Australian economy to suffer lag effect: TRP

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T. Rowe Price's Global Asset Allocation review for January sees reduced expectations for both global growth and inflation, with Australia set to suffer from the lagging effect of the Reserve Bank of Australia's (RBA's) tightening cycle.

The U.S. economy is expected to remain resilient amid moderate growth, which comes after the U.S. Federal Reserve (U.S. Fed) signalled a move to cut rates at some point in 2024. This is contrasted by the RBA's hawkish approach due to high wage inflation, the European Central Bank's (ECB's) balancing act between "fragile growth and inflation", the Bank of Japan's desire to introduce more positive rate policy and challenges in Chinese growth.

"Stock and bond markets soared at the end of 2023 following Chairman Powell's surprise pivot in policy at the December 13th press conference. Investors were left scrambling to adjust their 2024 rates forecasts as just a month prior, Powell talked down any suggestions that they were close to considering rate cuts," the review said.

"His message at the press conference appeared to be an about face as he laid out expectations for lower rates next year. While not taking a victory lap, Powell acknowledged that their aggressive policies were indeed having the intended impacts of helping rein in inflation, while to their and the market's surprise has had little impact thus far on employment. With the markets celebrating the "soft landing," they quickly priced in six rate cuts, double what the Fed has laid out.

"Given the wide divergence in views, every data point ahead is likely to drive volatility. With U.S. economic growth having proved so resilient and the consumer and unemployment still far from broken, upside surprises to growth or inflation could have markets running back their rate cut views."

T. Rowe also highlighted how Australia's strong housing market has encouraged resilience alongside elevated wage growth and rising consumer confidence.

"We expect a sluggish Australian economy in 2024, reflecting weaker global growth and the lagged effects of past RBA tightening. Commodity prices have held up fairly well so far, providing support to Australia. But with most regions expecting slower growth in 2024, they may be close to the top of their range," the review said.

“Turning to the earnings outlook, consensus forecasts for 2024 are for a decline of 5% to 10%. In our view, earnings risks are skewed to the downside. Resilience in economic activity and employment supported equities in 2023, but have created the risk of a nastier downturn in 2024 by forcing central banks to disappoint market expectations of interest rate cuts.

“We continue to maintain a defensive posture as we expect the more cyclical parts of the Australian share market to come under greater earnings pressure in 2024. This should see quality, defensive and growth companies benefit as their earnings could prove more resilient.”

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