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The Forward View: Australia April-2023

Economy to slow despite jobs, population surge

NAB Group Economics

Overview

- The economy continues to evolve in line with our near-term forecasts, with signs that consumption is plateauing ahead of a likely slowdown later in the year. We continue to see well below trend GDP growth of around 0.7% y/y over 2023 as higher rates increasingly weigh on household budgets.
- To allow time to assess this flow-through, the RBA paused its rate-rise cycle in April. The risk of further rate rises remains – especially if inflation or wages surprise to the upside – but the slowing data flow is likely to make rate rises harder to justify as time goes on. As such, we now see the current 3.6% cash rate as the likely peak (down from 4.1%).
- With rates assumed to peak 50bps lower, we have somewhat revised up our expectations for GDP growth in 2024 – though at 1.3% y/y this remains below trend.
- The complex dynamics of rebalancing goods and services spending, rebounding population growth, tightening monetary policy and a clouded global outlook continues to shape the outlook for Australia's economy.
- The unemployment rate remains at record lows, but strong population growth and slowing activity should see labour market pressures ease with unemployment likely to reach 4.7% by end-2024 before settling at 4.5% in 2025. We continue to expect wage growth to pick up but remain consistent with at-target inflation.
- Likewise, inflation is well above target but higher frequency data suggest that inflation peaked in Q4 – although the Q1 release next week will be a key test. The pace of global goods disinflation, strength of domestic rent and energy price growth, and the pace of wage growth remain key uncertainties but for now we continue to see inflation returning to around 3% by end-2024.
- The housing market is likewise caught between competing forces, with higher rates impacting borrowing power and driving down approvals, but underlying population dynamics still pointing to a shortfall of housing supply. Prices falls have temporarily abated, and we now expect a total fall of 4% across 2023 (previously -11%). However, there remains considerable uncertainty as to how the market will adjust.

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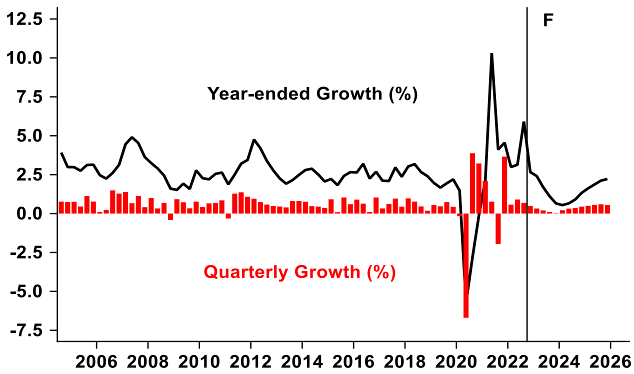
Key Economic Forecasts

	2022-F	2023-F	2024-F	2025-F
Domestic Demand (a)	4.9	0.9	0.4	2.0
Real GDP (annual average)	**3.7**	**1.5**	**0.9**	**2.0**
Real GDP (year-ended to Dec)	**2.7**	**0.7**	**1.3**	**2.2**
Terms of Trade (a)	6.0	-4.4	-2.8	-1.1
Employment (a)	4.1	2.2	0.7	1.5
Unemployment Rate (b)	3.5	4.0	4.7	4.5
Headline CPI (b)	7.8	4.7	2.9	2.7
Core CPI (b)	6.3	4.8	3.0	2.8
RBA Cash Rate (b)	3.10	3.60	3.10	3.10
$A/US cents (b)	0.68	0.74	0.73	0.78

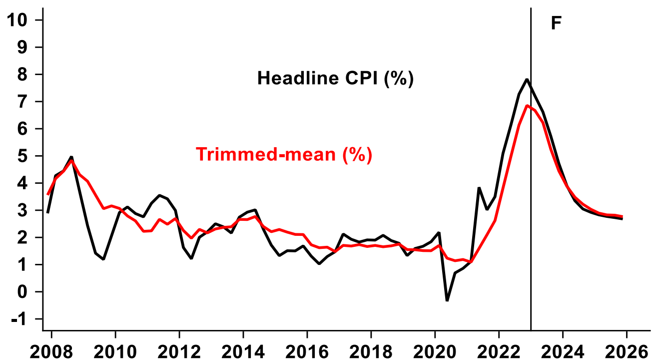
(a) annual average growth, (b) end-period, (c) through the year inflation

Chart 1: GDP forecasts



Source: Macrobond, NAB Economics

Chart 2: CPI forecasts



Source: Macrobond, NAB Economics

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Labour Market, Wages and Consumption

Another strong month of employment growth left the unemployment rate at 3.5% in March, and there has only been modest easing in job vacancies. We continue to see a gradual rise in unemployment over the coming two years as the economy begins to slow.

Employment rose 53k in March, following a 65k rise in February, and the participation rate was steady, leaving unemployment at its very low level of 3.5%. There was a small fall in hours worked in the month but full-time employment rose. Overall, the employment to population ratio remains at a near-record level of 64.4%.

