BULLETIN

6 December 2023

Australian national accounts, September quarter. Household spending stalls. Real household disposable income contracts on high inflation, higher taxes and rising interest rates.
Q3 domestic demand: 0.5%qtr, 2.2%yr
Q3 real GDP: 0.2%qtr, 2.1% yr

The Australian economy limped along in the September quarter, expanding by just 0.2% in the quarter. This is weaker than we expected. Growth over the year was 2.1%, less than population growth over the same period. While the population surge earlier in the year has supported demand overall, it is now rolling over and will not provide the same support in 2024. Domestic final demand was up by 0.5% in the quarter and private final demand by just 0.2%. This is a subdued – and view-changing – picture.

The policy drag on Australian households is clearly biting. Nominal household disposable income barely increased in the quarter (+0.1%), despite strong growth in labour income. When the drag from inflation is factored in, this amounts to a substantial contraction in real household disposable income. The drag from higher tax is significant, detracting 1.2ppts from gross income in the quarter and 3.6ppts over the year. Some of this can be attributed to the expiry of the Low and Middle Income Tax Offset, but non-income tax receipts also increased strongly over the past year. The tax take from total gross income, at around 17¾%, is the highest recorded in the quarterly national accounts. The drag on incomes from rising net interest payments was much smaller than the drag from tax, at 1.1ppts over the year.

Consumption was flat in the quarter. This was well below our expectations. Government subsidies provided a considerable offset (reflected in strong growth in government consumption), but even allowing for that, this is a weak outcome that has been flattered by a catch-up in (imported) vehicle deliveries. Compounding the weak picture, the recent history for consumption has also been revised down. Even with consumption as weak as it has been, household income was weaker. The measured household saving ratio therefore declined further, to 1.1%.

Business investment was also relatively soft. As we predicted, machinery and equipment investment was not resilient to the ending of tax incentives. Even allowing for the catch-up in vehicle deliveries mentioned above, this component of investment was broadly flat in the quarter, at +0.2%. Infrastructure activity is a positive, expanding by 2.3%qtr, 9.3%yr, as investment in the energy transition lifts. Dwelling investment remains subdued, however, rising only 0.2% in the quarter to still be down a little on the year. The housing construction industry remains supply constrained and is slowly working through the backlog of already approved homes.

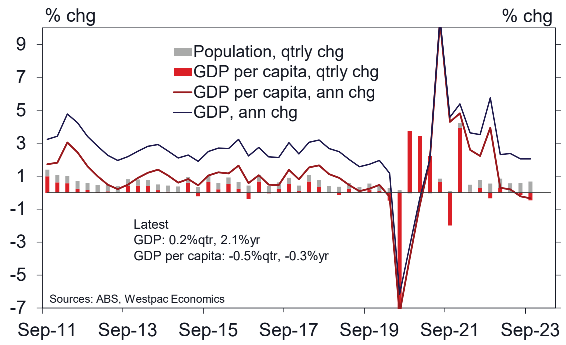
With hours worked declining and GDP increasing – if only marginally – measured productivity increased by 0.9% in the quarter (0.6% in the market sector). The extraordinary 2% decline in the level of productivity recorded in the June quarter was also revised smaller, to –1.6%. This is as we recently predicted. These data are noisy and subject to measurement error and so should be treated with due care. As Westpac Senior Economist Pat Bustamante and Economist Jameson Coombs outlined in their note last week, the decline in the level of productivity in Australia (and Canada) can be partly explained as the mechanical impact of the population surge. As the catch-up after the reopening of borders fades, both the capital–labour ratio and measured productivity will recover almost mechanically. While it is understandable that policymakers were worried about recent weakness in productivity, they should never rest their policy decisions on the shaky grounds of short-term movements in productivity and unit labour costs.

GDP: September qtr 2023

	% qtr		% yr	
	Jun	**Sep**	**Jun**	**Sep**
Private consumption	0.1	0.0	1.1	0.4
Dwelling investment	0.5	0.2	–0.2	–0.3
Business investment*	2.5	0.6	10.1	8.0
Private final demand*	0.6	0.2	2.0	1.4
Public spending*	1.5	1.4	2.9	4.2
Domestic demand	0.9	0.5	2.3	2.2
Stocks – private non-farm #	–1.0	0.9	–0.9	–0.7
– other #	–0.2	–0.5	–0.2	–0.4
GNE	–0.4	0.9	1.1	1.0
Exports	4.5	–0.7	7.6	6.8
Imports	1.8	2.1	3.5	2.2
Net exports #	0.8	–0.6	1.2	1.3
Statistical discrepancy #	0.0	–0.1	–0.2	–0.2
Non-farm GDP	0.4	0.2	1.6	1.6
GDP, real	**0.4**	**0.2**	**2.0**	**2.1**
GDP, nominal	–0.7	1.2	3.9	4.5
GDP deflator	–1.2	1.0	1.8	2.4
Household deflator	1.3	1.4	5.8	5.6
Earnings per worker (non-farm)	0.9	2.0	5.4	5.3
Real household disp income	–0.3	–1.3	–2.7	–4.3

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

Australia: weak growth despite rising population



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The National Accounts data update shows decisively that the combined effect of monetary and fiscal policies is crimping domestic demand and bringing it back into balance with supply. Some of the narratives sustaining the hawkishness in the RBA's recent communications – including the productivity slump and the earlier resilience of equipment investment – are no longer operative. Related to this, the data on average earnings and labour costs in today's accounts were not especially concerning. While the next two months of inflation data remain a key focus, today's data are view-changing. In the face of subdued domestic demand growth and a household sector under extraordinary income pressure, further macroeconomic policy tightening would be hard to justify.

