The Forward View Australia: February 2025

Coming in for landing

NAB Economics

Overview

- The economy remains resilient and we still expect a soft landing.
- Our forecasts are largely unchanged, with growth returning to trend this year (~2.25%), unemployment edging up to 4.25% and underlying inflation settling around 2.5% from mid year.
- We expect rates to fall gradually but this is contingent on a realisation of our CPI forecasts which are softer than the RBA's February forecasts.

The economy continues to play out largely as we expect. The major data since our last update has been the NAB Monthly Business Survey, retail sales and this week's labour force and wage price index data.

While the NAB Monthly Business Survey softened in January across most activity variables, the ABS labour force data showed ongoing resilience. The Q4 wage data which also showed some gradual further easing also align with our view that unemployment in low 4% range is sustainable.

Accordingly, our forecasts are largely unchanged this month, though we have increased our Q4 pick for GDP, now 0.6% q/q (1.2% y/y), with consumption looking to have risen more strongly than expected in late 2024. An ongoing recovery in consumption will be important to see stronger growth sustained.

The bigger picture remains that we see GDP growth returning to trend this year (2.25% y/y) and staying there as household spending growth recovers – though this will also require an uptick in both building activity and business investment growth.

We see employment growth remaining positive and the unemployment rate rising slightly from here but levelling off at around 4.25% - which we think is sustainable.

Together, this sees inflation return to, and settle at, the mid-point of the target from around mid 2025. But there will need to be ongoing cooling in services inflation and sustained easing in the housing cost components.

Consequently, and following the RBA decision this week, our rate track is unchanged with a gradual series of cuts taking the cash rate to 3.1% by early 2026. That said, we see the risks skewed to an even more gradual and shallower cutting phase should inflation not settle as neatly around 2.5% as we expect.

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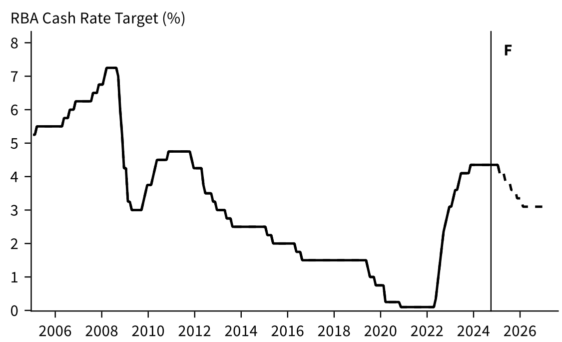
Key Economic Forecasts

	2023	2024(f)	2025(f)	2026(f)
Domestic Demand (a)	2.9	2.0	2.4	2.2
Real GDP (annual ave)	**2.1**	**1.1**	**2.0**	**2.2**
Real GDP (year-ended)	**1.5**	**1.3**	**2.2**	**2.2**
Employment (a)	3.4	2.6	2.5	1.5
Unemployment Rate (b)	3.9	4.0	4.2	4.2
Headline CPI (b)	4.1	2.4	2.9	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

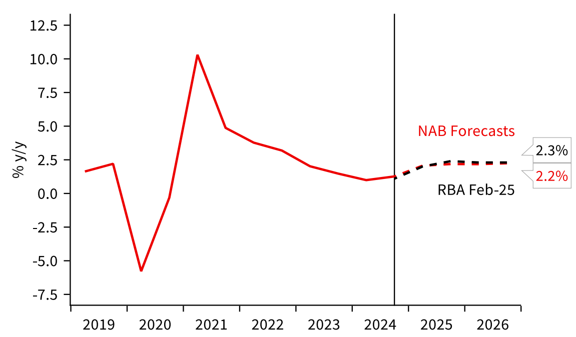
(a) annual average growth, (b) end-period

Chart 1: RBA Cash rate forecast



Source: Macrobond, NAB Economics

Chart 2: GDP forecasts



Source: National Australia Bank, Account in-house, Macrobond

21 February 2025 | Authors: Michelle Shi, Gareth Spence

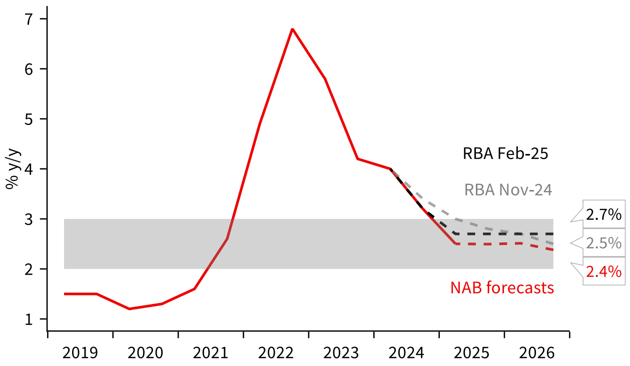
Monetary Policy

The RBA eased rates by 25bps to 4.1% but cautioned against expectations of much further cuts.

