Outlook Q4 2024 & Quarterly review

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Economic Outlook Q4

The Reserve Bank of Australia (RBA) kept the official cash rate unchanged at 4.35% in Q3, as we had expected. Our base case remains for the RBA to commence easing in Feb/Mar 2025. Despite hawkish jawboning by the RBA, we expect start of an easing cycle to come into focus as the unemployment rate gradually increases. With the RBA Board not explicitly considering the case for a rate hike at the September meeting, we view this as a sign the RBA is thinking about a softening of their language sometime during Q4.

RBA Governor Bullock has been resolute in sticking to the script with a continued laser focus on returning inflation to target and lingering concerns around the upside risks to inflation. The RBA Board, rightly, wants to see results in sustainably lower inflation prints before thinking about reducing interest rates. With underlying inflation having fallen little over the past year in quarterly terms, the Board remains vigilant to the upside risks. Q2 CPI data showed trimmed mean inflation running at 3.9% YoY, only very slightly above the RBA's expectations for the print at 3.8% YoY, and still well above the 2-3% target band[1].

As expected, Q2 GDP was soft at 0.2% QoQ (1.0% YoY)[1]. This annual growth rate is the lowest since 1992, outside of the Covid period. Much of the weakness in GDP is across private sector segments, with private investment falling. Consumer spending remains weak reflected by soft income trends and higher tax costs. However, tax cuts could help consumer spending recover in Q4. The savings rate is at a historically low level of 0.6%[1]. The key area of strength remains Government spending which has contributed nearly all of the economic growth in FY24. Public consumption is now 22.7%[1] of GDP (from ~20% pre-Covid) - and likely to grow further given State and Federal Budget commitments.

The pace of annual wages growth has steadied to around 4% p.a[1]. Signs of increased slack in the labour market has reduced the risk of a further reacceleration in wage costs, particularly in the private sector. The risk for the RBA is that the strength in public sector wages persists as various enterprise bargaining agreements are re-negotiated. Further complicating matters is that we still have elevated wages growth in an environment of anaemic productivity. This remains a persistent inflation challenge for the RBA and is keeping inflation outside the band.

Arguably, the most important guidepost for the RBA looking forward will be employment - as it has been for the US Federal Reserve (Fed) in choosing their timing for easing monetary policy. Recent local jobs data points to resilience in the labour market with the unemployment rate steady at 4.2%[1] and a record high participation rate. This aligns with the RBA's assessment that "the labour market is operating above full employment". If the current momentum persists, the risks will tilt to a later rather than an earlier start in the RBA easing cycle. The RBA expects only a small pick-up in the unemployment rate to 4.3% by year-end 2024.

In summary, we expect that monetary policy will continue to bite through the back half of this year. We remain in a higher for longer cash rate environment regardless of what other major global central banks are doing with monetary policy. Thus, we expect the timing of the first rate cut could be Feb/Mar 2025, with 75bps worth of cuts in 2025 for a terminal cash rate of 3.6%.

Credit Outlook Q4

AUD credit had another solid quarter in Q3, with demand for yield driving spreads tighter. Investor fund flows continued to paint a picture of relative strength in risk assets. The underlying strength of investment grade corporate balance sheet appears to be the main driver of investor confidence. The H124 reporting season from listed companies was solid with no major surprises above and beyond what's already evident from the trends seen in late 2023, i.e., weaker real and nominal consumer demand.

A robust issuance pipeline throughout the quarter saw issuers look to lock in lower all-in funding costs as global bond yields fell. The primary volumes in the local fixed income market are running well ahead of last year's run-rate. We expect primary issuance to slow during the quarter, which should help to limit any technical pressure on credit spreads.

We expect Australian credit spreads to remain range bound over the next 3 months supported by a domestic economy with gradually improving GDP growth and prospects for a rate cut in Q125. Investors can continue to pick up 'carry' in a relatively benign macro-outlook with a soft landing being our baseline case.

We retain our overweight stance on Australian credit. High quality fixed income, inclusive of AUD credit, are set to benefit from declines in US treasury yields. The macro backdrop is still conducive for high quality fixed income – government bonds and investment grade credit. Bonds usually exhibit relatively strong total returns in the lead up to, and immediately after, central banks commence cutting rates.

