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The Forward View: Australia Oct 2023

Growth to remain subdued, but avoid a major downturn

NAB Group Economics

Overview

- Our forecasts are unchanged this month with official data, the NAB business survey and our internal transactions data all pointing to ongoing resilience in aggregate.
- That said, with the ongoing pass through of higher rates and inflation still high we see consumption growth remaining soft in H2 2023 and expect below trend GDP growth of 1-1.5% in 2023 and 2024.
- We continue to expect the unemployment rate to rise to around 4.9% through 2024 with slower labour demand growth unable to absorb the full impact of high population growth. However, forward-looking indicators of the labour market remain healthy. More broadly, despite the slowing in growth to date, the labour market has remained resilient.
- The Q3 CPI released next week will provide a key marker of the ongoing moderation in inflation. In quarterly terms, we see a 1.1% increase in the quarter for both the headline and trimmed mean measures. While this would mark a small reversal in the trend easing in quarterly terms, year-ended inflation will continue to moderate.
- For monetary policy the pace of this ongoing moderation in inflation remains crucial. The improvement in the year-ended rate will be driven partly by base effects as large outturns in Q3 and Q4 of 2022 fade. The moderation from 4% to 3% will be more difficult. Domestic factors will continue to grow in importance as global factors continue to fade (although the war in the Middle East highlights that geopolitical and other risks can materialise rapidly).
- For now, domestically wage growth has not accelerated to a pace inconsistent with inflation returning to target and expectations in the medium- and long-term remain anchored.
- The depreciation in the exchange rate over recent months presents some upside risk though typically exchange rate passthrough is gradual and global price inflation is easing. How firms pricing decisions respond to slower consumer demand will also be important
- In terms of housing, prices continue to rise and, as explored in this month's theme, this has continued to challenge affordability.

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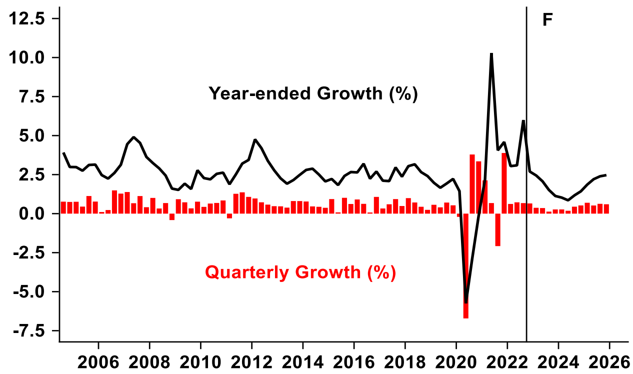
Key Economic Forecasts

	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

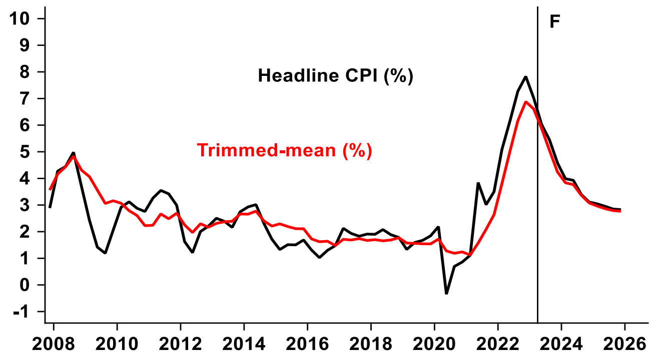
(a) annual average growth, (b) end-period

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 labour market remains tight with unemployment at 3.7% and job vacancies remaining elevated despite falling in Q3. Still, we continue to expect unemployment to start to rise as the economy slows.

Data on job vacancies for August (Q3) showed an 8.9% decline since May. Vacancies are now down around 18% from their peak in early 2022 but at 390k, the number of vacancies remains very elevated relative to pre-pandemic levels. Vacancies have fallen most in frontline services sectors like retail and hospitality, but these remain the most elevated, alongside public services like health and education.

Employment growth has remained strong as vacancies have declined, keeping unemployment at low levels even as the population has grown rapidly. As the economy slows, however, employment growth should also slow and some vacancies may be ‘extinguished’ rather than filled. As a result, we see the unemployment rate rising to around 4% by end-2023 and approaching 5% by end-2024.

