The Forward View: Australia July 2024

Rates on hold but still hopes of a soft landing

NAB Economics

Overview

- The key change to our forecasts over the past month was the shift on our view for the timing of the first RBA rate cut. We now expect the first cut to occur in May 2025 – though we still expect the RBA to ultimately cut rates by 125bps over the subsequent year or so. We acknowledge the upside risks to rates in the near-term, but we ultimately see the RBA maintaining its strategy of trying to hold onto labour market gains. That sees the need to remain on hold for longer.
- On inflation, we have firmed up our pick for Q2 – now expecting 1.0% q/q (4.0% y/y) for the trimmed-mean and 1.0% q/q (3.8% y/y) for headline. Nudging up the profile sees underlying inflation end the year at 3.7% y/y.
- Our outlook for growth is broadly unchanged. Growth is expected to remain well below trend this year but improve to around its trend rate over 2025 and 2026 at ~2.25%.
- The unemployment rate is still expected to rise to around 4.5% by end 2024 and stay there through 2025. As has been our view for some time, this will largely reflect a cooling in labour demand amid still-strong population growth, rather than an outright decline in employment.
- In terms of the recent data flow, we see growth as having remained soft in Q2. ABS retail sales data and our internal transactions data suggest another quarterly decline in real retail sales. Our Monthly Business Survey measure of business conditions also points to a further loss of momentum – falling further below average in June.
- Inflation has remained higher than we (and the RBA) expected, although the market services components of the monthly CPI indicator – though still high - show a clearer easing trend. That said, overall inflation remains important and has shown little further moderation in H1 2024.
- Pressure in the labour market continues to ease, with forward indicators continuing to soften. That said, job vacancies remain elevated pointing to ongoing resilience in the near-term.

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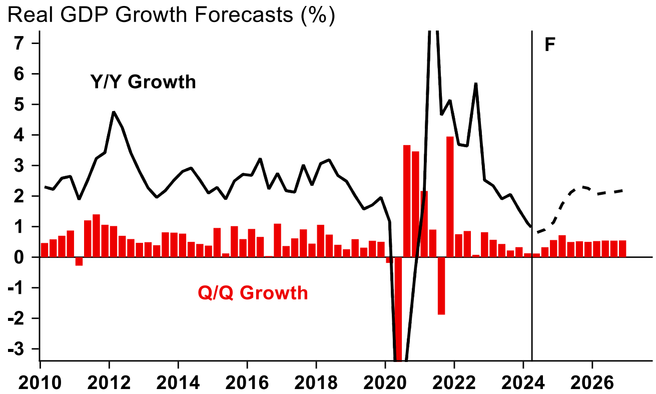
Key Economic Forecasts

	2023	2024(f)	2025(f)	2026(f)
Domestic Demand (a)	2.8	1.7	2.1	2.0
Real GDP (annual ave)	**2.0**	**1.0**	**2.1**	**2.1**
Real GDP (year-ended)	**1.6**	**1.1**	**2.3**	**2.2**
Employment (a)	3.3	2.3	1.7	1.9
Unemployment Rate (b)	3.9	4.4	4.5	4.4
Headline CPI (b)	4.1	3.0	3.0	2.4
Core CPI (b)	4.3	3.7	2.7	2.5
RBA Cash Rate (b)	4.35	4.35	3.60	3.10
$A/US cents (b)	0.68	0.69	0.75	-

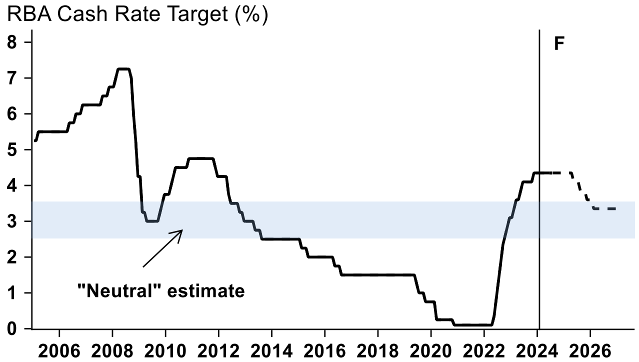
(a) annual average growth, (b) end-period

Chart 1: GDP forecasts



Source: Macrobond, NAB Economics

Chart 2: Cash rate profile



Source: Macrobond, NAB Economics

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

Labour Market & Household Consumption

The labour market continues to show resilience but is loosening.

