The Forward View: Australia Nov 2024

Back to the future for RBA policy outlook

NAB Economics

Overview

- We now expect the RBA will start cutting rates in May 2025 (previously February) - back to where we were in September. As outlined in our Monetary Policy Update, the main reason for the change is that the labour market has been stronger than expected.
- The unemployment rate was 4.1% in October and it has been essentially unchanged since April. Other labour market indicators continue to point to a tight labour market and wage growth remains above the level consistent with the RBA's inflation target (given the weakness in productivity). With capacity utilisation also still above average, this indicates that there is still excess demand. While the demand/supply gap has been easing, progress has been only gradual.
- Q3 CPI inflation came in as expected, with a sharp fall in headline inflation to 2.8% y/y, but this partly reflected the impact of electricity subsidies and trimmed mean inflation, while also moderating, was 0.8% q/q (3.5% y/y) and so still above the RBA's target. Components of the CPI sensitive to domestic demand are also showing some persistence at an elevated level.
- While growth is likely to have remained soft in Q3, it should improve from there, returning to an around trend pace over 2025 and 2026. The pick-up in Q3 retail sales volumes is a sign that improving household finances are starting to filter through to activity. While we have lowered our near-term unemployment rate expectations, the still soft GDP growth in the second half of this year should see the unemployment rate move higher, and it is still expected to peak at around 4.5%.
- Once the RBA starts reducing rates, we expect it will do so only slowly, with the cash rate not expected to move back to neutral (3.10%) until mid-2026. Even with an unemployment rate of 4.5%, the labour market would be close to full-employment, and with around trend GDP growth, and inflation only expected to reach the mid-point of the RBA's target band by mid-2026, there will be no pressure on the RBA to move rates down quickly.
- The election of Donald Trump as US President is likely to lead to material changes in US policy, although when, and to what degree, is highly uncertain. A key exposure for Australia will be how possible tariff increases affect China and the flow through of likely lower global growth to commodity prices. One immediate impact has been for the AUD/USD, for which we have lowered our projections.

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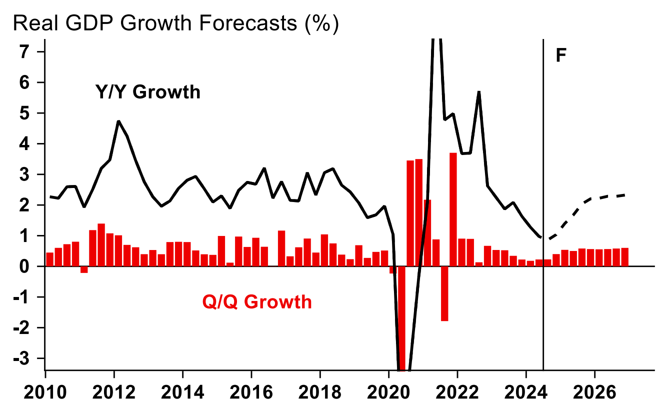
Key Economic Forecasts

	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	2.6	1.7	1.5
Unemployment Rate (b)	3.9	4.2	4.5	4.3
Headline CPI (b)	4.1	2.9	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	0.66	0.67	-

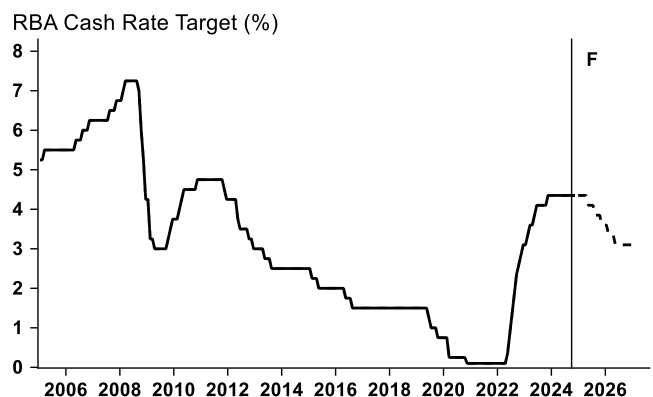
(a) annual average growth, (b) end-period

Chart 1: GDP forecasts



Source: Macrobond, NAB Economics

Chart 2: Cash rate profile



Source: Macrobond, NAB Economics

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Labour Market & Household Consumption

October data showed that the labour force remains tight, unemployment remained stable despite slightly softer jobs growth and broader economic trends.