It was a decidedly cautious cut, framed as 'removing the cautionary raise from November 2023' while still maintaining policy restrictiveness. The RBA recognised that progress on easing inflation had been made, but was quick to caution against expecting further cuts. They warned that cutting *"too much too soon"* could stall disinflation and lead to inflation settling above the midpoint of the target band.

The SoMP contained updated RBA forecasts. Underlying inflation has been revised down and now re-enters the target band 6 months earlier (mid-2025) but stays steady at 2.7% over the forecast period. Importantly, this settles *above* the midpoint of the target band and is higher than the end-point of the November forecasts. The RBA noted that *"the pick-up in momentum in domestic activity will maintain tight labour market conditions and sustain some upward pressure on inflation."*

Chart 3: RBA trimmed mean inflation forecasts



Source: National Australia Bank, Account in-house, Macrobond

The unemployment rate has also been revised down to 4.25% across the forecast period. This reflects the 'surprising' strength in the labour market to date, though the RBA have not gone as far as to revise their estimate of full employment. Instead, the downward revision on the unemployment rate reflects the 'uncertainty' on labour market tightness, which the RBA acknowledges is a key risk.

Taken together, what does this mean for the outlook? The RBA's forecasts are now more closely aligned to NAB forecasts, though we anticipate a faster pace of disinflation. Based on our inflation forecasts, we stick to our call that the cash rate will ease gradually from here, with four more 25bp cuts to take the cash rate to 3.1% in February 2026.

However, this will be data-dependent and risks are skewed towards a shallower cutting phase if data does not come in as expected. Governor Bullock emphasised that they needed to see more evidence that upside risks are abating to cut further – including sustained progress on market services and housing inflation, and wages growth.

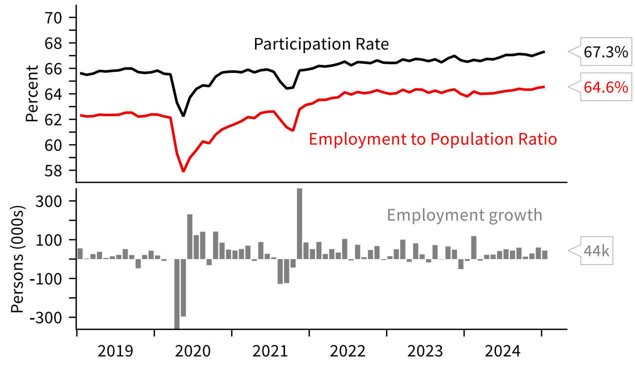
Labour Market

Strong employment growth in January reinforces labour market resilience, even as unemployment rate edges up to 4.1%.

The labour market remained resilient in January 2025, with 44,000 new jobs and a new record participation rate of 67.3%. The employment-to-population ratio was also up 0.1pp to a record 64.6%, driven by a relatively large increase in female employment.

This suggests that strong demand for workers in recent months has been matched by a growing workforce – as evidenced by continued increases in the participation rate and the employment-to-population ratio. This corresponding supply response is supporting a tight labour market without necessarily adding as much pressure on wages.

Chart 4: Labour market indicators

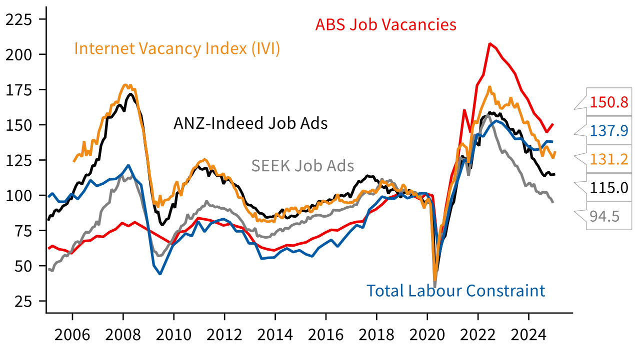


Source: National Australia Bank, Australian Bureau of Statistics, Macrobond

The unemployment rate rose from 4.0% to 4.1%, but the ABS flagged that some of the increase in unemployment reflected more people than usual waiting to start or return to work. This will likely reverse in February (as it has done in previous years) as this cohort commences work.

