# The Forward View: Australia June 2024

## Subdued growth but signs consumers holding up

## NAB Economics

## Overview

- Our overall view of the economy is largely unchanged – with growth tracking through a very weak period and the expectation that the labour market will soften further through 2024. We continue to expect inflation to moderate – though this process has not been smooth – and the RBA to have the scope to begin easing rates later in the year. With GDP growth rebounding somewhat in H2, unemployment stabilising at around 4.5% and inflation returning to the target band by late 2025 we continue to see a relatively soft landing.
- Indeed, GDP grew just 0.1% q/q in Q1, to be up 1.1% y/y. This was in line with our forecasts but, in the detail, the picture has changed somewhat with revised estimates of overseas travel leaving household consumption growth looking stronger at 1.3% y/y. The softness in the quarter came largely from private investment – especially construction - with offsetting movements in trade and inventories.
- Higher frequency indicators, including business conditions in the NAB Monthly Business Survey, suggest growth will likely be no better in Q2. We continue to expect a pickup in activity in the second half of the year with easing inflation and tax cuts supporting households. On balance our year-ended growth forecast is now marginally lower at 1.3% for 2024, with growth still likely to return to trend rates around 2¼% beyond that.
- Despite the slowing in growth, the labour market has remained resilient with strong employment growth seeing the unemployment rate at 4.0% in May. We continue to expect further gradual easing in the labour market, with the unemployment rate rising to around 4½% by end-2024. This is consistent with further easing in the pace of wage growth.
- The question remains how long rates will need to remain at their current restrictive level to see inflation back into the target range. We still see a first cut in November but the exact timing is heavily data dependent. Underlying inflation remains around 4.0% y/y and the data flow from here will be critical – especially the Q2 CPI out in late July. So too will be the assumed kick in growth in H2 2024.

### Table of Contents (Click Through)

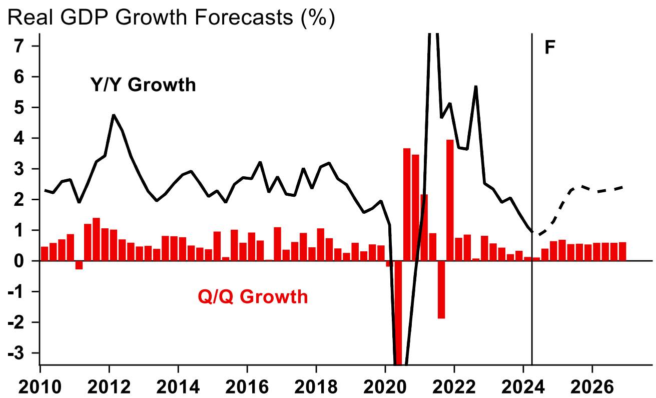


### Key Economic Forecasts

| | 2023 | 2024(f) | 2025(f) | 2026(f) |
|---|---|---|---|---|
| Domestic Demand (a) | 2.8 | 1.8 | 2.4 | 2.4 |
| **Real GDP (annual ave)** | **2.0** | **1.0** | **2.2** | **2.3** |
| **Real GDP (year-ended)** | **1.6** | **1.3** | **2.4** | **2.4** |
| Employment (a) | 3.3 | 2.3 | 1.8 | 2.1 |
| Unemployment Rate (b) | 3.9 | 4.5 | 4.4 | 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 | - |

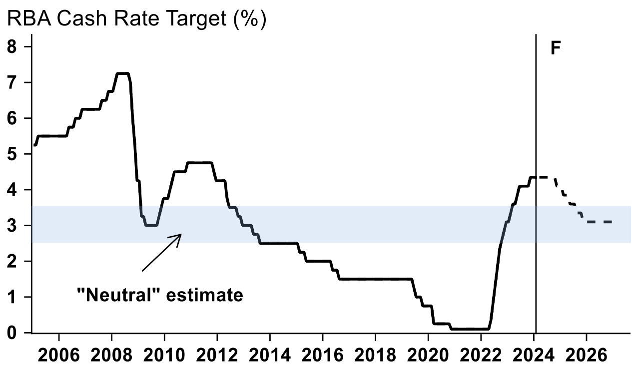
(a) annual average growth, (b) end-period

### Chart 1: GDP forecasts




Source: Macrobond, NAB Economics

### Chart 2: Cash rate profile




Source: Macrobond, NAB Economics

**18 June 2024** | Gareth Spence, Head of Australian Economics | Brody Viney, Senior Economist | Alan Oster, Chief Economist

# Labour Market, Wages & Consumption

**The unemployment rate edged back down to 4.0% in May with employment growth holding up.**

Employment rose 40k in May with the unemployment rate edging higher to around 4% in trend terms. Our assessment is that the underlying pace of employment growth is still marginally below the pace of population growth and this dynamic should continue as subdued economic activity feeds through to businesses hiring decisions, eventually seeing the unemployment rate up to around 4½% by end-2024.

