BOQ GROUP

3 March 2023

ECONOMIC UPDATE

As good as it gets

Key Points

- **GDP grew by 0.5% in Q4, weaker than I had anticipated;**
- **Other indicators suggest the economy was performing better than that GDP figure at the end of last year;**
- **Outlook for economic growth should be decent in the current half year but be below par in the 2023-24 financial year;**
- **Wages growth remains low and is not a driver of the current inflation rate.**

We found out recently that GDP grew by 0.5% in the December quarter. This was the slowest pace of growth since September quarter 2021, a time when both Sydney and Melbourne were in COVID lockdown. That pace is a little under the average quarterly growth rate of 0.6%.

Slowing in the pace of economic growth is consistent with the wider evidence. The growth of credit, new orders, job vacancies and retail trade (adjusted for inflation) all took a step down in the December quarter. The unemployment rate was reported to have risen. The slowing in economic momentum was put down to rising cost of living and increasing interest rates. Flooding played a role. Worker and material shortages acted to constrain the growth rate (and push up inflation).

But I think the economy was doing better than the reported growth rate. The pace of new orders slowed but remained above its long-term average. Worker shortages remained firms' biggest constraint, the lack of orders was far less of a concern for most. Household spending grew strongest in discretionary areas such as recreation and accommodation and food services. Capex intentions remain firm.

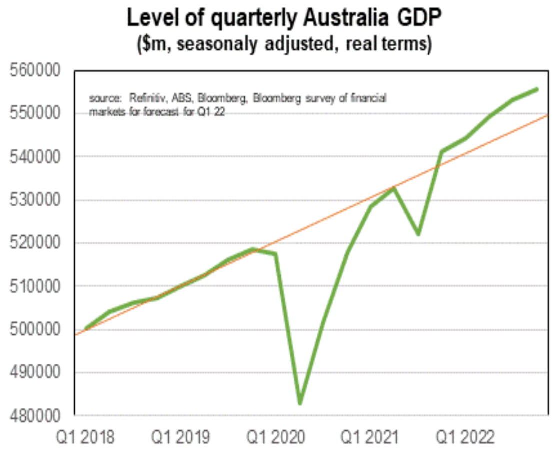
Although the recorded GDP figures was lower than I (and most of my peers) anticipated, I have not changed my view about the path of economic growth. The second half of last year was a step down from the first half. The impact of higher interest rates and cost of living concerns and will see this half year weaker again although growth rates could still be OK (close to average quarterly growth rates). The second half of this year will be below-par. The first half of next year could be weaker again.

There are risks both ways around that view. Consumer spending could decline quicker than I anticipate as indebted households struggle with rising mortgage rates, cost of living concerns and falling house prices. Australian economic data has tended to be weaker than forecast over recent weeks. But the global economy has started the year in better shape than most analysts had anticipated. And tough competition has meant that the mortgage rate has risen by less than the cash rate.

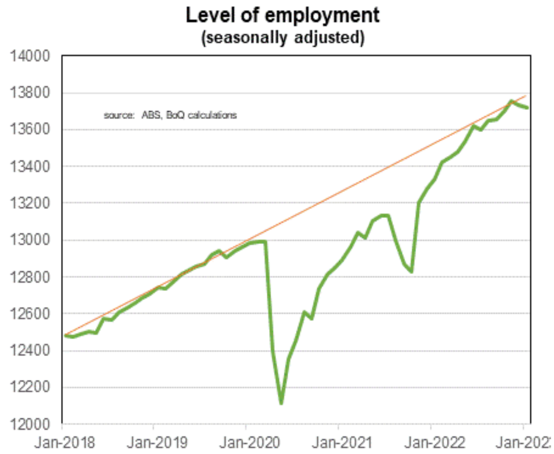
The RBA calculated that non-farm average earnings per hour grew by only 2.5% in the year to December quarter. That suggests that wages growth is not a cause of the current inflation concerns. The GDP data indicates that the rate of consumer inflation is less than what is taking place in the wider economy. Profit margins have risen across a number of sectors of the economy although it was only comfortably above normal levels in a few sectors (notably mining).

The combination of average GDP growth and strong increase in hours worked implies a very weak productivity performance (growth in GDP per hour worked was at its weakest since September 1986). That could reflect a tight labour market pulling in inexperienced workers that take time to develop skills for their new job. It is also likely to reflect that temporary factors (such as flooding) held back production. More concerning for the future of productivity growth was that by my calculation consumption reached its highest ever proportion of economic activity.

