Global Overview & Australia

Inflation still high for services. Wage pressures peaking. The impact of higher rates. Serious slowdown underway - but how deep? And what about rates?

Alan Oster, Group Chief Economist, June 2024

Global macroeconomic summary

There are a number of areas of concern on the global economy

- Russian responses to Ukraine war and commodity prices spike. But China still a concern geopolitically. **Now worried about the Middle East – and potential for a global oil price shock. But not in our forecasts yet.**

- **Central Banks were aggressive in increasing rates over 2023.** Lags are important and for most economies the slowing is here. **US the main surprise – it's still strong into early 2024 (albeit weaker than we all expected in Q1)**. We expect the weakness in the US will be even more evident into 2024 (mid-year). Growth of around 1.5% through 2024. But year average around 2.2%.

- **Manufacturing economies are suffering now - eg China and Germany.** Service sectors look more stable but not really accelerating.

- **China has seen a big slowing in momentum post vaccine changes.** Property market also an issue. As are consumers not spending. No major policy change in the offing. We see 4.5% growth in 2024. And below 5% in 2025 and 2026. **Really quite weak**.

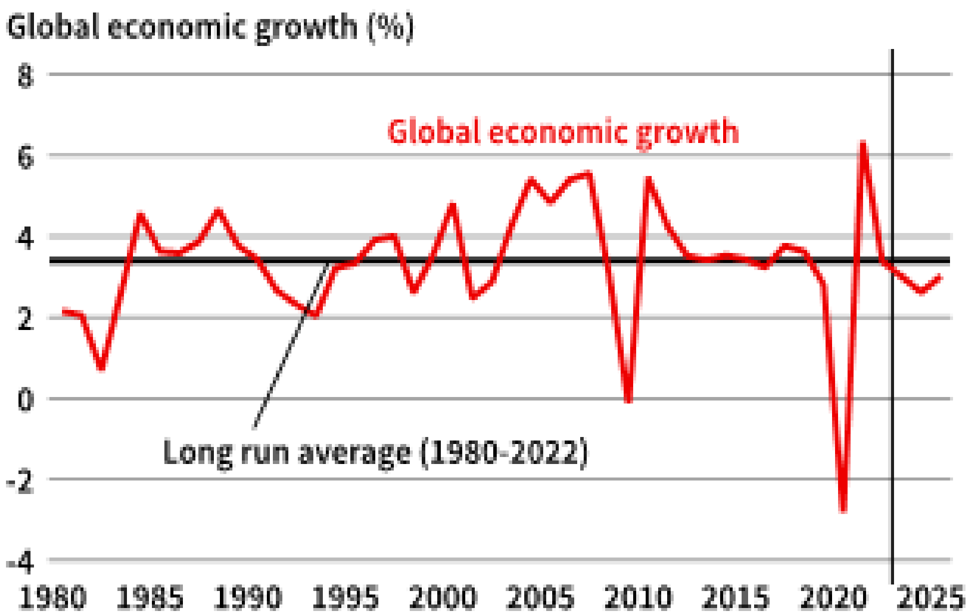
- **Globally, outside of COVID and GFC, 2024 looks like being the worst year since 2002.** Global economy outlook is tough even without geopolitical problems. 2025 and 2026 not a lot better.

- **Markets are of the view that central banks in 2024 will be in cutting mode.** Timing depends on growth and inflation profile:
  - Some economies have started to cut – including Euro, and Canada;
  - UK a touch later (August) and the US (September/November);
  - Australia late in 2024 (Nov) and NZ (early next year).

Global economic forecasts

2023 was soft at 3.3% and slowing during the year. Shows up most in 2024 year averages. At 2.9% the slowest growth rate outside COVID and GFC since 2002. Big slowing in US (ahead) and major economies (mainly already here). China under pressure. More normal in 2025 but still not great. 2026 only a touch better

	2022	2023	2024	2025	2026
US	1.9	2.5	2.4	1.4	1.8
Euro-zone	3.5	0.5	0.6	1.0	1.4
Japan	1.5	1.9	-0.3	0.6	0.7
UK	4.3	0.1	0.8	0.8	1.2
Canada	3.8	1.1	1.3	1.4	1.8
China	3.0	5.2	4.5	4.8	4.5
India	6.4	7.7	6.6	6.2	6.4
Latin America	4.2	2.2	1.3	2.1	2.1
Other East Asia	4.2	3.2	3.4	4.0	4.0
Australia	3.8	2.1	1.2	2.2	2.2
NZ	2.4	0.6	0.3	2.7	3.0
Global	**3.5**	**3.2**	**2.9**	**3.0**	**3.1**



Australia macroeconomic summary

Economy has slowed a lot. Rates, rents and global softness driving a serious slowdown. How deep?

- **GDP growth to slow to around 1.3% during 2024. Currently around 1% (year to Q1 2024).**
  - Key drivers, slower global growth and rate rises. And lack of orders and confidence in some sectors.
  - Growth in 2025 back to around trend (2.2%). And similar beyond that.

- **Unemployment still very low at around 4%. Unemployment path critical.**
  - Shortage of labor still high – especially skilled labor.
  - Seasonal issues still have a big influence on monthly numbers.
  - But we still expect unemployment to be around 4.5% by late 2024, and broadly similar thereafter.

- **Price inflation has peaked but will stay high for a while.**
  - Purchase costs has slowed. As has wages. But Service inflation still elevated.
  - Core currently around 4% but will slow to around 3.4% by late 2024 and 2.8% by end 2025. And 2.6% by early 2026.
  - Headline reflecting budget changes at 3.1% by end 2024 but stay around that rate in 2025.

- **Wages growth too, has probably peaked (around 4.1% currently).**
  - Wages growth may have peaked. And consumer expectations remain reasonable.
  - Cyclical productivity after bottoming, now improving a touch - which reduces unit labor cost increases.
  - Expect wages to gradually reduce to around 3.8% by 2024 – and a little lower in 2025 (3.4%).

- **RBA now data watching. At the peak and late this year to start cutting.**
  - RBA in data watching mode.
  - **Budget hasn't helped RBA. RBA to sit at 4.35% for most of 2024.**
  - **We still see cuts starting in late 2024 and gradual loosening cycle. Down to 3% by late 2025.**
  - Markets now pessimistic re rate cuts and timing - cut in mid 2025 and maybe another by year end.
  - That is not enough – real rates would rise in that scenario.

Australian Budget 2024-25, Big Picture

Key points:

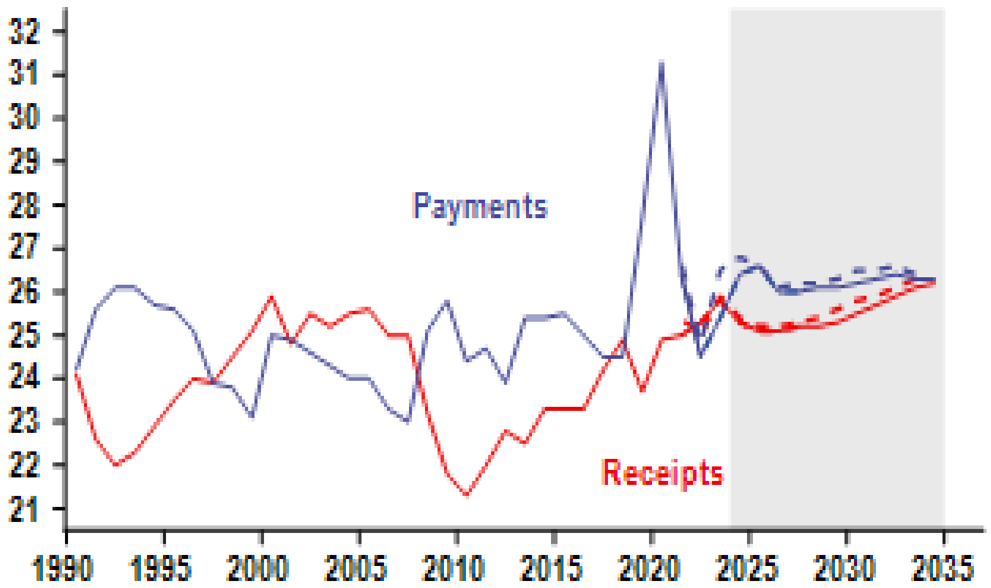
- Budget as expected with more focus on interventionist policy.
- Future Made in Australia, Cost of Living Relief, Tax cuts.
- Additional spending on Housing, Childcare wages, and Instant Asset write-offs. But little in the way of revenue measures.
- Economy slow but improving – forecasts not that different to NAB.
- Structural budget repair kicked down the road – even before election spending.
- Budget implies a structural loosening of policy but rate cuts still coming.

On underlying cash balance

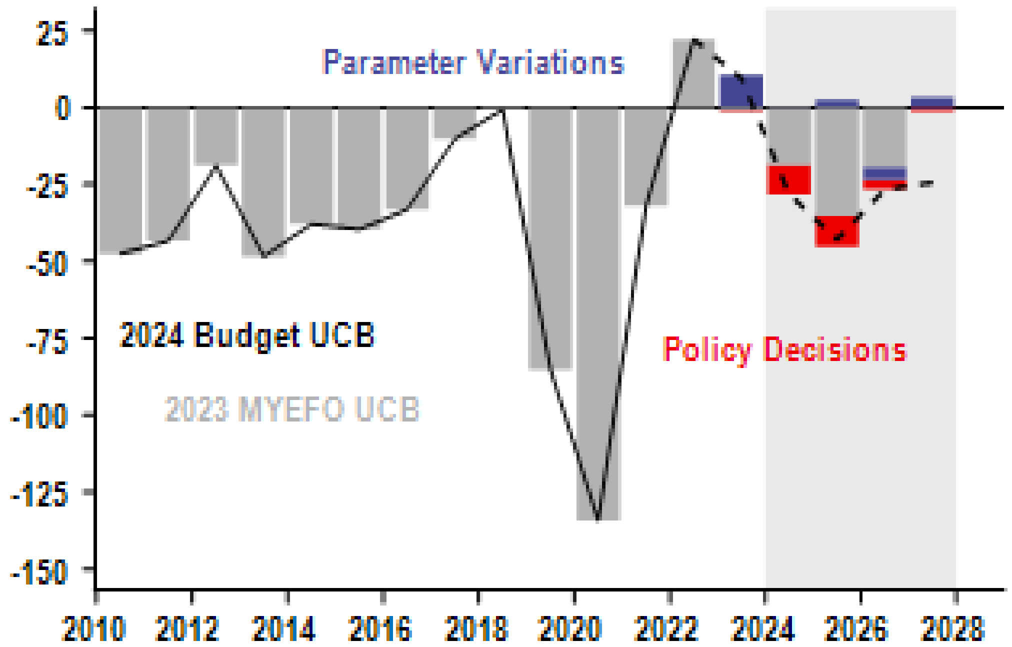
Now driven by extra expenses

Reasons for change in the underlying Budget position

Now driven by lower commodity prices and weaker labour market



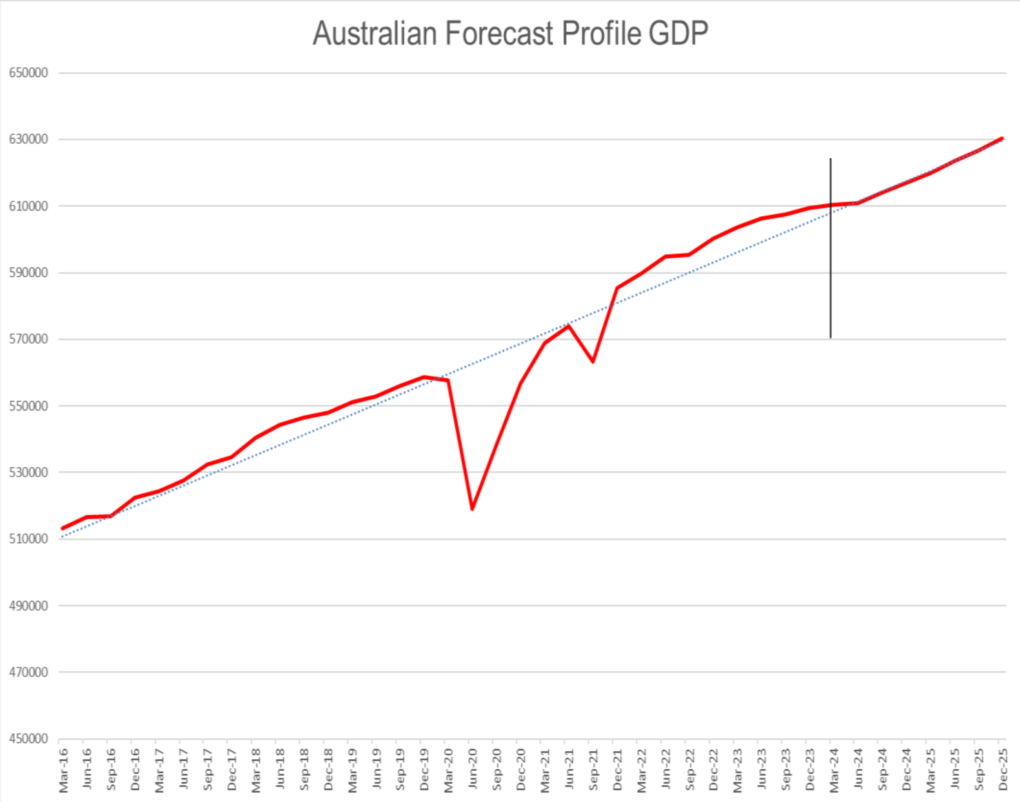
X-axis shows first year of relevant financial year. Dotted lines show 2023 Budget estimates.
Source: Macrobond, Commonwealth Treasury, NAB Economics.

