The Forward View: Australia Oct 2024

Rates to ease from Feb with soft landing on track

NAB Economics

Overview

- We have brought forward our expectations for the timing of rate cuts, now seeing a first cut in February 2025 (previously May). As discussed in our Monetary Policy Update, the change in timing largely reflects the shifting balance of risks on inflation with our forecast profile broadly unchanged.
- Importantly, we continue to see a gradual pace of cuts back to 3.10% by early 2026. This profile for the cash rate sees the RBA cautiously normalising policy settings back to neutral in an environment in which inflation has subsided but the labour market remains close to full employment and GDP growth is recovering towards trend – effectively a soft landing.
- We still don't expect the RBA will be in a position to cut in November or December. While growth is very slow and will likely finish the year around 1.0% y/y, underlying inflation remains above the RBA's target band and a range of indicators – including capacity utilisation in the NAB Business Survey – suggest the balance of supply and demand is still tighter than normal.
- The upcoming Q3 CPI print will be impacted by subsidy effects but the detail should show steady progress on inflation with trimmed mean expected to print at 0.8% q/q (3.5% y/y). There are encouraging signs on wage growth and rental vacancies that temper the upside risks to the inflation outlook, but we expect the RBA will want more evidence – likely in the Q4 CPI print.
- The labour market continues to evolve in line with, or slightly better than, we had expected. To date, the rise in the unemployment rate has been driven by supply with employment growth remaining robust, and we expect this to continue in coming months before stabilising around 4½% in 2025. On this trajectory, the labour market would not be an impediment to the RBA commencing a rate cutting cycle but nor would it generate pressure to rapidly ease policy settings.
- Housing markets continue to reflect a mix of dynamics, including strong population growth, supply constraints, elevated construction costs and affordability challenges. The strong price growth seen through 2023 has given way to a more mixed picture, with Brisbane and Perth prices still rising strongly but Melbourne and, to a lesser extent, Sydney more subdued. Overall population growth has passed its peak but the outlook for some monetary policy easing will likely be a support through 2025.

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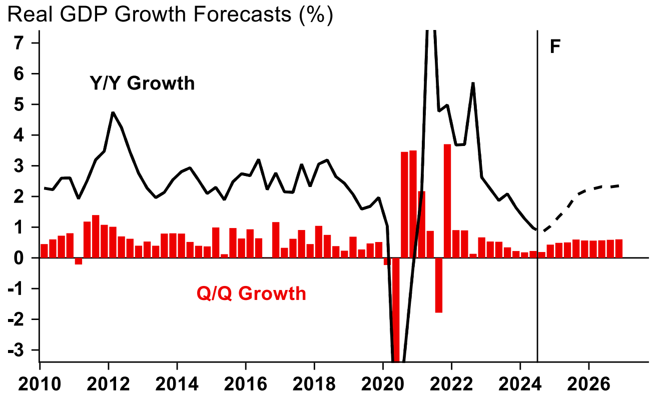
Key Economic Forecasts

	2023	2024(f)	2025(f)	2026(f)
Domestic Demand (a)	2.8	1.6	1.9	2.4
Real GDP (annual ave)	**2.0**	**1.0**	**1.8**	**2.3**
Real GDP (year-ended)	**1.6**	**1.0**	**2.2**	**2.3**
Employment (a)	3.4	2.5	1.7	1.6
Unemployment Rate (b)	3.9	4.4	4.5	4.3
Headline CPI (b)	4.1	2.9	2.9	2.3
Core CPI (b)	4.3	3.4	2.6	2.3
RBA Cash Rate (b)	4.35	4.35	3.35	3.10
$A/US cents (b)	0.68	0.69	0.75	-

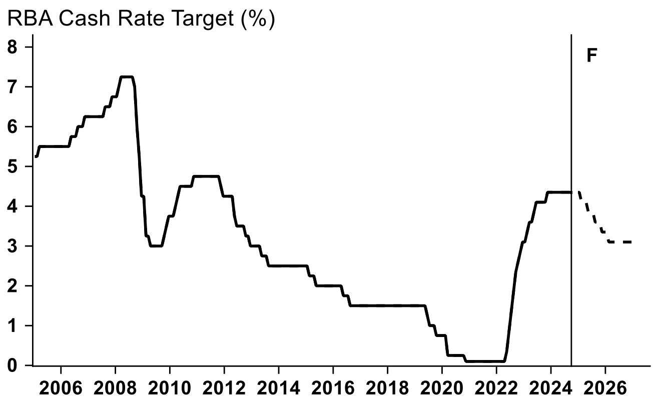
(a) annual average growth, (b) end-period

Chart 1: GDP forecasts



Source: Macrobond, NAB Economics

Chart 2: Cash rate profile



Source: Macrobond, NAB Economics

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

Labour Market & Household Consumption

Another month of robust employment growth in August reinforced that the labour market is proving resilient even as activity has slowed.

