Embargoed until 11:30am AEDT, 19 December 2023

The Forward View: Australia Dec 2023

Slow growth to persist in Q4 and into 2024

NAB Group Economics

Overview

- After incorporating the data for GDP, CPI and the labour market over the past month our forecasts are largely unchanged. At a high level, these data have confirmed that the economy is growing at a well-below trend pace, inflation pressure is continuing to moderate and the labour market has remained healthy.
- Households continue to face into the pressures from higher rates and inflation, adjusting both the amount of spending and the savings rate. Dwelling investment growth also remains weak (though not as bad as feared) while business investment will likely remain mixed as the impact of policy support wanes, but capacity utilisation remains high and a large infrastructure and private sector pipeline of buildings & structures work leads to some spill overs on equipment spending.
- Overall, we still expect GDP to grow by 1.4% y/y over 2023 (0.2% in Q4) and 1.7% over 2024. Soft consumption growth will be the key dynamic while both dwelling and business investment on net make little contribution.
- Our outlook for the labour market is unchanged with the unemployment rate expected to rise to around 4.5% by end 2024. Some of the pressure has begun to ease in the labour market with job vacancies/ads continuing to fall with population growth remaining strong and participation still high.
- We see trimmed-mean inflation ending 2023 around 4.5%, easing to 3.25% by end 2024 and tracking within the upper half of the RBA's target band by end- 2025. We consider the risks as balanced around this profile with our Business survey still pointing to elevated price pressures but an increasingly notable slowing in activity should place downward pressure on prices.
- Based on the outlook for weak activity growth, an ongoing easing in labour market pressures (with wage growth topping out around 4%) and continued easing in inflation we still believe the cash rate is at, or near, its peak for this cycle. We continue to pencil in a hike in February for a cash rate peak of 4.6%. However, in the near term the data (particularly for inflation) will be important. Equally, the RBA will be increasingly concerned about the pressure on the consumer and how that will affect future growth and employment.

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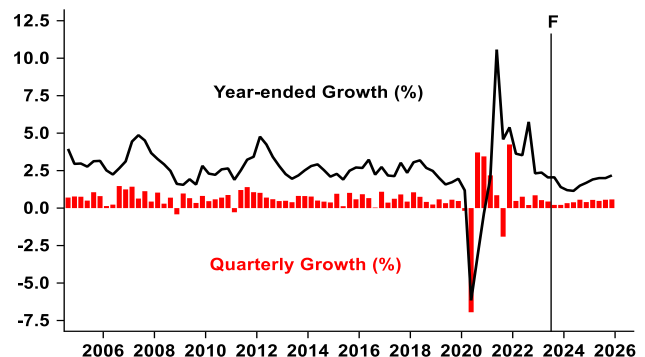
Key Economic Forecasts

	2022	2023-F	2024-F	2025-F
Domestic Demand (a)	5.1	2.2	1.5	2.0
Real GDP (annual average)	**3.8**	**2.0**	**1.4**	**2.0**
Real GDP (year-ended to Dec)	**2.3**	**1.4**	**1.7**	**2.2**
Terms of Trade (a)	7.2	-6.7	-2.2	-3.5
Employment (a)	4.5	3.3	1.5	1.4
Unemployment Rate (b)	3.5	3.8	4.5	4.4
Headline CPI (b)	7.8	4.3	3.4	2.7
Core CPI (b)	6.3	4.4	3.2	2.8
RBA Cash Rate (b)	3.10	4.35	4.35	3.35
$A/US cents (b)	0.68	0.66	0.73	0.78

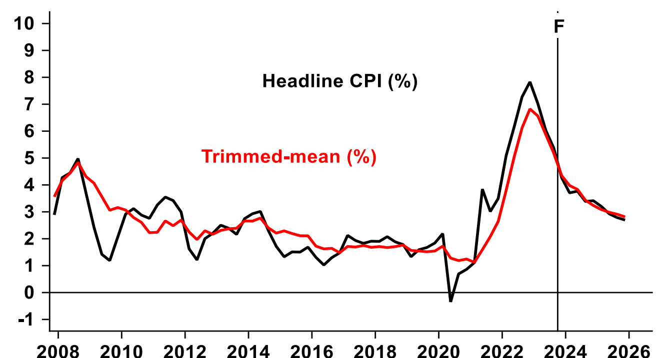
(a) annual average growth, (b) end-period

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 rose to 3.9% in November, but the labour market remains very strong with jobs growth broadly keeping pace with the very strong population growth.

Employment rose 61k in November, backing up a slightly revised 43k increase the month prior – though hours worked were fairly steady in the month. Nonetheless, there was a small rise in the unemployment rate to 3.9% as the participation rate rose a further 0.2ppts to a new record high of 67.2%.

Population data to June show net migration topped 518k over the past year, reflecting a combination of both elevated arrivals and lower-than-normal departures. This has lifted population growth to 2.4% y/y, and more timely estimates to November indicate a run rate as high as 3% - with the pandemic-era 'population gap' now fully closed. The MYEFO update forecast net migration to slow to 375k in 2023-24 and 260k in 2024-25 as both flows normalise.

