The Forward View Australia: May 2025

A tariff reprieve, but a weaker starting point

NAB Economics

Overview

- The economy continues to track broadly as expected and though downside risks have emerged, we still see the economy on track for a soft landing.
- We have lowered our expectation for GDP growth this year to 1.8% yoy but left our inflation and labour market tracks unchanged.
- The RBA will need to continue to lower rates in the near term to ensure that the labour market remains healthy.

There has been a steady stream of domestic and global data in May. Our expectations of the risks around the global backdrop have eased somewhat over the past month with a de-escalation of tensions between the US and China. For Australia, the impact on confidence has been fairly muted to date.

Domestically, the recent run of data suggests that inflation has continued to gradually moderate and that the labour market has remained resilient. However, activity indicators point to the risk that growth may not be rebounding as quickly as expected. Consumption partials for Q1 suggest that the consumer lost momentum after a pickup in growth in Q4. The read across our business surveys also suggests that the outlook for investment growth remains soft, and while the labour market components have been relatively better, there is a risk that softer profitability and trading conditions flows through to the labour market.

The RBA lowered the cash rate by 25bp this week and published revised forecasts. Both the statement and the press conference have developed in a more dovish direction and acknowledged that the balance of risks have shifted to the downside. Their forecasts for the economy continue to converge towards our own, and we continue to see the need for the RBA to return the cash rate to a neutral stance over coming months but have lifted our terminal rate expectation to 3.1% (from 2.6%) in recognition of a more modest offshore headwind.

We continue to expect below trend growth this year (but ongoing recovery next year); the unemployment rate to drift higher, peaking at around 4.4% in late 2025; and underlying inflation to settle around the middle of the target band from mid-2025.

While global trade tensions have eased to a degree over recent weeks the risk of a re-escalation remains and high levels of global uncertainty will likely persist for some time. For now, confidence measures have not deteriorated significantly, while financial markets and commodity prices have rebounded, we see these "amplifications" as the biggest risk to our forecasts for this year.

Contents

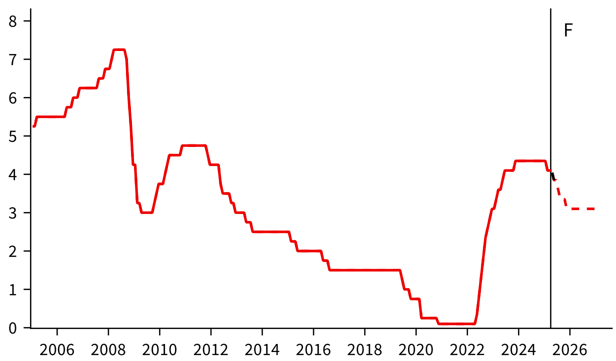
Key Economic Forecasts

	2023	2024	2025(f)	2026(f)
Domestic Demand (a)	2.9	1.9	2.0	2.3
Real GDP (annual ave)	**2.1**	**1.0**	**1.7**	**2.1**
Real GDP (year-ended)	**1.5**	**1.3**	**1.8**	**2.2**
Employment (a)	3.4	2.4	2.5	1.6
Unemployment Rate (b)	3.9	4.0	4.4	4.3
Headline CPI (b)	4.1	2.4	2.8	2.8
Trimmed-mean CPI (b)	4.2	3.3	2.5	2.5
RBA Cash Rate (b)	4.35	4.35	3.10	3.10
$A/US cents (b)	0.68	0.62	0.70	0.73

