

GEELONG CHAMBER OF COMMERCE ECONOMIC UPDATE

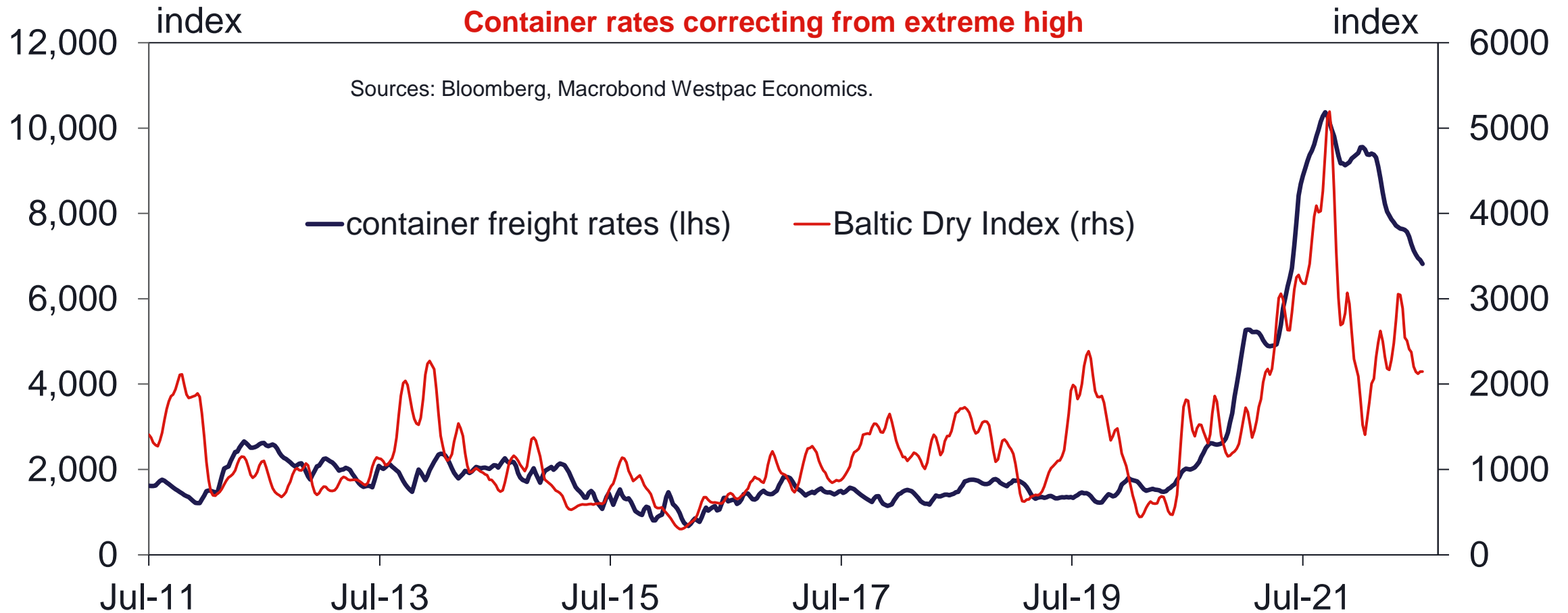
Presented by Westpac Chief Economist, Bill Evans

Westpac Institutional Bank

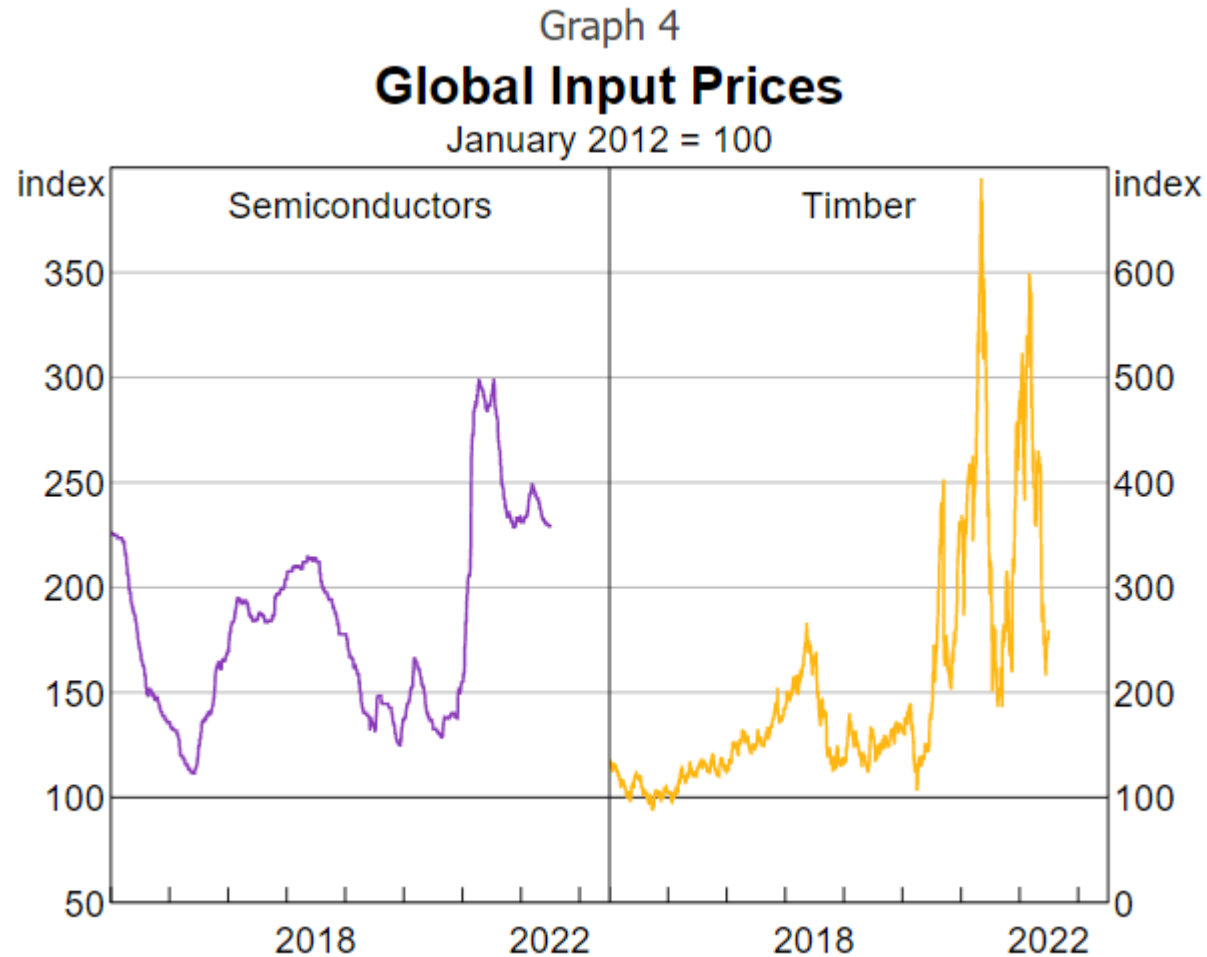
August 2022



Shipping rates ease, container rates fall but still very high



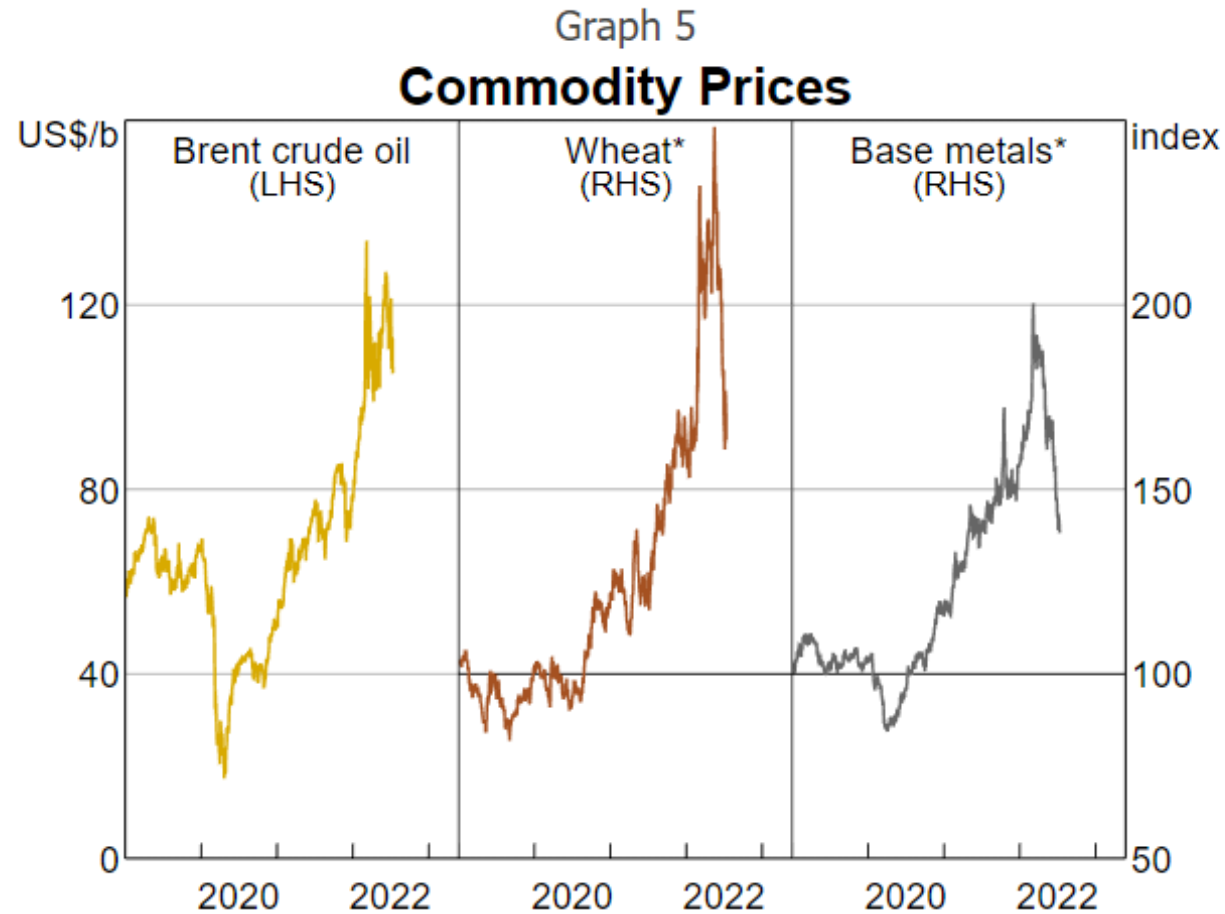
Global input prices – easing as demand slows and supply frees up



Sources: Bloomberg; RBA; Refinitiv



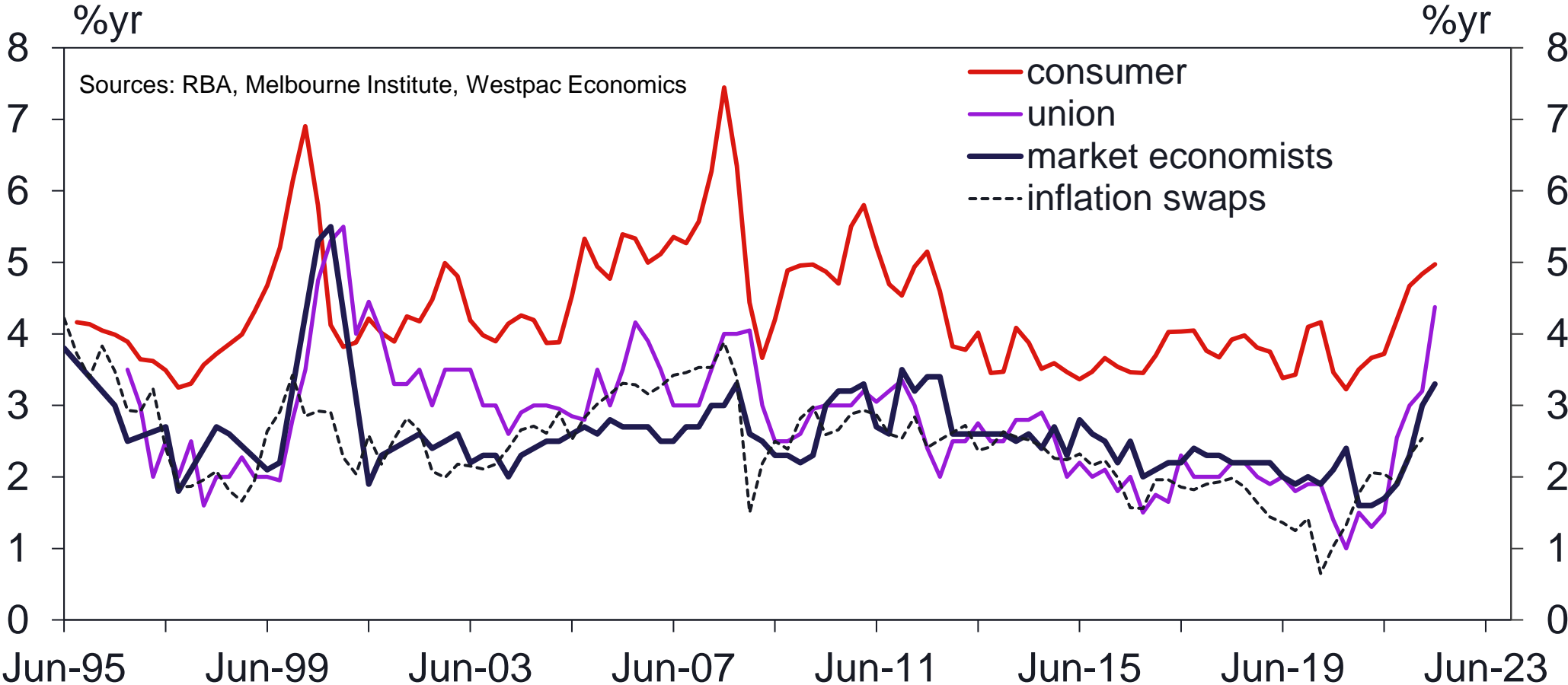
Commodity prices – second inflation stage now easing



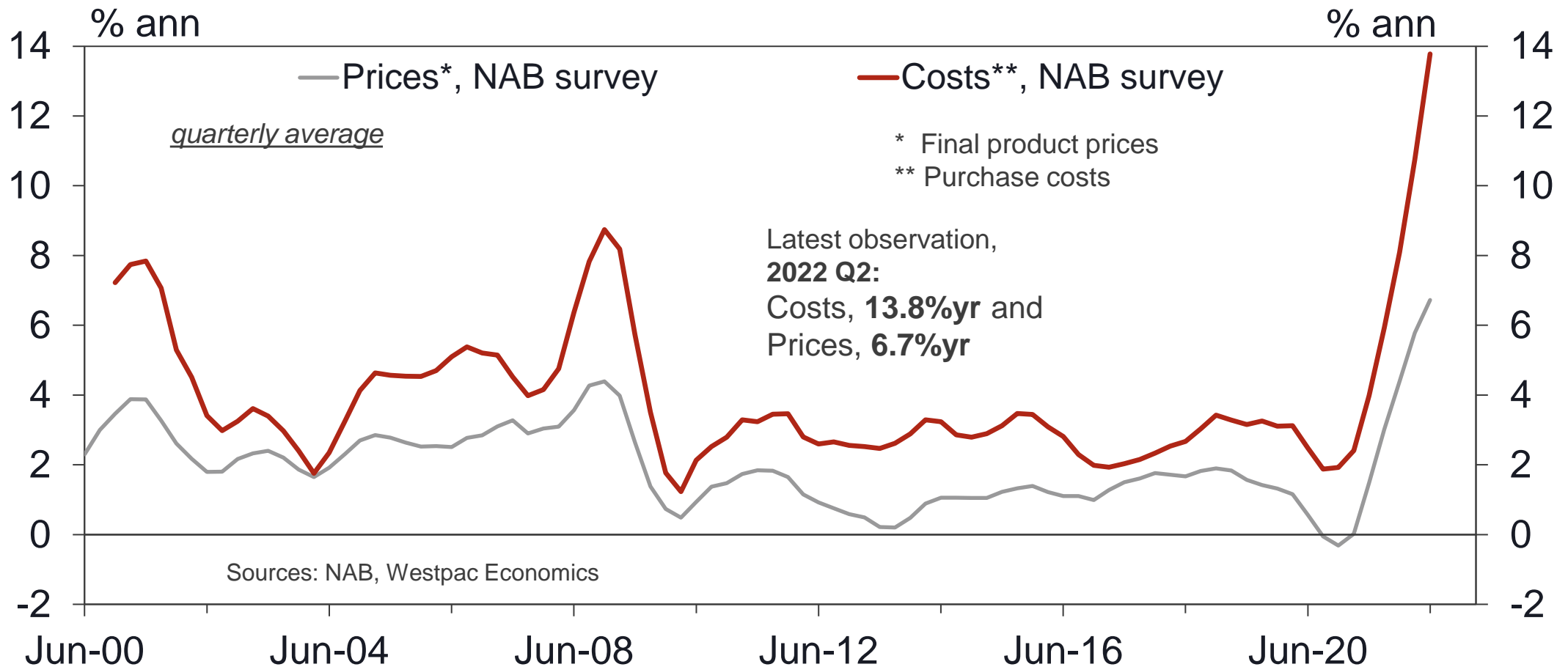
* January 2019 = 100.
Sources: Bloomberg; RBA



