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, October 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 late 2023 and into 2024.**
  - Fear central banks have overdone it. Peak in rates certainly very near.
  - US economy has continued to surprised on the up side.
  - But too early to say growth will be fine. Lags important and softer growth to come.

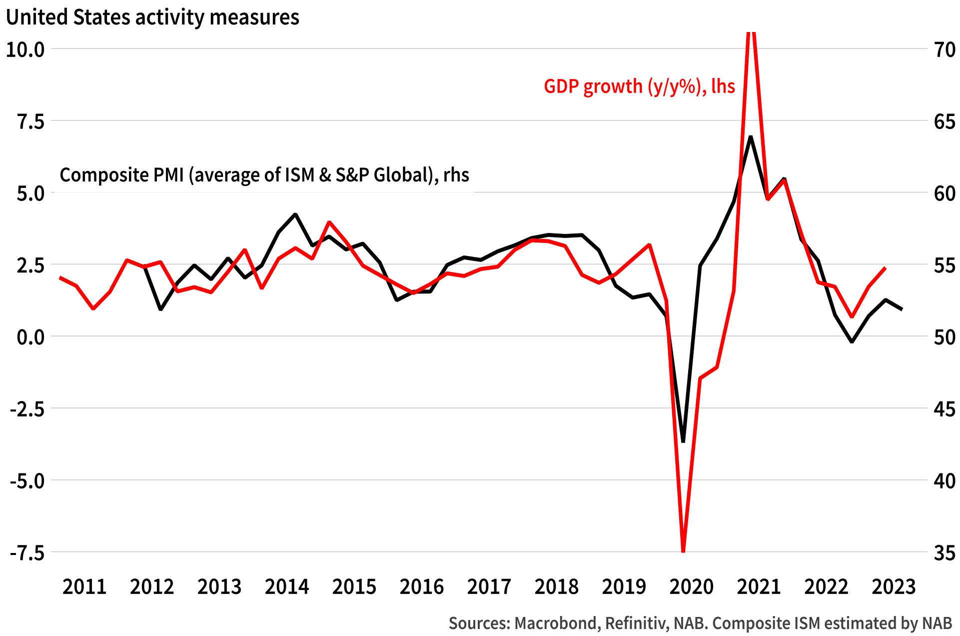
- **China has seen the combination of the virus and problems in the property market dramatically slow growth in 2022 to around 3%.** Has reopened now **and seen an early bump in activity in early 2023. But growth prospects seem to have petered out**. Recently saw rate cuts in China and talk of fiscal packages to stimulate growth. We are at 5.0% for 2023 and 4.5% in 2024.

- **Globally, outside of COVID and GFC, the worst year since 2023. And 2024 looks weaker – reflecting very soft H2 in 2023.**

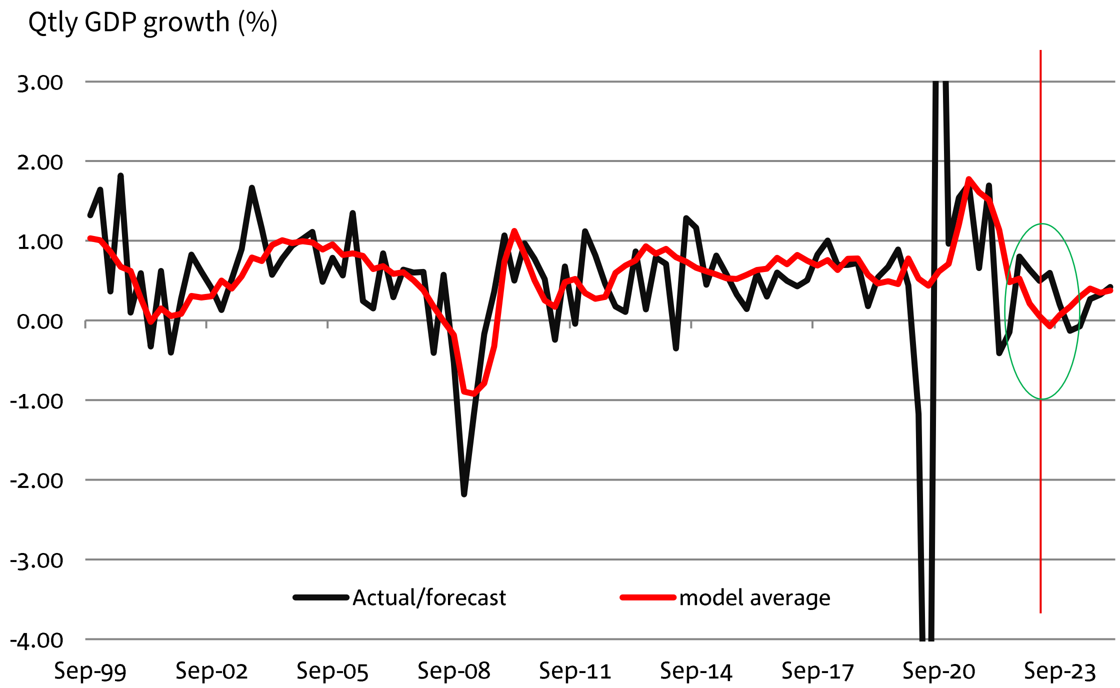
US data has generally been stronger than we and models expected.

That has seen fears of the Fed going again soon. Bond and equity market sell offs. Interest rate markets less convinced. Lags from policy changes still tricky/variable.

US GDP and implications from Survey data



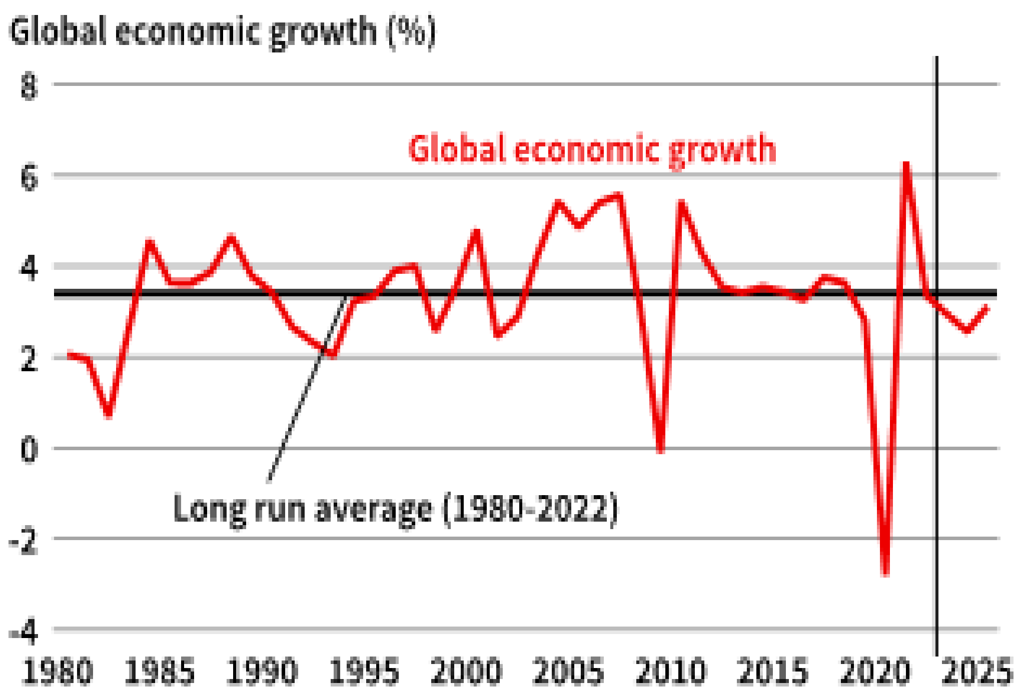
Lags from NAB's models of US Activity – Quarterly



Global economic forecasts

2023 was quite weak at 3% and slowing during the year. Shows up most in 2024 year averages. At 2.6% the slowest growth rate outside COVID and GFC since 1990. Big slowing in US and major economies. China under pressure. Still weak, more normal in 2025.

	2020	2021	2022	2023	2024	2025
US	-2.8	5.9	2.1	2.1	0.8	1.7
Euro-zone	-6.3	5.6	3.4	0.5	0.6	1.1
Japan	-4.3	2.3	1.5	1.9	0.7	0.8
UK	-10.4	8.7	2.5	0.4	0.6	0.9
Canada	-5.1	5.0	3.4	1.4	1.3	1.6
China	2.2	8.1	3.0	5.0	4.5	4.8
India	-6.0	8.9	6.7	6.3	5.2	6.2
Latin America	-6.8	7.0	3.9	2.0	1.4	1.9
Other East Asia	-2.8	4.5	4.2	3.0	3.3	4.1
Australia	-1.8	5.2	3.7	1.8	1.1	2.2
NZ	-1.5	6.0	2.7	0.8	0.3	3.0
Global	**-2.8**	**6.3**	**3.4**	**3.0**	**2.6**	**3.1**



Australia macroeconomic summary

Economy slowing a lot. Rates and global softness driving a serious slowdown. How deep?

- **GDP growth to slow to around 1% during 2023 and around 1½ % in 2024 - was 2.7% through 2022.**
  - Key drivers: slower global growth and rate rises (including fixed loan maturities in mid 2023).
  - Business survey showing stress in retail as is our internal transaction data.
  - Business investment will slow. House prices recovering but still fragile.
  - Growth in 2025 back to around trend (2.3%).

- **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 4.0% by end 2023, and 5% by late 2024.
  - That is a tough outcome (by Dec 2024 implies 230k more on JobSeeker).

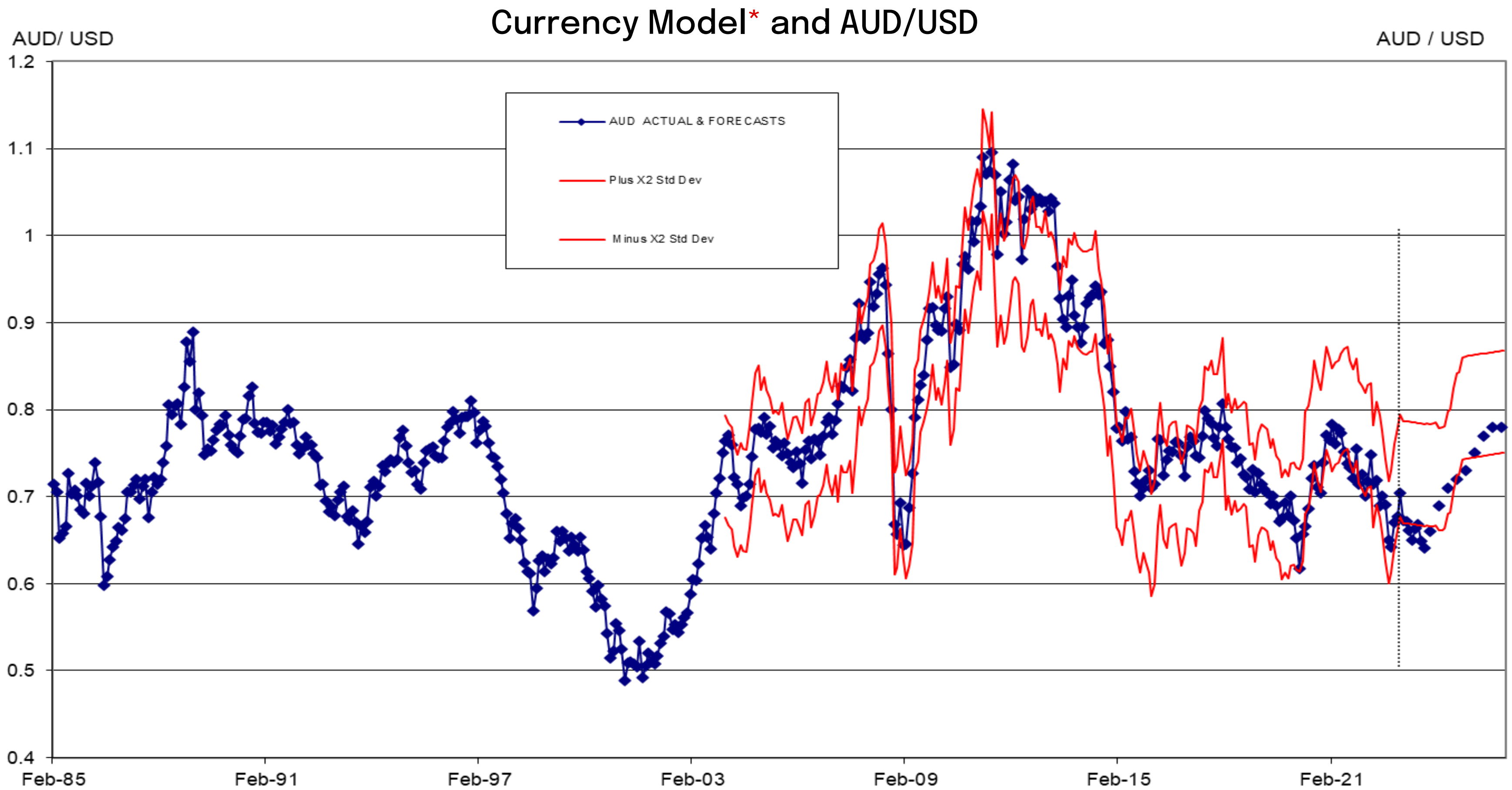
- **Price inflation has peaked but will stay high for a while.**
  - Purchase costs still very high and business is fully passing on prices (maintaining profit margins).
  - Headline and core around 4.3% by end 2023 and around 3% by late 2024.
  - High energy costs and faster wages growth see only moderate slowing in out years.

