Global Overview & Australia

High inflation for longer and increased wage pressures. The impact of higher rates. Serious slowdown looming - but how deep?

Alan Oster, Group Chief Economist, July 2023

Global macroeconomic summary

Problems ahead

There are a number of areas of concern on the global economy:

- **Russian responses to Ukraine war (effectively closed off gas supplies to Europe) has seen commodity prices spike**. With Ukraine war likely to continue, commodity prices to stay high for some time.

- **In the US (and globally) Central Banks have been aggressive. Lags are important and suggest that the weakness will be based in 2023 and late in the year reflects into 2024.**
  - Fear central banks have overdone it. Peak in rates certainly very near.
  - US economy particularly looks very exposed to lagged policy effects in late 2023. Getting close to the peak in rates now but expect weak activity will force rate cuts in early 2024.
  - NZ (especially) and UK and Europe also look exposed. NZ and Euro already in technical recessions.

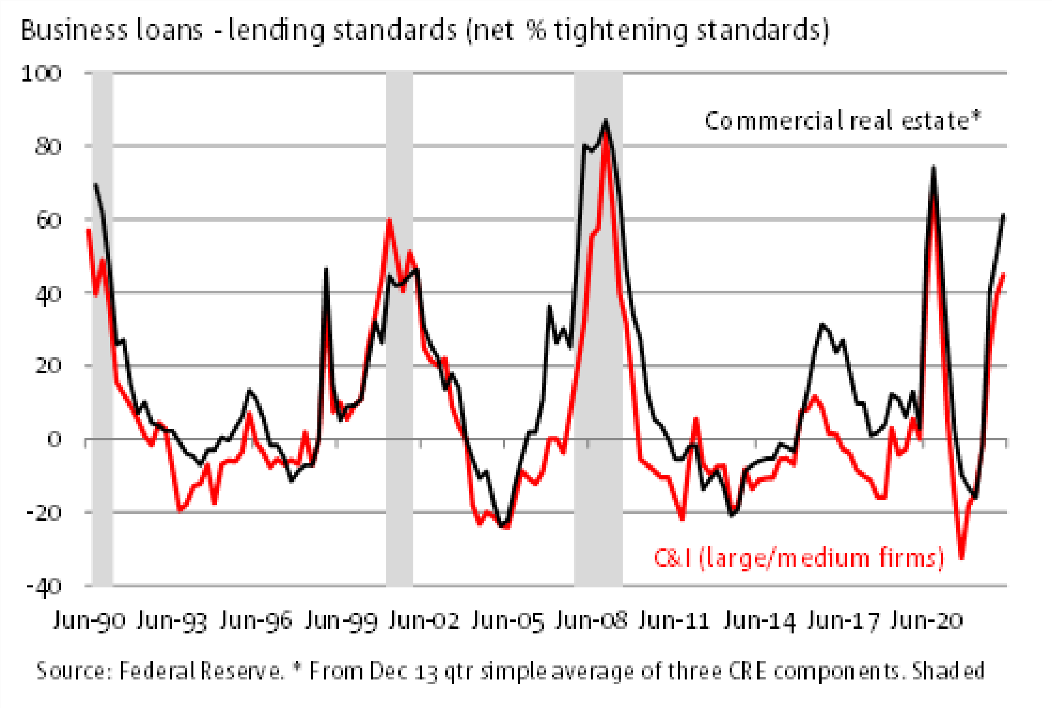
- **China has seen the combination of the virus and problems in the property market dramatically slow growth in 2022 to around 3%.** Has reopened now **and seen an early bump in activity in early 2023. But growth prospects seemed to have petered out**. Recently saw rate cuts in China and talk of fiscal packages to stimulate growth. We are at 5.6% for 2023 and 4.5% in 2024.

- Saw problems with banks in the US and more concerning Credit Suisse. But seems to have been managed. But at costs to confidence and have seen increased cost of funds, and credit tightening

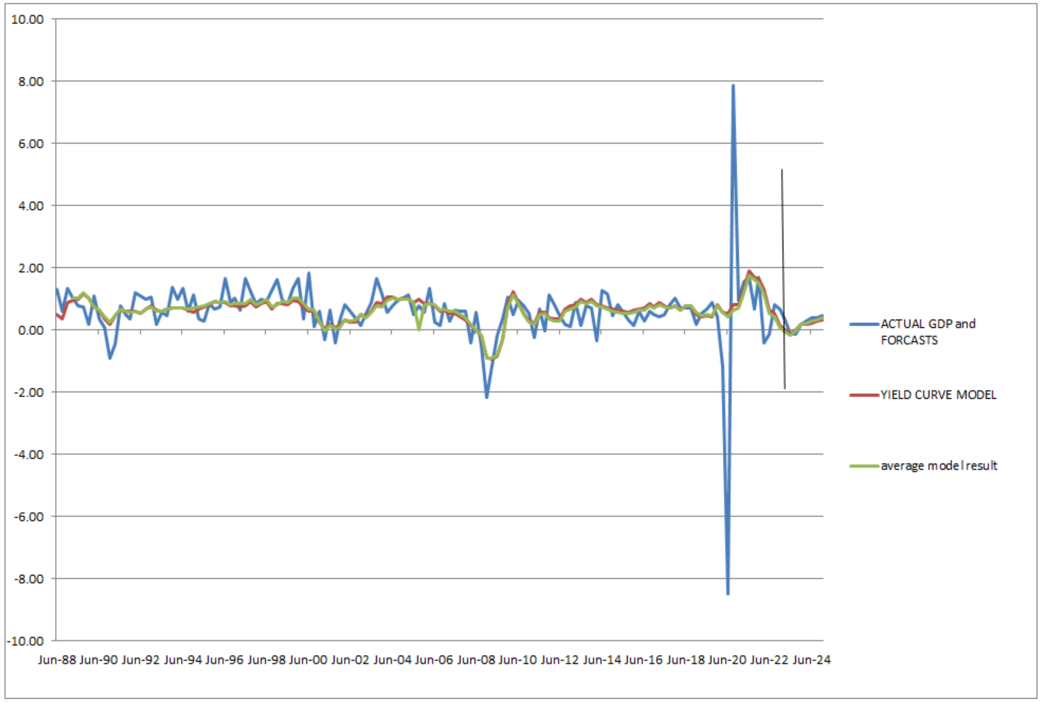
- **Globally outside of Covid and GFC the worse year since 2023. And 2024 looks weaker – reflecting very soft H2 in 2023 – e.g. USA**.

Important to realise that US banks have been tightening well before the recent crisis.

And lags are important



Lags from NAB's models of US Activity – Quarterly



Global economic forecasts

2023, outside of GFC and COVID, the lowest since 2001 at 2.8%. We still see a recession in the US, NZ and Europe in 2023. Japan and the UK appear to have narrowly avoided a recession. China to improve further in 2023 but not great. 2024 global growth lower to around 2.6%. More normal in 2025.

	2020	2021	2022	2023	2024	2025
US	-2.8	5.9	2.1	1.3	0.6	1.8
Euro-zone	-6.2	5.3	3.5	0.6	0.8	1.1
Japan	-4.3	2.2	1.5	1.2	0.6	0.8
UK	-11.0	7.6	4.1	0.4	0.6	0.9
Canada	-5.1	5.0	3.4	1.5	0.6	1.4
China	2.2	8.1	3.0	5.6	4.5	4.8
India	-6.0	8.9	6.7	5.6	5.6	6.2
Latin America	-6.8	7.0	4.0	1.6	1.0	1.8
Other East Asia	-2.8	4.5	4.2	2.8	3.6	4.2
Australia	-1.8	5.2	3.7	1.3	0.5	1.9
NZ	-1.5	6.0	2.4	0.6	0.2	2.3
Global	**-2.8**	**6.3**	**3.4**	**2.8**	**2.6**	**3.1**

Australia macroeconomic summary

Economy slowing a lot. Further rate hikes likely with serious slowdown looming. How deep?

- **GDP growth to slow to around ½% during 2023 and a touch below 1% in 2024 - was 2.7% through 2022.**
  - Key drivers: slower global growth and rate rises (including fixed loan maturities in mid 2023).
  - Business survey now clearly showing big slowing, as is internal transaction data.
  - Business investment will slow. House prices recovering but still fragile. Up around 5% in next 12 months.
  - Growth in 2025 back to around trend (2.25%).

- **Unemployment to remain around current levels (3¾%) for a number of months yet.**
  - Shortage of skilled labour at record highs.
  - But will rise thereafter to around 4.3% by end 2023, 4.6% by mid 2024 and 5% by late 2024.
  - And around 4.7% by late 2025.
  - That is a tough outcome (by Dec 2024 implies 230k more on JobSeeker) but risks are that it could be worse.

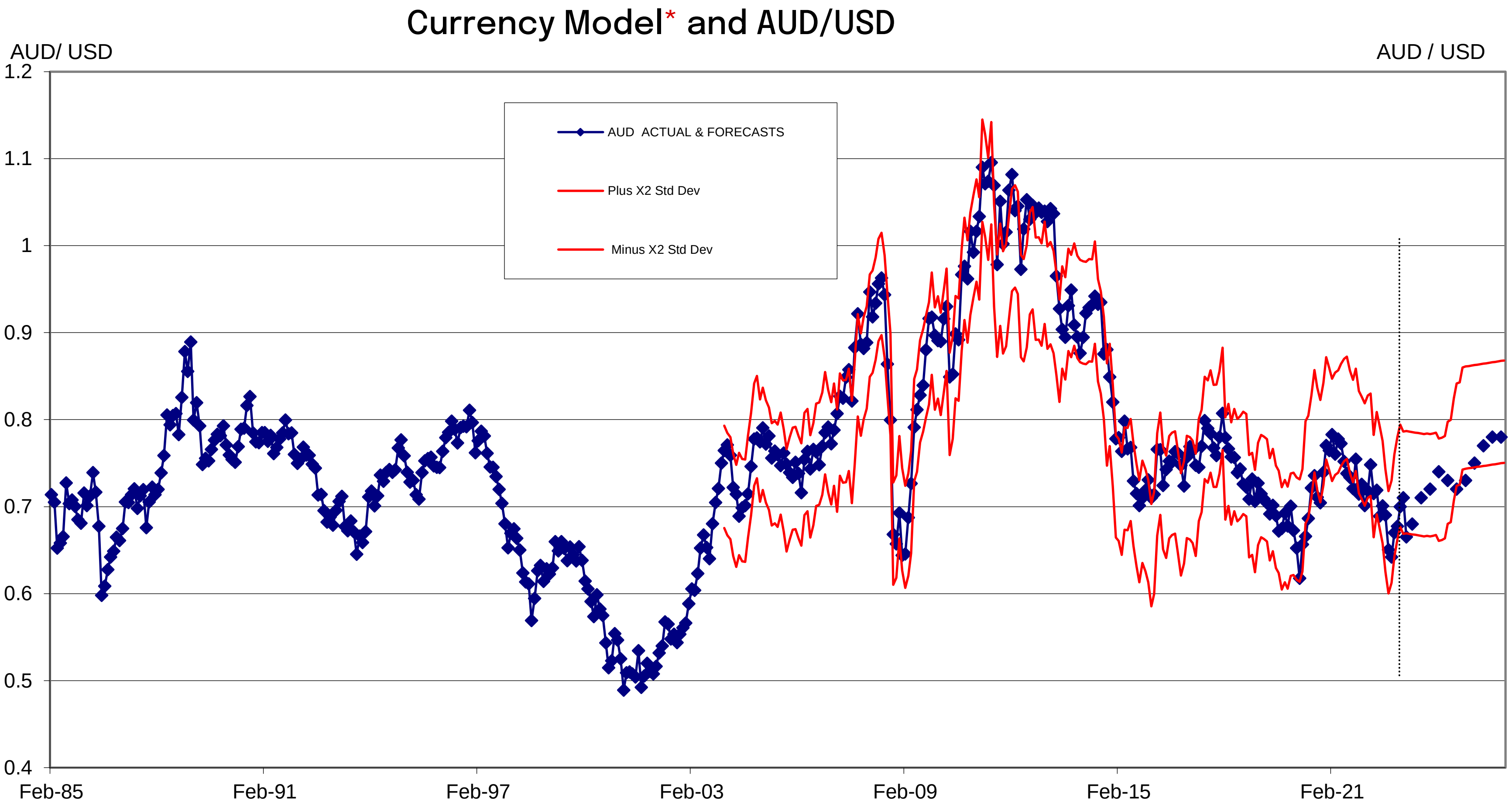
- **Price inflation has peaked but will stay high for a while.**
  - Purchase costs still very high and business is fully passing on prices (maintaining profit margins).
  - Headline around 7% by early 2023 and around 6.5% in core terms.
  - High energy costs and faster wages growth see only moderate slowing in out years – core 3% by end 2024.

- **Wages growth to accelerate further from here (currently 3.7%).**
  - National wages case has added to forward wage pressures as cyclical productivity slowing increases unit labour costs.
  - We see wages growth of more than 4% going forward.