Currency Outlook Q4

The AUD finally caught a tailwind towards the end of Q3 reaching a high of US$0.6915 cents, pushing through a multi-year resistance level of 0.68/0.69[2]. News regarding fresh China stimulus and a weaker USD were the key forces propelling the AUD higher. The impressive rebound in the AUD suggests the currency could test US$0.70 cents in Q4. The RBA's decision to keep the target cash rate on hold with little change in the Board's assessment of the economy also helped to underwrite the AUD. The prospects of a RBA rate cut in 2024 are rapidly diminishing with the RBA maintaining its mildly hawkish stance driven by sticky underlying inflation from service sector price pressures. With the US Fed commencing their easing cycle with a powerful 50bp cut, and the prospect of at least another 50bps by year-end, a rapidly narrowing AUS/US cash rate differential should provide a durable downside floor.

The recent substantial stimulus measures launched by the Chinese authorities pushed iron ore prices above US$110/t, after trading down to a low of US$89/t in Q3[2]. Renewed investment in social housing coupled with infrastructure investment should lift China's steel consumption in 2024 and thus, be AUD supportive.

Downside risk factors we are mindful of include, increased volatility as the U.S. Presidential election in November draws closer and note that the polls have narrowed. Geopolitical event risk has materially escalated which tends to benefit the USD over the AUD.

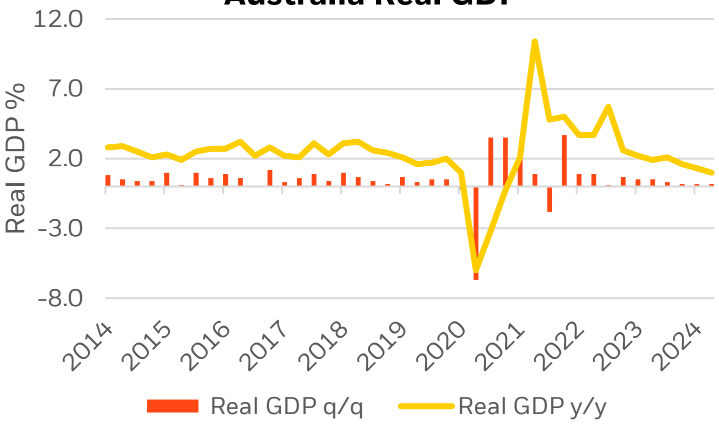
Any opinions, forecasts represent an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation.
Source unless otherwise specified: BlackRock as of 03/10/2024. 1. Australian Bureau of Statistics (ABS) as of 03/10/2024 2. Bloomberg as of 03/10/2024

GDP – Q2 2024

- ▲ QoQ GDP **grew 0.2%,** broadly **in line with** expectations.
- ▼ YoY GDP slowed from **1.1%** to **1.0%**.

Australian Q2 2024 GDP rose +0.2% QoQ, the eleventh consecutive quarter of GDP growth. In per capita terms, GDP contracted by -0.4% QoQ /-1.5% YoY extending the per capita recession to 6 quarters. Household spending fell -0.2% QoQ, the weakest growth since September 2021 during the COVID Delta-variant lockdown. The household saving to income ratio remained steady at 0.6%, with gross disposable income growing faster than nominal household consumption. The largest contribution to growth was government expenditure which increased by 1.4%, driven by continued strength in social benefits to households.

Australia Real GDP



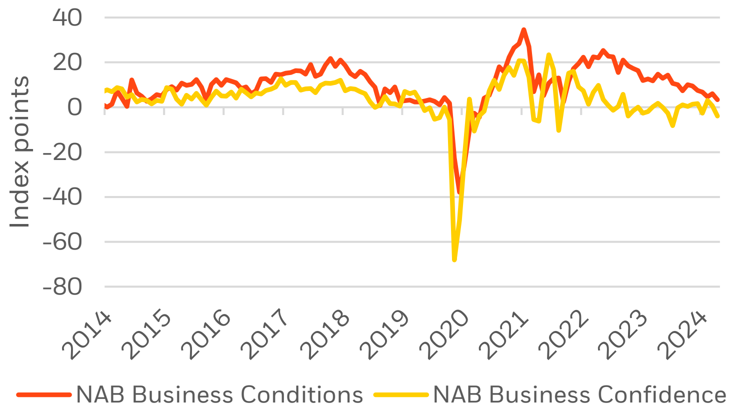
Source: ABS, Bloomberg, BlackRock as of 30/09/2024

