The Forward View: Australia August 2024

Slow growth and further gradual progress on inflation

NAB Economics

Overview

- Recent data flow shows that the economy has little momentum, with the labour market still healthy but cooling and inflation gradually moderating.
- Our outlook is broadly unchanged. We see below trend growth persisting this year, though expect a consumption led improvement in H2 2024, and around trend growth over 2025. There will be a rotation away from population supported growth to a recovery at the individual/household level, as headwinds to household budgets wane – though consumer reactions will be important here.
- Both the labour force data and the wage price index show that the labour market continues to gradually cool but remains healthy. The unemployment rate has now risen ~0.7ppts from its trough to 4.2% but employment continues to match strong population growth. We see the unemployment rate gradually drifting higher, reaching 4.6% by end 2025 as labour demand cools further.
- The Q2 CPI confirmed that the moderation in inflation slowed over H1 2024 with the easy gains from recovering supply chains fading and services inflation remaining higher. That said, we expect inflation to continue to moderate, with underlying inflation falling to 3.5% by end 2024 and 2.7% by end 2025.
- Some pressure in the housing market appears to be easing with rents and price growth nudging down over recent months. That said, the demand/supply imbalance will continue to support both prices and rents in the near term.
- On rates, both the data flow and recent communications from the RBA point to an extended pause, with cuts unlikely to occur this year. We continue to pencil in May 2025 for the first cut but see all the meetings in H1 2025 as live.
- Overall, our forecasts continue to see a soft landing for the economy with growth returning to trend and inflation moderating without a more substantial downturn in activity. Importantly, the labour market will remain relatively healthy with the unemployment rate peaking a little below its pre-COVID level.

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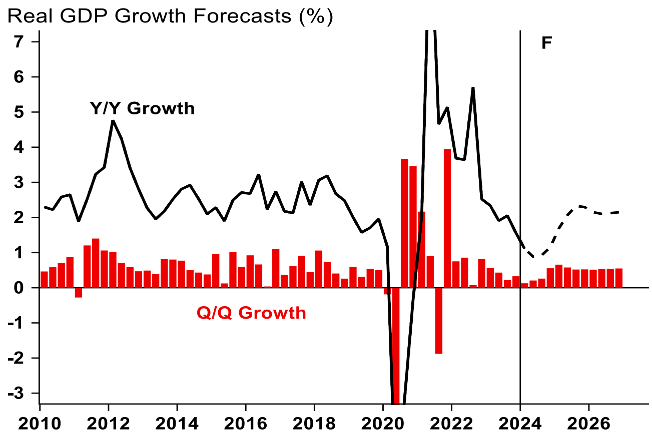
Key Economic Forecasts

	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**	**1.2**	**2.3**	**2.2**
Employment (a)	3.4	2.5	1.6	1.6
Unemployment Rate (b)	3.9	4.5	4.6	4.5
Headline CPI (b)	4.1	3.0	3.0	2.4
Core CPI (b)	4.3	3.5	2.7	2.4
RBA Cash Rate (b)	4.35	4.35	3.60	3.10
$A/US cents (b)	0.68	0.69	0.75	-

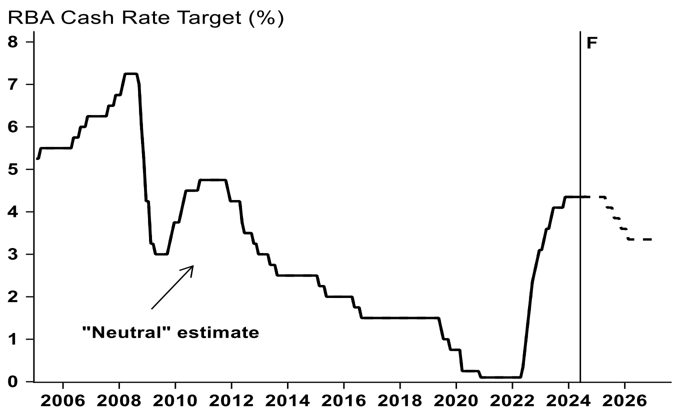
(a) annual average growth, (b) end-period

Chart 1: GDP forecasts



Source: Macrobond, NAB Economics

Chart 2: Cash rate profile



Source: Macrobond, NAB Economics

20 August 2024 | Gareth Spence, Head of Australian Economics | Tony Kelly, Senior Economist | Alan Oster, Chief Economist

Labour Market & Household Consumption

The labour market remains healthy but the unemployment rate continues to gradually drift higher.