**Wage growth in the Q1 National Accounts was soft – though these measures can be volatile – and the minimum wage is set to rise less this year than last year.**

Average hourly wage growth was 0.5% q/q in Q1, below the recent WPI (0.8%), though in year-ended terms the national accounts measure remains stronger at 5.5% y/y reflecting compositional and other effects. Wider average earnings per employee was even softer at 0.1% q/q (4.6% y/y), reflecting adjustments in average hours worked.

These measures can be volatile but they nonetheless align with our assessment that wage pressures have peaked, and the recent Fair Work minimum wage decision further supports this view with a 3.75% rise set to take effect in July. We see underlying hourly wages, as measured by the WPI, easing to around 3¾% by end-2024.

**Household consumption has been more resilient than previously thought, but growth is still subdued.**

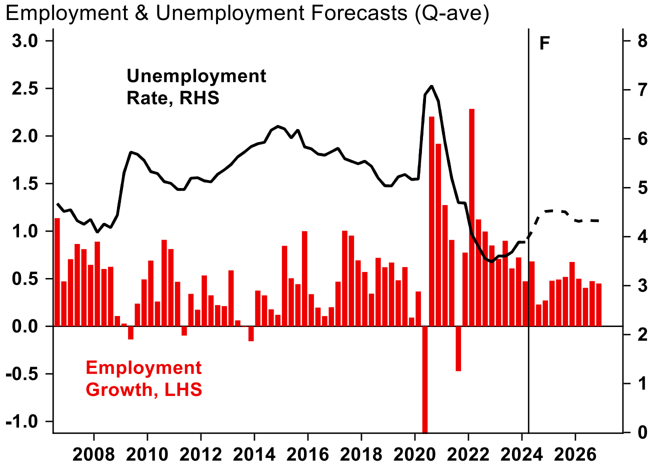
Significant revisions to estimates of overseas travel by households saw the ABS revise up the level of real consumption over 2022 and 2023, leaving consumption growth in 2023 noticeably stronger at 1.0% y/y (previously 0.1%). (Note the revisions did not add to GDP given the spending was done overseas.) In Q1, consumption grew by a reasonable 0.4% q/q (1.3% y/y), supported by energy use and some major entertainment events.

While this is still a subdued rate of growth, this suggests households have performed relatively better than previously thought, especially given the upward revisions were concentrated in discretionary spending. On a per capita basis, consumption is only declining modestly once adjusting for international students and energy subsidies.

A corollary to the upward revision to consumption was a downward revision to the savings rate, which was 0.9% in Q1. This is well below pre-COVID rates as households save less of their income in order to maintain spending.

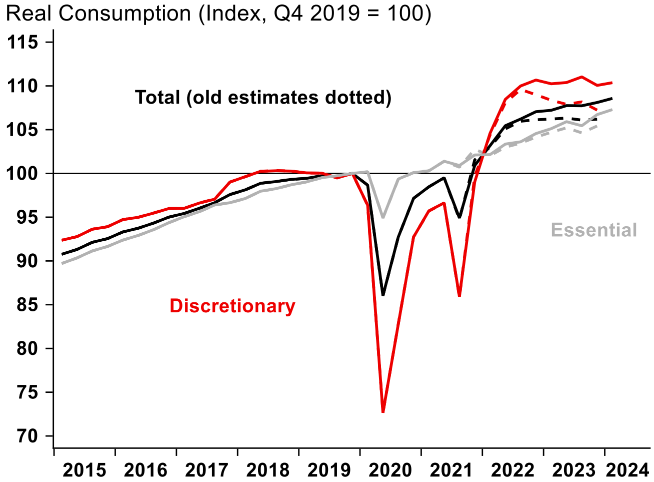
We expect a softer rate of consumption growth in Q2 with household incomes still under pressure from inflation. Nonetheless it remains our view that consumption should pick up in the second half of the year as inflation eases and households also benefit from tax cuts and, eventually, easing monetary policy.

