1. The International Environment

High inflation remains the key challenge facing most central banks. After earlier declines, headline inflation rates have edged up again in many economies in recent months, driven mainly by higher fuel prices. Core inflation has eased further in year-ended terms, but progress has been gradual, largely because strength in core services inflation has been persistent. In addition to the tragic human toll, conflict in the Middle East is also a significant source of uncertainty for the global outlook. It presents a potential upside risk to inflation if the conflict were to disrupt energy supply in the region. Separately, the El Niño weather pattern may also push up food price inflation.

Economic activity has held up better than generally expected in a number of advanced economies, particularly in the United States. This is despite the cumulative effects of tighter monetary policy. This resilience reflects the combined effects of fiscal policy, tight labour markets and healthy household balance sheets. Growth in Europe has slowed more clearly, and growth in G7 economies is forecast to slow further in the year ahead and remain below average through to at least 2025. The post-pandemic recovery in the services sector is now well advanced and so less likely to continue to drive economic growth in the period ahead. Business investment has been a key driver of economic growth in recent quarters, but investment intentions point to weaker business investment growth going forward.

Chinese economic growth has continued to recover over recent quarters from the pandemic disruptions to activity, but the recovery has been uneven and the level of activity remains below the trend expected prior to the pandemic. While household consumption has been recovering, demand for property remains very weak. Combined with financial stress among real estate developers, this has led to a persistent decline in residential real estate investment and prompted Chinese authorities to take further steps to stabilise the property market, as well as address local government debt risks. Policy support for infrastructure investment this year has helped to bolster overall investment, so steel production in China has been steady. This has supported the price of iron ore (which is a key Australian export). The renminbi has also stabilised around multi-decade lows. Growth in China is expected to moderate in the next two years as the consumer recovery slows and the effect of stimulus measures fades.

Central banks in advanced economies have maintained or increased policy rates over recent months, in line with the prior expectations of market participants. Meanwhile, government bond yields at longer maturities have increased noticeably, led by US Treasuries, but they have also been quite volatile. In most advanced economies, government bond yields reached their highest levels in more than a decade in October, before declining of late. This has been accompanied by an appreciation of the US dollar and declines in the prices of riskier assets. Though global financial conditions have tightened moderately over this period, equity prices in the United States and Europe are still higher than a year ago, while corporate bond

spreads remain close to their long-term averages.

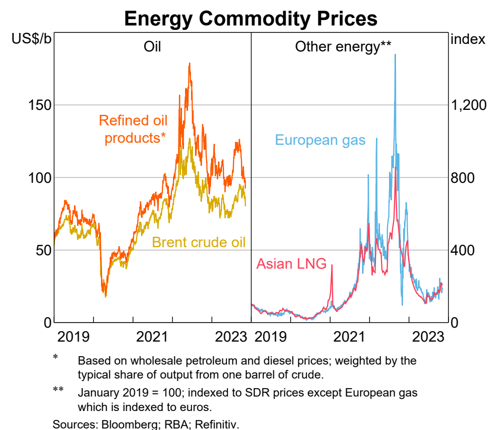
Most of the increase in longer term yields over recent months has been driven by higher real yields, with inflation expectations increasing only modestly. The rise in real yields is likely to reflect a number of factors, including: increased uncertainty around the economic and policy outlook; expectations of a larger supply of government bonds associated with sizeable fiscal deficits, most notably in the United States; the simultaneous reduction in central bank asset holdings; and market participants upgrading their estimates of the level of neutral interest rates. Policymakers at several central banks have suggested that the increase in longer term yields could reduce the need for policy rate increases if they result in a sustained tightening of financial conditions beyond that implied by expected policy rates. Most advanced economy central banks judge policy rates to be restrictive and that they will need to be kept at least around these levels for an extended period to bring inflation back to target. With the exception of Japan, market participants generally expect there will be some modest policy easing towards the middle of 2024.

Higher oil prices have put upward pressure on headline inflation, but core inflation has continued to ease, albeit gradually

Headline inflation has ticked up in many economies in recent months, largely because of higher fuel prices in the September quarter (Graph 1.1; Graph 1.2). While oil prices remain well below 2022 peaks, they have risen since June, following the extension of supply cuts by Saudi Arabia and Russia. LNG prices have increased significantly more recently due to the Israel–Tamar gas field shutdown and an increase in other supply risks heading into the European winter. By contrast, thermal coal prices have declined, partly due to relatively high inventories in Europe and China. The Hamas–Israel conflict and the related prospect of rising geopolitical tensions in the Middle East more broadly pose additional upside risk to energy prices. Global food price inflation has moderated in many economies over recent months but remains high; the El Niño weather pattern is an upside risk to the prices of some agricultural commodities over the year ahead.

Core inflation has continued to moderate gradually in advanced economies in year-ended terms. However, progress has been uneven, and monthly core inflation has edged higher in a few economies recently. Lower core goods price inflation has been the main driver of lower inflation in advanced economies (Graph 1.3). By

Graph 1.1

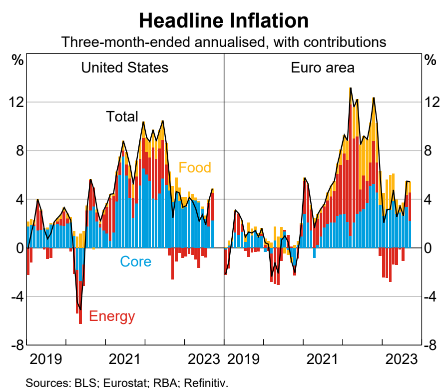


* Based on wholesale petroleum and diesel prices; weighted by the typical share of output from one barrel of crude.

** January 2019 = 100; indexed to SDR prices except European gas which is indexed to euros.

Sources: Bloomberg; RBA; Refinitiv.

