BULLETIN

6 March 2024

Australian national accounts, December quarter. Economy limps into year-end. Demand stalls as slowdown spreads beyond the consumer.

Q4 domestic demand: 0.1%qtr, 2.3%yr
Q4 real GDP: 0.2%qtr, 1.5% yr

The Australian economy posted a weak finish to 2023, expanding by just 0.2% in the final quarter and annual growth moderating to 1.5%yr. The economy tracked a 1% annual growth pace through the second half of last year. Outside of the extremes seen during COVID, this is the weakest six month performance since the GFC hit fifteen years ago. Domestic final demand was essentially flat in the final quarter, the detail showing the weakness evident across the consumer sector since mid-2022 is starting to spread to other cyclically sensitive areas.

While both results and much of the remaining detail was in line with our expectations, the report underscores the extent to which policy tightening and cost of living pressures are weighing on demand and activity. The private-public split is also notable: private demand essentially flat over the second half of 2023 with almost all of the gains overall coming from increased public demand.

Private consumption again came in about flat, rising just 0.1%qtr and having now barely grown for five successive quarters. Per capita spending has fallen 2.8% since the September quarter of 2022. The mix showed further declines in discretionary spending categories with gains confined to basics like food, health and fuel.

The picture on household incomes was a little brighter, public sector wage gains and some easing in income tax payments from recent highs driving a 1.5%qtr rise in real household disposable incomes (i.e. after interest and tax). While that marks the best quarterly gain in two years, real disposable income is still 3.4% below its December 2021 level. Moreover, most of the improvement has flowed to saving rather than spending, the household saving rate lifting from 1.9% to 3.2%. Even with that lift, 'new' saving is relatively low, implying that consumers are still drawing on the additional saving reserves accumulated during the pandemic to support spending.

Private investment is starting to show clearer signs of weakening, particularly in areas known to be more sensitive to cyclical swings. Dwelling investment declined 3.8%qtr, the move lower following five flat quarters. Business investment is also showing a further loss of momentum, the 0.7%qtr rise in the December quarter following a similar pace in September, having averaged 2.4%qtr over the previous two years. Notably, machinery and equipment investment, which tends to be more cyclical, recorded an outright decline of 1.3%qtr. Activity in the infrastructure and non-residential building space continues to be supported by a large pipeline of work, both recording gains in the quarter.

Around productivity, the accounts again show a modest improvement with a 0.5% gain in the December quarter as weak output growth combined with a 0.3% decline in hours worked. While GDP per hour worked is still down 0.5%yr, it has improved markedly from the dismal –5.2%yr read at the start of 2023. Unit labour costs rose 1.3%qtr, lifting the annual pace to 6.6%yr. While that is still a somewhat troubling pace for domestic cost pressures to be rising at, we are still experiencing significant volatility around productivity and unit labour cost measures, making underlying trends difficult to discern.

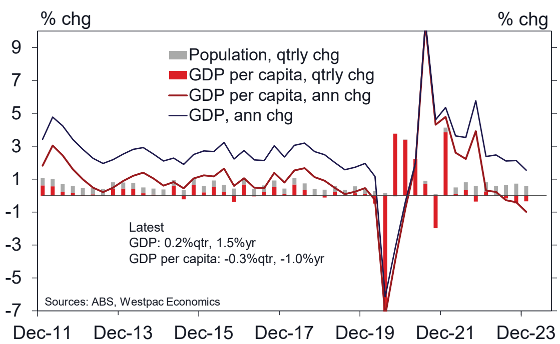
Looking ahead, the economy is expected to see continued weakness near-term with a policy 'pivot' providing more support from the middle of the year.

GDP: December qtr 2023

	% qtr		% yr	
	Sep	Dec	Sep	Dec
Private consumption	–0.2	0.1	0.1	0.1
Dwelling investment	0.6	–3.8	0.3	–3.1
Business investment*	0.8	0.7	8.2	8.3
Private final demand*	0.1	0.0	1.4	1.3
Public spending*	1.9	0.4	4.7	4.7
Domestic demand	0.6	0.1	2.3	2.3
Stocks – private non-farm #	0.9	–1.0	–0.6	–0.6
– other #	–0.6	0.7	–0.5	–0.3
GNE	1.0	–0.2	1.0	1.3
Exports	–0.2	–0.3	7.5	4.2
Imports	2.3	–3.4	2.5	3.5
Net exports #	–0.6	0.6	1.4	0.4
Statistical discrepancy #	–0.1	–0.2	–0.2	–0.1
Non-farm GDP	0.3	0.2	1.6	1.4
GDP, real	**0.3**	**0.2**	**2.1**	**1.5**
GDP, nominal	1.4	1.4	4.5	4.4
GDP deflator	1.2	1.1	2.4	2.8
Household deflator	1.4	0.8	5.6	4.6
Earnings per worker (non-farm)	2.1	0.4	5.1	5.2
Real household disp income	–1.0	1.5	–4.1	0.3

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

Australia: weak growth, per capita declines



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An improving inflation situation should allow the RBA to begin moving interest rates lower from September.

On the fiscal side, the Stage 3 tax cuts will come in from July and other support measures are likely to be announced with the May Budget. The more general easing in cost-of-living pressures will also improve conditions for households.

However, working against these forces will be slowing population growth, a softer labour market and diminished pandemic savings reserves, which will tend to restrain the upturn.

Matthew Hassan, Senior Economist, Westpac Group

Domestic demand (Andrew Hanlan)

Domestic demand (0.1%qtr, 2.3%yr): spending growth across the economy has slowed to a near stand-still, as anticipated. The economic slowdown has broadened from the consumer to other sectors of the economy.

