January Monthly Economics and Markets Review

QUEENSLAND TREASURY CORPORATION

Overview

Domestic economy

Recent data suggests that inflation and economic activity slowed towards the end of 2023, supporting the market's view that the cash rate will remain unchanged at 4.35 per cent in February.

International economy

Major central banks kept policy settings unchanged at their January meetings as inflationary pressures continued to ease. The expected continuation of this process and orderly moderation in economic momentum has seen policymakers increasingly highlight that rate cuts could be forthcoming, though at a slower pace than markets have priced. Several key US data releases pointed to slightly stronger-than-expected economic conditions in December.

Short-term interest rates

Better than expected US economic data and Federal Reserve officials pushing back on market expectations of imminent rate cuts saw domestic bond yields increase over most of January. However, these gains couldn't be sustained as lower than expected financing needs for the US Treasury and a softer than anticipated Q4 2023 outcome for Australian inflation. Three-year Australian Government bond yields ultimately end January five basis points lower at 3.56 per cent after having been, at one point, nearly 30 basis points higher than where they ended December.

Long-term interest rates

It was a similar story for domestic longer-end yields with these rising strongly for most of the month (at one point these were nearly 35 basis points higher than the end of December) before this momentum faded with Australian Government 10-year yields finishing January six basis points higher at 4.01 per cent.

MATURITY	ISSUER	YIELD	1 MONTH BPS CHANGE	1 YEAR BPS CHANGE
3 Year	QTC	3.84	-3	25
	Australian Government	3.56	-5	40
	US Government	3.98	-3	20
5 Year	QTC	3.94	0	24
	Australian Government	3.62	-2	35
	US Government	3.83	-1	32
7 Year	QTC	4.19	2	29
	Australian Government	3.81	2	41
	US Government	3.88	0	41
10 Year	QTC	4.53	6	31
	Australian Government	4.01	6	47
	US Government	3.91	4	50

AUSTRALIAN DOLLAR CROSSES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
AUD/USD	0.6609	-3.0%	-6.6%
AUD/EUR	0.6086	-1.3%	-6.1%
AUD/GBP	0.5192	-2.9%	-9.6%
AUD/JPY	96.6804	0.6%	5.7%

MAJOR CURRENCIES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
EUR/USD	1.0860	-1.7%	-0.5%
GBP/USD	1.2729	0.0%	3.3%
USD/JPY	146.28	-3.7%	-13.2%
USD/CNY	7.0943	-0.2%	-5.2%

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:

Recent data suggests that inflation and economic activity slowed towards the end of 2023. Notably, CPI inflation eased sharply in the December quarter, while there was a marked fall in both retail sales and employment in December. Job advertisements also point to a softening of labour market conditions and consumer sentiment remains at a historically low level.

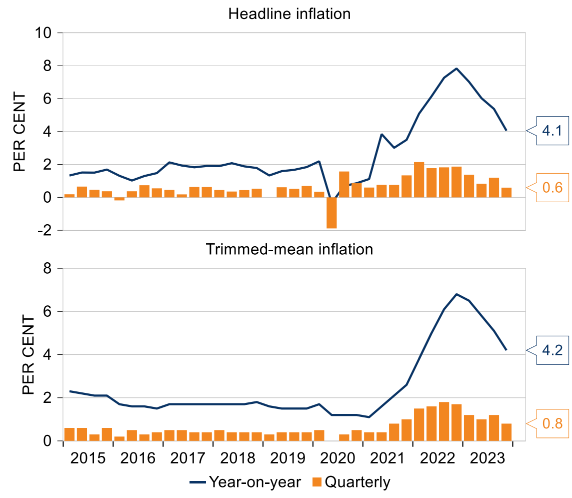
REVIEW:

- CPI inflation slowed sharply in the December quarter, taking annual headline inflation to its lowest rate in two years.
  - Headline CPI inflation eased to 0.6 per cent in the quarter, which saw annual inflation fall sharply from 5.4 to 4.1 per cent. Underlying inflation also eased, with annual trimmed-mean inflation slowing from 5.1 to 4.2 per cent.
  - These improvements largely reflected declines in tradable and goods prices, though market services inflation also eased in the quarter. The largest drags on inflation came from globally traded goods that were previously affected by supply constraints, including furnishings & household equipment and transport prices (eg, fuel and motor vehicles).
- Nominal retail sales were weaker than expected in December, with a 2.7 per cent fall in the month more than offsetting the 2.2 per cent rise in November. Retail sales growth was just 0.8 per cent over the year, which is its slowest annual pace since July 2000 (outside of the COVID-19 lockdown periods).
- Employment fell sharply by 65.1k in December, following strong increases in October and November. The unemployment rate was unchanged at 3.9 per cent, with lower employment offset by a fall in the participation rate. Looking through the monthly volatility, employment growth slowed towards the end of 2023 and the unemployment rate drifted higher.
- Job advertisements and vacancies also point to a softening of labour market conditions. Job vacancies fell by 0.7 per cent over the three months to November 2023, marking the sixth consecutive quarterly decline. Similarly, SEEK job ads are 17 per cent lower over the past year and 33 per cent lower than their May 2022 peak. Despite these declines, job vacancies and advertisements remain well above their pre-COVID levels.
- Measures of consumer sentiment remained low in January. The Westpac-Melbourne Institute Consumer Sentiment Index declined by 1.3 per cent, with the latest read in the bottom seven per cent of all observations since the survey started in the mid-1970s. ANZ-Roy Morgan Australian Consumer Confidence also remains well below its average level, despite a modest improvement in January.
- The NAB Business Survey pointed to a fall in business conditions in December, with conditions now just slightly above their long-run average. Business confidence rebounded after a sharp fall in November, though it remains below average. Most importantly, the quarterly rate of price and cost growth slowed sharply in December. Growth in labour costs eased to 1.8 per cent (from 2.3 per cent), input costs to 1.6 per cent (from 2.5 per cent) and retail prices to 0.9 per cent (from 1.2 per cent).
- The Australian Government announced changes to the previously legislated 'Stage 3 tax cuts'. Under the proposed changes, tax cuts for those earning more than $200,000 will fall from $9075 to more than $4529, while those on $70,000 will receive $1,429 (up from $625). Those earning $40,000 will receive $654 (previously $0). According to Federal Treasury, the changes are '*broadly revenue neutral, will not add to inflationary pressures and will support labour supply*.'

WHAT TO WATCH:

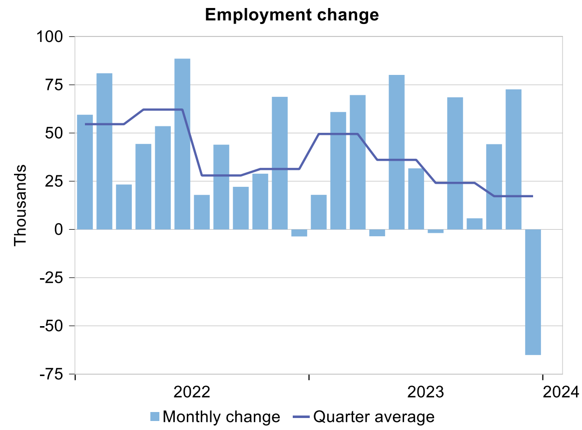
While the RBA is widely expected to keep the cash rate unchanged at 4.35 per cent at its February Board meeting (5-6 February), the post-meeting statement will provide insights into how it is viewing the recent run of soft data. The Labour Force Survey (15 February) will also be closely watched to see whether the weakness in December continued in January. Other key data out in the month include retail sales volumes (2 February) and the wage price index (21 February) for Q4, as well as the monthly CPI indicator (28 February) for January.

CHART 1: HEADLINE AND TRIMMED-MEAN INFLATION HAVE BOTH FALLEN SHARPLY FROM THEIR Q4 2022 PEAKS



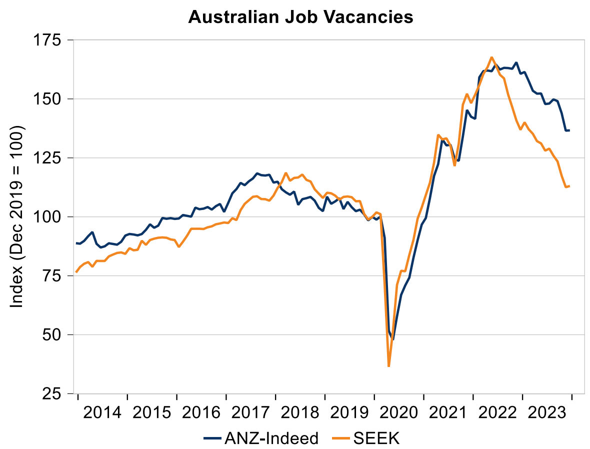
Source: Australian Bureau of Statistics, QTC, Macrobond

CHART 2: QUARTERLY EMPLOYMENT GROWTH CONTINUED TO EASE TOWARDS THE END OF 2023



Source: Australian Bureau of Statistics, QTC, Macrobond

CHART 3: SEEK JOB ADS HAVE FALLEN BY A THIRD FROM THEIR MAY 2022 PEAK



Source: ANZ-Indeed, SEEK Australia, QTC, Macrobond

International economy

SUMMARY:

Major central banks kept policy settings unchanged at their January meetings as inflationary pressures continued to ease. The expected continuation of this process and orderly moderation in economic momentum has seen policymakers increasingly highlight that rate cuts could be forthcoming, though at a slower pace than markets have priced. Several key US data releases pointed to slightly stronger-than-expected economic conditions in December.