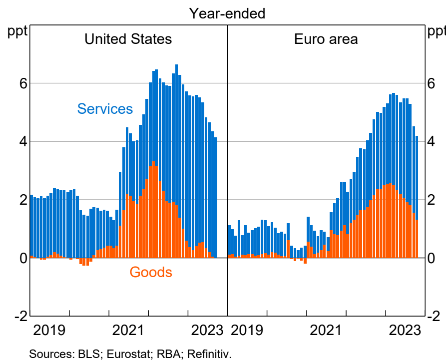
Graph 1.2

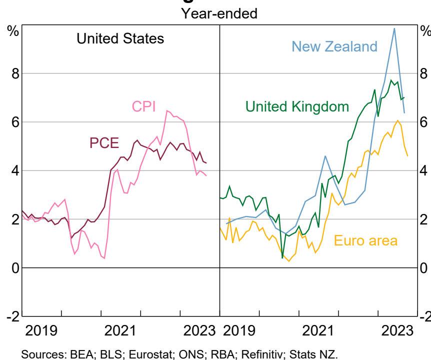


Sources: BLS; Eurostat; RBA; Refinitiv.

contrast, inflation in core services prices has eased by less in advanced economies, with a high degree of persistence in both shelter and other services prices.

Non-housing services inflation looks to have peaked but remains high in most advanced economies. This is consistent with strong demand for services relative to supply and is also reflected in still-tight labour markets (see below) (Graph 1.4). By contrast, rent price inflation is yet to ease and remains well above pre-pandemic norms in most advanced economies. The United States is a notable exception, with rental price inflation having eased materially over the past year, in line with an increase in the supply of housing and softer demand.

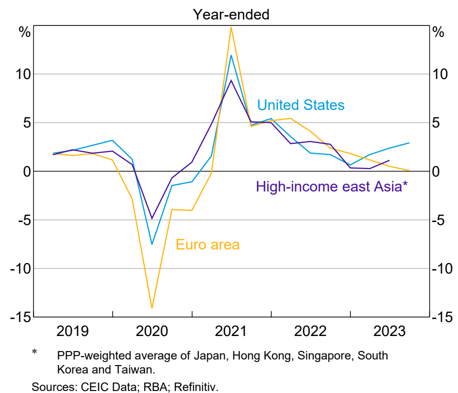




Economic activity has held up better than expected in some advanced economies, but timely data suggest that growth is waning

Growth in advanced economies has slowed, but by less than had been previously anticipated. GDP growth has been surprisingly resilient in the United States and in some high-income east Asian economies (including Japan and South Korea) in recent quarters, even though tighter monetary policy and cost-of-living pressures have continued to weigh on real incomes and demand (Graph 1.5). By contrast, economic growth has continued to slow in the euro area, with partial indicators suggesting this is also true in Canada and the United Kingdom.

The post-pandemic recovery in the services sector in advanced economies is well progressed and will not provide as much support to growth in the year ahead. Indeed, survey measures of services sector conditions have moved into contractionary territory in many advanced economies (Graph 1.6). Conditions in the manufacturing sector have also continued to deteriorate in Europe. Conversely, manufacturing sector conditions have recovered somewhat in the United States according to some measures and have held up more in east Asia, in part reflecting the resilience



in demand from the United States. In turn, this has seen export volumes from high-income east Asia stabilise over 2023. Exports from China have also stabilised, following sharp declines earlier in the year.

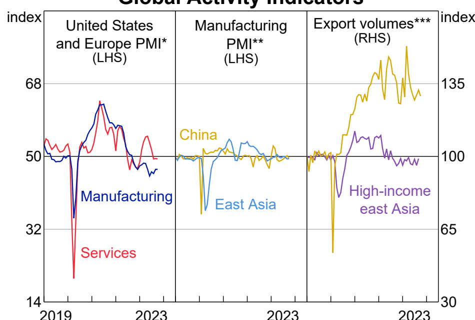
Resilient labour markets have continued to support household consumption, while business investment has been supported by government policy

Labour market conditions in advanced economies remain tight but have eased a little over the course of this year. Job vacancy-to-unemployment ratios are still high relative to historical norms but have declined from their peaks, suggesting some improvement in the balance between labour demand and supply (Graph 1.7). Consistent with this, wages growth remains high but has eased a little in a number of advanced economies; the United Kingdom remains a notable exception as high inflation continues to feature prominently in wage negotiations and put upward pressure on wages (Graph 1.8).

The resilience in labour markets has been a key factor supporting household consumption in advanced economies, notwithstanding the headwinds from tighter monetary policy. Strong nominal income growth and a diminishing drag from headline inflation saw growth of real household disposable income in year-ended terms turn positive in many advanced economies in the June quarter (and earlier in the United States) (Graph 1.9). In addition, household balance sheets remain healthy, with large accumulated savings balances in many economies and housing prices recovering. Household consumption growth has been especially strong in the United States. Although US households have been drawing down the extra savings that were accumulated during the pandemic in order to support consumption, recent data revisions show a larger stock of

Graph 1.6

Global Activity Indicators



* Purchasing Managers' Index; PPP-weighted average of the United States, euro area and the United Kingdom.

** Purchasing Managers' Index; east Asia is a PPP-weighted average of Japan, South Korea, Taiwan, Indonesia, Malaysia, Philippines, Thailand and Vietnam.

