Global Overview & Australia

Inflation still high for services. Wage pressures peaking. The impact of higher rates. Serious slowdown underway - but how deep? And what about rates?

Alan Oster, Group Chief Economist, August 2024

Global macroeconomic summary

There are a number of areas of concern on the global economy

- Russian responses to Ukraine war and commodity prices spike. But China still a concern geopolitically. **Now worried about the Middle East – and potential for a global oil price shock. But not in our forecasts yet.**

- **Central Banks were aggressive in increasing rates over 2023.** Lags are important and for most economies the slowing is here. **US the main surprise – it's was still strong into H1 2024**. But we have long thought suspected the weakness in the US will be even more evident into 2024 (second half of the year). **That now apparent.** Growth of around 1.5% through 2024. But year average around 2.2%. Sahm's rule suggests recessionary times ahead (unemployment up 1/2% over 12 months).

- **Manufacturing economies are suffering now- eg China and Germany.** Service sectors look more stable but not really accelerating.

- **China has seen a big slowing in momentum post vaccine changes.** Property market also an issue. As are consumers not spending. No major policy change in the offing. We see 4.5% growth in 2024. And below 5% in 2025 and 2026. **Really quite weak**.

- **Globally, outside of COVID and GFC, 2024 looks like being the worst year since 2002.** Global economy outlook is tough even without geopolitical problems. 2025 and 2026 not a lot better.

- **Markets are of the view that central banks in 2024 will be in cutting mode.** Timing depends on growth and inflation profile:
  - Some economies have started to cut – including Euro, and Canada;
  - UK a touch later (August) and the US (50 points in September and cuts every meeting till around 3% Fed funds - late 2025). New Zealand from September – thereafter aggressive cuts.
  - Australia in first half of 2025

Global economic forecasts

2023 was soft at 3.2% and slowing during the year. Shows up most in 2024 year averages. At 3% the slowest growth rate outside COVID and GFC since 2002. Big slowing in US (ahead) and major economies (mainly already here). China under pressure. Same in 2025. 2026 only a touch better

	2022	2023	2024	2025	2026
US	1.9	2.5	2.3	1.4	1.8
Euro-zone	3.5	0.6	0.8	1.2	1.4
Japan	1.5	1.8	-0.2	0.7	0.7
UK	4.3	0.1	0.8	0.8	1.2
Canada	3.8	1.2	0.9	1.4	1.8
China	3.0	5.2	4.5	4.8	4.5
India	6.4	7.7	6.6	6.2	6.4
Latin America	4.2	2.2	1.3	2.1	2.1
Other East Asia	4.2	3.1	3.8	3.7	3.9
Australia	3.9	2.0	1.0	2.2	2.3
NZ	2.4	0.6	0.2	2.5	3.1
Global	**3.5**	**3.2**	**3.0**	**3.0**	**3.1**

Australia macroeconomic summary

Economy has slowed a lot. Rates, rents and global softness driving a serious slowdown. How deep?

- **GDP growth to slow to around 1.2% during 2024. Currently around 1% (year to Q1 2024).**
  - Key drivers, slower global growth and rate rises. And lack of orders and confidence in some sectors.
  - Growth in 2025 back to around trend (2.2%). And similar beyond that.

- **Unemployment still very low at around 4%. Unemployment path critical.**
  - Shortage of labor still high – especially skilled labor.
  - Seasonal issues still have a big influence on monthly numbers.
  - But we still expect unemployment to be around 4.5% by late 2024, and broadly similar thereafter.

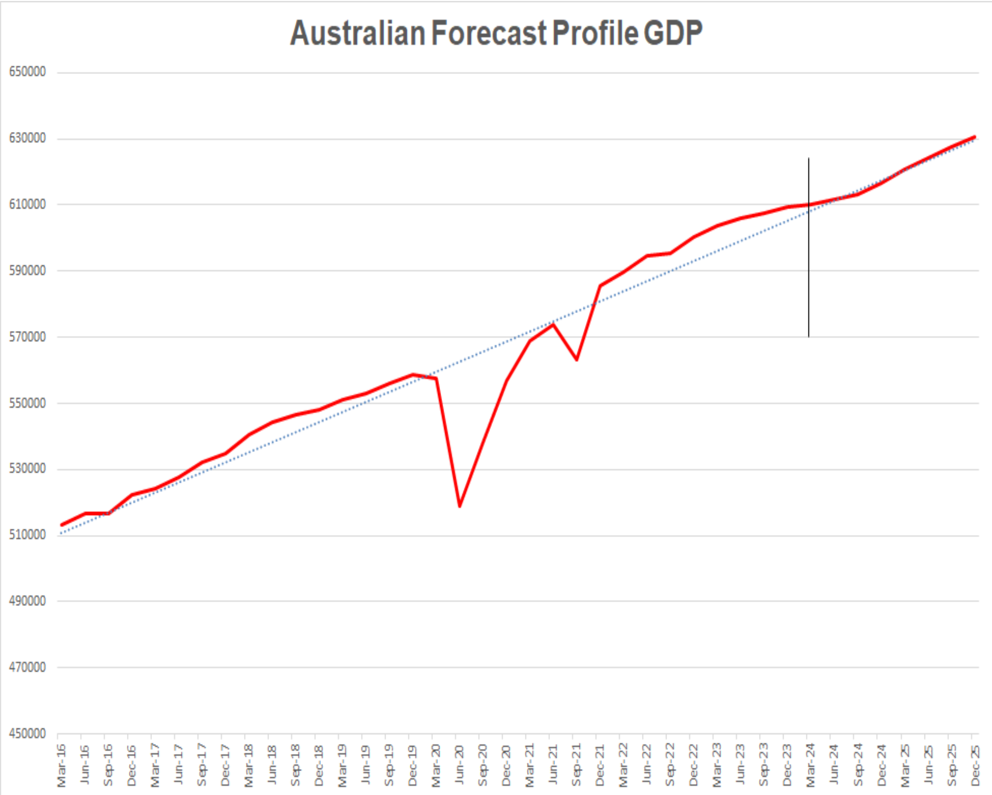
- **Price inflation has peaked but will stay high for a while.**
  - Purchase costs has slowed. As has wages. But service inflation still elevated.
  - Core currently around 4% but will slow to around 3.4% by late 2024 and 2.8% by end 2025. And 2.6% by early 2026.
  - Headline reflecting budget changes at 3.1% by end 2024 but stay around that rate in 2025.

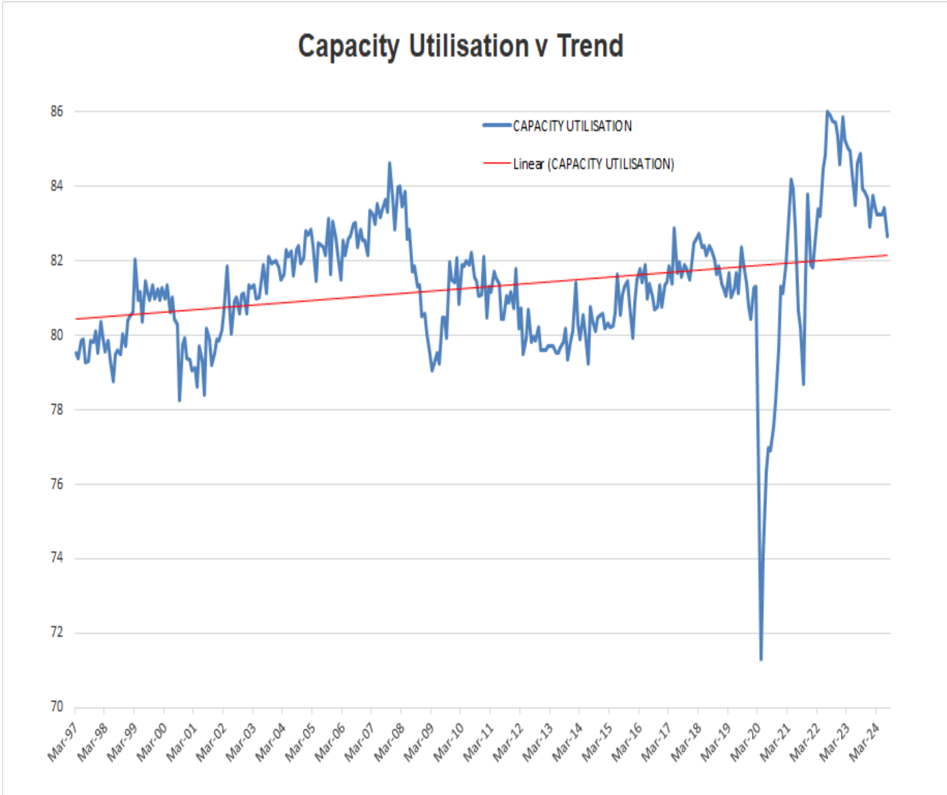
- **Wages growth too, has probably peaked (around 4.1% currently).**
  - Wages growth may have peaked. And consumer expectations remain reasonable.
  - Cyclical productivity after bottoming, now improving a touch - which reduces unit labor cost increases.
  - Expect wages to gradually reduce to around 3.8% by 2024 – and a little lower in 2025 (3.4%).

- **RBA now data watching. At the peak and to start cutting in H1 2025.**
  - RBA in data watching mode. In a very uncertain environment.
  - **We still see cuts starting in H1 2025. Currently we have May 2025 but could well come earlier. Down to 3% by mid 2026.**
  - Markets still playing with cuts by late 2024. And down to around 3¼% by late 2025.