**Chart 3: The labour market is easing gradually as the economy slows**



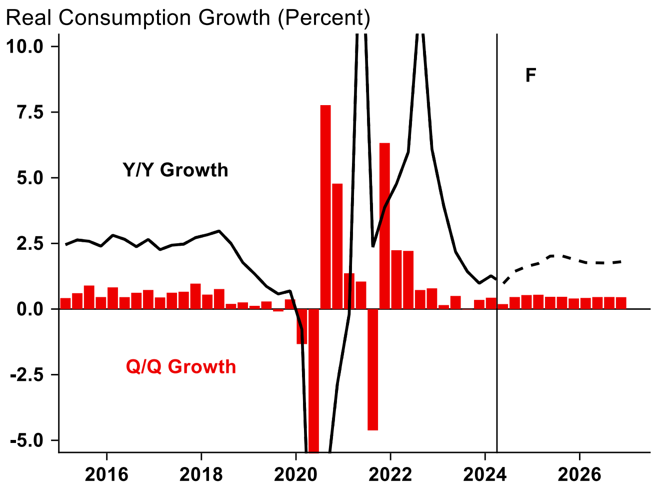

Source: Macrobond, NAB Economics

**Chart 4: Consumption was revised higher due to updated estimates of overseas travel**




Source: Macrobond, NAB Economics

**Chart 5: Consumption growth is still subdued but expected to pick up later in the year**




Source: Macrobond, NAB Economics

## Housing & Construction

**House price growth continues to show a divergence across states, with Perth, Brisbane and Adelaide continuing to rise very strongly, while Sydney continues to rise more slowly and Melbourne remains weak.**

Growth in the 8-Capital city dwelling price index edged up further in May, rising 0.8% m/m to be 8.8% higher over the year. Prices rose 2.0% in Perth, 1.8% in Adelaide and 1.4% in Brisbane in the month, with Perth now up 22% over the year, followed by Brisbane at 16% and Adelaide at 13%. Sydney and Melbourne continue to lag, with Sydney up 0.6% in the month (8% higher over the year) and Melbourne up edging 0.1% higher (to be just 1.8% higher over the year).

More broadly, the resilience in the economy, the healthy labour market and strong demand against a weakening supply backdrop continues to be reflected in dwelling prices despite the sharp increase in interest rates. The combined 8-Capital city dwelling price index is up around 30% since the onset of the pandemic, with Sydney, Hobart, Darwin and Canberra up a similar amount. Perth, Brisbane and Adelaide are up around 60%, while Melbourne has lagged, up just 11%. Regional prices are up around 50%.

Rents growth has also eased slightly over recent months on average across the capitals but remains strong and continues to track at around 8.5% y/y. Perth continues to lead the increase in rents at 13% y/y, with the remaining mainland capitals clustered around 8.5-9.5% y/y.

The pressure in the rental market is likely to continue for some time, with rental vacancy rates still very low. In May the vacancy rate edged up in Sydney (1.4%), Melbourne (1.4%) and Brisbane (1.1%) and was broadly flat and lowest in Perth and Adelaide at just 0.6%.

We expect these dynamics to continue in the near-term with the CoreLogic 8-capital city dwelling price index rising by around 5% this year, and rents continuing to rise strongly. Population growth looks to have peaked but remains strong while the supply side continues to be challenged.

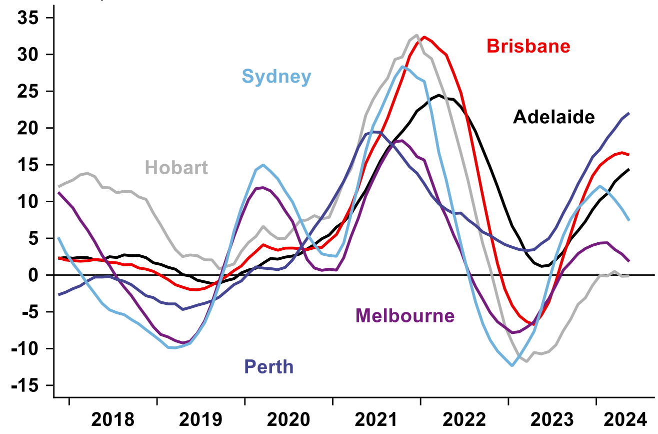
**Indeed, dwelling approvals remain low – and fell for both detached and higher density dwellings in April.**

While trend dwelling approvals for detached houses appear to have stabilised (at a low level), approvals for higher density dwellings continue to trend lower.