So far, the strength of labour demand has seen the economy successfully absorb the rebound in population with the employment-to-population ratio broadly steady since mid-2022. Rather, the rising participation rate is driving the gradual lift in the unemployment rate.

With migrants more likely to be working-age than the population as a whole, the composition effect of elevated net migration is likely contributing to rising participation. However, there may also be some lingering participation benefits from individuals drawn into the labour market when workforce shortages were most acute, as well as some gains in access to the labour market from the shift to working-from-home and childcare policy changes.

While the composition effect will fade as migration normalises, labour demand will also soften as the economy slows, and we expect the unemployment rate to reach around 4.5% by end-2024.

Wage growth measures in the national accounts continued to strengthen in Q3, while productivity also picked up a little.

Total wage income per employee (AENA) grew 1.9% q/q to be 5.2% higher year on year, and AENA per hour grew by a significant 3% q/q (4% y/y). These measures capture compositional changes in the labour market as well as underlying wage growth and can be volatile, but are now running in line with the hourly Wage Price Index (WPI) on an annual basis.

The strength of nominal wage growth measures, as well as subdued economic growth, saw nominal unit labour costs growth lift to 2.2% q/q (6.4% y/y). However, softening in hours worked in the quarter led to a rebound in measured GDP per hour worked, rising 0.8% q/q (though the measure remains 2.1% lower in y/y terms).

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

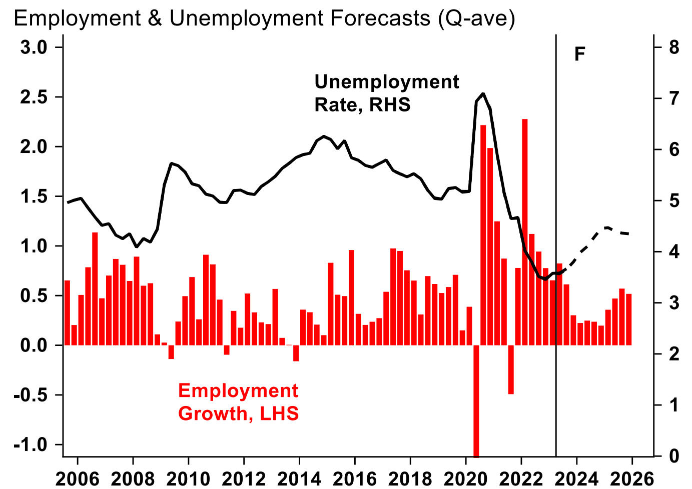


Chart 4: Net migration has passed half a million, reflecting both high arrivals and low departures

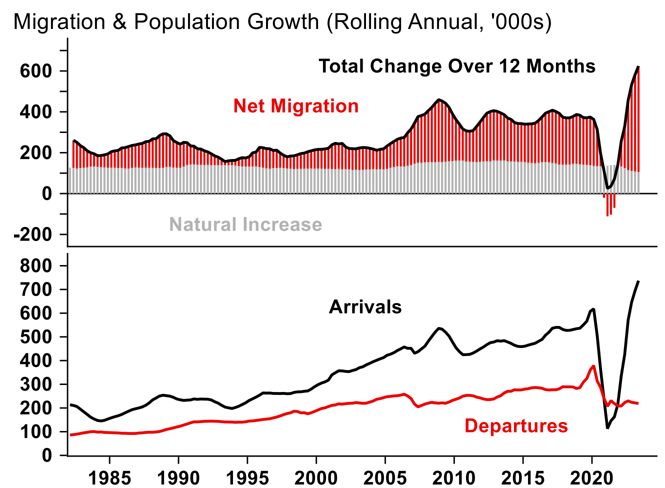
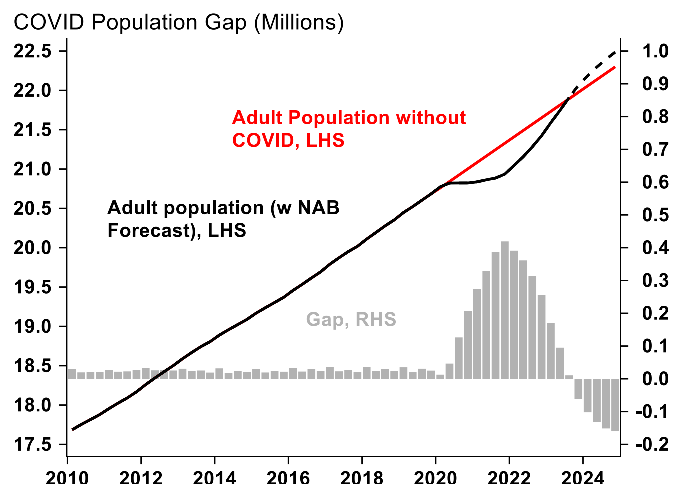


Chart 5: The population rebound means the pandemic-era population gap has now fully closed



Household Consumption & Savings

Real household consumption was flat in Q3, partly reflecting the impact of government subsidy measures as well as pressures on incomes.

