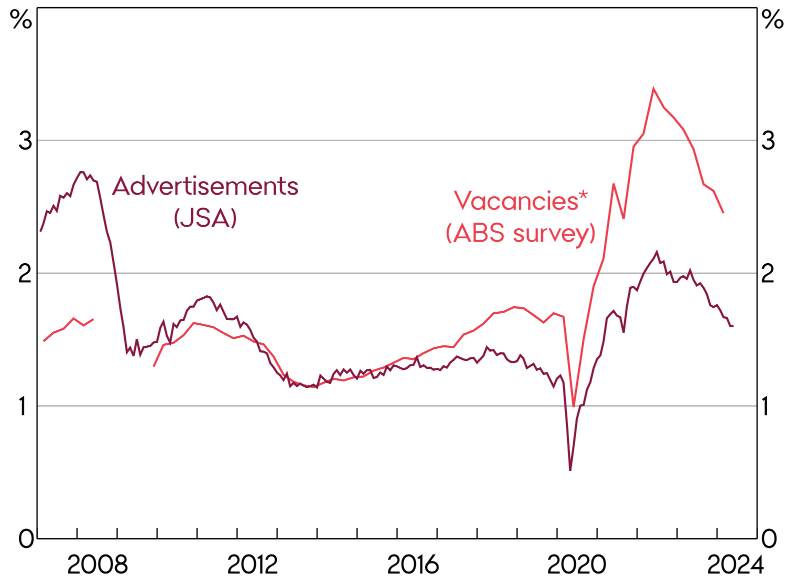


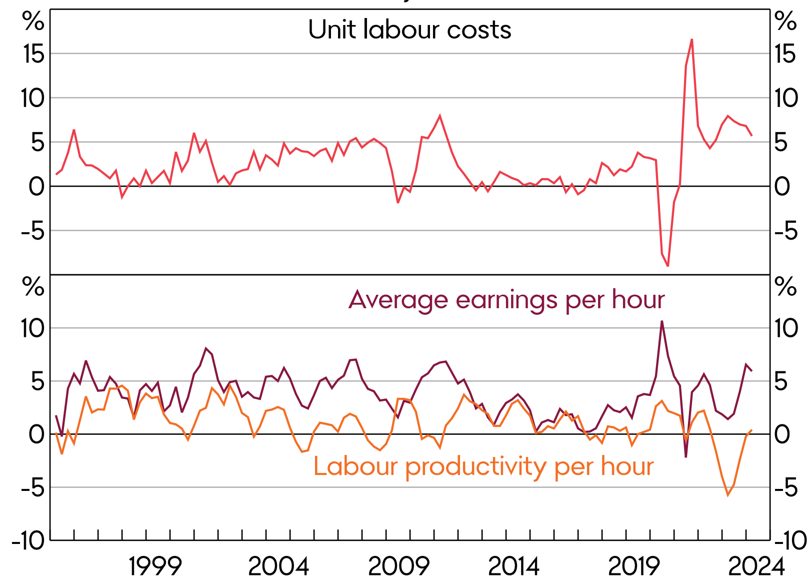
* Sum of the unemployment and underemployment rates.
** Employed people who want, and are available, to work more hours.
Source: ABS.



* Seasonally adjusted.

Sources: ABS; RBA.





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