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The Forward View: Australia Sep 2023

Growth to remain subdued despite signs of resilience

NAB Group Economics

Overview

- Following the release of the Q2 national accounts, we have slightly upgraded our growth forecasts, seeing GDP growth of 1.1% over 2023 and 1.4% in 2024. The upgrade largely reflects the slightly stronger than expected result for Q2 and an upward revision to Q1, as well as a small improvement to our outlook for Q3.
- At ~1%-1½%, our expectation remains that growth will be well below trend over the next two years, weighed down primarily by sluggish growth in household spending as inflation and monetary policy weigh on households.
- Elsewhere, we expect dwelling investment to remain weak, though the strength in housing demand and higher prices will provide some support. On the business side, outcomes will likely be more mixed with the end of the instant asset write off to weigh but a large pipeline of buildings & structures work underway. Public sector spending on infrastructure is also likely to remain a key support.
- The themes of households adjusting to higher rates and inflation but strong population growth supporting aggregate outcomes remains central to the outlook. For now, our transactions data points to resilience in nominal spending for the first two months of Q3 and business conditions remain above average, with capacity utilisation still high.
- Our outlook for the labour market is also unchanged. The rebound in population growth – running at 0.7% per quarter – has eased some labour shortages but the unemployment rate remains very low. We see the unemployment edging higher over Q4 to 3.9% before increasing to around 4.9% by the end of 2024.
- Inflation is expected to moderate to 4.4% by end-2023 and 3.1% by end-2024. In the near term, Q3 will likely see an acceleration with wage pressure, energy and services prices offsetting ongoing disinflation in goods prices.
- On rates, we continue to pencil in one last hike in November before the RBA remains on hold until mid-next year. That said, with rates peaking well below most other countries, the risk remains that the RBA stays on hold for even longer.

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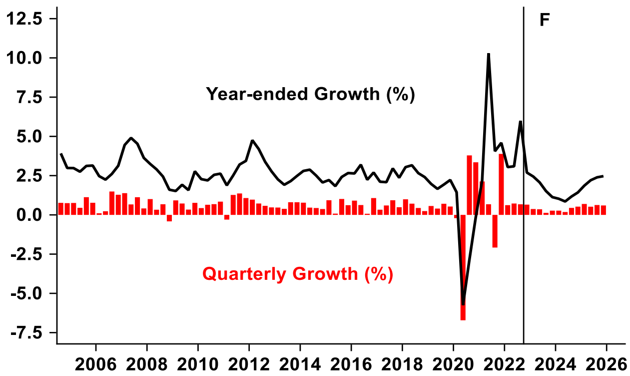
Key Economic Forecasts

	2022	2023-F	2024-F	2025-F
Domestic Demand (a)	4.9	1.9	0.6	2.2
Real GDP (annual average)	**3.7**	**1.8**	**1.1**	**2.2**
Real GDP (year-ended to Dec)	**2.7**	**1.1**	**1.4**	**2.5**
Terms of Trade (a)	6.3	-7.3	-3.4	-3.5
Employment (a)	4.2	3.3	1.0	1.1
Unemployment Rate (b)	3.5	3.9	4.9	4.7
Headline CPI (b)	7.8	4.6	3.1	2.8
Core CPI (b)	6.3	4.3	3.1	2.8
RBA Cash Rate (b)	3.10	4.35	3.35	3.10
$A/US cents (b)	0.68	0.66	0.73	0.78

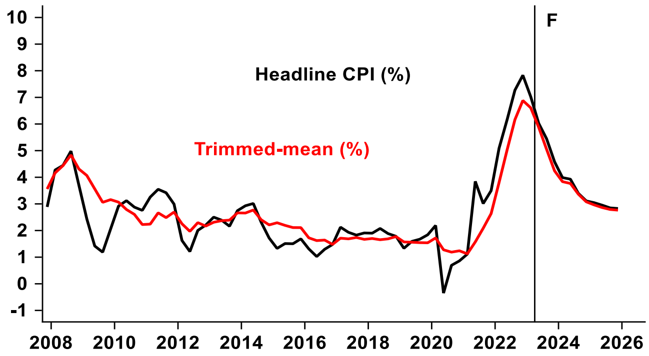
(a) annual average growth, (b) end-period

Chart 1: GDP forecasts



Source: Macrobond, NAB Economics

Chart 2: CPI forecasts



Source: Macrobond, NAB Economics

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Labour Market, Wages & Consumption

The unemployment rate has ticked up to 3.7% in recent months, but the rise has partly reflected record participation as employment growth remains robust alongside strong population growth.

