The Forward View: Australia May 2024

Inflation still too high despite slow demand growth

NAB Economics

Overview

- A number of data releases in April and May have provided valuable information about how the economy is tracking, confirming that demand growth remains subdued and the labour market is easing in line with our forecasts, but inflation nonetheless remains elevated at 4.0% y/y.
- The upcoming Q1 National Accounts release will provide a more detailed picture of how household incomes, consumption and savings have evolved, while the resilience of business investment in the face of slowing activity will also be of interest. We expect another very small positive for quarterly GDP growth but volatility in the trade and inventories components leave some risk of a negative.
- More broadly, we continue to expect below-trend GDP growth in 2024, with the unemployment rate gradually rising to around 4.5% as the population outpaces employment growth. Household income should strengthen later in the year on the back of rising real wages and tax cuts, bringing growth back to around trend in 2025.
- Treasury's forecasts in the recent Federal Budget paint a similar picture. While the government's energy subsidies will impact headline CPI measures over the next couple of years, what matters for the economy is the overall fiscal impulse (across federal and state levels). We assess this impulse to be moderately expansionary, but not enough to derail our expectation that subdued consumption growth will bring underlying inflation back into the RBA's target band in 2025.
- The outlook for wage growth remains a key factor shaping inflation and monetary policy, with the Q1 WPI print of 4.1% y/y supporting the view that wage pressures have passed their peak. The current rate of wage growth is still uncomfortably high for the RBA but we expect some easing over time as the labour market softens.
- On balance, we maintain our view that the RBA will keep rates on hold until a first cut in November – though there is now a risk this slips to early-2025.
- Demand pressures and supply constraints continue to shape prices for dwellings and rents. The Federal Budget had a focus on addressing supply issues, while migration is forecast to slow to more normal rates in 2024-25. Nonetheless, we expect a tight housing market will persist for some time yet.

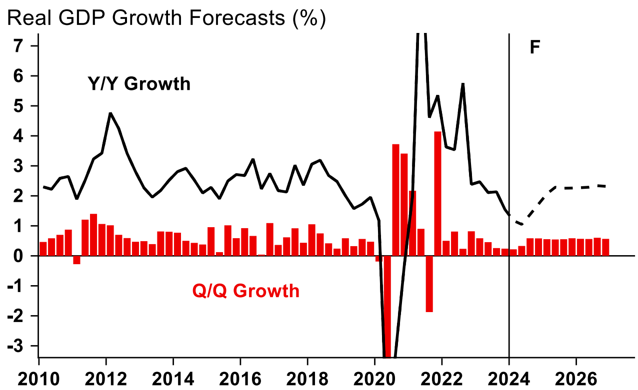
Table of Contents (Click Through)

Key Economic Forecasts

	2023	2024(f)	2025(f)	2026(f)
Domestic Demand (a)	2.3	1.5	2.1	2.3
Real GDP (annual ave)	**2.1**	**1.2**	**2.2**	**2.2**
Real GDP (year-ended)	**1.5**	**1.6**	**2.2**	**2.2**
Employment (a)	3.3	2.3	1.9	1.9
Unemployment Rate (b)	3.9	4.5	4.3	4.3
Headline CPI (b)	4.1	3.0	3.0	2.5
Core CPI (b)	4.3	3.4	2.7	2.5
RBA Cash Rate (b)	4.35	4.10	3.10	3.10
$A/US cents (b)	0.68	0.69	0.75	-

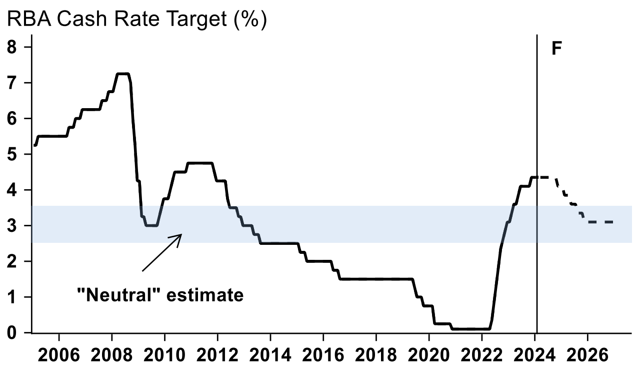
(a) annual average growth, (b) end-period

Chart 1: GDP forecasts



Source: Macrobond, NAB Economics

Chart 2: Cash rate profile



Source: Macrobond, NAB Economics

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

Labour Market, Wages & Consumption

The unemployment rate rose back to 4.1% in April though employment growth remains robust.

