The Global & Australian Economic Outlook in Brief: March 2023

NAB Group Economics

Global central banks find themselves caught between competing forces – persistent high inflation and banking sector instability in both the United States and Europe. There has been some improvement in advanced economy business surveys early in 2023, and we have revised up our expectations for US Q1 GDP growth, highlighting the resilience of advanced economy economies to-date. At the same time, a boost to the global economy is evident from China's abandonment of its zero-COVID policies. We have been expecting growth to slow materially this year, and the banking developments reinforce this view, even though we assume authorities will be able to contain the problem and that the level of stress will subside from here. Our global forecasts are little changed; we still only expect global growth of 2.6%, while we have marked down slightly our expectation for growth in 2024 to 2.7%; these rates of growth are well below the historical average.

- We estimate **global consumer price inflation** was 8.4% yoy in January, down from 9.6% yoy in September 2022, but only modestly lower than the December reading. This gradual easing has been slower than most central banks anticipated, and inflation remains well above central bank targets. Similarly, measures of core inflation in the major advanced economies remain high and, where they have eased, progress has been slow.
- **Banking stress** emerged this month with some banks in the US and Europe requiring emergency funding. Despite some issues being idiosyncratic to individual institutions, fears of broader systematic risk resulted in a selloff in banking stocks in both regions. Volatility in financial markets also increased in response to the banking sector concerns, particularly in in bond markets. Government bond yields for the major advanced economies – which until March had broadly been trending higher – fell by around 50 basis points between early and mid-March. It is too early to know if the fears around the banking sector in the United States and Europe will remain isolated to individual institutions or whether financial contagion could spread. Even in a best-case scenario, increased caution could lead to a further tightening in lending standards, negatively impacting near-term economic activity. Our baseline forecasts assume that current banking stress is contained, but if the problems broaden and deepen, a steeper fall in activity would be on the cards.
- Global **commodity prices** also fell sharply in mid-March with the aggregate S&P GSCI index down around 7% when compared with the start of the month. This was driven by energy commodities (with non-energy prices essentially flat since the start of March) with oil prices dropping to their lowest levels since Russia's invasion of Ukraine.
- The banking system stresses resulted in a large shift in financial market expectations of **central bank policy rates**. Between the start of March and mid-month, the rate profile moved considerably lower – with markets pricing a lower peak and an earlier start to rate cuts. The Fed had been considering increasing rates by 50bp this month, but stepped back from this, raising rates by 25bp. It stated further tightening 'may be appropriate' so there is now less conviction about future rate increases (previously 'will be appropriate'). Its median member projection is for one more 25 bp increase (also our expectation). Similarly, the European Central Bank raised rates by 50bp this month, but its decision was regarded as 'dovish' in that it refrained from providing any guide to future rate moves.
- The Euro-zone is now estimated to have (slightly) contracted in Q4 but the business surveys in February moved further away from contractionary territory and we expect it to grow in Q1. We have also revised upwards our estimate of US Q1 GDP growth. While growth has clearly slowed (outside the US), labour markets are still very tight and core inflation measures remain high. As the full impacts of tighter monetary policy are yet to be felt and the current problems with some US and European banks are also a negative for the economy, we still consider that the outlook over the next 1-2 years for the major **advanced economies** is one of weak growth, including the possibility of 'mild' recessions (particularly US and UK).
- Growth in major **emerging market economies** slowed considerably in Q4, with year-on-year growth at around 2.9% (from 4.2% yoy in Q3). Slower growth in East Asia (particularly Malaysia and Taiwan) and China were the key drivers of the downturn. However, PMI surveys were indicative of a rebound in activity in emerging markets in February. The EM composite PMI rose to 53.9 points (from 51.9 points in January and negative readings in October and November 2022), with China the key driver of the upturn as its economy continues to normalise post the end of its zero-COVID policy and, more recently, and Chinese New Year disruptions).
- Overall, there has been minimal change to our global forecasts this month. Our global forecast for 2023 is unchanged at 2.6%, while our 2024 outlook is marginally weaker at 2.7%. We anticipate a moderate recovery in 2025, with growth at 3.2% (in part reflecting easing monetary policy in 2024).
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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For Australia, our outlook for the economy is broadly unchanged. The Q4 national accounts showed GDP rose by a healthy 2.7% over 2022 and that prices pressures remain elevated and broad. We expect growth to slow sharply to 0.7% y/y in 2023 and 0.9% in 2024. Two years of well-below trend growth will see a slowing in labour demand growth which will see the unemployment rate rise to 4% by end 2023 and 4.7% by end 2024. A very tight labour market has seen an acceleration in wage growth over the past year or so, and we expect growth in the hourly Wage Price Index to peak at around 4% before easing as some of the tightness in the labour market fades. Inflation is expected to moderate over the next two years – but only reach the top of the RBA's target band by late 2024. Domestic factors – including wage growth – will be increasingly important for where inflation settles as global pressure eases. For now, while having strengthened, wage growth does not appear inconsistent with "at target inflation". Our rate view is unchanged, and we still expect 25bp increases at each at the April and May meetings, to a peak of 4.1% - where we expect the cash rate to stay until early 2024.

