November 2021

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

We have trimmed our global economic forecasts this month to 5.7% for 2021, however should this occur, it would still be the strongest rate of growth since 1973. That said, a range of headwinds to growth have emerged recently – adding to COVID-19, which remains the key risk to our outlook. Inflationary pressures continue – with double digit growth in producer prices in September – reflective of disruptions in global shipping, shortages of key inputs, labour and energy (most notably the electricity shortages in China in September and October). While major central banks continue to identify these inflationary pressures as transitory, a few emerging market central banks, along with Norges Bank and the Reserve Bank of New Zealand, have started to lift rates, while markets have brought forward their expectations for advanced economy rate increases.

- Risks to our near-term forecasts have increased. **COVID-19 remains the key risk**, particularly in emerging markets, where vaccination rates are generally lower, leaving these economies more exposed to additional outbreaks (and the associated downturns in activity). In addition, supply chain bottlenecks – including in container shipping – continue to constrain economic activity globally. Electricity shortages in China (which could worsen during winter) add additional risk.
- **Inflationary pressures continue** – particularly for producer prices, which rose by around 12.8% yoy in September, reflecting a broad range of factors, including the strength of commodity prices (in early November the Refinitiv CoreCommodity CRB Index was at its highest level since December 2014), shortages of key inputs (such as semi-conductors), labour and most recently energy (particularly electricity in China) along with disruptions to shipping (leading to surging freight rates). Consumer price inflation has also risen notably. Major central banks continue to identify these factors as transitory.
- Despite these pressures, **central bank policy rates remain well below pre-COVID-19 levels**, with a few emerging markets (led by Brazil, Russia and Mexico) lifting rates. That said, the market expectations around the timing of advanced economy rate increases have moved forward in recent months (with Norway's Norges Bank and the Reserve Bank of New Zealand having already lifted rates in recent months) – albeit the Bank of England surprised markets by remaining on hold in November.
- The initial Q3 data for the major **Advanced Economies** (AE) suggest overall growth was robust in the quarter but off Q2's rapid pace. While the rebound provided by an easing of COVID-19 restrictions led to another very strong quarter in the Euro-zone (2.2% q/q), growth slowed notably in the US to 0.5% q/q (still solid but well down on 1.6% q/q in Q2). For the other major AEs we expect mixed results in Q3. We now think Japan GDP may have fallen (due to COVID-19 restrictions and supply bottlenecks affecting production). While the UK looks to have had another strong quarter of growth, the pace has slowed as the bounce from re-opening fades. The slowdown in US growth reflected several factors including supply bottlenecks, the unwinding of fiscal stimulus and COVID-19 headwinds.
- Overall, **aggregate measures for EM manufacturing and services strengthened in October**. The EM manufacturing PMI edged up to 51.4 points (compared with 50.8 points in September and a negative 49.6 points in August). The key drivers of this increase were India and Indonesia – the latter rose to 57.2 points in October (from 52.2 points previously), a record high, as easing COVID-19 restrictions supported strong growth in output. The aggregate EM services PMI increased more moderately, up to 54.2 points in October (from 53.6 points previously). As with the manufacturing PMI, India was the key driver – rising to 58.4 points – with demand underpinned by new business and a backlog of work coming out of the mid-year COVID-19 shutdown. That said, COVID-19 remains a major threat in India, with less than a quarter of its population fully vaccinated.
- Following a weak outcome for Q3 GDP, **we have lowered our forecast for China's economic growth** in 2021. During the quarter, China was negatively impacted by a sizeable COVID-19 outbreak, the near-default of major property developer Evergrande and electricity shortages. The latter factor – largely driven by high coal prices meeting unprofitably low, regulated electricity prices – could remain an issue in Q4, adding downside risk to our forecasts. We expect China to grow by 8.3% in 2021 (down from 8.7% previously).
- Reflecting changes to individual country forecasts, we now forecast the global economy to grow by 5.7% in 2021 (down from 5.9% previously) – albeit this would still be the strongest growth rate since 1973. The weaker outlook for China was the key driver of this downgrade, along with more modest cuts to the United States and Japanese forecasts. Our forecasts for 2022 and 2023 are unchanged – at 4.5% and 3.5% respectively – the latter being in line with the long-term average growth rate for the global economy.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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For Australia, our internal data and NAB Monthly Business Survey indicate the economy is again rebounding strongly as NSW and Vic reopen following the extended lockdowns through mid-2021. We have tweaked our forecasts for activity – now expecting a fall of around -3.8% in Q3 and a larger +3.0% rebound in Q4. This sees year-ended growth of 1.6% in 2021, but we expect well above trend growth of 4.0% in 2022 and more normal growth of around 2.3% in 2023. The unemployment rate should peak in the December quarter as both employment and participation recover, before resuming its downward trajectory, ending 2022 at around 4.2% and 2023 at 3.8%. In terms of inflation, we have revised up our profile in the near term, incorporating the stronger than expected Q3 result and some additional strength in prices due to ongoing supply impacts and still high goods demand. We have also brought forward our expected path for the cash rate, now expecting 'lift-off' in mid-2023 and an ongoing steady normalisation through to end 2024. We also expect the QE program to be wound up in February 2022. Risks remain related to the pandemic, resolution of supply chain issues, and the pace of recovery and normalisation of goods and services consumption, as well as the impacts of potential new macro-prudential policies.