Employment rose 38k in April but with continued strong adult population growth and a very moderate pickup in the participation rate (back to 66.7%) this was not enough to hold the unemployment rate steady. These data remain volatile month-to-month with another unusual rise in the number of unemployed waiting to start a job. Trend data from the ABS put the unemployment rate at 4.0%.

More broadly, while labour demand is still elevated employment growth is now tracking slightly below the pace of population growth. This should see the overall labour market continue to gradually ease over the year ahead to a peak unemployment rate of around 4.5%. The Treasury forecasts outlined a similar easing in the Budget.

Consistent with an easing labour market, wage growth appears to have stopped accelerating but at over 4% remains uncomfortably high for the RBA.

The Q1 WPI printed at 0.8% q/q and 4.1% y/y, down from 4.2% in Q4. Private sector wage growth slowed to 0.8% q/q and public sector wage growth was a soft 0.5% q/q, though this partly reflects shifting timing of when wage rises occur. The average private sector pay rise for those getting a wage increase was unchanged at 4.4%.

The wage data supports our, and the RBA's, assessment that wage pressures have likely peaked, but at over 4% the pace of wage growth is at the upper limit of what the RBA would see as sustainable over the long term – especially given the risk that trend productivity growth is closer to 0.5% than the 1% assumed in the central bank's forecasts.

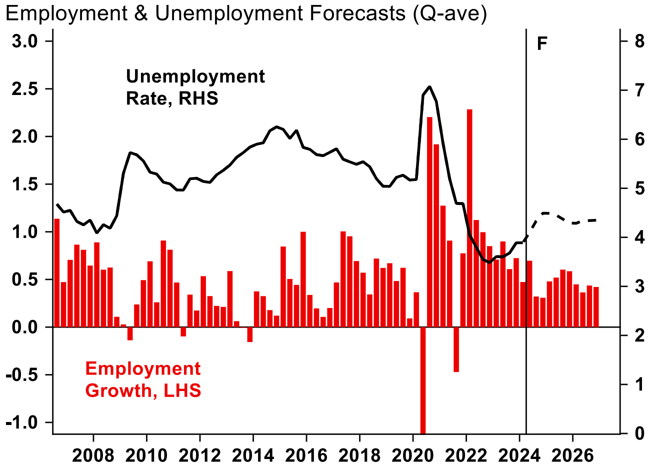
We expect some further easing in wages from here, back to around 3½% in 2025 and 3¼% in 2026. The next award and minimum wage decision is likely to be lower than last year's 5.75% (though there are large increases for aged care workers and potentially childcare workers still to come) and public sector EBAs have tended to embed increases around 4% tapering to 3% in future years.

Retail volumes declined 0.4% in Q1, but we see consumption strengthening later in 2024.

The fall in retail volumes was led by household goods (down 2.9% q/q), partly offset by a rise in clothing, other retail, and cafes, restaurants & takeaway. With non-retail consumption likely to be more robust, we expect the Q1 national accounts to show another quarter of subdued consumption growth overall, in the range of 0.1-0.2% q/q.

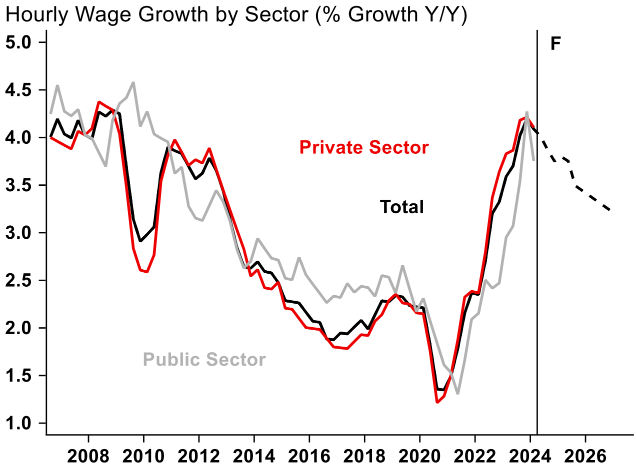
Looking ahead, household incomes remain under pressure but we see some improvement in the second half of the year with inflation easing and support from income tax cuts. As a result we continue to expect household consumption to strengthen gradually through the second half of 2024 and into 2025.