The August labour force data showed a 48k rise in employment, keeping the trend pace of employment growth at a healthy 0.3% m/m. That kept the unemployment rate steady at 4.2% with the participation rate remaining around its record high at 67.1%.

There are still signs of underlying softening in the labour market, with job vacancies continuing to decline – falling another 5.2% in the three months to August. However, at 330k (or around 2.2% of the labour force), the level of vacancies remains above pre-COVID levels and should continue to support employment.

With growth remaining very slow and the labour supply continuing to recover, we expect the labour market to loosen a little more over the remainder of the year before the unemployment rate stabilises around 4½% in 2025. Wage growth should also gradually ease from its peak at the beginning of the year, with underlying hourly wage growth likely stabilising in the 3-3.5% range over time.

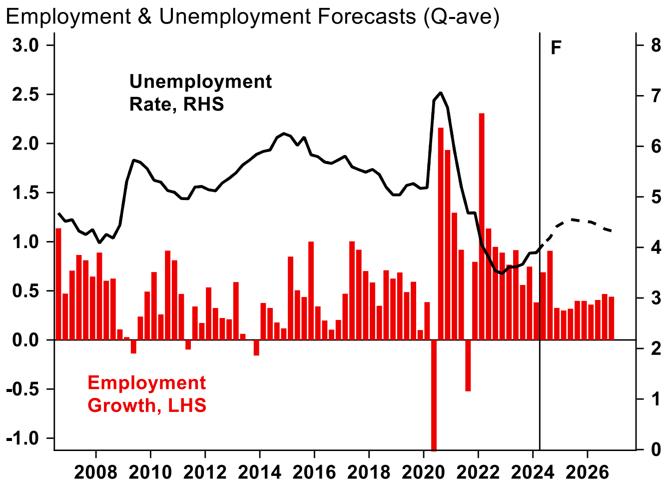
Nominal retail trade picked up in August but subsidies will impact headline consumption growth in Q3 ahead of a gradual improvement in household incomes beginning to show up in spending.

Retail sales rose 0.7% m/m (3.1% y/y) in August after a flat result in July, with strong growth in department stores, clothing & footwear, other retailing and cafes & restaurants, though household goods retailing fell in the month. [NAB's transaction data] suggests some of the pickup may have unwound in September but still point to positive nominal growth for the quarter as a whole, in terms of both retail and total consumer spend.

How this translates into real consumption volumes for the quarter will be complicated by the impact of energy subsidies, which reduce measured household consumption and boost government consumption in the ABS National Accounts. We expect the subsidy effect to subtract as much as 0.4ppts from household consumption growth, likely leaving overall consumption growth as a small negative in the quarter, even if the underlying pulse of household consumption activity is flat or positive.

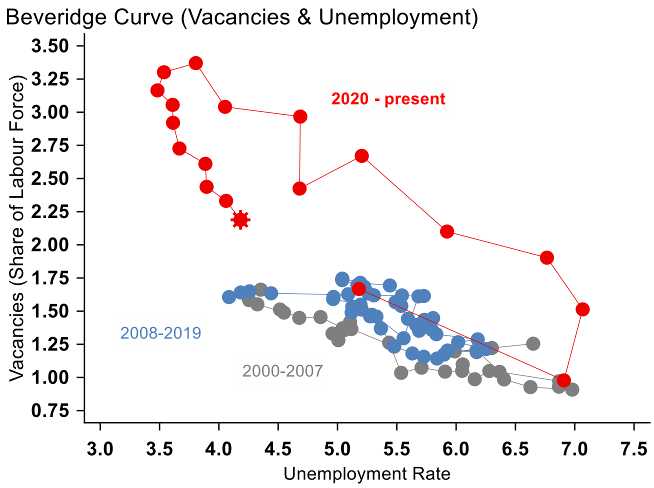
Looking further ahead, we continue to expect a gradual strengthening in the pace of household consumption growth as disposable income is supported by robust employment and wage growth, income tax cuts and energy subsidies, as well as a fading drag from inflation and likely rate cuts in H1 2025. For the economy, this strengthening demand will be partly offset by slowing population growth – albeit to the extent this is driven by international student flows, some of this effect will be measured in slowing services exports growth rather than household consumption.