All in all, this data reinforces our view that the labour market will only loosen slightly from here. Instead, the risk is now shifting to whether the labour market may re-tighten as growth picks up.

Chart 5: Indicators of labour demand



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

Wages

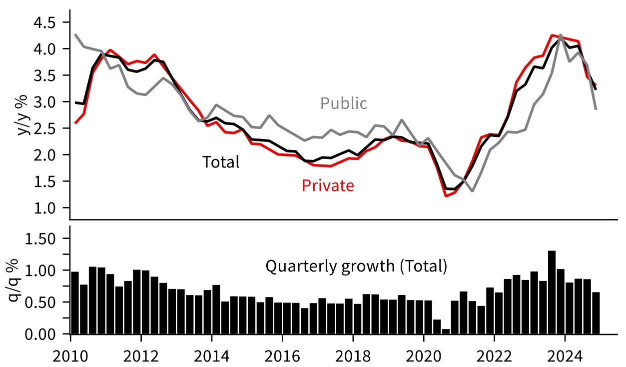
While labour demand remains strong and the unemployment rate is still low, wages growth eased further in Q4.

Wage Price Index (WPI) data this week confirmed that wages growth continued to cool at the end of 2024. WPI was up 0.7% q/q and 3.2% y/y. In annual terms, WPI growth has slowed by around 1ppt from its peak of 4.2% over 2024. While a large degree of the run-up was driven by the large minimum and award wage increases while inflation was high, the easing has been notable in comparison to pre-GFC times, where a 2ppt increase in the unemployment rate occurred for a similar decrease in the WPI.

Public sector wages growth (+2.8% y/y) was noticeably softer than a year ago. Only 23% of the public sector received a wage movement compared to 38% a year ago, when a large number of new enterprise agreements and changes to state wage policies came into effect. Those agreements would also have contained smaller increases for the second year, feeding into a much smaller public sector contribution to overall wage growth than in previous quarters.

Private sector wage growth also softened (+3.3% y/y), easing to its lowest annual rate since June 2022. Only 14% of jobs recorded a wage change, the lowest for a December quarter since 2019. The ABS also highlighted that the share of private sector jobs under individual agreements receiving multiple pay rises within a year has slowed to 21% in Q4 2024, from 35% in 2021.

Chart 6: Wages growth



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

Q4 data was in line with WPI forecasts in the February SoMP, providing some comfort to the RBA that wages growth is easing as expected (especially in individual agreements which are more sensitive to labour market dynamics). It is worth noting that higher award wage decisions for aged care and childcare will come into effect in Q1 2025, which the RBA expects will contribute to *"increased volatility to the quarterly WPI".*

Importantly, this release adds further weight to our view that the level of the unemployment rate that is not inflationary is lower than the RBA estimates. Governor Bullock noted that they will continue to revisit their assessment of full employment in coming months. We continue to see an unemployment rate in the low 4% range as sustainable and non-inflationary.

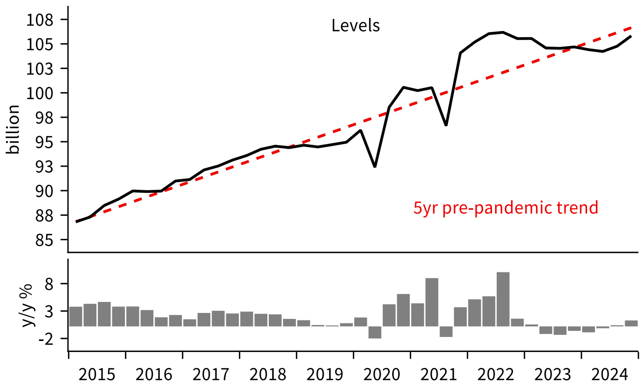
Consumption

The trajectory for growth remains key to the evolution of the labour market, which has remained tight even while growth slowed. Partial data suggests that consumption picked up further in Q4 2024, but uncertainty around whether this will be sustained remains.

