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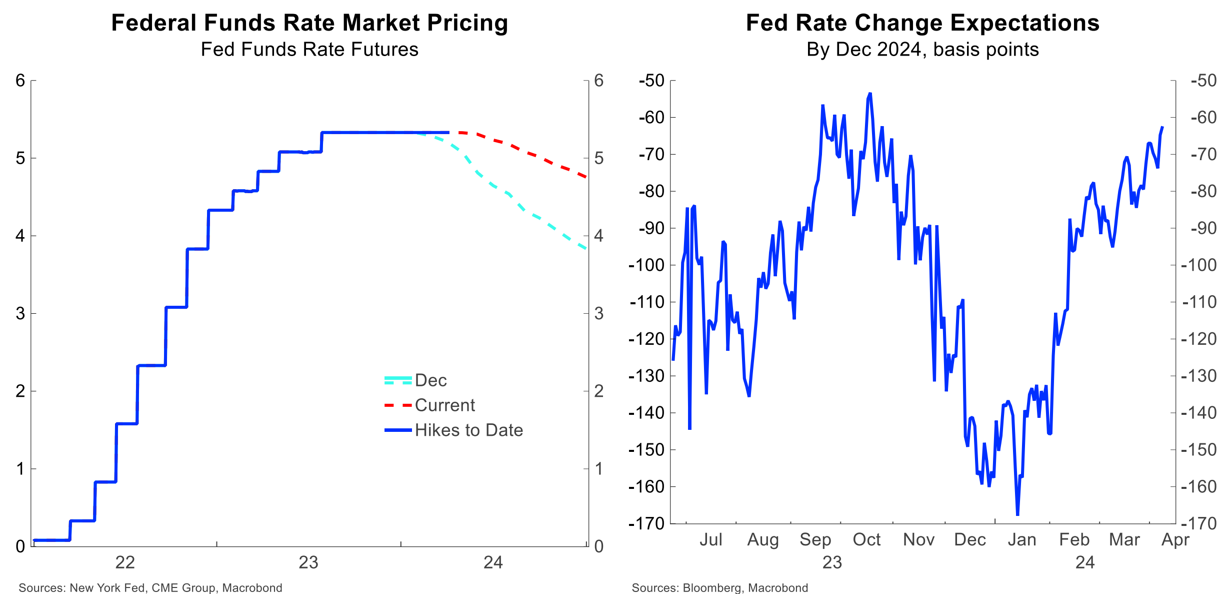
Markets Looking To US Inflation Report

A blockbuster non-farm payrolls report led to markets repricing the extent of cuts from the Federal Reserve in 2024. Interest-rate markets attach an 89% probability of the first cut occurring by July and only a 53% chance of a June move. This means the first cut is no longer fully priced until September, compared with July before non-farm payrolls. For 2024, markets expect around 62 basis points of cuts – slightly less than the 75 basis points implied by the Fed's median dot plot expectation. Market views around the degree of cuts in 2024 have steadily been wound back over 2024, since peaking at almost 170 basis points in the beginning of the year. Bond markets reacted swiftly, as the 2- and 10-year treasury yields closed at their highest levels since November 2023.