The weakness in dwelling approvals (and completions) is somewhat confronting given the strength in population growth. Rising financing costs, uncertainty in the construction industry and the high cost of inputs all appear to be weighing on the sector.

**Chart 6: Price growth has diverged across the capitals**

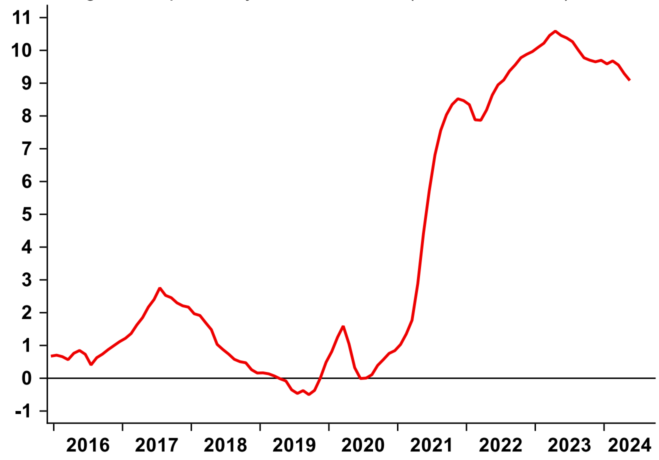
CoreLogic Hedonic Dwelling Price Growth by Capital City (Year-ended,%)




Source: Macrobond, NAB Economics

**Chart 7: Rents growth has eased but remains high**

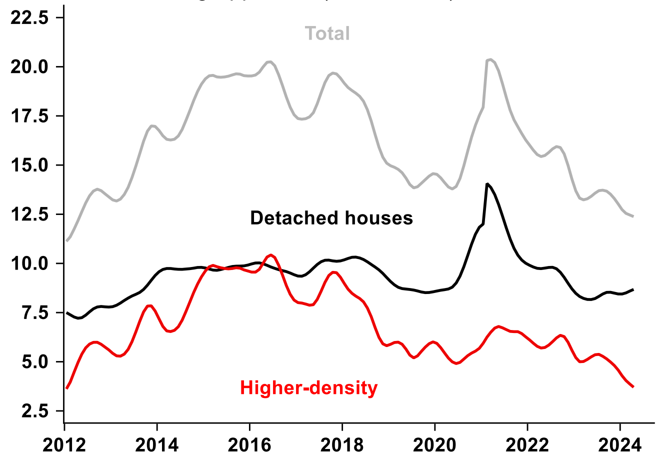
CoreLogic 8-Capital City Rents Growth (Year-ended, %)




Source: CoreLogic, NAB Economics

**Chart 8: Dwelling approvals remain low**

Residential Building Approvals (Trend, 000s)




Source: Macrobond, NAB Economics

# Business, Trade & FX

**Business investment declined in Q1 on the back of lower construction activity, while more recently business conditions have eased.**

Underlying business investment fell 0.7% q/q in Q1 (3.9% y/y), ending a run of strong growth. New machinery & equipment investment rose 2.0% with data centres a key driver, but this was more than offset by a 4.3% fall in non-dwelling construction. A fall in construction activity on oil and gas projects played a role though there was a rise in exploration activity. Software investment was also up, contributing to strong growth in intellectual property product investment.

More recently, the business conditions in the NAB Monthly Business Survey eased slightly in May, down to +6 index points, though the employment component improved after falling in the month prior. Confidence fell back into negative territory in the month and forward orders also remained negative, reflecting firms' concerns about the outlook which may weigh on investment activity. However, capacity utilisation is still above average.

Updated ABS capex expenditure expectations for FY 2024-25 also suggest nominal investment activity will slow further in the year ahead, though easing costs growth (from currently elevated rates) may be a factor here. On balance we have revised down our near-term business investment forecasts but still see a positive outlook into 2025.