- **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. Labour shortage of workers and NWC continue to see upward pressure
  - Will be most apparent in Q3 2023 but will approach 4.3% by early 2024.

- **RBA now on hold data watching. Very near the peak and cuts next year.**
  - RBA decisions very much focused on inflation but increasingly worried about the economy.
  - **With weaker inflation than expected and a worsening outlook RBA is on pause but might (or might not) get a final hike by November to 4.35%.**
  - **For 2024 we still see cuts starting in August/Sept 2024 and down to 3.1% by early 2025.**

Currency model USD 0.72+/- 5c

Recent movements very much reflecting strength of the USD. Australia a proxy for risk in uncertain world and China fears. Model seriously under valuing AUD at present. But expect it will recover.



- 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 = 66c AUD/USD
End 2024= 73c AUD/ USD
End 2025= 78c AUD/ USD

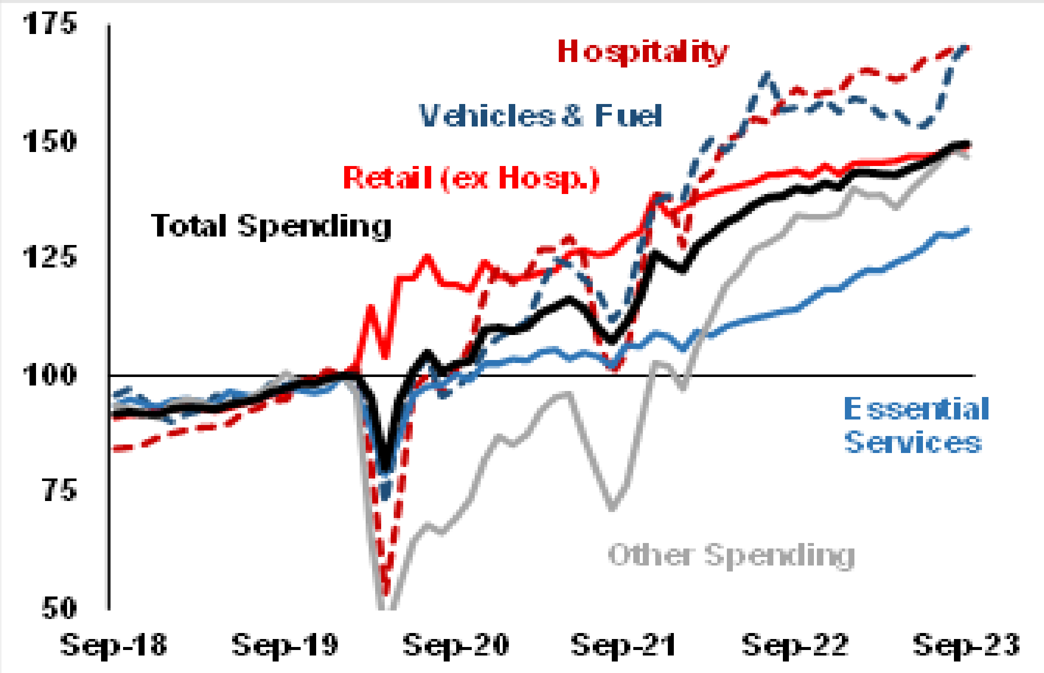
Data Insights

- NAB Data
- Business Survey

Indeed our internal data (in nominal terms) for retail sales shows its still a struggle.

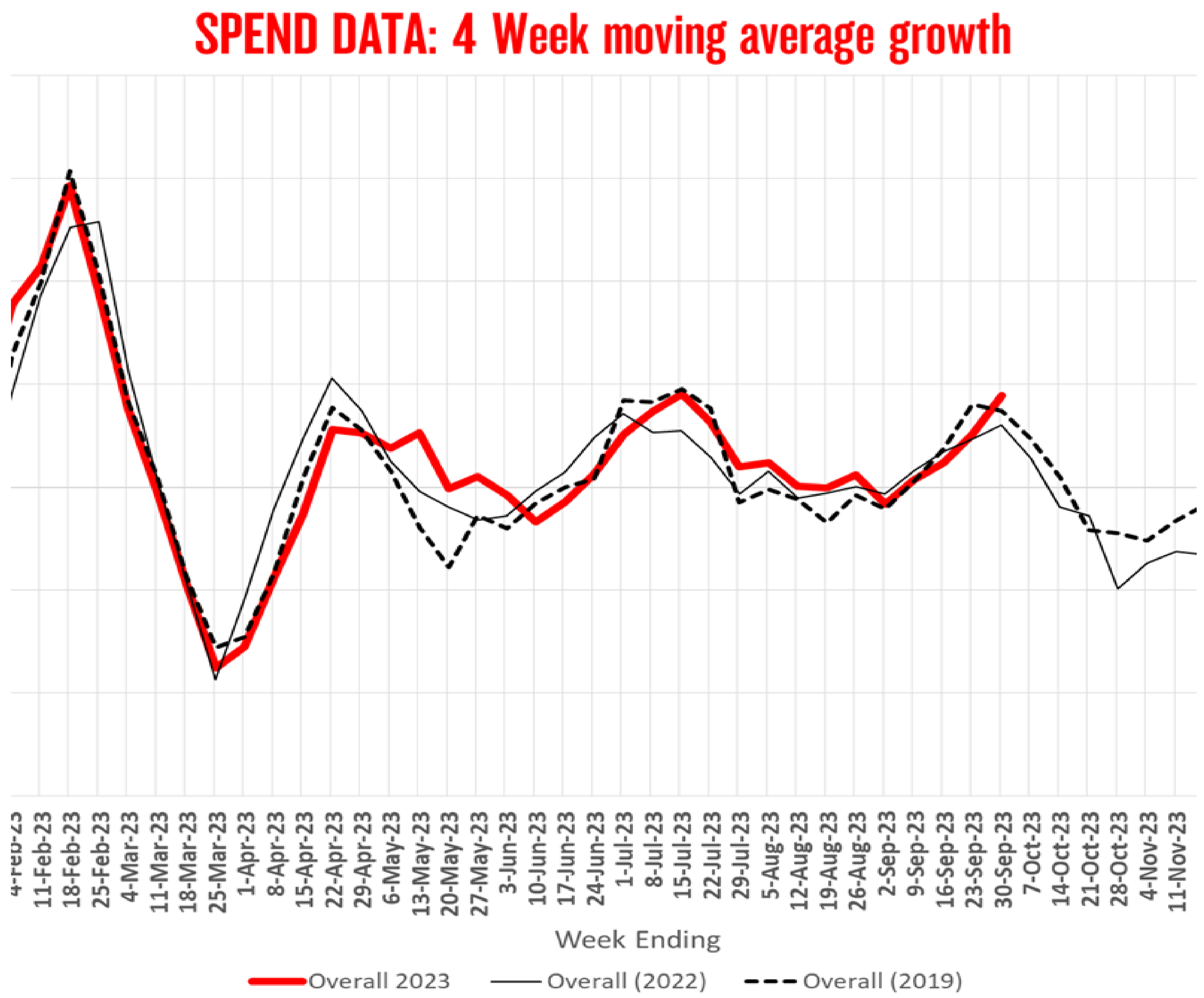
Total consumption better. September still sees retail a struggle – up 0.4% in the month after better August. Consumption better with big kick in fuel retailing as prices soared. Overall moderate real rise in Q3 consumption looks likely. Real retail sales to fall again in Q3.

	Jul-23	Aug-23	Sep-23		
	m/m	m/m	m/m	3m/3m	y/y
Goods Retail	0.3	0.6	0.5	1.1	3.5
Hospitality	0.3	1.2	0.0	2.6	5.4
Total Retail	**0.3**	**0.7**	**0.4**	**1.4**	**3.9**
Vehicles & Fuel	2.1	6.8	2.3	6.8	8.8
Essential Services	2.3	-0.4	1.1	3.8	14.9
Other Spending	2.0	2.2	-1.1	5.5	9.4
Total Spending	**1.1**	**1.4**	**0.3**	**3.0**	**6.8**
Goods	0.6	1.5	0.8	1.9	4.3
Services	1.7	1.2	-0.2	4.3	9.9
Discretionary	1.1	2.2	0.2	3.6	5.9
Non-Discretionary	1.0	-0.4	0.7	1.6	8.6



Weekly data patterns for consumption in September.

Strong end of the month. Encouraging.



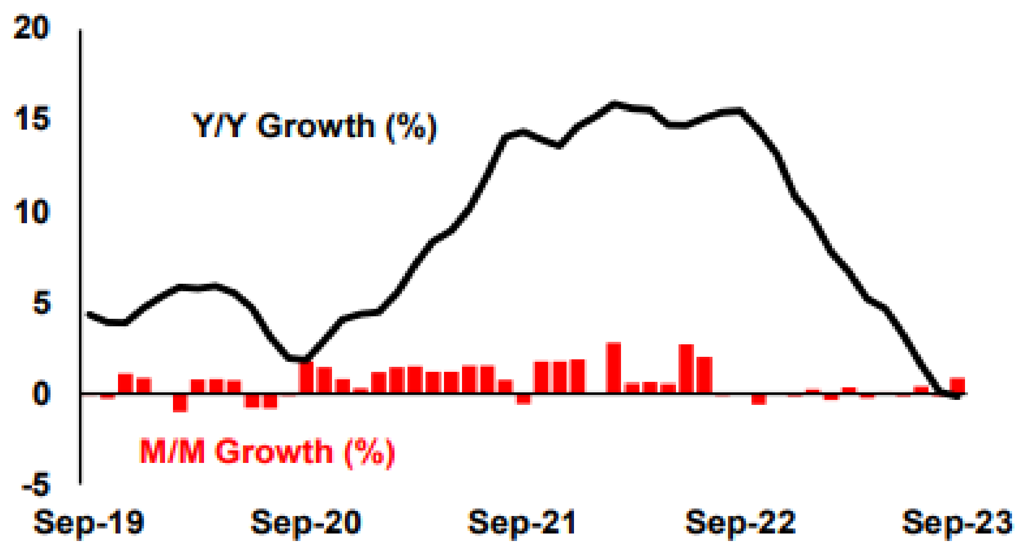
Inward credit still very soft – but better September.

Health, Utilities, Retail and Mining better. Agri and Arts & Rec a struggle.

	Jul-23	Aug-23	Sep-23				Jul-23	Aug-23	Sep-23		
	m/m	m/m	m/m	3m/3m	y/y		m/m	m/m	m/m	3m/3m	y/y
Accom & Food	0.8	-0.1	0.1	0.6	-2.9	Mining	1.7	2.3	3.0	-0.2	-15.1
Admin & Support	-0.4	-0.7	-1.9	-0.1	12.9	Other Services	-2.5	1.0	0.6	-1.0	13.9
Agriculture	1.8	-0.7	0.2	2.3	-2.5	Professional Services	-1.4	0.6	-0.3	-0.4	-6.0
Arts & Rec.	-2.2	-3.2	-2.9	-6.0	9.8	Rental & Real Estate	1.6	-0.5	-0.4	0.5	-6.5
Construction	1.2	0.0	1.1	2.3	15.1	Retail Trade	-0.7	0.4	2.5	-0.1	2.0
Education	-2.3	1.3	0.5	-0.9	10.8	Transport & Postal	0.6	-0.2	-1.2	-1.7	-12.3
Utilities	1.2	-13.9	4.2	-10.8	-11.8	Wholesale Trade	1.0	-0.2	1.3	2.7	-0.3
Health	1.8	0.4	3.9	4.8	14.3						
Info & Media	1.4	-4.0	-3.4	1.0	6.7	**Total**	**0.4**	**-0.1**	**0.8**	**0.6**	**-0.2**
Manufacturing	0.8	-0.2	1.6	1.0	0.0	Total ex Mining & Agri	0.2	-0.3	0.7	0.5	1.6

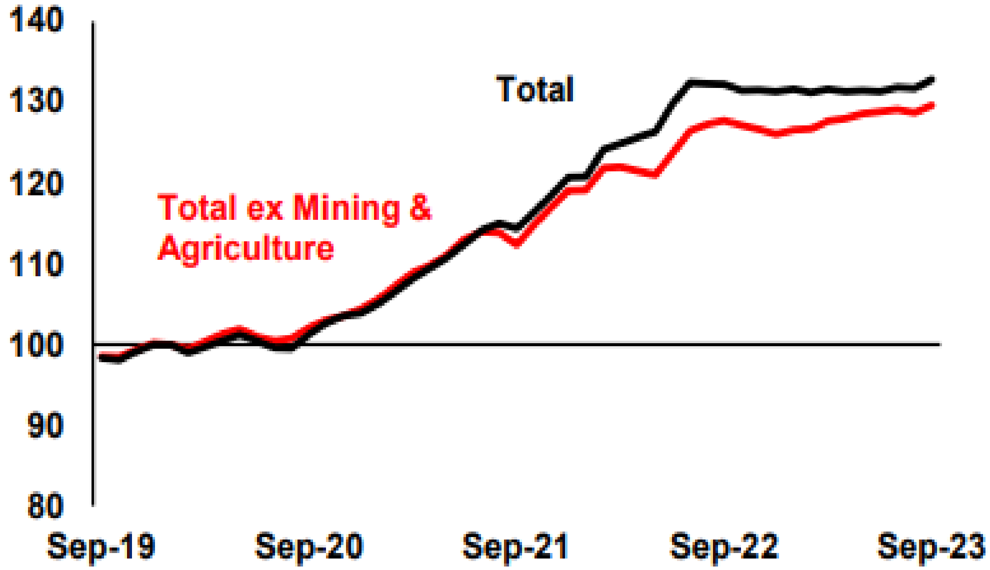
All data calculated as a three month moving average of seasonally adjusted monthly data.

