The Forward View: Australia March 2024

Growth subdued but will improve in late 2024

NAB Economics

Overview

- After Q4 GDP data confirmed a very subdued end to 2023, we expect growth to remain below-trend in the near term – but activity should improve later in the year as the pressure on households eases with rate and tax cuts as well as a moderation in inflation.
- The National Accounts release showed growth of just 0.2% q/q in Q4 – in line with NAB's forecasts – with annual growth falling to 1.5% y/y. Flat consumption was the defining story of the year, but declining dwelling investment and slowing business investment growth were also notable. Public demand and recovering exports provided offsetting support for growth.
- We continue to expect growth to remain below trend at 1.7% over 2024, before improving to around 2¼ % in 2025 and 2026. Household consumption will remain subdued in the near term but should pick up later in the year, while housing and business investment are also likely to be subdued before turning up later in the year.
- Households will continue to be supported by strong nominal income growth with hourly wages rising at their fastest annual pace since 2009. We expect wage growth to stabilise from here as the labour market eases further over the year ahead, and continue to see the unemployment rate peaking at 4.5% by end-2024.
- On inflation, price growth measures in the national accounts continued to ease in annual terms, albeit by less than CPI. Nonetheless, the subdued pace of demand growth and ongoing supply-side recovery – including the labour supply – should see further gradual progress towards the RBA's target band. Our profile has inflation returning to just over 3% by end-2024 and near the middle of the RBA's target band by end-2025.
- With the effects of restrictive monetary policy evident in activity data and inflation trending in the right direction, we see further rate rises as unlikely. A lift in measured productivity in Q3 and Q4 was also a welcome sign for policy makers, albeit the RBA's longer-term assumption of 1% annual growth remains optimistic.
- Given that inflation remains well above target, we expect the RBA Board to continue to take a cautious approach with November the most likely timing for a first rate cut. From there we see a profile of gradual rate cuts, back to around 3% by end-2025.

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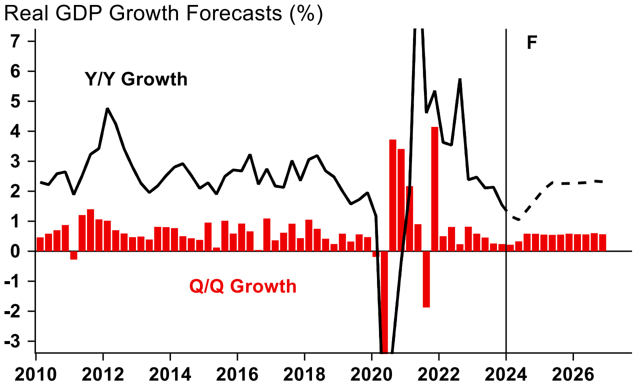
Key Economic Forecasts

	2023	2024(f)	2025(f)	2026(f)
Domestic Demand (a)	2.3	1.2	2.0	2.4
Real GDP (annual average)	**2.1**	**1.3**	**2.2**	**2.3**
Real GDP (year-ended to Dec)	**1.5**	**1.7**	**2.3**	**2.3**
Employment (a)	3.3	1.8	1.5	2.0
Unemployment Rate (b)	3.9	4.5	4.4	4.3
Headline CPI (b)	4.1	3.1	2.6	2.4
Core CPI (b)	4.3	3.1	2.5	2.4
RBA Cash Rate (b)	4.35	4.10	3.10	3.10
$A/US cents (b)	0.68	0.72	0.78	-

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

Chart 1: GDP forecasts

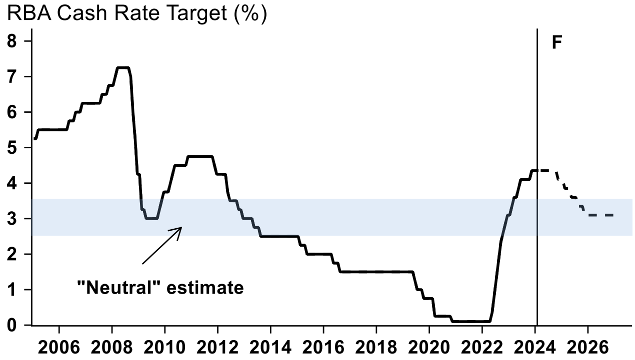
Real GDP Growth Forecasts (%)