On wages, we continue to expect to see a material pickup in hourly wage growth in Q3 when the Wage Price Index (WPI) is released in November. This should see year-ended wage growth surpass 4% by the end of 2023, before the softening labour market begins to ease wage pressures later in 2024.

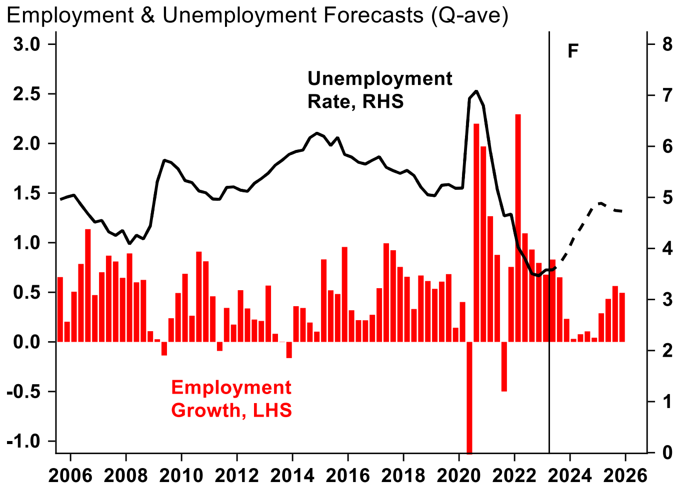
Retail trade growth was soft in August though price movements may have played a role in the result. The level of spending is high but households’ discretionary spending is under pressure.

Nominal retail trade data from the ABS showed sales rose 0.2% in August, softening from a more solid 0.5% in July. Spending on food fell 0.3% in August (though falls in fruit and vegetable prices may have contributed) and household goods spending fell 0.4%. On the other hand, spending on clothing, department stores and other retailing all rose in the month, as did cafes & restaurants (up 0.7%).

More recently, transaction data analysis in NAB’s *Monthly Data Insights* suggested retail spending grew 0.4% in September. More broadly, the transaction data suggests overall consumer spending grew around 3% in nominal terms for Q3 as a whole. Fuel price increases contributed to spending growth in August and September, but overall spending still rose with fuel excluded.

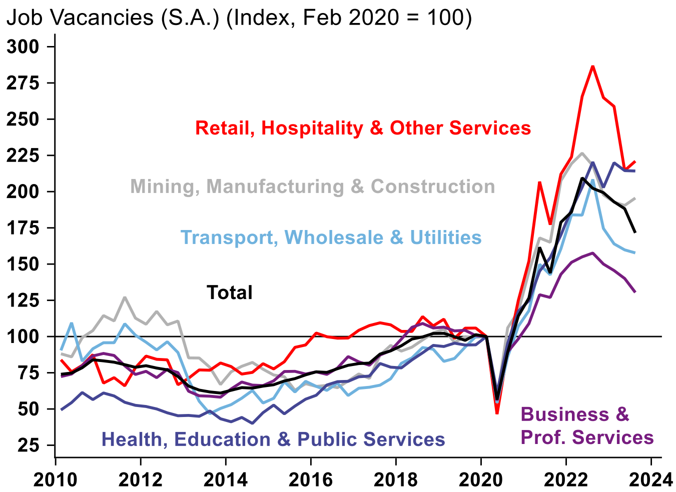
This suggests consumption growth likely remained positive in real terms for the quarter, although the result is still expected to be subdued in a continuation of the slow consumption growth seen in Q2. Population growth remains a key factor supporting consumption with per-capita consumption expected to continue declining for the time being as households continue to adjust to higher interest rates.

