Comments from the desk of the Chief Economist: May 2024

NAB Economics

Economic Outlook

Over the last month we have had lots of new data and policy announcements. Included in that has been the recent Federal Budget, the RBA forecast updates and policy announcements, our own Business survey, and interesting data developments both on inflation and the labour market. And over the next few weeks we will get Q1 GDP.

First, on the big picture, our measures of capacity utilisation (as reported by the Reserve Bank in their SOMP) suggest that, in level terms, demand is still exceeding supply. Hence the labour market remains tight with employers still finding it difficult to get suitably skilled labour. That said, the growth momentum in the domestic economy continues to slow. While overall business conditions were around long run averages (+7 points) the May read suggested a big slowing in the employment indicator (the weakest read since early 2022). Also, there are now as many sectors showing below long run average reads, as above average reads (the latter mainly services related). Notably the sectors reporting below average reads included retail, wholesale, construction and manufacturing. Business confidence remains well below average and there was a sharp fall in forward orders (my favourite measure in the Survey) – again in the interest sensitive sectors. Interestingly, in the April survey, there were also signs that wage/price pressures may be moderating.

On inflation, the Q1 trimmed mean CPI at 1.0% was a touch higher than expected but not that much (NAB had expected 0.9%). Wages data on the other hand in Q1 at 0.8% (for y/y growth of 4.1%) was a touch lower than expected. On balance we have revised our trimmed mean end year 2024 forecast up to 3.4% (was 3.2%) and the longer-term number (to end 2025) to 2.8% (was 2.6%) but still have 2.5% by early 2026. These numbers are very similar to the new RBA projections. While Budget measures (especially energy subsidies) will lower the headline numbers to around 3% by end 2024 their expiry will probably see slightly higher headline numbers by end 2025 (NAB expects a headline rate of 3.0% by end 2025). More to the point, the RBA should (and will) ignore subsidy effects from energy prices and concentrate on the trimmed mean.

Clearly, a lot has been said on the policy ramifications of the Budget – see our full commentary on NAB's website. However, my overview comments would be that the Budget was clearly stimulatory and more than I expected. So, it won't help the RBA. Also, I didn't really like the new "interventionist tone" of the government's policy stance. But it was foreshadowed. Overall, while not helping the RBA, I don't think it will prevent them from cutting later in the year but wouldn't rule out a start early next year depending on the data.

Much will depend on the economic outlook and unemployment. We continue to worry about the near term and hope the consumer will be better in the second half of 2024, as inflation reduces and tax cuts and Budget measures help consumers. Thus, our near term (i.e. 2023-24) forecasts are below the Treasury's 1.75% - we are at 1.5% - but we still get through the year growth of around 1.6% rising to around 2¼% in the out years, which is very similar to both the Treasury and not that much below the RBA.

A lot depends on the impact of Budget measures (including tax cuts). Here the evidence is mixed. In response to a recent NAB Survey of consumers, around 60% said they would either save the cuts or use it to pay down debt. It is also notable that RBA forecasts don't see much of a kick from these measures in the second half of the year.

That then leads to what happens to unemployment – and the ability of the consumer to juggle their finances. The April read of unemployment is a touch worrying but I would caution that the trend numbers are around 4% with employment growth of around 30k per month. That, in my view, is insufficient to stop the unemployment rate rising to around 4½% by end 2024. That also seems to be the Treasury view but less so the RBA's – although I bet the RBA will be privately concerned.

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Finally, on recent trends, there has been a lot of talk in the press of a big slowing in bank consumer transactions in April. That however is not what our NAB transactions data suggests. Our data suggests retail trade was up around 0.7% in April albeit total consumer spend (a proxy for private consumption) was close to flat. My read on all this is that the weekly data into April was poor early in the month but picked up substantially late in the month – with a change in the weekly seasonal pattern evident. In any event, we will find out what the ABS says about April, next week.

As noted above, our revised forecasts were broadly unchanged this month. For interest rates, we still see the RBA cutting in November – but as noted above we wouldn't rule out a later start depending on the data. However, we still see four cuts in 2025 bringing the cash rate to a broadly neutral 3.10% by end 2025. This highlights an important difference to market pricing – which has the first cut in early 2025 and then only one other cut in 2025 (i.e. a terminal rate of around 3.8%). The current pricing would see a significant increase in real rates over the next 18 months. That, in my view, is not consistent with the RBA's dual target goals. Unemployment would loom large in that environment, despite a significant fall in actual and expected inflation.

On risks to the forecasts, I'm becoming a touch more bearish on both unemployment and the consumer, but we haven't really changed much in the forecasts. So far, not much change on the inflation outlook but with services still strong there might be a risk that inflation stays higher for a lot longer. Hence less scope for rate cuts.

Globally we haven't really changed our outlook – with growth of 2.9% this year followed by a tiny pickup in both 2025 and 2026 (3.0% and 3.1% respectively). I must say that I was surprised by the generally stronger numbers from the Federal Treasury – around 3.3% over the entire forecast period. On our forecasts we see the US economy starting to weaken significantly into the second half of the year, but Europe is doing better. Japan, on the other hand, had a very poor start to 2024. Also, we are concerned about China with growth of only 4.5% this year. On rates we see most central banks cutting this year. The ECB and the Bank of Canada are likely to be the first cabs off the rank in major economies (June/July) followed by the Bank of England (August) and the Fed in September (with two cuts this year). And finally, the RBA late this year and the RBNZ early 2025. In short, the global economy is not doing us any favours in the near to medium term.

Finally, all central banks and governments will be anxiously watching the data flow. But again, after a tough 2024, Australia will do better than most in the medium term – growth returns to trend, unemployment remains very low, the inflation rate returns to target and the cash rate should be broadly neutral.

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