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

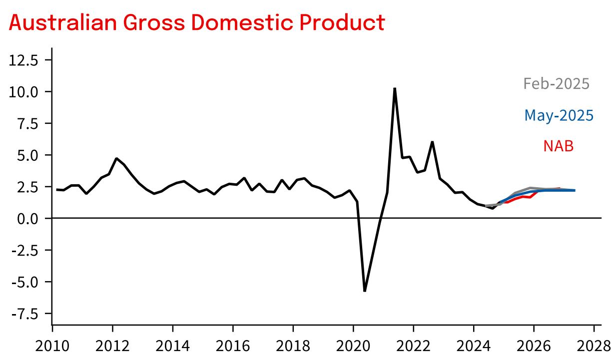
0

Chart 1: RBA Cash rate forecast



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

Chart 2: GDP forecasts



Source: National Australia Bank, ABS, RBA

23 May 2025 | Authors: Michelle Shi, Gareth Spence

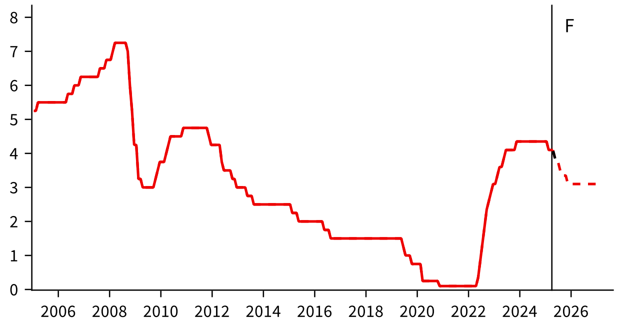
Monetary Policy

We expect the RBA to continue lowering rates over H2 2025, taking the terminal cash rate to 3.1% by November.

While the RBA cut by less than we expected at the May meeting, their forecasts for the economy continue to converge towards ours. The tone of the post-meeting statement and the Governor's press conference was more dovish and forecasts for inflation are now "around target" as opposed to "a little above target" in the February SoMP. Notably, the RBA was more explicit in its assessment that the global shock to trade would be disinflationary for Australia.

We now see the RBA cutting by a further 25bps at the July, August and November meetings, taking the cash rate back to a broadly neutral stance of 3.1%. However, we no longer expect policy to move to an accommodative stance and have revised up our terminal cash rate expectation to 3.1% (was 2.6%). That said, should the global backdrop deteriorate further, the RBA could well act to provide further support by taking the cash rate to an accommodative stance.

RBA Cash Rate Target (%)



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

We have long held the view that the RBA would need to ease towards neutral as inflation moderated to ensure the gains in the labour market over recent years were maintained. Six months ago, inflation was expected to moderate, the unemployment rate was expected to edge only slightly higher and growth in 2025 was expected to rise to around trend. Without the added headwinds from global growth, a series of cuts was appropriate but expected to be only gradual.

Even though inflation and labour market outcomes have broadly come in as expected, the risks have since shifted to the downside. The global backdrop has deteriorated which will indirectly weigh on domestic conditions, as will weaker than expected growth in 2025 so far. As a result, we believe that the RBA will need to normalise rates more quickly over H2 2025. We see this in the context of an economy broadly in balance allowing the RBA the scope to respond pre-emptively to the outlook for growth and the labour market.

The RBA's key forecasts moved further towards our own in May. The SoMP forecasts saw a 0.3ppt downward revision to growth over 2025 to 2.1% (NAB: 1.8%) - largely from downward revisions to household consumption and business investment. Our expectations for growth are aligned in 2026. Labour market forecasts saw a 0.1ppts upward revision to the peak unemployment rate in H2 2025 (NAB: 4.4%). Underlying inflation was revised down a tenth to 2.6% yoy (NAB: 2.5%) through the forecast period.

However, the RBA continues to assess the labour market as tight and that aggregate demand continued to exceed supply capacity. That said, the SoMP continues to highlight the uncertainty of measuring excess capacity in real time and highlights misjudgement of operating capacity as a key risk to their forecasts. A downside surprise to the RBA's growth forecasts in H1 2025 (which we think is likely) would see the gap close further.

The most obvious risk to the downside for our rate track remains the global backdrop and its (uncertain) transmission to the local economy. Larger fallout could see the need for the RBA to take policy into stimulatory territory, taking the cash rate below 3% for a period before eventually normalising rates.

To the upside is a more cautious RBA. To date, the RBA has only gradually reassessed the degree of spare capacity in the economy with real time assessment of both potential output and the NAIRU highly uncertain. This means that unless pushed the RBA could take a more gradual path towards neutral while watching the inflation data over time.

