The Forward View: January 2024

Inflation easing but rate cuts still some time away

NAB Economics

Overview

- Globally, US growth looks to have slowed into Q4 but is still solid while the Euro-zone/UK and Japan economies treaded water in the second half of 2023. Major advanced economy growth is expected to be subdued this year and, with inflation declining, central banks are expected to cut rates (except for Japan). We expect growth in China to slow in 2024 as it continues to struggle due to ongoing softness in domestic demand, the property sector shakeout and weak global demand for exports.
- For Australia, our business survey and transaction data suggest that growth remained weak in Q4 and near-term indicators suggest conditions will remain soft in early 2024.
- Accordingly, we now see the current 4.35% cash rate as the peak for this cycle and expect the RBA to stay on hold until November. From there, we see the RBA easing by 125bps through 2025.
- GDP growth is expected to improve slightly in 2024 but remain below trend, before improving to over 2% in 2025. Household consumption will remain the key dynamic but housing and business investment are also likely to be subdued, weighing on growth.
- Our outlook for the labour market is unchanged with the unemployment rate expected to rise to 4.5% by end 2024. A significant degree of tightness in the labour market has faded but the unemployment rate is still low and forward-looking indicators of labour demand remain healthy.
- On inflation, we now expect 0.8% q/q (4.2% y/y) for underlying inflation in Q4. The monthly partial data points to a larger than expected decline in goods prices, while the introduction of larger rental subsidies will weigh in the quarter.
- Overall, these forecasts point to a soft landing, without a major downturn in activity or scarring in the labour market. While inflation has been high, the supply side impacts are now waning (or even correcting), particularly for goods. On the services side, some components such as rents will likely remain strong but other components will ease as demand growth slows. That will give the RBA more scope to focus on activity and the labour market as the year goes on.

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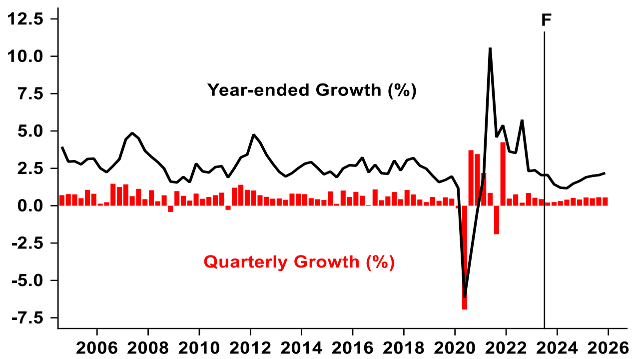
Key Economic Forecasts

	2022	2023(f)	2024(f)	2025(f)
Domestic Demand (a)	5.1	2.2	1.4	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	1.6	1.2
Unemployment Rate (b)	3.4	3.8	4.5	4.4
Headline CPI (b)	7.8	4.2	3.1	2.7
Core CPI (b)	6.3	4.3	3.1	2.6
RBA Cash Rate (b)	3.10	4.35	4.10	3.10
$A/US cents (b)	0.68	0.68	0.73	0.78

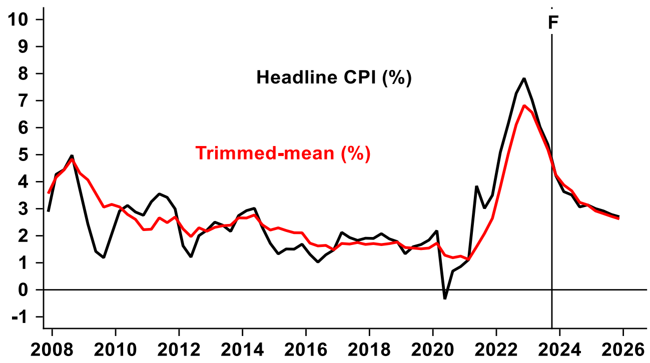
(a) annual average growth, (b) end-period

Chart 1: GDP forecasts



Source: Macrobond, NAB Economics

Chart 2: CPI forecasts



Source: Macrobond, NAB Economics

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Global Update

Global growth is set to slow in 2024 before a modest recovery in 2025. The timing and scale of central bank policy rate cuts is a key uncertainty.

