NAB MONETARY POLICY UPDATE 14 JULY 2021

RE-AFFIRMING OUR RATE VIEW AND AN UPDATE ON THE OUTLOOK FOR QE

NAB Economics

Bottom line: NAB has affirmed its view of the RBA holding rates until 2024 and we have also updated our view on QE. While we see the risk of an earlier late-2023 rate hike, we do not see a large risk of a hike as early as 2022 as the market is currently pricing. We expect cash rate "lift-off" to occur in early 2024 and for QE to continue to be tapered gradually, ending in mid-to-late 2022. We see the risks around this view as balanced. We expect the first hike will be an increase in the target cash rate by 40bps, taking it to 0.50%, with a rapid normalisation over the next 2 years leading to the overnight cash rate trading between 1.75-2.0% in 2025. Key to the lift in rates will be when inflation has 'sustainably' returned to target. The RBA notes that it will take 'several' quarters of inflation above 2% to be judged as sustainable and that this will likely require wages growth to be sustainably above 3%.

NAB's monetary policy call has long been that the RBA would first hike rates in 2024 and that well before then QE would be tapered given the improvement seen in the economy and labour market to date. The recent RBA Board meeting has led us to re-confirm this view despite markets pricing in a rate hike as early as 2022. The RBA clearly remains committed to trying to achieve maximum employment in order to ensure actual inflation is sustainably at target after a prolonged period of inflation being below target. The judgement around 'sustainability' also confirms the RBA will be backward looking, waiting until actual inflation is sustainably at target. Importantly, Governor Lowe noted it will take 'several quarters' of inflation being above 2% and wages growth being (most likely) sustained at 3% plus in order to judge inflation is sustainably at target.

The RBA remaining backward looking is why we see the risks around our view as balanced. A forward looking, inflation targeting, RBA could traditionally be expected to respond in late 2023 on our latest forecasts as published in today's Forward View. Our updated forecasts see GDP in 2021 around 5%. That in turn is consistent with unemployment of around 4.8%. More importantly by end 2023 we have growth of around 2.2% with the unemployment rate at 4.2%. As noted in our wages note yesterday we see near term temporary upward pressures in wages but, importantly, this is not a sustained kick up in wages – rather in the near term the key driver is the rate of improvement in the labour market and the closure of international borders.

The RBA has instead laid out a view that it will wait until actual inflation is clearly in the target range of around 2-3% with wages growth above 3%. While the closure of international borders is likely to lift near-term wages, it is unlikely to be sustained given international borders are expected to be gradually re-opened from mid-2022. As a result, we see the fundamental pick up in wages as a mid to late 2023 issue – with wages growth accelerating to around 3% by late 2023. At that time, we also see core inflation approaching 2.2%. That is, the conditions that are likely to satisfy the RBA's criteria will be emerging by late 2023. Our core views are:

- First rate hike to occur in early 2024. We see the first move as lifting the cash rate target by 40bps to 0.50%; this is to allow normalisation of the ES rate corridor and would see the actual cash rate trade closer to 25bp (i.e. it would effectively be a 25bp rate hike). Following this, we see increases of around 25 points per quarter – a fairly rapid normalisation as the RBA again becomes forward looking. By mid-to-late 2025 we expect the cash rate to trade around 1.75-2.00% depending on the degree of excess liquidity in the cash market at that point.
- As for QE, this is clearly very dependent on the economy's performance. For a big picture view point we would expect the total QE program from September to total around $100bn. That in turn would imply a continued tapering of weekly target purchases. We expect this to be gradual with the program concluding around mid-to-late 2022.

Clearly there are risks to that timing. If the recovery is even stronger than we expect and unemployment even lower, then fundamental wage pressures would be expected to emerge earlier. That is the main risk of an earlier mid-to-late 2023 rate hike. However, it will take time for the RBA to assess whether a faster momentum in wages/core inflation is temporary or permanent. Thus, we see no reason to see anything from the RBA in 2022 with the local central bank lagging the RBNZ, BoC and the Fed through the rates normalisation process.

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