So where are we at now

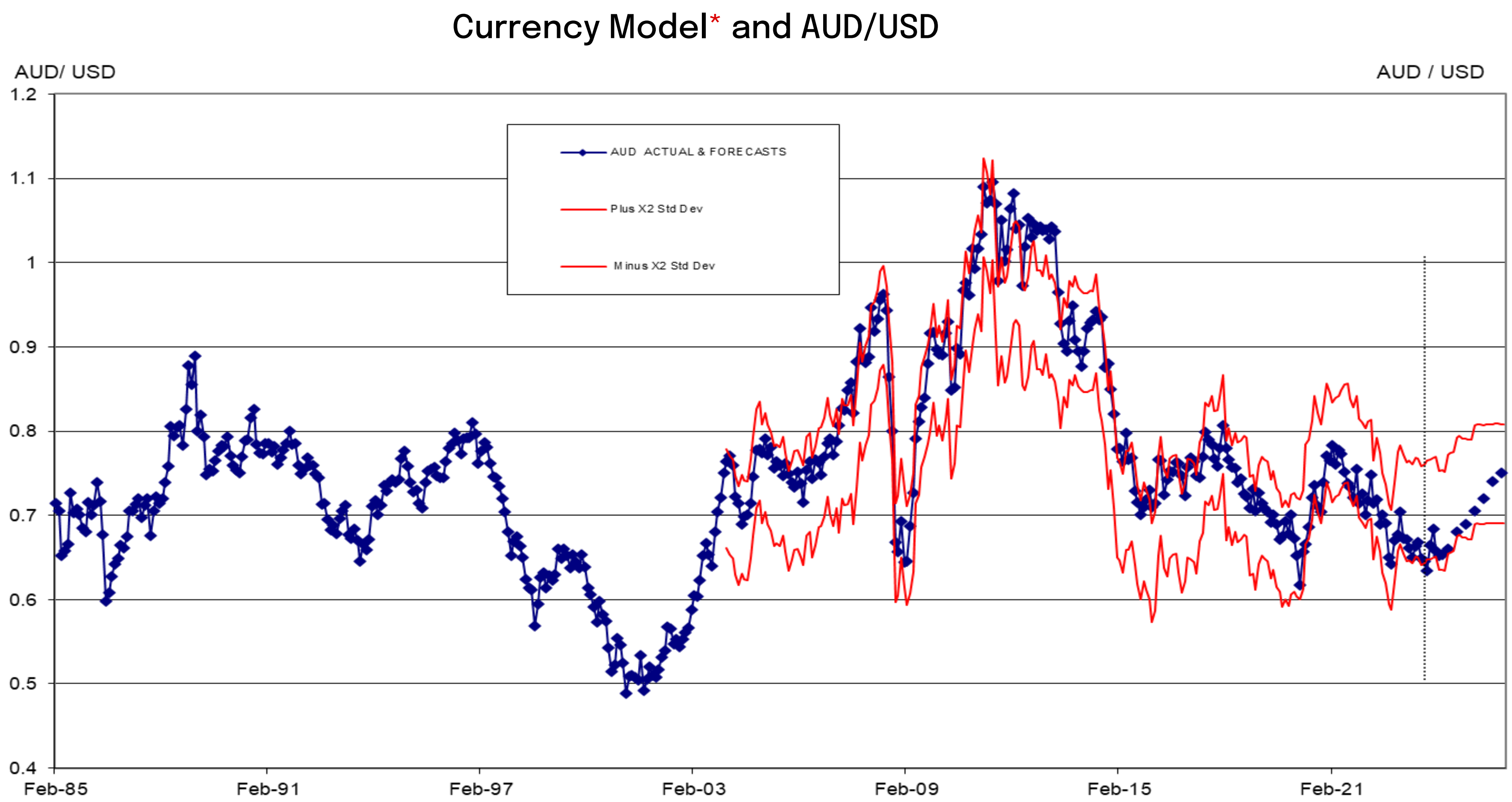
In level terms, demand still above supply but rapidly closing. Both GDP and capacity utilisation to LR trends suggest the same





Currency model USD 0.69+/- 5c

Recent movements very much reflecting strength of the USD. Australia a proxy for risk in uncertain world and China fears. Model seriously under valuing AUD at present. But expect it will recover



- Model driven by: commodity prices; US TWI – as measure of USD strength; long and short run rates; relative unemployment; relative equity markets and VIX

Forecasts:

End 2024= 69c AUD/ USD
End 2025= 75c AUD/ USD

Data Insights

- NAB Data
- Business Survey

Retail was up in June on the back of discounts (up 0.5% and similar to our data). But in real terms Q2 retail was down -0.2%

July looks flat in both retail and consumption. With discretionary spend down in July, weaker than last year for both retail and consumption. So, no sign (yet)of a surge post the July tax cuts

Headline Table (Long Version)

	May-24	Jun-24	Jul-24		
	m/m	m/m	m/m	3m/3m	y/y
Goods Retail	0.2	0.8	0.2	1.5	5.6
Cafes & Restaurants	0.4	0.9	-0.3	0.7	4.0
Total Retail	**0.3**	**0.8**	**0.1**	**1.3**	**5.3**
Vehicles & Fuel	0.8	-2.5	1.1	-0.5	2.2
Essential Services	-0.2	0.2	-0.5	0.6	4.5
Other Spending	0.3	1.4	-0.9	0.5	4.5
Total Spending	**0.3**	**0.6**	**-0.1**	**0.9**	**4.8**
Goods	0.3	0.3	0.3	1.2	5.1
Services	0.2	1.0	-0.6	0.6	4.4
Discretionary	0.5	1.2	-0.4	1.3	5.0
Non-Discretionary	-0.2	-0.5	0.4	0.2	4.3
Total ex Fuel	0.2	0.8	-0.2	1.0	4.9

Excludes taxes, rent, mortgages, gambling, finance, insurance, and other non-consumer transactions. Data are seasonallyadjusted and subject to revision.

Business inward credit growth (business revenues) in July flat - but up 7% y/y

Y/y weakness in mining, arts and rec, and manufacturing. Strength in utilities, media, rental & real estate, education and food

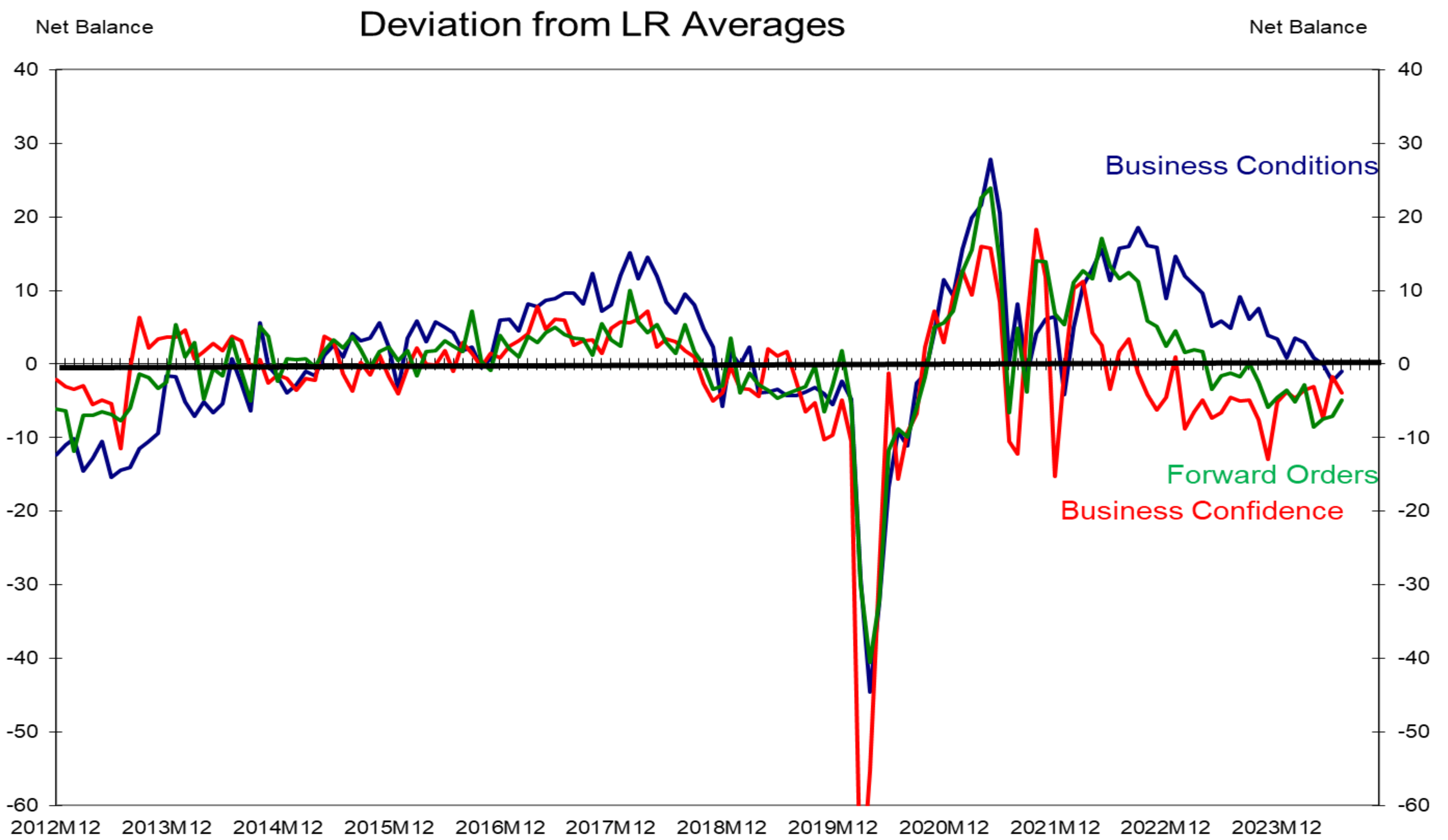
Headline table

	May-24	Jun-24	Jul-24		
	m/m	m/m	m/m	3m/3m	y/y
Total	**0.6**	**0.3**	**-0.2**	**2.2**	**7.0**
Total ex Mining & Agri	*0.9*	*0.7*	*-0.2*	*3.0*	*8.9*
Accom & Food	0.3	1.1	0.0	2.0	11.8
Admin & Support	0.1	-0.3	-1.6	0.2	1.4
Agriculture	-0.2	0.3	1.3	4.2	3.5
Arts & Rec.	-1.1	-0.5	3.0	-0.2	0.3
Construction	0.6	0.2	0.9	1.8	7.9
Education	2.4	0.7	-1.2	5.6	13.6
Utilities	4.2	-0.2	-0.3	9.9	27.9
Health	1.5	2.1	-1.2	3.6	10.5
Info & Media	4.2	-3.6	-1.9	5.8	24.9
Manufacturing	0.0	-0.6	-1.0	0.3	4.5
Mining	-2.4	-5.1	-2.1	-7.9	-11.6
Other Services	3.3	-0.9	2.8	3.5	12.8
Professional Services	-0.5	1.7	-0.1	2.8	12.6
Rental & Real Estate	1.0	2.6	-1.0	4.7	16.3
Retail Trade	1.9	-1.2	-0.2	2.5	14.9
Transport & Postal	2.4	0.5	0.6	6.5	-8.8
Wholesale Trade	-0.1	3.4	-0.1	3.3	7.2

All data calculated as a three month moving average of seasonally adjusted monthly data.