Chart 3: We expect the unemployment rate to stabilise at around 4½%



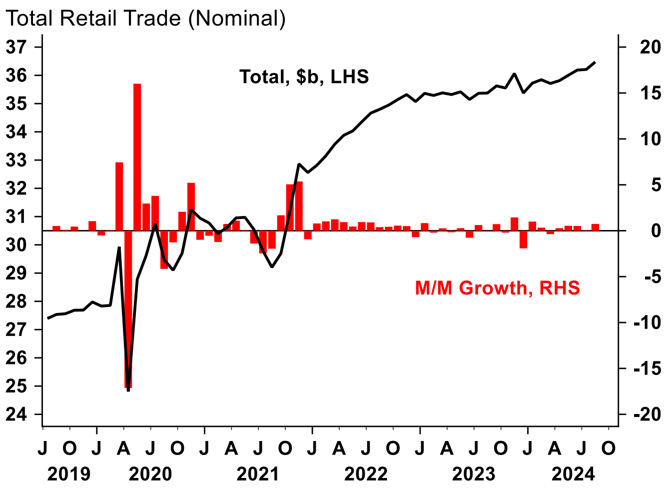
Source: Macrobond, NAB Economics

Chart 4: Vacancies have declined as growth has slowed, but remain above pre-COVID levels



Source: Macrobond, NAB Economics

Chart 5: Total retail trade grew 0.7% m/m in August



Source: Macrobond, NAB Economics

Housing & Construction

Building activity data for Q2 points to ongoing weakness in the supply of new dwellings.

Completions rose by 7.2% q/q (9.2% y/y) but continue to track at a relatively low rate – below 45k dwellings per quarter. The improvement in completions was driven by an increase in detached housing (to 28k per quarter) which fell to December 2020 lows in the previous quarter. The higher density components tracked sideways around 17k per quarter – a relatively low rate.

However, despite the rise in completions in Q2, housing supply remains challenged. Commencements (starts) fell 1.1% in the quarter and are now down 3.6% y/y. A further rise in detached housing was offset by a fall in the high-density component and both remain around their lowest level since 2016. More recent data on building approvals suggests that commencements have likely troughed, though remain well below the rate required to match the strength in housing demand.

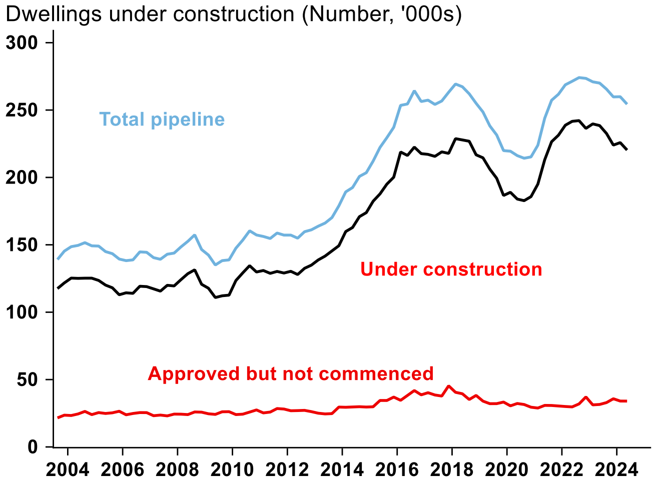
The rise in completions and fall in commencements saw the volume of dwellings under construction ease in the quarter to 222k – around 20k below the recent peak in late 2022 but well above the levels seen in late 2019 (prior to covid disruptions in early 2020). The number of dwellings approved but not commenced tracked broadly sideways at ~30k in Q2. Scaling the pipeline of new dwellings by current rates of work done suggests there are around 5.6 quarters of work outstanding – a still elevated rate but a little below the peak of 6.5 quarters in early 2023.

Capital city house price and rents growth continues to slow in annual terms across both the CoreLogic and PropTrack measures but will likely end the year 5-10% higher.