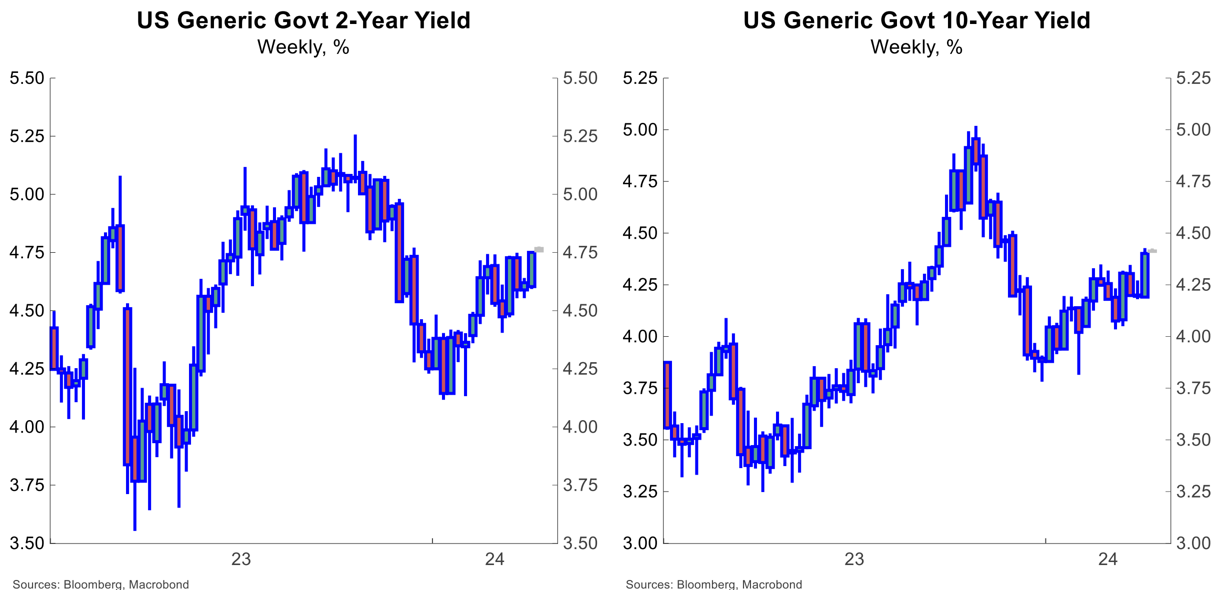
The report showed that the US labour market remains very robust, with strong jobs growth and low unemployment. As noted by Richmond Fed President Thomas Barkin, the unemployment rate has been below 4% for 26 months for the first time since the late 1960s. While the job market remains strong, growth in wages continues to slow suggesting that labour supply is also increasing.

A key question is whether this strength suggests it will take longer to get inflation down to the 2% target and whether interest rate cuts will need to be delayed. But as Fed Chair Powell stated in the March press conference, strong jobs growth alone would not be a reason to be concerned.

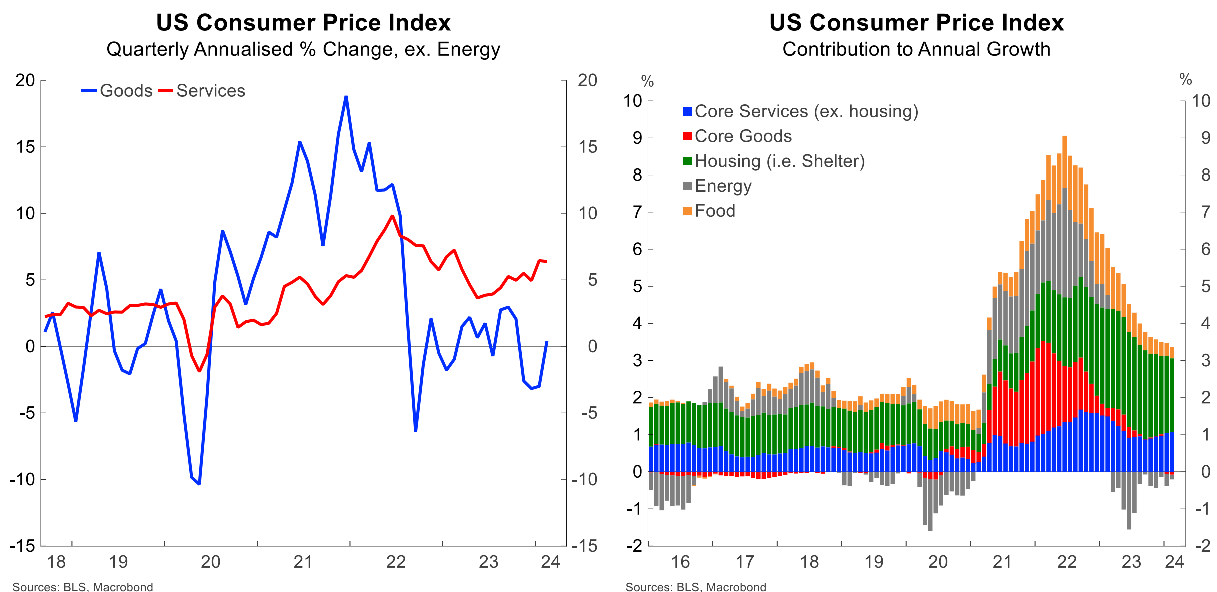
This is where the latest March consumer price index (CPI) report – due Wednesday night – will be very closely watched. Inflation has continued to gradually subside and trend towards the Fed's 2% target. However, the January and February prints surprised to the upside and other data – such as producer prices – also indicated that the risk of stubborn price pressures can't be ruled out.

