

Australia's lucky economy

The Australian economy is slowing, but a combination of factors, including a relatively cautious central bank, means that the chances of a soft landing are high



Sydney's central business district

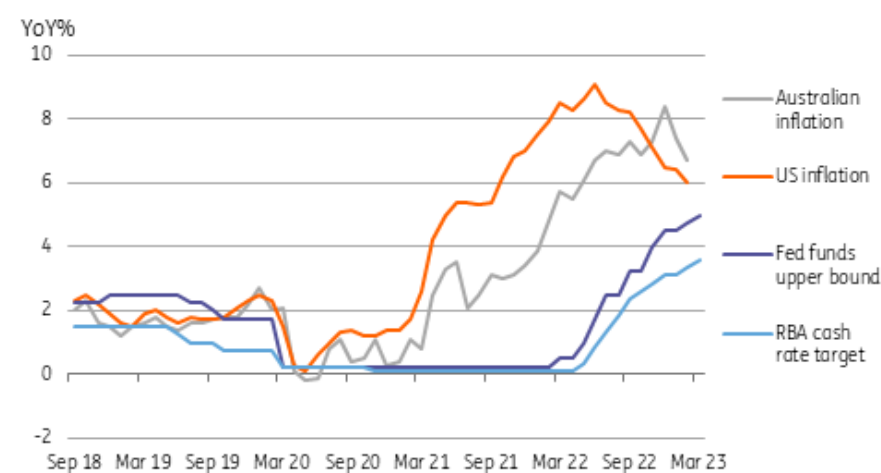
Like the US, but different

In some ways, the Australian economic conjuncture resembles that of the United States. The economy has been slowing, though is still growing at a reasonable pace, with pockets of weakness in the housing market offset by a stubbornly tight labour market.

More than the US, however, China's re-opening, together with a more pragmatic view about Australian imports following some political spats in 2022, should provide greater support to exports, the extraction industries and agriculture. Although to be clear, our expectations for further Chinese demand growth are relatively modest.

Australian inflation is still well above the Reserve Bank of Australia's 2-3% target range, at 6.7% year-on-year in February. But the latest report showed it falling faster than expected. There also seem to be few risks from Australian wage growth rates, which differ from the US in remaining very benign, though the wage growth numbers are still rising slowly.

Inflation and policy rates in Australia and the US



The economy is slowing, but gently

With this mixed backdrop, it is not surprising that the message from the RBA has been equally mixed. At its February meeting, the RBA suggested that inflation would not return to its target range until 2025. We believe this statement is meant to reinforce the RBA's inflation-fighting reputation, but it paints far too pessimistic a picture and in contrast, we see inflation coming down close to the target, even if not actually hitting it, by the end of this year.

The March meeting delivered a very different message, with a minor tweak to the text being interpreted as meaning the RBA was within one 25bp hike of peak cash rates. That view looked quite challenged shortly after the meeting, as labour data painted a much more robust image of the labour market, though the latest inflation data put that view back on track again.

Minutes from the previous meeting confirmed that a pause was the RBA's intent and the financial turmoil that has rocked markets, together with a more moderate outlook for rate hikes in the US means that one more hike may well be it for this cycle. And possibly not even that.

We revised up our peak cash rate some months ago to 4.10% after the December inflation spike, but recent events have encouraged us to trim that by one 25bp hike to a peak of 3.85%, still low in both an absolute and relative sense.

The impact of the RBA's tightening so far will continue to come through into the broader economy only gradually, as re-setting mortgages incrementally adjust to the higher cash rates, increasing debt-service costs further, and pandemic-boosted cash balances are drawn down, leading to a moderation of consumer spending. Growth should continue to slowly moderate, and inflation will continue to make progress lower over the coming months.

RBA sounding, but not acting, hawkish

If there is one big difference between Australia and the United States' economic backdrop and policies, it is that the RBA seems to be trying much harder to achieve a soft landing than the US. That is leading to some mixed messaging, with strong rhetoric not entirely backed up by strong actions. However, if we had to choose, we think Australia will pull it off. Inflation will prove to be far

less sticky than even the RBA has suggested. And even if 3.85% turns out to be the lower end of where peak rates do eventually settle, the absolute level of rates will still likely be lower than the equivalent Fed funds rate, giving Australia's economy a better chance of a soft landing than the US.

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