The Global & Australian Economic Outlook in Brief: October 2022

NAB Group Economics

Rapidly tightening monetary policy, an energy price shock in Europe and deteriorating domestic conditions in China (due to a property downturn and the impact of zero-COVID policies) are set to slow global economic growth to 2.3% in 2023. With the exception of the extreme shocks associated with the global financial crisis and COVID-19, this would represent the slowest growth rate since 1993. Advanced economies are expected to be particularly weak - the US and the Euro-zone are forecast to record no growth while the UK economy is tipped to marginally contract. The recovery in 2024 is relatively modest – with growth at 2.8% - well below the long run average of 3.4% (from 1980 onwards).

- Volatility in **financial markets** (especially bonds) rose in September, with the MOVE index rising in late September to its highest level since July 2009 (excluding a brief spike at the start of the COVID-19 pandemic). Bond yields for major advanced economies have continued to trend higher since the start of August – pushing well above pre-pandemic rates. While markets continued to adjust their monetary policy expectations – reflecting the competing forces of persistent inflation and deteriorating economic activity – the UK government's mini-budget was met with a severe market reaction. Yields on 10 year UK gilts rose rapidly above 4% (the highest rates since 2008), forcing the Bank of England to intervene to safeguard pension funds and the government to reverse course on this policy.
- Global **inflation** remained stable at 8.7% yoy in August (unchanged since June). A range of factors – including slowing growth in producer prices, falling freight rates and food prices – point to weaker inflation in coming months, but there remain some risks, including the impact of the Russia-Ukraine conflict on European natural gas supply and disruptions due to China's zero-COVID policies. In addition, OPEC+ has committed to cuts to oil production, which could limit downside pressure to oil prices.
- Given that inflation remains well above the targets of major central banks, these institutions have continued to increase their **policy rates** with the US Federal Reserve implementing its third straight 75 bp hike in September. Despite already slowing economic activity, we expect further rate increases from major central banks in coming months – driving a weak economic growth outlook. Central banks continue to prioritise inflation reduction over economic growth, and due to the lagged nature of inflation data, there is a strong possibility of higher-than-necessary policy rates resulting in a deeper than anticipated recessions in advanced economies.
- We expect only slightly lower overall growth in Q3, than in Q2, in the **major advanced economies** (AEs), with improvement in the US to be offset by slower growth elsewhere, including the Euro-zone and Japan. US partial data continue to point to positive GDP growth (after declines over the first half of the year). The UK is likely to see a small fall in GDP (but Q2 growth was revised up to a small positive instead of a small decline). We still expect to see the Euro-zone, UK (starting this year) and the US (in 2023) go into recession, with some quarters of negative growth due to the tightening in financial conditions and energy supply shock.
- Trends have remained divergent in **emerging market** (EM) business surveys, however deteriorating conditions in China have driven weaker readings for manufacturing and services in September. EM manufacturers are more trade dependent than their advanced economy peers. Trade volumes – which rapidly accelerated between mid-2020 through early-2022 – are showing signs of plateauing in July. Various indicators – such as rising inventory levels and deteriorating container freight rates – point to declining demand in advanced economies. This suggests that EM export trends are likely to soften in coming months
- **Business surveys continue to point to weakening conditions** in the global economy. That said, the JP Morgan global composite PMI was marginally less negative in September. Key to this outcome was a partial recovery in the services sector reading – which returned to neutral territory in September – primarily in the advanced economies. Overall, the previously wide gap between PMI measures for advanced economies and emerging markets narrowed significantly in September. Improving trends in services are unlikely to persist, with tightening financial conditions in most major markets, along with higher energy costs, driving slowing economic growth in late 2022 and into 2023.
- We continue to expect **global growth** to slow significantly in 2023, down to 2.3%, before modestly recovering to 2.8% in 2024. These increases are well below the long run average of 3.4% (from 1980 onwards). The United States and the Euro-zone are forecast to record no growth in 2023, while we expect a marginal contraction in the UK economy for the full year.
- For more detail on the global outlook, please see the [Forward View – Global](), released yesterday.