Chart 3: The unemployment rate rose back to 4.1% in April but employment growth remains robust



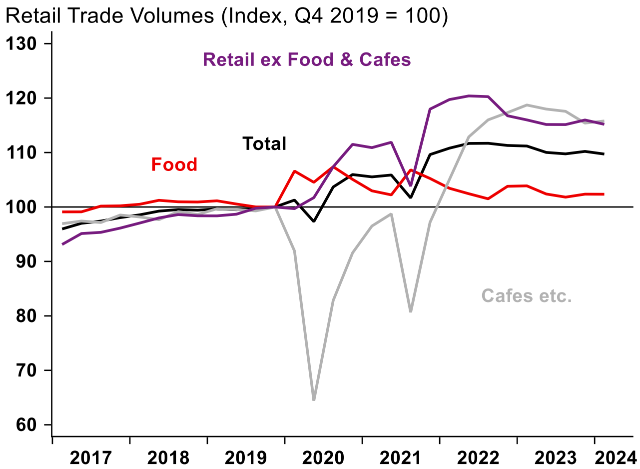
Source: Macrobond, NAB Economics

Chart 4: Hourly wage growth edged lower in Q1 but remains over 4%



Source: Macrobond, NAB Economics

Chart 5: Retail volumes declined in Q1, continuing a subdued period



Source: Macrobond, NAB Economics

Housing & Construction

The housing market continues to be pressured by strong demand amid ongoing challenges on the supply side which will likely continue the upwards pressure on prices and rents in the near term.

Both the CoreLogic and PropTrack Capital city dwelling price measures suggest that price growth is currently tracking around 5% in annualised terms over the last 6 months – well below the rates of ~10-15% seen across the measures in mid-to-late 2023. Nonetheless, growth of around 5% could still be considered relatively robust with interest rates high and given the pressures faced by the household sector.

The easing in pace has been driven by a slowing in Sydney, Brisbane and Melbourne, with Adelaide tracking sideways and Perth, despite edging down in the month, having accelerated over the past 6 months. Price growth in Hobart remains muted.

Though price growth has slowed, rents growth remains strong across a range of measures – with new rents continuing to rise by 9% y/y according to CoreLogic and the broader CPI measure of all rents rising by 8% y/y in Q1. Vacancy rates remain exceptionally low across the capital cities and with still strong population growth, the rental market will likely remain tight for an extended period.

The supply-side will need to see a significant improvement before we see a notable easing in the price and rents pressures in the housing market.

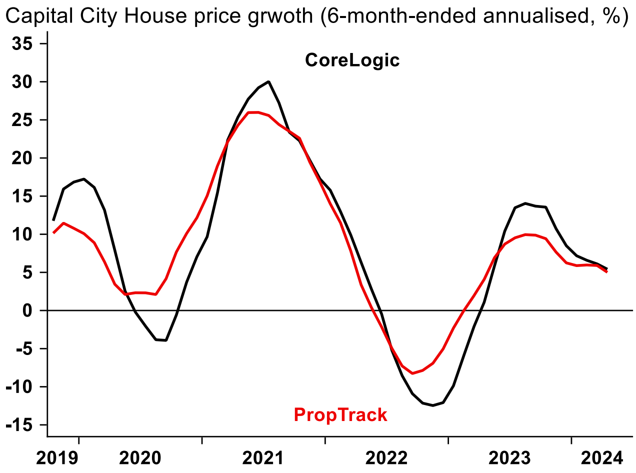
Building approvals continue to ease after a brief period of stabilisation in mid-2023 despite a small uptick in both the detached and higher-density components. In rolling annual terms approvals continue to ease, tracking around 163k p.a. (and around 152k if annualised over the past 3 months), implying further easing in completions which tracked at around 172k p.a. in the March quarter.

While pinpointing the key drivers of the weakness in construction is difficult amid strong demand and price growth, input prices and borrowing costs remain high even if material and labour availability constraints have eased. Anecdotally, buildings/developers also appear to be more cautious committing to large projects given the sharp increases in prices and other disruptions over recent years.

Encouragingly, the Federal budget included further discussion and focus on improving supply side constraints as opposed to policy that historically have focused on the demand side. We see the Government's goal of building 1.2m houses over the next year as ambitious but worthy.