The unemployment rate rose from 3.5% to 3.7% in July and remained there in August, despite the economy adding more than 60k more jobs across the two months. This should have been enough to keep the unemployment rate unchanged with a run rate of around 33k jobs needed per month to keep up with the ongoing rebound in population growth. However, the participation rate has also risen – to a new record high of 67%.

We continue to expect employment growth to slow and the unemployment rate to rise more materially as the year progresses, reaching around 4% by end-2023 and approaching 5% by end-2024.

On wages, the Q2 WPI was slightly softer than expected at 0.8% q/q (3.6% y/y) and the broader Q2 National Accounts measure of average earnings was also subdued. We still expect a pickup in Q3, with growth of over 4% expected by the end of 2023, before the softening labour market begins to ease wage pressures in 2024.

As expected, the Q2 National Accounts showed very weak real consumption growth and this is likely to continue into 2024.

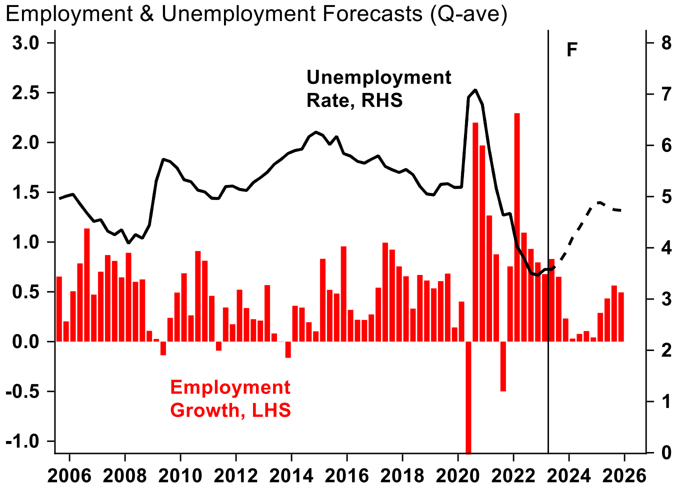
Consumption growth in Q2 edged down to 0.1% q/q (1.5% y/y), from a revised 0.3% q/q growth rate in Q1. A 5.8% q/q increase in vehicle purchases supported the result, likely reflecting some supply chain normalisation. Without the rise in vehicles, overall consumption would have been flat.

Discretionary consumption declined for the third consecutive quarter, down 0.5% q/q, with falls in recreation & culture (down 2.5%), household furnishings (down 2.5%) and tobacco & alcohol (down 1.0%) – though transport services consumption continued to recover, rising 3.2%. Spending on essentials remained robust, rising 0.5%, including increases in dwelling services and utilities.

Overall goods consumption rose 0.3% q/q while services consumption was flat, possibly marking the end of a long period of rebalancing from goods to services in the wake of the pandemic. Importantly, overall per capita real consumption fell for a second consecutive quarter as individual households cut back in the face of inflation and interest rate pressures.

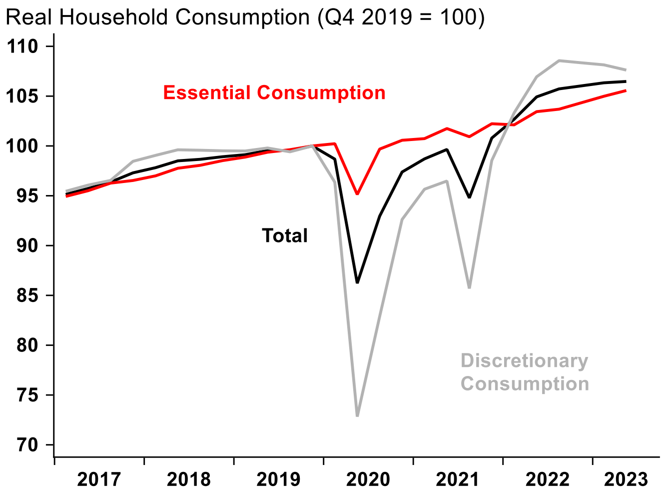
More timely data on nominal spending suggest consumption has been resilient through the first part of Q3, with NAB's *Monthly Data Insights* showing total consumer spending grew 1.1% in July and a further 0.8% in August. However, in real terms, consumption likely remains subdued, and we forecast this to remain the case into 2024, with per capita spending continuing to contract.