Unemployment was unchanged in October – remaining at 4.1% (in seasonally adjusted terms) – with little upward movement in this measure since June. Total employment rose by 16k jobs (the weakest increase in six months), while the participation rate edged down to 67.1%, from its record high in September.

Labour demand remains comparatively strong. Job vacancies have retreated from their mid-2022 peaks, however they remained well above pre-pandemic levels in Q3. Around 82% of respondents to NAB's Quarterly Business Survey reported that labour was a constraint on their output in September. This trend remains broad based across the economy, with the wholesale sector the outlier (at 63% in Q3). This has supported wage growth, with the WPI up by 0.8% q/q or 3.5% y/y (with the latter continuing to ease).

Conditions in the labour market are expected to weaken in coming months as jobs growth slows and labour supply continues to recover. This should see the unemployment rate edging higher to around 4.5% by early 2025 before stabilising as broader economic conditions begin to improve. It is worth noting that this is a comparatively low rate of unemployment by historical standards.

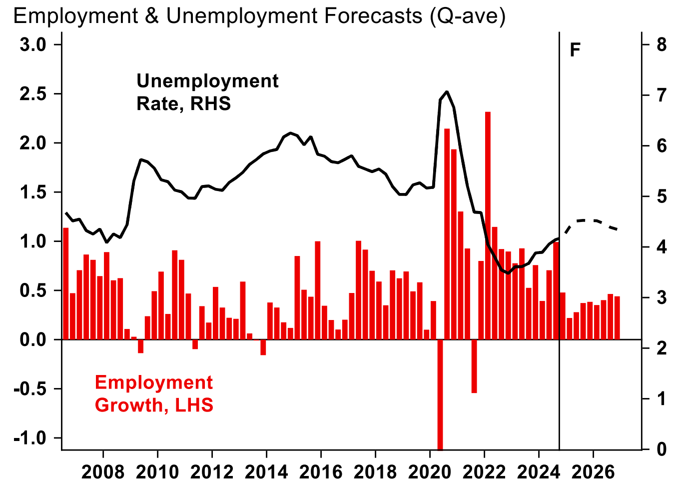
Nominal retail sales growth was softer in September (following the strong reading in August)

Retail sales growth was considerably softer in September, with nominal sales increasing by just 0.1% m/m (2.3% y/y), down from a robust 0.7% m/m in August. NAB's latest transaction data suggests a modest pickup in spending in October (up 0.4% m/m compared with a 0.2% m/m increase previously). This growth was driven by increases in goods retailing and cafes & restaurants, while spending on essential services and vehicles & fuel fell relatively strongly.

In real terms, retail sales rose by 0.5% q/q (seasonally adjusted) in Q3, following on from two straight quarters of decline. This increase was led by household goods (up 1.0% q/q) and clothing, footwear and personal accessory retailing (1.9% q/q) along with the other retailing category. In contrast, food retailing fell by 0.3% q/q in September, with prices in this category increasing comparatively strongly quarter-on-quarter.

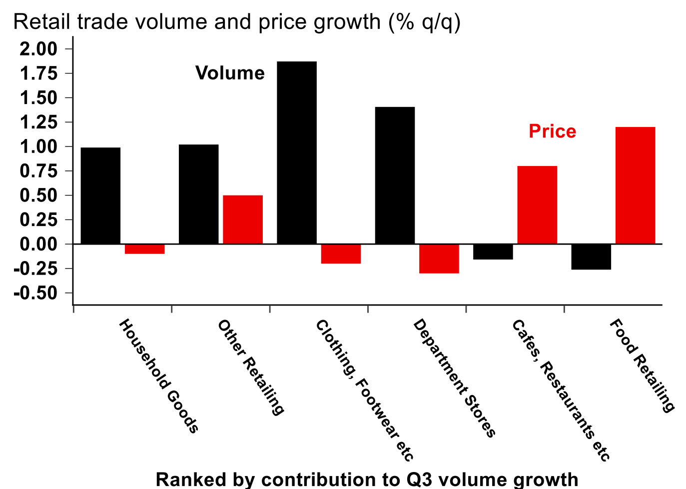
Household consumption growth is likely to be somewhat weaker than retail sales growth in Q3, reflecting the impact of energy subsidies (that will increase government consumption and reduce household consumption). A gradual recovery in household consumption is central to our economic outlook – with household incomes going forward benefiting from income tax cuts, weaker inflation, policy rate cuts along with the wage impacts of a still tight labour market.