Luci Ellis, Chief Economist, Westpac Group

Domestic demand (Andrew Hanlan)

Domestic demand (0.5%qtr, 2.2%yr): Spending across the domestic economy grew by 0.5% in the quarter to be 2.2% higher over the year - an uplift underpinned by rapid population growth, which increased by 0.7%qtr, 2.4%yr in the period.

Per capita domestic spending is now contracting, down by -0.1%qtr, -0.2%yr.

Public demand (1.4%qtr, 4.2%yr): Government spending, in the form of public demand, increased by a robust 1.4% in the quarter. That has annual growth at 4.2%, an above par reading but well down from the Covid related spending high of 8.5%yr at the start of 2022.

Public consumption had been cresting, at a high level, as the spike in Covid related spending unwound. In the year to March 2023, spending declined by -0.1%.

More recently, as governments actively subsidies consumer spending - notably for electricity bills - government consumption spending is up (advancing by 1.1%qtr, 2.6%yr in the September quarter). The flip side to this is that out of pocket expenses for consumers on electricity are down materially in the latest quarter.

Public investment grew by a brisk 2.8%qtr, 11.6%yr in September, supported by a surge in investments in much needed transport infrastructures.

Private demand (0.2%qtr, 1.4%yr): Demand across the private sector is soft, at 0.2%qtr, 1.4%yr, as consumer spending stalls.

Consumer spending (0.0%qtr, 0.4%yr): Consumer spending has hit the wall - flat in the quarter, with a very weak profile on the revised figures in these Accounts, to be up only 0.4% over the past year. The key driver, a sharp contraction in real household disposable income as high inflation, higher interest rates and additional tax obligations bite hard.

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

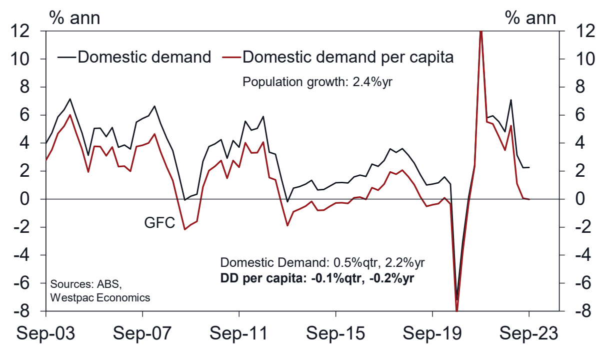
Home building (0.2%qtr, -0.3%yr): Home building activity has also stalled, inching 0.2% higher in the quarter to be down -0.3% over the past year.

The Covid related renovations boom is deflating, not withstanding a 1% uptick in the September quarter - work is 10.6% below the Q3 2021 peak. New dwelling investment is 2.5% higher over the past year, despite a -0.3% dip in Q3, supported by a sizeable backlog of work. The outlook is challenging, with approvals sharply lower.

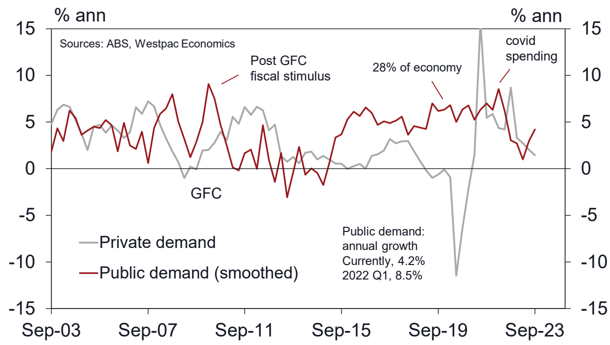
Real estate (2.0%qtr, -6.1%yr): The real estate sector, in the form of Ownership Transfer Costs (turnover in the property sector), advanced over the past half year, with gains of 3.3% and 2.0%, to still be 6.1% below the level of a year ago. Demand in the established property market is being supported by strong population growth and a robust labour market, at a time of limited supply.

New business investment (0.6%qtr, 8.0%yr): Business investment

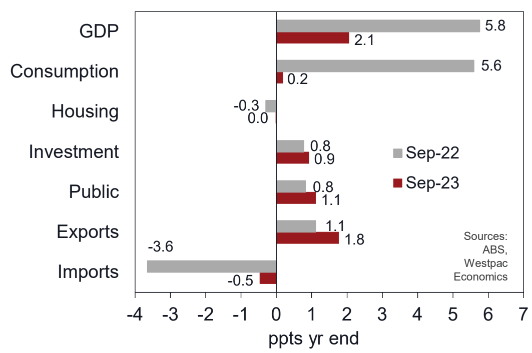
Domestic demand: per capita spending contracts