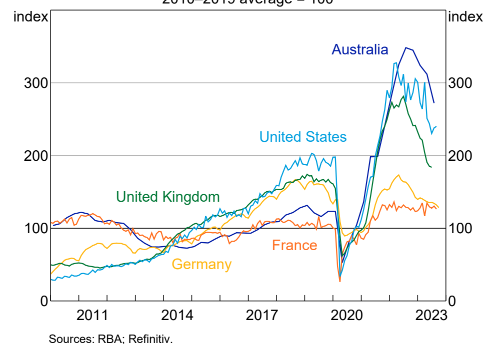
*** Merchandise exports; deflated using the United States import price indices for east Asia and China; high-income east Asia is a PPP-weighted average of Japan, South Korea, Taiwan, Singapore and Hong Kong.

Sources: CEIC Data; RBA; Refinitiv; S&P Global.

Graph 1.7

Vacancies-to-unemployment

2010–2019 average = 100

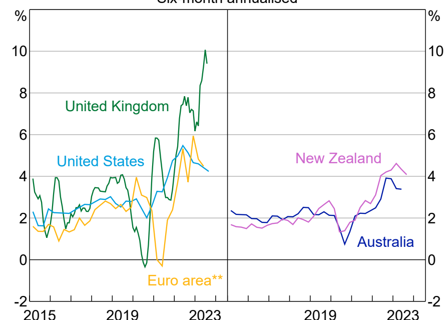


Sources: RBA; Refinitiv.

Graph 1.8

Wages Growth*

Six-month annualised



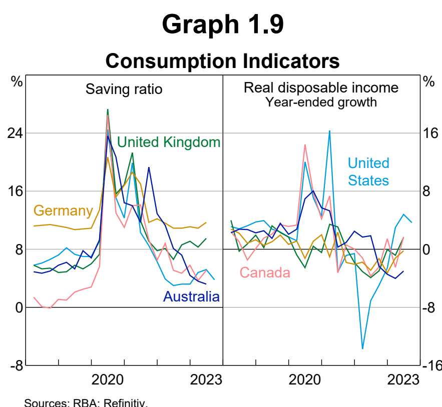
* Labour cost indices used where available; average earnings for the United Kingdom (compositionally controlled prior to April 2022).

** Year-ended.

Sources: BoE; RBA; Refinitiv.

savings is still available for consumption than previously thought. Overall, US households are saving a much smaller share of their incomes than was the case before the pandemic, but this is generally not the case in other advanced economies. Consistent with this, consumption growth has generally continued to slow, with below-trend growth in most other advanced economies in recent quarters.

Business investment has been a key driver of economic growth across several advanced economies in recent quarters (Graph 1.10). Business investment grew particularly strongly in the United States and the United Kingdom in the first half of the year, supported by substantial government support (e.g. tax incentives) as well as a post-pandemic catch-up in investment in transport and structures (e.g. warehouses). However, business investment intentions have been easing across several advanced economies, as tighter financial conditions and uncertainty about global growth weigh on the outlook; US business investment growth also stalled in the September quarter. Recent US policy initiatives such as the Inflation Reduction Act and the CHIPS and Science Act are designed to influence investment over longer time horizons and it is difficult to identify when they will have their greatest impacts on business investment growth.

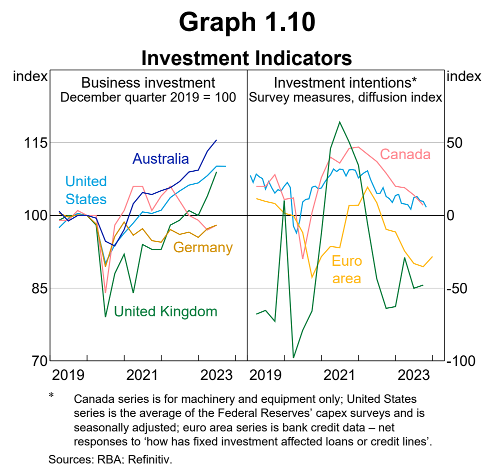


Chinese economic growth has picked up after a softer period in the middle of the year, but the property sector continues to weigh on activity

The Chinese economy continued to recover in the September quarter, but the level of GDP remains below the trend expected prior to the pandemic (Graph 1.11). The services (tertiary) sector has been the primary driver of growth in 2023, due to the removal of pandemic-related restrictions at the end of 2022. Consistent with this, urban household consumption continued to recover in the September quarter and the urban household saving rate declined (Graph 1.12). Much of the recovery in consumption has been driven by services, consistent with where inflation has picked up. Core goods inflation has been weak and fuel and food prices have declined (Graph 1.13).

Total fixed asset investment in China has been growing despite a persistent and marked decline in residential fixed asset investment. Private sector investment has been driven by a sustained expansion in manufacturing investment, while fiscal policy measures have driven growth in infrastructure investment (Graph 1.14).

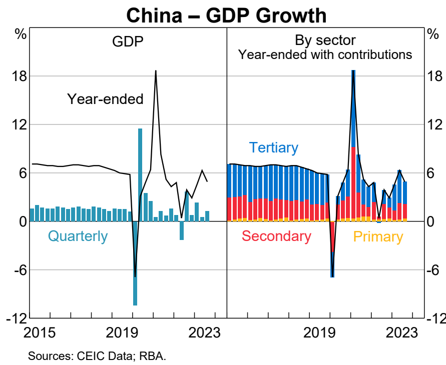
Conditions in the Chinese property sector remained weak in the September quarter, with



new housing sales, starts and investment all remaining at very low levels (Graph 1.15). Sales

Graph 1.11

China – GDP Growth

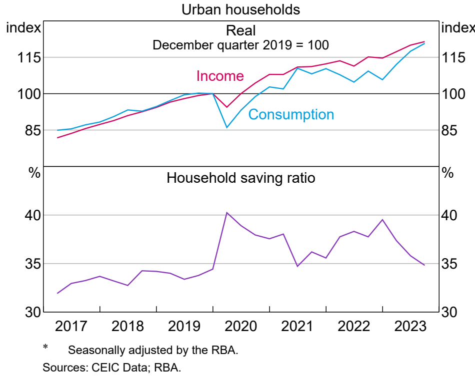


Sources: CEIC Data; RBA.