Flat growth q/q saw annual growth slow to just 0.4% y/y. However, measured consumption was significantly impacted by government subsidies in energy and childcare, which saw consumption in these categories decline for households (offset by a rise in government consumption). The impact of subsidies was evident in a 0.4% q/q fall in essential consumption.

This was offset by a 0.7% q/q rise in discretionary consumption, partly driven by a 13% rise in purchases of vehicles, likely reflecting easing supply chain issues and tax based investment incentives. Transport services consumption rose 3.9% and hotels, cafes & restaurants rose 0.9% with the ABS pointing to the FIFA Women's World Cup as a factor supporting spending.

Excluding electricity, gas & water and "other services" (which includes childcare), household consumption grew by a more robust 0.6% q/q and 0.9% y/y – but further excluding vehicles would take consumption growth back to 0.2% q/q suggesting a soft underlying trend.

High inflation, income taxes and interest rates continue to weigh on household cash flows, with nominal disposable income growing just 0.1% q/q (1% y/y) and continuing to fall in inflation-adjusted terms. Interest payments again rose sharply in the quarter, reaching 6.1% of gross income in Q3 (8.5% of disposable income)- around 2012 levels- while income taxes reached 17.2% of gross income.

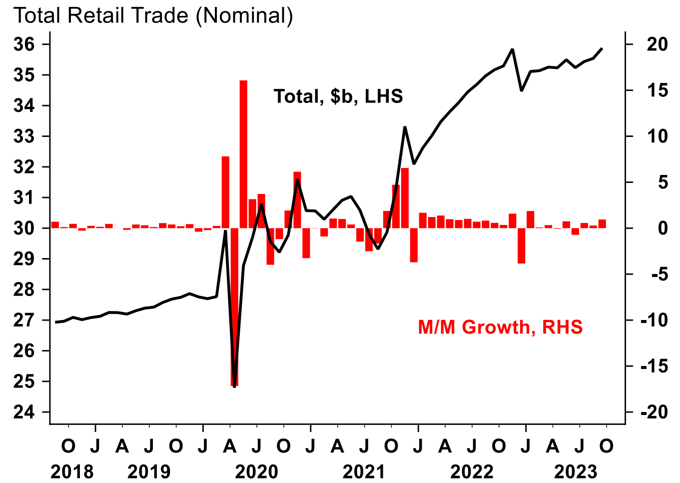
The fall in real income has continued to squeeze savings, with the average savings rate declining to 1.1% - well below the pre-COVID average

Consumption growth has likely remained subdued in Q4 but should improve as real income growth turns positive – most likely in the second half of 2024.

Nominal retail sales contracted 0.2% in October but NAB's transaction data suggests a pickup occurred in November, partly reflecting shifting spending patterns ahead of Christmas. That could also see retail sales fall in December as consumers continue to bring forward spending each year as Black Friday sales continue to grow. In real terms, consumption growth will likely remain very subdued in Q4 and early 2024.

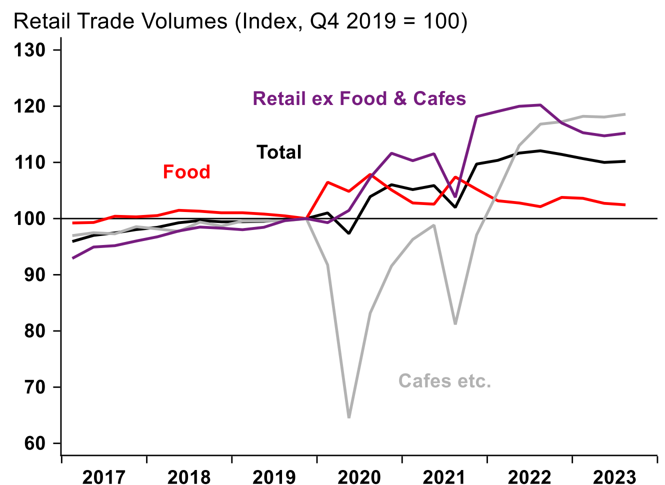
Over time, moderating inflation will ease the drag on real incomes, helping to see a gradual recovery in consumption growth through the second half of 2024. In per capita terms, this implies some further near-term falls in the level of real consumption.