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



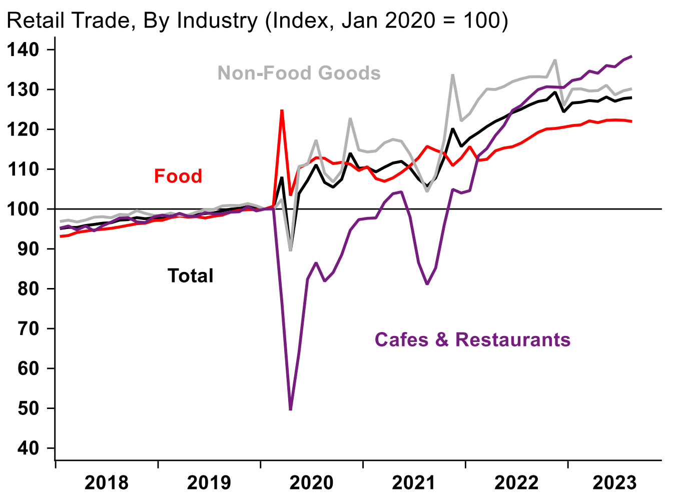
Source: Macrobond, NAB Economics

Chart 4: Job vacancies are declining but remain well above pre-pandemic levels across most sectors



Source: Macrobond, NAB Economics

Chart 5: Nominal retail trade remains robust, led by spending at cafes & restaurants



Source: Macrobond, NAB Economics

Housing and Construction

Despite the rapid rise in interest rates over the past year house prices continue to rise at a brisk pace and the very low rental vacancy rate continues to support strong rents growth.

The CoreLogic 8-capital city dwelling price index rose by 0.9% in September while the combined regional index continues to track at a lower rate, rising by 0.4% m/m. Overall, capital city house prices rose 2.5% over the past 3 months and are now up 5.1% over the past year.

Price growth in Sydney has slowed over recent months, but remains robust at 1% m/m. However, the smaller capitals have accelerated with Adelaide leading the rise at 1.7% m/m, followed by Brisbane and Perth at 1.3%. Melbourne continues to track at a slower pace rising 0.4% in the month and 1.3% over the past quarter.

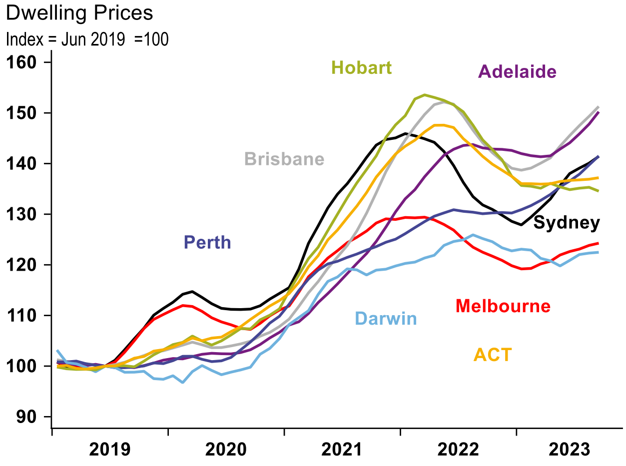
With the trend in house prices unlikely to change significantly over the next 3 months, prices are likely to end the year 8-10% higher and we continue to see gains of around 5% over 2024 (with rate cuts in H2 to provide some support). The ongoing increase in prices, from a high level, amidst the sharp increase in interest rates has led to a very sharp deterioration in housing affordability over the past year (discussed on Page 6). While higher house prices provide some support via the "wealth effect," the cost-of-living impact of more expensive housing could be a factor weighing on consumer spending.

Indeed, the picture in the rental market points to similar stress. Rents growth has slowed in annual terms over recent months but has shown some mixed trends across the capitals on a monthly basis. Growth in Perth rents is now strongest at 13% y/y followed by Melbourne at 12% and Sydney at 11%. Brisbane and Adelaide have tracked at a slightly slower, though still very strong pace of 7% and 8%, respectively, over the past year. While there had been some tentative sign of an easing in rental vacancy rates for Sydney and Melbourne over recent months, they again declined in September and remain very low across the remaining capitals.

Amidst strong demand, the supply side remains challenged. While, building approvals rose 7% in August (with both houses, up 6.8%) and higher-density (up 9.4%) rising in the month), total building approvals remain 23% lower over the past year and appear to have stabilised at a decade low rate of around 13.5k monthly.