- **RBA surprised by not increasing rates in July.**
  - RBA decisions very much focused on inflation but increasingly worried about the economy.
  - **The main question is, will the RBA be patient in the face of high inflation through 2023.**
  - **Doubt it. We now expect the RBA will peak at 4.6%. Expect August and September.**
  - **For 2024 we still see cuts to 3.1% from mid 2024.**

Currency model USD 0.68+/- 5c

Recent movements very much reflecting strength/weakness of the USD. Australia a proxy for risk in uncertain world with aggressive central banks and financial sector concerns. See AUD moving back up as recession hits USD - unemployment moves up and US rates move down.



- Model driven by: commodity prices; US TWI – as measure of USD strength; long and short run rates; relative unemployment; relative equity markets and VIX

Forecasts:

End 2023 = 72c AUD/USD
End 2024= 73c AUD/ USD
End 2025= 78c AUD/ USD

Data Insights

- NAB Data
- Business Survey

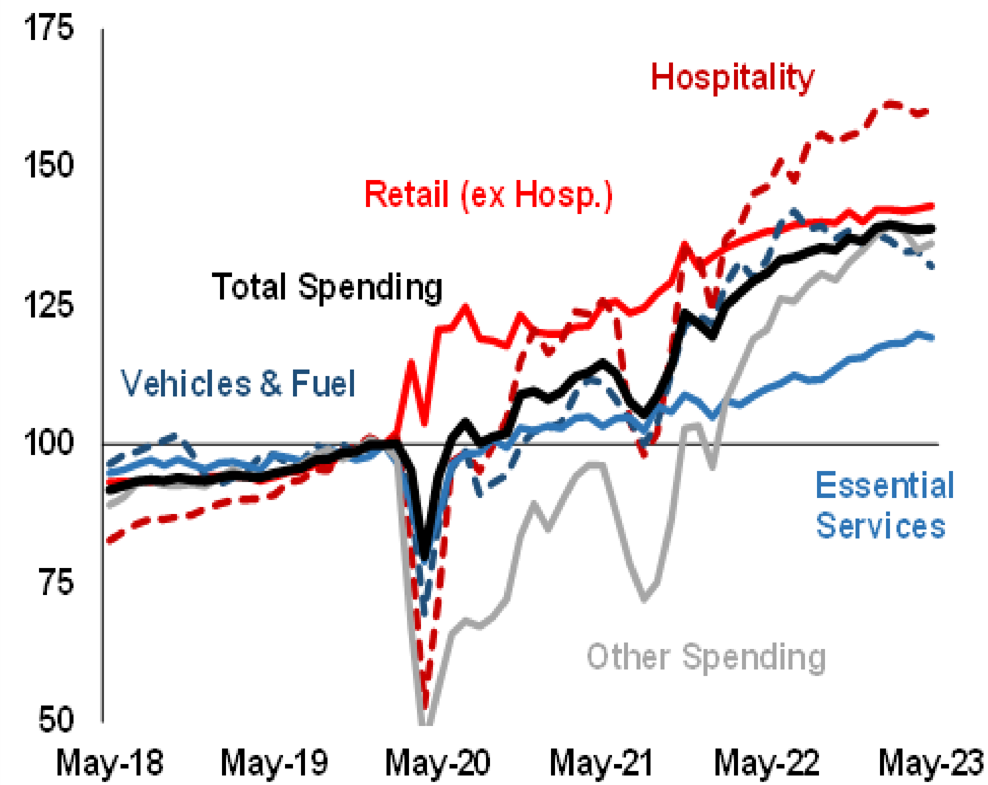
Indeed our internal data (in nominal terms) for consumer transactions are fairly negative in June, after an ok May and flat April.

But total consumption spend very weak – negative in June and flat over the last 3 months.

Headline

	Apr-23	May-23	Jun-23		
	m/m	m/m	m/m	3m/3m	y/y
Goods Retail	0.2	0.6	-0.9	0.4	2.8
Hospitality	-0.8	0.7	1.4	-0.1	7.1
Total Retail	**0.0**	**0.6**	**-0.5**	**0.3**	**3.6**
Vehicles & Fuel	0.5	-1.9	-1.1	-2.8	-4.7
Essential Services	1.7	0.7	0.4	2.6	11.4
Other Spending	-2.7	2.5	0.9	-0.9	10.1
Total Spending	**-0.3**	**0.8**	**-0.1**	**0.0**	**5.1**
Goods	0.3	0.2	-1.0	-0.1	1.6
Services	-1.0	1.6	0.9	0.3	9.7
Discretionary	-0.7	0.9	-0.2	-0.6	3.8
Non-Discretionary	0.6	0.6	-0.1	1.4	8.0

Excludes taxes, rent, mortgages, gambling, finance, insurance, and other non-consumer transactions. Data are seasonally adjusted and subject to revision.



Business inward credits (business revenues)

Recent trends see a softer trend in inward credits. Up only marginally in the 3 months to June (0.1%) – so down in real terms. June month falling in nominal terms.

- **Strength in the last quarter** – in Administrative services (travel agents), Education and Arts & Rec services (Taylor Swift impact)

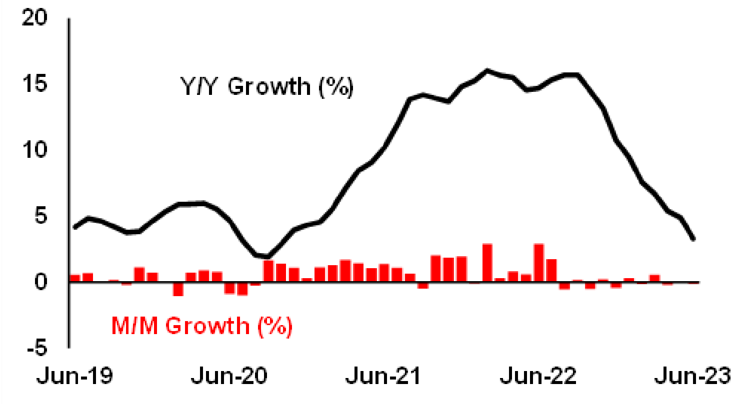
- **Weakness** in Utilities and Mining.

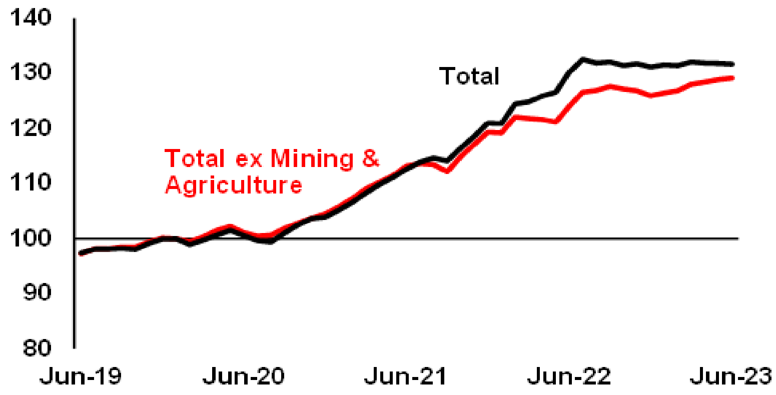
	Apr-23	May-23	Jun-23				Apr-23	May-23	Jun-23		
	m/m	m/m	m/m	3m/3m	y/y		m/m	m/m	m/m	3m/3m	y/y
Accom & Food	-0.1	0.6	-0.3	0.1	14.3	Mining	-3.7	-3.8	-4.8	-10.5	-11.7
Admin & Support	2.5	1.6	1.1	8.8	20.3	Other Services	4.3	1.6	0.4	6.4	22.9
Agriculture	-2.6	0.3	1.4	-3.1	-4.4	Professional Services	1.4	-0.6	1.1	-0.2	-6.5
Arts & Rec.	1.8	1.8	-1.7	5.1	21.0	Rental & Real Estate	-1.8	-1.2	-0.2	-1.3	-6.1
Construction	1.1	1.8	0.2	3.4	17.1	Retail Trade	1.5	1.0	-0.9	2.1	14.4
Education	5.3	-0.1	0.7	7.2	18.1	Transport & Postal	-3.0	-2.9	-0.8	-2.5	-7.8
Utilities	-12.9	3.4	-8.5	-15.2	16.8	Wholesale Trade	0.0	0.2	1.9	1.3	-2.4
Health	0.9	1.6	0.8	3.5	12.2						
Info & Media	-0.5	2.9	3.7	1.2	18.9	**Total**	**-0.2**	**0.0**	**-0.1**	**0.1**	**3.3**
Manufacturing	-1.0	-0.1	-0.2	-1.6	1.7	Total ex Mining & Agri	0.3	0.3	0.2	1.3	5.3

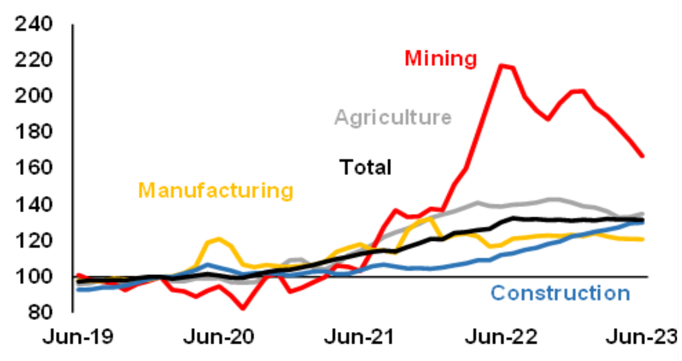
All data calculated as a three month moving average of seasonally adjusted monthly data.

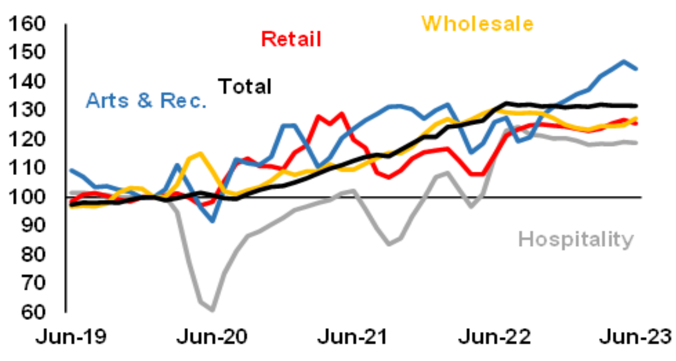
Softness in inward credits has become more evident recently – especially vis-à-vis last year.

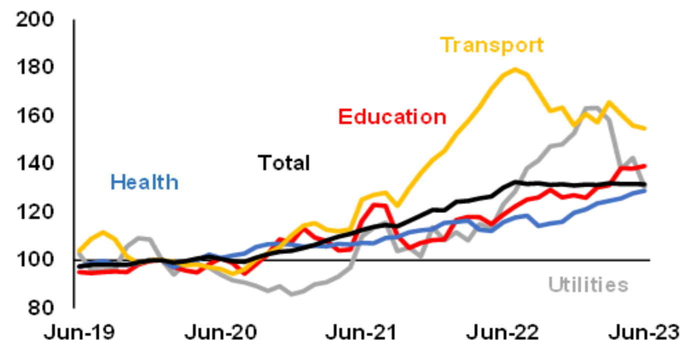
Arts & Recreation, Administration and Education have now seen the strongest growth recently, while Mining and Agri has seen a large fall (from very elevated levels). Utilities has also seen large falls recently.





