The Forward View: Australia Dec 2024

Easing inflation fears despite low unemployment

NAB Economics

Overview

- Our forecasts for growth are broadly unchanged following the release of the Q3 national accounts, though we have nudged down our forecasts for underlying inflation and the unemployment rate in the near-term.
- We still see growth picking up in early 2025 after a period of weak growth through late 2024. A rebound in consumer spending growth will drive overall GDP growth of around 2¼% over each of the next two years.
- The unemployment rate is expected to peak around 4.3% before edging down to around 4.2% over 2026 as the economy stabilises around its potential. That implies that employment growth remains positive over the next two years and that the unemployment rate settles around 1ppt below pre-COVID levels.
- We now see trimmed mean inflation of 0.6% q/q in Q4. Beyond that, inflation is expected to gradually ease back towards the mid-point of the RBA's target. We see underlying inflation back in the top half of the band by late 2025 (2.7%), and around 2½% by early 2026.
- On rates, the RBA Board's pivot at the December meeting skews the risks to earlier on our May call. With the upside risks to inflation fading, the RBA will be able to continue its strategy of minimising any slowdown in the labour market. Importantly, the RBA sees rates as restrictive and will look to ease as it gains further confidence that inflation is sustainably on track towards 2.5% over the next 18 months.
- The path to an RBA cut in February relies on the RBA reassessing their view of how far the labour market and activity are from balance. Their December meeting showed the beginnings of a shift, and the detail of the Q4 CPI print will be important for updating their view of how binding capacity constraints remain. Still, we expect the growth outlook and still low unemployment rate to create little urgency to adjust policy and remain of the view that May is a more likely starting point.
- Overall, our outlook is still very much for a soft landing, with the slowing in population growth offset by an improvement at the individual level as pressures on the household sector ease. That said, business investment growth is slowing and there are only tepid signs of a recovery in dwelling investment. Alongside consumption, both of these components will need to see some improvement for the private sector to gain momentum.

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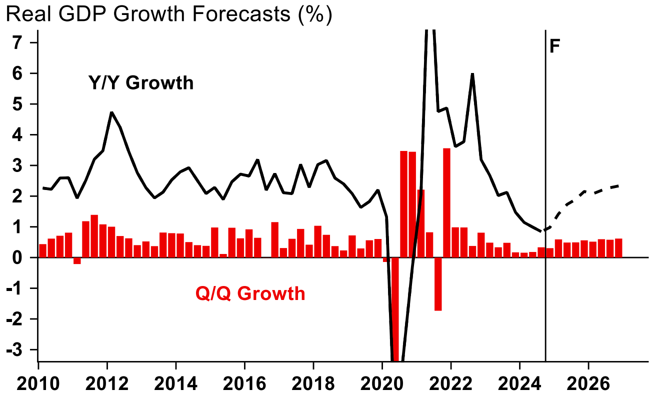
Key Economic Forecasts

	2023	2024(f)	2025(f)	2026(f)
Domestic Demand (a)	2.9	1.9	1.9	2.2
Real GDP (annual ave)	**2.1**	**1.0**	**1.8**	**2.2**
Real GDP (year-ended)	**1.5**	**1.0**	**2.2**	**2.3**
Employment (a)	3.4	2.6	2.3	1.9
Unemployment Rate (b)	3.9	4.0	4.2	4.2
Headline CPI (b)	4.1	2.7	3.0	2.4
Core CPI (b)	4.3	3.4	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	0.73

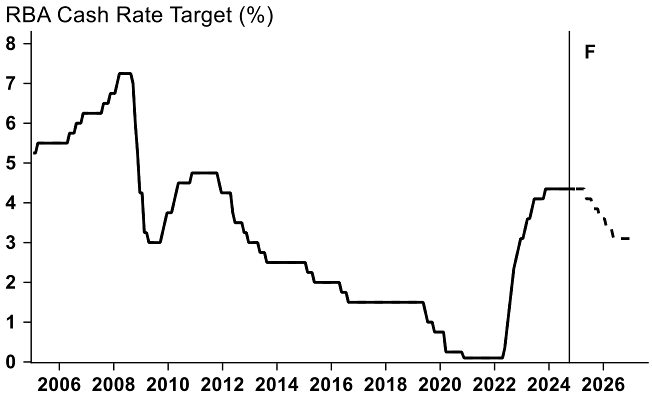
(a) annual average growth, (b) end-period

Chart 1: GDP forecasts



Source: Macrobond, NAB Economics

Chart 2: Cash rate profile



Source: Macrobond, NAB Economics

17 December 2024 | Authors: Gareth Spence, Antony Kelly, Michelle Shi

Labour Market & Population

A surprise 3.9% unemployment rate for November, notably lower than consensus and RBA expectations.

The unemployment rate fell to 3.9% in November, down from 4.1% across August to October amid strong trend employment growth of 35k. Other labour market indicators also remained healthy: the participation rate is near record highs at 67.0% while the underemployment rate fell a tenth to 6.1% in November (back to its equal lowest since April 2023).

