

## Australian and US economies - a comparison

Over the last few years, the parallels between the Australian and US economies have been clear. But with confusion reigning over the outlook for both economies, can we learn anything by making a closer comparison?



### Australia's growth profile is weaker

The obvious starting point for a comparison like this is growth, and here Australia does stand out with a much weaker growth profile following the post-pandemic surge in activity. GDP has slowed consistently since the fourth quarter of 2022, when quarter-on-quarter growth topped 0.8%. GDP growth has now slowed to 0.2% QoQ, with most of the slowdown coming from household spending.

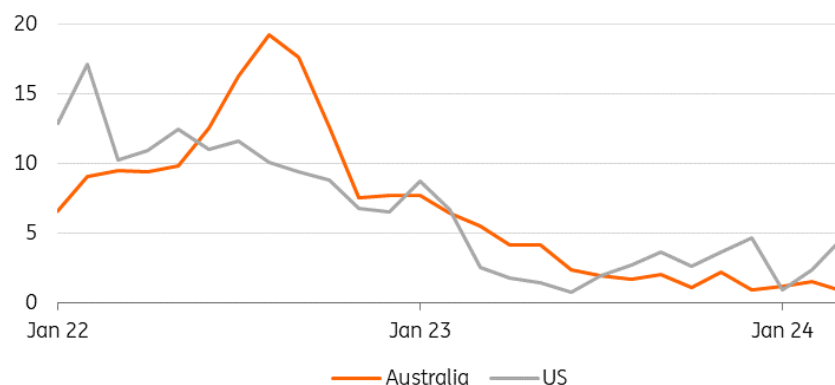
The contrast with the US is stark. Although GDP slowed to just 0.4% QoQ in the first quarter, that is still double that of Australia, and household spending is still providing much of the forward momentum. Prior to that, growth averaged more than 0.7% QoQ (almost 3% saar) in the prior six quarters.

We can see a similar pattern emerging in comparisons of retail sales growth. US retail sales growth slowed more rapidly following the reopening surge, but by about mid-2023, it seemed to bottom out and has been growing quite strongly again more recently. In contrast, Australian retail sales growth still appears to be slowing.

Retail spending in the US is dominated by higher income cohorts, for whom higher interest rates may be less of a burden (greater outright home ownership, net fixed income wealth and interest earnings) than lower income households. This may also help to explain the discrepancy between ongoing strength in US retail sales coupled with rising consumer delinquency rates.

One could argue that this shows that Reserve Bank monetary policy has been more effective than that of the US Fed. Either that, or other factors are weighing more heavily on Australia than the US. We will explore both ideas later.

## US and Australian retail sales YoY%



Source: CEIC, ING

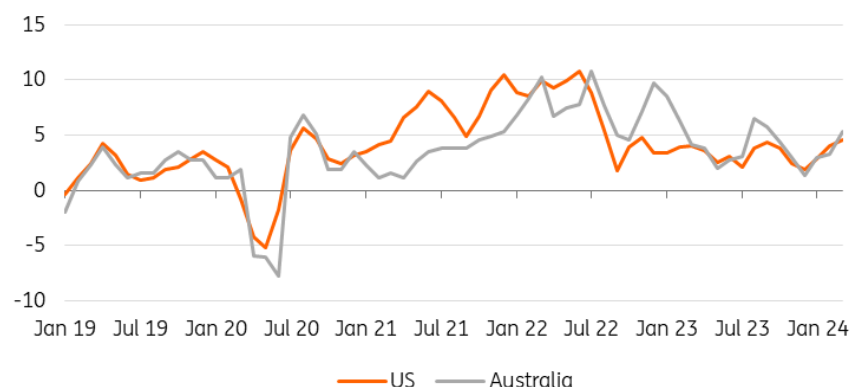
## Inflation - looks stickier in Australia

Unlike growth, there are much clearer parallels between Australian and US inflation. Both spiked close to double digits in the aftermath of the reopening, but came down rapidly after that, helped by unrepeated base effects. More recently, inflation has not only seemed to bottom out above both central banks' inflation targets but has begun to edge higher in both economies.

In both cases, what has not been helping inflation to subside quicker, has been recent month-on-month CPI gains. In order to come in at or below its 2% target, US inflation needs to average 0.17% month-on-month each month. For Australia, it is slightly easier, as the top of the 2-3% target range means that inflation only needs to come in at 0.25% MoM, so alternating 0.2 and 0.3% MoM would be sufficient.

