April
2024

# Economic and market update

## Economic Overview – as at 18th April 2024

## Global markets

The International Monetary Fund's '[World Economic Outlook]' is hot off the press. The IMF's track record forecasting isn't perfect, but they suggest further divergence in outcomes ahead and generally resilience to inflation and higher interest rates. The table below includes their forecasts for GDP this year and next for Advanced Economies, showing recovery from the current recessions in parts of Europe and an impressive soft landing in the US. Emerging market and developing economies are forecast to grow 4.2%, keeping global growth at a steady pace but still below the long-term average.

The timing of US rate cuts has once again been deferred after inflation continued to disappoint but also as the resilience of the US economy shone through, evidenced by better-than-expected jobs, manufacturing and housing data. The most recent comments from Fed chair J. Powell noting a "lack of progress on inflation" and therefore patience needed to "allow restrictive policy further time to work" sums it up well, and the markets have now pushed back the first cut to around September.

### World Economic Outlook Growth Projections

| (Real GDP, annual percent change) | 2023 | PROJECTIONS 2024 | 2025 |
|---|---|---|---|
| **World Output** | **3.2** | **3.2** | **3.2** |
| **Advanced Economies** | **1.6** | **1.7** | **1.8** |
| United States | 2.5 | 2.7 | 1.9 |
| Euro Area | 0.4 | 0.8 | 1.9 |
| Germany | -0.3 | 0.2 | 1.3 |
| France | 0.9 | 0.7 | 1.4 |
| Italy | 0.9 | 0.7 | 0.7 |
| Spain | 2.5 | 0.9 | 2.1 |
| Japan | 1.9 | 0.9 | 1.0 |
| United Kingdom | 0.1 | 0.5 | 1.9 |
| Canada | 1.1 | 1.2 | 2.3 |
| Other Advanced Economies | 1.8 | 2.0 | 2.4 |

Source: IMF, *World Economic Outlook*, April 2024.

The consequences of rates higher-for-longer go hand in hand with a soft landing and outperformance but have flowed through to weaker equity markets, and higher bonds yields driving a stronger US Dollar.

In contrast to the US, Europe appears to be quickly transitioning to easing cycles after the Swiss National Bank cut its main interest rate by 25 basis points in late March, and the European Central Bank are expected to follow suit in June. ECB President Christine Lagarde confirmed that a "disinflationary process is moving according to our timelines" and "if we don't have a major shock" then rates would be cut, although she also noted the risks associated with an escalation of conflict in the Middle East. The UK are also closer to cutting official rates after their inflation rate fell to 3.2% in March, however core inflation was still elevated at 4.2% and services inflation remains at 6%.

Japan's exit from negative interest rates last month coincided with fresh record highs for Japanese equities (the Nikkei briefly trading above 41k) and a renewed sense of optimism for the region, although markets have since been more cautious amid rising global geopolitical tensions. The Japanese Yen has weakened to almost 155 against the strong US Dollar with speculation that the Bank of Japan may need to intervene to stem the tide. Further rate hikes are expected, but at a very slow pace with the next BOJ quarterly forecasts to be released on 26 April.

The Chinese economy continued to defy pessimists after Q1 GDP beat forecasts at 5.3% y/y thanks to stronger export demand and even a rebound in the service sector, although still reliant on fiscal support. Structural headwinds via the real estate sector are persistent and domestic consumption is expected to decelerate further, but the GDP data and recent PMI surveys suggest the 5% growth target is in the ballpark. So while the post-COVID recovery has been fragile, with more monetary support expected later this year the short-term outlook is reasonable (including for Australian exports to the region).

In summary, while the IMF report reflects the broad consensus of a US soft landing and a tepid but steady recovery in Europe, markets remain on edge and geopolitical tensions are a reminder of how challenging the 'last mile' of the trek to sustainable benign inflation will probably be. The resilience of the US economy again brings into focus the possibility of an even longer cycle with no rate cuts at all this year, which could equate to a 'later landing' rather than a soft landing - but this scenario remains an outlier.

