

# Australian Economic Comment

Free to View -  
Economics

## Dismal productivity likely to delay rate cuts

Australia

- ◆ The market is all a-flurry with excitement about the prospect of central bank rate cuts. We suggest RBA observers should cool their engines. We see the RBA as likely to be one of the last of the developed economy central banks to deliver cuts, reflecting a range of factors. These include that the RBA was one of the last to start hiking, lifted rates by less than many others and that inflation is falling more slowly in Australia than in, say, the US. A deeper factor at work is that Australia's productivity performance in the post-pandemic period has been one of the poorest across the developed world (see chart). This has meant that growth in unit labour costs (wages adjusted for productivity) is well in excess of what is consistent with the RBA's 2-3% inflation target. A policy focus on the supply-side is needed. If productivity can be improved, rate cuts could be considered sooner.

**Paul Bloxham**  
Chief Economist, Australia,  
New Zealand & Global  
Commodities  
HSBC Bank Australia Limited

**Jamie Culling**  
Economist, Australia, NZ &  
Global Commodities  
HSBC Bank Australia Limited

First, the good news. Inflation has peaked and is heading in the right direction. It has also fallen a little faster than the RBA was forecasting back in November 2023 (although it is on a similar path to the RBA's forecast in August 2023). Given this, it is all but certain that the RBA will choose to hold its cash rate steady, at 4.35%, when it meets this week.

With the rate-hiking phase likely to be finished, the market has rapidly shifted to pricing cuts, following developments offshore, particularly in the US – perhaps a bit too rapidly, in our view (see *Five reasons why the RBA may not cut rates in 2024*, 8 January 2024).

It seems likely to us that rate cuts for Australia are quite some time away.

Start with the fact that, although Australia's inflation has eased, it is still well above the RBA's 2-3% target band.

Indeed, as a point of comparison, core inflation in Australia is still much further above the RBA's inflation target, than US core inflation is above the Fed's target. Over the year to Q4 2023, Australia's trimmed mean ran at 4.2% y-o-y, and even in the last six months of 2023 its annualised rate was 4.1%, well above the 2.5% midpoint of the RBA's target band (see *The RBA Observer: Good progress, but it's too early to talk about rate cuts*, 2 February 2024). By comparison, the US core PCE was 2.9% y-o-y in December and 1.9% six-month annualised, compared with the Fed's inflation target of 2%.

The key factors supporting elevated Australian core inflation are the domestic components, particularly rents, utilities, and insurance, all of which may prove to be sticky: rents, by a hard-to-fix housing shortage; energy, by the ongoing costs of the energy transition; and insurance, by the impact of climate change on making the weather more erratic.

*This is a Free to View version of a report with the same title published on 7-February-2024. Please contact your HSBC representative or email [AskResearch@hsbc.com](mailto:AskResearch@hsbc.com) for more information.*

**Disclosures & Disclaimer:** This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it.

**Issuer of report:** HSBC Bank Australia Limited

**View HSBC Global Research at:** <https://www.research.hsbc.com>

More broadly, services inflation is still running strongly, though it has eased from its peak.

The deeper problem here may be that productivity has been weak in Australia recently, and, as the chart below shows, much weaker than in much of developed world (see *Australia's productivity problems*, 10 August 2023).

Weak productivity growth has occurred at the same time as annual wages growth has picked up, from running at around 2% pre-pandemic to 4% recently. Wages growth of 4% would normally be consistent with the RBA's 2-3% inflation target if productivity were rising at 1-2% year. Instead, productivity has *fallen* by 2% over the past year. As a result, unit labour costs are running at 6.4% y-o-y, which is far too high for the RBA's inflation target.

Of course, as labour is a key input into services, high unit labour cost growth is more apparent in supporting services inflation, and likely to add to its 'stickiness'.

Why has productivity been so poor in Australia post-pandemic?

A possibility is that the exceptionally tight labour market at the end of the pandemic, exacerbated by the closed border, has meant a lack of skills in the economy and that has weighed on productivity. Or that the tight jobs market drive increased labour hoarding.

Another possibility is that changed workplace behaviour has played a role. Perhaps increased work from home has weighed on productivity.

However, labour markets have been tight across the developed world. Increased work from home has also been a key feature in lots of locations. And yet, Australia's productivity performance is distinctly worse than elsewhere.

A particularly stark contrast can be drawn between US productivity growth and Australia's. Australia's weaker performance is also more similar to Europe and New Zealand.