Employment growth has been supported by sectors of the economy that are downstream from robust government spending and public demand and tend to be less sensitive to cyclical conditions. Non-market sectors (public sector, education and health care) have dominated employment gains since the beginning of 2023; the non-market sector has accounted for 85% of employment growth over the year to Q3.

Forward looking indicators of labour demand are mixed. Some recent measures have softened over November (SEEK job ads fell 1.1% in November now 8.4% lower y/y, while applicants per ad increased again), but other measures appear to be stabilising – which will be important to watch over 2025.

The unemployment rate for Q4 is averaging 4.0% so far, well below the RBA's forecast of 4.3% in the November SMP. We expect the labour market to loosen in 2025 as jobs growth slows in line with forward indicators, but expect only a modest lift in the unemployment rate to around 4.3% by mid 2025.

Population growth slows as fewer students arrive.

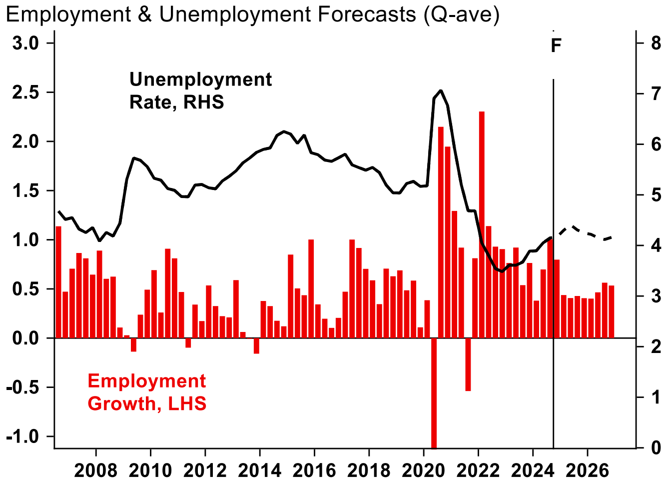
Annual population growth slowed to 2.1% over the year to June 2024, down from the peak of 2.6% in September 2023. This was marginally below the RBA's assumption for 2.2% and confirms that the 'catch-up' in migration has largely run its course.

Net overseas migration added 63,200 people to the population over the quarter and 446,000 people over the 2023-24 financial year (about 90,000 fewer than the previous financial year). There was a substantial decline in student arrivals – down about 33,900 students compared to last financial year – but student arrivals remained significantly higher than the five-year pre-pandemic average.

Western Australia was the fastest growing state, with the resident population growing 2.8% y/y, followed by Victoria at 2.4%. Net overseas migration was at least 60% higher in 2023-24 in each state and territory compared to the five-year pre-pandemic average, with the largest uptick in Western Australia (+332%) and Queensland (+170%).

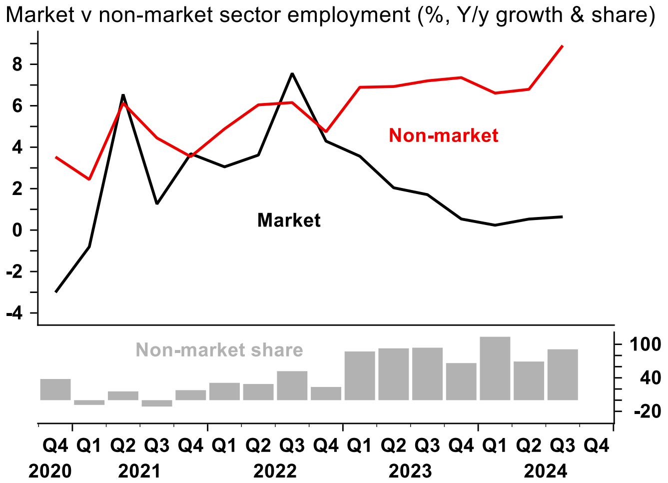
Population growth is expected to slow further, meaning the tailwind to aggregate activity measures provided by the period of catch-up growth will continue to fade.

Chart 3: Unemployment rate surprises in November, now well below RBA forecasts for Q4 2024



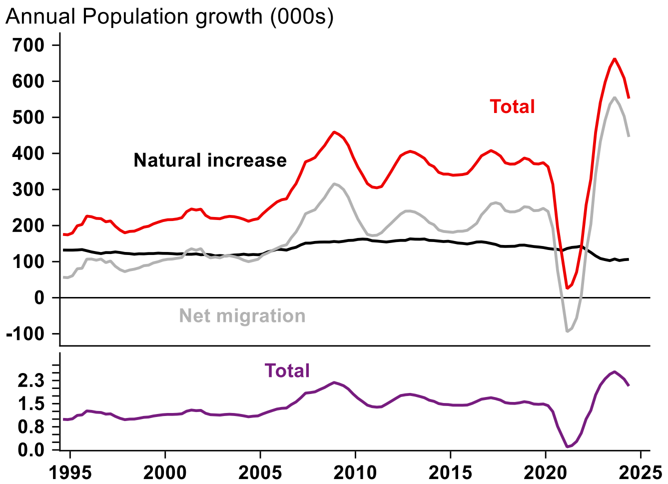
Source: Macrobond, NAB Economics

Chart 4: Non-market sector employment continues to drive new employment gains



Source: Macrobond, NAB Economics

Chart 5: Population growth slows further



Source: Macrobond, NAB Economics

Consumption

Household consumption growth was weak in the September quarter, but retail sales lifted in October and November alongside greater discounting activity.