The unemployment rate ticked up 0.1ppts to 4.2% in July, as the labour force participation rate rose 0.2ppts to 67.1%. While the unemployment rate continues to edge up, employment growth remained robust, increasing by 58k in the month. Both the labour force participation rate and the employment to population ratio remain at very high levels – an important support for aggregate household income.

Consistent with a gradual cooling in the labour market, the Wage Price Index showed a further slight easing in the quarterly pace of wage growth which will see the annual rate fall from around 4% to the low 3% range in Q3.

We see the unemployment rate continuing to rise, reaching around 4.5% by end 2024. Importantly, however, we see the rise driven by a slowing in labour demand that becomes unable to absorb still solid population growth, as opposed to an outright decline in employment. Alongside this build-up in slack in the labour market, we expect wage growth to continue to ease, stabilising in the 3-3.5% range over time.

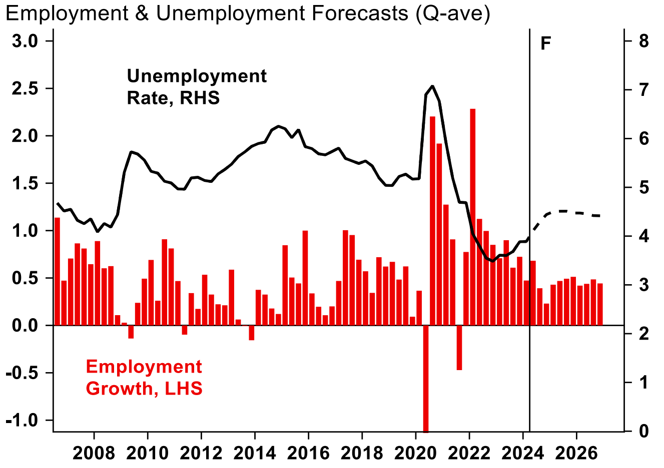
Consumer spending growth on track for a soft Q2.

Partial consumption indicators point to soft growth in Q2. Retail trade volumes declined by 0.3% in the quarter. NAB's consumer spending index – which picks up a wider range of service activity – grew by 1.1% q/q in the quarter and, with consumer prices rising 1.0% q/q, it too suggests only subdued volume growth. The experimental ABS household spending indicator looks even weaker.

These indicators do not always track closely to the national account's consumption measure, and a more positive picture emerges when looking at household income. Partly due to the drag from the rise in interest rates fading (in a growth sense), real household disposable income growth turned positive in 2023 Q4 and, while flat in 2024 Q1, it is being supported by strong employment growth and solid wage growth. As a result, we expect a further modest increase in aggregate household consumption in real terms for Q2.

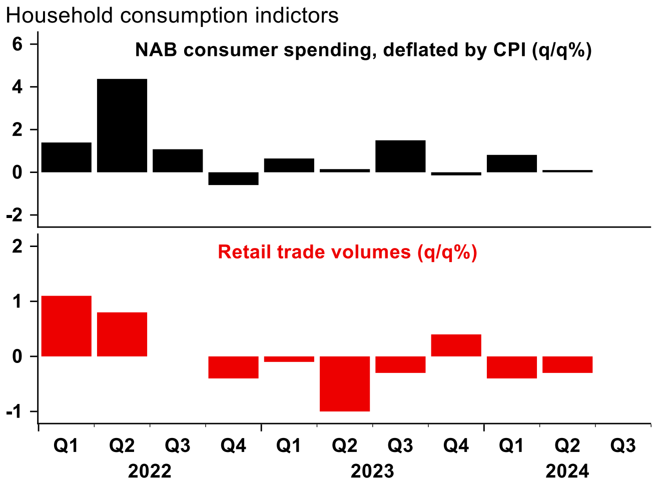
The stage 3 tax cuts, and other support to households, including by state governments, as well as further moderation in inflation, should support a lift in consumption growth as the year progresses. While the NAB consumption indicator was broadly flat in July, typically the boost to consumption from a shift in disposable income occurs over time. Mechanically, this will likely play out as an increase in the household savings rate in at least Q3 before easing back as consumption reacts. How resilient the labour market remains – particularly employment growth – will also be important for how consumption evolves from here.

