Too Early to Declare Inflation War Over

We start the week in the wake of important speeches delivered by central bank heads at the Jackson Hole symposium. The speech by the US Federal Reserve Chair, Jerome Powell, was the most highly anticipated. He was careful in his comments to not declare victory on the war against inflation. He said that inflation has moved down from its peak and that is a welcome development but warned that inflation "remains too high." Powell also said the Fed is "prepared to raise rates further if appropriate" and that they intend to hold policy at a restrictive level until they are confident that inflation is moving sustainably down toward their objective.

Right now, the US economy is displaying a mix of economic resilience, including low unemployment, and retreating inflation. The US Fed will wish this delicate mix continues. To maximise the chances of this, Powell also pledged to proceed "carefully" as he steers the final stages of the Fed's campaign to bring inflation down to the 2% target.

We are left with the idea that rates are likely to stay higher for longer but it is still too early to be fully convinced that the war on inflation is over. Markets are attaching a 65% chance of one more hike from the Fed and do not have a rate cut fully priced until closer to mid 2024.

Locally, this week is jam packed with economic data. Indeed, there are no fewer than eight major economic releases that will provide more colour around the outlook for the economy.

Retail sales: Today, there was the release of nominal retail sales for the month of July. The economic slowdown underway in Australia has been led by consumers, so this release provided an important update on the state of consumption. Retail spending jumped 0.5% in the month, partly reversing the large fall of 0.8% in June. But the increase was supported by temporary factors, especially the Women's World Cup during the month.

On Wednesday, monthly inflation, dwelling approvals and construction work done is released.

Monthly inflation gauge: The monthly measure of inflation has been trending lower, from 6.7% in April to 5.5% in May and to 5.4% in June. We expect this moderation continued in July with the annual rate easing to 4.8%. The biggest risk or uncertainty around the path of inflation in the current quarter is electricity.

Dwelling approvals: We anticipate a fall in approvals of 1.0% in July after a hefty fall of 7.7% in June. Dwelling approvals are substantially down from their recent peaks across the country, which suggests the current demand and supply imbalance in the housing market is set to persist for some time. The imbalance has been exacerbated by a shortage of dwellings amid strong population growth and a recovery for housing finance. Supply isn't likely to help address the challenge any time soon with approvals an early indicator that residential construction activity will soften further. Labour costs and shortages remain high for builders and developers in the residential construction industry, which are also contributing to a drop off in approvals. Elevated insolvency activity in the construction sector is also weighing on confidence, further limiting new developments.

Construction work done: The first of the partial economic indicators for second quarter GDP is construction work done. These partial indicators help finalise the GDP estimate, which we currently have forecast at a 0.4% rise for the quarter and growth of 1.8% for the year.

Construction work done has been trending higher, but this has been strongly influenced by public-sector works and private business projects. A catch-up underway from earlier delays, such as from COVID and adverse weather, is also supporting current activity. We expect a 1.5% lift to come though for the June quarter, after a rise of 1.8% in the March quarter.

Moving to Thursday, credit and private capital expenditure is published.

Private-sector credit: Demand for credit from the private sector continues to soften. The growth rate in the month of June was just 0.2%, which was the slowest pace since November 2020. Annual growth has also stepped down from 6.2% in May to 5.5% in June, as a slowing in economic activity and higher interest rates bite. Within the credit figures, business credit has continued to show resilience relative to housing, as businesses in aggregate enter this next leg of the economic slowdown from a position of financial strength. For July, we anticipate growth of 0.3% in the month, which is near the monthly average rate for 2023 so far.

Private capital expenditure: Picking up on the resilience of businesses, we expect private capital expenditure (capex) to rise 2.0% in the June quarter after a lift of 2.4% in the March quarter. An outcome in line with our forecast would lead to an annual lift of over 8%. The volume of investment is growing strongly but there is evidence of prices decelerating. This suggests that the disinflationary impulse from the resolution of supply-chain disruptions has arrived.

This capex release will also contain the third estimate for capex spending plans for 2023/24, which we expect should show a weakening in capex coming through for the current financial year if we adjust the estimates for historical norms (using realisation ratios).

The week is rounded out by more data on housing - dwelling prices and housing finance.

Dwelling prices: The upturn in dwelling prices that began in February will stay intact in August. A second consecutive hold in the cash rate from the Reserve Bank this month and ongoing strong net overseas migration flows supported demand and while advertised supply remains low prices are likely to continue to lift. However, the recent rise in new listings may help take some of the heat out of the pace of growth. We are anticipating CoreLogic’s metropolitan weighted capital cities index to have recorded growth of 1.0% in August.

Housing finance: A recovery is clearly underway and fresh data for July should confirm the recovery has run further. We are looking for a lift of 1.2% in the month, after a dip of 1.0% in June. Whilst housing finance numbers and values are recovering, the average value of loan sizes is easing, reflecting the restraint on borrowing capacity as rates have moved higher from the trough in April last year.

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Group Forecasts

		2023		2024			
End Period:	**Close (25 Aug)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	4.10	4.10	4.10	4.10	4.10	3.85	3.60
90 Day BBSW, %	4.14	4.30	4.30	4.30	4.22	3.97	3.72
3 Year Swap, %	4.11	4.00	3.95	3.90	3.80	3.70	3.60
10 Year Bond, %	4.16	3.75	3.55	3.45	3.30	3.25	3.20
US Interest Rates:							
Fed Funds Rate, %	5.375	5.375	5.375	5.125	4.625	4.125	3.625
US 10 Year Bond, %	4.24	3.80	3.60	3.40	3.20	3.10	3.00
USD Exchange Rates:							
AUD-USD	0.6404	0.67	0.68	0.69	0.71	0.73	0.74
USD-JPY	146.44	140	138	135	132	130	128
EUR-USD	1.0796	1.11	1.12	1.12	1.13	1.14	1.15
GBP-USD	1.2578	1.28	1.28	1.29	1.29	1.30	1.30
NZD-USD	0.5908	0.62	0.63	0.63	0.64	0.65	0.66
AUD Exchange Rates:							
AUD-USD	0.6404	0.67	0.68	0.69	0.71	0.73	0.74
AUD-EUR	0.5932	0.60	0.61	0.62	0.63	0.64	0.64
AUD-JPY	93.78	93.8	93.8	93.2	93.7	94.9	94.7
AUD-GBP	0.5091	0.52	0.53	0.53	0.55	0.56	0.57
AUD-NZD	1.0844	1.07	1.08	1.09	1.10	1.12	1.12

	2021	**2022**	**2023 (f)**	**2024 (f)**
GDP, %	4.6	2.6	1.0	1.4
CPI (Headline), %	3.5	7.8	3.9	3.2
CPI (Trimmed mean), %	2.6	6.9	3.8	3.1
Unemployment Rate, %	4.7	3.5	3.8	4.7
Wages Growth, %	2.3	3.4	3.8	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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