

THE ECONOMIC OUTLOOK

PRESENTATION TO THE URBAN DEVELOPMENT INSTITUTE
(QUEENSLAND)

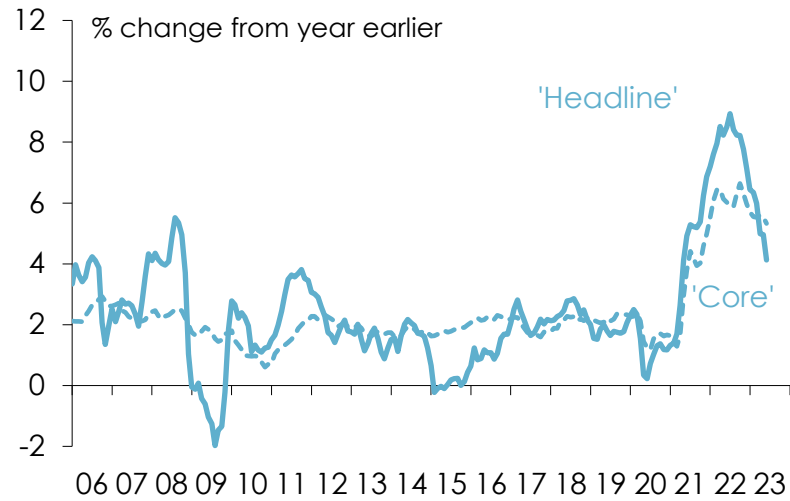
SOFITEL BRISBANE
10TH AUGUST 2023

SAUL ESLAKE

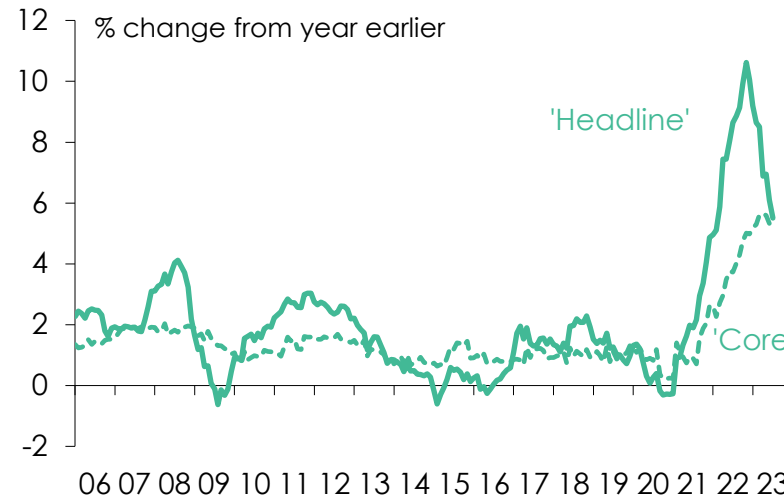
CORINNA ECONOMIC ADVISORY
INDEPENDENT ECONOMICS

Inflation rose sharply in all 'developed' economies in 2022, and although 'headline' inflation has now peaked, 'core' inflation remains 'too high'

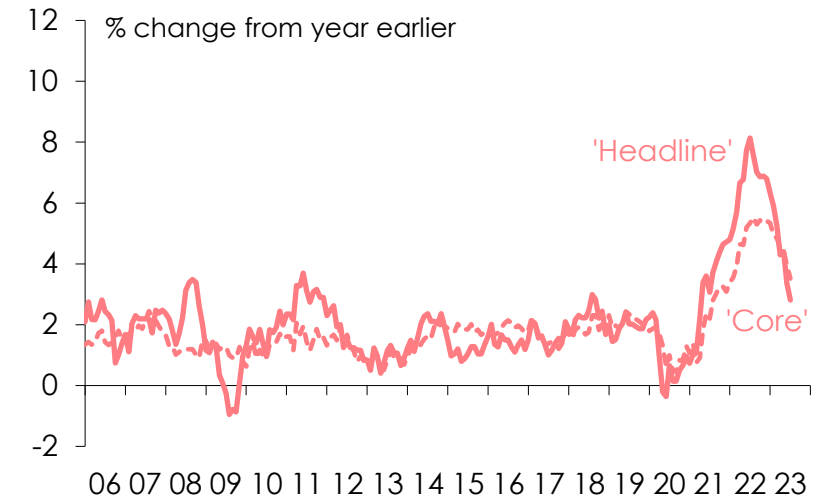
United States



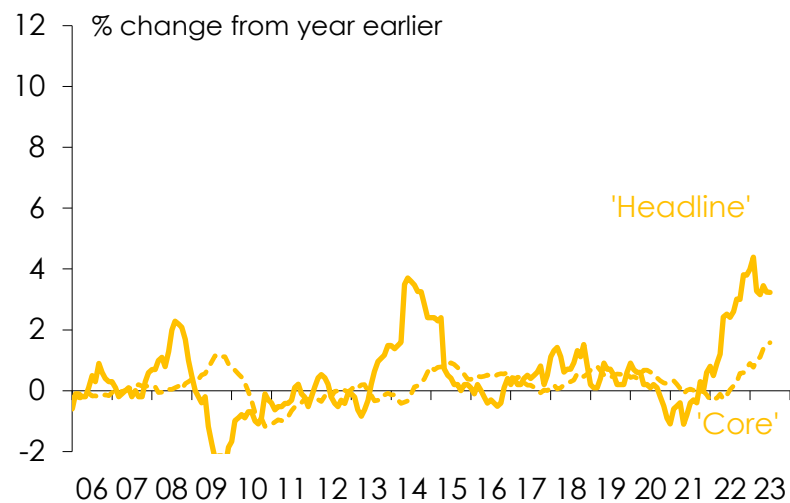
Euro area



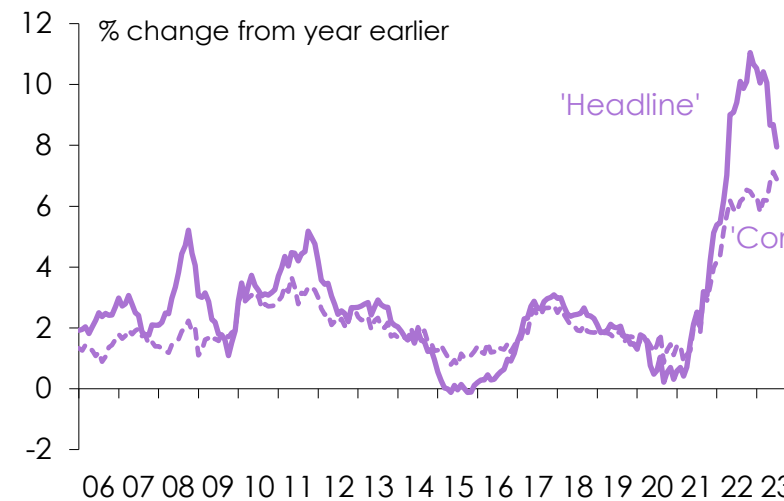
Canada



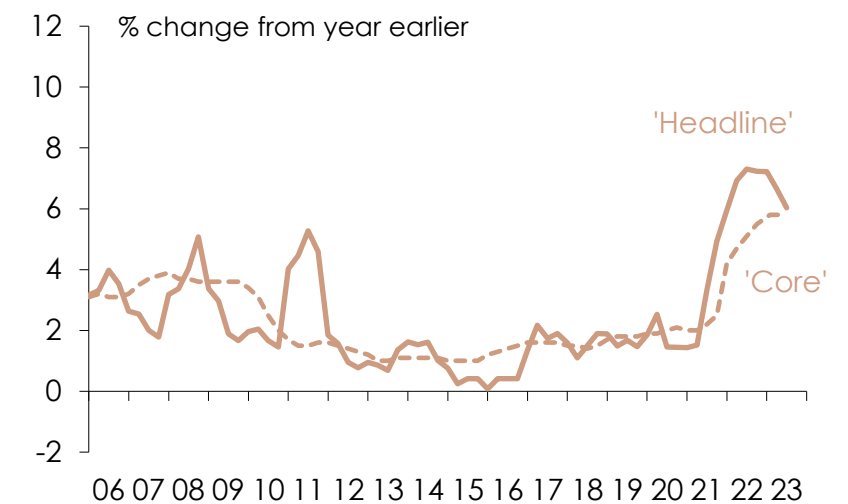
Japan



United Kingdom



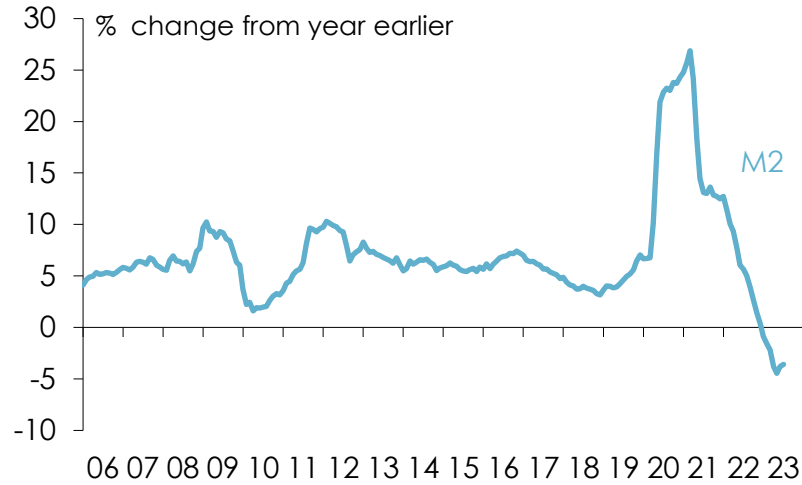
New Zealand



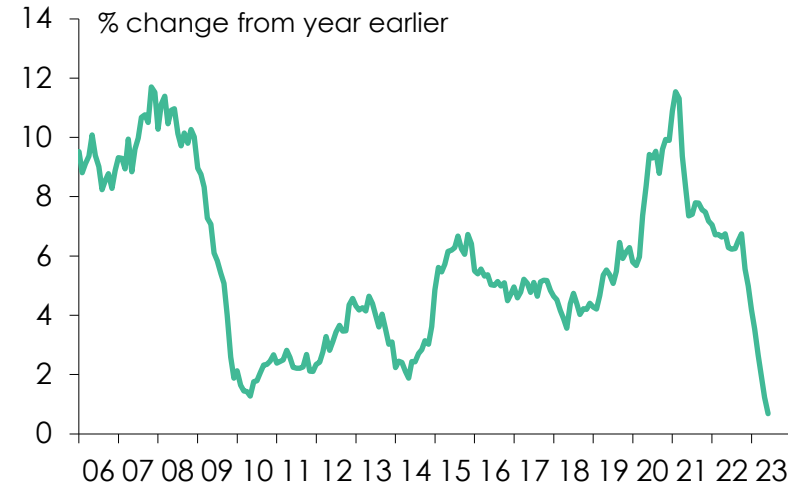
Note: 'Core' inflation is the annual change in the CPI excluding food & energy, except for Japan and NZ where 'core' inflation is derived from a statistical model maintained by the central bank. Sources: US Bureau of Labor Statistics; Statistics Japan; Bank of Japan; Eurostat; UK Office for National Statistics; Statistics Canada; Statistics NZ; RBNZ.

A common factor across the developed world was the rapid growth in the 'money supply' during the Covid-19 pandemic

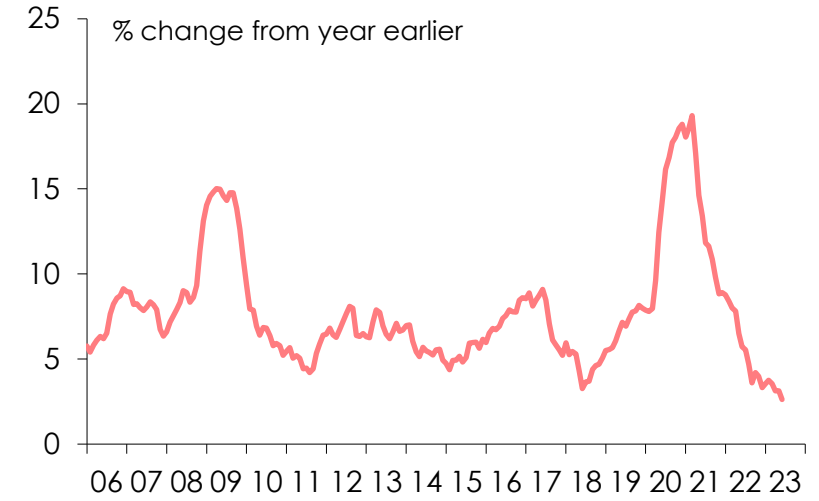
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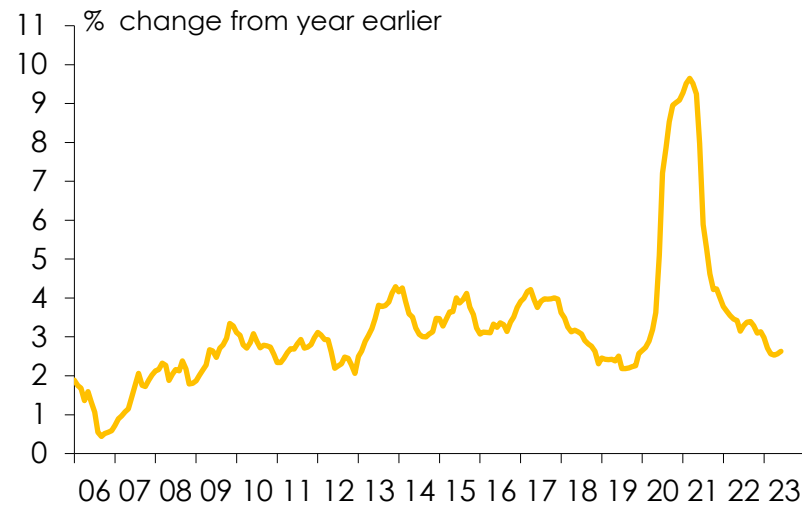
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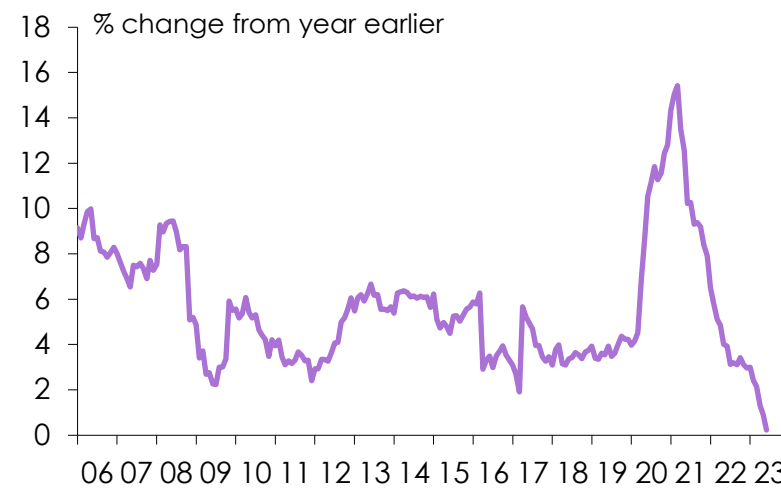
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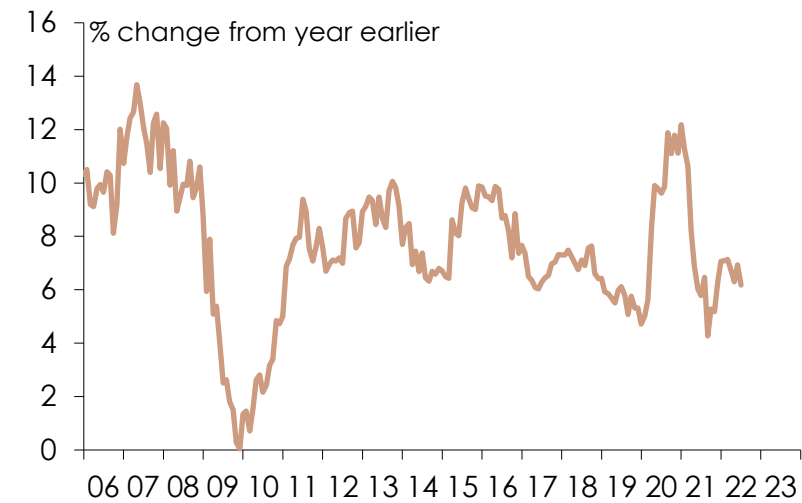
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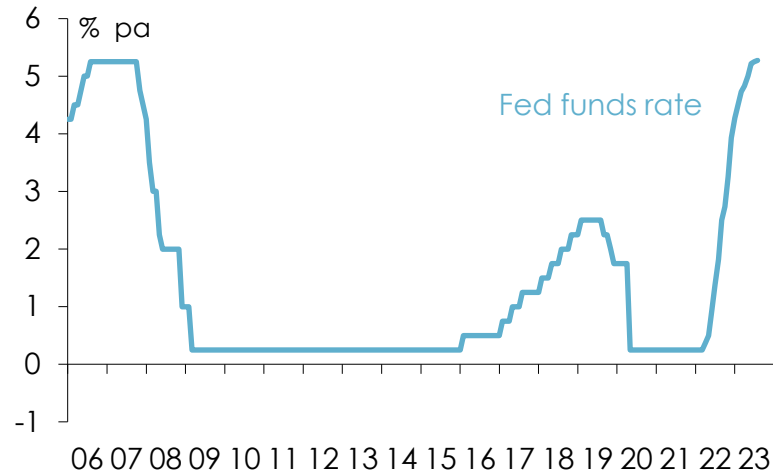
New Zealand



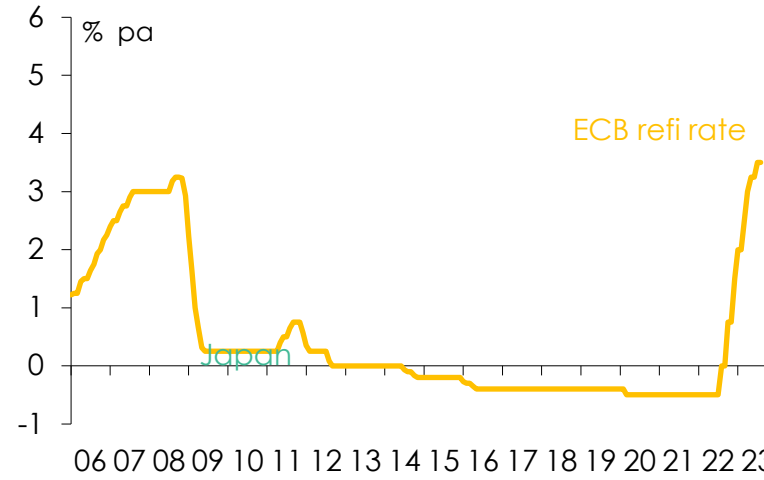
Sources: US Federal Reserve; Bank of Japan; European Central Bank; Bank of England; Bank of Canada; Reserve Bank of New Zealand.

