

5 September 2023

## Lift in US growth outlook to see more cautious Federal Reserve and sluggish AUD/USD in 2024

The US economy and the equity market have proved much more resilient to the FOMC's tightening cycle than earlier anticipated.

In particular, strong real consumption growth in June and July amid tight financial conditions and a decelerating labour market has highlighted the financial health of US households. Though it follows next-to-no growth February to May, paired with an emerging uptrend in structures investment, it is enough to warrant us removing the marginal technical recession previously forecast for Q4 2023 and Q1 2024.

Annual growth in 2023 and 2024 has therefore been revised up from 1.0%yr in both years to 2.0%yr and 1.3%yr. Our early estimate for 2025 is also benign at 1.5%yr. We retain our modest rise in the unemployment rate from 3.8% to around 5.0% in 2025, principally as a result of the ongoing recovery in participation and population growth rather than outright job losses.

Our expectation for inflation to mid-2024 is also unrevised. Current trends in the inflation detail and leading indicators for shelter inflation are consistent with 6-month annualised inflation back at 2.0% by end-2023 and the annual rate around 2.0%yr by mid-2024. It is the second half of 2024 and into 2025 where we see risks of inflation re-accelerating in the absence of even a small technical recession. These are risks the FOMC focus on and so will remain cautious of. From 2.0%yr at June 2024, a headline inflation rate around 2.5%yr is likely by mid-2025, with upside risks.

Less concern around a US recession coupled with prospects of re-accelerating inflation is consistent with a much more cautious FOMC than we had previously anticipated.

Because we expect that signs of headline inflation reaching 2.0%yr by mid-2024 will be apparent by March, we retain our view that the first rate cut will occur at the March meeting. But we no longer expect the cycle to accelerate to 50bps per quarter from the June quarter. Rate cuts are also expected to pause in late-2025 as inflation remains above 2.0%yr.

From 5.375% at February 2024, the fed funds rate is now expected to be cut to 4.375% by end-2024 and 3.375% in December 2025 compared to 3.625% at end-2024 and 2.625% June 2025 previously. The forecast decline in the 10-year yield now starts later and is shallower than previously projected. At the end of 2023, 2024 and 2025, it is now forecast at 4.10%, 3.40% and 3.10% compared to 3.60%, 3.00% and 2.70% before these revisions.

At end-2025, the US curve is still modestly inverse (-0.325%), and the real cash rate is 0.875% (slightly above neutral). These "imbalances" highlight the resilience of the US economy and the difficulties the FOMC is likely to experience in holding inflation at 2.0%yr.

Higher US interest rates and stronger GDP growth are likely to support a slower descent for the US dollar and consequently further weakness in the Australian dollar. From the current spot rate near USD0.64, we now look for USD0.66 at end-2023, USD0.70 end-2024 and USD0.73 end-2025.

Notably, not only is the starting point of this revised profile 2 cents weaker at December 2023, but also 4 cents lower at end-2024.

Through 2024 we had anticipated a 6 cent lift in AUD/USD, but under these new interest rate differentials (US rate cuts 75bps less in 2024), the lift in the AUD associated with improving global economic conditions will be more constrained.

In particular, risks around China should abate assuming policy makers continue their recent push, but only as their actions prove effective. This will support the Australian dollar, particularly in the second half of 2024 and into 2025.

**Bill Evans, Chief Economist**  
**Elliot Clarke, Head of International Economics**

### FORECASTS

Australia	Latest (05 Sep)	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Dec-25
Cash	4.10	4.10	4.10	4.10	3.85	3.60	3.35	3.10	2.85
10 Year Bond	4.14	4.00	3.80	3.60	3.40	3.30	3.22	3.12	3.02
10 Year Spread to US (bps)	-8	-10	-10	-10	-10	-10	-8	-8	-8
US									
Fed Funds	5.375	5.375	5.125	4.875	4.625	4.375	4.125	3.875	3.375
US 10 Year Bond	4.22	4.10	3.90	3.70	3.50	3.40	3.30	3.20	3.10
AUD/USD	0.6377	0.66	0.67	0.68	0.69	0.70	0.71	0.72	0.73

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