Trend employment growth has tracked around 40k m/m over recent months which has been a resilient outcome given the below trend growth in the economy. Employment growth at these levels has been enough to keep the unemployment rate at around 4% (though it has been volatile) – but we expect the unemployment rate to drift higher, reaching 4.5% by end 2024. While population growth appears to have peaked, it remains strong at 50k per month and, with below trend growth persisting through mid-2024, it is unlikely that labour demand will grow sufficiently to absorb the ongoing rise in population – even as pent-up labour demand is eroded.

That said, near term indicators point to some resilience in the near-term. Job vacancies, despite easing a further 2.7% (to be down 28% from their peak) in Q2, remain high at 350k. As a share of the labour force, they remain around 2.4% and there are currently 0.6 vacancies per unemployed a still historically high level.

Contrasting the ABS job vacancies series, various measures of job ads have declined and the actual and expected NAB Survey employment indexes have also pulled back (but remain positive) consistent with further loosening in labour market conditions.

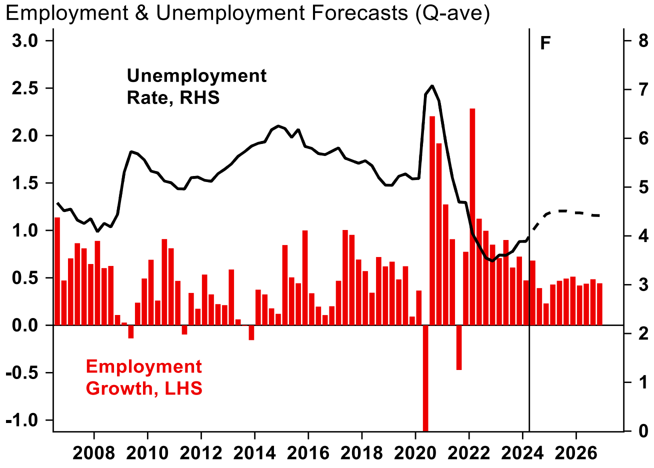
High frequency data suggest that consumer spending growth remained soft in Q2.

Retail sales data to May and our internal transactions data for June suggest that nominal retail sales increased by 0.5% in Q2, which would imply a fall in volumes terms of around 0.5%, similar to that seen in Q1. Broader consumption (including services and non-retail components) according to our transactions data is also soft – with a flat outcome for June and a Q2 quarter average increase of 0.9% in nominal terms. For now, we pencil in a small increase in aggregate household consumption in real terms for Q2.

The story around consumption has become more nuanced. The historical revisions released in last month's national accounts for Q1 suggest a much greater degree of resilience in aggregate. Discretionary spending is now 8.5% above pre-pandemic in real terms but has declined by 0.9% over the last two quarters. The rebalancing theme between goods and services also now looks to have run its course.

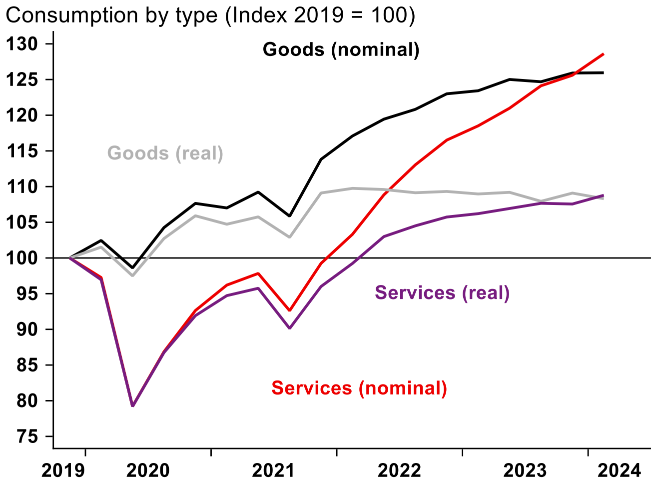
However, at the individual level the adjustment is starker. Per capital consumption is down 1.5-2.0%. The average savings rate across households has also shown a significant adjustment but remains positive. How households respond to easing budget pressures – as tax cuts flow through and inflation continues to moderate will be key in H2 2024.

