Chris Burrell's
Market View Blog

FINSIA Economic Indicators 2024

Paul Bloxham presented to 600 attendees at the FINSIA Economic Indicators 2024 lunch at The Brisbane Convention Centre.

Notes from your diarist are below for 2023 and 2024. Even for this well regarded economist, the juxtaposition of 2023 and 2024 shows how difficult economic forecasting was over the past two years.

Luncheon held on the **9th February 2024**
The Brisbane Convention Centre
Quest Speaker: **Paul Bloxham Chief Economics HSBC**

3rd February 2023

* World in a challenging place presently. Australian's facing some real challenges.

* Economy 2 effects: demand v supply (capacity to deliver)

* Pandemic arrives, smashed demand but also supply.

* Then mid 2020 demand started to pick up, different economies at different speeds.

* Reopened + major government stimulus. Central banks jumped on board.

* Problem supply side couldn't keep up. COVID shutdown Asia. Disrupted shipping containers, so shipping costs up substantially. Borders shut, labour shut down constrained = lead to inflation from 2021 o/seas 2021 Australia 2022.

* So left with inflation haven't seen for decades. Last print Australia 7.8%

* Challenge to bring inflation down, by preferably sort supply issues. But can't sort them quickly enough, so rather than supply, weaken demand by jamming interest rates high.

* Problem slowdown demand = slowdown economy & if big enough = recession.

* Fed one more hike, EU one more hike.

* Why didn't we see this coming?

* What we have seen is very unusual. Haven't seen for many decades.

* Initially FED said transitory, to a degree true as supply constraints have started to correct, but around for long enough to feed into inflation.

* People excited core US inflation 4.4%, but still double central bank target. EU 5% core.

* So growth will have to slow, US growth to slow to 0.8%, mild recession US, but tell-tale signs US losing momentum, PMIs weakening, bond market (smart money), yield curve inverted, so saying economy to go into recession.

* US already slowed down, sluggish, central bank not finished yet, EU forecast recession by HSBC.

* Market seeing central banks might cut rates by year end. That seems a stretch. HSBC see cuts for 2024, maybe late 2024.

* Asia: Asian economies also slowing, partly because demand from western economies slowing.

* Another factor at work. During COVID could spend on manufactured goods, but not services. So manufacturing helped Asia, but now demand for services weakens demand for services = weakening growth story in Asia.

* China COVID response = lockdowns. So pivot on COVID means HSBC forecast strong bounce back China. Inflation in Asia not up by as much, because Asia didn't do fiscal stimulus.

* Global GDP slows 3.3% to 1.95%, but inflation still too high. Fixed interest rates still to go up a bit = slowing demand.

* All of the above have a rhyming sound in Aust. Demand constrained, big fiscal stimulus, reopened economy (other than Vic), supply constraints, weather overlay constrained supply, so demand overwhelmed supply = inflation. RBA didn't see it coming. Then in May light bulb & RBA interest rate far too low, cash rate raised 300 basis points in 12 months. Last week, 7.8% inflation, underlying 6.5%. Inflation peaked US<EU<NZ.

* RBA's only option to raise interest rates further. So likely 2 x 0.5% rates rises in coming months. Monetary policy has large time lags so unclear when have done enough.

* GDP slows from 3.6% to 1.6% so consumer needs to slowdown. Consumption expenditure last year 6.5% slows to forecast 2% this year.

* Impact on asset prices incl. property prices. House prices down 11%.

* Unemployment 3.5% too low & putting pressure on employment. Reopening border helps with more workers.

* Conviction: growth has to slow. Unemployment has to rise. House prices to fall 15-20% in cycle. Interest rates to rise further & with lags, haven't flowed through to economy yet.

* RBA $186B loans to banks 3yr @ 0.10% fixed lead to fixed rate mortgages as 20% mortgage rate signed in early 2021, so roll off from sub 2% to 6% during this year. Complicated for RBA as effect more lagged than normal.

* Household saving went from 5% to 22% for quarters through 3Q22 = $180B set aside for spending. Supporting revenge spend etc. When will this runout & consumer slow down? Some stats show downward trend already.

* RBA needs inflation to slow & unemployment to rise. Then they pause. HSBC forecast after two more increases.

