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The Forward View: Australia Dec-2022

Slow growth ahead after final rebound bump in Q3

NAB Group Economics

Overview

- Our forecasts are little changed this month. The national accounts confirmed that the economy remained resilient in Q3, and the labour force data continues to reflect a healthy but tight labour market. That said, leading indicators of the labour market have eased slightly, while high frequency transaction data suggest that spending growth has slowed.
- Following growth of 0.6% in Q3 we expect a softer print of around 0.3% in Q4. We expect slower growth to persist into 2023 and 2024– which will see growth in annual terms slow to below 1%. The slowing in growth will mainly come via weaker growth in household consumption.
- Our forecasts for the labour market are unchanged – we still see the trough in the unemployment rate in Q4 at just below 3.5% before slower growth over the next two years is unable to absorb the recovery in population growth. That said, we only expect unemployment to rise just above a level that is consistent with full employment.
- We continue to expect inflation to peak in Q4 before easing over the next two years – reaching 3.2% by the end of 2024. Global indicators of inflation pressure have eased and will likely begin to flow through. Domestic pressures continue to build but are not yet inconsistent with at-target inflation.
- Following the 25bp increase in the cash rate at the December meeting, we see the RBA lifting rates at each of the next two meetings which will take the cash rate to 3.6% before pausing as global growth slows and inflation softens.
- The risks around our forecasts are largely unchanged. Should wages react more strongly to a tight labour market or inflation remain sticky, the RBA could lift the cash rate higher, slowing growth further. Alternatively, there is some risk that the RBA takes a slower path to 3.6% if the data slows in early 2023.
- The national accounts measure of household income and spending continue to reflect the dynamics at play in the economy. Income growth accelerated in the quarter – on the back of stronger wage growth – but slowed in annual terms as the impact of fiscal support waned and interest rates began to weigh on disposable income.

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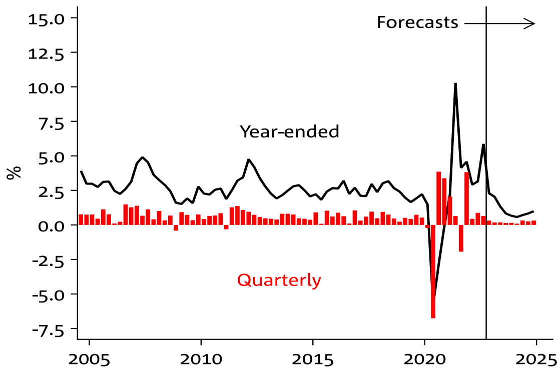
Key Economic Forecasts

	2021	2022-F	2023-F	2024-F
Domestic Demand (a)	6.3	5.1	1.7	0.5
Real GDP (annual average)	**5.2**	**3.5**	**1.2**	**0.8**
Real GDP (year-ended to Dec)	**4.6**	**2.3**	**0.7**	**1.0**
Terms of Trade (a)	17.2	5.1	-6.7	-2.9
Employment (a)	3.5	3.5	1.5	1.0
Unemployment Rate (b)	4.7	3.4	4.0	4.5
Headline CPI (b)	3.5	8.0	4.5	3.2
Core CPI (b)	2.5	6.4	4.4	3.2
RBA Cash Rate (b)	0.10	3.10	3.60	2.85
$A/US cents (b)	0.73	0.67	0.75	0.76

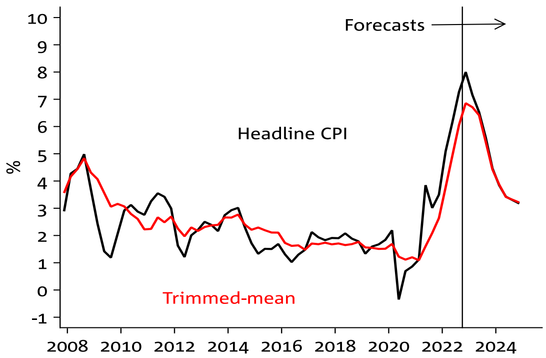
(a) annual average growth, (b) end-period, (c) through the year inflation

Chart 1: GDP forecasts



Source: ABS, NAB

Chart 2: CPI forecasts



Source: National Australia Bank, <Property Source not found.>

Gareth Spence, Senior Economist | Antony Kelly, Senior Economist | Brody Viney, Senior Economist | Alan Oster, Chief Economist

Labour Market, Wages, and Consumption

Unemployment remains very low, at 3.4% in October, and this is beginning to translate into stronger wage growth. Hourly wages grew 3.1% in the year to September and now look set to approach 4% in 2023.

Employment grew by 32k in October while the participation rate held broadly steady, with the unemployment rate falling to 3.4% as a result. Indicators of labour demand have shown early signs of easing but remain elevated, likely leaving the labour market very tight for the time being.