Real household consumption was flat in the September quarter, with year-ended consumption growth of just 0.4%. Essential spending fell 0.1% over the quarter as a result of electricity subsidies and lower fuel prices. Despite strong population growth and the start of tax cuts, discretionary consumption was no higher than it was 2 years ago and increased only 0.1% q/q. That said, abstracting from the treatment of electricity rebates, consumption growth improved (though remained weak) in Q3.

The savings rate ticked up from a revised 2.5% in June to 3.2% in September, pointing to further normalisation in savings patterns as pressures on households continue to ease.

More timely data, point to ongoing improvement in Q4 as ABS retail sales were up 0.6% m/m in October. This was driven by early discounting ahead of Black Friday sales and coincided with an improvement in consumer confidence, which has likely ticked up alongside tax cuts and electricity subsidies.

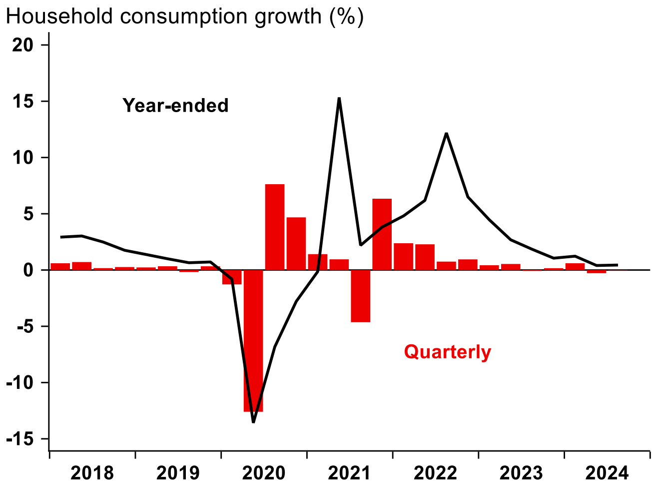
Beyond that, NAB's transaction data suggests that retail spending rose 0.3% in November after a strong 1.8% increase in October. Retail spending in November centred on Black Friday sales, with a significant uptick in clothing (5.1%). Discounting in October and competitive sales in clothing weighed on household goods and department store spending in November, with consumers continuing to prioritise discounting in spending decisions.

However, overall consumer spending was slightly weaker in November (down 0.2% m/m in the NAB transaction data). Some pull forward of spending from December into the growing Black Friday sales period may weigh on December data.

We continue to expect ongoing modest acceleration in consumption to support a pick up in growth from the trough through H1 2024. Real household disposable income growth rose to 2.3% y/y in Q3 after a protracted squeeze on households. Real income growth is now back to around its pre-pandemic average as the earlier squeeze has moderated in line with cooler inflation and stage 3 tax cuts.

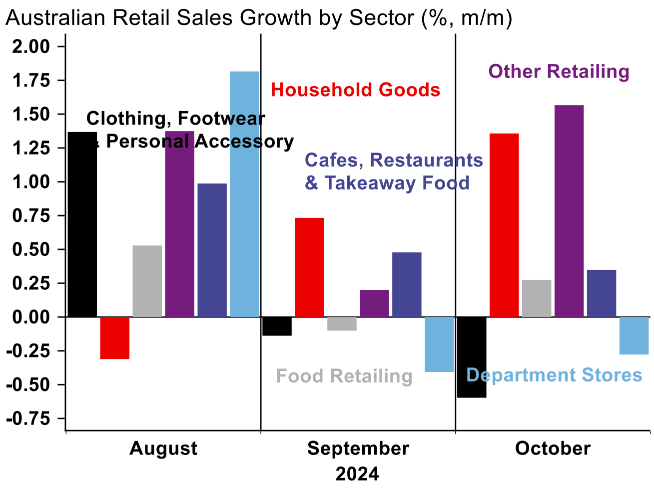
Q4 household consumption growth will likely edge up from the flat result in Q3 but will likely undershoot RBA forecasts in the November SMP (+1.0% y/y in the December quarter). To reach this, household consumption would need to increase by 0.7% in the December quarter in seasonally adjusted terms which is highly unlikely.