Specifically, the monthly pace of headline inflation was 0.4% in February. This represented an acceleration from the 0.3% January pace. In annual terms, headline inflation accelerated to 3.2%

in February – up from 3.1% in January and above expectations. The all-important core measure (which excludes volatile food and energy prices) was also stronger than expected at 0.4% in February. This contributed to the annual pace slowing by less than expected, to 3.8% compared to expectations for a slowdown to 3.7%.



On the positive side, the quarterly annualised pace of goods inflation has been hovering around zero since mid-2022 as the unwinding of supply chain disruptions contributed to goods prices either stalling or exhibiting outright deflation. This category cannot detract from inflationary pressures forever and will eventually start adding to pressures again.



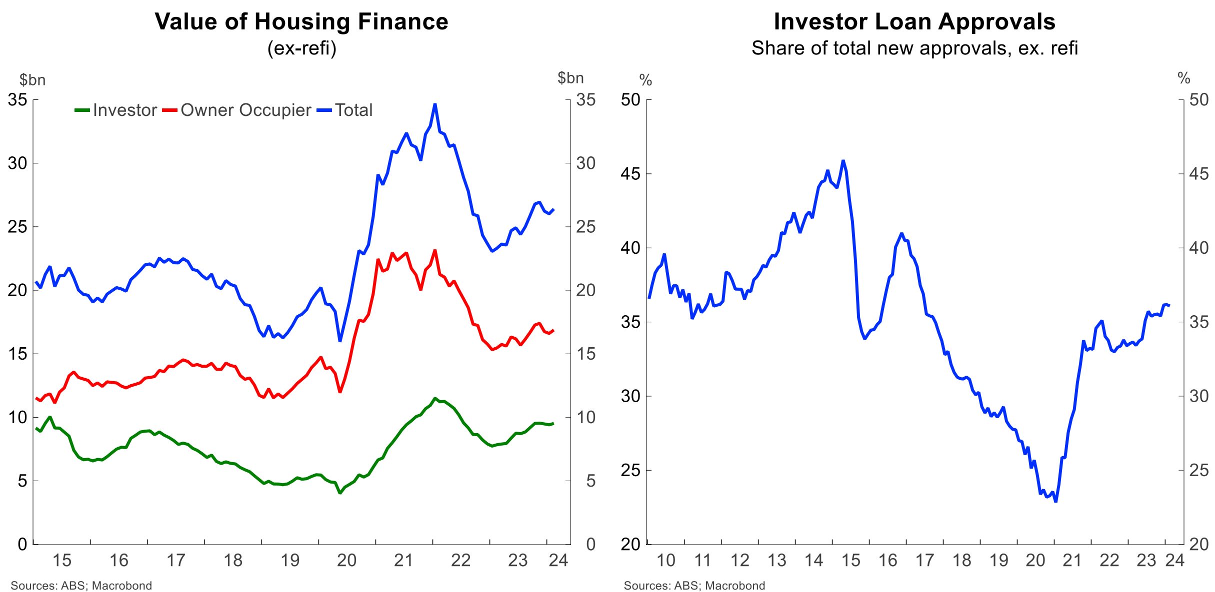
The concern for the Fed remains around services inflation. This has ranged between the mid-3s to the mid-6s in quarterly annualised terms since early 2023 and has been stubbornly trending higher over this period. Housing is one component of this sticky services inflation and the Fed will be watching for progress in this area. But housing inflation is slow moving and gains will be hard won as the supply side is inelastic in the near term. Outside of housing, the 'supercore' measure, i.e. core services ex. housing – often quoted by Chair Powell – remained at an elevated 4.3% in annual terms in February and continues to add around 1 percentage point to annual inflation. This will be

a key area of focus and closely watched by analysts and the Fed.