The Q3 Wage Price Index (WPI) release showed hourly wages grew 1% in the quarter and 3.1% y/y, the fastest rate of underlying wage growth since 2013. Private sector wages led the way at 1.2% q/q, and while the strong minimum wage rise likely played a role in the result, most of the increase came from individual agreements, which tend to be more responsive to labour market conditions.

Broader measures of wage growth in the Q3 national accounts were also very strong, with average earnings up 2.5% q/q and earnings per hour up 2.8% q/q. These measures can be more volatile but reflect broader composition effects including job switching and promotions as well as other payments.

Looking ahead, we continue to expect unemployment to gradually rise as the economy slows. However, given the responsiveness of wages shown thus far, we have revised up our wage growth expectations and now see annual growth reaching 4% in late 2023. This is likely to still be compatible with inflation at target – but any higher would be a more challenging scenario for policy makers to manage.

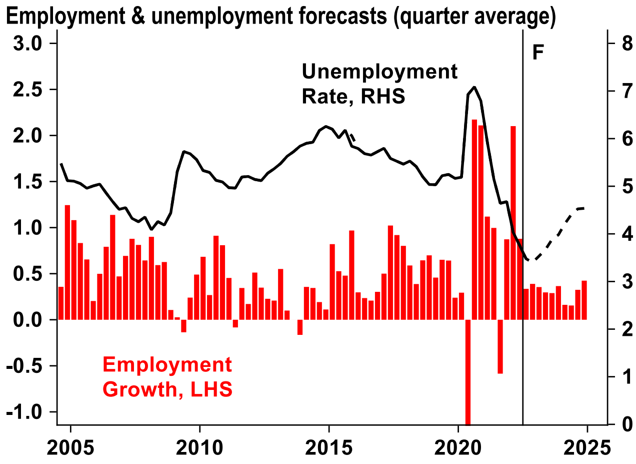
Household consumption rose 1.1% q/q in Q3 (up 11.8% y/y due to base effects from lockdowns). More recent data have been mixed, and we continue to expect a material slowing in 2023.

Consumption growth was once again driven by the ongoing recovery of services in Q3 (up 1.7%), led by hospitality (up 5.5%) and transport services (up 13.9%). Goods consumption grew by a more modest 0.3%, supported by a 10.1% increase in purchases of vehicles as supply backlogs cleared. Excluding vehicles, goods consumption fell 0.4%, reflecting the ongoing rebalancing seen across 2022.

More recent data has been mixed. ABS retail sales data showed a 0.2% nominal fall in October, but NAB's latest *Monthly Data Insights*, released today, showed a slight rebound in November with retail spending up 1.0%, possibly helped by Black Friday sales.

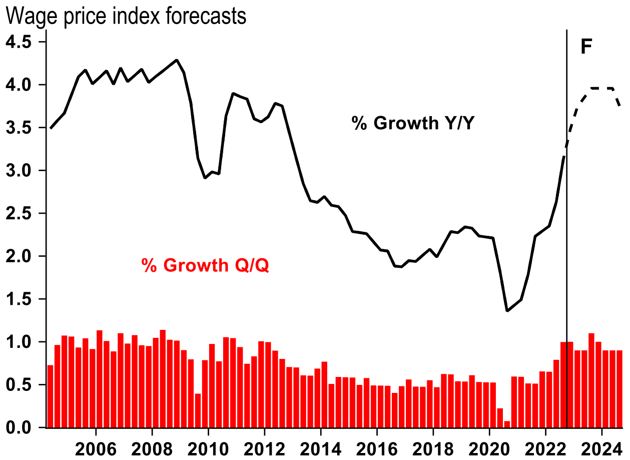
For 2023, we continue to expect a material slowing in consumption growth as inflation and higher interest rates weigh on real household disposable income. We expect largely flat or declining quarterly consumption growth across the year and into 2024.

Chart 3: Unemployment rate still expected to gradually rise to 4.5% in 2024



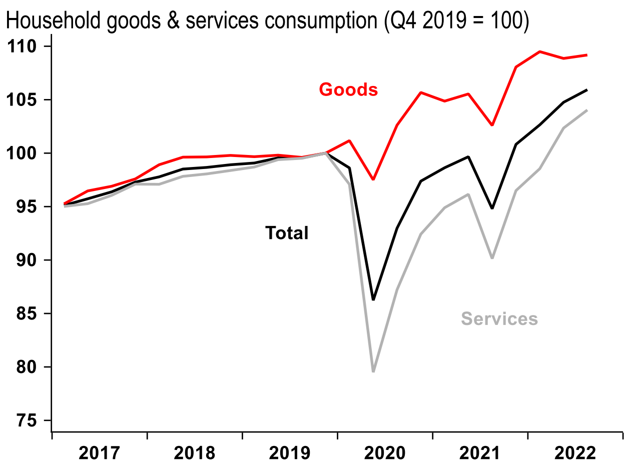
Source: Macrobond, NAB Economics

Chart 4: Wage growth now running at over 3% y/y and set to rise to 4% in 2024



Source: Macrobond, NAB Economics

Chart 5: Rebalancing of goods and services consumption now well progressed



Source: Macrobond, NAB Economics

Housing and Construction

House prices and sales continue to fall but some easing in supply constraints and fewer weather interruptions saw residential investment pick up in Q3.