Central banks, other than Japan's, have lifted their monetary policy interest rates sharply since mid-2022

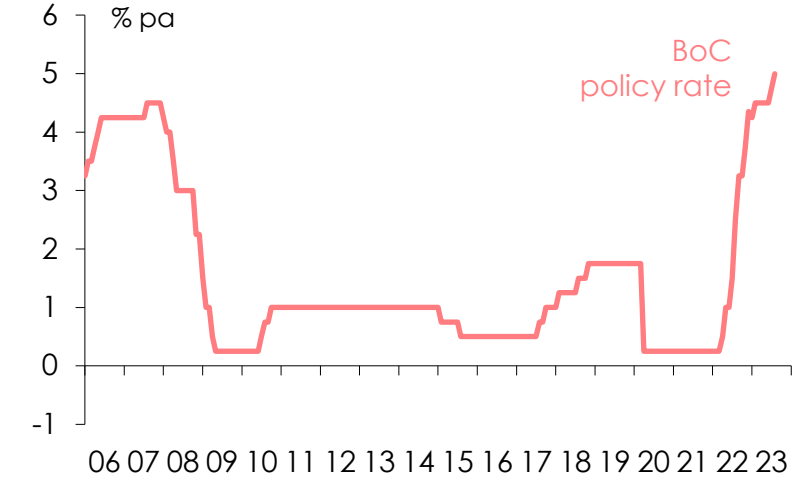
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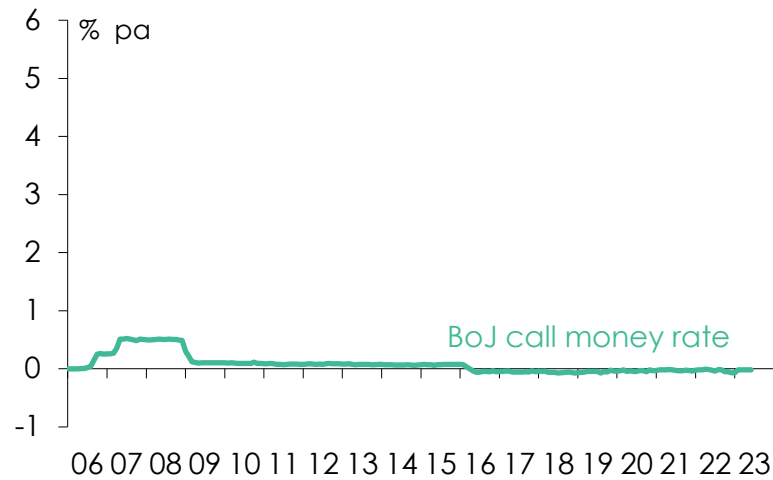
Euro area



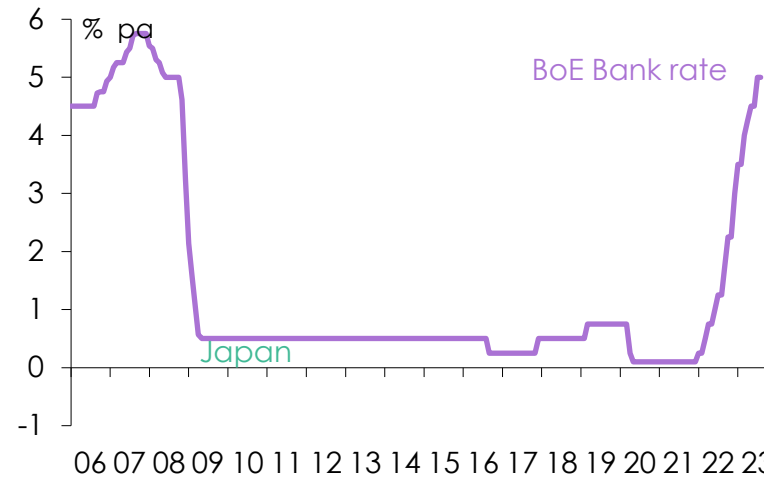
Canada



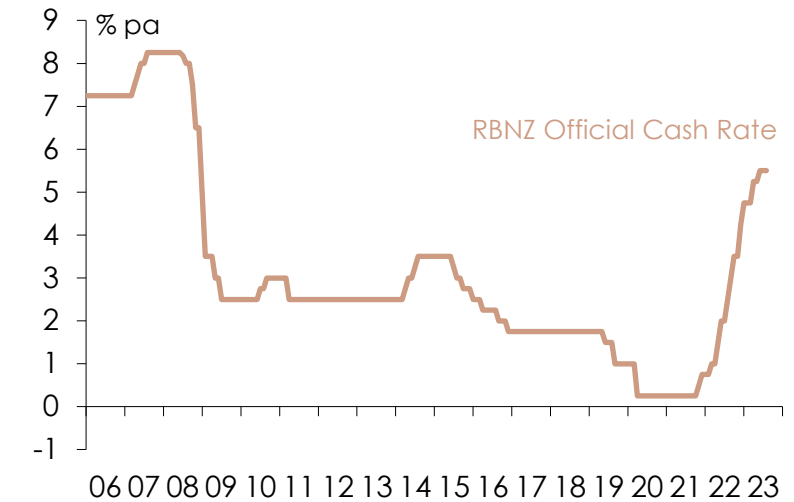
Japan



United Kingdom



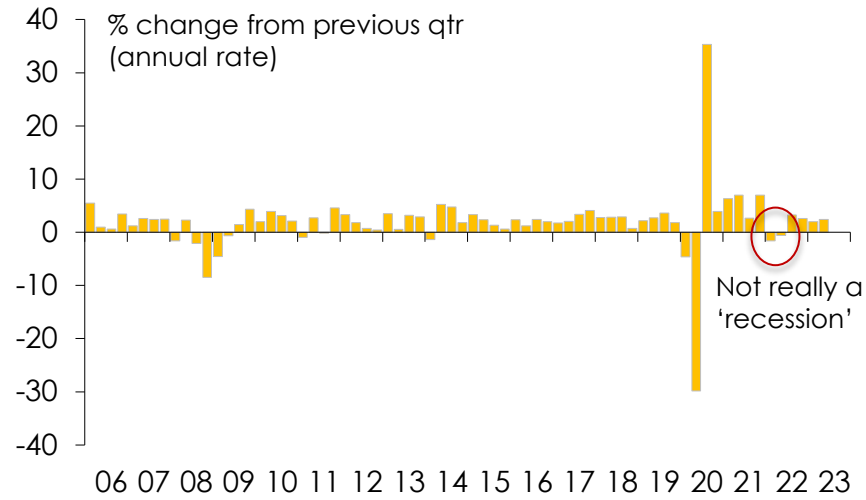
New Zealand



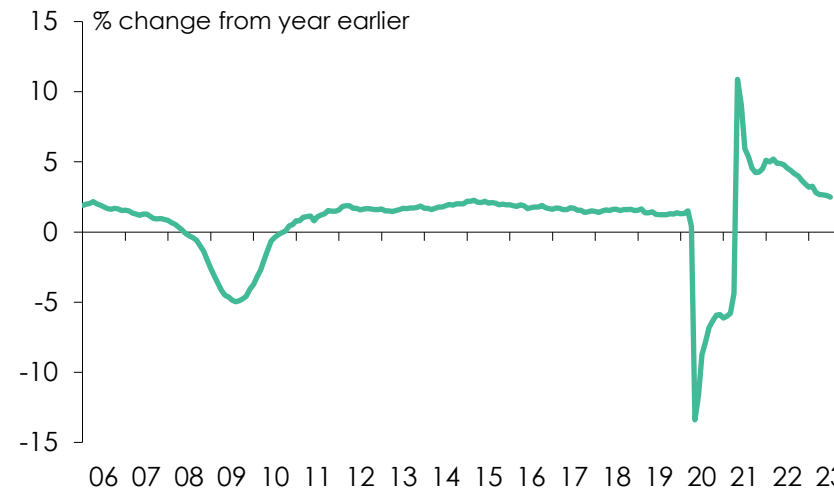
Sources: US Federal Reserve; Bank of Japan; European Central Bank; Bank of England; Bank of Canada; Reserve Bank of New Zealand.

The US economy has proved surprisingly resilient to the rise in interest rates and a 'soft landing' now looks more plausible

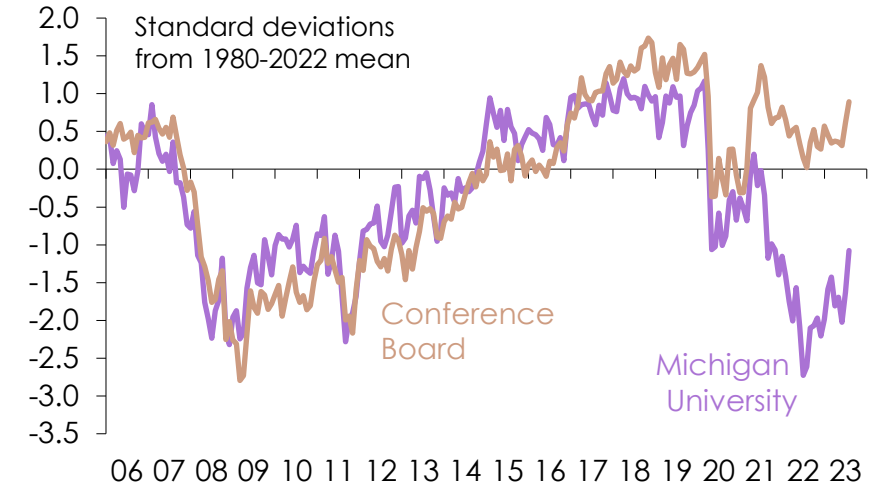
Real GDP



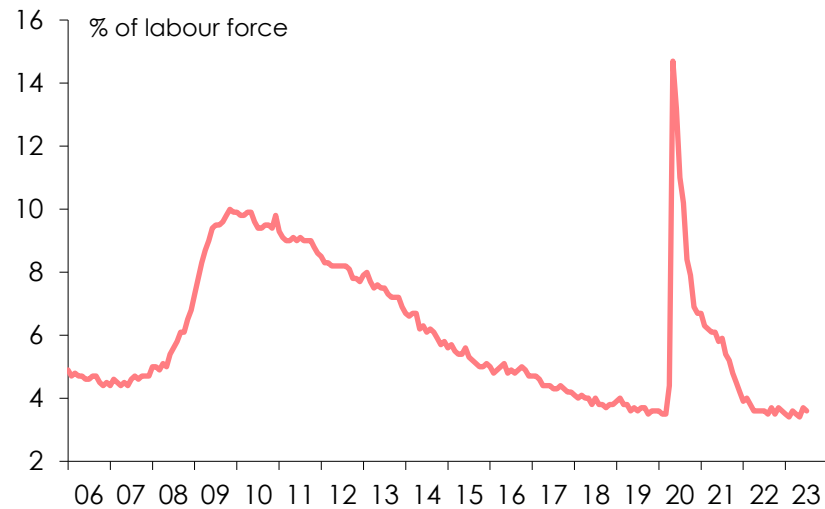
Employment growth



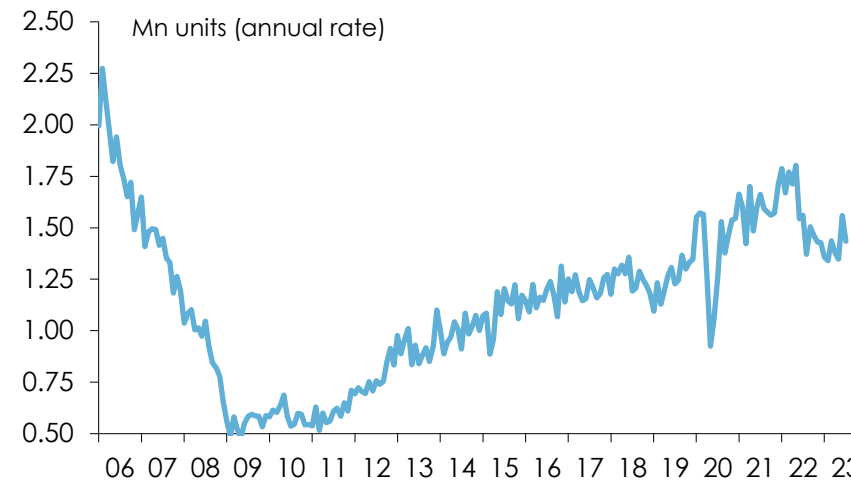
Consumer confidence



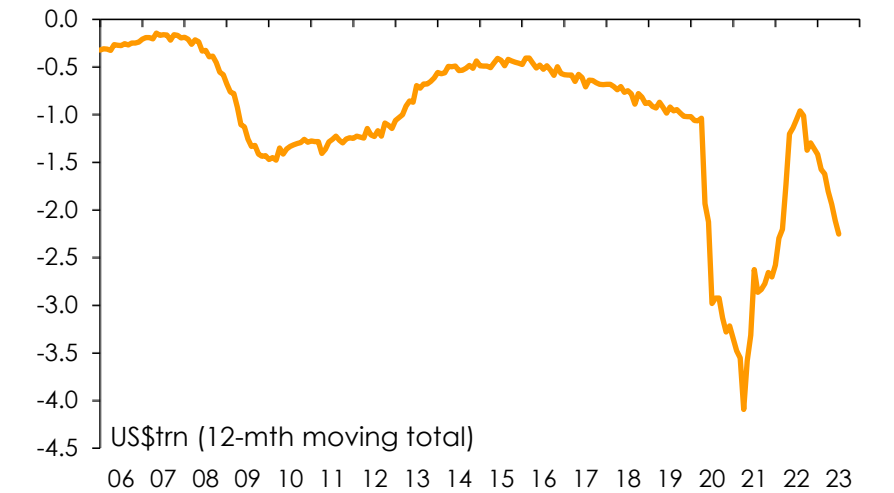
Unemployment



Housing starts

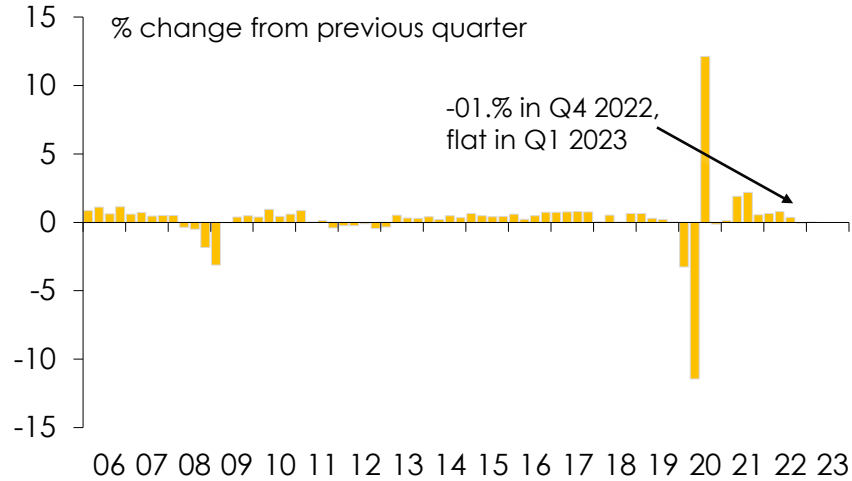


Federal Budget deficit

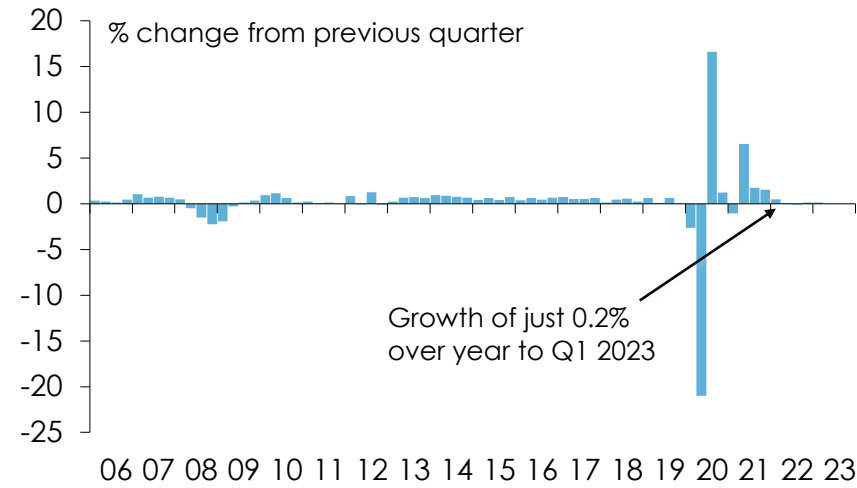


Both the euro area and the UK look less resilient, while New Zealand is already in recession (by one definition)