Graph 1.12

China – Household Consumption and Income*

Urban households



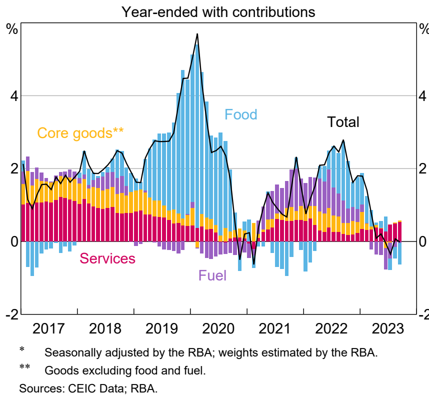
* Seasonally adjusted by the RBA.

Sources: CEIC Data; RBA.

Graph 1.13

China – Consumer Price Inflation*

Year-ended with contributions



* Seasonally adjusted by the RBA; weights estimated by the RBA.

** Goods excluding food and fuel.

Sources: CEIC Data; RBA.

in large cities have recently recovered a little in line with further policy easing, but it is not clear whether this will persist or lift buyer sentiment in smaller cities where the vast majority of new homes are sold. Aside from the direct impact of weak activity in the property sector, the continued stress on developers and flow-on effects to the financial system could weigh on economic growth in the medium term.

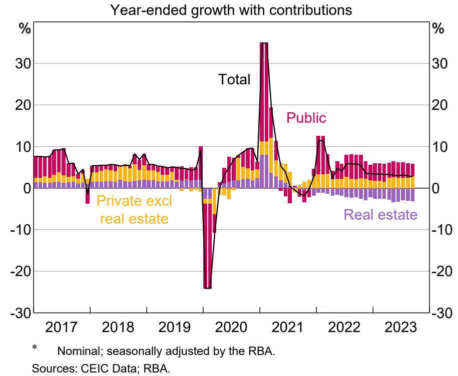
Chinese property developers remain under extreme stress

Chinese property developers' bond and equity prices have declined further over recent months, as weak demand for new housing continued to weigh on developers' earnings (Graph 1.16).

Graph 1.14

China – Fixed Asset Investment*

Year-ended growth with contributions

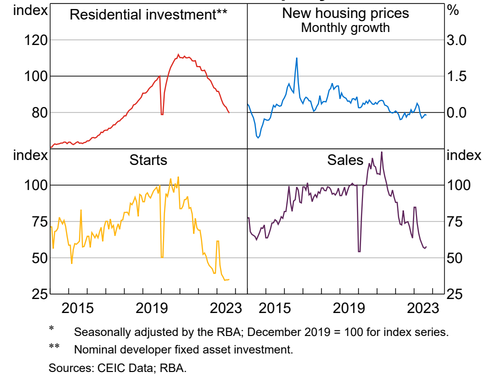


* Nominal; seasonally adjusted by the RBA.

Sources: CEIC Data; RBA.

Graph 1.15

China – Residential Property Indicators*



* Seasonally adjusted by the RBA; December 2019 = 100 for index series.

** Nominal developer fixed asset investment.

Sources: CEIC Data; RBA.

Private developers' financing conditions are especially challenging. They have little to no access to funding from capital markets and banks have been hesitant to extend loans as defaults have risen. Overall, more than half of large private developers (weighted by assets) have defaulted, and many others are likely to find it difficult to meet upcoming debt repayments. A prominent example is Country Garden – one of the largest private developers in China – which defaulted in October after missing an interest payment on a US dollar bond. Country Garden had previously warned it would be unable to meet upcoming payments and will now seek to restructure its debt.

Stress in the property sector has been contained thus far, but there are concerns about possible spillovers to other parts of China's financial sector. Defaults on shadow banking products, including trust loans and wealth management products, have increased further, and smaller regional banks with weaker capital adequacy positions remain particularly exposed to weak conditions in the property sector.[1]

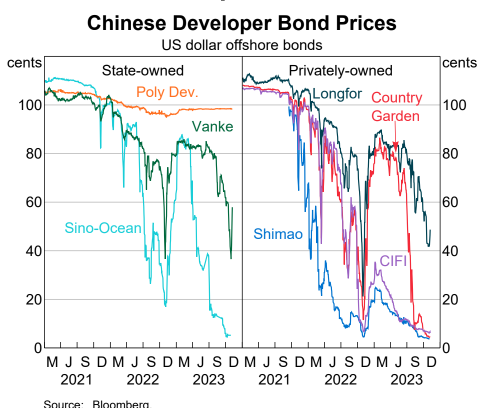
Chinese authorities have eased policy further

Chinese authorities have eased policy further to stabilise the property market and support the recovery more broadly. Key measures to support the property sector have included a further easing of household credit policies and purchase restrictions in large cities. In late October, central authorities also announced CNY1 trillion in additional borrowing to be transferred to local governments and spent in 2023 and 2024, at the same time raising the headline fiscal deficit in 2023 from 3.0 to 3.8 per cent of GDP. These transfers will support local government finances and should continue to support infrastructure investment in the near term.

The People's Bank of China (PBC) eased monetary policy modestly in September by lowering the reserve requirement ratio by 25 basis points for most banks (Graph 1.17). The additional liquidity allows banks to support a large volume of government bond issuance, including the accelerated issuance of local government special bonds, which typically fund infrastructure projects. In addition, following the PBC's guidance, banks have reduced interest rates on outstanding first-home mortgages (which make up around half of all housing loans). This is estimated to reduce the average mortgage rate paid on first-home mortgages by around 70 basis points, which is likely to support household consumption.

