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The Forward View: Australia Nov 2023

Growth outlook upgraded but 4.6% rate peak ahead

NAB Group Economics

Overview

- We have reviewed our forecasts for incoming data over recent months and nudged up our expectations for growth, lowered our peak unemployment rate to 4.5% and pushed up our inflation track in the near term.
- Alongside these forecast revisions, we now expect one further increase in the cash rate to a peak of 4.6% in early 2024. We then see rates on hold until around November 2024 (previously August), before the RBA begins easing policy back towards neutral.
- GDP is expected to grow by 1.4% in 2023 and 1.7% in 2024 – stronger than we expected 6 months ago - but still below trend. Household consumption will remain subdued, but growth is likely to remain positive. Elsewhere, dwelling investment is expected to fall in the near term, while business investment is broadly neutral over the next year or so.
- The labour market has also remained resilient, but we still expect some further slowing in labour demand to see the unemployment rate rising to around 4.5% by late 2024.
- This will see wage growth peak at around 4% – its strongest rate since 2009. We see 4% on the WPI as the threshold of comfort for the RBA in returning inflation back to the target band.
- We now see trimmed mean inflation ending 2023 around 4.5%, easing to 3.3% by end 2024 and tracking within the upper half of the RBA's target band by mid- 2025.
- With that set of forecasts we see any further moves on the cash rate as fine-tuning rather than the RBA needing to take the cash rate materially higher. There is still some impact of prior tightening to flow through, and we are well past the peak in inflation. From here, it is about the desired timeframe of the RBA to return inflation to target.
- For inflation, domestic cost pressures including labour costs and overheads (including energy costs and rents) will be increasingly important, as will the strength in overall consumer demand. Though services inflation is high, we see it easing as the impact of rates flows through, that said the rents component of the CPI is expected to remain strong but disinflation or even deflation in new building costs will be a key swing factor.

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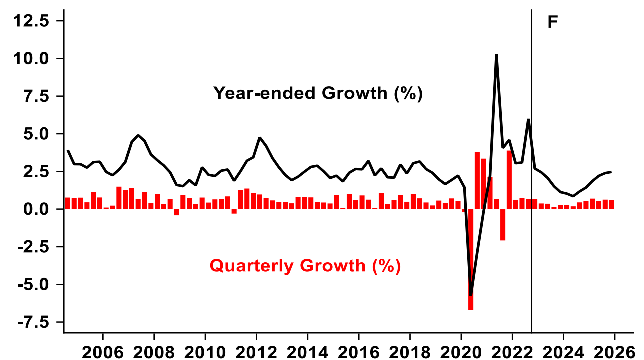
Key Economic Forecasts

	2022	2023-F	2024-F	2025-F
Domestic Demand (a)	4.9	2.0	1.3	2.3
Real GDP (annual average)	**3.7**	**1.9**	**1.5**	**2.2**
Real GDP (year-ended to Dec)	**2.7**	**1.4**	**1.7**	**2.4**
Terms of Trade (a)	6.3	-7.3	-3.4	-3.5
Employment (a)	4.4	3.0	1.4	1.5
Unemployment Rate (b)	3.5	3.8	4.4	4.3
Headline CPI (b)	7.8	4.5	3.3	3.0
Core CPI (b)	6.3	4.5	3.3	2.9
RBA Cash Rate (b)	3.10	4.35	4.35	3.35
$A/US cents (b)	0.68	0.66	0.73	0.78

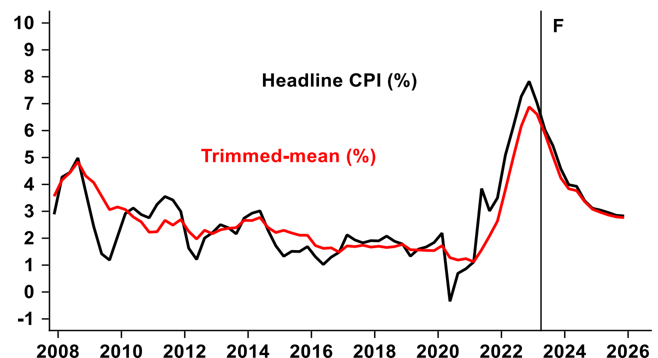
(a) annual average growth, (b) end-period

Chart 1: GDP forecasts



Source: Macrobond, NAB Economics

Chart 2: CPI forecasts



Source: Macrobond, NAB Economics

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Labour Market & Wages

The unemployment rate remains very low at 3.7% and participation rose back to a record high in October. We still expect some gradual easing in employment as the economy slows but now see a 4.5% unemployment peak in late-2025.

Employment rose 55k in October and the recent average remains around 30k per month, keeping pace with population growth. Hours worked rose by 9 million after falling in the prior two months, reinforcing the strength of the print albeit the referendum may have provided a temporary boost. The participation rate also increased, up 0.2pts to 67.0%, enough to see the unemployment rate tick up to 3.7% (after falling to 3.6% in September).

