OPTIMAL ECONOMICS

Weekly Economic Update

Labour market still running hot … means interest rates probably need to rise again

Australia's labour market is in rude health according to the June jobs report released on Thursday. There were more than 76,000 jobs created last month (most of them part time), enough to keep the jobless rate marooned at 4.4%. The ever-expanding, publicly funded care sector is one reason for this strength, but so too is our lousy productivity. That is, firms seeking to lift output must hire new workers because the productivity lemon already has been squeezed.

The persistent resilience of the jobs market is good news, but it will make Reserve Bank officials even more nervous. Many of the resulting out-sized wage gains are untethered from productivity, especially in the public sector. This is inflationary, as is the resumption of hostilities in in the Middle East war and the closure of the Straight … again. Remember, core inflation here already is above target … and has been accelerating, despite the RBA's three rate hikes.

Next week's Q2 inflation report on Wednesday will capture the early price impact of the war, including the initial painful spike in petrol prices. But crude oil prices have re-surged 25% in recent weeks to a 6-week high, so local petrol prices will spike again. Futures markets price in only around a one-in-four chance of a rate hike on August 11, but the chances of a hike later this year are rising.

A complication for the RBA is the ongoing correction in the housing market. Auction clearance rates last weekend slipped back below 50%, which means more falls in house prices. This will unleash negative wealth-effects and undermine confidence. Consumer confidence improved last week but remains at recession-like lows. It's bleak out there.

Meanwhile, there was an unlikely public pairing this week by a former RBA Governor and former union heavyweight, not often comfy bedfellows. But Phil Lowe and Bill Kelty each lamented Australia's terrible productivity and our falling living standards. They called out the lack of urgency on reforms that could prevent our apparently inevitable slide. Is anyone in Canberra listening?

On our living standards, there was reporting this week that Australia's living standards are the worst in 100 years. That's wrong – no horse and buggy drivers back in 1910 had access to smart-phones, air-conditioning and Seinfeld. *Growth* in living standards (not the level) is the weakest in decades, as the chart below shows, measured by per capita GDP. And the tilt towards mediocrity over recent decades is striking - the "worm" is all but horizontal this decade.

Overseas, there were two major developments that could have lasting implications for Australia. First, President Trump slapped a new 50% tariff on most imports from Canada. Not only does this unleash more global inflation pressure, it further undermines the push to dismantle barriers in favour of open trade, which has lifted millions of people out of poverty.

Second, the New British PM took office hinting at wanting flexibility on existing rules related to borrowing and spending. He also claimed to need "a little more" from already battered taxpayers to fund his big-spending promises, which include more cost-of-living relief. Bond markets hated it, with yields rising, including here in Australia.

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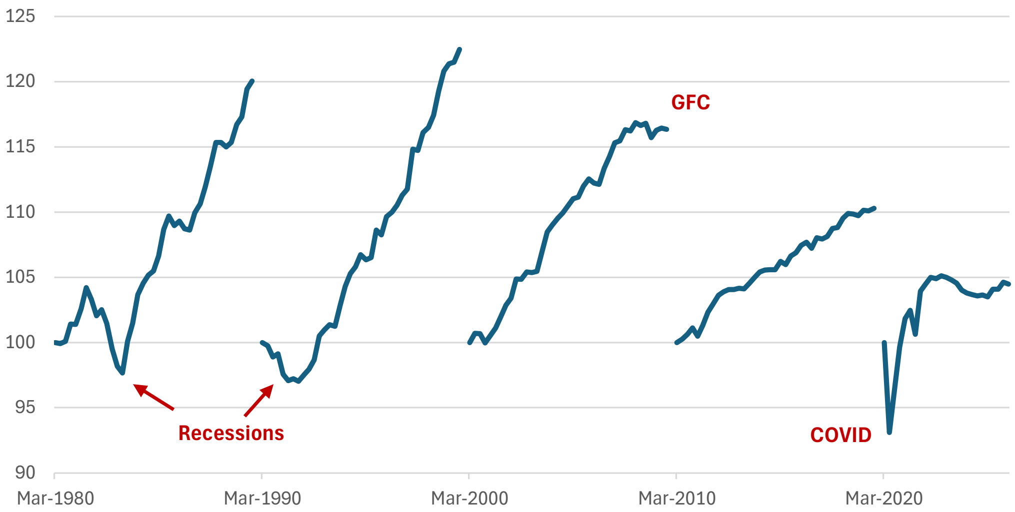
Per capita GDP by decade, constant price, level



Source: ABS, Optimal Economics.

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