Capital city house prices fell again in November. The CoreLogic measure was down -1.1% m/m, and the PropTrack indicator -0.2%, to be 7.5% and 4.7% respectively below their peaks. While unchanged from October, the pace at which prices are falling has moderated, although this can be partially explained by seasonality. The CoreLogic index indicates the largest falls have been in Sydney (-11%) and Brisbane (-8%), followed by Melbourne (-7%). Perth, Adelaide and Darwin are only down slightly from their peaks.

We expect that house prices will continue to decline well into 2023, with further rate rises likely and as the economy slows. From their 2022 peak, we expect prices will fall by around 20%. A tight rental market should be a supporting factor as is the strength of the labour market. While we expect unemployment to rise over our forecast horizon, the recovery in net migration may add to pressure on the rental market.

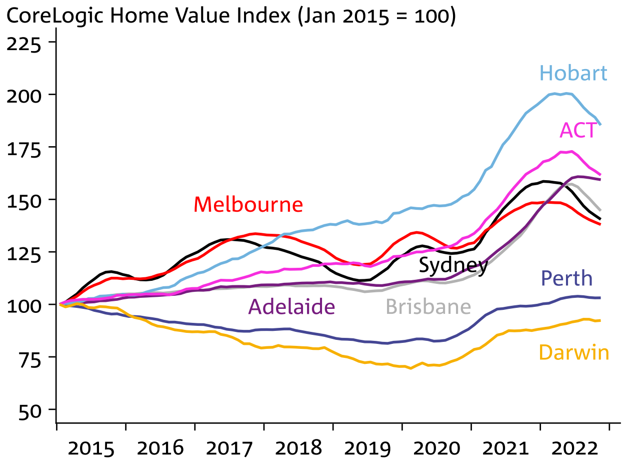
Dwelling sales have also fallen, and more so than prices. CoreLogic modelled sales volumes (based on our seasonal adjustment) declined by over 20% y/y in November. Housing turnover indicators such as new home loan commitments (-17% y/y in October) and ownership transfer costs (OTC, -16% y/y in Q3) have also fallen. OTC only has a small weight in GDP (<2%) but the 11% fall in Q3 meant it subtracted 0.2ppts from GDP growth in the quarter. Based on early data in Q4 for loan commitments and sales, OTC is likely to decline again in Q4.

In contrast, dwelling investment increased in Q3, up 1.0% q/q (but -3.9% y/y). This was the first increase since the same quarter last year. The ABS attributed the turnaround to a 'slight' easing of labour and material shortages, and fewer weather impacts. Despite the overall positive result, alterations and additions – which saw the big run up post-COVID again declined – and look to be trending down (but are still elevated).

Building approvals declined 6.0% m/m in October. However, they have broadly tracked sideways for much of this year and are a bit above their pre-COVID level. This is despite the sector generally being interest sensitive and a large run-up in construction costs (the monthly CPI new dwelling purchase by owner-occupiers was up over 20% y/y in October, although the m/m pace has slowed).

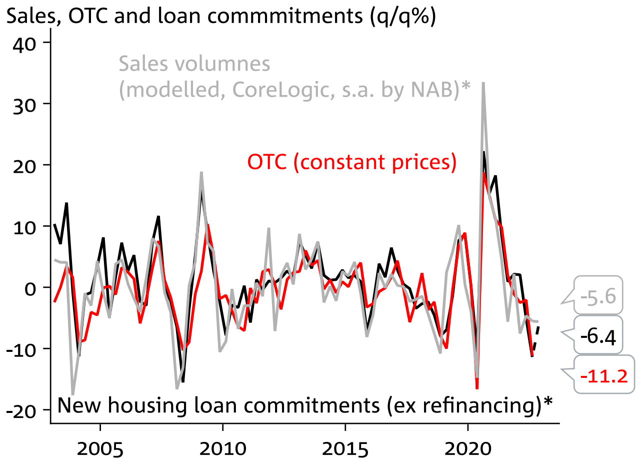
Because of supply constraints and weather interruptions, there is still a large pipeline of work in place. This will help sustain activity, particularly in coming quarters and, while residential investment may then to start to decline, it should remain solid out to 2024.