Chart 3: Unemployment moving higher in 2025, albeit still comparatively low by historical standards



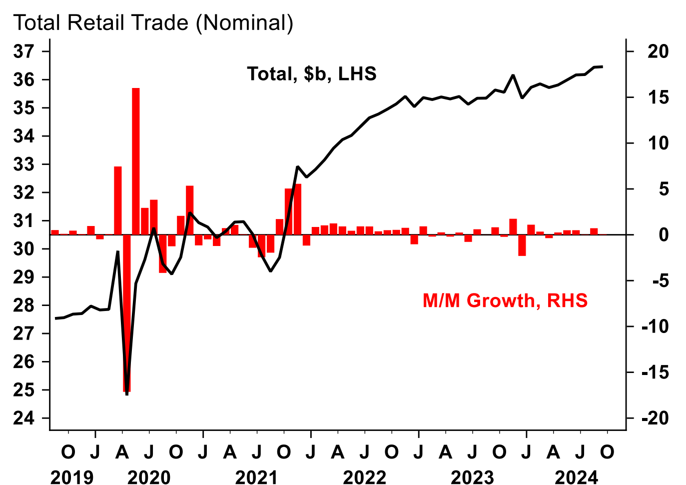
Source: Macrobond, NAB Economics

Chart 4: Mixed trends in spending patterns in Q3



Source: Macrobond, NAB Economics

Chart 5: Retail trade marginally higher m/m in September



Source: Macrobond, NAB Economics

Housing & Construction

Building approvals have lifted but remain low, but capacity constraints continue to limit new housing supply.

Building approvals rose by 4.4% m/m in September. Since February, approvals have increased by 12% on a trend basis with gains in both houses and 'other dwellings' (such as apartments).

That said, approvals are still low (particularly for 'other dwellings'), both by historical standards and relative to population growth. Around 45k dwellings were completed in Q2, whereas, in Q1, the population grew by 164k.

Building approvals will need to see further gains even to sustain this level of new housing supply. For now, activity is being supported by a still large pipeline of work. While the pipeline is still elevated, it has been falling and this is likely to continue as approvals are still below what is needed to sustain completions at their current level.

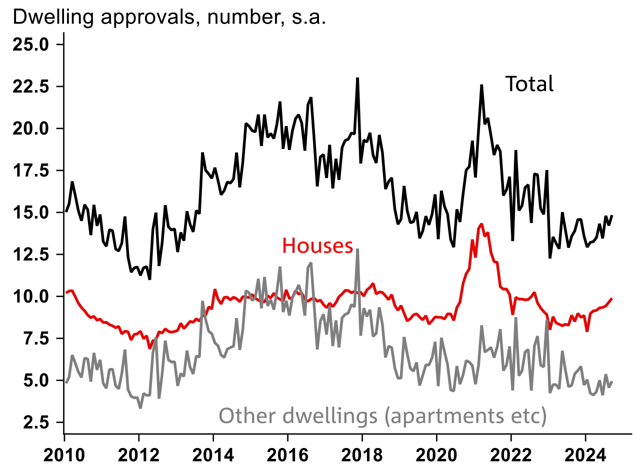
Housing completions have broadly tracked sideways since late 2021, despite the backlog of work. This likely reflects construction capacity constraints (and possibly other factors such as project viability given the large increase in construction costs that has occurred). NAB's Quarterly Business Survey indicates that finding labour and, to a lesser extent, the availability of materials, continue to be an issue for the broader construction sector. A sustainable lift in housing supply from here will not just require a further lift in approvals, but also further alleviation of these capacity constraints.

Capital city house price and, in particular, rents growth has settled at a slower pace over recent months.

Monthly capital city house price growth has settled at a lower rate since July, at around 0.2% to 0.3% m/m both on the CoreLogic and PropTrack indices. As a result, the annual growth rate eased down to around 6% y/y in October from 9-11% y/y earlier in the year. Over the year to October, price growth has been mixed across the capitals, including falls in Melbourne and Hobart. Perth, Brisbane and Adelaide have seen strong gains, although they too are seeing deceleration in the rate of growth.