There continue to be only limited signs of easing in the tightness of the labour market. The February job vacancies report saw the number of vacancies ease just 1.5% from November, remaining almost double the pre-COVID level with around 0.9 vacancies per unemployed. We expect the tight labour market conditions to continue flowing through to wage growth, which should rise to 4% this year.

Still, there continues to be a rapid rebound in population with a further spike in net permanent and long-term arrivals in February. We expect that, as the economy slows, employment demand will eventually cool and be unable to absorb the full rate of population growth, seeing the unemployment rate gradually rise to 4% by end-2023 and 4.7% by end-2024. However, given the unprecedented nature of the current level of labour demand and the swift rebound in population, it is difficult to know exactly how this transition will play out.

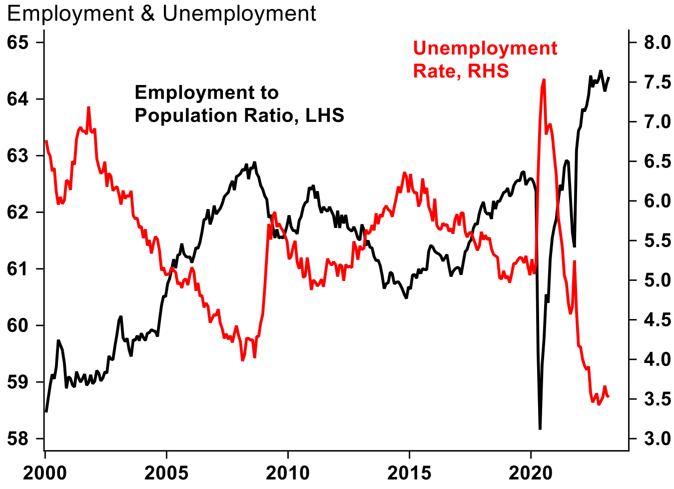
NAB's internal data suggest consumption growth slowed considerably in Q1, with real consumption to be flat or negative through the remainder of the year.

NAB's *Monthly Data Insights* for March showed a fall in retail spending of 0.8% m/m, with overall consumer spending down 1% m/m. The decline was spread across both goods and services spending, marking the first significant monthly decline in services since the Omicron wave in January 2022.

The fall in March came after a flat spending result for February, with the softness in nominal spending also reflected in the ABS's February retail trade print of just 0.2% m/m. Overall, NAB's data suggest total nominal consumer spending rose 2% across Q1. With inflation still high, this suggests another quarter of modest real consumption growth of around 0.2% q/q.

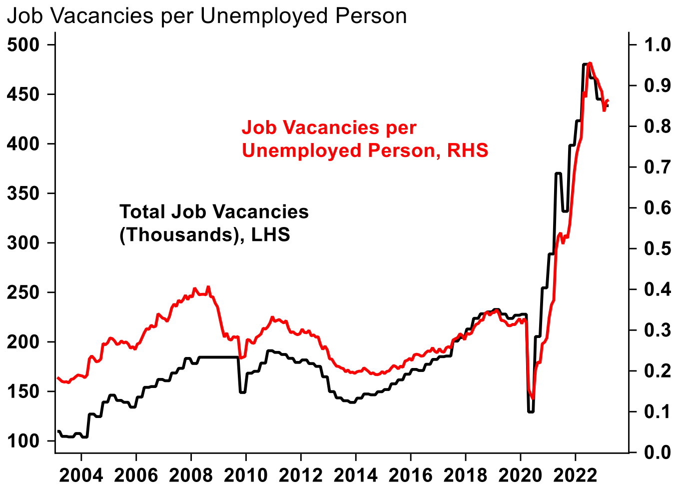
Looking ahead, the softening in spending is likely to continue as high inflation and the ongoing pass through of rate rises weighs on household budgets. As a result, we continue to expect flat or negative real consumption growth across the remainder of 2023 – although with rates possibly peaking at 3.6%, we have slightly upgraded our outlook for consumption in 2024.

Chart 3: Unemployment rate firmly at 3.5%, with employment growth very strong in Feb and March



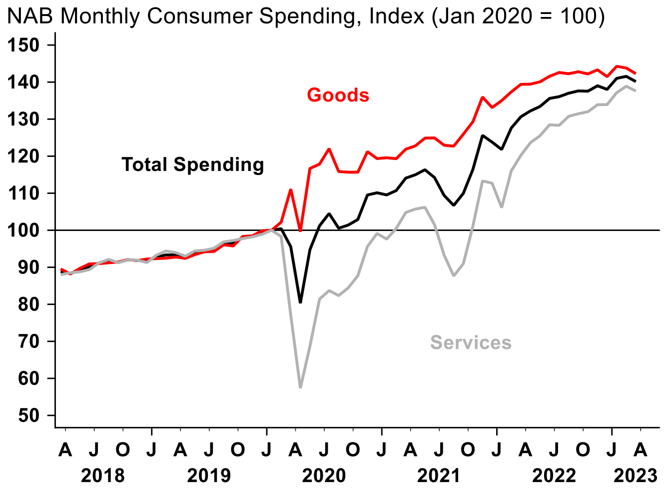
Source: Macrobond, NAB Economics

Chart 4: The number of job vacancies edged lower in February but remains almost double pre-COVID levels