Overall, these data suggest the labour market remains very tight. Nonetheless, we continue to assess that some easing is occurring, with job vacancies declining in Q3 and the share of firms significantly constrained by labour availability falling to 38% in the Q3 NAB Quarterly Business Survey (from a peak of over 50% in 2022).

Slower growth in economic activity should see this continue and the unemployment rate eventually begin to rise. However, given the resilience of the economy thus far and the upward revisions to our growth outlook through the forecast period, we expect employment growth to remain positive through the coming year. As a result, we now see a somewhat lower peak in the unemployment rate of around 4.5% in late 2024 (previously 4.9%).

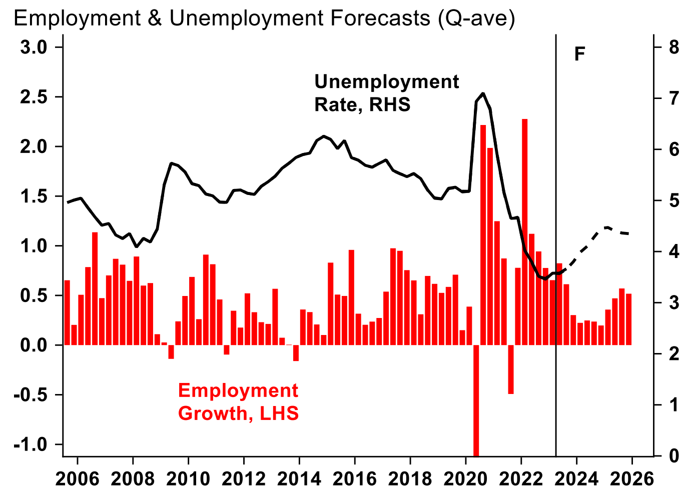
Hourly wage growth lifted to 4% in Q3, its highest rate since 2009. We continue to expect wage growth to stabilise over the coming year.

As expected, the Q3 WPI print showed a significant pickup, rising 1.3% Q/Q and 4.0% y/y. This was the strongest quarterly result in the history of the series, supported by the lift in minimum and award wages and the adjustment to age care pay levels, with wage growth strongest in accommodation & food and healthcare & social assistance.

Still, the wider tightness in the labour market also contributed to the strong result, with private sector wage growth rising to 4.2% y/y. Some 49% of private sector jobs saw a wage adjustment in the quarter and the average increase was 5.8%, suggesting increases were widespread across both award and non-award jobs. Public sector wage growth also continued to increase, reaching 3.5% y/y.

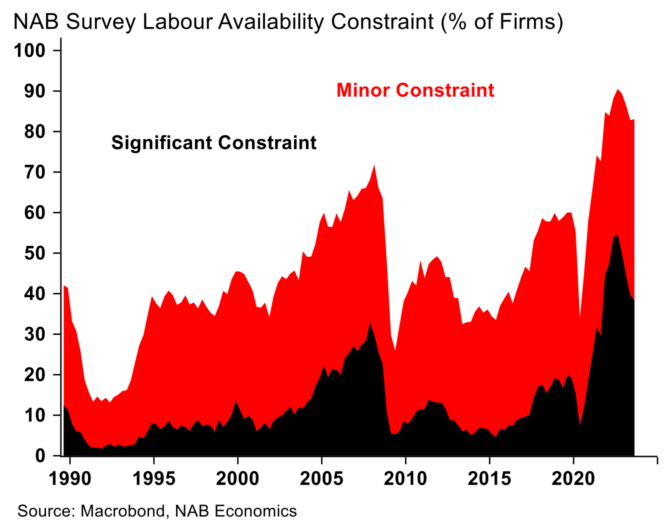
The slow-moving EBA component of wage growth will continue to strengthen, but recently lodged agreements average only around 3.9% per year and the easing expected in the labour market, as well as a somewhat cooler inflation environment, will help heading into the next Fair Work process. As a result wage growth should stabilise around or just below 4% over the coming year. This would be consistent with inflation returning to target, provided there is some positive rate of productivity growth over time.

Chart 3: Quarterly employment growth is expected to remain positive through 2024



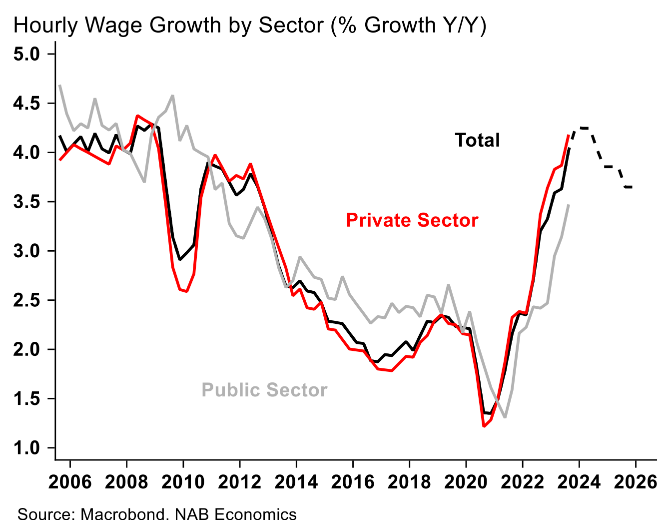
Source: Macrobond, NAB Economics

Chart 4: Fewer firms report labour availability as a significant constraint on output



Source: Macrobond, NAB Economics

Chart 5: Hourly wage growth rose to 4% in Q3, its highest rate since 2009



Source: Macrobond, NAB Economics

Household Consumption

Nominal retail spending rose reasonably strongly through Q3, reflecting a very modest pickup in underlying retail volumes after three quarters of declines.