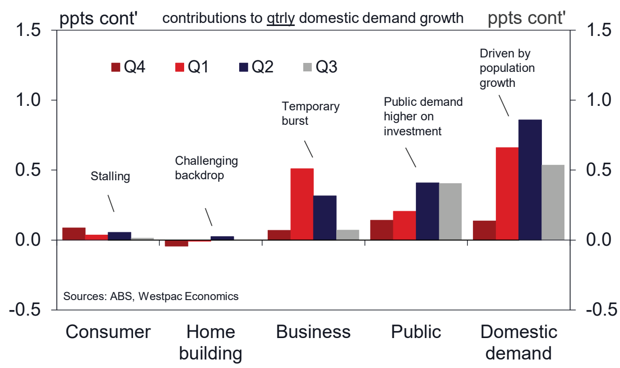
Public / private demand split



GDP growth: year-end contributions



Australia: domestic demand



growth slowed materially in Q3, to a modest rise of 0.6%, following a spending burst over the first half of the year - with Q1 and Q2 gains of 4.2% and 2.5%.

The September result included: equipment spending, 0.2%; infrastructure, 2.3%; new building, -1.5%; and Intellectual Property Products, 1.6%.

Equipment spending consolidated after Q1 and Q2 results of 5.1% and 3.9% - strength which was in part a catch-up (as supply constraints eased) and in part a bring forward (ahead of tax incentives ending on 1 July). With the stalling of household spending, it is a challenging investment outlook - albeit tempered by positives around business balance sheet strength and an economy still operating at a high level of capacity.

GDP: the expenditure estimate

The Expenditure estimate of GDP printed 0.3%qtr, 2.3%yr for the September quarter.

Domestic demand grew by 0.5% and there was a net subtraction of -0.2ppts from total inventories (+0.4ppts) and net exports (-0.6ppts).

Net exports was a sizeable negative for activity, subtracting 0.6ppts. Imports increased by 2.1%, led by an 8.4% rise in services as more of us holidayed abroad. Exports slipped, declining by -0.7%, with a 1.9% rise in services more than offset by a -1.2% decline in goods centred on a reduction in resource shipments, down -3.7%.

Total inventories added 0.4ppts to activity, including: non-farm business inventories, +0.9ppts (on a rebuild of mining inventories); public authority inventories, -0.4ppts; and farm inventories, -0.1ppts.

Household Sector (Matthew Hassan)

Australian consumers continue to come under intense pressure, with incomes contracting again in the September quarter and another sizeable savings draw-down required just to keep pace with inflation. Spending stalled flat in real terms. Downward revisions also lowered the historical profile, with the last three quarters now showing very weak gains in the 0.1-0.2%qtr range, annual growth slowing to just 0.4%yr, a -2% contraction in per capita terms. This marks the biggest per capita decline in spending since the GFC, larger than the annual declines seen during the full-blown recessions of the early-1990s, the early-1980s and the mid-1970s.

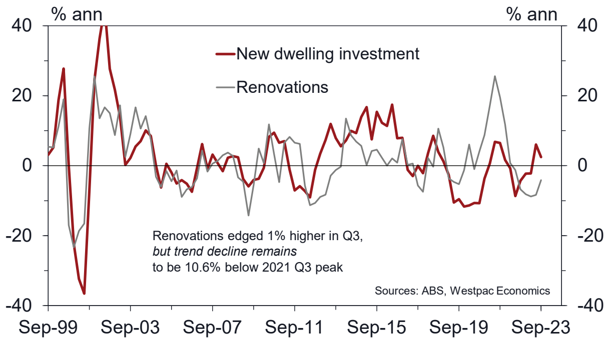
The September quarter spending result was materially weaker than expected – we had been anticipating a better but still subdued 0.5% gain. The detail shows the main downside surprise was around services which looks to have contracted about -1%qtr on a combined basis.

The detail here is a little more nuanced. By far the biggest fall was in utilities spending, but this is a by-product of government energy subsidies introduced mid-year, with the -16.9%qtr drop in the quarter reflecting the lower 'out of pocket' cost to consumers. That fall effectively took 0.4ppts off total consumption, accounting for all of the downside surprise vs our forecasts. This effect will clearly reverse as subsidies are withdrawn. We saw a similar -9% fall in utilities spending when the first round of subsidies were introduced in the September quarter of 2022, which progressively reversed over the following three quarters.

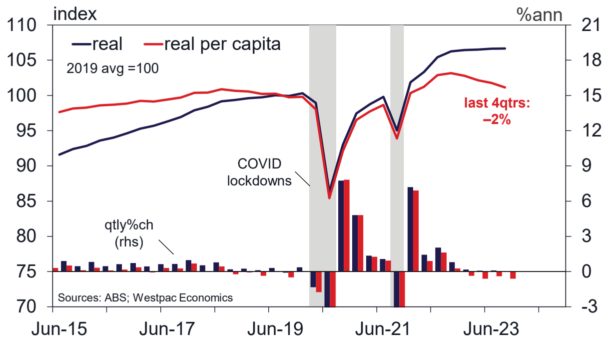
The rest of services spending is a little more mixed. While there were notable weak spots around recreation & culture (–1.1%qtr, 5.4%qtr) and other goods & services (–2.8%qtr, –4.1%yr), cafes & restaurants still posted a decent rise (+0.9%qtr, +2.6%yr) with transport spending also continuing to surge strongly (+3.9%qtr, +14.8%yr).

