# BULLETIN

1 March 2023

# Australian national accounts, Q4. Growth disappoints, as domestic demand stalls. High inflation and higher interest rates are biting.

## Q4 domestic demand: 0.0%qtr, 3.3%yr
## Q4 real GDP: 0.5%qtr, 2.7% yr

Economic activity in the Australian economy increased by 0.5% in the December quarter, well below market expectations of 0.8%.

Household spending rose by 0.3%, down from 1.0% in the September quarter. The major contribution to this slowdown was growth in discretionary spending which slowed from 1.9% in the September quarter to 0.4%.

Some stand-outs were transport services, where growth slowed from 12.8% in the September quarter to 5.7% in the December quarter; hotels, cafes and restaurants (5.2% to 1.6%), motor vehicle purchases (10% to 2.9%) and clothing & footwear (3.1% to -2.7%).

The slowdown in spending came despite a sharp fall in the household savings rate, from 7.1% in September to 4.5%. Note that the savings rate was 12.9% in the December quarter 2021. The current level of 4.5% is below our estimate of equilibrium of around 6%, indicating that households are beginning to drawdown part of the $300 billion in excess savings that built up since March 2020. Through 2023 we expect the savings rate will continue to fall as households use this buffer to support spending.

That fall in the savings rate reflected a squeeze in household incomes.

Household incomes came under considerable pressure in the quarter. Although nominal wages grew by a solid 2.1%, payments, including interest and tax, rose by a hefty 8.9% for a contraction of 0.7% in nominal disposable incomes and a fall of 2.2% in overall real disposable incomes. That compared with a fall of -0.2% in the September quarter. These numbers highlight the squeeze being faced by the household sector – despite solid nominal wages growth, households are going backwards largely due to rising interest costs and the surging cost of living.

Consistent with this slowdown in household spending, expenditure on renovations and additions fell by a hefty 4.2%, more than offsetting the 1.4% lift in new dwelling investment which largely reflects the pipeline that built up from the HomeBuilder program and is now winding down.

Business investment was lacklustre, declining by -0.8%, led lower by a fall in construction work and a 0.2% fall in equipment spending.

Overall, domestic final demand was flat in the quarter – down from 0.6% in the September quarter and 2.7% in the first half of 2022.

Net trade contributed 1.1ppts to growth, partly offset by changes in inventories which detracted 0.5ppts.

Domestic price pressures eased somewhat. The domestic demand implicit price deflator lifted by 1.4% (down from 2.0% in September) to be up by 6.6% over the year.

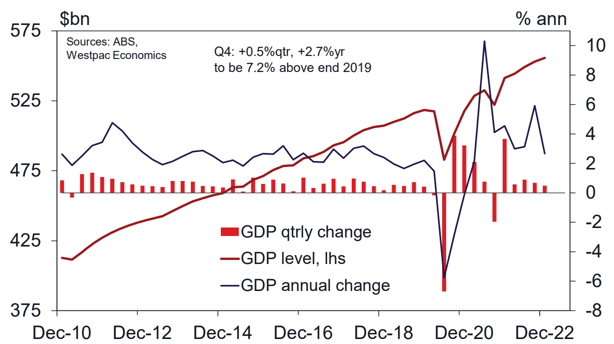
That easing was also replicated in the wage measures. Non-farm compensation per employee lifted by 0.9% in the quarter compared to a rise of 2.2% in September. Alternatively, non-farm compensation per employee per hour was flat in the quarter compared to a lift of 2.2% in September.

## GDP: Dec qtr 2022

| | % qtr | | % yr | |
|---|---|---|---|---|
| | **Sep** | **Dec** | **Sep** | **Dec** |
| Private consumption | 1.0 | 0.3 | 11.7 | 5.4 |
| Dwelling investment | 0.7 | -0.9 | -4.2 | -3.7 |
| Business investment* | 1.5 | -0.8 | 4.3 | 3.1 |
| Private final demand* | 0.7 | -0.1 | 8.4 | 3.7 |
| Public spending* | 0.2 | 0.2 | 3.0 | 2.5 |
| Domestic demand | 0.6 | 0.0 | 6.8 | 3.3 |
| Stocks – private non-farm # | 0.5 | -0.8 | 1.1 | -0.5 |
| – other # | -0.1 | 0.3 | 0.0 | 0.4 |
| GNE | 1.0 | -0.5 | 8.0 | 3.2 |
| Exports | 2.5 | 1.1 | 6.3 | 7.7 |
| Imports | 4.0 | -4.3 | 19.0 | 12.1 |
| Net exports # | -0.2 | 1.1 | -2.0 | -0.5 |
| Statistical discrepancy # | 0.0 | -0.1 | 0.2 | 0.0 |
| Non-farm GDP | 0.7 | 0.5 | 6.0 | 3.0 |
| **GDP, real** | **0.7** | **0.5** | **5.9** | **2.7** |
| GDP, nominal | 0.8 | 1.7 | 13.1 | 11.0 |
| | | | | |
| GDP deflator | 0.4 | 1.6 | 6.9 | 9.1 |
| Household deflator | 2.1 | 1.5 | 6.1 | 6.9 |
| Earnings per worker (non-farm) | 2.2 | 0.9 | 4.1 | 4.2 |
| Real household disp income | -0.2 | -2.2 | -2.3 | -3.3 |