Nominal retail turnover rose 0.9% in September, backing up smaller rises in the prior months to be up 1.8% over the quarter and 2% y/y. The monthly rise was driven by household goods (up 1.5) as well as department stores and other retailing, and there was a 1.0% rise in food – although spending at cafes & restaurants was flat in the month.

While price movements contributed to some of the nominal increase, the quarterly retail volumes data release showed there was also a small 0.2% increase in retail volumes in the quarter as a whole – ending a run of three consecutive quarterly declines. Retail volumes remain 1.7% lower y/y but the Q3 result suggests some stabilisation in demand after an extended period of adjustment as consumption has shifted back towards services and households have adjusted to higher prices and interest rate increases.

The quarterly rise was driven by non-food goods, which rose 0.4% q/q after a protracted fall over the past year. Cafes & restaurants also rose 0.4% q/q, continuing to gradually rise from an already high level, while food retail volumes edged down 0.3% in the quarter.

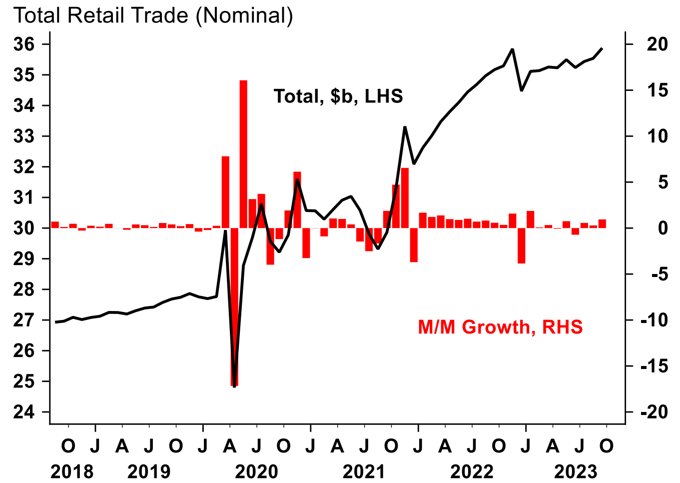
Transaction data analysis in NAB's *Monthly Data Insights* suggests the recent strength in nominal spending may have come to an end in October, with a small fall in retail spending and overall consumption in the month. However, some seasonal volatility is likely to be playing a part in recent months, with November spending expected to lift in the November Black Friday sales period.

Reflecting the resilience shown by households thus far, we have revised up our forecasts for household consumption in Q3 and through the forecast period, now seeing small positives for overall consumption.

We had seen consumption as likely to be broadly flat through the second half of 2023 and early 2024 but the growth in retail volumes in Q3 suggests a small positive for overall consumption for the quarter (likely in the order of 0.3%). Income generated by a strong labour market is an important factor supporting household demand, while population growth is playing a key role.

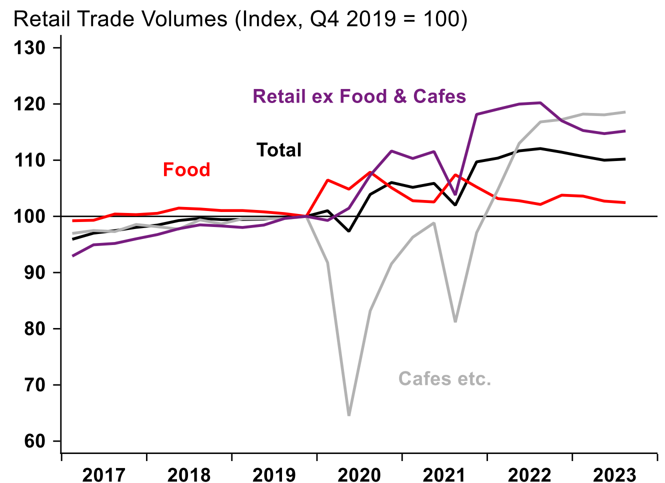
From here, we see small positives for quarterly consumption growth through the forecast period, strengthening later in 2024 and into 2025 as the drag on real incomes from inflation eases. In per capita terms, this implies some further near-term falls in the level of per capita real consumption before modestly growing in 2025.