Other components of spending were largely as expected. Retail components were about flat in the quarter, with a small decline in basic food mostly offsetting gains for household goods and

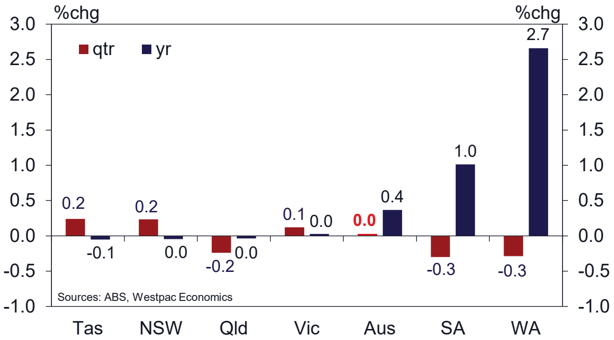
Home renovations boom deflates



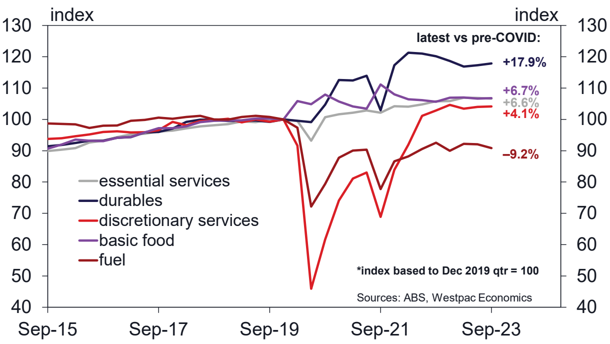
Consumer spending



Consumer spending: Q3 2023



Consumer spending: broad categories



clothing. Vehicle operations (mainly fuel) declined -0.8%qtr to be down -1.9%yr – high prices again a factor in the quarter.

The biggest positive came from vehicle purchases, which surged 13%qtr, contributing +0.4ppts to total consumption. Much of this looks to be a temporary lift as backlogged orders clear. Monthly vehicle sales – which foreshadowed the big September quarter gain – are already off their peaks and tracking a modest decline for the December quarter.

As such, to the extent that there are temporary factors at play (i.e. electricity subsidies and backlogged vehicle orders) these are essentially offsetting each other in the quarter, meaning the weak overall result is still a fair reflection of underlying conditions for consumer spending growth.

The picture around incomes and savings was also materially weaker than expected.

There were some positives. Total wage income showed a better than expected 2.5%qtr rise to be up 8.1%yr (we had been expecting something closer to 1.7%). That gain came despite a -0.6% decline in total hours worked. Average compensation per non-farm employee rose 2%qtr, but rose 3.1%qtr in per hour worked terms, the Fair Pay Award decision likely having an impact.

Non-labour income was again uneven, with rate rises again seeing a solid increase in interest received but with much more mixed gains across dividends and gross mixed income (mainly the profits of farm sector and unincorporated businesses). Non-labour income posted a modest rise overall.

The net result produced a solid 1.9%qtr rise in gross incomes, down only slightly on the 2.1% gains in the previous two quarters. However, households again saw a very large hit from increased interest and income tax payments, the latter being particularly eye-catching.

Interest payments rose 7.6%qtr to $36.7bn, the July-October pause in the RBA's rate hikes slowing the pace of increase compared to the double-digit quarterly growth over the previous five quarters. Total interest payments are now over one and a half times higher than they were at the start of 2022.

Income tax payments also rose 7.6% to be up an extraordinary 23.4%yr. Aside from surging employment and fiscal creeps, the September quarter increase also reflected the expiring low and middle income earner tax offsets (LMITO), worth around $8bn. Total income tax payments rose and hit 29.6% of labour income, nearing the all-time high of 29.8% reached in 2002.

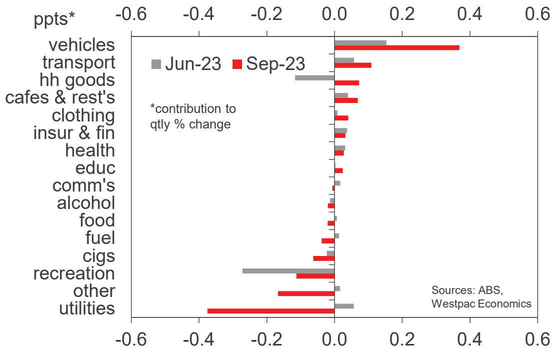
These drags nullified all of the gross income gains, disposable income (after interest and tax) barely rising 0.1%qtr annual growth and slowing abruptly to 1%yr. That trailed inflation by a long way, with the consumer price deflator rising 1.4%qtr and 5.6%yr. Real household disposable incomes – i.e. income after interest, tax and price increases – fell -1.3%qtr to be down -4.3%yr, the second largest annual decline on figures going back to 1960.

As this implies, consumers again had to lean on savings just to keep pace with inflation and hold spending flat in real terms. The savings ratio (the portion of income unspent) fell from 2.8% in the June quarter to just 1.1% in the September quarter – a 16yr low. The fall effectively 'freed up' an additional $5.7bn in funding for expenditure.