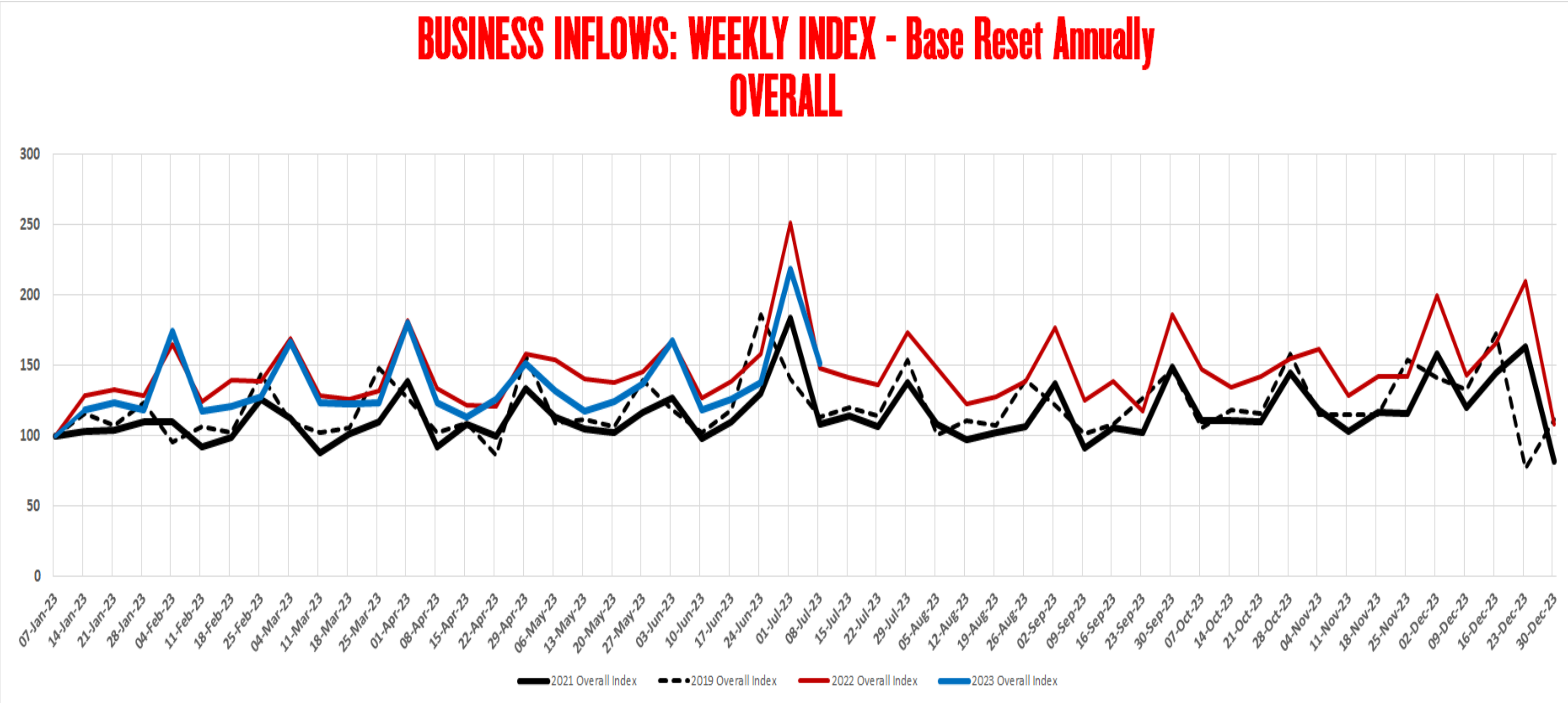






Business inward credits (business revenues)

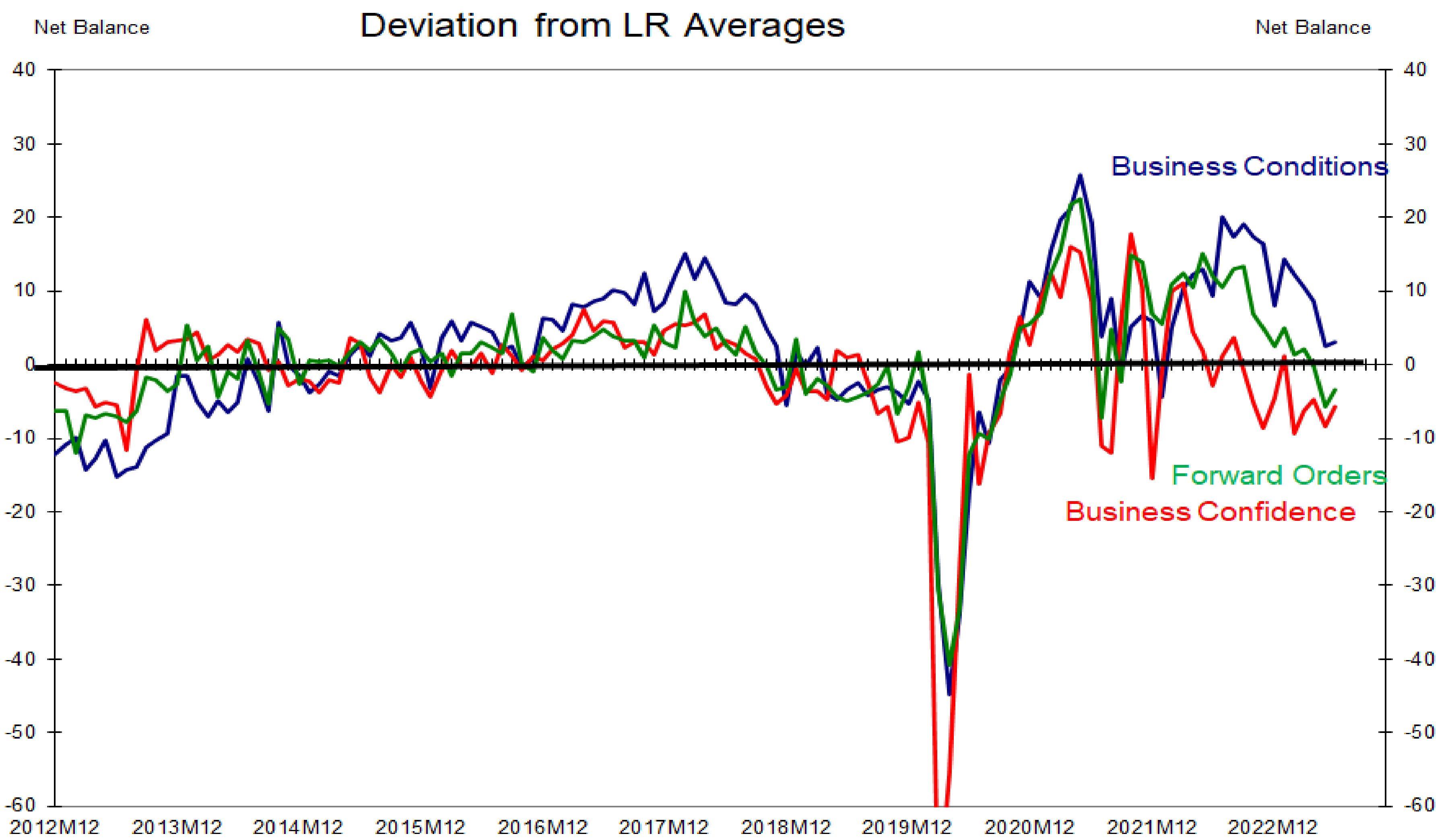
Annual reset data. 2019 benchmark to avoid y/y distortions. Some signs of EOFY effect but less than last year. See blue in the chart below.



Business Survey shows slowing growth momentum into June 2023.

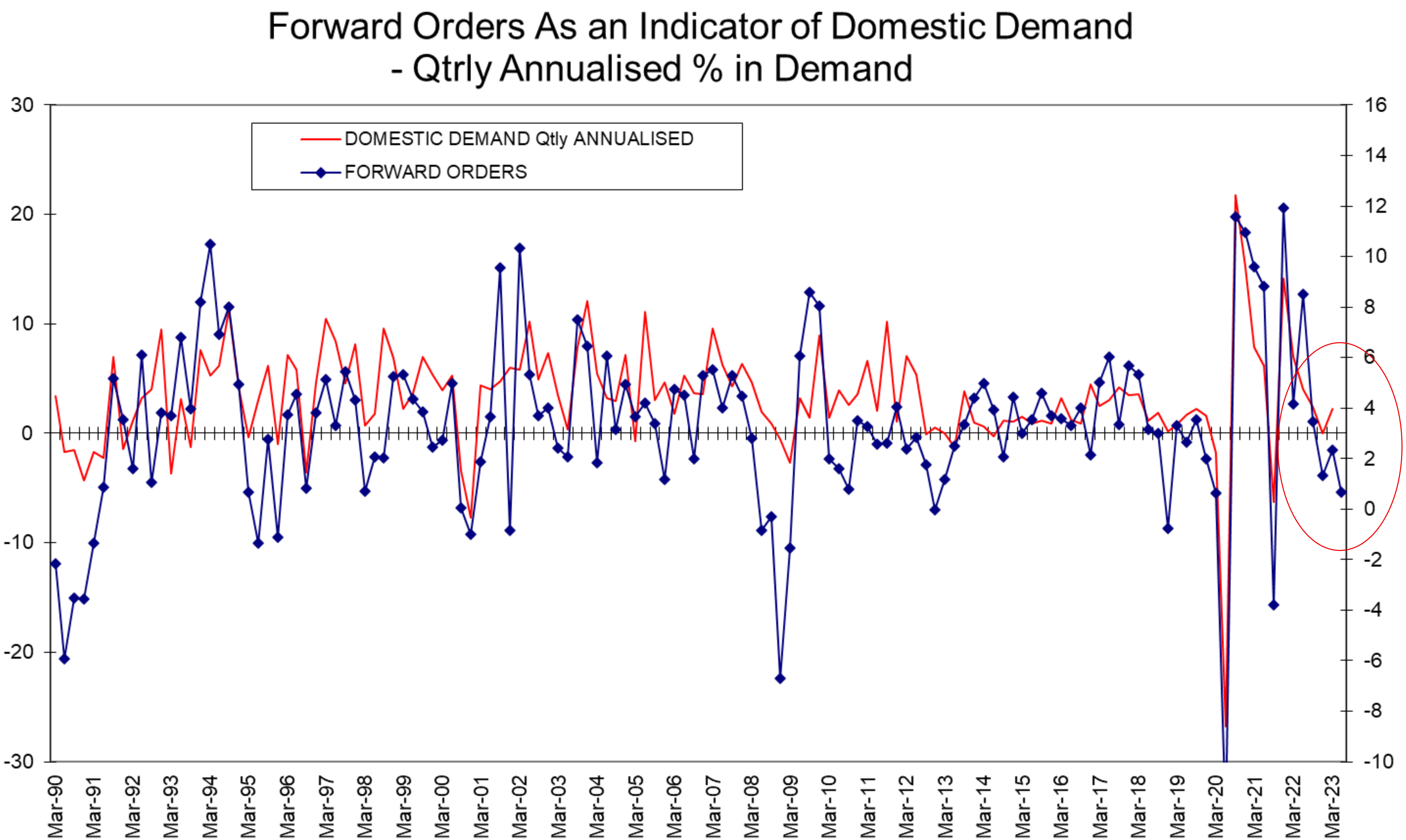
June business conditions still ok. But concern about forward orders and confidence.

Forward orders has best tracking history on the economy.



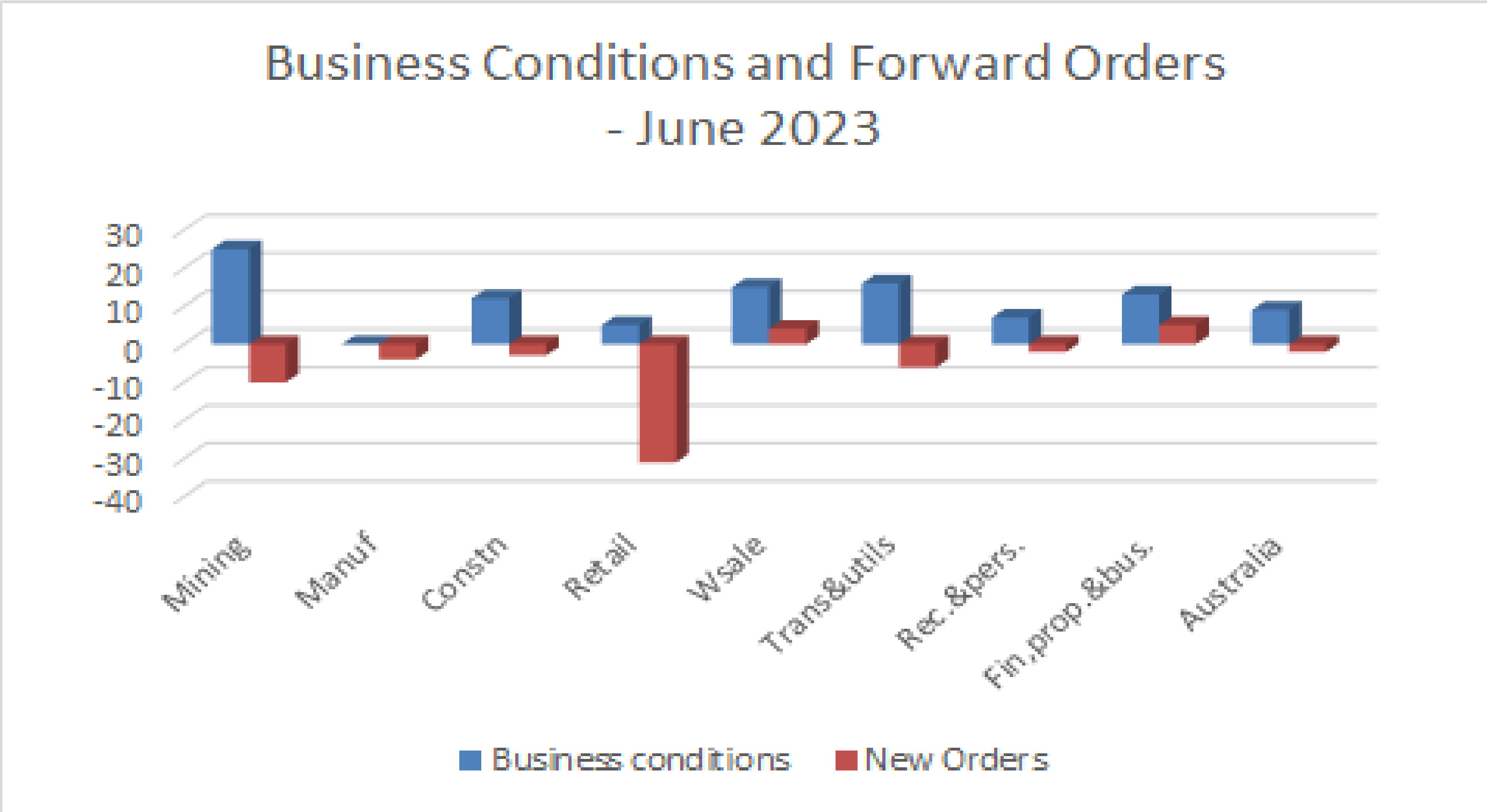
In the past new orders has tended to track the economy better than conditions.