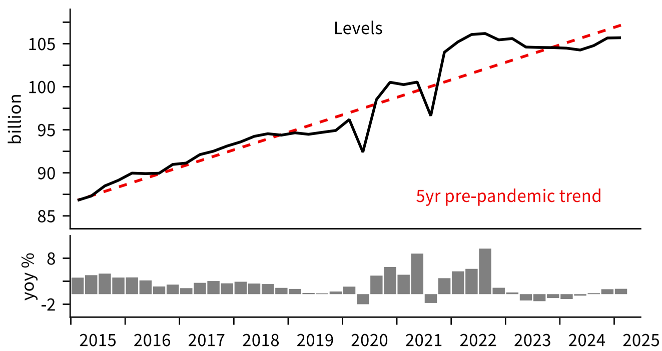
The bigger picture, with underlying inflation now back within the target band and an assessment that the risks around inflation have become more balanced (and the board likely gaining further confidence inflation will settle around 2.5%) the RBA can afford a greater focus on the employment component of the mandate. Indeed, the final sentence of the post meeting statement now includes the full aims of the RBA "*The Board is focused on its mandate to deliver price stability and full employment and will do what it considers necessary to achieve that outcome*.".

Consumption

Consumption has been weaker than expected in 2025 and will weigh on overall growth.

Partial spending indicators have been broadly flat over Q1, with Q1 household consumption growth now likely weaker than earlier expected. Weaker growth has been more obvious in categories with heavy Q4 discounting (like household goods, which reflected a 'pull-forward' of some spending to make the most of sales) but growth in other discretionary spending categories like eating out has also eased.

Retail volumes



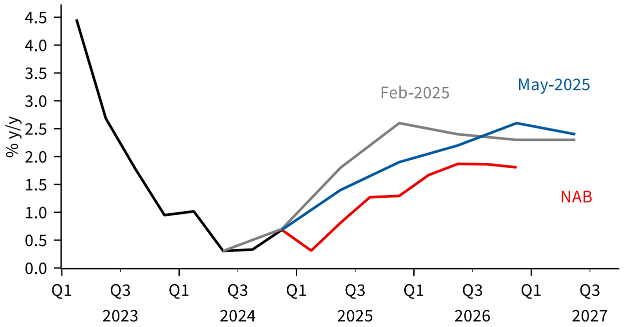
Source: National Australia Bank, Australian Bureau of Statistics, Macrobond

Ex-Tropical Cyclone Alfred did impact spending in Queensland, where stockpiling in some categories like food was not enough to offset less spending in other categories like eating out in March. Some recovery in spending is likely to take place in Queensland in coming months: NAB spending data for Queensland recorded a 1.7% mom increase in April, after falling 0.2% in March.

Even without the Queensland impact, this is a much weaker outlook on consumer spending compared to earlier in the year. Consumers have remained cautious and price sensitive, with the W-MI Consumer Sentiment Index still in firmly pessimistic territory, even as household disposable income growth improves. Continuing consumer caution is likely to see the household savings rate creep higher through 2025.

We now expect consumption growth of 0.2% in Q1 (compared to 0.4% previously) and 1.8% yoy for 2025. This is weaker than the revised RBA forecast and is a key driver of our softer overall growth forecast for 2025. As a result, easing monetary policy will be important to support households and broader economic activity.

Real household consumption forecasts



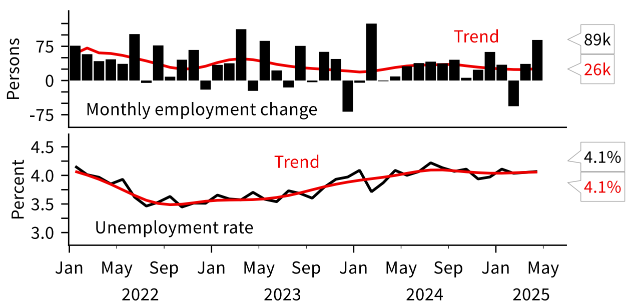
Source: National Australia Bank, Australian Bureau of Statistics, Macrobond

Labour market

Unemployment rate holds at 4.1% despite surprise 89K employment increase in April.