In the last three months, neither economy has managed to achieve required run-rates at or below that needed to hit the central bank's targets over the medium term. Australia's seasonally adjusted monthly series has exceeded 0.4% every month, suggesting an annualised rate of inflation above 5%. The six-month annualised figure looks better, as it still incorporates weak October and December readings. But unless we get some very weak price data in the coming three months, both of these data points will drop out of that calculation, and the six-month annualised figure will also move higher.

## Annualised inflation rates (3m annualised %)



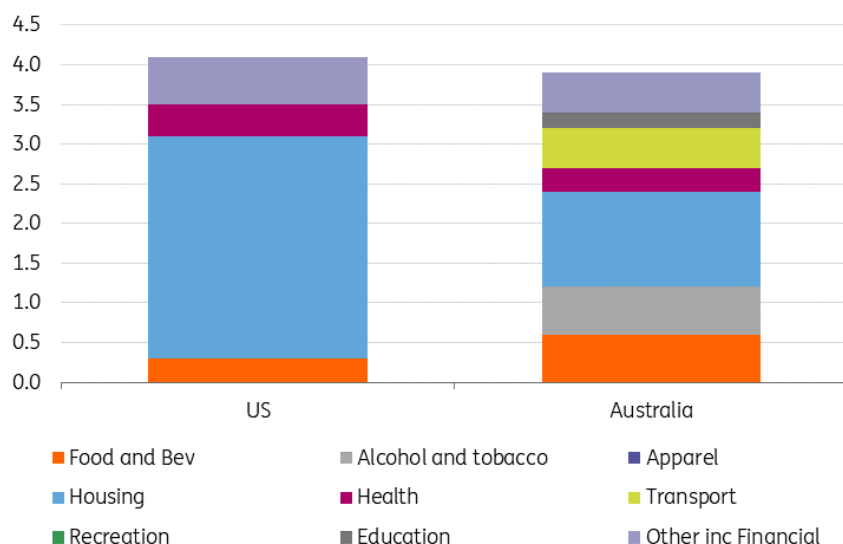
Source: CEIC, ING

## What's driving inflation in each economy?

Breaking down the drivers of inflation provides some answers to what is going on. We compare CPI measures rather than the Federal Reserve's preferred PCE measure as there is no Australian PCE equivalent.

For Australia, housing is the single biggest contributor to the current 3.5% inflation rate, contributing 1.2pp of the 3.6% inflation rate. But in the US, the contribution is even greater, as more than half of CPI inflation stems from housing in one form or another.

## Contributions to inflation (pp)



Source: CEIC, ING

Both Australia and the US register rising house price growth, but what is probably doing more damage to inflation than house prices, which are not directly measured in either set of CPI data, is rents.

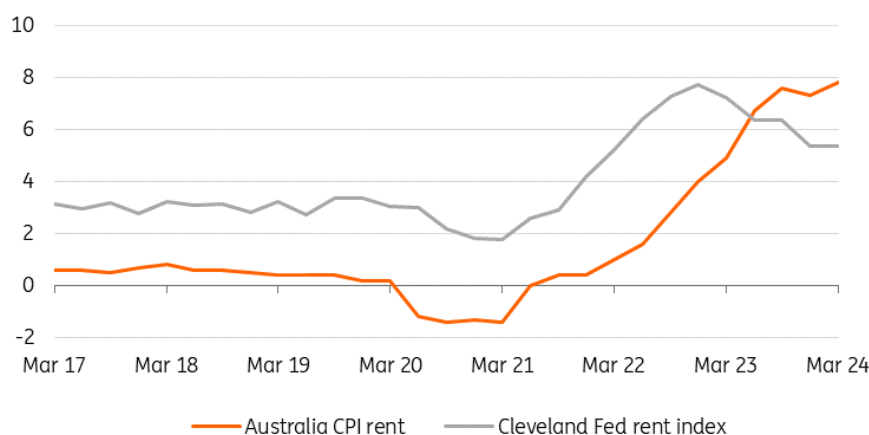
In the US, the Cleveland Fed measure of new rents is still rising, but the rate of growth has slowed

considerably. This measure has been shown to lead rents as measured by the Bureau of Labour Statistics by four quarters, so we can expect the large contribution of rents in the US inflation measure to drop substantially over the coming four quarters. It has already peaked.

In Australia, in contrast, rental growth as measured by the Australian Bureau of Statistics, appears to be accelerating, not slowing. Consequently, it looks to us as if this component of inflation will diminish in the US over the coming quarters but could become even more important in Australian inflation and, unless some other component of inflation drops, could lead inflation to edge higher still.