Domestic demand inched 0.1% higher in the quarter. The quarterly profile for 2023 is: 0.6%, 0.9%, 0.6% and 0.1%.

Private demand (0.0%qtr, 1.3%yr): The economic slowdown is more evident across the private economy as high inflation and contractionary policy settings impact.

Private final demand slowed abruptly over the second half of 2023, from Q1 and Q2 outcomes of 0.6% and 0.7%, to Q3 and Q4 outcomes of 0.1% and 0.0%.

In short, the private economy stalled over the second half of 2023.

Public demand (0.4%qtr, 4.7%yr): Public spending in the form of public demand has been supportive of activity.

This includes additional assistance to households – in the form of price relief/subsidies for electricity bills. In addition, public investment has been trending sharply higher on investment in transport infrastructure projects.

In the December quarter, public demand grew by a more modest 0.4%, including consumption +0.6% and investment, –0.2%, for investment to still be 13.7% higher over the year.

Consumer spending (0.1%qtr, 0.1%yr): Consumer spending has been broadly flat for the past five quarters, with household incomes under intense pressure from high inflation, higher interest rates and additional tax obligations.

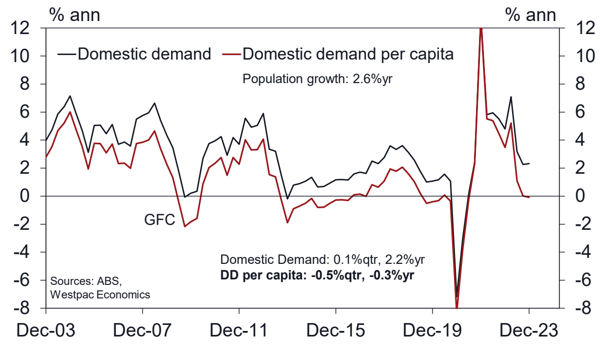
For more detail, see below for a discussion of the household sector.

Home building (–3.8%qtr, –3.1%yr): Home building activity weakened in the December quarter as higher interest rates and the economic slowdown impact. Activity contracted by –3.8%, including renovations, –4.2%, and new home building, –3.5%. This weakness contrasts with relatively flat outcomes over recent quarters. The outlook is challenging, ahead of any emerging policy relief in the second half of 2024.

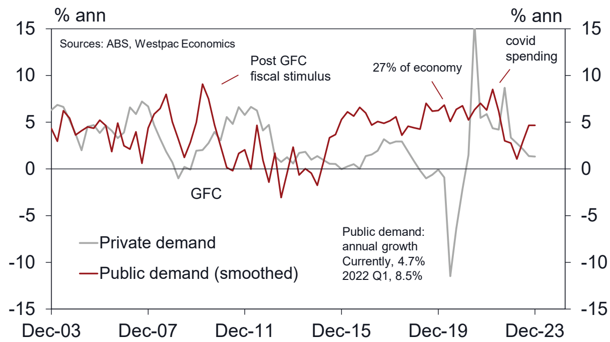
Real estate (3.5%qtr, 4.8%yr): The real estate sector, in the form of Ownership Transfer Costs (turnover in the property sector), expanded for a third consecutive quarter, rebounding after falling throughout 2022 and into early 2023. Property prices have squeezed higher on low volumes as demand rises (associated with strong population growth) in the face of limited supply.

New business investment (0.7%qtr, 8.3%yr): Business investment growth has lost considerable momentum – the burst of spending through to mid-2023 was, in part, always going to be temporary, and moving into the second half of 2023, the economic slowdown is impacting.

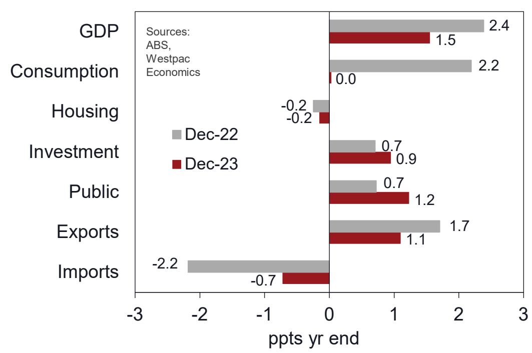
Domestic demand: per capita spending contracts



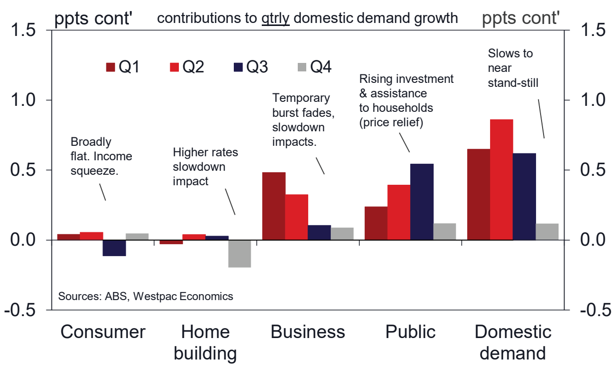
Public / private demand split



GDP growth: year-end contributions



Australia: domestic demand



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Throughout 2023, quarterly growth in business investment has cooled from: 4.0% and 2.6% for Q1 and Q2, to 0.8% and 0.7% for Q3 and Q4.

The Q4 result was flattered by a lumpy 5% rise in non-residential building. Excluding that, business investment contracted, declining by –0.3% in the December quarter. The cyclically sensitive equipment spending segment contracted, down by –1.3% after a modest Q3 rise of 0.6% – in contrast to gains of 4.3% and 3.8% for Q1 and Q2.

The December result included: equipment spending, –1.3%; infrastructure, 0.4%; new building, 5.0%; and Intellectual Property Products, 0.9%.