Source: Macrobond, NAB Economics

Chart 5: NAB's internal data suggest nominal spending declined in March across both goods and services



Source: Macrobond, NAB Economics

Housing and Construction

House prices have continued to stabilise over the last month and building approvals continued to trend lower amidst the strengthening in population growth.

The CoreLogic 8-Captial Cities index rose by 0.8% in March led by gains in Sydney, Melbourne and Perth while Brisbane also edged up. Hobart continued to fall at a relatively strong rate. Nonetheless, dwelling prices are down 9% from their peak in April 2022. The PropTrack house price index also indicates a stabilisation in prices after troughing slightly earlier (for a peak to trough decline of around 4%).

Alongside the apparent stabilisation in prices, we have upgraded our outlook for house prices. We continue to see small falls in the near-term of around 3.5%, which would take the peak-to-trough decline in the current episode to 12% (from our previous expectation of an 18% decline). After that we expect prices to remain flat for a brief period before picking up through 2024.

We still see the fall in prices as having been driven by a large reduction in borrowing power as rates have risen sharply the past year. However, the decline in prices has not fully offset the reduction in borrowing power which has fallen by around 25-30%.

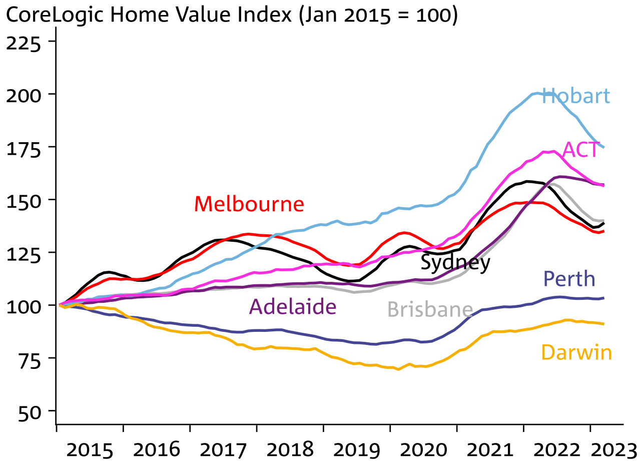
The very strong pickup in housing demand has been a key support. Population growth has rebounded strongly since the reopening of international borders in addition to the additional floorspace demands during the pandemic. A healthy labour market and strong rents growth are also supporting higher prices.

Turnover metrics show some improvement in the established market over recent months while new sales remain very low. As turnover rises the stability in prices may be tested given the low rates off affordability and very large reductions in borrowing capacity. However, the relative short fall in supply appears very large and could see house prices drive higher in the near term (see page 6 for further discussion).

The strength in demand has already seen a significant impact in the rental market where newly advertised rents continue to rise by over 10% in annual terms. Rental vacancy rates across the capitals remain extremely low, at or below 1%. The strength in rents is likely to continue in the near term, and flow through to existing lease agreements as they renew.

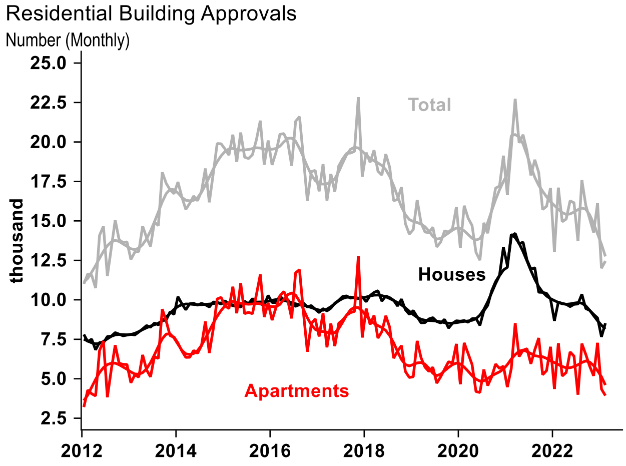
Lending approvals for housing fell a further 0.9% in February and are now down 31% over the year. The ongoing weakness was evident in both owner-occupier and investor segments. Reflecting the broader slow-down in new construction, lending for new builds fell 7% and is now down 28% y/y.