Source: Macrobond, NAB Economics

Chart 2: Cash rate profile

RBA Cash Rate Target (%)



Source: Macrobond, NAB Economics

19 March 2024 | Gareth Spence, Head of Australian Economics | Brody Viney, Senior Economist | Alan Oster, Chief Economist

Labour Market, Wages and Consumption

Hourly wage growth reached 4.2% in Q4, and wider measures were even stronger. However, there are clear signs of easing in the labour market.

The Q4 wage price index (WPI) showed hourly wages rose 0.9% q/q (4.2% y/y), the fastest annual rate of growth since 2009. However, the quarterly pace was a step down from Q3 (when minimum and award wage increases took effect). Both public and private sector wages grew at a similar rate across 2023 as enterprise agreements caught up with the strength seen in individual agreements earlier in the cycle.

Notably, the wider national accounts measure of average hourly earnings rose by a more rapid 5.8% across 2023, reflecting significant compositional effects as workers have moved into higher paying roles in a tight labour market.

That said, there are clear signs of easing in the labour market with the population now caught up to its pre-pandemic trend and the unemployment rate up to 4.1% in January. We expect correcting seasonal effects to support employment growth when February data is released but regardless see gradual further easing in the labour market as economic growth remains subdued this year, taking the unemployment rate to 4.5% by year end.

Further out, improving growth and normalising population should see the unemployment rate stabilise around 4¼-4½%. The easing labour market should limit the scope for further acceleration in underlying wages, which we see stabilising in the 3½-4% range.

The national accounts confirmed household consumption growth was negligible in 2023 but some of the pressures on households are set to ease.

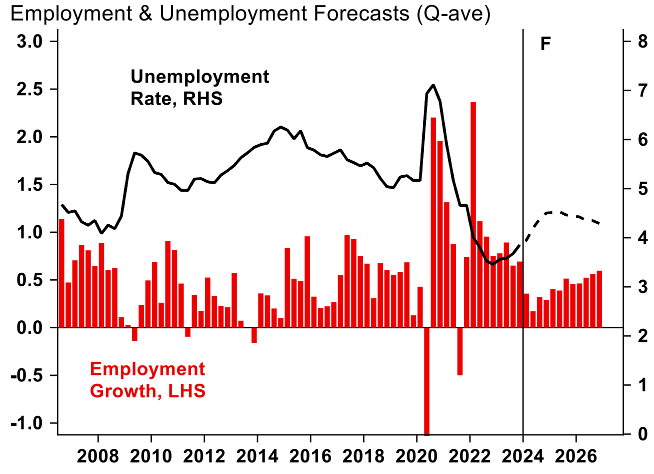
Real household consumption rose 0.1% in the quarter, leaving consumption growth at just 0.1% y/y for 2023. This is the slowest year-ended growth in household consumption in almost 40 years outside of COVID and the GFC.

Consumption of essentials rose 0.7% q/q to be 1.2% higher over the year, offset by 0.9% q/q fall in discretionary consumption which declined 1.6% over the year. That reflects the significant adjustments made by households as high inflation and rising interest costs continued to weigh on real disposable income.

Notably, consumption by international students is not included in household consumption, instead counting as an export in GDP data. We estimate that if students' consumption was included, consumption growth would have been 1.1% across 2023, helping to explain why business survey measures of demand have remained resilient.