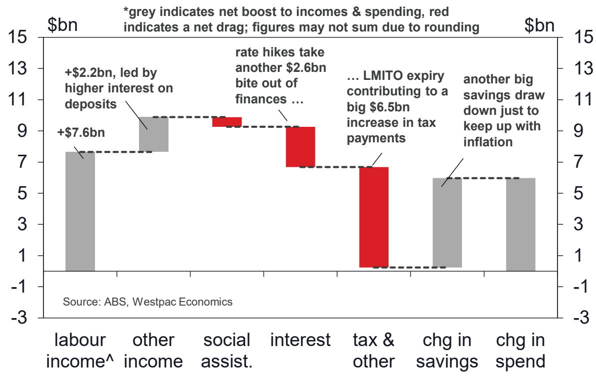
The savings rate is now well below the 'par' of 6.5% and notionally implies a draw-down on the 'additional savings' accumulated during the pandemic – estimated at around $260bn – running at about $12bn a quarter. In total, about $43bn, or 16.5% of this reserve now looks to have been drawn down.

Overall, the September quarter update is a bleak one for households possessing incomes under intense pressure, with diminished scope for support from savings and spending already

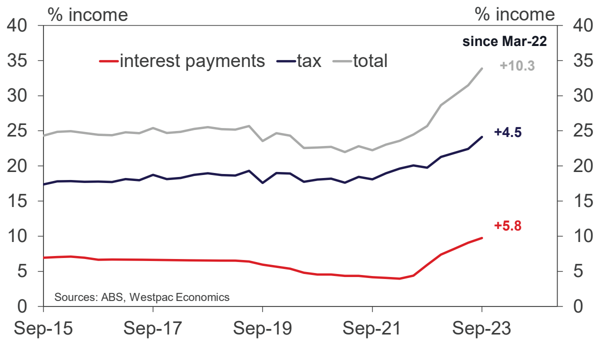
Consumer spending by category



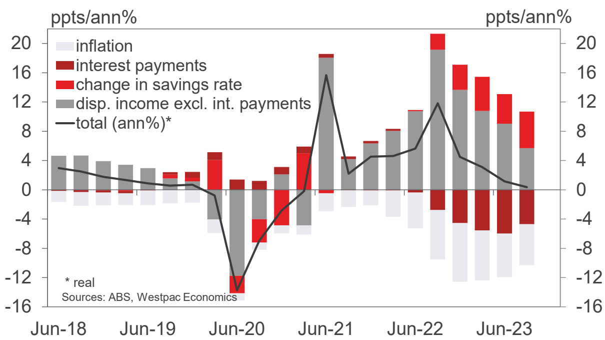
Household income flows: change, Q2 to Q3 2023



Household interest and income tax payments



Consumer spending: drivers and headwinds



weak, especially when viewed in per capita terms. With the Westpac card data pointing to further weakening in spending momentum through October-November, consumer sentiment stuck around historical lows, and an RBA interest rate rise in November still to impact, near term prospects look very challenging.

The States (Ryan Wells)

Domestic demand grew by 0.5% in Q3. Performances across the nation were broadly modest, with similar gains in state final demand reported across New South Wales (+0.3%), Victoria (+0.4%) and South Australia (0.5%), albeit with some exceptions, that being Queensland to the downside (–0.3%), while Tasmania (+1.5%) and Western Australia were materially to the upside (+2.4%).

Household consumption was the key disappointment in the quarter, stalling flat across the nation, as gains across New South Wales (0.2%), Victoria (0.1%) and Tasmania (0.2%) were effectively offset by declines in Queensland (–0.2%), South Australia (–0.3%) and Western Australia (–0.3%). There were notable developments at the tail-ends, including a surge in motor vehicle spending as suppliers continue to work through a backlog of orders, and a notable decline in out-of-pocket expenditure on household energy bills as a result of government rebates. On balance though, the broader picture is subdued. The detail highlights the current constraints households are facing with regards to their spending capacity, highlighted by a buckling in discretionary services spending. The profile here is mixed, but broadly across the states, declines in arts and recreation spending came alongside some lingering momentum in hotels, cafes and restaurants and transport services.

Making up for the lack of momentum in household consumption, the public sector was a contributor to domestic demand in the September quarter, notably in the form of government consumption (+1.1% nationally). That, in part, explains the stronger performances across Western Australia and Tasmania, where government consumption rose 3.2% and 2.7% respectively – largely as a consequence of energy bill rebates – compared to New South Wales (0.6%), Victoria and South Australia (1.0%) and Queensland (1.1%).

Production: an industry perspective

The Production estimate of GDP printed 0.2%, 2.1%yr for the September quarter.

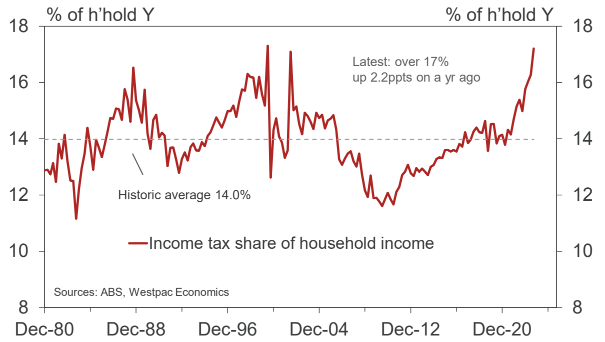
Activity conditions across the broad segments of the economy were distinct. The production measure for household services picked up slightly from earlier softness, as growth in business services retreated. Momentum across goods sectors continues to wane, with goods production being the softest in the quarter.