The CoreLogic 8-capital city house price index rose by 0.4% in September, led by gains in Perth, Adelaide and Brisbane, while Sydney prices rose at a slower 0.2% m/m. Prices declined in Melbourne and Hobart. The PropTrack index shows a broadly similar pattern, though suggests prices growth has slowed more significantly in Perth, with Adelaide now the fastest growing on their data.

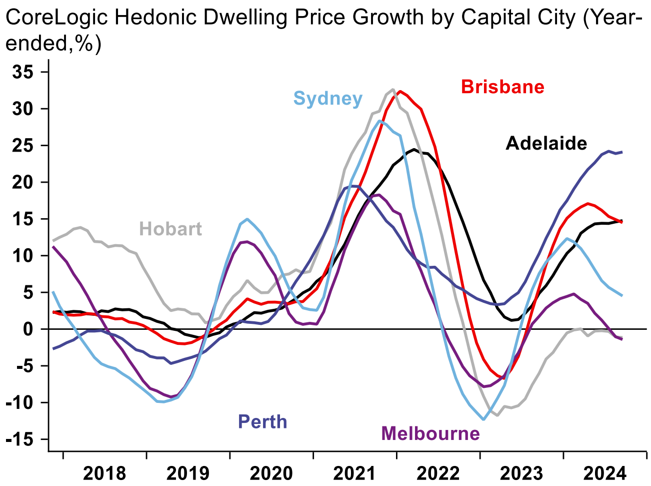
Rents growth has slowed sharply over the past 3 months despite only a modest uptick in rental vacancy rates. The slowing has been most pronounced in Melbourne, Sydney and Brisbane and, after a period of weakness, is now strongest in Hobart in monthly terms. Over the past year, growth has been strongest in Perth and Adelaide at 8% and 10%, respectively. Growth across the other capitals has been slower but still solid with each up 5-7% y/y.

Chart 6: The pipeline of dwellings under construction remains high but is easing



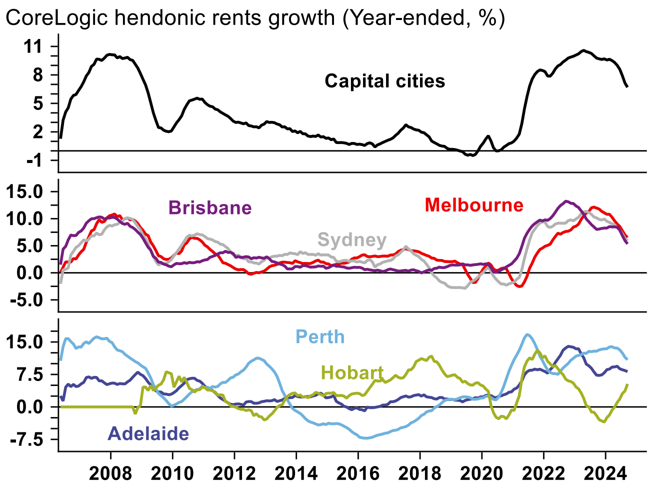
Source: Macrobond, NAB Economics

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

Business conditions rose in September, as did confidence, while capacity utilisation continues to track above average.

The September NAB Monthly Business Survey showed business conditions rose 3pts to +7 index points, around the long-run average, after dipping lower in the month prior. All three subcomponents rose, with trading conditions up 4pts and the employment and profitability indices both up 3pts. Confidence also rose 3pts but remained in negative territory at -2 index points.

Importantly, capacity utilisation was broadly steady in the month and, despite having trended downwards over the past two years, remains clearly above average. This suggests the balance of supply and demand remains somewhat tight even if the economy has slowed significantly over the past year. The upcoming NAB Quarterly Business Survey, to be released Thursday, will provide further detail on the constraints impacting businesses.

Elevated capacity utilisation should continue to support business investment, which in volume terms has been around a record high (excluding mining).

The goods trade surplus was broadly steady in August, with the outlook for China a key uncertainty.