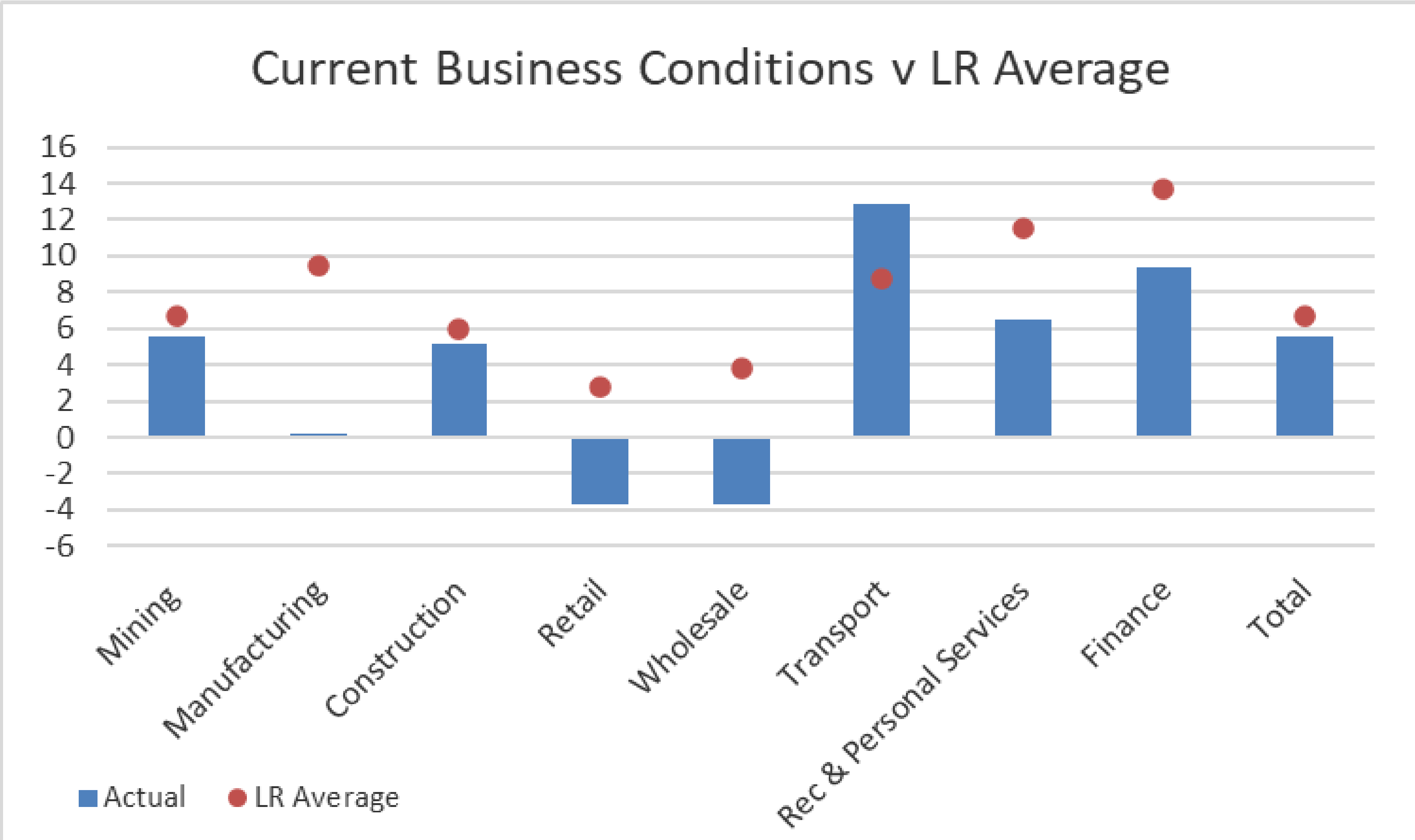
Business Survey shows slowing momentum during the last 12 months and July looks flat.

July survey similar to June. Business conditions now a touch below run averages. But confidence and increasingly forward orders weaker and well below trend. Overall, still ok - but no growth momentum, and some areas of real stress.



And interestingly compared to long run averages, clearly retail and wholesale are very depressed

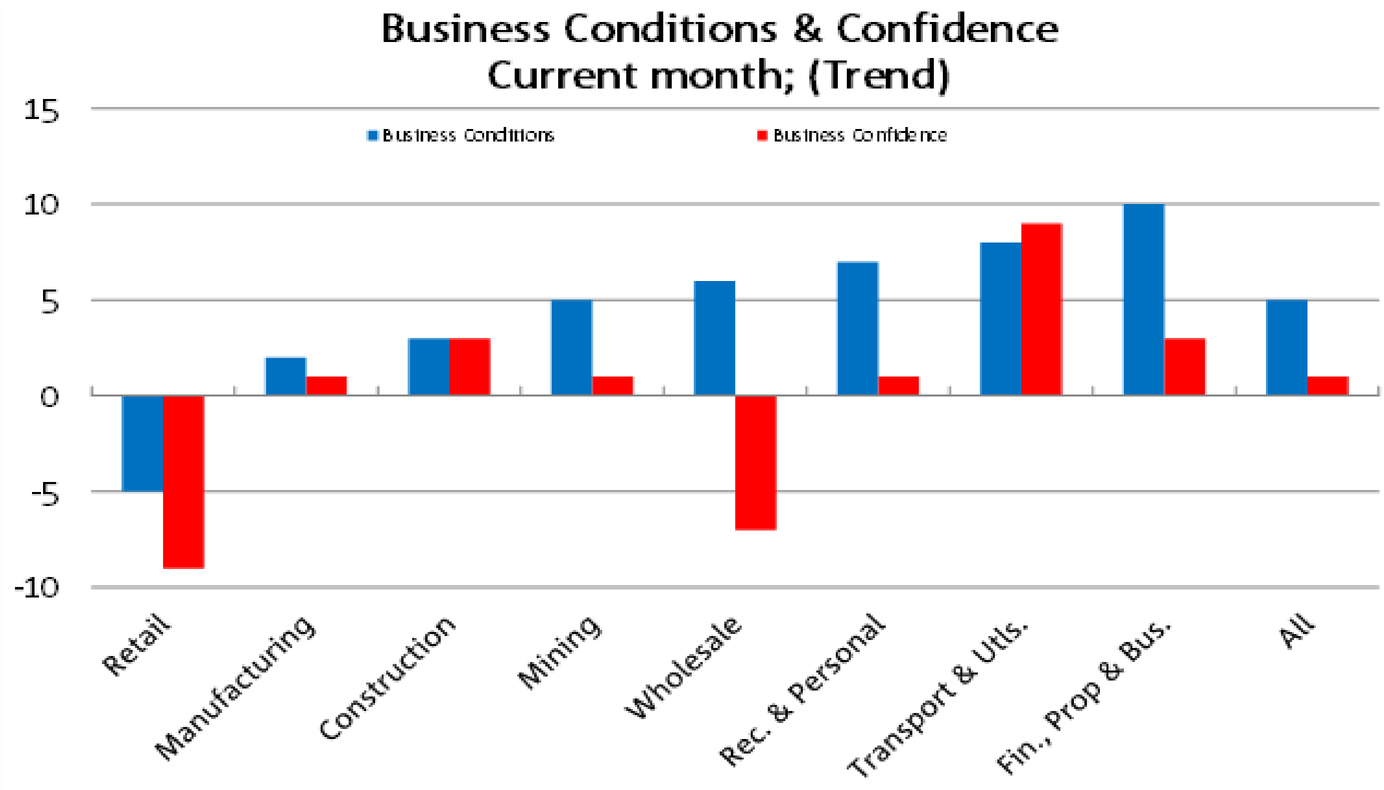
But so is manufacturing and some service sectors



By industry: Conditions and Confidence

Overall, many areas now below average for outcomes (around half). Retail a problem that reflects in wholesale confidence. Manufacturing also an issue. But big difference from conditions to confidence in retail/wholesale and personal & rec (hospitality) services