Household services rose 1.2% (3.4%yr) in Q3, a step-up from gains seen over the first half of the year (0.7% in Q1; 0.8% in Q2). There were some notable developments by sector, including an appreciable .8% lift in health care and social assistance – the largest household services sector. Growth in education and training remains little-changed, up 0.4% (1.6%yr), on par with the June quarter.

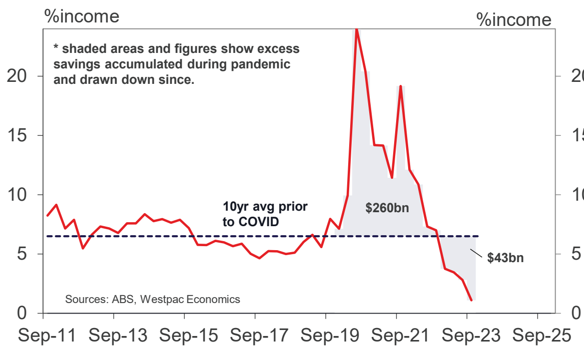
Speaking more directly to key consumer sectors, accommodation and food services posted a 1.5% increase in the quarter, as a consequence of major events and increased tourism activity. That remains consistent with an easing in momentum following strong spending in this sector last year, as annual growth fell from 6.6% to 5.0%. A similar theme is also present in arts and recreation services, albeit with more quarter-to-quarter volatility (3.8%yr). In line with our view, these results highlight the emerging weakness in households' discretionary spending capacity under the weight of high inflation and elevated interest rates.

Business services returned to a more subdued pace, rising 0.4% in the September quarter. The sectoral profile was mixed. Information media and telecommunications remains a clear front-runner (9.2%yr) and growth in real estate services (4.7%yr) remains buoyant, reflective of the improvement in housing market conditions. However, financial and insurance services are approaching a near-stall speed (0.4%yr) as professional, scientific

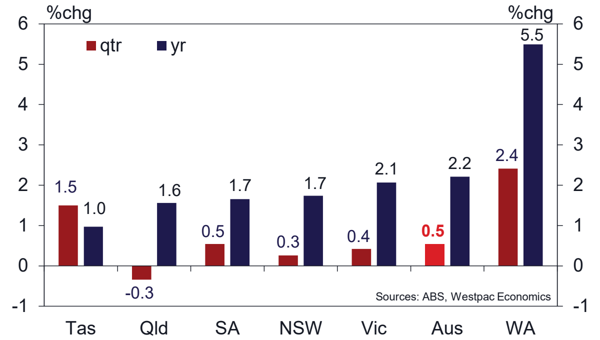
Household income tax climbs to historic high



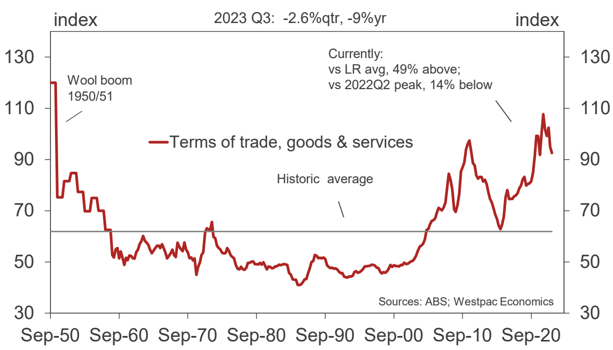
Household savings ratio



State demand: Q3 2023



Terms of trade, recedes from record high



and technical services continues to move lower (–1.8%yr). Overall, business services as a whole remain in a clear downtrend, growth shifting lower on an annual basis (1.4%yr) and soft relative to pre-pandemic trends.

Goods distribution continues to exhibit a slowdown, activity in the industry group lifting 0.5% to be just 1.0% higher versus September 2022. Transport, postal and warehousing remains a stand-out positive, up 1.5% (5.5%yr), supported by the tourism rebound. Notwithstanding the quarterly bounce associated with improved supply for motor vehicles, retail trade is continuing to track a weakening trend (–1.2%yr), reflective of the weakness in household spending as consumer's discretionary spending capacity remains under pressure. Wholesale trade also fell 0.9% (–2.0%yr) in the quarter.

Goods production was the key disappointment in the September quarter, declining 0.8% to be up 2.1% from a year ago. Weakness was broad-based but particularly evident in agriculture (–3.5%) and utilities (–2.6%) as a result of softening demand. Less severe declines were reported across mining (–1.0%) and manufacturing (–0.3%), although growth in these sectors are little-changed from a year ago (0.5%yr and 0.2%yr respectively). Activity in construction remained afloat, up 0.8% (3.0%yr), supported by public infrastructure projects and a sizeable pipeline of work.

Income (Andrew Hanlan)

The real income estimate of GDP printed 0.2%qtr, 2.0%yr.

Nominal GDP increased by 1.2%qtr, 4.5%yr, associated with a lift in prices of 1.0%qtr, 2.4%yr.

A fall in the terms of trade, –2.6%qtr, provided a hit to national income in the period. Global commodity prices have retreated from the highs of a year earlier, but remain elevated.

The following analysis is based on nominal data.