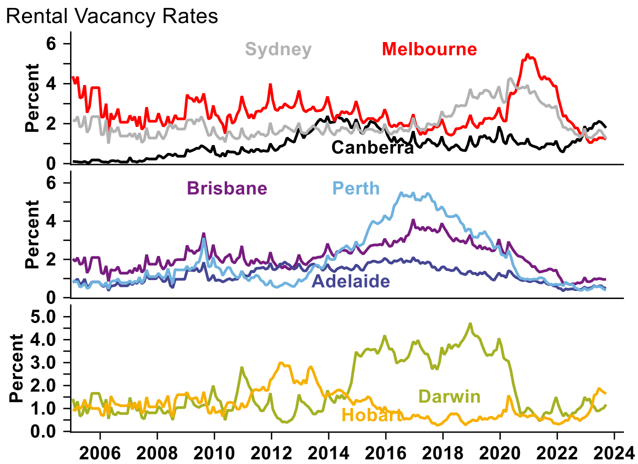
Our Residential Property Survey for Q3 (released later this week) continues to suggest that rising rates and construction costs remain large barriers to new construction despite a slight easing in the quarter.

Chart 6: House prices continue to rise relatively briskly



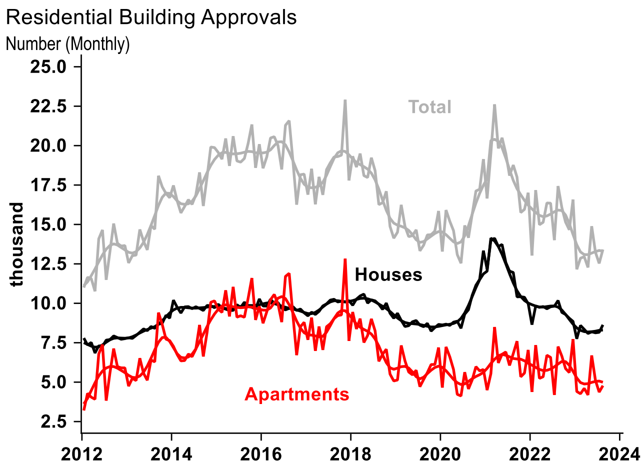
Source: Macrobond, NAB Economics

Chart 7: Rental Vacancy Rates Remain Very Low



Source: SQM, Macrobond, NAB Economics

Chart 8: Approvals have stabilised at a low level



Source: Macrobond, NAB Economics

Business and Trade

Business conditions eased in September but remained above the long run average, while cost growth measures also stepped down.

Conditions in the NAB Business Survey were down slightly in September but remain above average at +11 index points, where the index has hovered since May. Importantly, capacity utilisation remains high and there has been gradual improvement in forward orders. Confidence was steady and while still sitting well below average, has been around zero in net balance terms for several months.

The survey also showed some positive signs for inflation with cost pressures and price growth easing. Labour cost growth – which spiked to 4.0% in quarterly terms in July – fell to 2.0% in September, and purchase cost growth also eased materially, though both remain elevated. Output price growth eased, driven by an easing in rec & personal (0.8%), while retail price growth remained elevated (1.8%).

Business credit growth picked back up in August, rising 0.6% m/m after a softer 0.2% rise in July. In year-ended terms, business credit is up 7.4%, continuing a gradual moderation. Below-trend economic growth should continue to weigh on business credit and investment but so far investment has shown resilience in line with the broader economy and pressures generated by a very tight labour market.

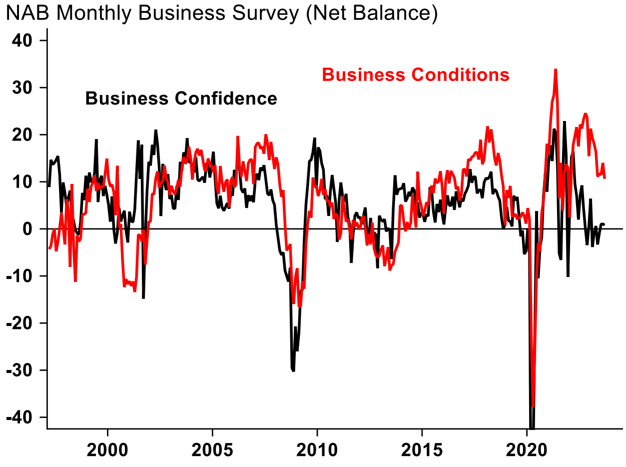
The trade balance rose in August, driven by a rise in non-monetary gold exports. Trade remains a key source of volatility for the forecasts.