- **Yesterday's labour market data showed a further deterioration in October, but a rebound in November is almost certain.** Overall, employment fell 46,000, although data collection timing meant NSW's reopening was only partly captured (and Vic's not at all). With a slight rise in participation, this saw the unemployment rate jump to 5.2%. Both employment and participation should recover strongly in November and December, making the unemployment rate hard to predict in the near-term. We expect unemployment to then resume its downward trajectory, with our slightly improved forecasts seeing it end 2022 at around 4.2% and 2023 at 3.8%.
- **Household consumption may have begun to turn around after significant lockdown impacts**. In real terms, retail turnover fell 4.4% in the September quarter – the largest fall on record. However, monthly nominal retail sales data rose 1.3% in September, ending a run of three months of decline, and NAB's internal data show strong growth in September and October (Cashless sales up 2.2% in October). Household consumption should rebound strongly in the December quarter as NSW and Victoria reopen.
- **House price growth and housing construction continue to moderate, although price growth is still robust.** Dwelling price growth eased slightly in October to 1.4% m/m, down from the pace seen earlier in the year, but still a very robust monthly growth rate. However, we expect price growth to slow much more appreciably in 2022. Forward indicators softened as new loan commitments and building approvals both declined, with the end of HomeBuilder, rising construction costs, and affordability all weighing on the market. Still, there is a large pipeline of work, and we expect dwelling investment to grow into 2022 before starting to decline.
- **A rapid rebound in business activity is underway as lockdowns ease.** The NAB Monthly Business Survey for October showed confidence building on the rebound in September, rising to +21 index points. Business conditions also recovered in the month, driven by large improvements in NSW, and while they are not as strong as seen in early 2021, they are now well above long-run averages and should improve further as Victoria reopens in November. Forward orders and capacity utilization also rose significantly. This is an encouraging sign for business investment, which we expect to continue to rise in the near term.
- **The RBA left the cash rate on hold but removed the 0.1% target on the April 2024 bond at the November meeting.** The April-24 target – a remnant of YCC – had come under significant market pressure, and defending it had little policy value. The RBA continues to present a dovish take on its upgraded set of forecasts. Inflation is expected to remain within the 2-3% target band – supported in the near term by transitory factors before the labour market begins to tighten and wage pressure takes over. The RBA's central case remains a rates 'lift-off' in 2024, but alongside our upgraded CPI forecasts, we have brought forward our expected lift-off to mid-2023. On QE, we see sufficient progress towards the RBA's stated goals that the program ends in February 2022.
- **Our forecasts for the exchange are unchanged this month despite the short-term volatility in the month.** The exchange rate in both US Dollar and Trade weighted index terms is broadly around the same level as a month ago at US74c. We see the AUD/USD around 72c by end 2021, before appreciating US78c by end 2022, and then paring back slightly to US77c by end 2023.
- **The trade surplus narrowed in September as iron ore prices pulled-back and imports saw only a small decline.** Nonetheless the trade surplus remains relatively wide at $12.2bn in monthly terms, with strong demand for Australia's minerals commodities and agricultural products outpacing the growth in goods imports over the past year. Services trade remains heavily impacted by border closures. It is likely both will begin to recover in 2022 as the international border opens fully and tourism and students return. Outbound tourism is also expected to rebound, but the pace of recovery in both imports and exports remains uncertain
- **Risks remain related to COVID and reopening, population flows, price pressures, and potential further macroprudential policy measures**. The pace of reopening and consumer behaviour in a 'living with COVID' scenario remain uncertain. With international travel requirements easing, there is the prospect of an earlier than anticipated upturn in immigration, but this could also affect outward flows. Global supply disruptions are also affecting Australia through higher prices and there is considerable uncertainty around how long these price pressures will persist. How quickly wages growth will respond to a tightening labour market is also unclear, with the risks around our rate call two-sided (though market pricing is focussed on earlier rate hikes). If credit growth continues to outpace income growth, further macroprudential measures could also be introduced.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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