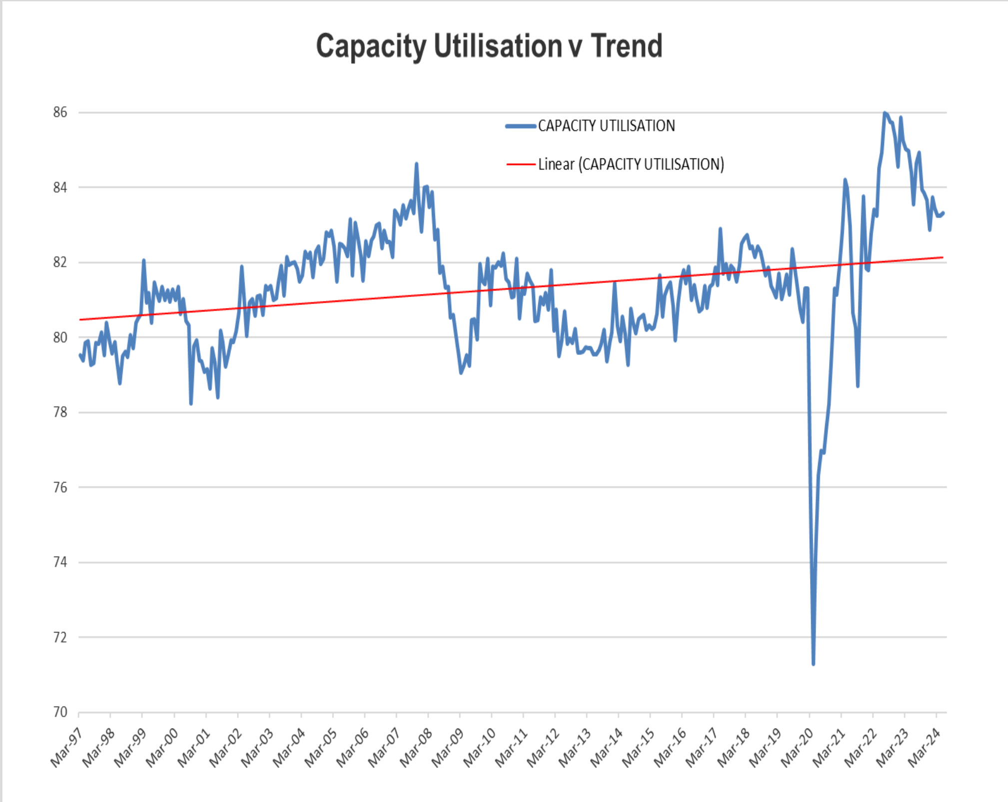


X-axis shows first year of relevant financial year.
Source: Macrobond, Commonwealth Treasury, NAB Economics.

So where are we at now

In level terms, demand still above supply but rapidly closing. Both GDP and capacity utilisation to LR trends suggest the same

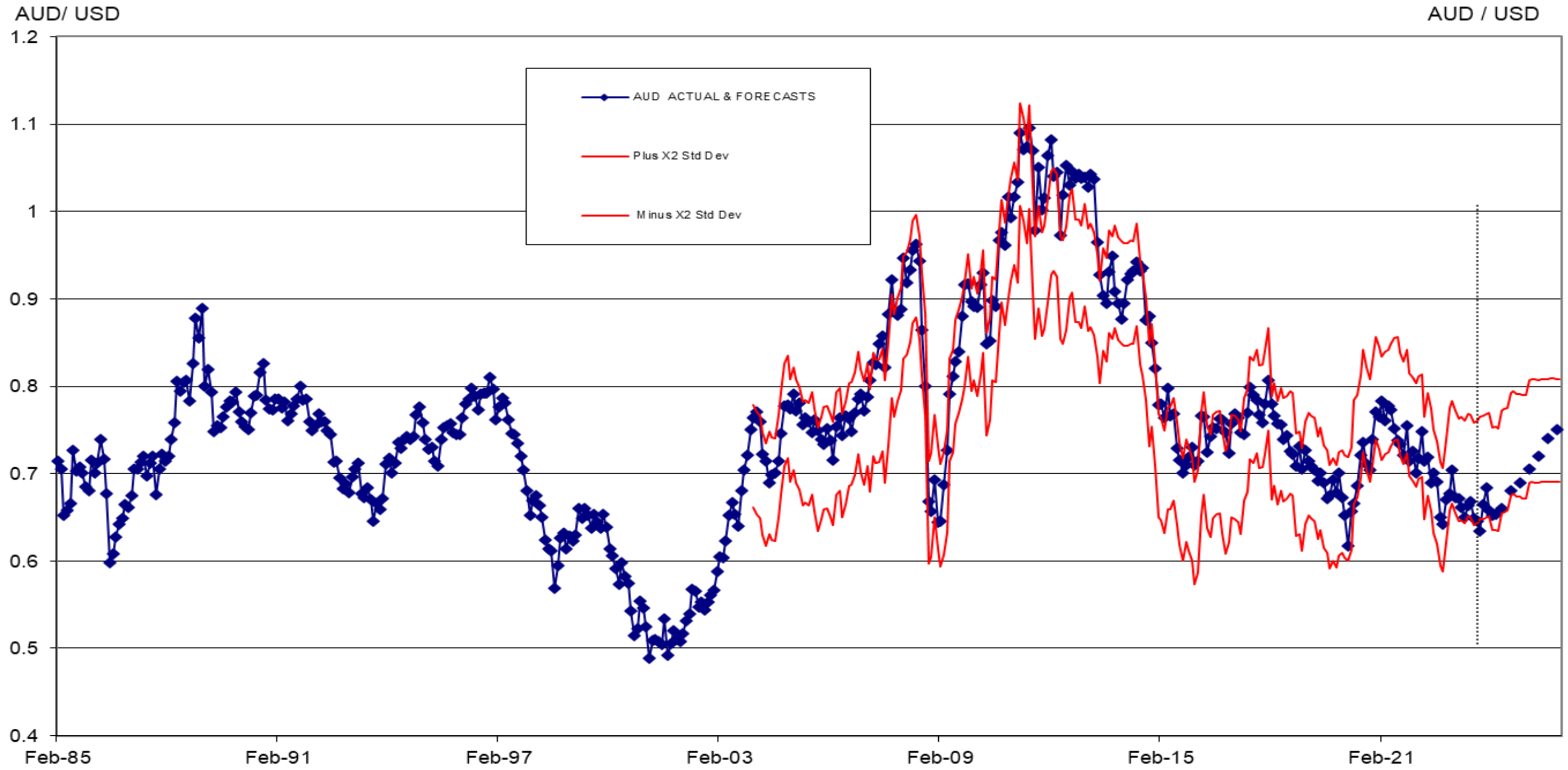




Currency model USD 0.69+/- 5c

Recent movements very much reflecting strength of the USD. Australia a proxy for risk in uncertain world and China fears. Model seriously under valuing AUD at present. But expect it will recover

Currency Model* and AUD/USD



- Model driven by: commodity prices; US TWI – as measure of USD strength; long and short run rates; relative unemployment; relative equity markets and VIX

Forecasts:

End 2024= 69c AUD/ USD

End 2025= 75c AUD/ USD

Data Insights

- NAB Data
- Business Survey

Retail Down in May

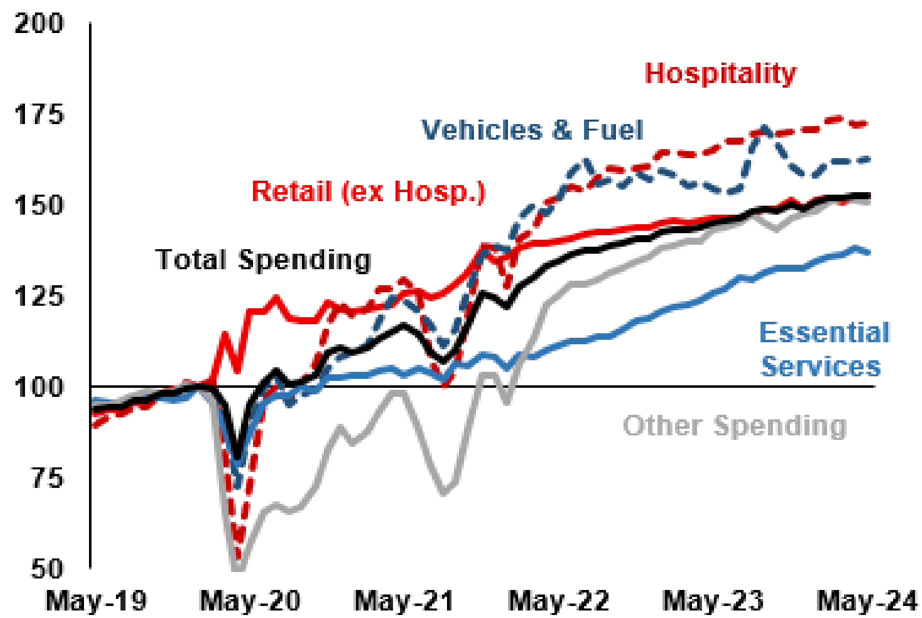
Total consumption fell-0.3% in May after a higher than expected April. Retail also fell by -0.2%. Our data however implied a higher April (0.8%) than the ABS found (0.1%). Over the year in nominal terms retail up 4.2% and total consumption 5.1%. So, after inflation not dissimilar to the National accounts. **In short still a struggle**

Headline Table (Long Version)

	Mar-24	Apr-24	May-24		
	m/m	m/m	m/m	3m/3m	y/y
Goods Retail	-0.6	1.2	-0.2	0.8	4.1
Cafes & Restaurants	0.4	-0.8	0.1	0.8	4.6
Total Retail	**-0.4**	**0.8**	**-0.2**	**0.8**	**4.2**
Vehicles & Fuel	0.2	0.1	0.2	1.8	5.1
Essential Services	0.5	1.0	-0.8	2.1	8.6
Other Spending	0.7	-0.3	-0.5	1.5	5.4
Total Spending	**0.0**	**0.6**	**-0.3**	**1.2**	**5.1**
Goods	-0.5	1.0	-0.1	1.0	4.3
Services	0.6	0.0	-0.4	1.5	6.1
Discretionary	-0.1	0.4	0.0	0.9	4.7
Non-Discretionary	0.2	0.8	-0.7	1.7	5.8
Total ex Fuel	0.0	0.6	-0.3	1.2	5.0

Excludes taxes, rent, mortgages, gambling, finance, insurance, and other non-consumer transactions. Data are seasonally adjusted and subject to revision.

Consumer Spending Index

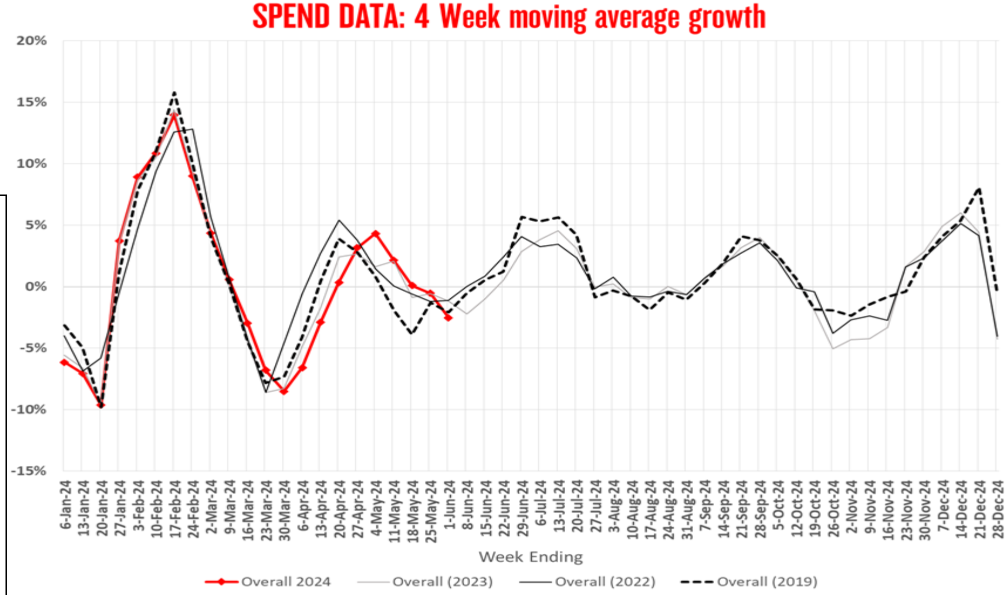


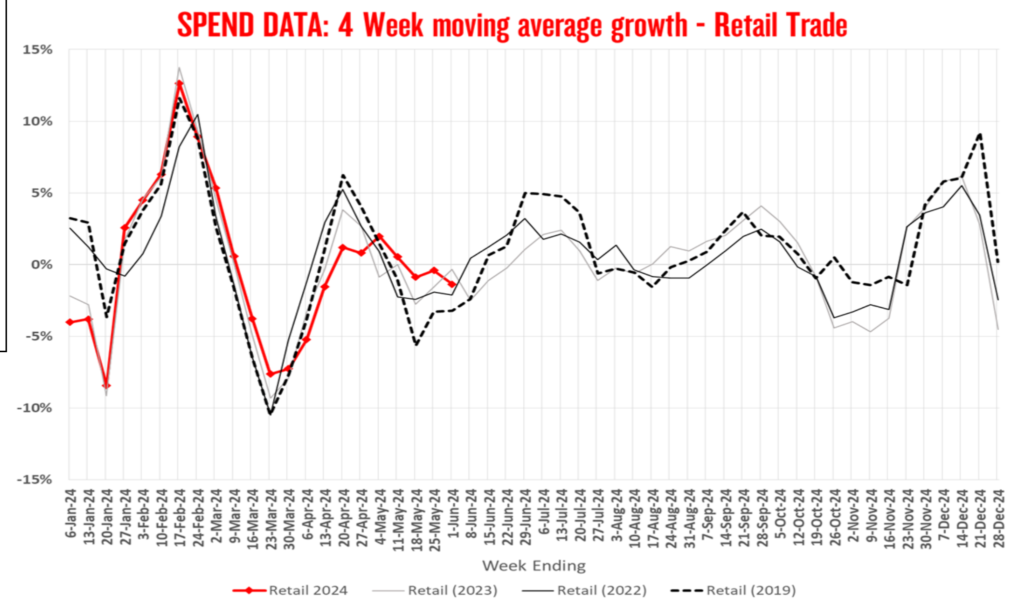
Weekly data patterns for consumption into late May show a weak end to the month