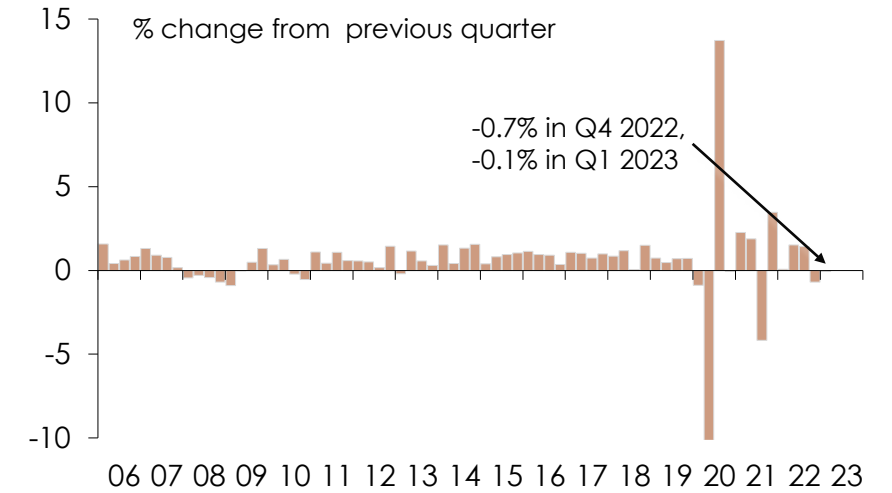
Euro area real GDP



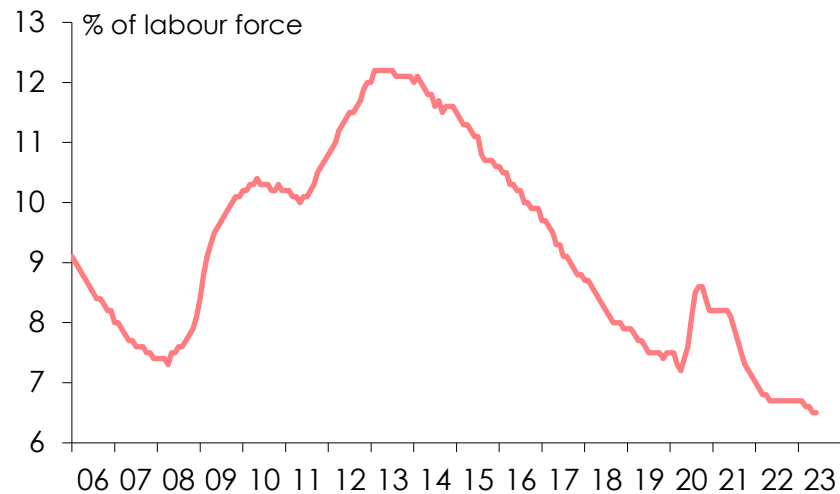
UK real GDP



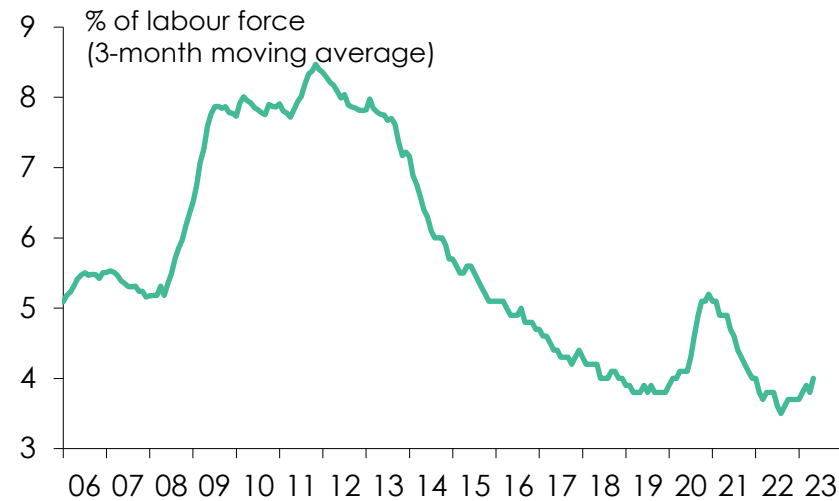
NZ real GDP



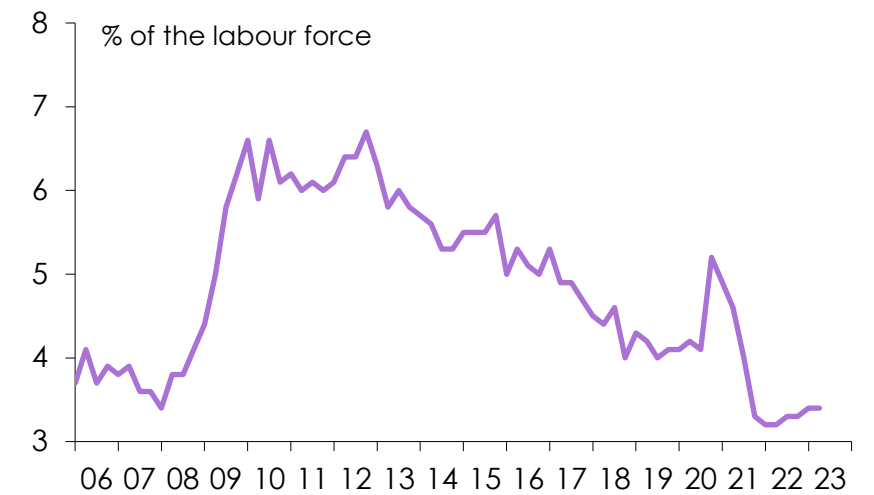
Euro area unemployment



UK unemployment

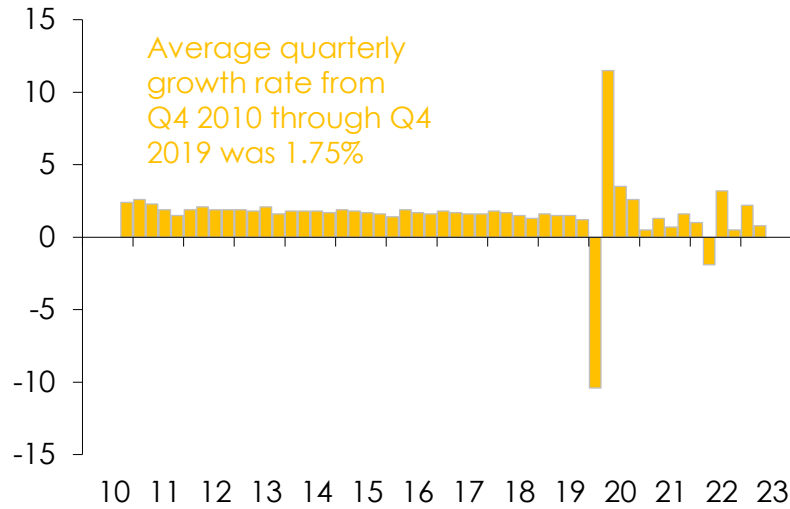


NZ unemployment

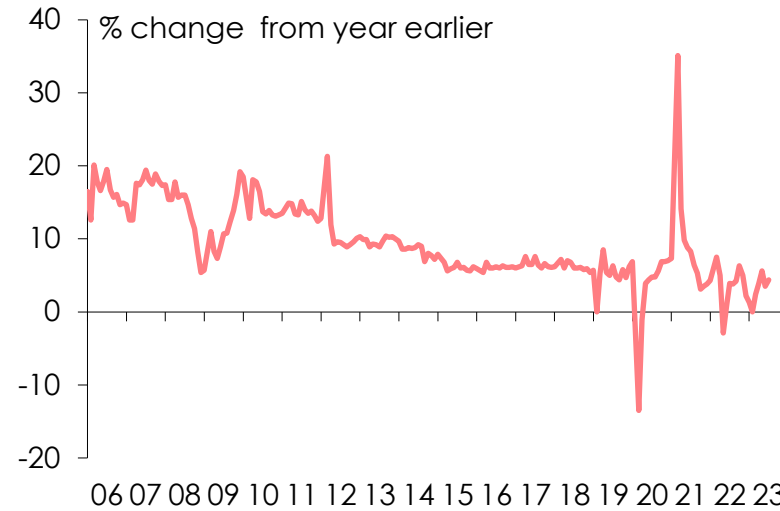


China's post-Covid recovery has been very modest

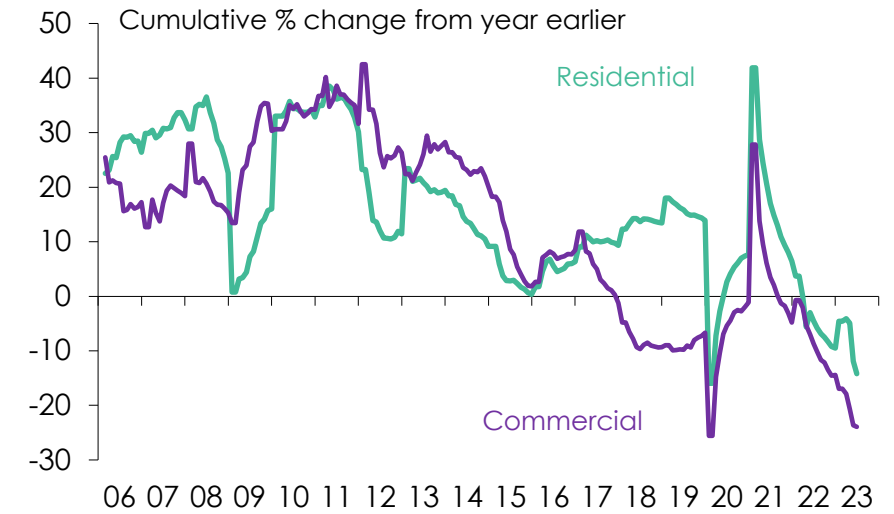
Quarterly real GDP growth



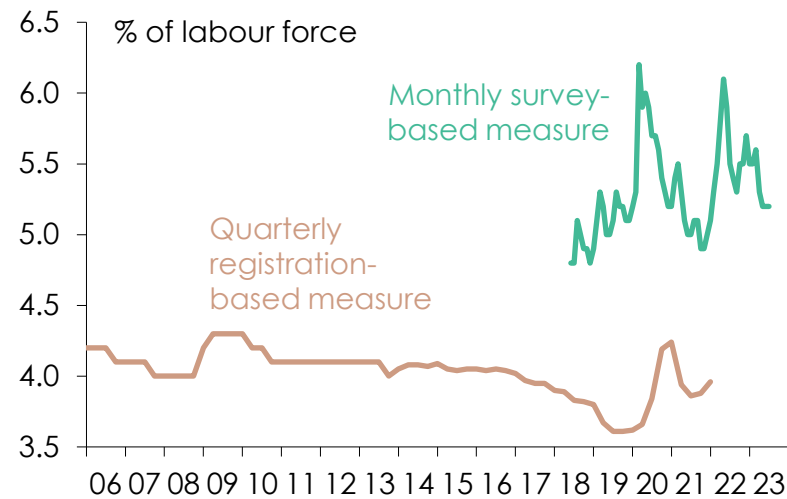
Industrial production



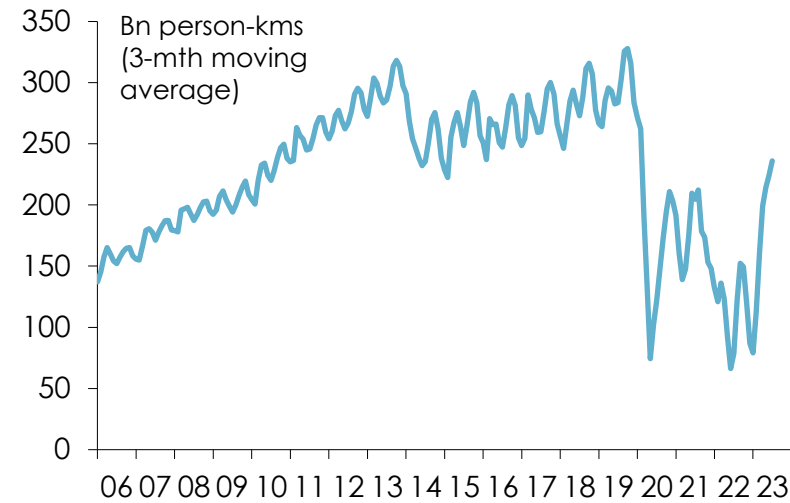
Real estate investment



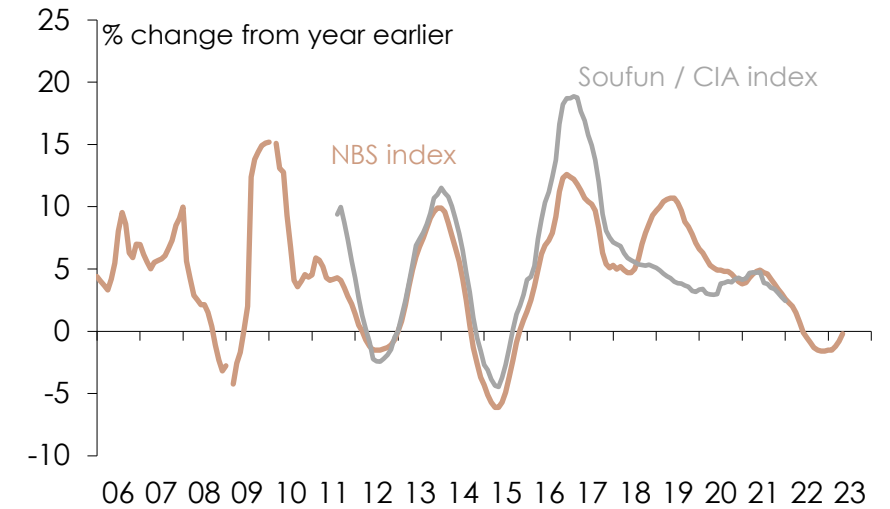
Urban unemployment rate



Passenger traffic volumes



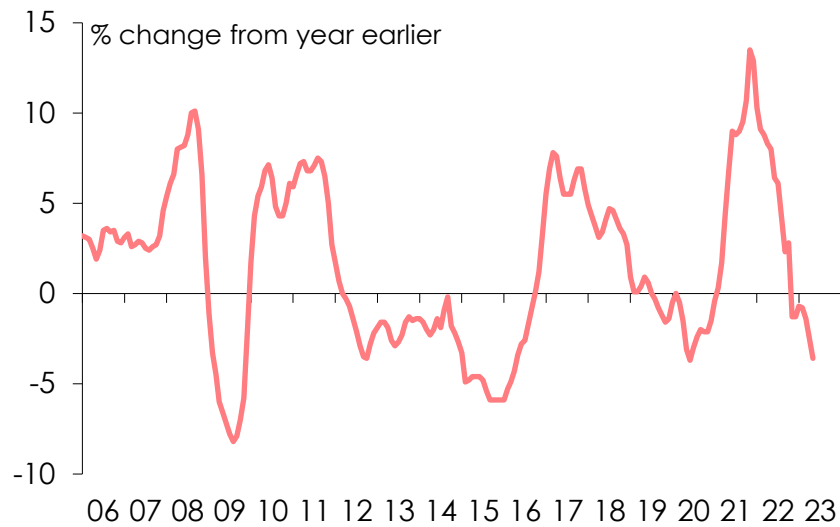
Residential real estate prices



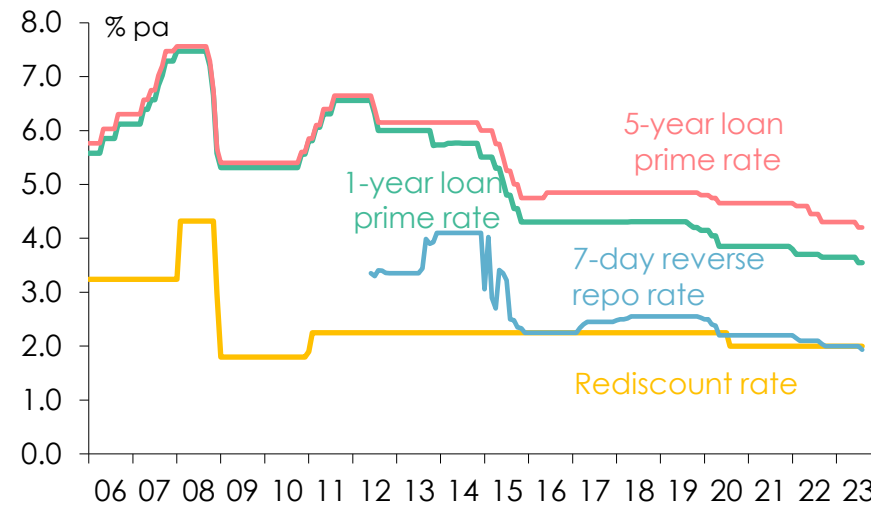
Sources: China National Bureau of Statistics.