Chart 6: Household consumption growth flatlines in the first quarter with tax cuts



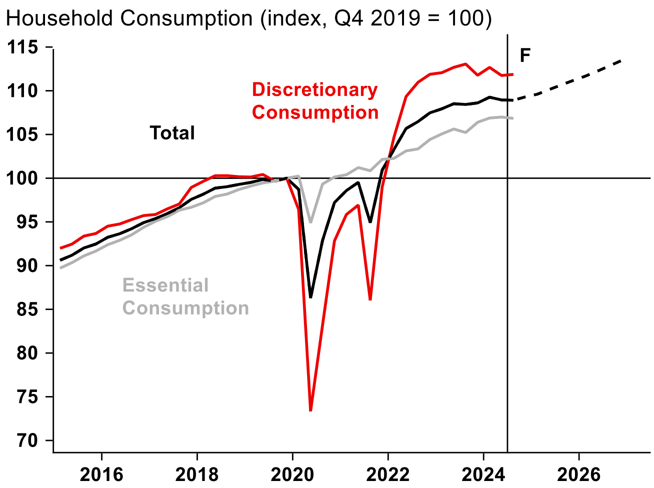
Source: Macrobond, NAB Economics

Chart 7: Strong uptick in nominal retail turnover in October in sectors with early discounting



Source: Macrobond, NAB Economics

Chart 8: Black Friday sales to boost retail in November



Source: Macrobond, NAB Economics

Housing & Construction

Dwelling investment has been tracking sideways but slowing population growth points to demand pressures levelling off.

Dwelling investment increased by 1.2% q/q in Q3, driven by a 1.7% increase in new dwelling investment. While it was the third consecutive increase, on a year-ended basis dwelling investment was down 0.5%. By state, over the last year, growth has been strongest in SA (7.9%) and WA (5.4%), and weakest in NSW (-4.3%) as well as Tasmania and the territories (down between 6 to 10%).

The level of new dwelling investment has broadly moved sideways since 2021. As a result, a large pipeline of work has only been slowly worked through, even while the level of building approvals has not been elevated. This points to ongoing supply constraints in the sector. On a more positive note, new dwelling construction cost growth has slowed in recent months (but still leaving the level of costs elevated).

Building approvals have trended up this year, including a 4.2% m/m increase in October, and are now around the level needed to sustain the current level of completions. Dwelling completions were around 45k in Q2 while population grew by around 115k in the quarter, on our seasonal adjustment. With the average household size over 2.5, this suggests that the supply/demand imbalance is not worsening, although the market may still be digesting the large increases in population growth over recent years.

As underlying housing demand pressures showed signs of moderating mid-year, capital city house price and rents growth have since slowed notably.

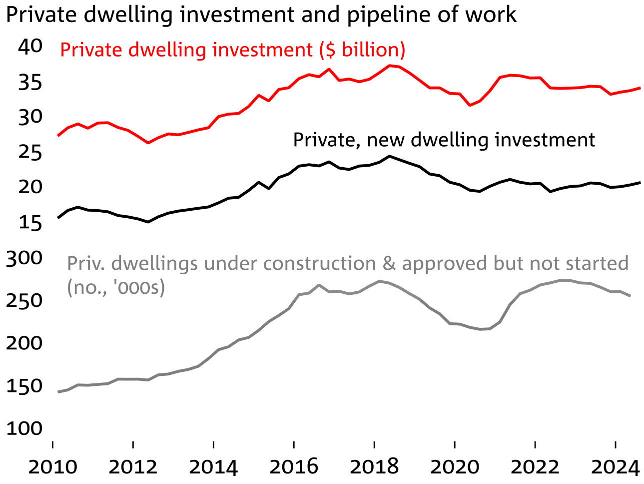
Capital city house prices grew by around 5½% over the year to November on both the CoreLogic and PropTrack indicators. This is down from the close to 10% growth rates earlier in the year, and is set to decline further as the monthly growth rate in November was only 0.1% m/m.

Over the year to November, Melbourne dwelling prices fell by around 2%, while there was moderate growth in Sydney (between 3.3% and 4.6%) and strong, double-digit, growth in Brisbane, Adelaide and Perth. Prices in Hobart and Canberra were close to flat, while Darwin saw a small rise.

Similarly, the capital city CoreLogic hedonic rents index grew by 5.0% over the year to November, down from the 9-10% year-ended growth rate experienced between mid-2022 and April this year. Indeed, the hedonic rents index is basically unchanged since June, with small falls in July/August, offset by small gains in the last two months.

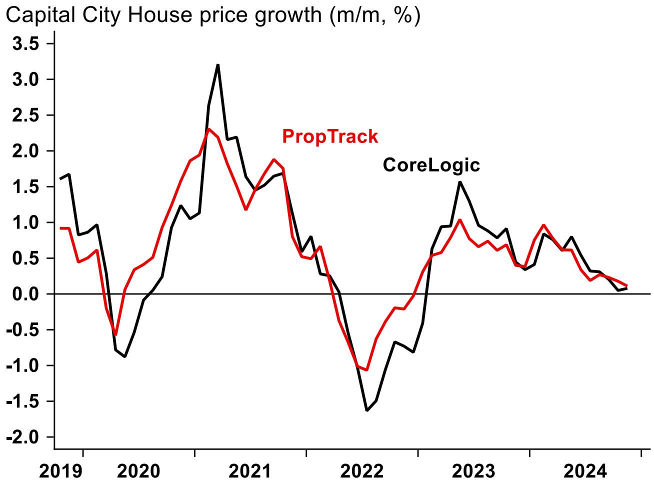
The CoreLogic measure is based on rental listings and leads the ABS CPI rents measure, which covers the total stock of rentals. If the recent weakness in advertised rentals persists then this should see growth in CPI housing rents decline over time. The CPI indicator grew by 6.7% y/y to October, but excluding Government rental assistance it would have grown by around 8%.

