

Monday, 4 September 2023

Lowe's Last Meeting at the Helm

Weeks don't get much bigger for economists than this one. A huge dump of major economic data woven together with the Reserve Bank's (RBA) September policy meeting and Philip Lowe's final public address as Governor of the RBA.

The crown jewel of the economic data calendar, the National Accounts, will be released on Wednesday. But in the lead up we will receive key partial inputs into the economic growth equation.

Business profits and inventories

The first cab off the rank is the businesses indicators release later this morning providing an update on business profits and inventory accumulation through the June quarter. We expect aggregate profits to take a hit, down 5.4% in the quarter, from a 0.5% gain last quarter – driven primarily by a fall in mining profits as commodity prices have continued to come off the boil. This is expected to be partially offset by growth in non-mining profits, though we expect to see greater divergence across industries reflecting evolving economic conditions. The composition of profits across the economy will be an important litmus test as to how demand is holding up. We will also be looking especially at any changes in profit margins. There is growing evidence that firm pricing power has peaked, and it is becoming more difficult for businesses to pass on cost pressures as demand moderates. This of course is a welcomed sign for the RBA. However, a compression in margins will be needed to confirm the breadth of this change in behaviour.

Inventory growth has been solid over recent quarters, boosted by resilient demand, changes in inventory management away from 'just in time' supply management, and an ongoing rebuild in some areas as supply chains normalise. We expect inventory growth continued in the June quarter but at a considerably slower pace (0.3% growth versus 1.2% last quarter), reflecting that inventories, especially for wholesalers, are running at elevated levels. We recently highlighted the risk of greater than usual discounting among wholesalers and retailers due to excess inventories. Changes in inventory accumulation in the June quarter will be an important indicator of whether this risk is being realised.

Current Account

The second important partial input into the national accounts is the June quarter balance of payments, due out tomorrow. The balance of payments is a breakdown of the country's interactions with the rest of the world, including trade, foreign income flows and the transfer of capital across borders. The foreign sector makes up a sizeable chunk of our economy and is therefore exceptionally important to our growth prospects. Australia printed a \$12.3 billion current account surplus in the March quarter, supported by the second largest trade surplus on record (\$41.1 billion). Services exports were the biggest highlight, surging to back around 82% of their pre-pandemic level. In the June quarter, we expect the surplus to narrow considerably to a

surplus of around \$4 billion. This is expected to be driven by a narrowing in the trade surplus and falling commodity prices as global demand softened, partly offset by a rise in income on overseas investments. In real terms we expect trade to contribute positively to growth in the June quarter, adding around 0.3 percentage points, following a 0.2 percentage point deduction last quarter.

National Accounts

The National Accounts on Wednesday will provide a detailed breakdown of Australia's economic activity in the June quarter, including growth in gross domestic product (GDP) – the total economic value generated by the economy. We expect to see further evidence of an underlying slowdown in activity as rate hikes continue to transmit through the economy and still-high inflation continues to erode incomes and wealth.

We anticipate GDP expanded around 0.4% in the June quarter, accelerating from a 0.2% rise in the March quarter but dragging annual growth down to 1.8% from 2.3% previously. This would represent below-trend growth in the economy but would by no means be indicative of recessionary conditions. Remember, the RBA is trying to manufacture an extended period of below-trend growth to bring inflation down, without slowing growth too heavily. A result in the ballpark of what we are expecting would suggest they are succeeding for the time being.

We expect a key feature of the June quarter release will be a shift in the drivers of our growth. Households are a crucial driver of our economic engine, but they are also highly sensitive to interest rates and are currently feeling a substantial squeeze on their incomes. This is likely to contribute to a softening in household consumption activity in the June quarter. We expect to see the external sector and businesses picking up the slack. Business capital expenditure (CAPEX) was very strong in the June quarter, supported by elevated capacity utilisation and improving supply conditions. In addition to net exports and business investment, strong population growth is expected to continue to support aggregate growth. However, per-capita growth, which is a better reflection of living standards, is expected to remain weak.

RBA

Nestled between the data releases is the RBA's September policy meeting on Tuesday. This will be Philip Lowe's final meeting as Governor of the Board, before current Deputy, Michele Bullock takes the reins later this month. It's widely expected by economists and financial markets that the RBA will leave the cash rate on hold at 4.10% for a third consecutive meeting.

The August minutes revealed that the RBA can see a "credible path back to the inflation target with the cash rate staying at its present level". Another hike therefore requires a surprise in the data undermining the credibility of this path. So far, the data has evolved within the RBA's expectations, leaving the path to the inflation target in-tact. There is therefore no impetus for the RBA to hike at tomorrow's meeting.

The interest will be in the accompanying policy statement. We will be looking for any signs that the Board has changed its assessment of the risks, as this will be key to policy moving ahead.

On Thursday, Governor Lowe is due to give his final public address as Governor. The speech is titled "Some closing remarks" and is likely to provide some observations and reflections on the Australian economy rather than any deep insights into the near-term path of interest rates.

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Group Forecasts

End Period:	2023			2024			
	Close (1 Sep)	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)
Aust. Interest Rates:							
RBA Cash Rate, %	4.10	4.10	4.10	4.10	4.10	3.85	3.60
90 Day BBSW, %	4.13	4.30	4.30	4.30	4.22	3.97	3.72
3 Year Swap, %	4.00	4.00	3.95	3.90	3.80	3.70	3.60
10 Year Bond, %	4.00	3.75	3.55	3.45	3.30	3.25	3.20
US Interest Rates:							
Fed Funds Rate, %	5.375	5.375	5.375	5.125	4.625	4.125	3.625
US 10 Year Bond, %	4.11	3.80	3.60	3.40	3.20	3.10	3.00
USD Exchange Rates:							
AUD-USD	0.6456	0.67	0.68	0.69	0.71	0.73	0.74
USD-JPY	146.22	140	138	135	132	130	128
EUR-USD	1.0780	1.11	1.12	1.12	1.13	1.14	1.15
GBP-USD	1.2590	1.28	1.28	1.29	1.29	1.30	1.30
NZD-USD	0.5945	0.62	0.63	0.63	0.64	0.65	0.66
AUD Exchange Rates:							
AUD-USD	0.6456	0.67	0.68	0.69	0.71	0.73	0.74
AUD-EUR	0.5989	0.60	0.61	0.62	0.63	0.64	0.64
AUD-JPY	94.36	93.8	93.8	93.2	93.7	94.9	94.7
AUD-GBP	0.5126	0.52	0.53	0.53	0.55	0.56	0.57
AUD-NZD	1.0848	1.07	1.08	1.09	1.10	1.12	1.12

	2021	2022	2023 (f)	2024 (f)
GDP, %	4.6	2.6	1.0	1.4
CPI (Headline), %	3.5	7.8	3.9	3.2
CPI (Trimmed mean), %	2.6	6.9	3.8	3.1
Unemployment Rate, %	4.7	3.5	3.8	4.7
Wages Growth, %	2.3	3.4	3.8	3.2

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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