Our expectation is that March will see continued gradual progress towards the target and that the monthly pace will slow from 0.4% to 0.3%. But it remains a bumpy road. Given the upside surprises over the past two months and jobs growth being hit for six in Friday's non-farm payrolls report, financial markets are likely to be volatile if the data surprises materially in either direction.

Domestic data

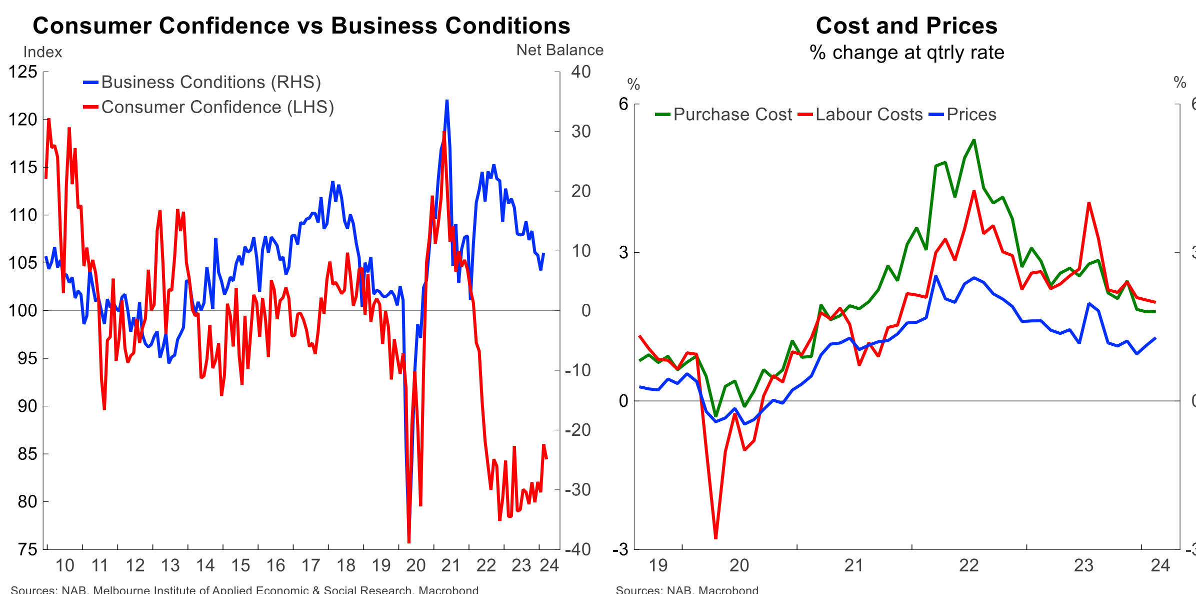
The first cab off the rank this morning was the February lending indicators release from the Australian Bureau of Statistics (ABS). This showed that new housing finance rose 1.5% in February. This followed a 0.8% drop in January – which was revised higher from an initial 3.9% fall. Owner-occupier loans rose 1.6% while investor lending was 1.2% higher. New housing finance has been trending higher – albeit with some volatility – since hitting a recent trough in January 2023. This broadly aligns with the beginning of the rebound in dwelling prices. Investor lending has been a standout and surged 21.5% in the past 12 months, compared to a 9.1% jump in owner-occupier lending over the same period. Investors have been particularly active in WA, where lending surged by almost 60% in 12 months. Queensland, SA, NSW and NT all also reported double-digit growth in investor lending over the past year. Investor loan approvals as a share of total approvals are just above 36% – around their highest levels since the investor-led boom of the mid-2010s. Owner-occupier lending has been in the double-digits in Queensland, WA and SA over the past year.



Tomorrow, the April Westpac-Melbourne Institute consumer sentiment survey will be released. Consumer sentiment has remained deeply entrenched in pessimistic territory through this cycle. In a sign that perhaps some of the storm clouds are starting to clear and sunshine is beginning to peak through, consumer sentiment has ticked slightly higher in early 2024, although it pulled back 1.8% in March, to 84.4. The key factors weighing on households remain unchanged – elevated inflationary pressures, a higher tax take from bracket creep, and interest rate increases from the Reserve Bank (RBA) impacting mortgage holders. However, the pressure on households from these factors has been easing, or at the very least, haven't been building as quickly as in the past. This has helped to underpin a broad stabilisation and now slight recovery in sentiment.