One problem China doesn't have is inflation – but the authorities remain very cautious about providing additional policy stimulus

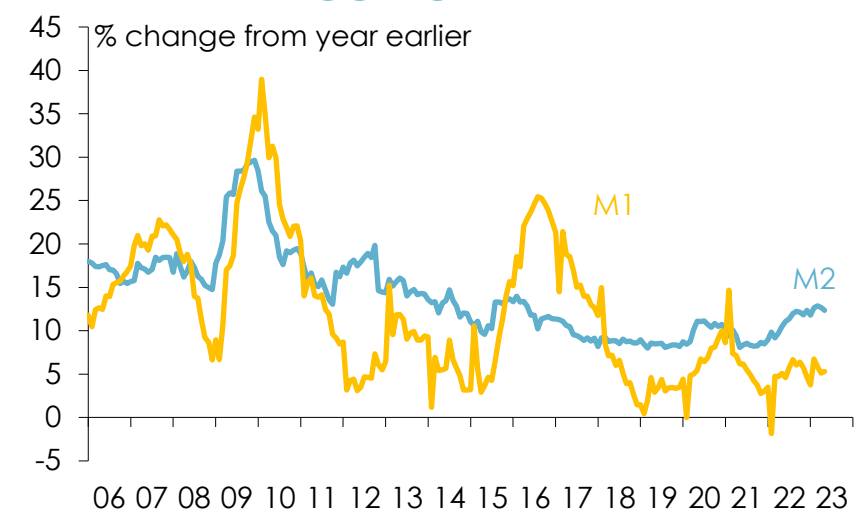
Producer prices



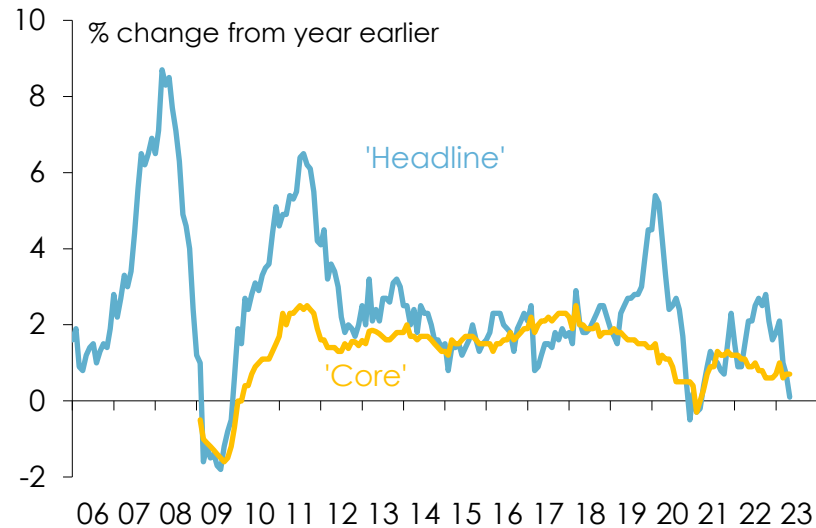
PBoC policy interest rates



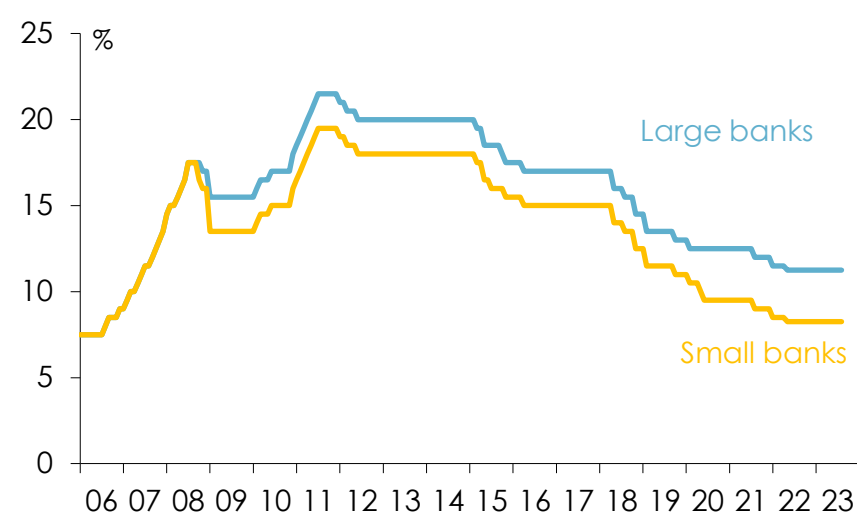
Monetary aggregates



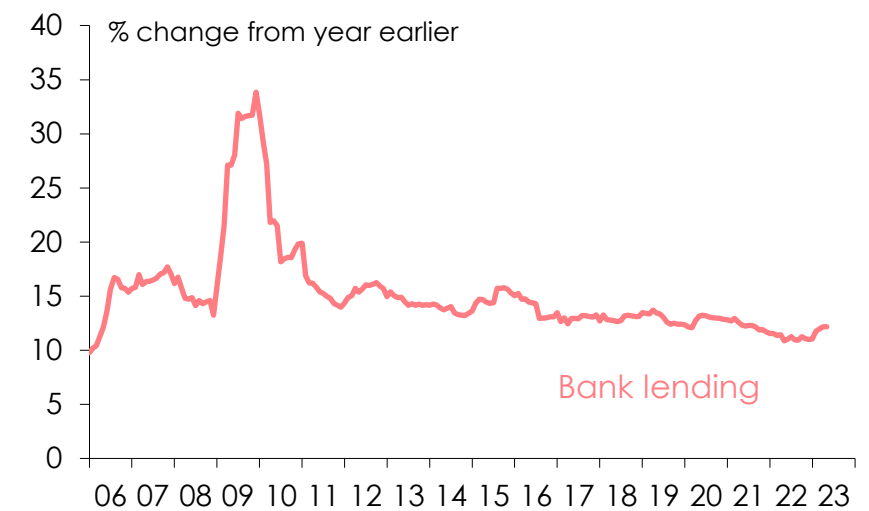
Consumer prices



Bank reserve requirement ratios



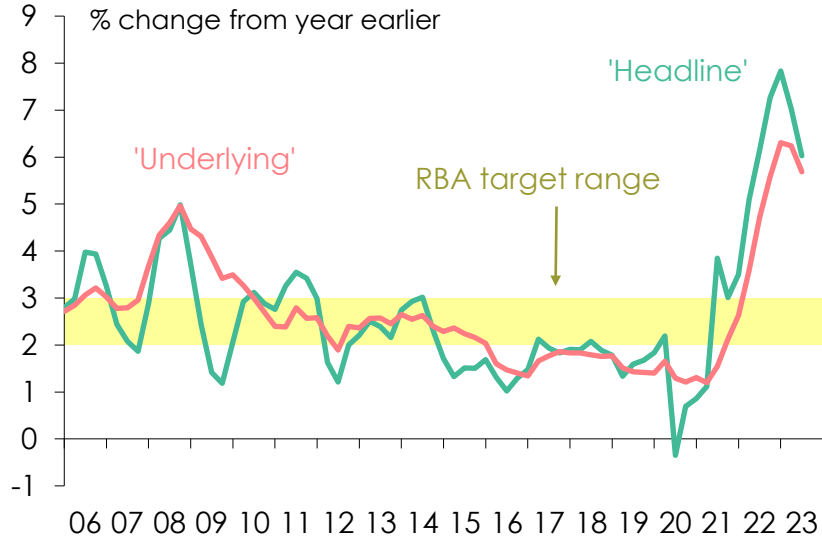
Credit growth



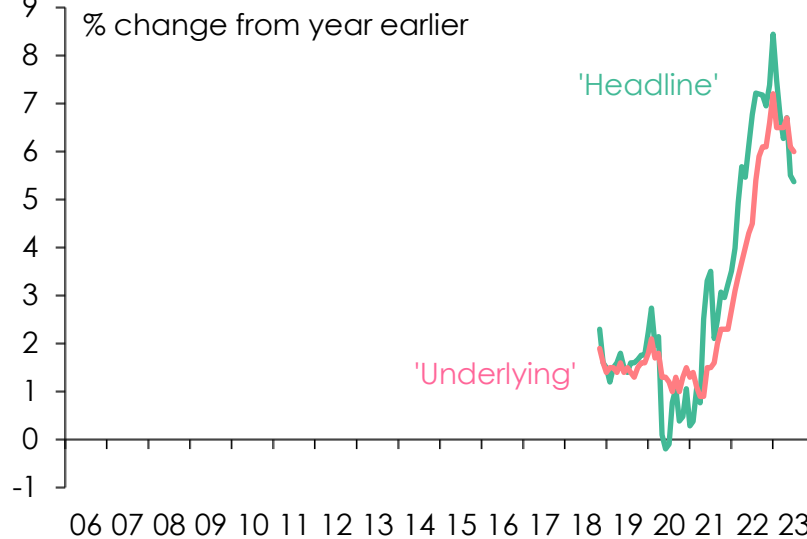
China National Bureau of Statistics, People's Bank of China.

In Australia inflation has eased from the peak at the end of 2022 but remains too high, especially for services

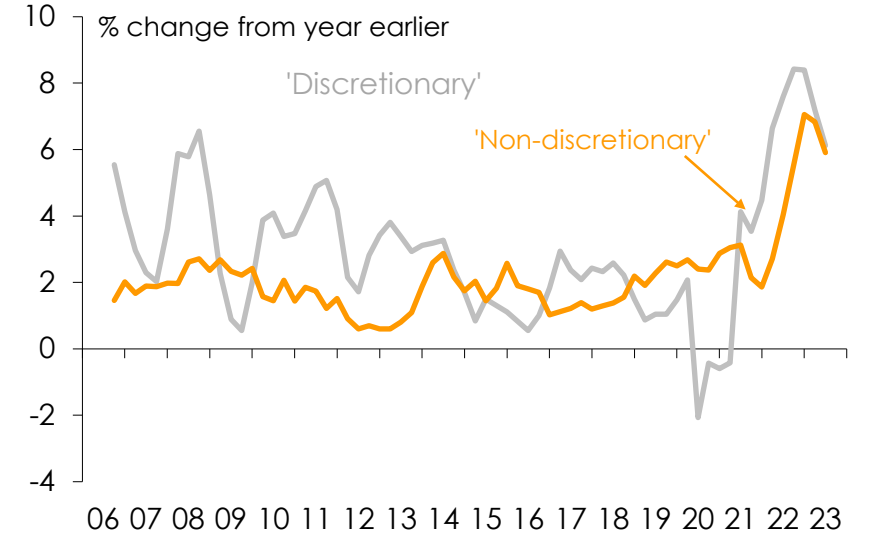
Consumer prices – annual change



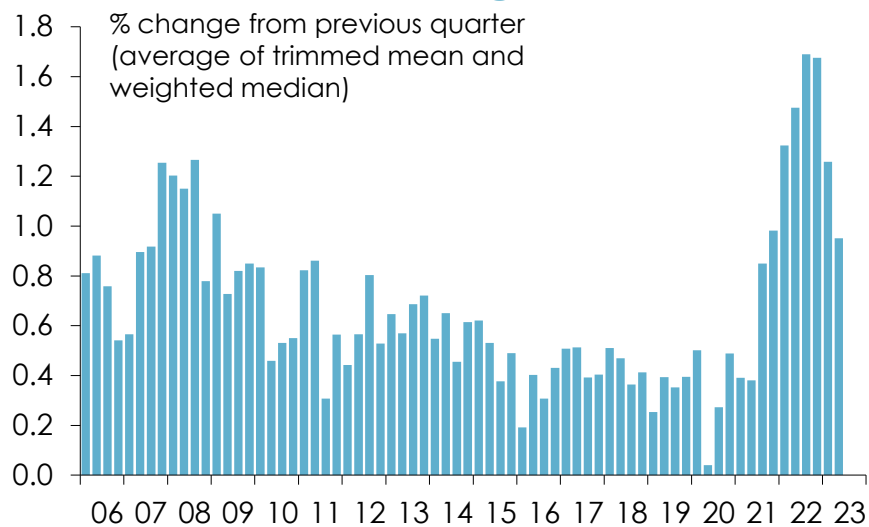
Monthly 'CPI indicator'



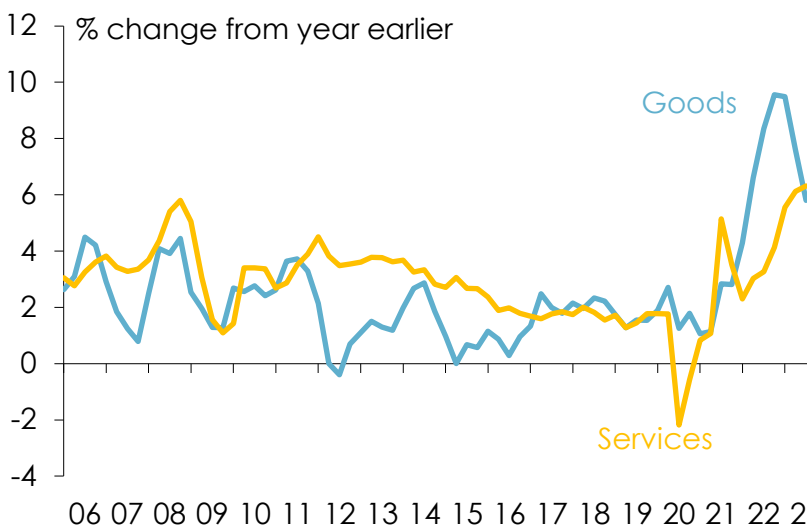
'Discretionary' vs 'essential' items



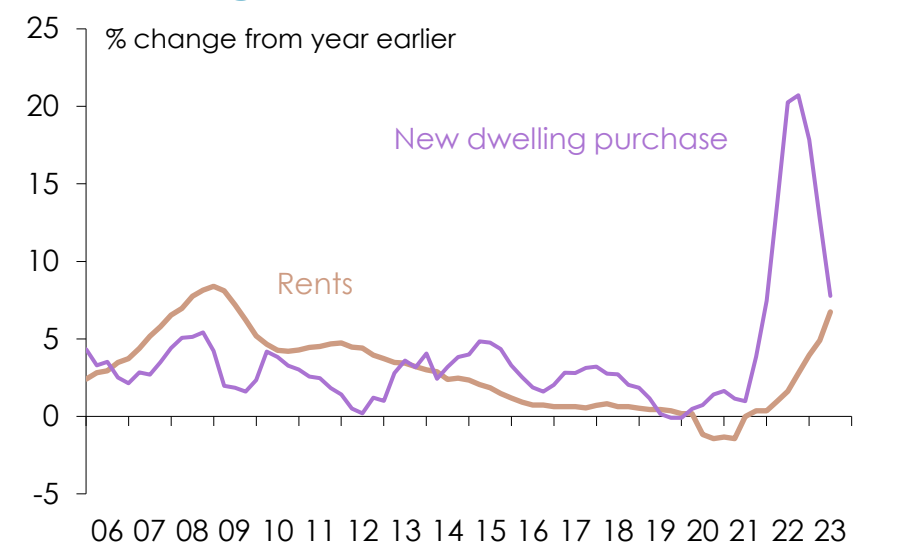
Quarterly 'underlying' inflation



Goods and services prices



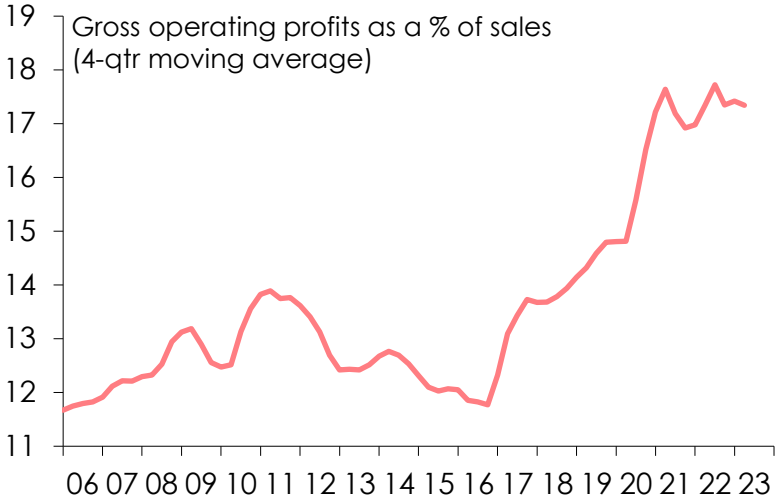
Housing costs



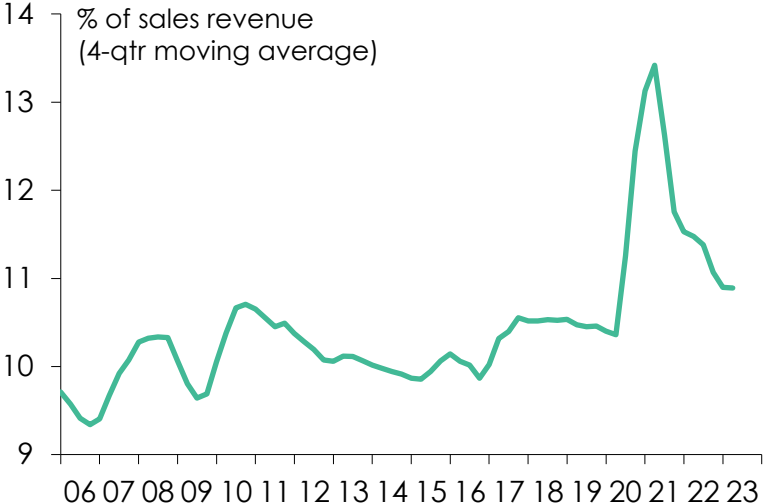
Note: 'Underlying' inflation is the 'trimmed mean' (derived from the middle 70% of price increases). Source: ABS.