Chart 6: House prices still falling but pace had moderated



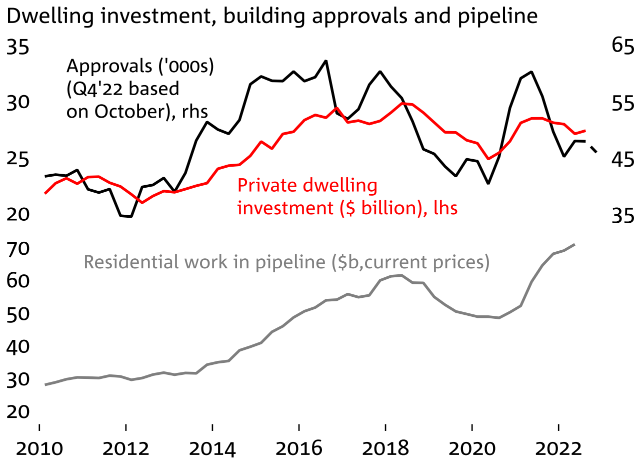
Source: National Australia Bank, CoreLogic, Macrobond

Chart 7: Housing market turnover has also declined



Source: NAB, CoreLogic, Australian Bureau of Statistics

Chart 8: Dwelling investment ticked up in Q3 – the large pipeline of work should continue to support activity



Source: National Australia Bank, Australian Bureau of Statistics

Business and Trade

Underlying business investment rose 0.7% in Q3 to be up 3.7% over the year. Business conditions remain elevated, but confidence fell into negative territory in November as global and domestic concerns loomed.

Both non-mining and mining investment increased in Q3, although mineral exploration declined for the second consecutive quarter. By type of investment, underlying machinery & equipment investment fell in Q3, but this was offset by a rebound in new building and new engineering construction likely reflecting fewer weather-related disruptions.

Business conditions in the NAB Monthly Business Survey were +20 index points in November (down 2pts from October). However, confidence fell to -4 index points, continuing a steady decline over recent months. The gap between current business conditions and business confidence is now at a record level in the history of the survey (with the exception of March 2020). Cost growth measures in the survey remain elevated, with retail price growth running at 2.9% in quarterly terms.

While capex expectations are elevated, and capacity utilisation is at very high levels, falling confidence and a clouded outlook for global and domestic growth will likely weigh on investment. As such we continue to expect only a modest further pickup over coming quarters.

A strong rise in imports saw net exports detract from GDP growth in Q3. More recently, the nominal trade balance remained elevated through October.

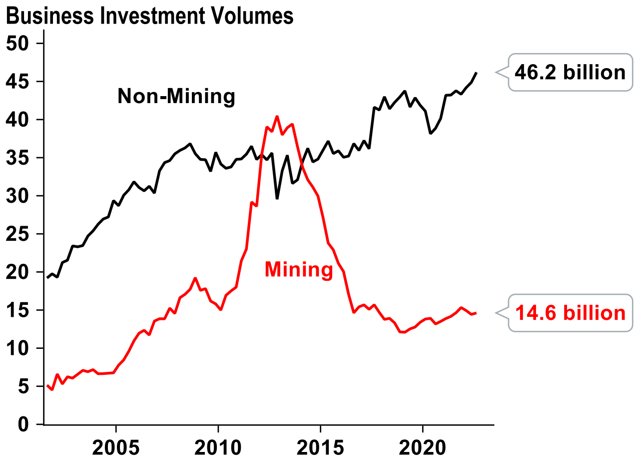
Export volumes rose 2.7% in Q3, with iron ore volumes rising and services exports also continuing to rebound strongly. However, the rise in exports was exceeded by a 3.8% increase in import volumes as fuel imports rose and the strong rebound in outbound travel saw services imports rise sharply.

The recovery in services trade is now well advanced, though both services imports and exports remain at around 70-75% of their pre-COVID levels. We continue to expect a slightly faster pace of recovery on services imports, weighing on growth overall.

The nominal trade balance was little changed in October at a very elevated at $12.2b (down just $0.2b from September). LNG exports rose slightly while iron ore and non-monetary gold fell, while on the imports side fuel import values declined.

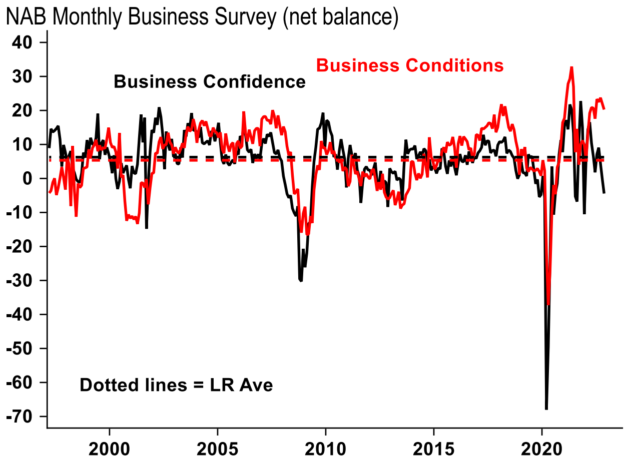
Slowing global growth remains a downside risk to exports, though the prospect of more reopening in China could provide support if it leads to a rise in construction activity. Softer domestic consumption growth should also flow through to imports.