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



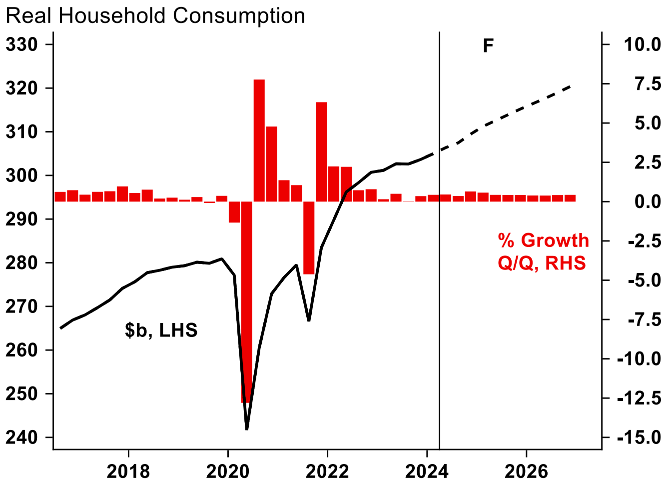
Source: Macrobond, NAB Economics

Chart 4: Indicators of household consumption point to soft growth in Q2



Source: Macrobond, NAB Economics

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



Source: Macrobond, NAB Economics

Housing & Construction

The broad trends of strong demand and weak supply for housing remain in place, with only modest near-term improvement in sight.

Building approvals over a 12-month period remain at around their lowest level since 2012. However, approvals have broadly tracked sideways over the last year or so, as some of the factors that have weighed on housing construction have stabilised or eased. The RBA has kept rates on hold since late last year, housing material cost inflation is back around its pre-COVID pace (even if the level of prices remains high relative to its pre-COVID trend) and labour and material shortages have eased somewhat. The lift in house prices also provides an incentive to invest.

While the trough in approvals may be close, at recent levels they imply an ongoing decline in completions. That said, the still elevated pipeline of work will help sustain activity, and we do not expect a further large fall in residential investment from here.

Overall, this suggests that there will be little catchup in supply in the near-term, even as underlying demand for housing remains strong. The ABS's monthly estimates of the 15yrs plus population in July show the annual growth rate edging down, but at 2.9% y/y in July it is only slightly off its recent peak of 3.1% y/y, although we continue to expect a moderation in population growth over time.

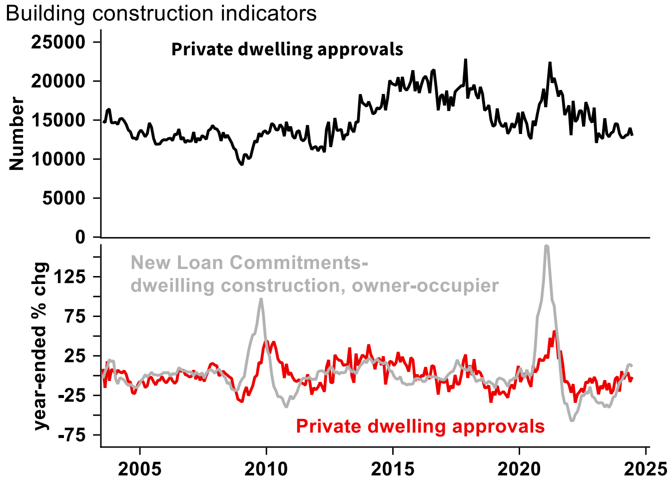
The demand/supply imbalance is mainly playing out in rising house prices and rents, although there are signs that the pace is moderating.

Capital city house prices continue to grow, although there has been some overall loss of momentum. The CoreLogic 8-Capital city dwelling price index grew by 0.5% m/m in July, similar to June, and slightly down on the monthly pace seen earlier in the year. The PropTrack measure – up only 0.2% m/m for capital cities in July - shows an even greater loss of momentum. Over recent months, prices have fallen in Melbourne, Hobart and Darwin. In contrast, price growth remains rapid in Perth, Adelaide and, despite some easing recently, Brisbane. We expect overall capital city dwelling price growth of around 7% over 2024 and 4% over 2025.

