The Global & Australian Economic Outlook in Brief: November 2022

NAB Group Economics

The impact of rapid tightening in monetary policy since late 2021 is becoming evident in a range of demand side indicators, however inflation has proved to be more persistent than central bankers had earlier anticipated. As a result, major central banks are set to continue rate hikes into early 2023. Combined with an energy supply shock, this will drive a sharp slowdown in economic growth next year – down to 2.2% – with the US, UK and Euro-zone set to enter recession. The recovery in 2024 is expected to be modest, with growth at 2.8%, well below the long run average of 3.4% (from 1980 onwards).

- **Inflationary pressures** are proving persistent – there was a slight uptick in consumer price growth in September to 9.0% yoy (following on from three months of stability at 8.7% yoy) – with a notable pickup in Eurozone prices (in part related to energy costs). Following the November FOMC meeting, the US Fed Chair noted that inflation had not come down as rapidly as expected – increasing the likelihood of further rate rises in coming months.
- Global **producer price** growth peaked in April (at around 18.8% yoy) and has subsequently eased (to 15.9% yoy in September). That said, there is a considerable disparity between producer price trends in China – where producers may be discounting in the face of weakening global goods demand – and the rest of the world.
- Major central banks have continued to lift **policy rates** – with both the US Federal Reserve and European Central Bank increasing rates by 75 basis points in early November and late October respectively. In the case of the Fed, it was the fourth 75 basis point increase in a row, and we anticipate an additional 100 basis points of increases over the next three meetings – bringing the fed funds rate to 5.0%. As inflation data are lagged, there is a risk that rates rise to levels above those necessary to curb inflation, resulting in deeper recessions in advanced economies.
- Among the **major advanced economies**, we expect the US, UK and Euro-zone to go into recession in 2023 due to the combination of tighter monetary policy and the energy supply shock. Mild weather and efforts to reduce consumption have led European gas storage to rise to a high level, contributing to a fall in prices (albeit they are still high). This suggests the short-term downside risk to the Euro-zone outlook is not as great as it was but much will depend on the severity of the winter. However, inflation remains high – Euro-zone inflation hit 10.7% y/y in October, a new record. Core inflation measures remain high across the AEs, suggesting that a greater than expected monetary tightening remains a downside risk to growth.
- Growth in **emerging markets** is typically more dependent on trade activity than advanced economies. Global trade data are available up to August, and although there is considerable volatility from month-to-month, suggest that EM export volumes peaked in June and have subsequently declined. This poses a significant problem for Chinese authorities – given that economic growth has been increasingly reliant on export oriented industrial output since the start of the COVID-19 pandemic, with household consumption weak due to the impact of lockdowns and a limited social safety net.
- A broad-based deterioration in global economic conditions was evident in **business surveys** in October. The JP Morgan global composite PMI edged further into negative territory – to 49.0 points (from 49.6 points previously) – primarily driven by weaker readings for services. Overall, measures of new orders and export activity continued to deteriorate – as tightening financial conditions and persistent inflation negatively impact demand in a broad range of economies.
- Our **global growth** forecasts are largely unchanged – with a significant slowdown anticipated in 2023, down to 2.2% (from 2.3% previously), reflecting lower growth expectations for the UK, east Asia (ex. Japan & China) and Russia, before a partial recovery in 2024 to 2.8%. These rates of growth would be well below the long run average of 3.4% (over the period from 1980 onwards).
- China's zero-COVID public health policies remain a key **uncertainty** for the global outlook. Rumours circulating on Chinese social media in early November suggested a committee had been formed to develop plans for a post-COVID-19 reopening – targeting March 2023 – however this has subsequently been countered by various officials, most notably China's National Health Commission. Risks related to the Russia-Ukraine conflict – particularly around energy and agricultural supplies from the region – also persist, while various geo-political tensions (most notably between the US and China) could also re-emerge.
- 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 expectation for the cash rate peak, increased our near-term outlook for inflation and pulled back our forecasts for economic growth in 2023 and 2024. To date, the economy has remained very resilient although there are some very early signs of a slowing. This strength, along with the broadening of inflation pressures in the Q3 CPI and expected pressure from energy costs, has led us to raise the near-term inflation peak and lift our expectations for 2023 with trimmed mean inflation to be tracking around 4.0% by the end of the year. As a result, we expect monetary policy will need to move into more clearly restrictive territory, and we now expect further 25bp increases at each of the next three meetings, taking the cash rate to 3.60% by March. Higher rates will begin to weigh materially on consumption over coming months, and we expect GDP growth to slow to below 1.0% over the next two years – though we don't see a recession. Our labour market forecasts are also slightly softer, with the unemployment rate to reach 4.5% in the second half of 2024. Wage growth should continue to increase but we expect it to peak at around 3.5%. There are risks wages accelerate more quickly, although global headwinds and uncertainty around how households will respond to higher rates weigh in the opposite direction.

