

Weekly Economics and Markets Review

- The Federal Government's Mid-Year Economic and Fiscal Outlook (MYEFO) showed a small improvement in the underlying cash balance in 2024-25, though this was more than offset by larger deficits over the rest of the forward estimates.
- Consumer sentiment fell in December, with Australian households more downbeat on the outlook for the economy.
- Financial market expectations for US interest rates shifted higher in response to the Federal Reserve signalling a slower pace of rate cuts over the coming year.

Week in review

Domestic

- The Federal Government's **Mid-Year Economic and Fiscal Outlook (MYEFO)** projects an underlying cash deficit of \$26.9 billion for 2024-25, an improvement of \$1.3 billion from the May Budget. This mainly reflects higher personal income tax receipts due to ongoing strength in the labour market and strong investment returns.
- The improvement in 2024-25 is more than offset by larger deficits over the remainder of the forward estimates. Over the four years to 2027-28, the cumulative deficit for the underlying cash balance is projected to be \$21.7 billion higher than in the May Budget.
- Larger underlying cash deficits over the forward estimates reflect both policy changes (\$17.5 billion) and parameter variations (i.e. economic conditions; \$4.2 billion). Key policy changes include extra funding for childcare workers, pharmaceuticals, the NDIS, early childhood education, the energy transition, road and rail infrastructure, and healthcare.
- Net debt is now projected to be \$708.6 billion (22.4 per cent of GDP) by June 2028, up from \$697.5 billion (21.9 per cent of GDP) in the May Budget. There were larger revisions to gross debt, which is now expected to be \$1.161 trillion (36.7 per cent of GDP) by June 2028, up from \$1.112 trillion (34.9 per cent of GDP) in May.
- MYEFO's outlook for GDP growth has been revised slightly lower for 2024-25, from 2.0 per cent to 1.75 per cent. The unemployment rate is expected to stabilise at 4.5 per cent by mid-2025, broadly in line with the RBA's forecasts.
- **Westpac-Melbourne Institute consumer sentiment** fell by 2 per cent in December. Consumers are more downbeat on the outlook compared to November, with both the 12-month and 5-year ahead outlook sub-indexes unwinding around half of the rally seen over the previous two months.

Offshore

- The **US Federal Reserve (Fed)** reduced interest rates by a further 25 basis points to 4.25-4.50 per cent and signalled a slower pace of rate cuts over the coming year. The median outlook for the Fed funds rate from the FOMC members was revised higher, with members now only seeing two 25 basis point rate cuts in 2025 (from four previously). This sees the Fed funds rate reach 3.75-4.0 per cent by the end of 2025.

- Fed Chair Powell said that while monetary policy is still restrictive, the Fed funds rate is getting closer to 'neutral'. Powell also noted that while he is 'optimistic' about economic conditions, he would not settle for inflation remaining above the 2 per cent target.
- Most **other central banks** held rates unchanged over the past week, with Sweden's Riksbank being the exception.
 - The Bank of Japan maintained its benchmark interest rate at 0.25 per cent. In the post meeting press conference, Governor Ueda dented confidence a hike is coming as soon as January, which saw the yen move sharply lower.
 - The Bank of England kept its benchmark bank rate on hold at 4.75 per cent, though policymakers were split over whether to cut rates.
 - The Norges Bank (Norway's central bank) held its policy rate unchanged at 4.50 per cent, while the Riksbank (Sweden's central bank) cut its key interest rate by 25 basis points.
- Recent **US economic data** continue to point to a two-speed economy, with improvements in the services and retail sectors being partly offset by weaker industrial and manufacturing activity.
 - Headline retail sales growth was stronger than expected at 0.7 per cent, while the control group (which contributes directly to GDP) was in line with expectations. S&P Global's Services PMI was also noticeably stronger than expected in December, pointing to ongoing resilience in consumer spending.
 - In contrast, recent data are consistent with weak activity in the industrial sector. Industrial production fell by 0.1 per cent in November and manufacturing production rose by a modest 0.2 per cent. There was also a sharper-than-expected fall in S&P Global's Manufacturing PMI and the Empire Manufacturing index in December.
- In the **UK**, the improvement in inflation appears to have stalled in recent months. Annual headline CPI inflation increased to 2.6 per cent in November (from 2.3 per cent), while core inflation accelerated to 3.5 per cent (from 3.3 per cent).
- **China's** retail sales rose by just 3.0 per cent over the year to November, marking the slowest pace in three months and falling well below consensus expectations for 5.0 per cent growth. Fixed asset investment also slowed slightly, while industrial production growth remained robust.