## Domestic economy

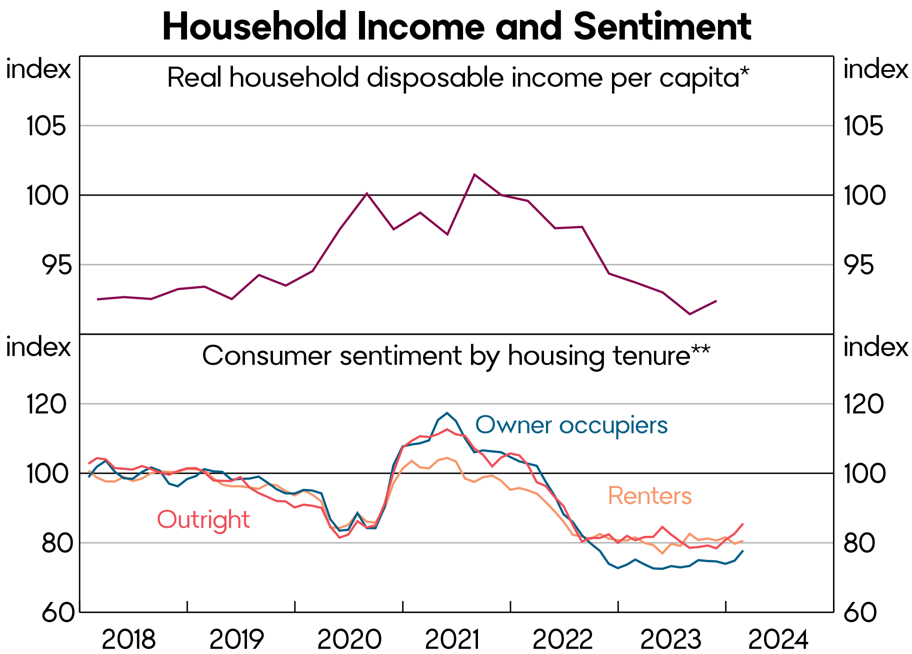
The mid-March RBA monetary policy decision of no change to the cash rate was universally expected however the minutes from the meeting released in early April were more interesting. The minutes reiterated the comments from Michelle Bullock in her 19 March press conference that the Board isn't ruling anything in or out, but stopped short of moving to a neutral policy position with the observation that the relative probabilities of another hike vs a new easing cycle were 'a little more even'. In other words, getting closer to balanced but not quite there.

A completely neutral position may be formally adopted in the May meeting (and justified in the accompanying RBA forecasts in the Statement on Monetary Policy) but the latest jobs data did little to support the argument for more imminent cuts. After the remarkable 118k increase in employment (s.a.) in February, only 6 600 jobs were lost in March, and the unemployment rate only rose 0.1% to 3.8%, while underemployment fell 0.1%. Tight labour markets are not showing any signs of weakening as the economy slows, although the recent surge in population growth via net migration and other pandemic anomalies are most likely deferring this inevitable decline.

Markets have taken the jobs data and the deferral of US rate-cut timing to heart, no longer fully pricing a RBA rate cut until February 2025. This matches our basecase scenario outlined below (which has targeted February '25 as the most likely timing for the easing cycle for over a year), however there are now risks that even this timeline is too short. Our economy remains in a unique position unlike a typical economic cycle, but the combination of

- Unemployment in the threes
- Record house prices
- Record stock prices
- Core inflation around 4%

does not appear in any manner consistent with an RBA easing cycle. The counter argument lies in the economic subtext: Australia remains in a per-capita recession, real household disposable income has fallen by its largest amount since the mid-1980s, and consumer confidence remains near record lows. As the chart below shows, owner-occupiers and renters are even more impacted by inflation and higher interest rates than outright property owners. Of course the primary cause of this cost-of-living crisis is the surge in prices over the last two years (i.e. inflation) - so cutting RBA rates too soon won't solve the underlying issue, nor improve the cost of living or real disposable income.




* Income after tax and net interest payments adjusted for inflation. Latest period has been adjusted for an estimate of population growth. December 2021 = 100. Latest observation December 2023.

** Average since 1996 = 100, three-month moving average. Latest observation February 2024.

Sources: ABS; RBA; Westpac-Melbourne Institute.

The monthly CPI indicator has continued to show steady progress for headline inflation (down to 3.4% y/y in each of the last three releases) however the core measures are averaging 4%. The next quarterly inflation data (for Q1) will be released on 24 April and is also expected to reveal CPI at around 3.5% but core closer to 3.9%. This will be a vital read for the RBA in combination with the latest jobs data, ahead of upcoming retail trade, housing data and the wage price index also for Q1.

The appendix shows a range of charts for the housing market, including how strong Australia's residential market is compared to our international peers, and the size of savings buffers. Scenarios where the RBA may ease the official cash rate despite stubbornly high inflation (i.e. before core CPI is at or below 3%) mainly centre on a harder landing, such as a sharply higher unemployment rate or a severe downturn for residential property. The charts show that while savings rates have fallen and some of the buffers accumulated during the pandemic have been eaten into, nevertheless arrears rates remain low. The last chart shows that around 5% of Australian variable rate borrowers have greater outflows (mortgage payments and essential expenses) than income - but that of this group around 80% of them have more than 6 months accumulated savings to offset the shortfall.

The Aussie Dollar has broken below its recent 64.50c low against the rampant US Dollar in line with weakness for the Japanese Yen, Singapore Dollar and Chinese Yuan. Our forecasts for a stronger AUD/USD in the second half of the year (as the Fed ease rates while the RBA remain on hold) are still in place, but clearly off a lower low than previously expected. Commodity prices are elevated including gold up at another fresh record high, a rebound in Iron Ore to around US$110 / tn and sharply higher energy prices. Geopolitical tensions may extend these market trends.

