

An aerial photograph of a city skyline, likely Sydney, Australia, with numerous high-rise buildings and skyscrapers. The city is situated along a long, sandy beach that meets the ocean. The water is a deep blue, and the sky is a lighter blue with some clouds. The overall scene is a vibrant and modern urban landscape.

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Economic Letter from Asia: On the RBA

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On the RBA

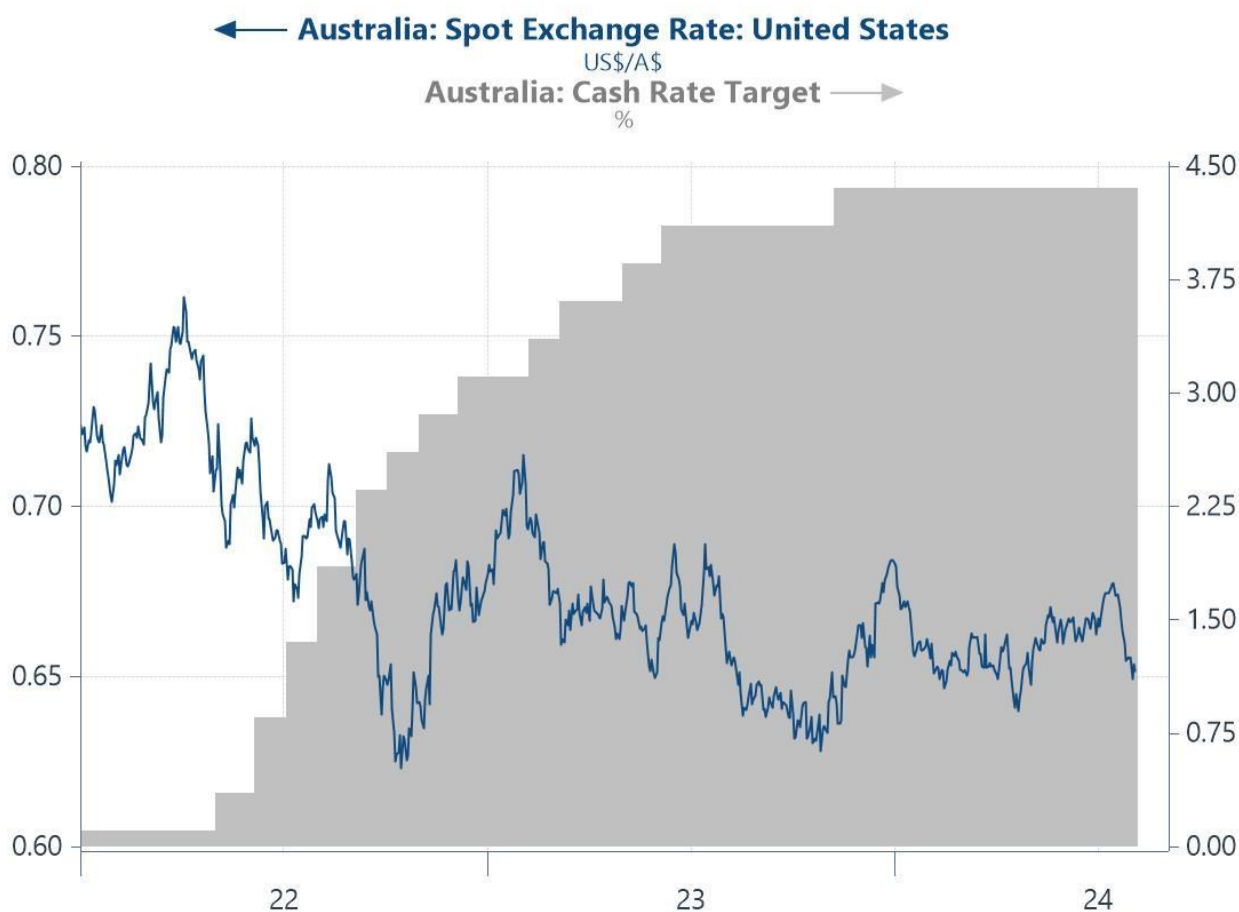
In this week's newsletter, we focus on Australia in light of the Reserve Bank of Australia's (RBA) decision earlier today. While the RBA has chosen to maintain its current policy rate, as many economists had anticipated, this decision reflects a complex assessment of the Australian economy. On the one hand, inflation remains significantly above the RBA's target, and any premature easing could risk reigniting price pressures. On the other hand, the household sector continues to show signs of weakness, with flagging consumption growth and lingering issues with housing affordability. As such, an additional rate hike could further strain this sector. Nonetheless, many Australian economists suggest that the balance of risk may lead the RBA to eventually lower its policy rate rather than pursue further tightening. However, the current consensus is for any initial rate cut to likely only occur early next year. In addition to inflation and household sector issues, we also analyse the current state of Australia's labour market, trade dynamics, and overall growth outlook.

