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Jobs & Confidence Under the Microscope

After a week firmly focused on the Reserve Bank (RBA) and interest rates, this week attention turns to households and businesses and how they are faring as the economic tide begins to turn.

The behaviour of households is a key uncertainty this year. Household consumption represents over half of our economic activity and is therefore paramount for growth. On one hand, a strong labour market, rising nominal incomes, accumulated savings and a surge in overseas arrivals are expected to support spending and growth. However, cost-of-living pressures and materially higher interest rates are eating into disposable incomes, while falling property prices are making households feel worse off and therefore less likely to spend.

As a leading indicator of household spending, consumer confidence tends to provide some insight into how consumption outcomes will evolve. However, throughout much of 2021 and 2022 there was a significant divergence between consumer sentiment and spending. Cost-of-living pressures and rising interest rates have pushed pessimism to recessionary levels. However, spending has remained elevated buoyed by pent-up demand, high savings, a strong jobs market and cushioned by the delayed transmission of monetary policy. This divergence narrowed somewhat late in the December quarter as signs emerged that spending started to lose some steam. In fact, the RBA noted last week that the spending impulse following the lifting of COVID restrictions "has now largely run its course."

Tomorrow, consumer confidence data for February will be released. January saw confidence improve slightly but remain heavily downbeat. The RBA's February rate hike and guidance that at least two more rate hikes are on the way are likely to see sentiment sour in February. However, some optimism that we are nearing the end of the tightening cycle is expected to limit any falls. Either way, sentiment is unlikely to improve materially until some of the pressures on households begin to abate. We are expecting the disconnect between confidence and consumption to further narrow throughout 2023.

Turning to businesses, tomorrow also features an update on business confidence and conditions in January. Resilient household spending over the second half of 2022 made for very strong trading conditions. However, momentum began to shift late in the year alongside early signs of a weakening spending pulse. In December, conditions softened for a third consecutive month but remained elevated relative to history. We expect this softening to extend through January as household demand comes off the boil.

In contrast, business confidence, which tends to be more forward looking, moved into pessimistic territory late last year as the economic outlook gradually deteriorated. December saw an improvement in the mood among businesses as cost pressures pulled-back, however, the negative disposition persisted. Signs that the outlook for the global economy improved, including the reopening of China and positive developments in the European and US economies, may have sparked some optimism among businesses in January. However, the underlying softening in domestic conditions is likely to translate into further weakness in confidence in the near-term.

On Thursday, the January labour force survey will be released, detailing the performance of the labour market in the first month of 2023. 2022 was a stellar year for Australia's jobs market, recording the largest increase in employment over a single calendar year on record. However, the strength was skewed more heavily towards the first half of the year. As the labour market reached its tightest levels in almost 50 years it became harder to extract additional slack from the market. As a result, employment growth decelerated and became more volatile. Still the labour market ended the year strongly and with an unemployment rate of 3.5% - close to a 50 year low.

We are expecting the unemployment rate to remain unchanged in January, while employment is expected to increase by 15k. Of particular interest will be how quickly labour supply is expanding. The reopening of international borders has seen a surge in arrivals who are expected to join the labour market and help meet some of the shortages currently experienced by businesses. Given labour demand remains strong an increase in supply will likely prompt strong employment growth over the start of 2023. However, as growth in labour supply begins to outpace demand, we are expecting to see an increase in the unemployment rate towards more sustainable levels. This dynamic is key to the trajectory of interest rates due to its feedback to wages growth and inflation and will be watched closely by the RBA.

The RBA will be on show, again.

No week would be complete without some action on the monetary policy front. After, opting out of a post-statement address last week, the RBA Governor Phillip Lowe is scheduled for two appearances this week. On Wednesday the Governor will appear in front of the Senate Economics Committee before addressing the House of Representatives' Economics Committee on Friday. The Governor is expected to be peppered with questions from parliamentary officials trying to extract more information from the RBA on its thinking around monetary policy settings. There is also likely to several enquiries on the RBA's communication, which has been heavily criticized.

International data

Looking offshore, the key data release for the week will be the US consumer price index (CPI) report for January, which is due out tomorrow night. Positive inflation developments have underpinned a surge in optimism that the Fed can manufacture 'immaculate disinflation' and steer the economy to a soft landing. Such an outcome hinges on inflation falling to target and wages growth softening to more sustainable levels without a significant increase in unemployment.

Tomorrow's inflation report will be a key test to this school of thought. Consensus has headline CPI inflation slowing to 6.2% in annual terms, from 6.5% in December. Core inflation is expected to decelerate to 5.5% in annual terms from 5.7% previously. Any upside to these numbers will likely prompt a large market reaction and increase sympathy for Jerome Powell's comments that interest rates will be "higher for longer".

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Forecasts

		2023				2024	
End Period:	**Close (10 Feb)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	3.35	3.60	3.85	3.85	3.85	3.60	3.35
90 Day BBSW, %	3.47	3.97	4.05	4.05	3.97	3.72	3.47
3 Year Swap, %	3.92	3.80	3.75	3.70	3.60	3.55	3.50
10 Year Bond, %	3.71	3.45	3.30	3.10	2.90	2.70	2.55
US Interest Rates:							
Fed Funds Rate, %	4.625	4.875	4.875	4.875	4.875	4.375	3.875
US 10 Year Bond, %	3.73	3.40	3.30	3.20	3.10	2.90	2.70
USD Exchange Rates:							
AUD-USD	0.6917	0.70	0.71	0.72	0.74	0.75	0.76
USD-JPY	131.36	132	131	130	129	128	127
EUR-USD	1.0678	1.08	1.09	1.10	1.11	1.12	1.13
GBP-USD	1.2062	1.21	1.22	1.23	1.24	1.25	1.26
NZD-USD	0.6305	0.64	0.65	0.66	0.67	0.68	0.68
AUD Exchange Rates:							
AUD-USD	0.6917	0.70	0.71	0.72	0.74	0.75	0.76
AUD-EUR	0.6480	0.65	0.65	0.65	0.67	0.67	0.68
AUD-JPY	90.906	92.4	93.0	93.6	95.5	96.0	96.5
AUD-GBP	0.5738	0.58	0.58	0.59	0.60	0.60	0.60
AUD-NZD	1.0971	1.09	1.09	1.09	1.10	1.11	1.13

	2021	2022 (f)	2023 (f)	2024 (f)
GDP, %	4.6	2.6	1.0	2.0
CPI (Headline), %	3.5	7.8	3.9	3.1
CPI (Trimmed mean), %	2.6	6.9	3.6	3.1
Unemployment Rate, %	4.7	3.5	4.6	5.1
Wages Growth, %	2.3	3.6	4.5	3.5

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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