*adjusted for asset sales. # ppt contribution to growth
Sources: ABS, Westpac Economics

### Australian economy: growth slows to 0.5% in Q4



1 March 2023

The national accounts are depicting an economy where the pressures from rising interest rates and falling real wages are weighing more heavily on household spending than expected at this stage of the cycle. Inflation remains too high but there are signs that despite tight labour markets, wage pressures are easing – exerting even more pressure on the household sector through persistent falls in real wages.

Construction, both non-residential and residential, is weak while businesses, despite record high capacity utilisation and attractive tax incentives, are responding to these demand signals and slowing equipment investment.

The Reserve Bank Board will be mindful of these signals but will remain focussed on its task of ensuring a return to the inflation target zone of 2-3%. That will still require further rate increases in March, April and May.

The Board will not receive another update on the economy through the national accounts until the day after the June Board meeting. We expect that there will be sufficient evidence in line with the signals from today's accounts to allow it to pause before the rate cuts that we expect from the March quarter in 2024 ensue.

Our current forecast that the Australian economy is likely to stagnate over the second half of 2023 and into 2024 is certainly consistent with the messages from today's accounts.

**Bill Evans, Chief Economist**

## Domestic demand (Andrew Hanlan)

Domestic demand (0.0%qtr, 3.3%yr): Domestic demand stalled in the final quarter of 2022, indicating a soft end to the year for the domestic economy.

That is the weakest outcome since June 2014 (outside of a lockdown period, namely Q1 and Q2 of 2020, as well as Q3 2021).

Public demand (0.2%qtr, 2.5%yr): Government spending, in the form of public demand, is cresting at a high level as the spike in COVID related spending unwinds. Over the 3 quarters since March 2022, public demand declined a fraction, down by -0.1%.

Private demand (-0.1%qtr, +3.7%yr): Demand across the private sector went backwards in the final quarter of 2022, inching 0.1% lower. That is the weakest outcome since the sluggish period of 2019 (outside of lockdown impacted quarters).

Consumer spending (0.3%qtr, 5.4%yr): Consumer spending expanded by only 0.3% in the final quarter of 2022, representing a small decline in per capita terms. The key surprise, a lack of strength in overall services spending.

For more detail, see below for a discussion of the household sector.

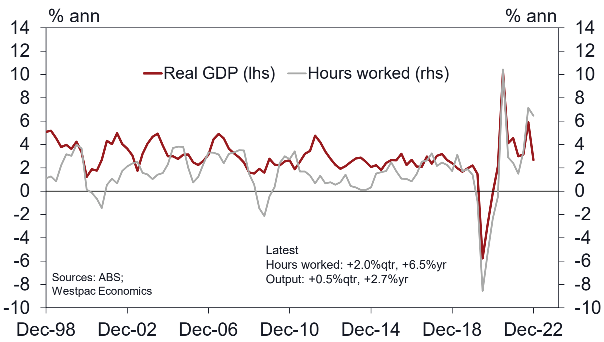
Home building (-0.9%qtr, -3.7%yr): Home building activity ended the year with a decline of -0.9%, led by a -4.2% fall in renovations more than outweighing a 1.4% rise in new home building work.

Renovation work, after a strong upswing, is easing back from elevated levels. Renovations peaked in September 2021, some 21.5% above that at end 2019, and have declined by 10% since then.

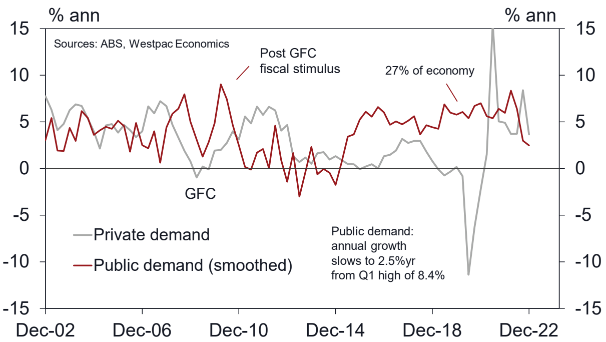
Real estate (-6.2%qtr, -20.6%yr): The real estate sector, in the form of Ownership Transfer Costs (turnover in the property sector), is in a sharp downturn as rapid interest rates rises bite, reducing turnover in the established property market. The sector fell by -6.2% in the quarter, following a sharp Q3 drop, of -11.2%.