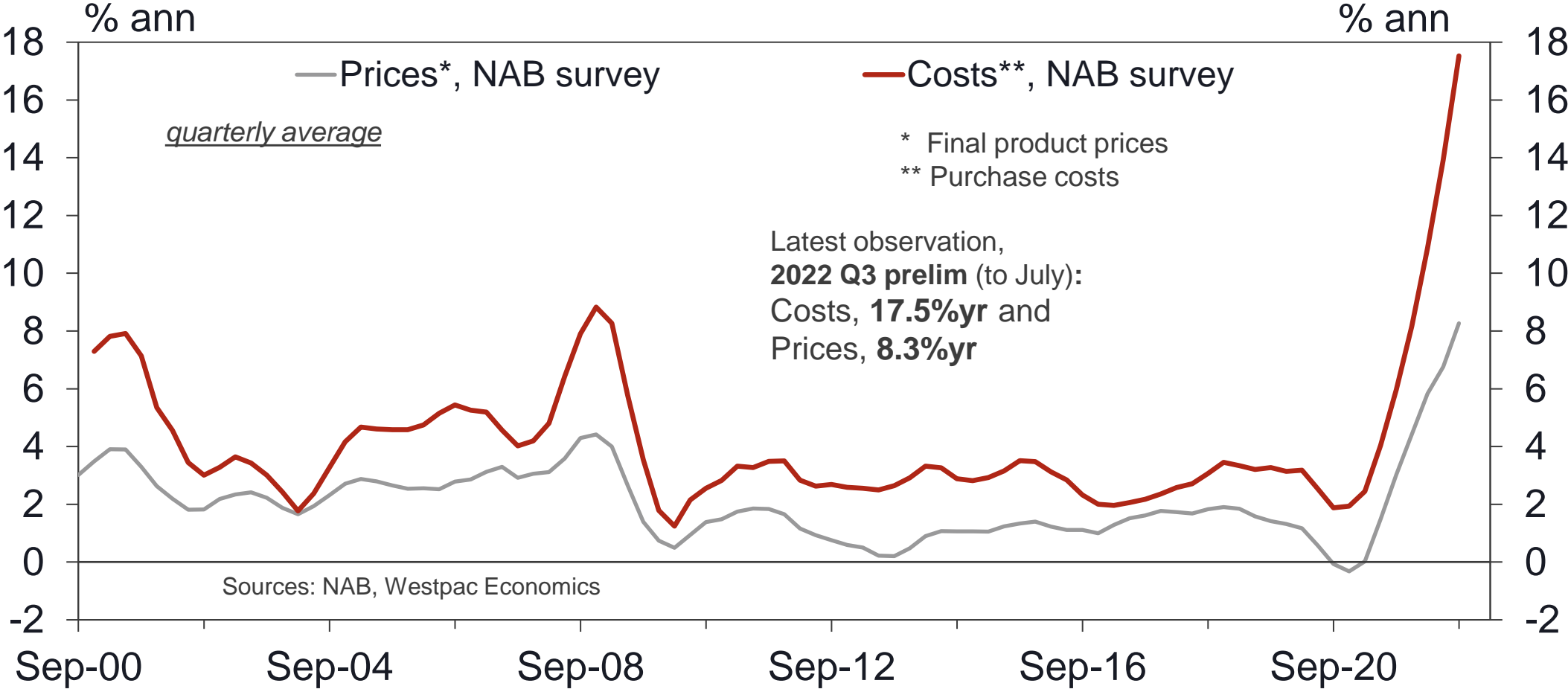
Short term inflation expectations – over 1 year are worrying



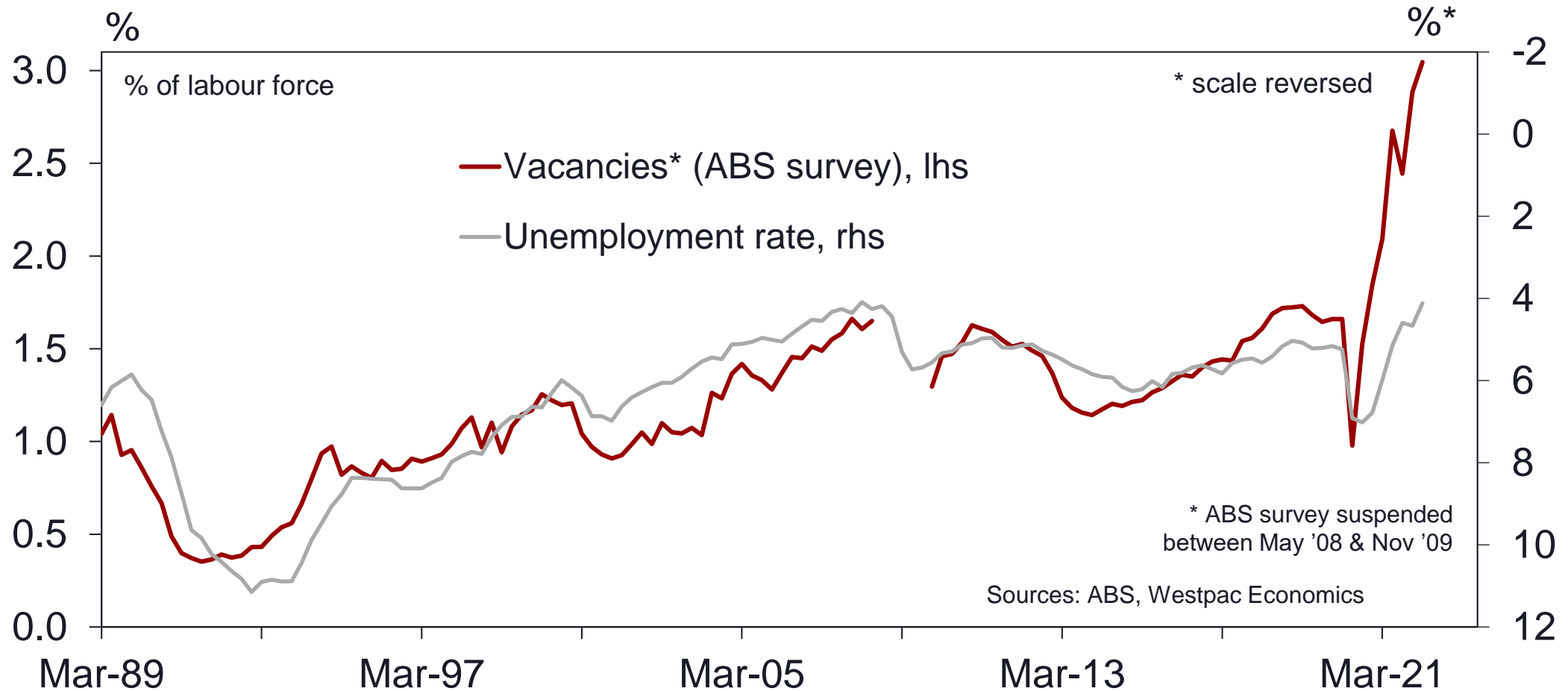
Surging costs leading to price pressures (June)



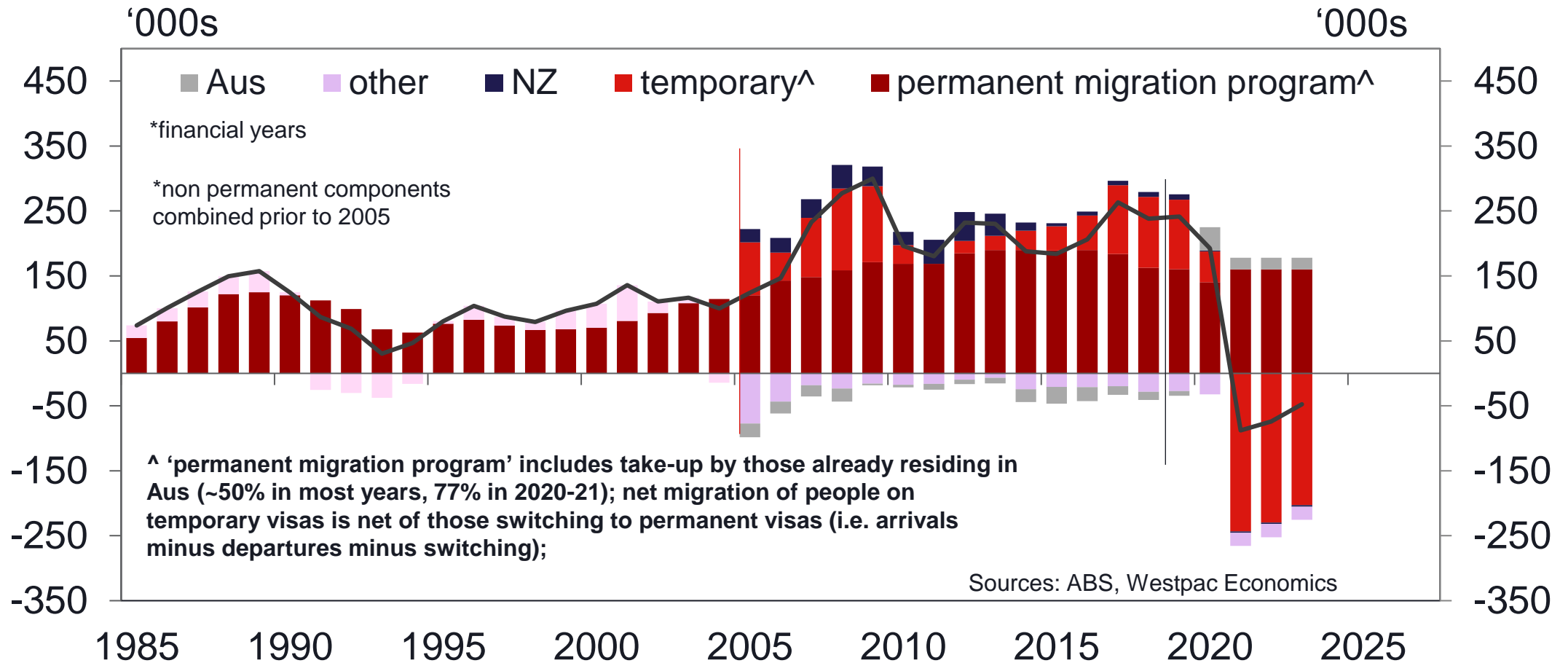
Surging costs leading to price pressures (July)