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



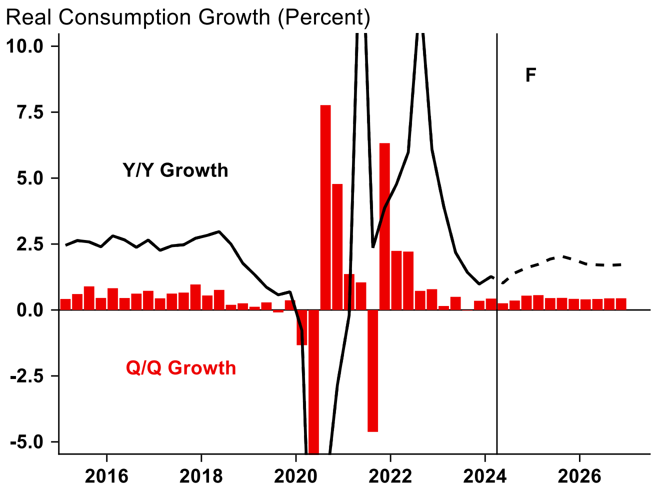
Source: Macrobond, NAB Economics

Chart 4: The goods/services spending rebalance looks to have run its course



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

The broad trends of strong demand and slowing supply growth continue to be the dominant dynamic in the housing market.

The CoreLogic 8-Capital city dwelling price index rose by 0.7% m/m and is up 8.3% y/y. Annual price growth has slowed from above 10% in early 2024 but remains strong. The capital city picture remains the same. Perth dwelling prices continue to grow strongly rising 2.0% m/m (24% y/y), followed by Adelaide at 1.8% m/m (15% y/y) and Brisbane, 1.2% m/m (16% y/y). Sydney prices rose a further 0.5% (6.3% y/y) while Melbourne edged down a further 0.2% (1.2% y/y). The mainland capitals have all more than recovered their fall over the year to early 2023 (as rates increased sharply). Overall, the 8-capital city price index is now up 30% on its pre-pandemic level.

Rents growth edged down across the capital cities in the month. It remains strongest in Perth and Melbourne, followed by Brisbane and Adelaide. Sydney rents growth slowed sharply in the month, rising just 0.1% m/m. Overall, rents growth remains very strong according to the CoreLogic Capital city (new rents; 8.5% y/y) and the CPI measure (all rents) 7.5% y/y.

Rental vacancy rates appear to have eased slightly since early 2024. That said, given the very tight starting point, they remain low and will likely see strong upward pressure on rents in the near term.

Though dated, the most recent population data released in late June showed that population growth likely peaked in Q3 last year but remains historically very strong at 2.5% and well above its previous peak in 2008. Therefore, the demand/supply imbalance will likely persist for some time particularly with the supply side remaining challenged.

Indeed, dwelling approvals, despite a rebound in the month, remain low.

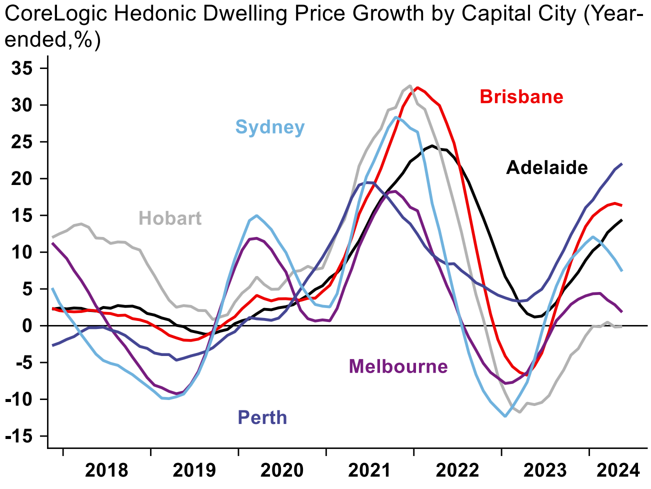
The 5.5% overall rise in approvals in the month was driven by a 16.3% increase in the volatile high-density series. House approvals rose 2.1% - and both series remain around their lowest levels since mid-2013 in trend terms.