Chart 9: Dwelling investment broadly tracking sideways



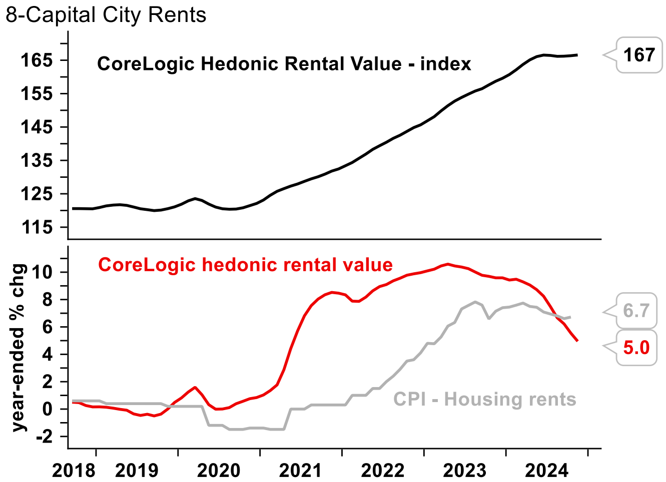
Source: National Australia Bank, Australian Bureau of Statistics

Chart 10: Dwelling price growth has slowed to a crawl



Source: Macrobond, NAB Economics

Chart 11: Advertised rents growth has also fallen away



Source: CoreLogic, NAB Economics

Business, Trade & FX

Business investment falls in the September quarter.

Business investment declined by 0.6% in Q3. The decline was driven by a large fall in new buildings (-1.8%) and new engineering construction (-1.5%), but partially offset by a rise in machinery & equipment (0.6%) and intellectual property products (1.5%). Business fixed investment has weakened in line with weaker confidence and slower growth.

NAB's November monthly business survey weakened across most activity measures, reversing any positive gains seen over the October survey. Business confidence fell sharply and is now well below average. By industry, conditions fell in all industries except construction and mining. Capacity utilisation has gradually trended lower through 2024 but remained unchanged in November and above its long-run average. This suggests that the supply and demand imbalance is easing but some inflationary pressure remains.

The ABS Capex Survey for Q3 revealed a further softening in investment intentions for 2024-25. The latest estimate takes annual growth in nominal capex to 2.7% (based on historical realisation ratios), below the Q2 estimate of 4.1%. Part of this may stem from easing cost growth, but may also suggest that capex expectations for the remainder of the financial year are weakening.

Small contribution from net trade as fewer students arrive and more Australians holiday overseas.

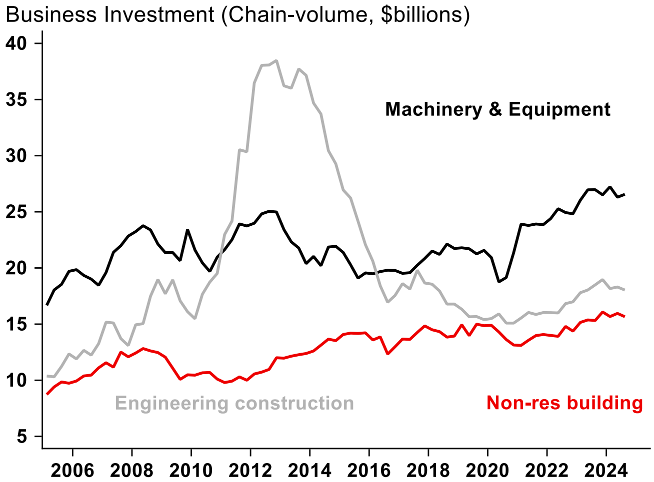
Net exports contributed 0.1ppt to GDP growth in Q3, as exports grew modestly (+0.2%) and imports fell (-0.3%). Growth in export volumes was driven by demand for coal, particularly for thermal coal in Asian markets according to the ABS. Services exports fell over the quarter (-3.6%) due to fewer than normal international student arrivals in Q3 for the start of semester two.

Goods imports fell 1.5% over the quarter, mainly due to a decline in vehicle imports and intermediate goods. Services imports offset this, with a strong 10% q/q uptick in travel debits as Australians spent more time and money abroad.

Our outlook for the AUD/USD was materially revised down last month and more downside risks have emerged.