But it's too early to put the umbrellas away yet and it will be some time before clear skies are in view. We don't expect a material turnaround in sentiment until the second half of 2024. By that

point, inflation is expected to have continued to gradually cool, tax relief will be starting to flow through in the form of the updated stage 3 tax cuts, and we expect the RBA to be able to begin the rate cutting cycle. As a result, the April update will likely be another broadly sideways move, as these key drivers of improved sentiment are still some way off.



The March monthly business survey will also be released on Tuesday. Unlike consumer sentiment, business confidence and conditions have held up well during this cycle. As we have noted on several occasions, this reflects that businesses benefit from the aggregate economy, which has been supported by incredibly strong population growth. On the other hand, households feel more of the per capita economy, which has been weak, evidenced by the per capita recession we are in.

Despite this, conditions have continued to slow as economic growth has weakened and the full effects of interest rate increases have flowed through. Confidence has continued to hover around neutral for over 12 months, with occasional spikes above or below that in certain months. Going forward, more of the same is likely through the first half of 2024, as the year is expected to be one of two halves. Like consumer confidence, business confidence and conditions are likely to begin trending more materially higher once the key pressures on the economy ease.

Measures of input costs and output prices will be important to review. Purchase and labour costs, and final prices have been trending lower as inflationary pressures subside. Like with overall inflation, it is likely that these trends continue but that progress will be slower over coming quarters. These measures will certainly be worth a look for another signal regarding whether the progress on inflation is continuing in line with the RBA's expectations.

Central bank meetings

Several central banks will be meeting this week. The key decision will come from the European Central Bank (ECB) on Thursday night. In addition, the Bank of Canada and the Reserve Bank of New Zealand will meet earlier in the week. No moves are expected. However, investors will be watching comments from policy makers closely for insights on how they are assessing the latest flow of data and for clues on when easing cycles may begin.

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Group Forecasts

		2024			2025		
End Period:	**Close (05 Apr)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	4.35	4.35	4.10	3.85	3.60	3.35	3.10
90 Day BBSW, %	4.36	4.37	4.12	3.92	3.67	3.47	3.30
3 Year Swap, %	3.92	3.95	3.85	3.75	3.65	3.60	3.55
10 Year Bond, %	4.10	4.05	3.95	3.85	3.90	3.90	3.95
US Interest Rates:							
Fed Funds Rate, %	5.375	5.125	4.625	4.375	4.125	3.875	3.625
US 10 Year Bond, %	4.40	4.00	3.90	3.80	3.85	3.90	3.95
USD Exchange Rates:							
AUD-USD	0.6579	0.68	0.69	0.70	0.71	0.72	0.72
USD-JPY	151.62	148	145	141	137	133	130
EUR-USD	1.0837	1.11	1.13	1.14	1.15	1.16	1.17
GBP-USD	1.2638	1.27	1.28	1.29	1.30	1.30	1.31
NZD-USD	0.6013	0.63	0.64	0.64	0.64	0.65	0.65
AUD Exchange Rates:							
AUD-USD	0.6579	0.68	0.69	0.70	0.71	0.72	0.72
AUD-EUR	0.6071	0.61	0.61	0.61	0.62	0.62	0.62
AUD-JPY	99.75	99.9	100.1	98.7	97.3	95.8	93.6
AUD-GBP	0.5206	0.53	0.54	0.54	0.55	0.55	0.55
AUD-NZD	1.0941	1.07	1.09	1.09	1.11	1.12	1.11

	2022	**2023**	**2024 (f)**	**2025 (f)**
GDP, %	2.4	1.5	1.6	2.5
CPI (Headline), %	7.8	4.1	3.0	2.7
CPI (Trimmed mean), %	6.8	4.2	3.1	2.8
Unemployment Rate, %	3.4	3.8	4.5	4.6
Wages Growth, %	3.3	4.2	3.2	3.1

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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