

THE FORWARD VIEW: AUSTRALIA NOVEMBER 2021



RATES LIFT-OFF BROUGHT FORWARD AS REBOUND BEGINS

OVERVIEW

- The economy is again rebounding strongly as NSW and Vic reopen following the extended lockdowns through mid-2021. Our internal spend data, as well as the NAB Monthly Business Survey point to a solid pickup in activity in October with more to come in November.
- Ahead of the Q3 national accounts to be released next month, 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, well above trend growth of 4.0% in 2022 and more normal growth of around 2.3% in 2023.
- Owing to a smaller than expected rise in unemployment in recent months, we have also slightly lowered our near-term peak in unemployment to around 4.7%, before the unemployment rate resumes its downward trajectory, ending 2022 at around 4.2% and 2023 at 3.8%. In the near term, the pace of the rebound in hours worked and the level of employment are likely to be more important indicators given the large shifts in labour force participation over recent months.
- 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. The profile is also slightly stronger in the out year with a small upgrade to our projections to wage growth.
- With a stronger inflation outlook we have 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, though the RBA has confirmed it will hold purchased bonds (under both YCC and QE to maturity).
- We see the risks around these forecasts as balanced. Many of the factors supporting growth prior to the recent lockdowns are expected to persist in the near term, with both dwelling and business investment expected to provide support, while household services consumption is expected to gradually recover. However, the pace of normalisation remains uncertain with the rebalancing from goods spending to services consumption likely to play out over time.
- The risks around our rate call are also balanced. Our forecasts point to inflation remaining within the target band from here, supported in the near term by temporary factors which we expect to fade as the labour market tightens. According to the RBA’s stated conditions, this points to rate hikes beginning in mid-2023. However, the level of employment consistent with a material pickup in wage growth remains uncertain, as does the pass through to consumer prices.

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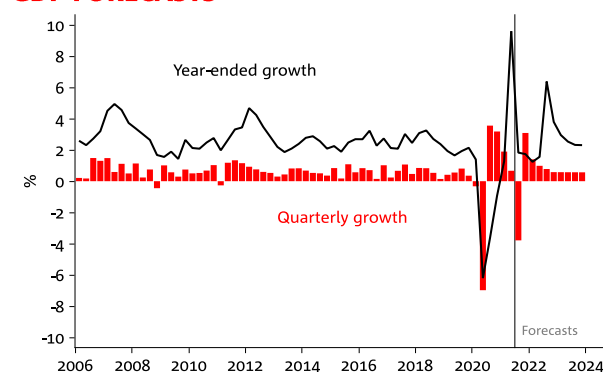
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KEY ECONOMIC FORECASTS

	2020	2021-F	2022-F	2023-F
Domestic Demand (a)	-2.6	4.7	3.4	3.2
Real GDP (annual average)	-2.4	3.5	3.3	2.5
Real GDP (year-ended to Dec)	-0.9	1.6	4.0	2.3
Terms of Trade (a)	-0.6	20.6	3.6	-0.8
Employment (a)	-1.7	3.3	1.9	1.8
Unemployment Rate (b)	6.7	4.7	4.2	3.8
Headline CPI (b)	0.9	3.0	2.1	2.0
Core CPI (b)	1.3	2.2	1.8	2.7
RBA Cash Rate (b)	0.10	0.10	0.10	0.75
\$A/US cents (b)	0.77	0.72	0.78	0.77

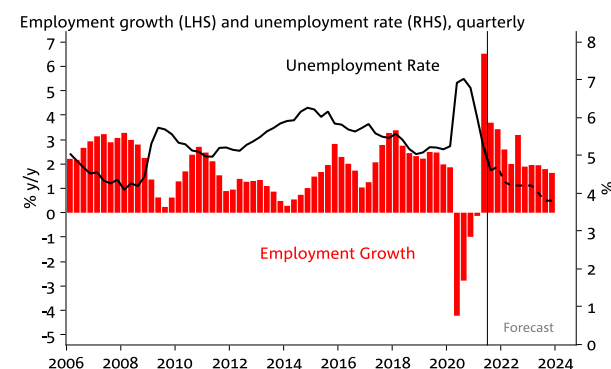
(a) annual average growth, (b) end-period, (c) through the year inflation

