Australia: Growth and inflation both slow

A double whammy of slowing growth and moderating inflation, but it won't be enough to get the central bank to pause next week

Governor of the Reserve Bank of Australia, Philip Lowe

0.5%

4Q22 GDP growth

QoQ sa

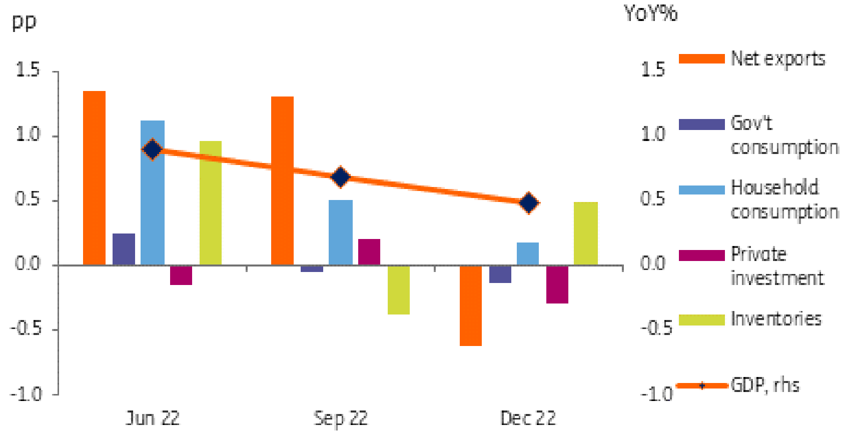
Lower than expected

4Q22 GDP growth slows, and looks like it will slow further

Despite some stronger private investment data earlier in the week, which led to the consensus of forecasters revising up their expectations for today's GDP release, the published growth figure actually came in quite a bit weaker than the 0.8% quarter-on-quarter expectation, growing only 0.5% from the previous three months.

Following some slightly softer monthly labour reports, is this finally conclusive evidence that the economy is slowing? It certainly looks that way.

Contribution to QoQ GDP Growth



Source: CEIC, ING

Consumer spending falling, inventories rising

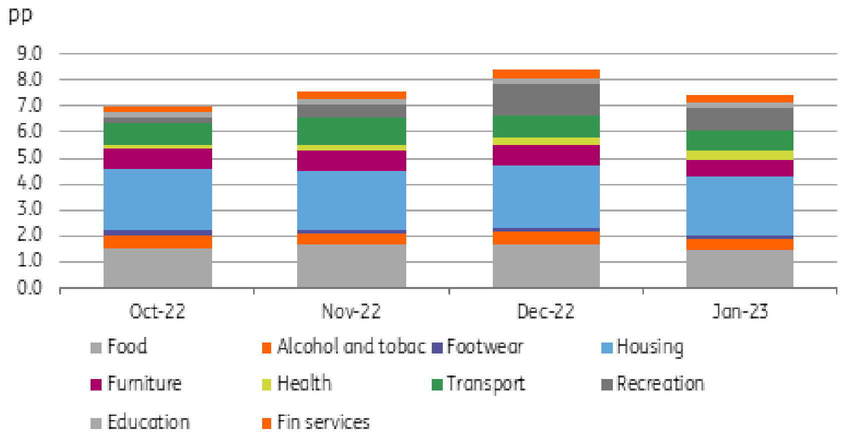
To work out what exactly is going on, we've calculated the contributions to quarter-on-quarter seasonally adjusted GDP growth broken down into some of its main constituents, to see what is weakening, and what is holding up better, and compared this over the last three quarters.

When you do this, you see that the total GDP growth rate has declined at a very steady pace over the last few quarters. Much of that decline can be laid at the feet of private consumption, the growth rate of which has dropped steadily over this period. Helping to pull the total down this quarter, net exports were also a drag.

Somewhat worryingly, the fourth quarter GDP growth total would have been closer to zero had it not been for some inventory building, some of which will probably prove to have been involuntary, and will reverse in the coming quarters.

So in short, it does look as if there is more to this than just some statistical noise, and we could be looking at a sub 0.5% QoQ figure for the first quarter.

Inflation falls are broadly spread



Source: CEIC, ING

Inflation also fell sharply

January inflation also dropped sharply following its surge higher in December, dropping to 7.4%, a full percentage point below the December figure.

We have performed a similar breakdown of the inflation numbers to see what is driving this result, and what we find is very different to the GDP numbers.

Whereas the GDP figures appear to have some obvious drivers for the latest weakness, this is much less apparent in inflation, where the contributions to inflation have remained very steady, but slightly weaker across a wide range of components. Even the reversal of the big surge in holiday prices, which helped lift the inflation rate in December, had a relatively modest impact on the inflation rate in January. The recreation sub-component which encompasses holiday travel dropped back 0.3pp in terms of its overall contribution to the inflation total. Accounting for the rest of the drop in today's inflation rate, were small declines across a wide range of items.

That actually sounds like a more solid slowdown in inflation than if it were just the result of, say, food price swings or gasoline costs for example. And indeed, the inflation rate excluding volatile items fell to 7.2% from 8.1%, suggesting that this was a fairly broad-based, though at this stage, modest, decline in core inflation.

Should the RBA take notice?

Combined with the GDP numbers, these latest inflation figures may prompt thoughts of a different tack by the Reserve Bank of Australia, coming just a week before its next rate-setting meeting. However, we think this would be a bit premature. And financial markets seem to agree.

For one thing, the inflation rate, though sharply down, remains well above 7%, a rate that hardly indicates a pause is likely anytime soon. Moreover, today's drop in inflation, though broad-based, only reverses last month's spike, so we really aren't any better off yet, even if the signs for further declines are a little more promising. And finally, the RBA at its last rate-setting meeting provided very strong forward guidance that suggested inflation would not return to its 2-3% target range until 2025. This is a forecast we completely disagree with, but that is irrelevant to the fact that the RBA will want to maintain its hawkish credentials right up until the point that either the market calls its bluff or policymakers drop the pretence and admit things are going better than they had predicted.

Markets have scaled back their expectations for RBA tightening following today's figures, and the implied peak rate from cash rate futures in October has dropped back to 4.182% from 4.275% the day before. But markets are still pricing in a much greater than 50% chance of a rate hike next week, and after some initial weakness, the Australian dollar has shrugged off the data and has appreciated for most of the day.

Author

Robert Carnell
Regional Head of Research, Asia-Pacific
robert.carnell@asia.ing.com

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