Chart 9: Capex expectations remain high, though capacity constraints remain an issue



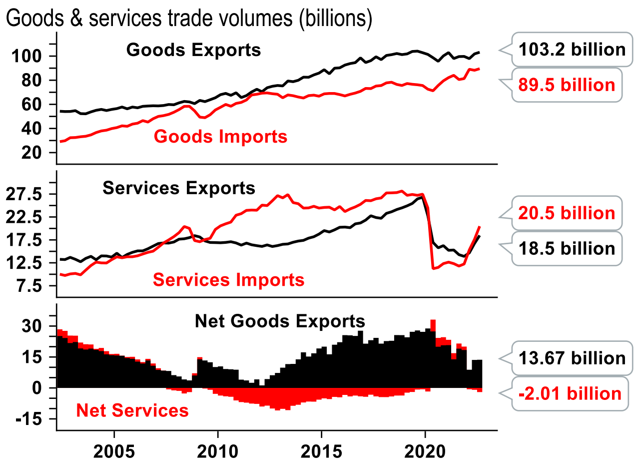
Source: Macrobond, NAB Economics

Chart 10: Business conditions remain strong but confidence is now into negative territory



Source: Macrobond, NAB Economics

Chart 11: Net exports detracted from growth in Q3 as services trade continued to recovery



Source: Macrobond, NAB Economics

Monetary Policy, Inflation and FX

The RBA increased the cash rate by 25bps in December, taking the cash rate to 3.1%, its highest rate since early 2013.

The Board's post meeting statement was little changed and contained much of the same tone as the previous month's Board minutes, speeches by the Governor and Deputy Governor and Lowe's senate estimate s appearance. The statement continues to emphasise that "the board expects to increase rates over the period ahead" but is also seeking to keep the economy "on an even keel" if it is able to do so. Importantly, the post meeting statement continues to emphasise that the Board's focus is on returning inflation to target

In terms of the economy, the RBA expects growth to slow to around 1.5% over each of the next two years (slightly above our forecast) on the back of weaker growth in household spending. Staff forecasts also see inflation moderating through 2023 as global supply chains recover and commodity prices level off. However, inflation is expected to remain above target until the end of 2024.

Ultimately, the RBA remains focused on where domestic inflation pressures settle as global factors wane and notes that a more sustainable balance of supply and demand will be required in order for inflation to return to target.

We continue to see the RBA further lifting rates at each of the next two meetings taking the cash rate target to 3.6% by March.

From there we see the RBA on hold, as the impact of prior rate rises continue flow through and growth slows. The resulting small increase in the unemployment rate should ease wage pressure – keeping it to a peak of 4%and ensuring that inflation settles back around the target over time.

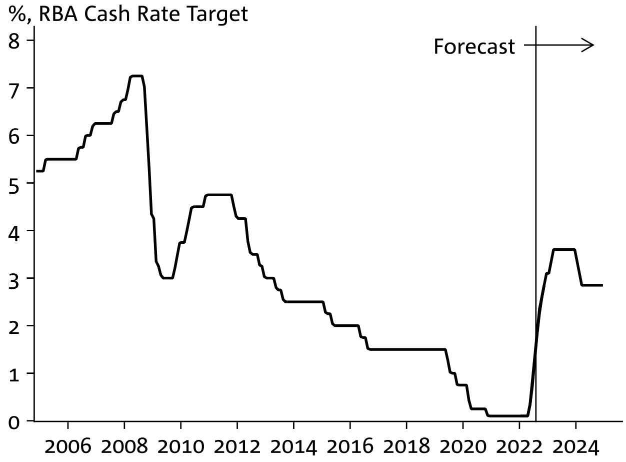
That said, we see risks around this as the peak for the cash rate. It is difficult to see the RBA holding off further increases after what we expect will be a very strong Q4 CPI released in late January and likely another solid wages print in February ahead of the March meeting – but a very strong pullback in consumer spending over December and January may see a slowing in the pace of hikes.

However, the cash rate is still relatively low by historical standards and the RBA continues to signal that they expect to do more – while noting that the labour market is running up against capacity constraints.

Our forecasts for the AUD/USD have been revised up sightly and we expect the Aussie to end 2022 at around US67c before drifting up to around US76c over the next two years.

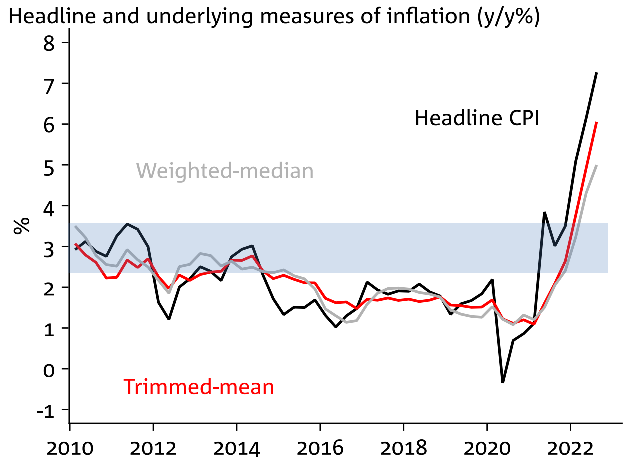
The change in view largely comes off the back of the USD having peaked, and is now expected to depreciated over the next two years.