Global inflation trends have diverged in recent months. The disinflation trend in emerging markets stalled from July 2023 onwards (albeit with a large cross-country variation). Inflation in advanced economies has slowed to 3.1% y/y in November 2023 and is closing in on central bank targets.

This has increased the likelihood of central bank policy rate cuts in 2024. At the time of writing, financial markets fully price six 25bp rate cuts by the US Federal Reserve and five by the European Central Bank starting around mid-year. This is even after central bank officials have attempted to downplay expectations of cuts. We expect both the Fed and ECB to ease rates more gradually (by 100bps this year).

China's economy is expected to slow in 2024. Reports suggest that the country's annual growth target will be unchanged this year at "around 5%", but reaching this target will be challenging given the ongoing softness in domestic demand, the property sector shakeout and weak global demand for manufactured goods. The start of this year has also seen a deterioration in domestic equity markets. We expect China to grow by 4.5% this year.

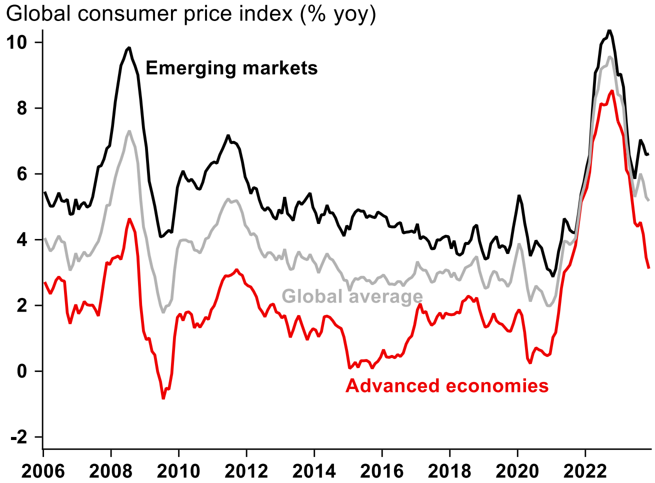
Advanced economy growth is likely to be sluggish in 2024, with growth picking up over 2025, helped by rate cuts. US growth looks to have slowed in Q4 2023 and we now expect it be a little above 2% q/q annualised which is still solid. However, US interest rates are restrictive, and with fiscal policy also likely to be less supportive, we expect subdued growth over 2024. The Euro-zone and UK economies largely stalled over H2 2023, but business surveys suggest the worst has passed and we should see better (but still sluggish) growth over 2024. We expect a similar outcome for Japan.

Overall, global economic growth is expected to slow to 2.7%. Outside the extreme outliers of the global financial crisis and the initial wave of COVID-19, this would be the weakest rate of growth since 2001. We expect a modest recovery to a still below historical average 3.0% in 2025.

We believe the risks around our forecasts are well balanced to both the up and downside. The key uncertainty remains the outlook for central bank policy rates – particularly the timing and size of rate cuts – although given the lagged nature of monetary policy, any changes to rates are likely to have a larger impact next year than in 2024.

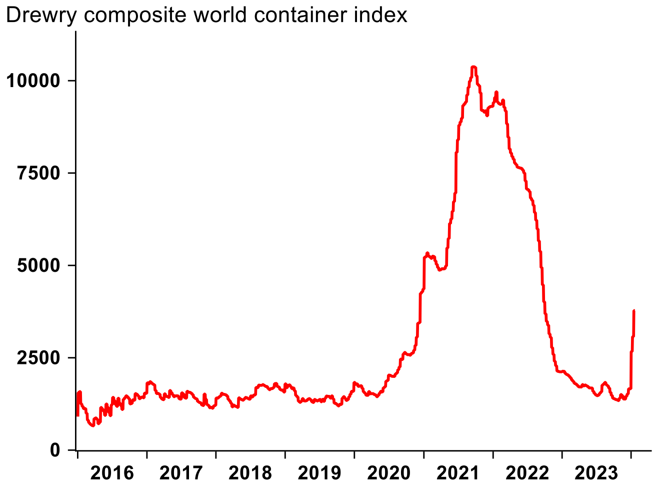
Geopolitical factors remain a risk. Recent disruptions to shipping through the Red Sea and Suez Canal have seen a spike in freight rates which, if sustained, will add to global inflation and is already causing some factory disruptions (but in degree is not close to the peak COVID disruptions). The 2024 US Presidential election brings with it the potential for significant shifts in economic, trade and foreign policy, which could impact the global economy.