Markets

US Treasury yields increased after the US Federal Reserve signalled that the pace of interest rate cuts next year is likely to be slower. The Treasury curve also steepened sharply with the 2s10s curve increasing by 12 basis points. The prospect of higher interest rates saw equities fall, while most currencies were weaker against the US dollar. Global oil prices fell as central bank commentary added to concerns that weak economic activity could dent demand for oil next year.

Economic and Market Calendar

DATE	DETAILS
Domestic	Tuesday: RBA Minutes (December meeting)
Offshore	US: PCE inflation (Nov), University of Michigan Consumer Sentiment (Dec F), Conference Board Consumer Sentiment (Dec) JP: Tokyo CPI (Dec) UK: GDP (Q3 F)

Economic and Financial Market Charts

CHART 1: THE FEDERAL GOVERNMENT'S MYEFO SHOWED A SMALL IMPROVEMENT IN THE UNDERLYING CASH BALANCE IN FY25, THOUGH THIS IS MORE THAN OFFSET BY LARGER DEFICITS FROM FY26

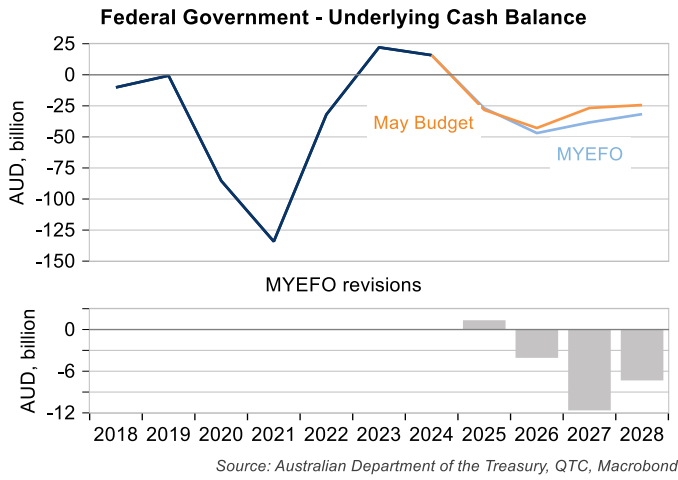


CHART 2: UNDERLYING CASH DEFICITS OVER THE FORWARD ESTIMATES REFLECT BOTH STRUCTURAL FACTORS AND (TO A LESSER EXTENT) A CYCLICAL SLOWDOWN

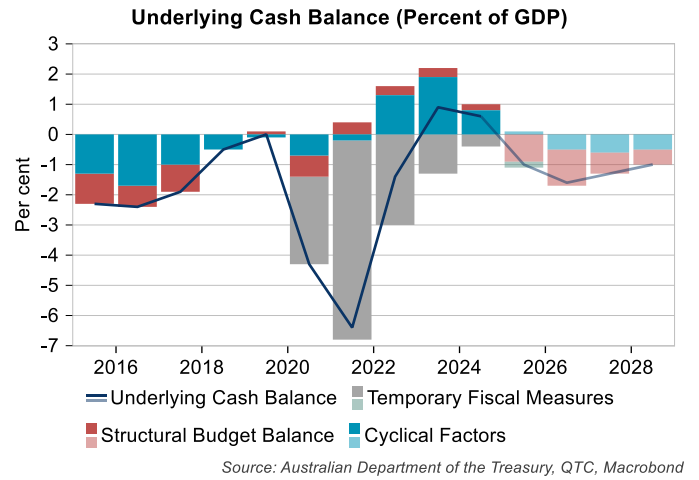


CHART 3: GROSS DEBT IS HIGHER OVER THE FORWARD ESTIMATES RELATIVE TO THE MAY BUDGET, DRIVEN BY A DETERIORATION IN THE HEADLINE CASH BALANCE