Chart 6: House price have shown signs of stabilisation



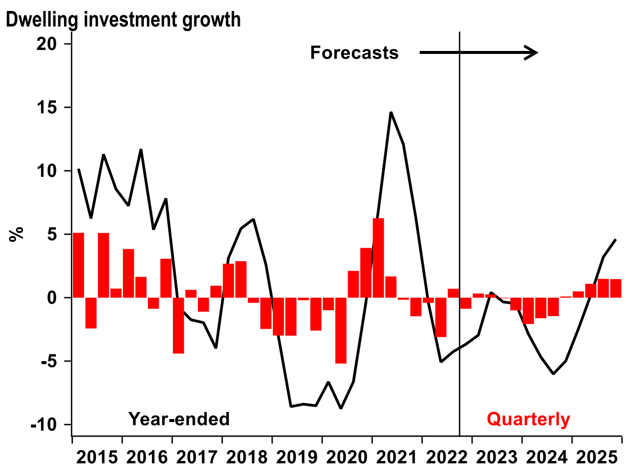
Source: National Australia Bank, CoreLogic, Macrobond

Chart 7: Building approvals have fallen sharply



Source: Macrobond, NAB Economics

Chart 8: Dwelling investment is likely to fall as the pipeline of outstanding work is completed



Source: ABS, National Australia Bank

Business and Trade

Business conditions have continued to hold up although confidence remains low and credit growth has slowed significantly.

Business conditions in the NAB Monthly Business Survey eased 2pts in March but at +16 index points, remained well above the long-run average. Confidence appears to be stabilising at a lower level, at -1 index points in March, but forward orders remain positive and capacity utilisation remains very high.

There are also signs that cost pressures and prices are easing somewhat. Labour cost growth was 1.9% in quarterly equivalent terms (down from 2.6% in February), purchase cost growth was 1.8% (down from 3%), overall price growth was 1.2% (down from 1.6%) and retail price inflation was 1.6% (down from 2%). These growth rates all remain well above their pre-pandemic norms but are in line with expectations that inflation likely peaked in Q4.

Business credit growth continues to slow as the outlook for the economy softens and higher rates weigh on lending, rising 0.4% in February to be 11.9% higher y/y. Importantly, a run rate of 0.4% m/m annualises to around 5%, more in line with the historical norms for business credit growth after a period of rapid growth in 2021 and 2022.

With both confidence and credit growth slowing, business investment is also likely to slow over the coming year as higher rates tilt the cost-benefit balance for new capital investments.

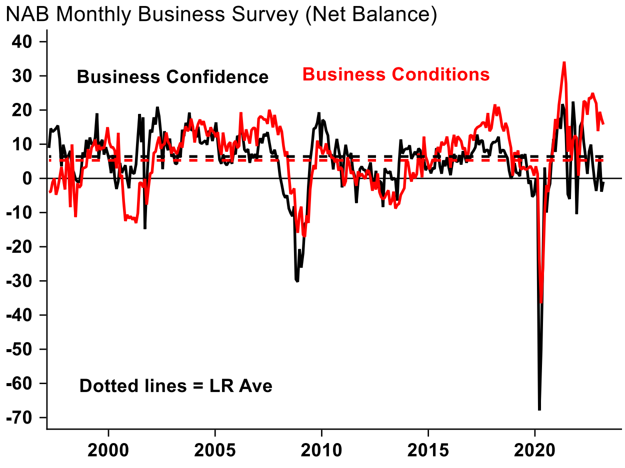
The trade balance picked up in February, driven by a large fall in imports related to vehicles. Freight services costs continue to moderate as global supply chains return to normal.

There was a 9.1% fall in imports in February as the large January surge in vehicle imports was reversed. Exports also fell, down 2.9% in the month, driven by a fall in metal ores and minerals largely reflecting slightly lower export volumes. On net, the trade surplus increased to $13.8b (from $11.3b in January).

Freight services costs, which reached a peak of 6.6% of the value of goods imported in August 2022, have continued to moderate and were down to 4.4% in February. How quickly these savings pass through to consumer prices remains to be seen as some elevated costs are likely still embedded in inventories.

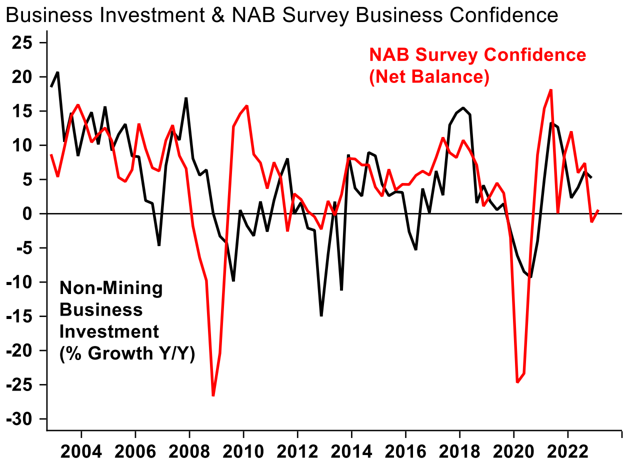
In terms of real economic growth, we expect a small positive contribution from exports through the forecast period as trade normalises further, with recent positive news on Australia's trade relationship with China further cause for optimism.