Chart 12: Cash rate expected to rise to 3.6% by March



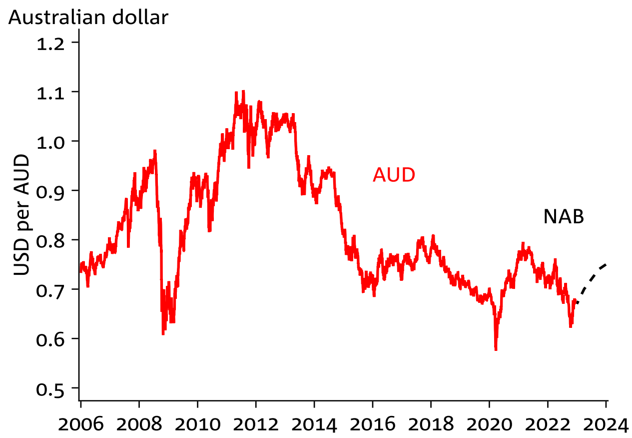
Source: Macrobond, NAB Economics

Chart 13: Both headline and trimmed-mean inflation reached new highs in Q3



Source: National Australia Bank, Australian Bureau of Statistics

Chart 14: AUD/USD to trade below below US65c in the near term



Source: National Australia Bank, Macrobond Financial AB

Theme of the Month: Household savings

The Q3 national accounts showed that the household savings rate continued to normalise and is now broadly back to pre-pandemic levels.

How households behave over the period ahead as budgets are squeezed by both higher interest rates and inflation will be important for how household consumption plays out in 2023.

Households may choose to save at an even lower rate in order to maintain consumption, in which case aggregate demand may remain more resilient (and the normalisation of goods spending will be slower). However, should households become more cautious and maintain current savings rates or even increase savings in the anticipation of future pressures, the impact of rates and inflation may weigh more heavily on consumer spending.

With consumption making up around 60% of GDP this dynamic will become increasingly important for growth as the recovery in services spending runs its course. Also, how demand for goods evolves will play a significant role in inflation outcomes. A more material pull-back in demand could see a return to discounting and a faster easing in inflation. Resilient demand could see inflation remain higher for longer.

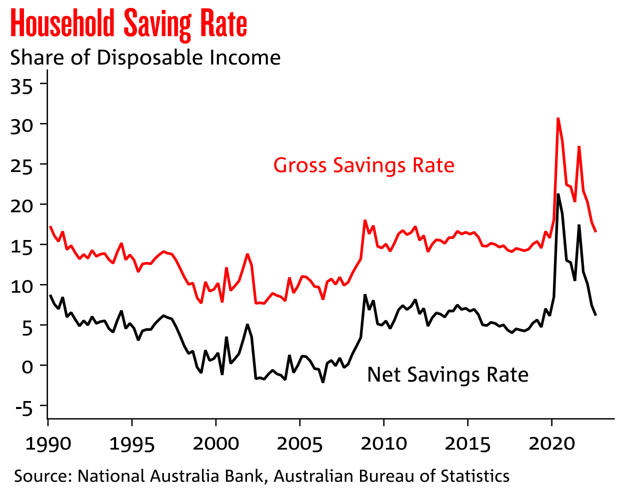
It is important to remember that the household savings rate as measured by the quarterly national accounts is a flow measure and in addition to the dynamic discussed above, how households choose to run down or preserve their accumulated stock of savings (wealth) will be important. Further, it is an aggregate measure and the distribution of income, debt and savings will all matter for spending decisions.

Also, this measure is calculated as a residual and therefore any assumptions made by the ABS on both the sources and uses of income, as well as in consumption will impact the savings rate. Because of this, it can be subject to substantial revisions over time.

Nonetheless, the quarterly measure of savings provides additional insights into how broader macroeconomic forces continue to impact households.