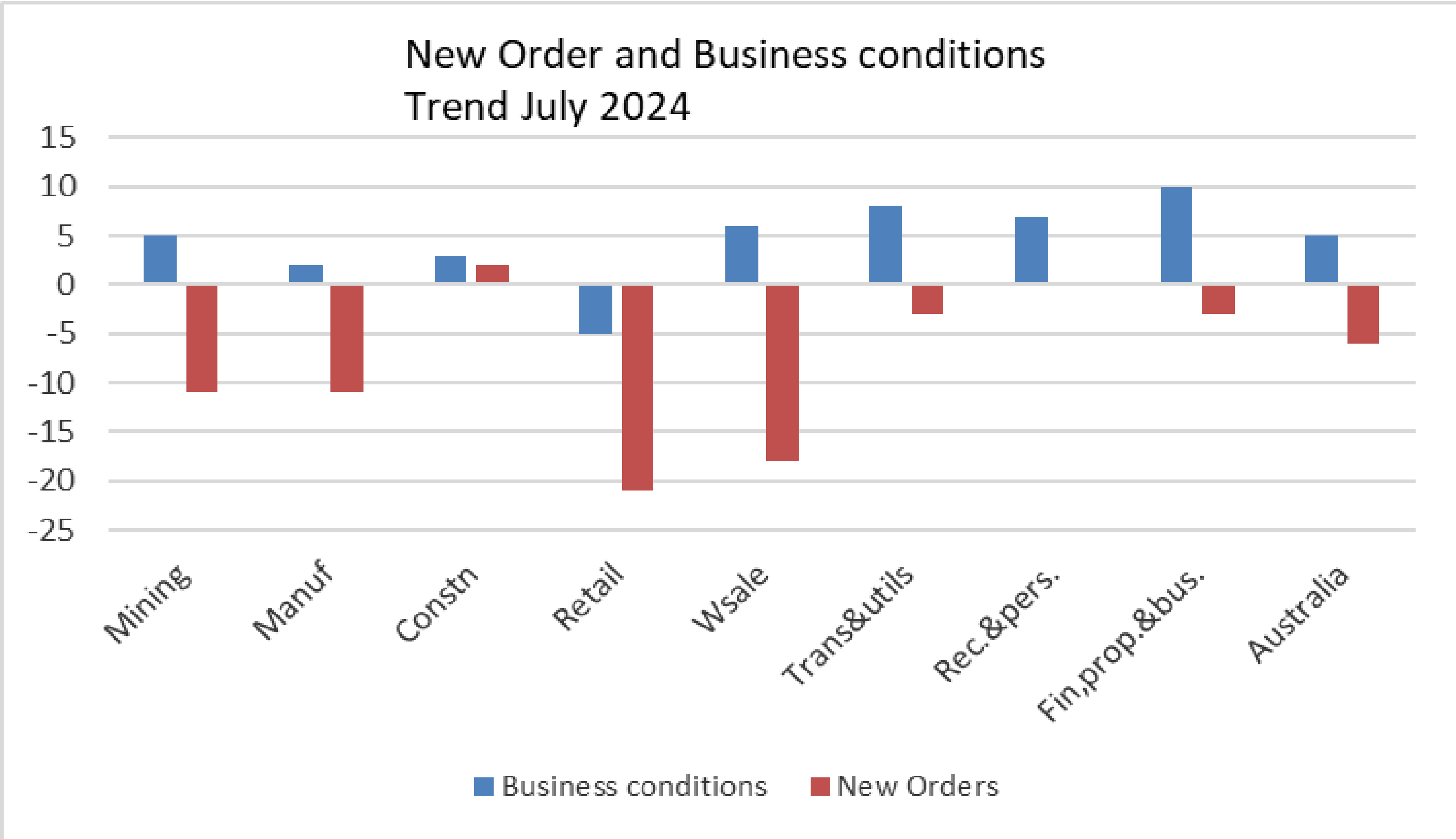
July 2024



Long run average

Interesting split for orders across industries

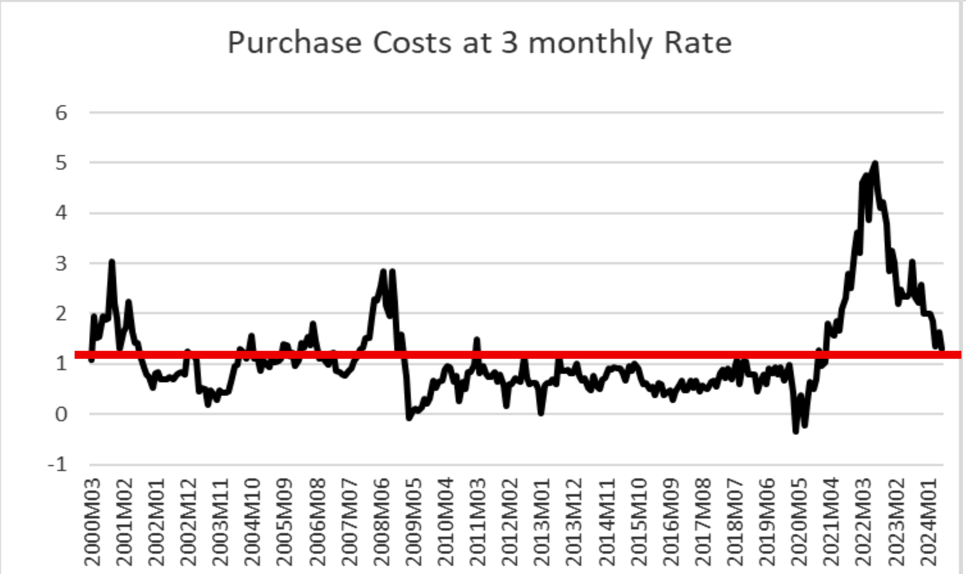
Orders were very weak in mining but can be volatile. Manufacturing now an issue. But retail and wholesale have been weak for ages and not getting better



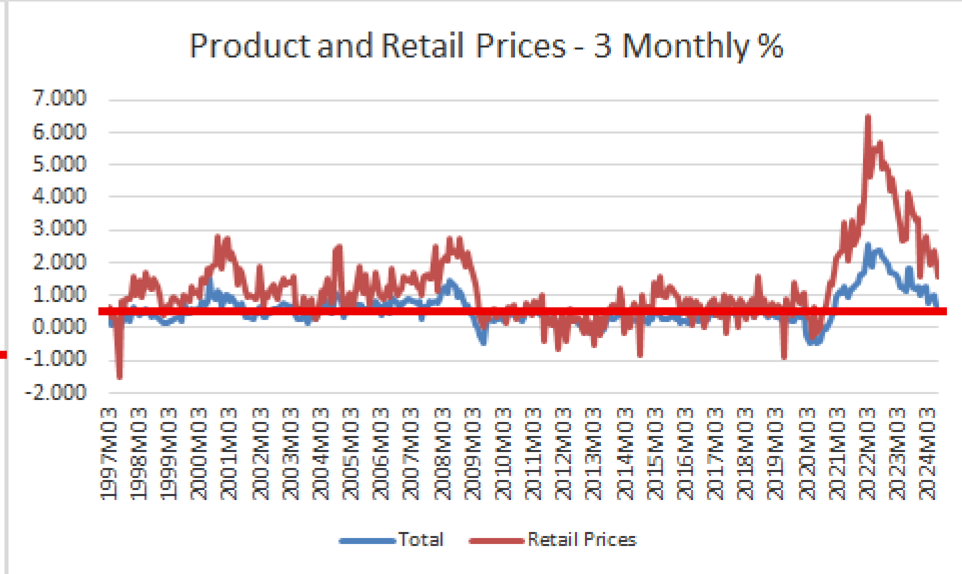
NAB Business Survey

Business Survey prices has been choppy but by June/July looks weaker. But still elevated. Purchase costs around long run averages. Price pressures even in retail easing now (but elevated).