Total factor income (TFI), which is GDP (I) minus taxes less subsidies, increased by a modest 0.7%qtr, 4.0%yr.

Total compensation of employees, the wage income bill, increased by a brisk 2.6% in the quarter, associated with the decline in hours worked in the period, a fall of -0.6%. The National Wage decision delivered an oversized increase in award wages, providing a boost to wage incomes in the period.

Company profits (private non-financial) contracted by a sharp -4.5% in the quarter, much weaker than the quarterly partial from the Business Indicators survey, an implied decline of -0.9%. Of note, mining profits retreated from their highs on lower commodity prices.

Gross mixed income, spanning small business and the farm sector, were little changed in the period, edging 0.3% higher to be 4% lower over the past year.

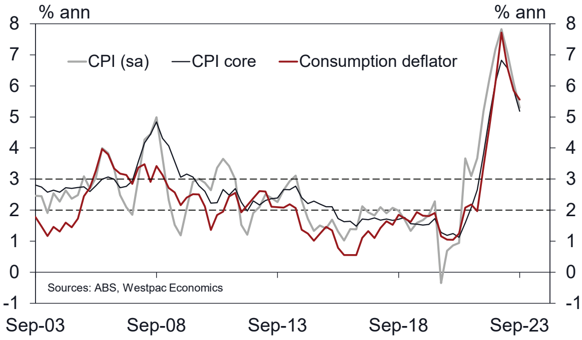
Total financial corporations posted a 2.1%qtr, 6.4%yr increase on a lift in lending for the established housing market.

Inflation (Justin Smirk)

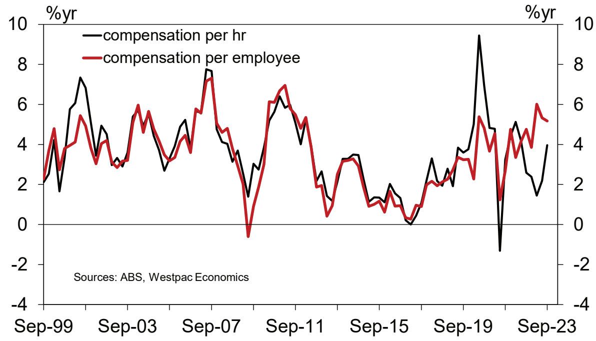
Mirroring the CPI, in September the National Accounts price measures reported a pickup in inflationary pressures in the quarter but a moderation in the annual pace from the December 2022 peak.

The GDP implicit price deflator lifted 1.0% in September following a 1.2% contraction in June (revised from -1.5% which was the largest drop since June 2009). The decline in June may have seemed surprising at first given the strength of other price measures but we have to remember that the terms of trade can have a significant impact on the GDP deflator and the larger the contribution from international trade to GDP the larger the impact the terms of trade has on the GDP deflator. In the June quarter the terms of trade fell -7.2% with a further -2.6% fall in September.

Consumer inflation off peak, but still too high



Workers compensation



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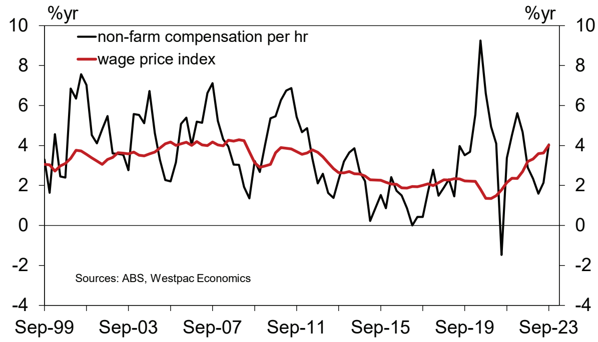
Workers' compensation – NA vs WPI



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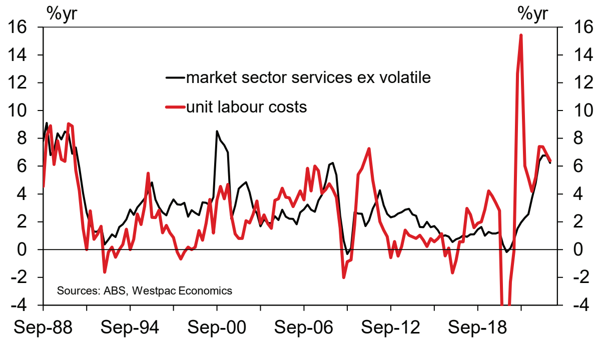
Unit labour costs & services inflation



6 December 2023

The Domestic Final Demand deflator (DFD), which is not impacted by changes in the terms of trade as it only measures domestic prices, lifted 1.3% following a gain of 1.2% in June. However, this measure does suggest the inflationary pace has eased as it was up 5.3% in the year to September, a moderation from the recent peak of 7.3%yr in December 2022.

The Gross National Expenditure deflator (GNE), which is immune to changes in the terms of trade, gained 1.7% in September building on the 0.9% increase in June and 1.2% in March. However, overall the inflationary pace has moderated since 2022, lifting 5.4% in the year to September compared to 7.2%yr in December 2022.

The household final consumption expenditure deflator (HFCE) did lift 1.4% in the quarter, building on the 1.3% gain in June and 1.0% in March but it nevertheless still reported a moderating in the annual pace to 5.6%yr, down from 5.8%yr in June and the recent peak of 7.7%yr in December 2022.

