The Forward View: January 2025

RBA revisions, rates and risks ahead

NAB Economics

Overview

Global (jump to section)

Sub-par global growth is expected to continue. Global growth is expected to ease to 3.1% in 2025 and 3.0% in 2026, though there is significant policy uncertainty, particularly in the US.

Monetary policy settings in advanced economies are expected to ease further, but at a slower pace than 2024. We expect the Fed to hold for the first half of the year before cutting 50bps in the second half and then 50bps in 2026.

There are notable risks to the year ahead. Uncertainty is elevated, particularly around the timing and scale of US tariffs and whether retaliation leads to further tariff rate escalation.

Australia (jump to section)

We have brought forward our expected first rate cut to February, though maintain that this will be a gradual easing cycle. We continue to see value in waiting for more clarity on the outlook but given the RBA's December communication and the softer outlook on key inflation components it is unlikely to be compelling enough to shock market pricing for a cut.

We believe that despite its resilience, current labour market dynamics are not inflationary. The RBA's re-assessment of labour market tightness in February will be a critical consideration in monetary policy, as will their revised inflation outlook.

Our forecasts are broadly unchanged. Growth is expected to pick-up this year, driven by improving consumer spending. This will take annual GDP growth to about 2.25% over 2025 and 2026. The labour market is expected to loosen (but not significantly), with unemployment edging up to 4.3% by the end of 2025. Underlying inflation is expected to moderate further and re-enter the RBA's target band as early as Q1 2025.

However, there is still uncertainty around the timing and scale of the consumer spending recovery. If muted, cautious consumption may weigh on growth prospects but could accelerate disinflation progress. There is also a risk that the labour market re-tightens with the pick-up in growth later this year, which could pose new wage inflationary risks.

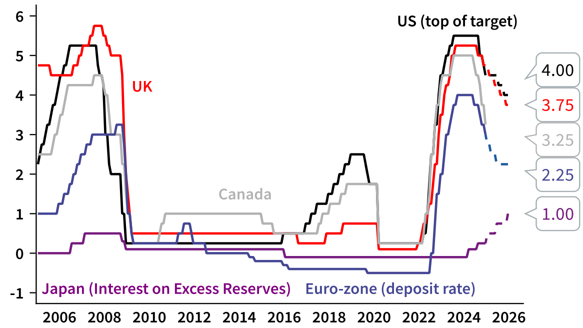
Contents

Key Economic Forecasts

	2023	2024(f)	2025(f)	2026(f)
Domestic Demand (a)	2.9	1.9	2.0	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	2.4	1.6
Unemployment Rate (b)	3.9	4.0	4.2	4.2
Headline CPI (b)	4.1	2.4	3.0	2.4
Core CPI (b)	4.3	3.3	2.5	2.4
RBA Cash Rate (b)	4.35	4.35	3.35	3.10
$A/US cents (b)	0.68	0.62	0.67	0.73

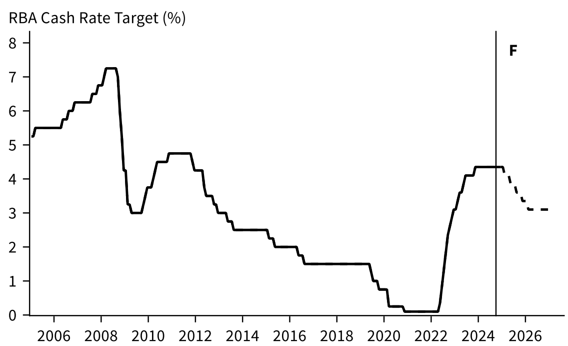
(a) annual average growth, (b) end-period

Chart 1: Major AE central bank policy rates (%)



Source: National Australia Bank forecasts, Macrobond

Chart 2: RBA Cash rate forecast



Source: Macrobond, NAB Economics

31 January 2025 | Authors: Gareth Spence, Antony Kelly, Gerard Burg, Michelle Shi

Global economy

- Global growth to remain below longer run average amid elevated policy uncertainty.
- Advanced economy central bank easing will slow.

Global growth looks to have been sub-par in 2024.

Our estimates put global growth at 3.2%, a little below the 3.5% average growth recorded so far this century. That said, growth picked up in the second half of the year, with our tracker pointing to growth of 0.9% q/q in both Q3 and Q4.