The RBA's August decision

The Reserve Bank of Australia (RBA) maintained its policy rate at 4.35%, as widely anticipated. The central bank's decision to keep its stance restrictive, rather than easing, was primarily driven by persistent inflation. The RBA now expects inflation to take longer to return to its target than previously anticipated. Additionally, while growth forecasts for H2 2024 through H1 2026 have been upgraded, a more subdued growth rate is anticipated for H1 of this year. The RBA also highlighted the ongoing uncertainty in Australia's economic outlook, and acknowledged headwinds via rising unemployment and weak household

consumption. Externally, China, Australia's major trading partner, continues to face economic challenges, with weakened demand impacting commodity prices. On the currency front, the Australian Dollar has shown muted initial reactions to the RBA's decision, although it has already weakened significantly in recent days due to disappointing inflation data. We will explore these issues in greater detail in the following sections.

Chart 1: RBA cash rate target and AUD/USD

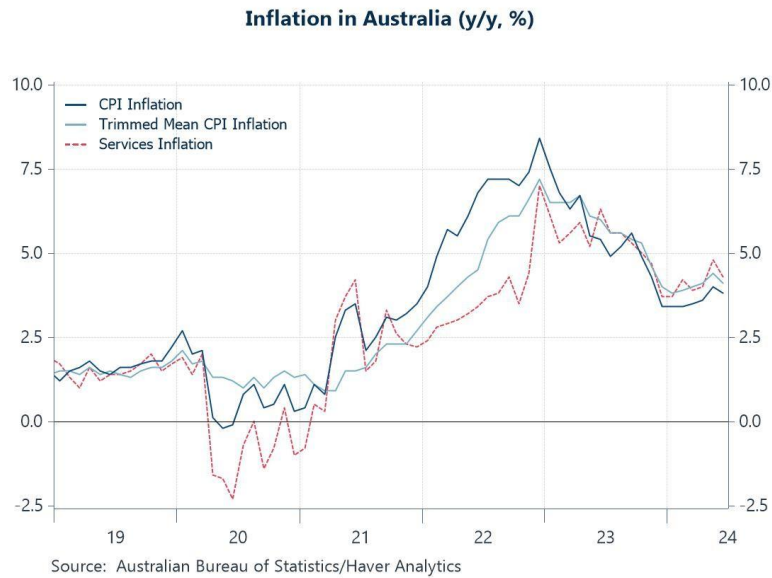


Source: Reserve Bank of Australia/Haver Analytics

Inflation

To understand the key drivers behind the RBA's recent decision, we first need to examine the latest inflation developments in Australia. The June CPI readings, released just days before the decision, showed that inflation eased to 3.8% y/y, as illustrated in Chart 2. Furthermore, underlying price pressures, as measured by trimmed mean inflation—a closely-watched gauge of core inflation—also moderated. This led market observers to reduce their expectations for a potential RBA tightening move at the August meeting. However, it's important to note that inflation remains significantly above the RBA's target range of 2-3%. A substantial portion of the inflationary pressure can be attributed to the services sector, where price increases have been partly fuelled by robust wage growth over recent months, amid persistently tight labour market conditions.