## Interest Rate Outlook

The RBA Official Cash Rate is most likely at its cycle peak at 4.35%. Rates are expected to be on hold for most of 2024. A longer cycle (into 2025) as core inflation persists above 3% is still the basecase scenario outlined below, while other advanced economies are much closer to their easing cycles, many commencing around mid-2024. Earlier RBA cuts are possible but would require faster progress with inflation than forecast, and/or a much sharper slowdown for our economy.

## Economic Forecasts: basecase scenario

| | 2022 | 2023 | | | | 2024 | | | | 2025 | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| % (actual, forecast) | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 |
| GDP q/q | 0.9 | 0.5 | 0.5 | 0.3 | 0.2 | 0.1 | 0.0 | 0.4 | 0.4 | 0.5 | 0.6 |
| GDP y/y | 2.3 | 2.4 | 2.1 | 2.1 | 1.5 | 1.1 | 0.6 | 0.7 | 0.9 | 1.3 | 1.9 |
| Unemployment | 3.5 | 3.5 | 3.5 | 3.6 | 3.9 | 3.8 | 4.2 | 4.5 | 4.8 | 5.0 | 5.1 |
| CPI (q/q) | 1.9 | 1.4 | 0.8 | 1.2 | 0.6 | 0.8 | 0.7 | 0.8 | 0.7 | 0.7 | 0.7 |
| CPI (y/y) | 7.8 | 7.0 | 6.0 | 5.4 | 4.1 | 3.2 | 3.3 | 3.0 | 3.0 | 2.9 | 2.9 |
| CPI (core y/y) | 6.8 | 6.6 | 5.9 | 5.2 | 4.2 | 3.8 | 3.7 | 3.3 | 3.1 | 3.0 | 3.0 |
| RBA cash rate | 3.1 | 3.6 | 4.1 | 4.10 | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 | 3.85 | 3.35 |
| AUD / USD | .6815 | .669 | .666 | .6435 | .682 | .6515 | .66 | .68 | .72 | .74 | .77 |

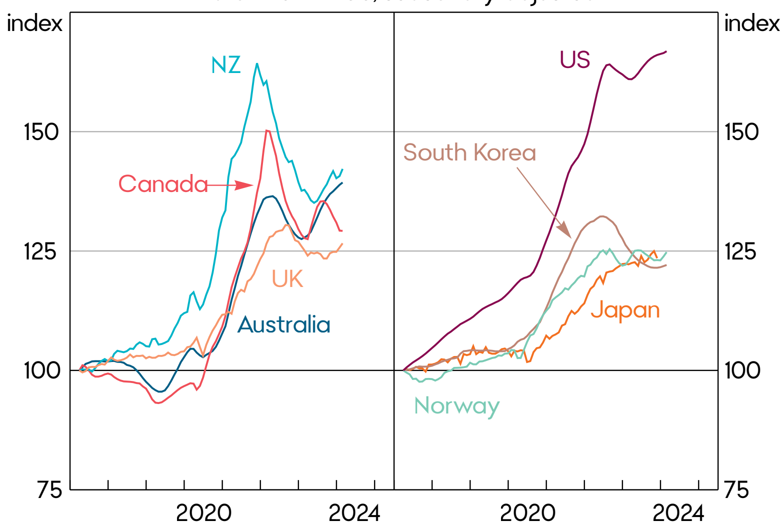
## Benchmark rates

| | 28 / 2 / 2023 | 29 / 2 / 2024 | 31 / 3 / 2024 | 18 / 4 /2024 |
|---|---|---|---|---|
| 90-day bills | 3.56% | 4.335% | 4.34% | 4.36% |
| 3-year swap | 4.11% | 3.90% | 3.81% | 4.08% |
| 5-year swap | 4.27% | 4.14% | 3.96% | 4.27% |
| AUD/USD | .6730 | .6495 | .6515 | .6450 |
| ASX 200 | 7 258 | 7 699 | 7 897 | 7 642 |
| Credit Index (iTraxx- 5 yr) | 87.3 | 64.3 | 65.2 | 71.5 |