Both for retail and total consumption

	18/05/2024	25/05/2024	1/06/2024	3/06/2023
Total Spending (4wma, s.a.)				
4-week Growth	0.1	-0.5	-2.5	-1.2
Sector Growth (4wma, s.a.)				
Retail	-0.9	-0.4	-1.4	-0.3
Hospitality	0.6	-1.2	2.3	1.1
Essential Services	2.2	-1.5	-10.2	-5.5
Other Services	0.9	0.1	-3.0	-1.9
State Growth (4wma, s.a.)				
NSW	1.5	0.2	-2.9	-1.7
VIC	-0.1	-0.3	-1.8	-1.0
QLD	-0.8	-0.9	-2.4	-0.5
WA	-1.1	-1.9	-2.9	-2.1
Other	0.7	-0.6	-2.7	-1.6

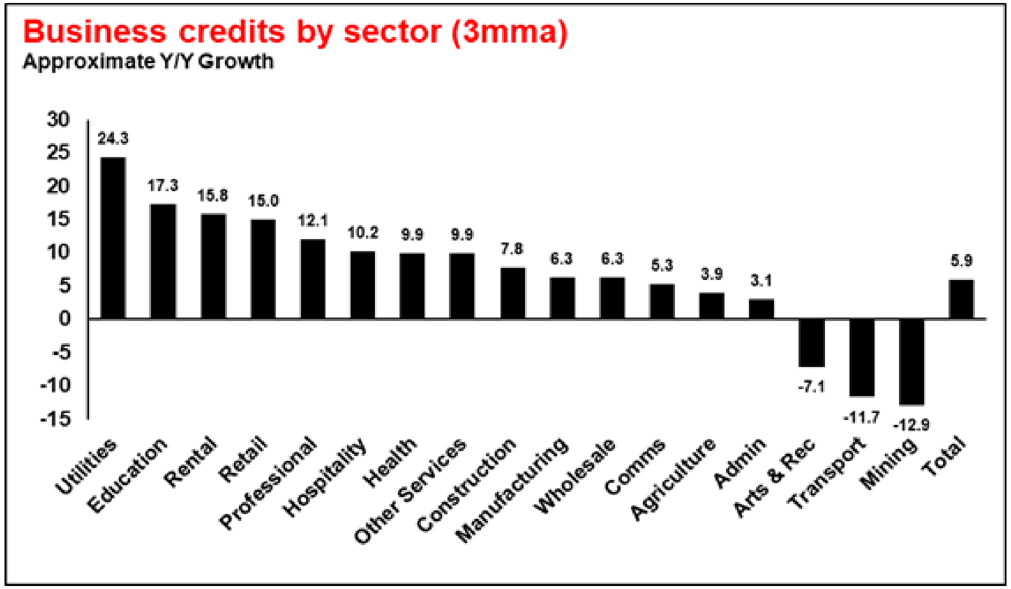
Essential services includes health, education, utilities and communications. Other spending includes arts & rec, transport, construction, and other services. All data seasonally adjusted using monthly factors and subject to revisions.

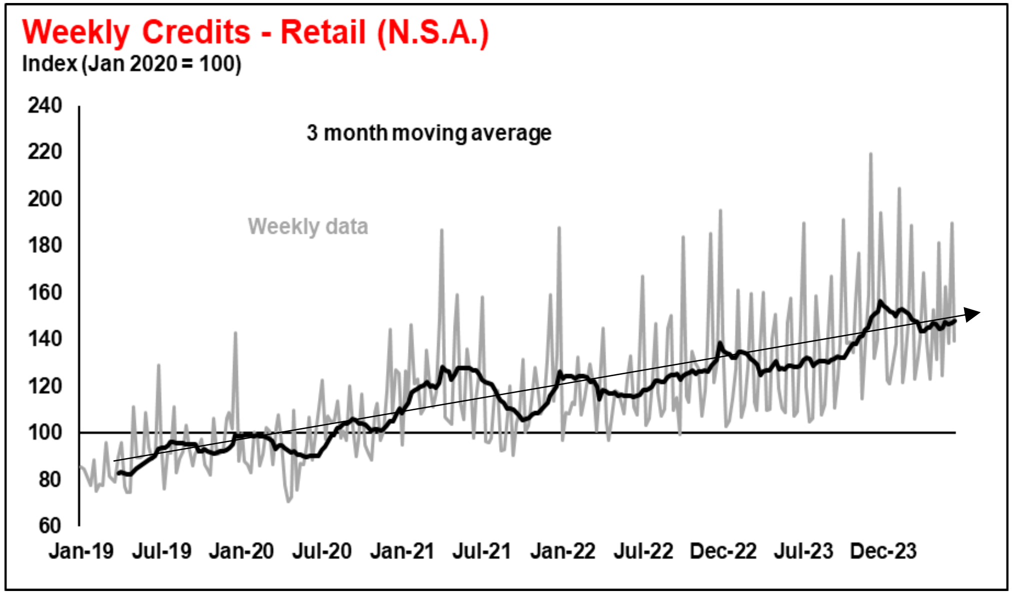


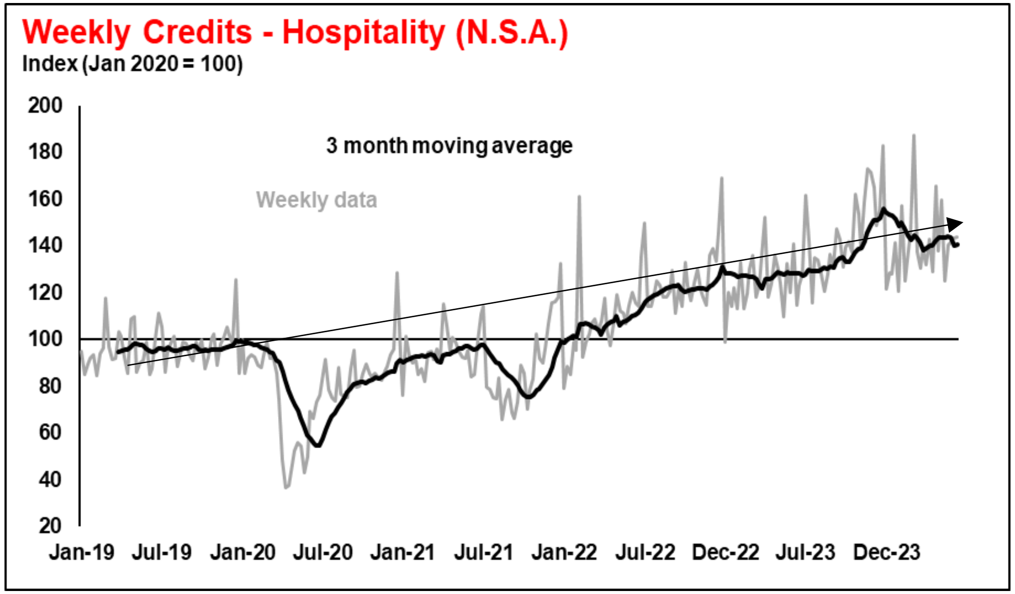


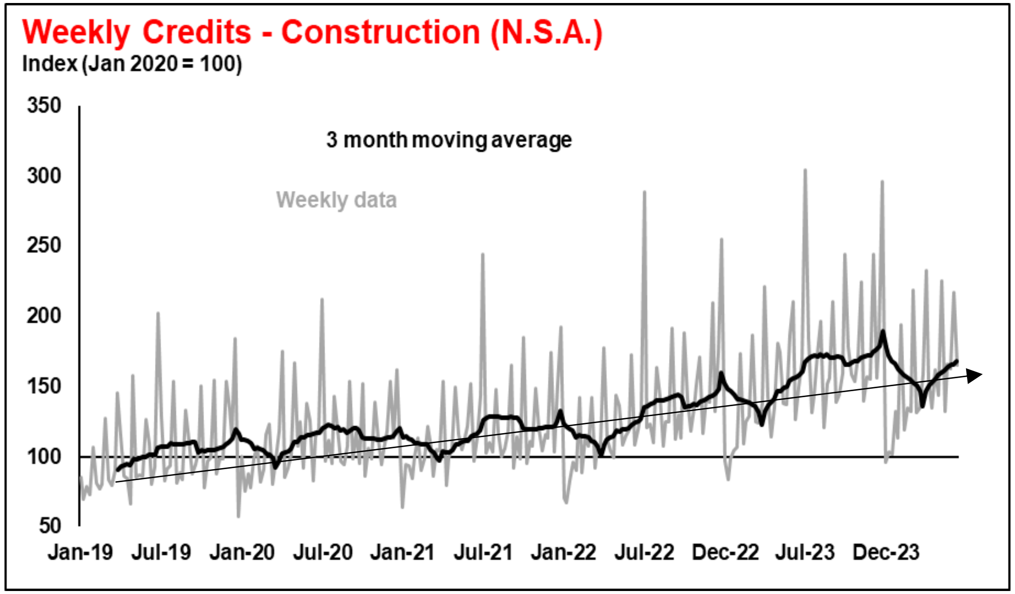
Business inward credit growth in May up around 6%

Not great in real terms. And reflects increases NAB share. Strength in education, utilities, communications, health and retail. Arts & rec and transport still suffering as is mining