Sending concerns recently about domestic demand



In the past new orders has tended to track the economy better than conditions.

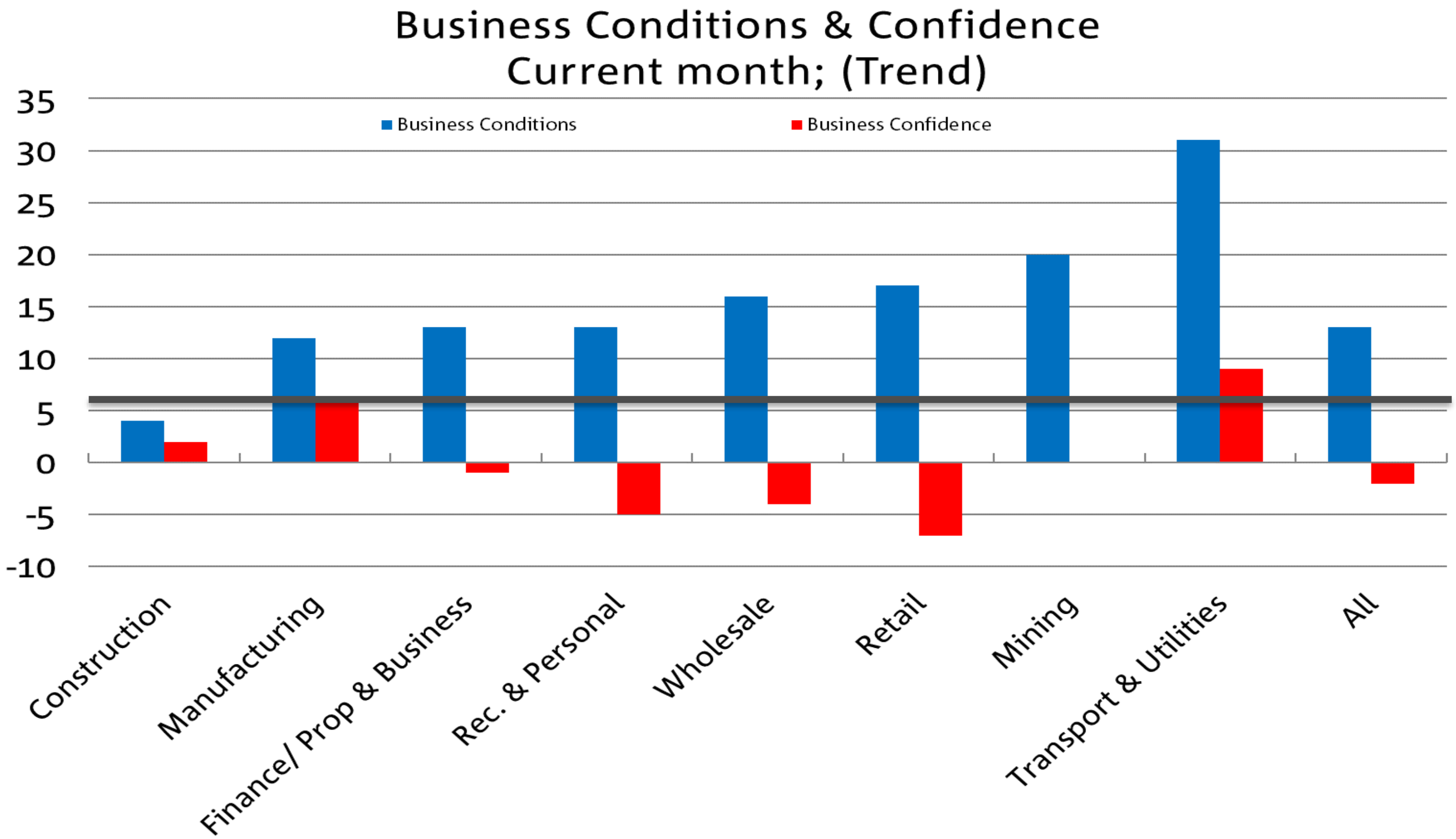
Interesting split for orders across industries. Orders weak in retail and mining. Not great in Rec and personal services either.



By industry. Overall big differences between confidence and actual conditions outcomes.

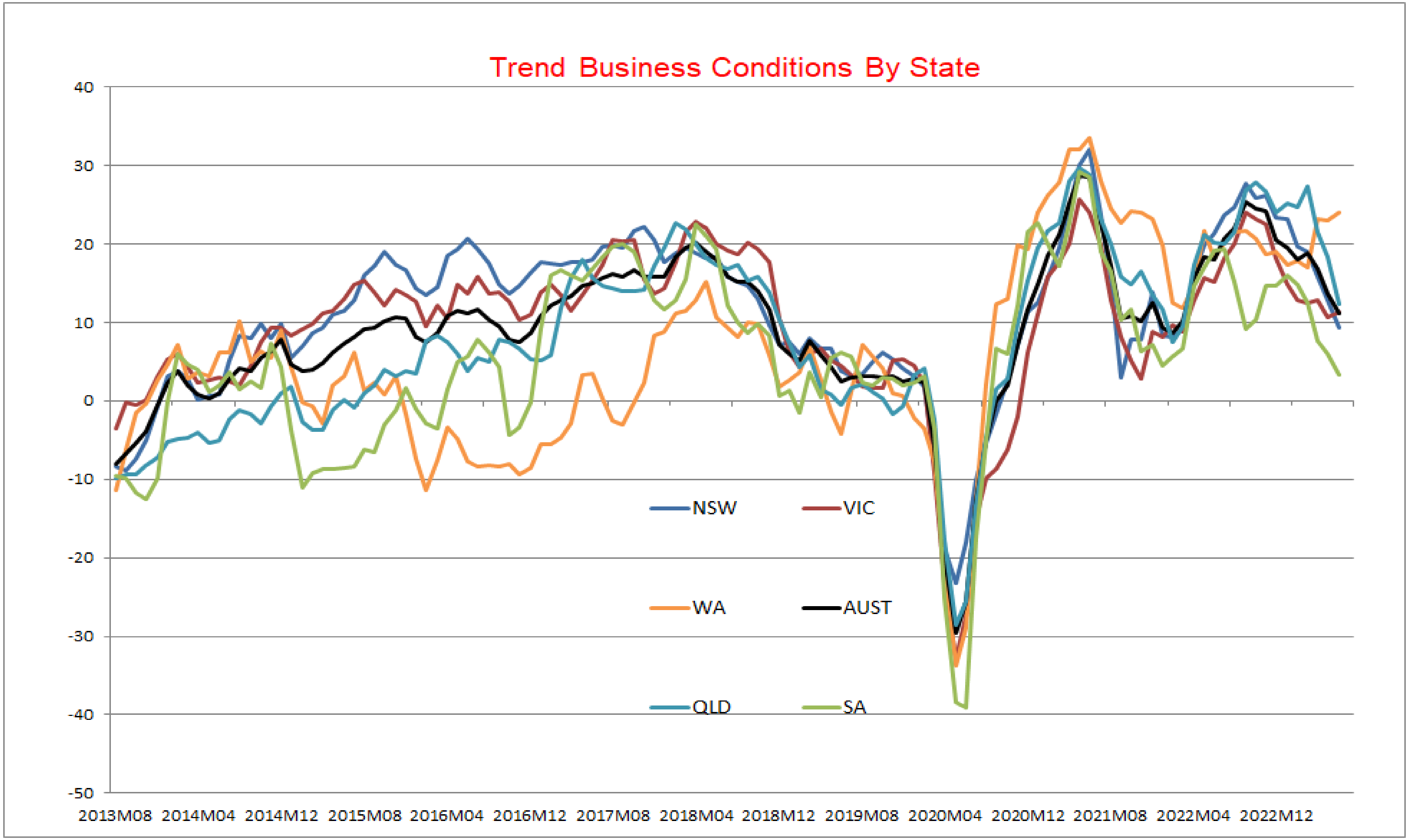
Transport and mining still strong. Overall economy still ok – recent declines still flowing into trend data. Construction the laggard. Mining a bit worried. But big difference from conditions to confidence in retail/wholesale and even services (personal & rec services).

June 2020



Most states are weakening but WA still holding up.

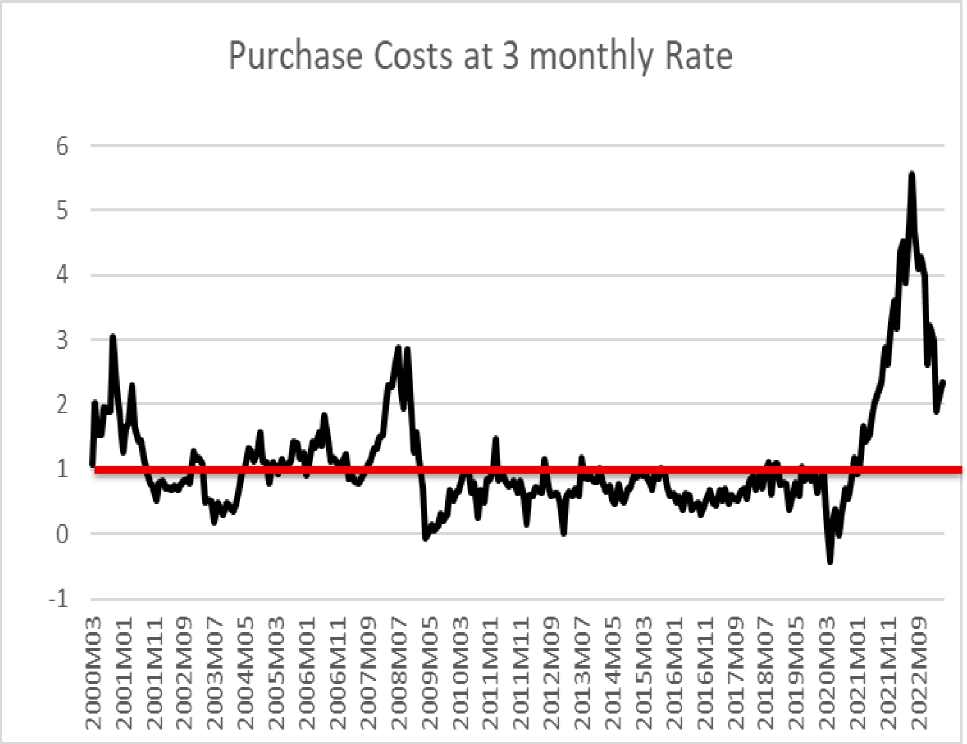
SA weaker.



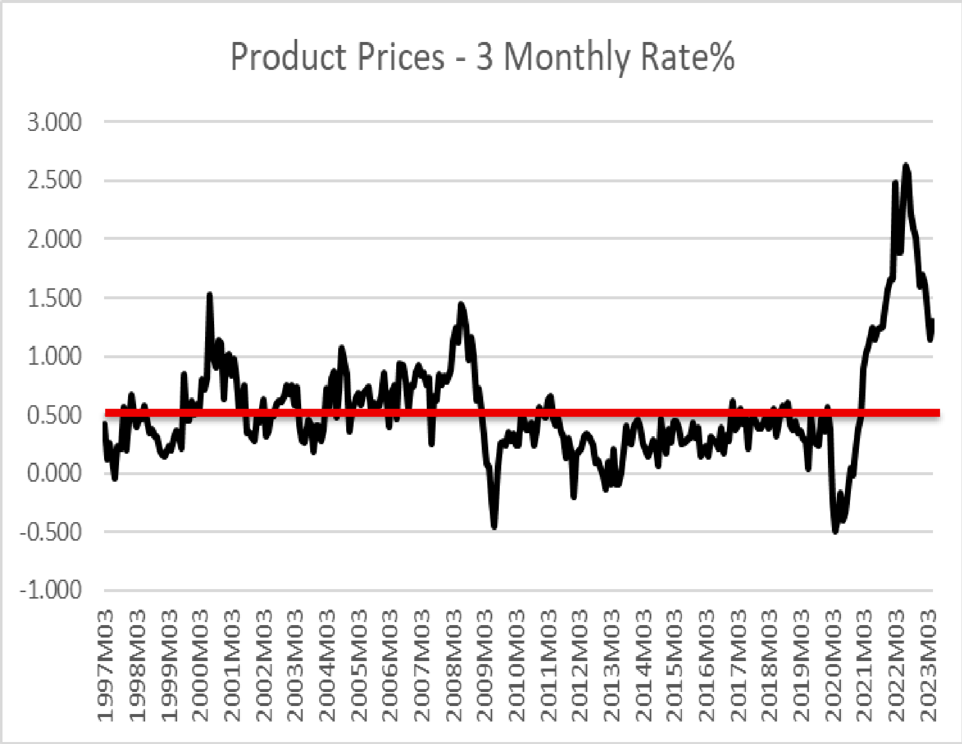
NAB Business Survey

Clearly showing very high purchase costs peaked last year. But still elevated and a bit sticky.
General inflation pressures also still elevated – more so than purchase costs.