Chart 6: Nominal retail trade rose in September, backing up rises in the prior two months



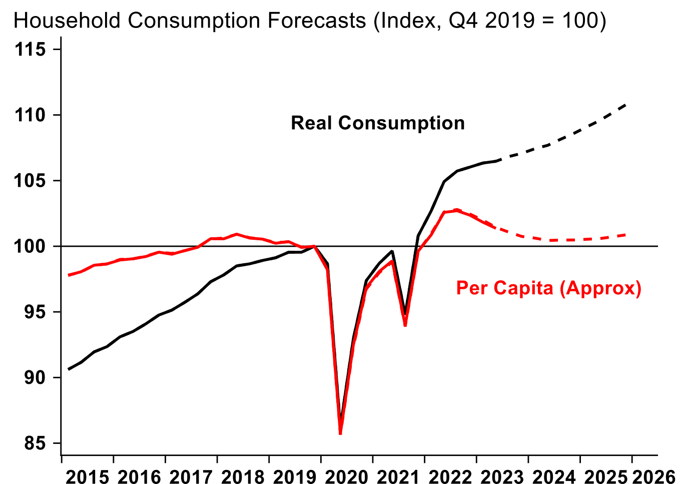
Source: Macrobond, NAB Economics

Chart 7: Underlying retail volumes rose in Q3 after three quarters of declines



Source: Macrobond, NAB Economics

Chart 8: We now see household consumption growth remaining positive through the forecast period



Source: Macrobond, NAB Economics

Housing and Construction

Both house prices and rents continue to rise at a solid pace, pressured by strong population growth amidst weaker supply.

The CoreLogic 8-capital city dwelling price index rose by 0.9% in October and is now 7.6% above its recent trough in January. Price growth appears to have moderated in the two largest capitals from earlier in 2023 (though Sydney significantly outpaced the increase in the other capitals for a period – and is up 11% since January). The smaller capitals including, Perth, Brisbane and Adelaide continue to increase rapidly – all rising by around 1.5% in October.

Prices in regional areas continue to rise at a more modest pace, though they are around 48% higher than pre-COVID levels reflecting strong growth during the pandemic – while capital city prices are around 30% higher.

Capital city rents growth rebounded in October after moderating in recent months – rising 0.6% m/m and 10% y/y. Capital-city vacancy rates edged lower according to both the SQM and CoreLogic measures in October and remain historically low. Therefore, the upward pressure on rents will likely persist for some time.

Both the pressure in prices and rents continues to see a significant deterioration in housing affordability, with little adjustment to the sharp increase in interest rates having occurred over the past year.

The supply side of the housing market continues to be challenged despite rising house prices. Total residential building approvals fell 4.6% in September (houses down 4.6% and high-density approvals down 5.1%). Overall, approvals are down 20% over the past year – with the higher density segment down 30% despite the very strong growth in capital city population. In trend terms, approvals continue to track at their lowest rate since 2012 and imply an ongoing annual completion rate of ~142k.

New approvals have faced a number of headwinds over the past year, following the sharp increase in rates (and associated uncertainty) with input costs remaining high despite easing supply constraints. The Q3 PPI showed input costs for the house building sector were flat, however, that leaves the input cost index up 29% since Q1 2020. For high density dwellings such as apartments, the cost base has likely risen even further.

These housing market dynamics will continue to have a range of impacts on the broader economy. Dwelling work done will likely decline further in the near term, while construction costs and rents growth will continue to drive inflation. The deterioration in affordability alongside other cost of living pressures will likely weigh on consumption growth (though higher house prices will support wealth).

Chart 9: House prices continue to rise relatively briskly

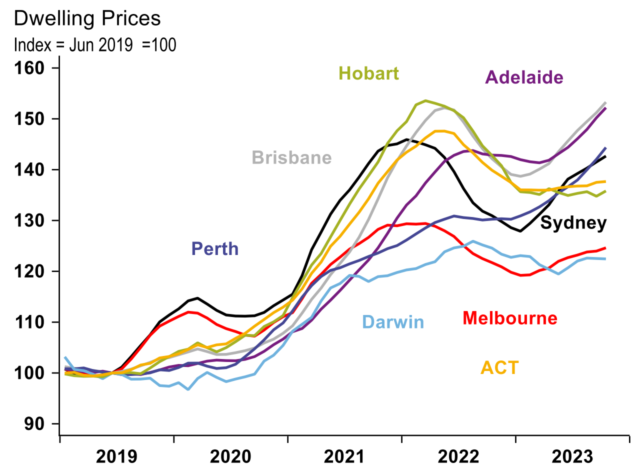


Chart 10: Rents growth ticked back up in October after easing over the prior 6 months