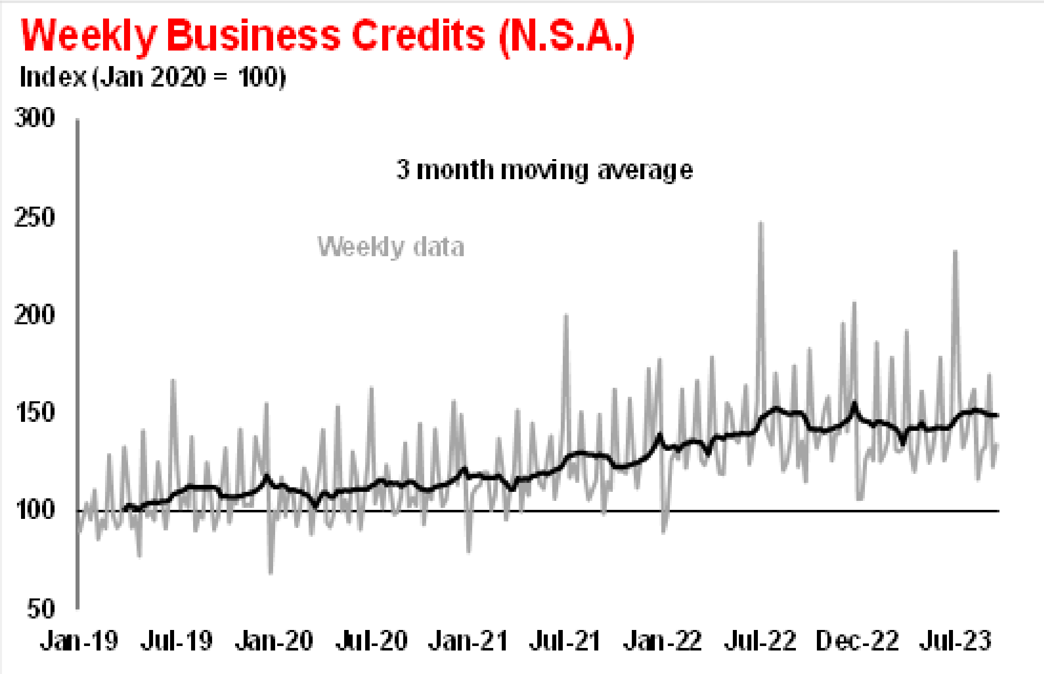
Chart 17: Business Credits Growth (%)



Business inward credits (business revenues)

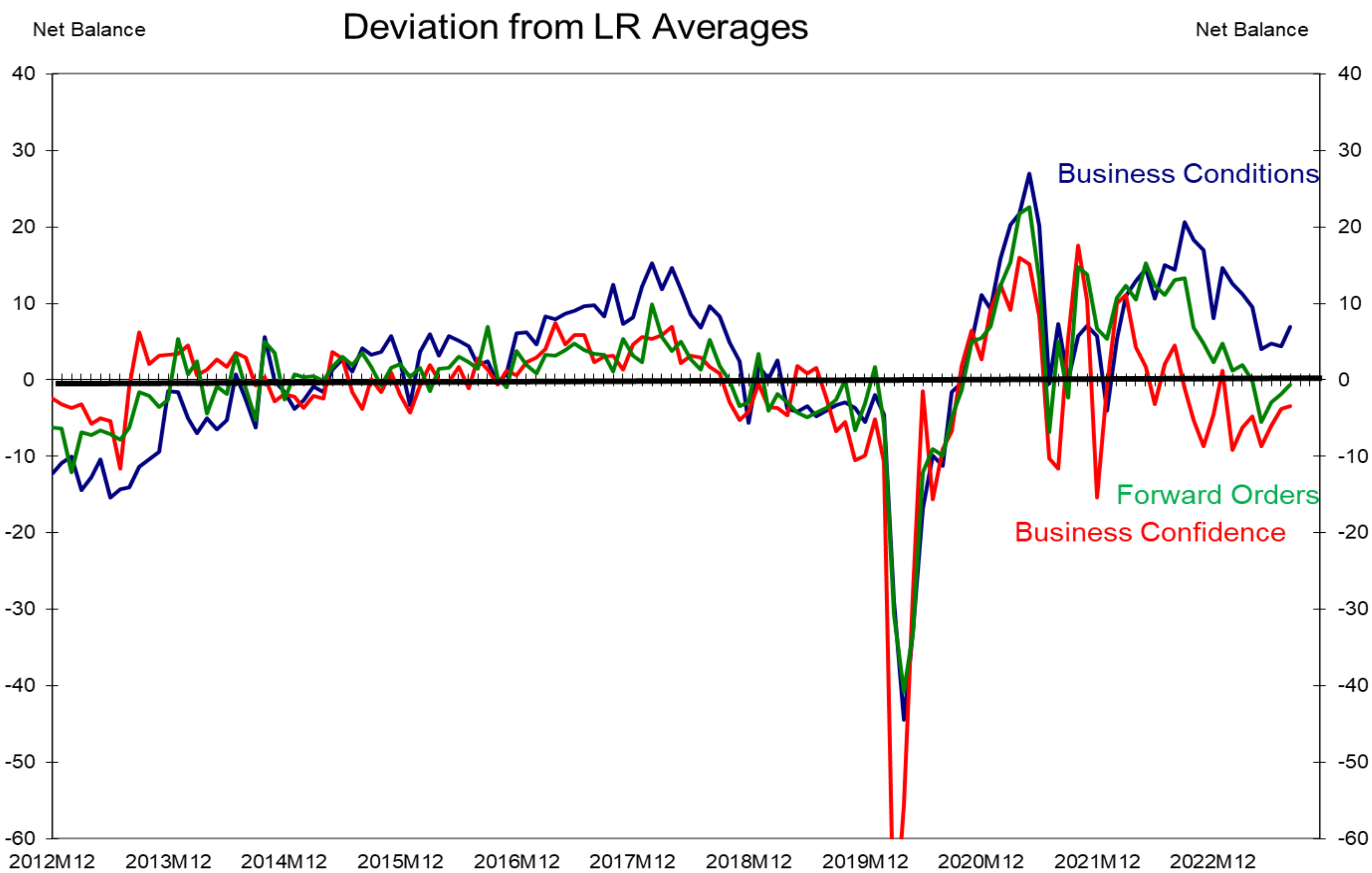
Health, Arts & Rec plus Construction the best, Mining and Agri struggling.





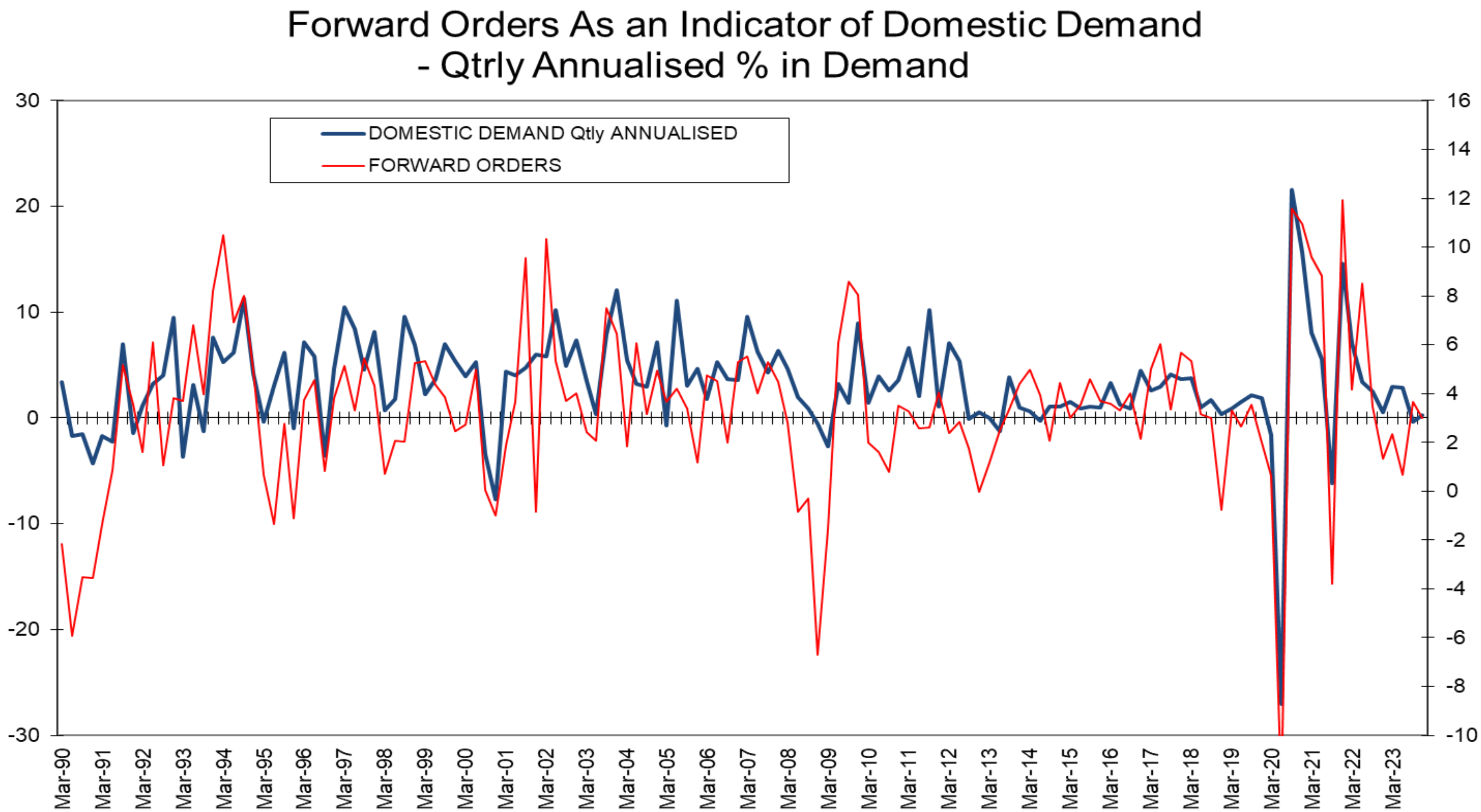
Business Survey shows momentum slowing a lot early this year. But stabilising in August/September.

September conditions still reasonable. And looks like forward orders are past the worst. But confidence still not great. And forward orders in the past has the best tracking record to the economy.



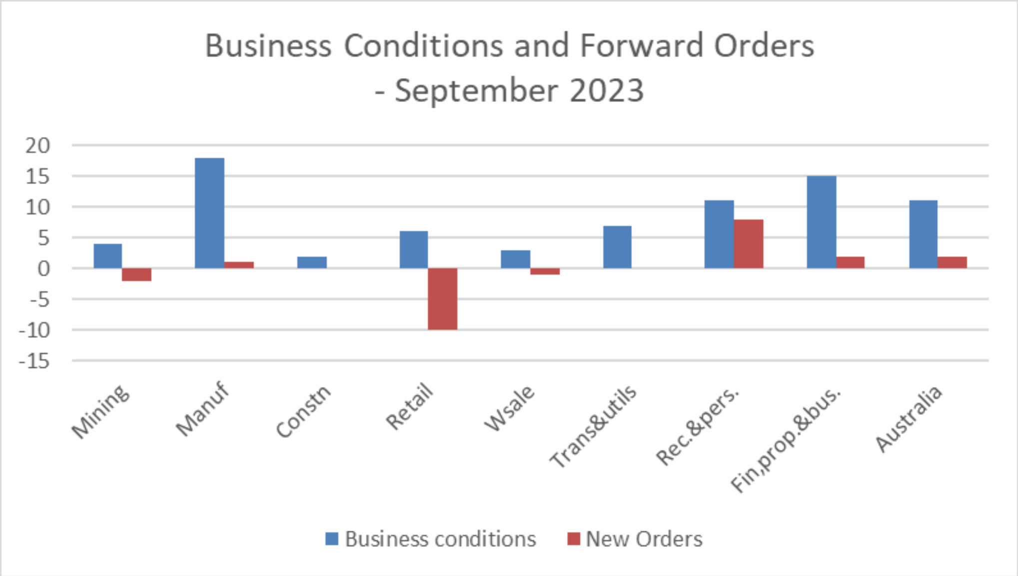
In the past new orders has tended to track the economy better than conditions.

Forward orders suggest subpar domestic demand for a while but not as bad as feared a few months ago. Broadly consistent with our forecasts.