The 89K (0.6% mom) increase in employment was notably higher than consensus expectations of around 23K, but came after a large fall in February and was matched by a rebound in the employment-to-population ratio to 64.4%. Despite volatility in monthly employment, the unemployment rate remains stable and was unchanged in April at 4.1%. The participation remains high at 67.1%.

Labour market indicators

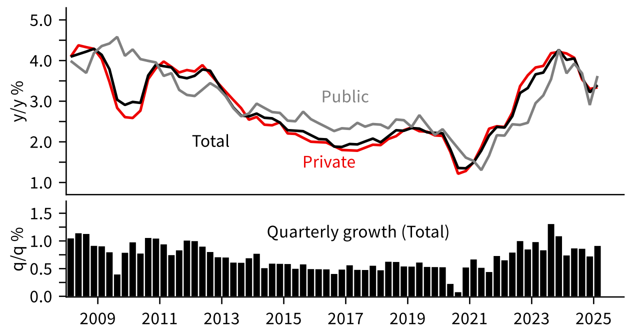


Source: National Australia Bank, Australian Bureau of Statistics, Macrobond

Wages growth was 0.9% qoq in Q1 2025, which was slightly stronger than consensus expectations but in line with RBA forecasts. This was boosted by administered wage increases, especially from the Stage 3 Aged Care Work Value Case, and the Early Childhood Education and Care Worker Retention Payment.

Private and public sector wage growth was similar in quarterly terms, at 0.9% and 1.0% respectively. New enterprise agreements in larger states were a key driver of public sector wage outcomes: 39% of public sector jobs saw a pay increase, the highest since Q3 2018 and more than double the share that saw a wage change in the comparable period a year ago.

Wages growth

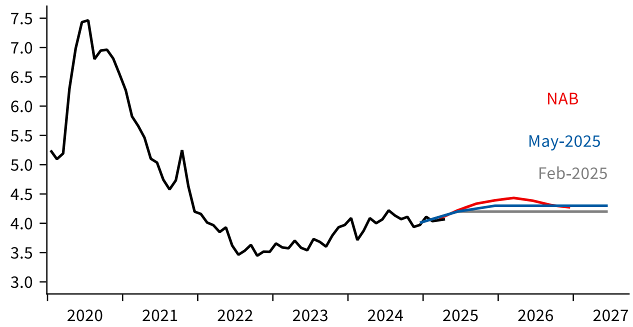


Source: National Australia Bank, Australian Bureau of Statistics, Macrobond

The slightly stronger quarterly read on wages growth does not change our view on the labour market. We continue to assess that the labour market is close to balance and do not view an unemployment rate in the low 4s as a barrier to sustaining inflation near target. The RBA appears increasingly open to this view, and they have continued to flag that *'the assessment of full employment is uncertain'.*

Forward indicators have remained largely stable, though recruitment difficulty measures (NAB, JSA) have eased. We expect that the unemployment rate will pick up to a still healthy peak of 4.4% in the second half of 2025, before settling at about 4.3% in 2026.

RBA Unemployment Rate Forecasts



Source: National Australia Bank, RBA

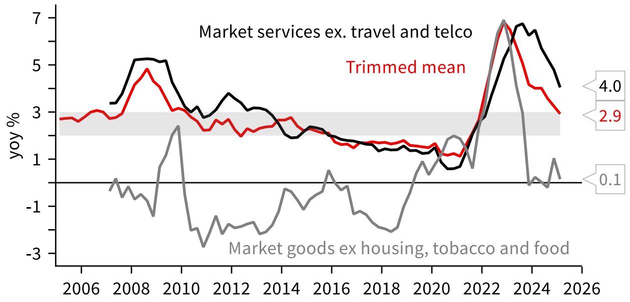
Inflation

RBA shows more comfort around the inflation outlook as annual trimmed mean inflation gets back to target band.

