Cliff Notes: balancing risks to growth and inflation, a worthwhile pursuit

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Australia’s Q2 GDP came in slightly above expectations at 0.4%, 2.1%yr. Upward revisions to earlier data notwithstanding, there has been a clear loss of momentum from H2 2025 to H1 2026, from an annualised pace of 2.8% to 1.5%. Household consumption grew just 0.4% in Q2, and this gain was principally due to a surge in EV sales (0.27ppts of the 0.4% gain) in response to the Middle East conflict’s energy price spike. Highlighting the financial resilience of the consumer, however, a stronger-than-expected lift in real disposable incomes allowed the savings ratio to edge higher in the quarter despite higher interest and tax payments. Public demand was also soft in Q2, up just 0.2% as cost-of-living support rolled off and the infrastructure work program, most notably in NSW and Victoria, passed its peak. Business investment meanwhile edged lower, though solid non-residential construction tied to data centres, renewables and related infrastructure implies the pipeline of work remains in an uptrend. On housing, Cotality home prices fell 0.9% in August after downwardly revised 1.2% and 0.9% declines in June and July. Prices are now 3.6% below their March peak nationally, and down 4.6%/4.7% in Sydney/ Melbourne. On a rolling 3-month basis, the volume of sales is 15% lower over the year. Unsurprisingly, the moderation in housing credit growth is gathering pace. That said, a substantial pipeline of approved projects means housing construction should remain a positive force for GDP for the foreseeable future. Towards the end of the forecast horizon in 2028 though, risks are growing, with dwelling approvalsdeclining 3.6% in July. On external trade, Q2 was not as weak as initially feared. The current account deficit widened by just $1.8bn to $27.2bn and net exports added 0.1ppts to GDP. Resource exports rebounded after disruptions from cyclones, but there was also a significant pull-back in tourism spend by Australians overseas due to flight cancellations related to the Middle East conflict. Talking About Trade provides further detail on these sub-plots and the implications. Those with a particular interest in agriculture and related trade should also dig into our latest Quarterly Agriculture Report. Across the Tasman, at its September meeting, the RBNZ lifted the OCR by 25bps to 2.75% as expected. The RBNZ’s revised OCR forecasts are little changed from May and signal a pause in October before a 25bp hike to 3.00% in December. Justifying this cautious approach, a majority of MPC members see upside risks to inflation, but all see downside risks to growth. Westpac continues to expect a steady but determined tightening cycle, with the next 25bp hike not forecast until December but a peak of 4.00% seen in Q3 2027. Over in the US, during his address to the Jackson Hole Symposium last weekend, Chair Warsh emphasised the Committee’s focus on inflation risks and willingness to tighten further if necessary. To make his point, Chair Warsh focused attention on the most elevated of the US’ major inflation benchmarks, headline PCE inflation at 3.7%yr and 4.1% on a six-month annualised basis, as well as the breadth of price gains, which remains well above pre-pandemic levels. Chair Warsh then made clear that the Committee “must be confident that underlying inflation is moving to our objective, clearly and at sufficient speed”…. “Otherwise, we have work to do.” The FOMC remaining on hold from here requires evidence of sequential disinflation month-on-month from next week’s August report. Without this, the market will likely fully price a hike for the September meeting, and a follow-up come November. Overnight Federal Governor Waller made a similar point, noting that: if "there is continued progress toward our 2% goal, then I am willing to support holding the policy rate at its current level"; but "if inflation comes in hot, I would consider a rate hike". While qualitative in nature, the Beige

Book was arguably the most informative US release of the week. Since July, employment growth has remained subdued, with seven districts reporting only "slight" or "modest" growth and five no change. Upstream price pressures persist, with "input price pressures notably elevated in manufacturing and construction"; that said, "heightened price sensitivity among customers" continued to limit firms' ability to pass through these higher costs. It is one thing for producer price inflation and capacity constraints to bolster input prices, but to hold up the CPI/PCE, these pressures must be passed through to the consumer basket. Along with stability in the labour market, consumers unwillingness to accept full passthrough is why we continue to believe the FOMC can remain on hold through 2028 if they can weather the immediate angst over recent inflation data. If the Committee instead choose to hike in September and/or November, corrective cuts may be required in late-2027 or into 2028. A prudent approach to policy was apparent in Canada this week, the Bank of Canada’s Governing Council voting to remain on hold. In their words, the global economy has shown resilience and "Canadian economic activity strengthened in the second quarter”. But "demand for labour remains subdued and indicators point to continued excess supply ". Also, like in the US and Australia, "there has been little evidence of higher energy prices spreading to other components of inflation". As for the RBNZ and other developed-world central banks, balancing the risks around growth as well as inflation is a challenge for the Bank of Canada, but one worth pursuing.

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