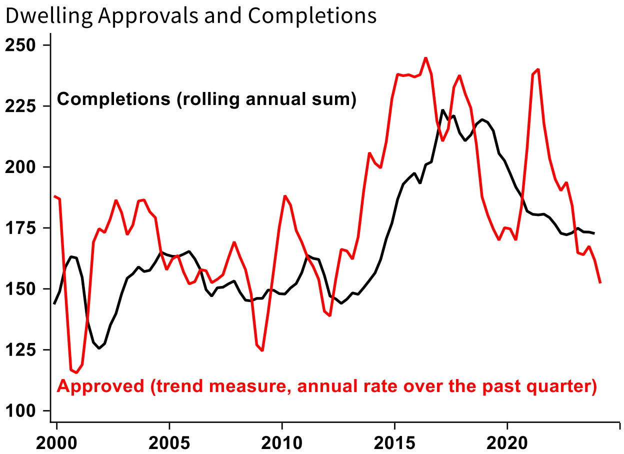
Though complex and likely to take an extended period there clearly needs to be some improved coordination across all three levels of government, and a focus on increasing density around transport infrastructure/working locations.

Chart 6: Price growth has slowed but rents growth remains strong.



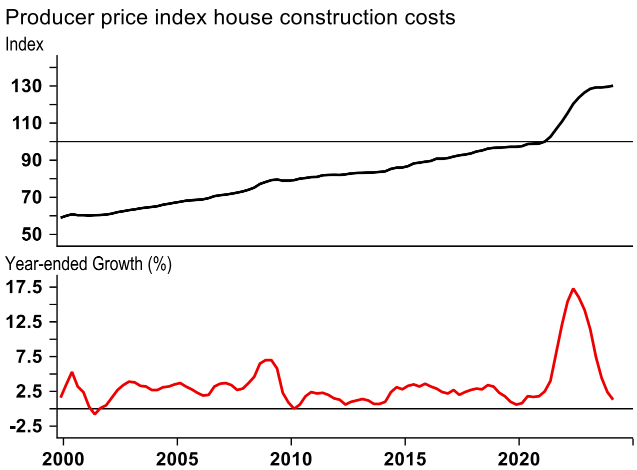
Source: Macrobond, NAB Economics

Chart 7: The approval run rate implies further falls in completions



Source: Macrobond, NAB Economics

Chart 8: Construction costs remain elevated even as supply chains heal.



Source: Macrobond, NAB Economics

Business, Trade & FX

Business conditions were back at their long-run average in April, while business credit growth is holding up.

Conditions eased to +7 index points in the NAB Monthly Business Survey, with a fall in the employment component back to its average level of +2 index points and profitability and trading conditions also around average. Retail and other goods-related sectors remain the weakest in the survey while conditions in services sectors are still strong.

Leading indicators remain mixed with capacity utilisation still above average but forward orders weak. Regardless, businesses still appear to be investing with credit growth running at 0.5% m/m and 7.0% y/y to March and signs of strong investment in the imports data (discussed below).

On balance we have revised up our forecasts for underlying business investment in the near term, now seeing modest real growth around 2.5% y/y for 2024. We will have a clearer read on business investment plans later in the month when the ABS capex survey is released.

The goods trade balance fell further in March on the back of strong imports growth, suggesting a subtraction from Q1 GDP but pointing to strong investment.

The goods trade surplus fell to $5b in the month, with exports little changed but imports rising 4.2% m/m. Export values continue to be supported by elevated commodity prices – though NAB continues to see longer term prices easing (see the Minerals & Energy Outlook).

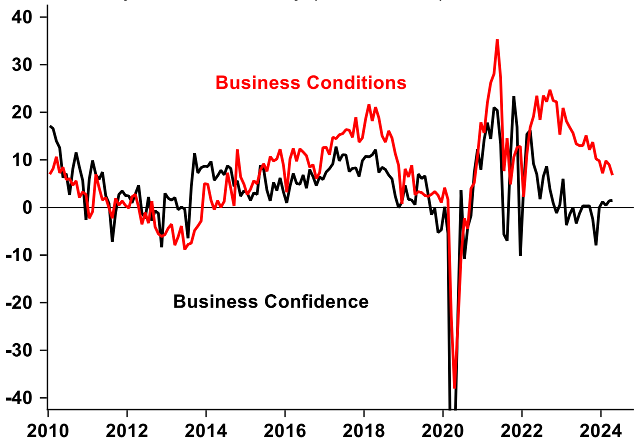
The lift in import values in the month was driven by a large rise in computers and related equipment, as well as fuel and industrial supplies, while there were also meaningful increases in consumption goods.