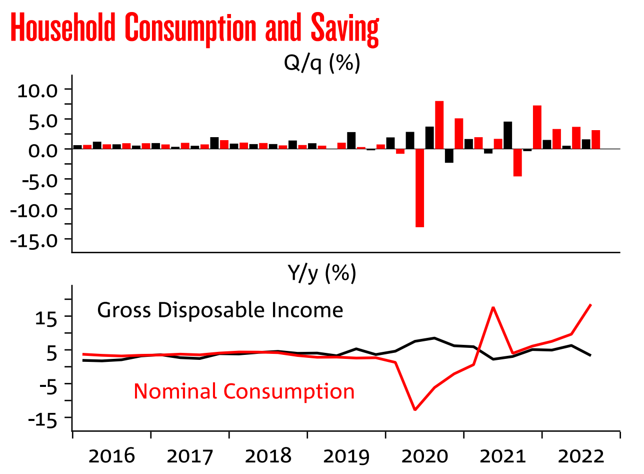
In the Q3, household consumption growth (driven by an ongoing rebound in services) of 3.1% (in nominal terms) outpaced the 1.6% rise in household disposable income. This saw the net savings rate fall to 6.9% after rising as high as 21.3% in early 2021. Excess savings – measured as the difference between actual savings and those which would have been accumulated given income growth and assuming the savings rate had remained at its pre-pandemic level were broadly unchanged at ~$250bn.

Chart 15: The household savings ratio fell to 6.9% in Q3



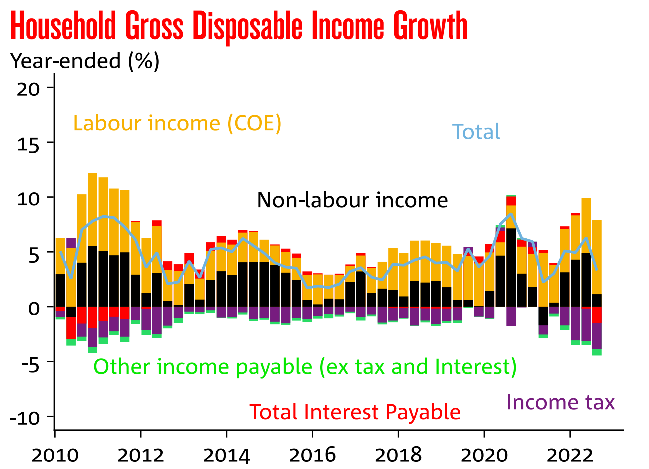
Source: National Australia Bank, Australian Bureau of Statistics

Chart 16: Consumption growth outpaced income growth in the quarter



Source: National Australia Bank, Australian Bureau of Statistics

Chart 17: Disposable income growth was supported by strong growth in labour income



Source: National Australia Bank, Australian Bureau of Statistics

The household income account continues to reflect the key dynamics underlying disposable income growth, in particular the fading impact of the pandemic and increasing pass through of higher interest rates. The rise in household disposable income in the quarter was driven by strength in wage income – supported by both growth in employment and faster wage growth. This will likely remain an important support to the sector overall even as pressure builds at the household level.

The waning of government support to households as restrictions have eased is also evident. Social assistance benefits (which captures welfare payments but not job keeper) fell 2.1% in the quarter, though it remains around 15% higher than pre-COVID levels. Social assistance benefits increased by 42% in Q2 2020, and by 25% in Q3 of 2021 as NSW and Vic went through the delta lock downs. This was an important support to income growth during the pandemic but will likely be a drag as we move further away from lockdowns and support unwinds.

While institutional arrangements (and social support) differ significantly across countries there are some key similarities across comparable economies where rates have moved more quickly and to higher rates.

NZ saw a similar dynamic of household support and restrained spending, which saw the savings rate reach above 15% in 2020. Since then, NZ has seen a faster normalisation in the savings rate, which fell to 0% in Q1 (a bit below its pre-COVID level) but rebounded in Q2.

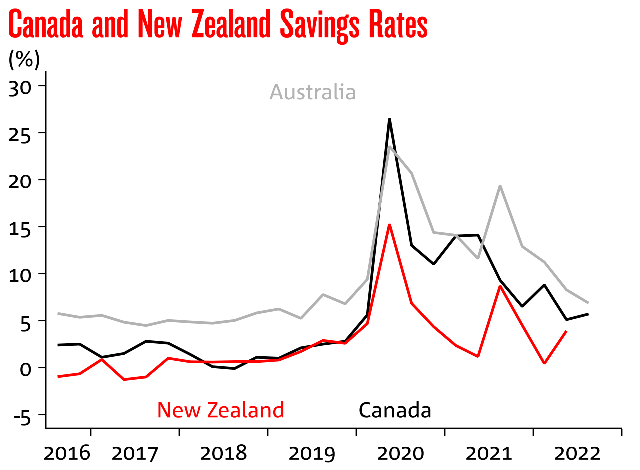
Canada, like Australia, has a seen a more gradual normalisation in the savings rate which remains a little above its pre-pandemic level in Q3 – though is also close to pre-pandemic levels.

Interestingly, the UK, where rates have not moved to the same degree as Canada but inflation pressures have been more significant, has a seen similar outcomes for the savings ratio which also remains above pre-COVID levels. The savings ratio rose to over 26% in Q2 2020 and has gradually fallen back to 7.8% in Q2 2022.

