Will Interest Rates Fall in 2025

2025 Interest Rate Call

BY PAUL MIRON

Our Economic View

Despite the ever-changing economic landscape, the most discussed, and perhaps the most critical, question for 2025 is when and how much interest rates will be cut.

Last week, 68% of market commentators and economists predicted a rate cut in February. Perhaps most of these commentators have personal biases due to their own mortgages. Msquared holds a contrarian view regarding interest rate movements as several risks that will delay rate cuts need to be considered. We believe that even if rates are cut, it will only be 0.25% and much later in 2025, perhaps as late as Q4.

Australia's Economy is becoming increasingly complex. Despite being in a per capita recession, with GDP easing together with inflation, unemployment recently fell to 3.9% from 4.1%. This is counterintuitive and goes against traditional economic logic which says that as economic growth shrinks, unemployment should rise. However, as long as unemployment is below the Treasury's forecast of 4.5% by June 2025, there is little urgency to cut rates. We believe that many economic commentators are placing too much emphasis on what they are interpreting as dovish RBA messaging. The RBA board recently said it was "gaining some confidence that inflation is moving sustainably towards the target". Indeed, this is an improvement in messaging; however, in my opinion, it is not enough to justify that rates will be cut in February 2025 or the near future.

We also need to consider that significant changes to the Board have been announced to commence in March 2025, with two RBA boards now in operation and a Federal Election looming. It is possible the Board would be more inclined to delay any rate cuts until after the election to avoid the perception of political signaling. This may delay the RBA in considering cutting interest rates and give enough time for real risks to our interest rate market to kick in "Trumponomics." and provide a rationale to pause and see the impacts of prospective tariff wars. Without a doubt, Trump will act on his tariff war promises. However, it is difficult to predict accurately the full impact and extent of his actions, as well as the unintended consequences to the global economy and the ripple effect to the Australian economy.

As a result, we expect the Chinese economy will continue weakening further, impacting our exports to China. Let us keep in mind that recently the Treasury announced their prediction of a $100bn shortfall in our trade with China over the next four years due to a plunge in mining exports. These impacts are significant as China is our main trading partner. The Federal Government may be forced to exercise some fiscal constraint in an attempt to balance the trade deficits.

Concurrently, Trumponomics will result in higher fiscal spending in the US and other inflationary policies reverberating throughout its economy. The US economy is still strong and many economists are suggesting that US interest rates could be increased beyond 2026, despite interest rates being cut this month. If this plays out, there will be added negative pressure on the AUD. The RBA will want to prevent our currency from falling below 55 cents to the USD so as to avoid inflationary pressure on our economy as Australia is a net importer of consumer goods. This is another contributing factor in keeping interest rates on hold for 2025. In the last RBA interview, RBA Governor, Michelle Bullock, reinforced the damage that inflation has caused to everyday Australians.

Despite these negative aspects, Australia's economy is still relatively healthy, with low unemployment and net migration remaining the country's main economic drivers. However, higher interest rates for longer will continue to pressure businesses' cashflows, and record company failures will continue throughout the year.

Property prices will most likely moderate further despite the record undersupply of new properties and net migration remaining relatively high. The market is not constrained by access to capital as was the case in previous cycles, such as the 1980s (recession and stock market crash triggering a credit crunch) and in 2017 (Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry), but by affordability constraints impacting property in the aggregate. However, we expect other sections of the property market to perform relatively well, such as established apartments and high-end unique properties.

Considering the above, how will this impact private credit in 2025?

Private credit has come into the spotlight over the last 12 months, being recognised as a suitable asset class to add to diversified portfolios. Borrowers are more accepting of private credit, and there is an increase in demand for alternative finance. We have seen numerous acquisitions of private credit firms by domestic

and overseas fund managers who are eager to capitalise on the market's tremendous opportunity.

However, in 2024 we started to see the potential downside of investing in private credit. Several high-profile borrowers have collapsed, leaving investors exposed to inflated valuations, high-risk second mortgages, and specialised security such as development sites, pubs, restaurants, and facilities secured solely by business which have failed. Therefore, despite all the positives and opportunities, private credit does not come without risk. Investors need to appreciate that not all mortgage managers are the same and that not all types of mortgages carry the same risk.

Msquared Capital's ethos centers around ensuring that all our offerings are secured by real estate, excluding specialised properties. This approach is designed to provide our investors with security and confidence in their investments.

I have been fortunate enough to be interviewed by several publications in the last few months, especially about the increasing focus on regulation within the private credit sector. As a fund manager, we encourage greater discussion and education about the industry, a unified reporting framework, and standardisation regarding borrower protection, enabling a fairer, level playing field. With the growth of private credit, I am confident it will continue to emerge as a mainstream financing option for borrowers. Furthermore, it will complement investor portfolios, offering a reliable income stream that is lowly correlated to the rest of market. For further discussion, please find my most recent interview, Money Management: [ASIC ups scrutiny of private market funds | Money Management]

I would like to thank you for all your support in 2024 and look forward to working with you in 2025.