The March data rounds out Q1, with the strength in goods imports implying a subtraction from GDP growth. However, recent quarters have seen a pattern of volatility in net exports offset by shifting inventories and this may play out again here. In addition, the strength of capital and intermediate goods imports (up 5.8% and 3.6% respectively in nominal terms) may partly reflect business investment growth in the quarter.

We continue to see the Aussie appreciating in the second half of the year, ending 2024 around US69c before drifting higher over 2025 – to around US75c.

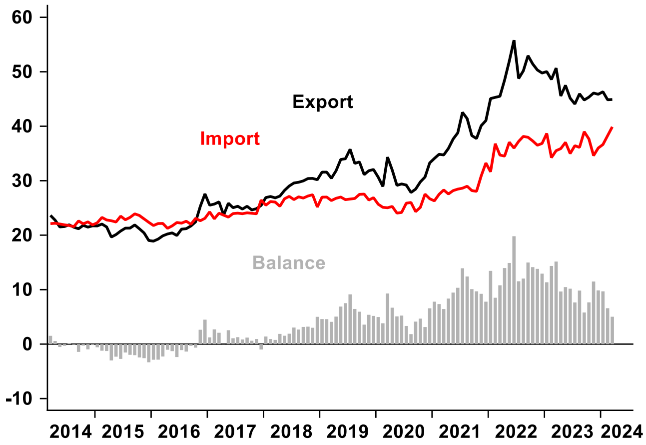
The Aussie lifted a little above US65c through the first part of May, supported by the upside surprise in Q1 CPI and related changes in interest rate pricing. Some positive signs from Chinese policy makers on support for the property market are also supportive. Longer term, the outlook for further appreciation over the year depends in large part on our expectation that the US Fed will begin to cut from September.

Chart 9: Business conditions in the NAB survey around their long-run average



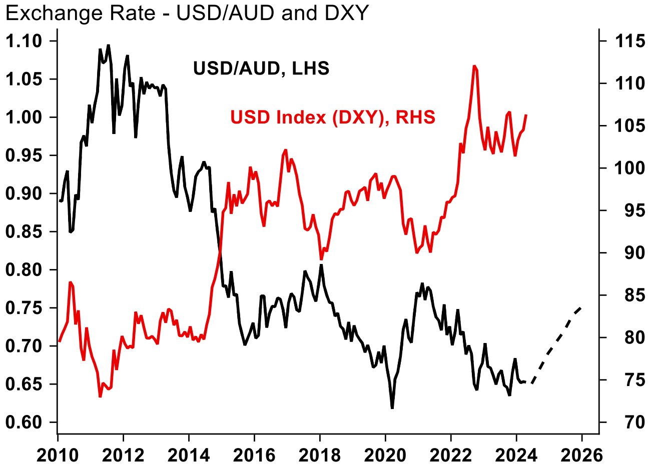
Source: Macrobond, NAB Economics

Chart 10: The goods trade balance remains in surplus, despite falling iron ore prices



Source: Macrobond, NAB Economics

Chart 11: The AUD is expected to appreciate as the US economy weakens



Source: Macrobond, NAB Economics

Inflation

The Q1 CPI surprised to the upside with both headline and trimmed-mean inflation reaccelerating to 1.0% q/q, highlighting the ongoing bumpy path.

Nonetheless inflation continued to moderate in year-ended terms, falling to 4.0% on the trimmed mean measure. Headline inflation declined to 3.6% y/y and is well below its peak of 7.8% in Q4 2022.

The key upside surprises were the outcomes in health and education, while market services such as rents, insurance, and restaurant meals, postal services as well as property rates & charges all continue to rise strongly in annual terms. Goods components typically remain softer.

The slightly stronger than expected result for underlying inflation highlights the ongoing uncertainty in how quickly inflation tracks back to target from here. While rates (and other pressures) are clearly slowing consumer demand there continues to be "echoes" of previous high rates of inflation including through indexed prices.

The housing market will remain a key wedge in the inflation numbers with rents growth expected to remain very strong in the near term, and the new dwellings component also remaining strong – with the PPI showing that cost pressures continue to build, not ease, in the homebuilding sector. This implies that an easing in other components will need to offset the still strong price growth in housing components.