The trade surplus rose by $2.3 billion in the month, to $9.6 billion. Exports rose 4%, almost entirely driven by a $2 billion increase in the volatile non-monetary gold component. Rural and coal export values fell, offset by a gain in iron ore. Imports were little changed with fuel and travel services imports up but aircraft and industrial transport equipment down.

Freight services costs continued to moderate, falling to 3.8% of good imports from a peak of 6.6% in August 2022. This is an important disinflationary force for goods prices that is expected to continue flowing through to consumers over the months ahead. More broadly, Q2 balance of payments data showed goods import prices have continued to gradually decline albeit the level of prices remains very elevated.

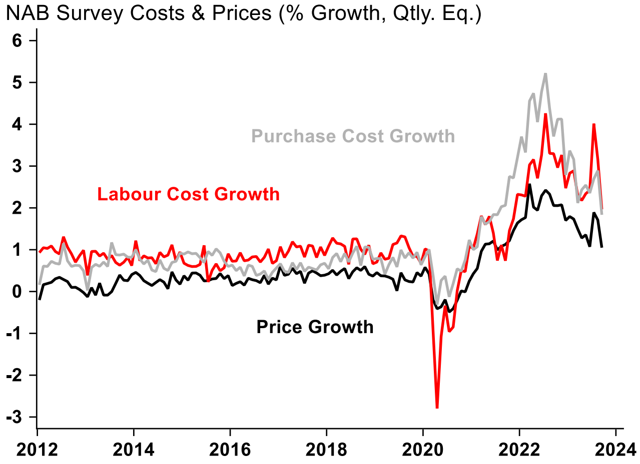
Looking ahead, trade volumes remain a key source of volatility for the forecasts. On the imports side, supply chains continue to improve but demand is also softening, while on the exports side the outlook for China remains uncertain, and the recovery in services trade is also ongoing. At the same time, recent quarters have seen significant movements in inventories alongside trade. On balance we see a fairly stable profile for net exports.

Chart 9: Business conditions remained above the long run average in September



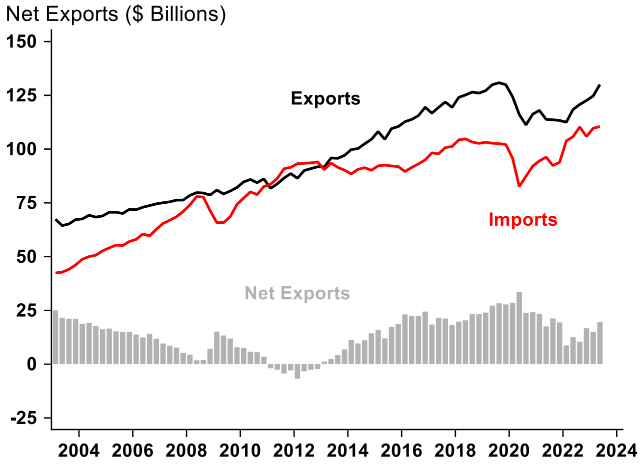
Source: Macrobond, NAB Economics

Chart 10: Cost growth measures stepped down in the NAB Business Survey in September



Source: Macrobond, NAB Economics

Chart 11: Freight services costs have continued to decline, though goods import prices remain elevated



Source: Macrobond, NAB Economics

Monetary Policy, Inflation and FX

We expect the Q3 CPI to show a quarterly print of 1.1% for both headline and underlying inflation, seeing the year-ended rates fall to 5.2% and 5.0% respectively.

The key drivers of the headline are a large rise in fuel prices which were up sharply in the quarter, offset by declines in fruit & veg and childcare. Of some concern is our expectation for services inflation (ex telco and travel) to continue to strengthen in annual terms. Rents growth, in particular, is expected to remain strong.

The moderation in inflation from its peak has been reasonably sharp, helped significantly by global goods disinflation. While there is always some variation across CPI components, at around 1.0% q/q it appears as if most of the easy gains have been eroded – i.e. inflation will likely moderate quickly to around 4% but bringing it back into the RBA's target band from there could be more challenging.