Chart 6: Essential consumption fell in Q3, reflecting the treatment of energy and childcare subsidies



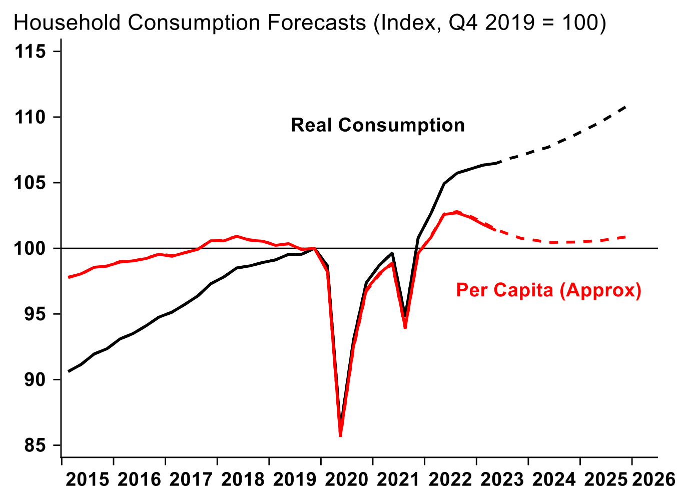
Source: Macrobond, NAB Economics

Chart 7: The household savings ratio declined further in Q3 but remains positive



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

House price growth slowed further in November, though rents growth remains strong as vacancy rates across the capital cities hover around historic lows.

The CoreLogic 8-capital city dwelling price index rose by 0.6% in November and is now 8.2% higher over the year. Growth rates in both Sydney and Melbourne have slowed significantly in H2 2023 (with the latter recording a small decline in November). Price growth remains robust in the other major capitals, led by a 1.9% m/m increase in Perth in the month, though both Adelaide and Brisbane also recorded increases over 1% m/m. Overall, prices have now risen by 9.6% since their recent trough and are now 1% above the previous peak in early 2022. Regional prices have seen a more muted cycle and are around 40% higher than pre-pandemic.

Though rents growth saw a marginal slowing in Q3, the pace of increase accelerated in November, with rents across the capital cities rising 0.7% m/m, to be 8.1% higher over the year. The capital city vacancy rate has hovered near 1% since mid-2022 compared with its decade average of around 2%. Adelaide and Perth remain extremely tight with the vacancy rate around 0.5% with the markets in Sydney and Melbourne marginally less tight at around 1.4%.

Demand for housing is likely to remain strong in the near term with population growth still strong (albeit expected to slow) while supply will likely take some time to catch up. Around 52k dwellings were estimated to have been added to the dwelling stock in September (net of demolitions) up from 32k in the June quarter – likely reflecting the ongoing easing in supply constraints. However, the current run rate of approvals implies an ongoing pull-back in annual completions (supply into the housing market) and ongoing weakness in dwelling investment as the existing pipeline of work is completed. Further, both rents and prices of constructing new dwellings will continue to be important for CPI inflation dynamics. Pressure on rents will likely persist for some time and will also likely result in a rise in the average household size going forward. On the construction side cost inflation has eased but prices remain around 30% higher than pre-pandemic. While supply chains continue to normalise the large pipeline of work will continue to support demand for inputs and therefore whether prices fully correct or remain high remains to be seen. Dwelling price growth in the established market (not directly measured in CPI) will likely continue to slow as affordability constraints increasingly bind – particularly in Sydney and Melbourne – though we continue to see modest gains in 2025.

Chart 9: House prices growth is diverging across the capitals

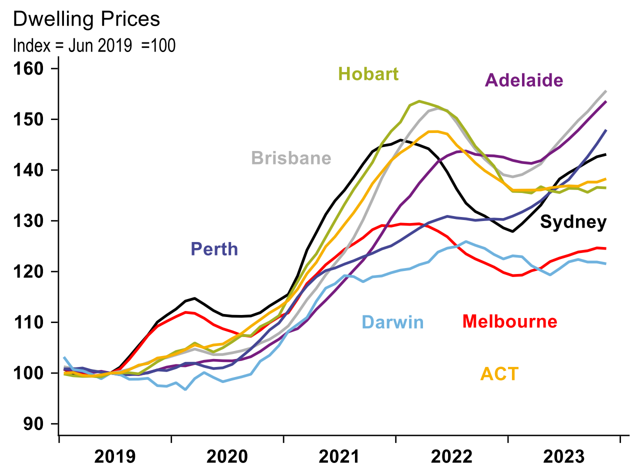


Chart 10: Rents growth remains strong

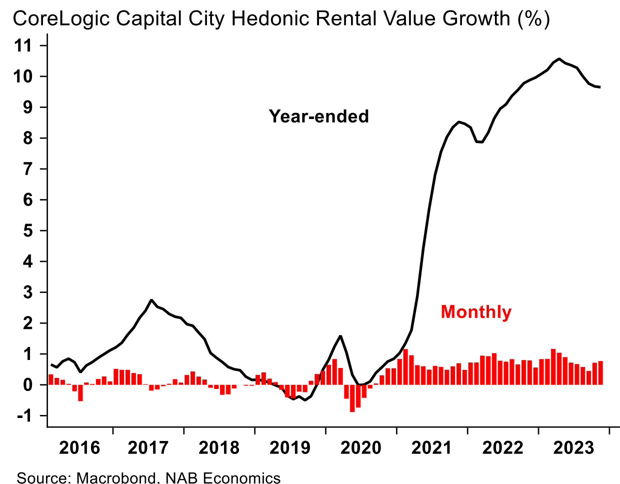
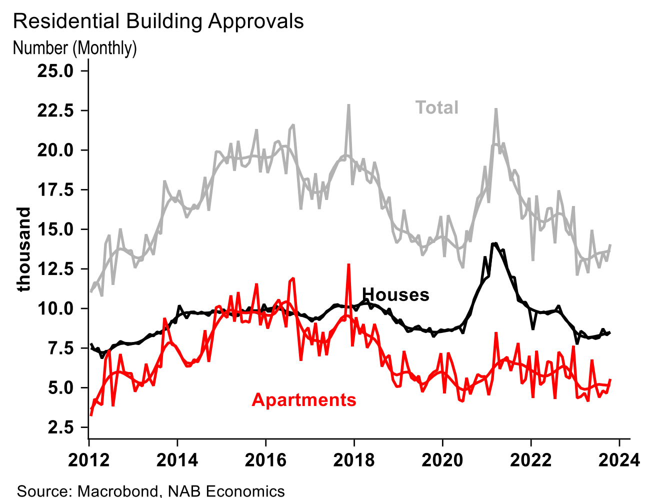