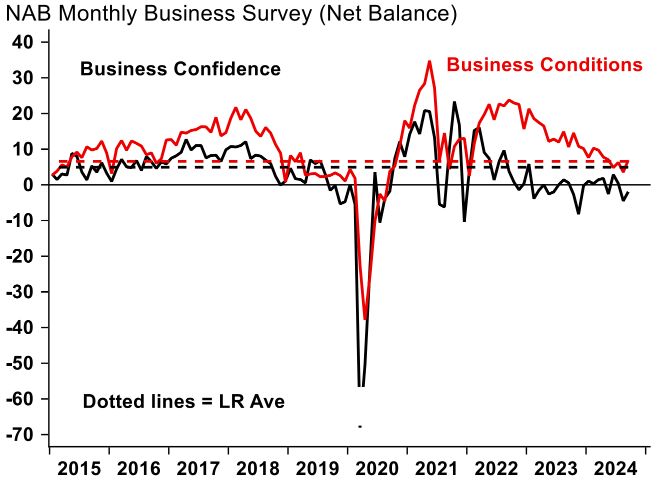
Both goods exports and imports were down slightly in August, leaving a net goods surplus of $5.6b. Coal exports ticked up while iron ore was steady and rural commodities edged down. On the imports side, consumption goods imports fell in the month as vehicle imports dropped, while capital goods imports continued to trend upwards.

The outlook for key commodity prices remains uncertain, with China's growth slowing under the weight of structural challenges in the property market and weak consumer demand. As discussed in our China Economic Update, recently announced monetary policy stimulus measures are unlikely to be enough to move the dial but expectations remain that more significant fiscal measures may follow, providing some support to iron ore prices. Whether these materialise, however, is uncertain.

Our outlook for the AUD/USD remains for the currency to rise to around US69c by the end of this year before rising to around US75c over 2025.

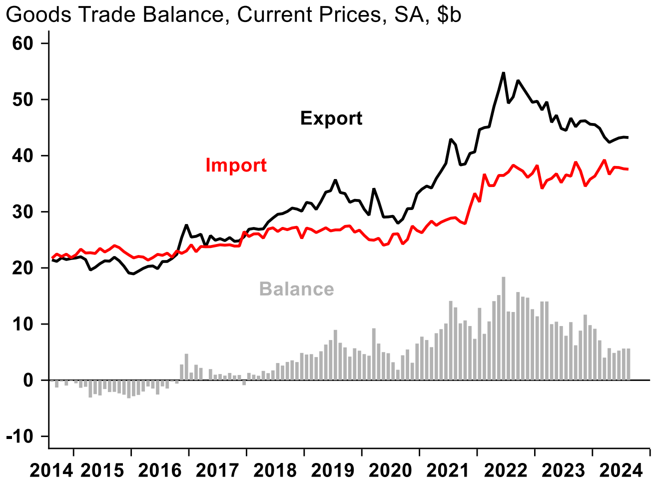
This outlook is driven by an expected softening in the USD, as the US economy slows and the Fed continues its monetary policy easing cycle. However, the global growth back drop, commodity prices and sentiment around the Chinese economy will also be key factors.

Chart 9: Business conditions remain around their long-run average despite lingering low confidence



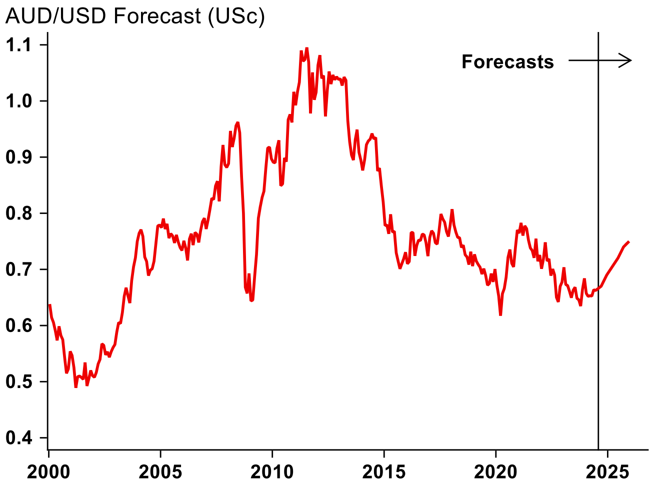
Source: Macrobond, NAB Economics

Chart 10: The nominal goods trade balance was broadly steady to August



Source: Macrobond, NAB Economics

Chart 11: The AUD is expected to appreciate into 2025



Source: Macrobond, NAB Economics

Inflation

The monthly CPI indicator saw headline inflation decline to 2.7% y/y, with the impact of electricity subsidies subtracting around 0.5ppts off the headline result.

Abstracting from the subsidies, headline inflation declined to 3.2% in August as base effects or prior petrol price rises faded. While results were mixed in the month, the monthly indicator continues to show that market services prices continue to track more strongly than goods prices and will need to ease further.