In short, the US economy appears to be getting the sort of cyclical upswing in productivity that often follows a recession, but this does not appear to be the case in Australia. A possible explanation is that the pandemic related policy measures taken to keep workers in their jobs and protect businesses from insolvency were much stronger in Australia, New Zealand and much of Europe, than they were in the US. As a result, many workers retained their jobs through the pandemic and corporate insolvencies were exceptionally low. But this also meant that the economy was not shaken up as much as during a typical recession in Australia.

Our colleague, Fabio Balboni, recently wrote about this question of cyclical versus structural weakness in productivity for Europe (see *Cyclical or structural? Weak eurozone productivity and what it means*, 2 February 2024). Fabio noted that there is limited evidence of labour hoarding being the cause and that the 'chances of a bounce-back in productivity in the near-term seem tiny', which is likely to support elevated underlying inflation pressures in Europe.

For Australia, recent work by local research institute, e61, led by Dan Andrews, points out that although Jobkeeper was highly successful in keeping workers in their jobs, over time, as the economy reopened, 'the wage subsidy started to tie individuals to less productive firms translating into weaker income growth and poorer skills use'.

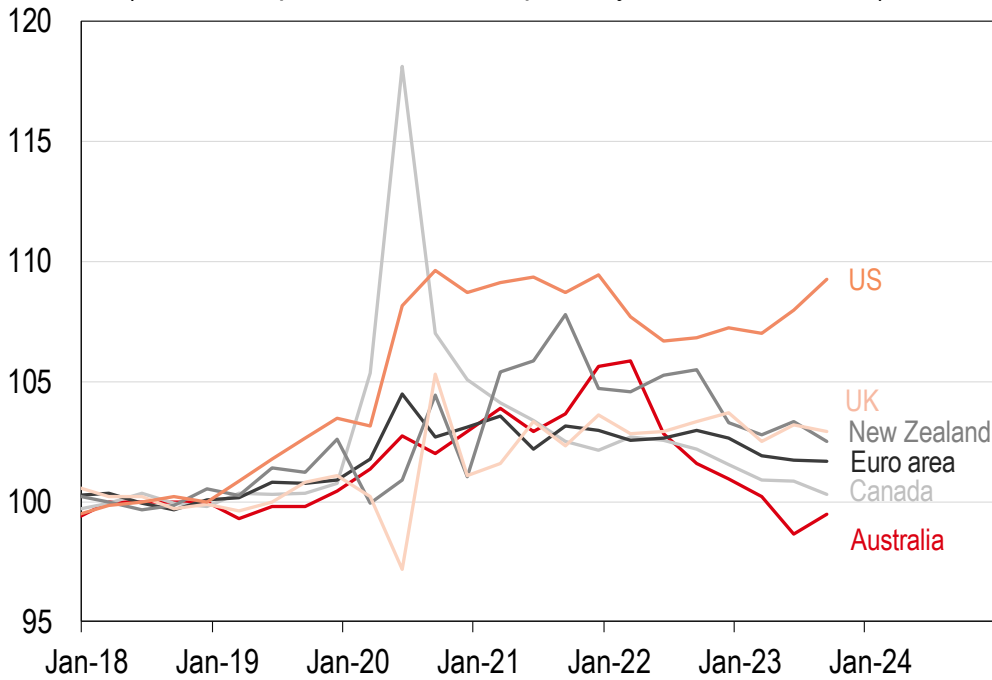
We wrote about the possibility that the extraordinary forbearance offered through the pandemic, and lack that of a policy focus on using the 'crisis as an opportunity' to do reform, was potentially a missed opportunity (see *If the pandemic doesn't shock Australia to do reform, what will?*, 6 April 2022).

As we pointed out in our more recent outlook piece for 2024, the best thing for fiscal policymakers to focus on would be supply-side reform that lifts productivity (see *Australia in 2024: Managing an economy at full employment*, 22 January 2024). This would help to lift living conditions, but also reduce the cost of living (aka inflation) sooner.

Without a lift in productivity, rate cuts may be a distant prospect.

Chart 1. Australia's productivity performance post-pandemic has been dismal

### Measured Labour Productivity (Real GDP per hour worked, quarterly, index 2018 = 100)



Source: OECD

Reference

e61 Institute, 'What can jobkeeper teach us about job retention schemes?', by Dan Andrews, Matt Nolan, and Lachlan Vass. *E61 Micronote 15*, 20 November 2023.