Mining investment was volatile over the second half of 2023, with a Q3 9% jump partly reversed by a Q4 -5.3% drop. Non-mining investment cooled, from a brisk 12%yr to June 2023, followed by a choppy second half, down by -0.5% in Q3 and then up 2.8% in Q4 (a figure likely flattered by the lumpy 5% bounce in non-residential building). What is unclear, from the available data is the asset mix across mining and non-mining - how much of that Q4 fall in equipment spending of -1.3% was across non-mining and how much due to mining.

GDP: the expenditure estimate

The Expenditure estimate of GDP printed 0.4%qtr, 1.6%yr for the December quarter.

Domestic demand inched 0.1% higher and there was a net positive contribution of 0.3ppts from net exports (+0.6ppts) and total inventories (–0.3ppts).

Net exports added 0.6ppts to activity. Imports were sharply lower, –3.4% (goods –2.8% and services –5.3%) associated with softer domestic spending. Exports edged lower, –0.3% (goods –0.4% and services +0.5%).

Goods exports continue to disappoint, to be –0.1% lower over the year and still below pre-covid levels, down by –1.6%, led by resources, down by –5.2% vs pre-covid.

Total inventories subtracted –0.3ppts to activity, including: non-farm business inventories, –1ppt (on softer sales and volatility in mining); public authority inventories, +0.44ppts; and farm inventories, +0.24ppts.

Household Sector (Matthew Hassan)

Australian consumers continued to struggle in the December quarter, incomes performing better but spending essentially flat, implying another significant decline in per capita terms.

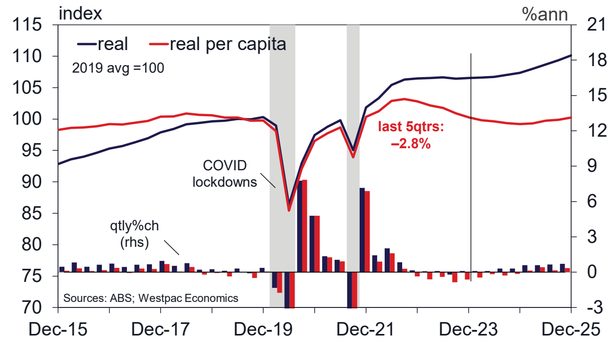
Real consumer spending rose just 0.1%yr in calendar 2023, a -2.5%yr contraction in per capita terms, comparable to the slump seen during the GFC and considerably steeper than the falls seen during the recessions of the early-1990s, the early-1980s and the mid-1970s.

The December quarter spending result was in line with Wespac's expectations. However, the mix showed a slightly weaker picture on goods spend and a slightly firmer result for services, the latter largely relating to shifts in energy spending associated with government rebate schemes. Total utilities spend rebounded 6.9%in Q4 following a very large 16.8% drop in Q3 that reflected reduced 'out-of-pocket' expenses due to increased rebates.

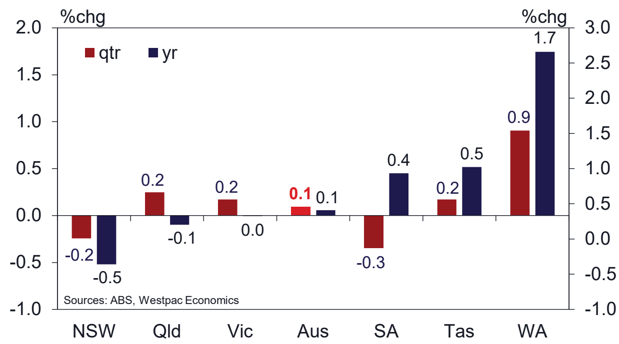
Outside of this, gains in the quarter centred on basics like food, health and fuel (all up +0.9%qtr), with a reasonably firm 1.1%qtr gain for household goods (+1.1%qtr) and smaller rises for rises for education, insurance and finance and 'other' goods and services. Recreation & culture spend posted a slight 0.2%%qtr gain but is still down 0.2%yr.

On the other side of the ledger, spending on vehicles, cafes & restaurants, and clothing was sharply lower, down –3.6%qtr, –2.8%qtr and –2.5%qtr respectively.

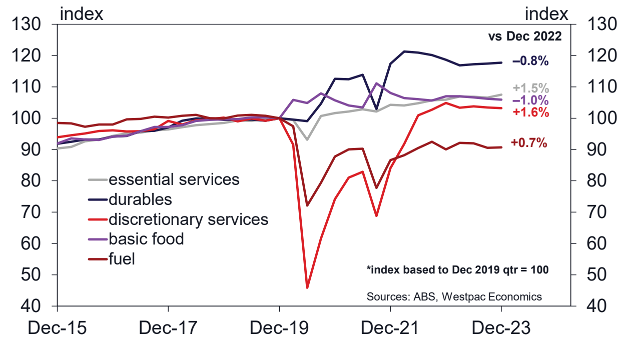
Consumer spending



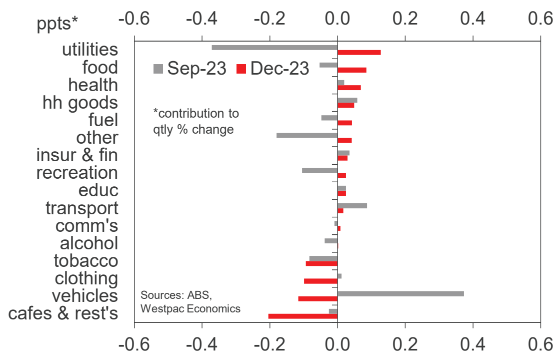
Consumer spending: Q4 2023



Consumer spending: broad categories



Consumer spending by category



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The upside surprise to incomes mainly reflected public sector wage gains and a bigger than expected pull back in tax payments.