Indeed, as the common global inflation shock wanes, leading to disinflation (or even deflation) in goods prices, domestic factors will become increasingly important. Wage growth will be key – though not the only factor – but to date has not accelerated to a rate that is clearly inconsistent with inflation returning to the target band.

The depreciation of the exchange rate presents some upside risk, though the passthrough is typically slow while the disinflation in global goods is likely a larger driving force.

For rates, we continue to see the RBA hiking a further 25bps in November, before staying on hold until the second half of 2024.

The RBA remained on hold in October for the fourth consecutive month and made very few changes to the post meeting statement.

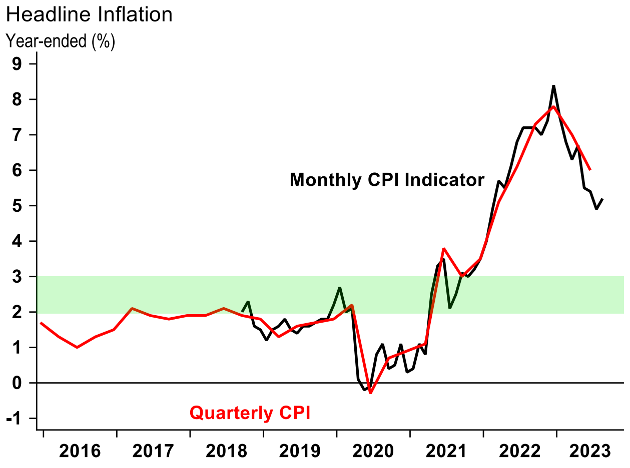
The RBA reiterated that rates continue to slow the economy ("working to establish a better balance of supply and demand") and that "they will continue to do so". Therefore, while inflation remains high, the RBA sees rates in restrictive territory and that it is on track to return to the target band by 2025. That said, the risk remains that a prolonged period of above-target inflation poses the risk of high inflation expectations becoming ingrained and a larger cost of even slower growth and higher unemployment to bring it back to target.

Ultimately, we see the Q3 CPI pushing the RBA – particularly with services inflation remaining strong – to provide some further insurance in balancing the risks.

The AUD/USD weakened further over the month, currently trading around US63c and at times lower.

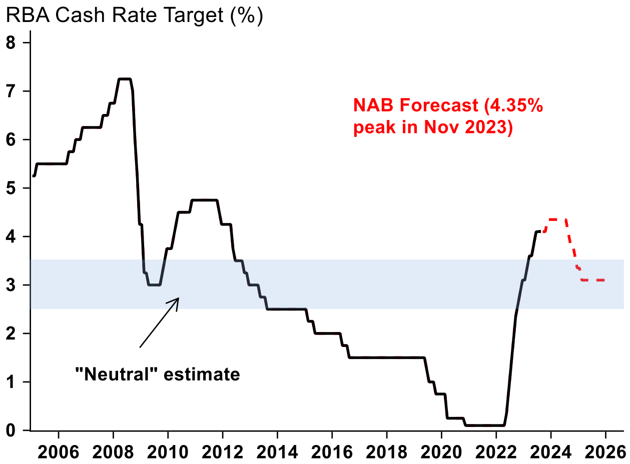
We continue to see the Aussie ending the year at around US66c before tracking higher over 2024 – ending 2024 at around US73c.

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



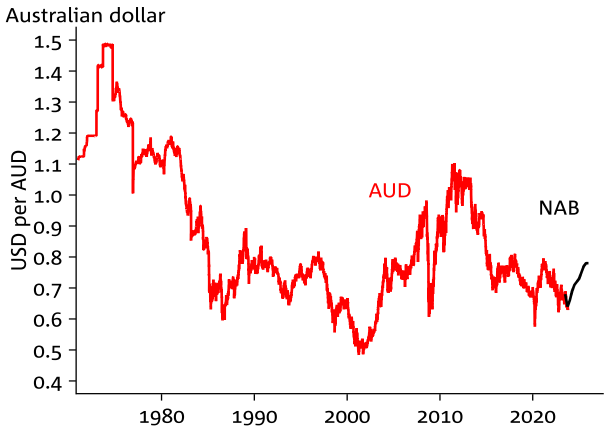
Source: Macrobond, NAB Economics

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: The Stark Deterioration in Housing Affordability

Despite the rapid rise in interest rates over the past year, which has seen a reduction in borrowing power of over 30%, house prices have remained resilient – and indeed they have already reversed a large proportion of the initial ~10% fall.