In short, there is a decent chance that US inflation data moderates over the coming months, reducing the risk of an inflation overshoot. The likelihood of Australia matching that improvement is lower in our view.

## US and Australian rentals (%YoY)



Source: CEIC, ING

## Labour market - downright confusing

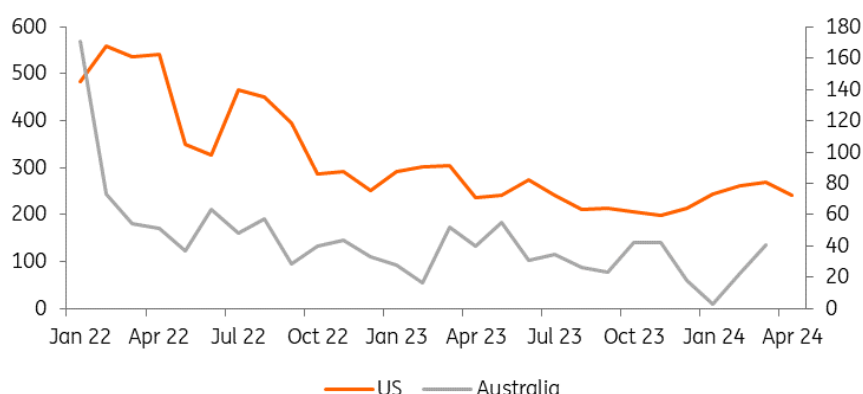
At best, labour market data for each economy can be viewed as unhelpful. It could be actively misleading, but in the long run, a weakening labour market is usually a good sign that tight monetary policy has indeed been slowing demand in the rest of the economy, though it may only emerge with long and unpredictable lags.

Conversely, US non-farm payroll gains had been showing a slight strengthening trend since the beginning of the year until the latest April data edged the three-month trend down again. Australia's comparable employment series had weakened a lot towards the end of last year. But it has picked up since the beginning of this year, and pending the next set of numbers, has been gaining in strength.

Both sets of data are horribly volatile, even smoothed. And the unemployment rates in both economies remain very low. In neither case does the data strongly suggest anything that might be a precursor to a recession. Although the US ISM employment components are pointing to the risk of outright declines in nonfarm payrolls in coming months while the National Federation of Independent Businesses hiring intentions survey, which has been the best individual indicator of payrolls, points to private sector employment growth slowing to sub-50,000 by the summer.

## Employment data isn't helping much

Monthly change 000's 3mma



Source: CEIC, ING

## Wages have only just peaked in Australia

Wage growth in both economies is still high. A simple benchmark for the rate of wage growth that is consistent with the inflation target is to simply add the trend rate of productivity growth to the inflation target. That should ensure that a representative firm in the economy should be able to maintain profit margins while still allowing wages to grow at this rate, though it ignores factors such as whether current profit margins are sustainable or not.

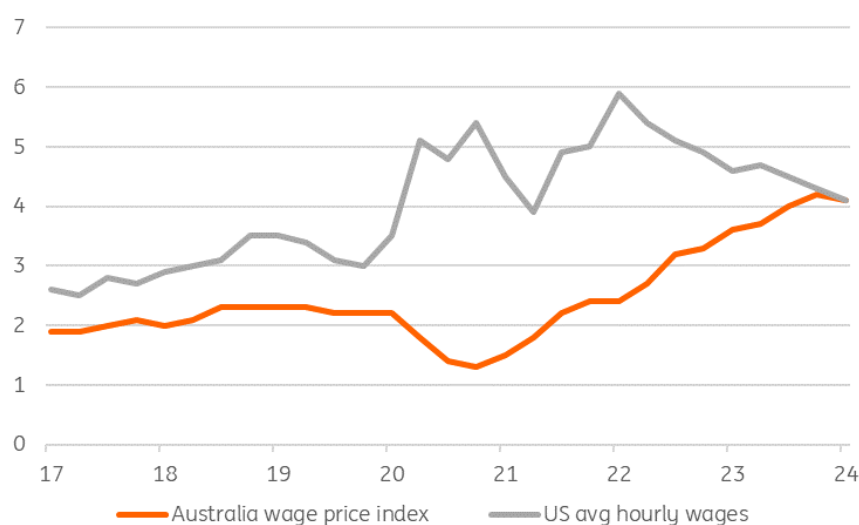
Using this rough yardstick, wage growth in Australia at 4.1%, according to the wage price index, is a little higher than consistent with the top of the 3% inflation target, assuming a trend productivity rate of 1%.