Purchase Costs – July NAB Survey

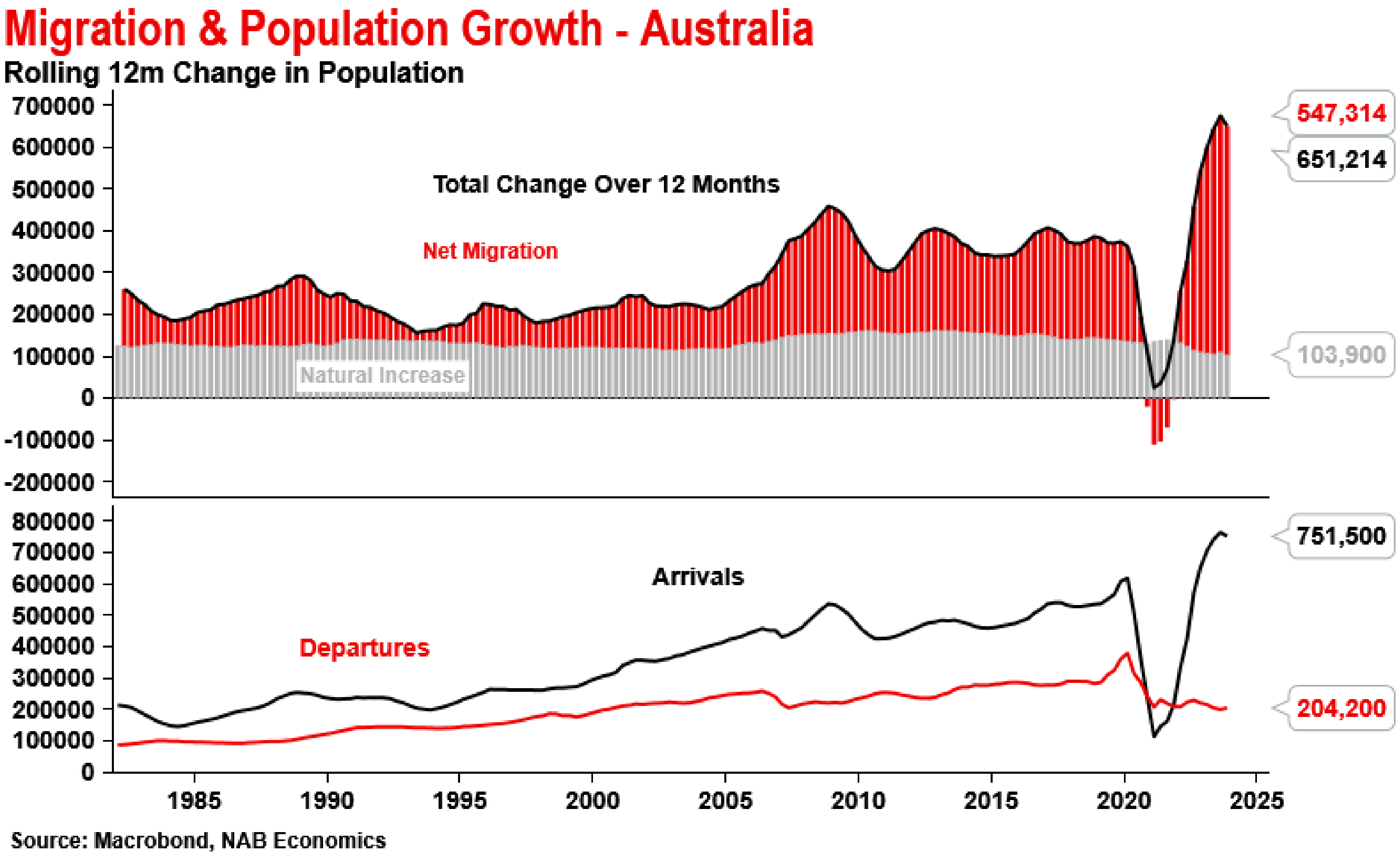


Total Economy wide and retail prices – July NAB Survey

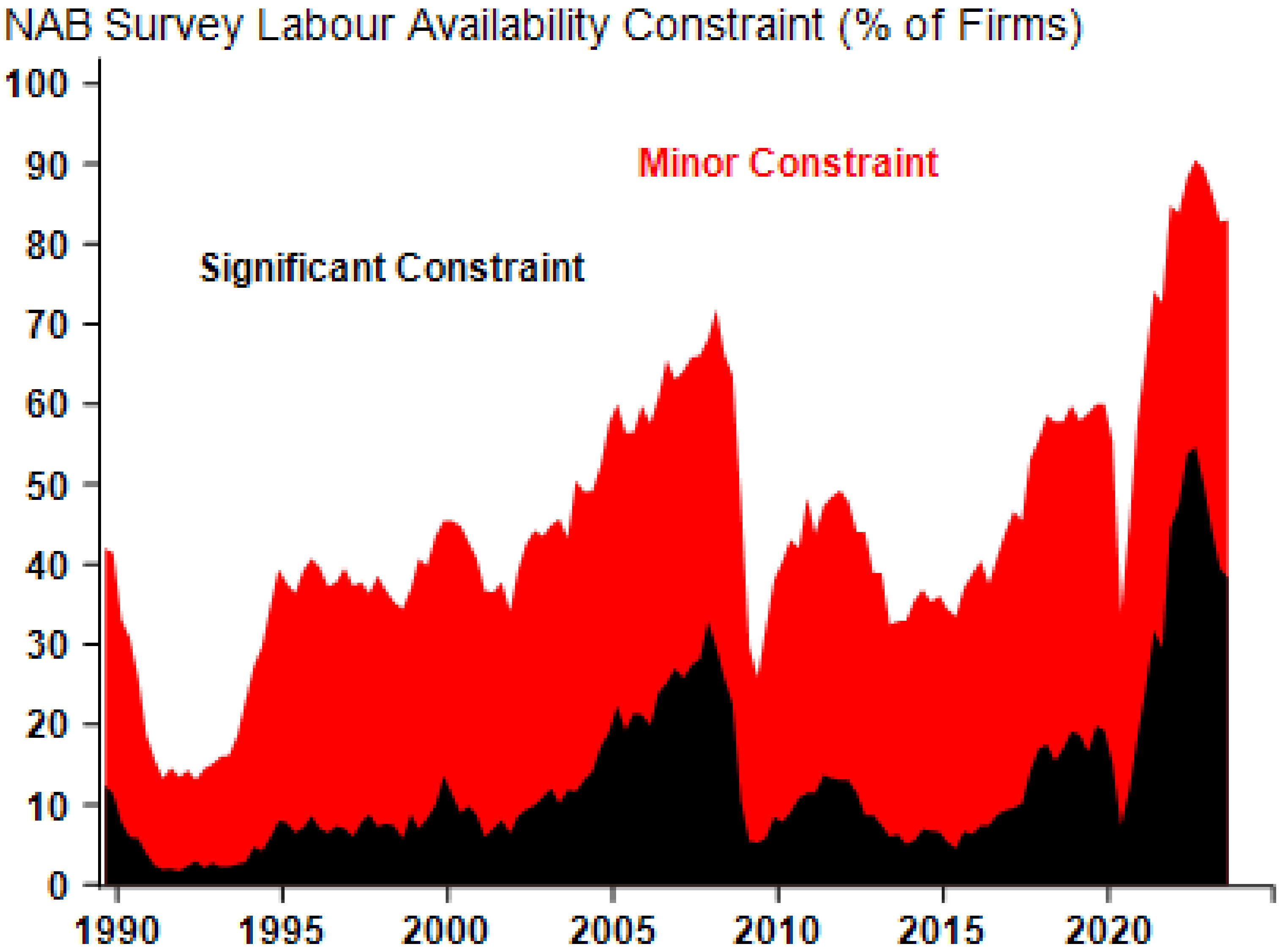


Population growth has rebounded sharply

Across all states except Tasmania…



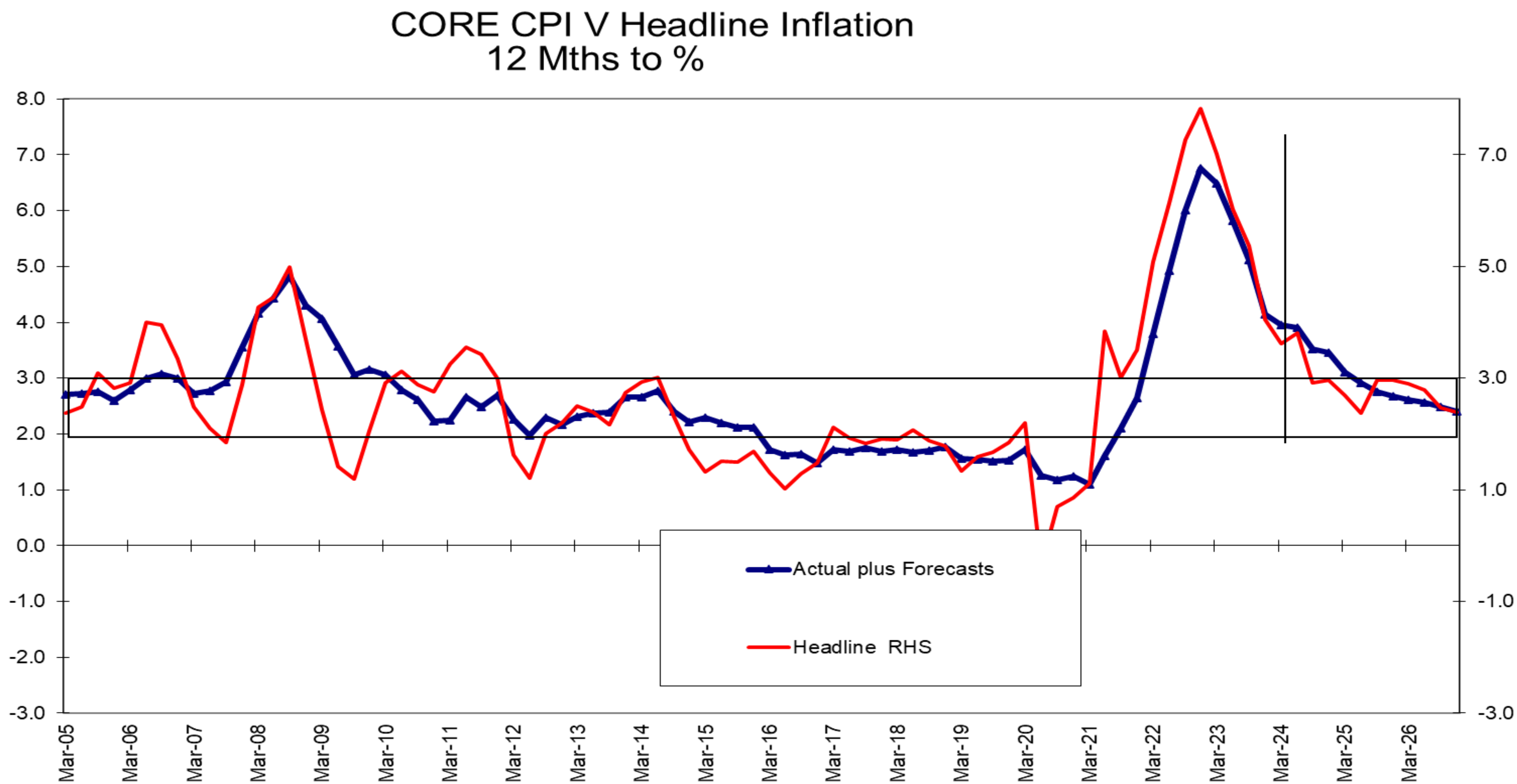
Obviously, labour shortages are still a significant constraint but have eased a touch recently