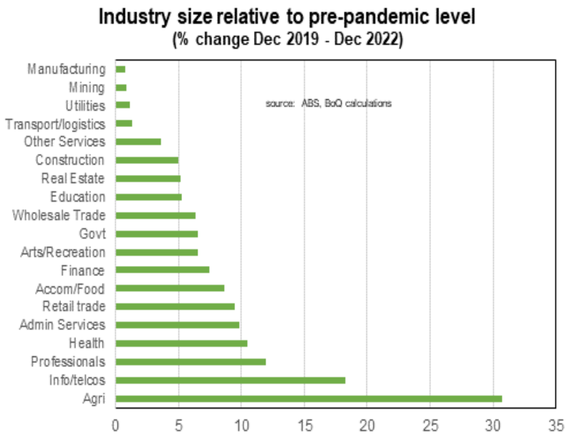
The economy is above its pre-pandemic path.



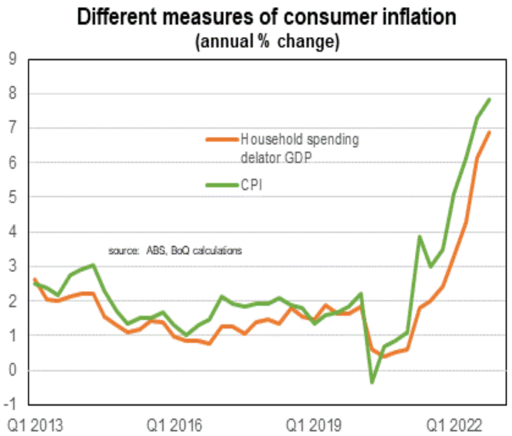
But the level of employment is not.



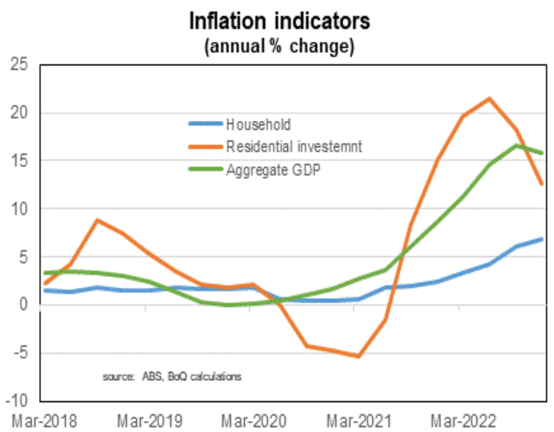
All sectors are now bigger than they were pre-pandemic.



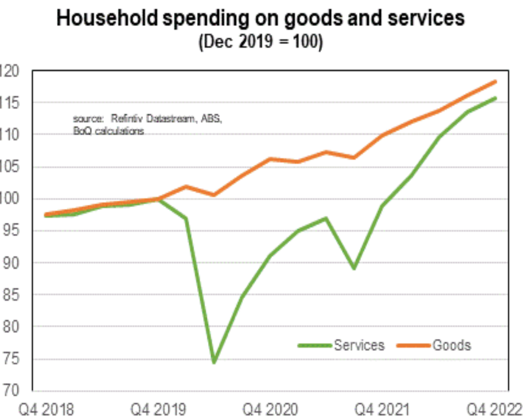
The GDP measure for consumer inflation is below that of the CPI.



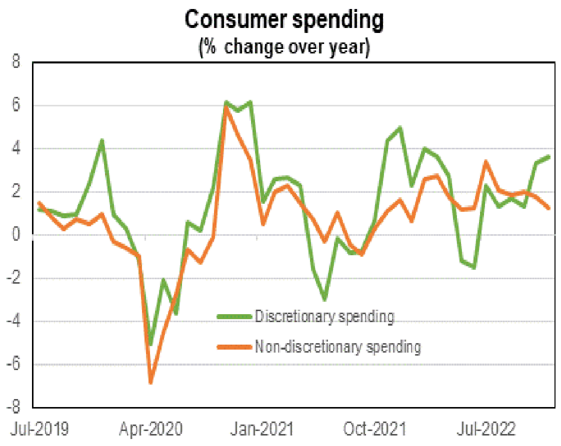
Inflation has been high for households. But it has been even higher in the wider economy.



