Comments from the desk of the Chief Economist: January 2024

NAB Economics

Local Economic Outlook

Last week, we changed our cash rate forecasts on the back of a lower-than-expected inflation outlook. Today we released our latest local and global forecasts (Forward View – January 2024) ahead of the RBA Board meeting next week.

As can be seen in our December Business Survey, growth slowed sharply in late 2023. Business conditions have returned to their long run average after a period of very strong outcomes through late 2022 and H1 2023. Both profitability and trading conditions are now below average, with the overall result propped up with a still healthy read for employment. That said retail and consumer-related sectors are clearly struggling with weak forward orders, weak confidence and below average-conditions. Our internal transactional data suggests the strength in November retail sales were indeed a pull-forward of spending, with an offsetting decline in December.

As we look at the first half of 2024, we see no reason to expect a better half. Indeed, the risks for the consumer are probably on the downside. And more recently there are emerging signs of weaker activity in manufacturing and construction – two very cyclical sectors – via our business survey.

Interestingly, our behavioural surveys also point to growing concerns about job security. That is a very recent development. Thus, in the first half of 2024 we do not expect to see GDP growth of more than ½%. For the second half of 2024, we see Government relief to cost of living pressures (either in the May Budget or earlier) and Stage 3 tax cuts (however formulated) helping to lift momentum while the RBA may begin to gradually ease rates from November. Overall, we expect GDP growth of only 1.7% through the year.

That means the economy will not produce enough jobs to keep the unemployment rate from rising to around 4.5% by end 2024. As we have seen, trend employment growth is currently running around 19k per month. To stabilise unemployment the required rate is nearer 30k.

In many ways, as long as unemployment does not run significantly higher than the gradual deterioration we expect, the consumer can probably struggle through to better times in late 2024 and the prospects of relief from both fiscal policy and rates. That will involve a juggling of their incomes (more hours worked) and their outlays – especially cutting back on non-essential purchases (such as household goods and expenditure on holidays etc).

Effectively we are not changing our activity forecasts because the lower inflation outlook broadly is offset by lower nominal rates. In short real rates are likely to be little changed. The outlook beyond 2024 is for better growth as real rates reduce. We are still expecting growth of around 2.2% during 2025 with the unemployment rate remaining broadly unchanged around 4½%.

On inflation both the official CPI measures and our December Business Survey show good progress on lower goods inflation, while services inflation appears to have peaked. In short, businesses are becoming more concerned about maintaining market share rather than maintaining profit margins. That is how monetary policy works and we don't see any reason for that process to change in the near term.

We expect the trimmed-mean (core) inflation measure slowed to around 4¼% in the year to December 2023. Even though there may be a small rebound in inflation in Q1 as the impact of rent subsidies in Q4 drops out, inflation continues to show an easing trend. In our view, we are likely to see an underlying inflation rate of around 3.1% by late 2024 (previously 3.4%) and close to 2.5% by late 2025.

Those results suggest the RBA will start to cut in late 2024 as more focus turns to the labour market, but the reduction in rates will be at a modest rate. Our path of 25 points of cuts per quarter would see the cash rate at 3.1% by late 2025 – effectively neutral in our view.

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These forecasts always have risks. Much still depends on the reaction of the consumer and it is clear that consumption is not really doing much in real terms (and is even weaker on a per capita basis). The risk of a larger negative reaction as consumers worry about job prospects cannot be ruled out. Also, global developments are an important issue that have the potential to produce shocks in either direction. But on net, our judgment is the global economy is more likely to be a headwind than a help in 2024.

International Economic Outlook

Clearly geopolitical issues loom large - who knows what will happen in the South China Sea, the middle East and Northern Europe. But setting those issues to one side, the world economy is clearly slowing. For 2024 we expect global growth of only 2.7% and 2025 will likely also be below average (around 3.0%).

To-date the US economy has surprised on the upside but it would be a very brave analyst to expect that to continue. Monetary policy is famous for its long and variable lags and the tightening put in place by the Fed will ultimately curb growth. We see growth of only 1.5% in the US in 2024. The impact of global monetary tightening is already apparent in many other parts of the world. Germany and Japan are clearly suffering as is China - all big manufacturing centres. Clearly you would expect commodity prices to weaken in that environment.

Reflecting that, lower inflation and higher real rates will see 2024 as a year of global central banks cutting their nominal rates.

The exact timing will clearly be related to how much the major economies are suffering and how close inflation is to target. It is already clear that manufacturing-based economies are struggling most. So on timing the ECB might come first, then by mid year the US, Canada and New Zealand with Australia towards the end of the year.

The other point to make is that in 2024 it’s the major advanced economies that will be hurting. That said, the prospect of China maintaining a 5% growth rate are not promising – given slower population growth, weaker export markets and potential property market issues. We are expecting Chinese growth of around 4.5% in 2024 with downside risks.

In summary what is clear is that the world outlook (the weakest year since 2000 – ex COVID and the GFC) will not necessarily be helpful to the Australian economy. Hopefully however the globe will avoid an overly hard landing although geopolitical pressures do pose a risk.

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