JANUARY Monthly Economics and Markets Review

Overview

Domestic economy

There were mixed signals on the domestic economy in January. Labour market conditions remained resilient though inflation moderated by more than expected. Business conditions and confidence improved while consumer confidence ebbed.

International economy

Readings on the US economy continue to be firm while those on China's economy again strengthened. On the central bank front, the US FOMC appeared to flag a period of steady rates. This is the opposite of the indications given by the Bank of Japan who are guiding towards rates moving higher. US trade policy was a key area of focus for markets following President Trump's inauguration.

Interest rates

Australian Government three-year bond yields fell 10 basis points in January while 10-year yields dipped three basis points. That front-end yields moved by more reflected softer-than-expected inflation data for Q4 which saw markets add to pricing for RBA rate cuts. News around potential tariff increases and their effects also pushed yield moves around during the month.

MATURITY	ISSUER	YIELD	1 MONTH BPS CHANGE	1 YEAR BPS CHANGE
3 Year	QTC	4.06	1	22
	Australian Government	3.80	-2	24
	US Government	4.24	-3	10
5 Year	QTC	4.35	6	41
	Australian Government	3.95	2	33
	US Government	4.33	-5	34
7 Year	QTC	4.71	9	52
	Australian Government	4.18	4	38
	US Government	4.44	-4	44
10 Year	QTC	5.19	13	66
	Australian Government	4.42	7	41
	US Government	4.54	-3	52

AUSTRALIAN DOLLAR CROSSES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
AUD/USD	0.6237	0.3%	-4.4%
AUD/EUR	0.6001	0.4%	-0.6%
AUD/GBP	0.5022	1.4%	-2.6%
AUD/JPY	96.5874	-1.1%	-0.1%

MAJOR CURRENCIES	RATE	1 MONTH % CHANGE	1 YEAR % CHANGE
EUR/USD	1.0394	-0.1%	-3.7%
GBP/USD	1.2419	-1.0%	-1.9%
USD/JPY	154.86	1.4%	-4.4%
USD/CNY	7.1868	1.5%	-0.9%

Prices sourced from Macrobond and QTC 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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FUNDING AND MARKETS DIVISION
Economics, Credit and Markets Research

Michael Anthonisz
T: 07 3842 4711
E: manthonisz@qtc.com.au

HAVE A QUESTION?
Ask our economist

QUEENSLAND TREASURY CORPORATION
GPO Box 1096 Brisbane Queensland 4001
T: 07 3842 4600 www.qtc.com.au

Domestic economy

SUMMARY:

There were mixed signals on the domestic economy in January. Labour market conditions remained resilient though inflation moderated by more than expected. Business conditions and confidence improved while consumer confidence ebbed.

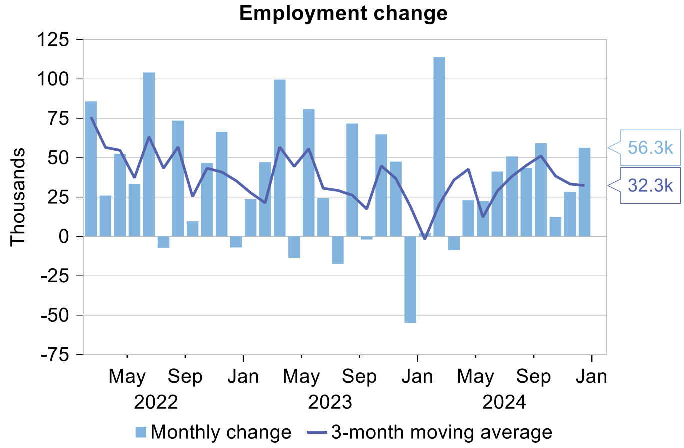
REVIEW:

- According to the ABS' CPI release for Q4:
  - Headline inflation was 0.2 per cent in Q4 to be up 2.4 per cent over the year. This was 0.4 percentage points slower than the prior quarter. Electricity subsidies lowered inflation over the quarter and the year.
  - Trimmed mean inflation was 0.5 per cent in Q4 to be up 3.2 per cent over the year. This was 0.3 percentage points slower than the prior quarter. Part of the moderation in trimmed mean inflation is due to that seen in the housing categories – new dwelling construction costs and rents – that have a large weight in the CPI. This will be pleasing for the RBA, though the softening in rents is overstated by the impact of rental subsidies.
- According to the ABS Labour Force report for December:
  - Employment lifted 56,300 in December as a rise in part-time (+80,000) more than offset a decline in full-time work (-23,700). The result was above consensus expectations for a 15,000 increase with the miss seemingly reflecting recent shifts in seasonal patterns around the summer holiday period.
  - The unemployment rate increased one-tenth to 4.0 per cent as the gain in employment was outpaced by strong labour force growth (+66,700). The strength in labour force growth reflected ongoing population growth (+42,500) and a surprise increase in the participation rate to 67.1 per cent.
  - Other key indicators were also firm. The employment-to-population ratio rose to a record high of 64.5 per cent and the underemployment rate fell one-tenth to 6.0 per cent.
- Job vacancies rose 4.2 per cent in the three months to November in the first quarterly increase in 2.5 years. The annual rate of growth was less negative (-10.3 per cent from -17.1 per cent) but vacancies are still roughly 27 per cent lower than the peak seen in May 2022. The lift in vacancies on the quarter was due more to the private (+4.7 per cent) than the public (+0.4 per cent) sectors.
- The *Westpac-Melbourne Institute Consumer Sentiment Index* fell for the second straight month in January, driven by a decline in perceptions of family finances. The 'time to buy a dwelling' index was up 10.2 per cent, consistent with expectations for house prices falling 5.9 per cent.
- Business conditions rebounded in December, partially unwinding a dip in November, with improvements seen across the trading, profitability and employment sub-components. Forward orders moved higher but remain negative, the same outcome observed for business confidence. There was an acceleration in retail and final product prices as well as for purchase costs, though a small easing in the pace of growth in labour costs.

WHAT TO WATCH:

There is now a clear and sustained slowdown in key measures of underlying inflation. Financial markets took this as a sign that the RBA will have no reason not to cut rates at its February meeting by pricing in a roughly 90 per cent probability that it would do so following the CPI. This decision will be important to watch, as will any commentary accompanying it. The latter could give clues about the path for policy in the months ahead.

CHART 1: EMPLOYMENT GROWTH CONTINUED TO ACCELERATE IN DECEMBER…

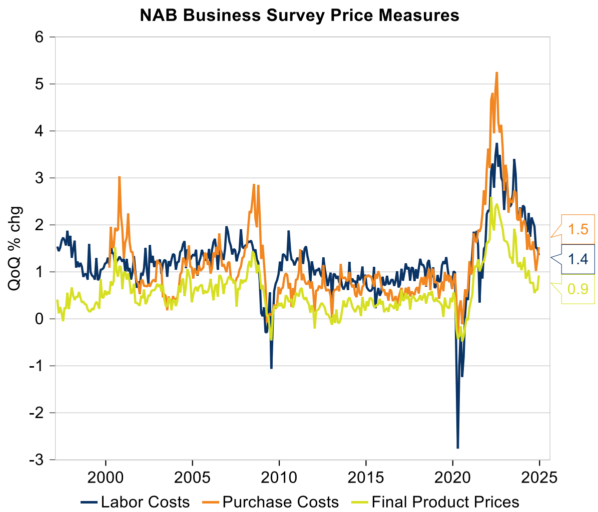


Source: Australian Bureau of Statistics, QTC, Macrobond

CHART 2: …WITH A RISE IN THE EMPLOYMENT-TO-POPULATION TO A RECORD HIGH – ANOTHER POSITIVE SIGN

Source: Australian Bureau of Statistics, QTC, Macrobond

CHART 3: MOST KEY PRICE PRESSURES IN THE NAB BUSINESS SURVEY BUCKED THE RECENT TREND AND ROSE IN DECEMBER



Source: National Australia Bank, QTC, Macrobond

International economy

SUMMARY:

Readings on the US economy continue to be firm while those on China's economy again strengthened. On the central bank front, the US FOMC appeared to flag a period of steady rates. This is the opposite of the indications given by the Bank of Japan who are guiding towards rates moving higher. US trade policy was a key area of focus for markets following President Trump's inauguration.

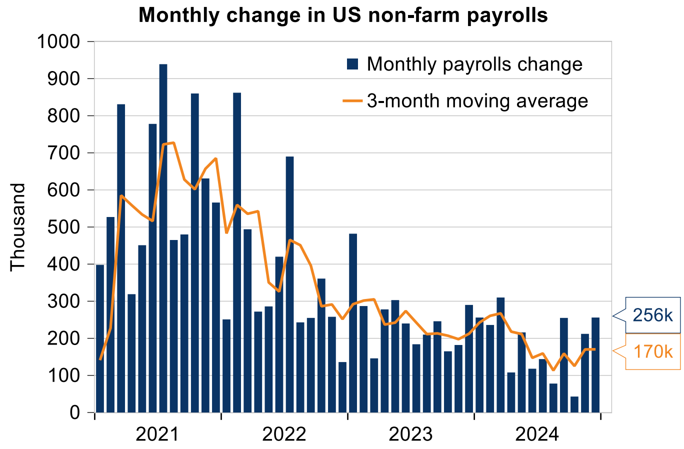
REVIEW:

- Following his inauguration, President Trump signed dozens of executive orders. Some of those include:
  - A memorandum for an *'America First Trade Policy'* to tackle US trade deficits, combat unfair practices like currency manipulation, and review trade agreements.
  - On environmental policy, Trump withdrew from the Paris climate agreement, reduced restrictions on new fossil fuel projects, and initiated the repeal of various pollution and energy-efficiency regulations. He also signed orders to promote oil and gas development in Alaska.
- From the January meetings of global central banks:
  - The FOMC left the target range for the federal funds rate unchanged at 4.25-4.50 per cent. The post-meeting statement appeared to upgrade the Committee's assessment of the labour market by referring to conditions as '*solid*' as opposed to having been easing and noted the unemployment rate had stabilised at a low level. It also removed reference to inflation having '*made progress*' back to the Fed's target, though in the post-meeting press conference, Fed Chair Powell referred to this as a '*language cleanup*'. The press conference was also notable for Powell indicating that the FOMC is not '*in a hurry*' to cut rates further, though it appears to be the case that further cuts are coming with Powell noting that rates remain '*meaningfully restrictive*'.
  - The Bank of Japan raised rates by 25 basis points to 0.50 per cent and flagged further moves if its economic and inflation forecasts are realised.
- In the US:
  - Non-farm payrolls increased by 256,000 in December, around 90,000 higher than the consensus expectations. The unemployment rate fell from 4.2 to 4.1 per cent, against expectations it would remain unchanged.
  - Core retail sales rose by a noticeably stronger-than-expected 0.7 per cent.
  - Core CPI was slightly lower than expectations in December, though there was a rebound in shelter related components as well as volatile items such as airfares plus new and used cars.
- In China:
  - GDP increased by 5.4 per cent over the year to Q4, above expectations for 5.0 per cent growth. On a year-average basis, growth was 5.0 per cent in 2024, meeting China's growth target. This pickup in growth was supported by the various stimulus measures introduced in the second half of 2024.
  - Industrial output was noticeably stronger-than-expanded, increasing by 6.2 per cent over the year to December (compared to a consensus estimate of 5.4 per cent).
  - Retail sales increased 3.7 per cent, exceeding consensus expectations by one-tenth, while fixed asset investment rose 3.2 per cent which was below consensus by one-tenth.
  - The international goods trade surplus reached a record high in USD terms in December as growth in exports outpaced that for imports. The outsized acceleration in exports to the US suggests front-loading ahead of the expected introduction of tariffs on US imports of Chinese goods.
  - Both new loans and new aggregate financing increased by more than expected in December. The increase in both categories was driven by a jump in short-term bill financing and government borrowing respectively.

WHAT TO WATCH:

It is difficult to determine the nature, size, scope and timing of any shifts in US trade policy given volatile news flow on this topic. Still, it is critical to monitor with this arguably the biggest swing factor for the global economy this year.

CHART 4: THE PACE OF US JOBS GROWTH HAS ALSO LEAPT HIGHER IN RECENT MONTHS

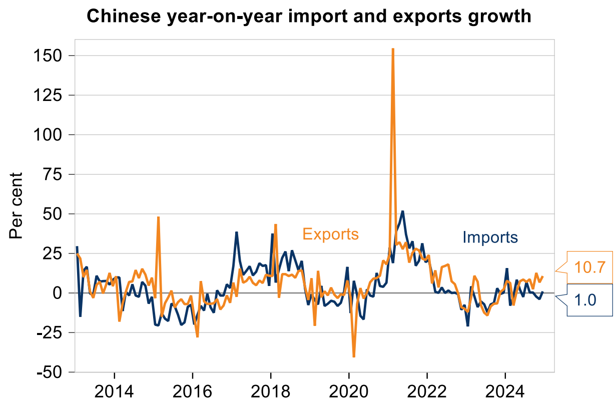


Source: U.S. Bureau of Labor Statistics (BLS), QTC, Macrobond

CHART 5: CHINA'S ECONOMY CONTINUES TO STRENGTHEN WITH GROWTH ACCELERATING FOR THE SECOND STRAIGHT QUARTER IN Q4

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

CHART 6: CHINA'S EXPORTS GROWTH IN DECEMBER APPEARS TO HAVE BEEN SUPPORTED BY FRONT-LOADING AHEAD OF THE POSSIBLE INTRODUCTION OF TARIFFS BY THE US



Source: China General Administration of Customs (GAC), QTC, Macrobond