Chart 3: Advanced economy inflation continues to fall



Source: Macrobond, NAB Economics

Chart 4: Red Sea shipping disruptions putting pressure on freights and supply chains



Source: Macrobond, NAB Economics

Global economic forecasts

	2022	2023	2024	2025
US	1.9	2.5	1.6	1.2
Euro-zone	3.4	0.5	0.4	1.1
Japan	1.5	2.0	0.4	0.7
UK	4.3	0.5	0.4	0.8
Canada	3.8	1.1	1.0	1.3
China	3.0	5.2	4.5	4.8
India	6.7	7.0	5.8	6.2
Latin America	4.1	2.1	1.4	1.9
Other East Asia	4.2	3.2	3.4	3.9
NZ	2.4	0.7	-0.1	2.7
Global	**3.4**	**3.1**	**2.7**	**3.0**

Household Consumption

Consumption will remain the key dynamic for the economy in 2024, with the pressures on household budgets expected to persist in the near term, but likely begin to ease in H2 2024.

Our internal transactions data suggests that household consumption growth remained soft in Q4 after the Q3 national accounts confirmed a sharp slowing, with a flat outcome for real spending in the quarter. Strong population growth has masked some of the slowing in spending growth with per capita spending continuing to fall in Q3 and likely to have done the same in Q4.

Our data also suggests retail sales fell by 1.3% in December after rising by 1.4% in November. This implies that the spike in retail sales in November was indeed due to the ongoing growth of Black Friday sales which have continued to see a pull-forward of spending from December – rather than a rebound in the pace of underlying spending growth.

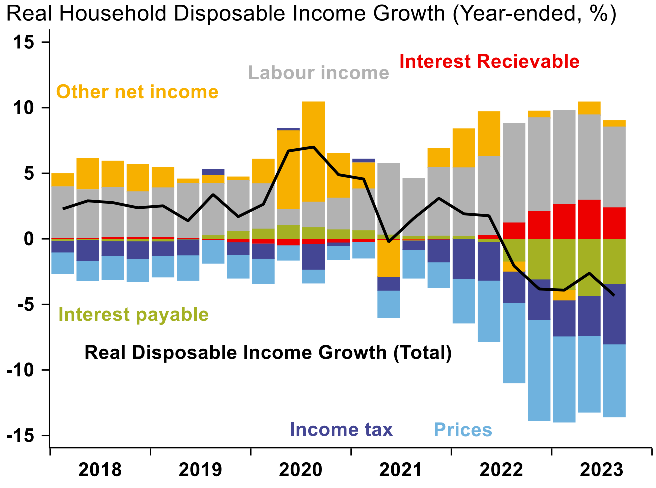
Looking forward, in the near-term, the increasingly evident pressures of higher rates and inflation will likely continue to weigh on real disposable incomes. Therefore, we expect consumption growth to remain very modest in H1 2024. To date, households have adjusted via a lower savings rate (and likely for some parts of the income distribution a run down in savings built up during the pandemic). The gross savings rate has fallen sharply (from high levels during the pandemic) and is at its lowest since pre-pandemic.

With inflation easing and wage growth holding up the inflation-wage gap will narrow, easing some pressure. Likewise, while the higher tax burden and ongoing passthrough of interest rates continue to weigh on disposable incomes, these headwinds should also ease following the Stage 3 tax cuts (however configured) and, later in the year, as interest rates begin to decline.

Conditions in the labour market will also become increasingly important with strong income growth having been a key support/offset to some of the pressure on incomes and savings. Indeed, our NAB Consumer Sentiment Survey shows that concerns around unemployment have risen and this may lead to households becoming more conservative in their savings decisions, leading to a larger pull back in spending.