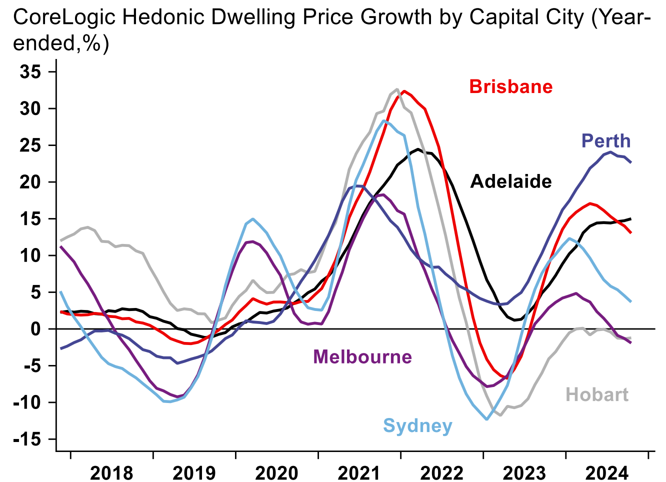
There has been an even sharper deceleration in rents growth. The CoreLogic hedonic rents index has declined slightly since June, even with only a small rise in vacancy rates. The slowdown has been broad-based, but most pronounced in Sydney and Brisbane. The CoreLogic measure is based on rental listings and so leads the ABS CPI rents measure, which covers the stock of all rentals, and so points to downwards pressure on the latter if the recent trend persists. The CPI measure is also impacted by subsidies – the increase in Commonwealth Rental Assistance on 20 September only had a small impact on Q3 CPI, with the full impact to come through in Q4.

Chart 6: Dwelling approvals rising but still low



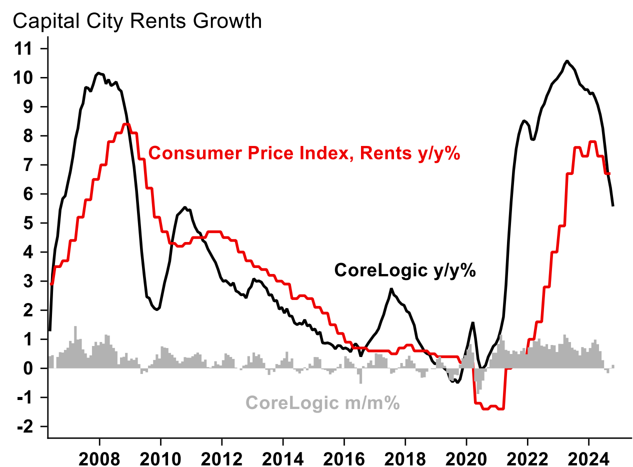
Source: Macrobond, NAB Economics

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

Trade & FX

US election implications – direct exposure to US via trade is limited, but there are other channels though which US policy shifts can affect Australia. At this stage we are not changing Australia forecasts other than the USD/AUD, which is likely to be lower as a result.

Trump's election as President is likely to usher in major changes in US policies. Large tariff increases – 60% tariffs on China and 10-20% on other imports have been flagged. Border security will be beefed up and, if delivered in full, his promises may add stimulus to the US economy.

To what extent the campaign policies are implemented, and their timing, is uncertain. Trump pushed through higher tariffs in his first term but not to the extent flagged in his campaign. The possible use of tariffs as a bargaining chip means actual increases may not be as large as threatened, as well as carve outs for certain nations, but we expect a material rise in tariffs nevertheless.