Total wage income posted a 1.4%qtr rise, coming in better than some partial measures had suggested with the difference centred on strong growth in incomes for public sector employees (up 3.3%qtr). Total hours worked also showed a milder than feared 0.3% decline in the quarter. Average compensation per non-farm employee rose 0.4%qtr but rose 1.6%qtr in per hour worked terms.

Non-labour income was again uneven. Rate rises provided a solid boost to interest received with a notable increase in social assistance as well, relating to energy (the income counterpart to the swings in utility spending) and rental support.

Against this, the quarter saw a sharp 4.1%qtr decline in gross mixed income (mainly the profits of farm sector and unincorporated businesses), which was down 8.6%yr for the year. The mix saw non-labour income posted a rise overall in line with the 1.4%qtr gain in wages.

Total gross income finished up 1.5%qtr and 7.7%yr. The gain was even stronger in disposable terms due to a 3.3%qtr pull-back in tax payments, which continue to cycle the end of the LMITO. That more than offset the impact of a further 4.9% rise in interest payments. Notably, the ABS made some significant revisions to household interest income and payment estimates with reductions to both essentially adding about $0.8bn to the level of disposable income. Both tax payments and interest payments are at elevated levels, up sharply since mid-2022.

The bottom line showed household disposable income posting a much better than expected 2.3%qtr rise to be up 5%yr in nominal terms. In real, inflation adjusted terms, disposable incomes rose 1.5%qtr to be up 0.3%yr, the consumption deflator up 4.6%qtr.

Much of the upside surprise flowed to saving rather than spending. The household savings ratio (the portion of income unspent) rose from 1.9% in Q3 to 3.2% in Q4, in line with the Q2 reading and still below the 6.5% rate we regard as 'par'. That in turn implies consumers are continuing to run down the notional excess savings reserve accumulated during COVID, our estimates suggesting $57bn of the $250bn reserve has now been depleted.

Overall, the income picture was a little better than feared but consumers are clearly facing intense pressures from interest rate rises, an increased tax take and surging cost of living. These pressures should ease as we move into the second half of the year but that will likely coincide with moderating population growth, a softer labour market and diminished scope and inclination to draw down on pandemic savings to for support spending

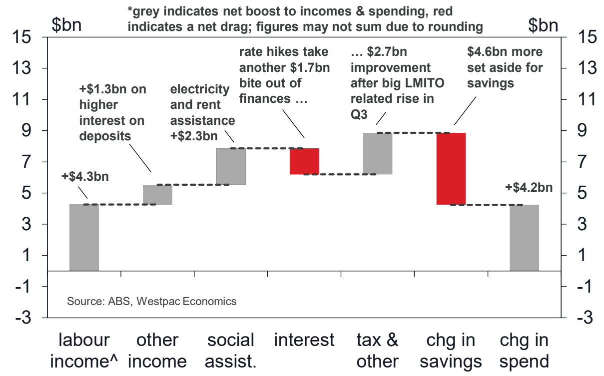
The States (Ryan Wells)

Nationally, spending across the economy slowed to a near stand-still, with domestic demand inching only 0.1% higher in the quarter. Domestic demand conditions were mixed across the states, with NSW and SA contracting, Vic and Tas holding flat, and Qld and WA posting solid gains.

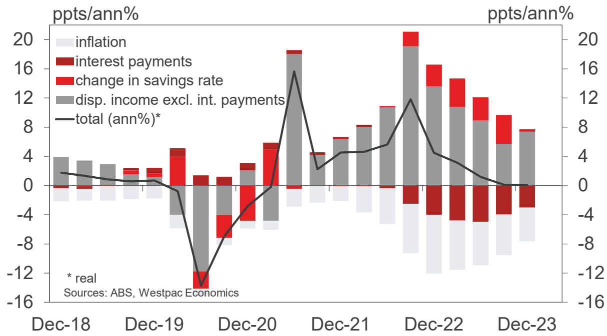
New South Wales exhibited the weakest performance across the nation in Q4 and over 2023, state final demand respectively contracting –0.4% and lifting only 1.4%yr. Households in New South Wales are clearly coming under intense pressure from the headwinds associated with inflation, interest rates and a rising tax take. Reflective of that, household consumption has slowed dramatically, from a pace of +18%yr at Q3 '22 to –0.5%yr at Q4 '23, currently the weakest out of all the states.

Housing investment was also quite lacklustre in the quarter, falling –5.1% (–4.0%yr), as the slowdown in new dwelling construction persists (0.8%yr) and renovation activity continues to cycle lower at an appreciable rate (–9.7%yr). Growth in new business investment nudged –0.5% lower in Q4 but remains 6.0% higher versus the end of last year. Here, both non-residential construction (14.2%yr) and

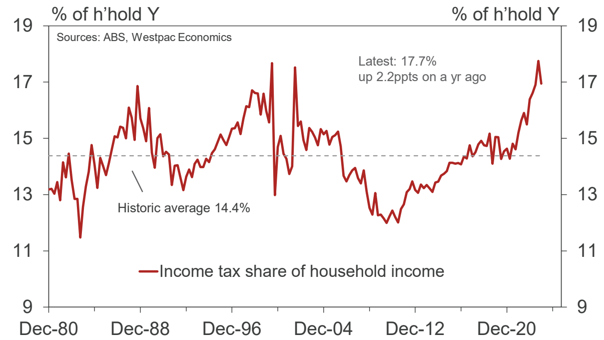
Household income flows: change, Q3 to Q4 2023