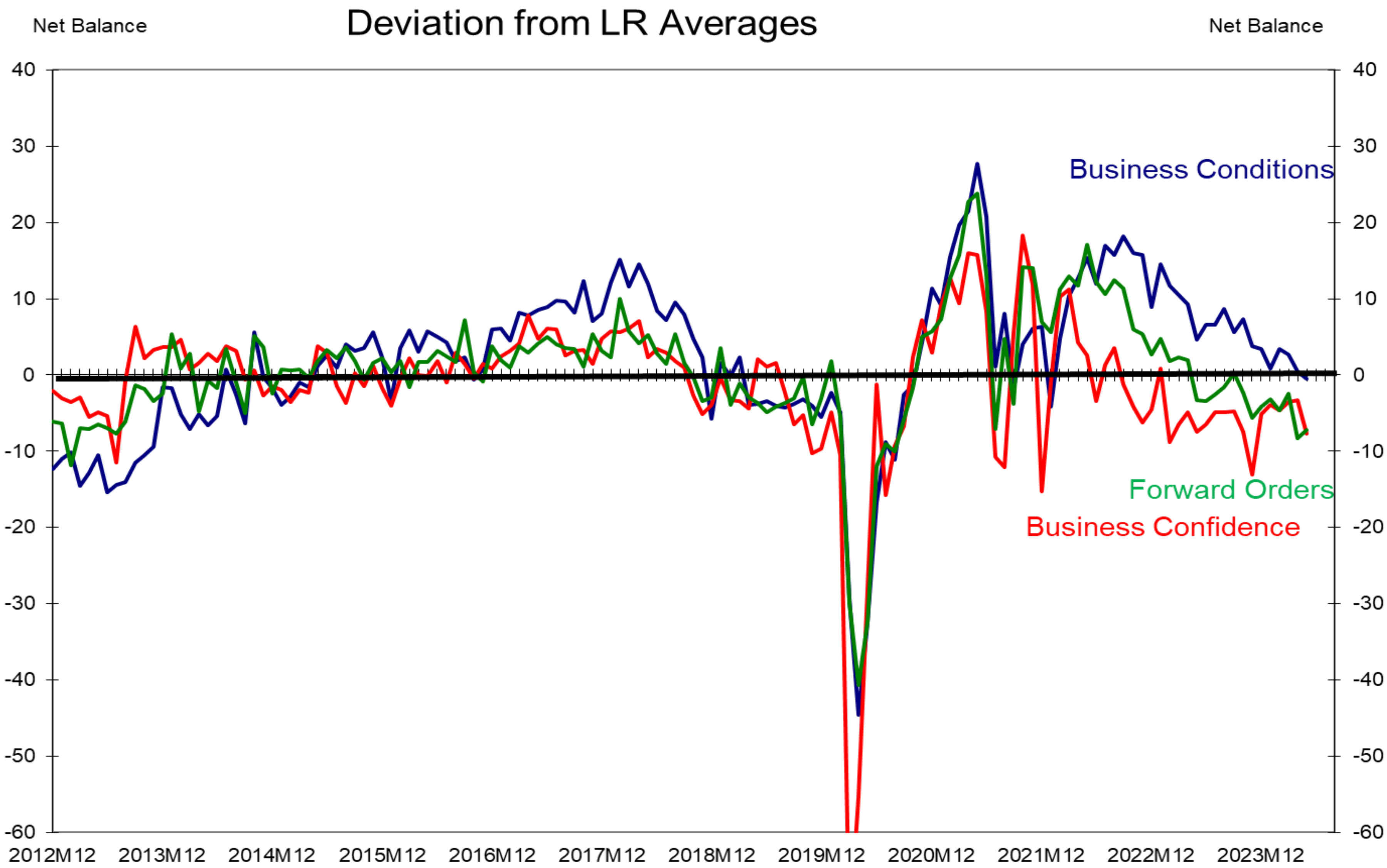






Business Survey shows momentum slowing a lot recently

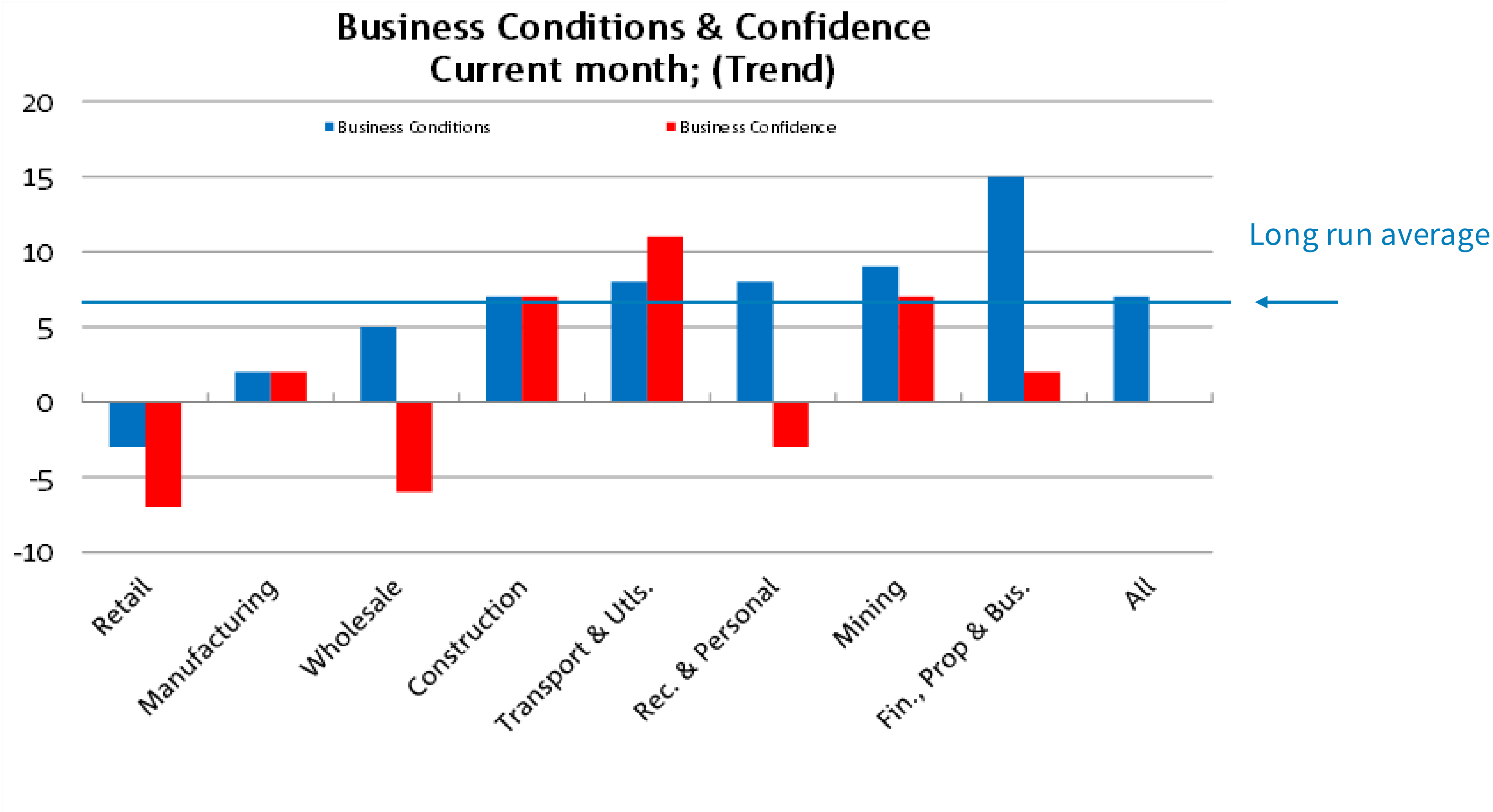
May Survey basically weaker - business conditions now a touch below run averages. But confidence and increasingly forward orders weaker and well below trend. Overall, still ok -but with growth momentum slowing further, and some areas of real stress.



By industry: Conditions and Confidence

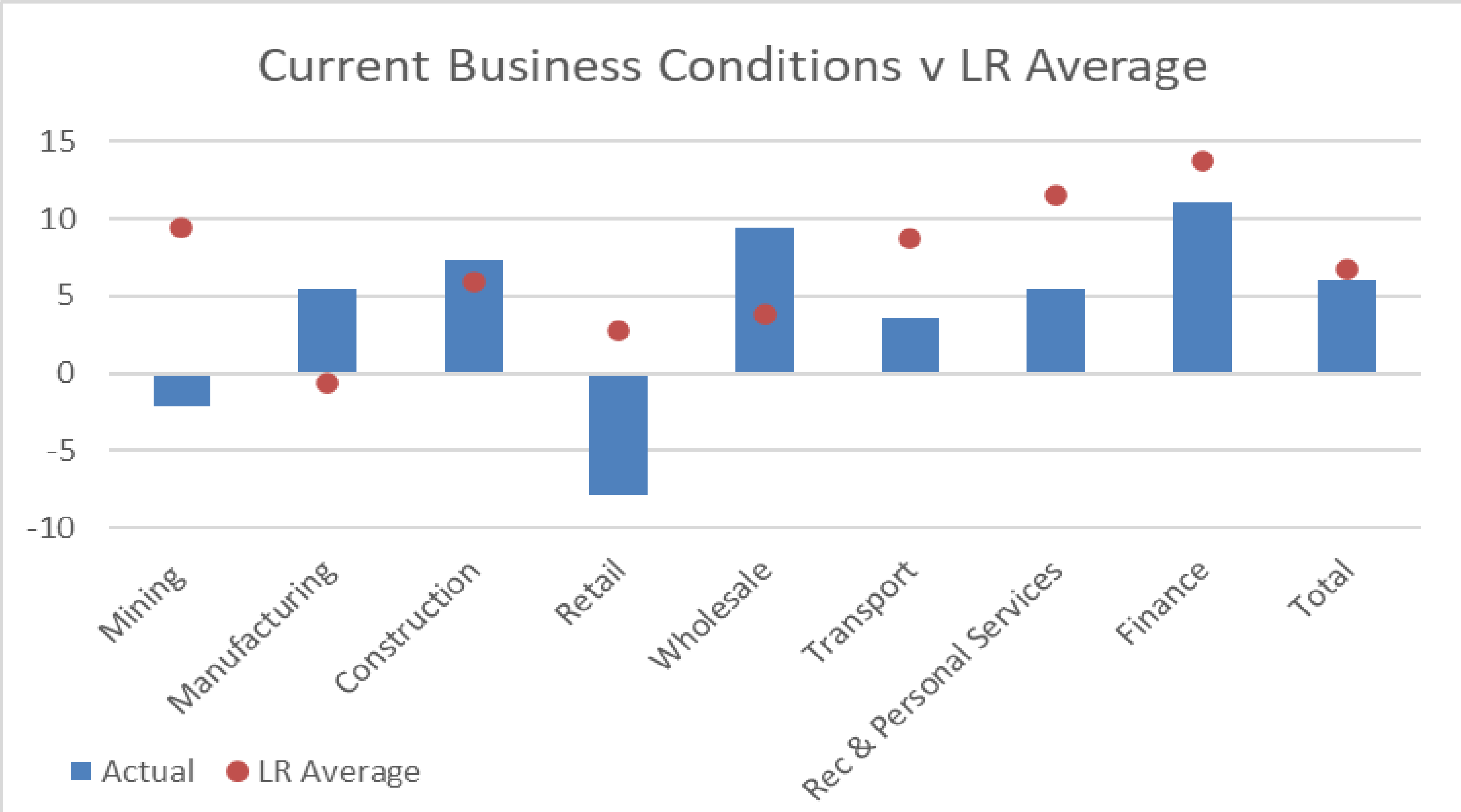
Overall, many areas now below average for outcomes (around half). Retail, wholesale, manufacturing and construction (line ball) have conditions below long run averages. But big difference from conditions to confidence in retail/wholesale and personal & rec (hospitality) services

May 2024



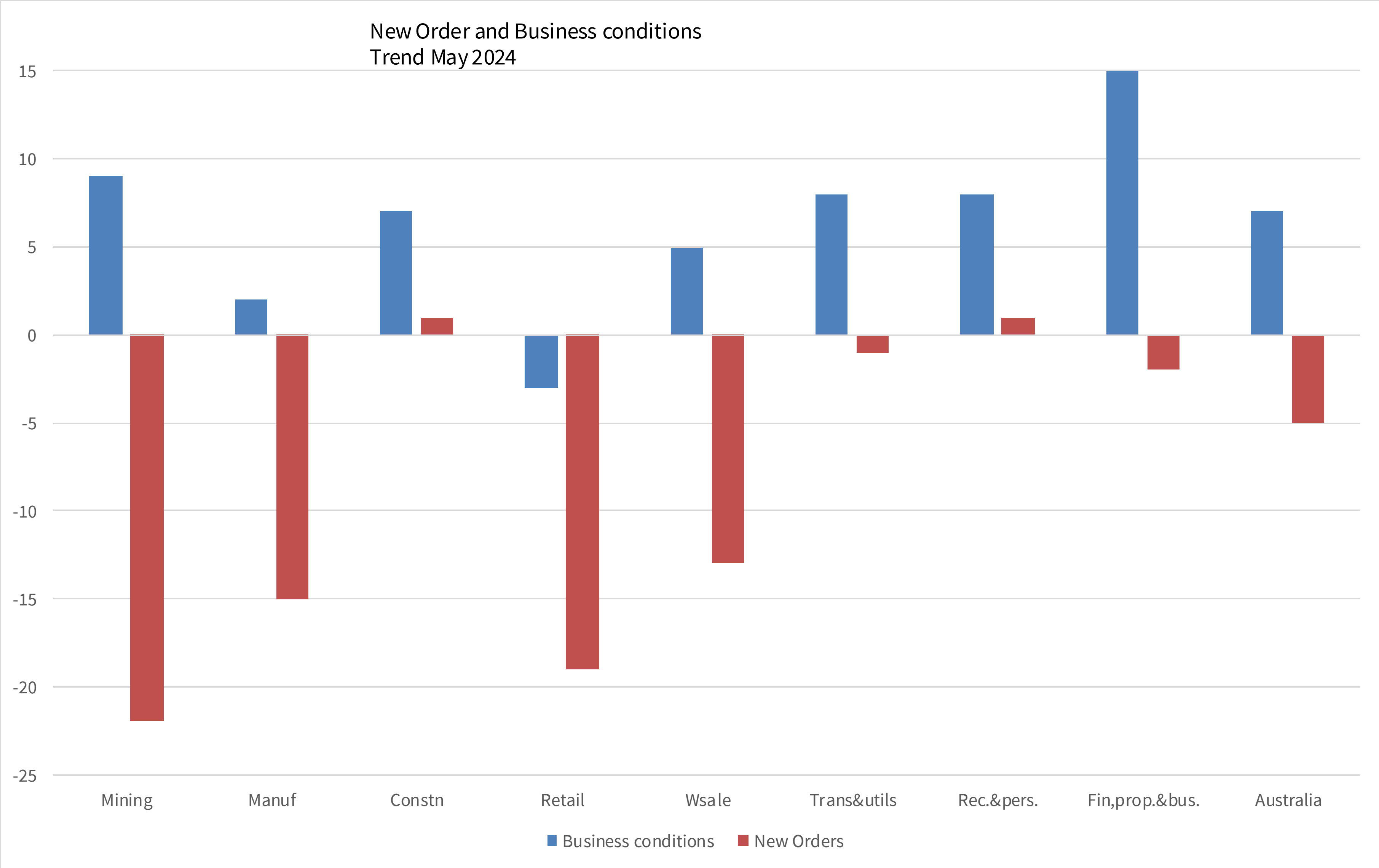
And interestingly compared to long run averages, clearly retail is very depressed