Similarly, there were further signs that rents growth continues to ease. Month-on-month growth in the CoreLogic rental index (for new rentals) has clearly softened in recent months. The easing pace of rental growth is broadly based, but most pronounced in Brisbane and Sydney. Rental growth remains high on a year ended basis, with the CoreLogic Capital city index up 8.0% y/y in July and the CPI measure (all rents) 7.5% y/y in Q2.

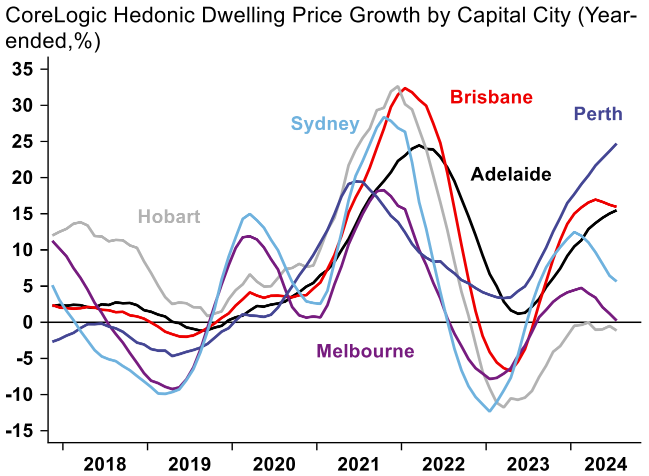
The adjustment to the underlying supply/demand imbalance is also occurring through changes in household size. RBA analysis continues to show a gradual increase in the average number of people per household, although it remains well below its pre-COVID level.

Chart 6: Signs dwelling approvals stabilising at a low level



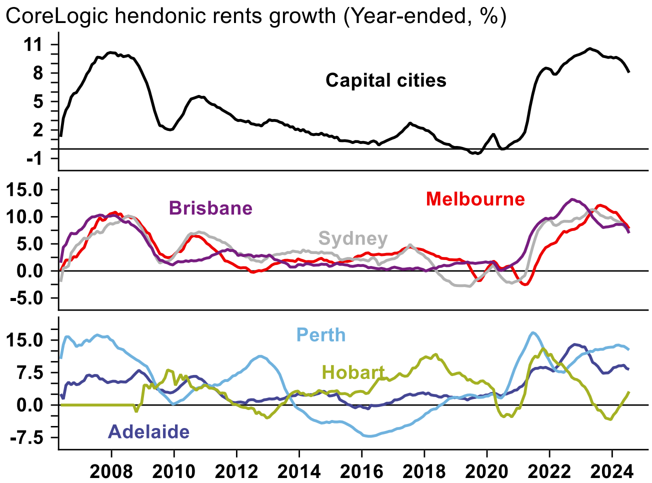
Source: Macrobond, NAB Economics

Chart 7: Price growth moderating overall, but large differences across the capital cities



Source: Macrobond, NAB Economics

Chart 8: Rents growth easing from a high level



Source: Macrobond, NAB Economics

Business, Trade & FX

The outlook for business investment remains mixed after solid outcomes over recent years. Business confidence remains low and conditions have eased to be just below average over recent months.

The NAB Monthly Business Survey for July showed a small rebound in business conditions which are now just below average. That said, they remain in positive territory and above the levels seen in previous downturns.

By industry, conditions remain weakest in retail, construction and manufacturing. Conditions in the services sectors have been more resilient.

While conditions have broadly held at around average levels, forward orders remain weak (driven by weakness in retail, wholesale and construction). Alongside the weakness in forward orders, capacity utilisation declined in the month. That said, capacity utilisation remains above its long run average.

Importantly, reported capex rebounded in the month (after a sharp decline last month) suggests that businesses are continuing to invest even as growth has weakened. The NAB Quarterly survey saw 12 month investment expectations broadly unchanged, at a just-above average level. The ABS Capex survey released on 29th August will provide an update of investment intentions across the mining and non-mining sectors.

The goods trade balance surplus widened slightly in June.