China's economy grew by 1.6% q/q in Q4 (its best result in over a year) and US GDP growth, while easing, remained solid, including a strong increase in domestic final demand. On a less positive note, there are concerns about the strength of the UK and Euro-zone economies, with the Euro-zone and UK S&P Global composite PMIs having moved lower since mid-2024, although they have stabilised over the last few months.

We expect the sub-par trend to continue, with global growth easing to 3.1% in 2025 and 3.0% in 2026, although the high degree of policy uncertainty – particularly in the US – means confidence in any point forecasts is lower than normal.

For the US, a fading of some supply side factors that have boosted growth and a negative impact from expected import tariffs should see growth slow (but still remain close to its long-term trend). In the case of China, structural problems in the economy, including weak domestic demand, growing export barriers, property market distress and a declining population, are likely to see growth slow. This raises the question of how Chinese authorities will respond. Over 2024 authorities rolled-out a series of relatively small stimulatory measures and our base case is that this pattern continues, although if US tariff impacts are large, they could do more.

Monetary policy settings generally eased over 2024, which should help underpin growth.

Last year, the US Federal Reserve cut rates by 100bps, as did the European Central Bank, while the Bank of Canada cut by 175bps and the Bank of England by 50bps. The People's Bank of China also eased policy.

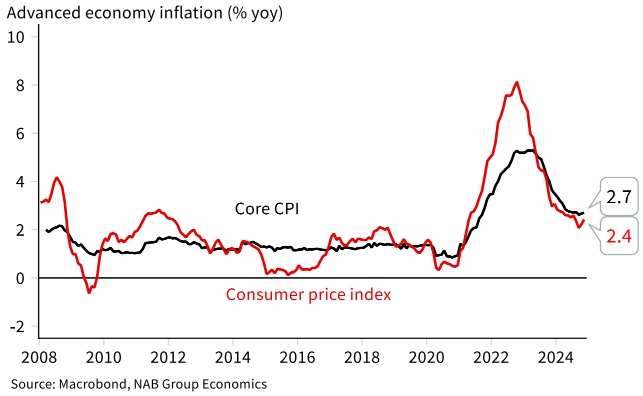
We expect some further policy easing this year but, overall, at a slower pace. While AEs have made progress in returning inflation to their central bank targets, progress stalled in the latter months of 2024. Headline consumer prices in AEs rose by 2.4% yoy in November, up from a three and half year low of 2.1% yoy in September, while core inflation was 2.7% yoy (up from 2.6% yoy in September).

At the country level and looking at higher frequency data, the story is more nuanced. Canada is close to target, as is the Euro-zone on a 3mth/3mth basis. In some cases, concerns over the growth outlook, such as for the Euro-zone, or the extent of the deterioration in the labour market (e.g. Canada), have added to the pressure to ease monetary policy.

However, in the US, with growth proving resilient, and downside risks to the labour market having receded, the Fed has paused easing. Last week we changed our fed funds rate call, and now see them staying on hold for several meetings – we have 50bps of cuts pencilled in for this year (previously 100bps) and another 50bps in 2026. In contrast, with its policy rate at a stimulatory level, the Bank of Japan increased rates this week (to around 0.5%) and is likely to move it gradually higher this year.

A risk remains that inflation settles at a level above central bank targets, which could result in a slower pace of cuts in 2025 than anticipated. To what extent central banks (particularly the US Fed) look through any tariff impacts will also be important.

Chart 3: Advanced economy inflation



Global risks in the year ahead.

While policy rates have been easing, changes in financial conditions have been more mixed. Yields on US government bonds have risen since mid-September, reflecting the strength of the economy and concerns that policy changes could be inflationary. Other AE government bond yields have also moved higher (albeit to differing degrees), likely led by US trends. In contrast, while volatile, US equity markets have risen post the Presidential election. This is partly on expectations that deregulation would be positive for profits and M&A activity and that business taxes may be cut.

The timing and scale of the Trump Administration's tariffs (and other policies) present a key uncertainty around our forecasts. We have pencilled in a smaller (but still significant) increase in the average applied tariff rate for the US than Trump mooted during the election campaign. We also assumed that they commence in mid-2025. A key risk is that they are introduced sooner and that retaliation by other countries could see tariff rates escalate further – in a similar fashion to the US-China trade war that commenced in 2018.

Growing trade barriers have, however, been a broader story than just the US. The EU, Canada and some EMs also imposed tariffs on some China imports last year, while other countries threatened to do so, and the possibility of trade restrictions broadening is a further risk. Similarly, fiscal policy settings are clouded in other regions, with attempts to slow the pace of fiscal contraction contributing to changes in government in France and Germany late last year.