That also holds true for US wages growth due to the lower inflation target. Average hourly wage growth in the US is now 3.9% year-on-year. What is different though, is the trend in wages. For Australia, this has only just peaked. Whereas in the US, although progress has been slow, wage growth has been heading lower for longer.

The best lead indicator we have for US wages is the quits rate within the JOLTS report. It peaked at 3% of all workers quitting their jobs in 2022 as the jobs market was at its most frenzied. While there are still lots of job vacancies, it appears that they may not be as attractive either in the role on offer or the rate of pay. The quits rate has since slowed to 2.1%. With fewer workers quitting, there is less incentive for employers to pay bumper salaries to retain staff and we expect US wage pressures to subside.

Again, this suggests that the risks to the Australian outlook are for inflation to remain stickier than the US implying rate policy to remain higher for longer in Australia (or rise) than the US.

## Wage growth US vs Australia (%YoY)



Source: CEIC, ING

## Monetary policy - Australian rates don't look all that restrictive

One factor that feeds into thoughts of where the macroeconomy is heading, and therefore where monetary policy is going, is just how tight the current monetary stance is.

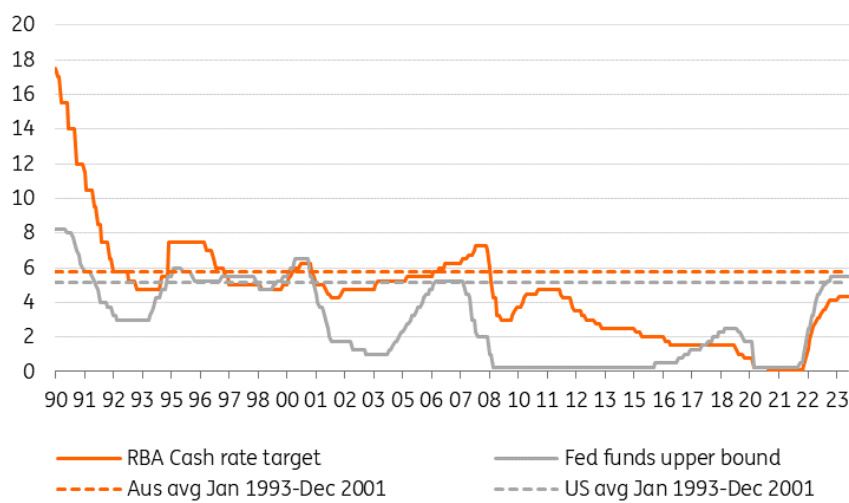
Over recent months, there has been a lot of discussion about this in the context of the US, where the activity indicators have held up far better than most expected, and inflation has ceased to make progress towards the Fed's target. Could it be that the highest policy rates in 23 years weren't actually as aggressive as was previously believed? Was the long-run rate for US policy closer to 4% than the high-2s that the Fed's dot plot assumed? Or is it simply that the longer end of the yield curve has undone some of the tightening the Fed intended?

For Australia, the cash rate target is about 100 basis points lower than the mid-point of the Fed's target range for the Fed funds, so the degree to which policy may be actually erring on the easy side looks an even more obvious critique.

Where the current long-run equilibrium policy rate for each economy is, is anyone's guess. Looking at a long-run chart of policy rates for both economies doesn't help much, as recent decades have been beset by periods of abnormal developments – the Global Financial Crisis, unorthodox policy (QE), and the pandemic. The period between 1996 and 2001 looks to us like a reasonably stable period, and here, adjusted for the US target “range” compared to the Australian point target, US rates were typically 50bp lower than those in Australia. Whether that period is indeed representative or provides an insight into long-run equilibrium rates is at best only a very rough guess. And the actual equilibrium policy rates for both economies could have changed substantially since then. That said, for almost the whole period since 1990, Australian policy rates have exceeded those of the US.

## Are RBA rates restrictive enough?

Policy rates (%)



Source: CEIC, ING

That makes the current situation, where Australian policy rates are about 100bp lower than their comparable US counterparts, look rather unusual. It is entirely possible that the r-star for both economies has declined over the period we have charted. But it seems much more of a stretch to argue that it would have declined by close to 150bp more for Australia than the US.