At these levels, approvals imply an ongoing decline in completions suggesting that there will be very little catchup in supply in the near-term.

The rise in rates, challenges in the building industry and still high prices for building work have all weighed on confidence in the sector - and any correction in prices remains uncertain.

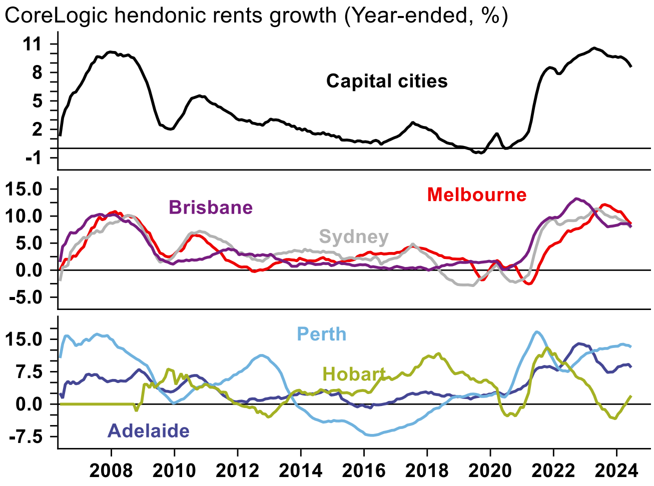
The NAB Survey indicates construction materials and labour cost growth remains elevated though has eased. This is consistent with the PPI measure of housing construction input costs which remain 30% higher than 2020.

Chart 6: Price growth has diverged across the capitals



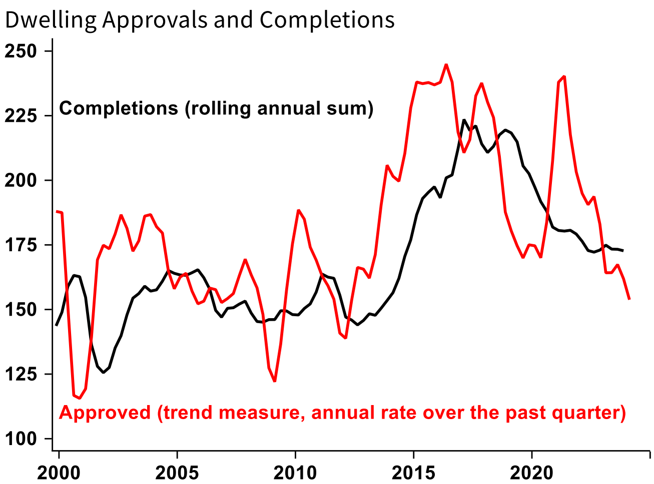
Source: Macrobond, NAB Economics

Chart 7: Rents growth has eased but remains high



Source: Macrobond, NAB Economics

Chart 8: Dwelling approvals remain low



Source: Macrobond, NAB Economics

Business, Trade & FX

Business conditions have continued to ease alongside the broader slowing in growth across the economy.

The NAB Monthly Business Survey for June showed further easing in business conditions which are clearly below average. Conditions remain weakest in retail (as does confidence), mirroring at least some of the weakness in consumer sentiment surveys. That said, while conditions have consistently eased for the better part of 18 months and confidence has been weak, they remain in positive territory.

Though confidence bounced, and is at its highest since early 2023, forward orders remain very weak and suggest ongoing weakness in the near term. The goods distribution sectors - retail, wholesale and manufacturing are weakest.

Capacity utilisation remains high suggesting that while growth has certainly slowed the level of activity remains high. Despite that, reported Capex eased further in the month and is now at a low level. The next run of business investment data will only be available in late August, providing an important update on how business investment is tracking as economic growth remains soft. Business investment rose over recent years, in part, supported by pandemic era tax and other support which have now ended or been wound back.

We expect ongoing softness in business investment in the near-term but a return to moderate growth in the next couple of years is part of our outlook of broader GDP growth returning to trend.