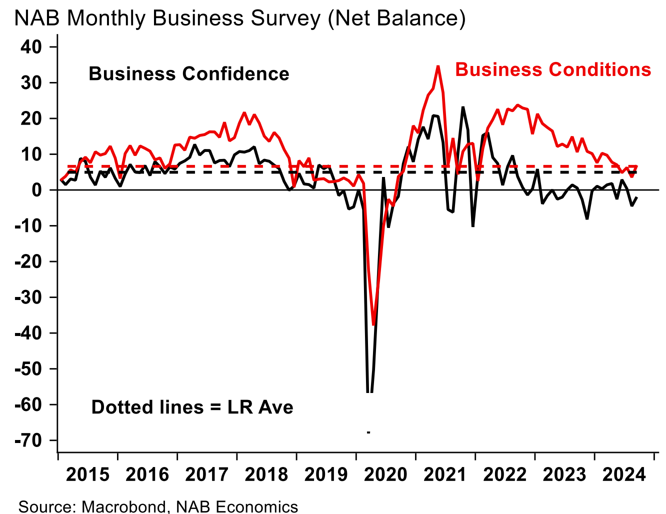
Materially higher tariff increases would drag on US growth although this could be offset by stimulatory fiscal policy. Even so, it is likely to be negative for global growth. Australia runs a trade deficit with the US, so we are well placed to obtain exemptions from tariffs. Even if this not the case, Australia's direct trade exposure to the US is small – goods exports are only around 0.8% of GDP. However, our major trading partners – in particular China – could be impacted, although it is possible their domestic policy could seek to simulate their economies in response.

For Australia, the bulk of our exports are commodities so even if demand fell, the impact on trade volumes would depend on where Australian producers sit on the cost curve. Lower demand would impact commodity prices, reducing mining sector profits and government royalty revenues.

There are no signs of stress in financial markets, including in equity markets, with the Australian market rising in the days following the election. However, Trump's election is one factor that has led us to lower our projections for the AUD/USD, with recent strong US data and lack of China stimulus also weighing. We now see a high risk of AUD/USD slippage in coming quarters, with our 0.64 end Q2 point forecast implying meaningful risk that we will revisit or exceed the 2024 YTD lows of around 0.6350 on occasion.

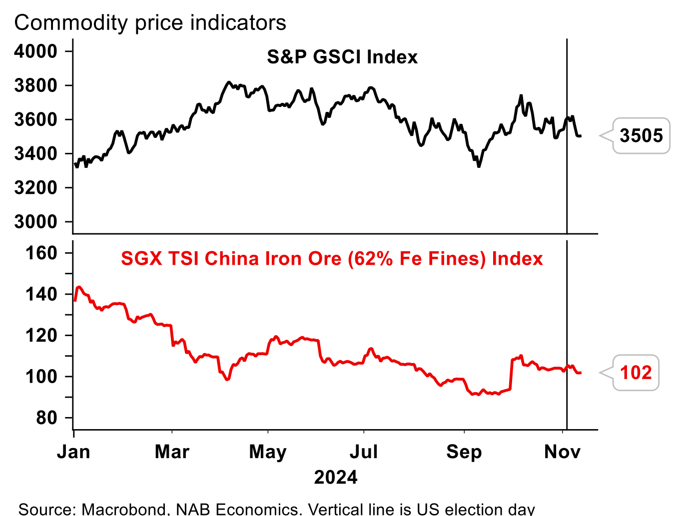
The AUD has historically acted as an automatic stabiliser for the economy and this is likely to continue, with a lower AUD improving trade competitiveness. A lower AUD does add to inflation, but this could be offset by the deflationary impact of lower global growth and exporters affected by US trade barriers may discount their prices in the search for new markets.

Chart 9: Australia's trade exposure to the US is limited, how tariffs affect the Asia region of more importance



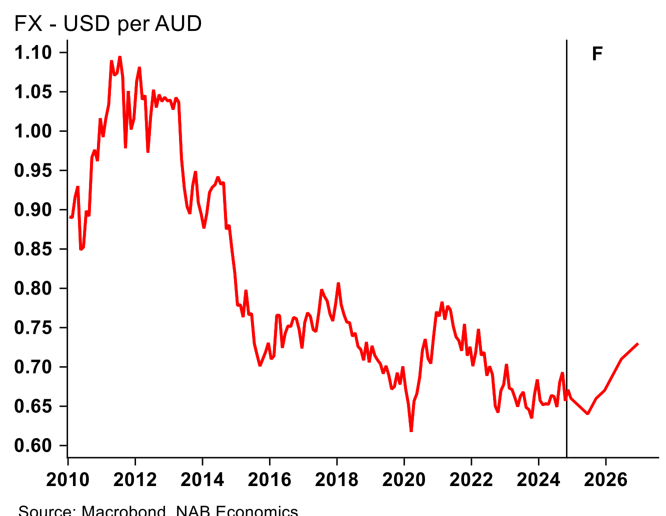
Source: Macrobond, NAB Economics

Chart 10: Commodity price reaction to US election muted, but China fiscal stimulus disappointment a drag