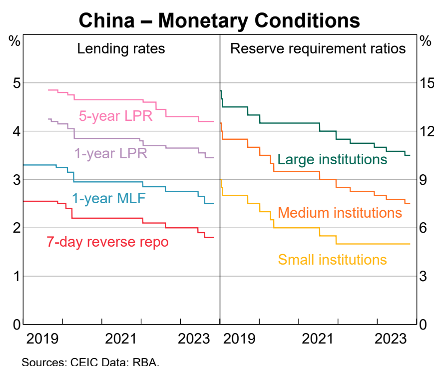
The renminbi has stabilised around multi-decade lows after depreciating by 6 per cent against the US dollar since March alongside

Graph 1.16



Source: Bloomberg.

Graph 1.17



Sources: CEIC Data; RBA.

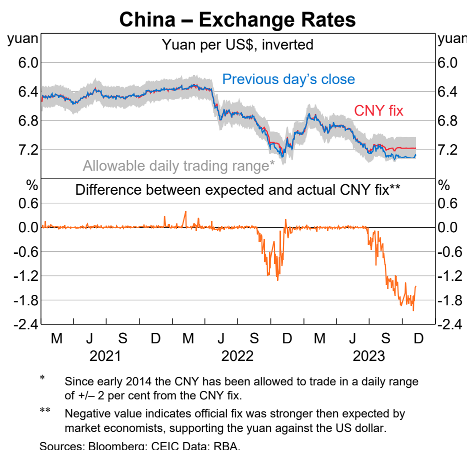
economic data that was better than the market expected and efforts by authorities to lean against the pace of depreciation (Graph 1.18). This has included the PBC setting the strongest 'CNY fix' – the midpoint of the permitted daily trading range of +/–2 per cent – for the renminbi since a survey of expectations began in 2018.

Chinese authorities have also announced measures to address local government debt risks. Several heavily indebted local governments have had limits imposed on additional financing and others have reportedly been allocated refinancing bond quotas, which can be used to repay the debt of local government financing vehicles (LGFVs). Though these quotas are modest relative to total outstanding LGFV debt, the refinancing program has raised expectations of further support, and the spread on LGFV bonds to Chinese government bonds has narrowed since its announcement.

World steel production has remained steady despite the weakness in the Chinese property sector, supporting iron ore and coking coal prices

Global steel production has remained steady, in turn supporting iron ore and coking coal prices over recent months (Graph 1.19; Graph 1.20; Table 1.1). Steel production in China has been broadly stable, with weak demand from the property sector offset by solid growth in infrastructure and manufacturing investment. Recent policy announcements by Chinese authorities, which are expected to support steel production in China in the near term, have supported iron ore prices further. Steady growth in steel production in India has also supported demand for coking coal, although India's share of world steel production remains small. Coking coal prices have increased significantly since the August *Statement*, partly because of supply disruptions in Australia (globally the largest exporter); these disruptions though have eased more recently.

Graph 1.18

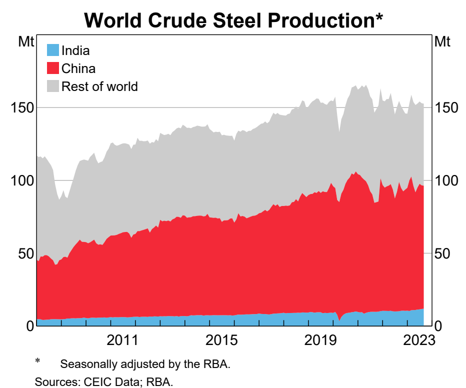


* Since early 2014 the CNY has been allowed to trade in a daily range of +/– 2 per cent from the CNY fix.

** Negative value indicates official fix was stronger then expected by market economists, supporting the yuan against the US dollar.

Sources: Bloomberg; CEIC Data; RBA.

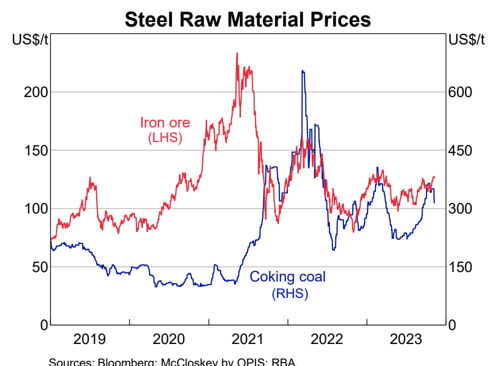
Graph 1.19



* Seasonally adjusted by the RBA.

Sources: CEIC Data; RBA.

Graph 1.20



Sources: Bloomberg; McCloskey by OPIS; RBA.

Table 1.1: Commodity Price Growth[(a)]

SDR terms; percentage change

	Since previous *Statement*	Over the past year
Bulk commodities	22	–1
– Iron ore	27	44
– Coking coal	30	–4
– Thermal coal	–11	–62
– Asian LNG spot	57	–41
– Lithium (Australian Spodumene)	–24	–49
Rural	–4	–20
Base metals	1	–5
Gold	2	11
Brent crude oil[(b)]	–6	–17
RBA ICP	7	–14
– Using spot prices for bulk commodities	11	–10

(a) Prices from the RBA Index of Commodity Prices (ICP); bulk commodity prices are spot prices.

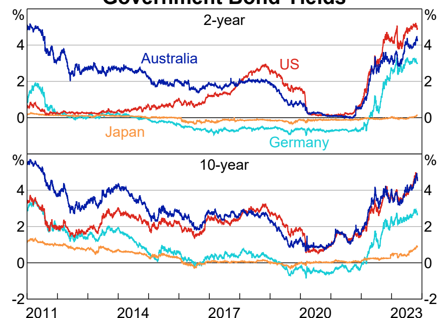
(b) In US dollars.