Australian economy

- Growth to pick up to 2¼% over 2025, seeing unemployment stabilise around 4¼% from Q2.
- More benign inflation backdrop supports gradual RBA easing from February, extending to 100bps of cuts through 2025.

Forward view: the year ahead.

Overall, our outlook continues to be for a soft landing, with a pick-up in consumer spending to drive growth of around 2.25% over 2025 and 2026. Partial data for Q4 points to a pickup in consumption– albeit more slowly than expected in mid-2024. If sustained that would mark H2 2024 as the low point for annual GDP growth. Both business and dwelling investment will also be key dynamics for growth this year.

Dwelling investment has been weak despite strong housing demand but appears to have stabilised. Business investment growth has slowed over the past year or so, after a period of strong growth. Business investment (especially in the non-mining sector) has been relatively weak as a share of GDP since the GFC. Both of these components will likely need to rise in order for growth of over 2% to be sustained.

On the labour market, our views are largely unchanged. We expect employment growth to remain positive and see only a small increase in the unemployment rate from here. That said, while some indicators point to ongoing tightness, we do not see current labour market conditions as particularly wage inflationary. We see an unemployment rate in the low 4% range as sustainable. However, the key dynamic will be the direction in the unemployment rate as economic activity recovers. Should the labour market retighten, wage growth may well re-accelerate. Conversely, a larger deterioration in the unemployment rate would weigh on households and the recovery for household spending.

Q4 CPI was in line with our published preview, but we have marked down our CPI profile since December, based on larger than expected disinflation in the housing components (confirmed in this week's data) and greater optimism on the ongoing gradual moderation in services inflation.

For the RBA, this should increase confidence that inflation is returning sustainably to the middle of the target band. The Board therefore is set to begin gradually easing from its modestly restrictive stance. While there remains little urgency to cut rates, we now look to February as the most likely starting point. We see the cash rate falling to around 3.1% by early 2026 as the RBA sticks the soft landing. However, uncertainty around the trajectory of the labour market, the degree of spare capacity in the labour market and subsidy-impacted inflation numbers mean that the RBA will likely remain cautious in its approach.

See the *Key Forecasts Tables* below for more information.

Q4 inflation data confirms that underlying inflation is easing more quickly than RBA forecasts.

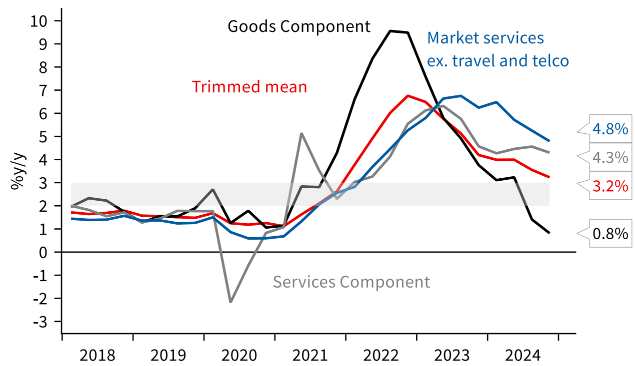
Q4 headline and underlying inflation eased in annual terms, in line with our forecasts. Headline inflation rose 0.2% in quarterly terms, which took the annual rate lower to 2.4%. Underlying inflation rose 0.5% over the quarter, taking the annual rate to 3.2%.

Electricity rebates continued to weigh on headline inflation, with households receiving the second instalment of the Commonwealth rebate. Fuel prices fell 2.0% q/q, off the back of the 6.7% fall in Q3.

Of note, new dwelling purchase prices *fell* in the quarter, down 0.2% q/q. This was the first fall since June 2021, and reflected builders increasing promotional offers to attract new customers. Some of these offers are likely temporary, but the broader trend of plateauing housing input costs is holding. Housing costs, alongside the declines in electricity and fuel prices, fed into the notable drop in goods inflation (which eased to just 0.8% in annual terms).

Services inflation slowed to 4.3% (from 4.6% y/y), driven by an easing in rent and insurance price growth. Looking at a subset of services closely watched by the RBA as in indicator of domestic demand pressure, market services inflation excluding travel and telco was 0.8%, its lowest since Q2 2021.