Relatedly, the ABS data show that non-tradables (components of the CPI basked with a larger domestic cost component) continue to rise at 3.8% y/y while tradables prices is tracking well below target at 0.5% y/y.

The housing component of the CPI – which remains a risk – shows some easing in rents pressure (though still high) over recent months. New dwelling cost inflation was soft in the month but continues to track at a too-strong 5% y/y.

The NAB Monthly Business survey showed an easing in output prices to 0.5% in quarterly terms (down from 0.7% in August) with this measure now slightly below its long-run average. Notably, the pace of retail and recreation & personal services price growth also eased in the month. At 0.5% in quarterly terms, retail price growth is now below its long run average, while recreation & personal services price growth remains a little above average. While price measures can be volatile on a monthly basis, these outcomes are an encouraging sign for further disinflation though this trend will need to be sustained. Nonetheless the survey continues to paint a picture of an easing in inflation pressure.

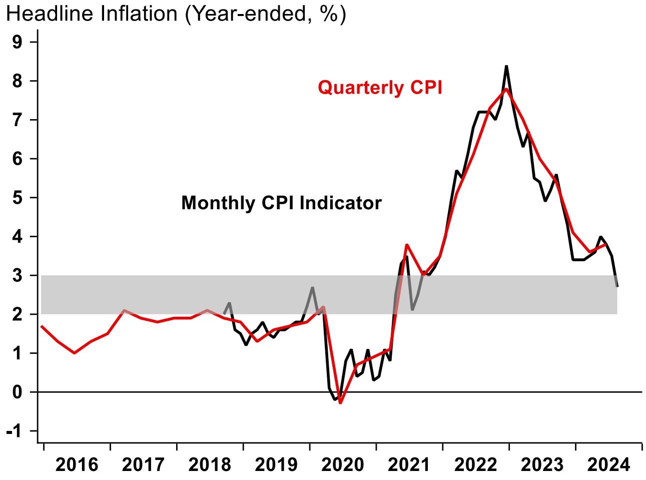
On the input side, labour cost growth edged down slightly but remains high at 1.7% in quarterly terms. Purchase cost growth also eased but also remains elevated – and higher than output price growth. Input costs growth is now clearly above the pace of growth in output prices in the business survey, pointing to some margin pressure as business are less able to pass on input costs pressures.

Our outlook for inflation is broadly unchanged. Though CPI data will remain volatile in the near term, we expect inflation to continue to gradually cool in H2 2024.

For Q3, we see a subsidy-impacted 0.3% q/q (2.9% y/y) for headline inflation. We forecast 0.8% q/q (3.5% y/y) for the trimmed-mean in Q3. That would mark some further gradual easing, following a period of very little progress in H1 2024.

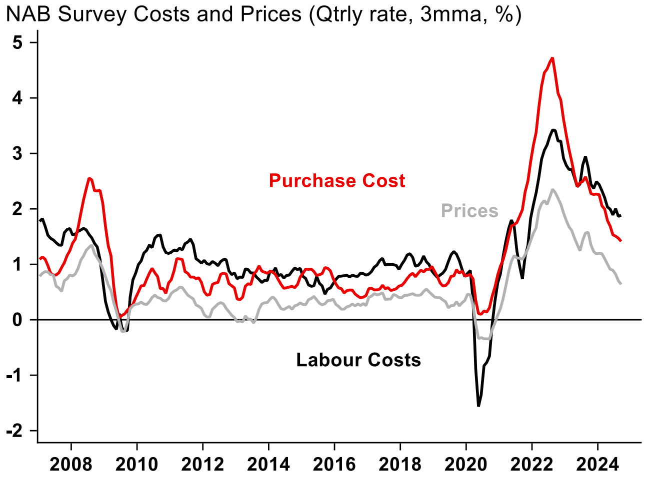
Further out we see inflation gradually easing back towards the middle of the target band with prints of around 0.7% q/q for underlying inflation in late 2024 and early 2025. That sees trimmed mean inflation fall to 3.4% y/y by end 2024, and into the top half of the target band by mid-2025, and around the middle of the target band by 2026.