Chart 11: Approvals have stabilised at a low level



Business and Trade

Business investment rose modestly in Q3 while more recent data shows business conditions eased in November.

The National Accounts release showed business investment grew 0.4% q/q (underlying basis) and while this was the equal lowest quarterly growth rate seen since Q4 2021, underlying business investment was still up 7.4% over the year.

Growth in Q3 was driven by the mining sector – where investment was up 9.6% q/q – while non-mining investment declined 1.0%. Consistent with the strength in mining investment, the strongest growth was recorded in new engineering construction (2.3% q/q) and mining exploration (3.8%), while machinery & equipment only managed to eke out a 0.2% q/q increase (underlying basis) and new building investment fell 1.5%.

More recent data in the NAB Monthly Business Survey showed business conditions eased 4pts in November to +9 index points and are now at their lowest level since early in 2022 – but still above the long-run average. Business confidence saw a second consecutive decline and at -9 index points, is now at its lowest level since 2012 (outside of the COVID period). Unsurprisingly, a further increase in rates saw confidence in the key consumer-facing sectors – retail and recreation & personal services – fall further into negative territory.

Forward orders softened and taken together with confidence suggest that businesses expect that conditions will weaken further. However, capacity utilisation remains high and continues to be reflected in elevated price pressures with both input cost and output price inflation still elevated.

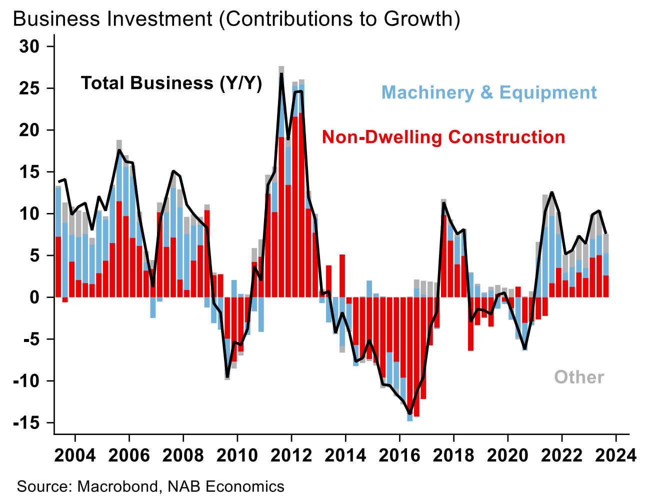
Net exports fell in Q3, driven by a fall in resources exports – though the impact on GDP was partly offset by a run-up in inventories.

Net exports detracted 0.6ppts from quarterly GDP growth. Export volumes fell 0.7% q/q, driven by a 4.7% fall in resource exports, partly offset by a rise in inventories with mining inventories up 8.9% in the quarter.

Rural export volumes jumped 12% q/q and travel services (tourism, students) were up 4.4% q/q. The growth in travel services, while still rapid, was the softest since borders were re-opened. In contrast, with the recovery in outbound travel far less advanced, growth in travel debits has accelerated in each of the last three quarters and in Q3 was 19.4% q/q.

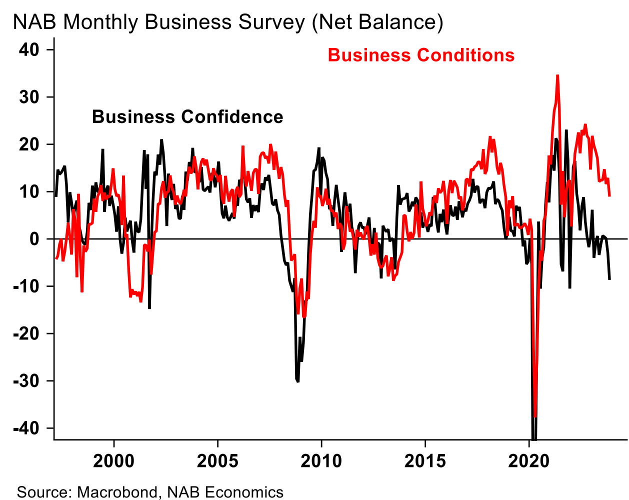
Goods imports also grew, but only by a modest 0.5% q/q, with capital goods rebounding from last quarter's fall (3.4%) and offsetting declines in consumption and intermediate goods imports.

