The Global & Australian Economic Outlook in Brief: June 2023

NAB Group Economics

After relatively robust growth in Q1, that reflected a rebound in activity in China and stronger than anticipated growth in India (among others), activity looks set to slow in the near term. China's recovery appears to be stalling, with the anticipated rebound in consumption yet to eventuate, while the tightening in monetary policy (particularly across much of the advanced economies) will negatively impact demand. There remains uncertainty around the future path of central bank policy rates – markets have one further hike for the Fed and ECB priced in – however much will depend on how rapidly inflation retreats. While global inflation has fallen from its peaks of late 2022, at 6.4% yoy in April, it remains well above the targets of major central banks, meaning that rates could be lifted higher still. We forecast the global economy to grow by 2.8% in 2023 before slowing to 2.6% in 2024 and edging up to 3.1% in 2025 – with this outlook below the long run average (of 3.4%).

- Fears around the **US banking sector** appear to have eased once again – following the failure of First Republic Bank in early May. Excluding the COVID-19 related plunge in early 2020, the US banking equities index fell in early May to its lowest levels since August 2016, before subsequently recovering to mid-March levels (post the initial fears). More generally, US equity markets have trended higher since late May (with these gains were concentrated among the eight largest tech firms). In contrast to the stronger trend in the US, other advanced economies and emerging markets have essentially tracked sideways since the start of the year.
- Overall, **global inflation** has continued to trend lower – down to around 6.3% yoy in April 2023. While this has slowed from a peak of around 9.6% yoy in September 2022, inflation has proved to be sticky – persisting at high rates for longer than major central banks had anticipated. Among the advanced economies, the US is leading the way lower, with the CPI up 4.1% in May (despite core inflation remaining relatively strong)
- With inflation still above target in most economies, **major central banks remain on a tightening bias**. The European Central Bank (ECB) raised rates by 25 basis points in June, while the US Federal Reserve (Fed) paused, albeit noting that a hike in July remains in play. Market expectations continue to suggest that both the Fed and ECB are near the peak of the current hiking cycle (with one further hike priced in for both institutions).
- Economic growth across the **major advanced economies** has been mixed, highlighted by the contraction in the Euro-zone over Q4 2022 and Q1 2023, while Japan saw growth recover over this period. While the fall in energy prices will help some economies (notably in Europe and Japan) the tightening in monetary policy is likely to keep growth generally subdued.
- Stronger readings for **emerging market** surveys in May were largely driven by China. The strength of China's services PMI is somewhat at odds with ongoing signs of weakness in the country's domestic demand. While policy makers have been considering stimulus, proposals have largely been supply side measures, with little indication that these will revive flagging demand. More generally, softer goods demand in advanced economies will impact trade activity going forward – hitting EM growth.
- Overall, our forecast for **global economic growth** in 2023 is slightly higher this month – reflecting the impact of stronger than anticipated activity in India, a pushing back of the expected slowdown in US growth to H2 2023 (which negatively impacts the global outlook in 2024) and a pickup in Latin America. We expect the global economy to expand by 2.8% in 2023 (from 2.7% previously), before slowing to 2.6% in 2024 (2.7% previously). Excluding the outliers of the Global Financial Crisis and initial wave of COVID-19, this would be the slowest rate of growth since 2001. We expect a modest upturn in 2025 (to 3.1%).
- There remain a range of **risks to this outlook**. This includes the risk that various major central banks could hike policy rates above our current expectations, leading to deeper than anticipated slowing in activity (including the risk of recession in many regions). Similarly, there is uncertainty as to when the easing of monetary policy will commence. There remains risk of further strains in the financial markets emerging, as additional policy rate rises could reveal previously unidentified vulnerabilities. China's economic recovery from its zero-COVID policies appears close to stalling – with the anticipated rebound in consumption yet to eventuate. Geopolitical factors could also influence the outlook; the Russia-Ukraine conflict has persisted for over a year, with little prospect of a near-term resolution, while tensions between China and the United States remain.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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For Australia, we are seeing increasing signs that the activity is slowing sharply after a very strong period of growth in 2022. At the same time, the labour market has remained very tight and inflation remains elevated. We now see the cash rate rising to 4.6% as the RBA seeks to better balance the risks around inflation, and we have slightly revised down our GDP growth forecasts as a result, expecting growth of just 0.5% y/y for 2023 and 0.9% y/y for 2024. We continue to expect unemployment to begin to rise in the second half of the year as the economy slows more materially, with the unemployment rate now forecast to reach 5% by end-2024. With rates moving higher, the risks to growth continue to rise with a recession now a 50/50 bet.