Sources: Bloomberg; McCloskey by OPIS; RBA; Refinitiv.

Government bond yields have increased substantially at longer maturities, amid elevated volatility

Government bond yields at longer maturities have increased noticeably over recent months, and in most advanced economies they reached their highest levels in more than a decade, before declining of late (Graph 1.21). Most of the increase in longer term yields has come from higher real yields. While there has been a small increase in longer term market-implied inflation expectations in recent months, these remain broadly consistent with central banks' inflation targets (Graph 1.22). Short-term bond yields have been more stable, reflecting market expectations that most central banks are at or close to the end of their policy tightening phases.

The increase in longer term real yields over recent months appears to partly reflect an increase in the term premium, which is the yield on bonds over and above what is explained by expectations of inflation and future shorter term real interest rates. Estimates of term premia declined in the period following the global financial crisis and have been negative for most of the past decade. The recent increase may reflect a number of factors, such as increased uncertainty around the economic and policy outlook and expectations of a larger supply of government bonds from debt issuance at the same time that central banks are reducing their asset holdings. Real yields may also have risen in part because of investors upgrading their estimates of the level of neutral interest rates, in



the wake of resilient economic activity in the face of high policy rates. At the same time, volatility of longer term government bond yields has increased, consistent with elevated uncertainty over the future path of inflation and interest rates (Graph 1.23).

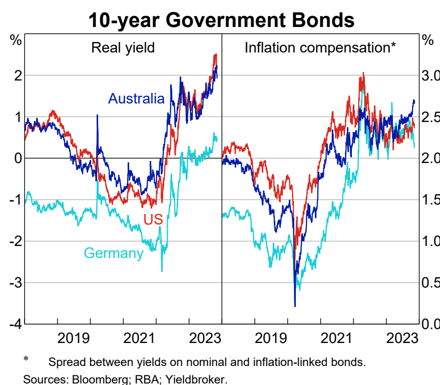
Private sector financial conditions have tightened moderately in advanced economies but compensation for credit risk remains low

Equity prices in the United States and Europe have declined over recent months, in part due to higher interest rates, which decrease the present value of future company earnings (Graph 1.24). Corporate bonds yields have increased alongside the rise in government bond yields and a modest widening of credit spreads (Graph 1.25). Nevertheless, equity prices in most major markets are still noticeably higher than a year ago, while corporate bond spreads are around their long-term average in Europe and the United States. This is despite the significant increases in policy rates to levels judged to be restrictive and increases in longer term risk-free rates. Levels of these asset prices suggest that market participants do not anticipate significant declines in corporate profits or a large rise in corporate defaults.

Corporate bond issuance in the United States and Europe has picked up in recent months. This may in part reflect some firms bringing forward their issuance to guard against the risk that

Graph 1.22

10-year Government Bonds

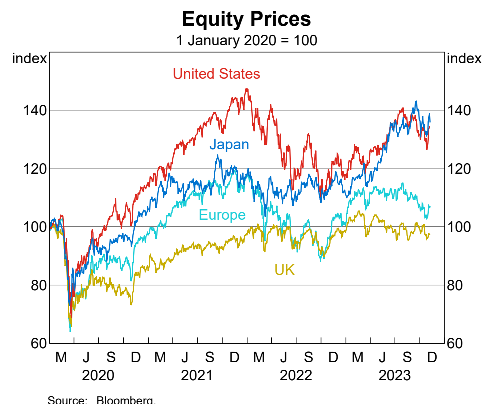


* Spread between yields on nominal and inflation-linked bonds.
Sources: Bloomberg; RBA; Yieldbroker.

Graph 1.24

Equity Prices

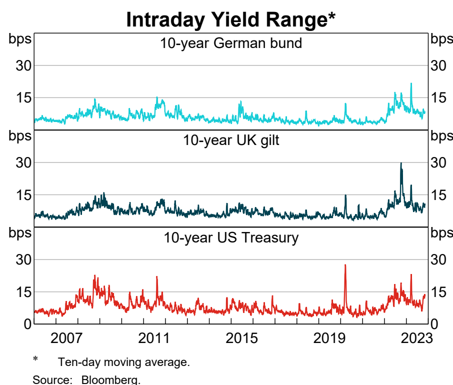
1 January 2020 = 100



Source: Bloomberg.

Graph 1.23

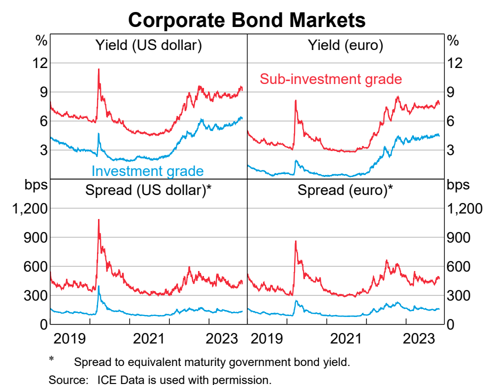
Intraday Yield Range*



* Ten-day moving average.
Source: Bloomberg.

Graph 1.25

Corporate Bond Markets



* Spread to equivalent maturity government bond yield.
Source: ICE Data is used with permission.

yields rise even further. Initial public offerings have also picked up in US equity markets following a long period of inactivity.

Central bank surveys have shown a broad-based tightening in lending standards and weakening in demand for credit this year. Credit growth has slowed sharply this year in the United States and Europe, although the rate of deceleration has moderated in the United States in recent months.

The US dollar has appreciated over recent months alongside a widening in US yield differentials

The US dollar has appreciated moderately on a trade-weighted (TWI) basis to be around 2 per cent higher over recent months. The appreciation has been broadly based and consistent with the widening in the yield differential between US Treasury bonds and other advanced economy government bonds.