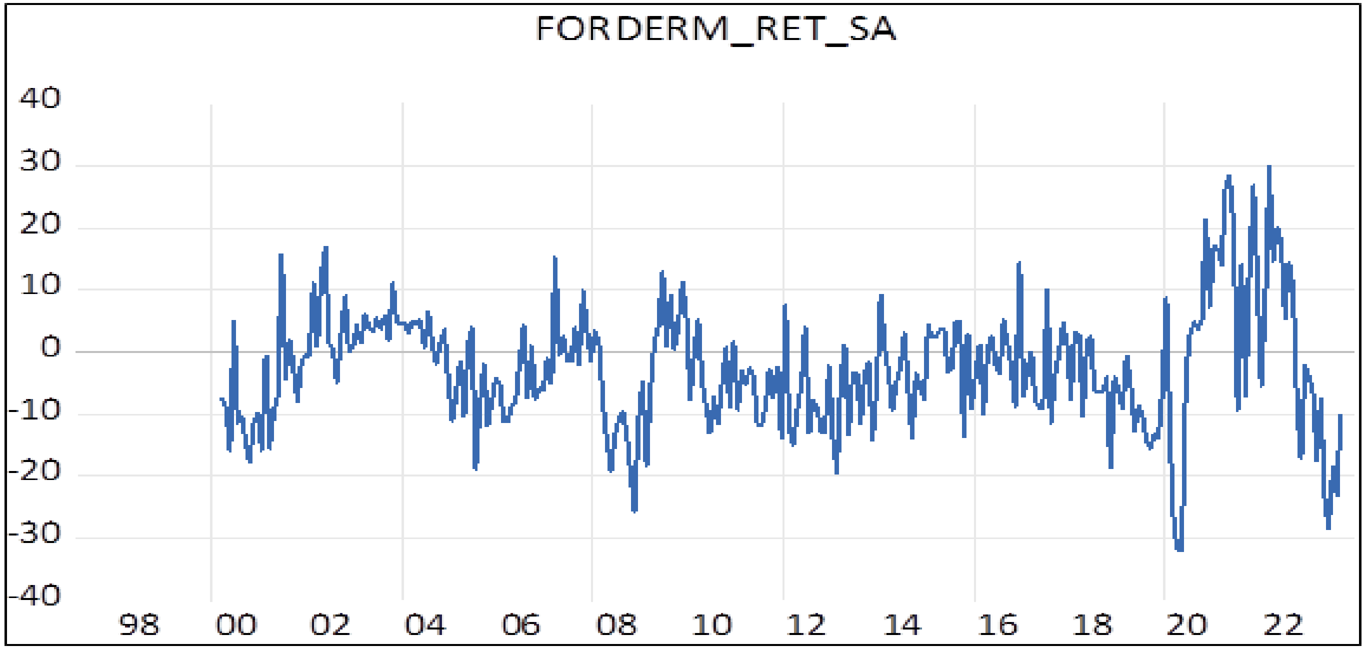


Interesting split for orders across industries.

Orders still weak for retail and maybe wholesale. But maybe past the worst in retail.



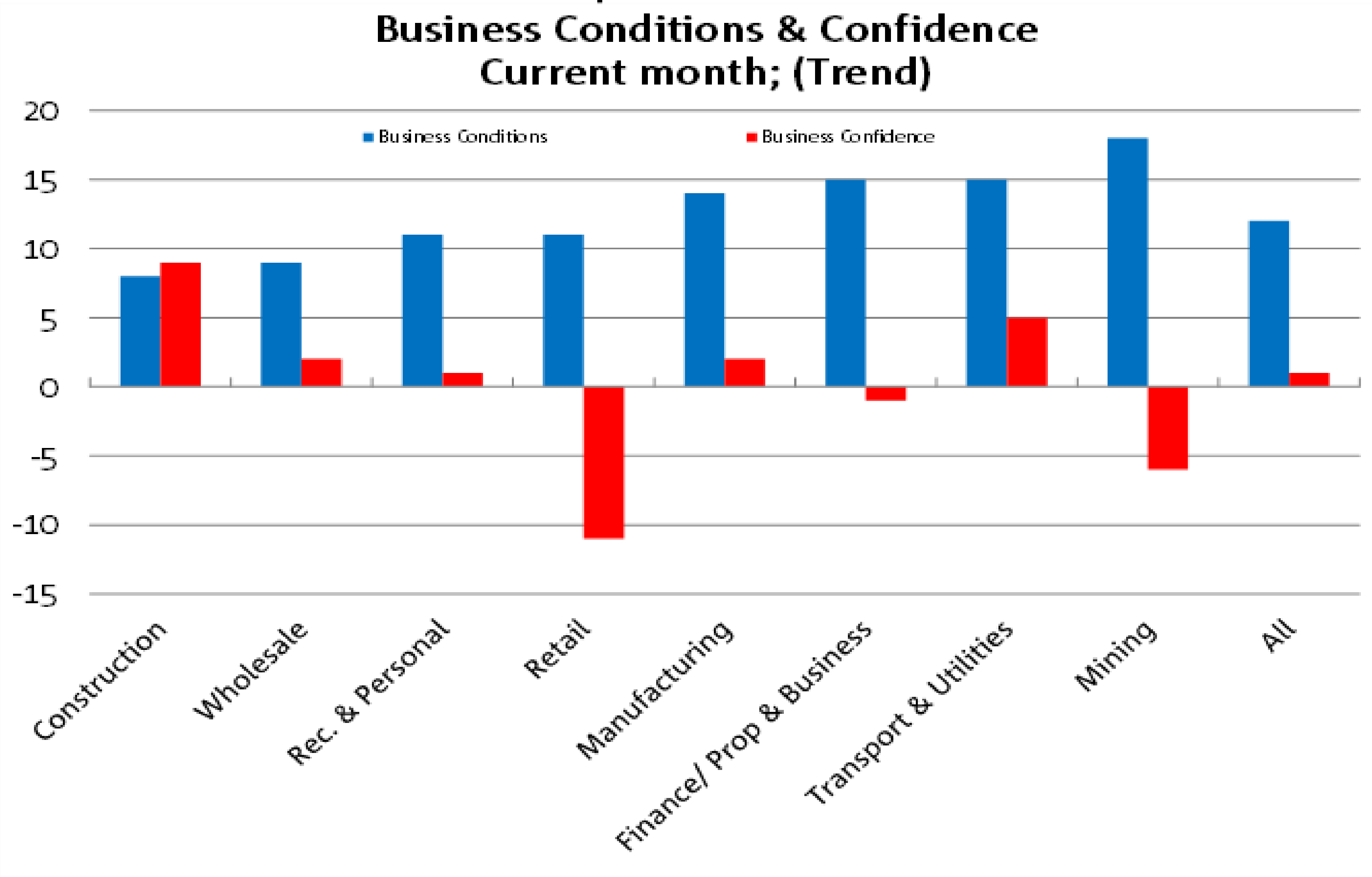
Forward Orders Retail – SA



By industry

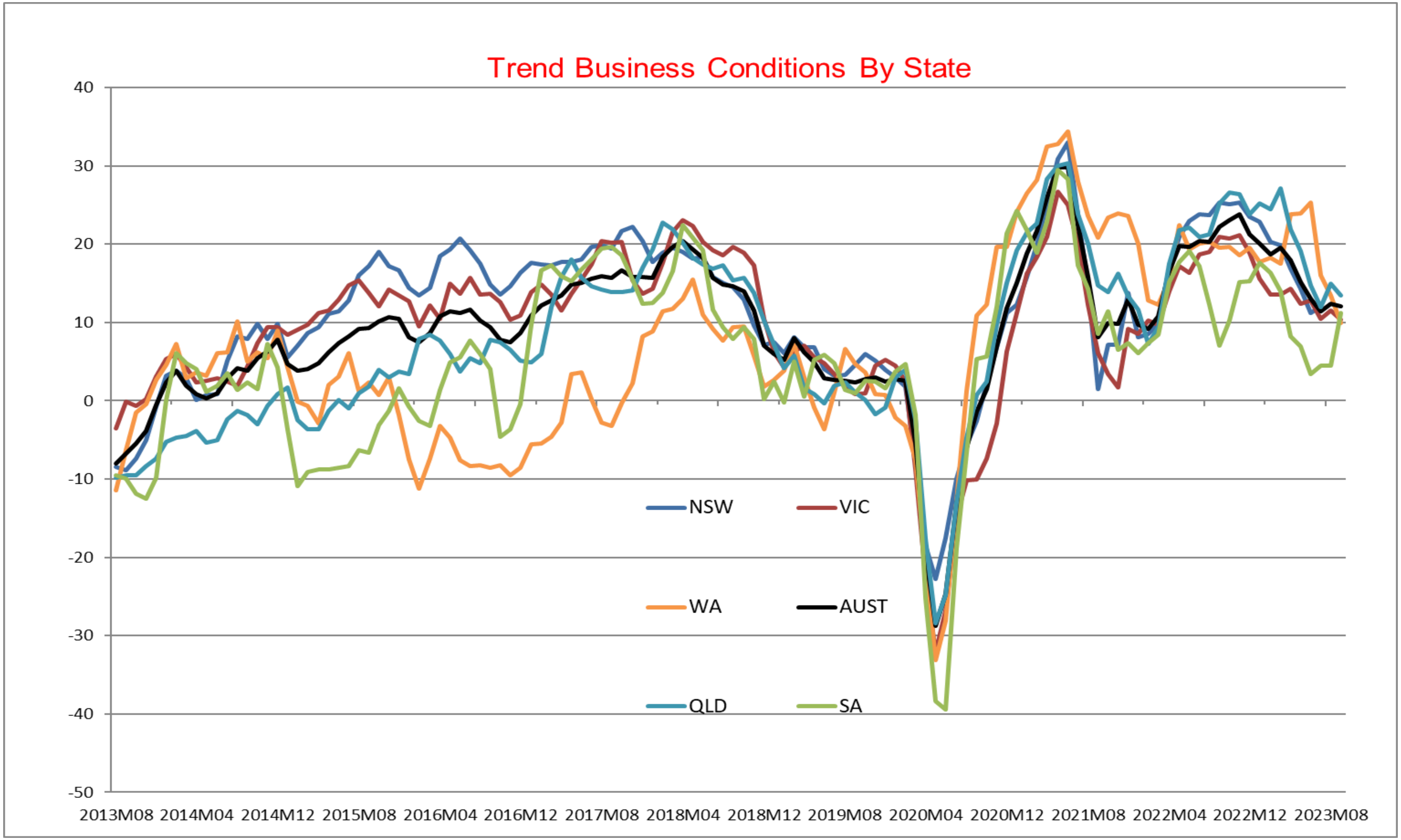
Overall big differences between confidence and actual conditions outcomes. Mining and transport conditions still very strong. Mining confidence less so. But big difference from conditions to confidence in retail/wholesale.

September 2023



Most states are stabilising after weakening earlier in the year.

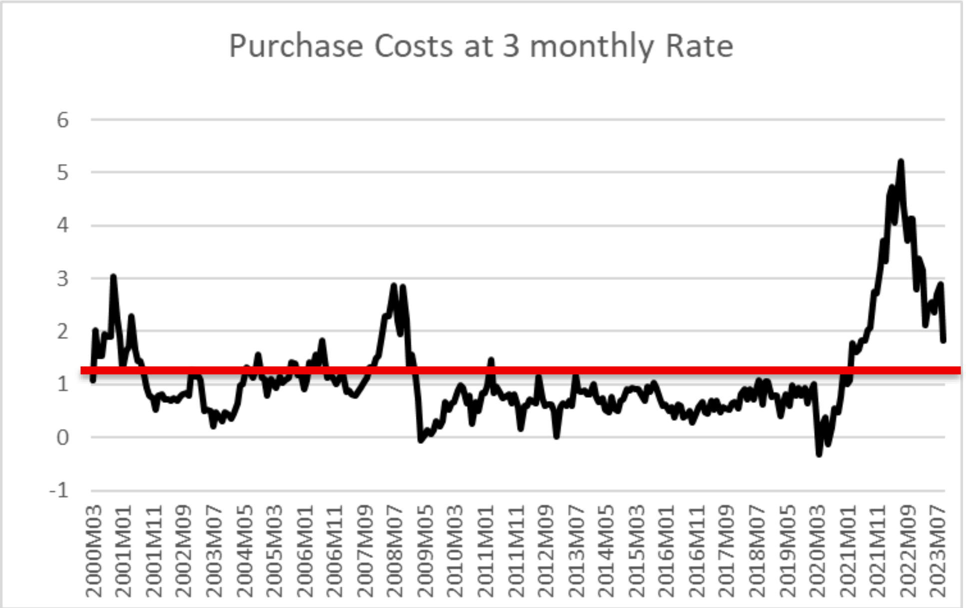
And not a lot of difference across states



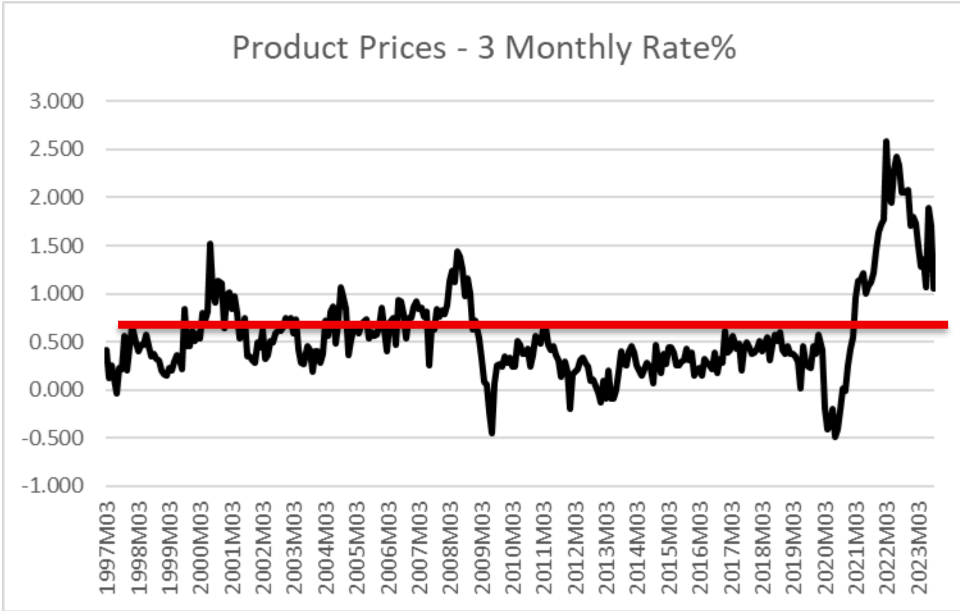
NAB Business Survey

Clearly showing very high purchase costs peaked last year. Recently kicked back up but lower in September. Albeit a bit sticky in level terms.