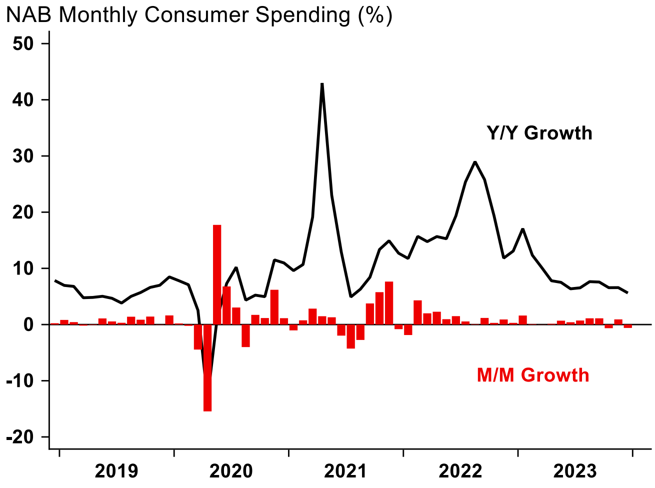
For now, the labour market remains healthy, with the unemployment rate unchanged at 3.9% in December. That said, unemployment has drifted higher over the past 6 months, and we expect it to continue to do so. The recent run of labour force releases has confirmed that employment growth is now tracking below the rate required to keep unemployment constant amidst the ongoing strength in population growth.

Chart 5: The pressures on household budgets will persist in the near-term



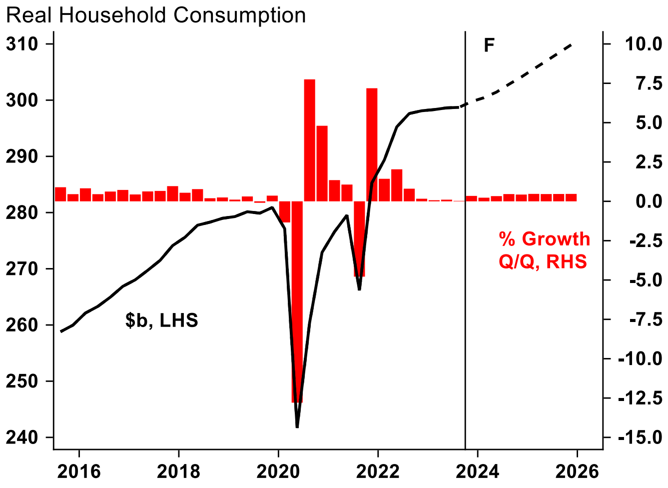
Source: Macrobond, NAB Economics

Chart 6: Transaction data suggest spending declined in December after a pickup in November



Source: Macrobond, NAB Economics

Chart 7: Consumption growth is expected to be muted in H1 2024 in real terms



Source: Macrobond, NAB Economics

Housing and Construction

Housing market dynamics will remain supportive of prices in the near term with rents still growing strongly, new supply continuing to ease and population growth remaining solid.

Though lagged, the building activity survey for Q3 (released last week) showed that despite a rise in completions in the quarter, new supply in coming quarters may continue to be challenged with commencements falling 10% q/q, to the lowest level since 2012.

The pipeline of outstanding work (264k dwellings) remains elevated. The inflow into the pipeline, building approvals, have risen a little from their decade low in January 2023, but have broadly stabilised at a relatively low level – around the pre-pandemic trough which had been the weakest outcome since 2012.

As a result, we expect dwelling investment to remain weak in the near term. This will have implications for both economic activity and inflation.

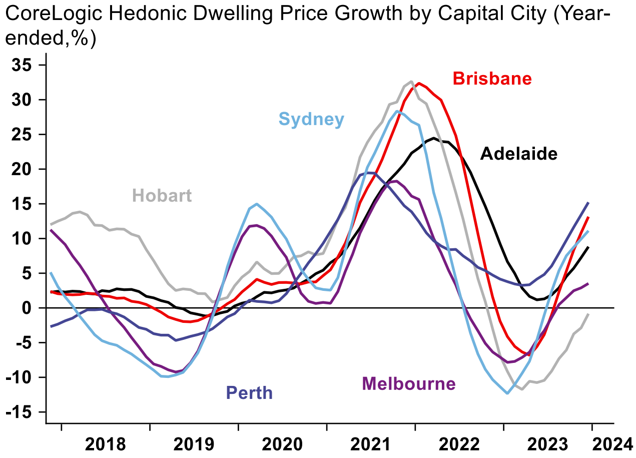
On activity, slowing rates of construction will weigh through its direct effects in GDP as well as the large multiplier to other industries such as manufacturing.