- **House prices are continuing to decline and loan approvals are declining sharply in response to higher rates.** The CoreLogic 8-capital city dwelling price index fell 1.1% and is now 6.5% off its peak in April. Loan approvals also recorded another solid decline in September, falling 8% to be 18.5% lower over the year. While the pace of decline in prices has eased slightly, we expect them to continue to fall with a total decline of around 20% by end-2023. On the activity side, building approvals have returned to pre-pandemic levels after a period of volatility, pointing to the normalisation of work done as the large pipeline of work is completed over the next 6-12 months.
- **Real retail sales continued to grow in Q3, but we expect consumption growth to flatline in 2023 and 2024.** The total volume of retail sales grew 0.2% in Q3, supported by the continued rebound of cafes & restaurants which grew 3.3% in the quarter. The result supports our expectation for another strong quarter of total consumption growth in Q3. Our October *Monthly Data Insights* suggests spending may now be beginning to soften but for now we expect consumption growth to hold up through Q4. Further out, however, we have lowered our expectations for consumption growth, with consumption to be broadly flat from 2023 with some small negatives likely into 2024.
- **Unemployment remained at 3.5% in September, and wage growth is expected to have reached 3% y/y in Q3.** September saw employment rise by 900 (less than 0.1%) and the participation rate was also unchanged, leaving the unemployment rate at 3.5%. We expect unemployment to gradually pick up as slowing economic growth weighs on labour demand and migration returns, likely to around 4.5% by late-2024. The tightness of the labour market and significant minimum wage increase likely drove a further pickup in wage growth in Q3 to around 0.9-1.0% q/q, putting annual wage growth at 3.0% for the first time since 2013. Wage growth is likely to continue picking up through 2023 despite the gradual easing in the labour market, peaking at around 3.5% y/y.
- **Business conditions remained strong through October, but business confidence eased in the month**. Business conditions in the NAB Monthly Business Survey were +22 index points in October, have remained around that level for several months. At the same time, confidence fell 4 points to 0 index points, below the long-run average. The drop in confidence aligned with some softening in forward orders, though capacity utilisation remains high. Capex expectations remained elevated in the Q3 Quarterly Business Survey, and we continue to expect a gradual further pickup in business investment, though capacity constraints in construction will limit non-residential building.
- **The trade surplus rose in September due to a large increase in exports, but net trade is likely to detract from Q3 GDP.** Iron ore and LNG drove export growth in the month, while goods imports were little changed. Likewise, services credits outpaced services debits as tourism-related flows continued to recover. Still, estimates for trade volumes over Q3 as a whole indicate a strong rise in imports and small decline in exports, detracting from GDP.
- **The Q3 CPI release saw headline inflation reach 7.3% y/y and (6.1% underlying).** For headline CPI, this is the strongest annual read in over three decades and trimmed mean CPI is also well above its previous peak, with inflation now clearly broadly based. Given this broadening, as well as expected pressure from energy costs, we have upped the near-term peak to 8% y/y in Q4 (6.8% underlying) and lifted our expectations for 2023 with trimmed mean inflation to be tracking around 4.0% by the end of the year.
- **The RBA lifted the cash rate by 25bps in November to 2.85%, and we expect three further increases, to 3.6%.** Given the resilience of demand and the higher profile for inflation, we now expect monetary policy will need to move into more clearly restrictive territory, with the cash rate to peak at 3.60% by March. Stronger wage growth or a de-anchoring of inflation expectations remain a risk and could warrant higher rates. However, global headwinds and uncertainty around how households will respond to higher rates weigh in the opposite direction.
- **The AUD/USD has traded in the mid-US64c range recently after falling to the low US62c range in October.** USD strength continues to be the driver of a weaker Aussie. Our forecasts are unchanged, and we continue to expect the Aussie to end the year around US65c before it strengthens to US72c by end 2023 and US74c by end 2024.
- For more detail on the Australian outlook, please see the [Forward View – Australia], released on Wednesday.

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