Compare that to the seasonally adjusted CPI which lifted 1.0% in both September and June for an annual pace of 5.3%yr to September and a recent peak of 7.8% in December 2022

There are some significant differences between the HFCE and the CPI, one of which is that the HFCE has a floating basket of goods and services with the weights set by consumption in that quarter whereas the CPI has the fixed basket with a fixed set of weights. As such the HFCE will be affected by changes in consumer spending patterns as relative prices change – i.e. we would expect to see consumers substituting cheaper goods for more expensive goods at times of high inflation and thus would expect to see a softer inflation profile with the HFCE compared to the CPI. The fact that HFCE inflation is stronger than CPI inflation would be consistent with higher rates of inflation for non-discretionary items (which consumers can't substitute away from) rather than discretionary items.

Wages, labour costs and productivity

Labour costs in the national accounts are measured by total compensation of employees, i.e. the wages bill.

Total non-farm compensation of employees rose 2.6% in the quarter, building on the 1.6% increase in June. Interestingly, despite the larger increase in the minimum wage this year the quarterly increase was less than the 3.2% increase in September 2022 and, as such, the annual pace eased back to 8.4%yr from 9.1%yr in June and the recent peak of 11.0%yr in December 2022.

Total non-farm compensation of employees is not a pure wage measure as it is affected not just by changes in rates of pay but also by changes in the number of employees and in hours worked as well as the composition of the workforce.

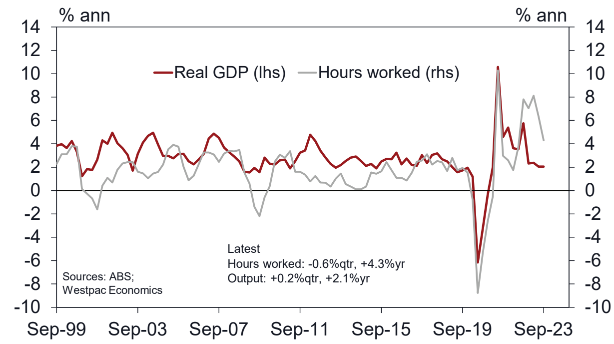
Non-farm compensation per hour worked lifted 3.1% in September, more in-line with what is expected given the larger than usual rise in the Minimum Wage. Non-farm compensation per hour lifted 1.3% in September 2022. This is why this measure is more in-line with the Wage Price Index (WPI) in reporting an acceleration in wage inflation, lifting to 4.1%yr in September from 2.1%yr in June and 1.6%yr in March.

The national accounts measures of hourly rates of pay can be significantly more volatile than that from the WPI. However, at least more recently the two measures do seem to be converging with the WPI lifting 1.3% in the September quarter for a 4.0%yr annual pace.

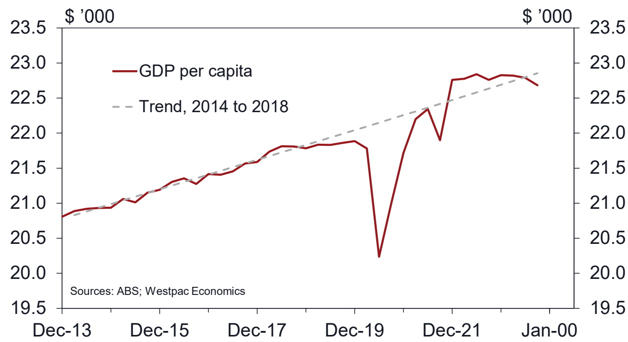
Labour productivity is measured as GDP per hour worked. With market sector hours worked falling -0.6% in September, taking the annual pace down to 2.8%yr from 4.9%yr in June and a recent peak of 9.1%yr in September 2022. The fall in hours worked saw GDP per hour worked (market sector) lift 0.5% in September, only the second quarterly increase in this series since December 2021.

Given the larger rise in employee compensation compared to hours worked unit labour costs (ULC), which measure the labour cost to produce one unit of GDP output, gained 2.2% in September highlighting robust domestic inflationary pressures. However, given the modest improvement in productivity, and the peaking in wage inflation, the annual pace of ULC moderated to 6.4%yr from 6.9%yr in June and the recent peak of 7.4%yr in March.

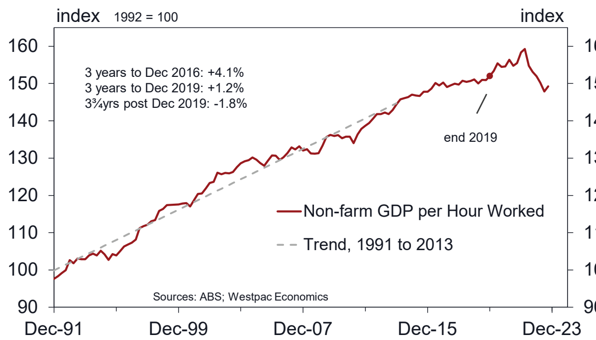
Hours worked: declined in Q3, down 0.6%



GDP per capita



Australia: labour productivity



Westpac Economics
Luci Ellis, Chief Economist
ph (61-2) 0421 835 252

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

Ryan Wells, Economist 0401 423628

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