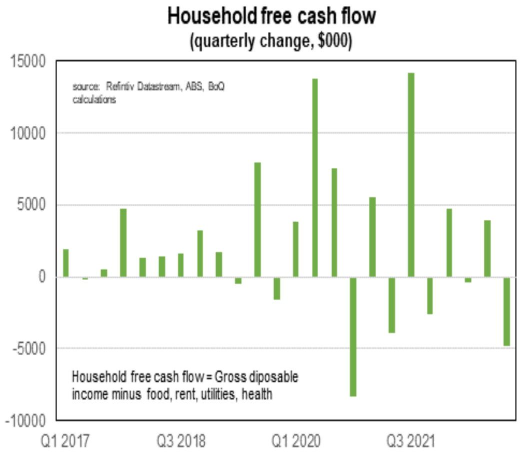
Spending on both goods and services has been strong over the past couple of years.



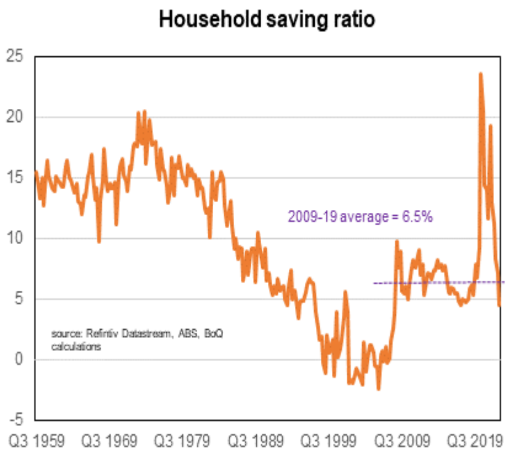
Consumer spending has been particularly strong for discretionary items.



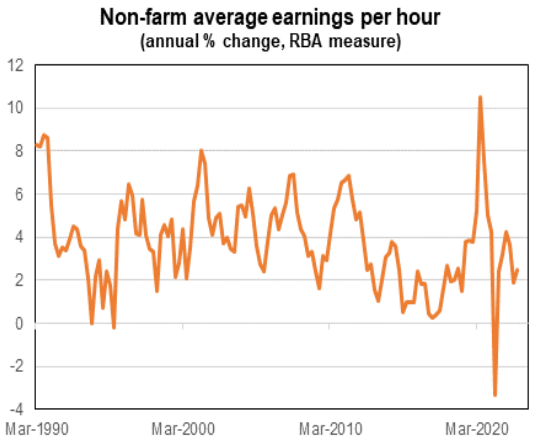
Modest income growth and high inflation for non-discretionary items has hit households.



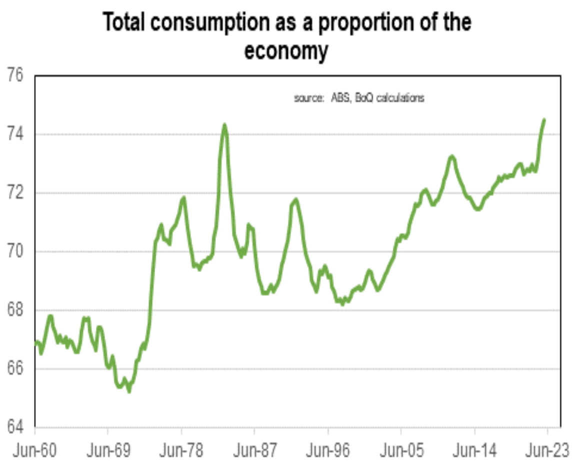
And is why they have reduced their saving.



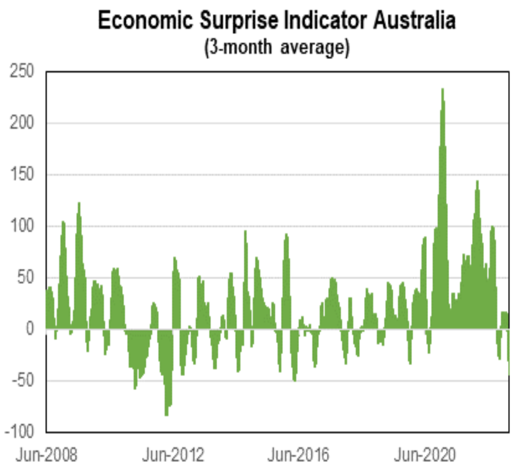
Wages growth remains low.