Chart 9: Business conditions remain strong and confidence is back around average



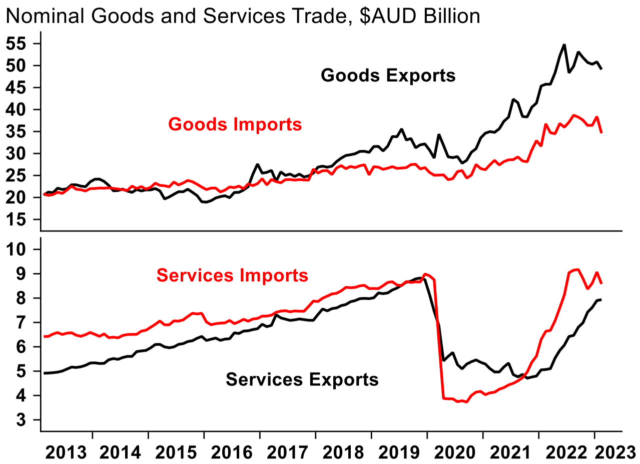
Source: Macrobond, NAB Economics

Chart 10: Business confidence has fallen and investment is likely to also slow over the coming year



Source: Macrobond, NAB Economics

Chart 11: A fall in imports saw the trade balance increase in February, but commodity prices remain a key factor



Source: Macrobond, NAB Economics

Monetary Policy, Inflation and FX

The RBA held the cash rate steady in April at 3.6% but maintained a hawkish bias.

The RBA continued to highlight the lags in policy and reflect on the fact that the full impact of the rapid increase in rates over the past year is yet to fully flow through while reiterating its commitment to bring inflation back to target – with the RBA setting a return to target by mid-2025.

We further trimmed our rate expectations in the month, expecting the RBA to remain on hold until mid-2024, before rates are cut back towards neutral. We acknowledge the risk that in the near-term the RBA could well take rates higher if challenged by the incoming CPI data (April) or WPI data (May). However, our view is that the longer the RBA waits, the less likely they are to increase rates further.

Regardless, with policy now in restrictive territory, and the RBA placing a strong emphasis on maintaining the gains in the labour market we are in sight of the likely peak.

Inflation looks to have peaked in Australia, but how quickly it moderates will now take focus. We see a print of 1.3% q/q (6.6% y/y) for Q1 trimmed mean.

Upstream indicators continue to show a moderation in price pressures, with shipping costs and measures of supplier delivery times in PMIs at or below pre-pandemic levels. Indeed, the NY Fed supply pressure index based on a range of these measures fell sharply in March.

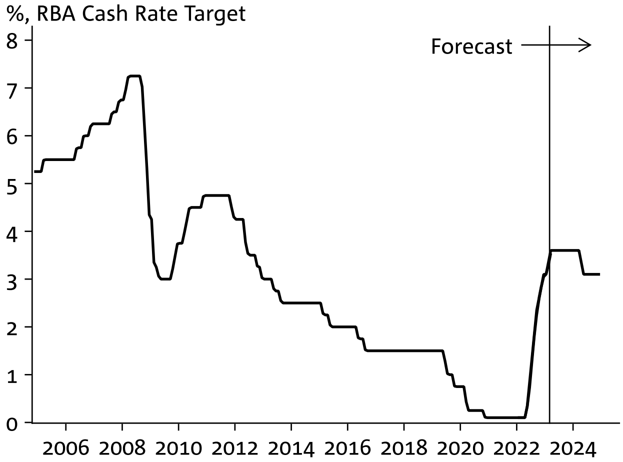
However, despite the moderation in upstream indicators, official measures of inflation globally are yet to see a significant disinflation. For Australia, the monthly CPI indicator eased from 7.4% to 6.8% in February and the NAB business survey measure of output prices saw further moderation. The full quarterly CPI released next week will likely moderate further, after peaking at 1.9% q/q in Q3 2023. That said, a print of around 1.3% is still very strong relative to the RBA's inflation target.

Looking forward, with supply pressures (and demand) for goods easing significantly it is likely we will begin to see more material goods disinflation. Services side inflation (particularly domestic) will become increasingly important for how quickly inflation moderates. Rents inflation is likely to strengthen further amidst the tight rental market and the focus on market services inflation (where stronger wages are a key factor) will remain a focus.

We see the AUD/USD rising to around US74c by end 2023 and US73c by end 2024.