Purchase Costs – September NAB Survey



Goods Costs – September NAB Survey

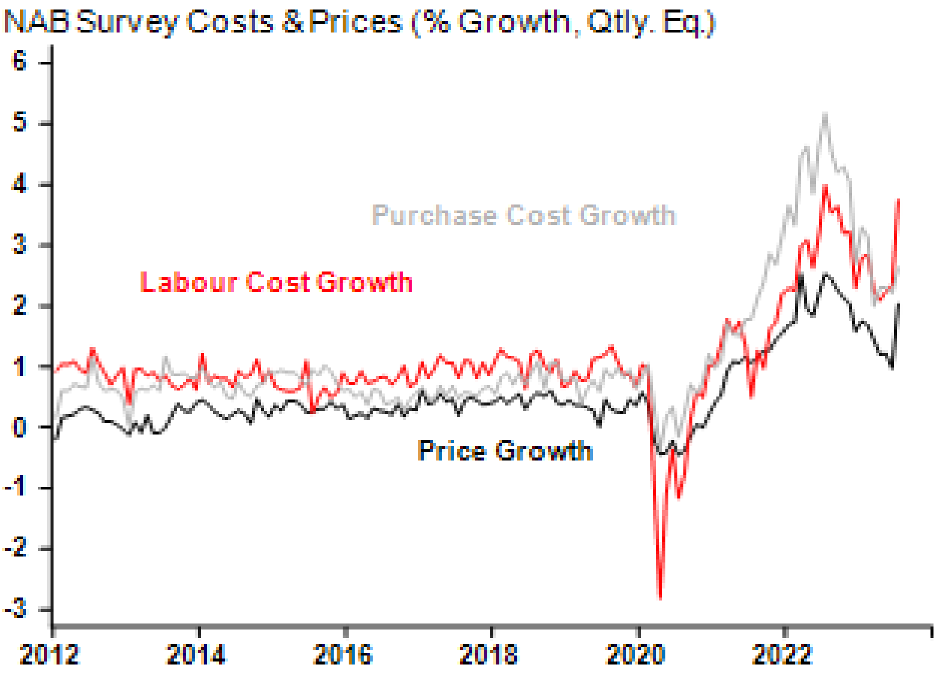


Survey has shown showed a big kick in wages and also prices.

But some firms didn't necessarily increase prices straight away.

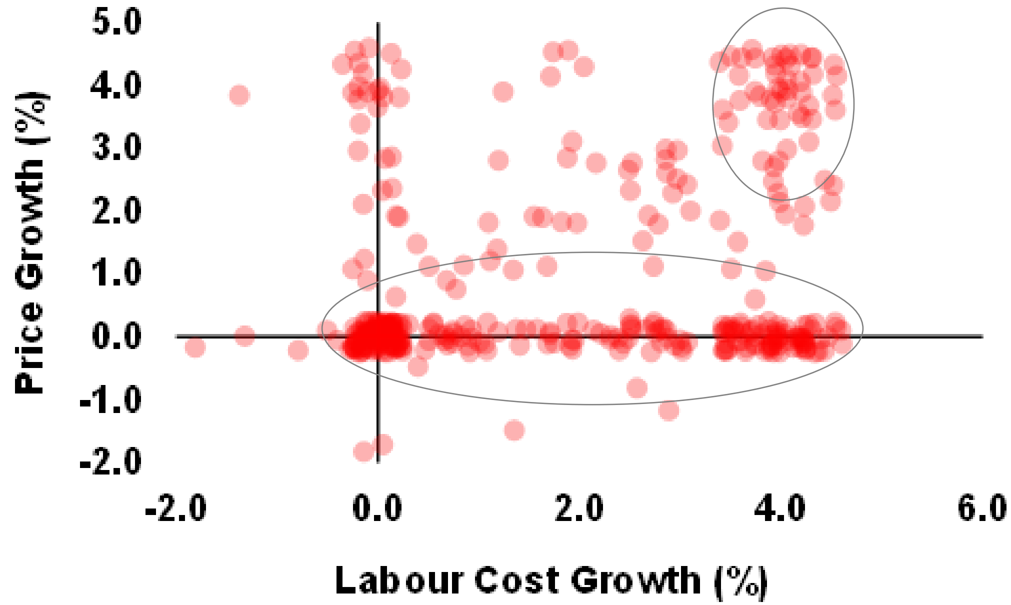
Pricing/wages relationship more complicated – different by sector.

Labour and Prices increases in July at Quarterly Rate

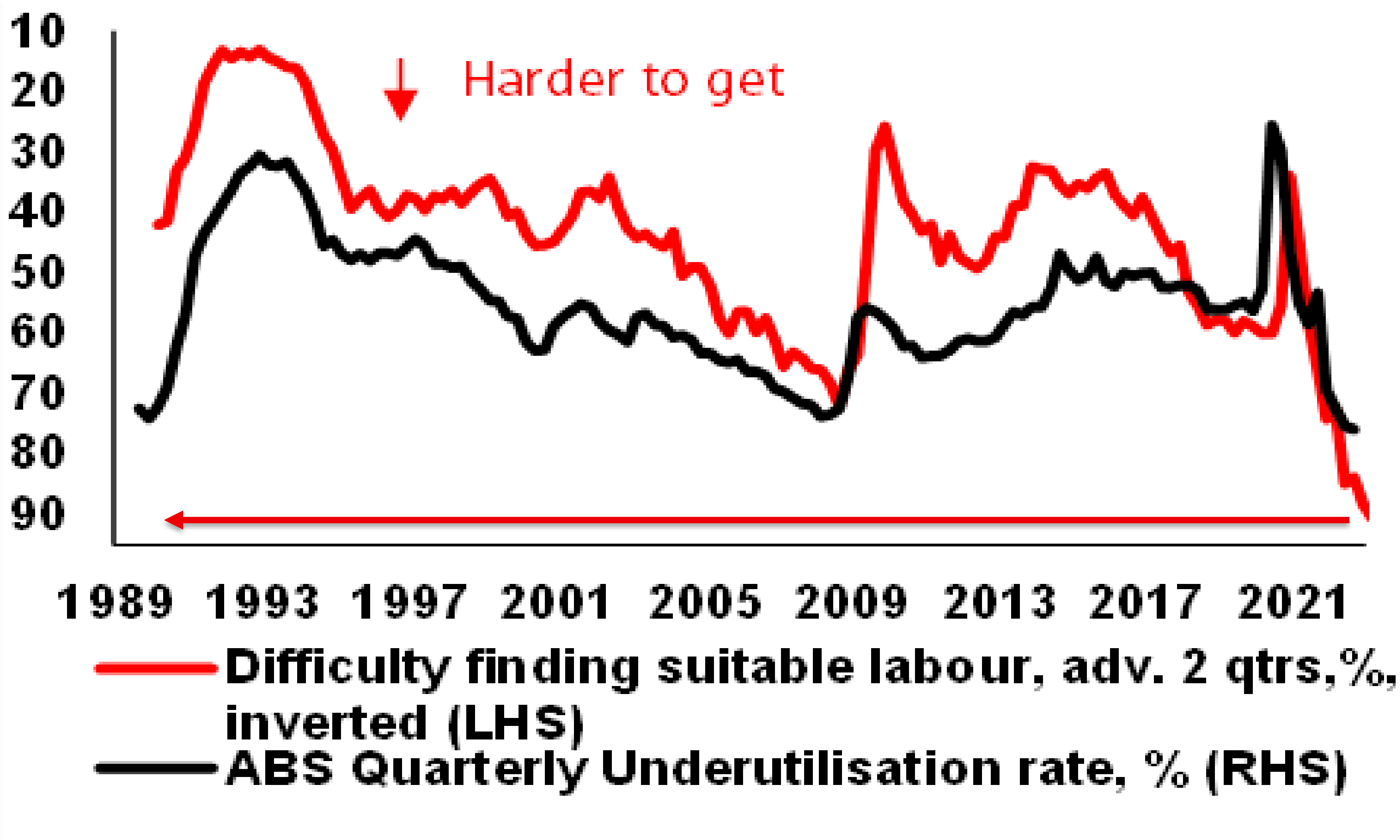


Source: Macrobond, NAB Economics

Individual Wage / Price responses

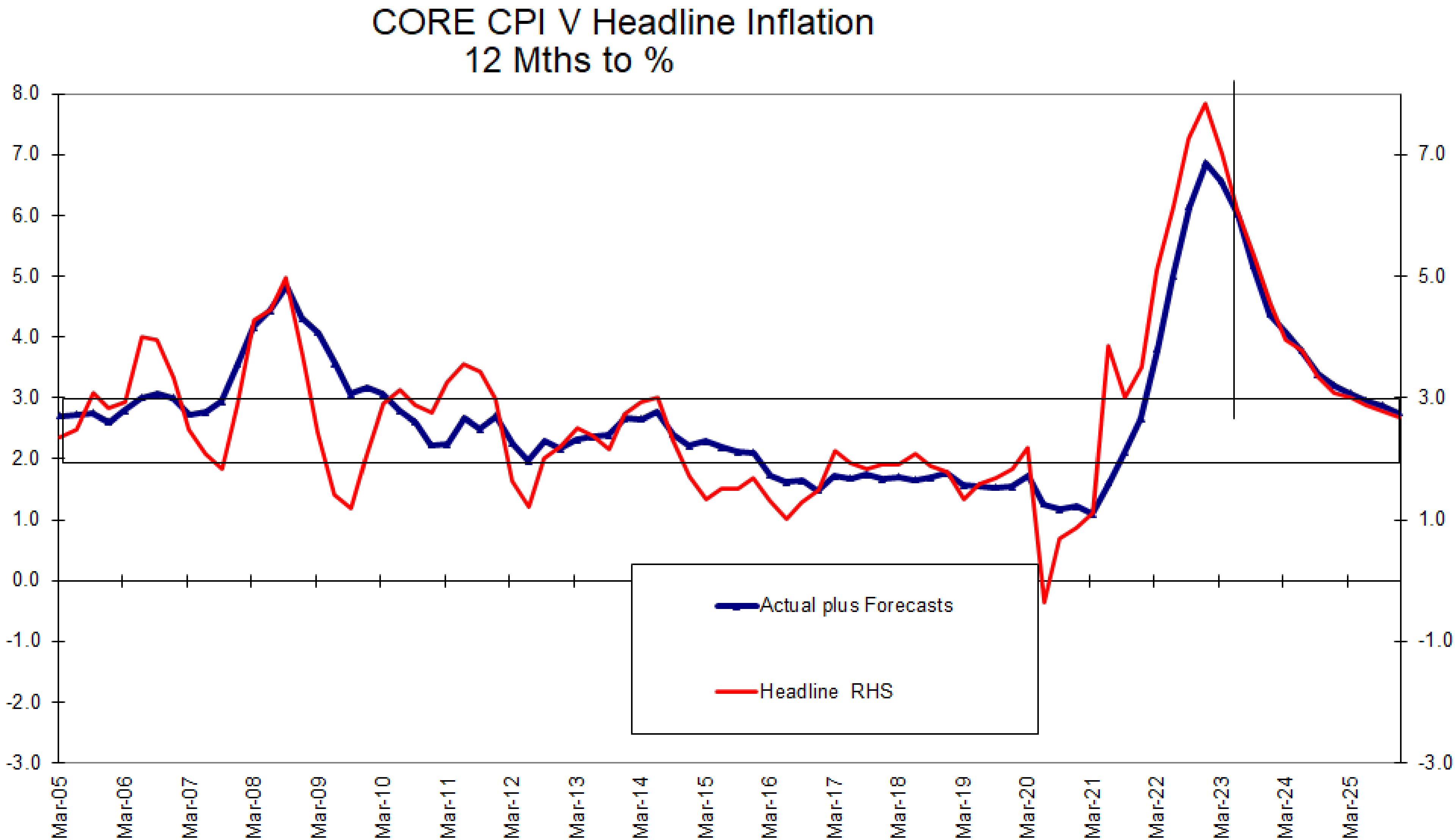


Obviously labour shortages are now a huge issue for business.



Core inflation

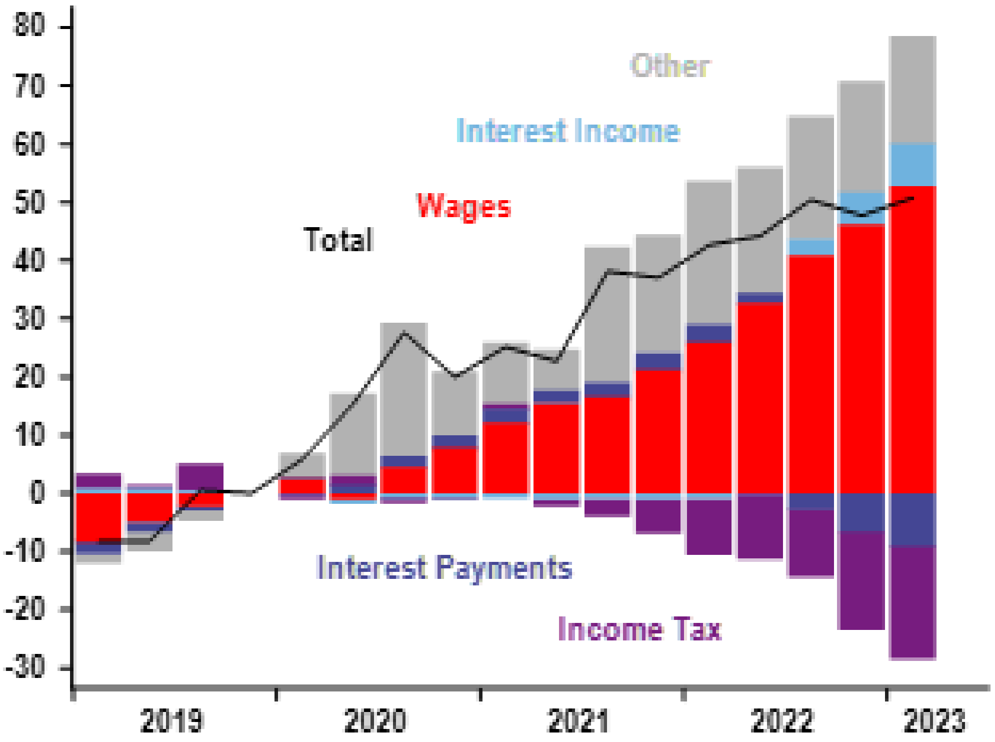
Hit by supply side problems and higher commodity prices (Russia) in 2023. Trimmed mean core inflation now at 5.8%, headline at 6%. Q3 2023 likely to remain high as electricity and wages flow through. But core at 4.1% by end 2023 and 3% by end 2024.