The Japanese yen has continued to depreciate over recent months and is around 10 per cent lower on a TWI basis since the beginning of the year. Weakness in the yen has reflected the Bank of Japan (BoJ) maintaining very accommodative policy settings in an environment of rising global yields.

Most advanced economy central banks have increased policy rates to levels they consider restrictive, and expect to maintain these settings for some time

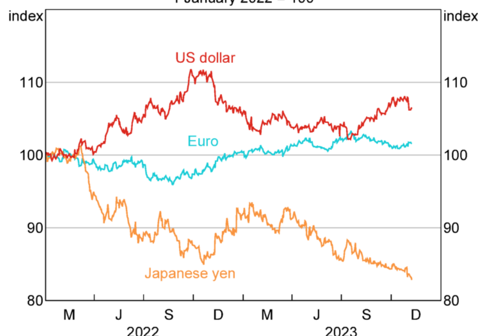
Most advanced economy central banks judge policy rates to be restrictive. Central bank commentary has increasingly focused on balancing upside risks to inflation and downside risks to economic growth, while many have noted that the conflict in the Middle East is an additional significant source of uncertainty. Nevertheless, policymakers at most central banks have emphasised the need to keep policy rates around at least their current restrictive levels for as long as necessary to bring inflation back to target. Officials from several central banks have indicated that recent increases in sovereign bond yields could reduce the need for policy rate increases if they result in a sustained tightening of financial conditions beyond that implied by expected policy rates. Market participants expect most central banks' policy rates have peaked and anticipate that there will be some modest easing towards the middle of 2024 (Graph 1.27; Table 1.2).

In October, the BoJ adjusted its yield curve control policies by replacing its strict 1 per cent cap on 10-year Japanese Government bond (JGB) yields with a softer 1 per cent 'reference rate'. Under the new policy, the BoJ will no

Graph 1.26

Trade-weighted Exchange Rates

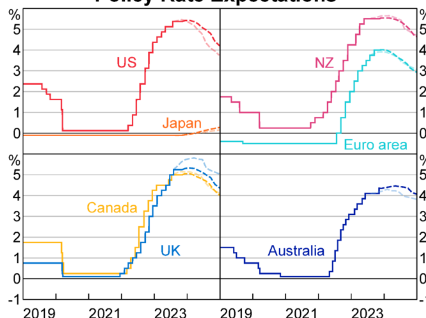
1 January 2022 = 100



Sources: Bloomberg; Board of Governors of the Federal Reserve System.

Graph 1.27

Policy Rate Expectations*



* Darker dashed lines show expectations implied by current overnight indexed swap rates; lighter dashed lines show the same expectations as the August SMP.

Sources: Bloomberg; RBA.

Table 1.2: Policy Rates at Advanced Economy Central Banks

	Change since August *Statement* (basis points)	Current level (per cent)	Expected peak (per cent)*
Australia	+25	4.35	4.35
United States	0	5.25–5.5	5.25–5.5
Euro area	+25	4	4
Canada	0	5	5
Japan	0	−0.1	N/A
New Zealand	0	5.5	5.5
Norway	+50	4.25	4.25
Sweden	+25	4	4
Switzerland	0	1.75	1.75
United Kingdom	0	5.25	5.25

* Values represent the peak policy rate that is fully priced in by markets.
Sources: Bloomberg; central banks.

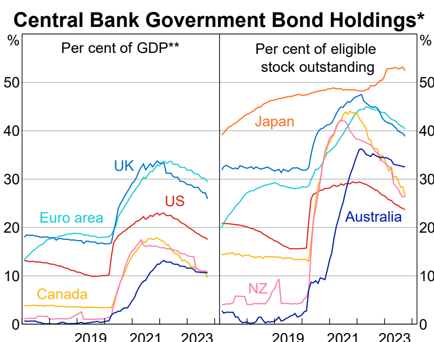
longer commit to strictly defend 10-year yields at 1 per cent. The BoJ has stated that it will continue large-scale JGB purchases to encourage yields to remain around this level, but with the flexibility to accommodate additional increases in yields. Other central banks are reducing their holdings of assets purchased under quantitative easing programs (Graph 1.28). Meanwhile, central banks have continued to wind down term funding schemes established or expanded during the pandemic (Graph 1.29).

Emerging markets are facing tighter external funding conditions

Emerging markets' external funding conditions have tightened moderately over recent months. Nevertheless, yields on US-dollar-denominated sovereign debt remain a little below 2022 highs, and spreads to US Treasuries have widened by only a small margin (Graph 1.30). Net portfolio outflows have been most pronounced in Asia, and several Asian central banks are thought to have intervened to support their exchange rates. Meanwhile, Bank Indonesia increased its policy rate by 25 basis points in October to stabilise the currency and mitigate the impact of imported inflation risks. Some central banks in Latin America – which started raising policy rates earlier and by more than advanced economies – have continued to reduce policy rates as core inflation has eased, though the market-implied expected rate of easing has moderated over the past month.

Graph 1.28

Central Bank Government Bond Holdings*



* Central government debt only, except the euro area. Holdings for euro area only include asset purchase programs; holdings for UK do not include financial stability purchases; other central banks include bonds held for operational or liquidity purposes.

** Four quarter rolling sum. Japan (not shown) is currently 99 per cent of GDP.

Sources: Central banks; debt management offices; RBA; Refinitiv.