Chart 4: Annual inflation by components

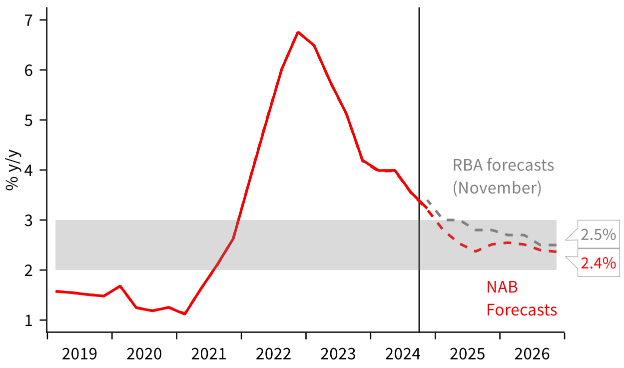


Source: National Australia Bank, Australian Bureau of Statistics

All in all, Q4 inflation data confirms that price pressures are continuing to ease, and more quickly than the RBA had anticipated. Their November forecasts put annual underlying inflation at 3.4%, two-tenths higher than the Q4 actual. The softer outlook on housing components is particularly important – these were persistent sources of price pressure that now appear to be easing.

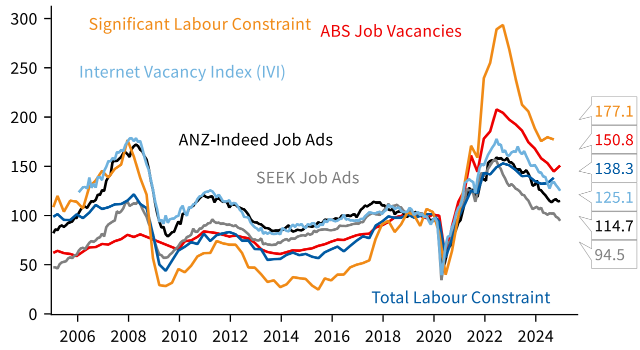
The 0.5% q/q trimmed mean outcome is not the new normal and we expect trimmed mean outcomes above that level in coming quarters. Even so, we expect underlying inflation to continue moderating on a year-ended basis. Underlying inflation could return to the top half of the RBA's target band in Q1 2025 and to the middle of the band in Q3, significantly earlier than the RBA's November forecasts.

Chart 5: Underlying inflation forecasts



Source: National Australia Bank, Australian Bureau of Statistics, Reserve Bank of Australia

Chart 7: Indicators of labour demand



Source: National Australia Bank, Australian Bureau of Statistics, ANZ-Indeed, SEEK Australia, National Australia Bank, Jobs & Skills Australia, Macrobond

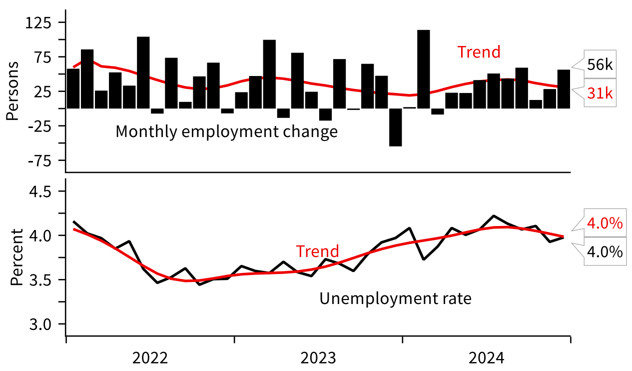
Labour market resilience to be a key focus of the RBA.

Labour market data has remained strong with employment growth of +56K in December. There was strength across indicators in December: both the participation rate (67.1%) and the employment to population ratio (64.5%) reached a new record high, while the underemployment rate fell to 6.0%.

As expected, the unemployment rate edged up to 4.0%. This also takes the Q4 average unemployment rate to 4.0%, well below the 4.3% forecast by the RBA in November.

Non-market employment demand has driven recent strength in employment gains. Difficulty in measuring output in key non-market sectors like healthcare and social assistance can in part explain the disconnect between slowing aggregate growth and robust employment growth. That trend may continue, with vacancies in healthcare & social assistance remaining elevated. Read more in our note *Mining, not just Health, drives growth and employment disconnect*.

Chart 6: Employment growth and unemployment rate



Source: National Australia Bank, Australian Bureau of Statistics, Macrobond

ABS job vacancies for Q4 showed total vacancies were up 4.2% in the three months to November. This was the first rise in vacancies after nine consecutive quarters of decline, led by notable increases in customer-facing industries such as Arts & recreation services and Accommodation and food services.

This, alongside other timely measures of labour demand, which either flattened or picked up in late 2024 (Chart 7), suggest that the forward-looking measures of labour demand have stabilised at healthy levels.