But so is mining and most service sectors



Interesting split for orders across industries

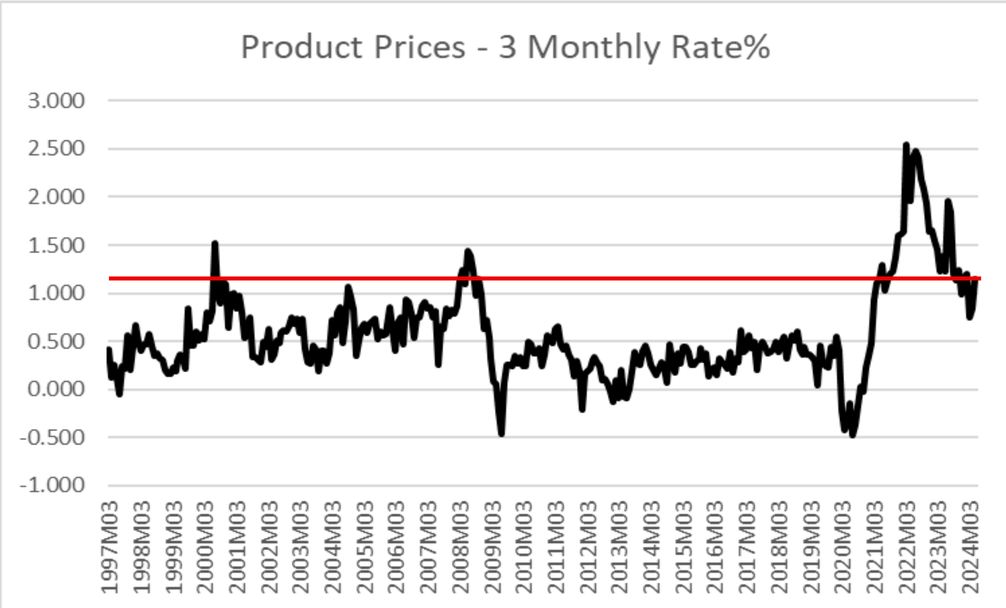
Orders were very weak in mining but can be volatile. Manufacturing now an issue as is construction. But retail and wholesale have been weak for ages



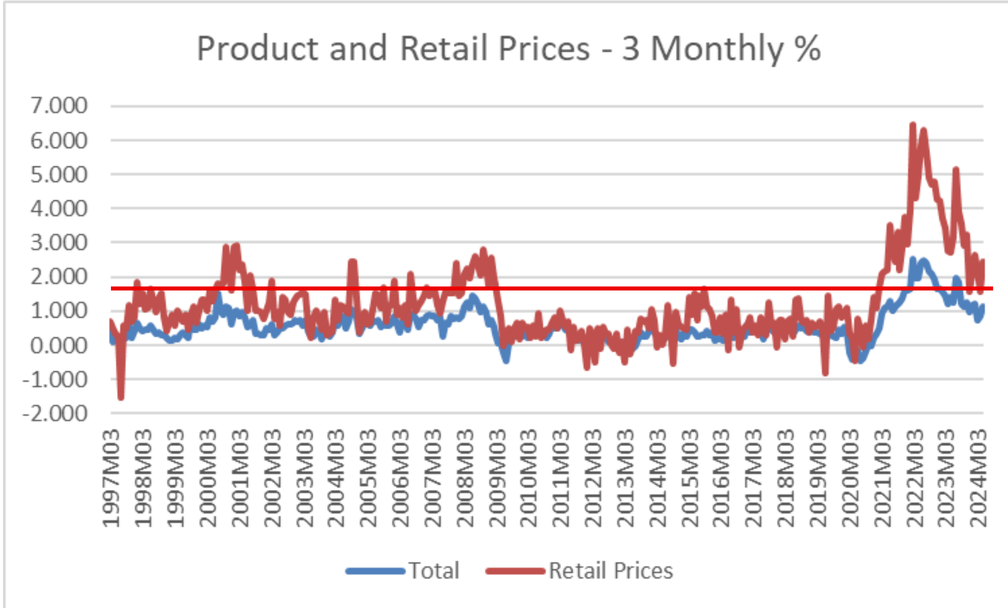
NAB Business Survey

Business Survey in early 2024 showed lower trends in wages prices. But by May remains sticky. Purchase costs up but around long run averages. Price pressures however, still sticky - especially retail prices