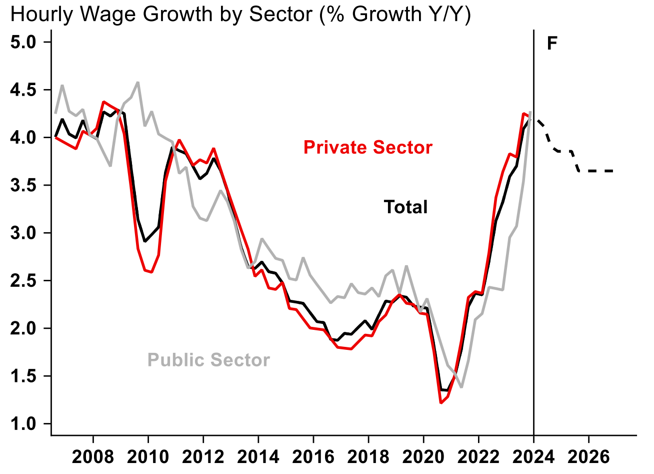
Nominal retail sales data showed a 1.1% rise in January but we expect household consumption to remain subdued in the near term. As 2024 goes on, however, the persistent strength in nominal incomes alongside easing inflation, tax cuts and (eventually) interest rate cuts should boost real disposable incomes and see consumption growth strengthen.

Chart 3: There are clear signs of easing in the labour market but the unemployment rate gradually rising



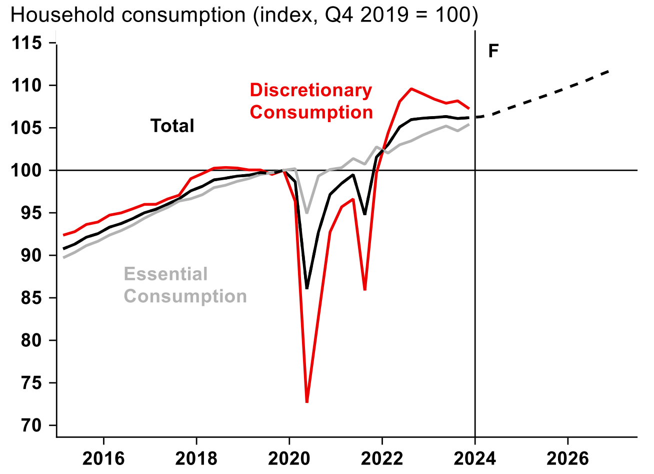
Source: Macrobond, NAB Economics

Chart 4: Wage growth has risen to over 4%, the fastest rate since 2009



Source: Macrobond, NAB Economics

Chart 5: Household consumption was flat in 2023 but should strengthen over time



Source: Macrobond, NAB Economics

Housing and Business

House prices continue to rise at a moderate pace, with rises in the smaller capitals outpacing growth in Sydney and Melbourne.

The CoreLogic 8-capital city dwelling price index rose by 0.6% in February to be 10% up over the year. Price growth remains highest (and very strong) in Perth, at 1.8% m/m thought is also strong in Brisbane (1.1%) and Adelaide (0.9%). Sydney prices rose 0.5% in the month while Melbourne edged higher. The capital city index is now 25% above its pre-COVID level, with prices in Brisbane, Adelaide and Perth around 50% higher. This has occurred despite the sharp rise in interest rates and associated reduction in borrowing power reflecting the sheer strength in demand.

Similarly, rental vacancies remain low with PropTrack data showing a vacancy rate of 1.1% for Sydney and Melbourne and around 0.8% across the other major capitals. CoreLogic rents growth continues to track strongly at 9.3% y/y.

We continue to see house prices rising by around 5% this year and next with the demand and supply imbalance likely to persist. Though we expect population growth to slow as the level of students in the country normalises and "catch-up" in other areas of migration runs its course it will remain above pre-pandemic rates in 2024.

The supply side will likely remain challenged with little evidence of a normalisation in input costs and other capacity constraints. Indeed, dwelling approvals remain low (despite stabilising) and imply further falls in the annual completions rate in the near term.

Underlying business investment rose in Q4, while more recently business conditions rose in February.