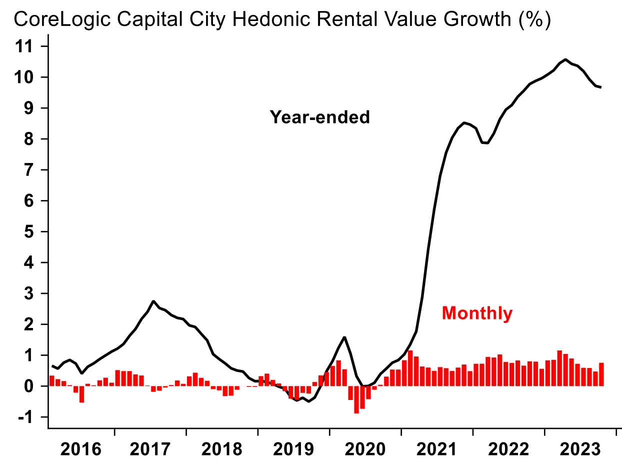
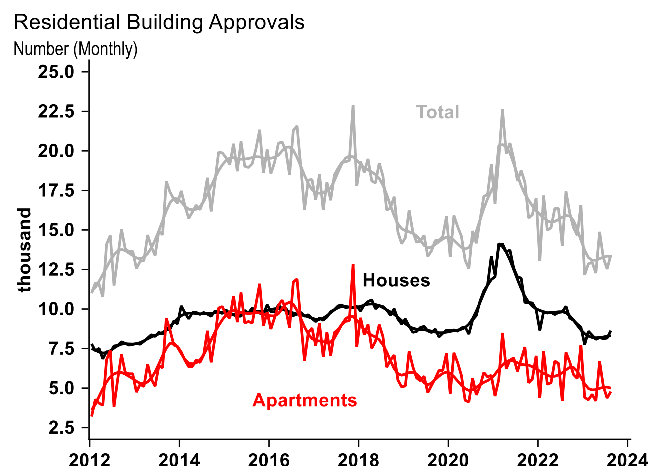


Chart 11: Approvals have stabilised at a low level



Business and Trade

Business conditions remained resilient in October though forward-looking indicators continue to follow a weaker trajectory.

Business conditions edged up in October, driven by increases in mining, construction, and transport & utilities. Generally, conditions remain strong across industries and states - albeit the wholesale industry turned negative during October. The ongoing resilience in activity continues to see solid reads in capacity utilisation – currently at a well above average 84%. Confidence and forward orders continue to track on a weaker trajectory and edged lower in the month.

Cost and price pressures eased in the month but are still high. In addition to the monthly survey measures of costs, our quarterly measure of overhead costs growth also remains elevated.

The outlook for business investment is mixed. Investment in machinery & equipment picked up noticeably during the pandemic, in part supported by policy measures such as the accelerated instant asset write-off. While that has now ended, capacity utilisation generally remains high, and the pipeline of public infrastructure work is clearly elevated. That said, due to capacity constraints and inflationary pressures the Federal government's infrastructure review saw some projects trimmed from the pipeline.

Indicators of investment intentions remain positive, though have pulled back in recent reads. The ABS Capex survey saw expectations for 2024 ease in Q2 but still positive (3.5% nominal), while the NAB Quarterly business survey saw expected investment over the next 12 months ease in Q3 but remain around average levels.

For now, business credit growth remains robust - rising by 0.7% in September and up 6.4% over the year. While business credit is typically more cyclical than housing credit – high capacity utilisation, a large pipeline of investment work (including renewables projects) and ongoing demands for higher working capital continue to support credit demand. That said, we continue to see business credit growth slowing significantly in 2024.

The goods trade surplus decreased to $6.8b in September but trade should be broadly neutral for GDP growth in Q3 overall.

The decline in September reflected a fall in goods exports, driven by non-monetary gold, and a rise in imports driven by industrial transport equipment.

Monthly services trade data is no longer published so a complete Q3 estimate is not available. However, both goods imports and exports appear to have risen in real terms, suggesting a flat or small positive contribution to GDP growth.

Chart 12: Business conditions remained above the long run average in September

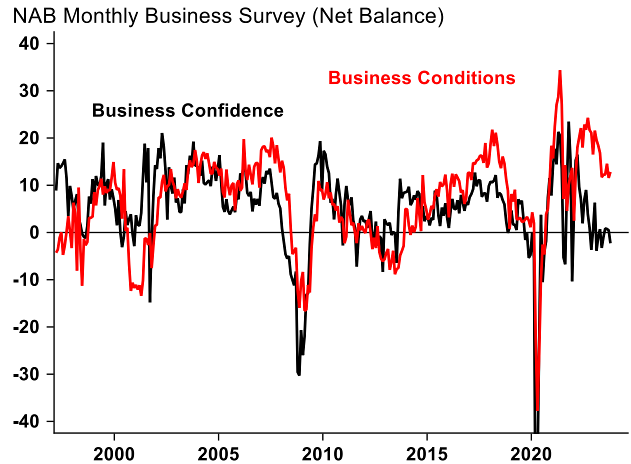


Chart 13: The pipeline of engineering construction work is elevated.