GDP FORECASTS



Source: National Australia Bank, Australian Bureau of Statistics

LABOUR MARKET FORECASTS



Source: National Australia Bank, Australian Bureau of Statistics

LABOUR MARKET, WAGES AND CONSUMER

As expected, September saw the labour market continue to deteriorate. Both employment and participation fell significantly, with the unemployment rate edging up as a result. October data will also be somewhat lockdown-affected, but a strong rebound remains likely by the end of the year.

Employment declined 138,000 (-1.1%) in September, following a similarly large fall in August. The decline was largely driven by Victoria, which saw employment fall 123,000 (-3.5%) as lockdown continued, while impacts were more muted in NSW. Nationally, full-time employment actually increased while part-time employment fell, causing total hours worked to increase slightly (against expectations).

September also saw the participation rate decline a further 0.7pts to 64.5% - but unlike in past months, the flow of people leaving the labour force wasn't enough to offset employment losses and the unemployment rate edged back up to 4.6%.

What happens next remains difficult to predict, with NSW reopening mid-October but Victoria remaining in lockdown for most of the month. The two states will initially push employment in opposite directions before a wider recovery takes hold, and participation should also begin to rebound. That could see the unemployment rate peak at around 4.7% in the December quarter.

After the initial adjustment to reopening, we expect the unemployment rate to resume its prior trajectory and now see the rate falling to around 4.2% by end 2022 and below 4.0% by end 2023.

November will also see the release of the Q3 WPI, which is likely to show a rise in quarterly terms to around 0.7% q/q which we expect to continue in the near term.

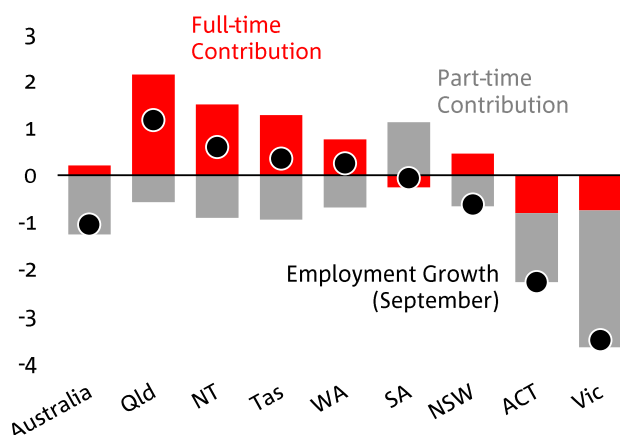
Consumption has also been affected by lockdowns but there are signs things may have begun to turn around, with retail trade up in September and NAB data also showing some improvement.

In real terms, retail turnover fell 4.4% in the September quarter – the largest fall on record – reflecting the impact that the most recent lockdowns have had on consumption and the likely large contraction in household consumption when national accounts data are released.

However, monthly nominal retail sales data rose 1.3% in September, ending a run of three months of decline. Qld and NSW led the way, with cafes & restaurants, clothing & footwear, and household goods retail all turning the corner in a sign of the positive early effects of reopening.

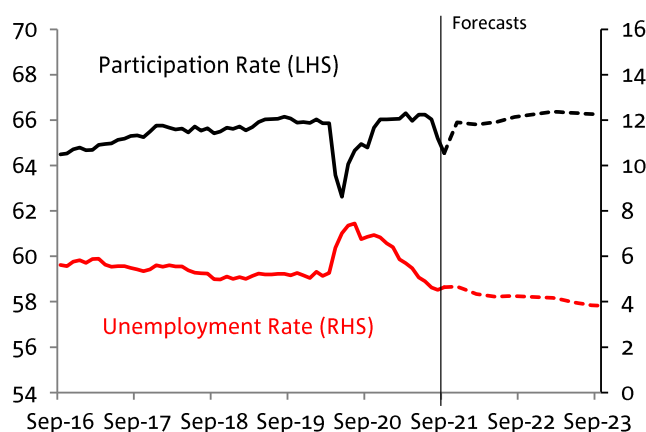
NAB's internal data from early October also showed a jump in spending in NSW, providing further evidence of the likelihood of a strong rebound as reopening progresses – likely to show up in official data over October and November as the two largest states meet major reopening milestones. That should see consumption rebound strongly in the December quarter before normalising in 2022.