Retail spending, which accounts for about 30% of total consumer spending, was 1.0% q/q higher in volume terms in Q4. This marked the first time since Q3 2022 that per capita retail volumes have *risen.*

This brings retail spending volumes back closer to their pre-pandemic trend, after the significant up-tick during the pandemic and subsequent pull-back amid pressures on household incomes. Spending in Q4 has been supported by easing inflationary pressures and higher real disposable incomes, especially as the labour market remains robust.

Chart 7: Retail volumes



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

The ABS noted that 'continuous promotional activity' was a key driver of stronger retail sales volumes. Household goods was the best performing industry (up 3.3% q/q) with consumers continuing to take advantage of discounting – retail price growth in Household goods has been noticeably weaker than overall retail price growth since early 2023.

The ABS' new measure, the Monthly Household Spending Indicator (MHSI), provides additional timely spending data and covers about 68% of household consumption, including some services. Nominal spending on MHSI services was 2.1% higher q/q, with strong quarterly increases for recreation and culture (+2.2%) and hotels, cafes and restaurants (+2.7%).

NAB transaction data suggests that there has since been a slight pull-back in early 2025, with consumer spending down 0.3% m/m in January. This is not surprising after the strong uptick in Q4 spending, but raises the question of whether the Q4 pick-up in spending will be sustained through 2025.

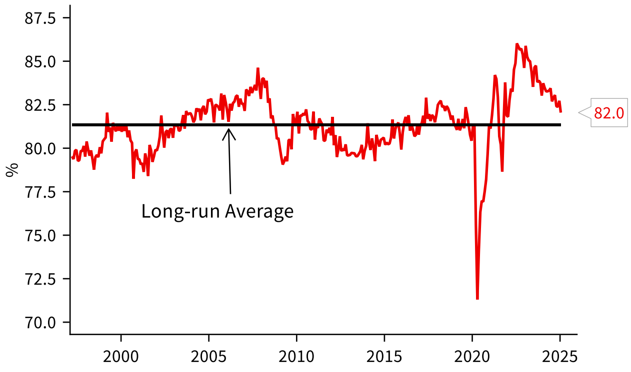
The RBA also flagged uncertainty around consumption in the SoMP, noting that evolving spending patterns in Q4 make it more difficult to gauge underlying momentum. However, as real disposable income growth continues to improve and the labour market remains robust, we expect that there will be an improvement in household consumption that carries through 2025.

Businesses

While consumer dynamics remain important, business investment will also need to pick-up to ensure growth remains around trend.

The January NAB business survey saw business conditions weaken, along with most measures of activity. There was a notable decline in capacity utilisation which fell to 82.0%, the lowest in three years, but we note that this still sits above the long-run average.

Chart 8: NAB survey capacity utilisation



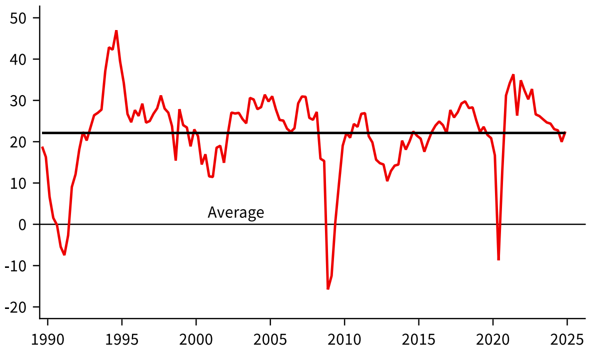
Source: National Australia Bank, National Australia Bank, Macrobond

A squeeze on margins may be weighing on conditions. Cost pressures measured in the survey remain elevated, but businesses are not fully passing these onto consumers where demand remains weak. Further easing of non-labour and labour costs over 2025 may alleviate some of these concerns, especially if there is a sustained up-tick in consumer demand.

Business confidence increased in January despite weakness in other parts of the survey. Businesses may be taking on a more favourable outlook with inflation increasingly under control and with rate cuts on the horizon. However, business confidence has been volatile in recent years so it is unclear whether this level of confidence will be sustained.

Similarly, the NAB quarterly business survey also recorded improvements in expected business conditions in the next 12 months and capex plans in the next 12 months. If this translates into actual capex later this year, this may be positive sign for business investment in 2025-26.

Chart 9: NAB survey capex 12m expectations (net bal.)