Business Conditions – Aug 2024

- ▼ **Conditions fell by 3pts** from +6pts (May) to +3pts (Aug)
- ▼ **Confidence fell by 1pt** from -3pts (May) to -4pts (Aug)

Over the quarter, the NAB Business Survey saw business confidence rise sharply to +4pts in June, the highest since early 2023. However, confidence fell to +1pt in July and moved back into negative territory at -4pts in August. This decline was significant across several sectors, with confidence weakest retail and wholesale. Business conditions fell to +4pts in June, rose to +6pts in July (the first improvement in five months) and then dropped back below average to +3pts in August. The decline in conditions was mainly due to a decrease in employment, indicating that weaker trading conditions and profitability might now be more significantly impacting labor demand. Capacity utilization continued to remain elevated.

NAB Business Survey



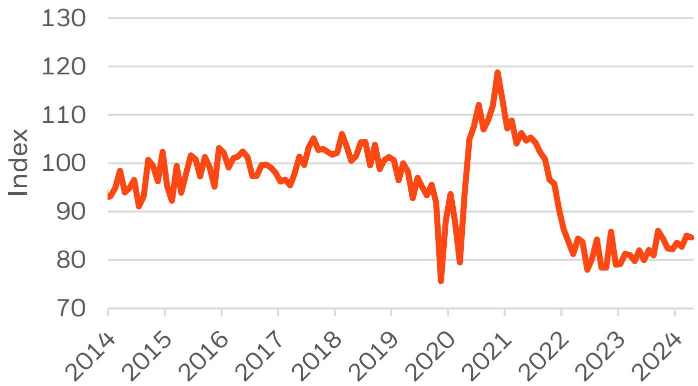
Source: NAB, Bloomberg, BlackRock as of 30/09/2024

Consumer Sentiment – Sep 2024

- ▼ The Westpac-M.I. Index of Consumer Sentiment **fell 0.5% MoM** from 85.0 in August to **84.6 in September**.

While consumer sentiment improved over the quarter, rising by +1.2%, the index results remain pessimistic. With cost-of-living pressures and fears of interest rate hikes easing, consumers are increasingly worried about the future of the economy and its impact on employment. There is a sustained improvement in family finances due to moderating inflation and fiscal support, with the 'family finances vs a year ago' sub-index rising 1.2% in September and up 13.1% since July. Consumers are slightly more confident that pressures on family finances will subside, with the 'family finances, next 12 months' sub-index also ticking up 0.2% in the month. On the other hand, the 'economic outlook, next 12 months' sub-index fell 2.6% and the 'economic outlook, next 5 years' sub-index declined 1% over the month

Westpac Consumer Sentiment



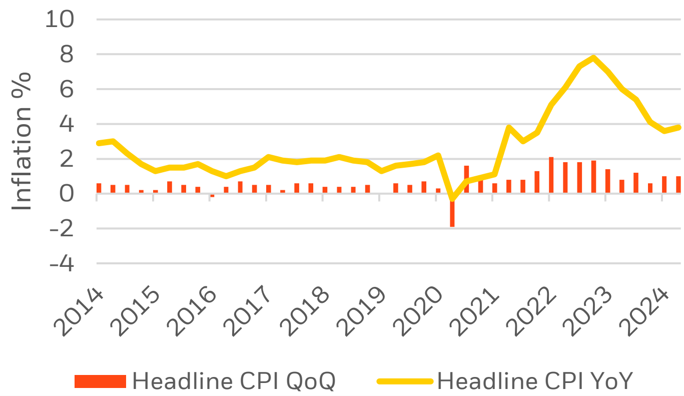
Source: Westpac, Bloomberg, BlackRock as of 30/09/2024

Inflation – Q2 2024

- ▲ Headline CPI **increased** by **1.0% QoQ**
- ▲ Annual inflation **rose 0.2%** from to 3.6% to **3.8%**.