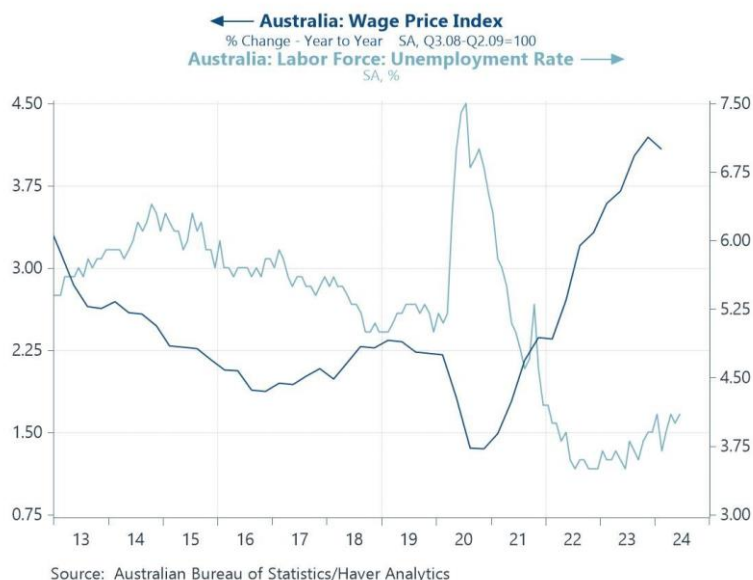
Chart 2: Inflation in Australia



The labour market

Examining the Australian labour market more closely, Chart 3 illustrates that while conditions remain tight relative to historical standards, recent data suggests a slight easing. Wage growth, although still elevated at 4.1% for Q1, has experienced its first decrease since Q1 2022. Additionally, the unemployment rate has been rising gradually, reaching 4.1% in June. Despite these trends, Australia's labour market is still considered tight overall, as these metrics remain significantly stronger compared to pre-pandemic levels. However, despite the strong nominal wage growth mentioned earlier, the situation for Australian households has not necessarily improved. One possible explanation lies in Australia's real wages, which, according to the OECD, remain below pre-pandemic levels. This indicates that, despite recent salary increases, Australian workers have experienced a decline in their actual purchasing power over the past few years. However, this phenomenon is not unique to Australia. Workers in other developed economies, such as Japan and Germany, are experiencing similar challenges.

Chart 3: Australia's labour market



Households and housing

Next we examine the prospects for the household sector in more detail. Chart 4 shows that deleveraging remains a key theme, with total household debt decreasing to 184.7% of disposable income in Q1 2024, from 188.2% in Q2 2022. However, housing affordability has worsened. This is evidenced by the increasing proportion of mortgage repayments relative to income and the rising mean price of dwellings. This trend is expected, as mortgage payments are a function of both property prices and interest rates, among other factors. Looking ahead, Australia's household affordability issues are expected to persist for some time. This is due to underlying factors that are likely to continue. Interest rates are expected to remain historically high, while house price growth is likely to continue due to strong demand and insufficient supply growth.

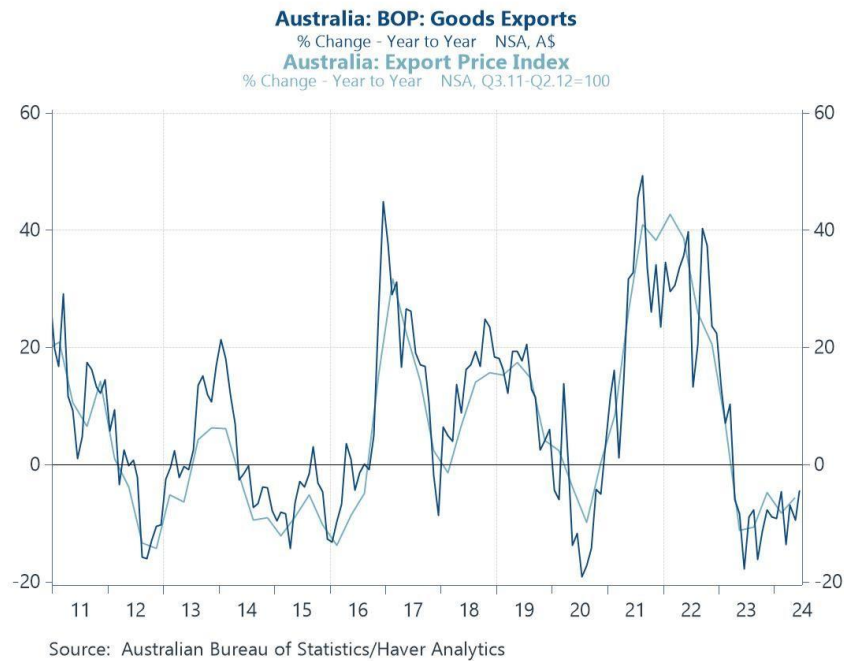
Chart 4: Australia household debt and housing affordability



Trade

We turn next to Australia's trade sector. The economy has faced persistent declines in nominal goods exports, with y/y decreases observed since April 2023. However, as shown in Chart 5, much of this decline can be attributed to price effects, suggesting that the actual volume of exports may not have fallen as significantly as value-based measures indicate. A closer look reveals that the drop in export prices has been largely driven by specific goods categories, such as coal and natural gas products. When excluding these price-related effects, exports continue to be a positive contributor to Australia's real GDP growth, even as other growth drivers, like private consumption, remain weak.