Trimmed mean inflation for Q1 was 0.7% qoq, in line with RBA forecasts. There is ongoing disinflation across a range of key components, including market services and housing.

The disinflation in market services has been broad-based (including for insurance which has faced elevated prices), with quarterly price growth now no longer elevated relative to history. New dwelling prices declined over the quarter (-0.4%) amidst weaker demand and promotional offers to attract customers. Rents inflation eased, consistent with slower growth in advertised rents.

Trimmed mean inflation

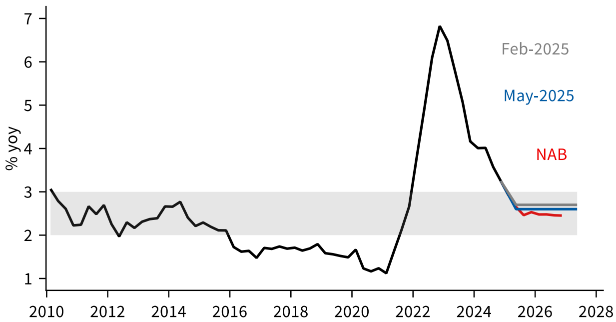


Source: National Australia Bank, Macrobond

Market goods prices outside of food, tobacco and new dwellings remain benign at 0.0% qoq and 0.1% yoy. Looking forward, we expect only modest net price impacts from global tariff developments in Australia, but we continue to assess the shock to be net disinflationary for Australia. The RBA has come around to the same assessment, given China accounts for a large share of our imports with import prices likely to be lower due to trade diversion. However, uncertainty remains around the volume of trade diverted and the extent this flows through to Australian prices, especially given some global supply chain disruptions are possible.

The RBA have slightly revised down their forecasts for trimmed mean inflation to settle at 2.6% yoy over the forecast period (from 2.7%) which is now characterised as 'around the mid-point' of the target band. This is now closer to our own forecasts, which sees trimmed mean inflation settle at about 2.5%. The RBA's increasing comfort with the inflation outlook, alongside other forecast changes, opens the door to further easing.

Trimmed Mean Inflation Forecasts



Source: National Australia Bank, ABS, RBA

Housing

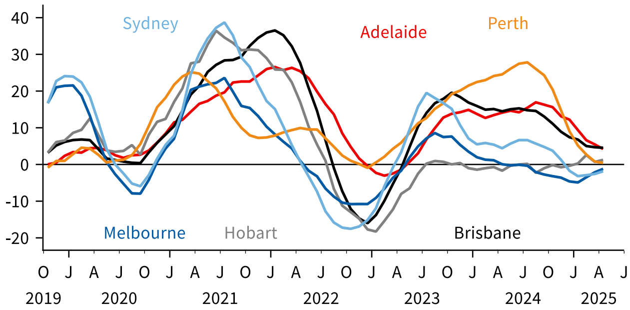
House prices continue to rise but at a more modest pace than over recent years.

The Cotality (CoreLogic) 8-Capital City dwelling price index rose by 0.3% in April, marking a 0.5% rise over the past three months after falling slightly over the prior three.

Prices in Sydney and Melbourne have each risen over the last three months after Sydney prices fell in late 2024/early 2025 and Melbourne prices had declined persistently for a year or so. Brisbane, Adelaide and Perth have continued to rise, though at a more modest pace over recent months after very rapid growth over recent years.

Rents growth appears to have stabilised at around 0.2-0.4% mom after small falls in late 2024. In annual terms rents growth has slowed sharply from around 8-10%, to around 4%. While rents growth has slowed, vacancy rates remain historically low across the capital cities. The vacancy rate is lowest in SA, WA and Victoria.

CoreLogic Hedonic Dwelling Price Growth by Capital City (6-month-ended Annualised,%)



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

Dwelling approvals declined by 8.8% mom in March, partly due to the impact of ex-cyclone Alfred (with falls in Qld and NSW). However, for the quarter approvals were up 3.8% qoq and they are up around 20% yoy. The pipeline of work has been gradually declining (from an elevated level) since late 2022, but with approvals now running above completions the pipeline may stabilise from here. However, we do not expect to see much upwards momentum in residential investment: completions have largely tracked sideways for several years, held back by industry supply constraints.