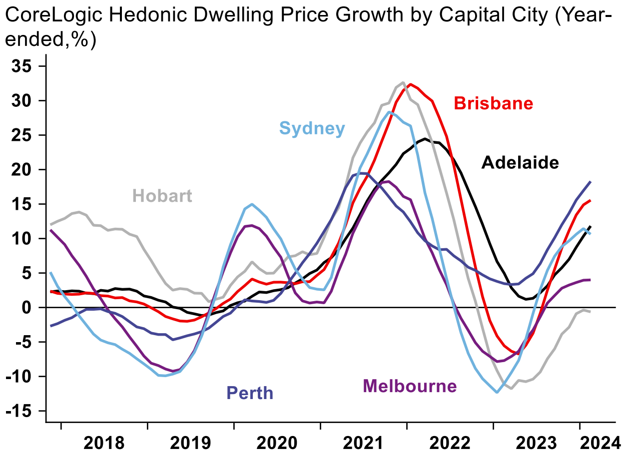
The national accounts showed a 0.7% q/q rise in underlying investment to be 8.3% higher over the year. New machinery & equipment investment fell (down 1.3% q/q) on lower agricultural equipment and transport equipment spending, but investment on data centres and warehouses drove a rise in new non-dwelling construction (up 2.5% q/q).

Growth was driven by the non-mining sector (2.8% q/q). Non-mining sector investment has trended up over the last few years consistent with elevated capacity constraints. Mining investment has also trended up, but given the strength of prices, it has been a muted investment cycle.

There has been a clear deceleration in the cost of investment. The business investment implicit price deflator grew by 2.9% y/y to Q4 2023, down from over 8% y/y in 2022.

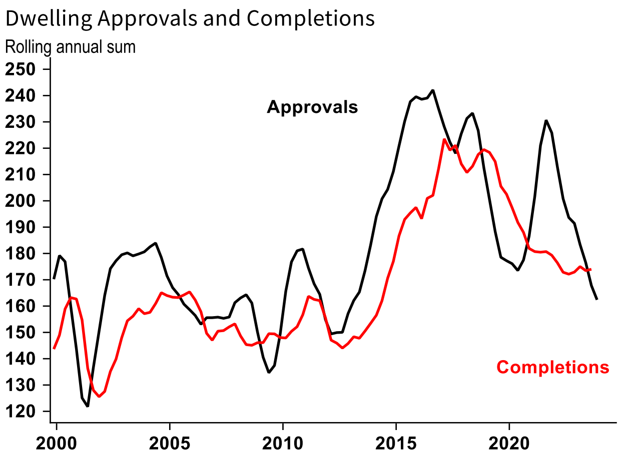
The growth in investment comes despite persistently low business confidence in the NAB Monthly Business Survey and weakness in forward orders. However, business conditions rose to +10 index points in February to be back above the long-run average and capacity utilisation despite edging down in the month, remains well above average.

Chart 6: House prices growth is diverging across the capitals



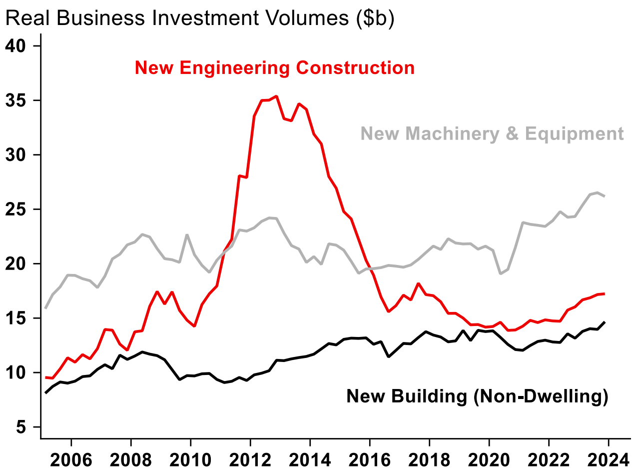
Source: Macrobond, NAB Economics

Chart 7: 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

Chart 8: Underlying business investment rose over the course of 2023



Source: Macrobond, NAB Economics

Inflation Outlook

The monthly CPI indicator tracked sideways at 3.4% y/y in January – and will likely see a more gradual easing from here.

The seasonally adjusted measure edged up to 3.6% y/y, and the exclusion measures including the annual trimmed mean and CPI ex. volatile items are tracking at a higher rate – though both edged lower to 3.8% and 4.0% respectively.

However, the first month of the quarter is weighted towards goods prices. The February monthly data, released in late March, will contain more significant updates to the services categories, including insurance, postal, telecom, audio visual, restaurant meals, hairdressing, other household services, vehicle maintenance and repair and other vehicle services.