Australia: Job vacancies pointing to explosive market

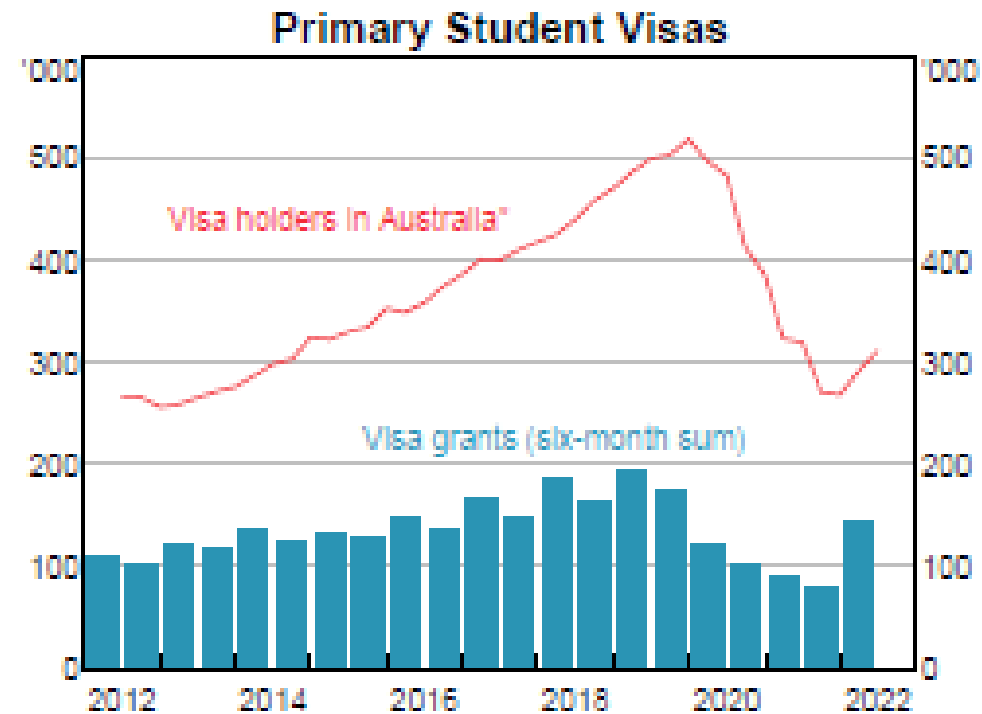


Net migration: major groups



Primary student visas

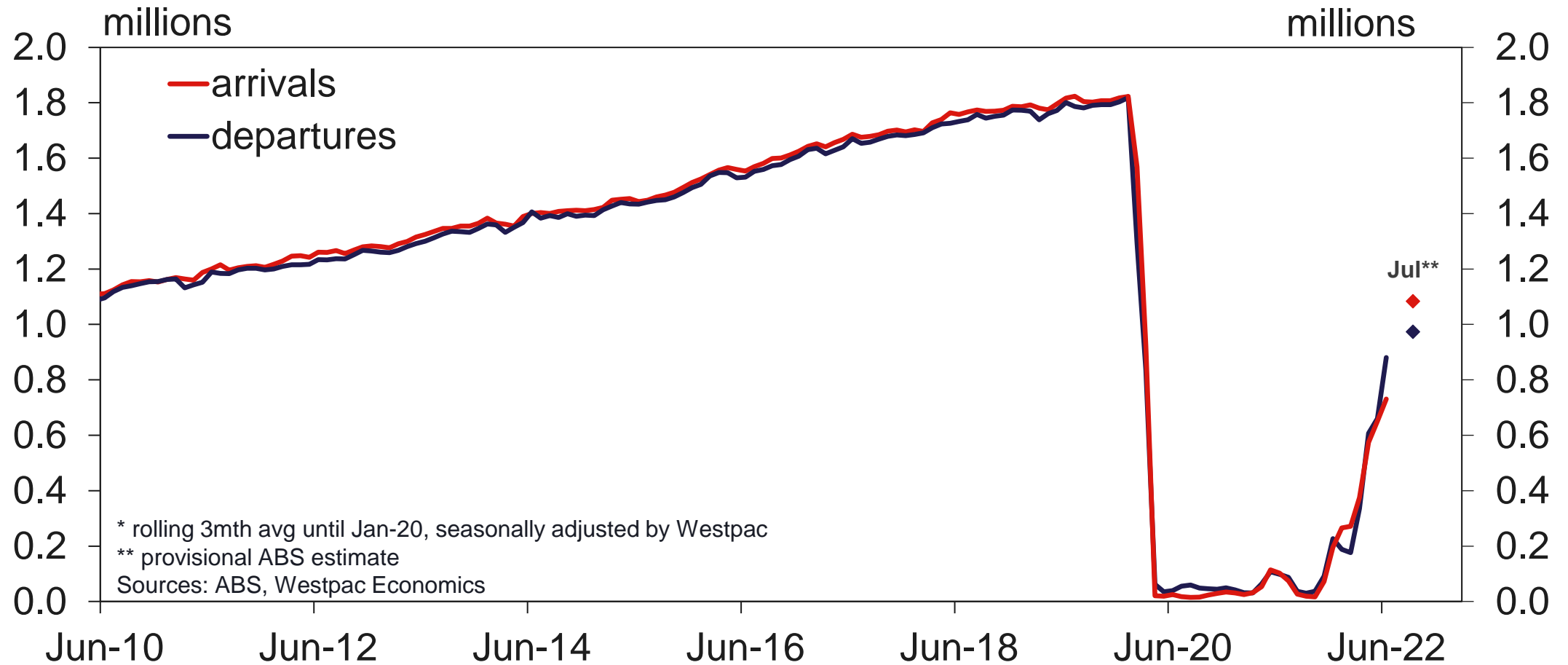
Graph 2.22



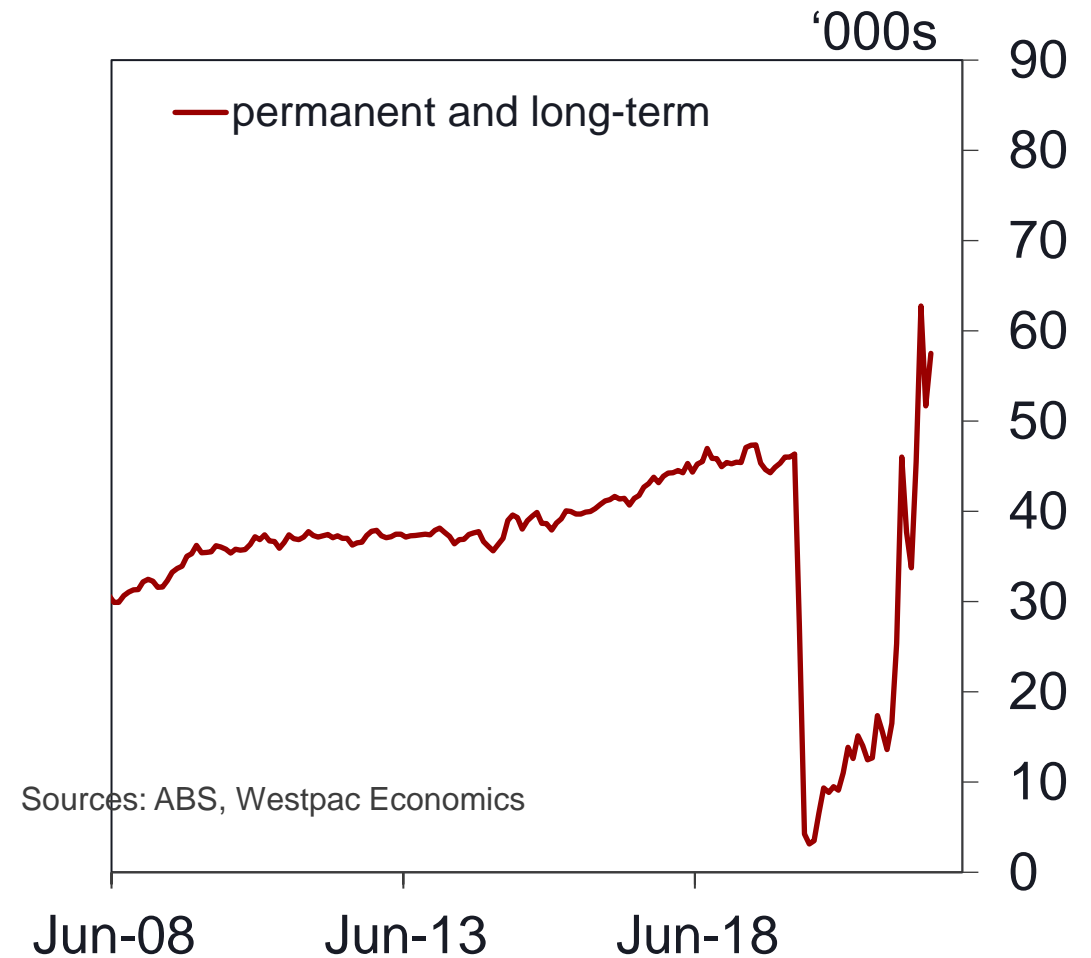
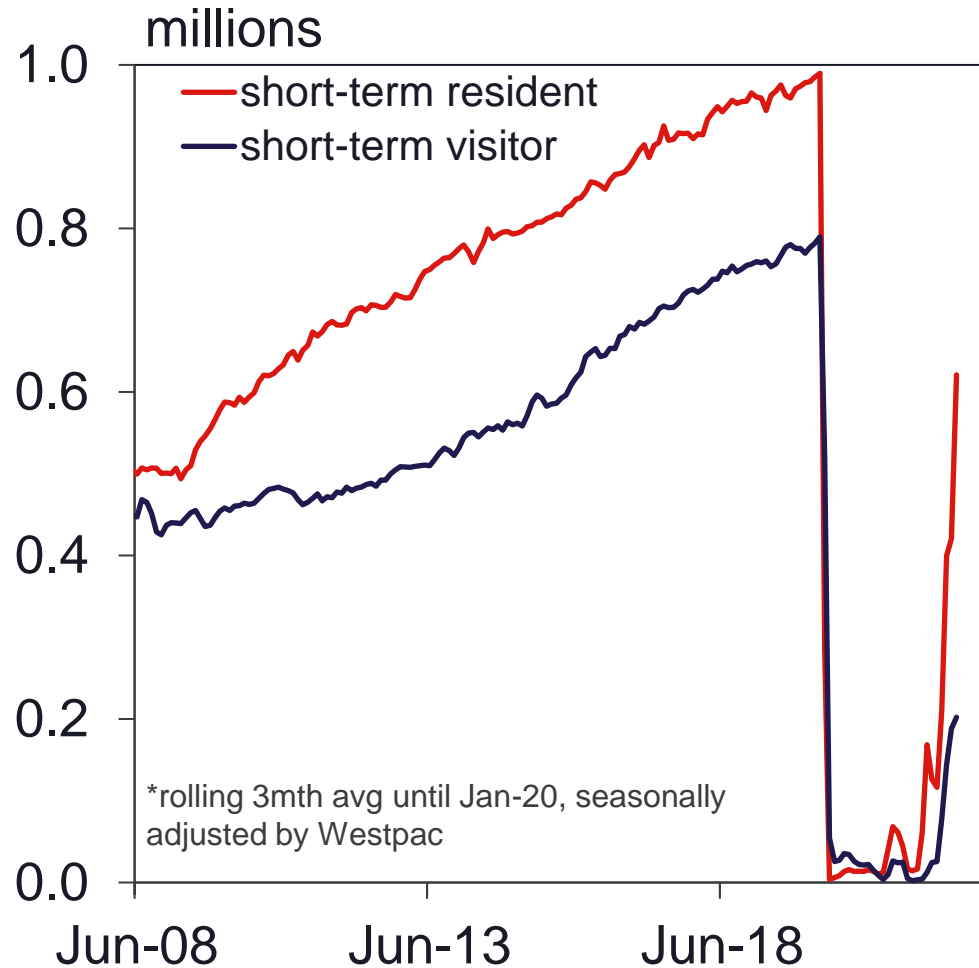
* Seasonally adjusted until March 2020; original data from April 2020 onwards.

Sources: Department of Home Affairs; RBA.

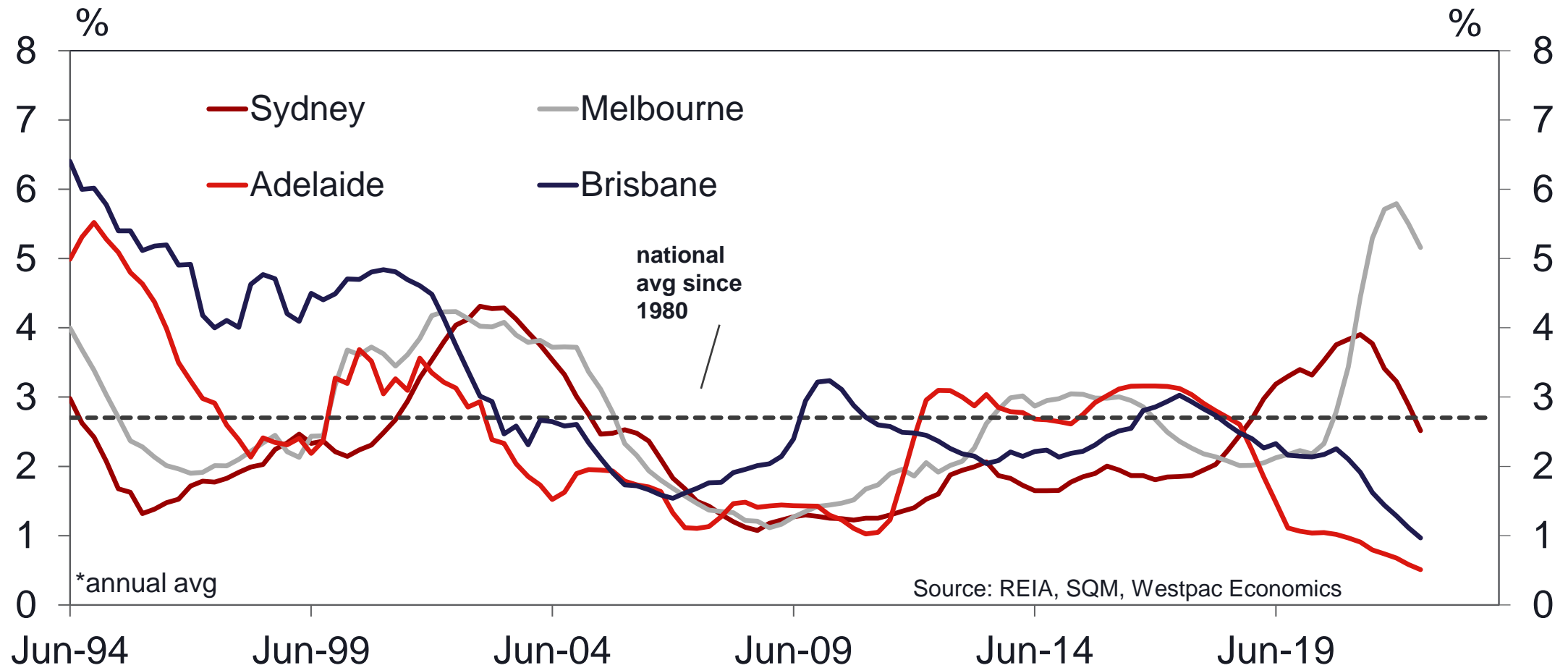
Total overseas arrivals and departures



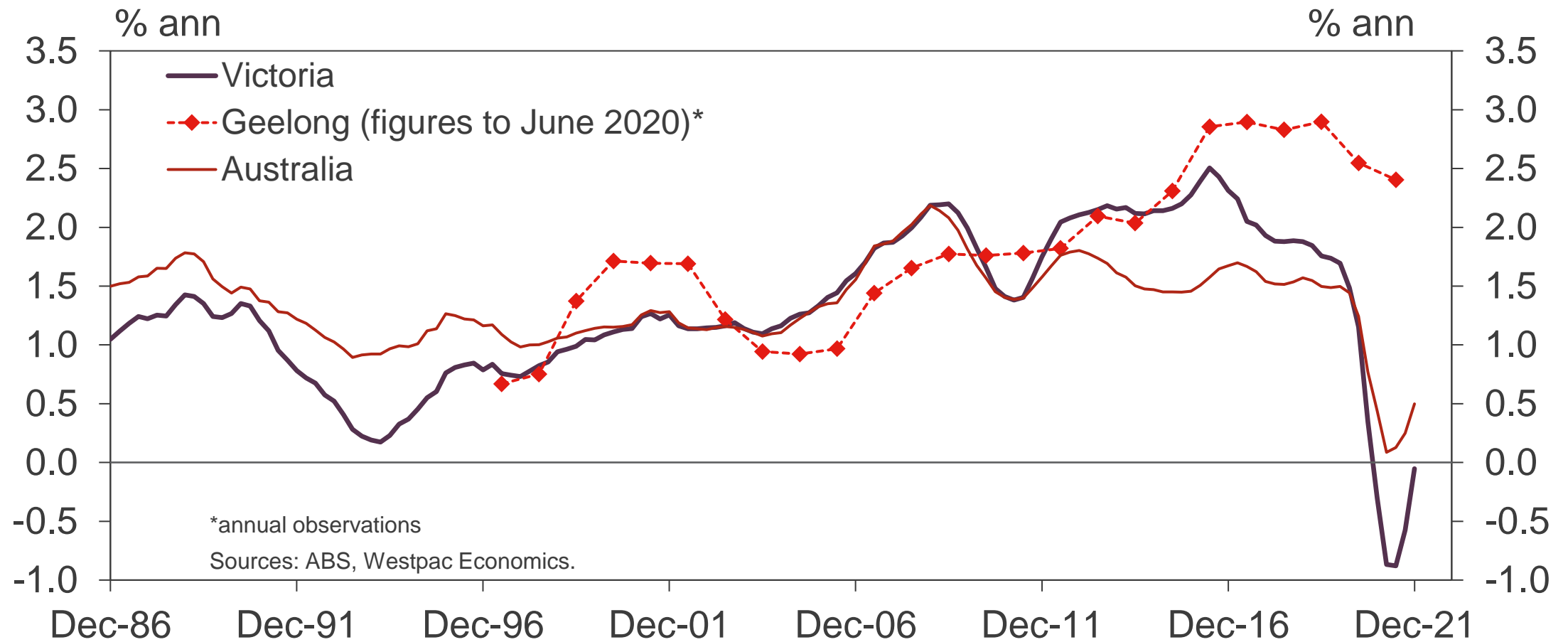
Overseas departures – surge in long term departures.



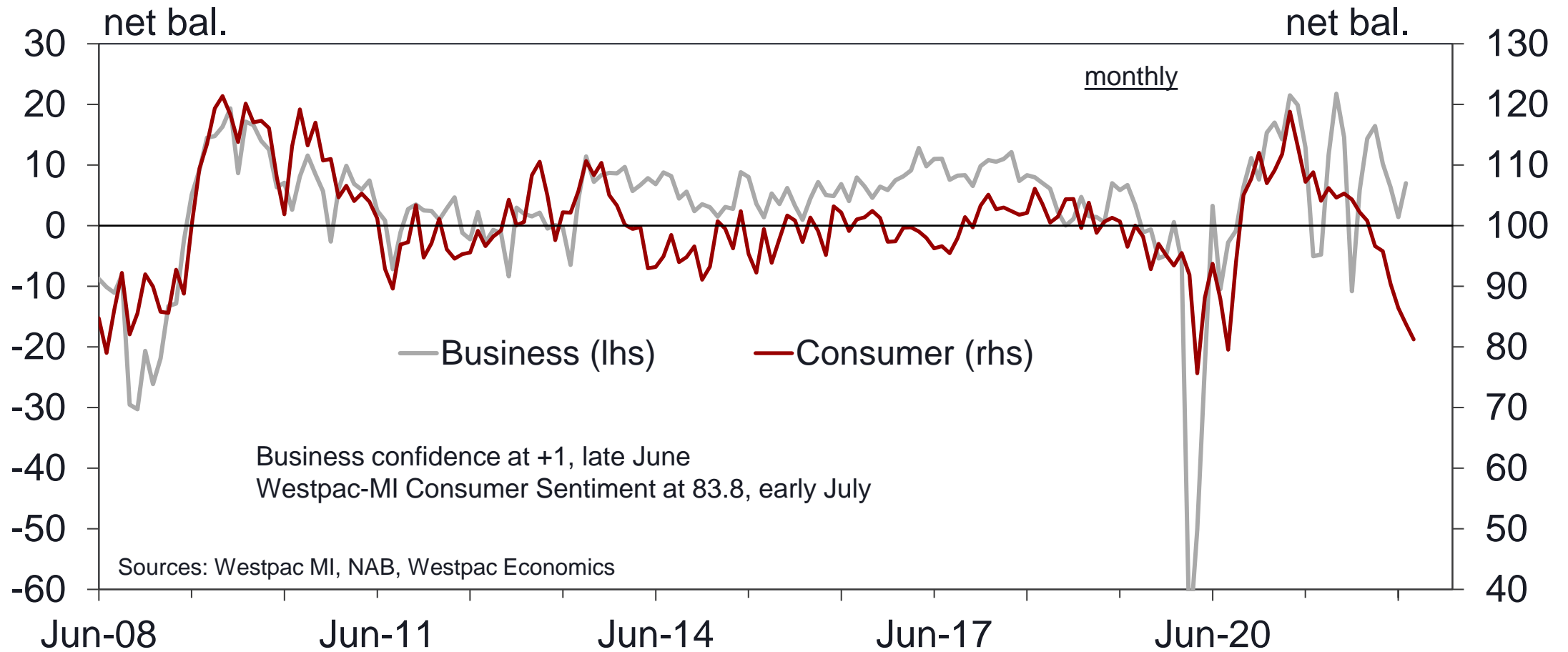
Rental markets: vacancy rates; Adelaide a standout



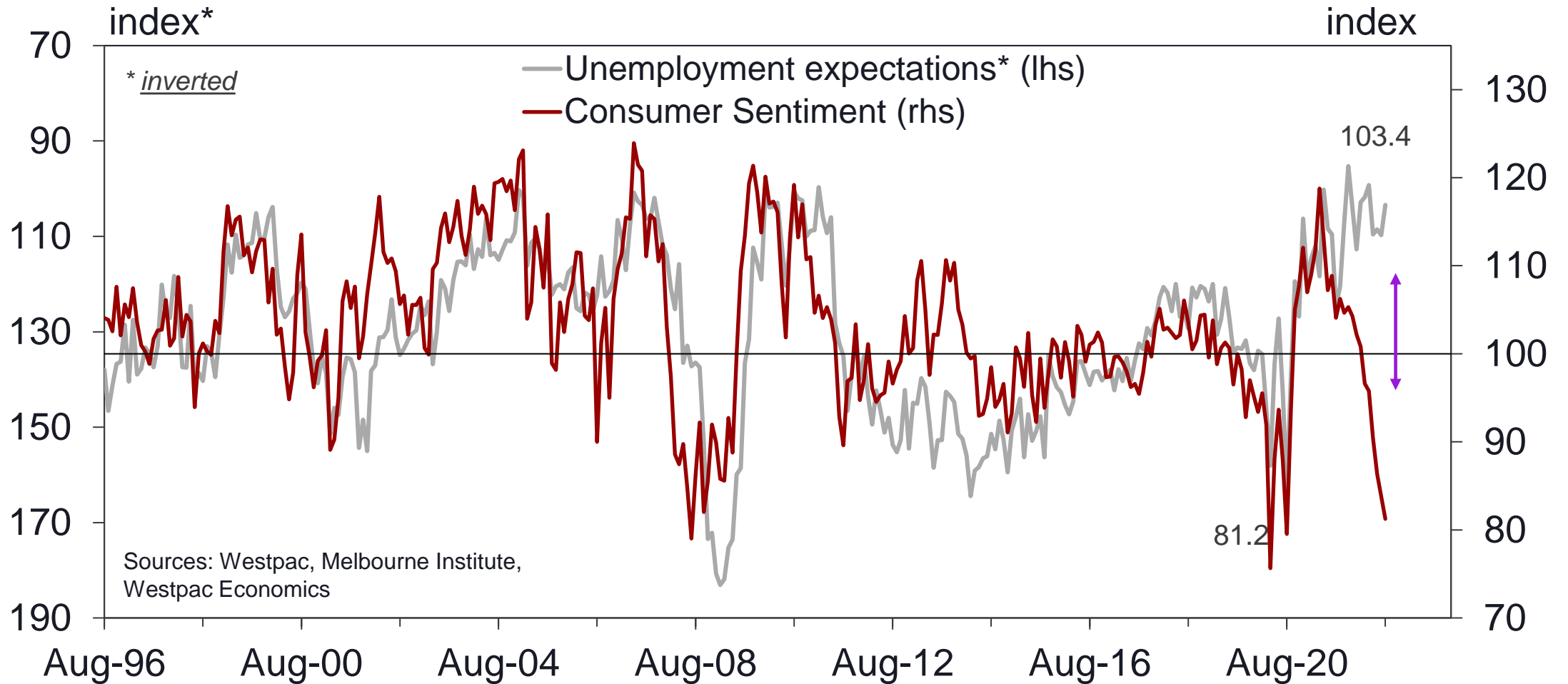
Population growth: Geelong holding up well