New business investment (-0.8%qtr, +3.1%yr): Business investment ended the 2022 year on a softer note than anticipated, declining by -0.8%. Volatility in construction was a factor, with a pull-back in Q4 after a strong Q3.

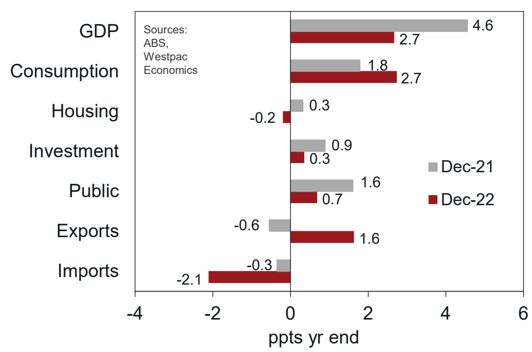
### Hours worked jumped 2% in Q4



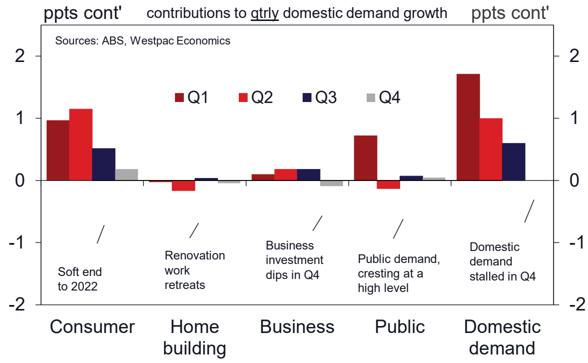

### Public demand cresting at a high level




### GDP growth: year-end contributions




### Australia: domestic demand



Equipment spending was softer than anticipated, slipping by -0.2%, dented by a fall in such expenditure by the mining sector. The soft result is despite positive business capex plans against the backdrop of limited spare capacity and generous tax incentives.

**GDP: the expenditure estimate**

The Expenditure estimate of GDP printed 0.6%qtr, 2.6%yr for the December quarter.

As noted above, domestic demand was flat, while there was a net positive contribution of +0.6ppts from net exports (+1.1ppts) and total inventories (-0.5ppts).

Net exports made a sizeable positive contribution to growth in Q4, adding 1.1ppts.

Export volumes grew by 1.1%, centred on services, up by 9.8%qtr, +46.4%yr. The national border reopening has enabled a rebound in foreign student numbers and international holiday makers. Service exports directly added 0.3ppts to activity in the quarter, while a dip in goods exports subtracted 0.1ppt.

Import volumes pulled back, down by -4.3%, to still be up a strong 12.1% over the year. The Q4 fall was broadly based, across goods, -3.8%, and services, -6.5%. The fall in imports added 0.9ppts to activity.

Total inventories subtracted -0.5ppts from Q4 activity.

Non-farm business inventory levels corrected, declining by -0.3% in Q4, after a 2.4% run-up in Q3, associated with some one-offs in mining (transport disruptions) and retail (a bring forward of stocking to avoid delays). This subtracted 0.8ppts from activity.

Public authorities added 0.23ppts to growth (reversing a -0.2ppts impact in Q3), while farm stocks added 0.04ppts.

**Household Sector (Matthew Hassan)**

The Australian consumer posted a weaker than expected finish to 2022, spending slowing and incomes coming under pressure from the rising cost of living and higher interest rates.

Consumption rose just 0.3% in the final quarter, well below our estimate of a 0.8% gain. The downside surprise centred on a much weaker than expected quarter for services components.

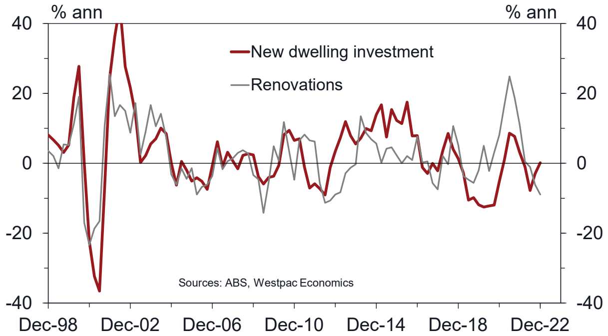
Other categories were a touch firmer than expected: our 'retail proxy' up 0.2%qtr vs. a 0.2%qtr decline in retail sales; new vehicle purchases up 2.9%qtr vs. a flat result for vehicle sales; and vehicle operations down 1.8%qtr vs. a 3% fall in fuel sales.

By contrast, the remainder ex dwellings, consisting mostly of services, rose just 0.4%qtr. We had expected something in the 2-3% range, based partly on a strong rise in services spending in our **Westpac Card Tracker**, centred on travel and tourism-related categories.