Services inflation has proven more persistent than goods inflation thus far, and as such we expect the monthly indicator to remain around 3.5% over coming months.

Looking further out, we continue to expect inflation to moderate with consumption growth staying muted over H1 2024 and cost pressures continuing to ease, albeit gradually.

That said, gains will likely be less easy to come by with the moderation in headline inflation to date largely driven by a moderation in goods price inflation (including outright falls in some categories) – with this impact likely to fade over time. Services inflation remains higher, though we expect some easing.

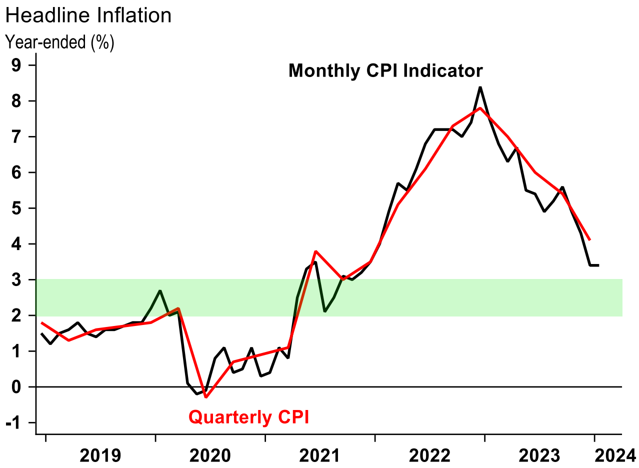
Though wage growth remains a concern for services inflation, we also know that other overheads such as utilities and commercial rents have added to cost pressures in the services industries. As these factors begin to ease, some of the pressure on services prices should also decline. On wages, we think growth is currently around its peak and that it should slow as the labour market eases further.

That said, rents inflation (around 6% of the CPI basket) will likely remain strong given the tightness in the housing market. On the goods side, new building costs growth remain solid (and prices remain around 30% higher) and will be another swing variable given their 8% weight in the CPI.

Price measures in our monthly business survey – though volatile – have showed little further easing in reported input and output price pressures over recent months. This is consistent with our view that the full quarterly CPI will show a 0.9% increase in Q1 (up from 0.8%) in Q4.

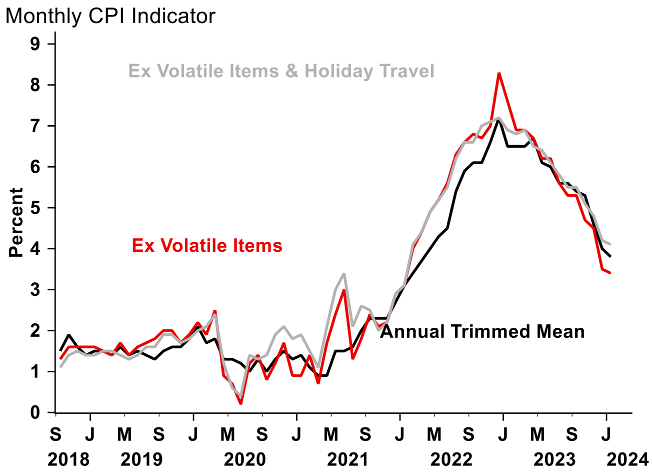
We continue to forecast inflation declining to around 3.1% by end 2023, and 2.7% by end 2025.

Chart 9: Monthly CPI inflation tracked sideways in January



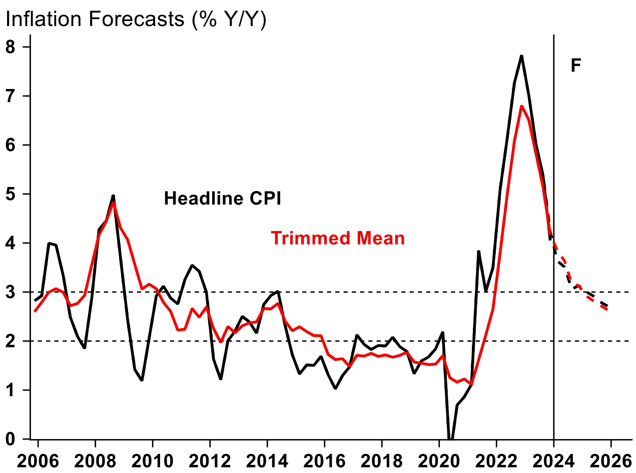
Source: Macrobond, NAB Economics

Chart 10: Monthly CPI ex volatile remains high



Source: Macrobond, NAB Economics

Chart 11: Inflation is expected to continue moderating



Source: Macrobond, NAB Economics

Monetary Policy and FX

We expect the RBA to remain on hold until November, before rates are eased back towards 3% over 2025.