SEPTEMBER EMPLOYMENT DECLINE DRIVEN BY VIC, MOSTLY PART-TIME



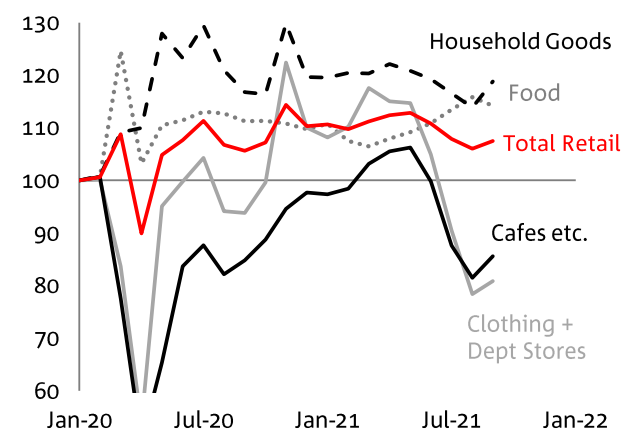
Source: NAB, Australian Bureau of Statistics

PARTICIPATION AND UNEMPLOYMENT RATE TO RESUME TRAJECTORY AFTER LOCKDOWNS



Source: NAB, Australian Bureau of Statistics

RETAIL TRADE BEGINNING TO TURN THE CORNER (INDEX, NOMINAL)



Source: NAB, Australian Bureau of Statistics

HOUSING AND CONSTRUCTION

House price growth and housing construction continue to moderate. However, house price growth is still robust and a large pipeline of work should see residential investment continue to rise for now.

Dwelling price growth eased slightly in October to 1.4% m/m (eight capital city average), 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 as the impact of low interest rates fades and as affordability constraints start to bite. Over 2022 [we expect](#) capital city dwelling prices to grow by around 5%, well down on the over 20% pace in 2021.

New home loan commitments (ex. refinancing) declined by 1.4% m/m in September. While there did not appear to be any large impact on house prices from the recent lockdowns in NSW, Victoria and the ACT, sales may have been more affected. Reflecting this, new loan commitments to owner-occupier have fallen from recent peaks more in these states than in Queensland, WA and SA (and investor activity has also been relatively subdued).

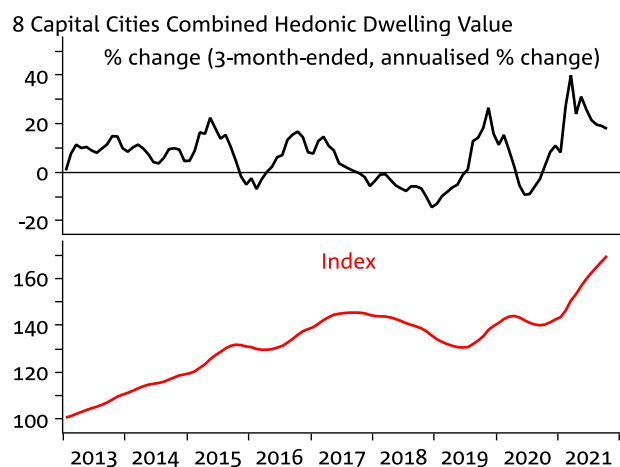
New loan commitments (ex refinancing) fell by 2.6% in Q3, well down on the 10-20% pace over the preceding year. As a result, the owner transfer costs (OTC) component of GDP is likely to fall. Despite representing less than 2% of GDP, OTC has contributed at least 0.2ppt to quarterly growth in each of the last four quarters. The end to lockdowns in October raises the prospect of some rebound, although APRA's increase in the minimum interest rate buffer for banks to use in assessing home loan serviceability will work the other way even if the impact is only modest.