- **Employment rose by 65k in February, unwinding softer prints in December and January** which were in part affected by unusual seasonal effects. The rebound was accompanied by an uptick in participation and was enough to drive the unemployment rate back down to 3.5%. Leading indicators of labour demand have softened slightly with both job ads and vacancies easing recently, but they remain elevated. On labour supply, the latest population estimates from the ABS showed strong growth of 0.5% q/q in Q3 – driven by a rebound in net migration. Slower demand growth amidst the pick-up in supply should see the unemployment rate rise to 4.0% by end 2023 and 4.7% by end 2024. This loosening in the labour market will see some of wage pressure ease somewhat – we expect growth in the WPI to peak at around 4.0% y/y before easing in late 2024 and into 2025.
- **Household consumption rose 0.3% q/q in Q4 2022 as spending continued to rebalance from goods to services.** The national accounts showed a 1% fall in goods spending with services spending up 1.2% q/q, while both discretionary and non-discretionary components rose in the quarter. Higher frequency data suggest consumption has held up in early 2023 in nominal terms but may be approaching a turning point. Nominal retail sales rose 1.9% in January and NAB's internal transaction data – released in the *Monthly Data Insights* note last week – suggests nominal spending remained flat at around the same level through February. With prices still rising, these nominal data indicate another weak quarter of consumption growth in real terms but for now we continue to see a small positive for Q1 2023 overall - around 0.2% q/q.
- **We continue to see further falls in house prices in 2023 despite the recent stabilisation.** After declining by around 9% from the peak in early 2022, we see capital city house prices declining by a further 11% over 2023. This would take the total peak-to-trough decline to around 20%. We see this as primarily driven by a large reduction in borrowing power for most households, though at present the rebound in population growth, a healthy labour market and a tight rental market are key offsets. In the rental market, vacancy rates remain low – and will likely continue to do so – as population growth rebounds with a key implication the strength in rents growth. New advertised rents growth is currently tracking at around 11% y/y while the CPI measure is currently tracking around 4% y/y. On the activity side, building approvals continued to weaken in January suggesting that construction activity will decline significantly once the existing pipeline of work is completed.
- **Business conditions in the NAB Monthly Business Survey edged down 1pt in February to +17 index points.** Confidence fell 10pts to -4 index points, with the fall driven by wholesale, recreation & personal services, and finance, business & property. Confidence is now well below average after trending down over the past 6 months, despite conditions holding up and capacity utilisation remaining high. As pandemic stimulus wanes and uncertainty remains elevated, we expect business investment growth to remain soft over 2023 and into 2024.
- **Net exports made a large positive contribution to GDP in Q4 2022, reflecting both increased exports and a fall in imports.** We continue to see net exports providing some support for growth across 2023 as global trade in goods and services normalises and exports recover, while the slowdown in consumption growth will weigh on imports.
- **Inflation looks to have peaked in Q4 but the monthly business survey suggests price pressures remain elevated.** The Monthly CPI indicator for January showed year-ended inflation eased to 7.4% (from 8.4% in December) while global supply chain indicators and freight costs continue to recover. The easing in global pressures should continue to flow through to domestic prices, though the speed and timing remains uncertain. We see inflation easing to 4.5% by end 2023 and 3% by end 2024 – though how domestic pressures evolve, particularly given the tightness in the labour market, will be important for where inflation settles as global factors fade.
- **The RBA increased the cash rate by 25bps in March to 3.6% and we continue to see rates reaching 4.1% in May, before staying there until 2024.** That said, the RBA post meeting statement, subsequent minutes as well as the Governor's speech in early March point to dovish turn by the bank, signalling that they are close to a pause but expect to do more in the near term. As we approach the inflection point, the RBA will become even more data dependent.
- **We see the AUD/USD rising to around US78c by end 2023 and US80c by end 2024.** That said, this view is predicated on a longer term weakening in the USD while volatility remains high at present.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Tuesday.

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