# Disclosure appendix

The following analyst(s), who is(are) primarily responsible for this document, certifies(y) that the opinion(s), views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Paul Bloxham and Jamie Culling

This document has been issued by the Research Department of HSBC.

HSBC and its affiliates will from time to time sell to and buy from customers the securities/instruments, both equity and debt (including derivatives) of companies covered in HSBC Research on a principal or agency basis or act as a market maker or liquidity provider in the securities/instruments mentioned in this report.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking, sales & trading, and principal trading revenues.

Whether, or in what time frame, an update of this analysis will be published is not determined in advance.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at [www.hsbcnet.com/research](http://www.hsbcnet.com/research).

## Additional disclosures

- 1 This report is dated as at 5 February 2024.
- 2 All market data included in this report are dated as at close 4 February 2024, unless a different date or a specific time of day is indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking, Principal Trading, and Research businesses to ensure that any confidential or price sensitive information is handled in an appropriate manner.
- 4 You are not permitted to use, for reference, any data in this document for the purpose of (i) determining the interest payable, or other sums due, under loan agreements or under other financial contracts or instruments, (ii) determining the price at which a financial instrument may be bought or sold or traded or redeemed, or the value of a financial instrument, or (iii) measuring the performance of a financial instrument or of an investment fund.

# Disclaimer

---

This document has been issued by HSBC Bank Australia Limited, which has based this document on information obtained from sources it believes to be reliable but which it has not independently verified. Neither HSBC Bank Australia Limited nor any member of its group companies ("HSBC") make any guarantee, representation or warranty nor accept any responsibility or liability as to the accuracy or completeness of this document and is not responsible for errors of transmission of factual or analytical data, nor is HSBC liable for damages arising out of any person's reliance on this information. The information and opinions contained within the report are based upon publicly available information at the time of publication, represent the present judgment of HSBC and are subject to change without notice.

This document is not and should not be construed as an offer to sell or solicitation of an offer to purchase or subscribe for any investment or other investment products mentioned in it or to participate in any trading strategy. It does not constitute a prospectus or other offering document. Information in this document is general and should not be construed as personal advice, given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on it, consider the appropriateness of the information, having regard to their objectives, financial situation and needs. If necessary, seek professional investment and tax advice.

The decision and responsibility on whether or not to purchase, subscribe or sell (as applicable) must be taken by the investor. In no event will any member of the HSBC group be liable to the recipient for any direct or indirect or any other damages of any kind arising from or in connection with reliance on any information and materials herein.

Past performance is not necessarily a guide to future performance. The value of any investment or income may go down as well as up and you may not get back the full amount invested. Where an investment is denominated in a currency other than the local currency of the recipient of the research report, changes in the exchange rates may have an adverse effect on the value, price or income of that investment. In case of investments for which there is no recognised market it may be difficult for investors to sell their investments or to obtain reliable information about its value or the extent of the risk to which it is exposed. Some of the statements contained in this document may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors.

This document is for information purposes only and may not be redistributed or passed on, directly or indirectly, to any other person, in whole or in part, for any purpose. The distribution of this document in other jurisdictions may be restricted by law, and persons into whose possession this document comes should inform themselves about, and observe, any such restrictions. By accepting this report, you agree to be bound by the foregoing instructions. If this report is received by a customer of an affiliate of HSBC, its provision to the recipient is subject to the terms of business in place between the recipient and such affiliate. The document is intended to be distributed in its entirety. Unless governing law permits otherwise, you must contact a HSBC Group member in your home jurisdiction if you wish to use HSBC Group services in effecting a transaction in any investment mentioned in this document.

Certain investment products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. Investors should consult with their HSBC representative regarding the suitability of the investment products mentioned in this document.

HSBC and/or its officers, directors and employees may have positions in any securities in companies mentioned in this document. HSBC may act as market maker or may have assumed an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell or buy securities and may also perform or seek to perform investment banking or underwriting services for or relating to those companies and may also be represented on the supervisory board or any other committee of those companies.

From time to time research analysts conduct site visits of covered issuers. HSBC policies prohibit research analysts from accepting payment or reimbursement for travel expenses from the issuer for such visits.

In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (ABN 48 006 434 162 AFSL No. 232595).

© Copyright 2024, HSBC Bank Australia Limited, ALL RIGHTS RESERVED. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of insert issuing entity name. . MCI (P) 061/09/2023, MCI (P) 073/10/2023, MCI (P) 007/10/2023, MCI (P) 008/01/2024

---