Leading indicators of housing construction are trending down although they remain at solid levels. New loan commitments for dwelling construction by homeowners, fell by a further 5.0% in September, to be 45% down since February. The number of building approvals fell by 4.3% in October; even this was flattered by a very large spike in NSW apartment approvals (which can be very volatile).

The most obvious factor behind the run-up and subsequent decline in approvals (and loans for construction) is Homebuilder. While it ended in March, it likely pulled forward some activity so there is a risk of further falls. Construction costs are also rising rapidly – the producer price index for inputs to housing construction increased by 8% y/y in Q3, a level last seen in the 1980s. Low mortgage interest rates and the strength in house prices are factors supporting activity, but their impact will fade over time. How quickly, and to what extent, net migration resumes as international border restrictions ease will also be an important factor going forward.

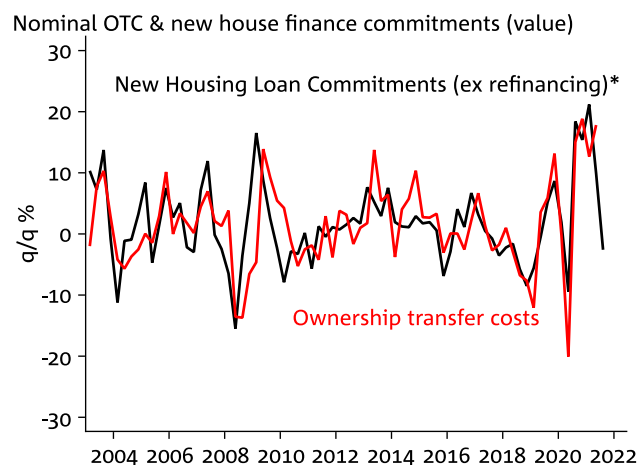
Despite the fall off in building approvals, there is still a large pipeline of work. Capacity issues and delays caused by lockdowns mean it will take a while to work through. As a result, we still expect dwelling investment to grow into 2022 before starting to decline.

MODERATING BUT STILL STRONG, HOUSE PRICE GROWTH



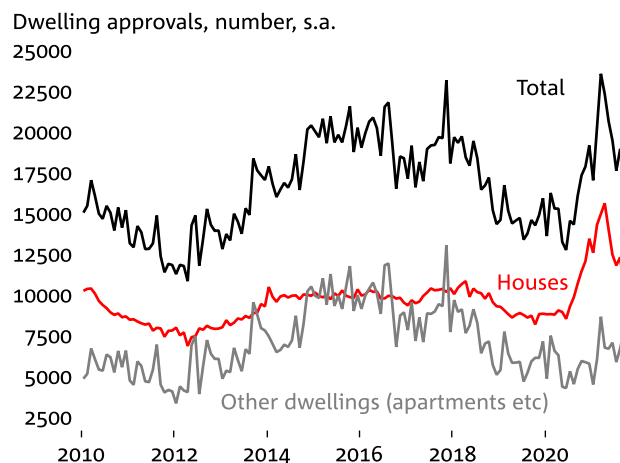
Source: National Australia Bank, CoreLogic

NEW HOME LOANS DOWN IN Q3 – SIGNALS END TO BOOST TO GDP FROM OTC



Source: NAB, Australian Bureau of Statistics.

APPROVALS TRENDING DOWN



Source: Macrobond, National Australia Bank

BUSINESS AND TRADE

While there is no doubt that the lockdowns through mid-2021 have again had a significant impact on activity, the business survey suggests a rapid rebound is underway with confidence and conditions strengthening over the past two months.

Confidence built on the rebound in September, rising to +21 index points in October. The gains were driven by a pickup in Vic as business anticipated a reopening post the survey period. Overall confidence is now back to positive territory across all states and industries.

Business conditions also continued to recover in the month and while they are not as strong as seen in early 2021, they are now well above long-run averages. That said, the ongoing uneven impacts of lockdowns remain evident, with rec & personal and transport & utilities still in negative territory.

