



FIRST 25BP INCREASE NOW EXPECTED MID-2019

NAB Group Economics

- We have delayed the timing of when we expect the RBA to start a gradual rate hiking cycle.
- The change reflects the fact there is no sign yet of stronger wages growth and unemployment has been stuck around 5.5% for the best part of a year.
- While still very data dependent we now have the start of the rate hiking cycle in mid-2019
- We still expect the economy to strengthen, leading to a declining unemployment rate. This should eventually translate into stronger wages growth and give the RBA confidence that inflation will track back to its 2.5% target. However, we acknowledge there is considerable uncertainty around the timing at which wages growth will strengthen, and the time of the RBA's next move will remain highly data dependent.

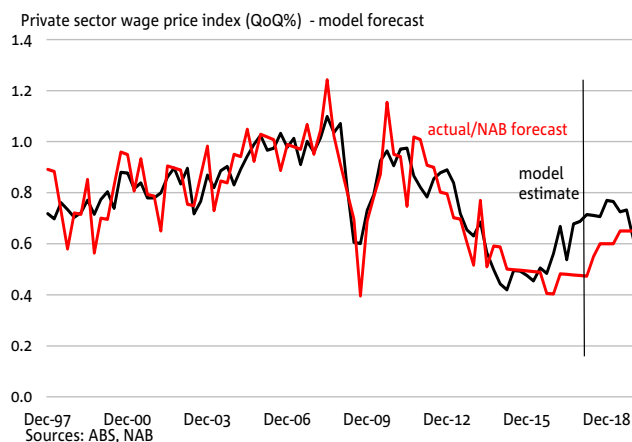
For some time NAB has been forecasting that if the economy were to improve as expected, then the RBA would at some point feel confident enough with the economic outlook to start the process of raising the cash rate from its current low level of 1½%. In particular, our view has been that economic growth will strengthen over the coming year and that, with the pace of jobs growth already solid, this would lead to a declining unemployment rate and as a result upwards pressure on wages growth and inflation.

We still consider that this is the most likely trajectory for the economy and RBA policy. However, this week's data on wages and the labour market indicate that November 2018, our previous forecast for the first rate rise, is too early and we now expect the RBA to be on hold through the rest of this year.

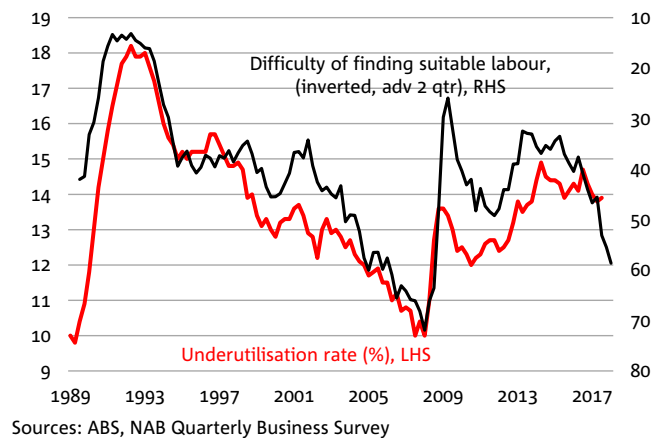
The unemployment rate ticked up 0.1ppt in April to 5.6%, and while the monthly data can bounce around, it adds to the evidence that progress in reducing the unemployment rate has stalled. The ABS measure of the trend unemployment rate has been at 5.5% since August last year; while jobs growth has been solid over this period, this has been offset by further increases in workforce participation. On the wages front, the Wage Price Index (WPI) for the March quarter 2018 was unchanged at 2.1% y/y, with private sector wages growth also unchanged at a slightly weaker 1.9% y/y and showing no signs of accelerating.

The RBA's view on the outlook for the Australian economy is similar to NAB's, in that it expects growth to strengthen, and for unemployment to decline leading to a pick-up in wages. The Bank continues to expect progress on unemployment, wages and inflation to be only gradual and has made clear that there is not a strong case for a near-term change in the cash rate. This week's wage and unemployment data clearly will have done nothing to change this view. Quite reasonably, the RBA does not see 2% wages growth as consistent with 2.5% inflation over time and wants to see some pick-up in wages before lifting rates.