Purchase Costs – May NAB Survey



Total Economy wide and retail prices – May NAB Survey

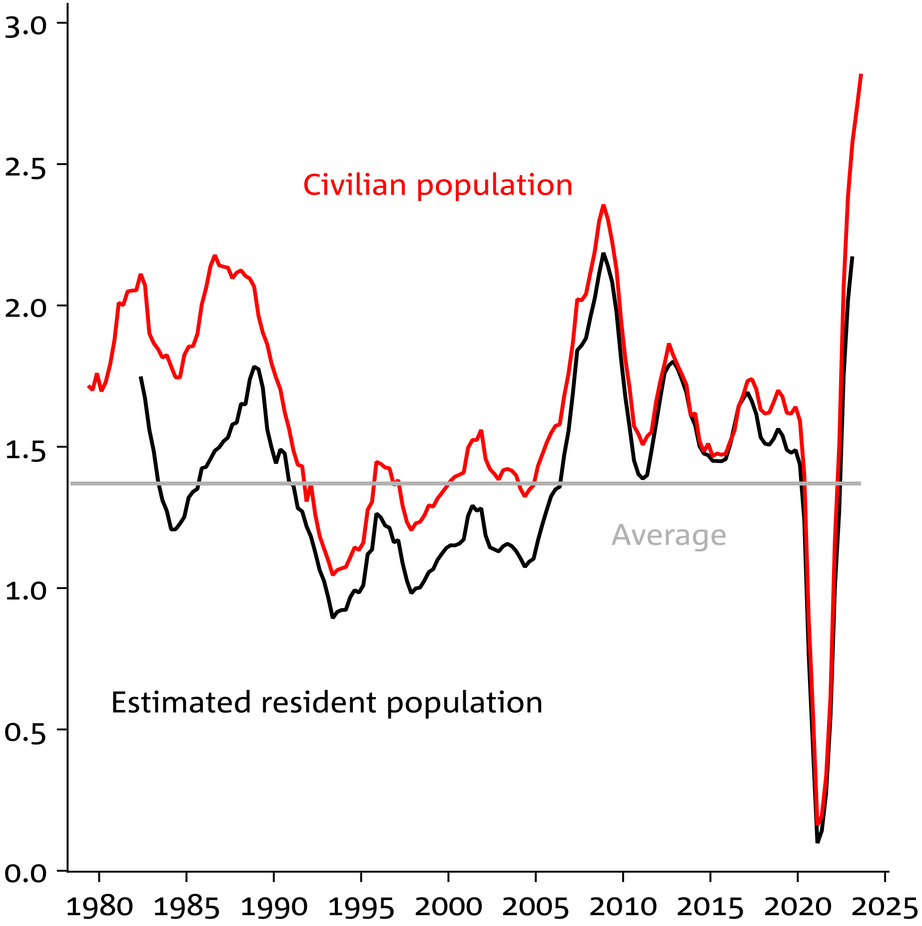


Population growth has rebounded sharply

Across all states except Tasmania…

Population Growth

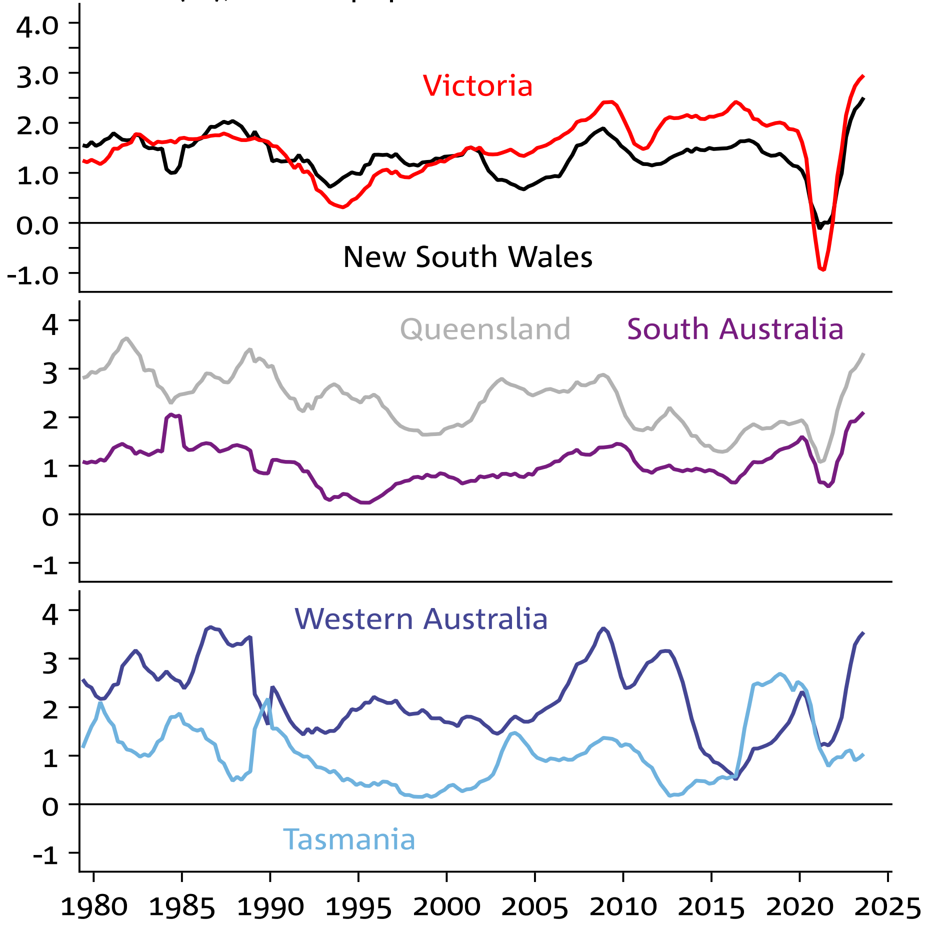
Year-ended



Source: National Australia Bank, Australian Bureau of Statistics

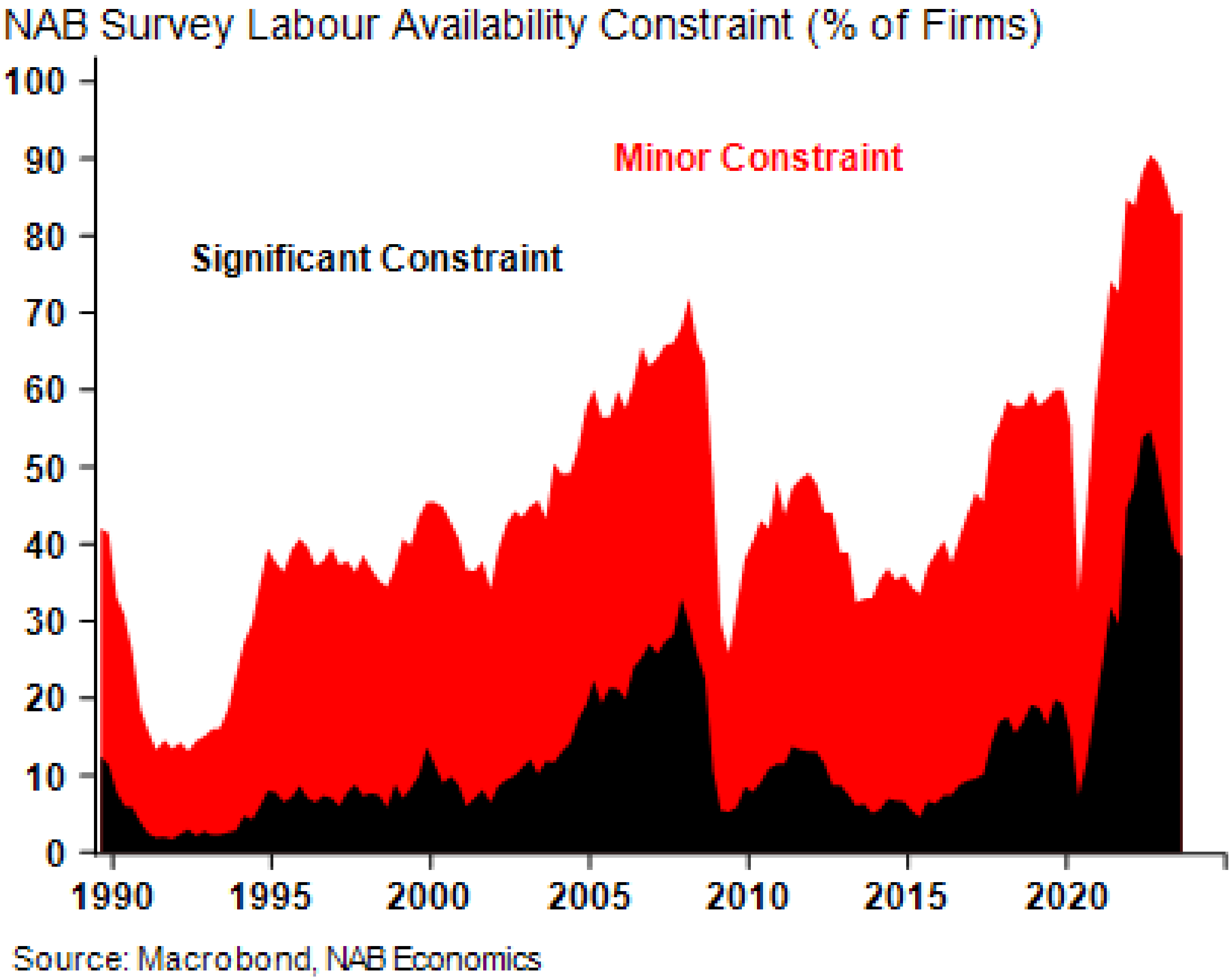
Population Growth by State

Year-ended (%), civilian population



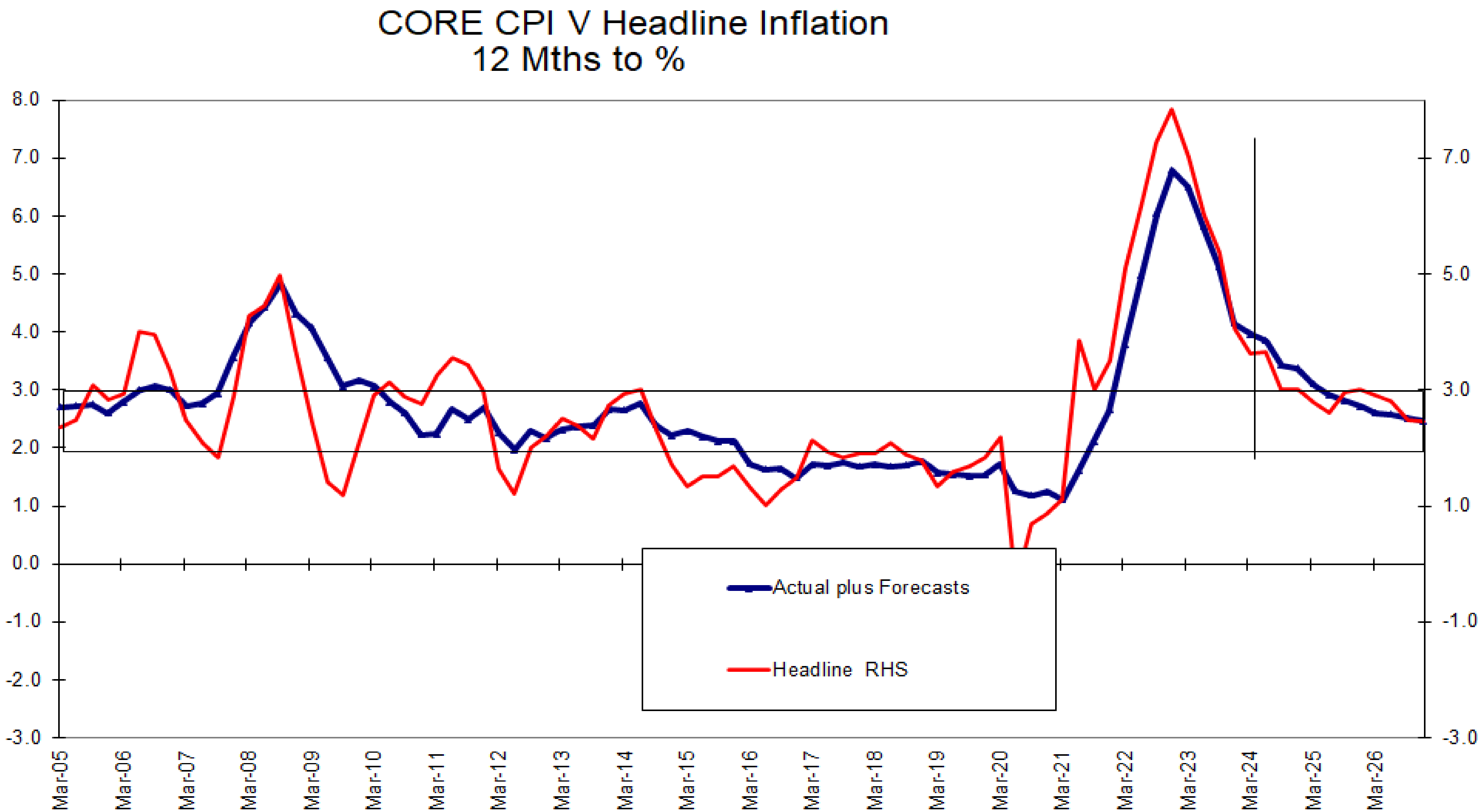
Source: National Australia Bank, Australian Bureau of Statistics

Obviously, labour shortages are still a significant constraint but have eased a touch recently



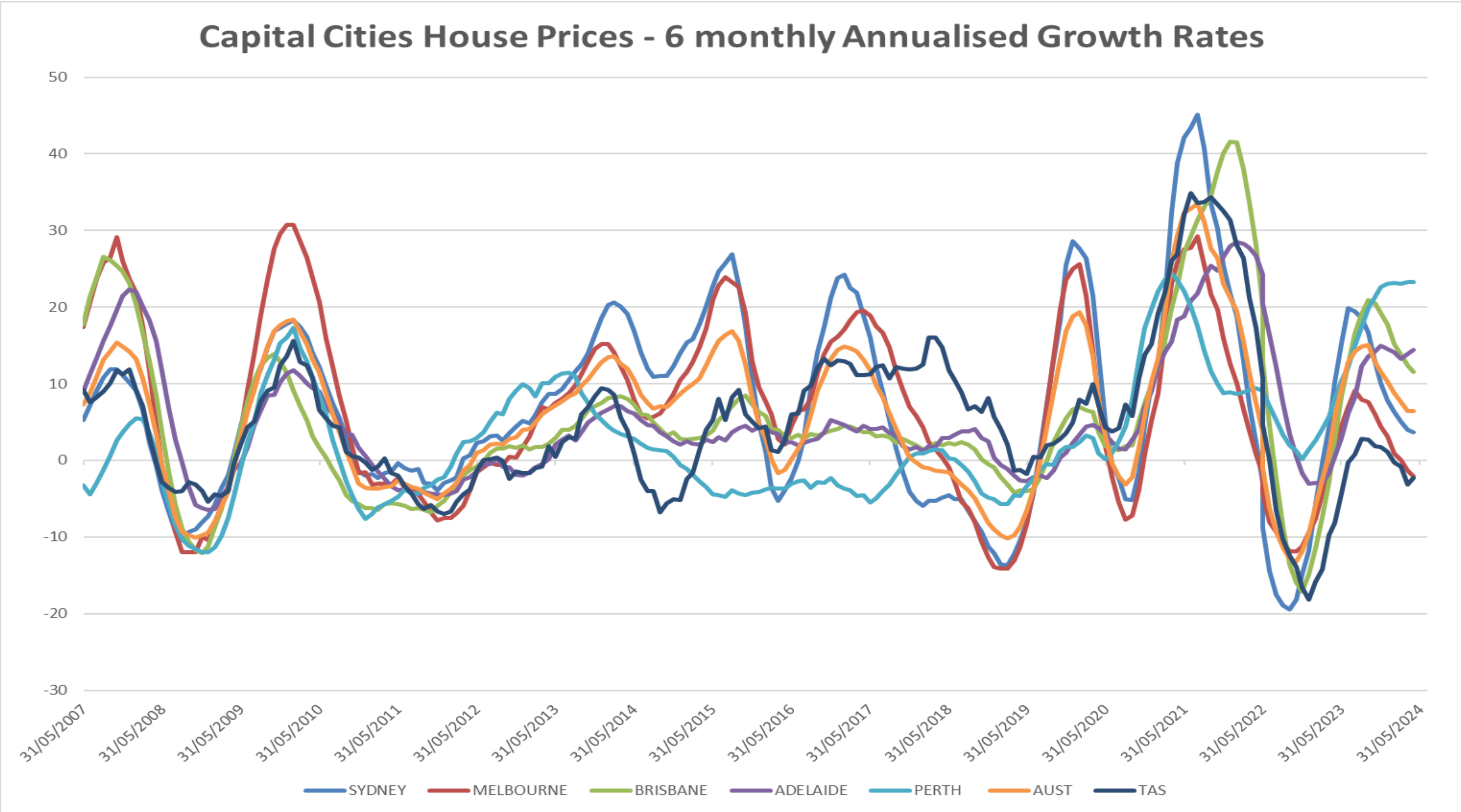
Core inflation

Trimmed mean core inflation now at 4.0%, headline at 3.6%. While early 2024 core edged higher as rents subsidies withdraw and services inflation still high (education and insurance etc). Core at 3.4% by end 2024 and 2.8% by end 2025. Back to the middle of the range by mid 2026. Headline effects by Govt subsidies – RBA will ignore it



House prices

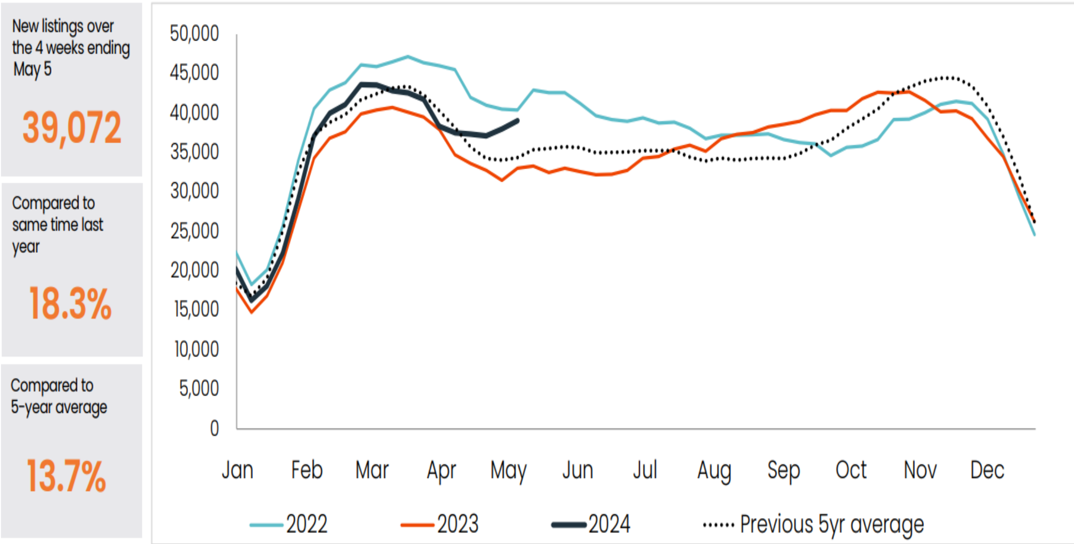
We are seeing a flattening out in previously very robust housing growth. But big differences are opening up across capitals into May 2024. Perth still growing at around 22% per annum (6monthly annualised). Adelaide and Brisbane around 10-14%. Sydney now growing around 3.0% annualised while Melbourne and Hobart edging down. Overall house prices across Australia around 6%



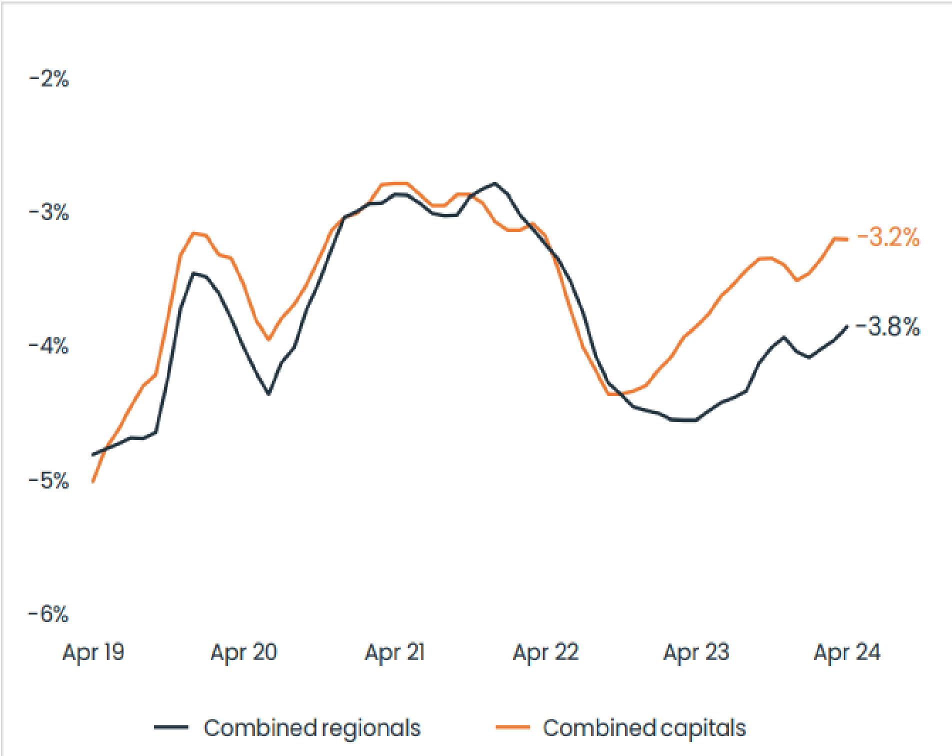
But be aware turnover has changed a lot recently – especially new listings and sales

With discounts rising. Could be signs of distressed sales – especially in Victoria