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For Australia, we have upped our Q3 expectation for consumption based on the resilience seen in internal and official measures of consumer spending and the ongoing strength in trading conditions in our business survey. However, that does not change our view that consumption – and therefore, overall growth – will slow from here with higher rates and inflation beginning to impact household budgets more heavily. That said, while we see growth slowing to well below 2% in each of the next two years, we do not expect a major downturn. Slower growth will see the unemployment rate drift up to around 4.2% by end 2024 after troughing around 3.4%. At these levels, it is likely that the unemployment rate would still be consistent with 'full-employment' and we expect wage growth to continue to rise, reaching around 3.5% in 2023. Domestic inflation pressure will become increasingly important as global impacts on the CPI begin to wane. We expect both the headline and trimmed-mean measures to peak in Q4 before easing through 2023. Where inflation is expected to settle will be important for the evolution of interest rates from here. For now, expected wage growth is consistent with 'at target' inflation and we therefore expect the RBA to pause after increasing rates at the November and December meetings, taking the cash rate to 3.1%.

- **Consumption appears to have remained resilient in Q3 despite ongoing rate hikes and higher inflation.** As a result, we have revised up our expectation for Q3 to around 1.3%, following the 2.3% q/q outcome in Q2. ABS retail sales (in nominal terms) rose 0.6% in August after increasing by 1.3% in July and overall retail sales remains around 20% higher than pre-COVID levels. Our internal transaction data suggests that goods spending remained resilient in September, while services spending (driven by travel and recreation) continues to recover.
- **Housing market conditions continue to adjust to higher rates.** The CoreLogic 8-Capital City Index declined by 1.4% m/m in August and the capital city PropTrack Home Price Index by 0.2%. Regional areas are also now declining. New housing loan approvals (ex-refinancing) fell further in August and are now down 13.5% on the year. The rental market remains tight with vacancy rates at very low levels across the capitals and new rents growth tracking at high rates. On the activity side, building approvals rose by 4.1% after a sharp decline last month. We see house prices declining by around 20% from peak-to-trough, mainly reflecting the reduction in borrowing capacity and affordability constraints.
- **The unemployment rate ticked up in August but remains very low at 3.5%.** While the data has been volatile over recent months, a rise of 34k in employment and increase in the participation rate to 66.6% has seen these variables return to their July levels. We expect that the unemployment rate will edge higher through 2023 and 2024 – as slowing growth cools labour demand. Nonetheless, job vacancies and advertisements remain high pointing to ongoing strength in the near term, notwithstanding, a small easing in some of these measures. Despite the expected increase in the unemployment rate, we expect it to remain broadly consistent with 'full-employment' given the exceptionally low starting point. Consequently, wage growth will continue to rise, reaching around 3.5% in 2023.
- **Business conditions strengthened further in September and are now at very high levels**. The broad-based strength in business conditions is evident across most states and industries. Trading conditions have risen to very high levels and the employment and profitability sub-indexes remain robust. Forward orders also remain at a high level pointing to ongoing strength in conditions in the near term and business confidence is around its long run average. Capacity utilisation eased in September but remains well above its long run average – consistent with a rise in reported capex. The ongoing strength in conditions, high rates of capacity utilisation and solid investment intentions point to some further pickup in business investment growth in the near term.
- **The trade surplus fell in August with a rise in exports more than offset by the increase in imports.** Exports were supported by coal and to a lesser extent, rural exports. Imports continue to reflect the ongoing strength in consumer demand with consumption goods imports rising strongly, with intermediate goods imports also rising. Services trade continued to recover, particularly on the imports side.
- **The RBA lifted the cash rate by 25bps in October to 2.60%, and we continue to expect two further increases of 25bp in November and December.** We expect the RBA will pause at 3.1% to assess the impact of rate rises on the economy after the very rapid series of increases through 2022. Inflation is expected to peak in Q4 before unwinding through 2023 – but where it settles will ultimately be determined by domestic inflation pressures including wage growth. For now, expected wage growth is consistent with 'at target' inflation, but we have very little experience with a labour market as tight as it is currently.
- **The AUD/USD is around 6% lower than a month ago, after trading in a US5-cent range over the month.** USD strength continues to be the driver of a weaker Aussie, though the TWI has also weakened over the past couple of months. We have slightly lowered our forecasts in the near term, expecting the Aussie to end the year around US65c before it strengthens to US72c by end 2023 and US74c by end 2024.
- **Forecast uncertainty remains elevated, with a number of large global shocks continuing to play out.** For Australia these include the highly uncertain outlook for the world economy given elevated inflation, the risk that this may de-anchor inflation expectations, rapid monetary policy tightening, the energy supply disruptions from the Ukraine/Russia war, and China's Zero-COVID policy as well as problems in its housing sector. These are occurring in the context of still resolving supply chain disruptions and a significant build up of savings in the household sector.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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