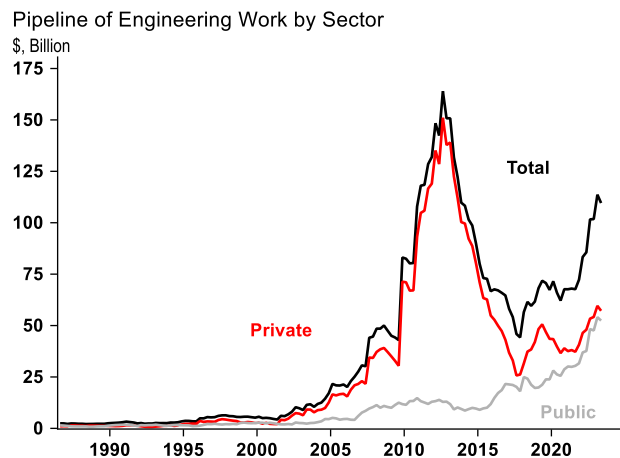
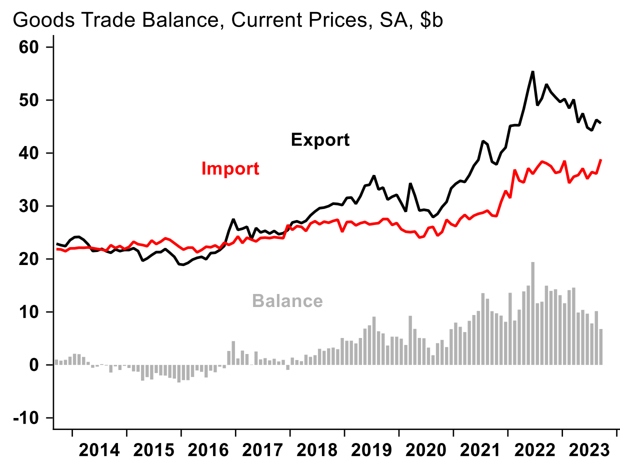


Chart 14: The goods trade surplus decreased in September but remains large



Inflation and FX

The Q3 CPI surprised slightly to the upside, with both the headline and trimmed mean measures showing quarterly rises of 1.2%.

Petrol prices were a key contributor to the headline result, but inflationary pressures were clearly broad-based with over 60% of the basket rising at an annualised pace higher than the top of the RBA's target range. Importantly, and as noted in the November SMP, prices for services which are more strongly influenced by domestic factors, continue to rise strongly.

That said, year ended inflation in both headline and core measures continued to moderate, falling to 5.4% and 5.2%, respectively. Inflation is now clearly past its peak for this cycle in Australia, but progress from here is likely to be more difficult and volatility given the large swings in prices that have occurred (including commodities) as well as the introduction and unwinding of policy responses to cost of living pressures.

We will glean a first read of inflation in Q4 next week, with the release of the October monthly CPI indicator. However, the first month of the quarter is dominated by goods price updates, with service prices updating in the second and third months. While the monthly indicator provides a timely read of at least some of the CPI components, the full quarterly will remain the focus given it is a more complete measure and contains a range of key analytical measures – including the underlying trimmed-mean and weighted median measures.

We see inflation continuing to moderate, but more slowly from here. We have pencilled in 1.0% q/q (4.5% y/y) for trimmed-mean inflation in Q4 and 3.3% y/y by Q4 2024. That outcome would mark an extended period of above target inflation but continue to show a clear easing trend.

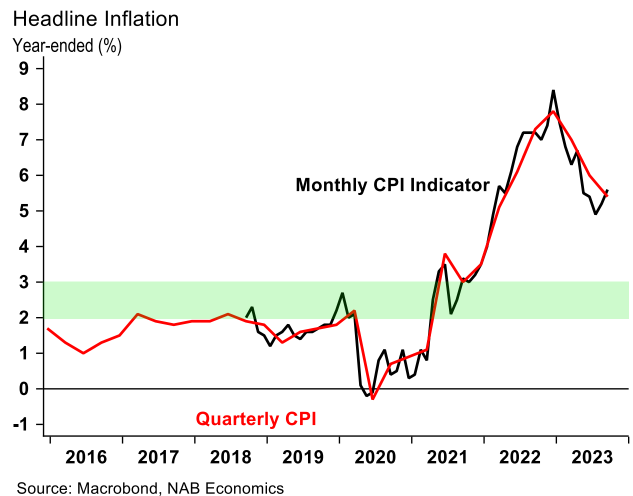
The global back drop will likely see further progress on inflation over coming quarters – though this will be mostly reflected in ongoing disinflation of goods prices. Easing global demand and freight costs alongside improving supply chains will continue to drive this.

The outlook for services inflation remains dependent on the local demand backdrop, amid ongoing pressure from labour costs as well as overheads, including rent and energy. The ability of businesses to pass through cost pressures will be dependent on the strength in consumer demand at the aggregate level, while individual balance sheets continue to come under pressure.

The AUD/USD strengthened over the month, currently trading around US64.7c after falling into the mid-to-high U62c range.