The rise in inflation has not been due to businesses seeking to increase their profit margins

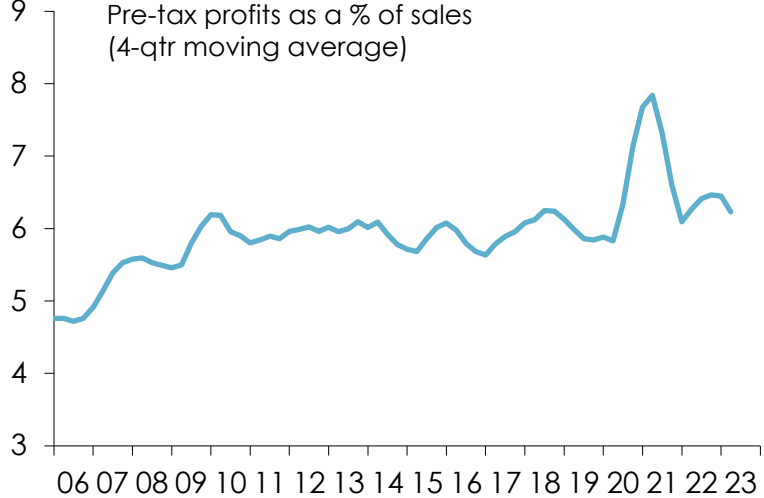
Gross operating profit margins



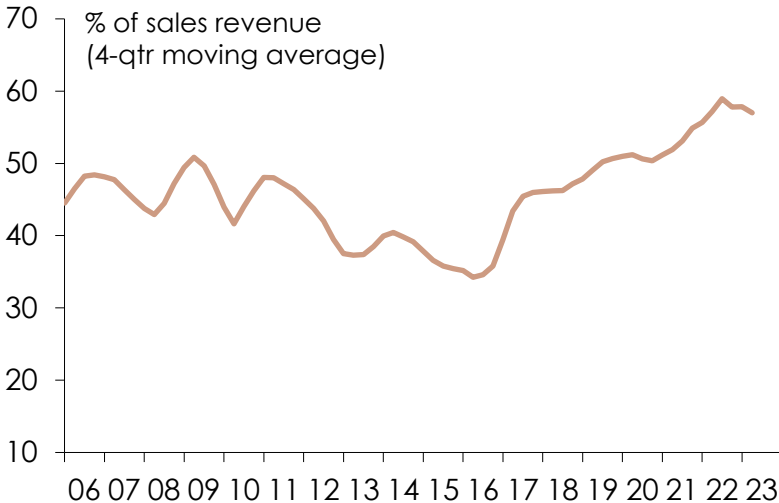
Non-mining sector gross margins



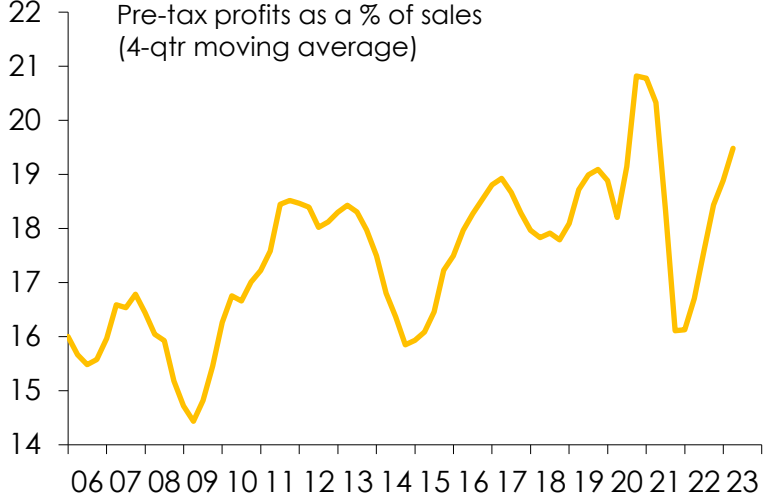
Retail sector gross margins



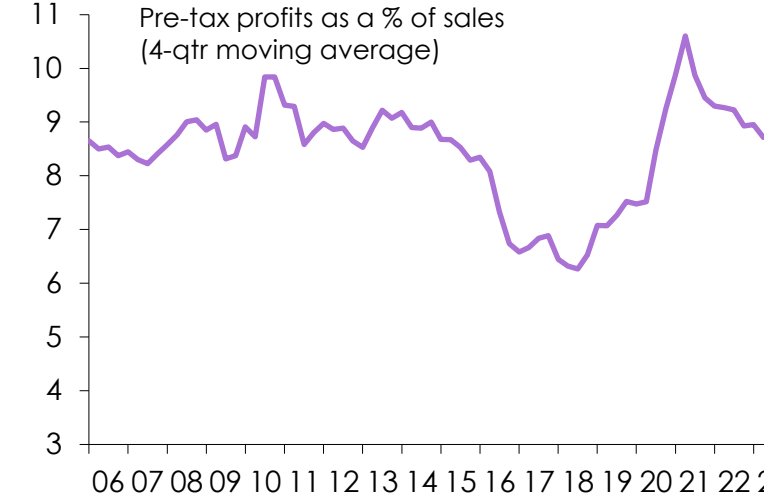
Mining sector gross margins



Transport sector gross margins



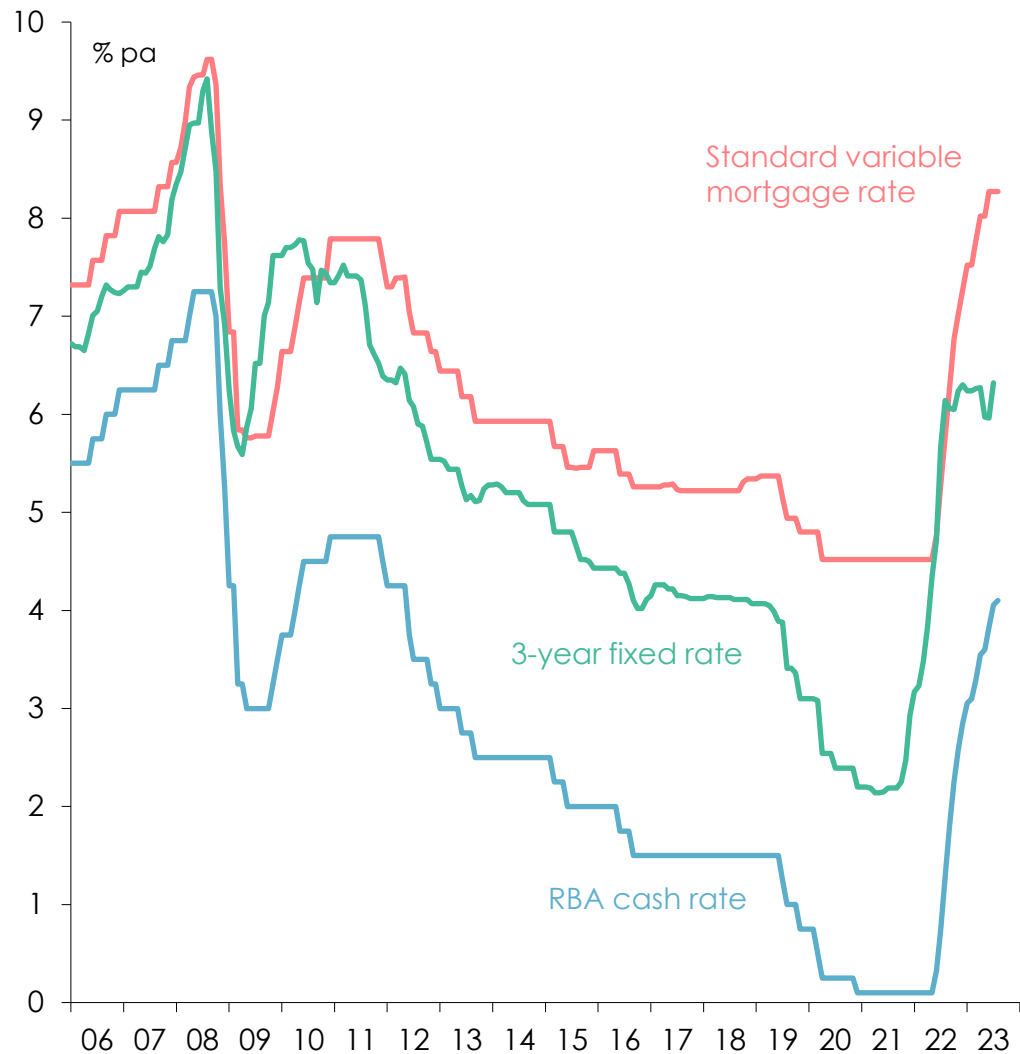
Construction sector gross margins



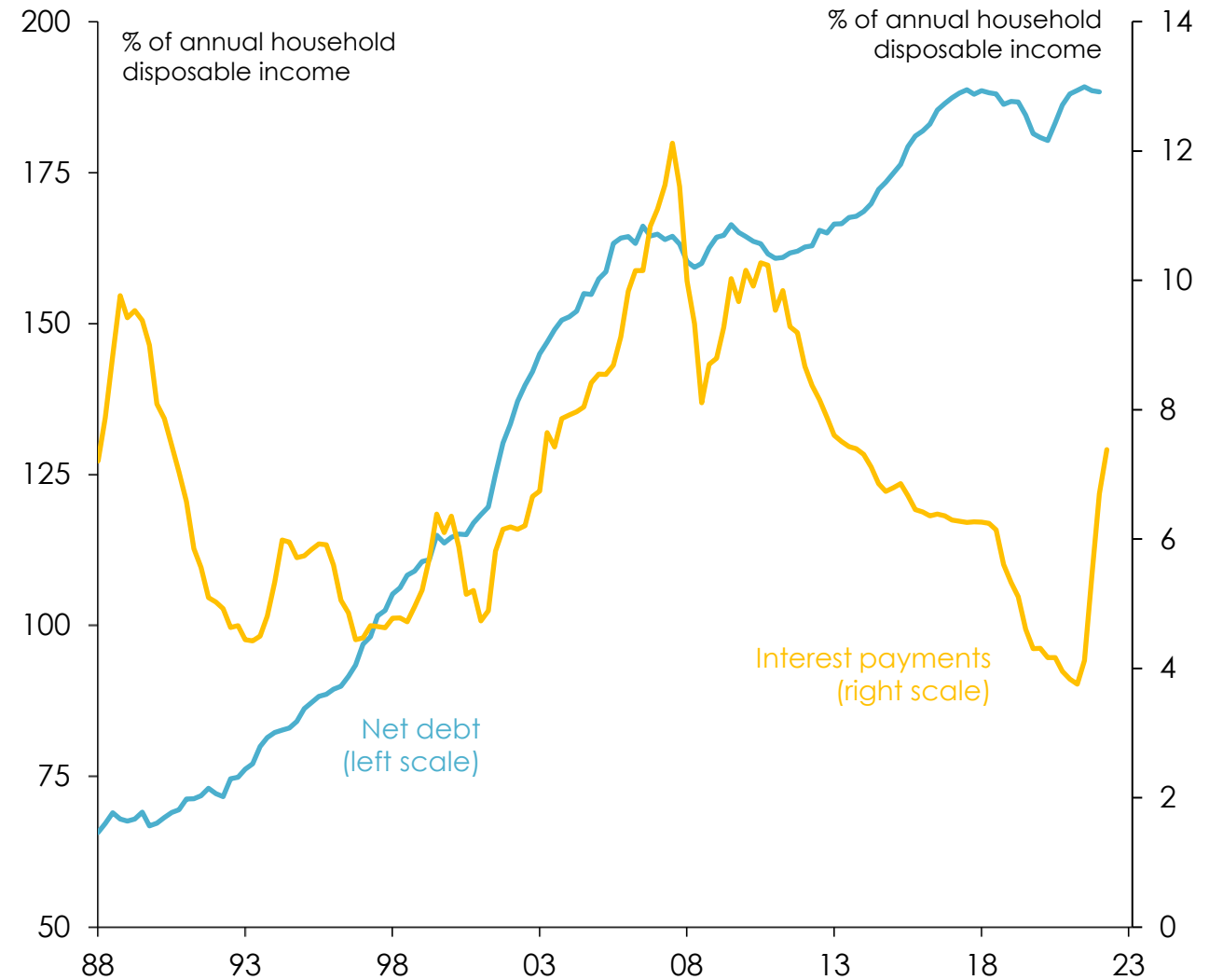
Source: ABS.

Since May last year the RBA has lifted interest rates more quickly than in any tightening cycle in the past three decades

RBA cash rate and mortgage rates



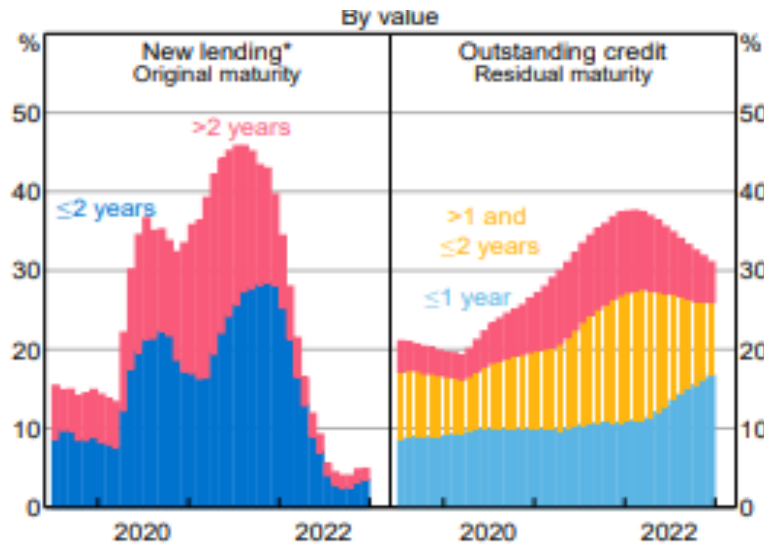
Household debt



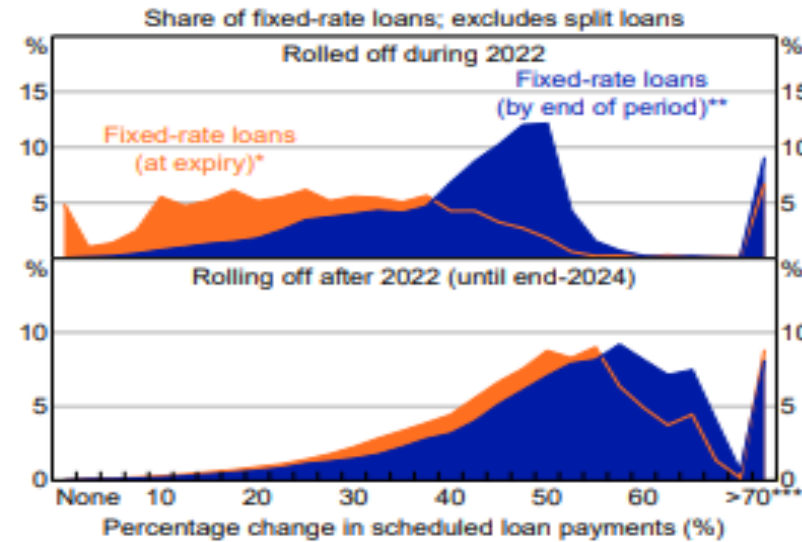
Source: Reserve Bank of Australia; Refinitiv Datastream; ABS, [Finance and Wealth Accounts](#).

