Economic and interest rate update

By Perpetual Corporate Trust
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Long-term, medium-term and short-term market drivers

Key Points

- Significant volatility and weakness in metals, tech shares and Bitcoin as markets worry about the appointment of a less supportive than expected new Fed chair. In truth, a healthy correction was needed given very strong recent performances, especially for silver.

- RBA raises interest rates as most but not all had expected. Forecast revisions strongly suggests another rate rise will be delivered, with May the most likely timing. The RBA is using a capacity constrained economy narrative to justify the rapid about face on interest rates. That story doesn't completely hang together in my opinion. Nevertheless, the latest forecasts anticipate a combination of slower growth and higher unemployment and interest rates will be required to return inflation to target.
- I continue to view the pre-eminence of the RBA's forecasts with a healthy degree of scepticism. The models are quite challenged in a world such as now with so many different conflicting forces.
- Tensions remain between the US and Iran, pressuring oil prices higher.
- US partial labour market data weaker than expected, continuing to support further easing expectations in the US, even though most Fed Governors currently favour a period of monitoring of the economy.
- Another big week for Australian and US data with the Household Spending Indicator, Consumer Confidence and the NAB Survey in Australia and Non-Farm Payrolls and Unemployment, Retail Sales, the CPI and Employment Cost Index in the US. In addition, there are numerous speeches from RBA and Fed officials.

The week in review

It's been a very volatile and weak week for markets, especially for precious metals, Bitcoin and technology shares. The key developments since our last report on 30 January have been:

- A sharp sell-off in gold and silver overnight on the 30th of January. This was attributed to the appointment of Kevin Warsh as the next chair of the Federal Reserve. Warsh is seen as less likely to cut interest rates aggressively and known to be in favour of reducing the size of the Fed's balance sheet, both moves likely to be less supportive of further gains in gold and silver prices. Given the prodigious rises in price over January – on top of very healthy gains over 2025 - prices seemed ripe for a correction, with Warsh's appointment perhaps more of a catalyst than a cause? Silver prices nearly halved during the week but have recovered slightly to still be 35% lower than just before our last report. Similarly, Bitcoin prices at their lows were nearly a third below the prices just prior to the Warsh appointment but have slightly recovered to be "just" 21% lower than just over a week ago. Tech shares were also quite weak, but not to the same extent as the move in precious metals and Bitcoin. The speed and size of the moves suggests considerable speculative positioning had built up in precious metals, while for Bitcoin and tech shares, markets continue to reassess arguably previously stretched valuations.
- The RBA confirmed the expectation of most – but not all economists – in raising the cash rate by 25bps at its February Board meeting to help return inflation to the 2.5% target. The

February forecast revisions do not see inflation now returning to the 2-3% band until mid-2027 and this assumes a further interest rate rise is delivered.

- Oil and other energy markets, which had been weaker of late, rose strongly the week before as tensions continued between the US and Iran, though talks late this week reduced prices somewhat. Still, oil remains some 5% higher than around 10 days ago.
- US partial labour market indicators for January have been printing fairly uniformly on the soft side of expectations. This supports expectations of further easing in the US (just over two cuts are priced before the end of the year, which seems reasonable). This is in stark contrast to tightening expectations priced into Australian markets (one and a half further rate rises hikes by the December Board Meeting), even though Fed officials are signalling it's appropriate to monitor the economy in the near term following three successive interest rate cuts late last year.

The RBA's revised forecasts

The table shows the RBA's revised forecasts released in the February Statement on Monetary Policy. Higher than expected inflation in both Q3 and Q4 of 2025, mean the Board must tighten policy to deliver at target inflation, which is effectively achieved by higher interest rates trimming growth and raising unemployment slightly compared to the staff's previous forecasts. The forecasts assume a 4.2% cash rate, which is a further 35bps higher than the new cash rate since last week's rate rise.

Market drivers

The RBA's actions in the short to medium term will continue to be driven by its dual mandate of full employment and low and stable inflation. To correctly forecast the economy, however, requires correct identification of the biggest forces impacting on the growth outlook.

Last week we introduced the longer-term Megatrends shaping the economy, business and society over the next few decades. As a reminder these were:

- AI and technology.
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- Climate Change and the Energy Transition.
- The Ageing Population.
- Rising Inequality.

The importance of the AI investment boom was generally underestimated last year and was a major offset to the expected drag on growth from President Trump's tariff agenda. Tariffs also proved less of a drag than initially feared due to delays and negotiated reductions, while importantly there was also less global retaliation.

What are the shorter-term drivers likely to shape the economic outlook this year?