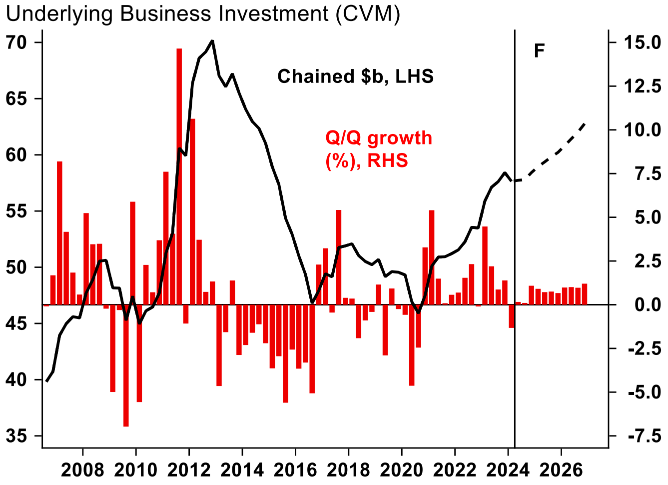
**Net exports detracted from Q1 GDP.** As expected, a significant rise in import volumes (up 5.1% q/q) caused a fall in net exports in Q1, subtracting 0.9ppts from GDP growth – though this was offset by a rise in business inventories. The rise in imports came across a mix of consumer, intermediate and capital goods, while the level of outbound tourism was revised up and now appears back to pre-COVID levels.

The combination of higher import volumes and softer export prices saw the current account fall into a $4.9b deficit in the quarter. More recent nominal goods trade data for April showed a $1.7b rebound to a $6.5b surplus as the earlier strength in imports unwound.

**Our outlook for the AUD/USD is unchanged, with the currency expected to rise to around US69c by the end of this year before rising to around US75c over 2025.**

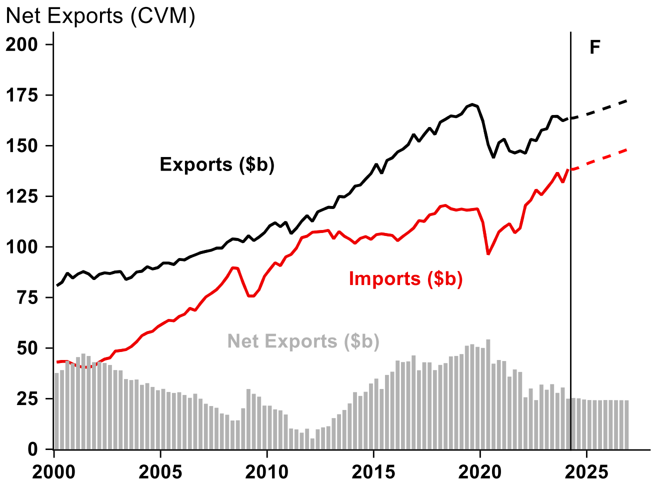
The key to this outlook will be a broader softening in the USD as the economy slows and the Fed begins to ease. The Aussie has traded around a cent lower than mid-May in recent days at around US66c though has tracked within a narrow US1c range over the past month.

**Chart 9: Underlying business investment fell in Q1, but capacity utilisation is still above average**



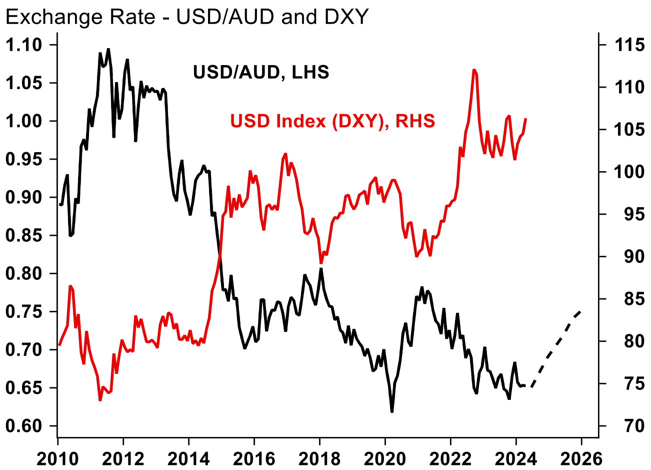

Source: Macrobond, NAB Economics

**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 monthly CPI indicator for April surprised to the upside rising 3.6% y/y – up from the 3.5% y/y and 3.4% y/y over the previous two months.**

The annual trimmed-mean and ex-volatiles measures have also shown a similar pattern over recent months – though they have tracked at higher rates of closer to 4%. The upward surprise was partly driven by a sharp increase in fruit prices though there was some evidence that other goods prices were disinflationary in the month. The next monthly release for the CPI indicator will include more information on the services components which have tracked more strongly than the goods components recently.