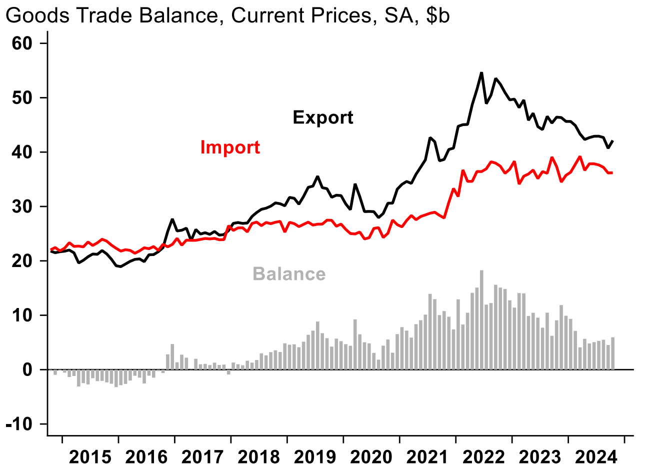
The quarter-end forecasts for 2025 now range from 0.64 to 0.67, in essence suggesting the same 2024 year to date range holds. However, there are downside risks to the forecasts and as such we would not be surprised to see the AUD/USD trade with a '5' in front of it at some point next year. This largely depends on the severity of the hit to global growth from Trump 2.0 trade policies, and what happens with the RMB.

Chart 12: Business investment growth has slowed, with forward looking indicators also weakening



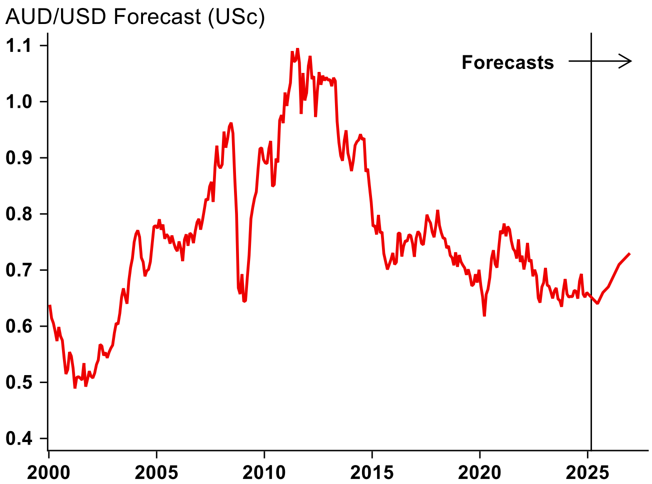
Source: Macrobond, NAB Economics

Chart 13: Modest increase in export volumes only



Source: Macrobond, NAB Economics

Chart 14: Downside risks to the AUD forecast



Source: Macrobond, NAB Economics

Inflation

Electricity and fuel drive low headline readings, but underlying inflation has also eased.

We expect inflation to undershoot the RBA's November SMP forecasts in Q4 with another low headline print driven by electricity rebates and lower fuel prices. Government subsidies, notably higher rent assistance, will also affect the trimmed mean, meaning that the optics are likely to be better than the substance of the print.

Even so, while parts of the inflation basket continue to suggest that domestic capacity and cost pressures remain, underlying inflation pressures overall have cooled noticeably from their peaks and trimmed mean inflation looks on track to fall within the RBA's target band in 2025. We discussed these themes in detail in RBA inclined to look through subsidy-buffeted Q4 CPI.

The October Monthly CPI Indicator supported the outlook for better near-term inflation. (AUS: Monthly CPI indicator holds at 2.1% on electricity rebates). That said, it contains little new information on services, where inflation remains somewhat elevated. Strength in services inflation continues to be driven by insurance (14% y/y), hairdressing, sports participation, recreation & cultural services (all 6%+).

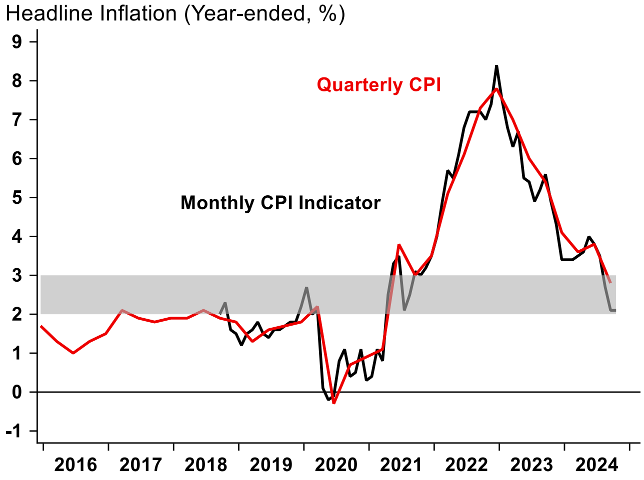
On the other hand, new homebuilding cost inflation has cooled noticeably. Cost and capacity pressures remain, but recently have been keeping prices elevated rather than driving further growth. Combined with the improved outlook for rents inflation, as slower growth in new leases filters through into average prices, housing components are a useful support for the RBA's growing confidence in the inflation outlook.

Our assessment is that wage-inflationary pressure in the labour market has eased substantially over the past year or so. This has been mirrored in a faster-than-expected moderation in WPI wage growth which has annualised around 3.2% over the past three quarters. While productivity growth remains relatively weak, we do not currently see the labour market as inconsistent with some further progress on inflation.

Inflation expectations appear to have remained anchored. Near term (1-year ahead) economist expectations remain elevated but expectations over a two-year horizon remain anchored at 2.5%. 10-year break-even bond market expectations also remain stable at around 2.5%.