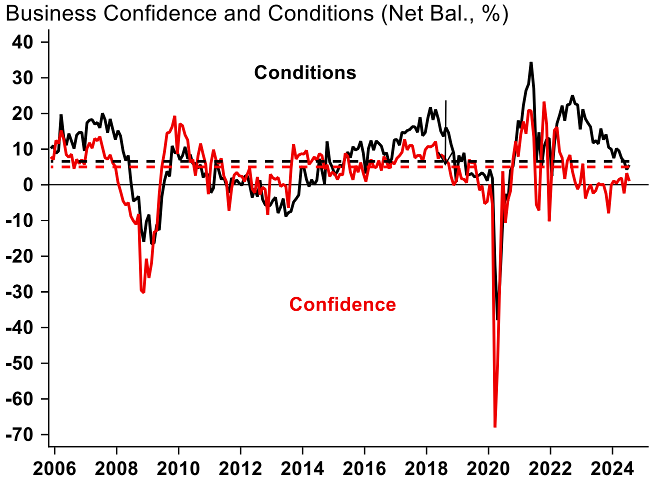
Exports rose 1.7% m/m in June, led by gains in LNG. Goods exports values remain comfortably above pre-pandemic levels but the recent easing in key commodity prices sees export values well below their peak in 2022. With prices declining by more than values in the month, the volume of exports is expected to make a positive contribution to GDP in Q2.

On the imports side, values were little changed with total imports up 0.5% in the month. Vehicle imports remain elevated as backlogs during supply chain disruptions are cleared. Interestingly on import prices, consumer goods prices were up 0.6% in the quarter (and 0.9% y/y) pointing to ongoing soft price pressures on the imports side. That said, there is little evidence of a correction in the level of prices to date.

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.

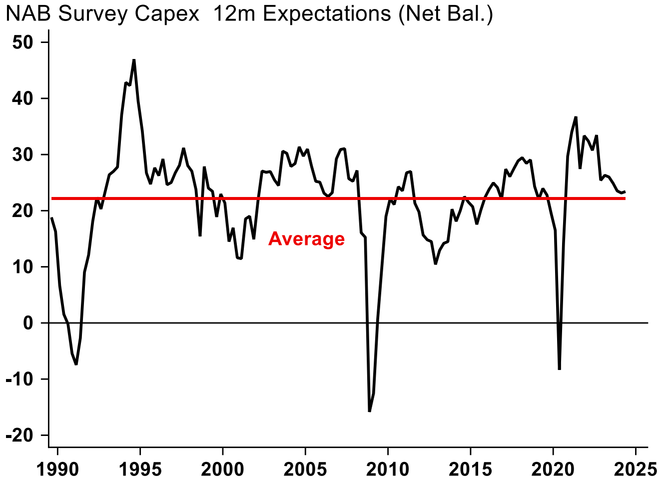
The key to this outlook continues to be a broader softening in the USD, as the US economy slows and the Fed begins to ease – with expectations firming up further for cuts by the US Federal Reserve in September. However, the global growth back drop, commodity prices and sentiment around the Chinese economy will also be key factors.

Chart 9: Business conditions remain broadly around average



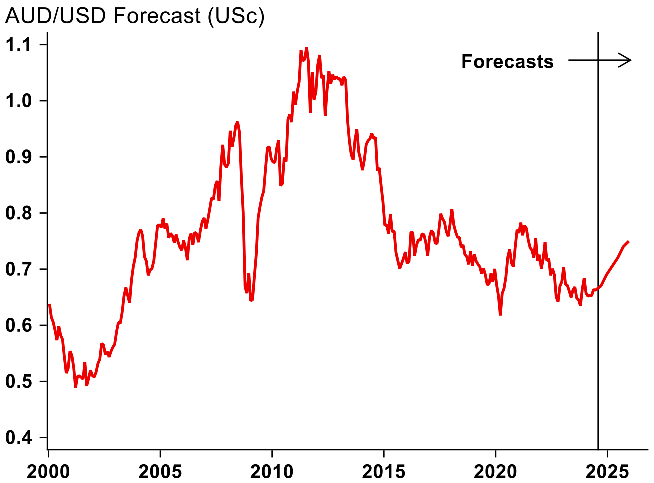
Source: Macrobond, NAB Economics

Chart 10: Capex intentions have held up



Source: Macrobond, NAB Economics

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



Source: Macrobond, NAB Economics

Inflation

The Q2 CPI showed a 1% q/q (3.8% y/y) increase in headline inflation, but a softer than expected 0.8% (3.9% y/y) increase in underlying inflation.

The data confirmed that the moderation in inflation through H1 2024 has slowed – easing by just 0.2ppts in underlying terms after a swift decline through 2023 after peaking at 6.8% y/y in late 2022. The data still show that much of the easing in inflation to date, has come via disinflation in the goods categories with supply chains recovering post pandemic. However, this now looks to have run its course.