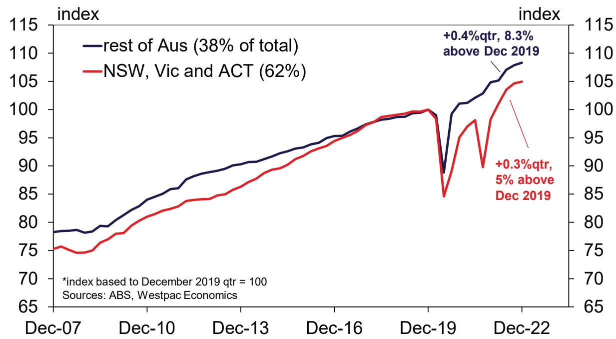
The more granular detail shows the Q4 gain centred on basic food (+2.4%qtr), with some support from cafes & restaurants (+1.6%qtr), and transport services (+5.7%qtr), albeit with both posting milder gains than in Q3.

Notably, despite a big lift in transport spend over the last year (+169%!) this line item is still 27% below its pre-COVID level. While some of this reflects longer-lasting shifts – reduced use of public transport for example – it suggests holiday-related travel is still only recovering slowly. Interestingly, the ABS noted that service imports (dominated by travel) declined 6.5%qtr, partly because the mix of outbound travel has favoured short-haul over long-haul destinations. More generally, the strength evident in our tracker measure may be associated with bookings for trips to be taken in 2023 – the national accounts measures are based on when travel is undertaken rather than when it is paid for.

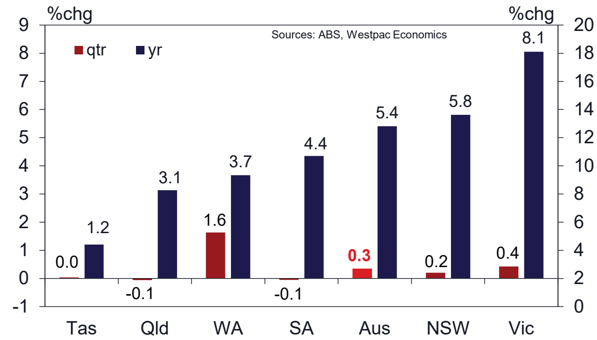
**Home renovations pull-back from 2021 highs**



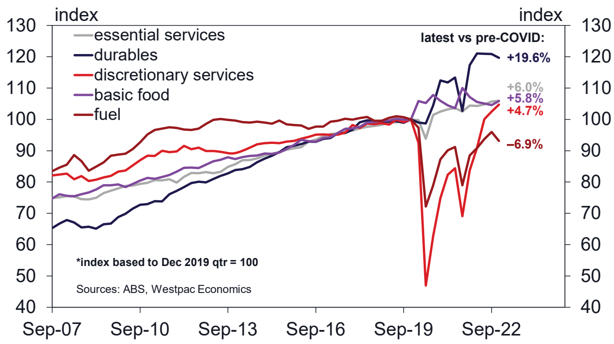

**Consumer spending: 'delta states' vs rest**




**Consumer spending: Q4 2022**




**Consumer spending: broad categories**



This issue may also have contributed to the other stand-out weak spot, recreation and culture spending, which declined 1.4%qtr and includes many tourism-related service items.

Other areas of weakness included: fuel, as mentioned, and clothing (–2.7%qtr but coming off a strong run) and household goods (–1.2%qtr, marking a third quarterly decline in a row).

Even with the Q4 undershoot and weakness still evident in some segments, the level and composition of spending are broadly consistent with COVID disruptions having now dropped out of the picture.

Household incomes also came under more pressure than expected with nominal disposable income (after interest and tax) down 0.7%qtr. Solid rises in wage income, interest returns and dividends were offset by a hit to small business earnings (including farms where weather events impacted), a big drag from higher interest payments, the net effect of falling social assistance and rising income tax paid. With prices rising 1.5% in the quarter, household disposable incomes contracted in real, 'purchasing power' terms.

On wages, total payments rose 2.1%qtr to be up 9.8%yr, the strongest annual gain in 15yrs. Total employment rose 1.1%qtr but hours worked were up 2%qtr. Average non-farm earnings per employee rose 0.9%qtr, annual growth nudging up only slightly to 4.2%yr.

Non wage incomes were more mixed. As noted, gross mixed income (mainly the profits of farm sector and unincorporated businesses) declined 1.5%qtr after a flat Q3, annual growth stalling flat. Rising deposit rates saw property income up 5.7%qtr but other components were soft, social assistance in particular continuing to track sharply lower, in part due to falling unemployment seeing a reduction in benefit payments.

Monetary tightening had a clear impact on disposable incomes, interest payment surging a further 22.4% to $25.2bn in Q4, an all-time high in absolute dollar terms. The rise effectively took 1.2ppts off disposable incomes in the quarter and 3.1ppts off disposable income growth over the year.