The so-called 'mortgage cliff' for fixed-rate borrowers will create additional strains but should be manageable

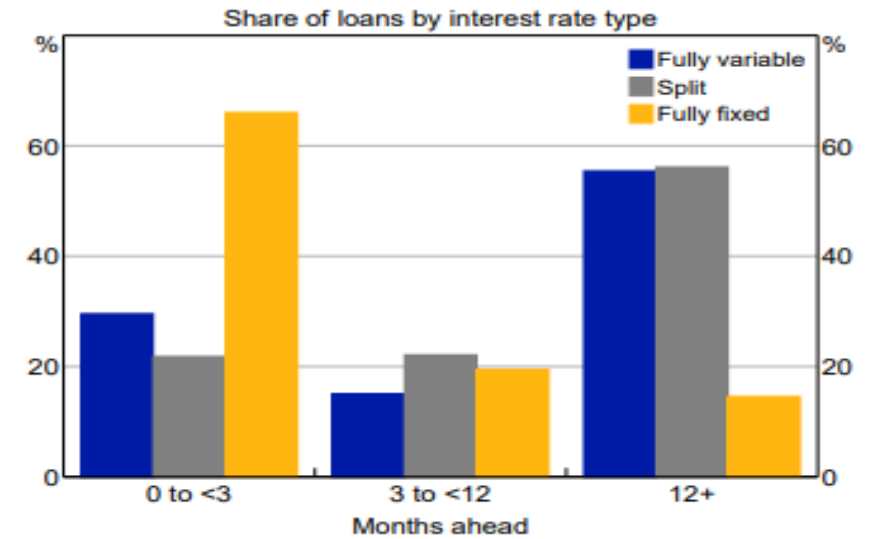
Fixed rate share of housing loans



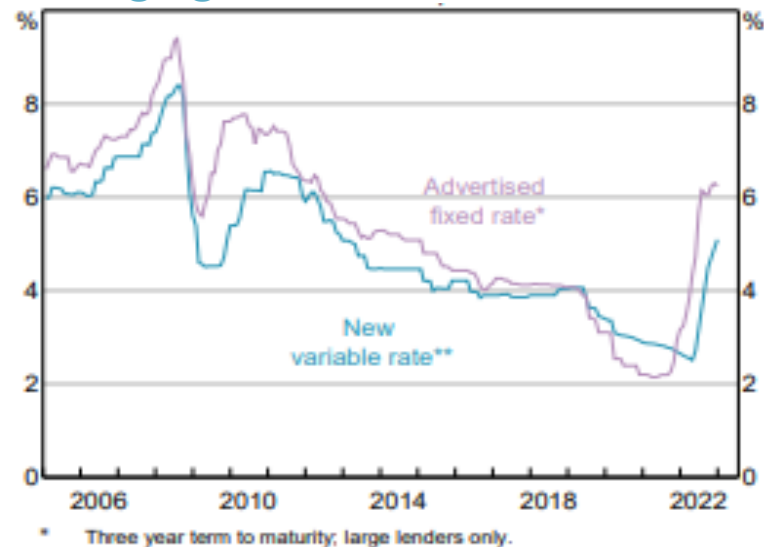
Increases in loan repayments



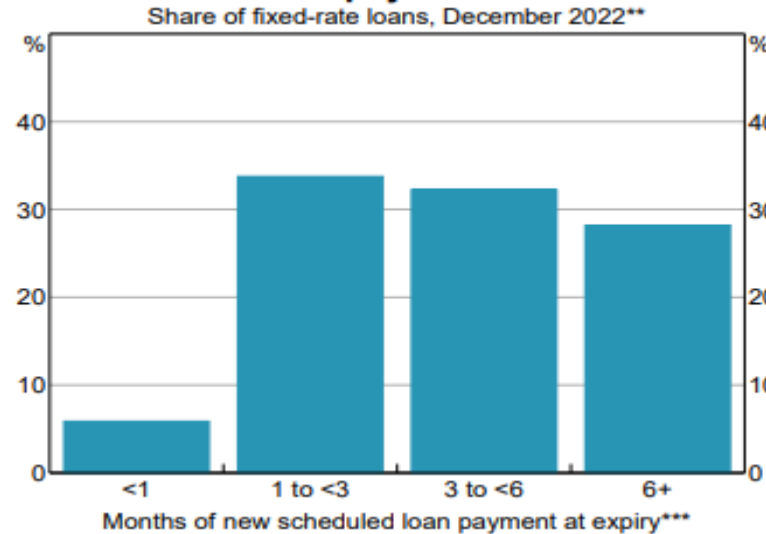
Mortgage prepayment buffers



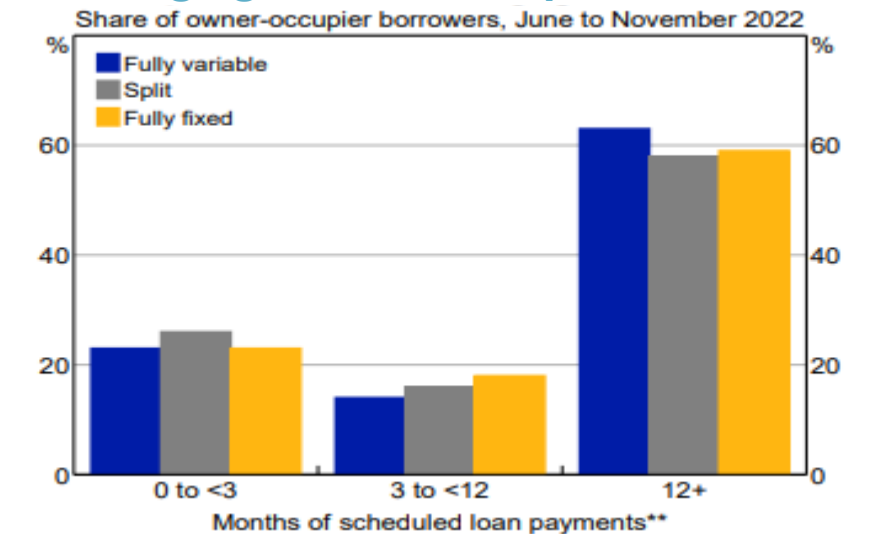
Mortgage interest rates



Months of repayments avoided

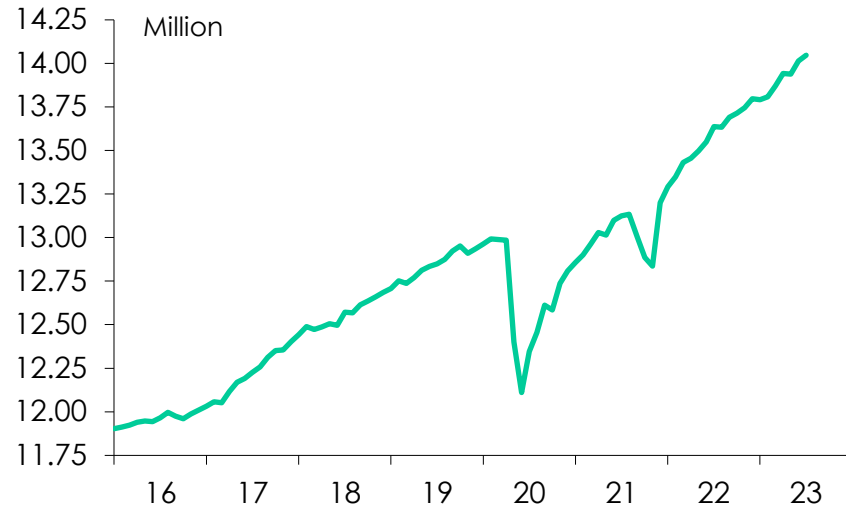


Mortgage holders' liquid assets

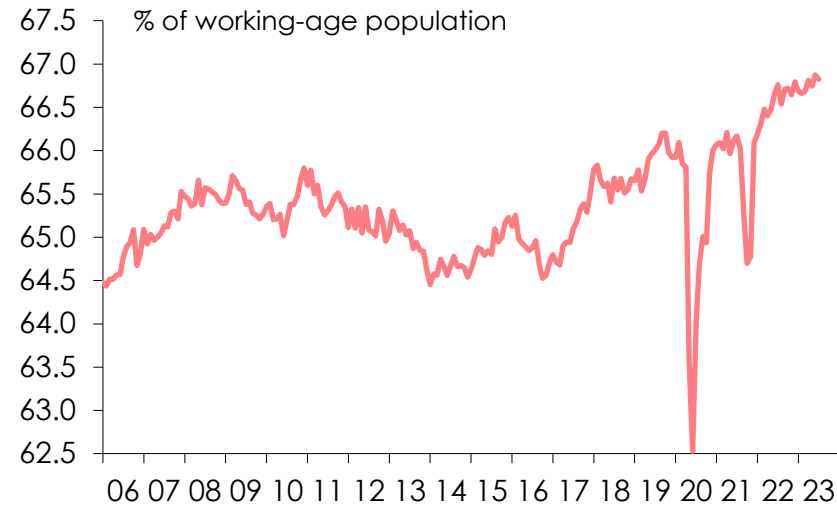


The labour market is very tight by historical standards, and wages growth has begun to pick up (though not as much as inflation)

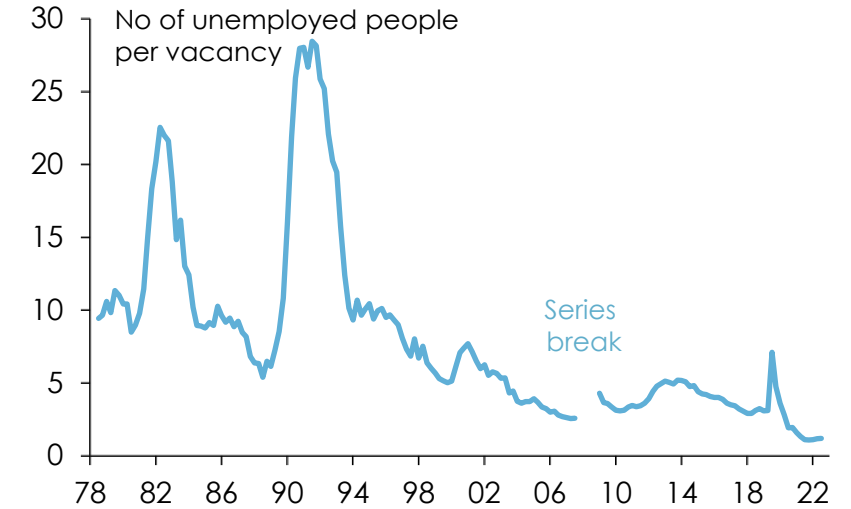
Level of employment



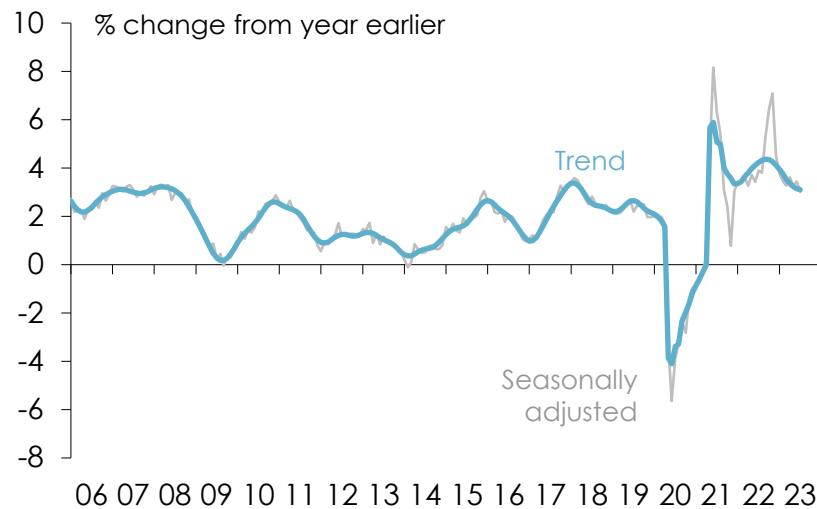
Labour force participation rate



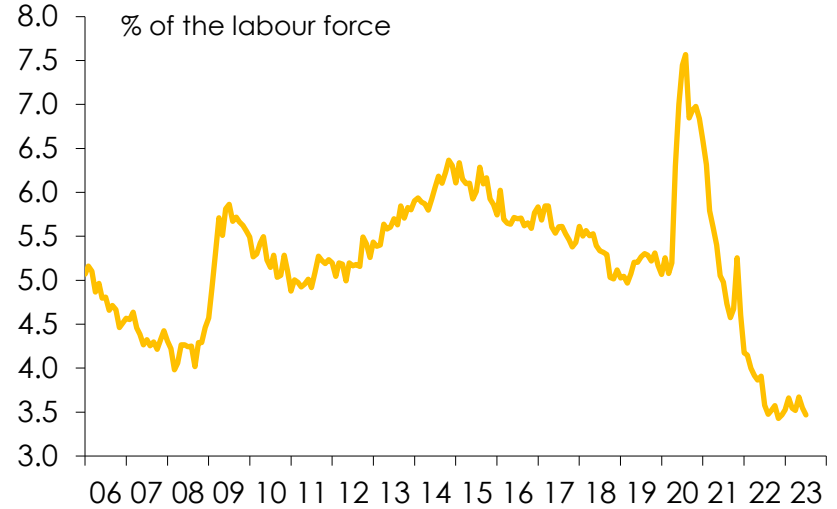
Unemployed people per vacancy



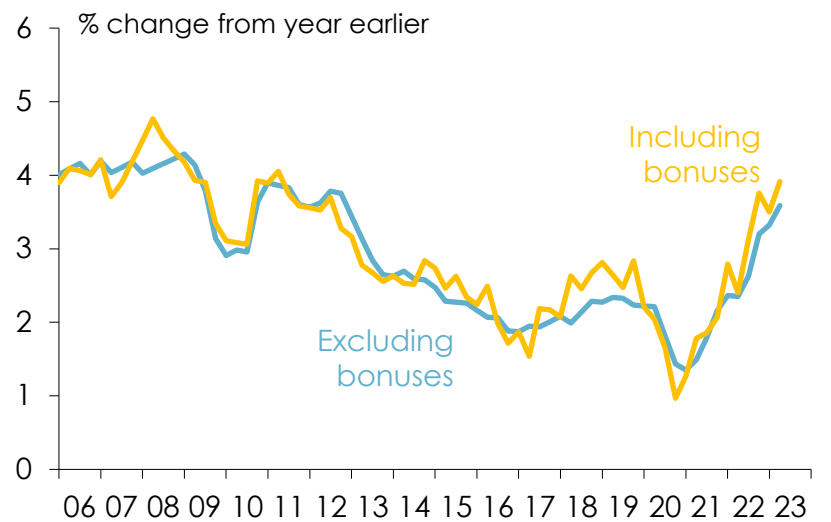
Employment growth



Unemployment rate



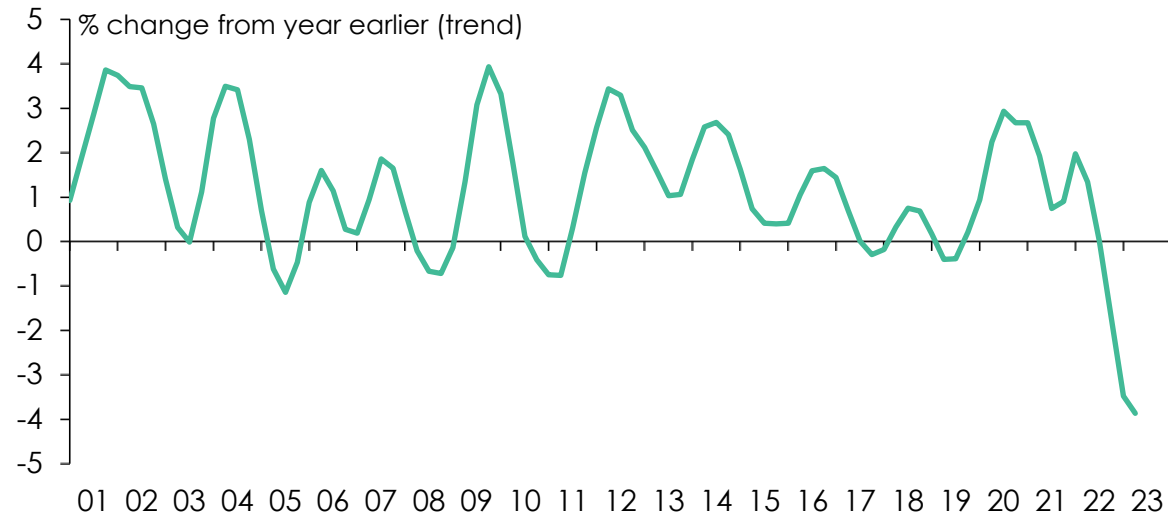
Wage price index



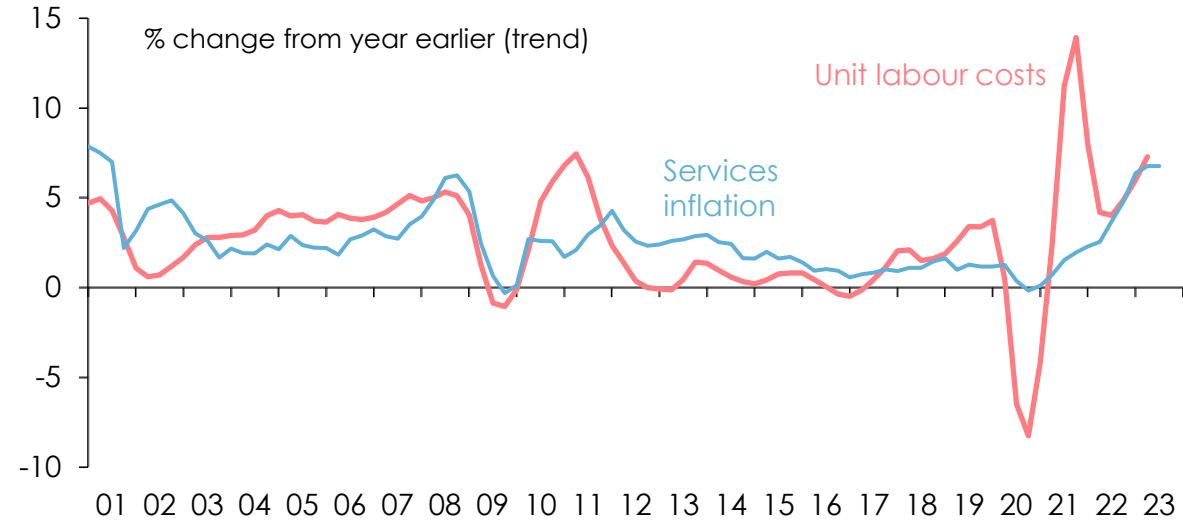
Source: ABS.

