NAB MONETARY POLICY UPDATE 29 OCTOBER 2021

NAB BRINGS FORWARD RATE RISE TIMING TO MID-2023; YCC TO END IN NOVEMBER GIVEN THE RBA'S LACK OF COMMITMENT; QE TO END IN FEBRUARY

NAB Economics

Key points

- NAB now sees the first rate rise in mid-2023– and a relatively aggressive series of hikes thereafter to bring the cash rate to 1.75-2.00% by end 2024.
- Core inflation is likely to remain around 2.3% for some time before supply constraints ease. Wages above 3% is still a key requirement to sustain inflation in mid target.
- YCC to end with the RBA showing little commitment to the 0.1% April 2024 target. RBA to pivot fully to outcomes-based forward guidance.
- QE to end by February 2022, little use for the policy with most other central banks ending or tapering their QE programs.

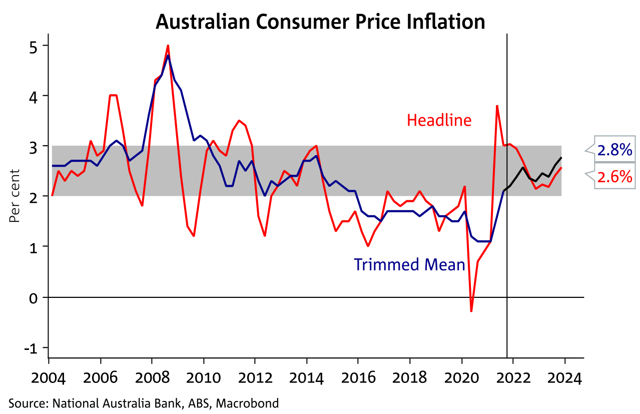
Analysis: Why we think unconventional policy will end and why we still do not believe market pricing of four rate rises in 2022

The recent inflation data was an upward surprise in core terms in Q3 2021. The core measures increased by around 0.7% and returned the inflation rate to the bottom of the RBA 2-3% target range for the first time since 2015. It looks like core inflation will increase a touch higher (to say 2.3%) by mid-2022. That is, there is still a temporary element to the current kick up in core inflation, but nonetheless inflation is running a little above where we had expected it to be.

NAB noted at the time that the YCC target may need to be addressed if the probability of risks are skewing higher with the risk that the RBA scraps this target in 2022, or if it does hike rates earlier removing the target altogether. The lack of the RBA's commitment to the YCC target this week suggests the RBA will end YCC at next week's November Board Meeting, which by extension will also include updated forward guidance by the RBA and require an upgrade for the inflation outlook included in the new set of staff forecasts released in the November SMP.

NAB's view is that wages pressures are also building as witnessed by our NAB Survey. Wages growth is likely to be around 3% by mid 2023. That said, by mid to late 2022 some of this pressure will ease as supply chain pressures in the goods market ease and international borders open up and hence supply issues in the labour market ease back a touch.

Associated with that we have also moved to increase our 2023 GDP growth forecasts to slightly above trend with unemployment reaching 3.8% in H2 2023. More details on the forecasts will come in our Forward View Report on 11 November. Our inflation profile and wages growth profile are below.



Underlying our expectation that the RBA would be slow to respond to a pick-up in inflation and wages growth and supporting our previous expectation for a 2024 lift-off for rates was the RBA's strong forward guidance that it sought to see actual inflation sustainably higher, with that guidance underpinned by the YCC policy. With inflation below target for many years prior to the pandemic, tolerating inflation towards the top end of the band through 2023 was conceivable given the commitment to sustainably higher wages and prices growth. The RBA's inaction points to much less patience on waiting to confirm sustainably higher outcomes, pulling the risks of hikes earlier.

Finally, we still see the RBA as being quite aggressive when rate rises start. With the first increase being 40 points (to a Cash rate of 50 points) with 25 point rises each quarter to the cash reaches around 2%.

QE and YCC

The RBA's unconventional policy measures undertaken at the height of the pandemic have clearly served their purpose. The RBA seemingly agrees with the Bank declining to intervene to lower the yield on the April 2024 bond over the past week. It is worth noting YCC and QE were initially adopted to lower funding costs and support the recovery in what was expected to be a protracted downturn. With the vaccines helping major states move out of lockdown it is clear growth will accelerate strongly during 2021.

There are also questions on the ongoing role of QE. Clearly there is a big review of the QE quantity, and perhaps its role, in the February 2022 RBA meeting. We now see the QE program ending at a February review meeting - alongside the introduction of a new form of market signalling / guidance. QE was initially undertaken partly in reference to the exchange rate - with what other central banks were doing in regards to their QE programs. Over recent months QE programs have been tapered or ended in several countries, including New Zealand and Canada while the UK is set to end its program by December 2021 and the US is set to begin to taper its program in November. By February 2022 many central banks will thus have ended their QE programs.

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