Chart 12: Both construction and machinery & equipment have contributed to investment growth



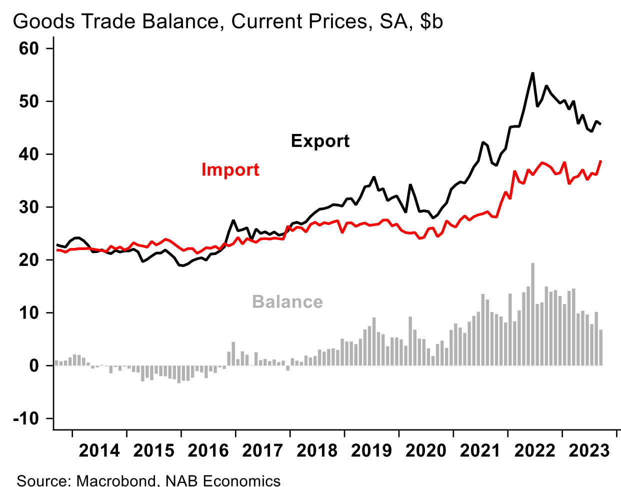
Source: Macrobond, NAB Economics

Chart 13: Business conditions eased in November but remain above average



Source: Macrobond, NAB Economics

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



Source: Macrobond, NAB Economics

Inflation and FX

The monthly CPI indicator surprised slightly to the downside in October, with annual inflation falling to 4.9% y/y.

However, the first month of the quarter sees a heavier weight of goods prices updated, and while we are likely seeing more disinflation (and even deflation in some components) we also know services inflation continues to track more strongly. The November read (published on 10th January) will provide more significant updates to key services components and therefore will be more important for assessing how the broader CPI has tracked in Q4. We see a 0.9% q/q print with downside risk – though the impact of subsidies will mask the true underlying pace of inflation in the quarter. For more detail, see our Q4 CPI preview, released yesterday.

While the true underlying pace of inflation will likely be higher than the top-level prints for the trimmed mean measure, the easing trend in the annual inflation rate will remain intact. Goods prices have been a key support and will likely continue to see the benefit of easing goods demand, lower freight costs and easing supply constraints (particularly for cars).

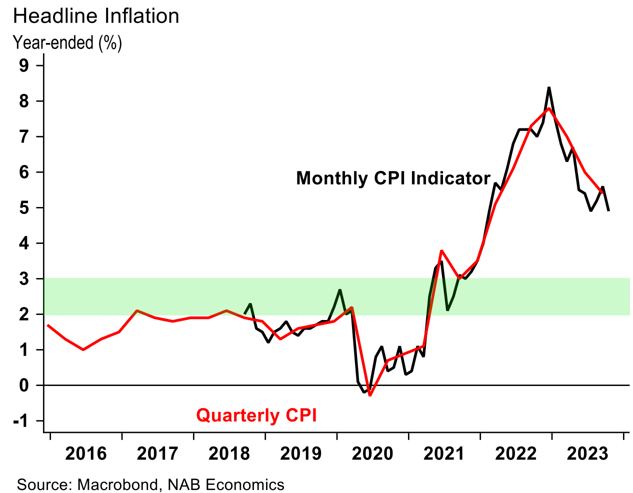
The trend in services inflation will remain key. Services prices have tracked more strongly than goods over recent quarters and are typically stickier (in a levels sense) – suggesting the easing on the downside may be more difficult with less scope to discount amidst weaker demand and ongoing, albeit likely slower, growth in wage costs. However, a broader set of pressures are supporting services prices a present including overheads and energy prices as well as additional "cyclical" wage costs. Therefore, as the economy continues to cool we expect services price pressures to ease further.

Overall, we see underlying inflation moderating to 3.25% by end 2024 (RBA: 3.3%) and 2.8% (RBA: 2.9%) by end 2025. That said, inflation numbers are likely to remain volatile as policy impacts and subsidies unwind. Nonetheless, this profile suggests a fairly orderly moderation in inflationary pressure and while inflation is expected to track well above the top of the RBA's target for an extended period, it returns to target without a major downturn in activity or increase in the unemployment rate.

The AUD/USD strengthened over the month, currently trading around US67.2c and is now up around 7% from its lows (high US62c range) in late October.