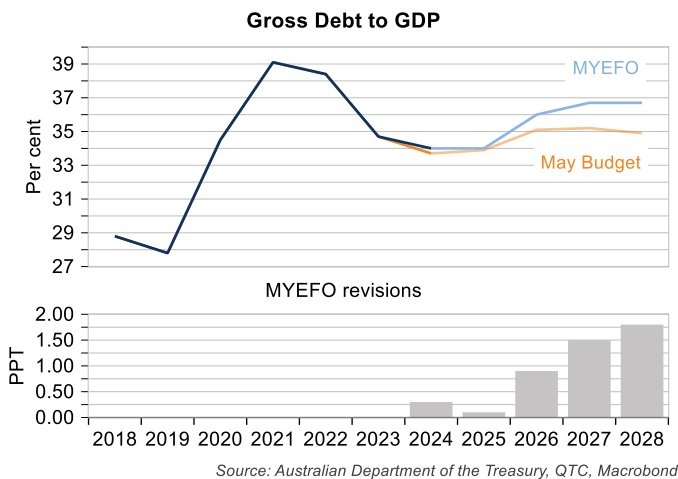


CHART 4: INCREASES IN GROSS DEBT AND HIGHER YIELDS IS EXPECTED TO PUT UPWARD PRESSURE ON FEDERAL GOVERNMENT INTEREST PAYMENTS OVER THE COMING DECADE

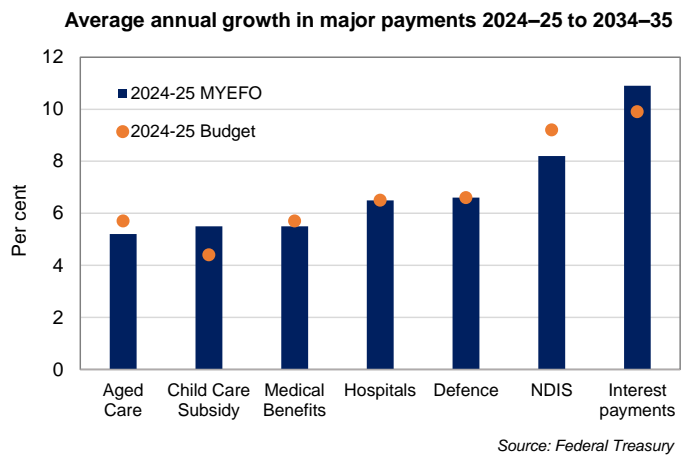


CHART 5: CONSUMER SENTIMENT HAS IMPROVED SINCE EARLY 2024, BUT REMAINS WELL BELOW ITS LONG-RUN AVERAGE

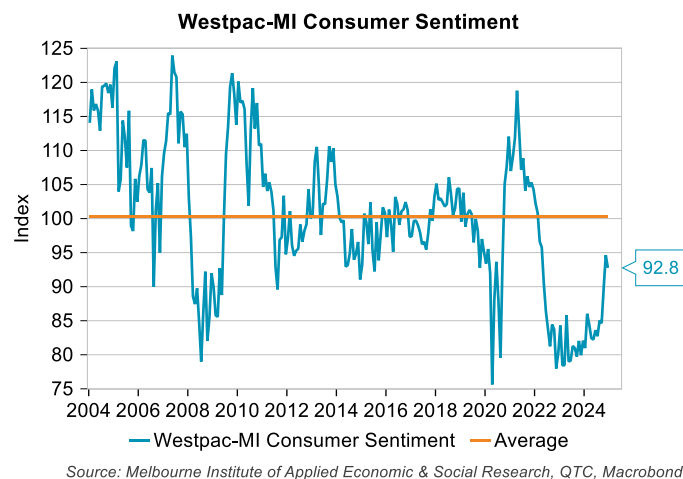
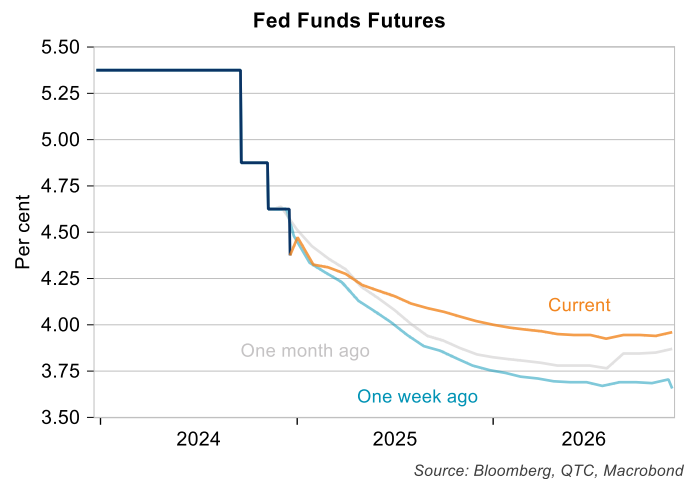