Chart 12: Monthly CPI inflation eased to 3.5% in July



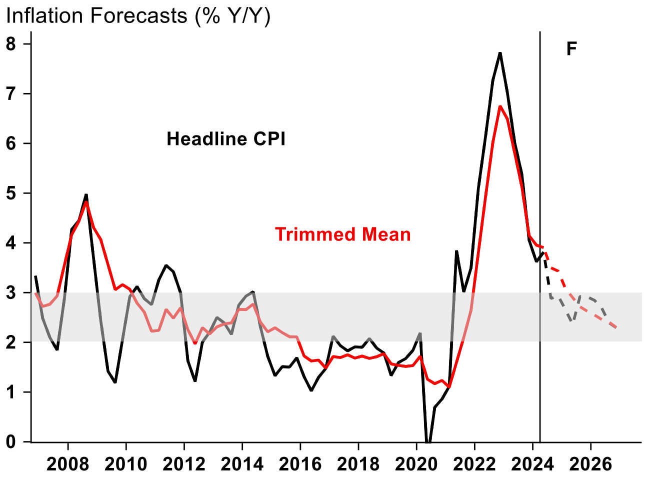
Source: Macrobond, NAB Economics

Chart 13: Survey measures of prices and costs continue to trend lower



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 have brought forward our expectations for the first rate cut by the RBA, now expecting February to be the first cut (25bps) followed by a gradual continued easing towards 3% by early 2026.

We had noted for some time that the recent data flow – CPI, labour market, business survey, national accounts and consumer spending data – pointed to the risk of an earlier move by the RBA and with the inflation backdrop cooling further over recent months, the risks of our overall profile are more balanced around February.

That said, we do not see the RBA as being ready to move this year, with underlying inflation well above target and an unclear read on volatile inflation and GDP data. In addition, there is ongoing uncertainty over the consumer response to easing real income pressures. That said, on our forecasts the next move will be down.

Indeed, the RBA removed the explicit consideration of a further increase at the September meeting, noting that the current level of the cash rate was sufficient to balance the risks of inflation taking longer than expected to return to target against the risk of a more significant downturn in the labour market.

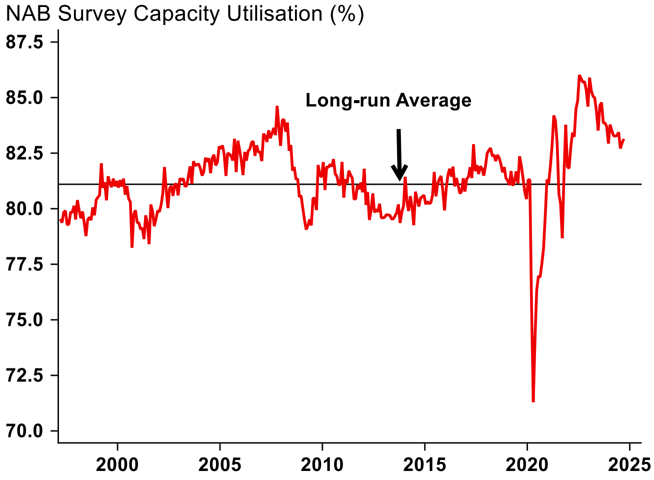
A key dynamic for the RBA outlook remains the extent to which household consumption growth rebounds in H2 2024 as the impact of tax cuts flows through household balance sheets and inflation pressures continue ease the strain on real incomes. This context was important for the new framing of scenarios around the need to for policy "to be held restrictive for a prolonged period or tightened further".

The RBA also continues to assess the risks around the supply-side of the economy noting the risks around the mis-measurement of the output gap or the assumption of slower productivity growth further out.

Overall, our outlook is broadly in line with the RBA's and importantly we see the RBA as able to navigate the challenge of returning inflation sustainably back to the middle of the target band and retain most of the gains in the labour market over recent years. That would mark a very soft landing with economic and employment growth remaining positive.

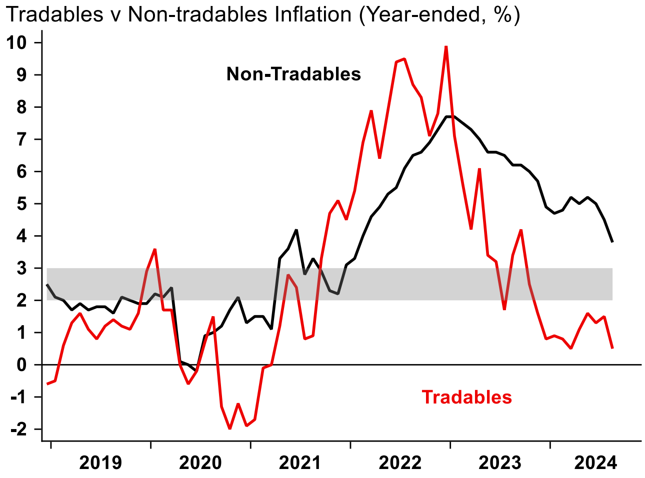
It also likely implies a later and slower pace of cuts back towards neutral when compared with many other advanced economy central banks – in part reflecting a less restrictive starting point as inflation returns to target.

