

Australia Economic Watch

RBA preview: Wake me up when Nov ends

No hike in October, but some risk in November

The RBA meets on October 3, and we see rates unchanged again. Michele Bullock's first meeting as the Governor means guidance could change to reflect the change in leadership. The rise in oil prices suggests to us a hawkish bias will likely be retained, but focus will be on the weakness in the consumer sector, in our view. Data-wise, monthly inflation rose slightly, but reflects more narrow-based inflation pressures.

Exhibit 1: Monthly inflation heatmap

Monthly inflation shows some cooling, but upside risk

	Aug-23	Jul-23	Jun-23	May-23	Apr-23	Mar-23	Feb-23	Jan-23	Dec-22	Nov-22
Total	5.2	4.9	5.4	5.5	6.7	6.3	6.8	7.5	8.4	7.4
Food & Non-Alcoholic Beverages	4.4	5.6	7.0	7.9	7.9	8.1	8.0	8.2	9.5	9.4
Meat & Seafoods	2.6	2.4	2.7	3.8	4.4	4.3	3.3	5.1	8.4	8.1
Fruit & Vegetables	-8.3	-5.4	1.0	2.7	3.5	5.9	5.8	5.1	9.8	9.5
Alcoholic Beverages & Tobacco	4.4	4.5	4.6	4.7	4.8	4.9	4.3	4.0	4.2	4.3
Alcoholic beverages	4.7	5.0	5.1	5.0	5.1	5.4	4.5	4.3	4.4	4.2
Tobacco	3.7	3.6	3.8	4.1	4.3	3.9	4.1	3.8	4.0	4.6
Clothing & Footwear	1.5	1.5	-0.7	-0.4	2.0	3.2	3.7	3.1	6.3	4.1
Housing	6.6	7.3	7.4	8.3	8.8	9.4	9.9	10.7	10.5	10.6
Rents	7.8	7.6	7.3	6.3	6.1	5.3	4.8	4.8	4.1	3.6
New Dwelling Purchase by Owner-Occupiers	4.8	5.9	6.6	8.3	9.2	11.1	13.0	14.7	16.0	17.9
Furniture, Furnishings & Household Equipment & Services	4.0	4.3	6.3	6.0	6.3	7.2	6.6	6.8	8.5	8.4
Health	5.2	5.2	5.2	4.7	4.7	5.4	5.0	5.0	4.2	3.6
Transport	7.4	0.3	-0.9	0.8	7.1	0.8	5.6	6.1	7.2	8.8
Automotive Fuel	13.9	-7.6	-10.6	-8.0	9.5	-8.2	5.6	7.5	10.8	16.6
Communication	1.6	0.3	0.6	1.1	0.2	1.2	1.2	1.3	1.5	0.7
Recreation	3.9	4.1	6.8	3.5	6.4	6.1	6.4	10.2	14.4	5.8
Travel & Accommodation	6.6	5.3	12.9	7.3	11.9	13.9	14.9	17.8	29.3	12.8
Education	5.5	5.2	5.2	5.5	5.5	5.5	5.6	4.6	4.6	4.6
Finance & Insurance	8.8	8.5	8.5	7.8	6.7	6.6	5.6	5.1	5.0	4.8

Source: BofA Global Research, Macrobond,

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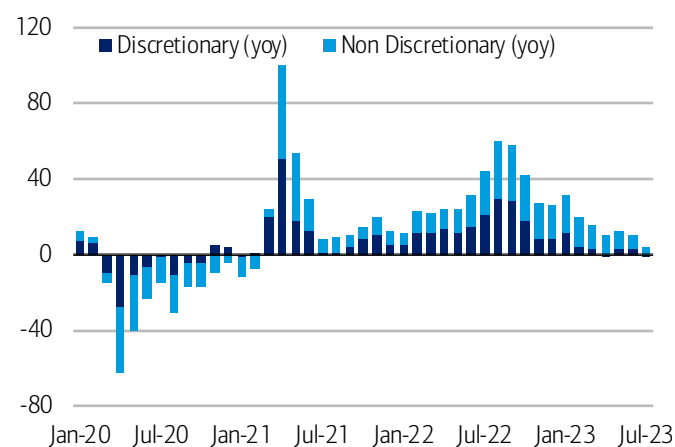
Weak spending outweighs inflation risk

Headwinds for the Australian consumers aren't news. The 1H of 2023 showed consumers are spending their wage on paying bills, with discretionary spending and savings falling sharply (Exhibit 2). Indeed, consumption is as soft as in 2021 when the country was in lockdown. This is despite population growth rising at a very high pace of 2.2% in the year to March 2023.

However, a build-up in savings has provided some offset and has allowed the RBA to tighten policy at a fast pace. In addition to the high living costs and traction from tighter monetary policy, excess savings are now declining (Exhibit 3). The RBA has already highlighted the outlook for household consumption remains uncertain, but some consumers are benefiting from rising housing prices, substantial savings buffers and higher interest income. With savings falling at a fast pace, we see an increased hurdle for hikes.