Trade data for May showed a narrowing in the goods trade balance. Exports rose 2.8% - led by gains in iron ore but were outpaced by a 3.9% increase in imports.

The value of exports ($44bn in May) continues to be well supported by high commodity prices, relative to pre-pandemic levels, though it is below its pandemic peak in 2022 of $56bn.

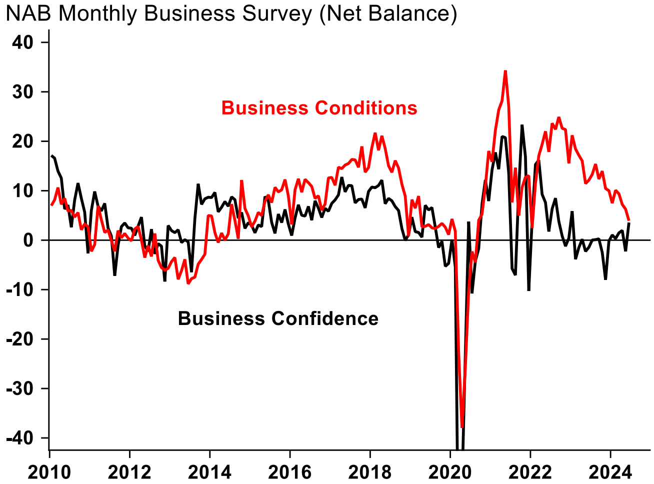
More broadly, the slowing in GDP growth through H1 2024 has been a result of a waning (and volatile) contribution from net exports as the recovery in student exports through 2023 looks to have run its course).

The Aussie has strengthened over the past month trading above US67c after being range bound between 66 and 67c over May and June.

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.

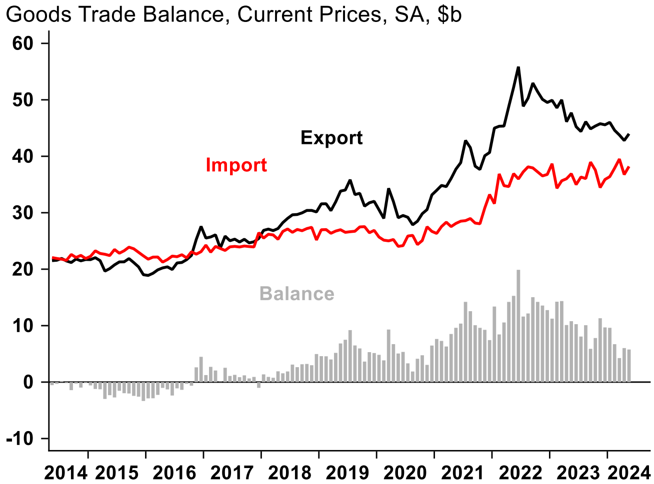
The key to this outlook continues to be a broader softening in the USD as the economy slows and the Fed begins to ease – with expectations firming up for a first cut in the Fed Funds rate in September with the key PCE and CPI reads pointing to a further easing in inflation.

Chart 9: Business conditions eased further in July



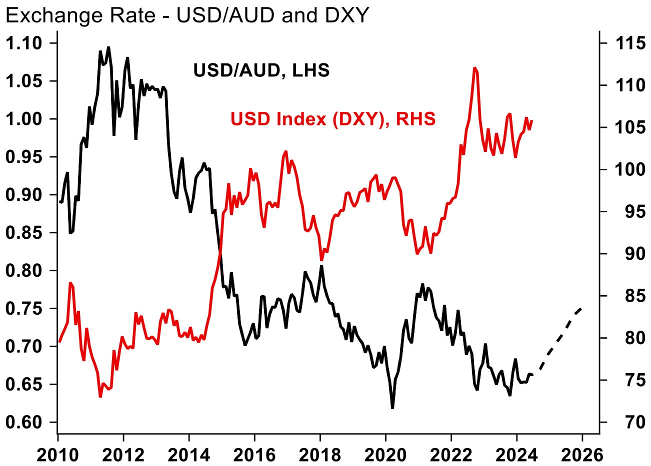
Source: Macrobond, NAB Economics

Chart 10: The goods trade balance remains in surplus, supported by high commodity prices



Source: Macrobond, NAB Economics

Chart 11: The AUD is expected to appreciate over the next two years



Source: Macrobond, NAB Economics

Inflation

The monthly CPI indicator showed a further acceleration in year-ended terms in June, rising to 4.0% y/y.