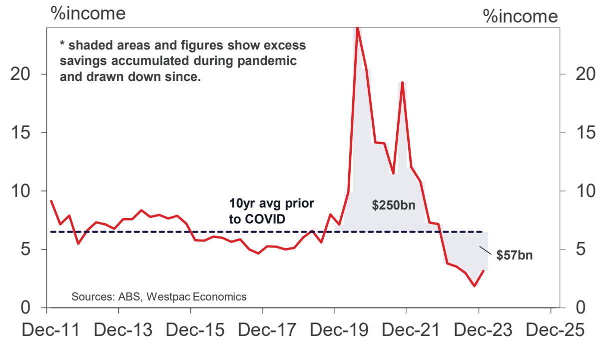
Consumer spending: drivers and headwinds



Household income tax still near historic highs



Household savings ratio



engineering construction (9.6%yr) are the key highlights – reflective of the pipeline of projects moving underway – though investment in machinery and equipment is now moving clearly lower (–1.3%yr), in response to a soft outlook for demand. Public investment is providing somewhat of an offset (7.9%yr), but even here, the state comparison is not in favour of New South Wales, with all other states tracking double-digit growth in this area.

Victoria's state economy neither expanded nor contracted in Q4, extending the slowing-trend in quarterly growth since the beginning of the year (Q1 0.8%; Q2 0.7%; Q3 0.5%), leaving activity 2.1%yr higher than end-2022. While consumption was positive in the quarter (+0.2%), growth remains flat on an annual basis, broadly in line with the national-level picture.

Business investment remains a key highlight in the state, forging 0.8% higher in Q4 to be 11.3% higher over the year. The broad-base to this strength – across non-residential construction (11%yr), engineering work (10%yr) and machinery/equipment investment (15%yr) – is bucking the wider trend across most other states. However, the picture around housing investment remains fragile. This segment contracted –3.1% (–5.1%yr), with weakness shared across both new dwelling construction (–6.6%yr) and renovation work (–2.1%yr). Public investment represented another drag in the quarter, down –3.5%, and with government consumption unable to provide much of an offset, up just 0.4%, public demand in Vic is the softest across the nation (–0.4%qtr, +4.0%yr).

Queensland continued on its relatively choppy growth path, albeit this time with a solid 0.6% rise in Q4 following a –0.3% contraction in Q3. Broadly speaking, the picture around the household sector remains fragile as consumption comes under growing pressure, having nudged down –0.1% over the course of the year. The picture around housing investment deteriorated notably as the year unfolded, a 4.8% gain over H1 2023 giving way to a –6.8% decline over H2 2023.

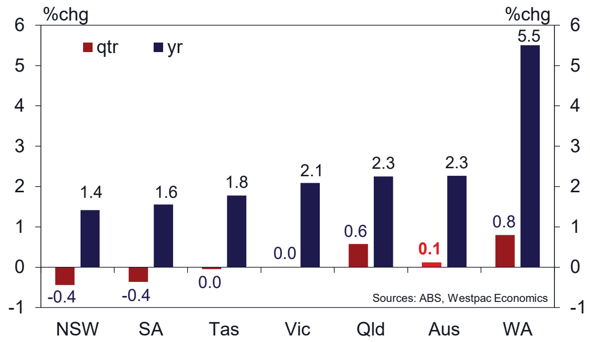
In the context of a fragile outlook for demand, it was encouraging to see growth in new business investment snap-back from its –2.7% decline in Q3 with a similarly-sized gain in Q4. Engineering work (9.5%yr) and machinery/equipment investment (8.3%yr) are the key supports here, with non-residential construction activity only a little higher than it was last year (1.4%yr). As is the case across most of the other states, the public sector also remains a chief driver of growth (5.7%yr), both with respect to government consumption (3.7%yr) and public investment (15.1%yr).

Western Australia continues to buck the wider trend, exhibiting the strongest performance across the nation both in Q4 and over 2023. State demand rose 0.8% to be 5.5% higher than last year. Where Western Australia stands in stark contrast is in the remarkable resilience of the state's household sector – consumption rising 1.7%yr (noting that State Government energy rebates have driven sharp swings in the quarterly profile) – associated with a stronger picture for incomes and savings. This, together with the extended uptrend in public demand (6.0%yr) – predominately driven by strength in public investment (25%yr) – is adding to the signs that Western Australia's performance is diverging in its favour.

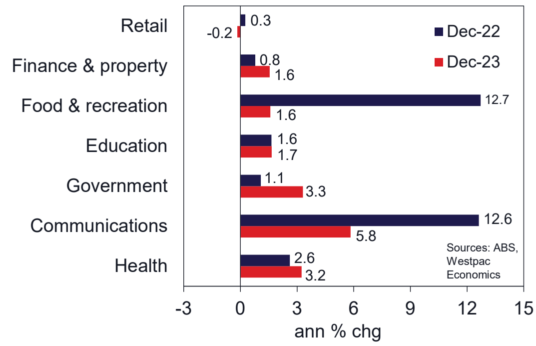
Detail around the private investment picture did shift into year-end, however. Growth in housing investment moderated sharply (10.2%yr to 1.9%yr) following an abrupt turnaround in new housing construction (15.6%yr to –1.8%yr). While still-elevated, growth in new business investment is tapering off its peak (16.3%yr to 14.8%yr).

South Australia contracted –0.4% in Q4 after a solid performance over mid-year, including gains of 1.3% in Q2 and 0.6% in Q3, leaving activity up 1.6%yr. Household consumption has exhibited a sharp turnaround, the 1.3% gain in H1 2023 giving way to a –0.8% decline in H2 2023. Weakness here is perhaps most broad-based in South Australia, with only a few 'pockets' of strength in transport services, vehicle purchases and health working against declines across most other categories, highlighting the extent to which financial pressures are mounting on South Australian households.