Chart 3: Unemployment rate will likely rise to around 5% as the economy slows



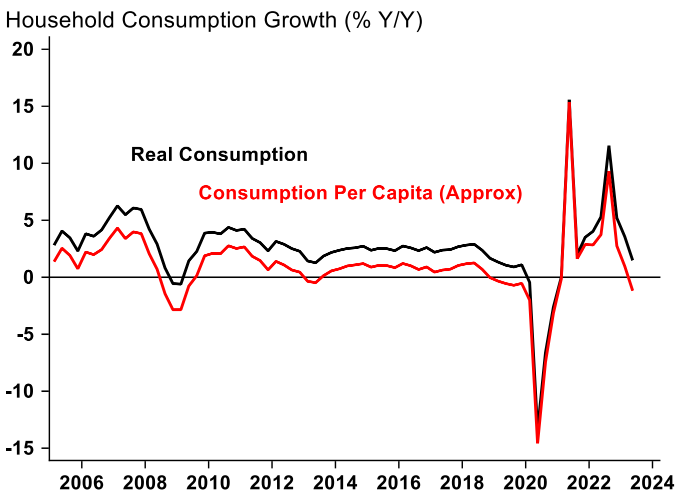
Source: Macrobond, NAB Economics

Chart 4: The Q2 National Accounts showed discretionary consumption has continued to decline



Source: Macrobond, NAB Economics

Chart 5: Consumption per capita is declining, albeit from an elevated level, and may continue to fall until 2024



Source: Macrobond, NAB Economics

Housing and Construction

The housing market continues to face the opposing forces of higher interest rates and strong demand from the rebound in population growth.

Both price and rents growth remain robust with demand from a rapidly growing population remaining strong amidst construction completion rates hovering around decade lows.

The Corelogic 8-Capital City dwelling price index rose by 1% in August after slowing to 0.8% m/m in July. Price growth edged up on the east coast, though Sydney and Brisbane continue to outpace Melbourne by a fair degree. Price growth in Adelaide and Perth edged lower but both continue to track at solid rates. Hobart remains the standout, with prices falling slightly in the month and in annual terms continues to track at the lowest rate of all capitals. Overall, the 8-Captial city dwelling price index has now regained more than half its losses after falling by 9.4% from its peak in early 2022.

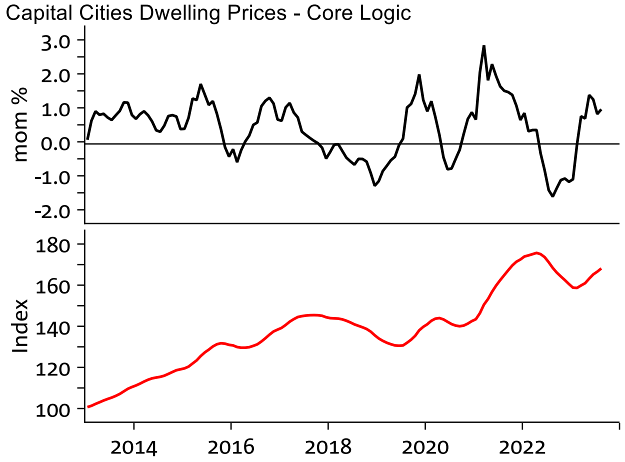
Rents growth has slowed slightly over recent months but remains up 9% y/y across the capitals. The most significant slowing has occurred on the east coast with Perth still strong. The rental market remains tight with vacancy rates declining slightly in August after ticking up over previous months.

Detailed completions data for Q2 will be released early next month, though national accounts data shows that the volume of new building investment rose in Q2. This was offset by falling work on alterations & additions as the impact of the HomeBuilder program and other pandemic supports continued to fade. New building investment picked up in NSW, Qld, WA and SA, but edged lower in Vic.

Building approvals appear to have stabilised in trend terms. The trend easing in the detached housing also appears to be slowing but remains around its lowest level in a decade. The volatile apartments series (which fell 8% in July) also remains low. At current rates the annual completion rate will converge to around 165k – around 10k less than current rates. However, the elevated pipeline of work (around 250k dwellings under construction or approved but not commenced) will support completion rates in the near-term as supply chains continue to heal.