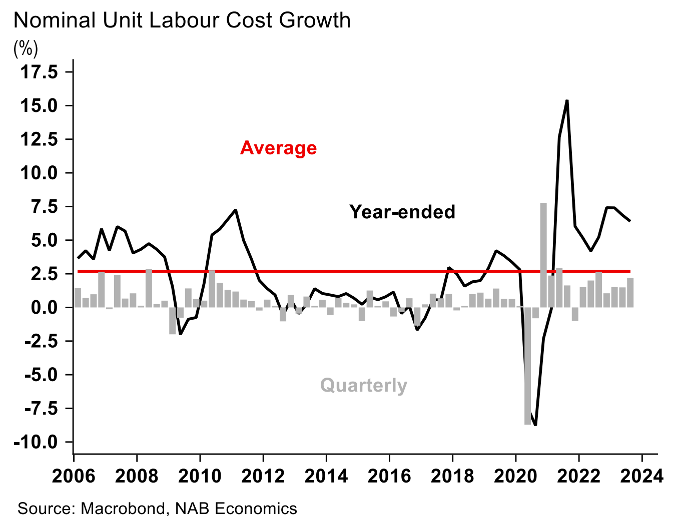
We continue to see the Aussie ending the year at around US66c before tracking higher over 2024 – ending 2024 at around US73c.

Chart 15: CPI pressures continue to ease but how quickly will continue to be important.



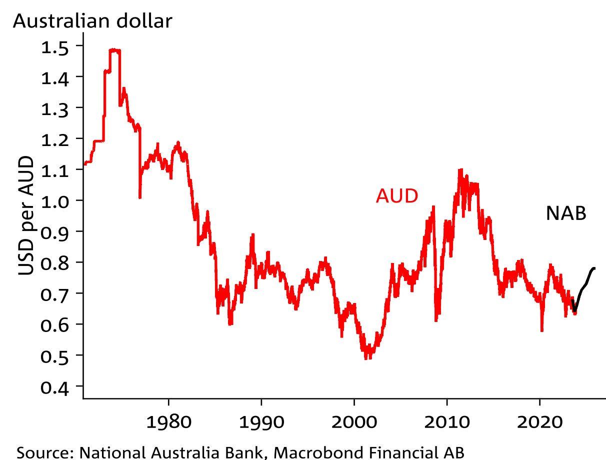
Source: Macrobond, NAB Economics

Chart 16: Unit labour costs growth has been strong and is a key upside risk to inflation over time.



Source: Macrobond, NAB Economics

Chart 17: AUD/USD set to end the year around US66c



Source: National Australia Bank, Macrobond Financial AB

Monetary Policy and the RBA outlook

As was widely expected, the RBA left the cash rate on hold in December following the 13th increase of the current cycle to 4.35% in November.

The post meeting statement noted that only a little new information had become available since the previous meeting – but that the monthly CPI indicator showed goods disinflation continuing to drive a moderation in overall inflation. Overall, the statement provided little new guidance on the outlook and likely reaction function of the RBA.

The broader context remains that rates are working to slow demand and the RBA expects some ongoing passthrough from previous rate rises.

Overall, the post meeting statement continued to read more dovishly than Governor Bullock's recent public commentary and suggests that the RBA continues to tread carefully despite the latest set of staff forecasts implying a further increase in the cash rate.

We continue to pencil in one final hike in February, taking the cash rate to a peak of 4.6% and staying there until late 2024.

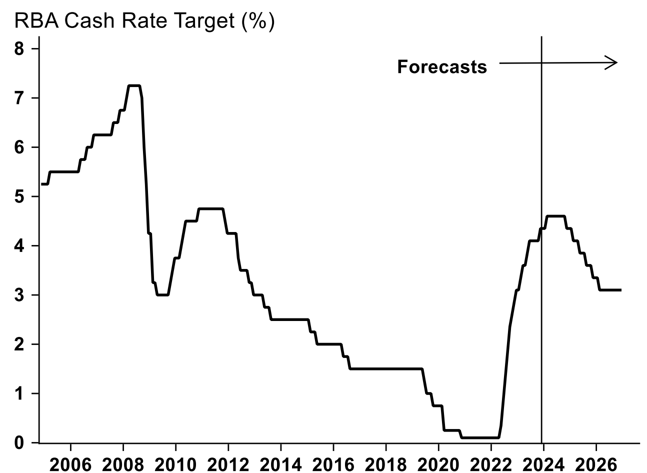
However, the data are unlikely to push the RBA board in the near term in the way that they were pushed in Q3. The impact of subsidies will see inflation moderate substantially in Q4, while goods prices will likely continue to aid the moderation in overall inflation. So while the true underlying pace of inflation will likely be a little higher than observed in the near term, inflation has continued to moderate and according to both our and the RBA's forecasts will be approaching the target band at the end of 2024 (after peaking at a very high 7.8% in Q4 2022).

Inflation expectations appear to have remained well anchored and wage growth is expected to moderate (and broadly be consistent with at target inflation). Indeed, the national accounts continues to suggest that broader wage costs have not reflected as much additional "cyclical" pressure than base wages as was expected.

Further, output growth has now clearly slowed and the pressure on households and thus consumption is increasingly evident. While the labour market has remained healthy, the extreme tightness seen in mid-to-late 2022 as the COVID recovery unfolded appears to have eased.