Source: Macrobond, NAB Economics. Vertical line is US election day

Chart 11: AUD forecast lowered on US resilience, Trump win and China stimulus disappointment



Source: Macrobond, NAB Economics

Inflation

Q3 CPI inflation came in as expected. Headline inflation fell sharply (and temporarily back into the target band) while the trimmed mean came in at 0.8% q/q (3.5% y/y).

The sharp slowing in headline inflation reflected the impact of electricity subsidies and a large fall in petrol prices. Looking through these volatile factors, underlying inflation moderated to 3.5% y/y – marking around 0.7ppts of progress on the year-ended rate in 2024 to date. While underlying inflation is now well off its peak of 6.8% in late 2022, it remains notably above the RBA's target and disinflation has been much more gradual this year.

The data continue to show that a large degree of the moderation in inflation to date has come through goods (and tradables) disinflation. Market services inflation has continued to track at a much higher rate of ~4.5% with progress over recent quarters only gradual.

In terms of services inflation, insurance continues to rise strongly at 14% y/y, while other household services including hairdressing, sports participation and recreation & cultural services also continue to rise strongly.

The housing component due to both its weight and recent trends continues to be a key dynamic. CPI rents growth has eased (and will be impacted by rent assistance increases in the next quarter) but remains high at 6.7%. New dwelling costs in the CPI have been softer in monthly terms but continue to track around 5% annually. So, while there are encouraging signs of a moderation in pressures from these components, they still remain a solid source of inflation.

Overall output price growth from the NAB Monthly Business Survey tracked sideways at a relatively benign rate in October. However, the consumer facing sectors continue to show stronger inflation. Retail price growth rebounded relatively sharply to 1.1% in quarterly equivalent terms, while recreation & personal services sector output prices continued to rise at 0.9% in quarterly equivalent terms.

In trend terms the NAB Business survey continues to point to easing inflationary pressure, though both purchase and labour cost growth remains well above pre-pandemic rates. While the period leading up to the pandemic was one of relatively low inflation, overall the survey suggest there is further progress to be made.

We continue to see trimmed mean inflation easing gradually. We have pencilled in 0.7% q/q (3.4% y/y) for Q4. We see trimmed mean inflation in the top half of the RBA's target band by mid 2025 and for it to be around the middle of the band by early 2026.