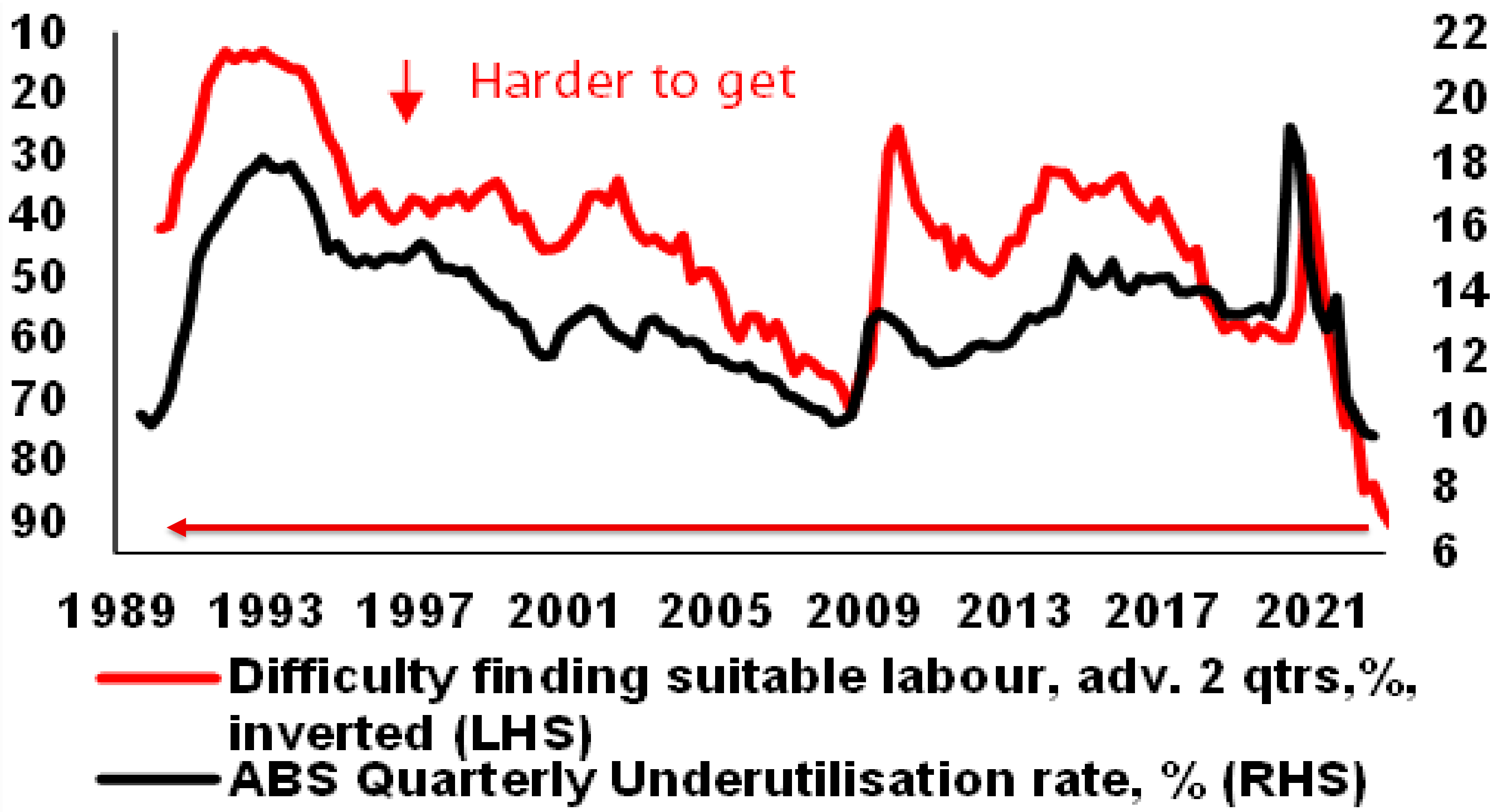
Purchase Costs – June NAB Survey



Goods Costs – June NAB Survey



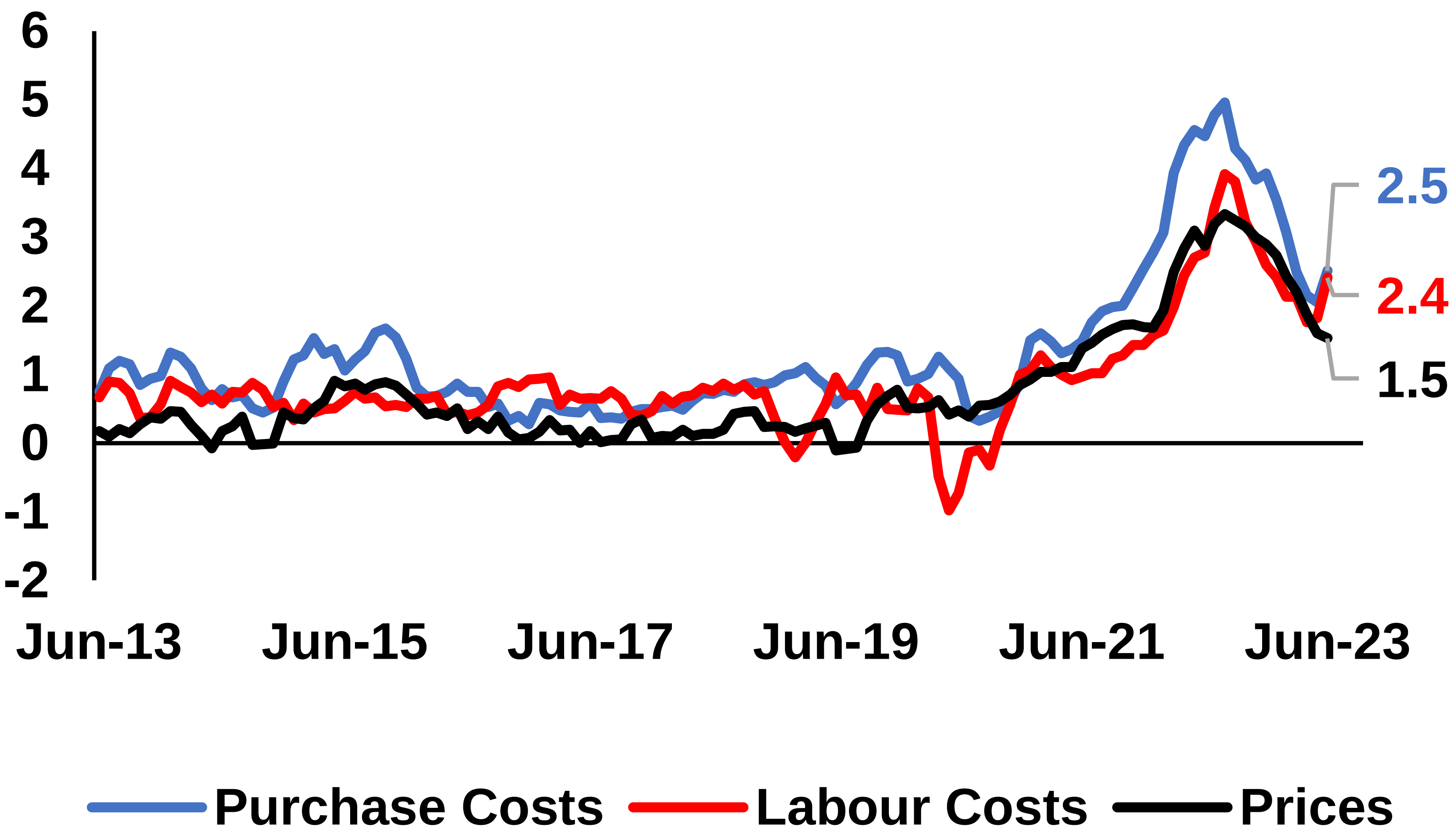
Obviously labour shortages are now a huge issue for business.



Our Business Survey is suggesting prices and purchase costs have peaked but remain high.

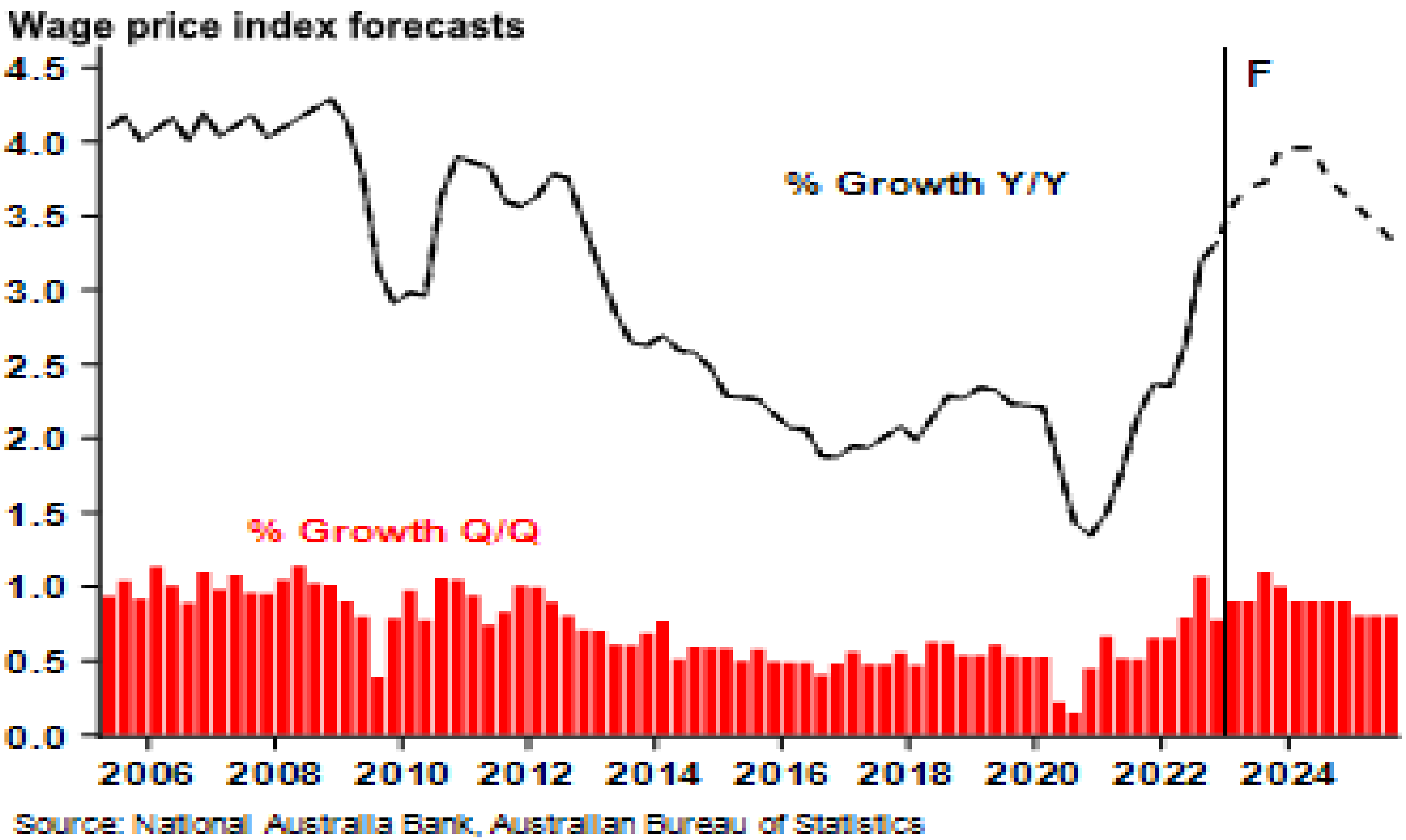
But wages are starting to increase.