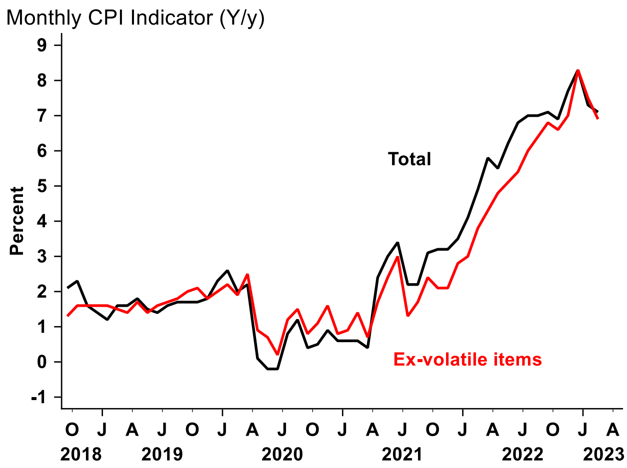
We have lowered our forecasts for the Aussie by around 4c in 2023 and 2024. While we still expect a broad-based weakening in the USD to occur, global growth and risk sentiment factors have become greater headwinds for the Aussie.

Chart 12: Cash rate expected to rise to 4.1% by May and stay there through H2 2023



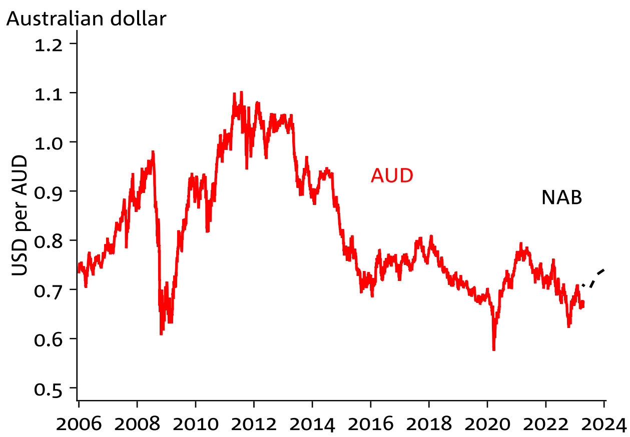
Source: Macrobond, NAB Economics

Chart 13: Inflation looks to have peaked in December



Source: ABS

Chart 14: AUD/USD to drift higher over coming years, reaching US80c by end 2024



Source: National Australia Bank, Macrobond Financial AB

Theme of the Month: Developments in Housing Supply

The rapid rebound in population growth since borders have reopened has seen housing demand rise quickly at a time when the supply of new dwellings has come under pressure.

Official estimated resident population data for Q3 2022 show that population growth has rebounded to 1.6% y/y on the back of the recovery in migration – which rose by 304k over the year. The labour force survey (while subject to revision) provides a more up to date estimate of civilian population growth which is currently growing at an annualised rate of 2.3%.

This rebound has been much stronger than expected, but likely in part reflects a “catch-up” of missed population growth during border closures. At its peak, when compared to pre-COVID growth rates, the gap between actual and trend population growth reached around 400k, based in the rebound in population growth in 2022 alone, this gap has now halved.

We are able to construct a simple measure of housing demand using an assumption for population growth as well as the average household size. Assuming the formation of new households is in line with the current average household size of 2.57 persons per dwelling (based on the 2021 census) and assuming population growth of 2.3% - nationwide Australia will require an additional 230k dwelling completions per year in order to house the growing population. (Note this, is a simple approach and does not account for the impact of demolitions on the housing stock or the demand for holiday homes and other additional dwellings.)

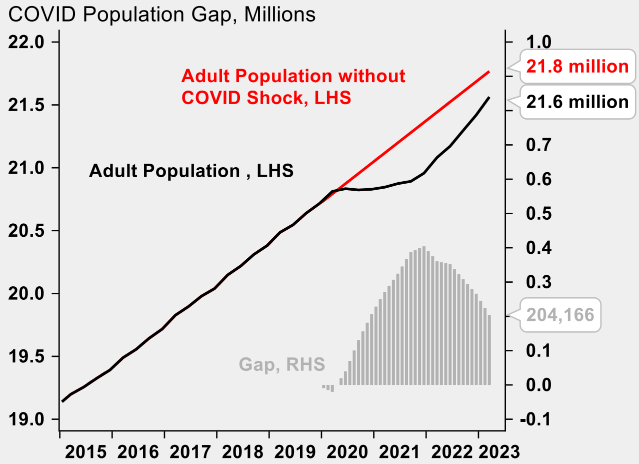
On the supply side, ABS Building Activity Survey data for 2022 Q4 showed a further small fall in the rate of new supply with completions down 2% q/q at 43k – around 2015 levels. The annual run rate continues to track around 170k across houses and higher density dwellings. At face value, the current run rate leaves a shortage of around 50k dwellings per year if current trends continue.

More broadly, the pipeline of work to be completed remains relatively high – with 274k dwellings under construction or about to be commenced - but this has resulted largely due to delays in construction with new approvals declining to relatively low levels. Current rates of building approvals point to ongoing completions of around 140k per year once the current pipeline is cleared.