In terms of inflation, slowing rates of work done should ease demand for inputs and put some downward pressure on construction prices which are around 30% above Q4 2019. That said, the pipeline is large and anecdotally labour constraints are still a factor in the sector. The NAB Business Survey shows that capacity utilisation remains above average but has eased in the construction industry. The ongoing imbalance between supply and demand in the rental market will see rents growth remain relatively strong in the near-term. This will directly contribute to inflation.

For dwelling prices, it suggests that there will be ongoing upward pressure, despite the affordability constraints that emerged over 2023. Indeed, house prices continue to rise, up 0.4% in January to be up 9.3% over the year. House price growth slowed in both Sydney and Melbourne in Q4, and weekly data suggest it has remained weak in January to date. Price growth in the smaller capitals – Brisbane, Adelaide and Perth – remains stronger. Our outlook for house prices is unchanged, seeing a gain of around 5% over 2024, with demand an ongoing support.

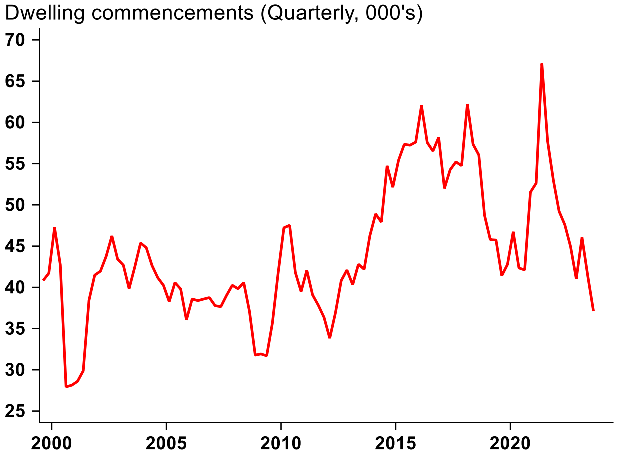
On the rental market, vacancy rates remain very low, at around 0.5%. Therefore, it is likely rents growth will remain elevated for the foreseeable future – though it has eased from its peak of over 10% y/y to around 8% y/y currently.

Chart 8: House prices growth is diverging across the capitals



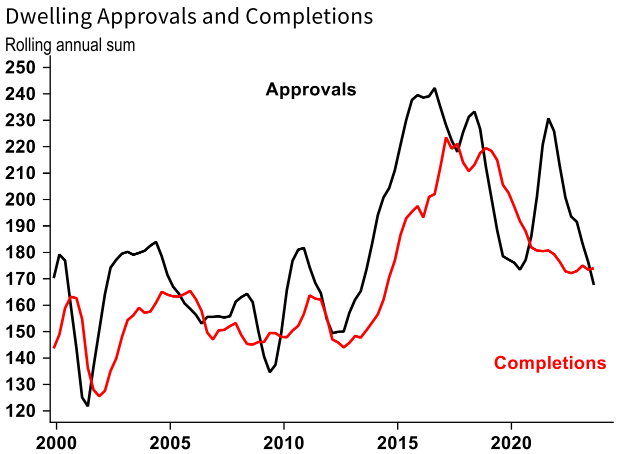
Source: Macrobond, NAB Economics

Chart 9: Despite an elevated pipeline of work, commencements continue to decline



Source: Macrobond, NAB Economics

Chart 10: Approvals have stabilised at a low level and point to an ongoing slowing in activity as the pipeline is worked through



Source: Macrobond, NAB Economics

Inflation and FX

We expect a 0.8% (4.2% y/y) print for underlying inflation in Q4 with the monthly CPI indicator pointing to a larger than expected easing in goods price inflation in both October and November.

In part the easing in trimmed mean inflation in Q4 was aided by the increase in rent assistance (a subsidy) which has the one-off impact of lowering the rental price level. This impact will wane in Q1 – and rents growth remains strong – so we may well see some reacceleration in the quarterly pace, though annual inflation will likely continue to show an easing trend.

Many of the easy gains in bringing down inflation have now been exhausted, though a larger than expected fall in many goods prices has offset the ongoing strength in services inflation. How long this can persist remains uncertain, but the very large run-up in goods prices during the pandemic suggests that there is room for ongoing adjustment in the near-term.

The outlook for services inflation, which remains high though appearing to have peaked, is more mixed. Rents (~6% weight in CPI) will likely bolster market services for some time. However, other services prices have been boosted by broad-based input cost growth.