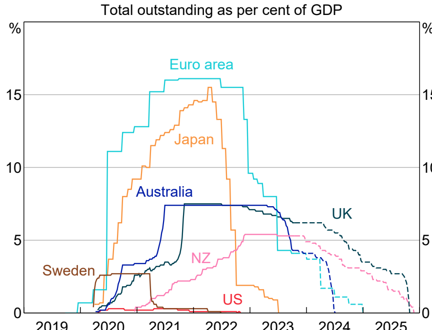
Growth in Australia's major trading partners is expected to remain below average over the next few years

Year-average GDP growth in Australia's major trading partners is expected to be around 3½ per cent in 2023, before slowing to 3 per cent in 2024 (Graph 1.31). This overall outlook is little changed from three months ago, with stronger forecast growth in the United States and Japan offset by weaker forecast growth in east Asian economies (outside of China and Japan).

Graph 1.29

Term Funding Scheme Projections*

Total outstanding as per cent of GDP

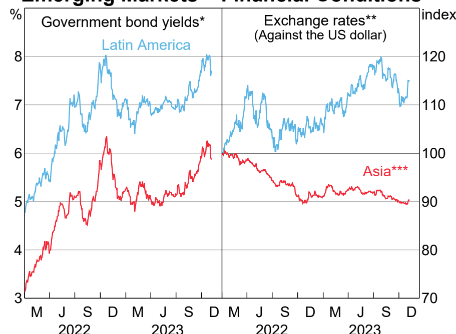


* COVID-19 pandemic response schemes only. Dashed lines represent projected repayments and/or maturities. Euro area projections from ECB Survey of Monetary Analysts. UK, Australia and New Zealand projections assume outstanding funding held to maturity.

Sources: Central banks; Refinitiv.

Graph 1.30

Emerging Markets – Financial Conditions



* US-dollar-denominated bond yields, weighted by market value.

** 3 Jan 2022 = 100.

*** Excluding China.

Sources: Bloomberg; JP Morgan; RBA.

Consensus forecasts are for moderate GDP growth in major advanced economies in 2023. A modest upward revision in forecast growth has been driven by stronger-than-expected economic activity data in the United States and Japan over recent months; US GDP growth forecasts for 2024 have also been revised higher. Consensus forecasts for GDP growth in the United Kingdom and euro area remain subdued. Overall growth in G7 economies is still forecast to slow substantially over 2024, before picking up in 2025. Growth in China is expected to slow in the next two years as the consumer recovery slows and the effects of stimulus measures fade. While the most recent GDP data in China were largely in line with forecasts in the previous *Statement*, the profile for expected growth has been revised downwards, reflecting the further deterioration in Chinese property market conditions and a judgement that potential spillovers to the household sector could be larger than previously thought.

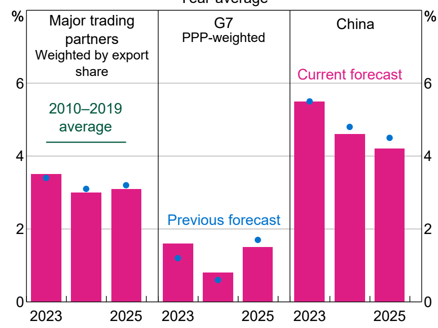
The outlook for global economic activity is uncertain, with risks tilted to the downside:

- *Financial conditions could tighten further or remain tighter for longer than expected.* If this tightening is not accompanied by stronger economic activity, this would present a downside risk to growth. Central banks and market participants are generally

Graph 1.31

GDP Growth

Year-average



Sources: ABS; CEIC Data; Consensus Economics; RBA; Refinitiv.

anticipating a less disruptive economic and employment cycle than in previous disinflation episodes, but these forecasts could prove too optimistic, with additional monetary and financial tightening leading to more pronounced downturns. Current monetary policy settings may be insufficiently restrictive if inflation proves to be more persistent than expected or picks up again. Some potential sources of greater inflation persistence include ongoing high rent inflation (if housing supply adjusts more slowly than expected) or an increase in inflation expectations. Potential future upside shocks to inflation could include an escalation of geopolitical tensions related to the conflict in the Middle East (which could increase oil prices) and/or a more disruptive than anticipated El Niño weather pattern (which could increase agricultural prices). There is also a risk that financial conditions could tighten further (independently of monetary policy settings) – for example, if increasing government debt or uncertainty about the response of monetary policy to a changing economic outlook were to drive sustained increases in long-term government bond yields. If a significant further tightening in financial conditions were to occur in a synchronised way across major advanced economies, a mutually reinforcing negative global economic and financial cycle could emerge.

- *There continues to be uncertainty (in both directions) about the effects of the cumulative tightening in monetary policy and broader financial conditions on economic activity.* It is likely that the overall tightening in financial conditions that has already occurred is still flowing through the economy, given the lags involved and more recent increases in long-term bond yields, but economic activity in advanced economies has so far been more resilient than expected. This resilience could be sustained if labour market tightness unwinds more slowly than anticipated or if recoveries in housing prices gather momentum and provide further support to household consumption growth through wealth effects. However, if growth in services sectors (which are relatively labour intensive) moderates further, unemployment and/or underemployment could rise more quickly than currently expected. This could, in turn, also support an easing in core services inflation, which to date has shown significant persistence.
- *Economic growth in China could slow more than forecast due to spillovers from continued stress in the property sector.* Despite the recent policy measures to stimulate the property market, demand for housing remains weak and this could persist for longer than expected. This could exacerbate financial pressures on property developers and increase stress in China's financial system. Ongoing weakness in the property sector could also weaken the recovery in household consumption through sustained low levels of consumer sentiment, by limiting potential household wealth accumulation and/or encouraging households to save more in other forms of wealth. While it is possible that the policy measures announced over recent months could prove to be more effective at stimulating the property market or infrastructure investment than expected, or that authorities adopt additional policy measures to further support the economy, the scale and impact of any additional support measures remains uncertain. ✠

Endnotes

[1] See RBA (2023), '5.1 Focus Topic: Vulnerabilities in China's Financial System', *Financial Stability Review*, October.