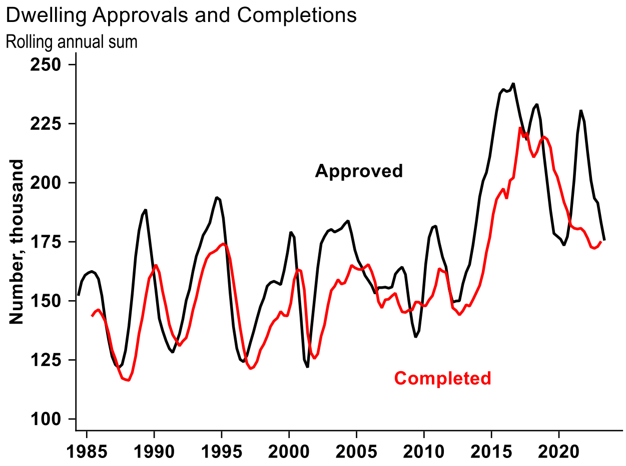
Indeed, the NAB monthly business survey showed conditions in the construction sector continued to improve in August with all three subcomponents picking up – and trading conditions now back at around average. That said, price pressures remain strong, with both input and output prices still high in the sector. Capacity utilisation reflects this, remaining very high.

Chart 6: The recent upwards turn in house prices has continued



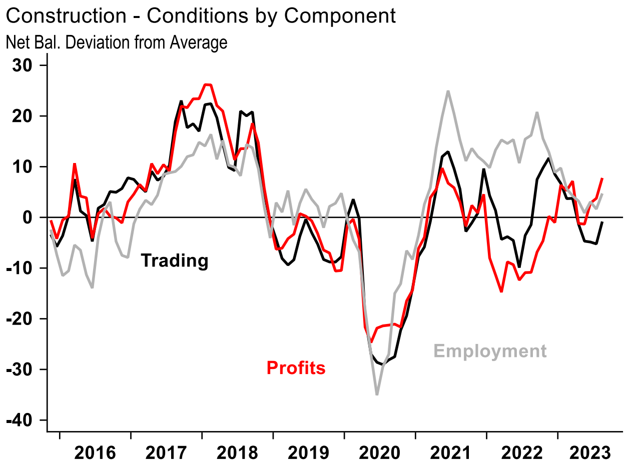
Source: National Australia Bank, CoreLogic

Chart 7: Current approval rates imply ongoing softness in completions.



Source: Macrobond, NAB Economics

Chart 8: Construction industry conditions have been improving



Source: Macrobond, NAB Economics

Business and Trade

Business investment continued to rise in Q2, while more recent data shows business conditions remained resilient through August.

The National Accounts release showed business investment again grew at a robust pace in Q2, up 2.1% q/q (underlying basis). Q1 growth was also revised up to 3.6% (from 2.9%), leaving underlying business investment to be up 8% over the year.

New machinery & equipment investment increased 4.3% q/q reflecting improving supply chains and support from the tail end of the instant asset write off. New building construction also rose, up 0.3%, while new engineering construction fell 0.4% q/q. The non-mining sector remained the key driver, with mining sector investment falling in the quarter.

More recent data in the NAB Monthly Business Survey showed business conditions rose 3pts in August to +13 index points, still well above long-run average levels. The confidence and forward orders measures both edged up though they remain below average, weighed down by deep negatives in the retail sector. Car retailing and personal & household goods have been driving this result, in part reflecting backlogs of orders being cleared.

Labour cost growth eased from the spike seen in July, while elevated purchase cost growth continued in the month, running at 2.9%. Output price growth also remained high.

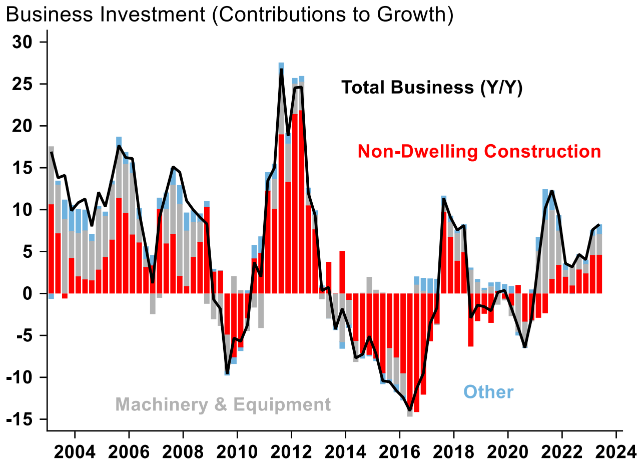
As expected, net exports made a significant contribution to Q2 GDP growth, adding 0.8 ppts as exports rose sharply. More recent data shows the nominal trade surplus declined somewhat in July but remains elevated.