With minimum wage increases expected to be smaller this year and next, and with overhead and energy cost pressures likely to ease, we expect that services inflation will also moderate. For now, these factors do not appear to have become 'baked-in' to the wage bargaining process or inflation expectations more generally.

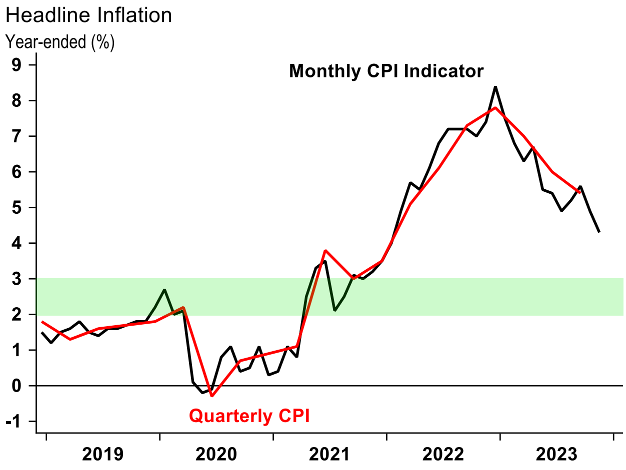
Further, like goods, weak consumer demand growth may place some downward pressure on margins. Therefore, alongside our forecasts for activity and the labour market we expect inflation to continue to moderate through 2024, with inflation falling to 3.2% y/y by Q4 and for inflation to be tracking in the top half the RBA's target band by end 2025.

Encouragingly, the NAB Monthly Business Survey for December showed a marked easing in both labour cost and purchase cost growth in the month, and a slower pace of retail price growth. While the survey price measures can be volatile on a monthly basis, if sustained in early 2024 this would be a material moderation in reported price pressures which had remained high through mid-to-late 2023.

The AUD/USD has weakened in early 2024 is currently around US65.9c.

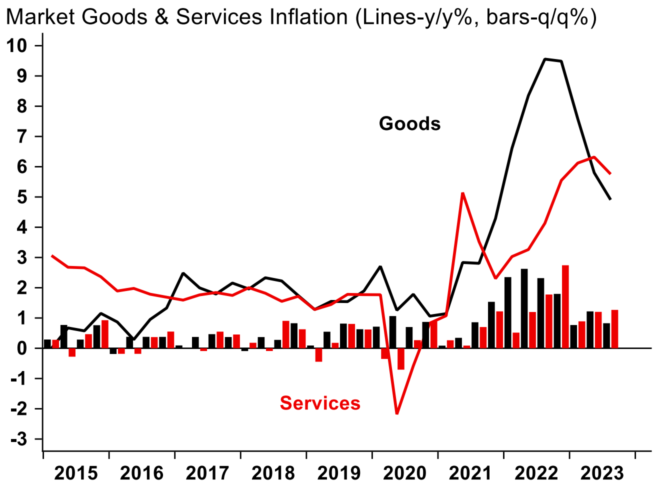
The AUD is expected to track higher over 2024 – ending 2024 at around US73c.

Chart 11: Inflation is expected to ease to around ~4.2% y/y in Q4



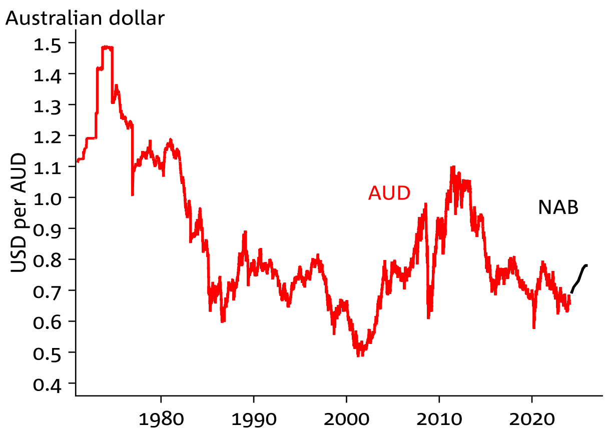
Source: Macrobond, NAB Economics

Chart 12: Goods inflation is easing while services remains elevated



Source: Macrobond, NAB Economics

Chart 13: AUD/USD still expected to appreciate



Source: National Australia Bank, Macrobond Financial AB

Monetary Policy and the RBA outlook

We now expect the RBA to remain on hold in February, making 4.35% the peak for the cash rate in this cycle.

