Weekly Economic Outlook

Monday, 20 September 2021

Central Banks on Centre Stage

The news this week in Australia and globally will mostly centre around central banks.

Tomorrow, the Reserve Bank (RBA) releases its minutes for its Board meeting earlier this week. And later in the week, the US Federal Reserve, the Bank of Japan and the Bank of England meet.

The minutes of the RBA are unlikely to reveal much new information after the RBA Governor's August appearance in front of the Senate and last week's speech to the Anika Foundation. The underlying message was that low rates are here to stay for some time. The RBA Governor continues to reiterate that he does not expect conditions will warrant a rate hike before 2024.

Lowe has emphasised that "it won't be enough for inflation to just sneak across the 2 per cent line for a quarter or two". The Governor gave some clues as to what sustainably in the range might imply, noting they "want to see inflation around the middle of the target range and have reasonable confidence that inflation will not fall below the 2–3 per cent band again". These statements could be a subtle signal that the hurdle for a rate hike is higher than in the recent past.

To meet this condition, Lowe spelt out that a tighter labour market is needed and that wages will need to grow by at least 3% annually. The preferred measure of wage pressures in the economy, the wage price index, grew at just 1.7% over the year to the June quarter.

Soft wages growth has been a feature of the Australian economy for the best part of the last decade, which means that even with a tightening labour market over next year, there is the possibility that annual wages growth won't reach 3% quickly and/or may not be sustained above that threshold quickly.

The labour market was tightening faster than policymakers anticipated in the lead up to the Delta outbreak. However, this was largely reflected in higher employment growth and lower unemployment, rather than stronger wages growth. Moreover, the lockdowns in NSW and Victoria are likely to weigh on wages growth in the near term.

Futures markets suggest investors expect around a 50 per cent chance of a rate hike by the end of 2022. However, Lowe has pushed back on these expectations. In his speech last week, Lowe stated that he finds it "difficult to understand why rate rises are being priced in next year or early 2023".

Sentiment data from consumers and businesses revealed that the roadmaps around reopening have helped consumers and businesses perceptions of the outlook.

The latest vaccination numbers suggest the roadmaps remain on track for NSW, Victoria and Australia. The 80% jab targets will be hit in mid October in NSW, in early December in Victoria and in mid November nationally according to COVID live data. These thresholds and timings give us an idea of reopening. On reopening, economic growth is likely to recover, led by pent-up demand from consumers.

Some fears about the NSW economy and the number of daily infections have also recently receded with the reproductive rate – R – now below the critical level of 1. And the seven-day moving average has fallen for nine consecutive days after the daily number of infections peaked on September 11.

Encouragingly, recent measures of consumer sentiment reveal that consumers are now optimistic about the outlook.

Recent business sentiment measures have stabilised, although suggest businesses are still downbeat about the outlook. This could change once reopening occurs and there is greater clarity around business requirements on reopening, especially around possible vaccine passports.

The jobs market will be vital to sentiment and the shape of the recovery once the big states of NSW and Victoria emerge from their lockdowns.

Last week's data showed a large fall in employment, but the bigger fall came through hours worked in these states. It shows businesses are trying to adjust to the disruption from delta by cutting hours worked wherever possible. Hours worked decreased by 3.7% between July and August 2021, while employment decreased by 1.1%.

The unemployment rate dropped to 4.5%, but that primarily reflected a fall in the participation rate, as people stopped looking for work. If one was to adjust for the participation rate (assume a steady participation rate) and for those people working zero hours, the unemployment rate would have been considerably higher and around 7%.

On Thursday, payrolls data for the fortnight ending August 28 will be published, but this data will have fewer insights than usual after the labour force data for the month of August was published last week.

Forward-looking indicators of employment, such as job vacancies and job advertisements, are holding up, despite the lockdowns, suggesting the jobs market could recover quickly after reopening. The unemployment rate though may kick up initially because people that have dropped out of the labour force will resume looking for work.

Later this week, attention will turn to the two-day US Federal Reserve Open Market Committee meeting (FOMC). The announcement following this meeting will occur early Thursday morning AEDT. FOMC officials are expected to send a clearer signal about plans to begin phasing out pandemic-era stimulus as early as November.

The FOMC Chair, Jay Powell, last month said that he believes a move to reduce or "taper" those purchases by the end of the year could be "appropriate" if the economy continues to evolve as expected. Previous remarks have also indicated they would give the market a heads up. There is widespread anticipation this heads up might materialise this week.

There will also be a fresh set of projections for growth, unemployment and inflation and, most importantly, individual expectations for when interest rates may begin to rise from today's near-zero levels.

The Bank of Japan meets Wednesday and the Bank of England on Thursday. No major changes are expected from these two central banks.

Elsewhere, focus will also stay on China and developments with the Evergrande group. Concerns remain about the credit risks and what the flow on to construction demand in China might be.

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Forecasts

		2021	2022				2023
End Period:	**Close (17 Sep)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	0.10	0.10	0.10	0.10	0.10	0.10	0.25
90 Day BBSW, %	0.01	0.07	0.10	0.15	0.20	0.40	0.65
3 Year Swap, %	0.24	0.55	0.70	0.80	0.95	1.10	1.20
10 Year Bond, %	1.30	1.55	1.70	1.80	1.90	2.00	2.05
US Interest Rates:							
Fed Funds Rate, %	0.125	0.125	0.125	0.125	0.125	0.375	0.625
US 10 Year Bond, %	1.33	1.60	1.70	1.80	1.90	2.00	2.05
USD Exchange Rates:							
AUD-USD	0.7299	0.75	0.76	0.77	0.78	0.78	0.79
USD-JPY	109.83	111	112	112	112	113	113
EUR-USD	1.1772	1.21	1.23	1.22	1.21	1.21	1.21
GBP-USD	1.3803	1.41	1.43	1.44	1.45	1.44	1.44
NZD-USD	0.7075	0.71	0.72	0.73	0.74	0.74	0.74
AUD Exchange Rates:							
AUD-USD	0.7299	0.75	0.76	0.77	0.78	0.78	0.79
AUD-EUR	0.6187	0.62	0.62	0.63	0.64	0.64	0.65
AUD-JPY	79.90	83.3	85.1	86.2	87.4	88.1	89.3
AUD-GBP	0.5293	0.53	0.53	0.53	0.54	0.54	0.55
AUD-NZD	1.0317	1.06	1.06	1.05	1.05	1.05	1.07

	2019	2020	2021 (f)	2022 (f)
GDP, %	2.1	-0.9	0.0	7.4
CPI (Headline), %	1.8	0.9	2.6	2.4
CPI (Trimmed mean), %	1.6	1.2	1.9	2.6
Unemployment Rate, %	5.2	6.8	5.4	4.0
Wages Growth, %	2.2	1.4	2.1	2.6

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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