Private Sector Wage Price Index (QoQ%)



Labour underutilisation and constraints



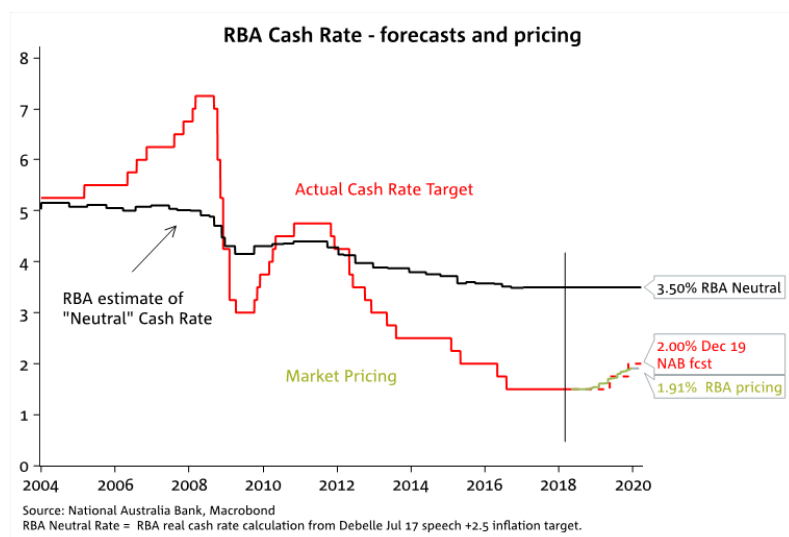
We still believe that conditions are in place for wages growth to rise in the future. Our modelling of factors that affect wages – inflation, labour market underutilisation, productivity and the terms of trade - suggest that we would already have expected to see stronger wages growth. Clearly this has not happened and may reflect the need for the unemployment rate to get closer to its long-term 'neutral' rate of 5% or lower, before

Contacts: Alan Oster – Chief Economist

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sufficient wage pressures emerge. This has been the experience of other countries in recent years. With the unemployment rate stuck around 5.5% recently, we now don't expect the unemployment rate to get close to the 5% mark until mid-2019. That said, businesses continue to indicate – through our Quarterly Business Survey – that they are finding it increasingly difficult to find suitable labour; historically this has been associated with a decline in the unemployment rate, as well as the underutilisation rate and, ultimately, wages growth.

As a result our forecasts for WPI growth are more conservative than the model projections but we still expect to see some acceleration in wages growth. We are projecting that by mid-2019 WPI growth will reach the 2½% y/y mark. At that time, with unemployment close to its full-employment level, growth above trend and wages growth gradually accelerating, we expect the RBA would have sufficient confidence that inflation will move back towards target and so start to gradually lift the cash rate off its current very low level. We expect once the tightening cycle starts, further rate increases will be very gradual. We are now expecting the first move to be in mid (May) 2019, with the next move after that not until late in the year (November 2019).



However we acknowledge that there is considerable uncertainty around the timing of the RBA's next move. The divergence of wages growth from what is suggested by the models makes this uncertainty greater than usual. The RBA will remain heavily data dependent and will want to see sustained signs of a pick-up in wages growth before moving, even if the rest of the economy moves in line with expectations.

AUTHORS

- Alan Oster, Group Chief Economist
- Peter Jolly, Global Head of Research
- Ivan Colhoun, Chief Economist, Markets
- Tony Kelly, Senior Economist

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Dean Pearson
Head of Economics
+(61 3) 8634 2331

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities

Tony Kelly
Senior Economist –
+(61 3) 9208 5049

Phin Ziebell
Economist – Australia
+61 (0) 475 940 662

Behavioural & Industry Economics

Robert De lure
Senior Economist – Behavioural
& Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural
& Industry Economics
+(61 3) 8634 3837

Steven Wu
Senior Analyst – Behavioural &
Industry Economics
+(61 3) 9208 2929

International Economics

Gerard Burg
Senior Economist – International
+(61 3) 8634 2788

John Sharma
Economist – International
+(61 3) 8634 4514

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

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