The annual pace of inflation rose to 3.8%, the first increase since Q4 2022. A closely watched measure of core inflation, the trimmed mean, also rose by 0.8% QoQ with the annual rate falling from 4.0% to 3.9%. Key contributors to rising prices in Q2 were clothing and footwear (+3.1%), health (+1.5%) and alcohol and tobacco (+1.5%) with moderation seen only in communication (-0.8%). Inflation has largely gone sideways this year as the easy gains from recovering supply chains fade. Services inflation will remain sticky as structural issues in housing and insurance persist. That said, Q3 should see a sharp fall in headline inflation as it is impacted by electricity subsidies expected to subtract around -60bps. The trimmed mean will also be impacted by a lesser degree.

Headline CPI



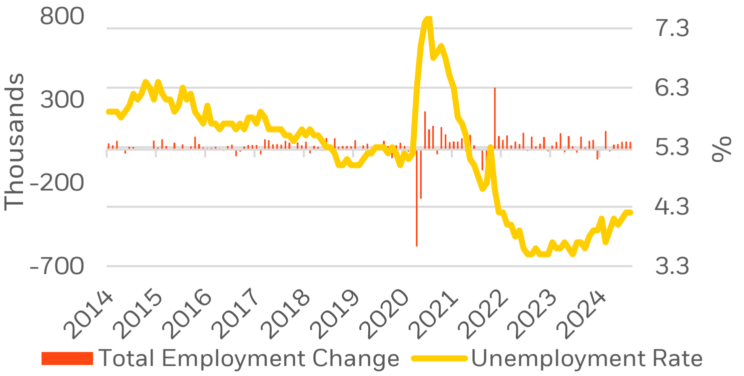
Source: ABS, Bloomberg, BlackRock as of 30/09/2024

Labour Market – August 2024

▲ Employment data saw the number of employed people **grow by 47,500**.
▶ The unemployment rate **remained steady at 4.2%.**

Australian employment for August rose by 47.5k, driven solely by part-time employment which increased by 50.6k, while full-time fell 3.1k. Despite the strong jobs growth the unemployment rate remained steady at 4.2%, with the participation rate unchanged at a record high of 67.1%. Unemployed people fell by 10.5k in August but increased by 86.6k over the last year. Seasonally adjusted hours worked rose by 0.4% MoM, with annual hours worked rising by 1.7%, slower than annual employment growth of 2.7%. Overall demand for labour remains strong, as does supply, with employment to population recording a new high of 64.3%

Monthly Employment Change & Unemployment Rate



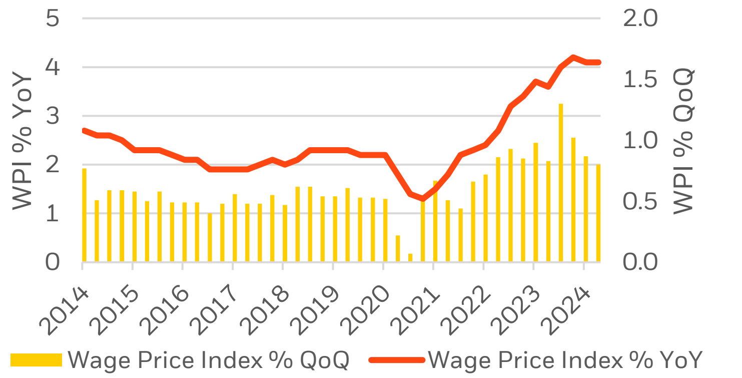
Source: ABS, Bloomberg, BlackRock as of 30/09/2024

Wage Price Index – Q2 2024

▲ Wages **increased by 0.80%** over Q2
▶ Annual wage growth was **unchanged at 4.1%** (exp. 4.0%)

In Q2 Australian Wage Price Index increased by 0.80% QoQ and the annual rate was unchanged at 4.1% despite the headline number that came in weaker than expected due to revisions to previous quarters. Private sector wages grew by 0.7% QoQ, and 4.1% YoY, the lowest quarterly rise since Q2 2021. Just 11% of private sector jobs got a pay increase in Q2, but those that did saw an average 4.2% increase, moderating a little from 4.4% in the past 2 quarters. Public sector wages grew faster at 0.9% and 3.9% YoY largely due to the newly synchronised timing pattern of Commonwealth public sector agreement increases. Wages are past the peak but are expected to moderate slowly over the year ahead, a faster easing in the labour market remains a downside risk.