Source: Macrobond, NAB Economics

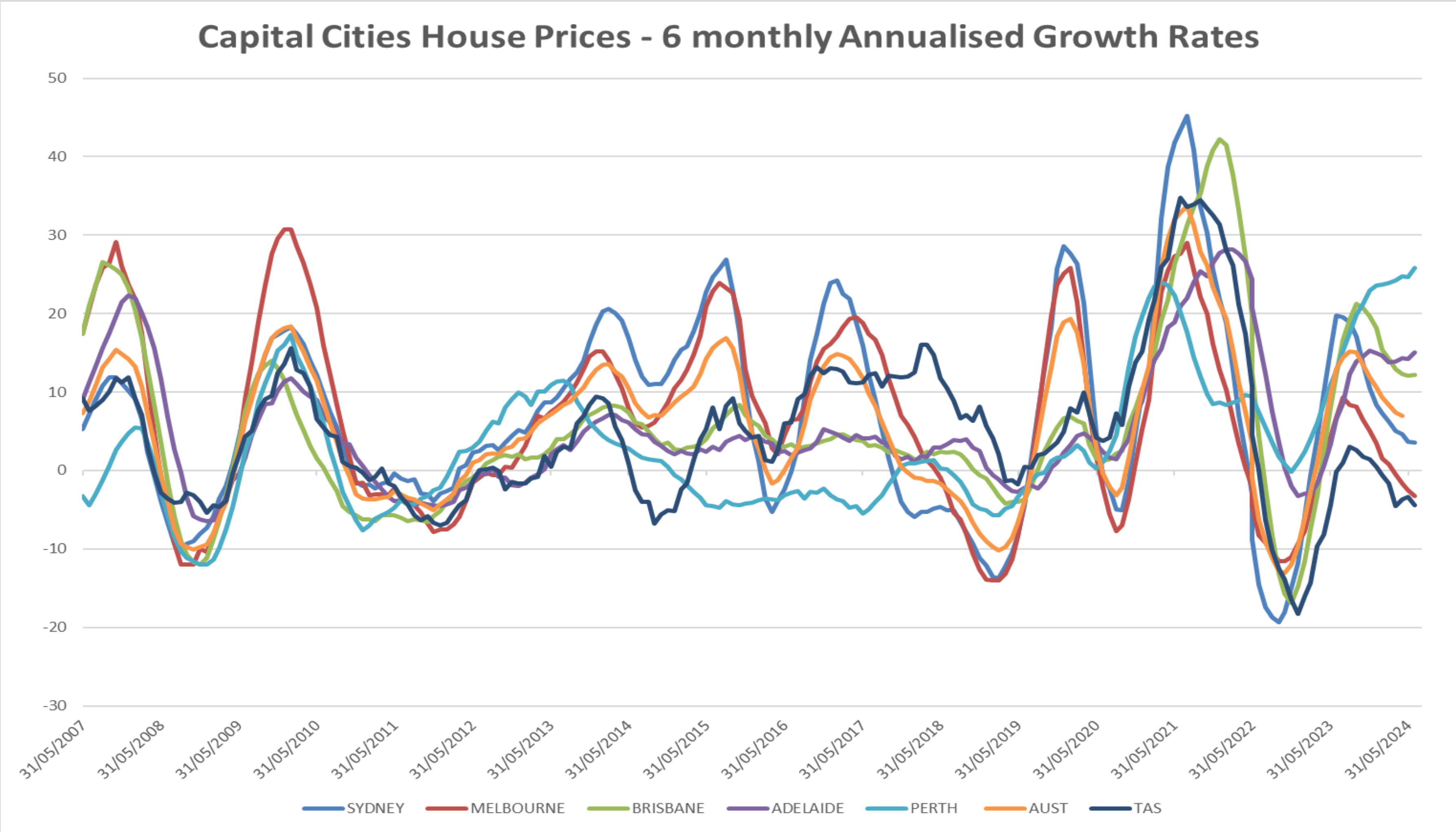
Core inflation

Trimmed mean core inflation now at 3.9%, headline at 3.8%. Slower growth will slow inflation but not evenly. Core at 3.4% by end 2024 and 2.8% by end 2025. Back to the middle of the range by mid 2026. Headline affected by Govt subsidies – RBA will ignore this



House prices

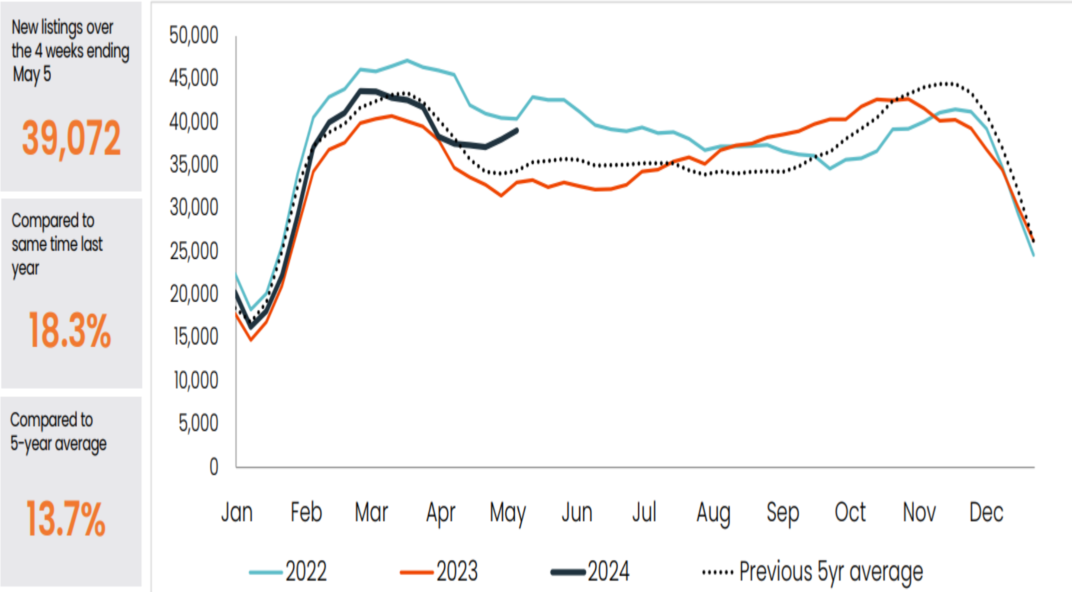
We are seeing a flattening out in previously very robust housing growth. But big differences are evident across capitals as at July 2024. Perth still growing at around 25% per annum (6monthly annualised). Adelaide and Brisbane around 12-15%. Sydney now growing around 3.5% annualised while Melbourne and Hobart down around -3%. Overall house prices across Australia up around 6½%



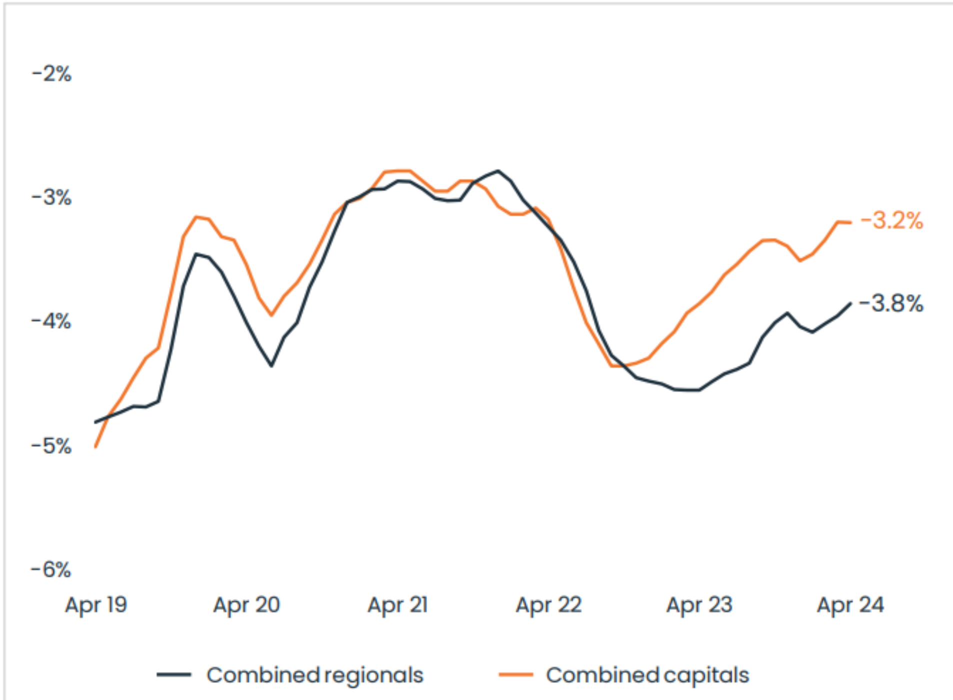
But be aware turnover has changed a lot recently – especially new listings and sales

With discounts rising. Could be signs of distressed sales – especially in Victoria