Purchase costs, total prices and Labour Costs - NAB Survey June 2023
Monthly at a quarterly rate %



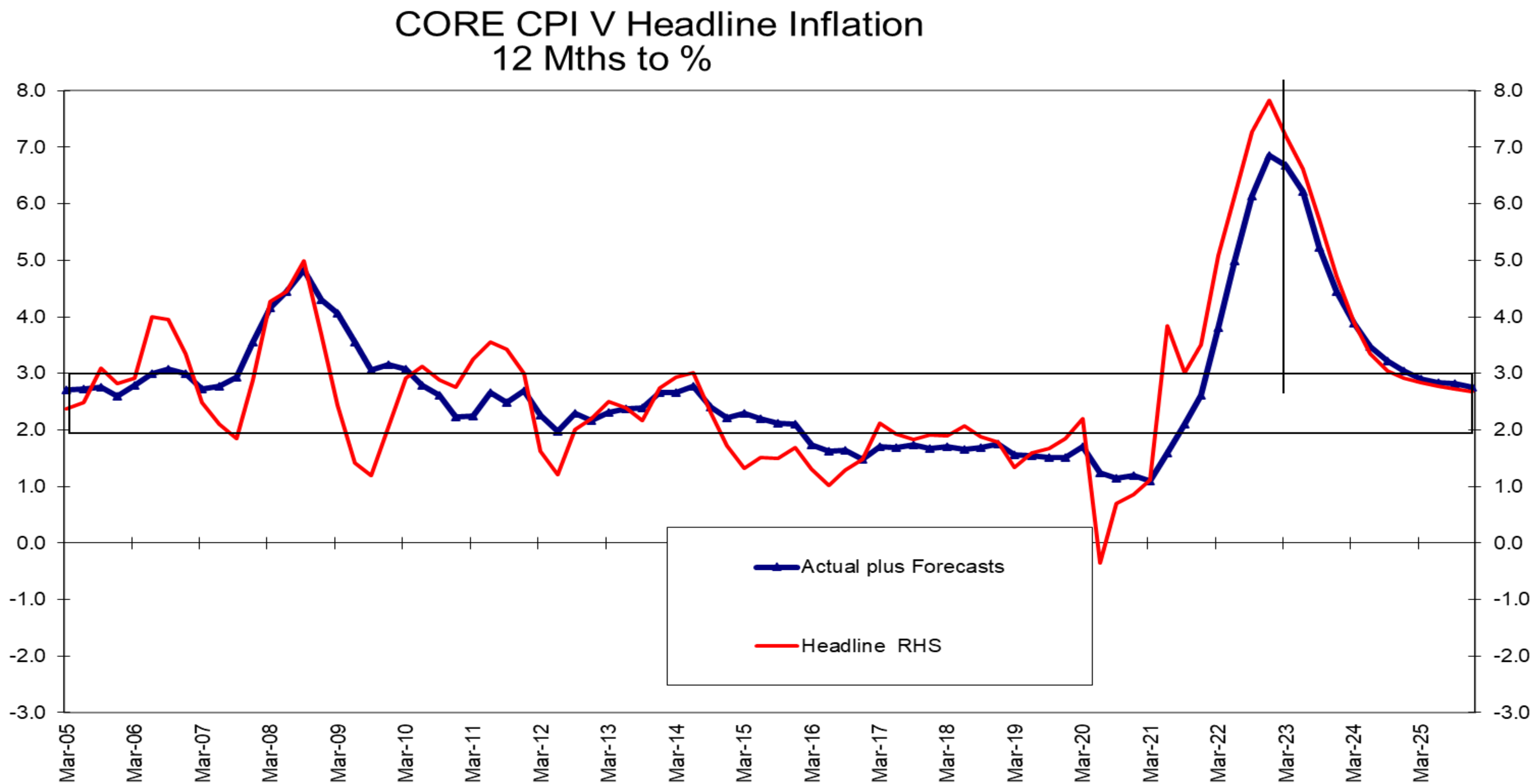
Wage pressure still ok in mid 2023(May).

But to accelerate from here. Around 4% on an hourly basis



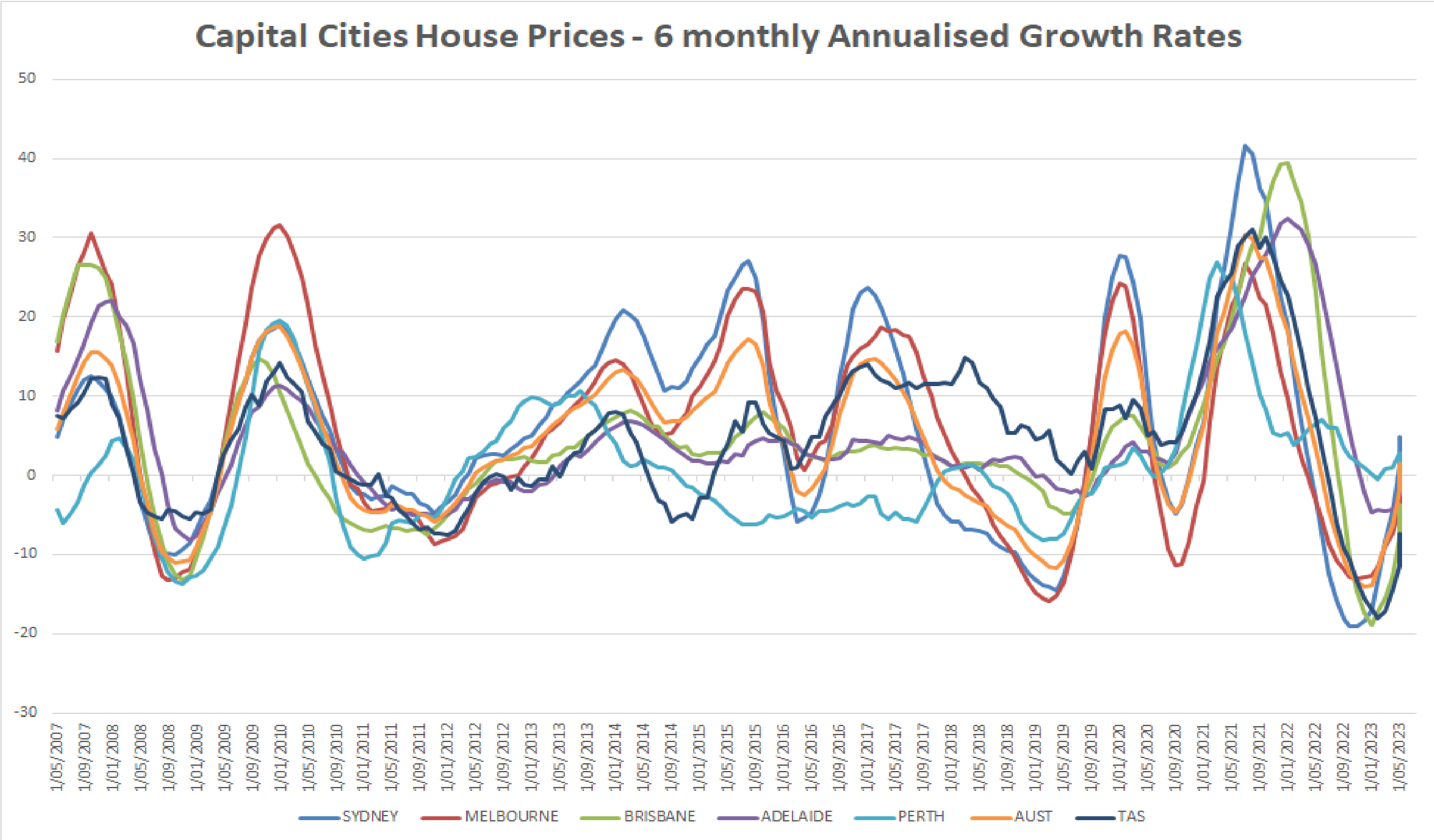
Core inflation

Hit by supply side problems and higher commodity prices (Russia). Trimmed mean core inflation now at around 6.5%, headline even higher at 7.2%. We expect core inflation into the target range by 2025.



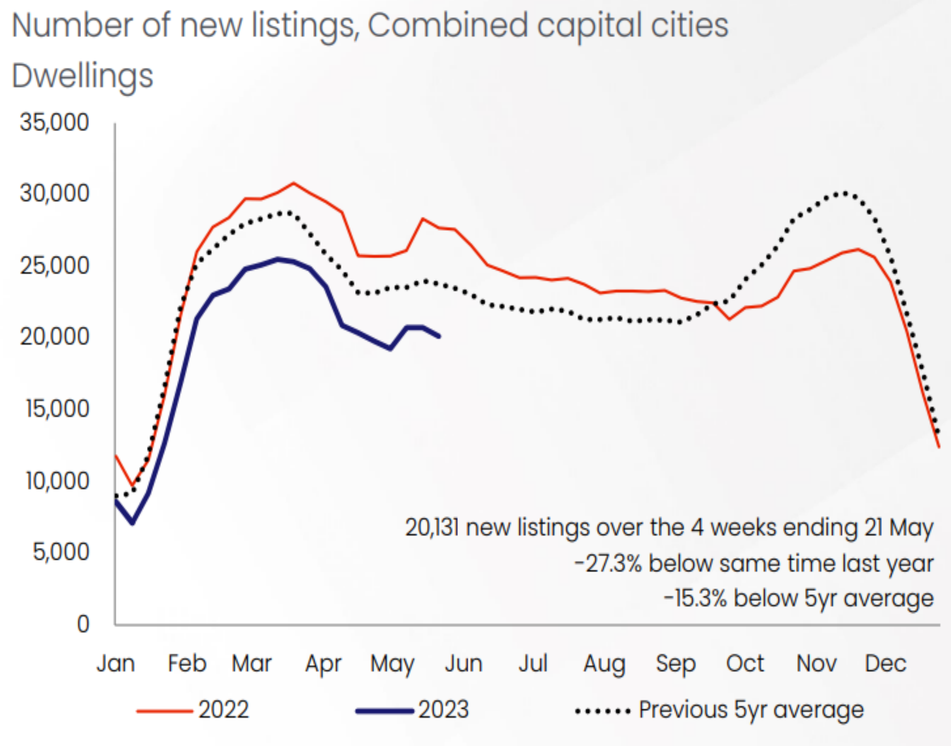
House prices

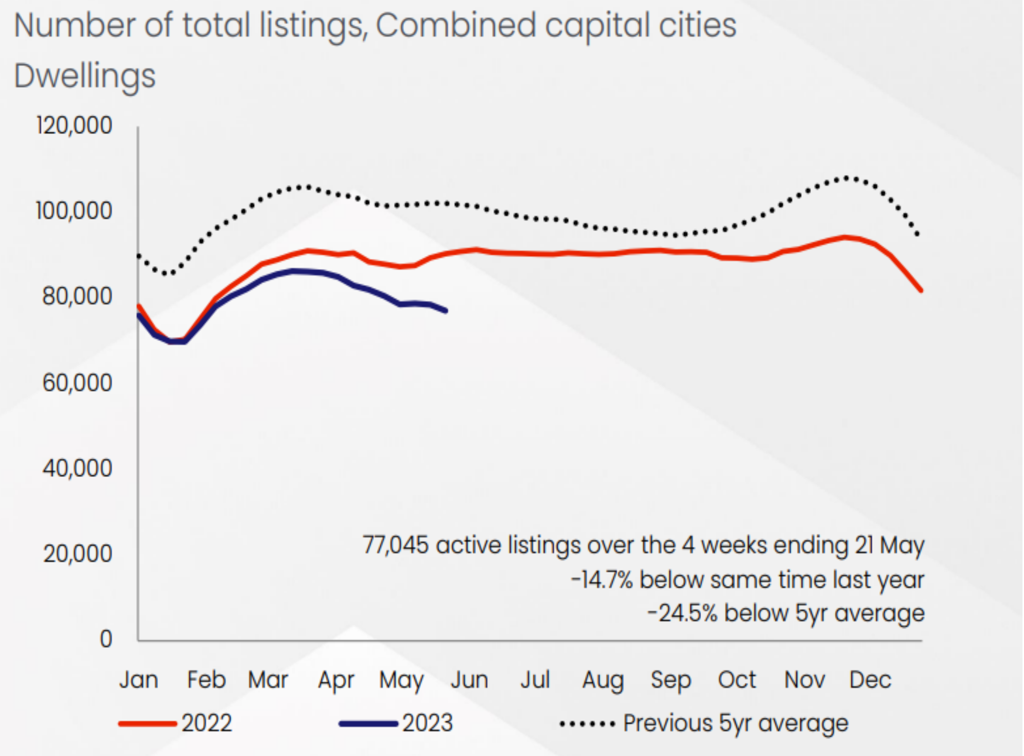
Are seeing a robust turnaround especially in Sydney and Perth (Sydney up 4.5% and Perth 1.3% over the past 6 months annualised). Recovery widespread. Across Australia now around 1.5% up over the last 6 months (at annualised rate). Melbourne and especially Brisbane less robust.



But be aware turnover is down around 25%.

So unusual recovery. And might hit some hurdles.