Exhibit 2: Consumption weakens sharply

As high rates gain traction

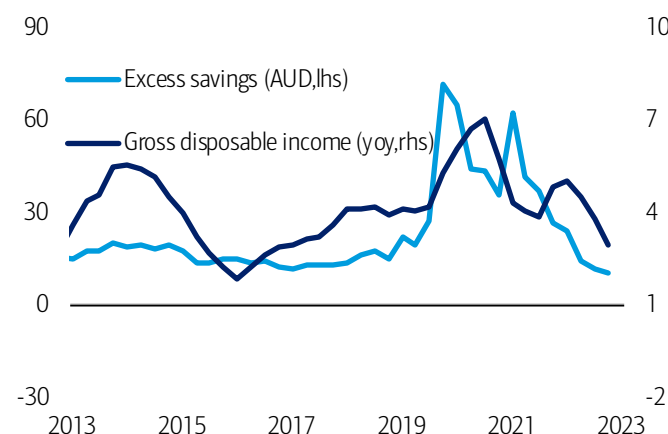


Source: Macrobond, ABS

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Exhibit 3: Savings are falling sharply

As is disposable income



Source: Macrobond, ABS

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Petrol prices test the RBA's tolerance for high inflation

Inflation remains elevated and well above target. The recent increase in petrol prices has added to near-term upside pressure that comes from seasonals, sticky services and spikes in household utilities (see the heatmap in Exhibit 1). The monthly CPI indicator rose 5.2% yoy in August, with the measure that excludes volatile items and holiday travel running at 5.5% in August, down from 5.8% in July.

Encouragingly, new dwelling prices rose 4.8% in the twelve months to August, the lowest since August 2021 and annual prices for food and non-alcoholic beverages were down to 4.4%, from 5.6% in July. In monthly terms, holiday travel and accommodation prices fell 3.9%, following a fall of 3.3% in July. Electricity prices fell 1.3% in the month of August 2023. The fall was driven by the introduction of rebates from the Energy Bill Relief Fund. Without the Energy Bill Relief Fund rebates in Melbourne, electricity prices would have risen 0.5% for the month.

However, fuel prices rose 13.9% in the twelve months to August. This is the highest annual movement since November 2022. In monthly terms, Automotive fuel prices rose 9.1% in August, following -0.2% in July. Rent prices increased 7.8% in the twelve months to August 2023, up from 7.6% in July, reflecting strong demand for rental properties and tight rental markets. The latter is unlikely to change, in our view. Petrol prices and higher rent prices will boost the official 3Q CPI print that is due in late October, just before the RBA meeting in November. While inflation outcomes remain consistent with the RBA's assumptions, a higher-than-expected print could see increased risk for a hike in

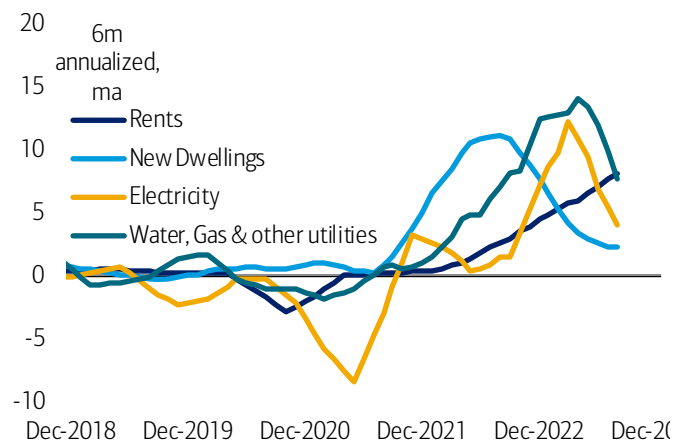
November. This is not our base case. The RBA is currently forecasting CPI to reach 4.1% by year end. This implies two prints of around 0.9% qoq for both 3Q and 4Q. We think this is likely. A sustained rise in petrol prices could see an upside surprise in CPI, but the RBA's current flexible assumption for inflation to return to target in "late-2025" along with guidance that the return to target could be "uneven" due to volatile items means the Bank is unlikely to react to a temporary rise in inflation, in our view. We think the composition of inflation will be more important. Signs of cooling demand that reflect traction from tighter financial conditions would support the extended pause. Indeed, the pulse of inflation is slowing (Exhibit 4).

With economic growth slowing and early signs of a cooling labour market, we do not see a strong case for a move for the rest of the year. Notably, the unemployment rate remained unchanged in August at 3.7%, suggesting conditions in the labour market remain very tight. However, student visas working rights from July 1 may have had some impact in boosting part-time employment growth as students will now be only allowed to work 48 hours per fortnight. Indeed, part-time employment rose by 62k people and was the main driver of employment growth in August. Leading indicators for employment are now suggesting the unemployment rate is likely to increase from here though at a slow pace.

We note however that leading indicators have pointed to higher unemployment for several months and the unemployment rate has been resistant to increase even with participation reaching record-highs. In our view, the unemployment rate is a lagging indicator, so we are yet to see the full effect of policy tightening and softer growth in the labour market. The ABS reported that the number of job vacancies fell by around 9% between May and August and has dropped by 18% from the peak in May 2022. Demand for workers eased again in August for the fifth straight quarter. This softness in vacancies coincided with an increase in the unemployment rate over the three months to August.

Exhibit 4: Domestic inflation pressures slow

But rents remain sticky

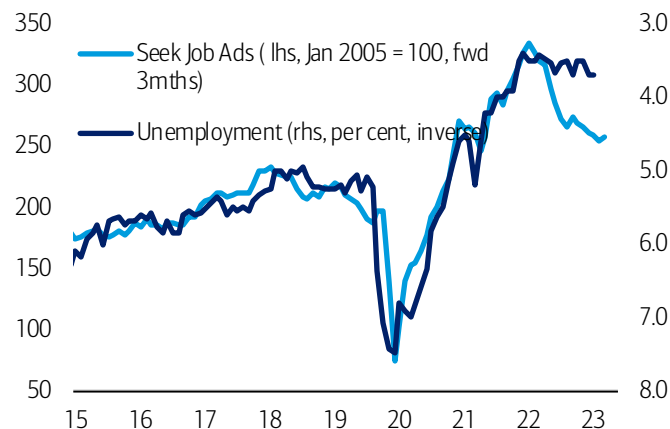


Source: ABS, Macrobond

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Exhibit 5: Leading indicators point to a rise in unemployment

The relationship has diverged of late



Source: Seek

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