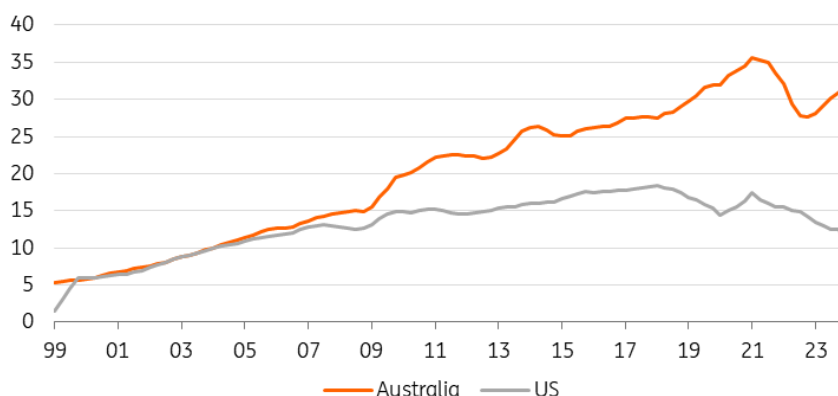
Consequently, we'd have to say that, in our view, the risk that current policy settings are looser than they need to be to hit the central bank's inflation target is higher for Australia than it is for the US. And consequently, the risk that rates have not yet peaked also looks higher.

## External sector - more price pressure from the US re-shoring?

In recent decades, the main influence of trade on domestic inflation is arguably the degree to which globalisation has helped depress prices and wages by developing more competitive and efficient supply chains. It seems reasonable to suppose that economies which have seen a greater impact of these trends should experience a higher negative impact on their price level, and a corresponding decline in trend policy rates – at least while the globalisation process was underway.

From 1999 just before China's accession to the World Trade Organization (December 2001), China accounted for a very small proportion of total trade (exports and imports) for both Australia and the US (about 5% for Australia and less than 2% for the US).

## Trade with China (% total)



Source: CEIC, ING

Since then, this proportion has climbed, but peaked in the US in early 2018 at around 18% of total trade, shortly into the Trump Presidency and the ensuing trade wars. Since this time, China's proportion of total US trade has been slowly subsiding.

In Australia, the proportion of Chinese trade to total Australian trade was higher and kept climbing until the middle of the Covid pandemic when it touched more than 35% of total trade. It is rising again now, though has not yet reached its mid-Covid peaks.

Right now, the de-globalisation trend seems more evident in the US than it does in Australia. That might argue that trend US inflation might run a little hotter than in Australia, all else being equal, and that policy rates might also need to run a little tighter. This is perhaps one area that does support the current disparity in policy rates between the two economies, though whether it is enough to account for the full 100bp+ spread seems highly dubious.

We expect US supply chains to continue re-orienting to improve security and increase US employment. This is the case whether Trump or Biden wins the forthcoming election - both are unafraid of using tariffs and financial incentives to re-shore.

## Demographics - big net inward migration more important for Australia

The final factor which we will consider, which could have a bearing on the relative policy stance of both central banks relates to population growth. In both the US and Australia, this is mainly driven by net inward migration. Recent data shows that the US birth rate is plummeting and is now down to just 1.6.

While there are reports of increased net inward migration to the US, most of these are likely to be illegal entries, and the official data on this doesn't show much going on. In contrast, Australian migration data shows a very substantial pick up immediately following the reopening of the economy, as migration delayed by the pandemic occurred.

This looks as if it may be peaking out, but in the meantime, it will have done a number of things. Firstly, it will have put pressure on goods and services where supply is slow to respond to rising demand. The most obvious place for this to have occurred is in the housing markets, where

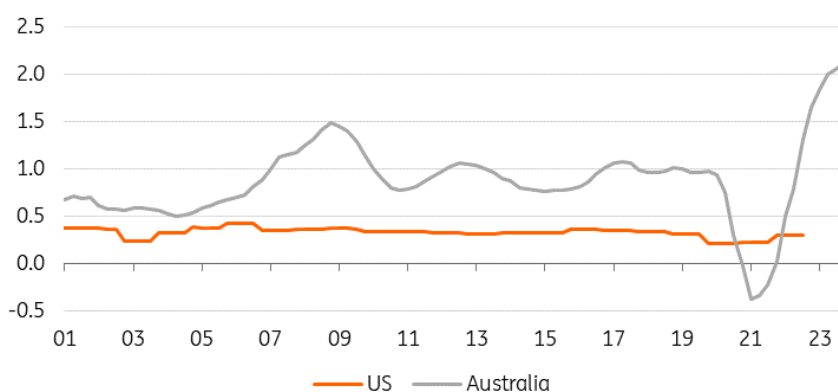


both rents and prices will have been pushed up. Secondly, It will also have provided increased labour supply at a time when other economies were experiencing reopening shortages, and this could have helped to curb wage growth relative to other economies – one of the explanations for why wage cost price inflation has been such a slow-burn higher.

