October Monthly Economics and Markets Review

QUEENSLAND TREASURY CORPORATION

Overview

Domestic economy

The RBA kept policy settings unchanged at its October meeting, as was widely expected. However hawkish commentary from the Bank following the meeting, coupled with a stronger Q3 inflation report has increased expectations that the Bank will raise rates at its next meeting on 7 November.

International economy

Many central banks across the globe kept policy settings unchanged over October amid a general easing in amid inflation dynamics and seeking more time to assess the impact of prior tightening.

Short-term interest rates

Domestic short-term bond yields rose notably over the month on expectations the RBA could raise rates later this year, or early next year. Australian Government three-year yields rose around 30 basis points to 4.4 per cent. Markets offshore were more mixed, with front-end rates rising in the US and Japan, but falling across Europe.

Long-term interest rates

It was a similar story for domestic longer-end rates, with Australian Government 10-year yields reaching 4.9 per cent (the highest since mid-2011). There were also increases in offshore longer-end yields, with the US Treasury ten-year yield rising above five per cent for the first time since 2007 (before finishing the month around 4.95 per cent).

MATURITY	ISSUER	YIELD	1 MONTH BPS CHANGE	1 YEAR BPS CHANGE
3 Year	QTC	4.69	38	89
	Australian Government	4.40	33	113
	US Government	4.93	13	43
5 Year	QTC	4.87	49	88
	Australian Government	4.53	40	109
	US Government	4.85	24	59
7 Year	QTC	5.14	53	97
	Australian Government	4.71	42	112
	US Government	4.93	32	77
10 Year	QTC	5.52	56	107
	Australian Government	4.90	44	117
	US Government	4.93	36	89

AUSTRALIAN DOLLAR CROSSES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
AUD/USD	0.6330	-1.5%	-1.0%
AUD/EUR	0.5987	-1.4%	-7.5%
AUD/GBP	0.5216	-1.0%	-6.5%
AUD/JPY	95.8144	-0.2%	1.2%

MAJOR CURRENCIES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
EUR/USD	1.0573	-0.1%	7.1%
GBP/USD	1.2137	-0.5%	5.9%
USD/JPY	151.36	-1.3%	-2.2%
USD/CNY	7.3171	-2.0%	-0.6%

Prices sourced from Macrobond & QTC and are correct at the time of publication.

The tables above show yields on bonds issued by the Queensland, Australian and US Governments as well as values for the Australian Dollar against a range of currencies and US Dollar against major currencies. The change in yields and exchange rates over different time periods are also included.

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Domestic economy

SUMMARY:

The RBA again kept rates on hold at its October meeting, though some hawkish commentary in the Minutes to that meeting, coupled with a strong Q3 inflation report has pushed up expectations that the RBA could raise rates at its next meeting.

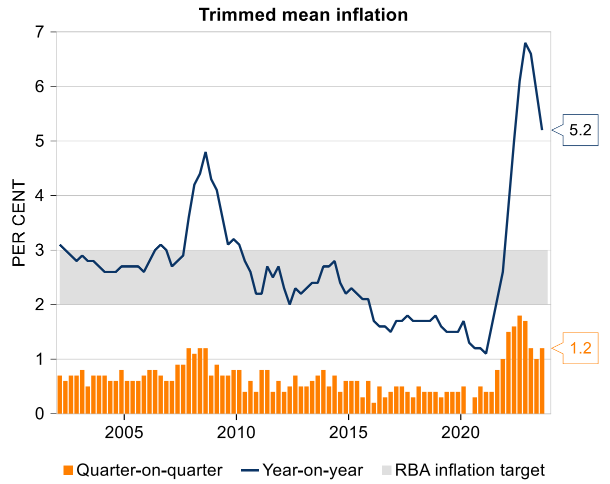
REVIEW:

- The RBA left the cash rate unchanged at 4.1 per cent at its October meeting, as was widely expected. The post-meeting statement maintained the Bank's tightening bias, suggesting that *'further tightening of monetary policy may be required'* and that the decision to hold policy unchanged provided *'further time to assess the impact of the increase in interest rates to date and the economic outlook'*. The statement suggested economic activity was stronger than expected over the first half of 2023, but that the economy was still growing below trend. Inflation was again suggested to have *'passed its peak'*, though the Bank acknowledged the recent notable rise in fuel prices.
- The Minutes to the October Board showed that the decision was once again between an increase in the cash rate or holding it steady. Ultimately, the decision to hold was based on the Board's assessment that there *'had not been sufficient new information over the preceding month'* to justify a rate hike. However, the discussion at the October meeting was more hawkish than expected, with the Board signalling its willingness to increase interest rates further if the outlook for inflation was revised higher. A key change to the Minutes was the Board highlighting that *'[it] has a low tolerance for a slower return of inflation to target than currently expected'.*
- RBA Governor Bullock reinforced this view in her first Q&A as Governor. Bullock said the Bank was *'very alert'* to upside inflation risks and noted the Board was prepared to respond with higher rates. Lowering inflation now is important as it would help contain future expectations and thus avoid a more difficult task of lowering of it in the future.
- Speaking the day prior to the Q3 inflation report (details below), RBA Governor Bullock stated the *'Board will not hesitate to raise the cash rate further if there is a material upward revision to the outlook for inflation'*. However, her comments were not all hawkish as she also noted the Board was *'mindful that growth in demand and the rate of inflation have been moderating, and that there are long lags in the transmission of monetary policy.'*
- The Q3 CPI report was notably stronger than consensus expectations and the RBA's most recent forecasts. This saw investors increase the odds that the RBA would raise rates at its next meeting on 7 November, with a roughly 50 per cent chance of a follow-up rise by March 2024. As for the details of the report:
  - Headline inflation rose 1.2 per cent in Q3, an acceleration from the +0.8 per cent rise in Q2. There was also a lift in the quarterly pace of underlying inflation measures, with the trimmed-mean rising 1.2 per cent (up from +1.0 per cent), the weighted-median up 1.3 per cent (from +1.0 per cent) and the CPI excluding volatile items increasing 1.0 per cent (from +0.9 per cent). Base effects saw both the annual rates of headline and underlying inflation slow.
  - Compositionally, energy and housing related categories were key drivers of the headline outcome, though significant pressures remain across both services and goods. Indeed, the increase on the quarter is notable as government subsidies for electricity, rent, childcare, and pharmaceuticals would have provided an offset of around half a percentage point.
- The unemployment rate fell a tenth to 3.6 per cent in September, though this mainly reflected unemployed people dropping out of the labour force. Employment rose by a modest 6.7k in September following a large 63.3k increase in August.
- The RBA's quarterly Financial Stability Review noted that Australia's financial system *'remains strong'* and that *'most Australian households and businesses remain well placed to adapt to the challenging set of economic conditions, though some are vulnerable to further shocks.'*
- This as the *Westpac-Melbourne Institute Consumer Sentiment Index* lifted in October but remains well below the series average (as has been the case since early 2022).
- The *NAB Business Survey* showed conditions eased in September but remain above the series average, while confidence was stable at levels below average. The drop in conditions was broad-based, with falls across profitability, trading, and employment.

WHAT TO WATCH:

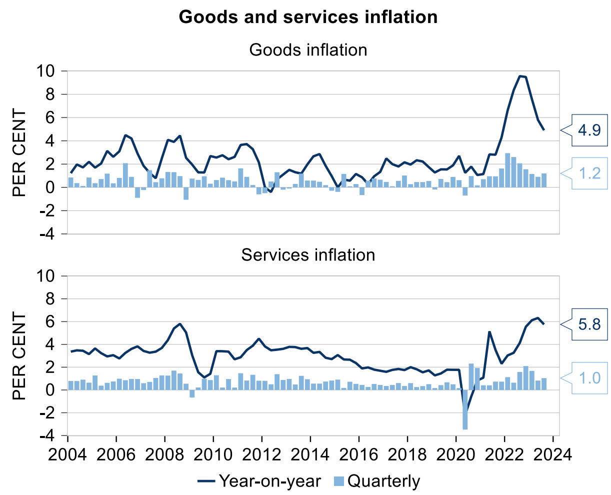
The RBA's next policy meeting on 7 November should give a signal of the RBA's appetite for recent upside inflation surprises. Meanwhile, its November *Statement on Monetary Policy* (released 10 November) will provide revised forecasts from the Bank.