# *Appendix:* Housing market comparisons

## Housing Price Indices*

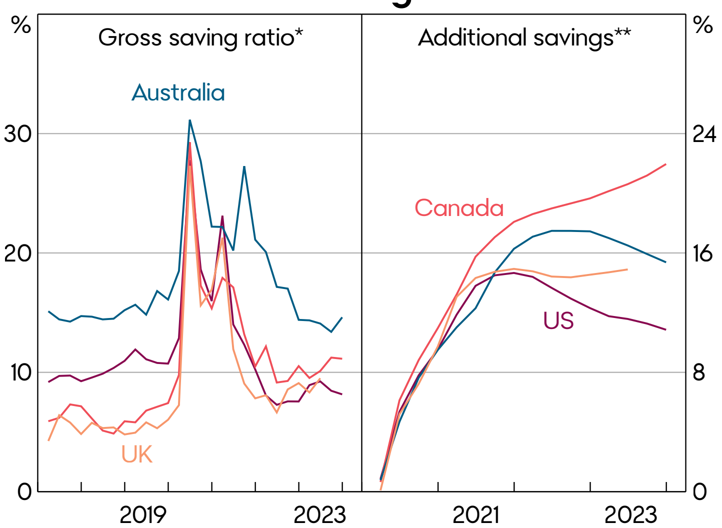
March 2017 = 100, seasonally adjusted




* Latest observations are February 2024 (Australia, Canada, New Zealand, Norway, South Korea, United Kingdom, United States), and November 2023 (Japan)

Sources: Notional sources; RBA; Refinitiv.

## Household Savings Indicators

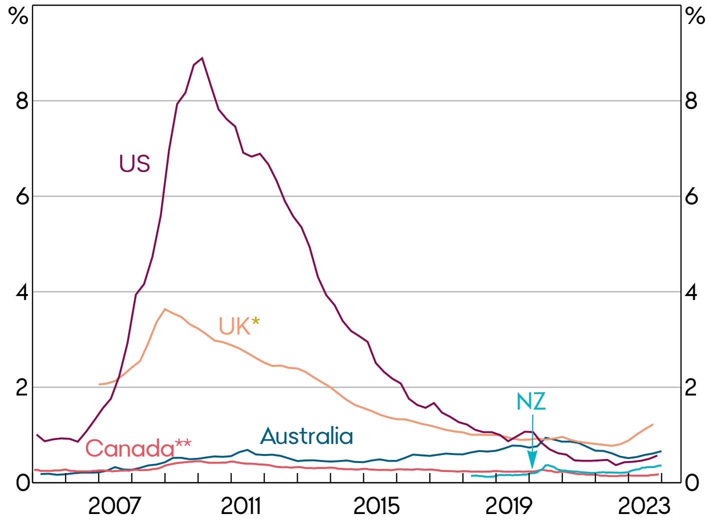



* Share of disposable income. Latest observations are December 2023 (Australia, Canada, United States), and June 2023 (United Kingdom).

** Share of annual disposable income; cumulation of additional savings estimated using the deviation of the saving ratio from its 2014-2018 average.

## Mortgage Arrears Rates

Share of loan balances in 90+ day arrears



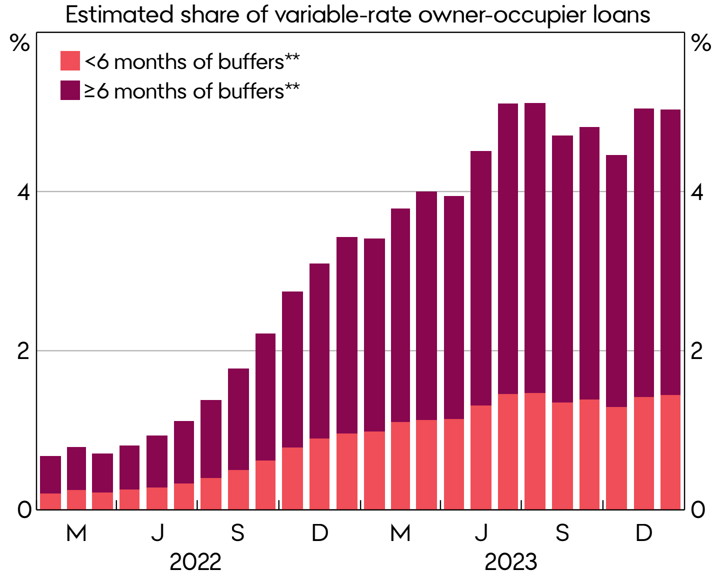

* Loans with arrears greater than 1.5 per cent of the current loan balance and of any length, as a share of the total value of outstanding loans. Latest observations are December 2023.

** Number of loans in 90+ day arrears as a share of the total number of outstanding loans.

Sources: APRA; national sources; RBA.

## Borrowers with Cash Flow Shortfall*

Estimated share of variable-rate owner-occupier loans




* Estimates of borrowers with minimum scheduled mortgage payments and essential expenses (proxied by HEM) exceeding their income. Monthly fluctuations can be attributed, in part, to compositional changes in the loan-level data. Based on Securitisation System data as at December 2023. Excludes borrowers in arrears, which accounted for less than 0.6 per cent of loans in December 2023.

** Buffers expressed relative to cash flow shortfall

Sources: ABS; Melbourne Institute; RBA; Securitisation System.