I'd nominate the following as important themes to take a view on:

- President Trump's policies.
- Previous increases in costs and prices, which continue to create stress for some businesses and consumers.
- The change in interest rate direction in Australia from modest easing to modest tightening.
- Stronger US economic growth as a result of the continuing boom in AI and data centre investment, fiscal easing and US interest rate cuts implemented in late 2025.
- An emerging mini boom in Australian mining, the spillover from the still much higher prices for precious metals, copper and lithium, despite recent falls.
- A moderately higher Australian dollar as Australian interest rates rise and US interest rates are more likely to fall a little further, while selected Australian commodity prices remain considerably higher than a year ago. Importantly, historically, stronger gold and copper prices have correlated well with $A strength.

Short-term market drivers and the economic calendar this week

This week, the markets' focus in Australia will be on the December Household Spending Indicator today (likely to be weaker than recent strong readings as Black Friday sales drag spending out of December into November in particular), the latest Consumer Confidence and NAB Business Survey releases on Tuesday (consumer confidence is likely to react negatively to the rate rise of last week, while Business Conditions and Capacity Utilisation should again be strong in part reflecting the (temporary) beneficial effects of the Ashes tour, but also some emerging strength in parts of Mining, particularly benefiting WA.

There will likely again be extra focus on the capacity utilisation measure as the RBA uses a capacity constrained economy narrative to explain higher inflation and justify the rapid about turn on monetary policy. The very low unemployment rate is a more likely source of any capacity constraints given NAB's cap use measure also includes labour force utilisation. Treasurer Chalmers committed on Sunday to the May Budget focusing mainly on productivity measures to raise the economy's speed limit, along with spending restraint and intergenerational housing equity. In addition, this week, there are two RBA speeches and another Parliamentary Committee appearance by senior staff.

It's a big week for US data as well with the delayed January Non-Farm Payrolls release (now out Wednesday) rounding out the suite of what has so far been weak January US labour market indicators. Payrolls are expected to rise only 70K after an even smaller +50K in December, while the unemployment rate is forecast to remain unchanged at 4.4%. The risk would seem to be on the high side for unemployment, though it's too early to expect any beneficial effects of last year's interest rate cuts to be impacting.

In addition, there's Retail Sales (the ISM survey reported strong Retail Spending in January), the broad wages measure (the ECI) and at the end of the week a slightly delayed US CPI report for January. Core inflation is seen at 0.2% m/m – average monthly increases of 0.165% are required to annualise at the Fed's target, though of course this is for the PCE rather than the CPI. There are also at least six separate Fed speakers, where it will be important to monitor for any shift in view from most members favouring a period of steady interest rates.

Economic Calendar – key Australian and US events this week

Monday 9 February – Household Spending Indicator (December).

Tuesday 10 February – Consumer Confidence (February); NAB Business Survey (January); RBA Senate Estimates appearance; (overnight) US Employment Cost Index and Retail Sales

Wednesday 11 February – RBA Hauser's fireside chat; (overnight) Non-Farm Payrolls and US Unemployment Rate (January).

Thursday 12 February – RBA's Hunter speech "Full Employment".

Friday 13 February – (overnight) US CPI (January)

Speeches from the Fed's Waller, Miran, Bostic (Monday), Hammack, Logan (Tuesday), Bowman, Logan (Wednesday), Miran (Thursday)

Interest Rate Markets

Australian short-term yields rose further over the past week as the market digested the not fully expected February rate rise and repriced for the likelihood of at least one further interest rate increase in coming months. This saw three month and six-month bill yields both rise 11bps from our last report, to 3.93% and 4.20%, respectively. This compares to the new official cash rate of 3.85%, showing the market is discounting around one and a half further interest rate increases before the end of the year.

Australian three-year bond yields also rose, but by only 5bps as US 2-year yields dropped slightly on account of the weaker US labour market indications. Payrolls and unemployment data on Wednesday remain very important. The Fed signalled at its January meeting an expectation that unemployment was stabilising, something that it will likely assess for a few months, given the lag between policy moves (three cuts in late 2025) and the expected impact on growth and activity. The FOMC also communicated the consensus expectation that US growth should strengthen, though Governor Waller, who was early in detecting downside risks to labour markets last year, is again expressing these concerns.

This relatively rare divergence in US and Australian monetary policy direction is likely to see Australian interest rates continue to drift higher, while US rates move slightly lower. Along with supportive commodity price developments, this is likely to support the A/US.

Next week, we'll look at some of my favourite indicators of the Australian economy, which will help assess the aggregate impact of the large and diverse forces referred to above.