CHART 1: THE QUATERLY PACE OF TRIMMED-MEAN INFLATION ACCELERATED IN Q3…



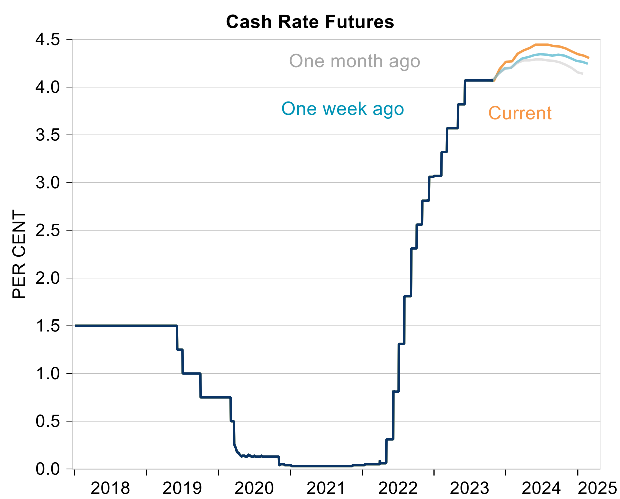
Source: ABS, RBA, QTC, Macrobond

CHART 2: … AS THE PACE OF SERVICES AND GOODS INFLATION ROSE OVER THE QUARTER….



Source: Australian Bureau of Statistics, QTC, Macrobond

CHART 3: …AND, GIVEN THESE OUTCOMES, MARKETS ASSESS A HIGHER PROBABILITY THE RBA WILL RAISE RATES FURTHER



Source: Bloomberg, QTC, Macrobond

International economy

SUMMARY:

Major central banks kept policy settings unchanged while assessing the impact of cumulative policy tightening, though in doing so, indicated a willingness to raise rates further if required. Economic momentum remained resilient in the US whilst continuing to improve in China.

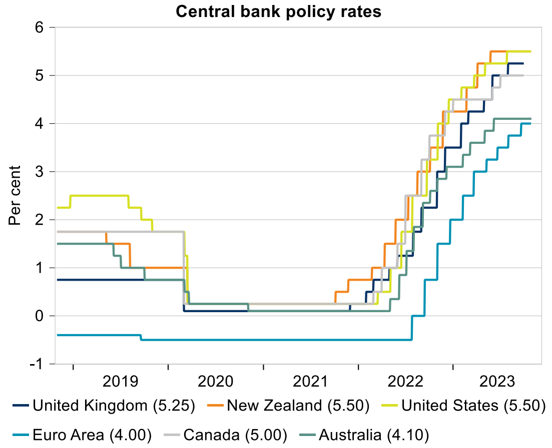
REVIEW:

- In global central bank news:
  - Commentary from US Federal Reserve officials was mixed with some stressing a preference to hold rates steady and assess incoming data, while others suggested that further rate hikes could be appropriate given upside inflation risks. The Minutes to the FOMC's September Minutes contained limited new information relative to the post-meeting statement but did highlight that *'all participants'* believed the Committee should *'proceed carefully'* and *'all'* agreed policy should remain restrictive for some time until the Committee was confident inflation was moving down sustainably toward its two per cent target.
  - The ECB kept policy settings unchanged at its November meeting, noting that the recent data flow had *'broadly confirmed'* its outlook. Whilst acknowledging that inflation has been *'too high for too long'*, its recent *'marked'* decline was noted, as was the improvement in core inflation. President Lagarde suggested that the impact of the Middle East conflict posed upside risks to inflation.
  - The Bank of Canada also kept policy settings unchanged, citing a slowing in the economy and a moderation in inflation. However, Governor Macklem did retain the Bank's tightening bias, suggesting the *'Council is concerned that progress towards price stability is slow and inflationary risks have increased, and is prepared to raise the policy rate further if needed'*.
  - The Reserve Bank of New Zealand kept the cash rate unchanged at 5.5 per cent, as expected. The post-meeting statement saw a slight alteration to the forward guidance which now suggests *'interest rates may need to remain at a restrictive level for a more sustained period of time'*. It had previously stated that rates needed to *'stay at restrictive levels for the foreseeable future'*; the implication being that rates may need to be kept restrictive for longer.
  - The Bank of Japan tweaked its Yield Curve Control policy, with the Bank no-longer conducting daily fixed rate purchases of ten-year Japanese Government Bonds at one-per cent. While this could see the yield on the ten-year Japanese Government Bond rise about one-per cent, policymakers still regard this as the *'upper bound'*, suggesting limited tolerance for the yield to rise meaningfully above one-per cent.
- The *IMF's World Economic Outlook* slightly downgraded its forecasts for global GDP growth in 2024 – as downward revisions to European and Chinese growth were partially offset by upgrades to that for the US – and slightly upped its 2024 global inflation forecast.
- China's National People's Congress approved an additional one-trillion Yuan in central government bond issuance for infrastructure spending intended to help the economy recover from previous natural disasters. The nation's fiscal deficit will now increase up to 3.8 per cent of GDP, above the usual limit of around three per cent.
- This news came as China's largest property developer, Country Garden, defaulted on some of its international debts after being unable to make some repayments.
- Inflation data globally were mixed, with the annual pace of US inflation easing, though the month-to-month outcomes showed signs of a pick-up in prices. Meanwhile, annual inflation rates in the euro area and UK also both moderated, though by less than expected in the UK. This all comes as labour markets across the globe remain historically tight.
- Economic activity remains resilient in the US as seen in labour market reports for September and the GDP outcome for Q3. In China, momentum continued to build following some softness in the middle of the year. Should it be sustained, these conditions in the worlds' two largest economies should put a floor under global GDP growth.