Export volumes rose by 4.3% q/q in Q2. While reasonably broad-based, there were particularly large increases in coal, helped by improved weather conditions (11% q/q after -9% in Q1), and travel service credits again grew strongly, up 18% q/q. The ABS noted that international student numbers are now above their pre-pandemic level; with total travel credits still 12% below the end 2019 level, this implies overseas tourism and business traveller numbers are still well off their pre-COVID-19 level.

Imports rose 0.7% q/q, with a fall in goods imports (-0.2% q/q) due to weakness in consumer and capital goods, offset by an increase on the services side (up 4.7%) - reflecting outbound tourism from Australia.

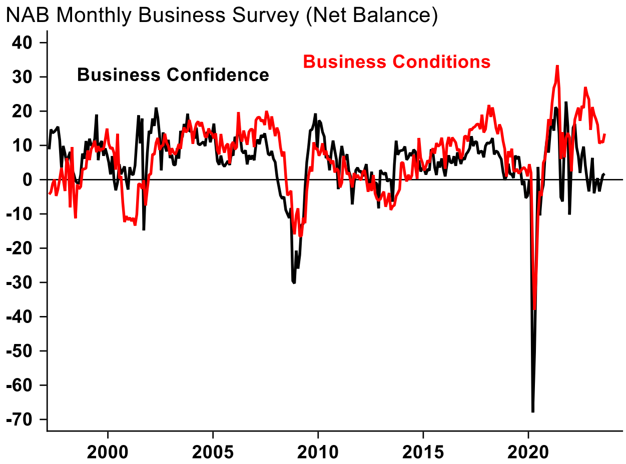
The monthly nominal trade balance declined by $2.2b in July, falling to $8.0b, with exports falling and imports rising. Further ahead, we continue to expect weak demand to weigh on imports but have marginally upgraded our imports profile to account for some rebalancing occurring between trade and business inventories after the fall in inventories in Q2.

Chart 9: Business investment rose 2.1% in Q2, driven by new machinery and equipment



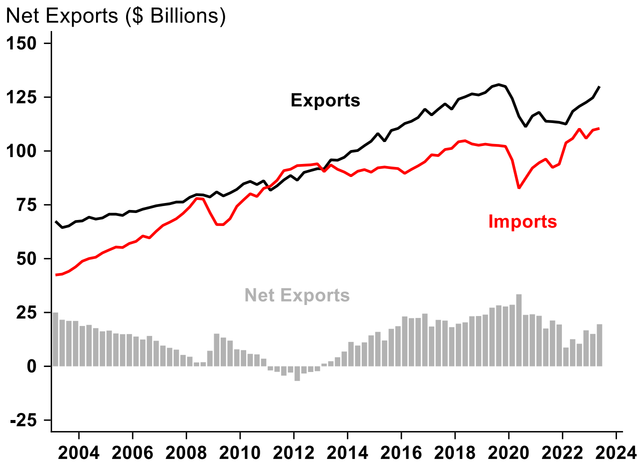
Source: Macrobond, NAB Economics

Chart 10: Business conditions rose in August, remaining well above the long-run average



Source: Macrobond, NAB Economics

Chart 11: A rise in exports made a significant contribution to GDP in Q2



Source: Macrobond, NAB Economics

Monetary Policy, Inflation and FX

The monthly CPI indicator for July showed further improvement in inflation in the month, though this is likely to regress in coming months as more services prices are updated.

The headline monthly measure eased to 4.9% (from 5.3%) though the ex-volatiles measure continues to track at a higher rate at 5.8% (from 6.1%). A larger number of services will be update in August including postal and telecom services as well as insurance, while council/property rates which are updated annually will be updated in the September quarter.

Oil prices have also rebounded to high levels recently and petrol prices will push up the August CPI reading as a result. More broadly, the impact of higher energy costs continues to flow through the economy and present some risk of second round effects of passthrough to output prices. Likewise, the large minimum and award wage rise in July will likely add pressure on the cost side for Q3.

That said, as the labour market softens and consumer demand growth slows, we expect to see an ongoing moderation in inflation through 2024 with inflation falling to around 3% by the end of the year.