Chart 12: Headline inflation will temporarily track within the target band

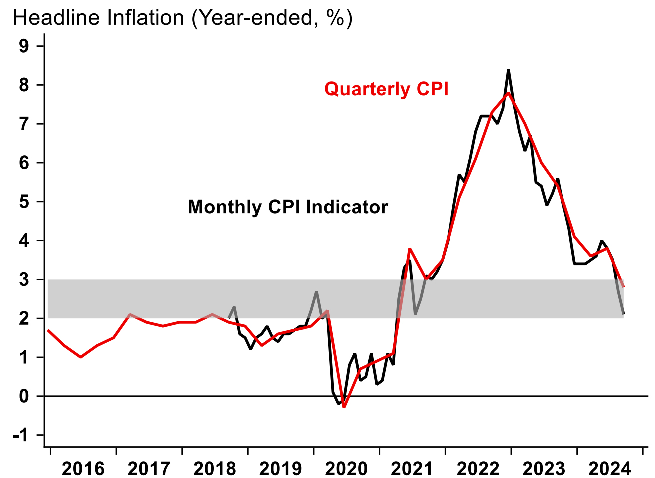


Chart 13: Services inflation remains elevated

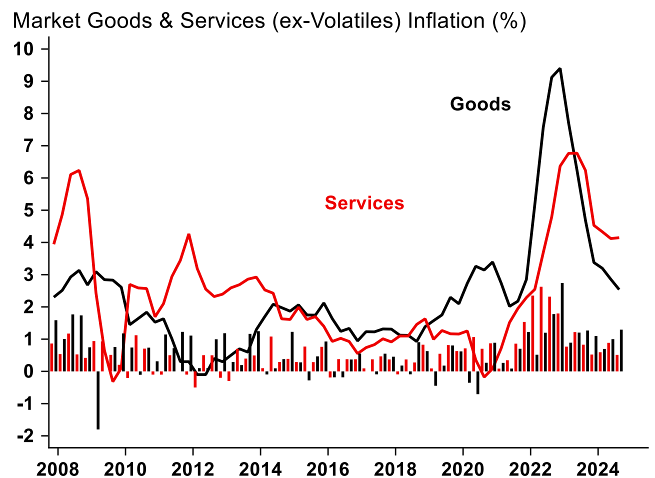
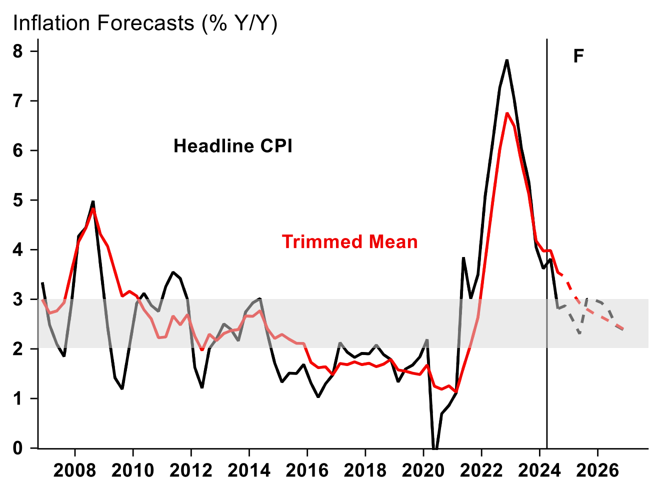


Chart 14: Trimmed mean inflation is still expected to return to the target band in 2025



Monetary Policy

We have pushed out our rate call back to May and still expect the profile of cuts to be gradual.

While underlying inflation printed as we had expected in Q3 at 3.5% y/y – marking some further small progress on disinflation –recent labour market data has been stronger than we expected, and we have revised our near-term expectation for the unemployment rate lower. That means, while inflation is expected to continue to gradually ease, the labour market will provide little impetus for the RBA to make pre-emptive cuts.

Importantly, the starting point for the RBA is that underlying inflation remains notably above target while the unemployment rate remains a little below a level consistent with full-employment. In a bigger picture sense, the key assessment is that the economy continues to operate with demand outpacing supply (though the gap is narrowing) and that the tight labour market is driving wage outcomes that are currently inconsistent with inflation sustainably returning target given weak productivity growth.

Overall, our forecasts suggest that the RBA will still be able to navigate the "narrow path", continuing the strategy of only modestly restrictive rates in order to minimise the cycle in activity and importantly maintain as much of the gains in the labour market over recent years as possible. Indeed, the November SoMP staff forecasts are broadly similar to our own.

In terms of the pace and magnitude of cuts, we continue to pencil in an average pace of one cut per quarter and a terminal rate of around 3.1% – signalling a shallower cutting phase than many other advanced economies.

On risks, the accumulation of data by the February 2025 meeting would have to show a significant deterioration over the next two months (unlikely given the recent run of strength) while inflation also needs to show greater signs of moderation. The RBA would also likely need to make a more significant reassessment of the output gap. The Q3 national accounts will be released in early December – likely showing another quarter of soft growth but also some rebound in the underlying pace of consumer spending growth suggesting that even before rates being to fall, easing pressure on households will see a lift in growth.

With rates only modestly restrictive and the economy having remained resilient, it could well be that the RBA stays on hold deeper into 2025 as inflation moderates only gradually if the labour market remains tight.