Wages growth the main driver of increased incomes after tax.

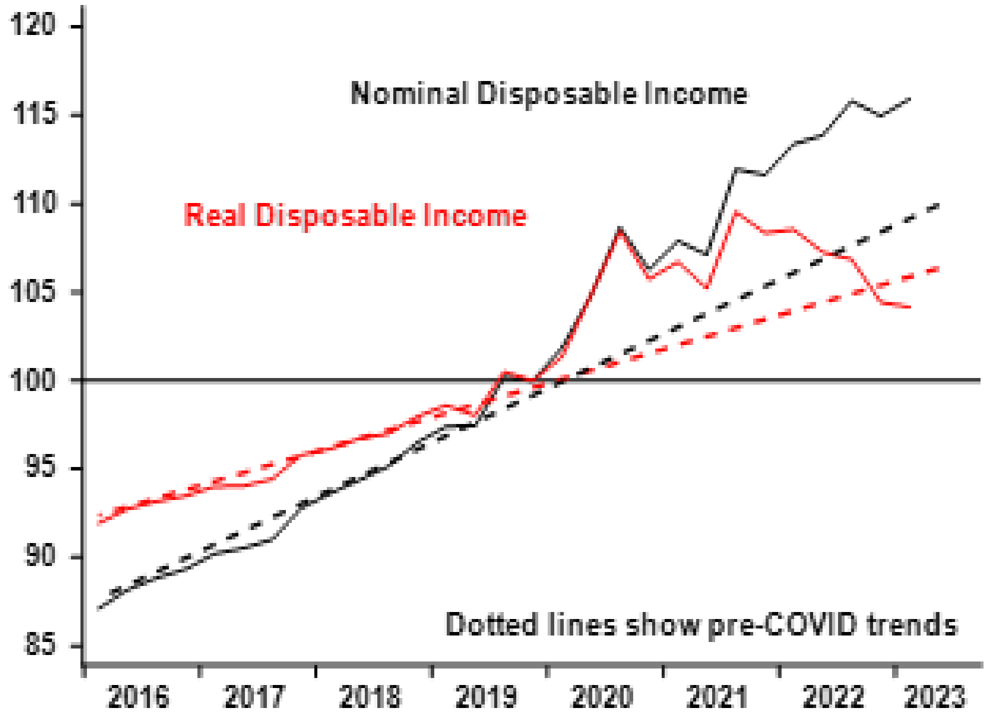
Tax take also important as a negative. Until early 2023. But Inflation is having a massive impact on real incomes.

Houshold Disposable Income Since 2020 ($b)



Source: Macrobond, NAB Economics

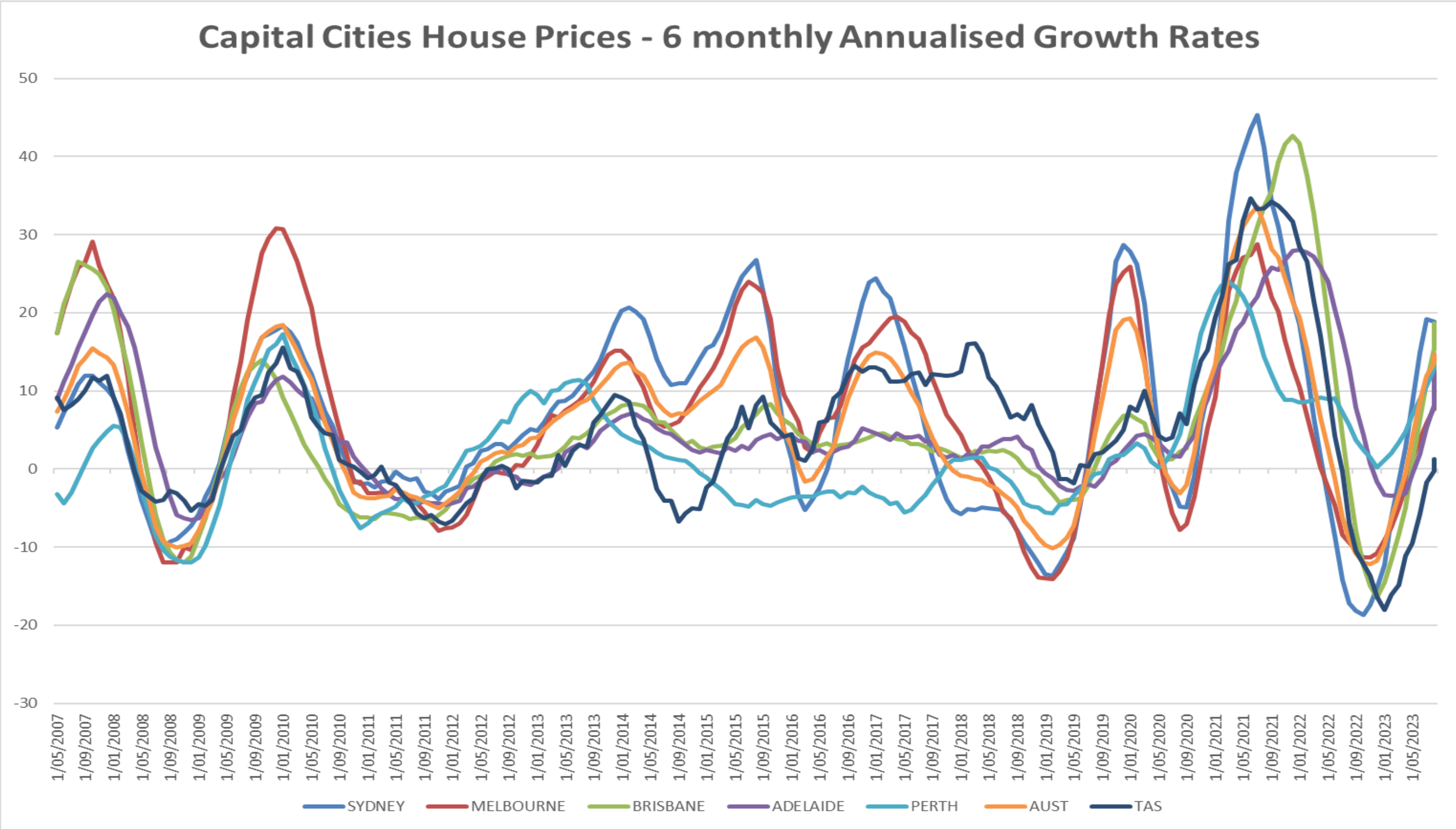
Real Household Disposable Income (Index, Q4 2019 = 100)



Source: Macrobond, NAB Economics

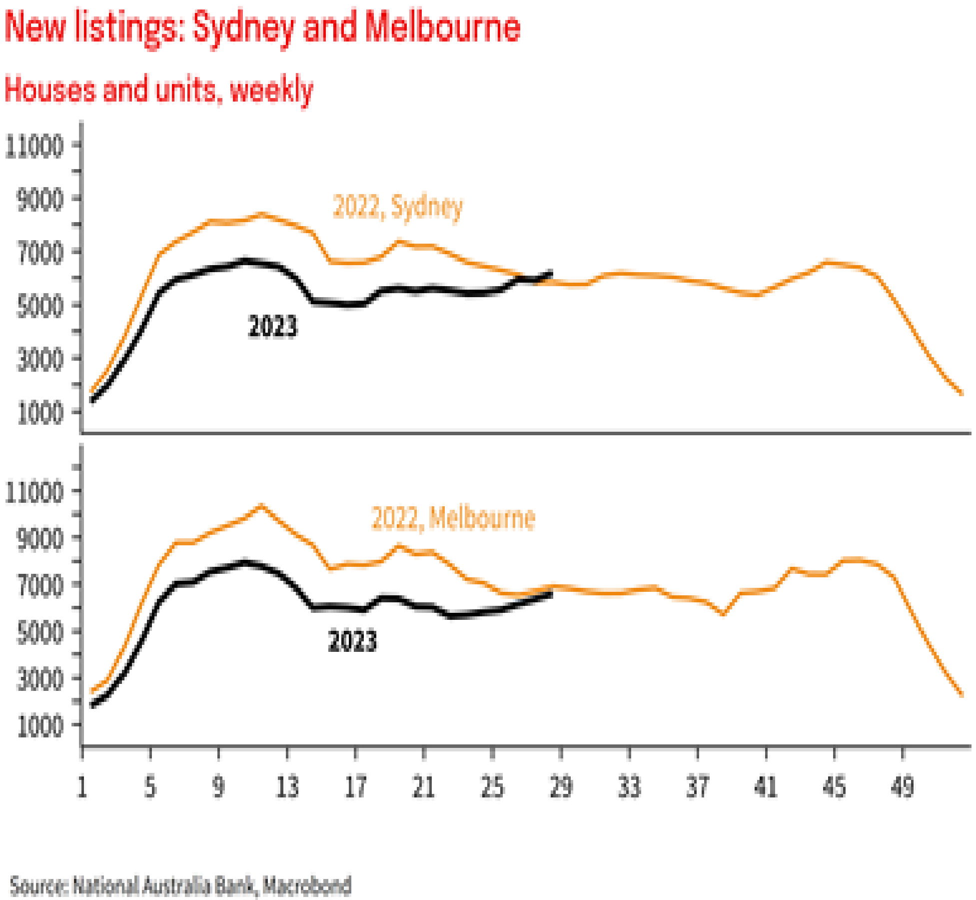
House prices

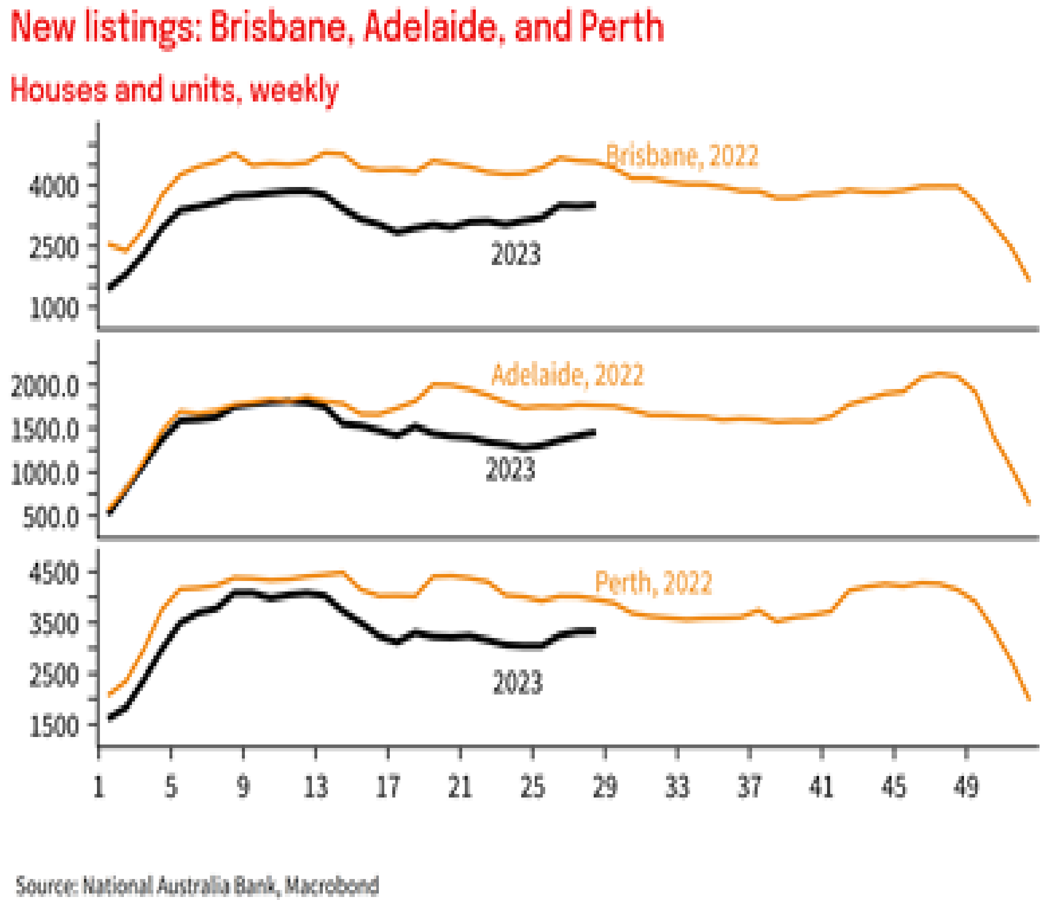
Are seeing a robust turnaround especially in Sydney and Perth (Sydney up 18.7% and Brisbane 18.7% over the past 6 months annualised). Recovery widespread - across Australia now around 14.7% over the last 6 months (at annualised rate). Melbourne and Tassie less robust (7.6% and 1.2% respectively).