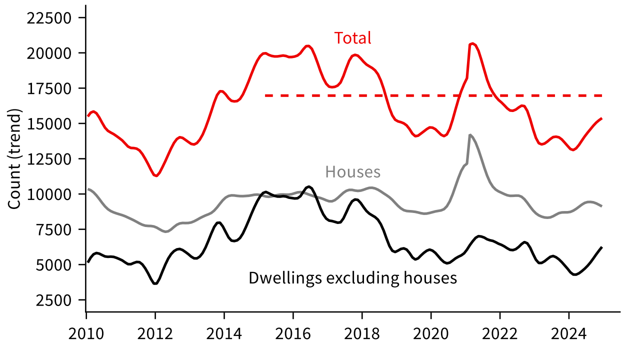
Source: National Australia Bank, National Australia Bank, Macrobond

Housing and construction

Building activity remains muted while dwelling price growth slows.

Residential construction remains muted as the sector faces ongoing capacity constraints and project backlogs. Dwelling approvals increased 0.7% m/m in December, driven by approvals for other dwellings. Approvals remain below average approval levels over the last decade, and the rate needed to meet the Housing Accord's target. However, approvals have been trending higher since early 2024 and represents an encouraging path forward (if sustained).

Chart 10: Dwelling approvals

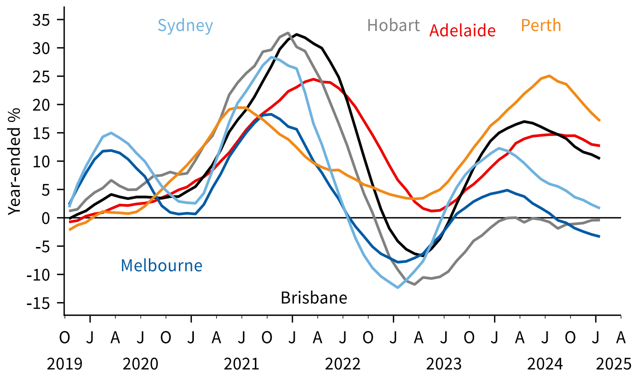


Source: National Australia Bank, Australian Bureau of Statistics, Macrobond
Note: Dotted line shows the decade average for total dwelling approvals

House price growth slowed in the second half of 2024 and remains soft in early 2025. CoreLogic's national Home Value Index was flat in January and slowed to 4.3% in annual terms. There are significant divergences by state: Melbourne home values are 3.3% lower y/y, alongside smaller declines in Canberra (-0.5%) and Hobart (-0.4%). This contrasts with the large increases in Perth (+17% y/y), Adelaide (12.7%) and Brisbane (10.4%), although recent data shows price growth in the smaller capitals has slowed.

The rental market has loosened since the record highs in rents growth in 2023-24. Advertised rents (as measured by CoreLogic) was subdued in the second half of 2024, with national rent values up 0.4% in the December quarter – the smallest Q4 change since 2018. Rental vacancy rates have eased slightly, at 1.9% in December, but remain well below the decade average of 2.8%.

Chart 11: Dwelling price growth by capital city



Source: National Australia Bank, CoreLogic Australia, Macrobond, Account in-house

Key Forecasts Tables

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	0.6	1.1	0.9	2.1	1.9
Dwelling Investment	0.7	1.2	0.0	-2.6	2.8	-2.0	-0.7
Underlying Business Investment	-0.4	-0.6	0.6	9.5	-1.2	1.0	1.5
Underlying Public Final Demand	0.9	2.4	1.1	4.1	5.3	3.2	2.4
Domestic Demand	**0.2**	**0.7**	**0.8**	**2.7**	**2.3**	**2.3**	**2.1**
Stocks (Cont. to GDP)	-0.4	-0.5	0.3	-1.0	0.1	-0.1	0.0
Gross National Expenditure	**-0.1**	**0.2**	**1.0**	**1.6**	**2.5**	**2.3**	**2.1**
Exports	0.6	0.2	0.3	3.7	1.2	2.1	2.2
Imports	0.2	-0.3	1.1	5.7	6.7	2.5	1.7
Net Export (Cont. to GDP)	0.1	0.1	-0.2	-0.3	-1.2	0.0	0.2
Real GDP	**0.2**	**0.3**	**0.6**	**1.5**	**1.3**	**2.2**	**2.2**
Nominal GDP	0.2	0.4	0.9	4.3	2.7	3.7	4.5
Labour Market							
Employment	0.7	1.0	0.6	3.0	2.7	2.0	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	2.9	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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