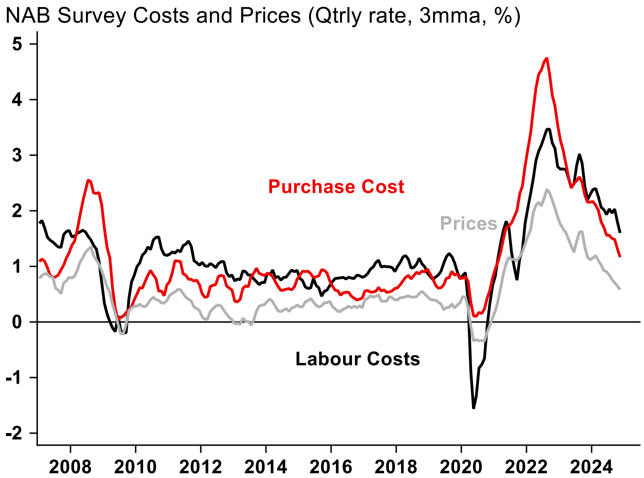
Looking forward we expect underlying inflation to continue gradually moderating. We now expect the Q4 trimmed mean to show a 0.6% q/q (3.3% y/y) increase (previously 0.7% q/q). For headline, we expect 0.3% q/q (2.5% y/y) in Q4. Further out, we see inflation moderating to the top half of the RBA's 2-3% target band by mid 2025 and be around the middle of the band in early 2026.

Chart 15: Headline inflation will temporarily track within the target band



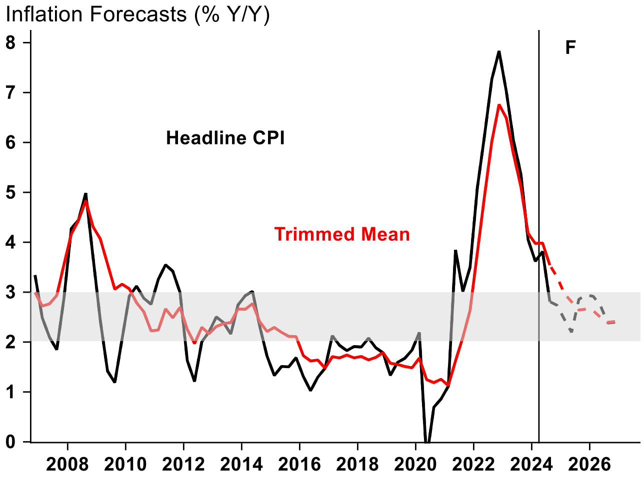
Source: Macrobond, NAB Economics

Chart 16: Services inflation remains elevated



Source: Macrobond, NAB Economics

Chart 17: Trimmed mean inflation is still expected to return to the target band in 2025



Source: Macrobond, NAB Economics

Monetary Policy

We continue to expect the first rate cut to come in May and for the RBA to gradually ease rates back towards 3%.

There was a significant shift in the RBA Board's communication following the December meeting. The key references to upside risks to inflation were removed from the post meeting statement and Governor Bullock also emphasised that upside risk to inflation had eased in the post meeting press conference. The RBA's confidence was growing that the RBA's inflation forecasts were playing out as expected.

Q3 GDP growth came in softer than expected at the time of the November SMP and though there appears to have been an edging up in growth in early Q4, it is likely that overall growth in 2024 will end up below the most recent staff forecasts (and meaningfully below the August set of staff forecasts). On inflation, we expect near-term data flow to come in slightly below the RBA's November expectations, though the impact of subsidies clouds the signal. For the RBA, consumption growth softer than expected, and positive signs on the inflation outlook, notably across housing, supports their reduced concern about upside risk.

That said, the unemployment rate is tracking below the RBA's forecast but remains close to a level consistent with full employment. Mitigating some of the risk of a still tight labour market is the fact that wage growth has eased notably – annualising at just over 3.0% for the past three quarters. While productivity is weak and services inflation still strong, overall inflation is moderating.

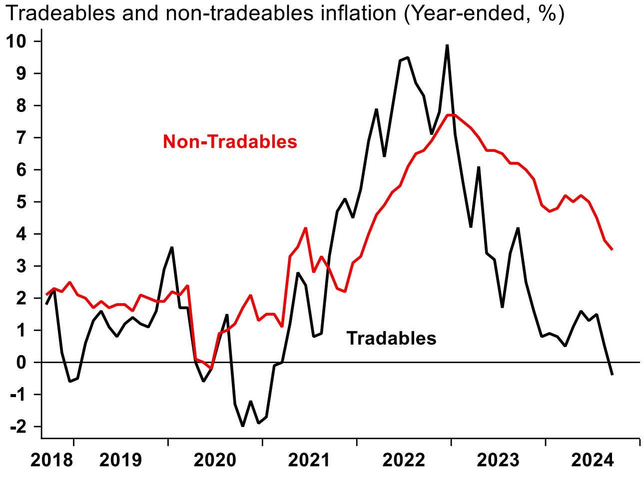
Both the headline and trimmed-mean CPI measures will be buffeted by subsidies in the near term making a clean read of underlying inflation difficult. Expenditure class data for categories including housing will be important given their weight and relative contributions over recent years.