The analytical measures including the annual trimmed-mean and the seasonally adjusted headline figure both accelerated further in the month to 4.4% and 3.8%, respectively. The ex-volatiles measure edged down but remains high at 4.0%.

However, the monthly measure remains only a partial indicator and information at the more granular level is key. The upside surprise in the month was largely on the goods side, while there were some encouraging signs of a stronger trend easing in market services inflation. That said, services inflation continues to track more strongly than goods inflation.

Based on the monthly information for May (giving us 2/3rds of the quarterly data) we have upped our trimmed-mean forecast to 1.0% q/q (4.0% y/y). That suggests that there has been little further moderation in the pace of inflation through H1 2024 after easing by around 2ppts in annual terms over 2023.

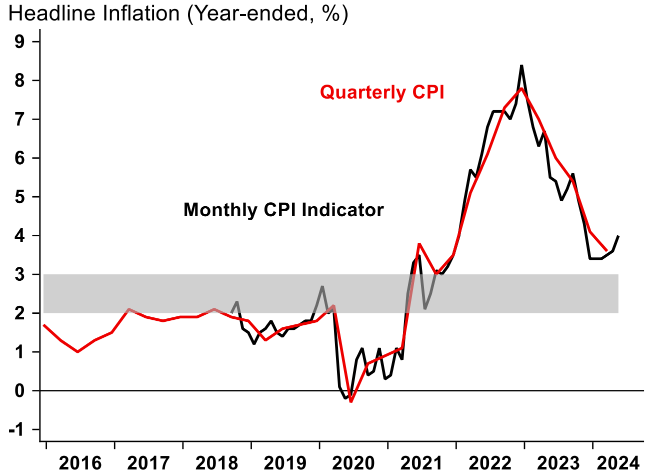
Further out, the trajectory of our inflation forecasts remains the same. After increasing the near-term slightly we now have the trimmed-mean measure easing to around 3.6% by end 2024, and 2.7% by end 2025. Headline inflation will remain volatile over the next couple of years as subsidies impact measured prices and then unwind in the out years.

Importantly though, we do not assess consumer price inflation as having reaccelerated. The track back towards target will likely remain bumpy with the impact of subsidies as well as ongoing volatility in several components.

But the broader inflationary back drop is likely easing. Wage growth appears to have peaked and has eased slightly, while the minimum and award wage increases also decreased in the current year. As the labour market continues to ease, it is likely that wage pressure will ease further. It is also likely that other business overhead costs which have been important, including utilities, insurance, commercial rents and other business services will also likely moderate. Indeed, the NAB Monthly Business Survey showed a reversal of last month's spike in purchase costs growth (and labour costs) but nonetheless it remains high.

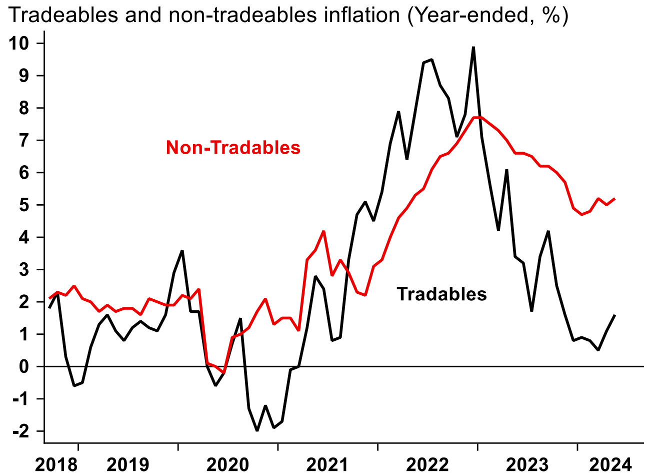
The ability of businesses to pass on cost pressure is also waning with consumer demand growth remaining weak. This suggests that ongoing cost pressures will have a greater impact on business margins rather than consumer prices.