Fiscal drags were also a factor for disposable incomes with income tax payments jumping 7.4%qtr to be up 16.3%yr. This reflects both rising employment – which sees more people covered by income tax requirements – and rising wages putting more earnings into higher marginal tax brackets.

The overall net effect saw nominal household incomes decline 0.7%qtr, the weakest quarterly result since 2012 (excluding the COVID period). Annual growth has slowed to 3.3%qtr. Incomes are coming under even more pressure from the rising cost of living, the consumption deflator up 1.5%qtr, 6.9%yr. Disposable incomes are down heavily in real, inflation-adjusted terms, –2.2%qtr and –3.3%yr.

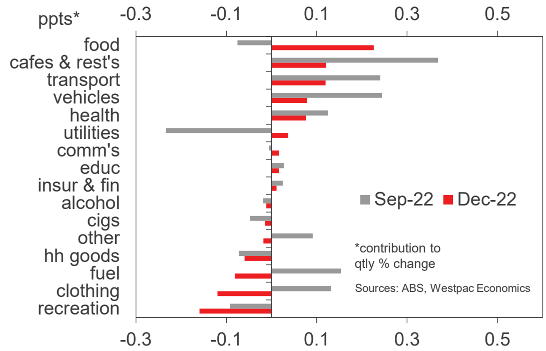
Consumers are using savings to buffer the income hit. The savings ratio (the portion of income unspent) declined from 7.1% in Q3 to 4.5% in Q4, the shift effectively 'freeing up' about $9bn in funding for expenditure. Notably, this is the first 'below trend' read, the 'normal' savings rate thought to be around 6-6.5%. Notionally, that implies a draw-down on the 'excess savings' accumulated during the pandemic – roughly in the $5-6bn range, noting that the accumulated stock of excess savings is thought to be around $300bn.

**The States (Elliot Clarke)**

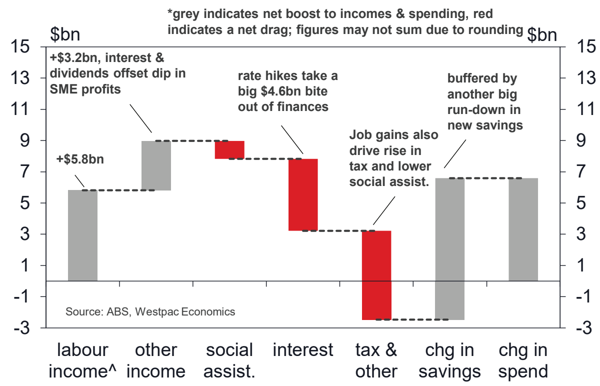
Conditions were mixed across the states in the December quarter, with NSW, Qld and SA all experiencing small declines.

New South Wales state demand edged down 0.1% in Q4, but remained 3.4% higher than a year ago. The headline state demand outcome came despite a 0.2%, 5.8%yr, gain for consumption, helped by continued strength in the labour market.

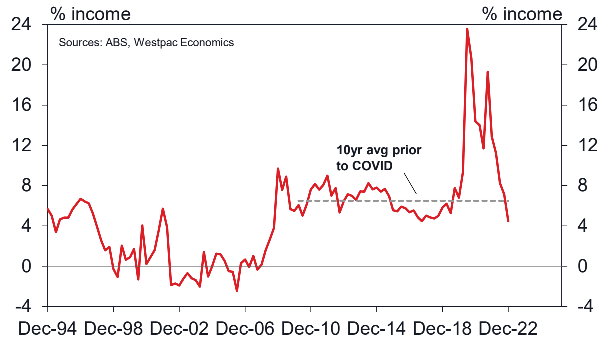
## Consumer spending by category




## Household income flows: change, Q3 to Q4 2022




## Household savings ratio




## State demand: Q4 2022


Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

Public demand also gained 0.2% in Q4, though over the year growth was modest at 2.4%yr. Investment was instead the source of Q4's contraction.

Following a particularly strong Q2 and Q3, with cumulative growth of 7.0%, business investment fell 1.1% in Q4. Note though, for 2022 as a whole, growth in business investment was modest at 2.1%, in line with the average during the pandemic. Of the components of investment, equipment spending was broadly flat in Q4 while non-residential construction fell 4.3%. Over the year, equipment investment is up 12% while non-residential investment is down 6.3%. Supply disruptions and elevated costs remain a significant impediment for construction. Further highlighting this, residential construction also fell in Q4 by 1.2% to be 1.6% lower than end-2021. While new home construction staged a rebound in the second half of 2022, renovation work plunged 7.8% in Q4 to be -6.3%yr highlighting the dramatic change in affordability and costs.

Victoria's economy eked out a 0.2% gain in Q4 after a flat Q3 but a strong Q1/Q2, leaving activity 4.1% higher than end-2021. While positive, consumption growth continued its abrupt deceleration in Q4 with a gain of just 0.4% (8.1%yr). Housing investment offset in the quarter as it contracted 1.4% (-2.6%yr). Renovation work fell another 1.9% to be 8.0% lower than a year ago. New housing meanwhile declined 1.2% in Q4 and is unchanged versus end-2021.