Confidence: consumers and businesses



Consumers: Sentiment & unemploy' expectations

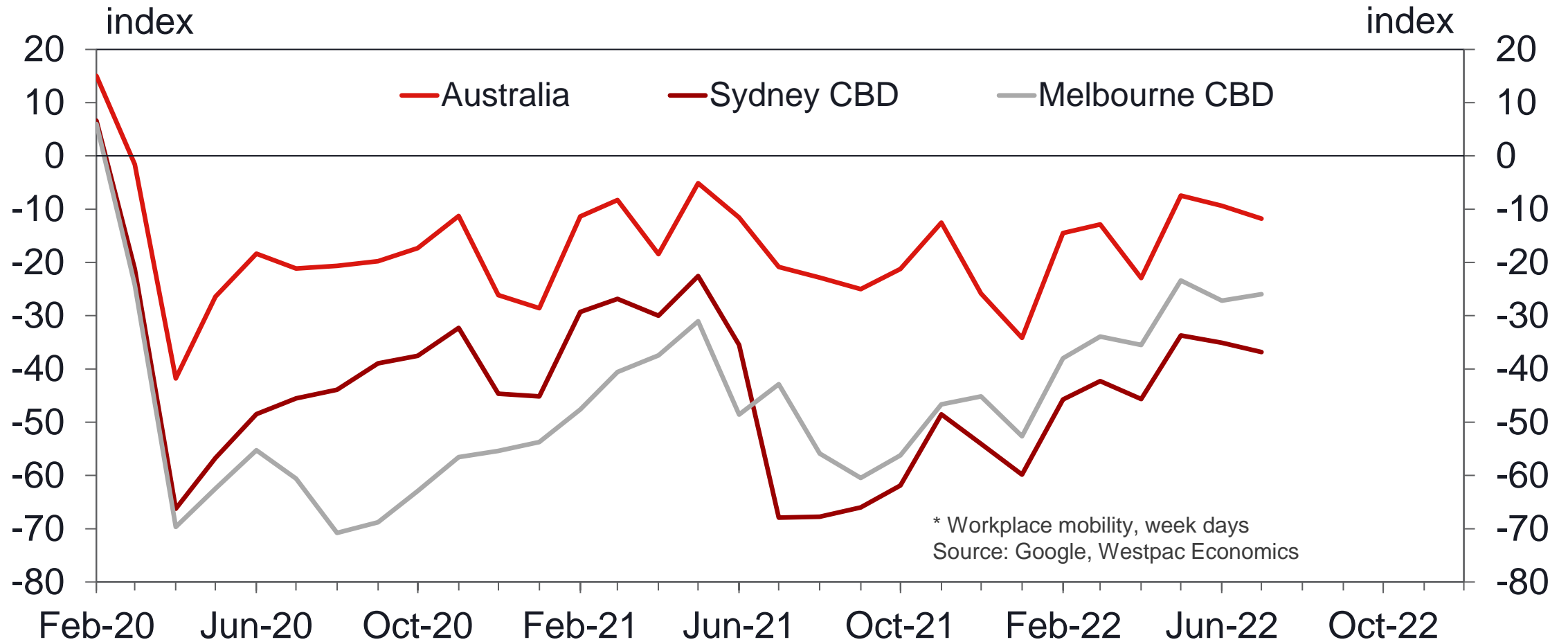


Financial and Economic Forecasts

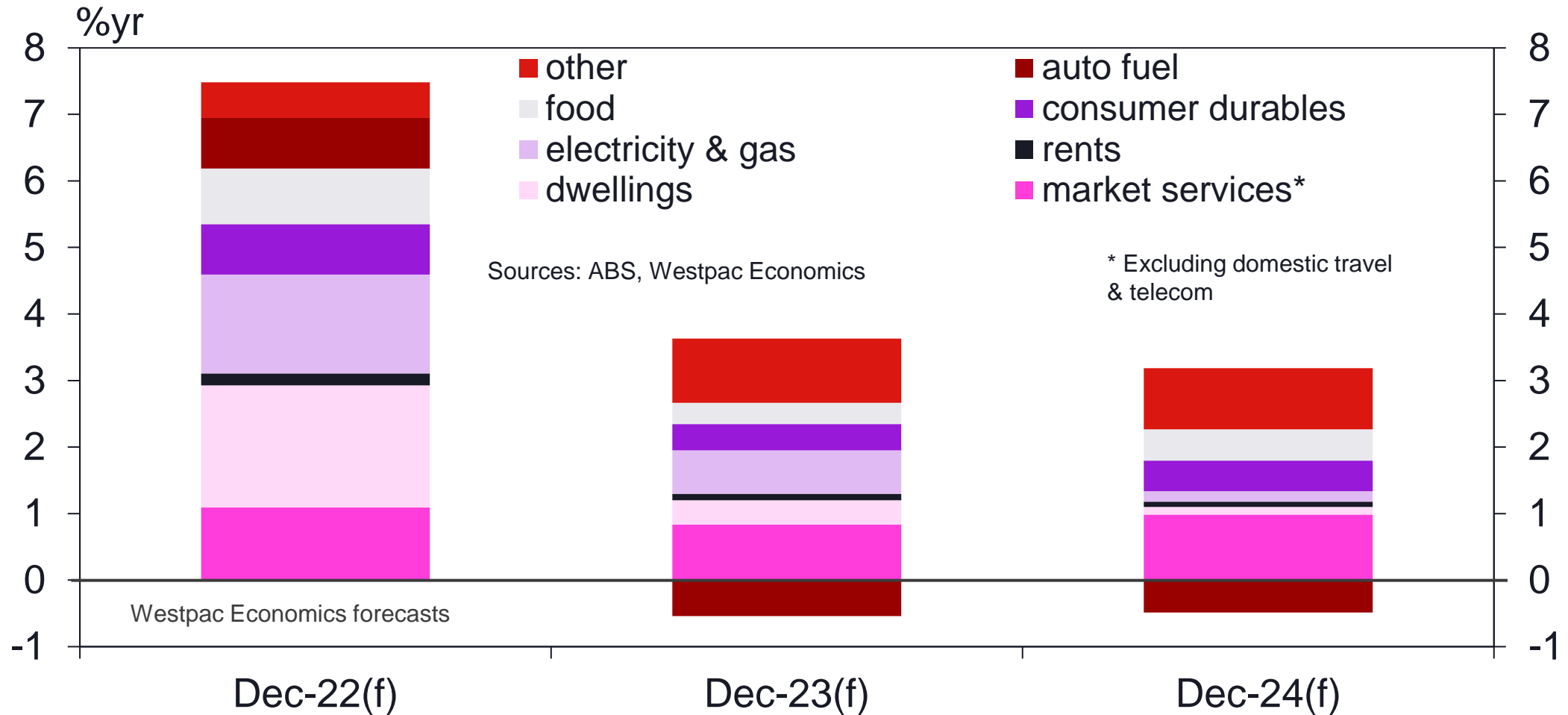
	End-2022	2023	2024
GDP (%pa)	4.4	1.0	2.0
Unemployment rate (%)	3.0	4.2	5.0
Inflation (%pa)	7.6	3.1	2.7
Dwelling prices (%pa)	-4.0	-10.0	2.0
Credit growth (%pa)	6.6	2.6	3.4
Wages growth (%pa)	3.25	3.9	3.6
Cash rate (%)	3.10	3.35	2.35
AUD/USD	0.73	0.78	0.80