The decline in inflation over recent months has occurred slightly more quickly than the RBA expected. This is an encouraging sign with the February meeting minutes noting that "the data had evolved in a manner that gave them more confidence that inflation would return to target within a reasonable timeframe while allowing employment to continue to grow".

However, the February minutes also note that despite the ongoing easing in inflation, "uncertainty remains elevated" and a "slower return of inflation to target would be costly for the economy" – pointing to the fact that the board has not declared victory in returning inflation to target.

We do not expect this position to change at the March meeting, with rates remaining on hold but the Board explicitly considering the option of a further increase in interest rates to ensure a timely return to target. We see the balance of risks as having remained unchanged since early February, with inflation still high but still expected to ease further amid ongoing weak private sector growth. Though we see the unemployment rate retracing the January rise, population growth also continues to outpace growth in labour demand – pointing to further increases in the unemployment rate over coming months.

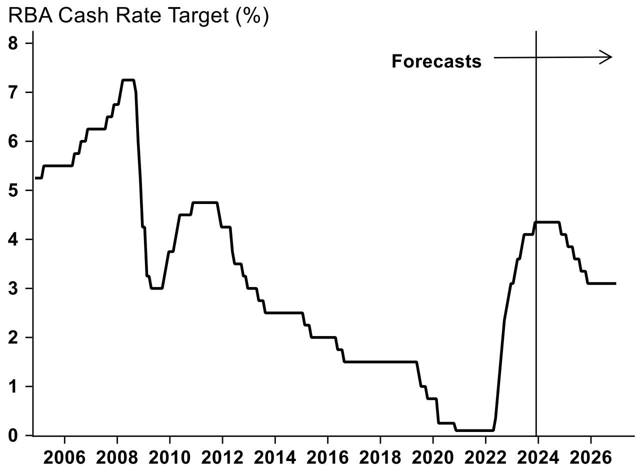
It is unlikely the RBA will explicitly consider cutting rates over coming months, with further progress needing to be made on inflation. The impact of "one-offs" continues to drive some volatility in the key inflation measures and the RBA is unlikely to get a clean read of price pressures until the Q2 CPI release (released in late July). Given the high starting point for inflation, it will likely wait for further evidence that services inflation is easing.

For now, it looks like the RBA will successfully navigate the challenge of returning inflation to target without driving a more significant downturn in activity. The labour market, while loosening, has not deteriorated significantly.

Our forecasts for the AUD/USD are unchanged. We see the Aussie ending the year around US72c before driving higher over 2025 – reaching US78c by Q4.

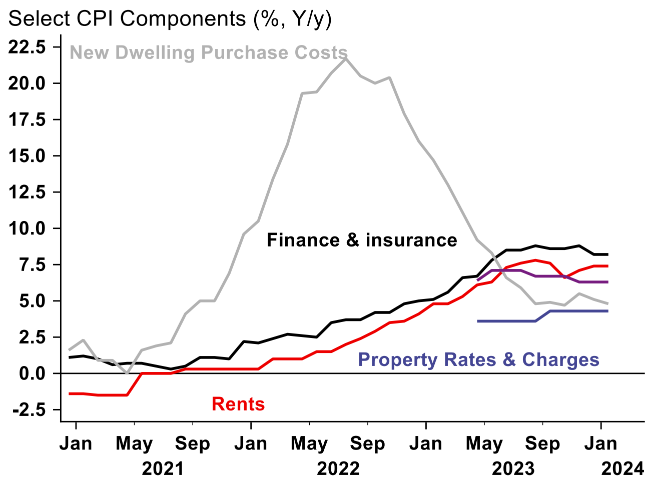
The Aussie has traded in the US65c range through March (with a short rise above US66c). Our expectation for an appreciation above US70c in H2 2024 is contingent on the reversal of the broad strength shown by the USD over the past year or so. In part, this will be reflected by the Fed beginning to ease rates in June – well ahead of an easing by the RBA and gradual pickup in global growth in 2025.