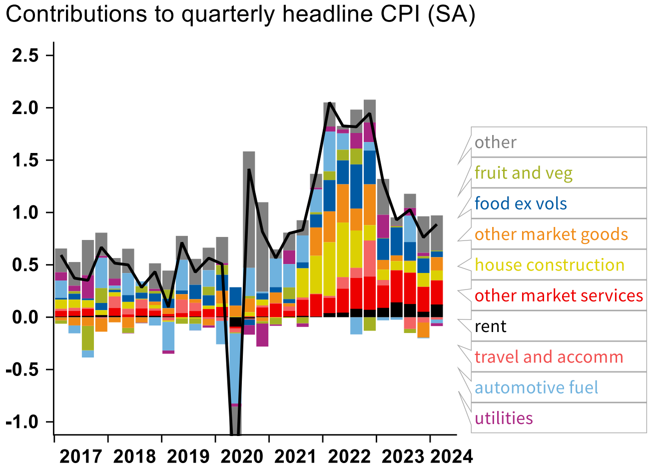
Looking forward, we see underlying inflation continuing to moderate – falling to around 3.4% by Q4 2024 and to around 2.7% by end 2025. That implies a further step down in the quarterly run rate through Q2 and Q3 for underlying inflation. We expect that ongoing softness in consumption growth this year will allow demand and supply to continue to rebalance.

The outlook for headline inflation is more mixed in the wake of the extension and expansion of energy subsidies in the Federal, Queensland and WA budgets, as well as increased rent assistance. Together these policies will subtract around 0.7ppts from measured CPI growth in 2024-25 before unwinding the next year. As a result, we see headline inflation of 3.0% y/y to end-2024 (below trimmed mean) and 3.0% again in 2025 (above), normalising to 2.5% in 2026.

Largely, we see the risks to inflation coming through further unexpected disruptions to global energy prices or disruptions to supply chains/shipping. Rates are well into restrictive territory globally and growth has slowed which should contain global goods prices. Domestically, as discussed on page 2, the pressures in the labour market and wage growth should continue to ease.

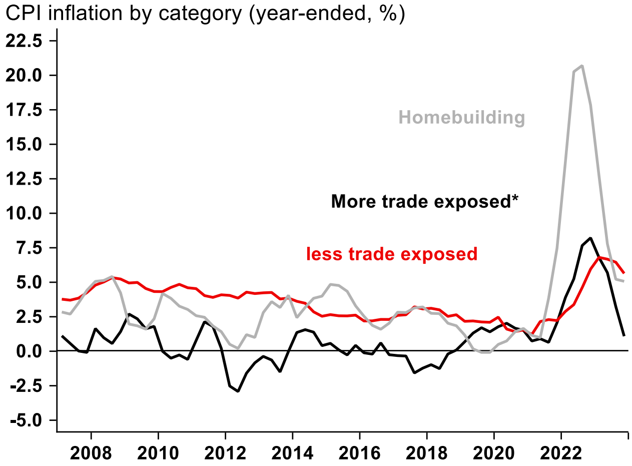
The next key marker for inflation will be the monthly CPI indicator for April (release in late May), which will provide an update on how goods prices are tracking, and our business survey for May (released in early June) – which has showed encouraging signs in easing cost pressures.

Chart 12: Inflation has moderated with services components now the main contributor



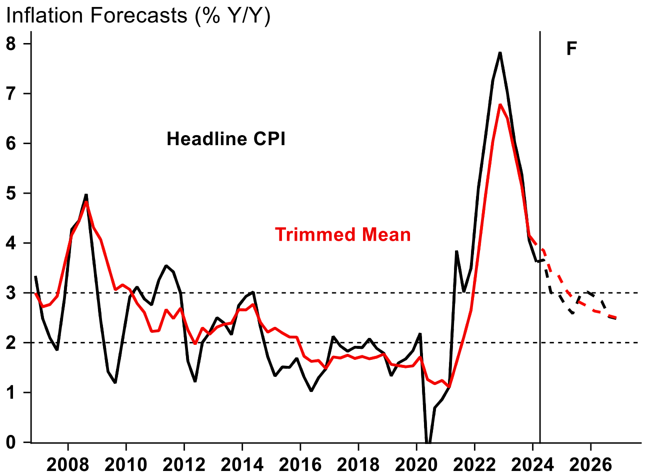
Source: National Australia Bank, ABS

Chart 13: Inflation in less trade exposed components remains well above target



Source: Macrobond, NAB Economics

Chart 14: Trimmed mean inflation is still expected to returned to within the target band in 2025



Source: Macrobond, NAB Economics

Monetary Policy

The RBA is likely to remain on hold in the near-term and sees rates as sufficiently restrictive to bring inflation back to target – meaning the key question is how long rates need to be held at 4.35% rather than whether rates need to rise further.