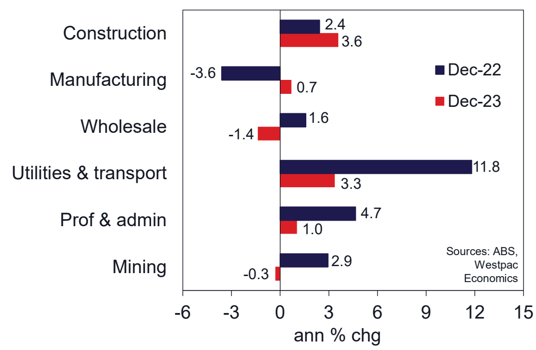
State demand: Q4 2023



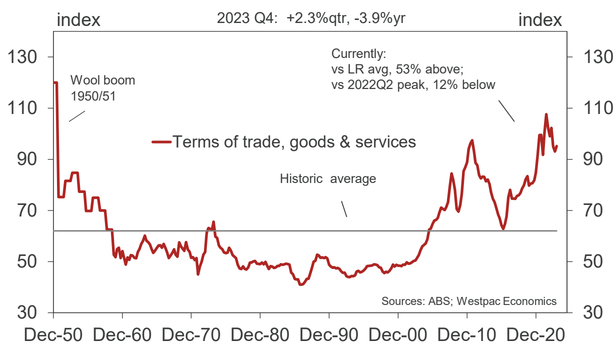
GDP by industry



GDP by industry



Terms of trade, elevated



Housing investment has been particularly choppy recently, in large part driven by renovation activity (–1.5%yr), though the emerging uptrend in new dwelling construction (10%yr) is constructive for the medium-term outlook. Broad-based weakness in new business investment (–3.9%yr) is adding to the challenges facing the state economy, though it is encouraging to see the public demand act somewhat as a buffer (5.8%yr).

Tasmania's economy stalled at year-end, state demand holding flat to be 1.8% higher versus end-2022. The public sector remains the key driver behind the state's growth (4.9%yr), owing largely to robust public investment (21%yr), though momentum looks to be fading.

The state's housing investment picture remains one of stark contrast between new dwelling construction (–12%yr) and renovation activity (+21%yr). On balance, it is adding to the headwinds facing activity in the state economy, including the slowdown in business investment (–0.2%yr) and lingering fragility in household consumption (0.5%yr).

Production: an industry perspective (Jarek Kowcza)
The production measure of the economy – GDP (P) – grew 0.2% in the December quarter, to be 1.5% higher in annual terms.

Weak consumer spending – particularly at a per capita level – alongside incredibly strong population growth was a key underlying theme throughout 2023. This impacted spending patterns across the economy. Consumers pulled back on discretionary consumption amid an environment of stretched budgetary pressures and high inflation. On the other hand, strong population growth supported essential items such as food, rent, utilities, and healthcare.

These trends continued in the December quarter and impacted outcomes at an industry level. Some of the weakest industries were those more directly exposed to lacklustre discretionary spending – which fell in the quarter. Accommodation & food services (–3.2%qtr, –0.9%yr) and arts & recreation services (–0.8%qtr, 0.7%yr) each contracted in the quarter and reported soft or negative annual growth.

Business surveys have shown that businesses most exposed to retailing (retail & wholesale trade) have consistently been pessimistic about the outlook. This was also reflected in the national accounts. Wholesale trade (–0.6%qtr, –1.4%yr) contracted in the quarter and year, while retail trade posted a small 0.3% quarterly gain, but was still down 0.2% in annual terms.

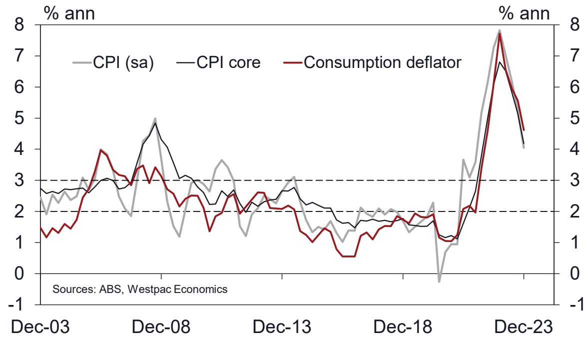
On the other side of the ledger, industries providing essential goods and services, such as healthcare & social assistance (0.5%qtr), and electricity, gas, water & waste services (0.9%qtr) were higher. Other services – which is a mix of services such as vehicle repair & maintenance, and personal care – was the strongest industry in the quarter, up 1.4%qtr, 5.6%yr.

Business services (representing five industries) grew 0.5%qtr, 1.8%yr. Four of the five industries grew in the quarter, led by professional, scientific & technical (1.2%), admin & support (0.7%), and financial & insurance (0.4%). Information media & telecommunications (0.1%) was broadly flat in the quarter after strong quarterly growth over the past two years, while rental, hiring & real estate services declined 0.7%, reflecting a pull-back in the hiring of machinery.

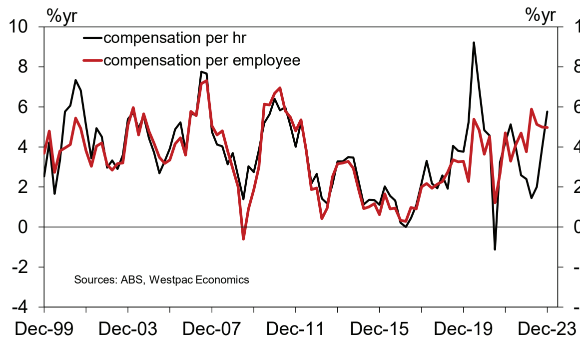
Elsewhere, the Voice referendum supported activity in public admin & safety, which rose 1.0% in the quarter.