But be aware turnover was down around 25%.

So unusual recovery. But now looks as though new listings are rising – particularly in Sydney & Melbourne. Distressed sales?

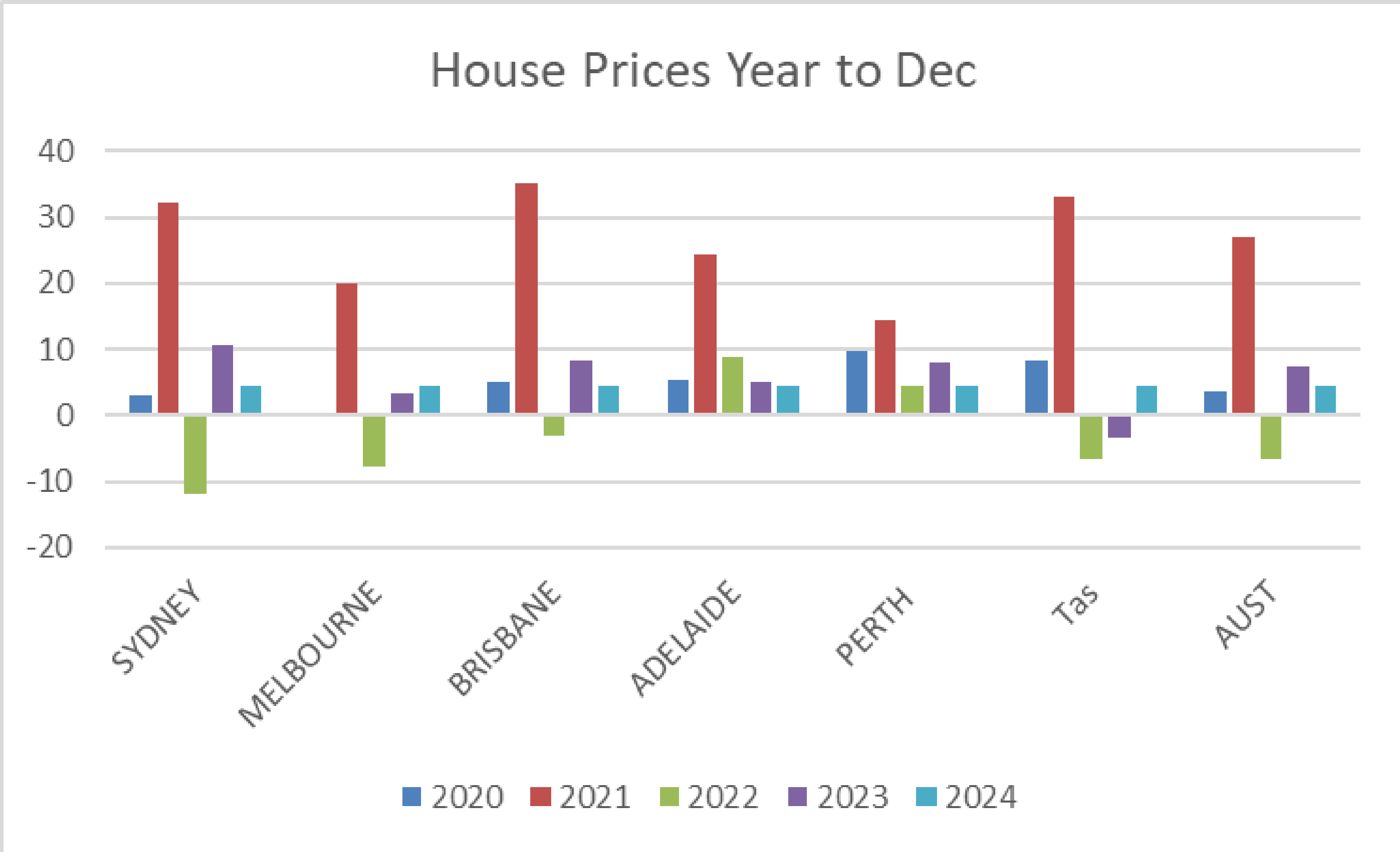




Source CoreLogic

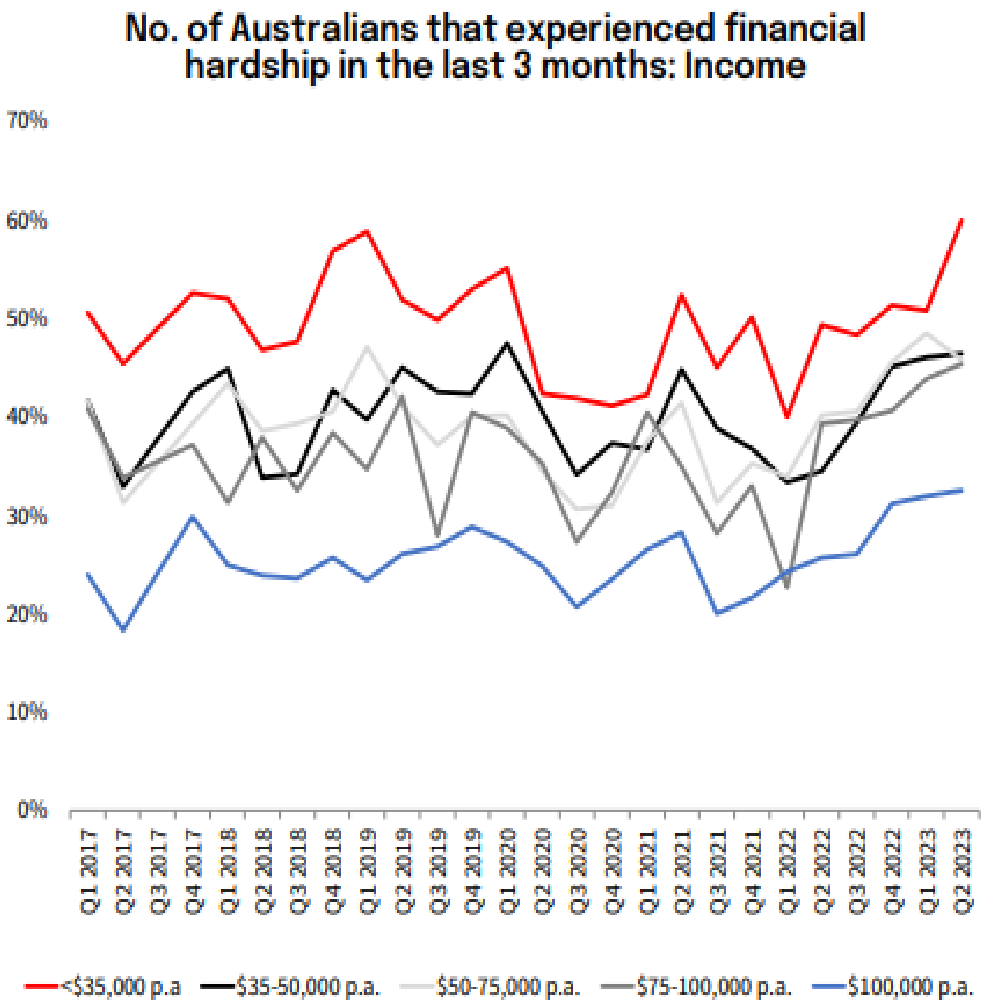
House price forecasts

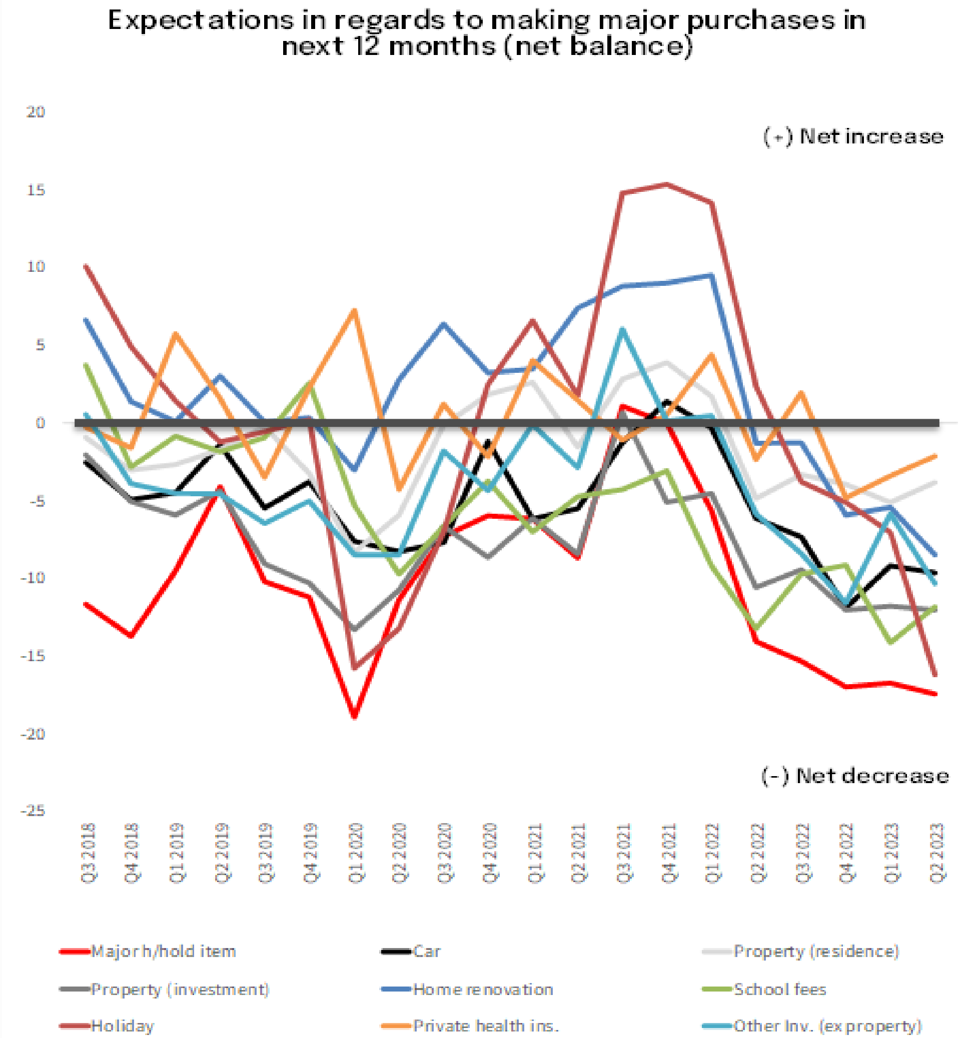
After increasing by around 27% house prices during 2021 (now revised higher), down around 7% during 2022. For 2023 looks to be up (+7%) during 2023 (lead by Sydney) and up around 5% in 2024.



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

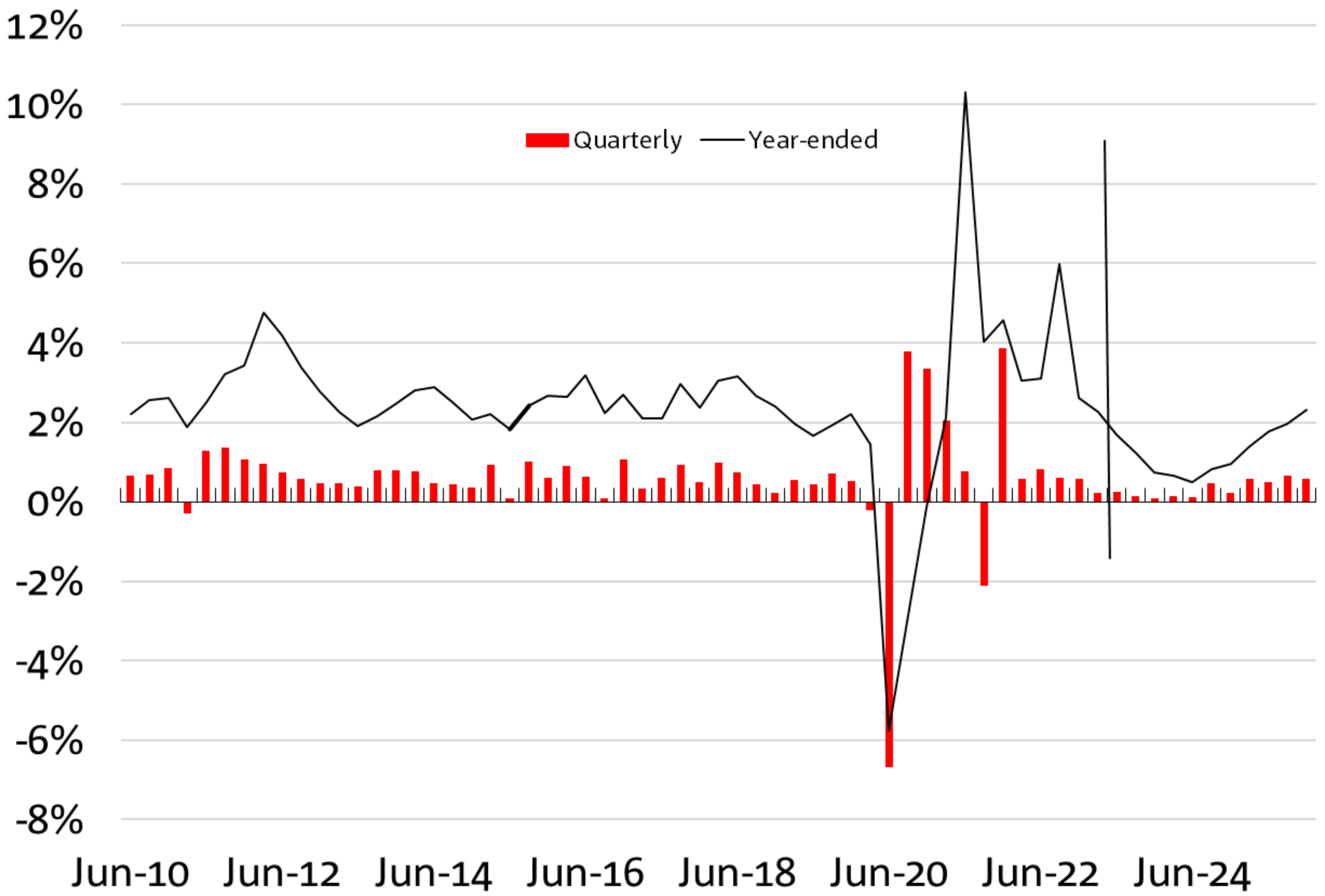
Stress most at lower to mid incomes (and youth to middle age). Liquidity impact from rate rises to hit from mid 2023. Especially household goods, school fees and holidays. Health Insurance least likely to suffer.