Sources: Westpac Economics

Australia workplace mobility: major CBDs

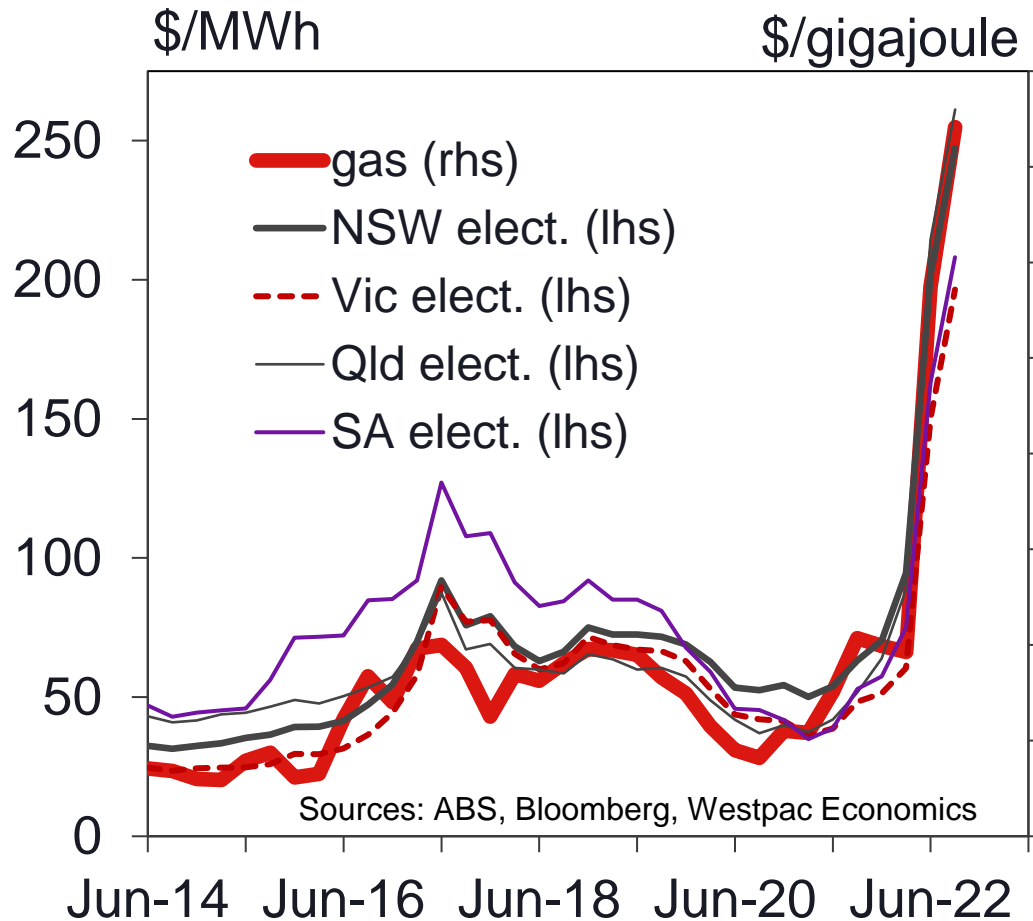


Annual inflation – can fall sharply next year if stage 3 fades

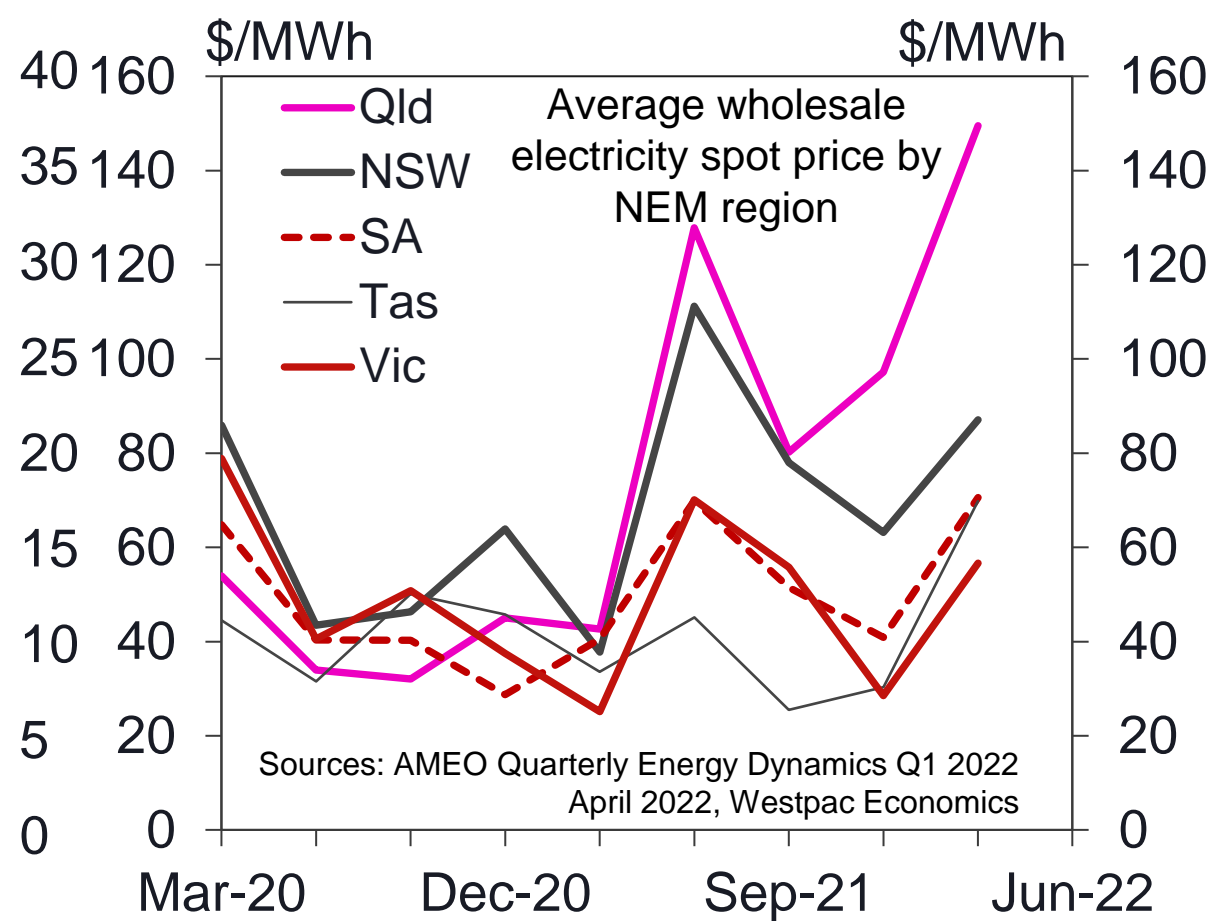


Gas sets marginal power prices but regional issues matter

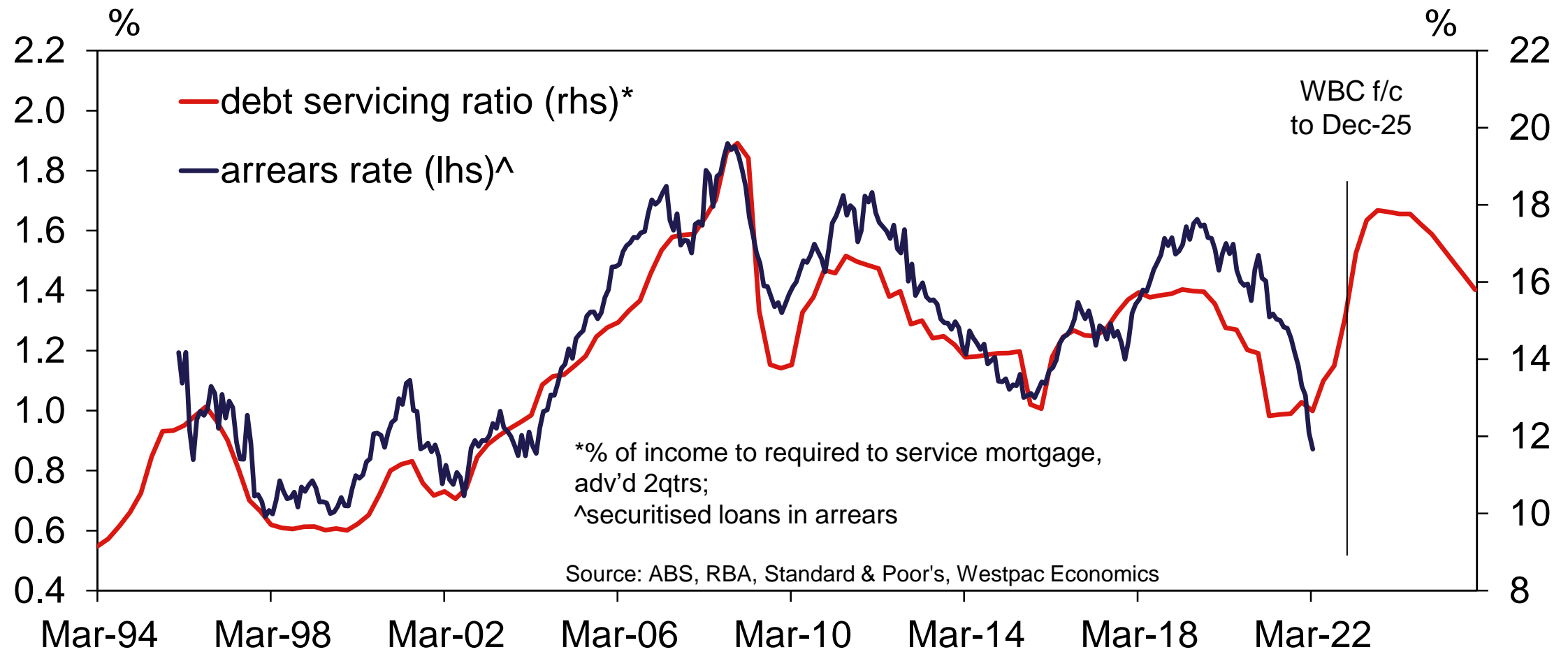
Spot electricity futures vs gas



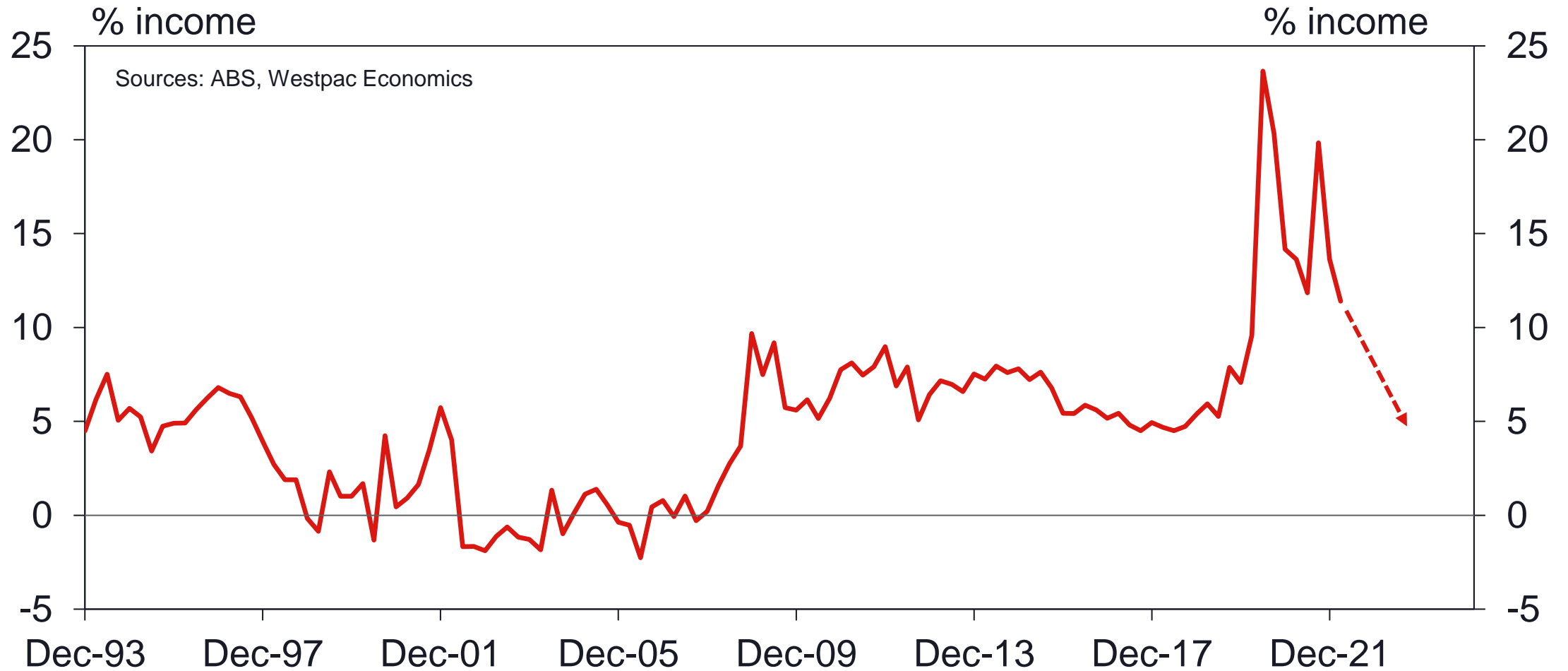
Regional power prices



Household debt servicing ratio vs arrears



Savings – \$250b in excess savings; \$25b if rate falls to 6%

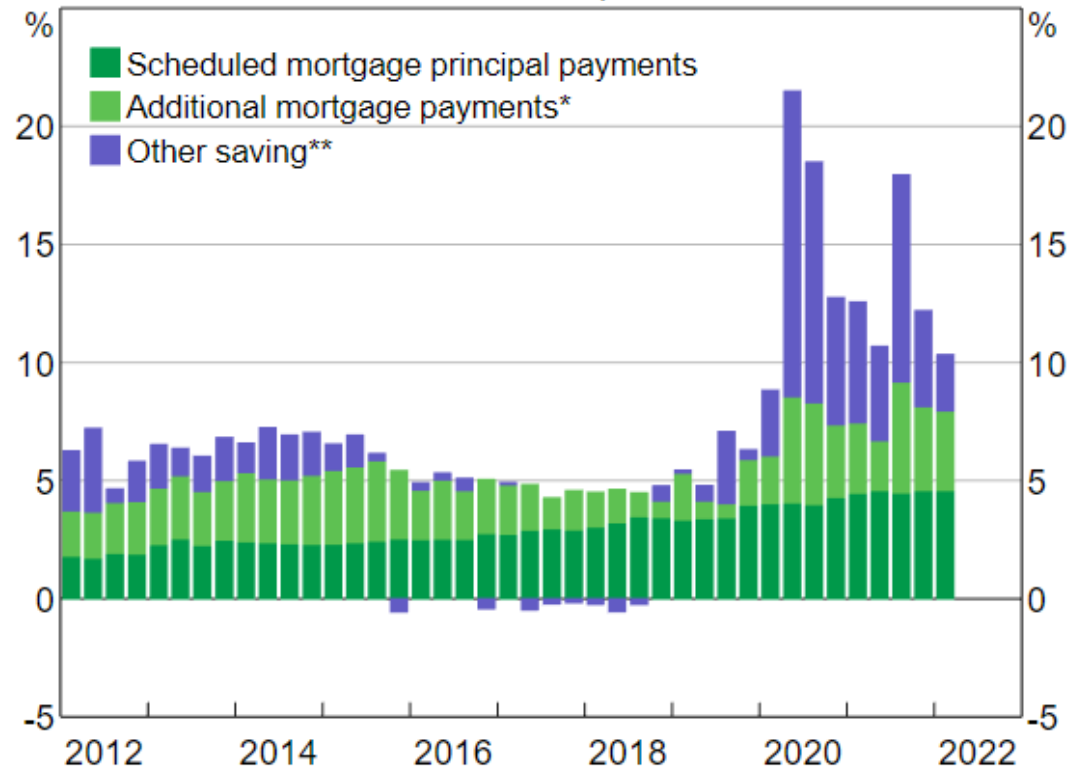


Household saving ratio – liquidity lift for non borrowers

Graph 9

Household Saving Ratio

Share of household disposable income



* Sum of net flows into redraw and offset accounts.

** Net of depreciation.

Sources: ABS; APRA; RBA

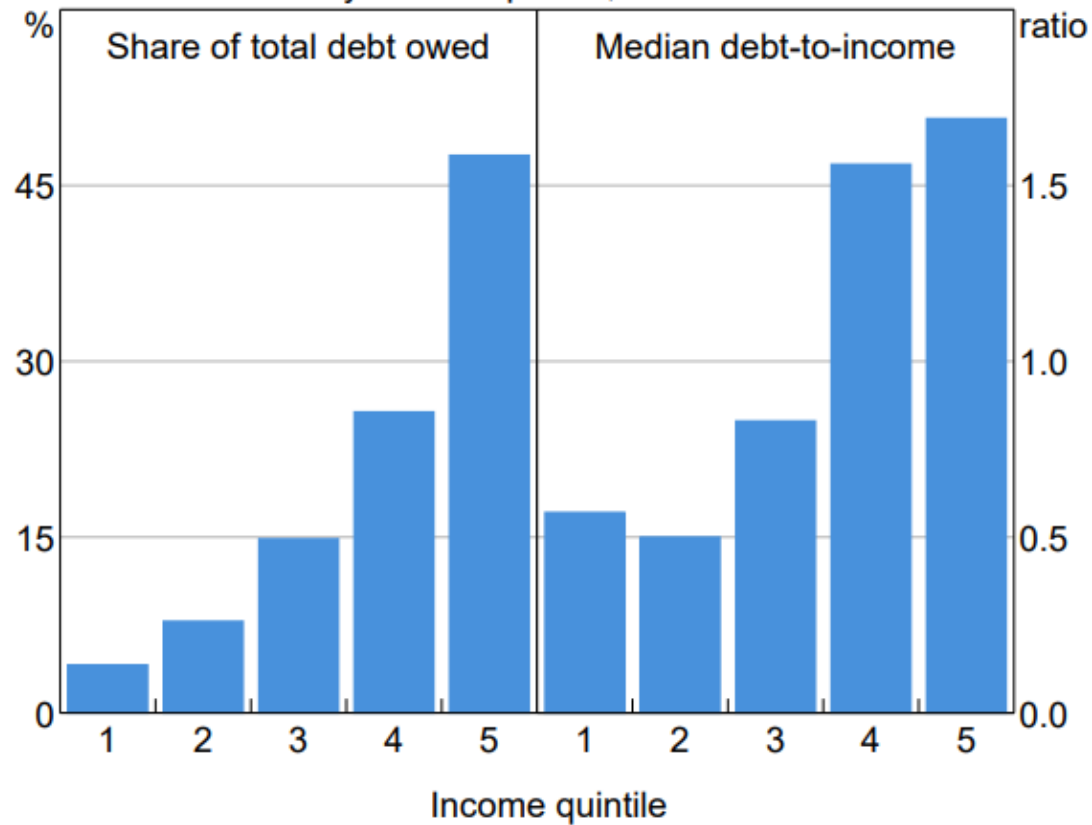


Distribution of household debt* (high income/high debt!)

Graph 7

Distribution of Household Debt*

By income quintile, 2019/20

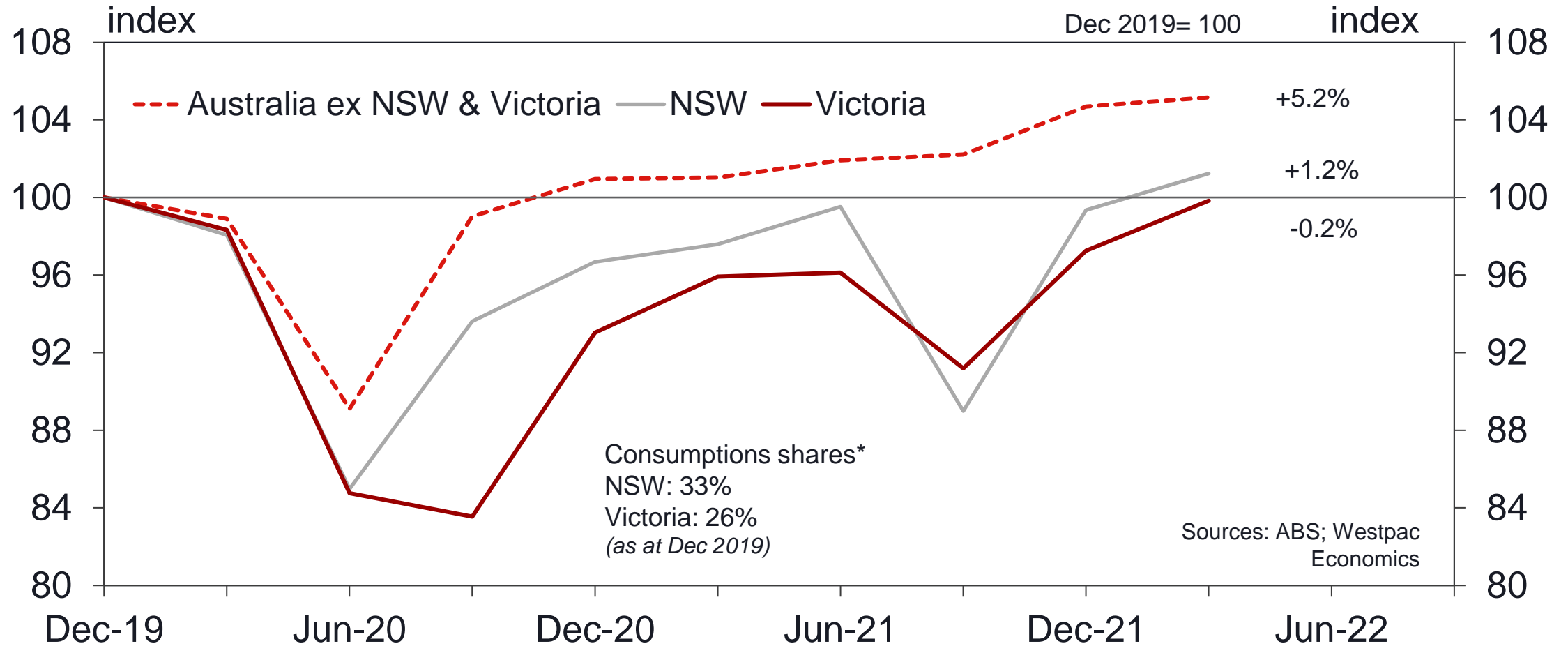


* Only includes households with debt.

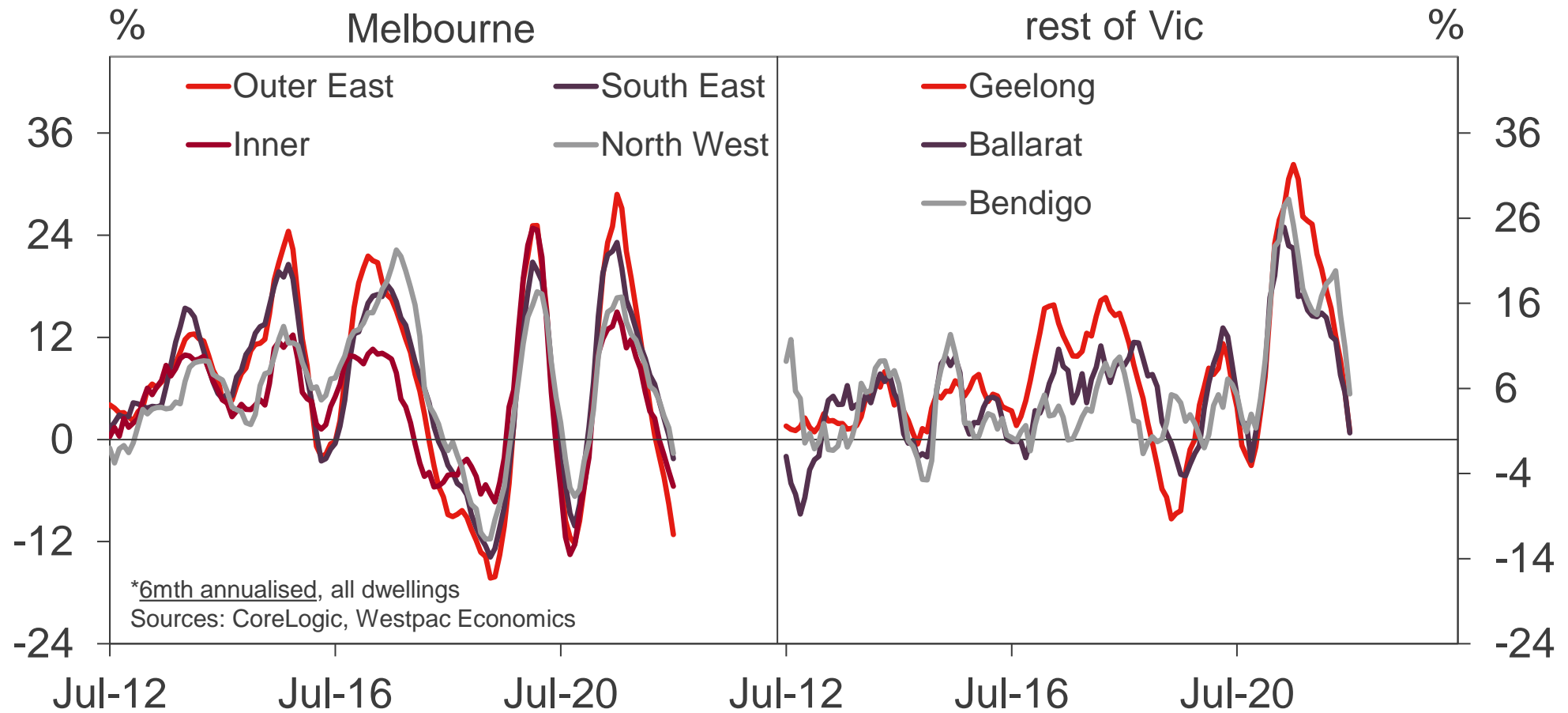
Sources: ABS; RBA



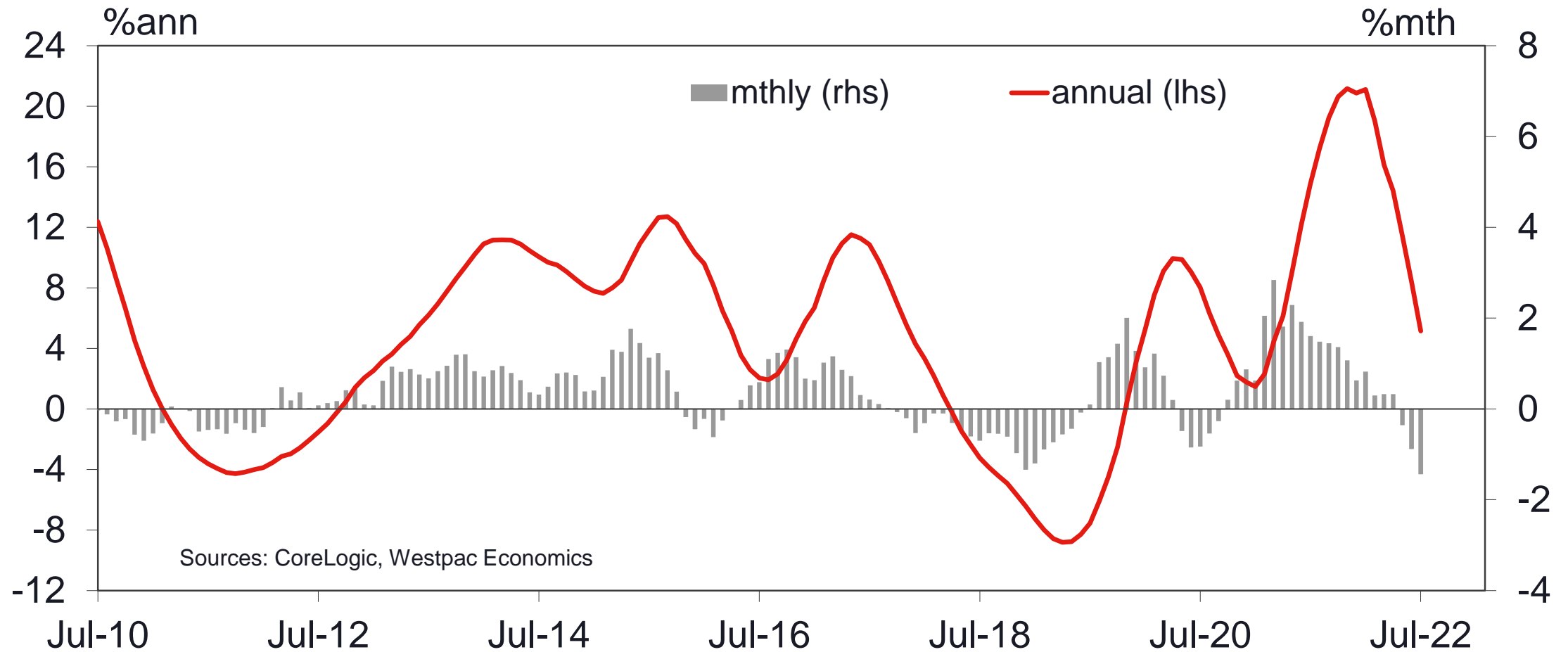
Consumer spending by state: paths diverge



