The Global & Australian Economic Outlook in Brief: May 2023

NAB Group Economics

Global economic data point to a bounce in growth in Q1, with China providing around 40% of this total. This momentum is not expected to last, as the boost from China's reopening starts to fade and tighter financial conditions impact global activity, leading to softer economic growth going forward. Stress in the US banking sector re-emerged in May, and could persist for some time, contributing to already tightening lending standards. Global inflation has continued to trend lower, but remains well above central bank targets, with core measures proving sticky. While we believe that central bank policy rates are at or near their peak, sustained high inflation could necessitate policy rates continuing to be lifted. We forecast global economic growth to slow to 2.7% in 2023 and 2024, before edging up to 3.2% in 2025 – with this entire outlook falling below the long run average for the global economy (of 3.4%).

- **Banking stress** remains an issue in the US with the failure of First Republic Bank in early May. There are broader concerns around the ongoing viability of regional US banks, in part due to deposit flight to larger competitors, meaning that this may not be the last bank to go under. Financial market reaction has been more muted than in March. That said, surveys of loan officers point to an on-going tightening in credit supply conditions in the US and Europe. The same surveys also point to a significant weakening in loan demand.
- Global **inflation** has slowed in recent months. We estimate global CPI inflation of 7.0% yoy in March 2023, down from a peak of 9.6% yoy last year. This is remains well above central bank targets and measures of core inflation in advanced economies are proving to be sticky – highlighting the risk of further policy rate hikes. On the plus side, supply side pressures have continued to ease.
- Global **commodity prices** – as measured by the aggregate S&P GSCI index – have drifted lower since mid-April, with lower energy prices the main contributor to this trend. West Texas Intermediate crude oil briefly rallied above US$80 a barrel around this mid-April peak – following the announcement of production cuts by OPEC+ members, however prices have subsequently fallen, with weakening economic activity likely to keep global demand relatively subdued.
- Among the **advanced economies**, the US, Euro-zone, Japanese and UK economies all grew in Q1, but at a subdued pace, and we expect Canada to also record positive growth. However, due to the lagged effects of central bank rate rises and the tightening in lending standards from the banking issues, we remain bearish on the outlook. In particular, we expect the US economy to contract at some point this year (with falls in Q2 and Q3 pencilled in) with spillovers to Canada. For the Euro-zone and UK, the cross winds from policy tightening but energy price relief should see subdued growth.
- Business surveys continue to point to relatively robust conditions in **emerging markets**, particularly in the services sector, but manufacturing has remained relatively soft. Weak global demand for goods (reflecting generally slower growth and the switch to services) is impacting EM and east Asian growth as it is relatively trade dependent, with Taiwan falling into recession.
- We estimate Q1 **world GDP growth** was 0.9% q/q, up from 0.1% in Q4 2022, with around 40% of this growth coming from China. Growth should slow in Q2, as the boost to China's growth from the removal of COVID restrictions fades, and also because of weaker advanced economy growth. Challenging this view, the global PMI continued to improve in April signalling some possible near-term upside risk. However, downside risk is coming from still high and sticky core inflation; while we expect the major central bank policy rates are at or near their peak, if inflation does not decline as expected this may push them to move higher.
- For each of 2023 and 2024 we still expect **global growth** of 2.7%. Excluding the global financial crisis and COVID 19 impacted 2020, this would be the slowest rate of growth since 2001. This should see some easing in central banks settings and so we are factoring in a modest upturn in global growth in 2025 (to 3.2%).
- Our forecasts are based on a view that policy rates have either peaked or are near their peak. However, the risk is that there will be additional tightening as, while headline inflation has fallen, measures of underlying inflation are proving to be sticky. Other downside risks come from continuing bank stresses and the as yet unresolved debt ceiling in the US, the possibility that further financial system strains will emerge, and geopolitics. The Russia-Ukraine conflict persists, with no resolution in sight, and tensions between the United States and China also remain
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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For Australia, we continue to expect growth to be well below trend at 0.7% and 1.2% in 2023 and 2024 respectively – though we have reverted to our previous expected rate call of a peak of around 4.1% and see a material risk that rates reach 4.35%. Consumption dynamics remain the key force at play, with pressures on households from inflation and rates to weigh on growth through H2 2023 and early 2024. This will lead employment growth to slow and unemployment to rise to 4.7% by end-2024, while inflation should moderate to 4% by end 2023 and 3% by end 2024 – though significant uncertainty remains around the inflation outlook with wage growth an important factor. Overall, the pattern of our forecasts is similar to the updated forecasts recently released by both the RBA and Treasury, albeit we are marginally more pessimistic in the near term.