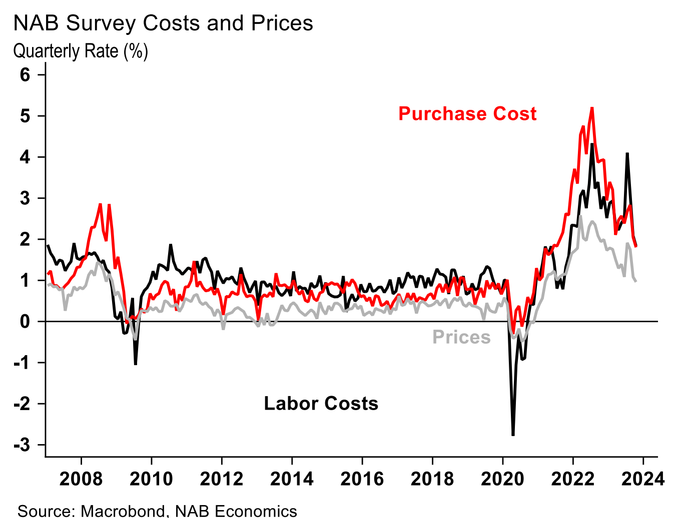
We continue to see the Aussie ending the year at around US66c before tracking higher over 2024 – ending 2024 at around US73c.

Chart 15: CPI pressures continue to ease but may be volatile in the near term.



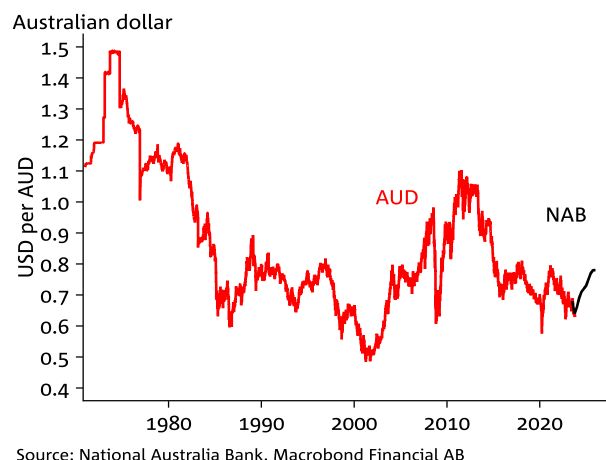
Source: Macrobond, NAB Economics

Chart 16: The NAB Business Survey points to an easing but ongoing pressure for input and output prices.



Source: Macrobond, NAB Economics

Chart 17: AUD/USD to drift higher over coming years, reaching US73c by end 2024



Source: National Australia Bank, Macrobond Financial AB

Monetary Policy and the RBA outlook

While inflation has peaked, slower progress than previously expected in returning to target saw the RBA lift rates to 4.35% in November.

After remaining on hold since June, the upside surprise to Q3 CPI (relative to the August staff forecasts) was enough to see the RBA lift rates further alongside a new set of staff forecasts which saw an upgrade to the activity outlook, and inflation firmly at the top of the target band by end 2025 with a lower unemployment peak of 4.25%. The latest set of staff forecasts were conditioned on a cash rate assumption of 4.6% - another full hike.

The RBA continues to balance the visible slowing in activity (particularly household consumption) and the ongoing passthrough of the steep increase in rates over the past year or so, against still well-above-target inflation. Broadly, growth has been stronger than the bank expected.

Overall, the RBA continues to see itself in a phase of "fine-tuning" given they note that rates are working to bring about a better balance of supply and demand. Therefore, adjustments to monetary policy are now about how quickly inflation is back at target with the latest hike a form of insurance to ensure inflation returns to target in a timely manner.

We see one further hike to 4.60% in February, with rates then on hold until late 2024, before the RBA begins easing back neutral.

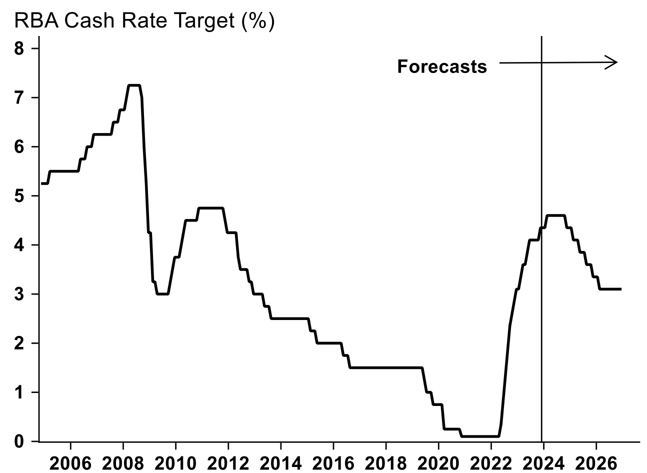
We agree with the notion that any further move from here is about fine tuning around the risks to inflation so that it returns to target by around mid-2025.

That said, with the RBA's (and our own forecasts) projecting inflation to remain above target for an extended period – and importantly only nudging down into the top of the target band by the end of 2025 – we see one further hike in 2024.

We see the risks around this view as two sided. Consumer demand remains resilient in aggregate, supported by strong population growth and a strong labour market meaning any further cost pressures are at risk of ongoing pass through. A still strong labour market and ongoing rapid population growth are also supporting demand.