We continue to see one further hike by the RBA – likely in November. The recent run of activity data suggests there may be some downside risk to this, but the resilience in the labour market and potential for 'sticky' services still present an upside risk.

The September post-meeting statement retained its hawkish bias in that a more restrictive policy may be required depending on the balance of risks. That said, the RBA now clearly sees rates working to slow the economy alongside the impact of inflation weighing on households' real income growth – seeing a period of below trend growth over this year and next.

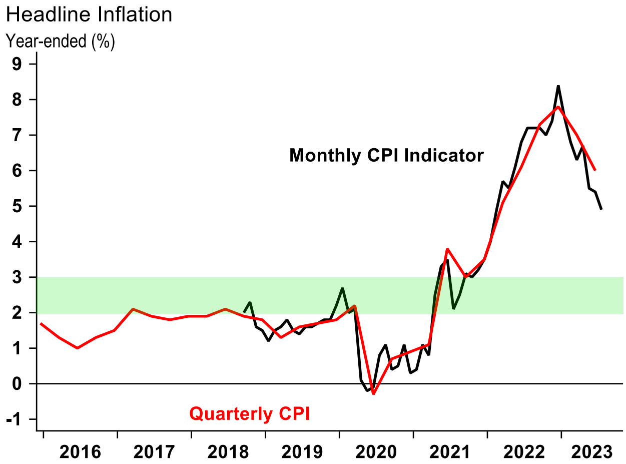
While there is some downside risk to activity, the gradual approach to policy by the RBA means there is some risk to upside for interest rates in the near-term. Further, should rates stay on hold at 4.1%, the risk is that rates stay higher for longer in a scenario where the economy remains resilient, or inflation becomes sticky. Services inflation, in particular, has remained more persistent overseas.

We continue to see the RBA shifting back towards neutral from mid-2024 with inflation moderating towards the target band and unemployment up near 5% on our forecasts.

The AUD/USD weakened further over the month, currently trading around US64.5c.

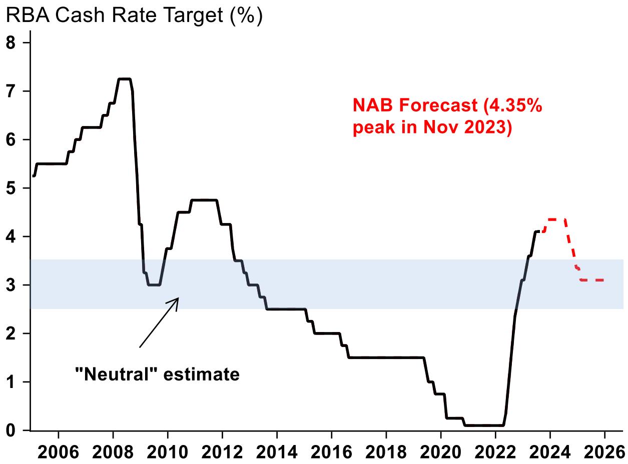
We continue to see the Aussie ending the year at around US66c before tracking higher over 2024 – ending 2024 at around US73c.

Chart 12: CPI pressures continue to ease but may be volatile in the near term.



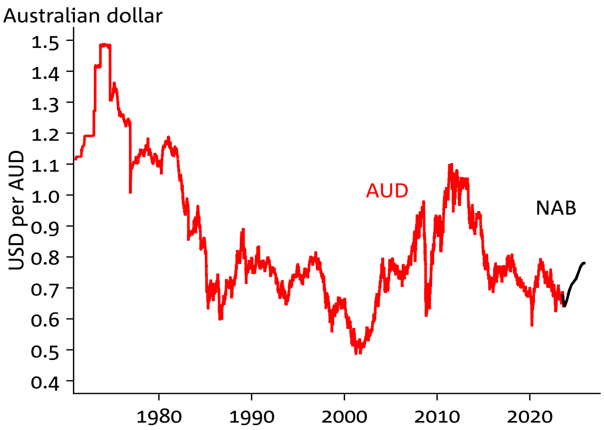
Source: Macrobond, NAB Economics

Chart 13: We expect one further increase in the cash rate, to a peak of 4.35%



Source: Macrobond, NAB Economics

Chart 14: AUD/USD to drift higher over coming years, reaching US73c by end 2024



Source: National Australia Bank, Macrobond Financial AB

Theme of the Month: Population and Labour Force Dynamics

Updated population estimates show a strong rebound in migration continues to drive growth. The COVID-era population gap is almost closed and employment growth now needs to average around 35k to keep pace.