A key influence on whether inflation persists at high levels will be whether the recent slump in labour productivity can be reversed

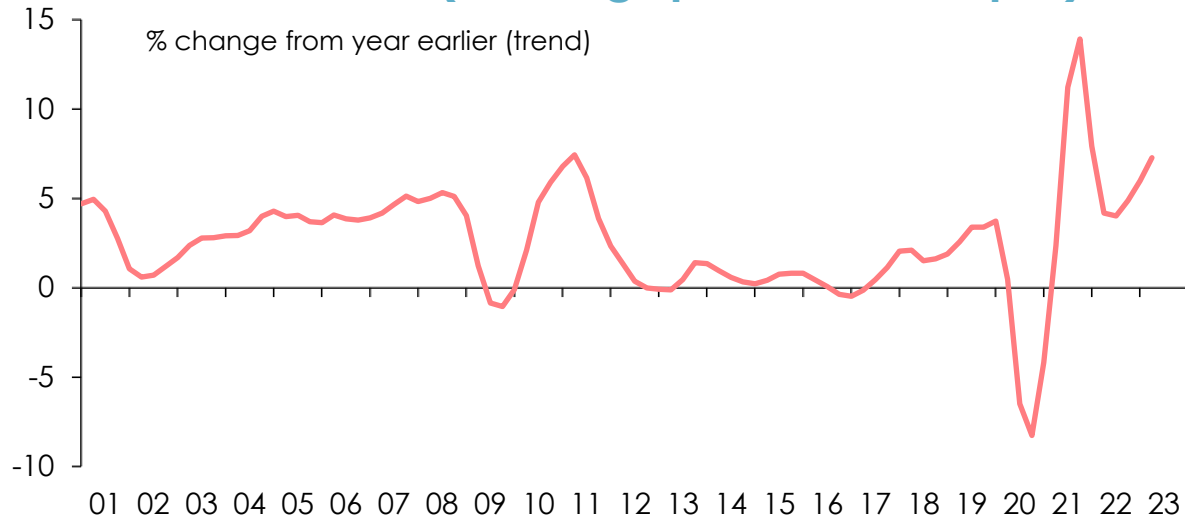
Labour productivity (output per hour worked)



Unit labour costs and services inflation



Unit labour costs (earnings per unit of output)



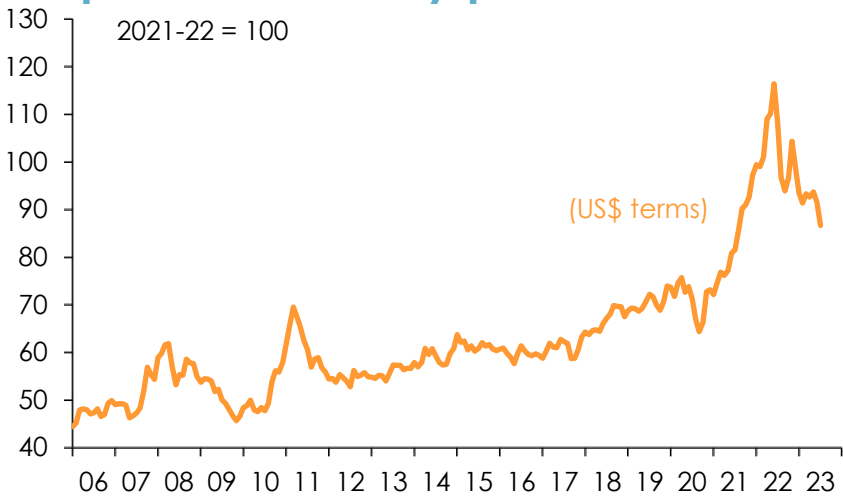
“Inflation could be more persistent than forecast if wages growth is stronger than expected, if productivity growth fails to recover or if profit margins widen as input costs decline ...

... The [Reserve Bank’s] forecasts for labour income remain consistent with the inflation target provided productivity returns to its pre-pandemic trend”

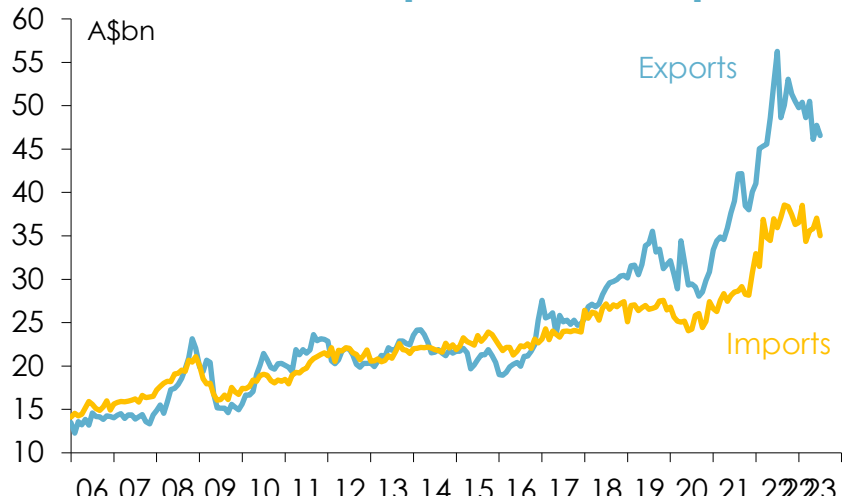
- RBA Statement on Monetary Policy, 4th August

Australia is continuing to register external surpluses despite key export commodity prices having fallen back from earlier peaks

Export commodity price index



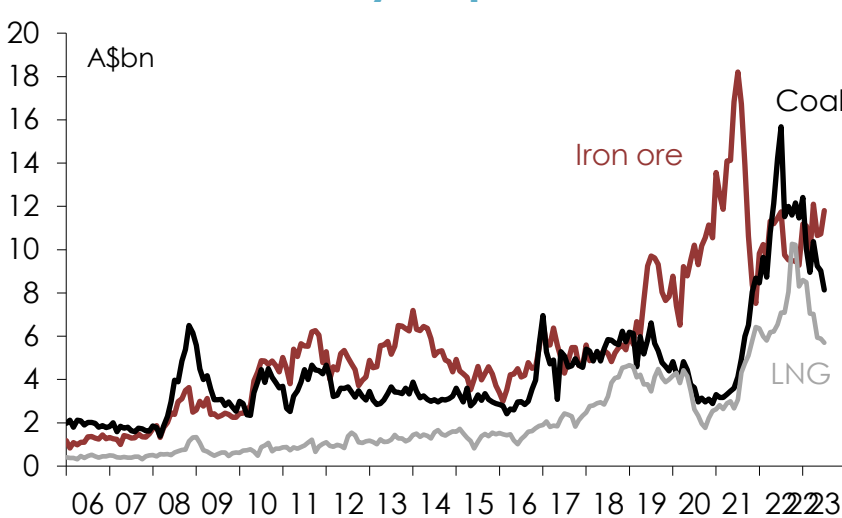
Merchandise exports and imports



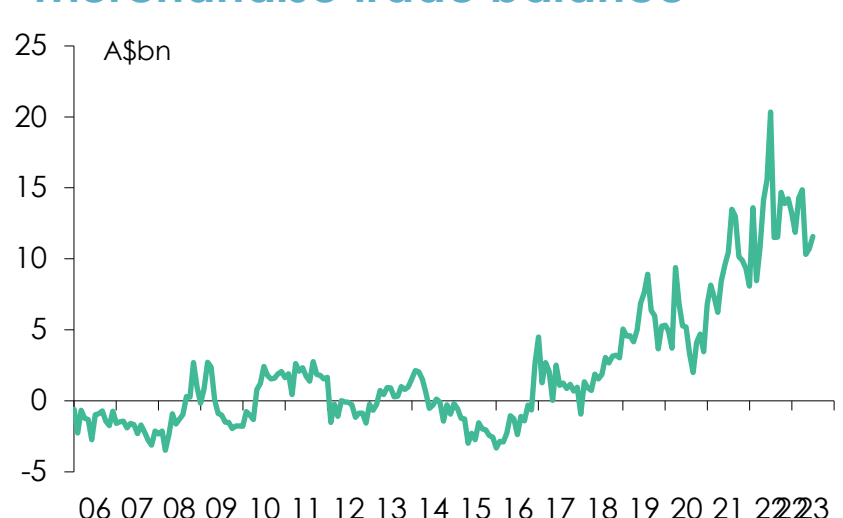
Tourism services trade balance



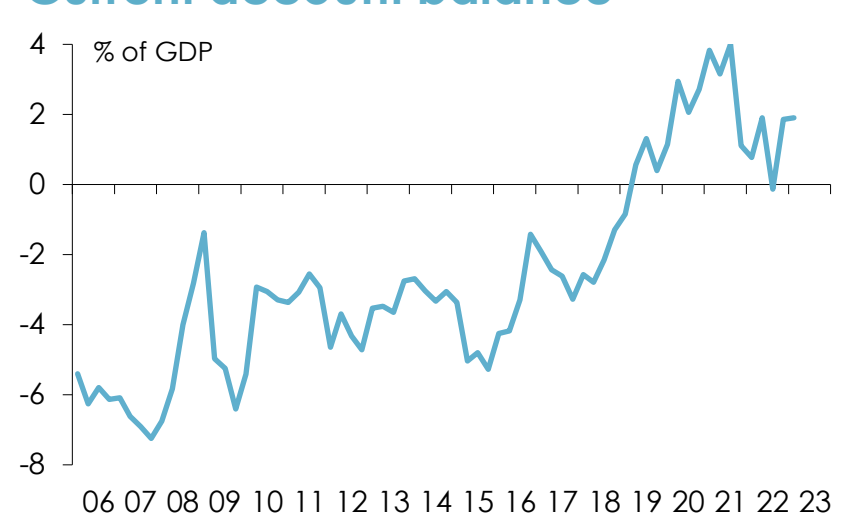
Bulk commodity exports



Merchandise trade balance

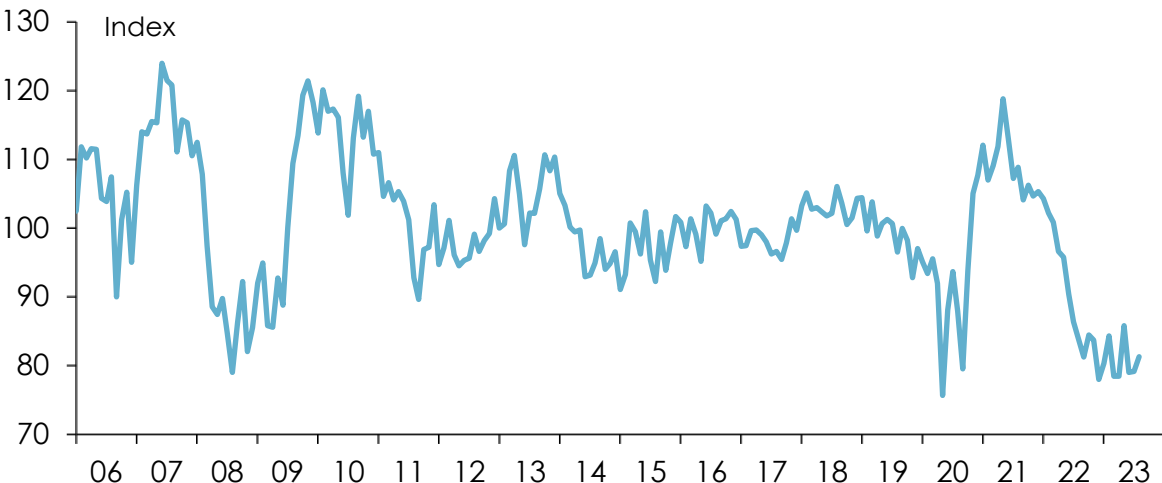


Current account balance

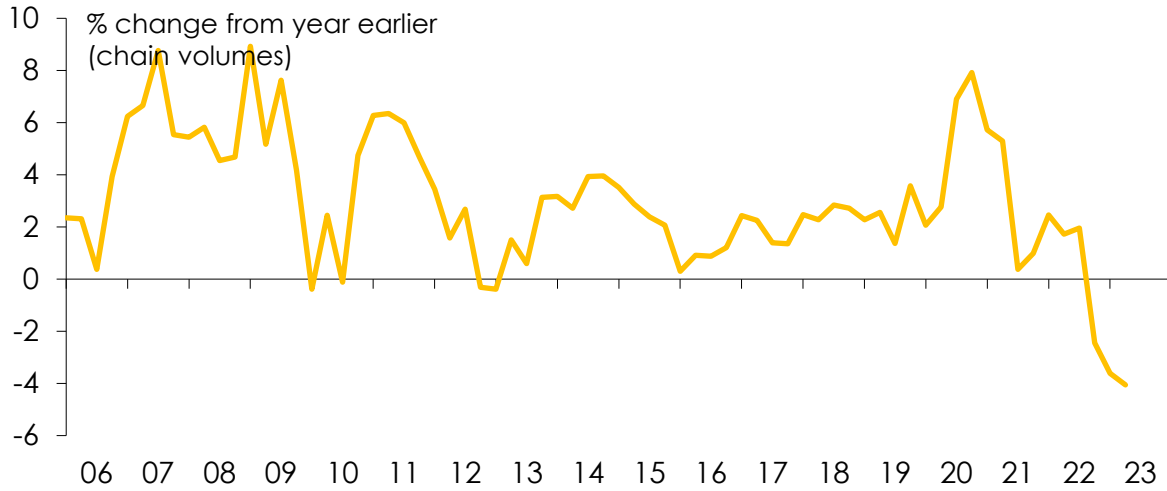


Household finances are under pressure from higher interest rates and falling real incomes

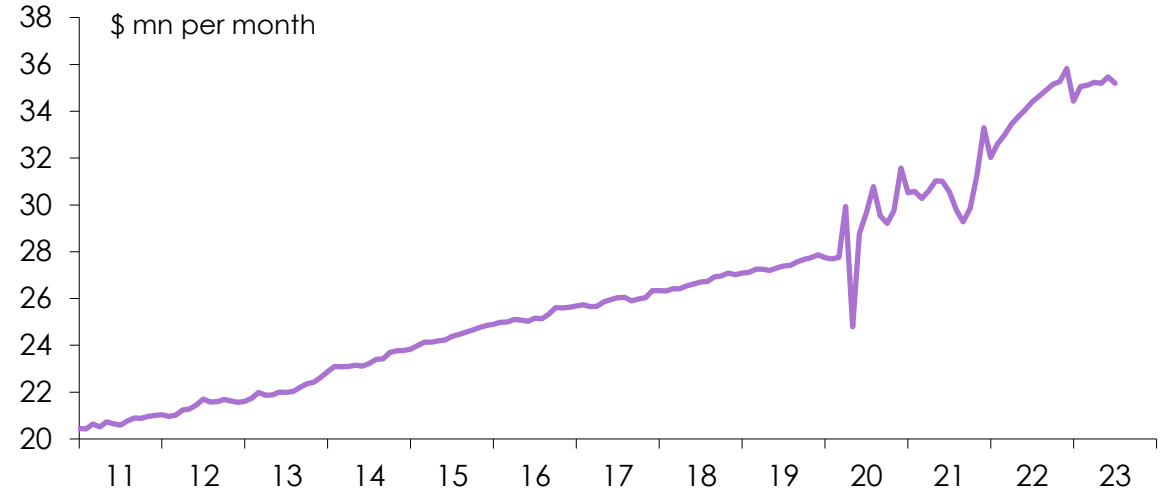
Consumer confidence



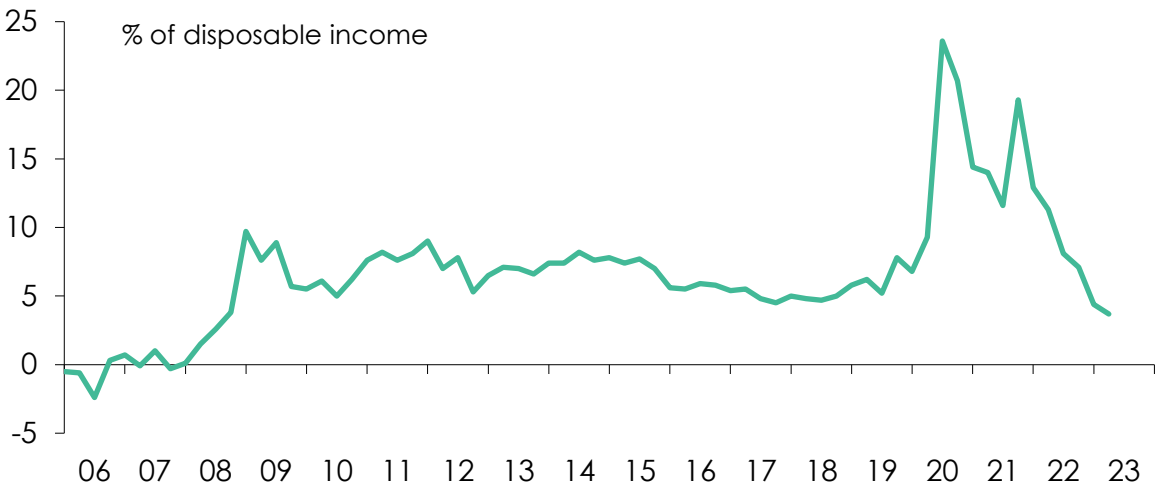
Household disposable income



Retail sales



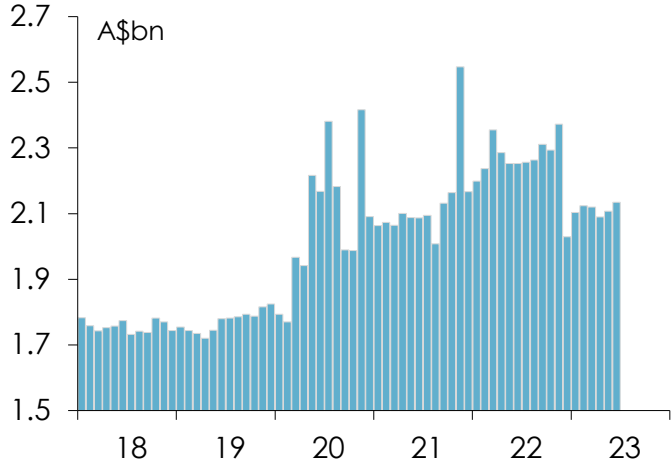
Household saving



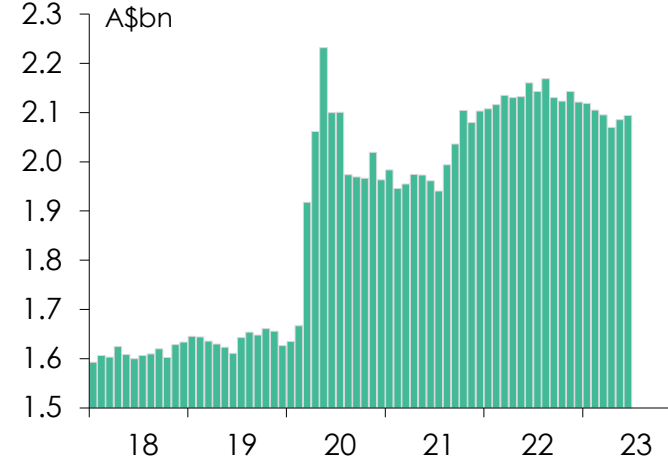
Sources: Westpac-Melbourne Institute; ABS.