Right now, the rate of inward migration seems to be peaking out, but until it declines, there is likely to remain upward pressure on house prices and rents. Wage growth also seems to still be rising, despite the increased labour supply. It is probable that the counterfactual would have been a lot higher wage growth without the inward migration, though the net effect for now taking into account other relevant factors still seems to be positive.

## Australian net inward migration has soared

Immigration % population



Source: CEIC, ING

## How is this likely to play out in markets?

Wrapping this altogether provides some food for thought when it comes to Australian markets relative to the US.

Currently, markets are pricing in more Fed easing relative to the RBA by the end of 2024 and 2025. On a relative basis, this looks appropriate, though with the outlook for the Fed still slightly hanging in the balance, one could argue that markets are not giving enough weight to the possibility that the RBA may not yet have taken rates sufficiently high to bring inflation down.

We are forecasting one rate cut from the RBA, less than we forecast for the US. And it comes later on. We haven't entirely dismissed the possibility of rate hikes. A couple more months of disappointing Australian inflation data could get us there, and the underlying drivers for inflation don't look as benign as they do in the US.

Australian 2Y yields are still well below comparable US Treasuries – reflecting the differential in policy rates. However, the balance of risks will likely see these spreads narrow as US yields come down faster than those in Australia. 10Y US Treasury yields also show a small positive spread over Australian 10Y government bonds, which we think could narrow further, either as US yields fall, and Australian yields fall less, or Australian bond yields move higher than Treasuries in the event

of another sell-off.

## G10 FX positioning overview



\*Note: Aggregate USD positioning versus G10 FX. As of 07 May 2024 (data reported with a lag).

Source: CFTC, Macrobond, ING

## AUD has room to rise before major US election risk event

As a result of expected rate divergence, we think the risks remain weighted to Aussie dollar appreciation against the US dollar in the medium term, though picking your moment against the USD is the main difficulty in what is likely to be a very choppy and noisy data-driven market. Still, CFTC data on speculative positioning shows AUD remains in net-short territory (31% of open interest), while the aggregate USD net-long-positioning against G10 is close to its five-year highs.

A medium-term bullish view on AUD/USD is also supported by our belief that markets have overdone their pessimism on the China outlook, and that commodity currencies like the AUD should benefit more than their non-commodity focused peers. From an economic-fundamental perspective, we estimate through our BEER model that the real AUD/USD is undervalued by 7% in the medium term.

We currently see early summer as the best period for AUD/USD to stage any significant rally. US data may start to show enough weakness in the coming months to warrant a rate cut by the Fed in September (our base case), while a neutral RBA should not harm AUD's rate profile. For what it's worth, seasonality suggests June and July would be stronger months for AUD/USD, while in August the pair depreciated in 16 of the past 20 years.

Our forecast for AUD/USD is flat into the end of this quarter at 0.66, as we expect US data to still show some resilience in the near term. In June and July, we could see the pair break higher and even eye the 0.685 December-2023 highs. However, markets should start trading the US election event risk more actively from August and may price a risk premium into China-exposed high-beta currencies like AUD due to a potential Trump re-election. That means AUD/USD could ease back around 0.67 into the US vote and an RBA cut in 4Q24.

## Summary forecasts

		2Q24	3Q24	4Q24	2024	2025	2026
GDP Annualised	Australia	0.4	1.2	1.6	1.0	2.0	2.5
	US	2.8	0.3	0.6	2.4	1.4	2.1
Inflation YoY%	Australia	3.7	3.5	3.4	3.5	2.9	2.5
	US	3.5	3.0	2.7	3.1	2.0	2.0
Policy rates (eop)	Australia	4.35	4.35	4.1	4.1	3.6	3.6
	US	5.25	5.00	4.50	4.50	3.25	3.25
3m rates	Australia	4.4	4.3	3.9	3.9	3.75	3.75
	US	5.4	5.2	4.7	4.7	4.0	4.0
10Y yields	Australia	4.3	4.1	3.9	3.9	4.5	4.5
	US	4.75	4.25	4.00	4.00	4.50	5.00
AUDUSD		0.66	0.67	0.66	0.66	0.66	0.70

Source: ING

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