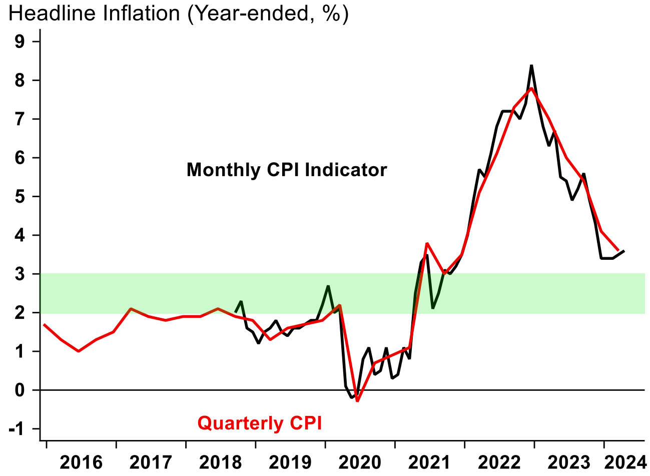
More broadly, both the goods disinflation (and deflation in some categories) and services price stories will remain important. To date, the moderation in goods inflation – and outright price declines in a number of categories - has been key in bringing inflation down from its highs of near 8% in late 2022. How long this dynamic can persist is uncertain and in part will be limited to how far retailers can discount prices.

On the services side, inflation has remained strong and has been driven by a range of factors. Wage pressure from a tight labour market and associated large increases in minimum and award wages over recent years has certainly been a factor, though wage pressure appears to have already begun to moderate as labour market tightness has eased. However, utilities and energy prices, commercial rents and insurance costs have all been additional factors.

The housing component of the CPI (which has a weight of around 14% in the basket) will also be important. While there is some evidence that CPI rents growth has moderated, it remains very strong at around 7.5% y/y and is likely to continue to grow strongly with the rental market remaining tight and a large increase in "new" rents still likely flowing though. Likewise, new home construction costs have shown some signs of easing but remain unhelpfully high at around 5% y/y. While supply chain and other disruptions have faded the strength in housing demand will likely support prices for some time.

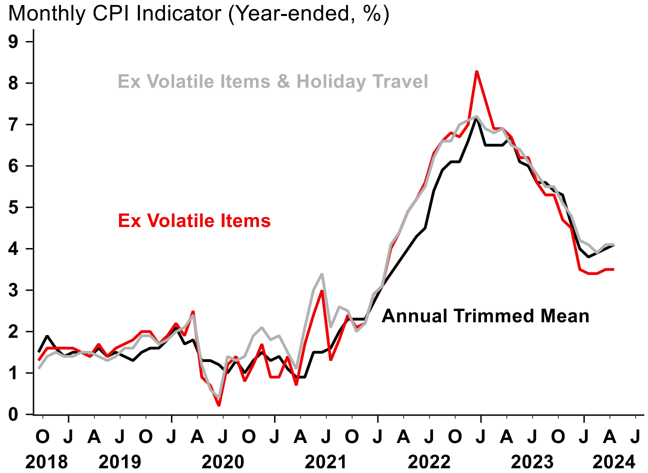
Overall, we expect the trimmed mean CPI to rise by 0.9% q/q (from 1.0% q/q in Q1) when the Q2 data is released in late July. Headline inflation is expected to rise by around 0.8/0.9% in the quarter. That outcome would continue to point to more gradual easing inflation over the coming two quarters – and inflation still tracking in the high 3% range. However, with consumer demand growth remaining soft and the labour market continuing to loosen we expect inflation to continue to moderate – falling to 3.4% y/y by end 2024 and to around 2.5% over 2025.