What does this mean for **monetary policy**?

We have brought forward our call for the first cash rate cut to February but still expect the easing process to be gradual, with the cash rate falling to 3.1% by February 2026.

We had seen some value in the RBA waiting to observe further data on wages, the labour market and the fuller picture on consumption growth in the national accounts for Q4 (all released shortly after the February meeting). While the Q4 CPI came in as we expected (and lower than the RBA's November forecast), the data confirmed that inflation is no barrier to cutting. The RBA are likely to revise down the inflation profile in the February SMP, and the Board will gain further confidence that inflation will return to the middle of the target band (and sooner than expected).

That said, the labour market will remain an important consideration. Labour demand has remained resilient and the unemployment rate has continued to hover around 4% (and around 0.3ppts below the November SMP forecasts) in late 2024. For the RBA, there will likely need to be some reassessment of the degree of tightness in the labour market compared with November.

While we see don't see current labour market conditions as inflationary and assess that an unemployment rate in the low 4% range can be sustained, the RBA has previously viewed an unemployment rate closer to 4.5% as consistent with full employment. A reassessment of that level and the balance of any change to the unemployment rate outlook will be important.

Three key **risks** to the outlook

The consumer spending recovery

A pick-up in consumer spending over 2025 is a key driver of our growth forecasts (as is the case for the RBA). However, there remains considerable uncertainty to the timing and extent of the recovery, with consumer spending weaker in H2 2024 than initially expected.

Consumer sentiment measures have been volatile in recent months. NAB's own Consumer Stress Index rose again in Q4 2024, with consumers wary about the year ahead. Read more about the survey *NAB Consumer Sentiment Survey Q4 2024*.

This may suggest consumer spending will be weaker than forecast – especially if consumers cautiously opt to save rather than spend. If so, this could weigh on broader growth and further limit the ability of businesses to pass on cost increases, which would see inflation ease even more quickly compared to forecasts.

Labour market re-tightens

The labour market was surprisingly resilient through 2024, which opens the door for continued strength in 2025 (especially as growth picks up) rather than the modest further easing that is forecast.

A slightly stronger than expected labour market this year should not, on its own, be cause for alarm for the RBA. However, they will be looking to assess the risk of a pick-up in wages growth. A sharp uptick in labour demand, at the same time population growth slows, could re-introduce wage pressures, which businesses could pass through to lead to stubbornly high services inflation.

Increasing global uncertainty

Geopolitical risks and uncertainty will weigh on the domestic outlook this year. US tariffs are not expected to significantly impact Australia directly, but will manifest in Australia's trade with Asia, which is expected to weaken. The key uncertainty is the timing and extent of the US tariffs, as well as China's policy response.

Table of Economic Forecasts

Global GDP forecasts table

	% Annual average growth y/y			
	2023	2024 (f)	2025 (f)	2026 (f)
US	2.9	2.8	2.3	1.7
Euro-zone	0.5	0.8	1.0	1.3
Japan	1.5	-0.2	1.1	0.6
UK	0.4	0.9	1.1	1.0
Canada	1.5	1.1	1.5	1.5
China	5.2	5.0	4.6	4.2
India	7.7	6.3	6.0	6.2
Latin America	2.2	1.8	2.3	1.9
Other East Asia	3.1	4.0	3.6	3.5
NZ	1.8	-0.6	0.7	3.1
Global	**3.3**	**3.2**	**3.1**	**3.0**

Australia forecasts table

	% 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	0.3	1.1	0.6	2.0	1.9
Dwelling Investment	0.7	1.2	-1.4	-2.6	1.4	-2.9	1.5
Underlying Business Investment	-0.4	-0.6	0.1	9.5	-1.7	0.5	1.5
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**	**2.2**
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**	**0.6**	**1.6**	**2.1**	**2.2**	**2.2**
Exports	0.6	0.2	0.3	3.7	1.2	2.1	2.2
Imports	0.2	-0.3	0.4	5.7	5.9	1.9	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	3.7	4.6
Labour Market							
Employment	0.7	1.0	0.6	3.0	2.7	1.9	1.5
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	2.4	4.1	2.4	3.0	2.4
Trimmed-mean CPI	4.0	3.5	3.2	4.2	3.2	2.5	2.4
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	4.48	3.96	4.48	4.05	4.05
$A/US cents (End of Period)	0.66	0.69	0.62	0.68	0.62	0.67	0.73

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

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