Business investment staged a partial rebound in Q4 to be broadly flat over H2 2022 and up 4.7% versus end-2021. In contrast to NSW, Vic business investment has been driven by non-residential construction over the past year while equipment investment has declined, respectively +14%yr and -2.5%yr. Public investment also fell away in Q4, although government consumption offset, with total public demand rising 0.3%, -0.3%yr.

Queensland was the weakest of the states in Q4 and over 2022 (bar Tas), state demand respectively contracting 0.3% in the quarter and gaining only 2.4%yr. Admittedly, Queensland's outcomes through the pandemic were much stronger than the south-east, so the state remains in robust health all considered.

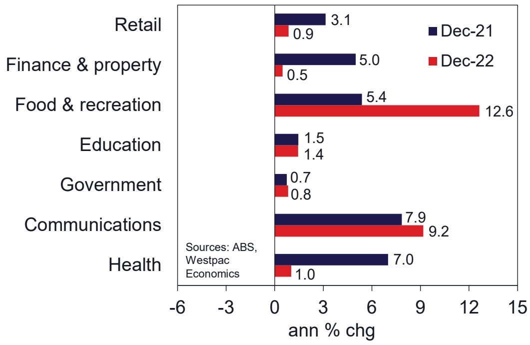
Consumption certainly looks to be coming under growing pressure though, activity falling 0.1% in Q4 and annual growth having slowed from a peak of 15%yr at Q2 2021 to 3.1%yr currently. Housing investment is also down 10%yr despite a pick up in new home construction over H2 2022. Renovation work continues to bear the brunt of concerns regarding affordability and input availability, having fallen 19% since Q3 2021. Business investment has throttled back over the period, annual growth slowing from 9.0%yr Q3 2021 to 2.0%yr currently as non-residential construction stalled while equipment spending remained robust.

Western Australia's economy continued on its choppy growth path in Q4, a 0.1% rise following a 1.1% gain in Q3. Annual growth remains very healthy at 3.2%yr, particularly given WA suffered a comparatively small loss of activity during the pandemic lockdowns that was recovered within a quarter. Household consumption jumped higher in Q4, 1.6%, holding annual growth around 3.7%yr. Housing investment also achieved a strong gain of 3.9% in Q4, though this follows a run of negatives back to Q2 2021 with activity in the sector -12% versus Q2 2021.

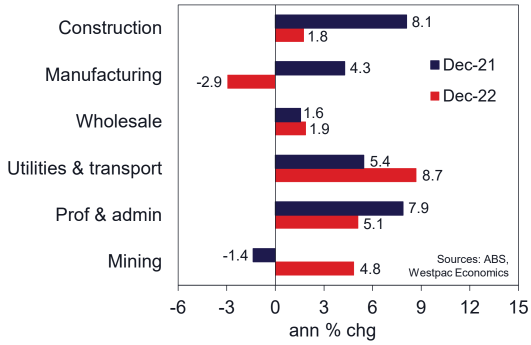
Offsetting household demand in Q4 was business investment which fell 0.4% on declining equipment investment to be just 1.1% higher over the year. Public demand also fell 2.4% in Q4, though this follows strength in Q3 and before that Q1, leaving annual growth at 4.9%yr.

South Australia's economy essentially stalled in H2 2022 after a strong six months to June. Annual growth remains robust at 3.2%yr. Consumption looks to be coming under pressure from financial conditions and uncertainty, with spending flat in Q4 after a strong run over the year to Q3, annual growth now 4.4%yr from 6.7%yr in Q3. Housing investment meanwhile is down 8.2% over Q3 and Q4, with the weakness broad based across new homes and renovations.