Activity in the construction industry – which has faced a range of challenges in this cycle – grew 0.6% and has been steadily trending higher since lockdowns lifted in late 2021. Despite the growth, dynamics within the industry continue to exhibit varying conditions. Growth in the December quarter was driven by engineering work as non-dwelling construction grew, reflecting public infrastructure projects and work on the renewable energy transition. Conversely, activity in the dwelling construction sector continues to face challenges and was a drag in the quarter.

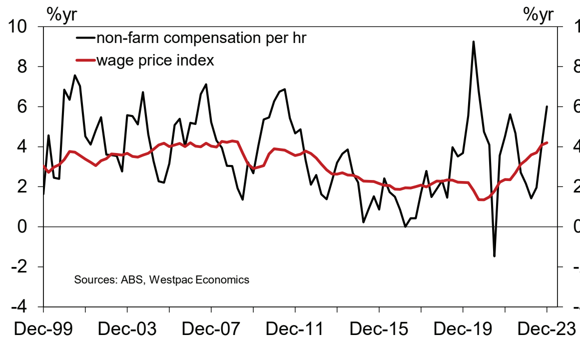
Consumer inflation off peak, but still too high



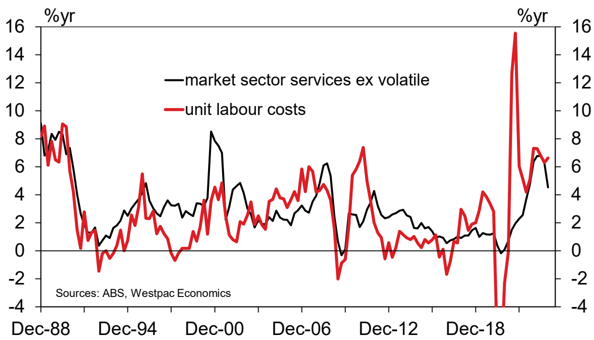
Workers compensation



Workers' compensation – NA vs WPI



Unit labour costs & services inflation



Agriculture, forestry & fishing (–3.4%qtr) was the weakest industry, as drier weather impacted farm production.

Income

The income measure of the economy – GDP (I) – grew 0.2% in the quarter, when excluding the impact of prices – i.e. in real terms. This was unchanged from 0.2% growth in the September quarter. In annual terms, real GDP (I) was 1.4% higher over the year.

The following analysis is based on the nominal measures of income in the national accounts.

In nominal terms, GDP (I) rose 1.4% in the quarter – matching the 1.4% growth rate in the previous quarter. In annual terms, growth in nominal GDP (I) has been running at between 4.0% and 4.5% over the past three quarters – this reflects a step down from very strong double-digit growth over 2022 and most of 2021.

Total factor income – i.e. GDP (I) minus taxes less subsidies on production & imports – rose 1.5% in the quarter and 4.2% in annual terms.

Total compensation of employees (COE) rose 1.4% in the quarter and 8.1% in the year. This was despite a quarterly fall in hours worked of 0.3%. Public sector COE growth was the stand-out – growing 3.3% in the quarter. On the other hand, private sector COE grew a more modest 0.9%. Increased employment activity to conduct the Voice referendum, in addition to higher growth in enterprise agreements – as indicated by the December quarter Wage Price Index – drove the gains. At an industry level, healthcare & social assistance (3.6%qtr) and public admin & safety (3.7%qtr) were the largest contributors to quarterly growth.

Gross operating surplus (GOS) for private non-financial corporations – i.e. corporate profits – was 2.9% higher in the quarter, after two consecutive quarters of contraction. In annual terms, this represented a 3.9% fall. The outcome reflected a rising in mining profits as higher commodity prices – as demonstrated in the increased terms of trade – supported mining company profits.

Gross mixed income (GMI) – representing profits of the unincorporated sector, including sole traders and farm businesses – fell 4.1% in the quarter. This has been weak over 2023 – contracting in three of the four quarters during the calendar year. In annual terms, GMI was down 8.6%.

Inflation (Justin Smirk)

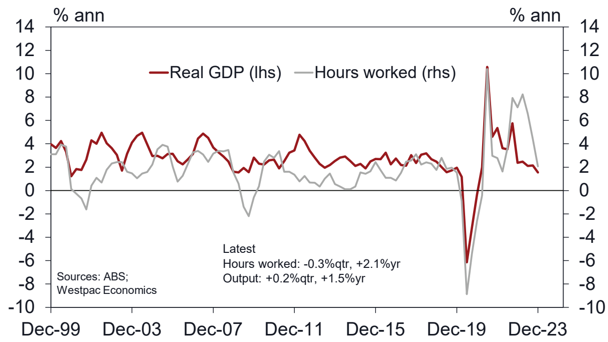
The National Accounts price indices presented a more mixed outcome on inflation compared to the December quarter CPI which reported a marked step down in the inflationary pulse.

The GDP implicit price deflator (IPD) lifted 1.1% in the quarter, following on from a 1.2% rise in the September quarter, resulting in the annual pace lifting from 2.4%yr in September to 2.8%yr in December.

