Weekly Economic Brief

8 December 2023 | Economist's View

How is the Australian economy holding up?

National accounts won't upset the RBA

Australia's national accounts (released this week) paint a picture of an economy continuing to muddle through despite the significant headwinds posed by cost-of-living pressures and higher interest rates. Real GDP rose by 0.2% over the September quarter, lower than the Bloomberg survey median expectation of 0.5% growth for the quarter, although backward revisions meant that year-ended growth was higher than expected at 2.1%. Population growth has been a key support to growth, with real GDP per capita having fallen for a third consecutive quarter. In this Week's Brief, we examine some of the key areas of the national accounts and the implications for the RBA's thinking.

Households remain challenged and at first glance appear to be stalling with real household consumption flat over the quarter. However, this weakness is somewhat distorted by government support to non-discretionary areas like energy, childcare, aged care and pharmaceutical products. This spending was categorised as government consumption, which rose by 1.1% over the quarter. The government support allowed households to shift their priorities, with discretionary spending rising by 0.7%, the first rise in a year.

Nevertheless, it is clear that some households are running out of room to continue to lift spending. Despite the Fair Work decision helping to boost wages since July, real disposable income fell by 1.3% over the quarter and was 4.3% lower than a year earlier. Multiple factors are weighing on disposable income, they key ones being the increasing burden of mortgage interest payments and more significantly an increasing tax burden and high inflation rates. With the temporary low and middle income tax offset (LMITO) ending in 2022-23 and bracket creep escalating as wages grow, income tax as a proportion of gross income is close to its highest ever level.

In light of this, the household saving rate fell to 1.1% in the September quarter, down from 2.8% in the June quarter and its lowest level since the GFC. Given the strength of population growth, this implies that many individual households are either actively cutting back on spending, drawing down on their accumulated savings or a mixture of both.

With the saving rate so low, future consumption growth will rely on an improvement in real disposable incomes and a draw down on existing accumulated savings. Inflation is forecast to continue easing and Stage 3 tax cuts will kick in mid next year which should help to stabilise real disposable incomes over the coming quarters. We also estimate that households have so far spent around one-quarter of the excess savings generated during the pandemic period. While some of the excess savings will have been converted into less liquid wealth and the savings pool is not evenly spread across consumers, we still expect it to continue to help prevent a collapse in household consumption.

The external sector flipped to be a drag on the economy in the September quarter, with export volumes falling and import volumes rising solidly. Mining companies had another tough quarter, with both their export volumes and profits falling. However, the outlook for profits is not as gloomy as the last six months, with the RBA's measure of commodity prices having bottomed in the September quarter and showing signs of improvement in October and November.

While exports of services have continued their recovery following the border reopening, they were outstripped by services import growth. Households that do have income to spare have been distributing it internationally, with travel services imports rising 19.5% over the quarter. This effect was in part due to catchup with travel services imports having lagged the post-COVID recovery in travel exports. Even after recording strong growth in the September quarter, travel imports remain 25% below their pre-COVID peak whereas travel exports are only 7.8% below their peak. This trend is likely to continue going forward, with the net boost from tourism flows appearing to have ended.

This week also saw the RBA Board meet, where it voted to leave the cash rate on hold at 4.35% after hiking at its previous meeting. The meeting was held the day before the national accounts release and flagged some of the things it would like to see in the data.

Firstly, the RBA wanted evidence that its monetary tightening has continued to restrict the demand side of the economy and this was indeed the case. It was also looking for signs of improvement in productivity so that wage growth becomes "consistent with the inflation target". On this, the national accounts technically delivered, with productivity recording a quarterly rise for the first time since the beginning of 2022. However, the main driver was a fall in hours worked and productivity is starting from such a depressed level that the RBA will want further evidence of improvement. While the national accounts generally delivered what the RBA was looking for, a data-dependent RBA will be closely watching the upcoming labour market and inflation data prior to its February meeting. For now, RBA watchers can sit back and enjoy the holiday break.

Table 1: Financial market movements: 30 November – 7 December 2023

EQUITY INDEX	LEVEL	CHANGE	10-YR GOVERNMENT BOND	YIELD	CHANGE	FOREIGN EXCHANGE	RATE	CHANGE
S&P 500	4,585.6	0.4%	US	4.15%	-17.7 bps	US Dollar Index (DXY)	103.54	0.0%
Nikkei 225	32,858.3	-1.9%	Japan	0.76%	8.6 bps	USD-JPY	144.13	-2.7%
FTSE 100	7,513.7	0.8%	UK	3.97%	-20.8 bps	GBP-USD	1.259	-0.2%
DAX	16,629.0	2.6%	Germany	2.19%	-25.6 bps	EUR-USD	1.079	-0.9%
S&P/ASX 200	7,173.3	1.2%	Australia	4.34%	-7.4 bps	AUD-USD	0.660	0.0%

Source: Bloomberg

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Economic update by region

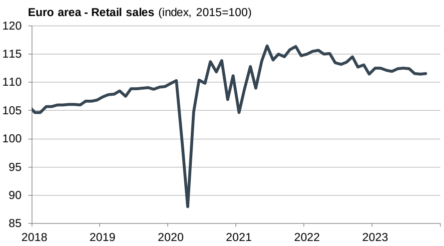
United States

US services sector remains in good health

- The ISM services PMI rose to 52.7 in November, a rebound from 51.8 in October. The sub-indices with some of the largest moves were inventories and new export orders which increased by 5.9 and 4.8 respectively. Industry respondents generally stated that supply chains are improving but some maintain concerns about labour market tightness.

Euro area/United Kingdom

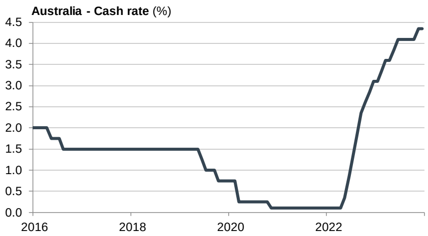
Euro area retail sales still soft



- Euro area retail volumes grew by 0.1% in November, following three months of declines. Higher online sales helped to support retail volumes over the month. Retail sales were 1.2% lower than a year earlier, continuing the negative annual growth experienced over the past year-and-a-half.

China/Japan

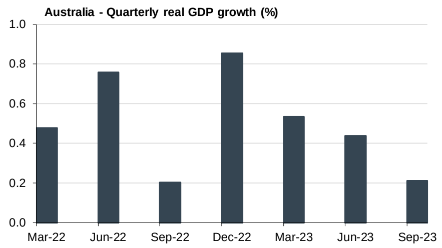
Chinese trade balance better than expected



- Growth in the value of China's exports surprised forecasters, with annual growth increasing to 0.5% y/y in November, up from -6.4% y/y in October. Imports were weaker than expected with annual growth falling into negative territory (-0.6% y/y).

Australia/New Zealand

RBA Board leaves cash rate unchanged



- The RBA kept the cash rate on hold at 4.35% at its December meeting. With data over the past month printing broadly in line or below expectations, the RBA opted to wait for more data on inflation and the labour market.
- Australian real GDP came in below expectations, increasing by a modest 0.2% (2.1% y/y) in the September quarter, down from 0.4% (3.4% y/y) in the June quarter. Household consumption lost further momentum, flatlining in the September quarter, after modest growth of 0.1% in the June quarter.
- Australia's merchandise trade balance increased to $7.1 billion in October, a rebound from September's $6.2 billion. The increase was driven by a 1.9% fall in goods imports, while exports rose by 0.4%.

Sources: ABS, Refinitiv, QIC