- **Employment rose 76k in May, bringing the unemployment rate back down to 3.6%.** Participation also rose in May, reaching a new record of 66.9%, driven by a rise in female workforce participation. So far, labour demand has been strong enough to absorb the rapid return of inward migration, but we expect this to change as the economy slows, seeing the unemployment rate begin to rise in H2 2023 and reaching 5% by end-2024. Wage growth continues to gradually strengthen and will be supported in Q3 by the significant increase in the minimum and award wages announced by the Fair Work Commission. We see hourly wage growth peaking around 4% before easing slightly as the labour market softens.
- **Consumption growth slowed in Q1 with discretionary spending falling, and we expect further softening into 2024.** Household consumption growth edged lower to 0.2% q/q (3.5% y/y) in Q1, with consumption of essentials up 1.1% in the quarter but discretionary consumption down 1% - the first quarterly fall in the discretionary category since the lockdowns of 2021. The savings rate also declined further, to 3.7%. More recent data showed nominal retail trade was flat in April, and we expect a flat quarter overall. Indeed, with the cash rate now expected to reach a higher peak of 4.6% by August, we see further slowing in consumption through the second half of the year and into 2024, with a series of quarters of slightly negative real consumption growth pencilled in.
- **Dwelling investment continued to decline in Q1, while house prices have remained resilient over recent months.** Investment in both new dwellings (-1.2%) and alterations & additions (-2.5%) declined in the quarter - with dwelling investment now down 6.2% from its peak in mid-2021. Recent building approvals data points to further weakness with new approvals continuing to trend lower. Total approvals are now 50% lower than their peak in early 2021. An elevated pipeline of work, likely around 6.4 quarters of outstanding work at current rates of work done, but we continue to expect an ongoing decline in dwelling investment as this is worked through. House prices continue to pick-up after declining relatively quicky over the year to January, and the rental market remains very tight, though we still see further downward pressure on prices from the impact of higher rates on borrowing power.
- **Investment rose in Q1 but business conditions have eased in recent months.** Business investment rose by 2.9% q/q in Q1 (on an underlying basis), the fastest quarterly pace since early 2021. Machinery & equipment investment was particularly strong (up 4.9%, underlying basis) and non-dwelling construction also increased (2.3% q/q). More recently, business conditions in the NAB Monthly Business Survey have softened, falling 7pts to +8 index points in May, just above the long-run average of +6. Confidence also fell in the month, down 4pts to -4 index points, and the forward orders index also fell into negative territory, down 6pts to -5 index points.
- **Net exports subtracted 0.2 ppts from Q1 GDP growth as imports outstripped exports growth.** Exports rose 1.8% q/q, with goods exports up 0.7% q/q despite a decline in resource export volumes (mainly coal). Travel credits were up 17% q/q (137% over the year) as the normalisation in travel continued. Imports grew 3.2% q/q, driven by consumption and capital goods (each around 5% q/q) and a rebound in service debits (3.1% q/q). Looking ahead, we continue to expect a positive contribution to real GDP growth from net exports through the forecast period as trade normalises further and consumption softens, weighing on imports.
- **On inflation, we continue to see a moderation to around 4% by end 2023 and 3% by end 2024 - but the risks are to the upside.** The monthly CPI indicator for April showed a rise in year-ended inflation to 6.8% y/y on the back of base effects. While only an incomplete read of the CPI basket, this shows significant further moderation in inflation is needed to reach the RBA's target band. Globally, upstream pressures continue to ease but how this is passed through to domestic consumer prices remains uncertain. Our Monthly Business Survey for May showed that price pressures remain elevated (with input costs including purchase cost growth and labour costs growth picking up in the month).
- **We have upped our rate call to 4.6%, with increases likely at the July and August meetings.** With the RBA squarely focussed on returning inflation to target by 2025, we see further increases in the cash rate in coming months to ensure that, as global factors moderate, inflation settles back in the 2-3% target band. That said, a higher expected rates profile will likely see the RBA downgrade its forecasts for activity and the labour market. And with the economy eventually slowing, we see cuts back towards neutral still occurring from around mid-2024
- **The AUD has strengthened over recent days after trading as low as US65.65c in early June.** We have trimmed our expectations slightly and now see the AUD ending the year around US72c before still drifting up to US78c by the end of 2024.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Tuesday.

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