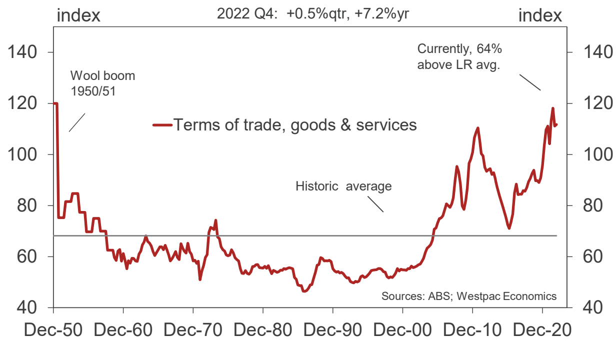
## GDP by industry



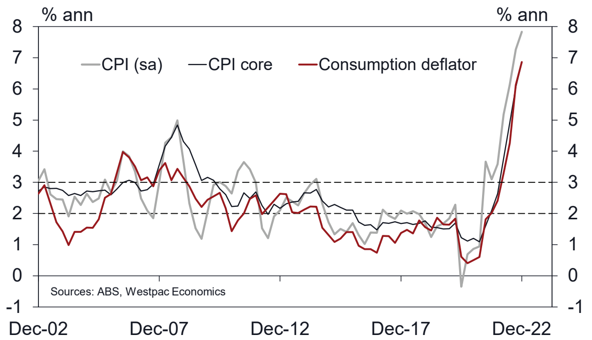

## GDP by industry




## Terms of trade, consolidated in Q4




## Consumer inflation surge



Business investment also stalled in Q4 after preceding strength, 12%yr. Like the rest of the nation, the cost of investment and uncertainty over the outlook are likely to hold back expansion. Down 16%yr, public investment is also currently not providing reason for the private sector to commit to new capacity. Though public consumption continues to largely offset this weakness, with total public demand only down 0.6%yr.

Tasmania had the weakest performance of all the states, both in Q4 and through 2022. Activity was stalled in Q4 and is up just 1.1%yr. The consumer is the primary driver of this trend, with spending also unchanged in Q4 and up 1.2%yr. Broad-based declines in housing investment circa 11% over the past year have acted as a material headwind for activity, offsetting the support received from business investment and public demand, respectively 4.2%yr and 2.7%yr.

**Production: an industry perspective (Ryan Wells)**
The Production estimate of GDP printed 0.5%qtr, 2.7%yr for the December quarter.

Activity conditions across the broad segments of the economy were subdued in the quarter. While public administrated and household services both posted gains, the latter exhibited a clear lack of momentum. Meanwhile, goods distribution contracted and business services and goods production both fell to a near-stall speed.

Household services underperformed yet again in Q4, expanding by only 0.7% after a tepid 0.2% increase in the previous quarter. Hospitality posted its weakest result since the onset of the ‘delta' outbreak, lifting only 1.4% in Q4, primarily weighed down by an easing in demand for domestic travel.

Lifts in arts & recreation (+2.4%qtr) and other services (4.9%qtr) more than reversed their respective contractions in the prior quarter, though health care and social assistance eased back for a second consecutive quarter (-0.2%qtr) on lower demand for public health.

The goods distribution sector contracted by -0.2%qtr, leaving annual growth at 5.3%yr in the December quarter. Transport, postal and warehousing was the only positive, at +0.6%qtr, +13%yr, with limited support from holiday travel and demand for air transport services. However, this was more than offset by the weakness in wholesale trade (-0.7%qtr, 1.9%yr), reflecting lower demand for machinery and equipment particularly in industrial and agricultural sectors.

Business services narrowly avoided a decline in Q4, managing to lift 0.1% to be 11.2% above its pre-pandemic level. Results were fairly mixed, with the continued strength in communications and administrative services being largely offset by weakness in professional services and financial services, reflecting a cooling as higher interest rates impact.

Goods production was also subdued in the quarter, rising only 0.1%, leaving the sector up 5.0% relative to pre-COVID levels. Broadly, adverse weather conditions look to have been the main drag on the sector, with declines across manufacturing (-1.8%), agriculture (-2.6%), utilities (-4.9%) and construction (-0.3%) all observed in the quarter. Mining was the stand-out positive, lifting 3.2% on supply chain improvements and higher production.

**Income (Andrew Hanlan)**
The real income estimate of GDP printed 0.5%qtr, 2.6%yr.

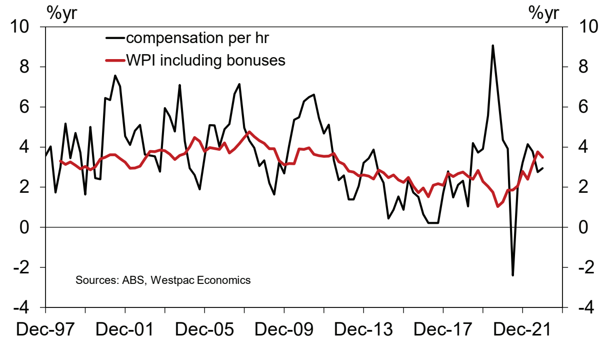
Nominal GDP grew by 2.1% in the quarter, with the GDP deflator increasing by 1.6% (as discussed below).

A small rise in the terms of trade, +0.6%, provided a modest boost to national income in the period.

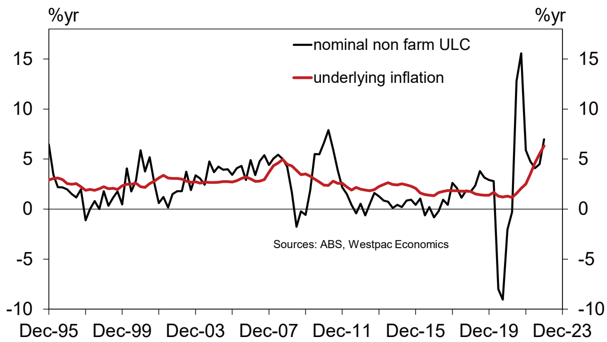
The following analysis is based on seasonally adjusted nominal data.