CHART 6: IN THE US, EXPECTATIONS FOR THE FED FUNDS RATE SHIFTED HIGHER IN RESPONSE TO THE FED SIGNALING A SLOWER PACE OF INTEREST RATE CUTS OVER THE COMING YEAR



Financial markets data table

The table below shows yields for bonds issued by the central financing authorities of various state governments in Australia as well as those on bonds issued by the Australian and US Governments. Further, there are values for the Australian dollar against a range of currencies, and major exchange rates against the US dollar. The change in these yields and rates over different time periods is also included.

MATURITY	ISSUER	YIELD	CHANGE (BASIS POINTS)			EQUITIES	RATE	CHANGE (PER CENT)		
			1 WEEK	1 MONTH	1 YEAR			1 WEEK	1 MONTH	1 YEAR
3 Year	QTC	4.05	4	-28	9	AUD/USD	0.63	-2.04	-4.13	-7.93
	NSWTC	4.04	5	-28	8	AUD/EUR	0.60	-1.11	-2.18	-2.46
	TCV	4.09	3	-27	5	AUD/GBP	0.50	-0.96	-3.21	-7.12
	WATC	4.00	5	-28	6	AUD/JPY	98.57	1.45	-1.89	2.16
	Australian Government	3.81	8	-31	10	AUD/CAD	0.90	-0.78	-1.46	-0.56
	US Government	4.34	17	9	28	AUD/NZD	1.11	0.29	0.19	2.50
5 Year	QTC	4.25	5	-31	22	AUD/SGD	0.85	-0.95	-2.51	-5.58
	NSWTC	4.25	5	-30	18	AUD/HKD	4.86	-2.08	-4.27	-8.37
	TCV	4.32	5	-30	19	AUD/KRW	904.99	-0.80	-0.30	2.65
	WATC	4.20	6	-31	19	AUD/CNY	4.56	-1.67	-3.37	-5.90
	Australian Government	3.90	10	-31	16	AUD/INR	53.21	-1.75	-3.31	-5.84
	US Government	4.42	24	16	54	MAJOR CURRENCIES				
7 Year	QTC	4.56	5	-31	31	EUR/USD	1.04	-0.93	-1.99	-5.60
	NSWTC	4.55	5	-30	24	GBP/USD	1.25	-1.09	-0.95	-0.87
	TCV	4.64	5	-30	26	USD/JPY	157.68	-3.56	-2.34	-10.95
	WATC	4.48	5	-31	25	USD/CHF	1.11	-0.93	-1.76	-4.79
	Australian Government	4.08	9	-32	20	USD/CNY	7.30	-0.37	-0.79	-2.21
	US Government	4.50	25	18	60	MAJOR COMMODITIES				
10 Year	QTC	4.97	5	-29	42	Brent Crude Oil	72.62	-1.08	-0.94	-8.53
	NSWTC	4.96	5	-30	33	Gold	2,596	-3.16	-1.37	26.89
	TCV	5.04	4	-30	30	Copper	9,029	-0.69	-0.65	5.04
	WATC	4.80	5	-30	33	Iron Ore	101.81	-4.01	0.89	-15.07
	Australian Government	4.27	9	-31	23					
	US Government	4.56	24	17	68					

Note: The Australian yield data (national and state) is sourced from QTC while the exchange rate and US yield data is from *Macrobond*.

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