Number of new listings, National Dwellings



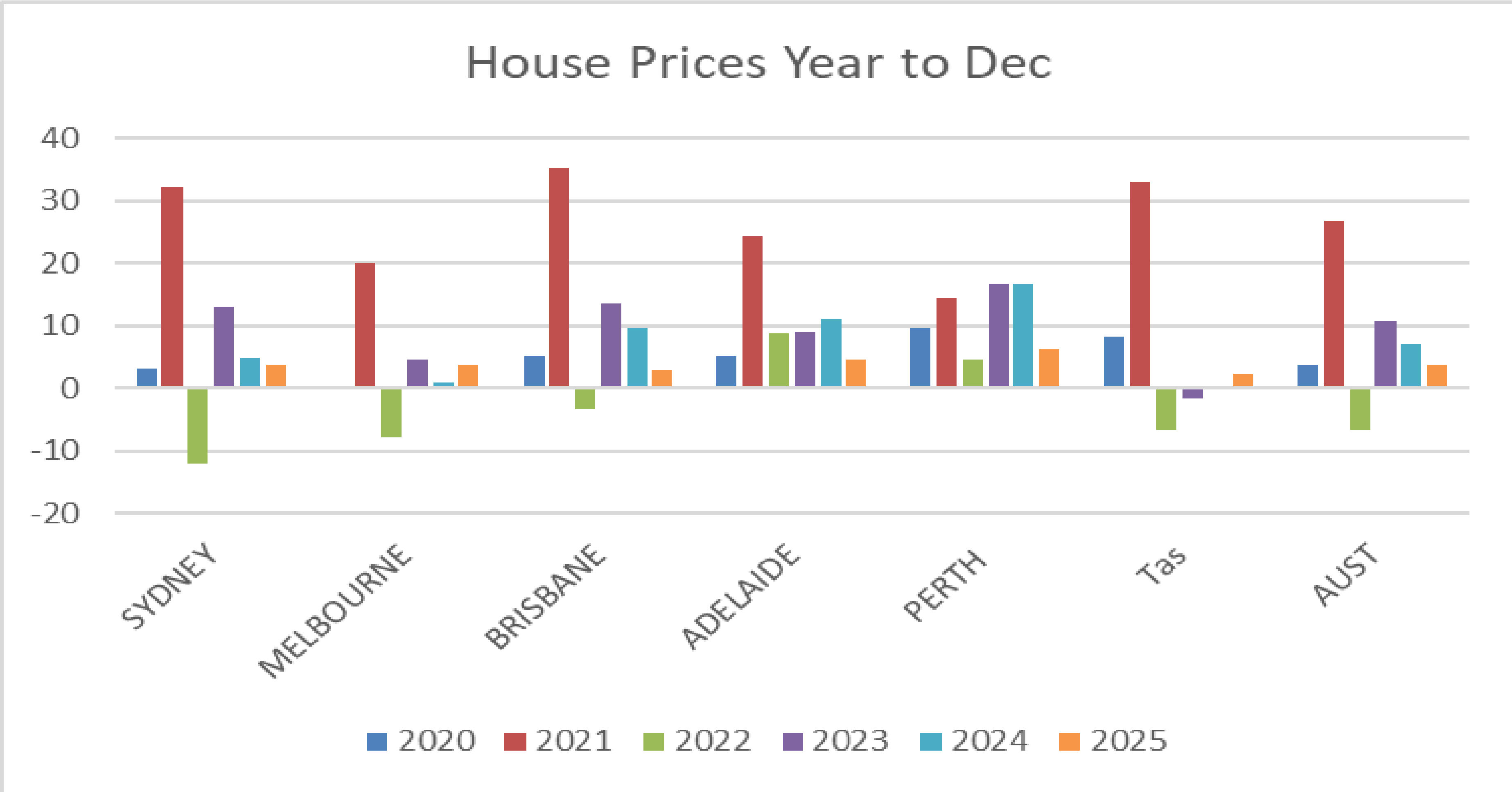
Median vendor discount



Source CoreLogic

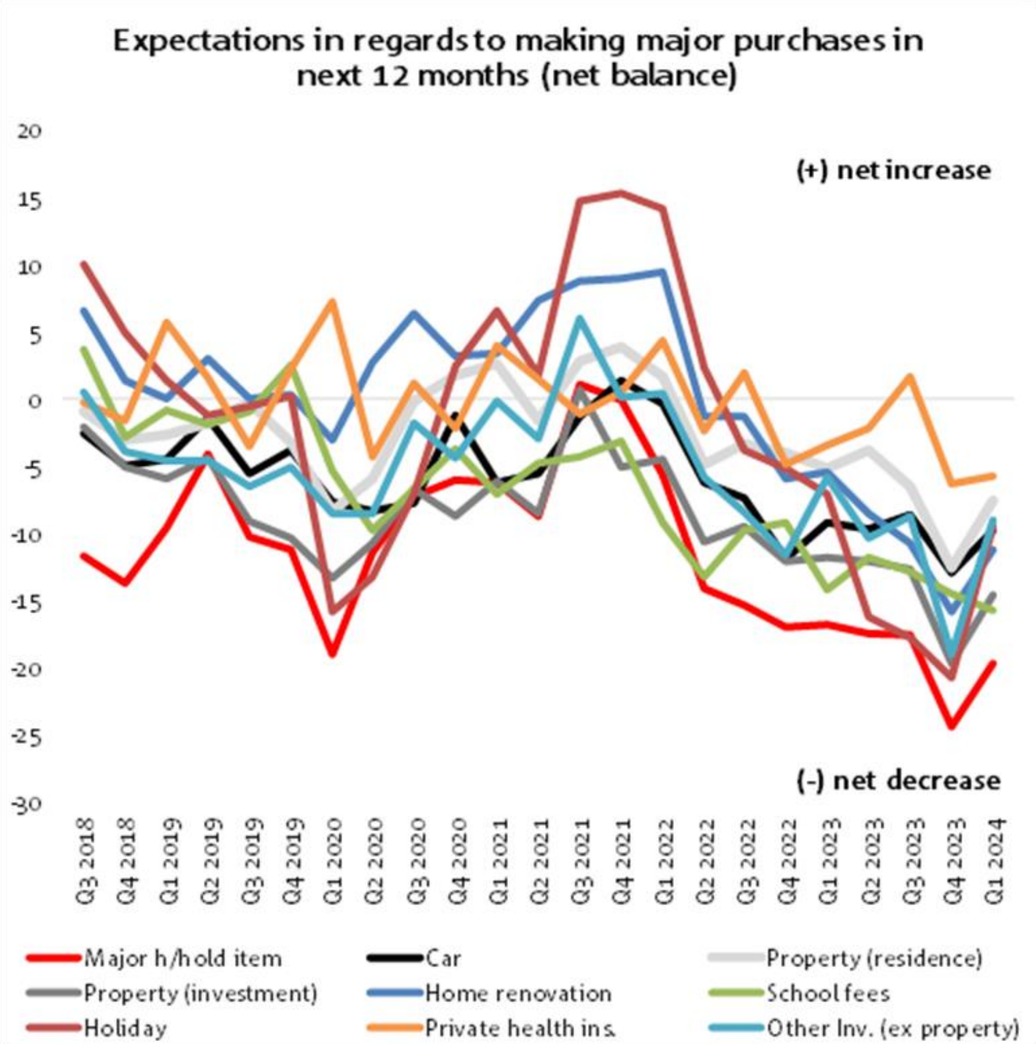
House price forecasts

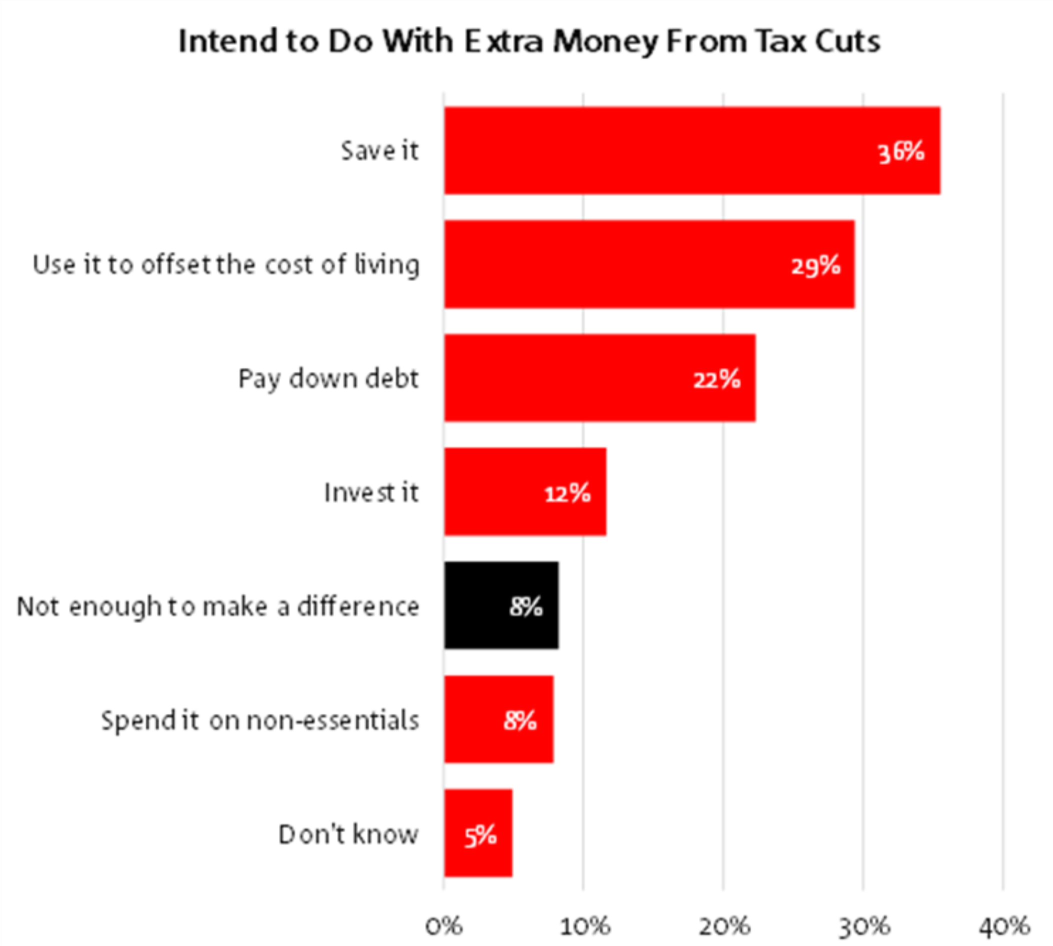
After increasing by around 27% during 2021, house prices down around 6.6% during 2022. For 2023 was up 10.2% (led by Sydney) and we expect Australian prices up around 7% in 2024 and a touch slower (3.7%) in 2025



Consumers also tell us that they are still adjusting their spending plans

May be past the worst. But less than 50% of tax cuts are planned to be spent



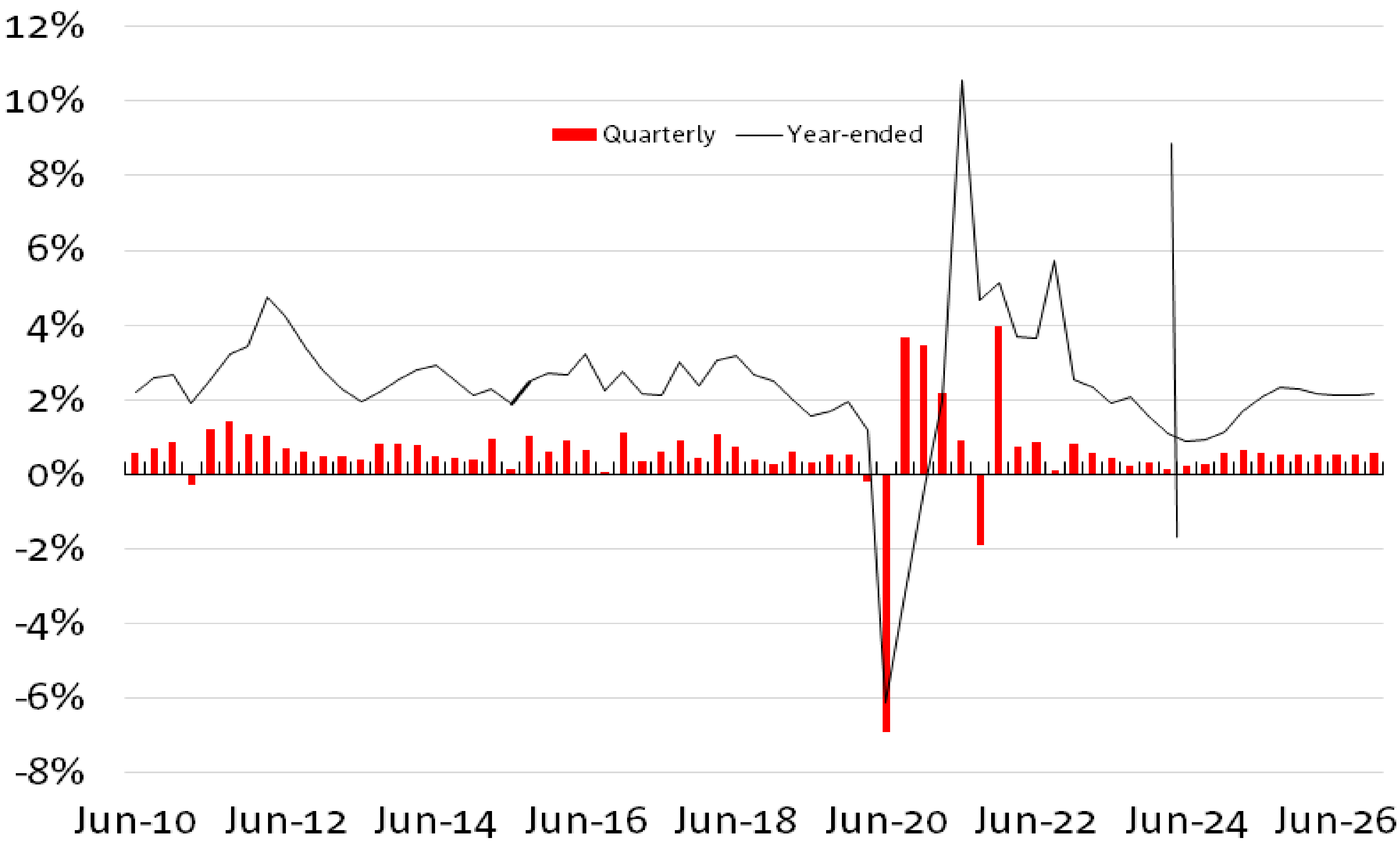


NAB data on the Claimant Count

(NAB customers receiving JobSeeker). Data has been volatile. Trend really going sideways recently but weaker from mid 2023. Implies labour market relatively still stable. Trend unemployment at 4% probably still realistic. But will rise later in the year.