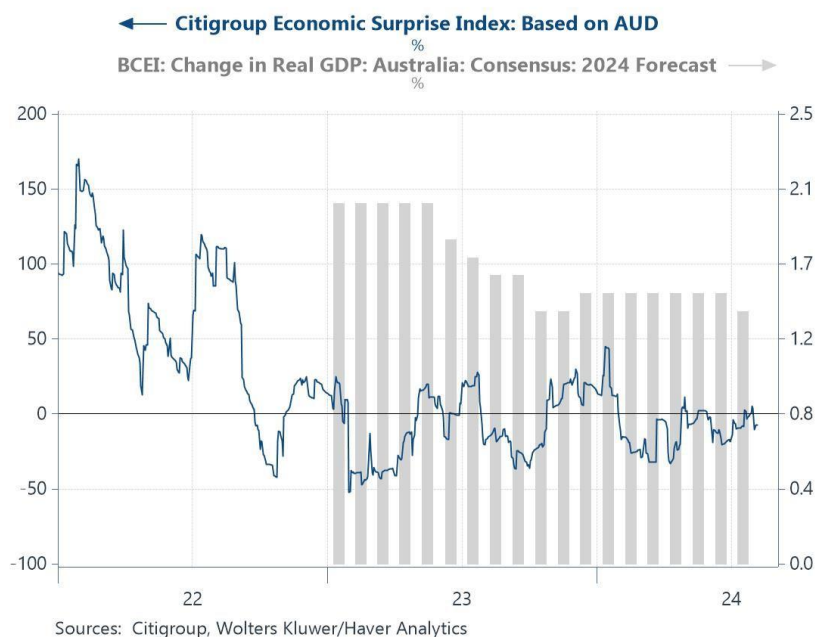
Chart 5: Australia exports and export prices



Growth

Lastly, we look at Australia's growth prospects. As shown in Chart 6, economic indicators from Australia have generally fallen short of expectations in recent months. Reflecting this trend, respondents to our monthly Blue Chip Economic Indicators survey have recently revised their consensus forecast for Australia's GDP growth in 2024 down to 1.4%, from an initial expectation of 2%. For context, headwinds facing the economy include weak household spending and ongoing tight monetary policy, among other factors. Nonetheless, and as previously discussed, the RBA remains in a challenging position: while easing policy might address some current issues, it could also create new problems.

Chart 6: Economic surprises in Australia and Blue Chip GDP forecasts



About the author



Haver Analytics is pleased to bring [Tian Yong Woon's](#) commentaries on the state of the global economy to its clients.

Tian Yong joined Haver Analytics as an Economist in 2023. Previously, Tian Yong worked as an Economist with Deutsche Bank, covering Emerging Asian economies while also writing on thematic issues within the broader Asia region. Prior to his work with Deutsche Bank, he worked as an Economic Analyst with the International Monetary Fund, where he contributed to Article IV consultations with Singapore and Malaysia, and to the regular surveillance of financial stability issues in the Asia Pacific region. Tian Yong holds a Master of Science in Quantitative Finance from the Singapore Management University, and a Bachelor of Science in Banking and Finance from the University of London.

Data featured in this commentary:

Chart 1: RBA cash rate target and AUD/USD

Series 1: [X193USB@INTDAILY](#)

X193USB@INTDAILY [Australia: Spot Exchange Rate: United States (US\$/A\$)]

Series 2: [R193RTR@INTDAILY](#)

R193RTR@INTDAILY [Australia: Cash Rate Target (%)]

Chart 2: Inflation in Australia

Series 1: [AUMPCY@ANZ](#)

AUMPCY@ANZ [Australia: Consumer Price Index (NSA, Yr/Yr % Chg)]

Series 2: [AUMPCMRY@ANZ](#)

AUMPCMRY@ANZ [Australia: CPI: Annual Trimmed Mean (NSA, Yr/Yr % Chg)]

Series 3: [AUMPCMSY@ANZ](#)

AUMPCMSY@ANZ [Australia: CPI: All Groups, Services Component (NSA, Yr/Yr % Chg)]

Chart 3: Australia's labour market

Series 1: [yryr%\(AUSWPI@ANZ\)](#)

AUSWPI@ANZ [Australia: Wage Price Index (SA, Q3.08-Q2.09=100)]

Series 2: [AUSELUR@ANZ](#)

AUSELUR@ANZ [Australia: Labor Force: Unemployment Rate (SA, %)]

Chart 4: Australia household debt and housing affordability

Series 1: [AUNFHDDI@ANZ](#)

AUNFHDDI@ANZ [Australia: HH Fin: Debt as a Percent of Gr Disposable Income (NSA, Percent)]

Series 2: [AUNHIAA@ANZ](#)

AUNHIAA@ANZ [Australia: Housing Affordability Index (NSA, Index)]

Chart 5: Australia exports and export prices

Series 1: [yryr%\(AUNBMGC@ANZ\)](#)

AUNBMGC@ANZ [Australia: BOP: Goods Exports (NSA, Mil.A\$)]

Series 2: [yryr%\(AUNPFXI@ANZ\)](#)

AUNPFXI@ANZ [Australia: Export Price Index (NSA, Q3.11-Q2.12=100)]

Chart 6: Economic surprises in Australia and Blue Chip GDP forecasts

Series 1: [V193CSI@INTDAILY](#)

V193CSI@INTDAILY [Citigroup Economic Surprise Index: Based on AUD (%)]

Series 2: [AAUD24@BLUECHIP](#)

AAUD24@BLUECHIP [BCEI: Change in Real GDP: Australia: Consensus: 2024 Forecast (%)]

For more info on our databases please email sales@haver.com.