Though it did not peak as high, market services inflation remains higher than goods inflation – with rents and insurance remaining key drivers. Services inflation has been driven by a tight labour market (and strong wage growth over recent years) as well as the impact of other domestic business costs, including insurance and utilities.

Indeed, the non-tradables component of the CPI (though easing slightly in annual terms in Q2) remains well above the rate of inflation in the tradables component.

The housing component remains an upside risk to inflation, with the demand/supply imbalance in the housing market likely to place upward pressure on rents for some time while the cost of new dwellings continues to rise at a considerable pace (~5% y/y).

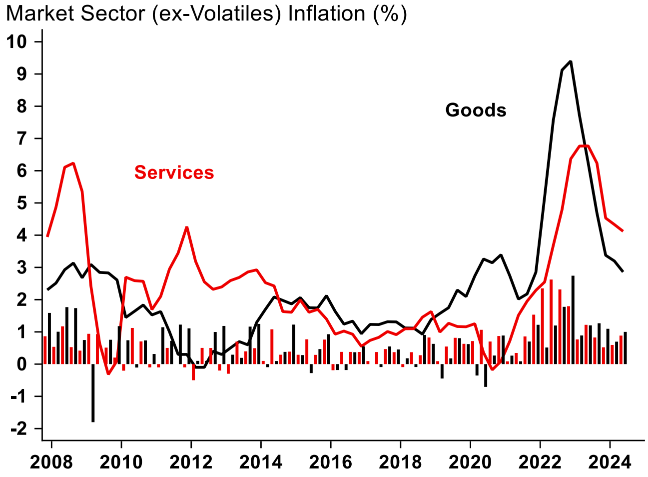
Importantly, however, the domestic inflation backdrop continues to cool. Wage growth looks to have passed its peak (although remains strong) and future minimum wage decisions are likely to be smaller – in line with the moderation in inflation. The echoes of inflation through other non-wage costs are also likely to continue to ease.

The weak consumer demand growth is also likely to limit the extent that businesses are able to pass on cost pressures – suggesting that a larger adjustment going forward will likely come through margins rather than consumer prices.

The NAB business survey suggests that the slowing in overall product price growth in June was maintained in July, while retail price growth fell to 0.9% in quarterly terms. However, highlighting the risk on the services side, rec & personal services price growth rose to 1.6% - still well off its peak but also still too strong. Encouragingly, on the input side, purchase cost growth slowed further in the month. Labour costs growth spiked (though this is a wage bill measure likely supported by strong employment growth as well as the minimum wage decision).

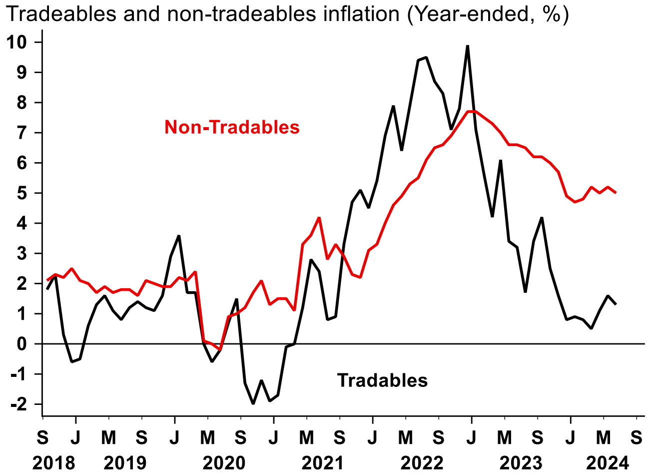
Our forecasts for inflation are broadly similar to those of the RBA. We see underlying inflation easing to 3.5% y/y by end 2024, and 2.7% by end 2025. By the middle of 2026 we see inflation around the middle of the RBA's 2-3% target band.