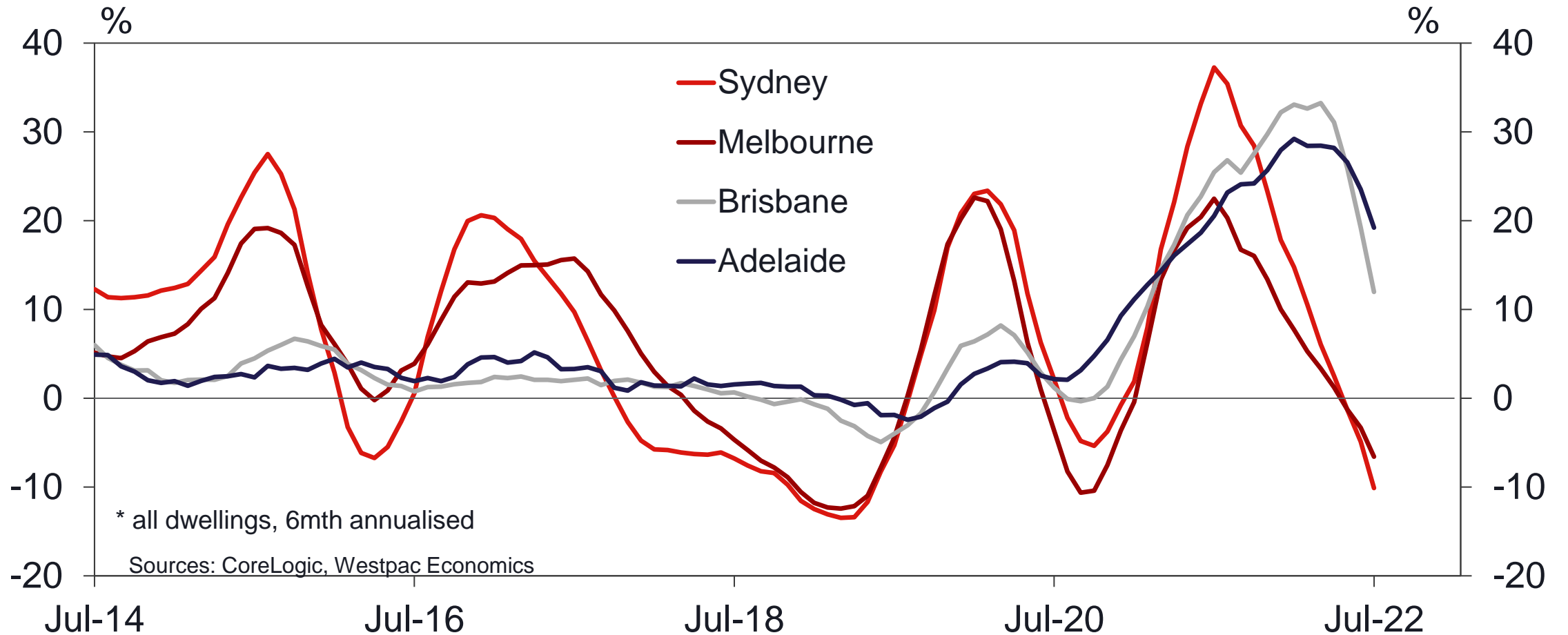
Dwelling prices: Victoria



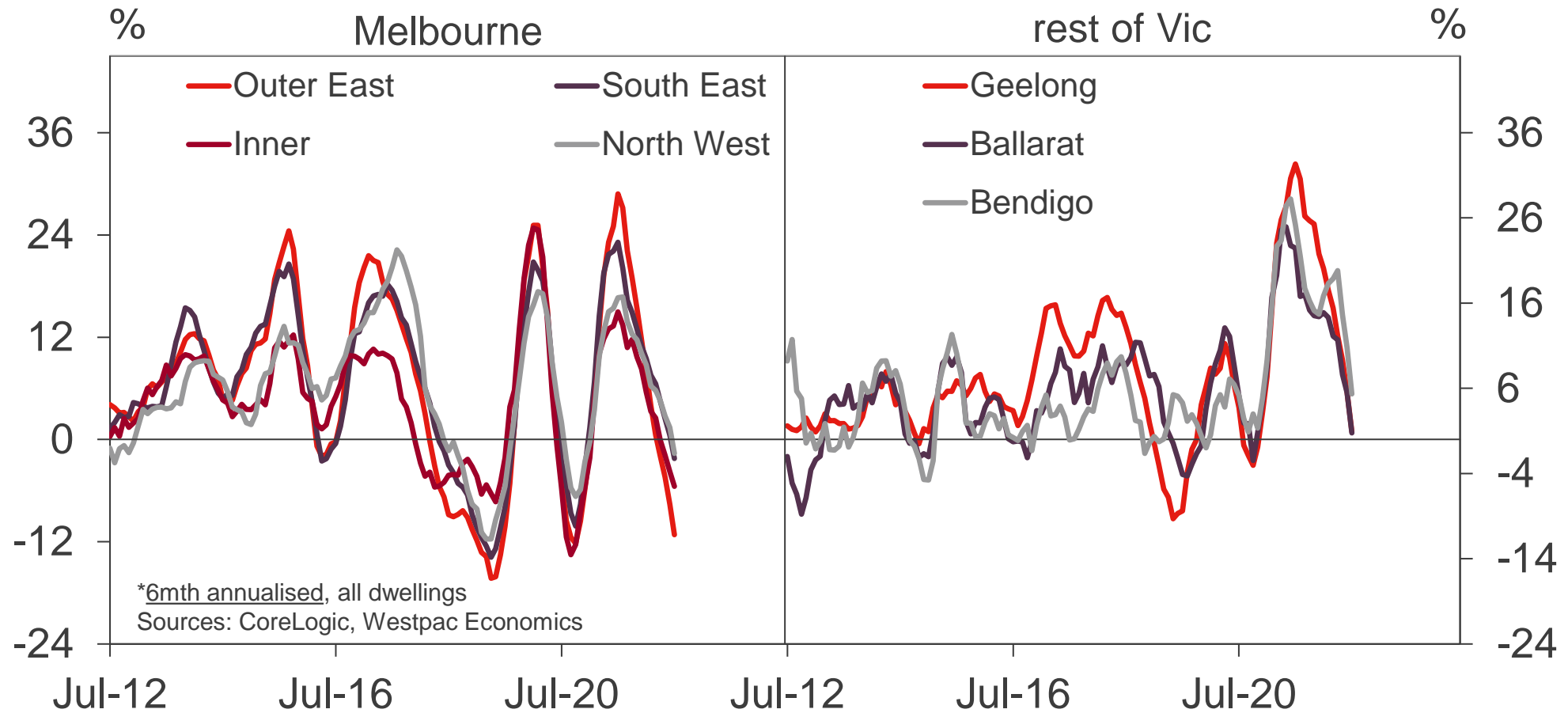
Australian dwelling prices: -6% H2 ; -10 % 2023



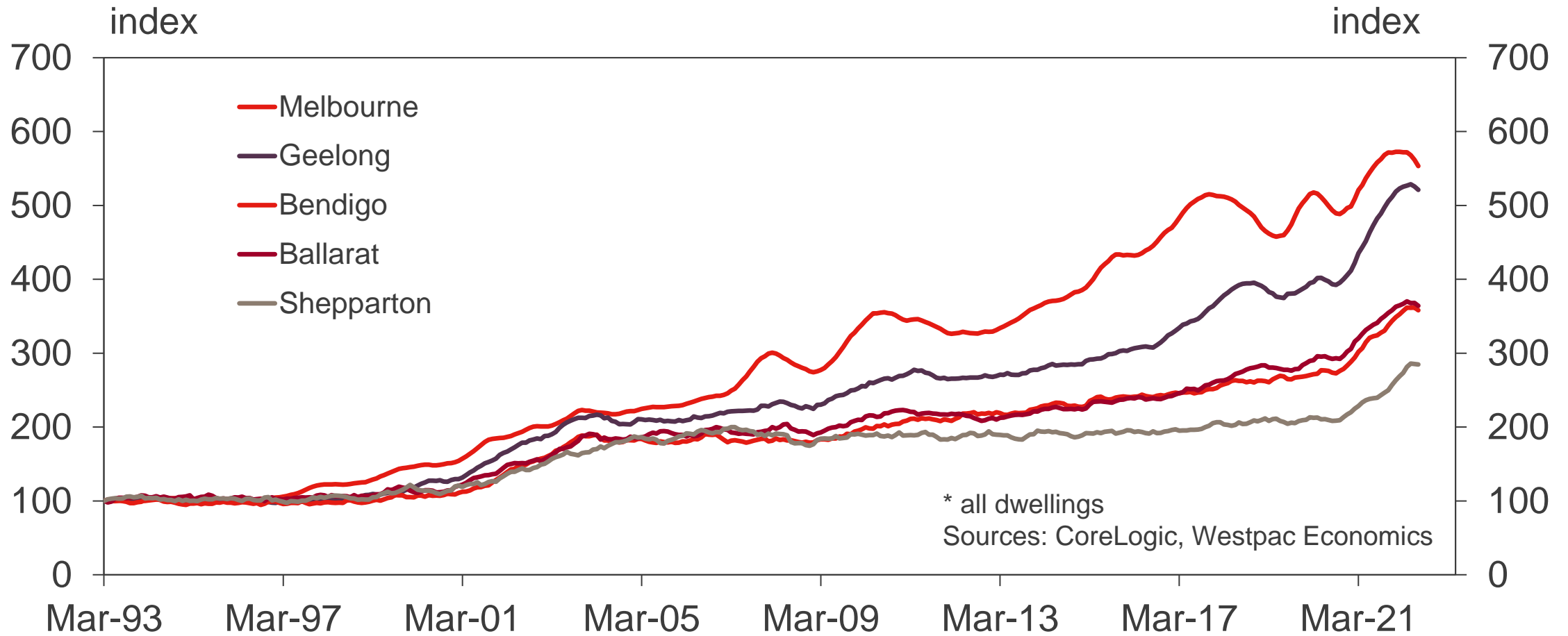
Australian dwelling prices: now turning quickly



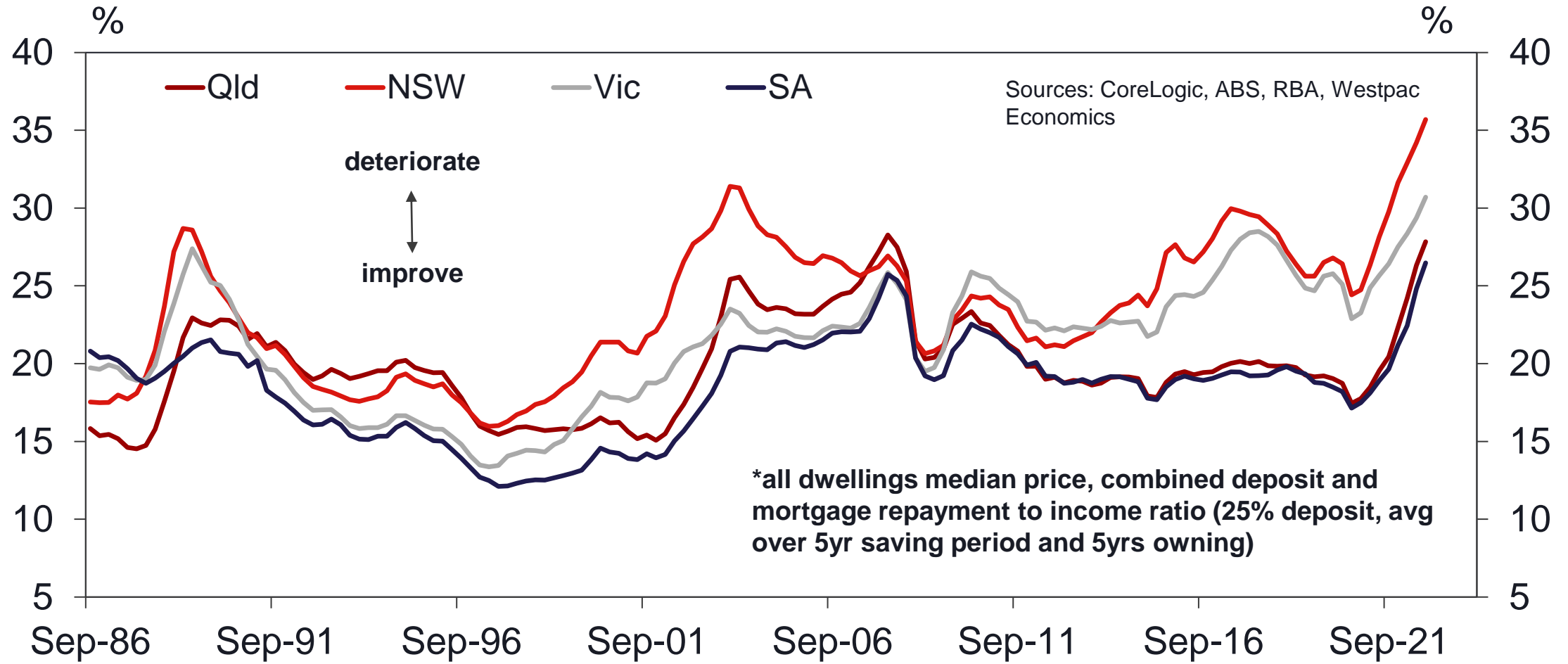
Dwelling prices – Geelong holding up better than others



Dwelling prices – Geelong closing the gap with Melbourne: best region



Dwelling affordability – QLD less affordable than Victoria by 2024



Detailed Forecasts – bond rates lower in 2023 and 2024

	Latest (22/8)	Dec-22	Dec-23	Dec-24
RBA Cash	1.85	3.10	3.35	2.35
3yr swap rate	3.40	3.25	2.80	2.75
AU10yr bond	3.52	3.40	2.65	2.15
Fed Funds	2.375	3.375	3.125	2.125
US 10yr bond	2.95	3.00	2.30	2.00
AUD/USD	0.69	0.73	0.78	0.78

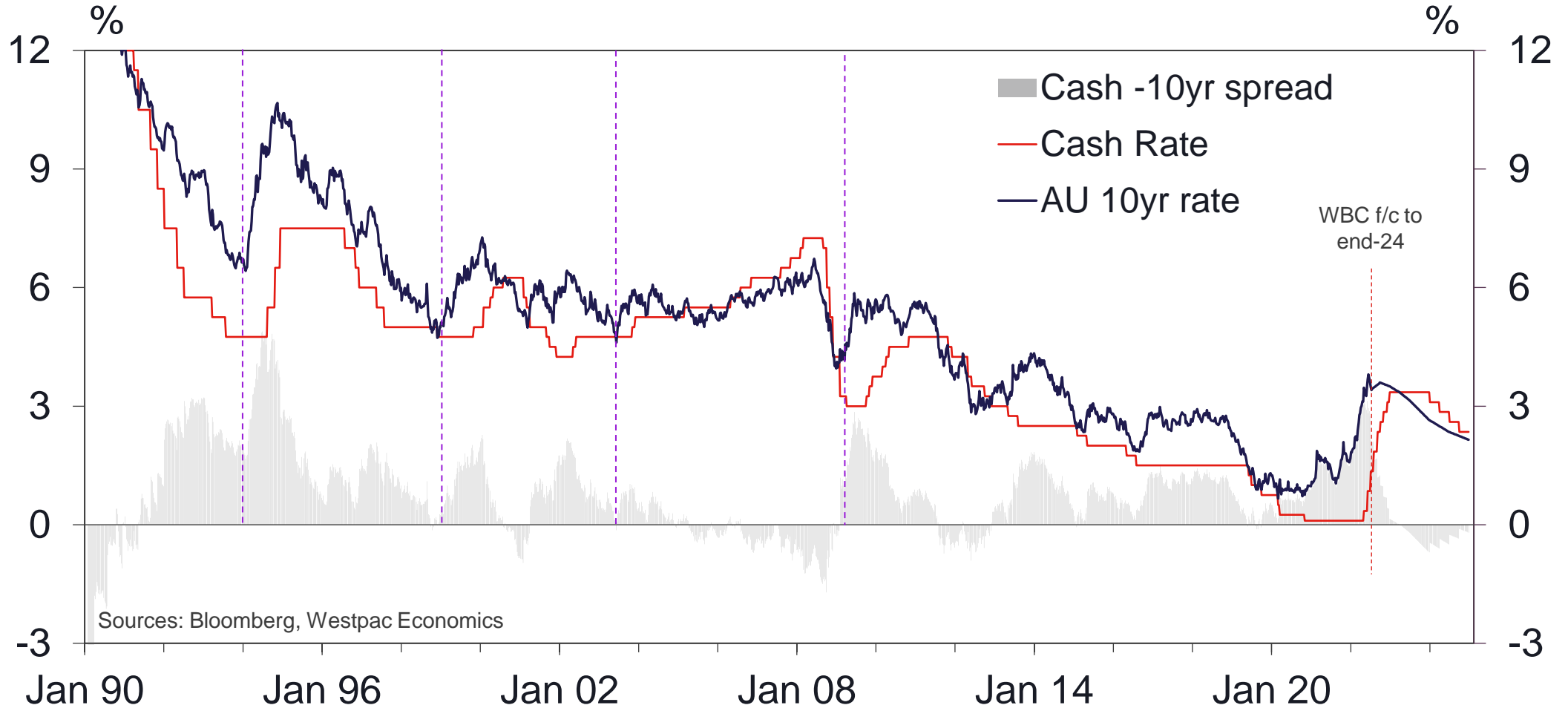
Sources: Bloomberg, Westpac Economics

WORLD INFLATION – SOME ISSUES.