Population growth was around 0.7% q/q in Q2 – a rate that annualises at over 3% – though growth over the year to March was 2.1% (Chart 15). More timely estimates of adult population in the labour force survey suggest the fast pace of growth has continued, with a rise of 2.8% over the year to August.

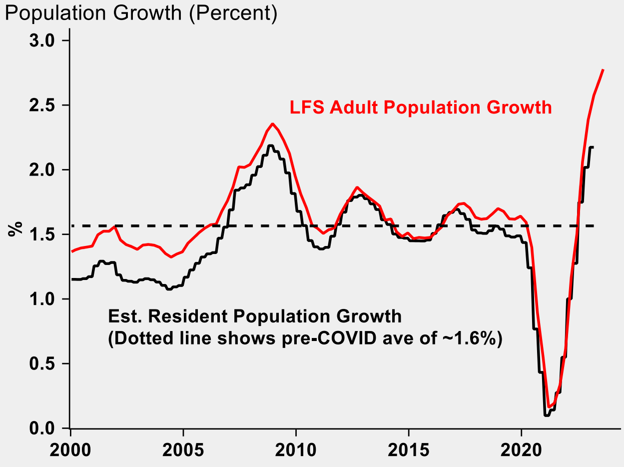
A strong rise in overseas arrivals is driving the rebound in population (Chart 16). Quarterly arrivals reached an historic high of over 200k in Q2 while departures have been more subdued at around 50k, leaving net overseas migration at a record high of over 150k in the quarter.

The rapid population rebound has almost entirely closed the COVID-era 'population gap' that emerged as a result of health-related border restrictions (Chart 17). Around the time that border restrictions were lifted in late 2021, the population was as much as 425k below its pre-COVID trend level. This gap has now fallen to less than 100k and looks on track to be eliminated by 2025.

With the population growing rapidly, the economy now needs to generate around 35k jobs per month to maintain a steady unemployment rate (assuming a constant participation rate) (Chart 18). So far, the significant unmet demand for labour in the economy has meant this has been possible.

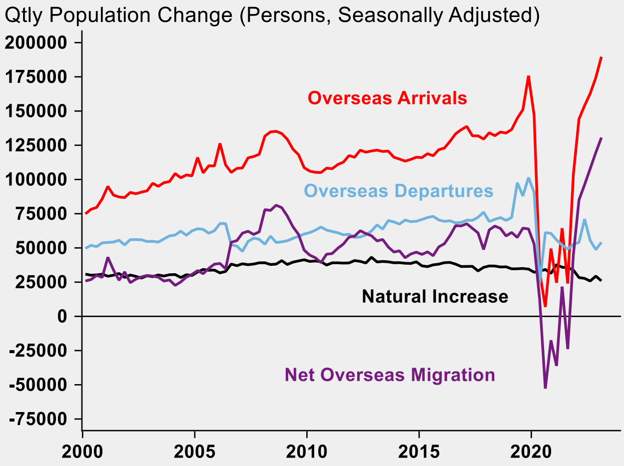
Whether or not this continues remains to be seen. Employment growth should slow as the economy softens, while the current high rate of migration is likely to be only temporary. Whether employment or population slows first will be key to the outlook for the labour market.

Chart 15: Population estimates have shown growth has continued to accelerate through 2023