At present, the delays in completions has seen the outstanding work yet to be done rise to around 6 quarters of work at current rates.

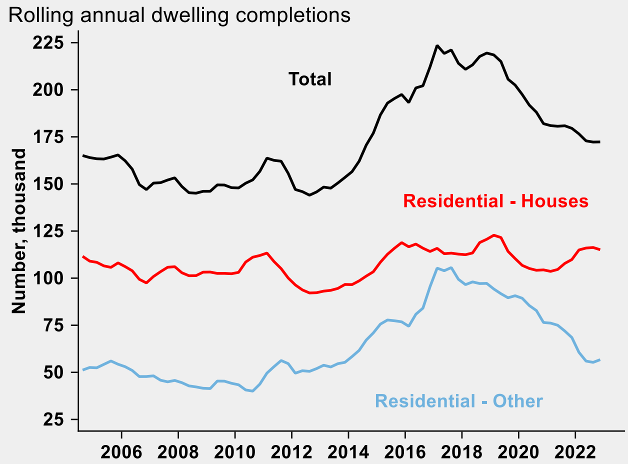
The weakness in approvals is somewhat surprising given the strong outlook for housing demand and the fact that dwelling prices appear to have fallen significantly less than expected. However, uncertainty has been high with interest rates rising sharply over the past year and

Chart 15: Population growth has rebounded rapidly since the reopening of borders



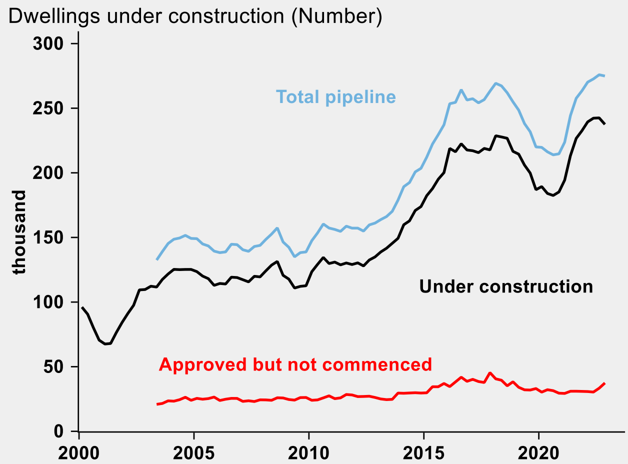
Source: Macrobond, NAB Economics

Chart 16: Completions have fallen back to 2014 levels in annual terms



Source: Macrobond, NAB Economics

Chart 17: The pipeline of new dwellings remains high, but approvals new approvals are falling



Source: Macrobond, NAB Economics

significant weather, cost and other supply disruptions likely weighing on development plans.

Indeed, the latest NAB Residential Property Survey (released last week) lists construction costs as the most significant constraint on new building, followed by interest rates and labour availability.

With the housing market tight and a likely ongoing "catch-up" in population in the near term the demand/supply imbalance is likely to persist for a while yet. This will likely see rental vacancy rates remain around historical lows and ongoing upward pressure on rents.

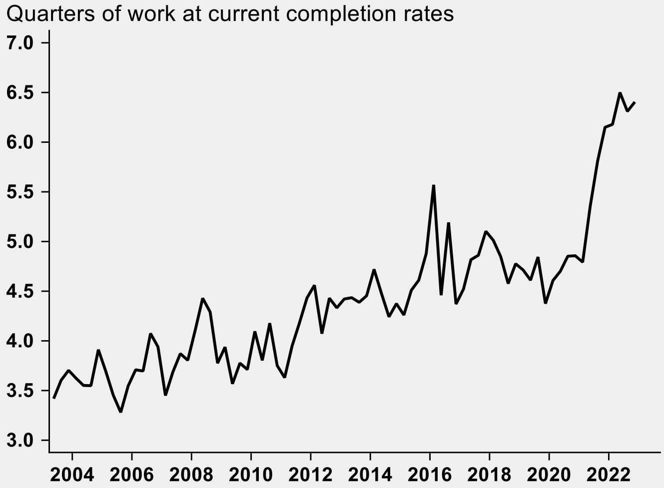
This will also likely spill over to the established housing market, with the additional demand likely to be a key price support. The rebound in population across the states and already tight housing markets suggests these pressures will be broad based across the states.

There are several key implications for the broader economy of any ongoing shortage of dwelling supply. The first is upward pressure on prices alongside higher rates have seen a sharp deterioration in housing affordability – the share of incomes spend on housing. Higher housing costs will further constrain budgets and possibly crowd out other consumption and investment.

The second key implication, is that rents growth is likely to remain elevated in the near term, boosting measured inflation in the CPI. CPI rents account for around 6% of household spending and are currently tracking at 4.0% y/y – the highest rate since 2012. Newly advertised rents continue to track at significantly stronger rates ~10% y/y across the capital cities – and present a big upside risk to inflation if the CPI measure converges to this.