This combination of higher prices and higher mortgage servicing costs (which typically move in opposite directions) has led to a sharp deterioration in housing affordability.

Most housing affordability measures summarise this impact at aggregate level by calculating the share of income spent by a household earning an average income on the median priced property. According to PropTrack calculations this measure has risen to around 33% of income from a 20-year low in 2020 of around 20%. This figure is closer to around 40% in NSW where Sydney house prices remain a step above the other capitals. It is around 35% in Victoria and South Australia and around 30% in Queensland.

However, the typical household (i.e. the average) is far from common and there is a large distribution of both incomes and property prices, with the analysis sensitive to both binding assumptions.

PropTrack's new affordability index captures a broader set of market dynamics, framing affordability as the share of recent house sales that a median income household could afford to buy (assuming a long run preference of 25% of gross income is spent on housing).

This measure has deteriorated sharply over the past year or so, falling to its lowest level since the mid-1990s (based on available data). This pattern is common across the states though there is some variation in the level of affordability. Affordability is below the national average in NSW, Tas and Vic. Above the national average in SA and Qld – and highest in WA.

The deterioration in housing affordability is one factor adding to the cost-of-living pressures faced by households at the current juncture. Rents growth has also been high and the time to save a deposit metrics also points to a weakening in accessibility – with the time to save for a deposit rising to very high levels.

While higher interest rates have driven a large proportion of the deterioration in affordability over the past year, housing supply over the long term will remain a critical factor amidst a relatively fast-growing population, while the impact rates will continue to be cyclical.

Chart 15: Mortgage Payments as a share of income (PropTrack calculations).

Chart 16: PropTrack Housing Affordability Index

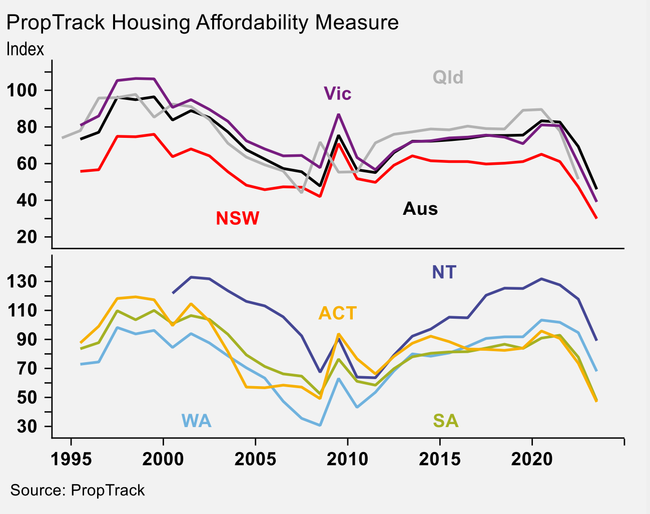


Chart 17: PropTrack Housing Affordability Index

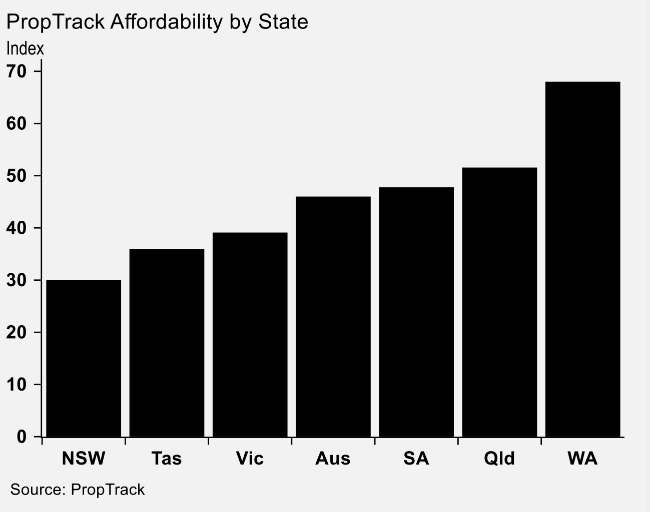


Table of Economic Forecasts

	% 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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