Number of new listings, National Dwellings



Median vendor discount

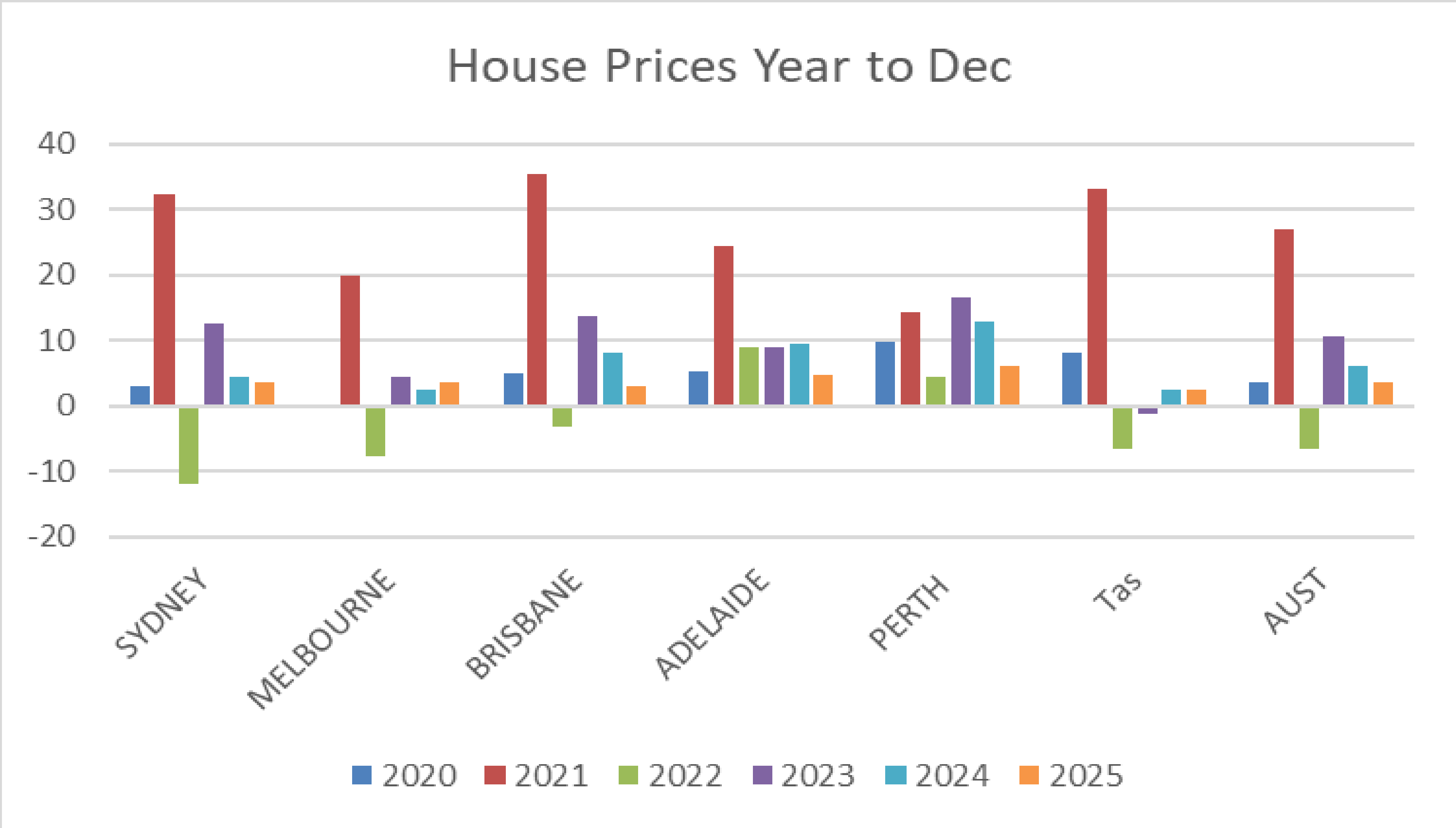


Source CoreLogic

House price forecasts

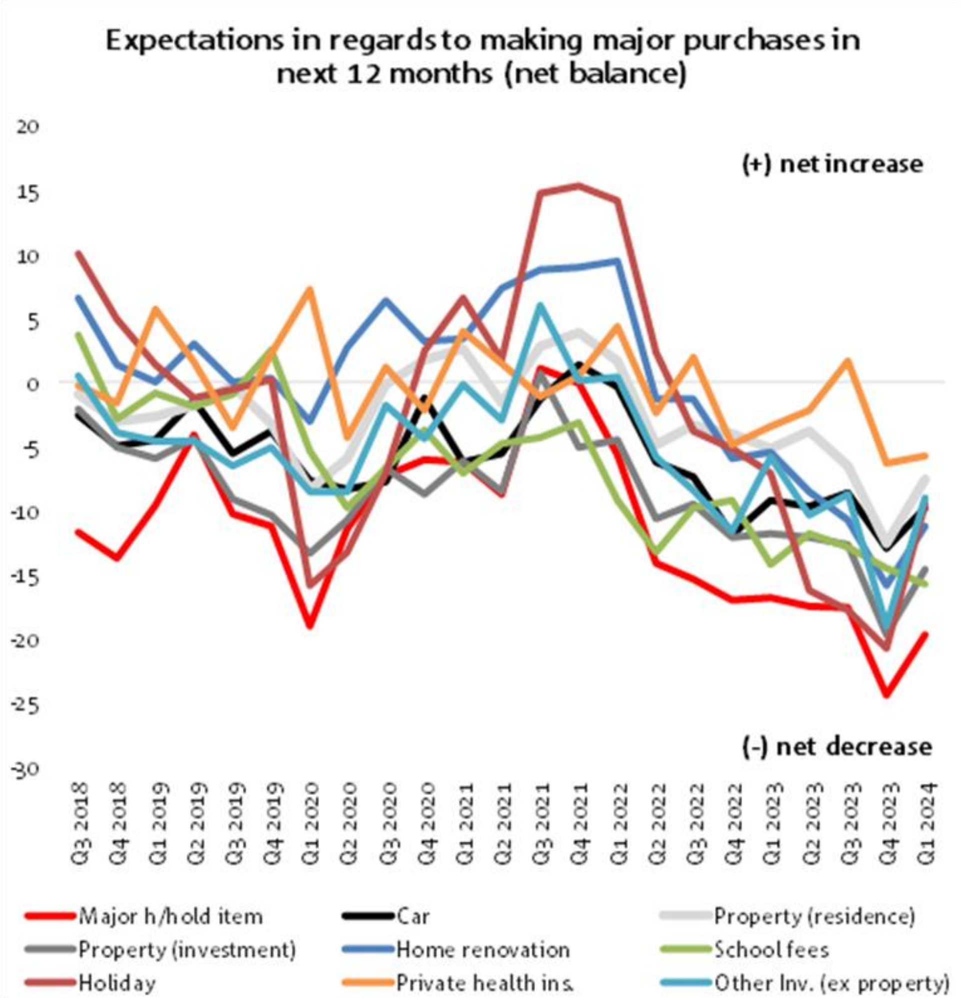
After increasing by around 27% during 2021, house prices down around 6.6% during 2022.

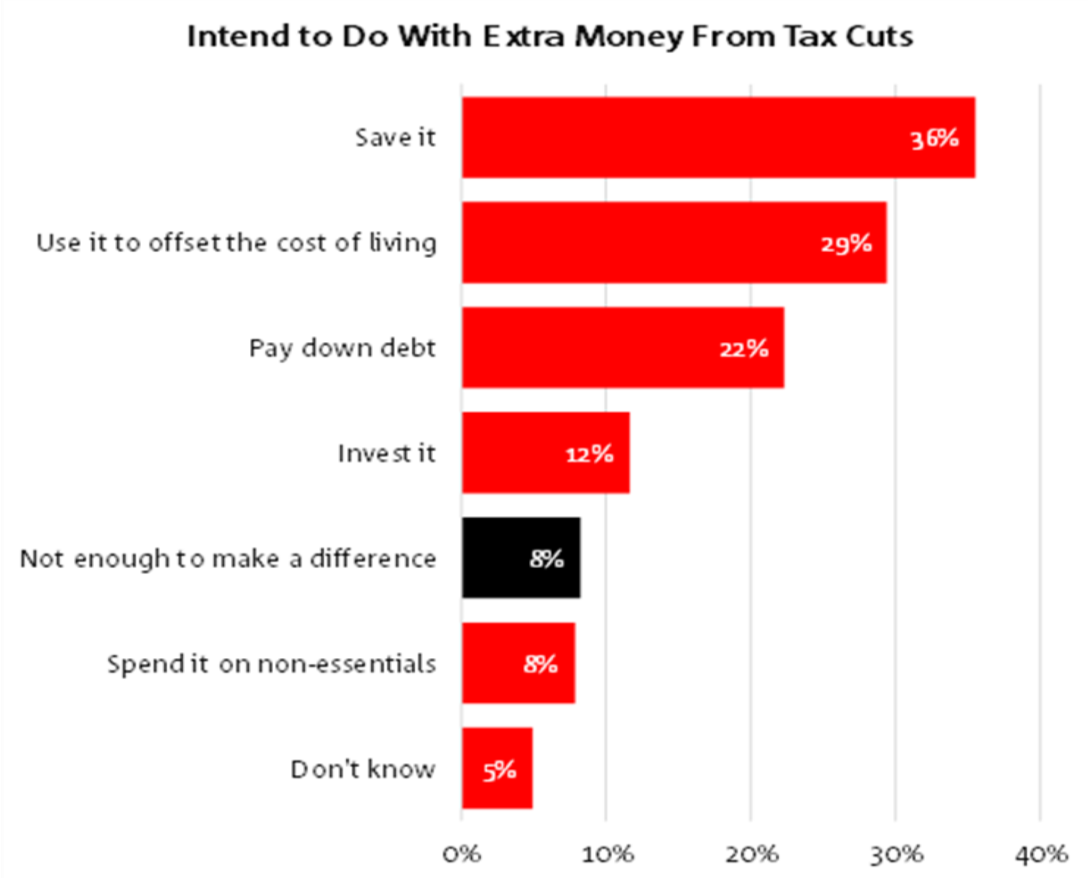
For 2023 was up 10.2% (led by Sydney) and we expect Australian prices up around 6% in 2024 and a touch slower (3.7%) in 2025



Consumers also tell us that they are still adjusting their spending plans

May be past the worst. But less than 50% of tax cuts are planned to be spent

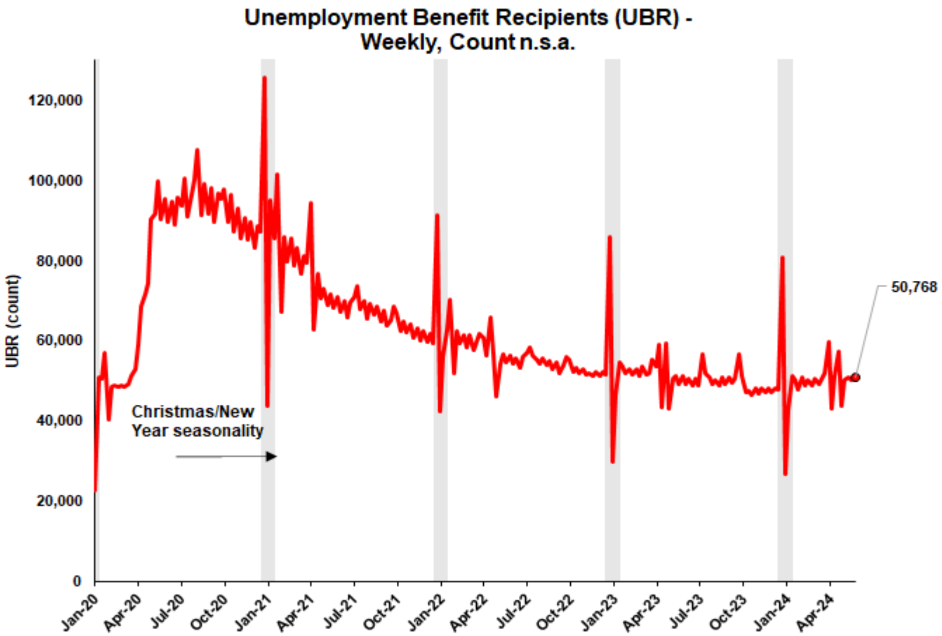


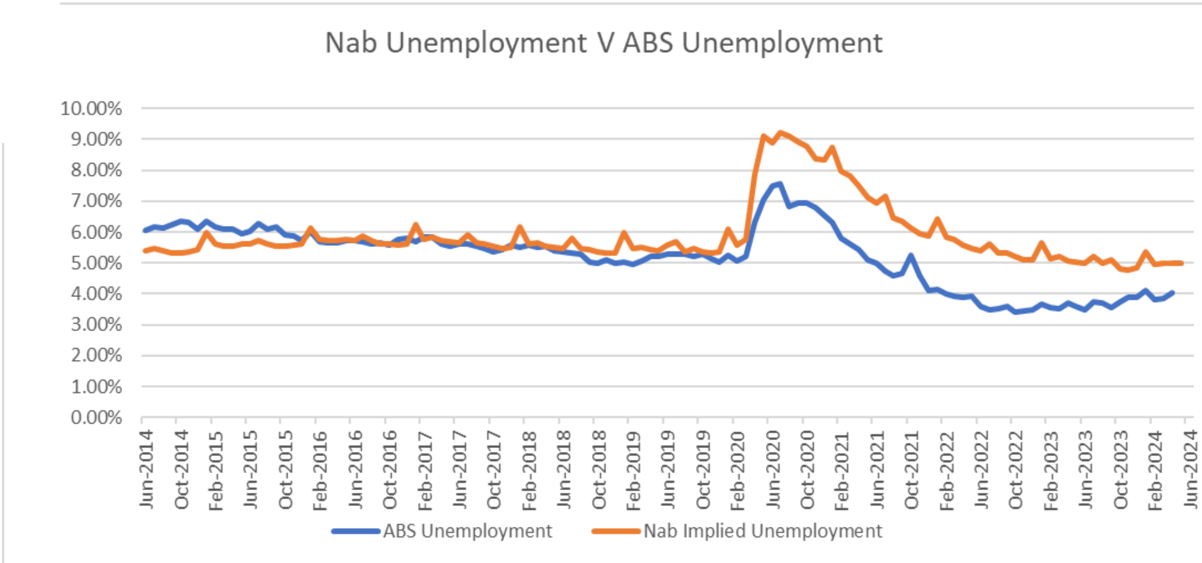


NAB data on the Claimant Count

(NAB customers receiving JobSeeker). Data has been volatile. Trend really going sideways recently but weaker from mid 2023. Implies a more stable labour market than recent ABS numbers suggest. Trend unemployment at 4% a better read