- **Employment declined 4k in April and unemployment rose to 3.7%, while wages continue to gradually strengthen across Q1**. The labour market remains very tight and trend unemployment remains at 3.6%. The softer April result was in line with our expectations for a gradual easing as the economy slows with the unemployment rate to gradually rise to 4% by end-2023 and 4.7% in 2024. Wage growth continues to gradually strengthen, with the Q1 WPI showing wages grew 0.8% q/q and 3.7% y/y. Importantly, under the surface the average private sector wage rise was 4.3%. This, alongside a likely significant minimum wage increase, should see wage growth reach 4% this year. This would not be inconsistent with inflation returning to target but will likely continue to be a focus given the importance of wages to services inflation over the forecast period.
- **Retail sales declined in Q1, flagging a likely soft quarter for consumption growth.** Despite positive nominal growth over the three months to March, the ABS's latest data confirmed the underlying volume of retail sales declined 0.6% in Q1. The result signals a likely soft Q1 result for overall consumption, with the now well-advanced services recovery needing to continue to make up for declining goods consumption. We expect consumption growth around 0.2-0.3%. Further ahead, we continue to see high inflation and higher interest rates weighing increasingly heavily on household budgets, causing real consumption to decline slightly through late 2023 and into 2024.
- **House prices have recorded further gains over the past month, despite a further increase in rates.** Both the CoreLogic and PropTrack house price measures showed further gains in April, rising by 0.7% and 0.2% respectively. Higher frequency CoreLogic daily data suggests prices increased further in early May, even as the RBA surprised with another rate increase - with the rapid rise in rents, rebound in population growth and growing expectations that rates may be near the top are all key offsets. A key factor for both rental and property prices over coming years will be the extent of the ongoing mismatch between supply and demand. Dwelling completions have fallen notably (albeit from very high levels) over the past year, and new building approvals continue to decline, so construction activity is likely to fall as the pipeline is eroded – putting further pressure on housing supply.
- **Business conditions continued to gradually ease in April but remain well above average.** Business conditions in the NAB Monthly Business Survey eased 2pts in April to +14 index points, still well above average. Confidence rose slightly and has now somewhat stabilized around 0 index points after falling for a number of months. Cost growth remained a challenge, with purchase cost growth picking back up after easing in recent months and labour cost growth still high. Nonetheless, price growth measures continued to gradually moderate. With confidence low and the economy expected to slow, we continue to expect business investment to be subdued over the coming year.
- **The trade surplus grew to $15.3b in March but we expect net exports to detract from Q1 GDP.** Growth in iron ore exports of 11.6% in March, driven by a lift in volumes, contributed to the strong monthly result alongside a 10.9% increase in rural goods exports, with exports increasing by 3.8% overall. Imports also rose, up 2.5% after a fall in February, driven by a sharp rise in imports of consumption goods. Overall, the nominal trade surplus totalled $40.3b for Q1 2023, up from $38.2b in Q4. However, based on movements in prices we expect net exports to subtract considerably from real GDP growth in the quarter – potentially by up to 1ppt.
- **The Q1 CPI showed headline inflation fell to 7.0% in Q1 after peaking at 7.8% in Q4 2022.** Trimmed-mean inflation slowed to 6.6% y/y after peaking at 6.9% y/y in Q4 (and in quarterly terms peaked in Q3 at 1.9% q/q). We see a further easing in inflation in Q2 with goods inflation continuing to moderate and the impact of the run-up in building costs fading. However, market services inflation is rising and rents growth, in particular, is strengthening significantly, meaning further progress will be gradual and the strength of wage growth will be a key factor. We see trimmed-mean inflation reaching 4% y/y by end-2023 and 3% by end-2024.
- **We have reverted to our previous rate call, expecting rates to peak at 4.1% in July**, with the strong risk that the RBA could take rates to 4.35%. The RBA surprised markets but lifting rates a further 25bps in May after just a one month pause. Following the May meeting the RBA released a full set of updated staff forecasts which were slightly softer on unemployment and wage growth than February. Importantly, the RBA continues to see inflation moderating but remaining above the target band until 2025. We judge this to be at the very limit of the "reasonable timeframe" the board will tolerate for a return to target, likely necessitating at least one more rise.
- **We see the AUD/USD rising to around US74c by end-2023 on the back of a weaker USD.** We see the Aussie tracking in the US70-74c range over 2024, strengthening to around US78c as the global economy recovers in 2025.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Tuesday.

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