We previously had expected the RBA to take some further "insurance" and increase rates according to their own forecast track to ensure that inflation would return to target within the next two years – reflecting that the risks remained firmly to the upside of this profile over 2023. However, the downside surprises to inflation – mainly coming through a correction in goods prices – means the data flow will not push the RBA at the February meeting in the same way as in November.

In the context of still high services inflation and the uncertainty over how long goods prices will decline there is still some risk for the RBA in achieving its forecast inflation track but given the seeming reluctance by the board to move higher we think the RBA will take the win in the short term and remain on hold. Rates are in restrictive territory and the impacts of previous increases are still flowing through. There is also increasing evidence in hard data that growth has slowed.

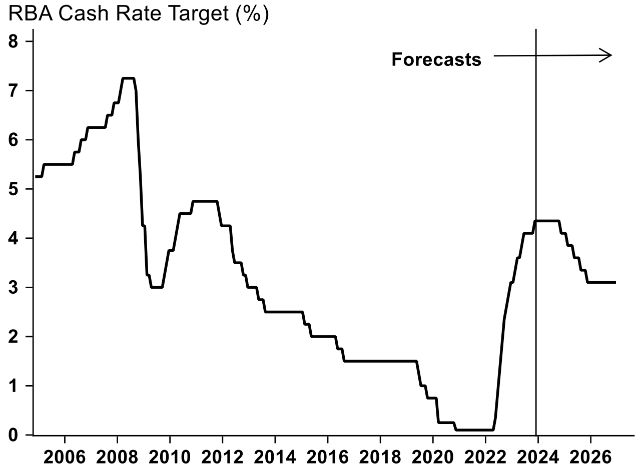
Further, with inflation easing slightly more quickly than expected at the November SMP, but unemployment coming in broadly as expected, the RBA Board will hope to hold onto most of the gains in the labour market (RBA staff forecasts see a peak unemployment rate of 4.25%).

That said, we don't see anything in the data yet that means rate cuts are imminent and the RBA is unlikely to move to an easing bias in the near term. Rather, they will sit and assess the impact of previous increases and the evolution of risks for inflation which look to have squared up over recent months. Nonetheless, as a forward-looking central bank, the RBA will eventually need to move rates back towards neutral as inflation fades and unemployment continues to rise.

We expect the RBA to begin easing from November, cutting rates by 125bps through 2025 to 3.10% which we see as broadly around neutral.

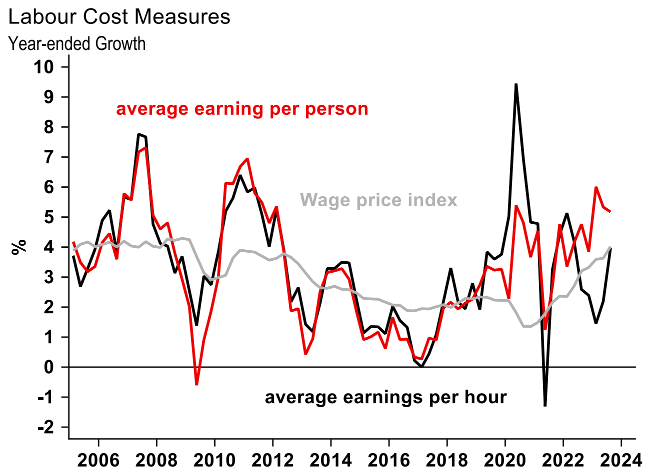
Taken together with our forecasts for GDP growth (which remains positive) and the labour market where tightness eases but generally remains healthy, we see the RBA as having navigated bringing inflation back to target without needing to drive a large downturn in activity. Helpfully, inflation expectations have remained anchored and despite the tightness in the labour market (and some very strong minimum wage outcomes) higher wage growth has not become embedded in the wage bargaining process.