That said, we expect that, as Victoria emerges from lockdown and state borders open up, household services as well as travel will recover. More broadly, forward orders strengthened in the month to an elevated level which suggests that the rebound in conditions are likely to be maintained. Capacity utilisation has also rebounded from its sharp fall in mid-2021 and is now back above average.

This is an encouraging sign for business investment going forward. While the NAB Quarterly Business Survey showed a pullback in intentions, they remained above average. An updated set of ABS Capex expectations will be released at the end of the month, ahead of the Q3 GDP release which will allow a first look at how investment has fared through the recent lockdowns. We expect business investment to continue to rise in the near term, with ongoing support from tax measures as well as the strength of the rebound in activity more broadly.

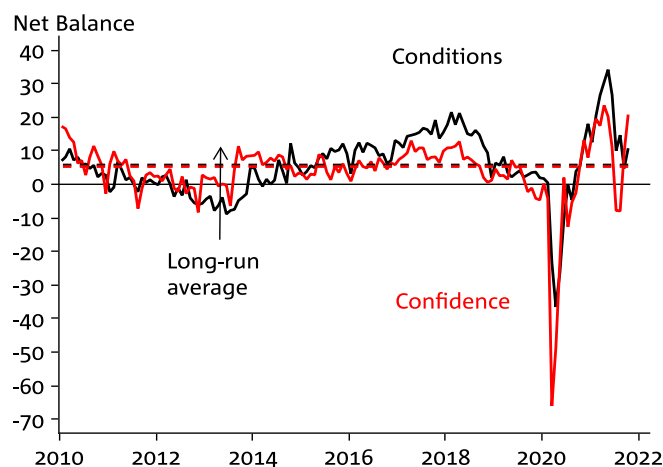
The trade surplus narrowed in September as iron ore prices pulled-back and imports saw only a small decline.

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.

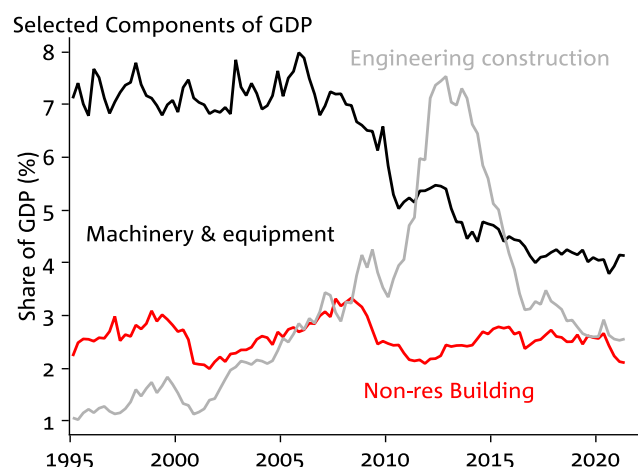
Services trade remains heavily impacted by border closures. It is likely both will begin to recover, most likely predominantly in 2022 as the international border opens fully and tourism and students return. Outbound tourism is also expected to rebound, but the pace of recovery in both imports and exports remains uncertain.

Overall, the September monthly data rounds out trade data for Q3, and in combination with trade prices data suggests net exports will contribute around 1.3ppt to growth in the quarter, following a subtraction of around 1.0ppts in Q2.

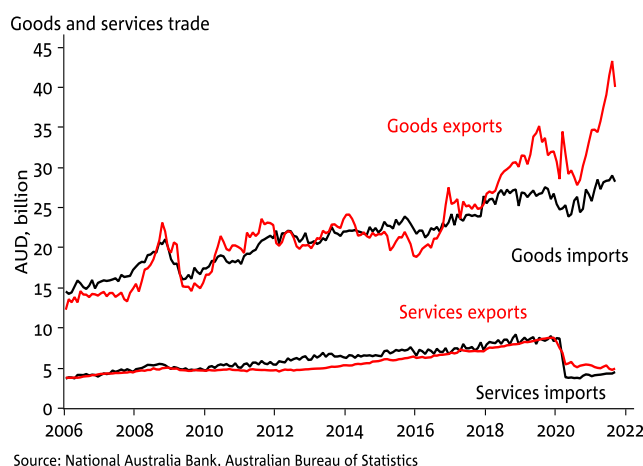
CONFIDENCE AND CONDITIONS RISE



INVESTMENT IS LOW AS A SHARE OF GDP



TRADE SURPLUS EASES BACK FROM RECORD LEVELS



MONETARY POLICY, INFLATION AND FX

The RBA left the cash rate on hold but removed the 0.1% target on the April 2024 bond at the November meeting. The weekly rate of QE purchases was maintained (still planned to be reviewed in February 2022), though the Apr-24 bond is now included in QE.

