OPTIMAL ECONOMICS

Weekly Economic Update

The war in Iran restarts as Australia's growth prospects are downgraded … again

There was little mainstream economic data released in Australia this week, but plenty of other developments to keep economists interested. Most of the news was bad.

The US started bombing Iran again in response to what the Trump Administration claimed were Iranian attacks on cargo ships and tankers attempting to pass through the now "open" Straight of Hormuz. The negotiated "ceasefire" didn't last long, and the resumption of open hostilities makes working through the details of an enduring agreement even more challenging. Predictably, oil prices soared.

On Wednesday, the Washington-based International Monetary Fund (IMF) downgraded expected growth for the world economy this year to 3.0% – and that was before the bombs started falling again. The IMF trimmed expected growth for Australia to just 1.9% (down from 2% previously). That puts us in the bottom half of performers for the 30 economies the IMF forecasts. But the IMF slightly upgraded expected growth for China and for world growth in 2027 (see chart over the page).

Back home, public remarks on Wednesday by the RBA's chief economist focussed on our lingering inflation problem and what might be causing it. Sarah Hunter said that "expansionary" economic policy had contributed to ongoing price pressures.

That position is uncontroversial and is widely accepted by most economists, but something the federal Government cannot bring itself to admit. But it's clear in the Budget papers that expansionary fiscal policy, including by the states, is adding to aggregate demand at a time of constrained supply. Guess what happens next?

Dr. Hunter also said Australia may need a period of higher unemployment to keep a lid on inflation expectations, which already have become untethered. That's also an uncontroversial view, but her boss the Governor tried similar language a while back and it didn't go down well, particularly with the unions.

But it's a truism of the famous Phillips Curve that presents the stable trade-off between inflation and unemployment. The bottom line is that interest rates here probably need to rise again.

Also on monetary policy, across "the ditch", the RBNZ raised the cash rate a quarter point on Wednesday, the first hike there in three years. NZ's cash rate is lower than Australia's but, like us, they have an underlying inflation menace that has persisted through the big fall in petrol prices since the first "end" of the war in Iran. There probably will be more rate hikes in New Zealand, too.

Australia and our Kiwi neighbours sit together in another unwanted pairing published this week by the OECD. It shows Australia and NZ suffering the largest falls in real wages among OECD countries over the last five years. This partly reflects our terrible productivity performance (our worst decade in sixty years!). The OECD rates Australia as the fourth worst for productivity growth, behind only the UK, Japan and Italy. NZ wasn't much better.

Finally, the correction in the Australian housing market continues, thanks to the combination of the RBA's three rate hikes earlier this year and the latest unhelpful tax changes. Auction clearance rates in Sydney

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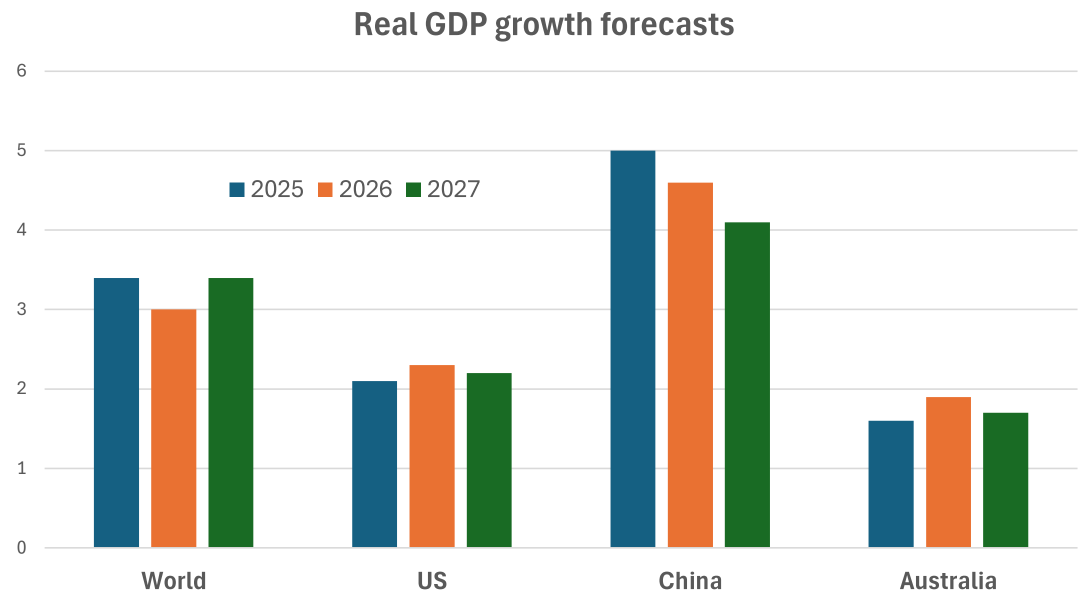
and Melbourne were below 50% for the third straight weekend, a sure sign that house price declines will continue.Dwelling commencements plunged 11% in the March quarter, albeit after a big rise in Q4.



Source: International Monetary Fund (IMF)

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