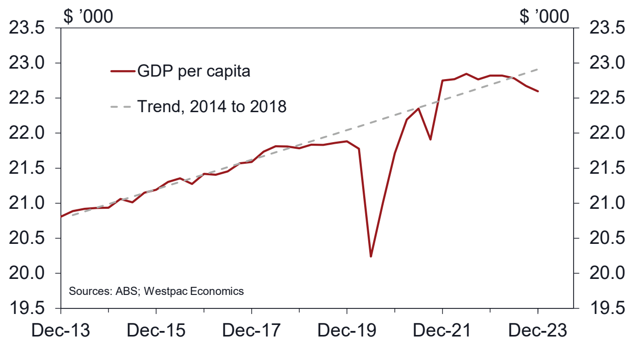
This is different to the CPI with the GDP IPD reporting a –1.2% decline in the June quarter compared to a 0.8% increase in the CPI. Readers may remember that the terms of trade can have a significant impact on the GDP deflator and the larger the contribution from international trade, the larger the impact the terms of trade has on the GDP IPD. In the June quarter, the terms of trade fell –7.0% with a further –2.1% fall in September to then lift 2.3% in December.

The Domestic Final Demand deflator (DFD), which measures domestic prices, gained 1.0% in December, a slight moderation from the 1.2% increase in September taking the annual pace down from 5.2%yr in September to 4.6%yr in December. While it may be running a bit faster than the CPI, which was 4.1%yr in December, the DFD deflator has seen a steady moderation in annual inflation since peaking at 7.3%yr in December 2022.

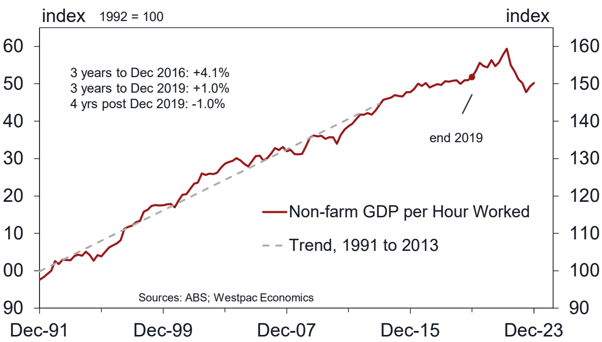
Hours worked: declined in Q4, down 0.3%



GDP per capita



Australia: labour productivity



The Gross National Expenditure deflator (GNE), which is immune to any price impact from changes in the terms of trade, lifted just 0.6% in December, a marked step down from the 1.7% increase in September, taking the annual pace down to 4.3%yr from 5.3%yr in September and the recent peak of 7.3%yr in December 2022. The annual pace in the CPI peaked at 7.8%yr in December 2022.

The Household Final Consumption Expenditure deflator (HFCE) gained 0.8% in the December quarter, down from 1.4% in September and 1.3% in June. This saw the annual pace of HFCE inflation ease to 4.6%yr in December from 5.6%yr in September and the recent peak of 7.7%yr in December 2022.

Compare that to the seasonally adjusted CPI (as the HFCE deflator is also seasonally adjusted) which lifted 0.7% in December and 1.0% in both September and June. The annual pace moderated to 4.0%yr from 5.2%yr in September and the recent peak of 7.8%yr 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.

As such, it is interesting to note that in December HFCE annual inflation was running a touch faster at 4.6%yr compared with the seasonally adjusted CPI at 4.0%yr. This could be indicative of household having a lack of cheaper alternatives to substitute to and, as such, would be part of the explanation for why consumption remains somewhat anaemic.

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 gained 1.4% in the quarter, a somewhat more moderate – but still solid – increase compared to the outsized 2.8% increase in September (which matched an outsized gain in the September quarter Wage Price Index (WPI) due to a larger than usual increase in awards/minimum wage) and the 1.6% increase in June. As a result, the annual pace continued to moderate from 9.1%yr in June to 8.4%yr in September and 8.4%yr in December. The recent peak in the annual pace of total employee compensation was 11%yr in September 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 and the nature of employment relationships.

We can narrow this down a bit more by looking at compensation per hour worked. Non-farm compensation per hour worked gained 1.5% in the December quarter, a moderation from the 3.5% surge in September (again due to the larger than usual increase in awards/minimum wage) but stronger than the 0.2% contraction in June. As such, the annual pace increased from a recent low of 1.4%yr in March to 2.0%yr in June, 4.0%yr in September and 6.0%yr in December.

This compensation per hours worked measure should be more in-line with the WPI. However, it's a far more volatile measure of labour costs and it is not unusual for it to temporarily surge well above the annual pace of the WPI which was running at 4.2%yr in the December quarter.

Labour productivity, measured as GDP per hour worked, rose 0.5% in December, a modest build on the 1.0% increase in September but still an improvement on the five negative prints from June 2022 through to June 2023. As such, GDP per hour worked is now down just 0.5% in the year to December, an improvement on the dismal –5.2%yr in March 2023.

Looking at the market sector, hours worked declined 0.5% in December resulting in a 0.6% increase in market sector GDP per hour worked building on the 0.8% increase in September. As such, GDP per hour worked in now up 1.3% to December, the first annual increase in this measure of productivity since March 2022.

Bringing this all together with unit labour costs (ULC), which measures the labour cost to produce one unit of GDP output, lifted 1.3% in December adding to the 2.2% increase in September. This saw the annual pace lift from 6.3%yr to 6.6%yr but it still down from the peak of 7.3%yr in June 2023. This lift in ULC inflation is something the RBA is watching closely as it is a key source of domestic inflationary pressure.

However, real non-farm unit labour costs (which are ULC deflated by the GDP deflator) fell –0.3% in December, compared to a 1.0% increase in non-farm nominal ULC, to see the annual pace ease back to 3.2%yr from 3.6%yr in September and a recent peak of 4.7%yr in June. This suggests firms have been able to pass on a large share of the increase in wage costs but even then, margins appear to be under a bit more pressure than they were in 2022 when real non-farm ULC inflation was negative.

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