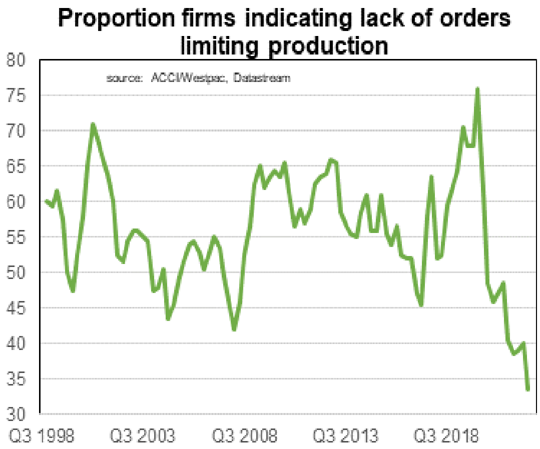
Consumption is at a record proportion of economic activity.



The data has typically been weaker than expected in recent weeks.

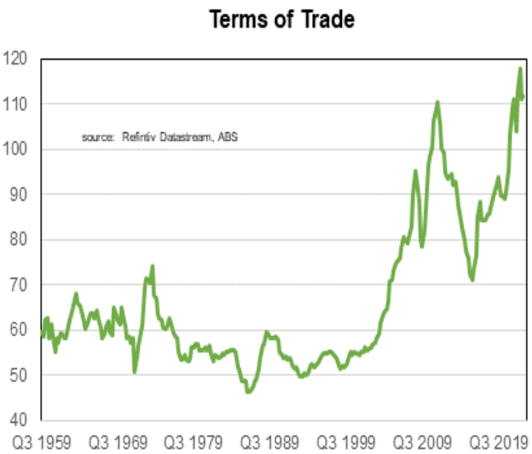


The amount of work is the least of firms' problems.

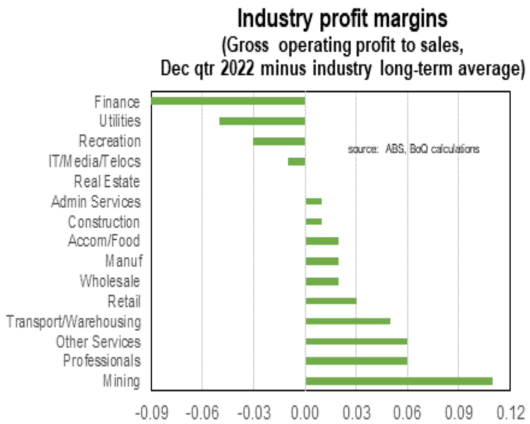


Growth in new orders has slowed, but is still above average.

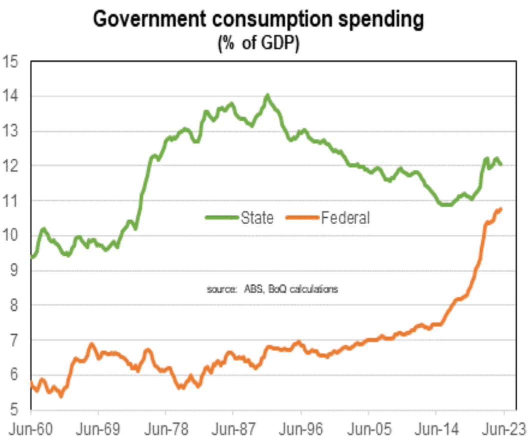
The terms of trade is near a record high.



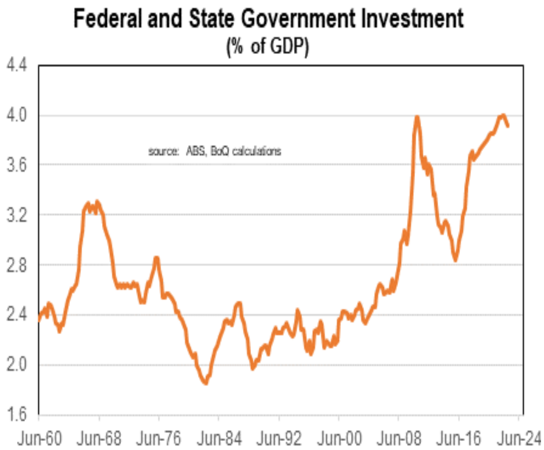
Profit margins are a little wider in most sectors, but only notably so in mining.



Federal Government consumption spending continues to grow faster than the wider economy.



Infrastructure investment has slowed reflecting people and material shortages.



We live in interesting times.
Regards

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