Chart 15: Domestic inflation pressures are still elevated

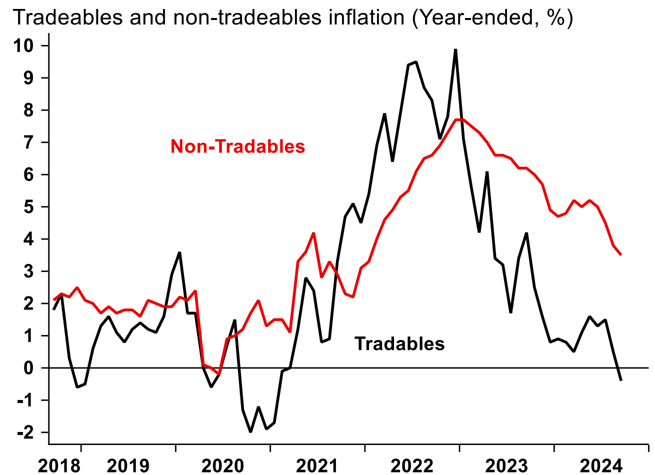


Chart 16: Survey cost and price growth continues to ease gradually

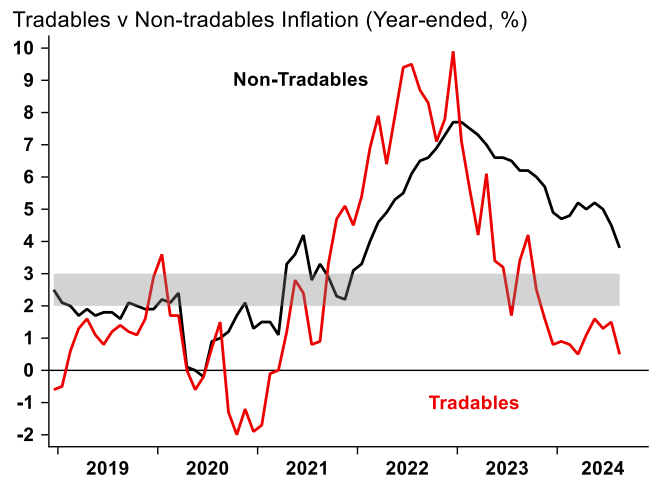


Chart 17: Wage growth will likely need to cool further to be consistent with at-target inflation.

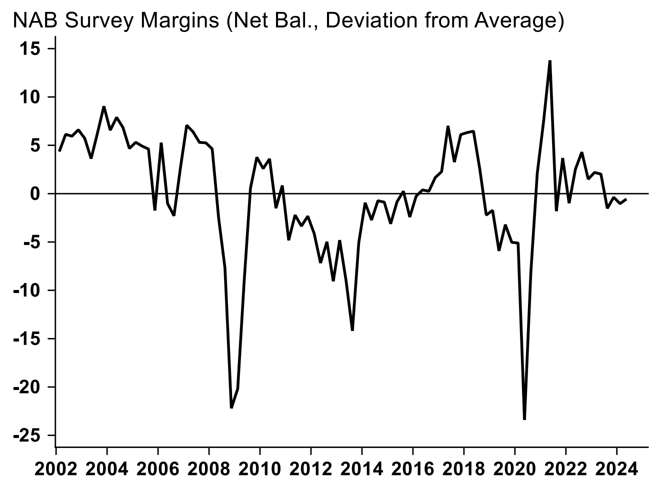


Table of Economic Forecasts

	% 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	0.1	0.8	0.4	1.7	1.9
Dwelling Investment	0.1	0.0	0.1	-2.9	0.2	0.9	2.0
Underlying Business Investment	-0.2	-0.5	0.1	9.2	-1.8	2.3	2.3
Underlying Public Final Demand	1.4	1.2	0.8	4.4	4.3	2.7	2.5
Domestic Demand	**0.2**	**0.3**	**0.4**	**2.7**	**1.4**	**2.3**	**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**	**0.4**	**1.8**	**1.7**	**2.3**	**2.4**
Exports	0.5	0.3	0.4	3.3	2.1	2.1	2.2
Imports	-0.2	0.2	0.4	4.9	6.5	2.5	2.6
Net Export (Cont. to GDP)	0.2	0.0	0.0	-0.2	-0.8	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	1.5	4.6	4.4	3.8	3.7
Labour Market							
Employment	0.7	1.0	0.5	3.0	2.6	1.3	1.7
Unemployment Rate (Q-Ave, End of Period)	4.1	4.1	4.2	3.9	4.2	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	2.8	2.9	4.1	2.9	3.0	2.4
Trimmed-mean CPI	4.0	3.5	3.4	4.2	3.4	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)	4.33	3.96	4.10	3.96	4.10	3.90	3.95
$A/US cents (End of Period)	0.66	0.69	0.66	0.68	0.66	0.67	0.73

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

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