Total factor income (TFI), which is GDP (I) minus taxes less subsidies, also increased by 2.1% in the quarter, while the taxes less subsidies line expanded by 2.0%.

## Non farm workers comp vs. WPI




## Unit labour costs vs. inflation




Total compensation of employees, the wage income bill, increased by 2.1% associated with the 2% rise in hours worked (as discussed in more detail above and below).

Company profits (private non-financial) rebounded by 3.7% in the quarter, reversing a 4.1% drop in Q3. Profits in the period rose across mining and the broader non-mining economy.

Gross mixed income, spanning small business and the farm sector, ended the year on a softer note, posting a fall of -1.5%, despite a lift in global rural commodity prices.

Total financial corporations, coming off a strong Q3 gain of +5.1%, also ended the year on a softer note, recording only a relatively small rise of 0.5%.

**Inflation (Justin Smirk)**
The GDP deflator jumped 1.6% in the quarter to be up 9.1% in the year. Recall that the terms of trade (ToT) edged higher in the quarter, up by 0.5%. A rise in the ToT not only impacts on incomes and profits but it will also boost GDP price/inflation measures.

The GNE deflator, which is not impacted by changes in the ToT, gained 1.3% in the December quarter to be up 6.8% in the year.

The consumer price deflator (household consumption deflator) gained 1.5% in December, a moderation from the 2.1% gain in September but on par with 1.5% lift in June and 1.6% gain in March. In the year to December, the household consumption deflator rose 6.9%yr, an acceleration from the 6.1%yr pace in September and the 2.6%yr pace a year earlier.

The seasonally adjusted CPI lifted 1.8% in December taking the annual pace from 7.3%yr in September to 7.8%yr; it was 3.6%yr a year earlier.

The household consumption deflator has a floating basket of goods and services so it captures the change in consumer preferences as relative prices change, that is, it can capture the impact of consumers moving away from more expensive goods and towards cheaper goods. As such, when there is greater than usual inflationary pressure, National Accounts consumption deflators tend to run at a more modest pace than the CPI measure.

**Wages, labour costs and productivity**

Labour costs in the national accounts are measured by total compensation of employees (COE), i.e. the wages bill. In the December quarter total non-farm compensation rose 2.1%, compared to a 3.3% gain in September and a 2.6% gain in June. This saw the annual pace lift a touch to 10.4%yr in December from 10.0%yr pace in September. 10.4%yr is the fastest pace since September 2007 (10.8%yr).

Non-farm compensation per hour was flat in December, a significant moderation from the 2.2% gain in September but a touch better than -0.9% in June. The annual pace for non-farm compensation lifted a touch to 2.9%yr from 2.8%yr in September but is down from the 4.1%yr pace in March which was the recent peak and the fastest pace since 4.4%yr in December 2020.

The national accounts measure of hourly rates of pay inflation are significantly more volatile than that from the Wage Price Index (WPI). The WPI (including bonuses) lifted 0.9% in the December quarter to be up 3.5% in the year.

Wages on a per hour basis, as measured by average hourly non-farm compensation per employee, have lagged behind the WPI - something that quite surprising given that it tends to outpace the WPI during times of a tight labour market. Those looking to the national accounts for some indication of broader wage inflationary pressures than what the WPI is revealing would surely be disappointed with this update.

When thinking about the inflationary impact of wage inflation it is important to take productivity into account. In December hours worked lifted 2.0% while hours worked in the market sector was even stronger with a 2.7% gain. However, given such a soft print on GDP, GDP per hour worked fell 2.4% while GDP per hour worked in the market sector fell 2.4%. In the year to December, GDP per hour worked in the market sector is down 5.7%yr which is the weakest we have seen dating back to 1995. If you look annual rate for GDP per hour worked in total, it is down 3.5% in the year to December and that is the weakest print since September 1986 (-3.6%yr).

With such poor productivity growth despite relatively soft wages inflation, non-farm unit labour costs lifted 1.6%, following on from a 2.2% gain in September, taking the annual pace to 7.0%yr from 4.5%yr. While annual growth in unit labour cost tends to be more volatile than underlying inflation, the current surge in unit labour costs does suggest that wages could be more inflationary than what the headline measures of wages suggests.

**Westpac Economics**

**Bill Evans, Chief Economist**
ph(61-2) 0400 456582

**Senior Economists**
**Andrew Hanlan, Matthew Hassan, Justin Smirk, Elliot Clarke**
ph (61-2) 0466 422382, 0409 227159, 0459 844 788, 0459 848856

**Ryan Wells, Economist**
0401 423628

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