Completions over 2024 were below the level required to match population growth (even with the latter slowing) and are also insufficient to meet the Housing Accord target.

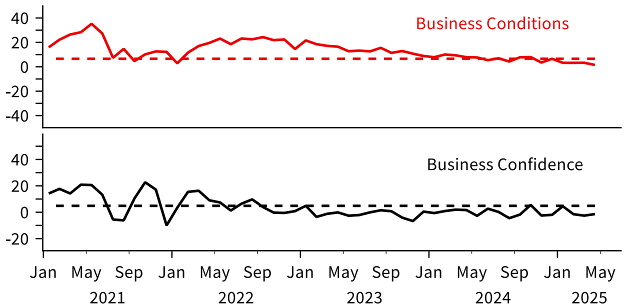
Businesses, trade and FX

Business conditions and confidence steady but below average in April after tariff chaos settled.

Business confidence in the NAB survey improved in April. Conditions eased slightly, but movement in the two headline measures were mild. The impact of global and tariff uncertainty has not shown up in confidence as we initially expected, though this is likely attributable to timing. The survey was fielded in the last week of April, about three weeks after the initial Liberation Day driven market volatility.

Despite passing the trough in growth late last year and the improved inflation outlook, business conditions and confidence remain largely below average in 2025 across both the monthly and quarterly NAB survey. These below average readings likely reflect still soft demand, weak profitability and pressure on margins.

Conditions and confidence (monthly)

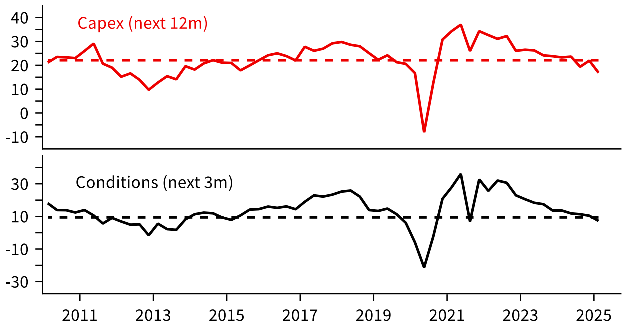


Source: National Australia Bank, Macrobond
Note: Dashed line shows long-run average

On other measures, there was a notable decline in capex, a decline in profitability and softer forward orders in the April survey. The sharp rise in capacity utilisation seen in March was also reversed, which takes capacity utilisation back to its long run average for the first time since mid-2021. These indicators will remain in focus as we monitor how businesses adjust to global uncertainty in coming months.

Leading indicators in the quarterly survey like expected business conditions over the next 3 months and capex plans over the next 12 months have also largely eased. ABS capex expectations will be released next week and provide more data on expected business investment. Overall, we expect subdued sentiment and global uncertainty to weigh on business investment in 2025.

Leading indicators (quarterly)



Source: National Australia Bank, Macrobond

Uncertainty remains high despite tariff de-escalation between US-China.

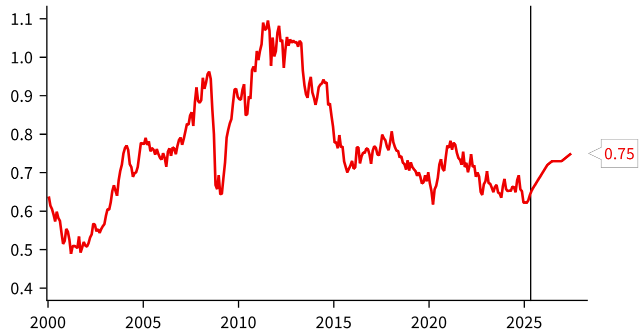
The key development in global trade in May was the significant de-escalation in the trade war between US-China. Both sides agreed to reduce the cumulative additional tariffs this year – to 30% for the United States and to 10% for China – although some of the tariff reduction is only paused for 90 days and pre-Liberation Day tariffs remain in place.