**Chart 12: The monthly CPI indicator saw Y/y inflation tick up in April**



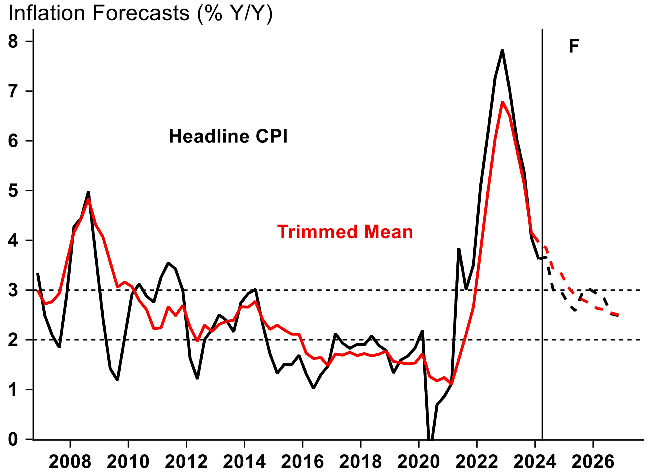

Source: Macrobond, NAB Economics

**Chart 13: Exclusion based measures of inflation continue to track more strongly**




Source: Macrobond, NAB Economics

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




Source: Macrobond, NAB Economics

# Monetary Policy

**For the RBA, a further easing in inflation and the confidence that inflation will settle at around the middle of the target band remain key.**

We continue to see the next move for the cash rate being a cut – likely in in November, though we acknowledge the risk is that it could come later – and see the RBA taking the cash rate back to around 3.1% over 2025, which we see as broadly neutral. We see inflation continuing to moderate, albeit more gradually, with trimmed mean inflation tracking down to around 3.4% y/y by end 2024. This further progress as well as the ongoing rise in the unemployment rate will likely give the RBA enough confidence that inflation is tracking towards the middle of the 2-3% target band by 2026.

Further, the rise in the unemployment rate will become an increasingly important factor as the RBA seeks to hold onto the gains in the labour market over recent years and - alongside its inflation objective – aim for a "full-employment" outcome of around 4.25%. While central banks are always data dependent, the fact that rates are in restrictive territory means that the outlook will become increasingly important as the year progresses. Given the long lags in monetary policy, waiting until inflation is back within the target band before cutting would likely be too late, running the risk of an inflation undershoot and a larger rise in unemployment. Importantly, we see inflation continuing to moderate in 2025 falling to around 2.6% y/y and unemployment stabilising at around 4.5% - a touch above but broadly around the RBA's assumption for full employment.

For us, the key risk is that not enough progress is made on bringing down inflation over the next 6 months and the fact that volatility in the inflation numbers will continue to make a clean read difficult. Both of these factors may challenge the RBA's confidence even if the unemployment rate continues to drift higher and weak growth persists.

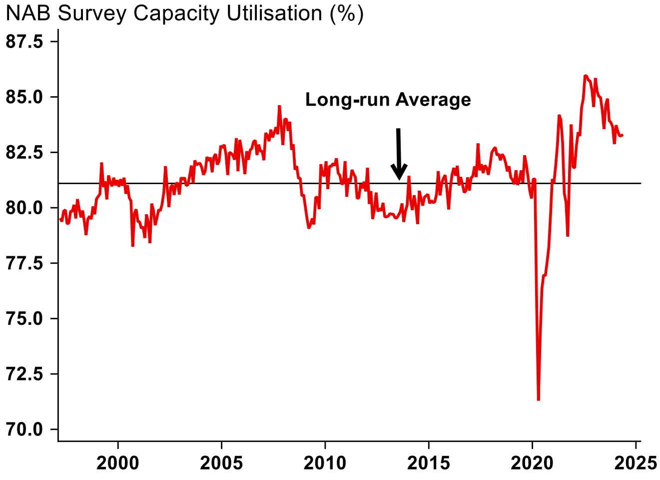
**The post meeting statement and press conference following the June meeting continued to highlight the upside risks to inflation but also the downside risks from ongoing soft growth.**

The recent slower progress on inflation was acknowledged as was the strong domestic cost growth backdrop including still strong wages growth. Importantly the RBA continues to assess that excess demand persists even while growth has been slow.

That said, the outlook was framed as highly uncertain given the weakness in output growth and developments in household consumption with revisions to the savings rate and per capita spending still falling.