Chart 14: The Cash rate is expected to remain on hold until late 2024



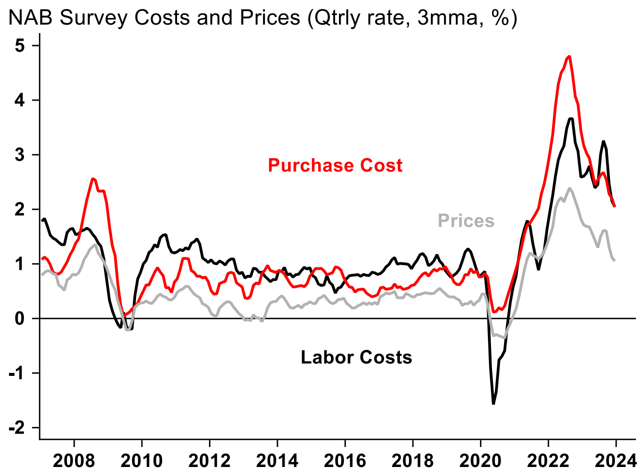
Source: Macrobond, NAB Economics

Chart 15: Wage growth has accelerated but is expected to slow from here



Source: Macrobond, NAB Economics

Chart 16: Cost and price growth in the NAB Survey is continuing to ease



Source: Macrobond, NAB Economics

Table of Economic Forecasts

	% Growth q/q				% Growth y/y			
	Q3-23	Q4-23 (f)	Q1-24 (f)	Q2-24 (f)	2022	2023 (f)	2024 (f)	2025 (f)
GDP and Components								
Private Consumption	0.0	0.3	0.2	0.3	4.5	0.5	1.5	1.9
Dwelling Investment	0.2	-0.3	-0.8	-1.4	-4.8	0.2	-4.3	0.9
Underlying Business Investment	0.4	-1.6	-0.6	0.3	4.5	5.8	0.2	2.6
Underlying Public Final Demand	1.0	0.5	0.5	0.5	2.7	4.3	2.0	2.0
Domestic Demand	**0.5**	**0.2**	**0.2**	**0.3**	**3.1**	**2.3**	**1.4**	**2.2**
Stocks (Cont. to GDP)	0.9	-0.3	-0.1	0.0	0.5	-0.8	0.0	0.1
Gross National Expenditure	**0.9**	**0.0**	**0.3**	**0.5**	**2.9**	**1.7**	**1.7**	**2.2**
Exports	-0.7	0.7	0.4	0.4	6.7	5.0	1.4	2.1
Imports	2.1	0.4	0.4	0.7	11.7	7.7	1.9	2.3
Net Export (Cont. to GDP)	-0.6	0.1	0.0	0.0	-0.5	-0.2	0.0	0.1
Real GDP	**0.2**	**0.2**	**0.3**	**0.4**	**2.3**	**1.4**	**1.7**	**2.2**
Nominal GDP	1.2	0.9	1.3	1.2	12.0	3.7	4.7	3.8
External Account								
Current Account Balance ($b)	30.3	18.3	8.1	1.8	26.3	18.3	3.0	-20.1
Current Account Balance (% of GDP)	1.2	0.7	0.3	0.1	1.1	0.7	0.1	-0.7
Terms of Trade	-2.7	-0.5	1.4	0.6	8.0	-7.3	0.7	-4.5
Labour Market								
Employment	0.7	0.7	0.2	0.2	5.3	3.0	0.9	1.5
Unemployment Rate (End of Period)	3.7	3.8	4.1	4.2	3.4	3.8	4.5	4.4
Ave. Earnings (Nat. Accts. Basis)	1.9	0.9	0.9	0.9	3.9	5.6	3.9	3.6
Wage Price Index (WPI)	1.3	0.9	0.9	0.9	3.3	4.1	3.9	3.6
Prices and Rates								
Headline CPI	5.4	4.2	3.6	3.5	7.8	4.2	3.1	2.7
Trimmed-mean CPI	5.2	4.2	3.9	3.7	6.8	4.2	3.1	2.6
RBA Cash Rate (End of Period)	4.10	4.35	4.35	4.35	3.10	4.35	4.10	3.10
10 Year Govt. Bonds (End of Period)	4.49	3.96	4.40	4.40	4.04	3.96	4.05	3.90
$A/US cents (End of Period)	0.65	0.68	0.69	0.71	0.68	0.68	0.73	0.78

Data are percentage growth rates over the quarter or year as noted, except where specified otherwise.

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