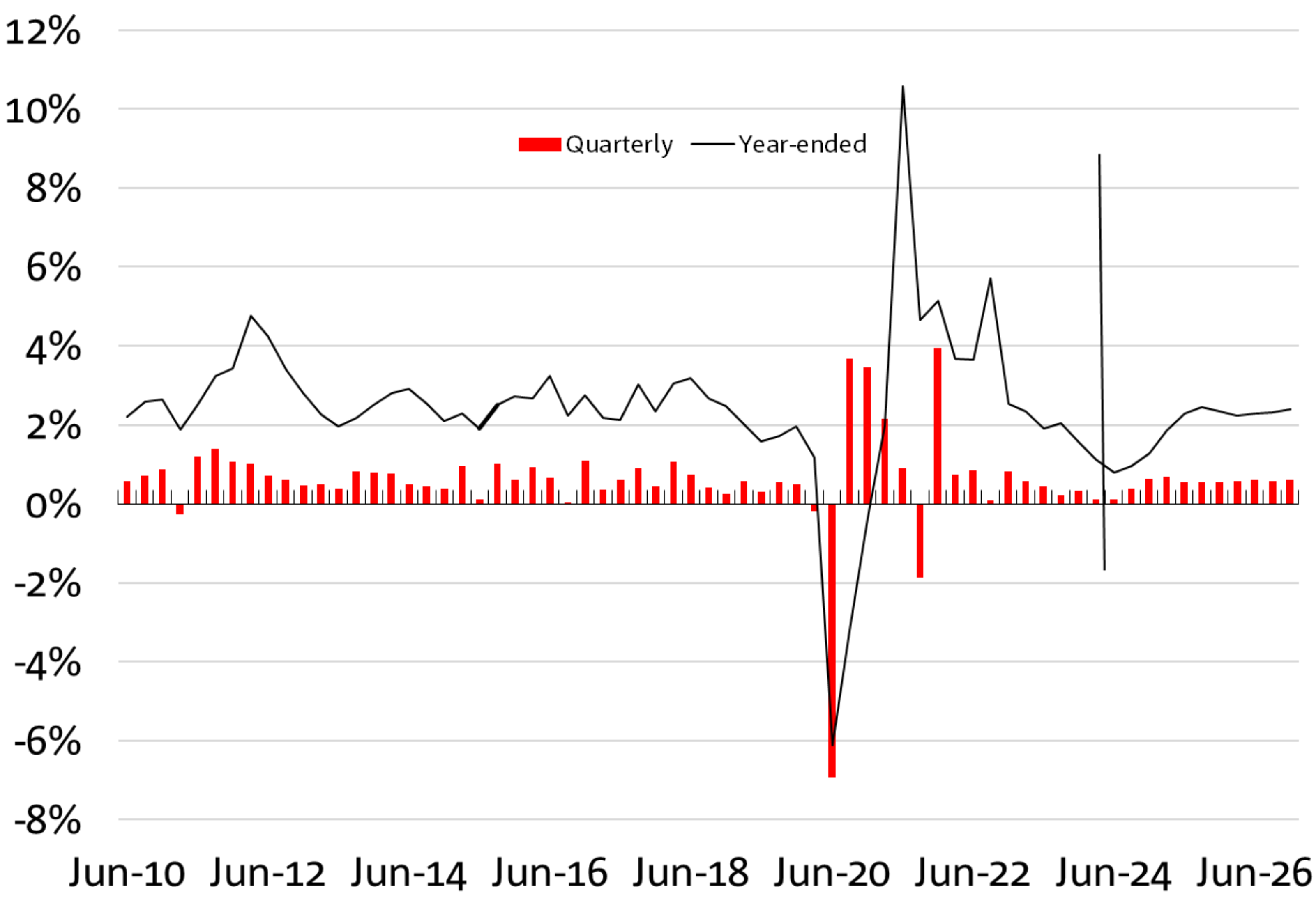
NAB data (LHS) and implied economy wide movements (RHS)





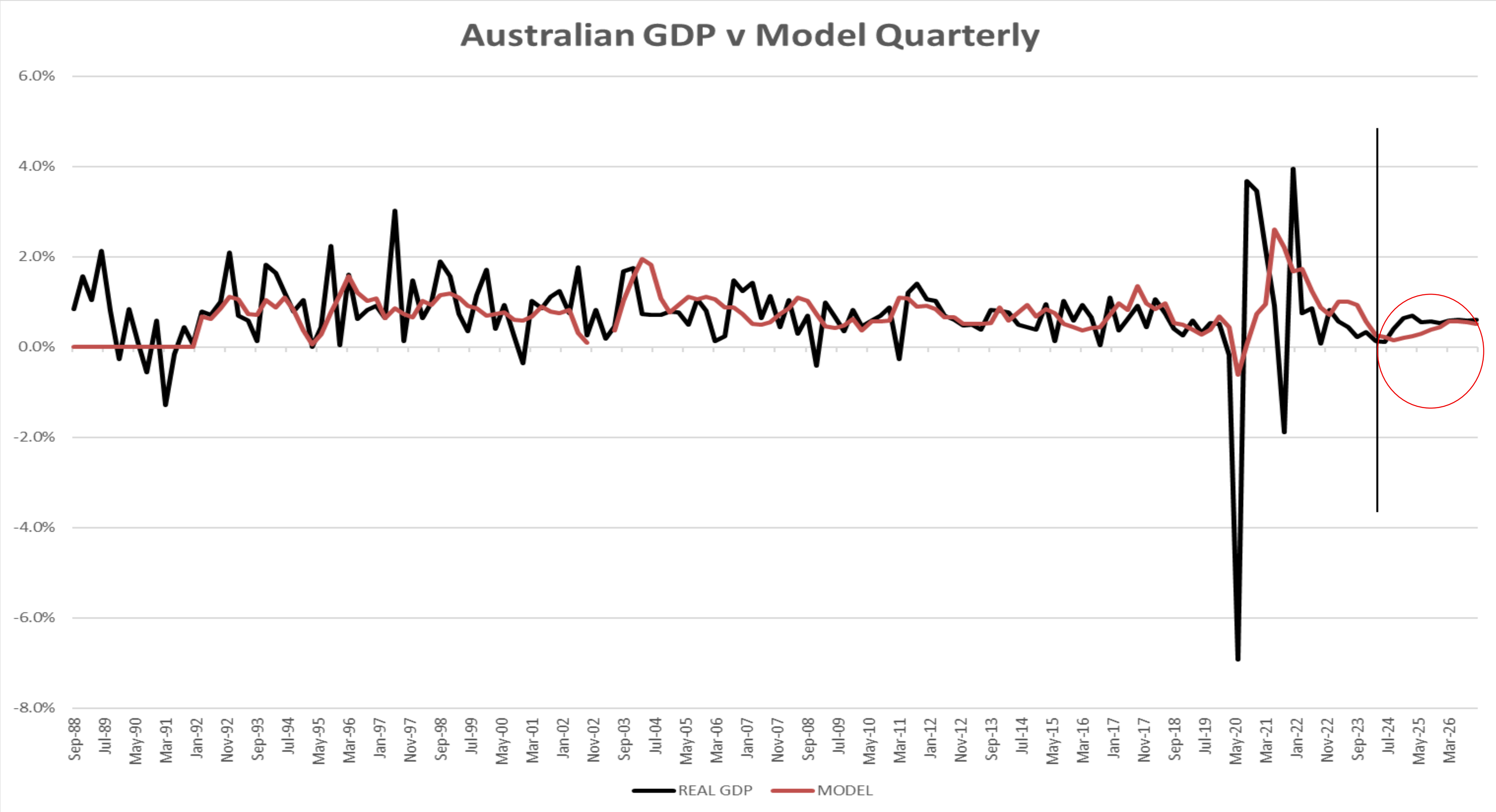
Our growth expectations

Economy very flat in late 2023/early 2024. Better in second half of 2024. Not a recession but no room for error. Around 1.3% through 2024. Currently up only 1.1% till Q1 2024. For 2025 (and beyond) we are back to trend at around 2.2%



NAB Model

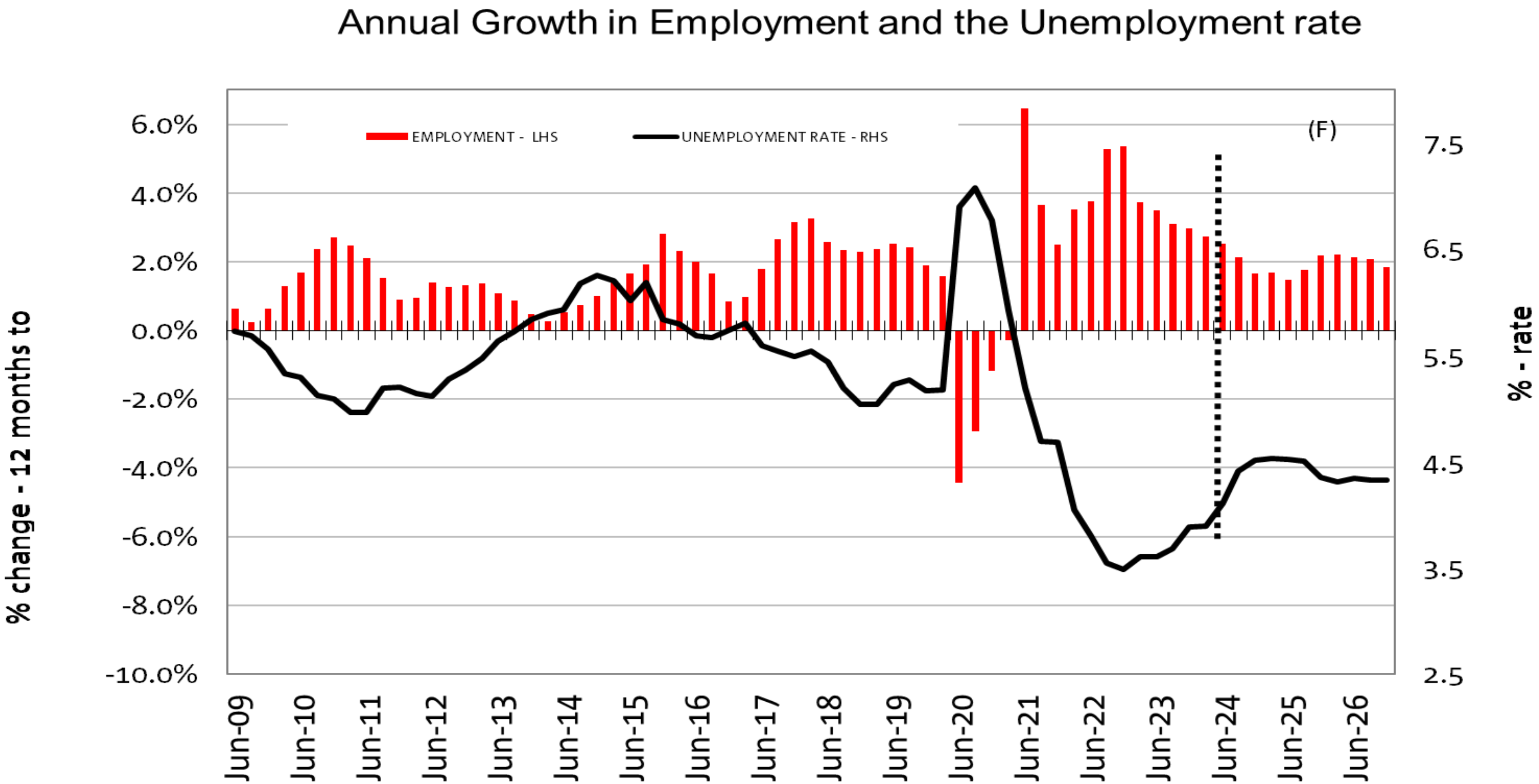
Obviously, model couldn't cope with COVID. Very similar to our forecasts but the consumers response is a big issue. As is investment. However, model not sure that activity will kick later this year and might go lower in Q2 2024



Labour market weakening a touch but still good

Unemployment now around 4% - up from 3.5% in mid 2023. We expect employment growth to continue but not enough to stabilise unemployment. Up to around 4½% by year end.

Then to edge lower in 2025 and 2026



On RBA

- RBA has focussed a lot on inflation but as the economy slows and unemployment rises the weights are changing.

- **But services inflation still high and sticky. Q1 was a surprise on the upside but only just** – we had 0.9% ABS published 1.0%.

- **We see the RBA staying at 4.35% through most of 2024. And rate cuts starting from late 2024. But possible it will be delayed to early 2025 depending on the data flow.**

- Basically, we are in the camp of higher for longer. We see cuts of around one per quarter meaning that the RBA will not be back to neutral (around 3%) till late 2025.

- **Markets now have no cuts in 2024 and only 1½ cuts (-40 points) in 2025. Given inflation and unemployment prospects that would see real rates rise in 2025.**

- RBA unlikely to follow that path.

- Medium term outlook much better but tough times (well below trend growth) inevitable in the next 12 months.