Comments from the desk of the Chief Economist: February 2024

NAB Economics

Local Economic Outlook

We have recently released our monthly business survey and our local and global outlooks as well as our NAB Data Insights. So where are we now?

To me, the NAB Business Survey for January showed further slowing in momentum with business conditions, confidence, and forward orders now all at below long-run averages. That said, the economy is still growing – albeit at a slow rate. There are however pockets of real weakness – especially retail/wholesale and manufacturing (which is obviously very rate sensitive). Forward indicators are also not shooting the lights out.

Against that our internal bank data suggested that retail spending was better in January – up around 1½%. But business revenues suffered. The other part of the survey that was interesting was a kick up in retail and purchase costs. While not alarming, it appears that after significant discounting in late 2023, business returned to trying to improve their margins.

As mentioned last month, our latest consumer survey suggested that individuals are now more concerned about their ability to get/keep their jobs. Obviously, the ABS Labour market data reinforced that concern. But a word of caution as this is an extremely seasonal period and the ABS noted that there were more than 20k individuals who had a job but were yet to start work. So, to me, I'd like to see the February data before getting too nervous. That said over the past 6 months unemployment has increased by around ½ a percent. Clearly an easing from the very tight labour market we had seen over the preceding year.

A couple of other data points are interesting. Our Q4 SME Survey showed weaker conditions and confidence at the SME level than our NAB Quarterly Survey which focuses on larger firms. And that the smaller the firm the worse the results - especially their cash flows. Also, our Commercial Property survey suggested that while CBD Hotels and Industrial are very strong, Office and CBD retail are not.

So, there are lots of different pressures at present but on our Australian forecasts we essentially have not changed much. As we look at the first half of 2024, we see no reason to expect much improvement from the current very slow growth. Indeed, the risks for the consumer are probably on the downside. That said, for the second half of 2024, we see Government relief to cost of living pressures, and Stage 3 tax cuts helping to lift momentum while the RBA may begin to gradually ease rates from November. Overall, we still 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 20k per month. To stabilise unemployment the required rate is nearer 40k.

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). Clearly there is much stress in both the bottom end of the income distribution (especially renters), as well as the mortgage belt.

For 2025 we are still expecting growth of around 2.2% with the unemployment rate remaining broadly unchanged around 4½%.

On inflation, despite some bumps along the road, we expect further progress on inflation with the trimmed mean falling to just above 3% by end 2024 and the top half of the RBA's target band by end 2025. In short, businesses are becoming more concerned about maintaining market share rather than maintaining profit

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margins. That is how monetary policy works and we don't see any reason for that process to change in the near term.

Our forecasts for activity are now very similar to the RBA – albeit they see core inflation not back to the middle of the target till early/mid 2026. As the Reserve Bank becomes more forward looking and with policy already restrictive, we expect that the RBA will need to starting cutting in late 2024 as more focus turns to the deteriorating labour market. After the late 2024 cut we see another 100 points of cuts in 2025 to bring the cash rate to 3.1% by late 2025 – effectively neutral in our view.

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 much worse on a per capita basis). The risk of a larger negative reaction as consumers worry about job prospects cannot be ruled out. To me, the critical downside risk is a faster than expected increase in unemployment. Were that to happen, the consumer's ability to juggle cash flows (increased employment and lower consumption in the near term) could be severely compromised.

Also, global developments are an important issue that have the potential to produce shocks in either direction. But on net, our judgment remains that 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. We expect global growth of only 2.8% in 2024 and 3% in 2025 still below average (around 3.4%).

Looking at recent developments, most of the world, excluding the US, is really struggling. Japan, Germany and the UK are in technical recession and Europe overall is skirting recessionary times. So why has the US done so well? There are several reasons, but one factor was fiscal expansion in 2023. However, fiscal policy will turn to a headwind in 2024 and interest rate settings are still clearly restrictive. So, we are expecting GDP growth of only around 1.1% over 2024 – albeit year average numbers will be around 2%. China's growth prospects are not great in a world of much slower demand and internal property market concerns. Meanwhile the Chinese consumer is very cautious. In brief we only expect growth of around 4.5% this year.

Reflecting all of the above, lower inflation and higher real rates will see 2024 as a year of global central banks cutting nominal rates, albeit there is a risk that some recent higher than expected inflation readings may delay the expected timing of rate cuts.

At this stage the ECB could be the first cab off the rank to cut. Most others – including the US Fed, Canada and the Bank of England could be mid-year while Australia (and New Zealand) could be nearer to the end of 2024 (November). The exact timing will clearly be related to how much the major economies suffer and how close inflation is to target.

In summary what is clear is that the world outlook (the weakest year since 2002 – excluding COVID and the GFC) will not be helpful to the Australian economy. Hopefully however the globe will avoid an overly hard landing although geopolitical pressures do pose a risk.

Finally on a more positive note, if our and the RBA's forecasts for Australia in 2025 are approximately right, then Australia will return to trend growth (around 2.2%), unemployment will still have a 4 in front of it (our forecast at 4.4%) and the RBA will be back into its inflation target with cash rates around neutral. That would be an excellent outcome and would cast Australia in a very positive light globally.

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