As a result of the de-escalation, we have revised up our forecasts for global growth in 2025 and 2026 from post Liberation Day estimates. However, we still expect growth to take a step down from its 2024 pace, to a low rate by historical standards given bilateral US-China tariffs remain elevated and uncertainty is high. Delayed investments are expected by businesses with further volatility likely as we approach the end of the 90-day pause.

The SoMP includes scenarios of a *much* more material increase in tariff barriers on the downside, and a reversal of US import tariffs to 2024 levels and a quick and sharp decline in uncertainty on the upside. In the latter, inflation remains above 2.5% through the forecast horizon, while in the former, it slows to around 2% by December 2026. The assumptions underlying these scenarios embed a very large escalation/reversal in trade policy and highlight the significant global uncertainty at play.

The initial AUD/USD volatility seen in the first half of April has since given way in May, with more subdued trading. We updated our AUD/USD forecasts in early May by lifting the AUD/USD profile (reflecting a weaker USD) which is expected to hit 0.70 by year end 2025 (previously 0.67) and 0.73 in 2026.

NAB Forecasts, AUD/USD



Source: National Australia Bank, Account in-house

Key Forecasts Tables

Australia forecasts table

	% Growth q/q			% Growth y/y		
	Q4-24	Q1-25 (f)	Q2-25 (f)	2024	2025 (f)	2026 (f)
GDP and Components						
Private Consumption	0.4	0.2	0.3	0.7	1.4	1.8
Dwelling Investment	-0.4	0.8	0.4	2.5	2.1	2.1
Underlying Business Investment	-1.3	-0.3	-0.4	-3.4	-0.9	1.0
Underlying Public Final Demand	0.9	1.0	0.7	5.7	3.1	2.4
Domestic Demand	**0.5**	**0.4**	**0.5**	**2.1**	**1.9**	**2.3**
Stocks (Cont. to GDP)	0.3	-0.1	0.0	0.1	-0.2	0.0
Gross National Expenditure	**0.6**	**0.3**	**0.5**	**2.3**	**1.9**	**2.3**
Exports	0.7	-0.1	0.4	1.7	1.0	1.5
Imports	0.1	0.2	0.4	5.8	1.7	2.1
Net Export (Cont. to GDP)	0.2	-0.1	0.0	-0.9	-0.1	-0.1
Real GDP	**0.6**	**0.3**	**0.5**	**1.3**	**1.8**	**2.2**
Nominal GDP	1.6	0.1	0.7	3.7	3.0	4.5
Labour Market						
Employment	0.6	0.8	0.5	2.4	2.0	1.7
Unemployment Rate (Q-Ave, End of Period)	4.0	4.1	4.2	4.0	4.4	4.3
Wage Price Index (WPI)	0.7	0.9	0.9	3.2	3.4	3.2
Inflation and Rates						
Headline CPI	0.2	0.9	0.6	2.4	2.8	2.8
Trimmed-mean CPI	0.5	0.7	0.6	3.3	2.5	2.5
RBA Cash Rate (End of Period)	4.35	4.10	3.85	4.35	3.10	3.10
$A/US cents (End of Period)	0.62	0.63	0.65	0.62	0.70	0.73

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

Group Economics

Sally Auld
Group Chief Economist
+(61 0) 422 224 752

Jacqui Brand
Executive Assistant
+(61 0) 477 716 540

Dean Pearson
Head of Behavioural & Industry Economics
+(61 0) 457 517 342

Australian Economics

Gareth Spence
Head of Australian Economics
+(61 0) 422 081 046

Michelle Shi
Senior Economist
+(61 0) 426 858 831

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 0) 477 723 769

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 0) 455 052 520

Thao Nguyen
Economist – Data & Analytics
+(61 0) 451 203 008

International Economics

Tony Kelly
Senior Economist
+(61 0) 477 746 237

Gerard Burg
Senior Economist – International
+(61 0) 477 723 768

Global Markets Research

Skye Masters
Head of Research
Corporate & Institutional Banking
+(61 2) 9295 1196