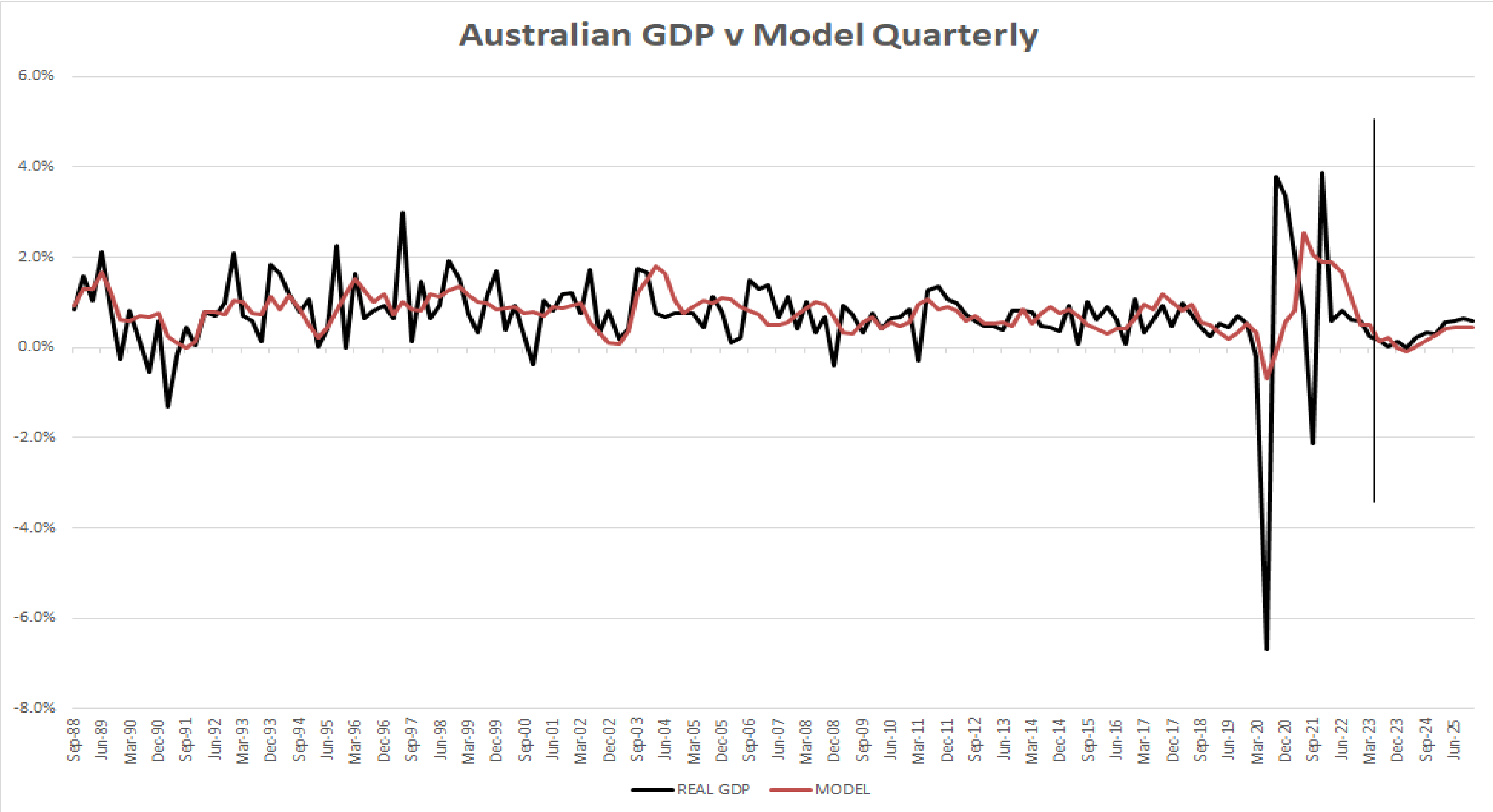
Our growth expectations.

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. RBA has moved down to our numbers by end 2023.
But we are still a touch more pessimistic in 2024. 2025 we are similar at around 2.3%.



My enhanced yield curve equation

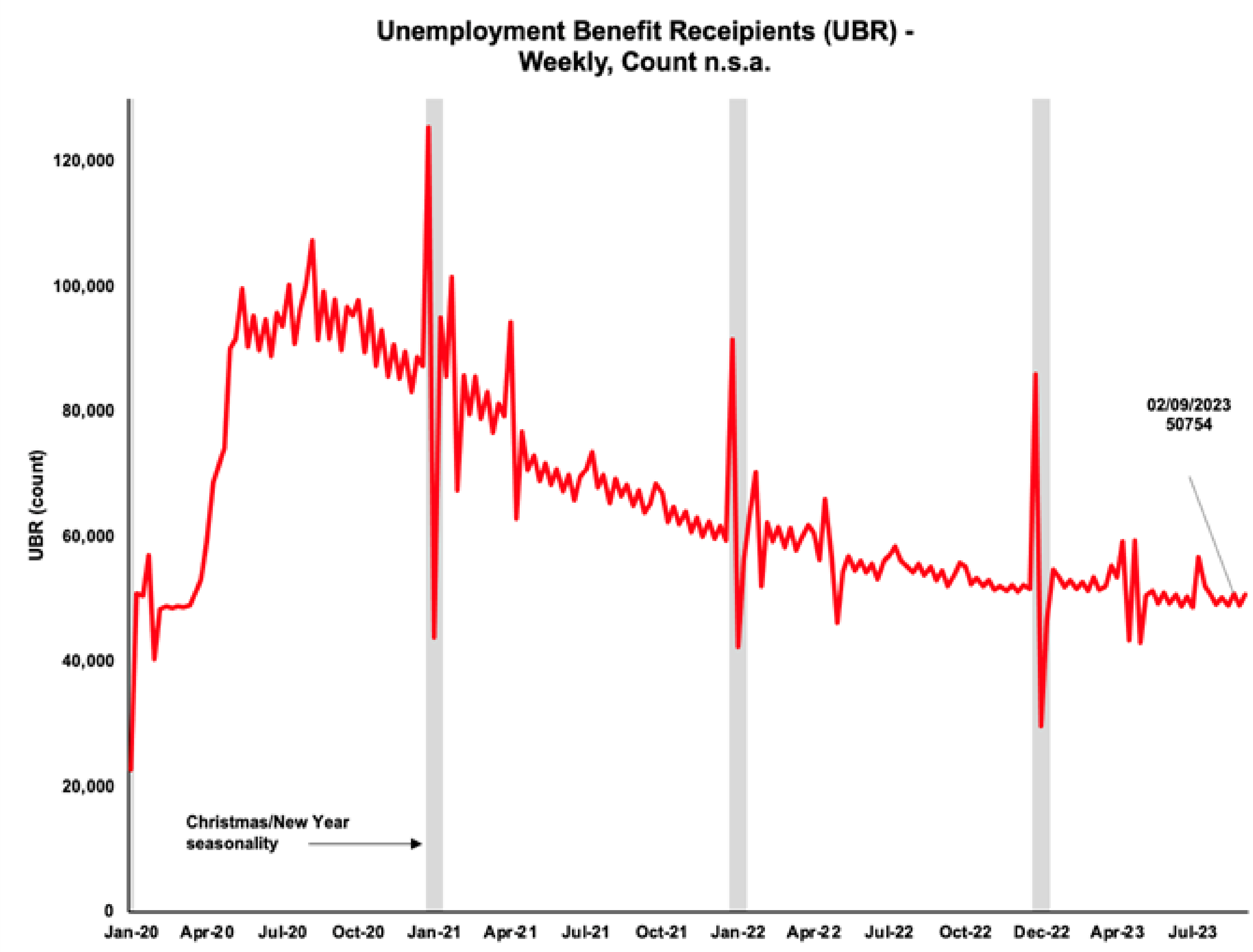
Obviously can't cope with COVID but as we move out of the virus, general forecast trends consistent with the model.



- 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

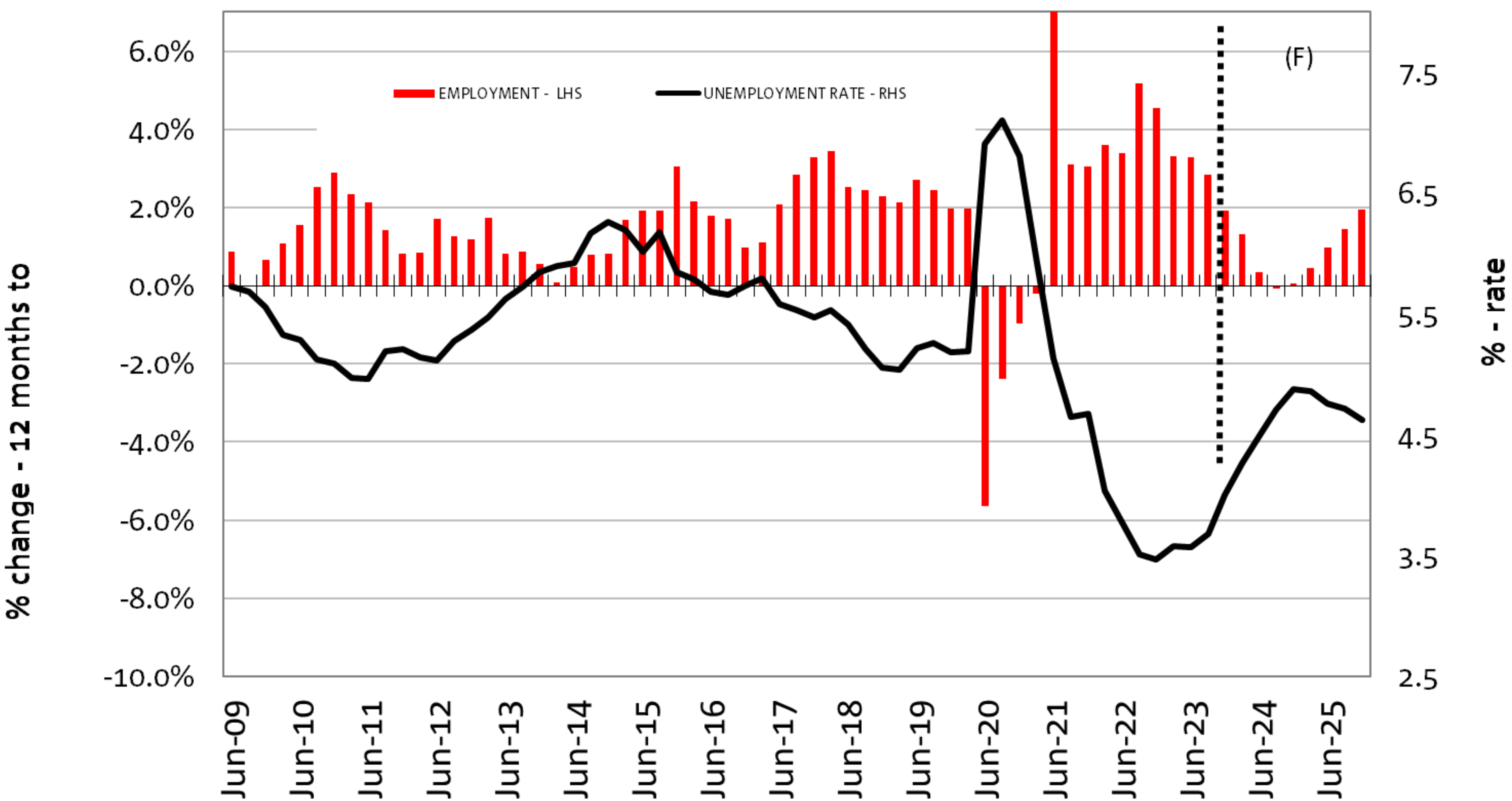
(NAB customers receiving JobSeeker). Data has been volatile. But basically going sideways at strong levels. Fundamentally labour market still strong.



Labour market very impressive

Unemployment has fallen to around 3.6% and likely to increase moderately to around 4.2% by year end, as economy fades. And increase further in 2024 to around 5% and ease marginally in 2025 – back to 4.6%.

Annual Growth in Employment and the Unemployment rate



On RBA

- RBA has focussed a lot on inflation but as the economy slows its getting more a line ball decision .

- But Q3 core is likely to be high – around 1.1% in Q3 for y/y of 5%. High service inflation will unsettle RBA. Hence we could still see a November hike to 4.35%.

- But it could be that they are done already at 4.1%.

- Much depends on what happens next re growth and inflation prospects.

- And we still see rate cuts starting from August/September 2024 :
  - aim to get back to 3% by early 2025.

- Medium term outlook much better but tough times inevitable in the next 12 months.