The updated set of RBA Staff forecasts released alongside the May meeting decision showed a downside revision to growth for 2024 (now 1.5% y/y) with 2025 unchanged at 2.4%, and an upward revision to inflation this year (due to the upside surprise in Q1 and the outlook for petrol prices). The unemployment profile was largely unchanged with unemployment gradually drifting higher, reaching 4.3% by mid-2025. These forecasts were conditioned on an unchanged cash rate until around May 2025.

The key risks listed in the SMP remain broadly unchanged, with the first relating to the risk of ingrained inflation requiring tighter policy and a larger downturn in the labour market which "would impose costs on [their] employment objective" and the second that inflation returns more quickly to target should slack arise more quickly in the labour market. For now, based on the data flow it appears that the RBA sees a greater risk on the activity side with little evidence that inflation expectations have drifted materially higher.

Since the RBA forecasts were released, the key data points have been the wage price index and the labour force data for April, which both surprised somewhat to the downside, pointing to further easing in labour market pressures and at face value an unemployment rate approaching something the RBA considers more sustainable.

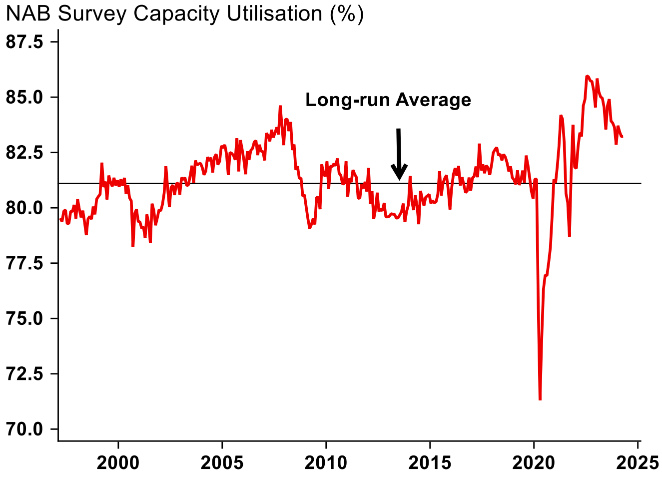
For us, by November the RBA will have enough confidence that inflation will continue to track towards the middle of the band, with increasing signs that demand and supply will come into better balance as the unemployment rate rises.

Indeed, while our own forecast profile is broadly similar to that of the RBA, we see a faster deterioration in the unemployment rate this year at the margin and underlying inflation moderating at a slightly faster pace.

That said, we see little probability that the RBA cuts prior to November with a clean read across both the labour force and CPI data remaining difficult given the volatility in each data source. Indeed, this points to the risk that it will take longer for the RBA to gain the confidence that inflation is on track to sustainably return to target.

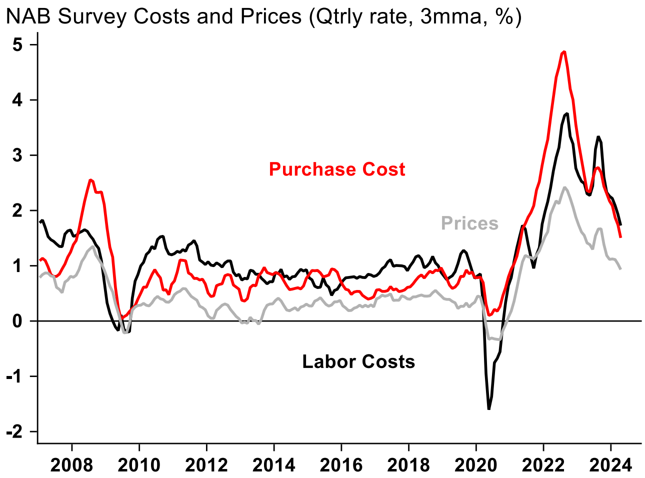
The Q1 national accounts will be an important update on how the economy has tracked in early 2024 – and provide a more complete picture of how household dynamics are playing out. As noted above, there is some risk of a negative print due to volatility in trade and inventories but given the persistence of inflation, we would not expect this on its own to be enough to bring rate cuts forward.