Chart 12: The Cash rate is expected to remain on hold until late 2024



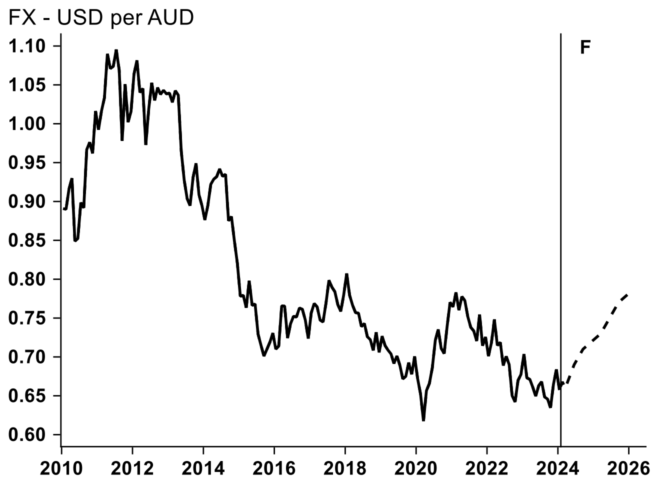
Source: Macrobond, NAB Economics

Chart 13: Housing related inflation remains high



Source: Macrobond, NAB Economics

Chart 14: AUD/USD still expected to appreciate



Source: Macrobond, NAB Economics

Table of Economic Forecasts

	% Growth q/q			% Growth y/y			
	Q4-23	**Q1-24 (f)**	**Q2-24 (f)**	**2023**	**2024 (f)**	**2025 (f)**	**2026 (f)**
GDP and Components							
Private Consumption	0.1	0.1	0.3	0.1	1.3	1.8	2.0
Dwelling Investment	-3.8	-2.4	-2.2	-3.1	-5.5	6.2	4.1
Underlying Business Investment	0.7	-0.6	-0.2	8.5	-0.3	2.6	3.4
Underlying Public Final Demand	0.4	0.5	0.5	4.8	2.0	2.0	2.0
Domestic Demand	**0.1**	**0.1**	**0.2**	**2.3**	**1.2**	**2.3**	**2.4**
Stocks (Cont. to GDP)	-1.0	0.2	0.1	-0.9	0.1	0.2	0.0
Gross National Expenditure	**-0.2**	**0.3**	**0.4**	**1.3**	**1.9**	**2.3**	**2.4**
Exports	-0.3	0.3	0.4	4.2	1.3	2.1	2.2
Imports	-3.4	1.7	1.0	3.5	3.5	2.5	2.4
Net Export (Cont. to GDP)	0.6	-0.3	-0.1	0.4	-0.4	0.0	0.1
Real GDP	**0.2**	**0.2**	**0.3**	**1.5**	**1.7**	**2.3**	**2.3**
Nominal GDP	1.4	1.2	1.5	4.4	5.1	3.8	3.8
Labour Market							
Employment	0.7	0.4	0.2	3.0	1.1	1.8	2.2
Unemployment Rate (End of Period)	3.9	4.0	4.2	3.9	4.5	4.4	4.3
Wage Price Index (WPI)	0.9	0.9	0.9	4.2	3.9	3.6	3.6
Prices and Rates							
Headline CPI	4.1	3.4	3.3	4.1	3.1	2.6	2.4
Trimmed-mean CPI	4.2	3.8	3.6	4.2	3.1	2.5	2.4
RBA Cash Rate (End of Period)	4.35	4.35	4.35	4.35	4.10	3.10	3.10
10 Year Govt. Bonds (End of Period)	3.96	4.40	4.40	3.96	4.05	3.90	-
$A/US cents (End of Period)	0.68	0.66	0.69	0.68	0.72	0.78	-

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

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