Chart 15: Capacity utilisation is above average



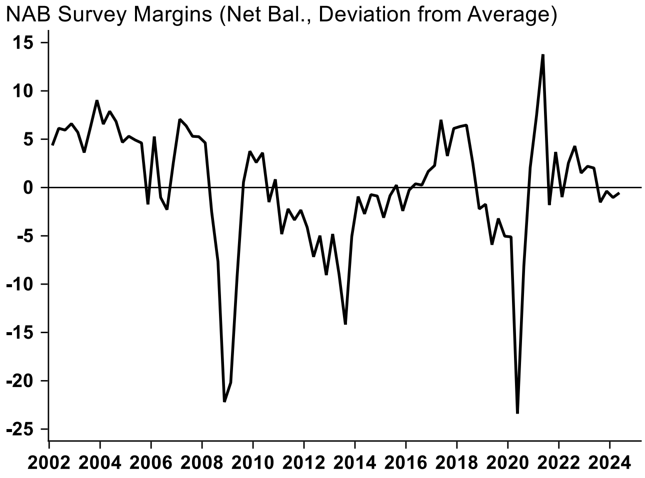
Source: Macrobond, NAB Economics

Chart 16: Domestic inflation pressures remain elevated



Source: Macrobond, NAB Economics

Chart 17: Margins are coming under pressure alongside slow demand growth



Source: Macrobond, NAB Economics

Table of Economic Forecasts

	% Growth q/q			% Growth y/y			
	Q2-24	Q3-24 (f)	Q4-24 (f)	2023	2024 (f)	2025 (f)	2026 (f)
GDP and Components							
Private Consumption	-0.2	-0.2	0.2	0.8	0.5	1.6	2.0
Dwelling Investment	0.1	0.0	0.1	-2.9	0.2	0.9	2.0
Underlying Business Investment	-0.2	-0.6	0.3	9.2	-1.7	2.0	2.2
Underlying Public Final Demand	1.4	1.2	0.8	4.4	4.3	2.7	2.5
Domestic Demand	**0.2**	**0.3**	**0.5**	**2.7**	**1.4**	**2.2**	**2.4**
Stocks (Cont. to GDP)	-0.5	-0.1	0.0	-0.9	0.2	-0.1	0.0
Gross National Expenditure	**-0.1**	**0.2**	**0.5**	**1.8**	**1.8**	**2.2**	**2.4**
Exports	0.5	0.3	0.4	3.3	2.1	2.1	2.2
Imports	-0.2	0.2	0.5	4.9	6.6	2.3	2.6
Net Export (Cont. to GDP)	0.2	0.0	0.0	-0.2	-0.9	0.0	0.0
Real GDP	**0.2**	**0.2**	**0.4**	**1.6**	**1.0**	**2.2**	**2.3**
Nominal GDP	0.2	1.4	1.6	4.6	4.4	3.8	3.7
Labour Market							
Employment	0.7	0.9	0.3	3.0	2.3	1.4	1.7
Unemployment Rate (Q-Ave, End of Period)	4.1	4.2	4.4	3.9	4.4	4.5	4.3
Wage Price Index (WPI)	0.8	1.0	0.9	4.2	3.6	3.4	3.2
Inflation and Rates							
Headline CPI	3.8	2.9	2.9	4.1	2.9	2.9	2.3
Trimmed-mean CPI	3.9	3.5	3.4	4.1	3.4	2.6	2.3
RBA Cash Rate (End of Period)	4.35	4.35	4.35	4.35	4.35	3.35	3.10
10 Year Govt. Bonds (End of Period)	4.33	3.96	4.10	3.96	4.10	3.90	3.95
$A/US cents (End of Period)	0.66	0.67	0.69	0.68	0.69	0.75	0.75

Data are percentage growth rates over the quarter or year as noted, except where specified otherwise.

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