* HSBC don't believe RBA will cut anytime soon with high inflation. Rate cuts maybe 2024, maybe end 2024.

* For all of cyclical HSBC positive Aust. GDP growth. Asia, immigration, big country to produce more renewables, incl. minerals via renewable energy.

Question time:

Q. What does history tell us?

Last pandemic Spanish flu 1919 after war, so different time.

But inflation in 1970s shows difficulty of inflationary times.

Differences US v Aust.

Wages growth in US became imbedded more quickly, cash flow Aust. wages growth too low, now picking up to 3-4% but not excessive.

Q. Aust. beneficiary terrible events Ukraine v Russia as a commodities doing well?

Paul agreed, but Aust. huge beneficiary rules based order post WWII, so any geopolitical events that impede rules based order is positive for Aust. med-long term.

Q. Bears?

Equity market excited about rates coming down, but markets too focused on such a fall. Lot of earnings reports also, given slowdown priced into bond market & expecting.

So be cautious, cycle different to normal. Higher rates for longer. Cycle likely more elongated.

<u>9 February 2024</u>

* Global economy holding up well. Last year v concerned re inflation & how long it would take to get it down & was a recession required to reduce inflation.

* Good news is inflation is coming down, in some countries more than others, & have done so without a global recession.

* US leading the way. US inflation peaked at 9% core PCI now 2.9%. Last 6 months annualized 1.9%.

* Economy in US still growing last qtr. 3.3% employment growing well. US story exceptional & increasingly likely a soft landing. Immaculate disinflation.

* How has this been achieved?

* $ issued during COVID saved & were ongoing supply issues, so demand > supply.

* Demand didn't fall that much in US, but supply picked up & achieved good productivity growth in US.

* EU inflation higher 10.6% due to higher gas prices during Ukraine/Russia war.

* Inflation down to 3.3%. EU got there by weak demand, incl. technical recession in Germany.

* Market in US pricing in cut of 120 points from April 24. HSBC view that won't cut so early, maybe June & likely won't go as hard as market is pricing in.

* Asia -China. Facing headwinds COVID slowed property t/over. Property developers insolvent. So won't be solved any time soon. So Chinese growth has to look for other drivers.

* Consumption as economy reopened. People going out to restaurants etc. Green - largest producer solar panels. Have done that well, so iron-ore demand incl. from Aust. has held up reasonably well.

Other risks in 2024.

* Geopolitics is best one. Some big elections, including US & what would another Trump presidency mean? Higher tariffs would be a challenge & to Asian economies & China.

Australia.

* Aust. not in as good a place as US, but not as bad as EU. Inflation peaked at 8% trimmed mean 4.2% cash flow target 2%.last 6 months annualized 4.1%. So cool engines on rate cuts in Aust.

Why slower in Australia?

* Aust. didn't lift interest rates as far. Did on purpose, as happy to do slowly & retain as many people in jobs as possible. Unemployment in Aust. v low. So Aust. rates cuts will lag o/seas.

* Aust. inflation being held up by domestic inflation, particularly services. Rents, insurance, electricity.

* Rents need new housing supply & not easily increased. Electricity transition to renewables expensive. Insurance lifted by lot of houses in flood plains.

* Also biggest input to services is wages inflation at 4%. Would be ok if had productivity? We don't. So businesses lift prices. So need to improve productivity - but not coming. Labour market regulation moving in wrong direction.

* Consumer slowing down, but growth still at 1.5% overall.

* Aust. housing. Price growth in 2023 higher than expected. Treasury was predicting 200,000 immigration, turns out 500,000. Migration slowing this year. House prices 10% first year HSBC predicting 5% 2024.

* Offices WFH, moving to NABERS building & out of second & third tier office properties.

* More an issue in US, partly due to higher gearing.

* GDP Aust. 2024 HSBC forecast 1.5%

* Global disinflation is helping us.

Question time:

Q. New look RBA. Lot of process change. Meetings reduced to 8 from 11. Press conferences. Lot of process change, but underlying objectives etc. unchanged. Modernization. Lot of fire & fury signifying nothing!

Q. 500,000 immigration should be reduced by students locked out for over a year coming back to continue their studies. So maybe 200,000-300,000 net.

Happy Investing in 2024,

Chris Burrell