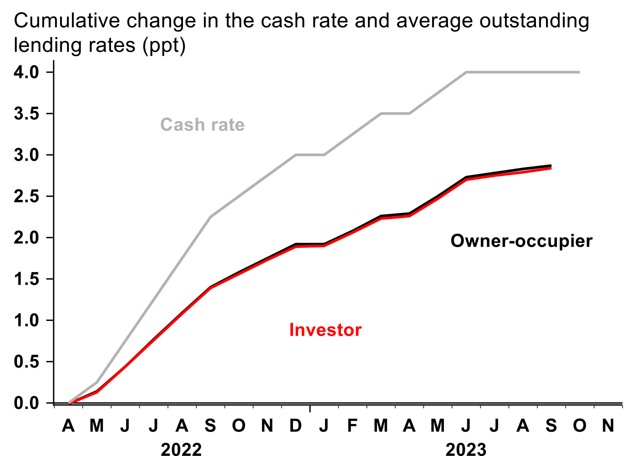
Offsetting this is the fact that the impact of ongoing pass through is yet to be fully reflected in consumer spending with savings buffers having been used in supporting spending to date. A larger than expected slowing in activity or a weaker than expected labour market would see a faster return to target. At the global level, global goods price disinflation will continue and easing energy costs will also help. The RBA has also been reluctant to take the cash rate higher from here and may choose to remain on the sidelines until pushed from further upside surprises to inflation.

Chart 18: The Cash rate is expected to peak at 4.60%



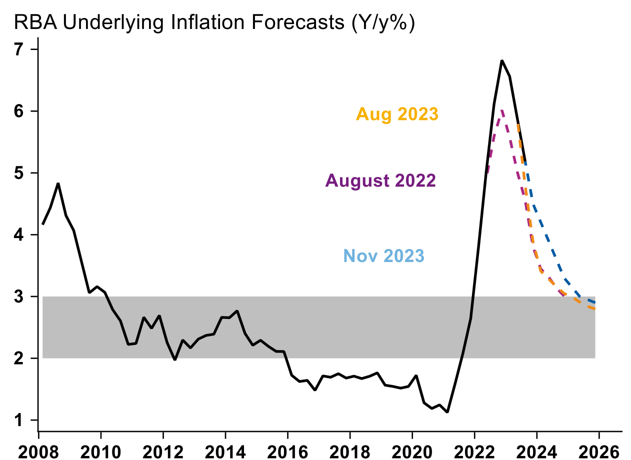
Source: Macrobond, NAB Economics

Chart 19: The full extent of cash rate increases are yet to flow through to outstanding lending rates



Source: Macrobond, NAB Economics

Chart 20: RBA forecasts place inflation at the top of the band by end 2025



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	0.3	0.2	5.2	0.9	1.4	2.0
Dwelling Investment	-0.7	-0.2	-1.5	-1.7	-4.0	-4.1	-5.0	8.6
Underlying Business Investment	4.2	2.1	-0.7	-0.6	4.5	5.0	2.0	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**	**0.2**	**0.1**	**3.4**	**1.8**	**1.6**	**2.7**
Stocks (Cont. to GDP)	0.3	-1.0	0.2	0.1	0.5	-0.9	0.2	0.3
Gross National Expenditure	**0.8**	**-0.4**	**0.4**	**0.2**	**3.5**	**1.0**	**2.0**	**2.8**
Exports	1.8	4.3	2.3	0.6	8.2	9.1	1.5	2.2
Imports	3.6	0.7	2.9	0.7	12.8	8.2	3.1	4.2
Net Export (Cont. to GDP)	-0.3	0.8	0.0	0.0	-0.5	0.5	-0.3	-0.3
Real GDP	**0.4**	**0.4**	**0.4**	**0.3**	**2.7**	**1.4**	**1.7**	**2.4**
Nominal GDP	2.2	-1.2	0.9	1.0	12.0	3.0	4.6	4.2
External Account								
Current Account Balance ($b)	34.8	30.4	34.2	25.1	26.4	25.1	3.1	-28.0
Current Account Balance (% of GDP)	1.4	1.2	1.3	1.0	1.1	1.0	0.1	-1.0
Terms of Trade	2.7	-7.9	-2.7	-0.6	7.2	-8.5	-0.3	-4.5
Labour Market								
Employment	0.7	0.8	0.6	0.3	5.2	2.4	1.0	1.9
Unemployment Rate (End of Period)	3.6	3.6	3.7	3.8	3.5	3.8	4.4	4.3
Ave. Earnings (Nat. Accts. Basis)	1.9	0.9	1.2	0.9	3.9	4.9	3.9	3.6
Wage Price Index (WPI)	0.8	0.8	1.3	0.9	3.4	3.9	3.9	3.6
Prices and Rates								
Headline CPI	7.0	6.0	5.4	4.5	7.8	4.5	3.3	3.0
Trimmed-mean CPI	6.6	5.9	5.2	4.5	6.8	4.5	3.3	2.9
RBA Cash Rate (End of Period)	3.60	4.10	4.10	4.35	3.10	4.35	4.35	3.35
10 Year Govt. Bonds (End of Period)	3.31	4.00	4.49	4.50	4.04	4.50	4.05	3.90
$A/US cents (End of Period)	0.67	0.66	0.65	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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