From the desk of the Chief Economist:
June 2024. Still data watching.
NAB Economics

Economic Outlook

Over the last month we have had lots of new data and another RBA announcement. While lots has happened not much has really changed vis-à-vis our expectations and how the data has, so far, played out.

First, on the big picture, the National Accounts was exactly in line with our overall expectations with GDP growth only just positive at 0.1% q/q and 1.1% y/y. Reflecting some new data showing locals spending more overseas, private consumption was stronger than we expected – up 0.4% in Q1 and history revised up to 1.3% over the past year – though for GDP purposes the higher consumption is offset by a larger negative on imports. Public demand was also stronger than expected – with public consumption up 1% in Q1 and 4.1% y/y. Against that, investment – both in dwellings and business investment – was weaker. Increased stocks and larger detraction from net exports (especially imports) largely cancelled themselves out. Overall, year-ended GDP growth was the lowest since 1992 (excluding the pandemic). One of the outcomes of the statistical changes was that the savings ratio fell further to 0.9%. Productivity was flat and cost pressures remained elevated. The domestic demand deflator was up 1% in Q1 and stronger in services.

When we turn to the NAB Business Survey for May and our internal data, it is really hard to see any increase in the growth momentum in Q2. The Business survey showed a further edge down in business conditions (with below average readings in retail, and most service sectors). That, together with very poor forward orders – again in retail, wholesale and hospitality – saw business confidence turn negative. Capacity utilisation is still elevated suggesting that demand still exceeds supply but the gap is closing. Price pressures however remain elevated. Our monthly transaction data series suggests that retail and consumption moved down in May, but the labour market is still hanging in there with unemployment still low at 4% – albeit edging higher in trend terms.

In such an environment – and with the RBA not really getting a full read on services inflation till the Q2 CPI in late July – it is little wonder the RBA is on hold and "not ruling anything in or out". But level of uncertainty is increasing. Obviously, they are concerned that services inflation remains too high and the Q2 CPI (in late July), which will provide the next full update on this front, will be critical. If not less than 1% on the trimmed mean, they could actually increase rates (we are at 0.85%). But equally they remain concerned re the consumer and unemployment. As the Governor said the outlook is "very uncertain".

As set out, in our Forward View, this week, we have not really changed our economic outlook and forecasts. Yes, we have lowered our forecast for Q2 GDP to only 0.1% but that really just reflects the run of weakish data we have seen. But we are still looking for a stronger second half of the year as inflation edges lower, tax cuts kick in and the prospect of rate cuts gathers momentum. Overall, we see GDP growth through 2024 now at 1.3% (was 1.6%) before kicking up to around 2¼% in 2025 and 2026. That would still see employment growth remaining positive but not enough to prevent the unemployment rate rising to around 4.5% by end 2024 and broadly stabilising at a slightly lower rate thereafter. Wages pressures already appear to be peaking (or probably have already peaked) and should ease somewhat alongside the labour market.

On inflation we still see the trimmed mean measure improving to around 3.4% by end 2024, 2.8% by end 2025 and 2½% by early/mid 2026. While much is made by some that inflation is still too high (and it is) I strongly believe we and the RBA need to be forward looking. In brief, with an economy flat lining (and excess demand shrinking quickly) do we really believe inflation will not ease? I don't – albeit the path downward will clearly not be smooth.

On the RBA clearly there are multiple issues involved. But a central bank needs to be somewhat forward looking. If growth slows as much as we and they think, why wouldn't the focus turn to the economy and

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preventing an over correction? And, that slower growth will impact inflation. That is where we see the RBA heading in the back end of 2024. Thus, we still 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.

On risks to the forecasts, I remain a touch more bearish on both unemployment and the consumer, but we haven't really changed much in the forecasts. I still wonder how much of the tax cuts will be spent and hence worry about whether the kick to activity in the second half of 2024 will be as big as we and the official family are hoping for. Against that, services inflation seems still quite resilient and there might be a risk that inflation stays higher for a lot longer. Hence a later start to the rate cutting profile.

Globally we haven't really changed our outlook – with growth of 3.0% this year (was 2.9% but the revision mainly reflects a stronger Russia than expected) followed by unchanged growth in 2025 (3%) and a tiny pickup in 2026 (3.1). 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 and 4.8% in 2025. On rates we see most central banks cutting this year. The ECB and the Bank of Canada have already started and are likely to be 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, as noted last month, 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.

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