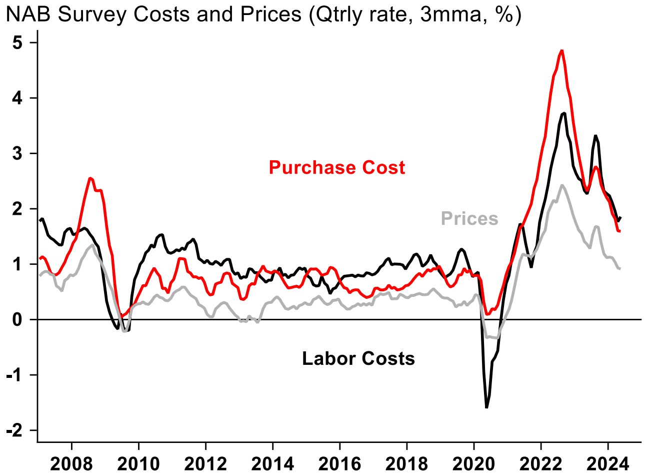
Ultimately, the Board continues to "not rule anything in or out" and with a month and a half to the next meeting, the Q2 CPI is shaping up as an important data print.

**Chart 15: Capacity utilisation has eased but remains high**



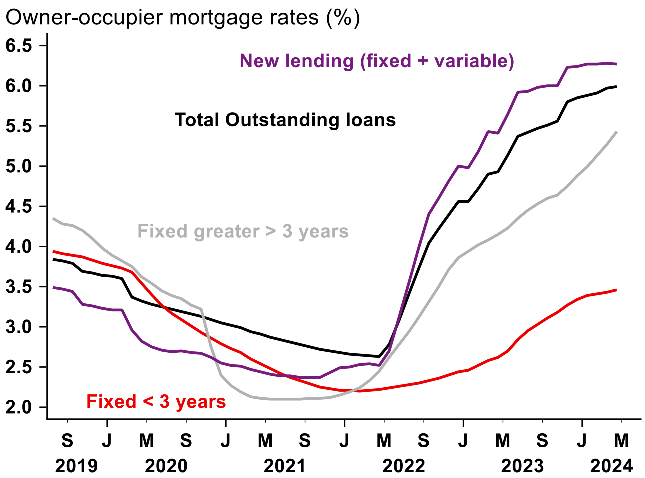

Source: Macrobond, NAB Economics

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




Source: Macrobond, NAB Economics

**Chart 17: The impact of higher rates continues to be acute for households**




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 | 0.3 | 0.4 | 0.2 | 1.0 | 1.6 | 1.9 | 1.8 |
| Dwelling Investment | -3.6 | -0.5 | -1.0 | -3.1 | -1.5 | 2.6 | 2.9 |
| Underlying Business Investment | 1.4 | -1.3 | 0.2 | 9.2 | 0.0 | 3.1 | 4.2 |
| Underlying Public Final Demand | 0.4 | 0.6 | 0.7 | 4.6 | 2.6 | 2.0 | 2.0 |
| **Domestic Demand** | **0.3** | **0.2** | **0.3** | **2.8** | **1.8** | **2.4** | **2.5** |
| Stocks (Cont. to GDP) | -1.0 | 1.0 | -0.3 | -0.9 | 0.2 | 0.0 | 0.0 |
| **Gross National Expenditure** | **0.0** | **1.0** | **0.0** | **1.8** | **2.2** | **2.5** | **2.5** |
| Exports | -1.3 | 0.7 | 0.1 | 3.0 | 1.7 | 2.1 | 2.2 |
| Imports | -3.5 | 5.1 | -0.1 | 4.9 | 6.6 | 2.7 | 2.6 |
| Net Export (Cont. to GDP) | 0.4 | -0.9 | 0.1 | -0.2 | -1.0 | 0.0 | 0.0 |
| **Real GDP** | **0.3** | **0.1** | **0.1** | **1.6** | **1.3** | **2.4** | **2.4** |
| Nominal GDP | 1.6 | 1.4 | 1.4 | 4.5 | 5.6 | 4.0 | 3.9 |
| **Labour Market** | | | | | | | |
| Employment | 0.7 | 0.5 | 0.7 | 3.0 | 1.7 | 2.2 | 1.8 |
| Unemployment Rate (Q-Ave, End of Period) | 3.9 | 3.9 | 4.1 | 3.9 | 4.5 | 4.4 | 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.

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