Wage Price Index



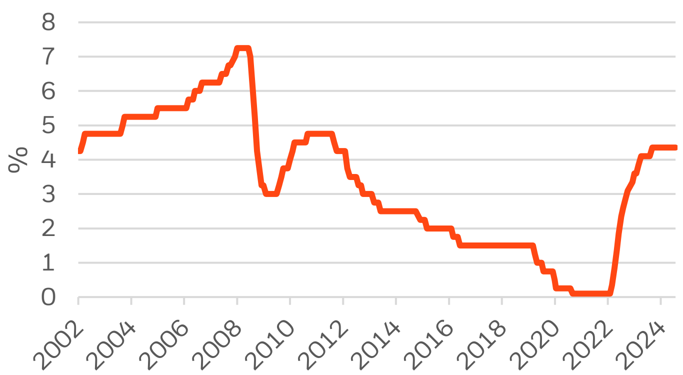
Source: ABS, Bloomberg, BlackRock as of 30/09/2024

RBA Policy Rate – Sep 2024

▶ The RBA left the cash rate **unchanged at 4.35%** during the quarter, as widely expected

The RBA left the cash rate unchanged at 4.35% and the interest on excess reserves at 4.25%. Despite inflation moderating due to falling goods prices the RBA remain concerned around the persistence of service inflation, the tightness of the supply side of the economy, ongoing strength in the labour market and weak productivity. The RBA continue to see the macro-economic environment as highly uncertain and wish to maintain a data dependent approach “not ruling anything in or out”. Overall, the press conference was less hawkish than the statement and no forward guidance was given. The RBA remain data dependant and are maintaining maximum optionality. We think that the necessary pre-conditions to cut maybe realised by early 2025.

RBA Cash Rate Target



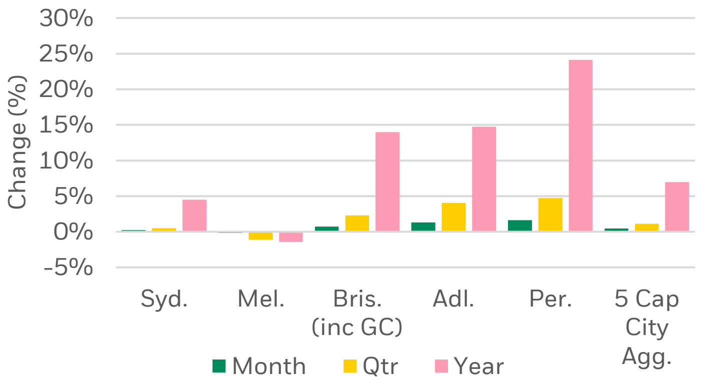
Source: RBA, Bloomberg, BlackRock as of 30/09/2024

House Prices – Q3 2024

▲ The CoreLogic national HVI **rose 1.0% in Q1**
▲ The CoreLogic national HVI **increased 6.7% over the year**

The CoreLogic national HVI rose 0.4% in September, which was broadly in line with the monthly change in July and August of 0.3%. Price momentum is beginning to wane, with the capital cities of Melbourne, Canberra, Hobart, and Darwin recording declines. Sydney also had the lowest growth since the three months ending February 2023 while the mid-sized capitals are also losing momentum, though they continue to outpace the others. Homeowners are increasingly looking to sell though CoreLogic has seen vendor metrics soften, signaling weaker selling conditions. Strong population growth coupled with low supply has been supportive of the housing market, however affordability is becoming an issue.

Core Logic Australian Home Value Index



Source: CoreLogic, Bloomberg, BlackRock as of 30/09/2024

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