Chart 12: The monthly CPI indicator saw an upside surprise in May



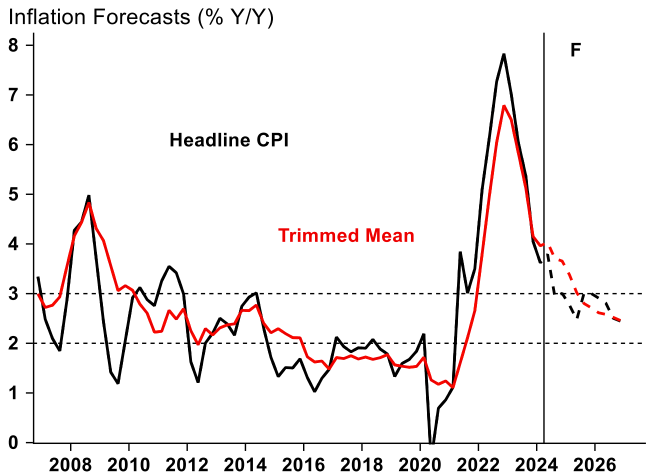
Source: Macrobond, NAB Economics

Chart 13: Non-tradables inflation remains higher than tradables



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

We now see the RBA remaining on hold until May 2025, before easing rates by 125bp over the year to May 2026.

After holding onto our call since late January 2024 that the RBA would begin to ease rates from November we had flagged the risk that rates could remain on hold for longer over recent months as the pace of moderation in inflation began to slow while activity (and the labour market) had played out largely as expected.

In firming up our expectation for the Q2 CPI (1.0% q/q) based on the monthly partial data it became clear that little further progress appears to have been made in H1 2024.

We see the board has having two options, increasing rates further (likely requiring a planned strategy of more than one hike) and ensuring that inflation moderates more quickly, while running the risk of ongoing weakness in growth and a larger deterioration in the labour market. Alternatively, the board may choose to remain on hold, and continue to face upside risk to inflation in the near term (or let the slated 2026 timeframe slip) but look to hold on to as large a proportion as possible of the gains in the labour market over recent years.

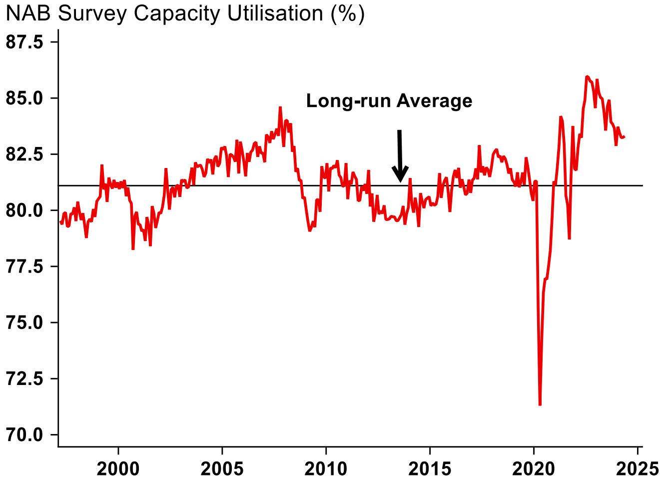
For now, we expect the RBA to remain reluctant to take the cash rate higher given unemployment is not far from their estimate of "full-employment' and the already weak growth backdrop. This option, however, would see the RBA on hold for longer, as policy is only moderately restrictive, meaning there is less scope for a pre-emptive easing based on the outlook.

Indeed, it is unlikely the RBA Board will have the data needed by November to give it the confidence that inflation will continue to moderate to the middle of the target band on the previously expressed timeline of mid-2026.

The post meeting communication in the statement, press conference and the minutes were consistent with this, highlighting "the need to be alert to the upside risks to inflation".