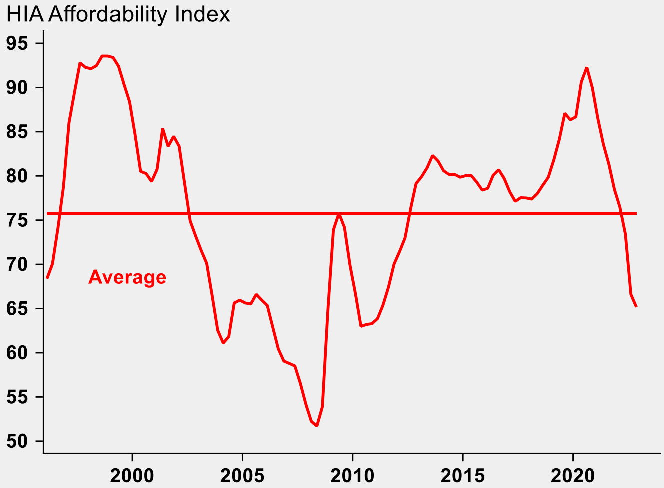
The third key implication is that household size is likely to rise alongside the cost of housing. That is, children are likely to remain at home longer, share houses will reform and the demand for floorspace will decrease. These factors may go some way to reverse pandemic trends towards smaller household size (which added 160k dwelling demand). However, frictions such as annual leases mean that this adjustment is unlikely to be instantaneous and rather take a period to play out.

Chart 18: There are around 6 quarters of work based on current completion rates



Source: Macrobond, NAB Economics

Chart 19: Affordability has deteriorated sharply



Source: Macrobond, NAB Economics

Key Domestic Forecasts:

	% Growth q/q				% Growth y/y			
	Q1-23 (f)	Q2-23 (f)	Q3-23 (f)	Q4-23 (f)	2022	2023 (f)	2024 (f)	2025 (f)
GDP and Components								
Private Consumption	0.3	0.1	-0.2	-0.3	5.4	-0.1	1.1	2.2
Dwelling Investment	0.3	0.3	0.0	-1.0	-3.7	-0.5	-5.0	4.6
Underlying Business Investment	-0.9	-1.1	-0.6	-0.6	3.5	-3.3	-1.4	2.7
Underlying Public Final Demand	0.7	0.5	0.5	0.5	2.5	2.2	2.0	2.0
Domestic Demand	**0.3**	**0.1**	**0.0**	**-0.1**	**3.3**	**0.3**	**1.0**	**2.5**
Stocks (Cont. to GDP)	0.1	0.0	0.0	0.0	0.4	-0.4	0.1	0.1
Gross National Expenditure	**0.3**	**0.1**	**0.0**	**-0.1**	**3.2**	**0.3**	**1.1**	**2.5**
Exports	0.6	0.4	0.4	0.3	7.7	1.7	1.9	2.3
Imports	0.5	0.1	-0.3	-0.4	12.1	-0.1	1.1	3.9
Net Export (Cont. to GDP)	0.0	0.1	0.1	0.2	-0.5	0.4	0.2	-0.2
Real GDP	**0.3**	**0.2**	**0.1**	**0.0**	**2.7**	**0.7**	**1.3**	**2.2**
Nominal GDP	1.4	1.1	0.4	0.4	12.0	3.3	4.3	4.3
External Account								
Current Account Balance ($b)	39.4	40.1	47.5	39.4	29.4	39.4	30.3	24.9
Current Account Balance (% of GDP)	1.6	1.6	1.9	1.5	1.2	1.5	1.1	0.9
Terms of Trade	-0.4	-0.8	-2.8	-2.1	7.2	-6.0	1.0	-2.5
Labour Market								
Employment	0.4	0.3	0.3	0.2	5.0	1.2	0.7	2.0
Unemployment Rate (End of Period)	3.6	3.6	3.8	4.0	3.5	4.0	4.7	4.5
Ave. Earnings (Nat. Accts. Basis)	0.9	0.9	1.1	1.0	4.4	4.0	3.6	3.2
Wage Price Index (WPI)	0.9	0.9	1.1	1.0	3.3	4.0	3.6	3.2
Prices and Rates (end of period)	**Year-ended**							
Headline CPI	7.2	6.6	5.7	4.7	7.8	4.7	2.9	2.7
Trimmed-mean CPI	6.7	6.2	5.2	4.4	6.9	4.4	3.0	2.8
RBA Cash Rate	3.60	3.60	3.60	3.60	3.10	3.60	3.10	3.10
10 Year Govt. Bonds	3.31	3.85	3.85	3.65	4.04	3.65	3.50	3.55
$A/US cents	0.71	0.70	0.73	0.74	0.68	0.74	0.73	0.78

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

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