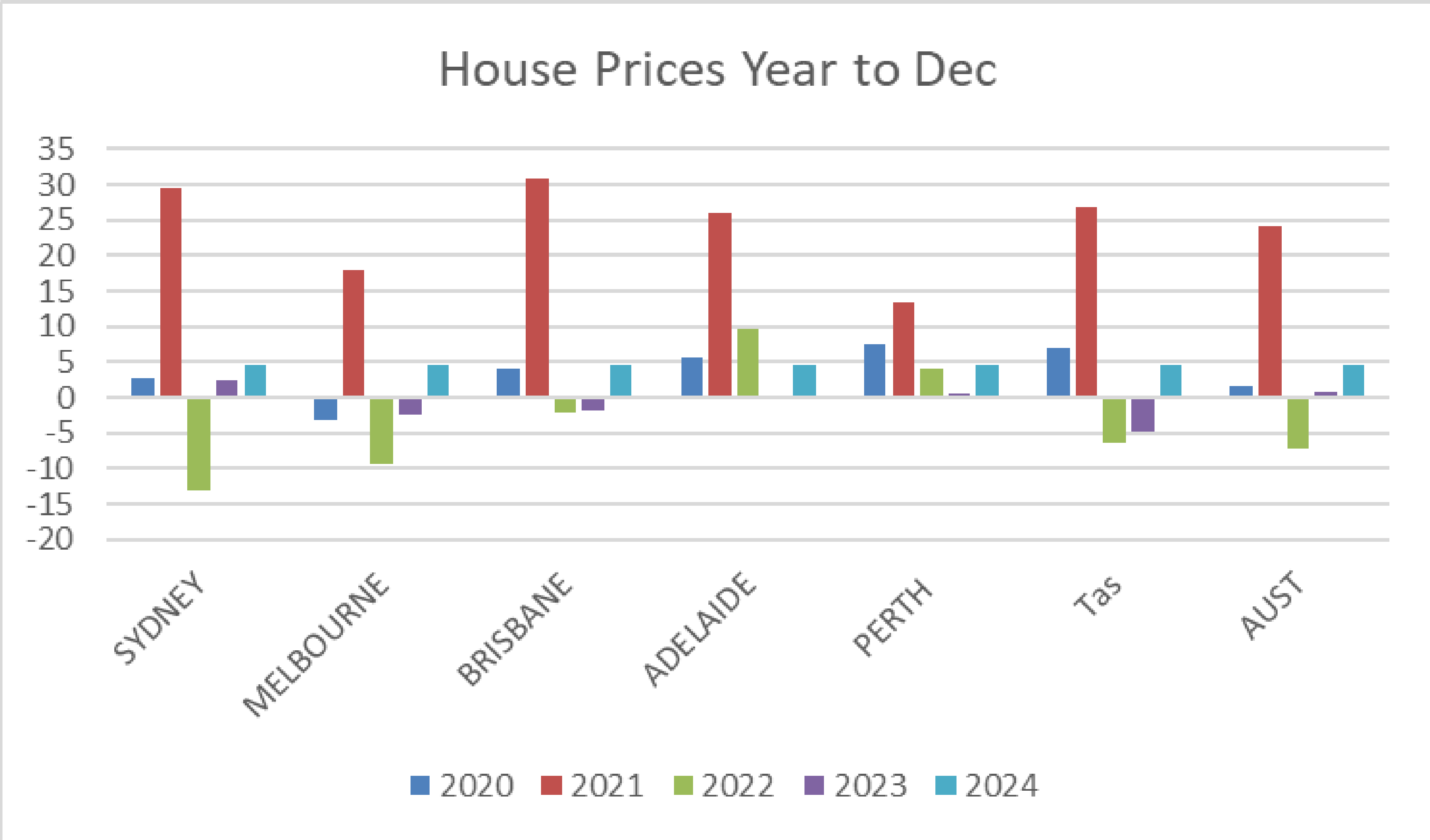




Source CoreLogic

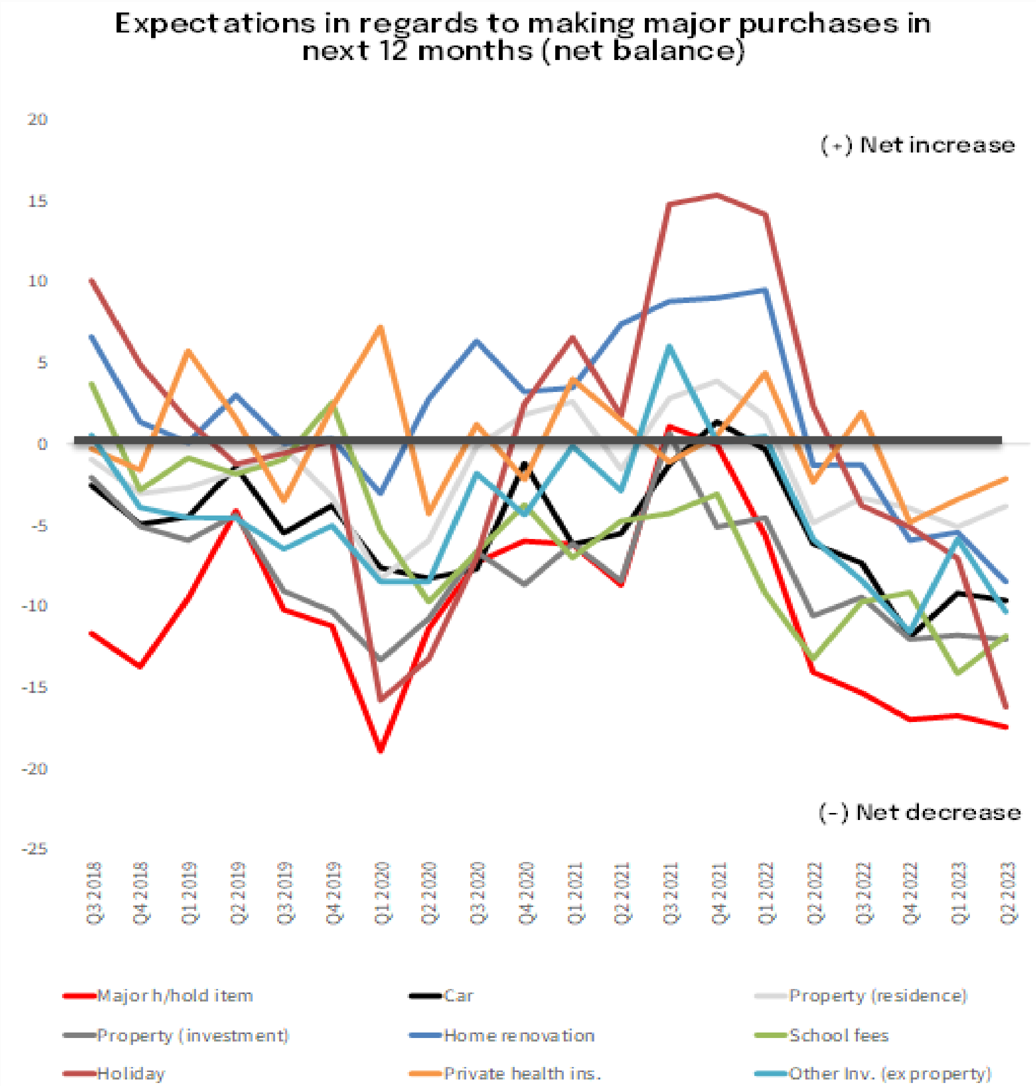
House price forecasts

After increasing by around 23% house prices during 2021 down around 7% during 2022. For 2023 looks to be roughly flat (led by Sydney) and up around 5% in 2024.



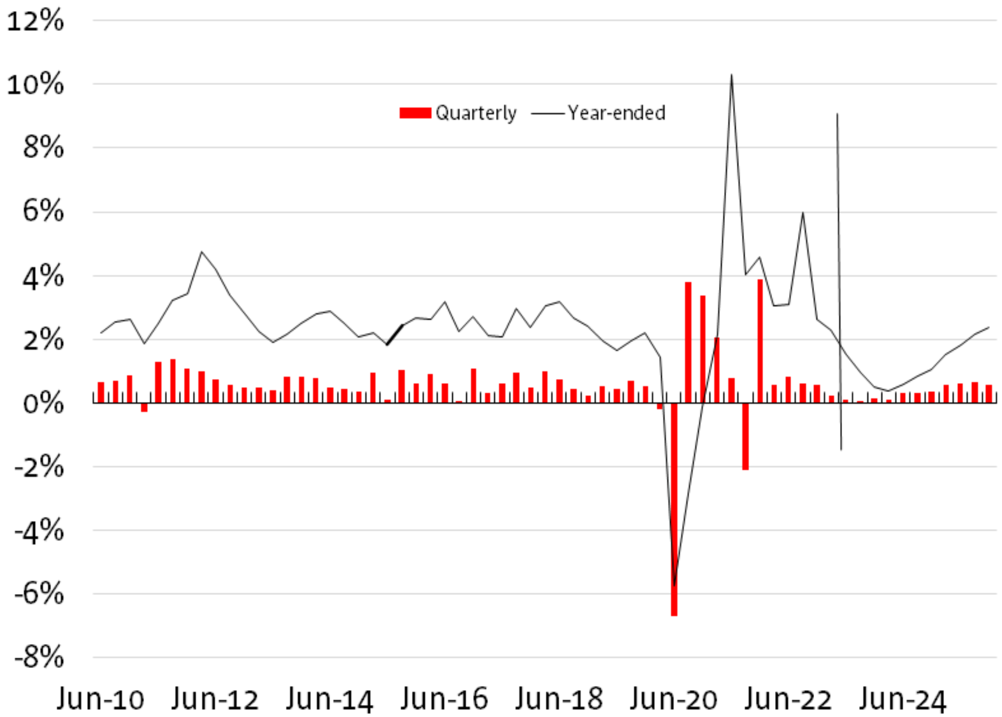
Consumers also tell us that they are adjusting their spending plans.

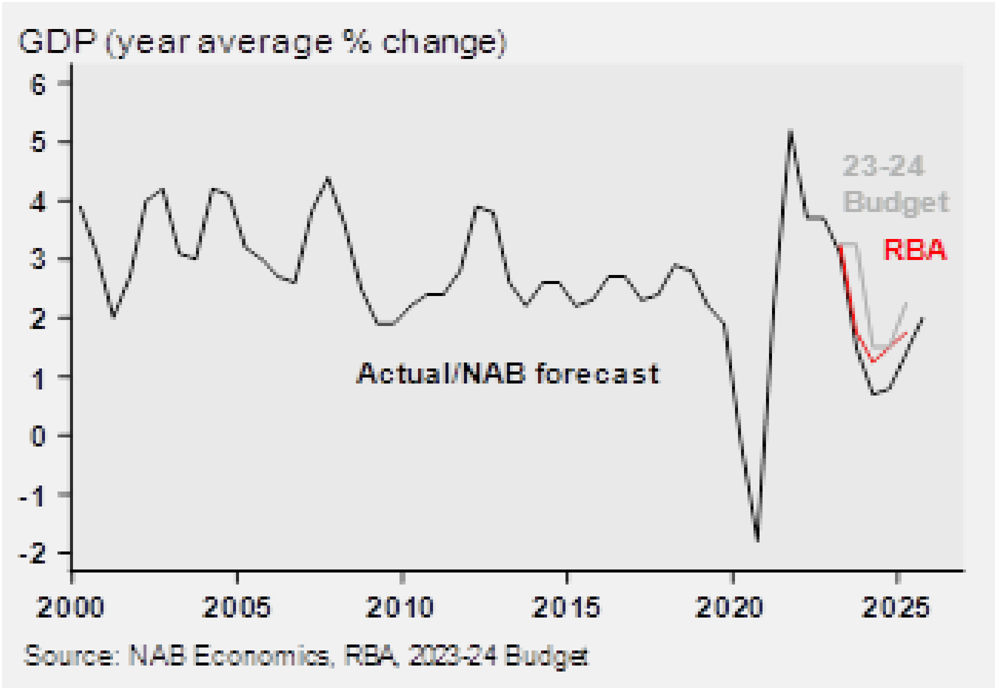
Liquidity impact from rate rises to hit from mid 2023. Especially household goods, school fees and holidays. Heath Insurance least likely to suffer.



Our growth expectations.