Chart 12: Market services inflation remains elevated



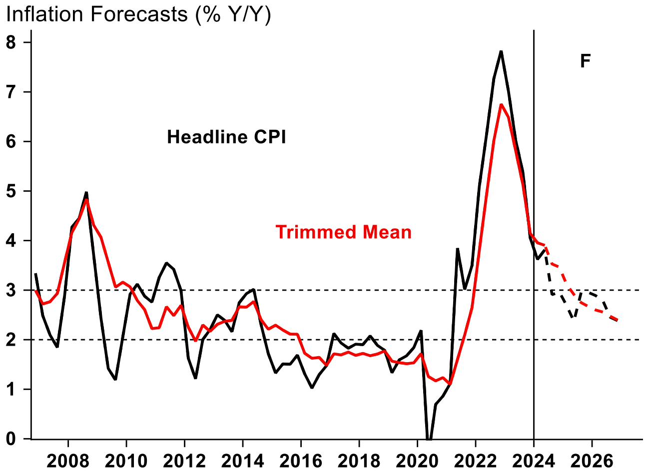
Source: Macrobond, NAB Economics

Chart 13: Non-tradables inflation remains higher than tradables



Source: Macrobond, NAB Economics

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



Source: Macrobond, NAB Economics

Monetary Policy

We expect the RBA to remain on hold until May 2025, but acknowledge the first cuts could come earlier in H1 2025.

Governor Bullock pushed back on expectations for a "near-term" cut, despite market pricing for a reduction in the cash rate by year's end, in both the post meeting press conference and the appearance before the parliament.

While Q2 CPI data was in line with the RBA's May forecasts, the RBA revised up its estimates of excess demand (in contrast to other central banks such has RBNZ which now see greater spare capacity in the economy). This was driven by expectations of more resilient growth in the economy and a slower rate of growth in the supply side. While the RBA acknowledges that assessing the output gap in real time is difficult, this upward revision is consistent with what has been observed in inflation.

On inflation, the RBA's assessment is that the supply-side impact of the pandemic has now faded – resulting in rapid disinflation of goods prices – while the demand side remains strong with services prices still increasing briskly.

That said, the RBA continues to follow a conservative strategy, allowing for a much more gradual moderation in inflation from here with the intent of maintaining positive employment growth (and minimising the rise in unemployment).

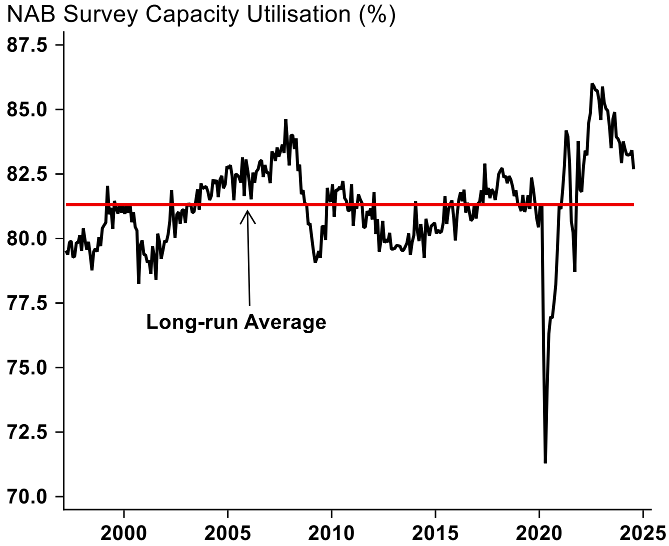
The latest set of staff forecasts see slightly stronger GDP growth this year and next (up 0.2ppts over 2025) and slightly slower moderation in inflation (3.5% in underlying terms at end 2024 and 2.9% by end 2025). Unemployment is now expected to rise to a slightly higher peak of 4.4% by June 2025 and stay there over the forecast period.

Our forecasts follow a broadly similar pattern, though see slightly slower growth and a marginally higher unemployment rate. In our view, the RBA will wait until underlying inflation is clearly moderating further and they are unlikely to have evidence of that this year.

That said, the inflation backdrop is cooling and further progress on inflation through H2 2024 will give the RBA the confidence it needs in H1 2025. With the RBA balancing bringing inflation back to target while holding onto labour market gains, the level of interest rates in Australia is also not as restrictive as in many other advanced economies. This in combination with a still positive output gap will mean the Board is less pressured to make "pre-emptive" cuts to the cash rate while inflation is still above target.