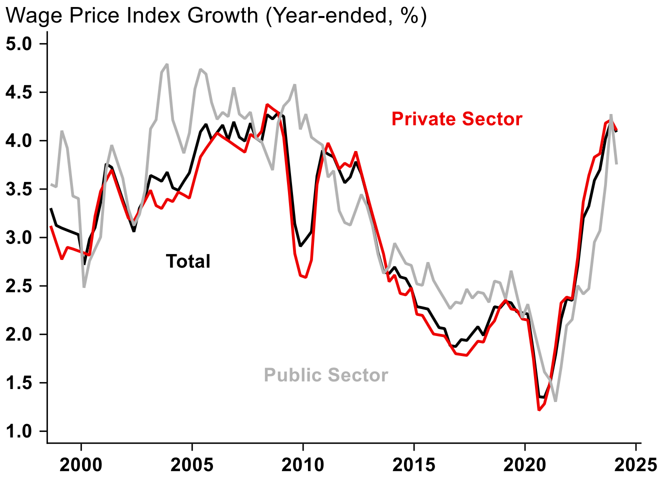
But the risks to growth and the labour market were enough to keep the RBA on hold – albeit likely uncomfortably. With no meeting in the month of July, the RBA was looking to the consumption partials, business surveys, labour force and CPI data as well as a new set of staff forecasts and an updated assessment of spare capacity by the August meeting.

Chart 15: Capacity utilisation has eased but remains high



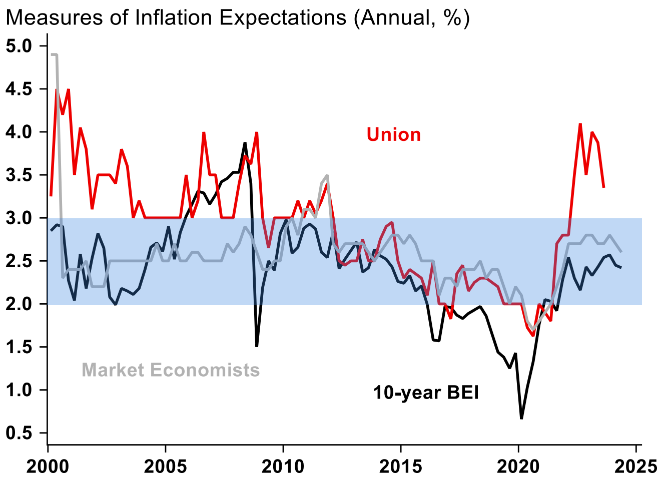
Source: Macrobond, NAB Economics

Chart 16: Wage growth appears to have peaked



Source: Macrobond, NAB Economics

Chart 17: The RBA assesses inflation expectations as having remained anchored



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	0.3	1.0	1.6	1.9	1.7
Dwelling Investment	-3.6	-0.5	0.1	-3.1	-0.7	1.7	2.5
Underlying Business Investment	1.4	-1.3	0.4	9.2	-0.9	1.9	1.7
Underlying Public Final Demand	0.4	0.6	0.5	4.6	2.1	1.6	1.4
Domestic Demand	**0.3**	**0.2**	**0.4**	**2.8**	**1.6**	**2.1**	**2.0**
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**	**0.1**	**1.8**	**2.0**	**2.3**	**2.0**
Exports	-1.3	0.7	0.1	3.0	1.7	2.1	2.2
Imports	-3.5	5.1	0.0	4.9	6.1	2.1	1.6
Net Export (Cont. to GDP)	0.4	-0.9	0.0	-0.2	-0.9	0.1	0.2
Real GDP	**0.3**	**0.1**	**0.1**	**1.6**	**1.1**	**2.3**	**2.2**
Nominal GDP	1.6	1.4	1.5	4.5	5.6	3.9	3.6
Labour Market							
Employment	0.7	0.5	0.7	3.0	1.8	1.9	1.8
Unemployment Rate (Q-Ave, End of Period)	3.9	3.9	4.1	3.9	4.4	4.5	4.4
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	3.8	4.1	3.0	3.0	2.4
Trimmed-mean CPI	4.2	4.0	4.0	4.2	3.7	2.7	2.5
RBA Cash Rate (End of Period)	4.35	4.35	4.35	4.35	4.35	3.60	3.10
10 Year Govt. Bonds (End of Period)	3.96	3.98	4.33	3.96	4.20	4.00	-
$A/US cents (End of Period)	0.68	0.65	0.66	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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