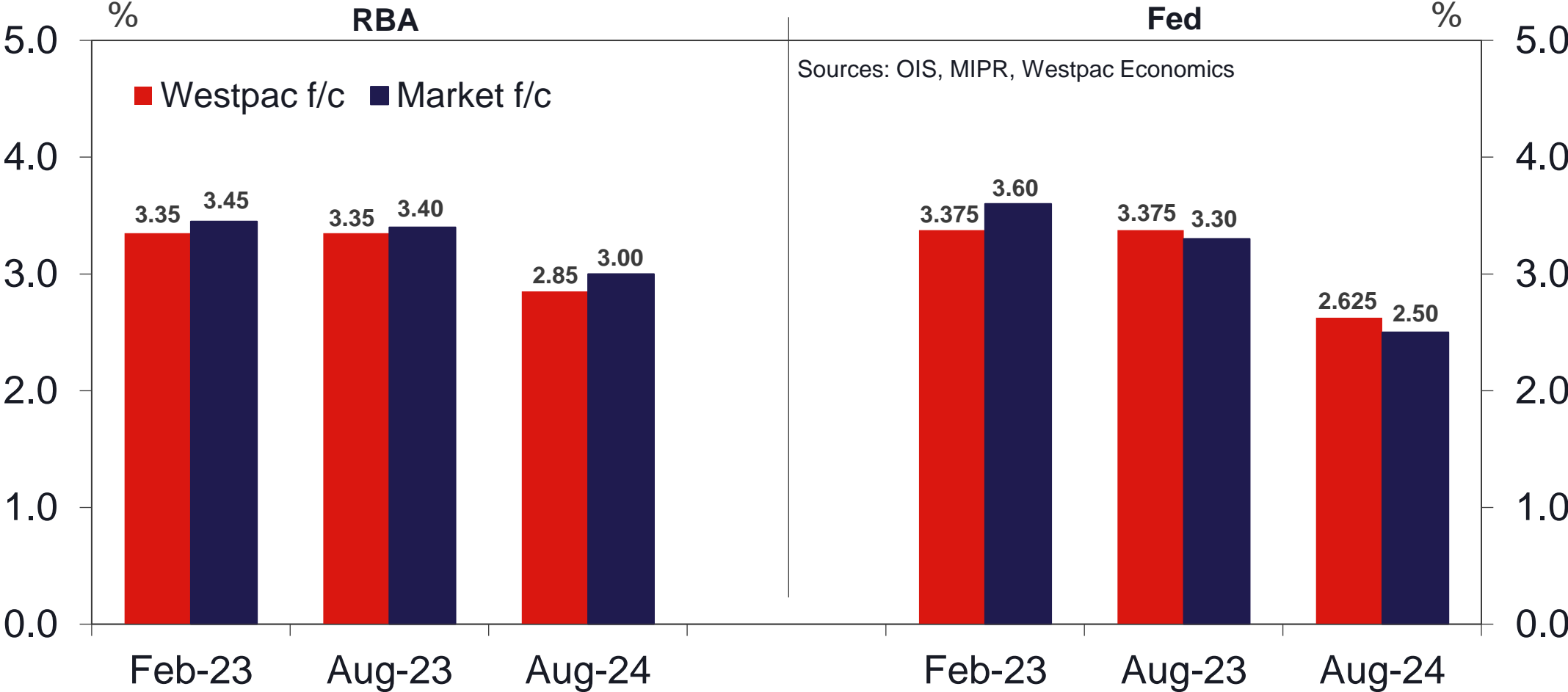
- Global shortage of skilled workers – where is China/Eastern Europe for the 2020's?
- Energy shortages; investment low in fossil fuels; transition to renewables is not smooth.
- Deglobalisation: just in case not just in time.
- Central banks have unleashed massive liquidity through balance sheet expansion.
- Risks of geopolitical – Taiwan Straits; Eastern Europe.



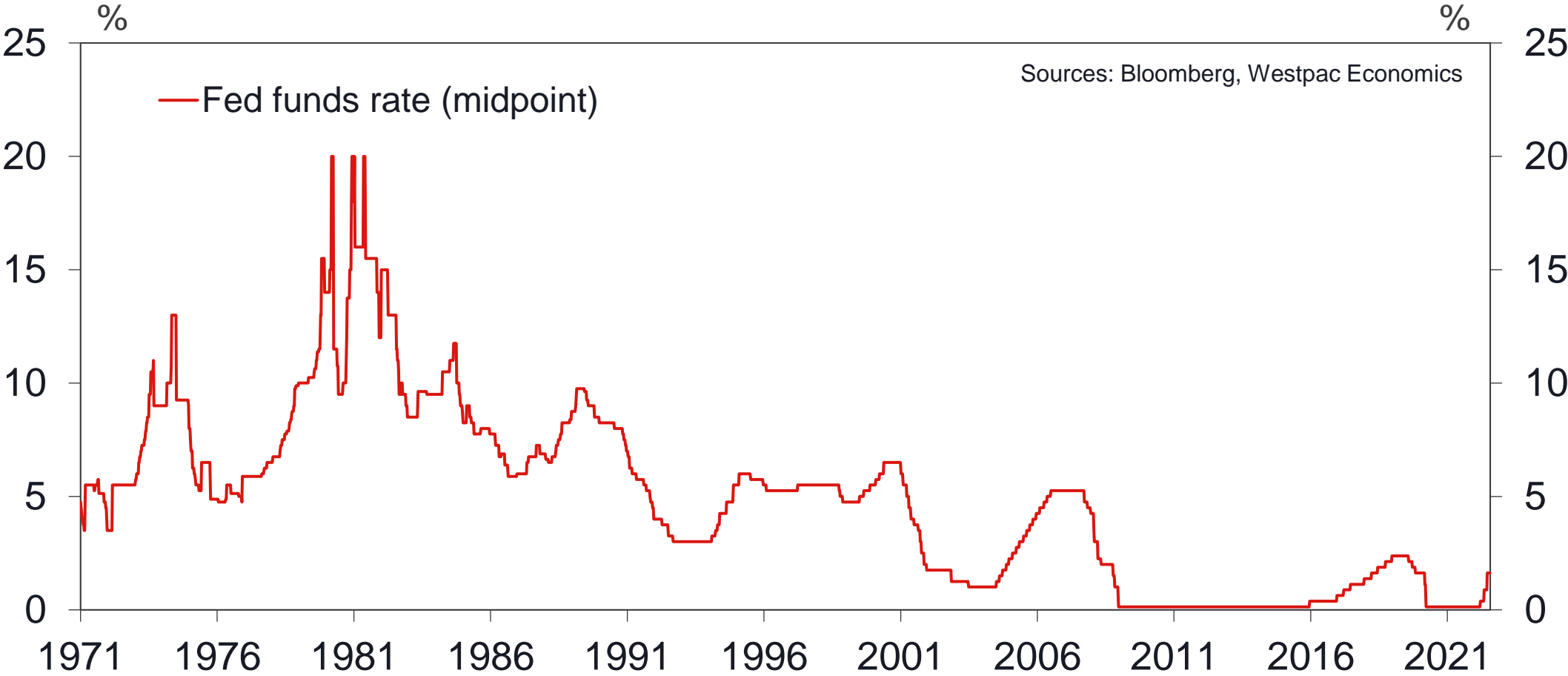
AU 10 year – RBA cash rate spread



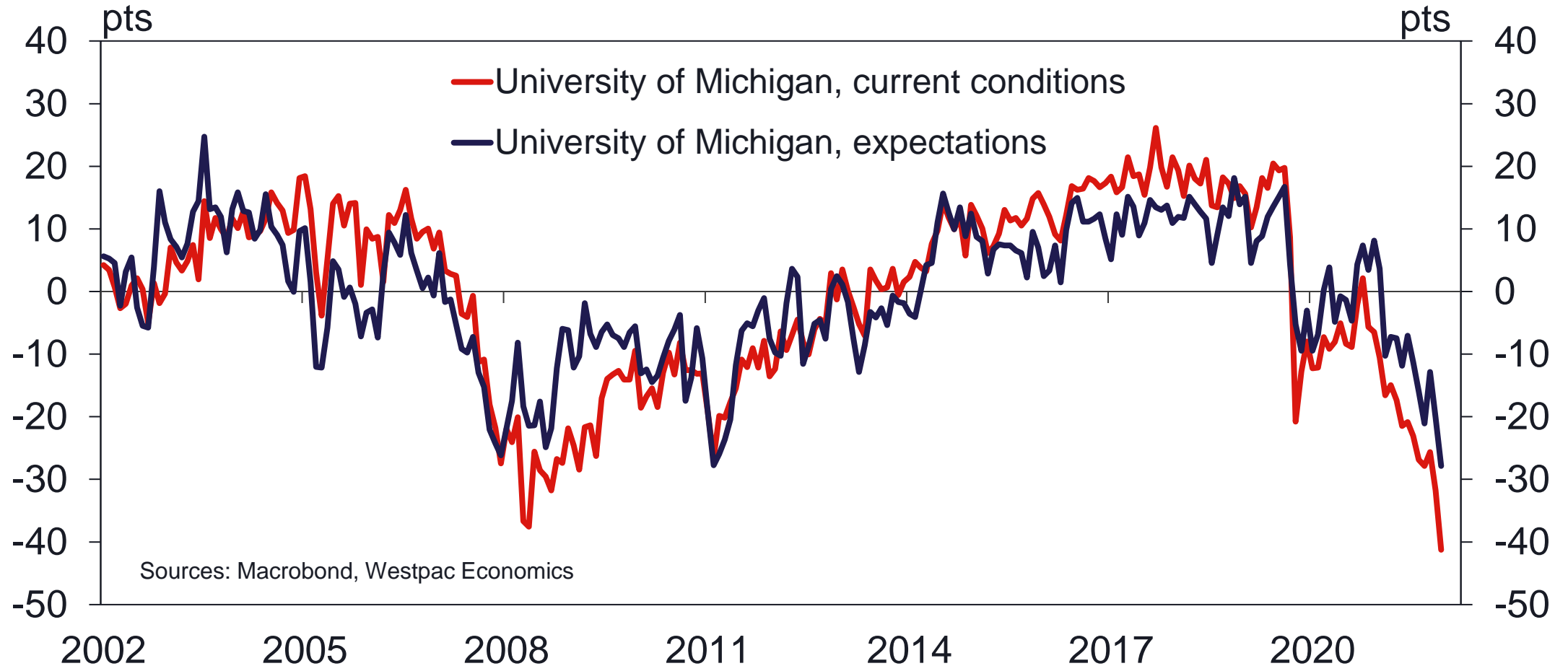
Market Expectations for RBA & US Fed – August 19



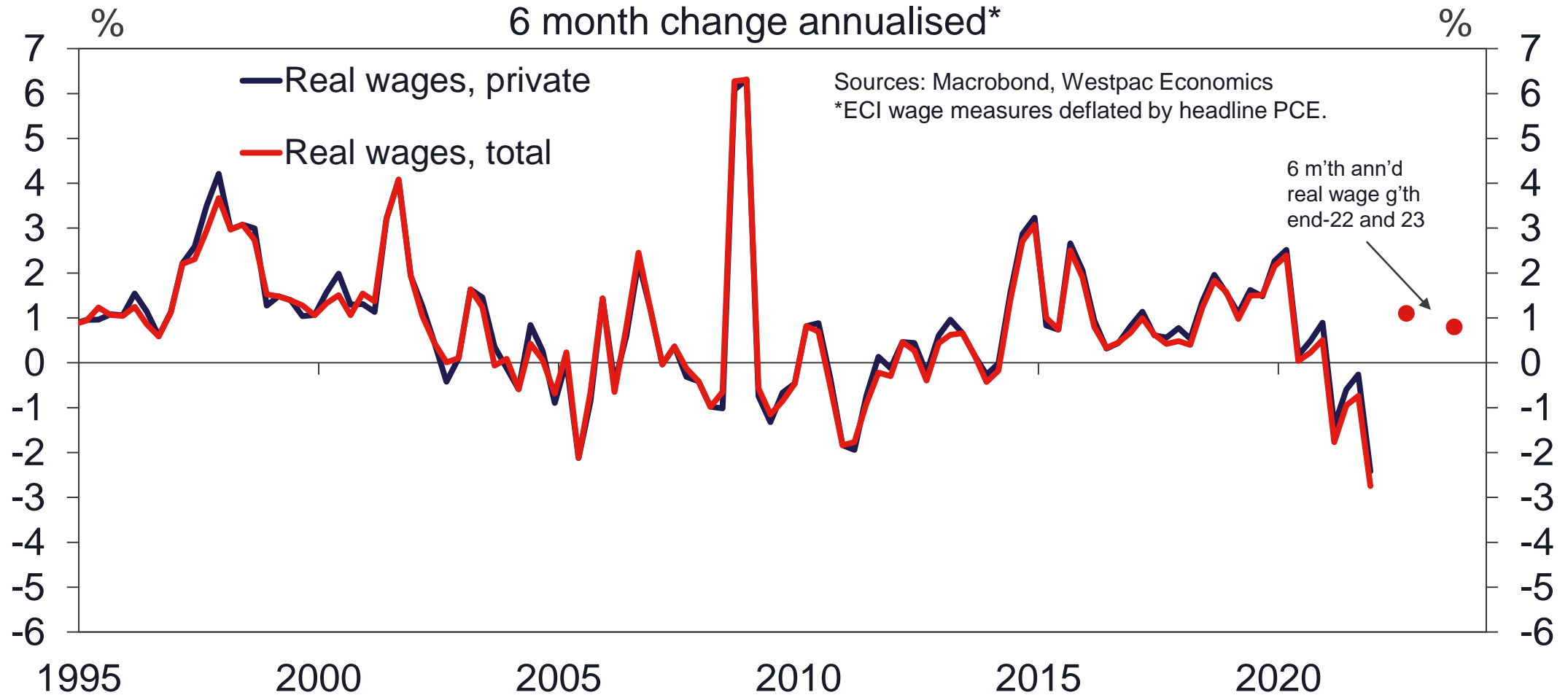
Fed funds rate – cut too soon in 1975 – a lesson for 2023



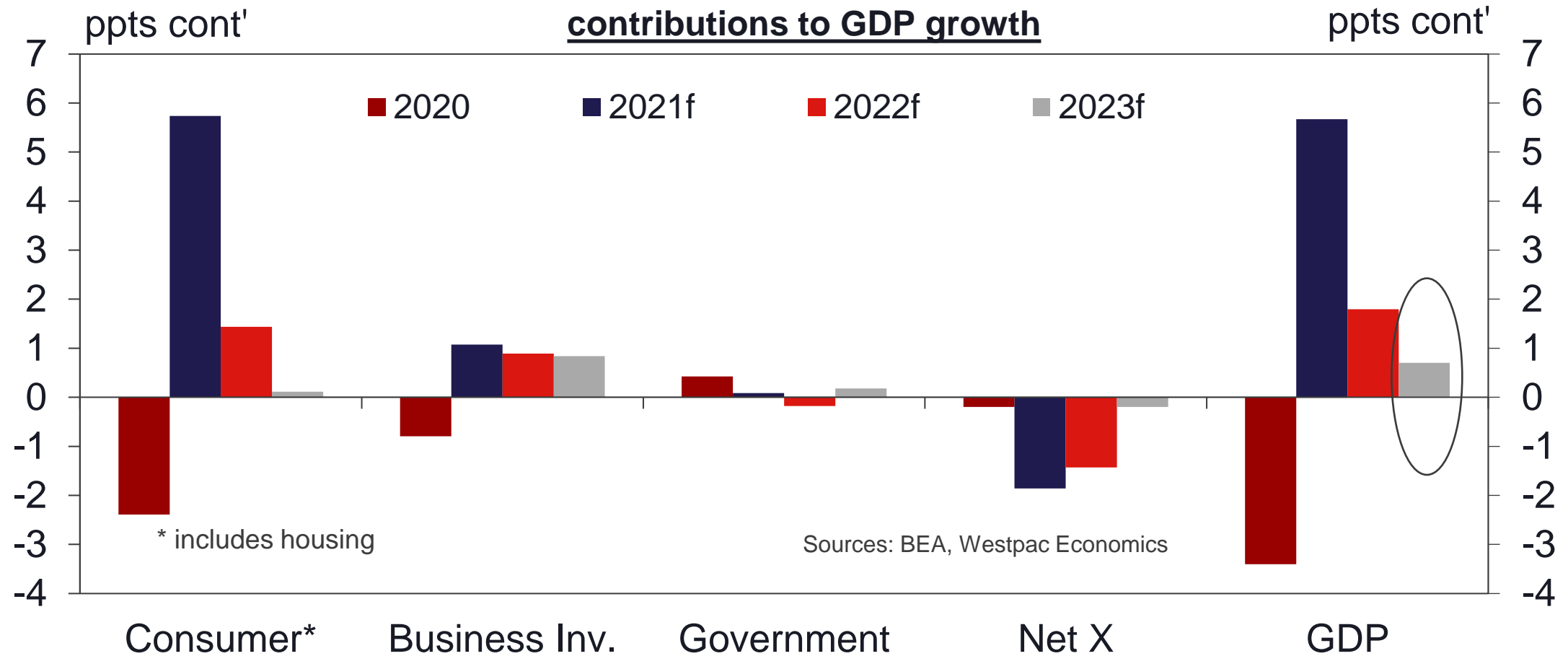
US: Inflation and interest rates have hit consumer sentiment hard