While we continue to see May as the first cut, there is a path to February. The resilience in labour market data is providing little urgency to cut, but if the RBA reassesses how far it is from balance and, consequently, how threatening it remains to the inflation outlook, the RBA could well move as soon as February. Faster than expected progress on inflation and/or signs that consumption growth is failing to accelerate could drive that shift.

The key data points in the lead up to the February meeting include the monthly CPI indicator for November, the Q4 CPI and the Labour force survey for December. We will also have reads on our monthly and quarterly business survey (which contains the labour market constraints on output question).

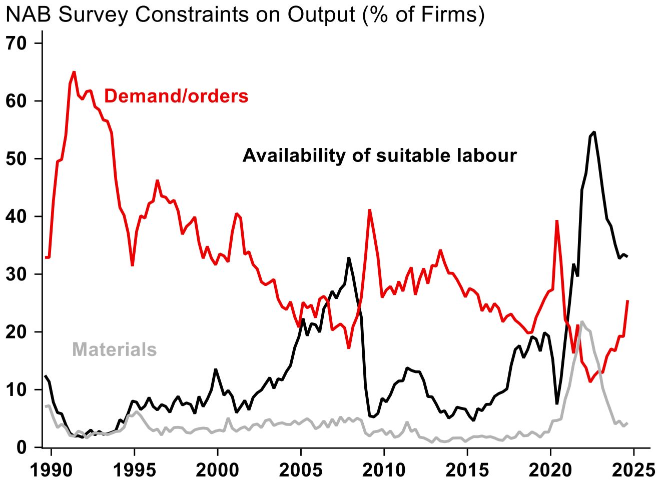
For now, we continue to pencil in May with the RBA likely to take a gradual approach to easing. Notably, the RBA's own inflation profile includes an assumed path for interest rates which embody a first cut in May.

Chart 18: Domestic inflation pressures are still elevated though other parts of the basket will allow headroom.



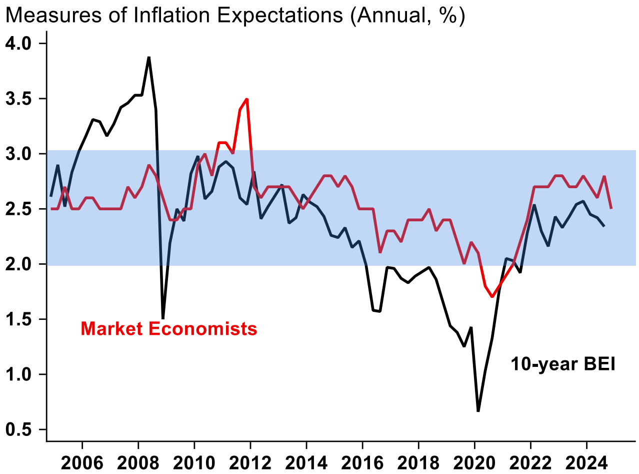
Source: Macrobond, NAB Economics

Chart 19: Labour constraints on output remain elevated, though the ability to pass on cost pressures is fading.



Source: Macrobond, NAB Economics

Chart 20: Inflation expectations remain anchored.



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	-0.3	0.0	0.2	1.1	0.5	1.9	2.1
Dwelling Investment	0.7	1.2	-1.4	-2.6	1.4	-2.9	1.5
Underlying Business Investment	-0.4	-0.6	0.2	9.5	-1.6	0.7	0.9
Underlying Public Final Demand	0.9	2.4	1.0	4.1	5.1	2.6	2.4
Domestic Demand	**0.2**	**0.7**	**0.4**	**2.7**	**1.9**	**2.0**	**2.3**
Stocks (Cont. to GDP)	-0.4	-0.5	0.2	-1.0	0.1	-0.1	0.0
Gross National Expenditure	**-0.1**	**0.2**	**0.5**	**1.6**	**2.0**	**2.1**	**2.3**
Exports	0.6	0.2	0.3	3.7	1.2	2.1	2.2
Imports	0.2	-0.3	0.3	5.7	5.9	1.8	2.0
Net Export (Cont. to GDP)	0.1	0.1	0.0	-0.3	-1.0	0.1	0.1
Real GDP	**0.2**	**0.3**	**0.3**	**1.5**	**1.0**	**2.2**	**2.3**
Nominal GDP	0.2	0.4	0.6	4.3	2.5	3.8	4.7
Labour Market							
Employment	0.7	1.0	0.6	3.0	2.7	1.9	2.0
Unemployment Rate (Q-Ave, End of Period)	4.1	4.1	4.0	3.9	4.0	4.2	4.2
Wage Price Index (WPI)	0.8	0.8	0.9	4.3	3.3	3.4	3.2
Inflation and Rates							
Headline CPI	3.8	2.8	2.7	4.1	2.7	3.0	2.4
Trimmed-mean CPI	4.0	3.5	3.3	4.2	3.3	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	4.45	3.96	4.45	4.05	4.05
$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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