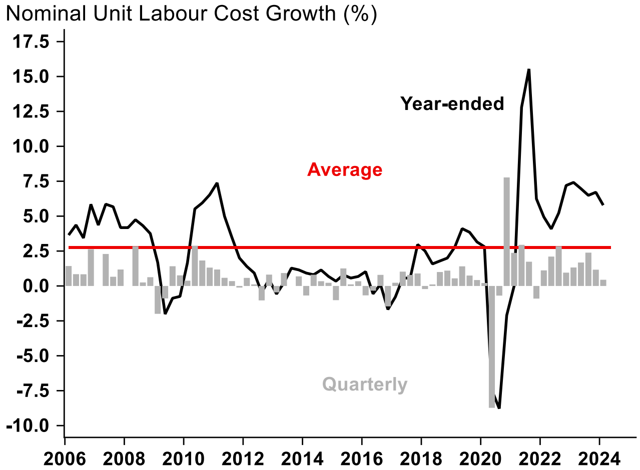
Ultimately, the RBA is balancing the need to keep inflation expectations anchored while navigating a soft landing for activity and the labour market. For now, growth has slowed but a still positive output gap and high unit labour costs growth poses risks.

Chart 15: Capacity utilisation is above average



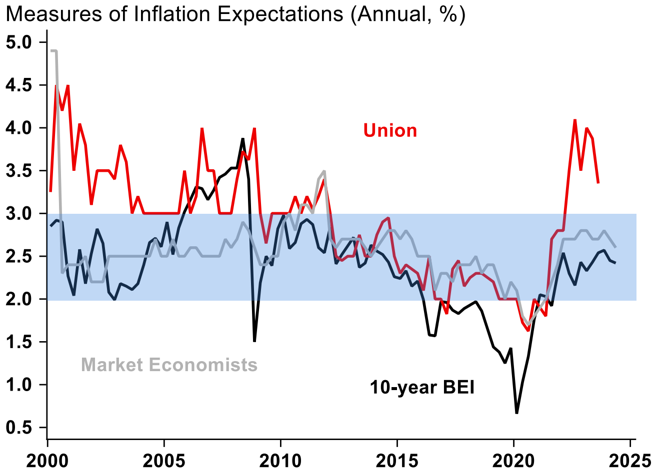
Source: Macrobond, NAB Economics

Chart 16: Unit labour costs growth is strong



Source: Macrobond, NAB Economics

Chart 17: Inflation expectations remain anchored



Source: Macrobond, NAB Economics

Table of Economic Forecasts

	% Growth q/q			% Growth y/y			
	Q1-24	Q2-24 (f)	Q3-24 (f)	2023	2024 (f)	2025 (f)	2026 (f)
GDP and Components							
Private Consumption	0.4	0.4	0.4	1.0	1.8	1.9	1.8
Dwelling Investment	-0.5	0.1	-0.8	-3.1	-0.7	1.7	2.5
Underlying Business Investment	-1.3	0.1	-0.2	9.2	-1.3	2.2	1.8
Underlying Public Final Demand	0.6	0.5	0.5	4.6	2.1	1.6	1.4
Domestic Demand	**0.2**	**0.4**	**0.4**	**2.8**	**1.7**	**2.1**	**2.1**
Stocks (Cont. to GDP)	1.0	-0.3	-0.2	-0.9	0.1	0.0	0.0
Gross National Expenditure	**1.0**	**0.1**	**0.2**	**1.8**	**2.0**	**2.3**	**2.1**
Exports	0.7	0.1	0.4	3.0	1.7	2.1	2.2
Imports	5.1	0.1	0.3	4.9	6.3	2.2	1.7
Net Export (Cont. to GDP)	-0.9	0.0	0.0	-0.2	-0.9	0.1	0.2
Real GDP	**0.1**	**0.2**	**0.2**	**1.6**	**1.2**	**2.3**	**2.2**
Nominal GDP	1.4	1.4	1.5	4.5	5.4	3.9	3.6
Labour Market							
Employment	0.5	0.9	0.4	3.1	2.0	1.6	1.5
Unemployment Rate (Q-Ave, End of Period)	3.9	4.1	4.3	3.9	4.5	4.6	4.5
Wage Price Index (WPI)	0.8	0.9	1.1	4.2	3.8	3.4	3.2
Inflation and Rates							
Headline CPI	3.6	3.8	2.9	4.1	3.0	3.0	2.4
Trimmed-mean CPI	4.0	3.9	3.5	4.1	3.5	2.7	2.4
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)	3.98	4.33	4.25	3.96	4.20	4.00	-
$A/US cents (End of Period)	0.65	0.66	0.67	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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Important notice