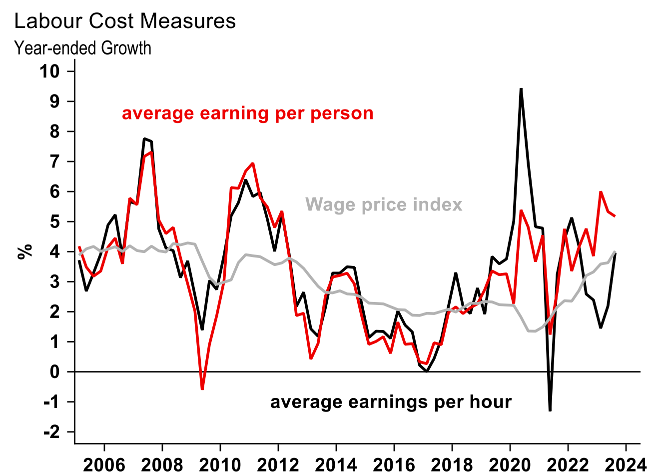
From a broader perspective, whether the RBA takes further action or not is really a trade-off of risks. With growth slowing and inflation moderating only gradually the key risk is that inflation becomes more entrenched or real incomes are further eroded. However, rates have moved relatively quickly and there are lags to activity and then the nominal side of the economy. With the RBA looking to preserve gains in the labour market these lags remain a focus.

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



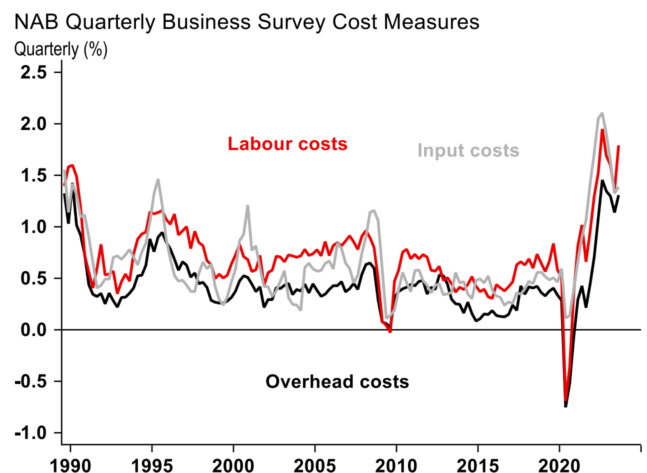
Source: Macrobond, NAB Economics

Chart 19: Wage growth has accelerated but is not excessive



Source: Macrobond, NAB Economics

Chart 20: Businesses continue to report strong cost pressures



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	0.1	0.1	0.0	0.3	4.5	0.5	1.4	1.8
Dwelling Investment	-0.2	0.5	0.2	-0.3	-4.8	0.2	-3.3	0.4
Underlying Business Investment	4.6	2.4	0.4	-1.4	4.5	6.0	0.8	2.8
Underlying Public Final Demand	0.7	2.0	1.0	0.5	2.7	4.3	2.0	2.0
Domestic Demand	**0.7**	**0.9**	**0.5**	**0.2**	**3.1**	**2.2**	**1.5**	**2.2**
Stocks (Cont. to GDP)	0.6	-1.0	0.9	-0.3	0.5	-0.8	0.0	0.1
Gross National Expenditure	**1.1**	**-0.4**	**0.9**	**0.0**	**2.9**	**1.7**	**1.8**	**2.2**
Exports	0.5	4.5	-0.7	0.7	6.7	5.0	1.4	2.1
Imports	3.3	1.8	2.1	0.3	11.7	7.7	2.0	2.3
Net Export (Cont. to GDP)	-0.5	0.8	-0.6	0.1	-0.5	-0.2	-0.1	0.1
Real GDP	**0.5**	**0.4**	**0.2**	**0.2**	**2.3**	**1.4**	**1.7**	**2.2**
Nominal GDP	2.3	-0.7	1.2	0.9	12.0	3.7	4.8	3.9
External Account								
Current Account Balance ($b)	34.1	30.0	30.3	18.3	26.3	18.3	2.7	-20.2
Current Account Balance (% of GDP)	1.3	1.2	1.2	0.7	1.1	0.7	0.1	-0.7
Terms of Trade	3.2	-7.2	-2.7	-0.5	8.0	-7.3	0.7	-4.5
Labour Market								
Employment	0.7	0.9	0.7	0.7	5.3	3.1	0.8	1.5
Unemployment Rate (End of Period)	3.6	3.6	3.7	3.8	3.5	3.8	4.5	4.4
Ave. Earnings (Nat. Accts. Basis)	1.7	0.9	1.9	0.9	3.9	5.6	3.9	3.6
Wage Price Index (WPI)	0.9	0.9	1.3	0.9	3.3	4.1	3.9	3.6
Prices and Rates								
Headline CPI	7.0	6.0	5.4	4.3	7.8	4.3	3.4	2.7
Trimmed-mean CPI	6.6	5.9	5.2	4.3	6.8	4.3	3.2	2.8
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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