Comments from the desk of the Chief Economist: March 2024

NAB Economics

Local Economic Outlook

Over the last month we have had lots of new data. That includes the Q4 GDP release, our NAB Business Survey and data notes, the RBA and finally yesterday's labour force estimates for March. So where are we and where to from here?

To me, the national accounts showed an economy losing momentum with the consumer and the construction sectors struggling. Our February Business Survey was similar in that it suggested overall business conditions were OK, but some areas showed real stress, including very weak forward orders in retail, wholesale and construction. In turn, that showed up in the confidence readings in those same sectors and overall confidence and orders at subpar levels. A combination of forward orders less stocks (often used overseas as an indicator of stress) suggested little new momentum into Q1 of 2024.

Our NAB data notes suggest that after a better January the consumer again struggled in nominal terms. And revenue of Business bank customers continues to be very subdued. Against that our NAB Business Survey suggested that after a struggle in late 2024 retailers increased prices. So, the ride down in inflation will be bumpy even if it continues to track down in year-on-year terms.

On a more positive note, the labour market looks less alarming. After the February numbers, the key message to me is that the kick up in unemployment in the last few months reflected seasonal adjustment problems rather than a rapid deterioration in the labour market. At 3¾%, unemployment has been relatively steady recently (after increasing from around 3½% in mid-2023) but is still likely to deteriorate moderately over the rest of the year.

So where is the RBA at? The markets are saying that this week's post meeting statement from the RBA was less hawkish. A lot depends on whether you really believe the RBA was seriously thinking of tightening rates in February. Personally, I doubt it. To me, both statements were talking about balanced risks (albeit the latest statement is probably clearer on that). That is, the RBA is still concerned that services inflation is too high (and we won't get a full read on that till late April) while the RBA is still worried about the consumer and whether unemployment accelerates faster than expected. They have also added concerns about China and geo-political risks. So it is not surprising that the Board is not ruling anything in or out when it comes to the future direction of rates.

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 the reconfigured 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.

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For 2025 we are still expecting growth of around 2.3%, with the unemployment rate remaining broadly unchanged around 4½%.

On inflation, despite some bumps along the road, we expect further progress with the trimmed mean falling to just above 3% by end 2024 and into 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 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 very similar to the RBA's at their February update – albeit they see core inflation not back to the middle of the target till mid 2026. As the Reserve Bank becomes more forward looking and with policy already restrictive, we expect that they will need to start 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 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.

It is however worth noting that the outlook in 2025 is quite encouraging. On our numbers GDP will be growing at around 2.3%, unemployment will still have a 4 in front of it, inflation will, by late in the year, be in the middle of the target range and the cash rate will, at 3%, be broadly neutral. That is a very encouraging outlook and globally will be impressive.

International Economic Outlook

Clearly geopolitical issues loom large - who knows what will happen in the South China Sea, the Middle East and Eastern Europe. But setting those issues to one side, the world economy is clearly slowing. We expect global growth of only 2.9% in 2024 (we revised that up from 2.8% basically due to better than expected data in India and Russia) and 3% in 2025, so still below average (around 3.4%).

Looking at recent developments, most of the world, excluding the US, is really struggling with Japan, the European Union and the UK either in or near recession. 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 in the US 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 policy 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 we see the main central banks cutting around midyear – including the Fed, the ECB, and the Bank of Canada. On current data flows the Bank of England could be a few months behind, 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.

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