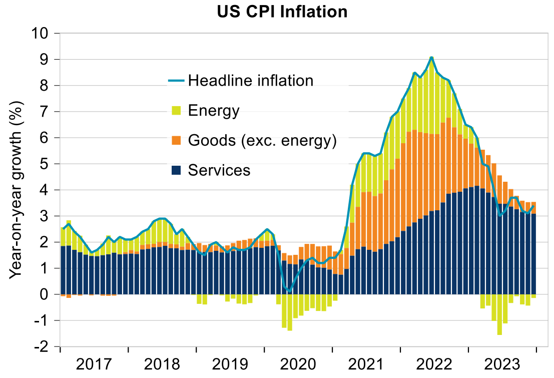
REVIEW:

- Most major central banks have left monetary policy unchanged in recent meetings.
  - The US Federal Open Markets Committee (FOMC) Reserve left the target range for the federal funds rate unchanged at 5.25-5.5% at its January meeting. The Committee now considers the risks employment and inflation are '*moving into better balance*' and perhaps as a result, removed the tightening bias from the statement. That is, the reference to '*the extent of any additional policy firming*' was replaced with '*the Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 per cent*'.
  - The ECB left its policy rates and formal guidance unchanged at its January meeting. During the press conference, President Lagarde noted that the consensus of the Governing Council was that discussing rate cuts was 'premature' and that policy should remain data dependent. Lagarde also acknowledged that 'the disinflation process is at work' and that inflation would 'ease further over the course of the year'.
  - The Bank of Japan (BoJ) kept policy settings unchanged at its January meeting, with this decision supported by a slowing of inflation in the December CPI release. Specifically, Japan's core CPI inflation (excluding fresh food) slowed to 2.3 per cent over the year to December, marking the second consecutive month of slower core inflation.
- US CPI inflation, retail sales and labour market data were stronger-than-expected in December, while other second-tier data were mixed.
  - US CPI inflation was stronger than expected in December. Annual headline CPI inflation increased from 3.1 to 3.4 per cent, while core inflation eased one-tenth to 3.9 per cent.
  - Retail sales increased by 0.6 per cent in December, supported by strong motor vehicle sales and online purchases. Core retail sales also increased by more than expected.
  - Non-farm payrolls rose by a larger-than-expected 216k in December and the unemployment rate was unchanged at 3.7 per cent.
- UK headline inflation increased to 4.0 per cent (year-on-year), supported by a rise in alcohol and tobacco prices. Core inflation remained high at 5.1 per cent.
- In the euro area, the ECB's January Bank Lending Survey pointed to credit standards continuing to tighten for firms and households, though at a slower pace. Loan demand again contracted for both firms and households, though the pace at which it did so eased.
- China's GDP grew 5.2 per cent in 2023, though annual growth benefited from a low base given Zero-COVID restrictions in 2022. Quarterly growth slowed from 1.5 to 1.0 per cent in the December quarter, suggesting that momentum waned towards the end of 2023.
- There continues to be signs of weakness in China's property sector. Real estate investment has fallen by 9.6 per cent over the past year, while property prices remain subdued. A Hong Kong court issued the liquidation of Chinese property developer Evergrande, which was once China's largest property developer and holds USD 333 billion in liabilities.
- Chinese authorities have recently attempted to stem the property sector slowdown by broadening developers access to commercial loans. The People's Bank of China (PBoC) also cut the reserve requirement ratio (RRR) by 50 basis points and lowered SME and agricultural lending rates by 25 basis points to support lending activity.

WHAT TO WATCH:

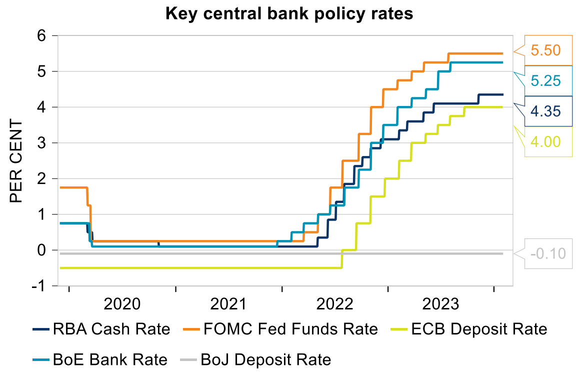
Markets are factoring in rate cuts starting in the middle of the year (US) or a few months earlier (euro area) or later (UK). Inflation continuing to moderate as it has recently will be front of mind for policymakers in determining whether market expectations are validated.

CHART 4: IMPROVEMENTS IN US CPI INFLATION HAVE BEEN DRIVEN BY SLOWER ENERGY AND GOODS PRICES



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

CHART 5: MAJOR CENTRAL BANKS HAVE PAUSED RATE HIKES IN RECENT MEETINGS



Source: Reserve Bank of Australia, Federal Reserve, European Central Bank, Bank of England, Bank of Japan, People's Bank of China, QTC, Macrobond

CHART 6: CHINA'S GDP GREW 5.2 PER CENT IN 2023, THOUGH MOMENTUM WANED TOWARDS THE END OF THE YEAR

Source: China National Bureau of Statistics (NBS), QTC, Macrobond

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