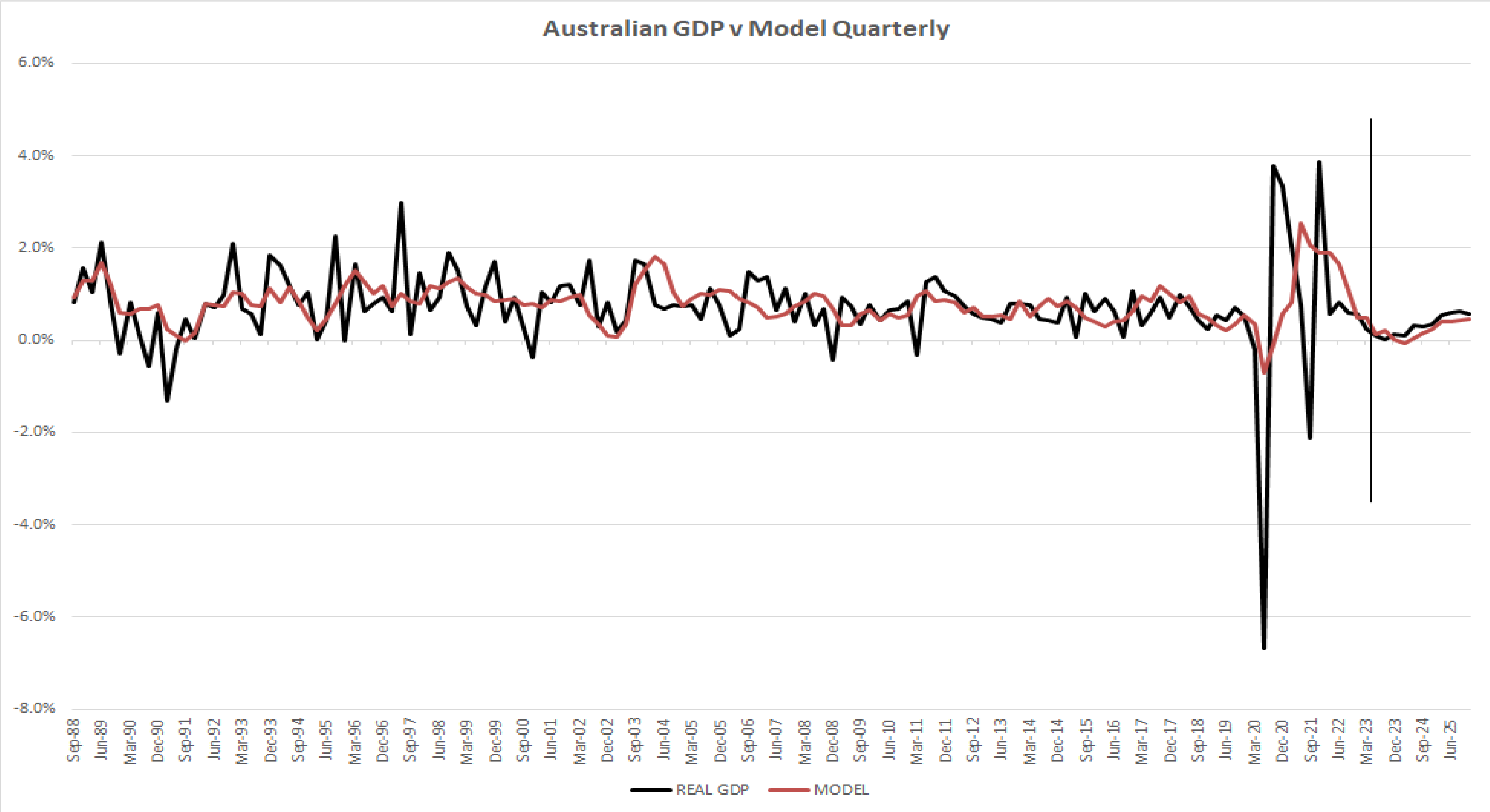
We see slower growth in late 2023. Economy very flat by late 2023/early 2024. Better in 2025
Not a recession but no room for error. We are now more pessimistic than RBA/Treasury (mainly consumption) but the shape of the forecasts are very similar.





My enhanced yield curve equation.

Obviously can't cope with COVID but as we move out of the virus, general trend consistent with the model.

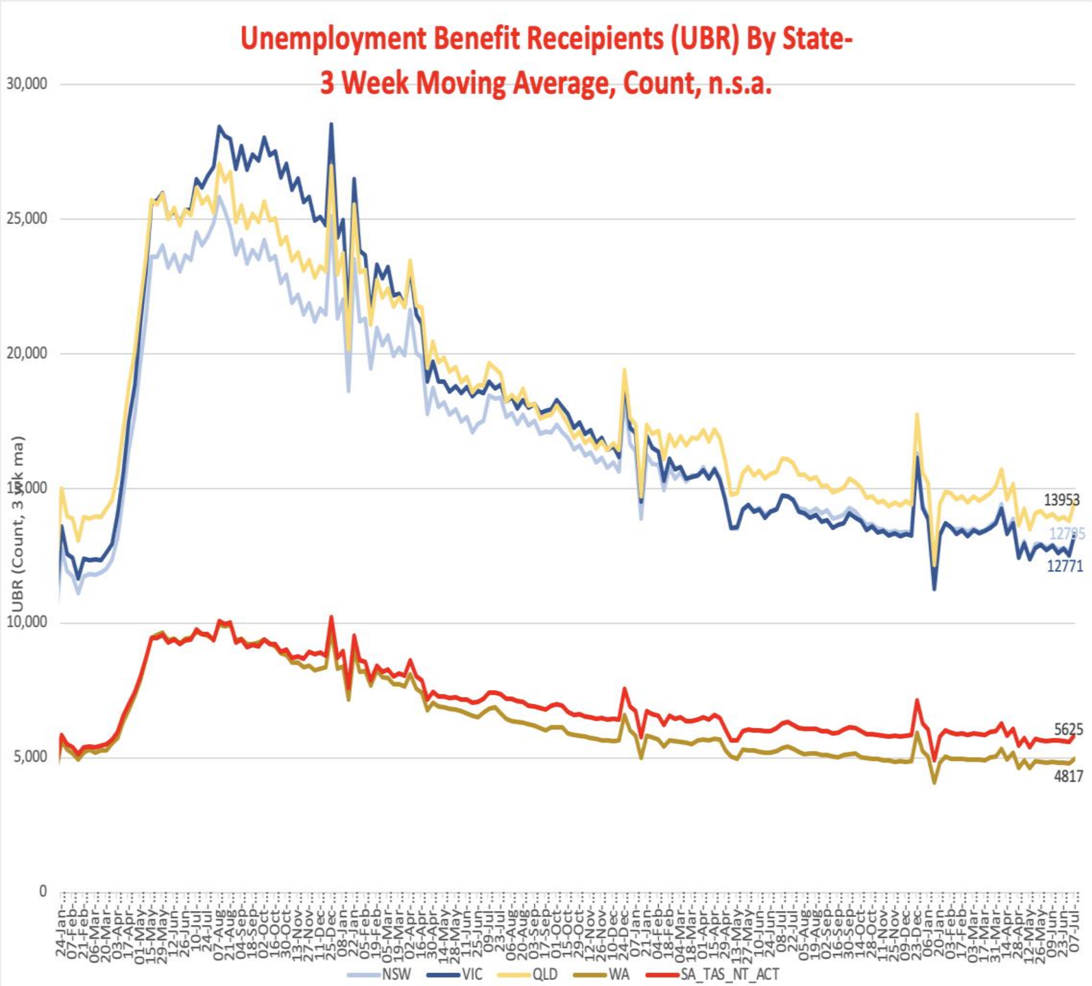


- Model driven by change in real rates, asset prices (house prices and equities), commodity prices, and US growth.
- Quarterly modelled.

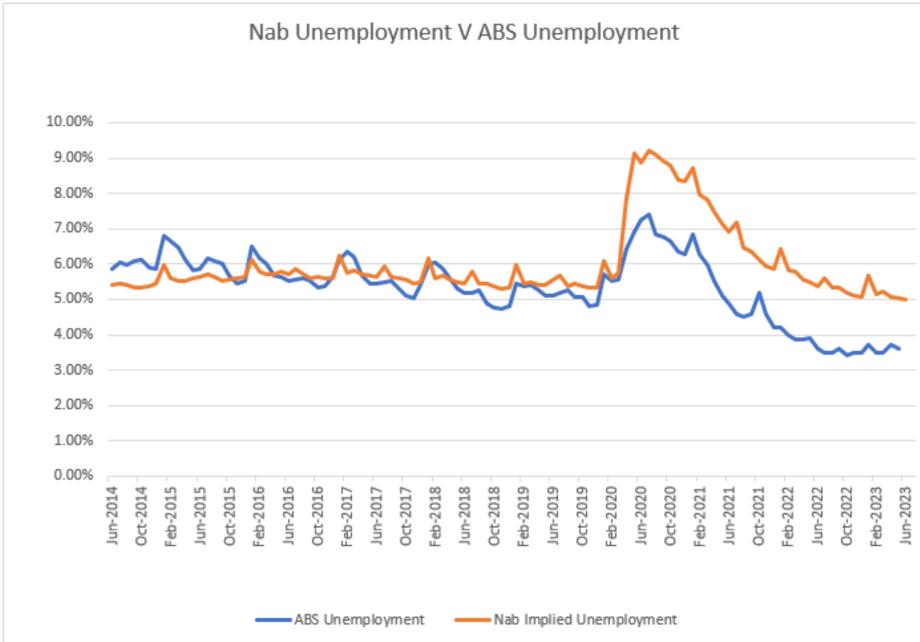
NAB data on the Claimant Count

(NAB customers receiving JobSeeker). Data has been volatile. By late June basically going sideways at good levels maybe up a touch in early July. **Fundamentally labour market still strong**.

3 Week Moving Average of NAB Claimant Count

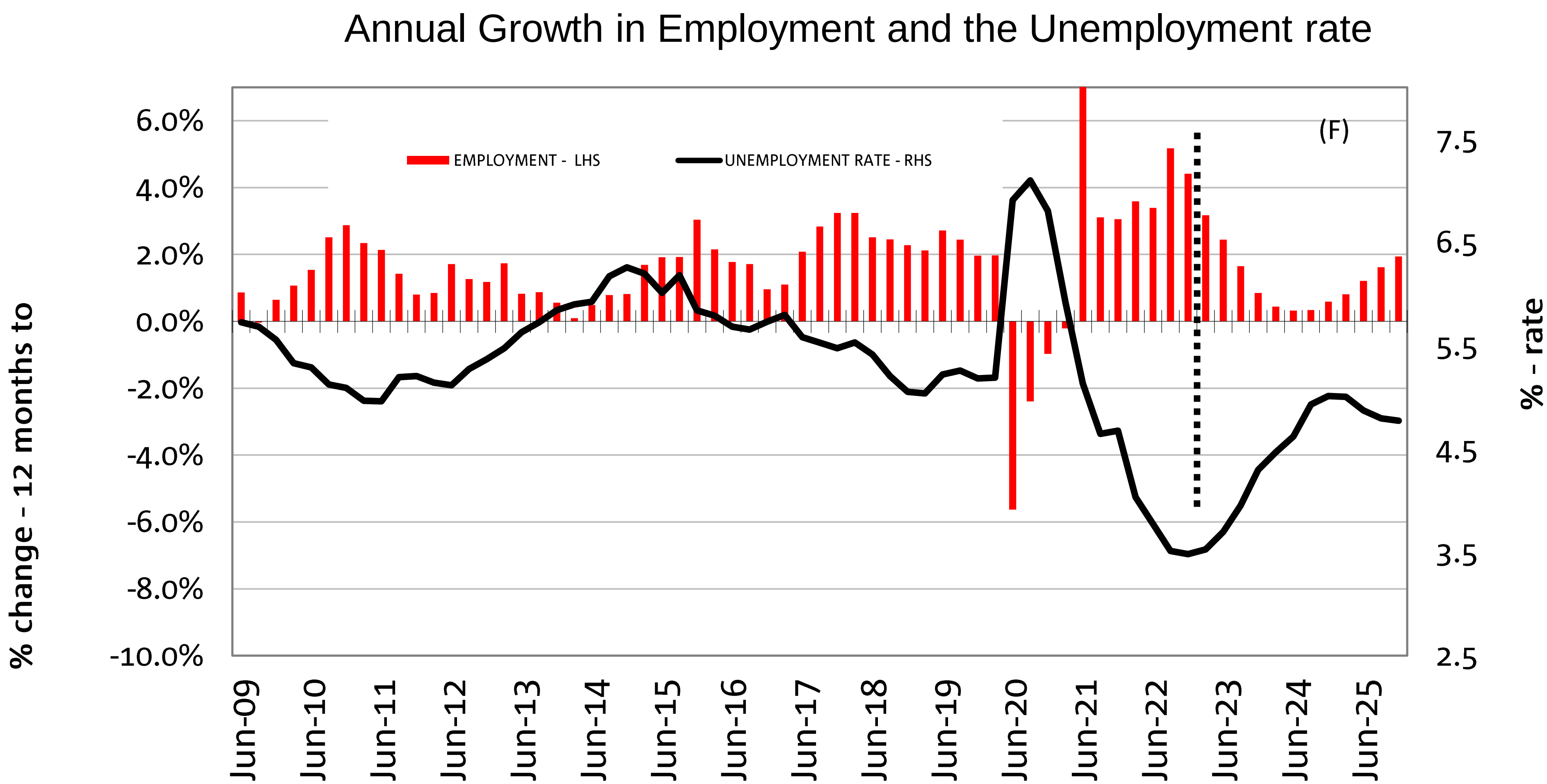


NAB Implied Economy wide Claimant Count



Labour market very impressive

Unemployment has fallen to around 3.6% and likely to increase moderately to around 4.3% by year end, as economy fades. And increase further in 2024 to around 5% and ease marginally in 2025 – back to 4.7%.



On RBA

- RBA has signalled that it wants to get policy much more restrictive in the inflation fight:
  - **Rhetoric has been ramped up;**
  - Fundamentally, they say that inflation is still too high and sticky;
  - We see it coming down quicker, because we expect a worse GDP outcome this year and next. But still not in target till late 2024.
  - **Timing of the economic slowdown is critical re rates view – as are wages and price pressures.**
  - **Prices while past their peak are still high and wages are picking up.**
- **RBA increasingly focussing on inflation not the economy;**
  - **So we have added another rate rise to 4.35% in August and have tentatively added another one to 4.6% in September.**
  - **July pause likely to be temporary.**
- **Serious slowdown now looming. Just how deep?**
- **Hence we still see rate cuts starting from mid 2024 - aim to get back to 3% by end of 2024.**
- **Medium term outlook much better but tough times inevitable in the next 12 months.**