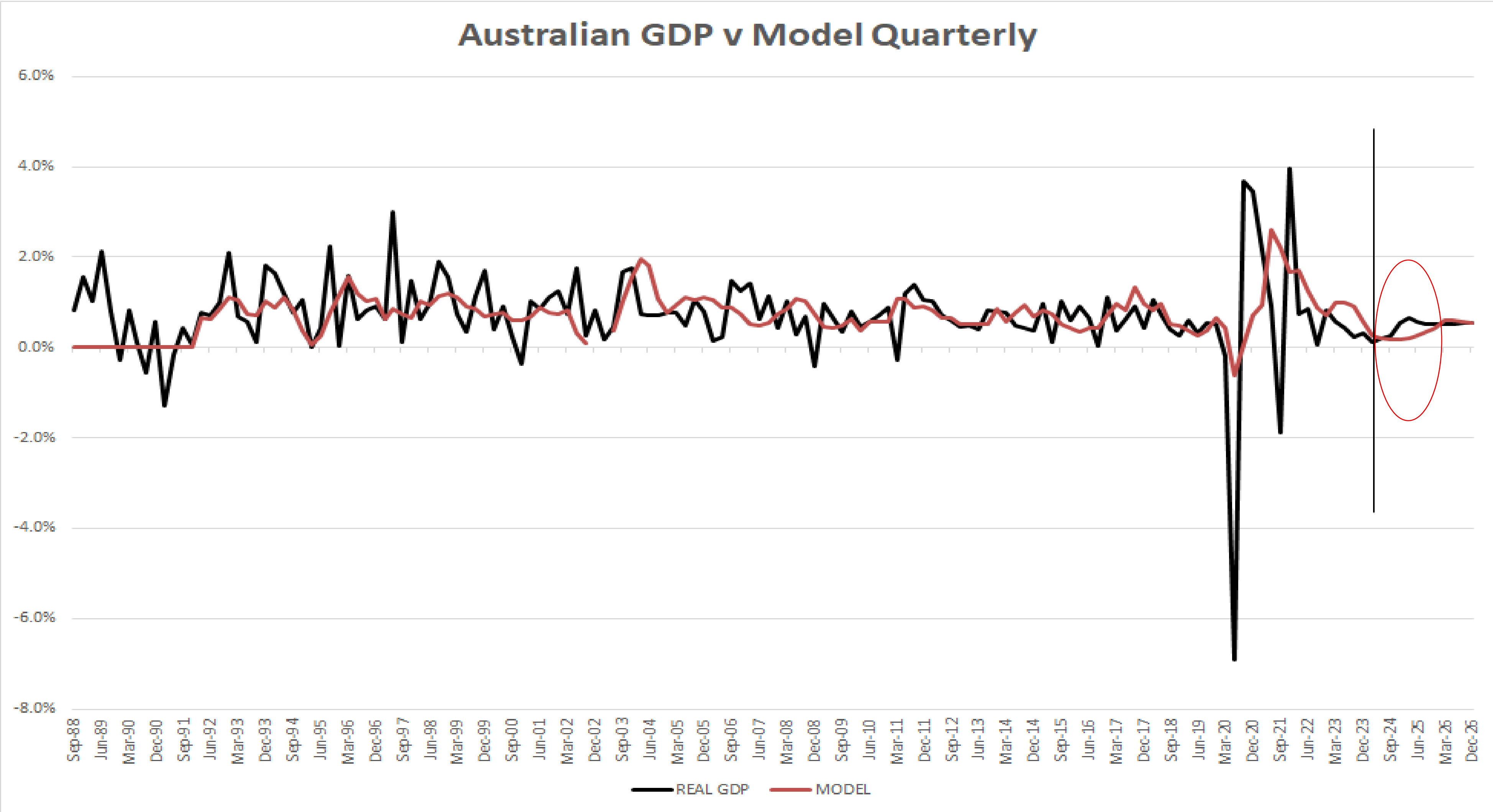
Our growth expectations

Economy very flat in late 2023/early 2024. Better in second half of 2024. Not a recession but no room for error. Around 1.2% through 2024. Currently up only 1.1% till Q1 2024. For 2025 (and beyond) we are back to trend at around 2.2%



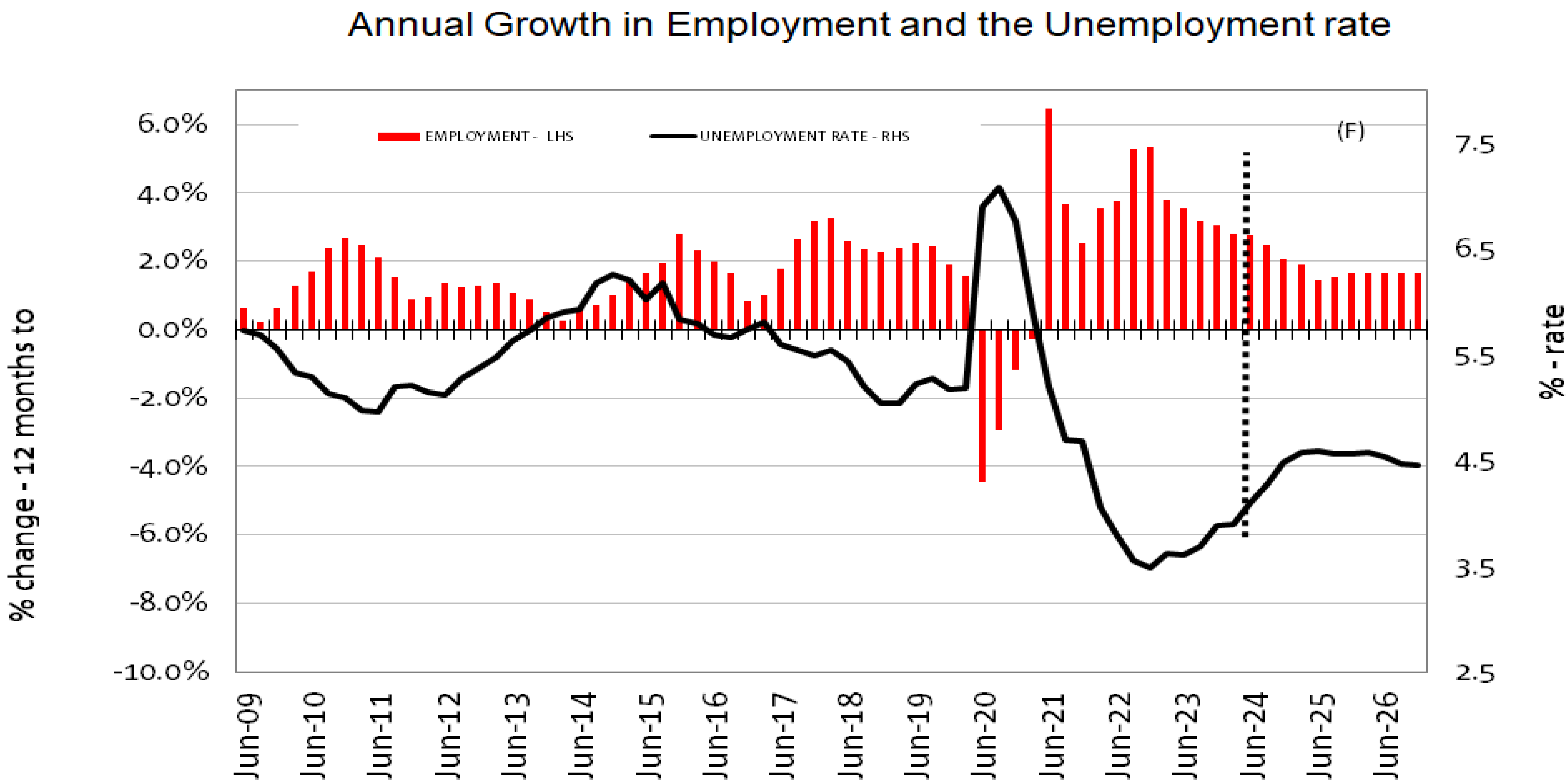
NAB Model

Obviously, model couldn't cope with COVID. Very similar to our forecasts but the consumers response is a big issue. As is investment. However, model not sure that activity will kick later this year and might go lower in Q2 2024



Labour market weakening a touch but still good

Unemployment now around 4% - up from 3.5% in mid 2023. We expect employment growth to continue but not enough to stabilise unemployment. Up to around 4½% by year end.
Then to edge lower in out year



On RBA

- RBA has focussed a lot on inflation but as the economy slows and unemployment rises the weights are changing.

- **But services inflation still high. Q2 core inflation was softer than expected at 0.8% - some signs that services inflation has topped out if not eased**

- **Data will be critical re when to cut. Likely in H1 2025.**

- **We now have cuts in mid 2025 – but could well come by early (Feb) 2025.**

- **Markets have been all over the shop. After toying with rate hikes recently they now have priced for cuts in late 2024 or early 2025.**

- **But as inflation slows and unemployment rises the RBA will have to cut – otherwise real rates are rising. That is tightening of policy.**

- **We see a terminal cash rate around 3.1% by early 2026.**

- Medium term economic outlook much better but tough times (well below trend growth) inevitable in the next 12 months.