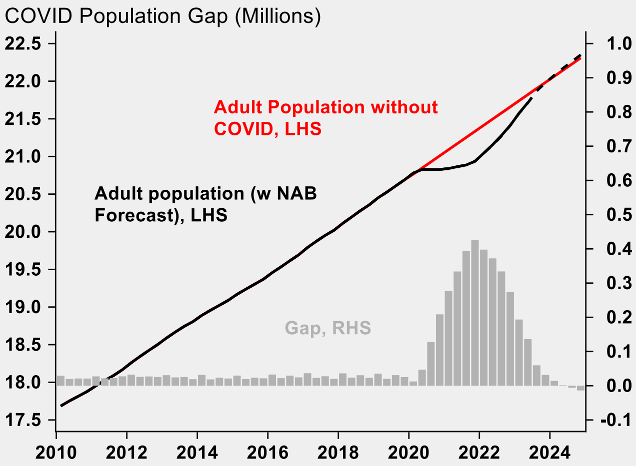
Source: Macrobond, NAB Economics

Chart 16: A rapid rebound in inbound migration has driven population growth



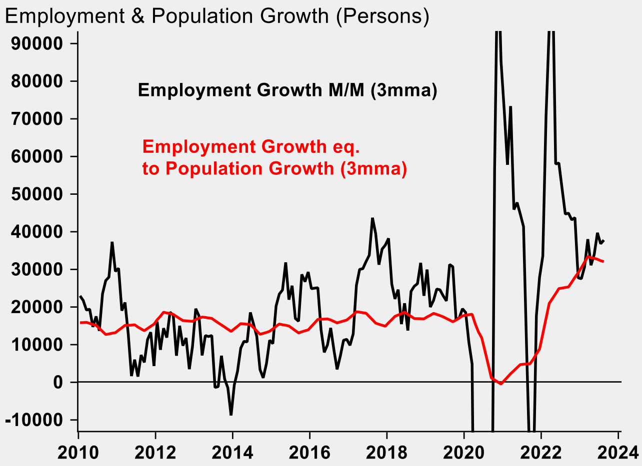
Source: Macrobond, NAB Economics

Chart 17: The population rebound has almost entirely closed the COVID-era 'population gap'



Source: Macrobond, NAB Economics

Chart 18: Employment growth of around 35k per month is needed to keep pace with the population surge



Source: Macrobond, NAB Economics

Table of Economic Forecasts

	% Growth q/q				% Growth y/y			
	Q1-23	**Q2-23**	**Q3-23 (f)**	**Q4-23 (f)**	**2022**	**2023 (f)**	**2024 (f)**	**2025 (f)**
GDP and Components								
Private Consumption	0.3	0.1	-0.1	-0.1	5.2	0.3	0.9	2.1
Dwelling Investment	-0.7	-0.2	-1.5	-1.3	-4.0	-3.7	-5.2	8.5
Underlying Business Investment	4.2	2.1	-1.5	-0.1	4.5	4.7	-1.0	2.9
Underlying Public Final Demand	0.8	1.8	0.5	0.5	2.6	3.6	2.0	2.0
Domestic Demand	**0.7**	**0.7**	**-0.1**	**0.1**	**3.4**	**1.4**	**1.0**	**2.7**
Stocks (Cont. to GDP)	0.3	-1.0	0.1	0.1	0.5	-0.9	0.1	0.3
Gross National Expenditure	**0.8**	**-0.4**	**0.0**	**0.2**	**3.5**	**0.7**	**1.5**	**2.9**
Exports	1.8	4.3	0.4	0.6	8.2	7.2	1.5	2.2
Imports	3.6	0.7	0.5	0.6	12.8	5.5	1.9	4.3
Net Export (Cont. to GDP)	-0.3	0.8	0.0	0.0	-0.5	0.5	0.0	-0.3
Real GDP	**0.4**	**0.4**	**0.1**	**0.3**	**2.7**	**1.1**	**1.4**	**2.5**
Nominal GDP	2.2	-1.2	0.6	1.0	12.0	2.6	4.2	4.2
External Account								
Current Account Balance ($b)	34.8	30.4	34.3	25.6	26.4	25.6	10.0	-18.8
Current Account Balance (% of GDP)	1.4	1.2	1.3	1.0	1.1	1.0	0.4	-0.7
Terms of Trade	2.7	-7.9	-2.7	-0.6	7.2	-8.5	-0.3	-4.5
Labour Market								
Employment	0.7	1.2	0.7	0.2	5.2	2.4	0.3	1.8
Unemployment Rate (End of Period)	3.6	3.6	3.7	3.9	3.5	3.9	4.9	4.7
Ave. Earnings (Nat. Accts. Basis)	1.9	0.9	1.3	1.0	3.9	5.1	3.8	3.6
Wage Price Index (WPI)	0.8	0.8	1.4	1.0	3.4	4.1	3.8	3.6
Prices and Rates								
Headline CPI	7.0	6.0	5.4	4.6	7.8	4.6	3.1	2.8
Trimmed-mean CPI	6.6	5.9	5.0	4.2	6.9	4.2	3.1	2.8
RBA Cash Rate (End of Period)	3.60	4.10	4.10	4.35	3.10	4.35	3.35	3.10
10 Year Govt. Bonds (End of Period)	3.31	4.00	4.25	4.10	4.04	4.10	3.80	3.90
$A/US cents (End of Period)	0.67	0.66	0.64	0.66	0.68	0.66	0.73	0.78

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

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Important notice