Chart 15: Capacity utilisation has eased but remains high



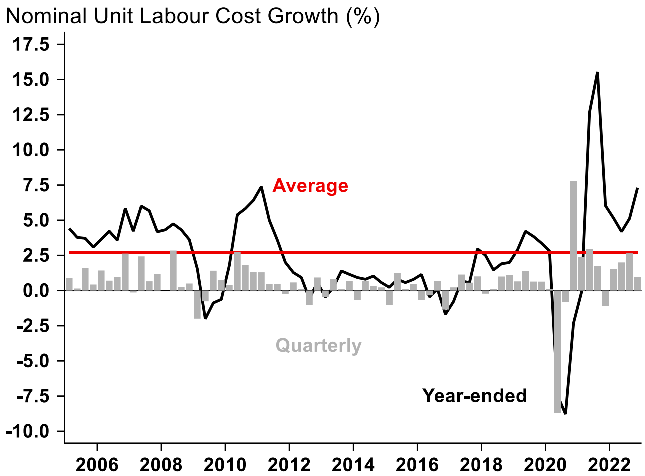
Source: Macrobond, NAB Economics

Chart 16: NAB Survey costs and price growth is trending lower but still elevated



Source: Macrobond, NAB Economics

Chart 17: Nominal wage pressures are expected to ease but over time productivity growth will be important



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	0.2	0.3	0.1	1.4	1.6	1.7
Dwelling Investment	-3.8	-2.4	-2.2	-3.1	-5.5	6.3	4.1
Underlying Business Investment	0.7	1.1	0.3	8.5	2.5	2.4	4.0
Underlying Public Final Demand	0.4	0.5	0.5	4.8	2.1	2.0	2.0
Domestic Demand	**0.1**	**0.3**	**0.3**	**2.3**	**1.6**	**2.2**	**2.3**
Stocks (Cont. to GDP)	-1.0	0.4	0.1	-0.9	0.2	0.2	0.0
Gross National Expenditure	**-0.2**	**0.7**	**0.4**	**1.3**	**2.4**	**2.2**	**2.3**
Exports	-0.3	1.0	0.4	4.2	2.0	2.1	2.2
Imports	-3.4	5.1	1.1	3.5	7.5	2.5	2.4
Net Export (Cont. to GDP)	0.6	-0.8	-0.1	0.4	-1.0	0.0	0.1
Real GDP	**0.2**	**0.1**	**0.3**	**1.5**	**1.6**	**2.2**	**2.2**
Nominal GDP	1.4	1.2	1.6	4.4	5.2	3.8	3.7
Labour Market							
Employment	0.7	0.5	0.7	3.0	1.8	2.2	1.7
Unemployment Rate (Q-Ave, End of Period)	3.9	3.9	4.1	3.9	4.5	4.3	4.3
Wage Price Index (WPI)	1.0	0.8	0.9	4.2	3.8	3.4	3.2
Inflation and Rates							
Headline CPI	4.1	3.6	3.7	4.1	3.0	3.0	2.5
Trimmed-mean CPI	4.2	4.0	3.8	4.2	3.4	2.7	2.5
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	3.98	4.30	3.96	4.20	4.00	-
$A/US cents (End of Period)	0.68	0.65	0.65	0.68	0.69	0.75	-

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

Group Economics

Alan Oster
Group Chief Economist
+(61 0) 414 444 652

Jacqui Brand
Executive Assistant
+(61 0) 477 716 540

Dean Pearson
Head of Behavioural & Industry Economics
+(61 0) 457 517 342

Australian Economics

Gareth Spence
Head of Australian Economics
+(61 0) 422 081 046

Brody Viney
Senior Economist
+(61 0) 452 673 400

Lea Jurkovic
Economist – Agribusiness
+(61 0) 452 090 770

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 0) 477 723 769

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 0) 455 052 520

Thao Nguyen
Economist – Data & Analytics
+(61 0) 451 203 008

International Economics

Tony Kelly
Senior Economist
+(61 0) 477 746 237

Gerard Burg
Senior Economist – International
+(61 0) 477 723 768

Global Markets Research

Skye Masters
Head of Research Corporate & Institutional Banking
+(61 2) 9295 1196

Important notice