US real wage growth negative; will take until late - '23 to recover



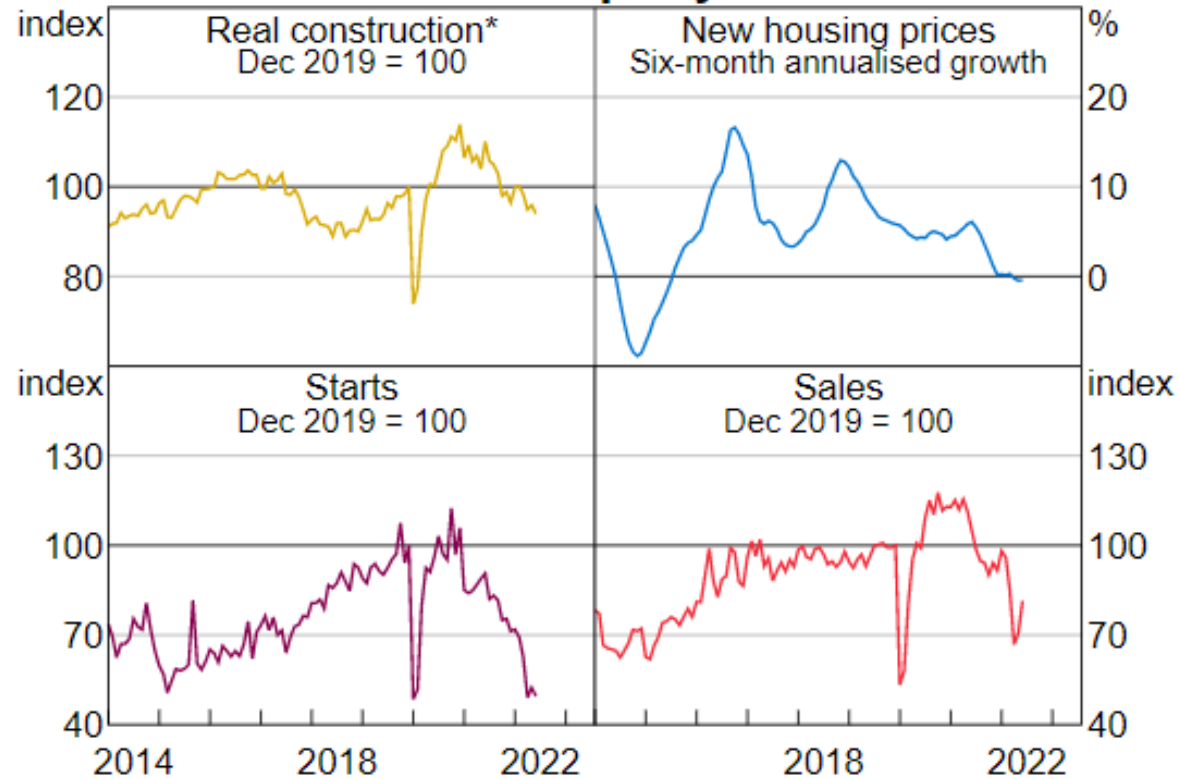
US consumer economic stagnation – 0.7% growth in 2023



China – residential property market indicators

Graph 1.11

China – Residential Property Market Indicators



* Residential real estate investment excluding the purchase of land; deflated using producer price data.

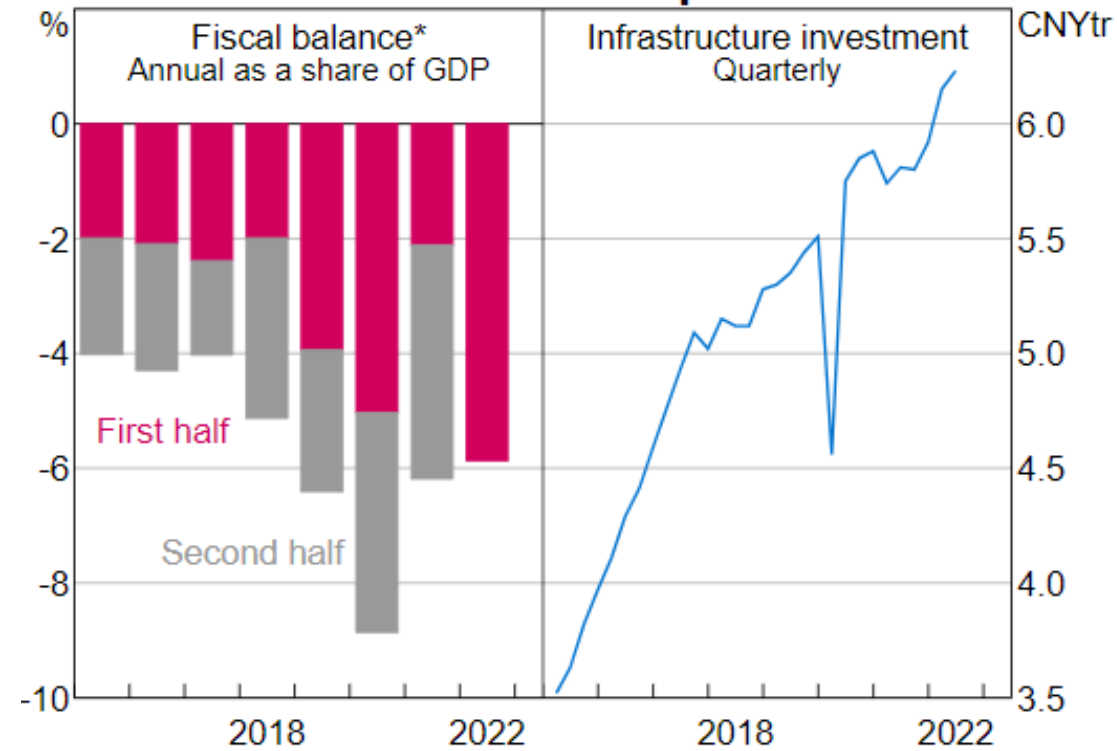
Sources: CEIC Data; RBA



China – fiscal impulse

Graph 1.12

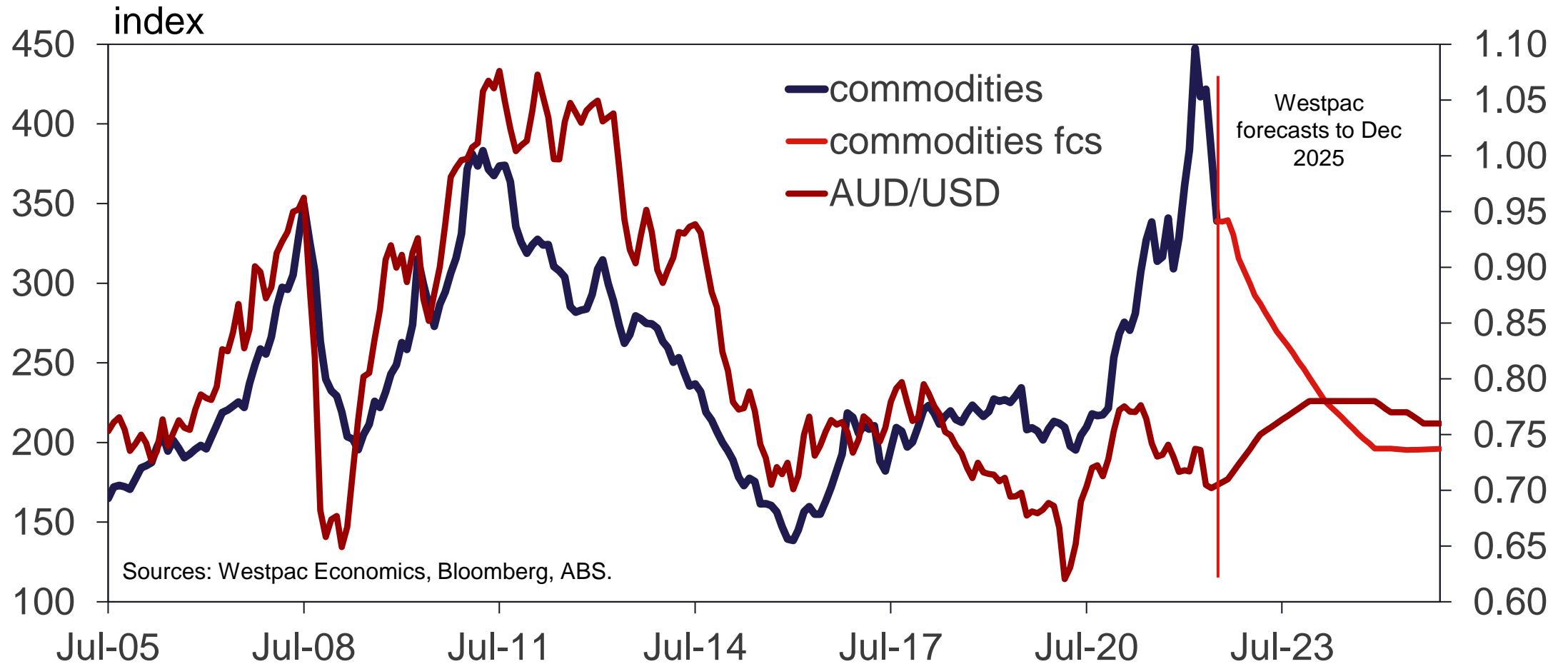
China – Fiscal Impulse



* Consolidated measure that includes central government, local government and government funds; as a share of previous year nominal GDP.

Sources: CEIC Data; RBA

AUD and commodities – risk on in 2023 if inflation down

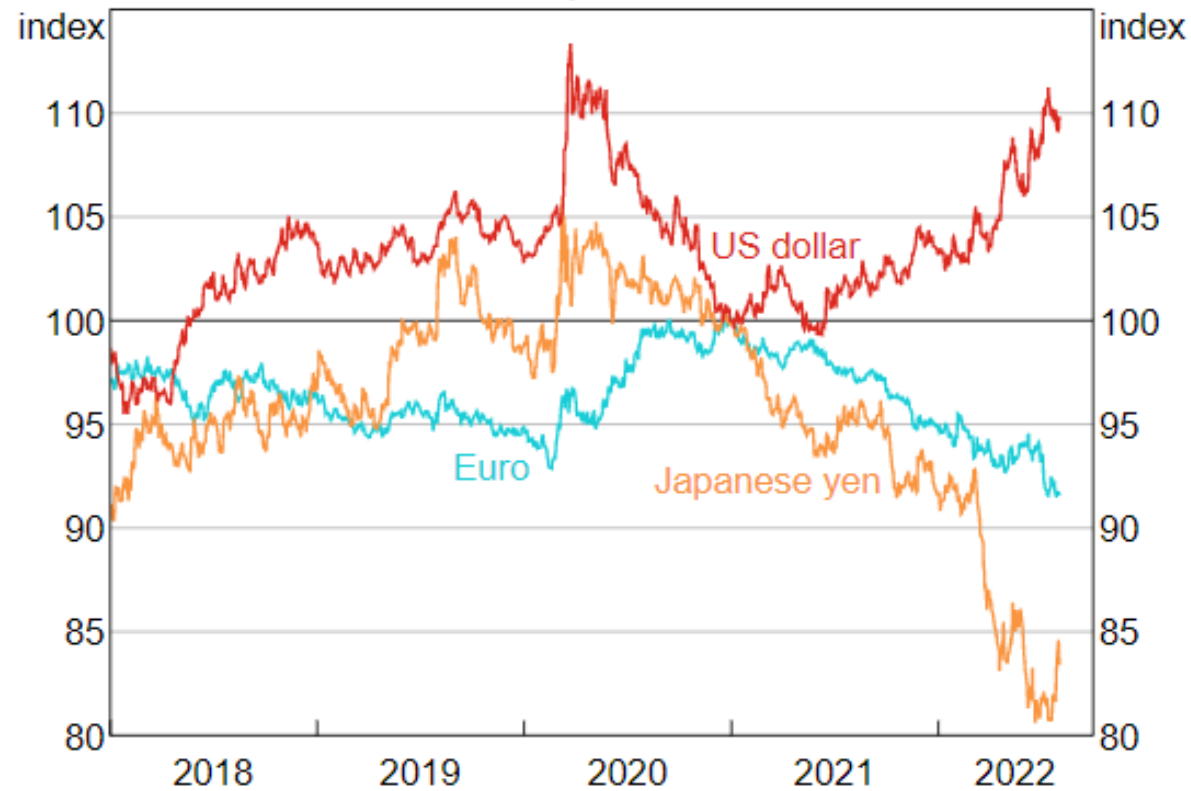


Trade-weighted exchange rates

Graph 1.25

Trade-weighted Exchange Rates

1 January 2021 = 100



Sources: Bloomberg; Board of Governors of the Federal Reserve System

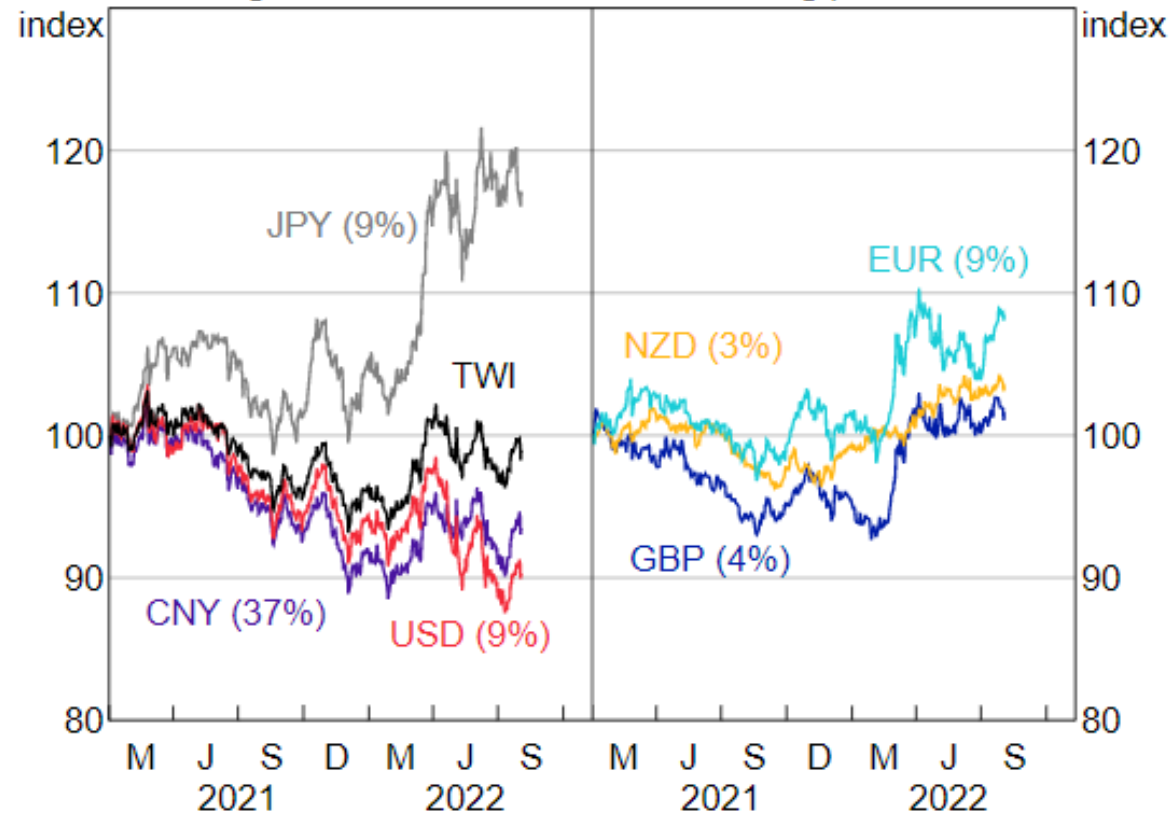


Australian dollar*

Graph 3.31

Australian Dollar*

Against currencies of selected trading partners



* Indexed to 1 January 2021 = 100, TWI weights in parentheses.

Sources: Bloomberg; RBA



Conclusion

- Three stages of Great Inflation: supply; war; inflation psychology takes hold.
- Material and labour shortages at extreme levels – not seen since 70's; labour should ease by 2024; demand and supply shock slowdown key to easing in inflation.
- RBA cash rate to rise quickly in 2022 – 3.1% by year's end; peak at 3.35% by Feb.
- High household debt will limit rate increases but offset by high savings – higher peak Debt Servicing Ratio than previous two peaks.
- With tight labour market (unemployment rate falls to 3.0%), inflation control relies on slowing interest sensitive sectors.
- Bond rates to fall in 2023 – lagged increase in property yields but no falls in 2023.
- Risk to economy is wage/price spiral; firms also identify scope; RBA should be nervous.
- Best chance to avoid spiral will be easing in commodity shocks and slowing demand.
- Falling prices in 2022 and 2023 – national; down 16% – SYD/MEL 18%.
- Border opening unlikely to see replacement of Covid losses in workforce.



Conclusion

- Central banks have erred with money printing during Covid – government support enough.
- Inflation must ease globally in 2023 to take pressure off central banks and avoid wage/price spiral.
- Bond rates have peaked (US 10 year Treasuries reached 3.6%) but progress towards much lower yields will be bumpy – US 10's @ 2.5% not sustainable yet.
- Biggest risk to outlook is if inflation is much stickier than currently expected particularly precluding FOMC from cutting rates when US consumer flat lines in 2023 and RBA from easing rates in 2024 (RBA forecast of 4.3% inflation in 2023 is risky)
- 2023 will mark the weakest consumer spending growth in US since GFC.
- China's prospects are still uncertain, current conditions in property markets are parlous – stimulatory policy (credit boost; lower rates); easing of restrictions on property and technology; zero Covid still cause for considerable caution as virus still spreads.
- AUD to benefit from easing of “risk aversion” in 2023 as inflation falls; although US FED and China's recovery will be critical for the remainder of 2022.



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