While consumers have cut back spending in some discretionary areas, in others spending remains at a high level

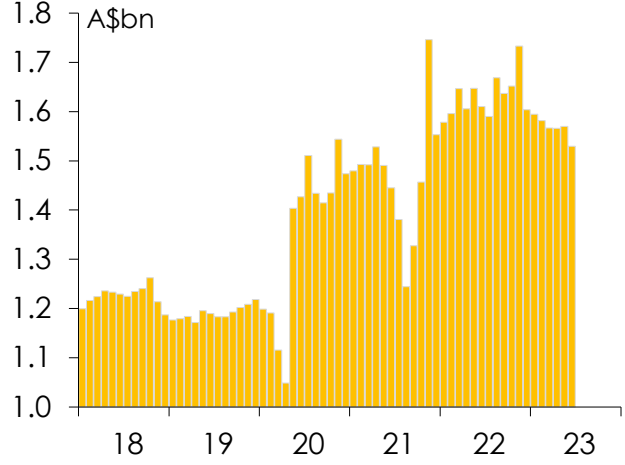
Electronic & electrical goods



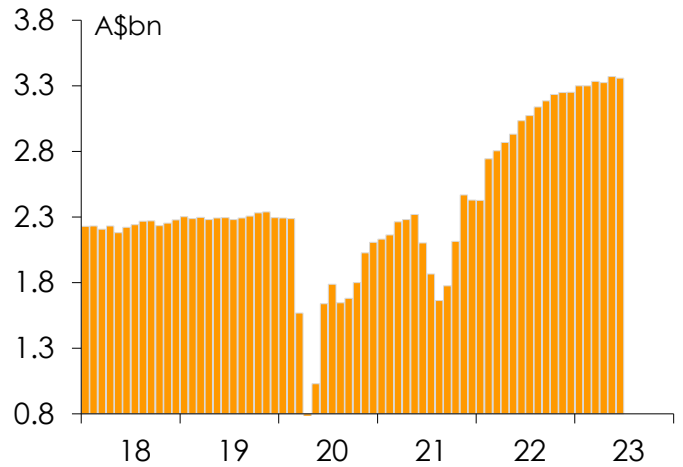
Hardware, building & garden supplies



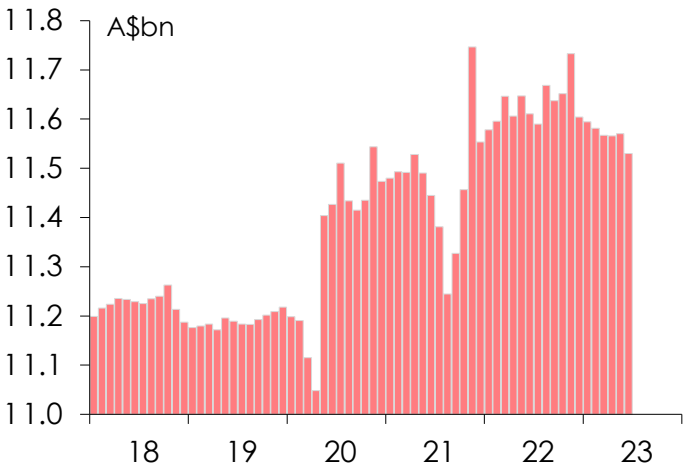
Floor coverings, furniture, housewares etc



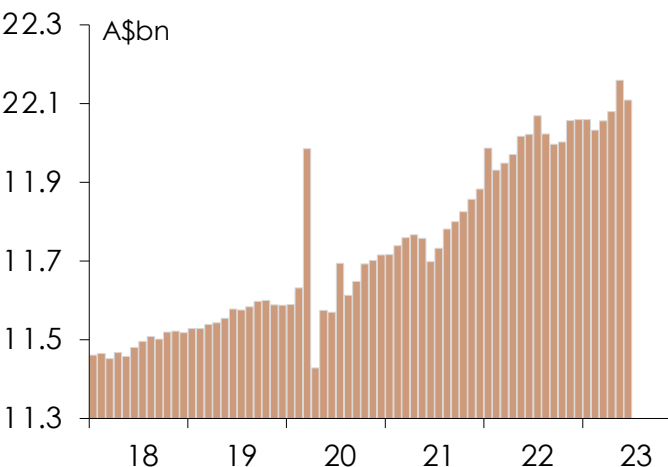
Cafes and restaurants



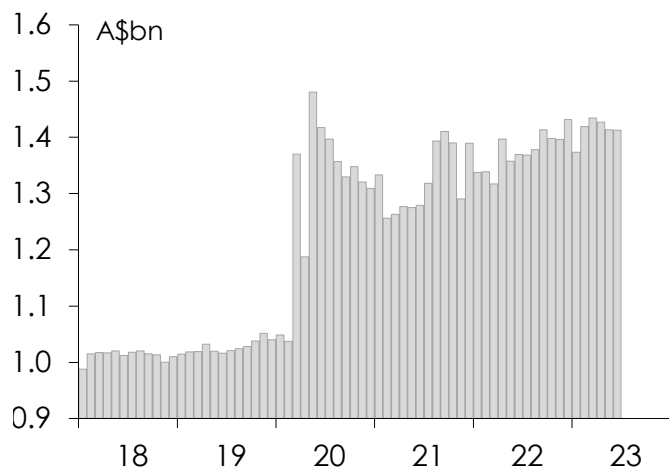
Clothing, footwear & personal accessories



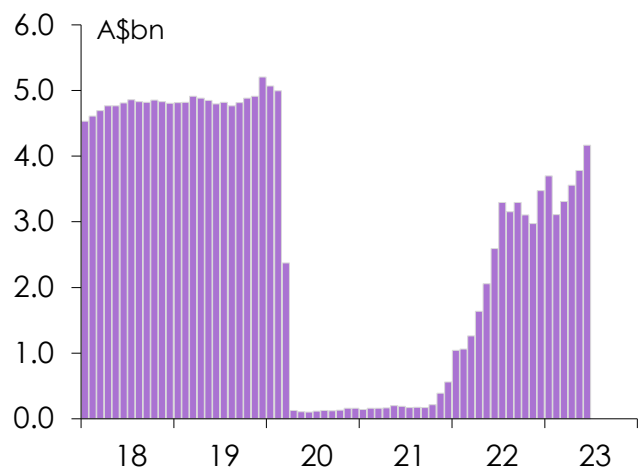
Pharmaceuticals, cosmetics & toiletries



Alcoholic beverages



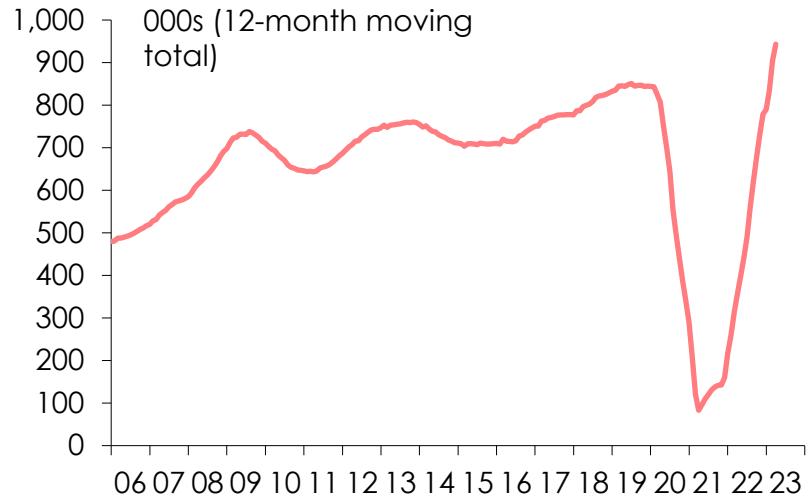
Overseas travel



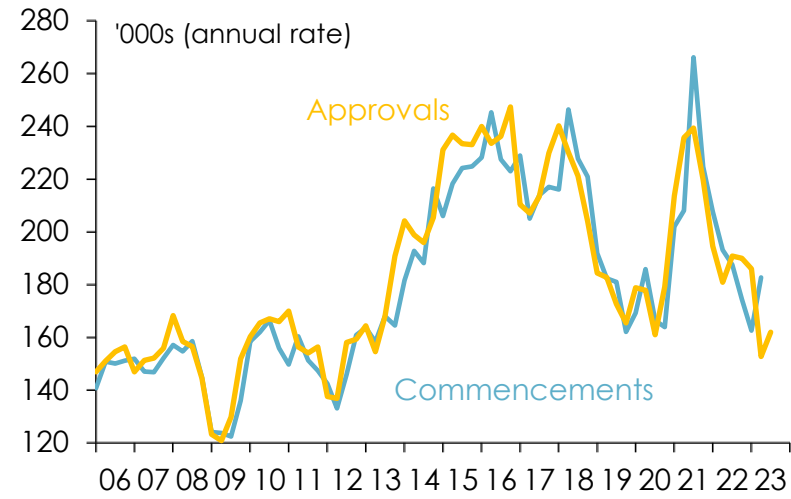
Source: ABS

Australia's housing market is again characterized by a mis-match between demand and supply

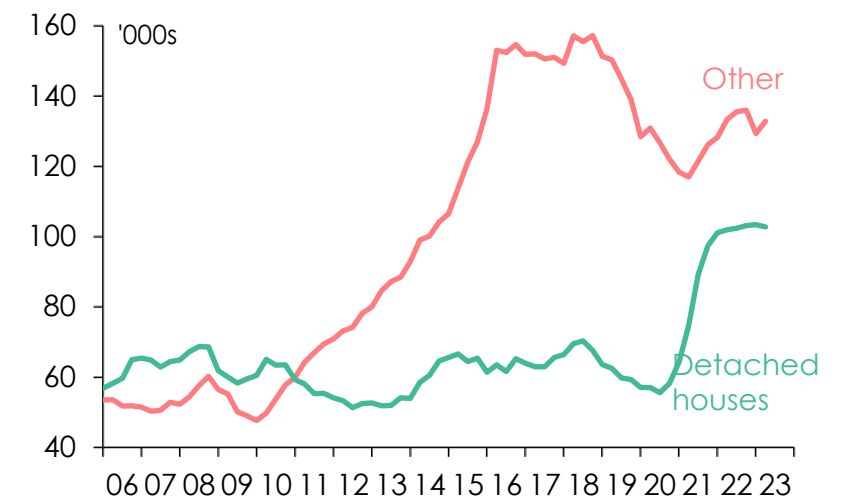
Permanent & long-term arrivals



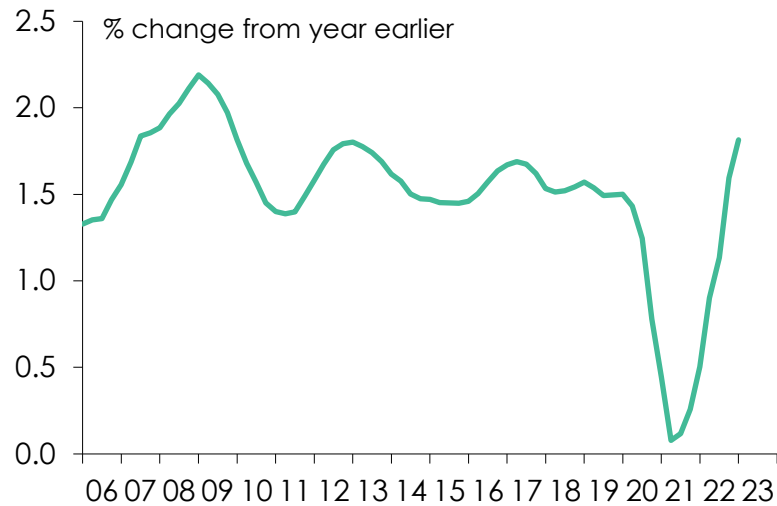
Residential building activity



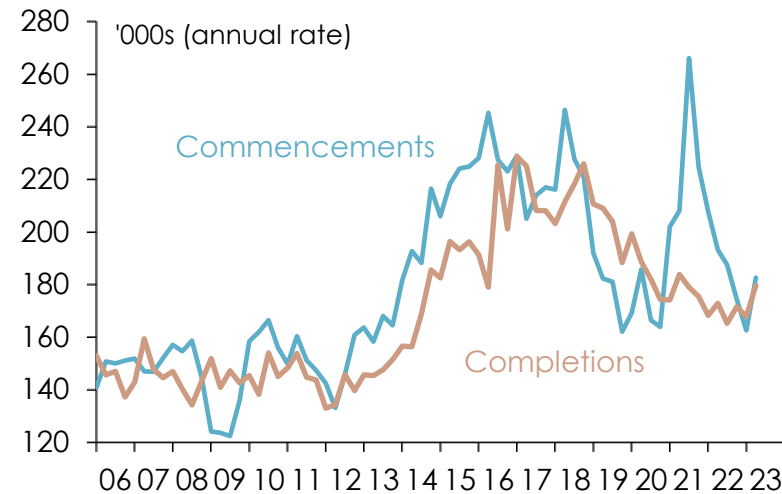
Dwellings under construction



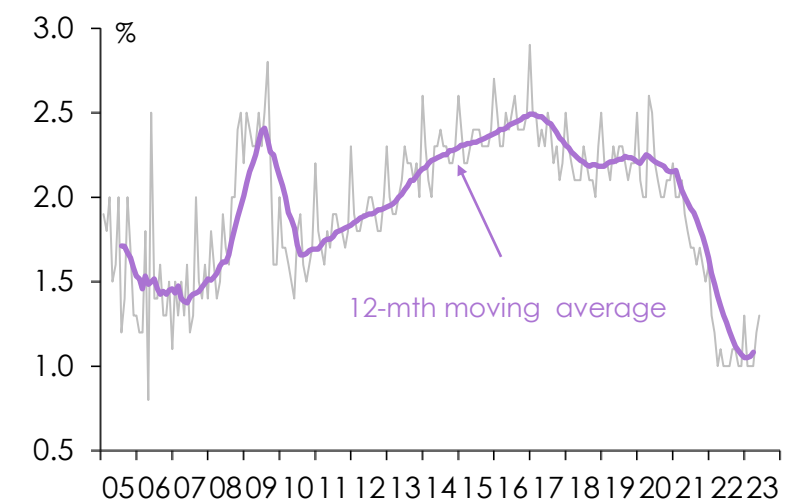
Population growth



Dwelling completions



Rental vacancy rates



Sources: ABS; SQM.

Conclusions

- ❑ **Almost all developed economies have experienced a surge in inflation since mid-2022**
 - partly reflecting common global factors (higher food & energy prices resulting from the war in Ukraine, and Covid-related supply chain disruptions)
 - and partly reflecting the widespread monetary policy mistake of leaving interest rates “too low for too long” made by all developed economy central banks
- ❑ **As result, developed economy central banks have lifted interest rates sharply over the past 14 months**
 - and there are now clear signs in almost all economies that inflation has passed its peak, though it still remains too high to allow central banks to start cutting rates, especially while labour markets remain tight
- ❑ **It remains unclear whether inflation can be brought under control without triggering recessions**
 - prospects for a ‘soft landing’ look better in the US than in Europe
- ❑ **Australia’s experience of inflation is thus by no means unique**
 - even though the RBA has lifted interest rates by more, and more rapidly, than at any time in the past 30 years, they remain below levels in most comparable countries
- ❑ **Most likely, Australian interest rates will remain at their current level for at least another 12, possibly 18 months, before inflation has fallen to a level that will allow the RBA to begin cautiously lowering rates**
 - the main risk to that view is the possibility of a further acceleration in wages growth in a tight labour market, especially if productivity growth remains weak
- ❑ **There’s a better-than-even prospect that Australia will avoid a recession, in part thanks to rapid population growth**
 - although we will likely have at least two quarters of negative growth in *per capita* real GDP
 - and the unemployment rate will likely rise by around 1 percentage point over the next 12-18 months

Important information

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