WHAT TO WATCH:

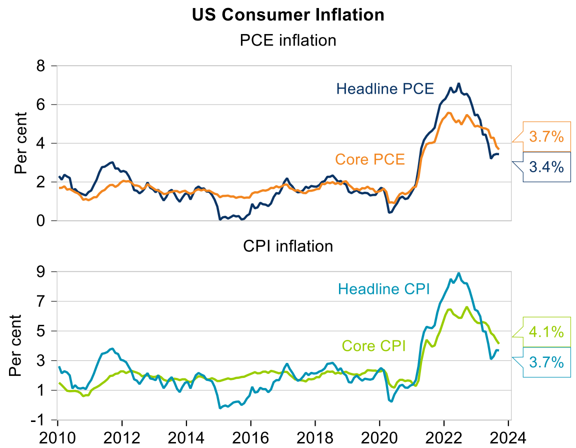
There are some signs of a moderation in global price pressures, though the path for core inflation to move back to central bank targets has not so far been a linear one. It will be important to watch how core inflation evolves through 2024 with the 'last mile' promising to be a long one. If this is the case, it will test central banks' nerves, as will potential feedback from headline inflation into core inflation on account of higher energy prices.

CHART 4: CENTRAL BANKS ACROSS THE GLOBE HAVE EASED THE PACE OF POLICY TIGHTENING



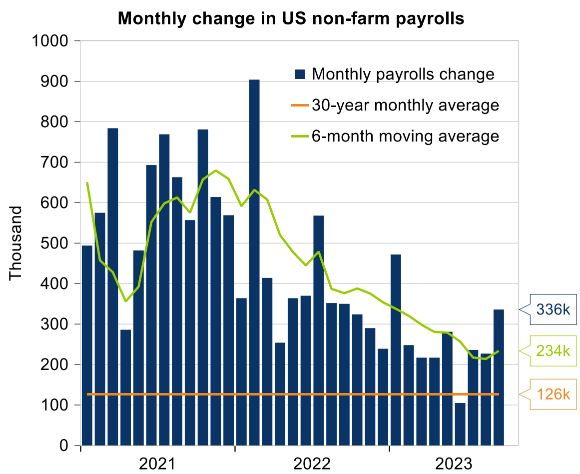
Source: QTC, Macrobond

CHART 5: THE YEAR-ON-YEAR RATE OF US INFLATION HAS EASED, THOUGH THE MONTHLY OUTCOMES HAVE INCREASED



Source: U.S. Bureau of Economic Analysis (BEA), U.S. Bureau of Labor Statistics (BLS), QTC, Macrobond

CHART 6: THIS AS US PAYROLLS GROWTH JUMPED SHARPLY IN SEPTEMBER



Source: U.S. Bureau of Labor Statistics (BLS), QTC, Macrobond