The US is an example of households being prepared to run down the ‘excess savings’ built up during the pandemic. The savings rate in October was the second lowest in over 60 years and there still remains a substantial amount of excess savings.

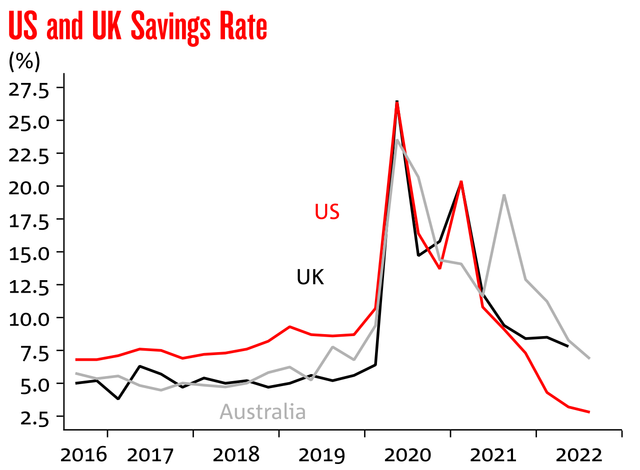
Going forward we expect household consumption growth to slow significantly in 2023 – with consumption remaining largely flat over the year – as rising interest rates continue to flow through to the household sector. How households choose to use their savings buffers will be important though we also know that a large degree of savings has flowed into mortgage prepayments and the flow measure of savings has already normalised. This suggests that we could see greater impacts through Q4 and into Q1 2023 following the resilience seen through 2022 to date.

Chart 18: International Savings Ratios



Source: National Australia Bank, Statistics Canada, Statistics New Zealand, Au

Chart 19: International Savings Ratios



Source: National Australia Bank, U.K. Office for National Statistics (ONS), U.S.

Key Domestic Forecasts:

	% Growth q/q				% Growth y/y			
	Q1-22	Q2-22	Q3-22	Q4-22 (f)	2021	2022 (f)	2023 (f)	2024 (f)
GDP and Components								
Private Consumption	1.8	2.1	1.1	0.6	3.5	5.7	0.2	0.0
Dwelling Investment	-0.5	-3.1	1.0	0.7	6.3	-1.9	0.3	-0.7
Underlying Business Investment	1.0	2.1	0.8	1.3	8.2	5.2	1.3	-1.6
Underlying Public Final Demand	2.6	0.4	-0.6	0.7	5.5	3.1	2.2	2.0
Domestic Demand	**1.7**	**1.0**	**0.6**	**0.7**	**5.2**	**4.0**	**0.9**	**0.5**
Stocks (Cont. to GDP)	0.5	-0.9	0.4	-0.2	0.4	0.4	-0.5	-0.1
Gross National Expenditure	**2.5**	**0.0**	**0.8**	**0.5**	**5.8**	**3.8**	**0.5**	**0.6**
Exports	-0.9	5.3	2.7	0.8	-2.4	7.9	2.7	2.2
Imports	11.5	1.4	3.9	1.3	1.9	19.1	1.4	0.3
Net Export (Cont. to GDP)	-2.2	0.8	-0.2	-0.1	-0.9	-1.6	0.3	0.4
Real GDP	**0.4**	**0.9**	**0.6**	**0.3**	**4.6**	**2.3**	**0.7**	**1.0**
Nominal GDP	4.1	4.1	0.8	1.4	10.3	10.7	3.0	4.1
External Account								
Current Account Balance ($b)	50.7	46.4	24.0	9.3	68.1	9.3	-42.0	-53.2
Current Account Balance (% of GDP)	2.3	2.0	1.0	0.4	3.1	0.4	-1.6	-2.0
Terms of Trade	8.2	4.8	-6.7	-1.6	9.0	4.2	-6.6	1.0
Labour Market								
Employment	2.1	0.9	0.3	0.4	2.4	3.7	1.3	1.1
Unemployment Rate (End of Period)	4.0	3.8	3.5	3.4	4.7	3.4	4.0	4.5
Ave. Earnings (Nat. Accts. Basis)	-0.3	1.6	2.5	1.0	3.1	4.8	4.0	3.6
Wage Price Index (WPI)	0.7	0.8	1.0	1.0	2.3	3.5	4.0	3.6
Prices and Rates (end of period)	**Year-ended**							
Headline CPI	5.1	6.1	7.3	8.0	3.5	8.0	4.5	3.2
Trimmed-mean CPI	3.8	4.9	6.1	6.9	2.6	6.9	4.4	3.2
RBA Cash Rate	0.10	0.85	2.35	3.10	0.10	3.10	3.60	2.85
10 Year Govt. Bonds	2.79	3.69	3.96	3.95	1.68	3.95	3.65	3.50
$A/US cents	0.75	0.69	0.65	0.67	0.73	0.67	0.75	0.76

Data are percentage growth rates over the quarter or year as noted, except where specified otherwise.

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