The RBA removed the 0.1% target – a remnant of YCC – on the Apr-24 bond amidst market pressure with the yield trading away from target and spiking higher (now 80bps) as the RBA held off intervening prior to the November meeting.

Both the post meeting press conference and the November SMP make the case that operationally defending the target had little value, while the risks around the outlook include the possibility of rates lifting off in 2023 – so defending the target could even hurt credibility in the long-run.

That said, the RBA continues to present a dovish take on its upgraded set of forecasts released over the past week. 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 continues to take an outcome-based approach, maintaining the guidance that inflation will need to be sustainably in the band before hiking, rather than relying on forecast outcomes.

Alongside our upgraded set of CPI forecasts, we have brought forward our expected lift-off for the cash rate to mid-2023, with a normalisation of rates to occur through to end 2024 seeing the cash rate reach 1.75-2.00%.

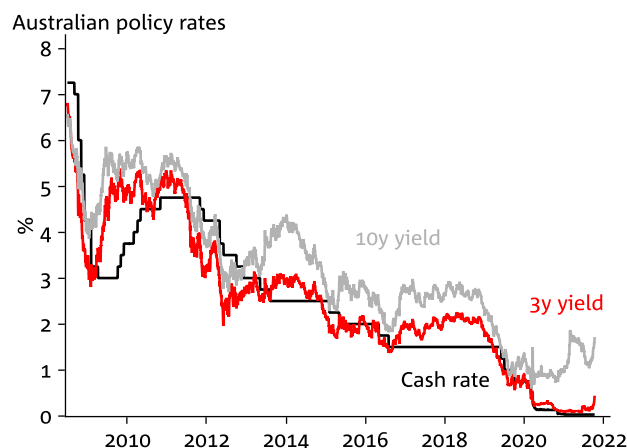
On QE, we see sufficient progress being made on moving towards the RBA's stated goals such that the program is ended in February 2022. It is important to note that it is the stock rather than flow of QE that will continue to suppress yields and support the economy and that therefore this support will remain in place until the RBA's holdings of these bonds mature.

The exchange rate in both US Dollar and Trade weighted index terms is broadly around the same level as a month ago at US74c.

However, in US Dollar terms it remains slightly above the level prevailing at the time of the QE announcement (broadly similar in trade-weighted terms) despite the strong rise in the terms of trade (acknowledging that commodity prices have eased more recently).

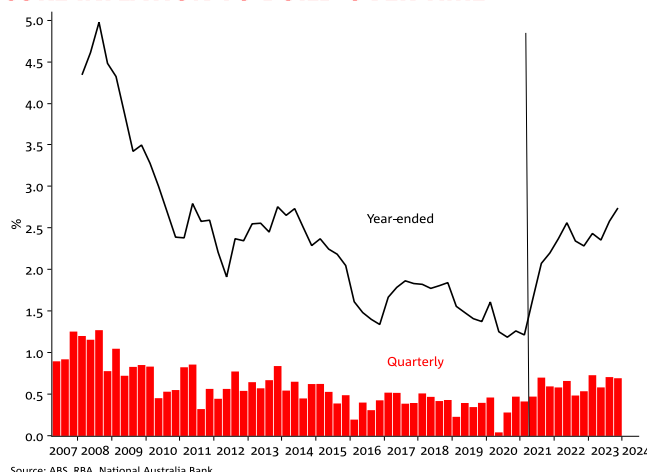
Our forecasts for the exchange are unchanged this month despite the short-term volatility in the month. We see the AUD/USD around 72c by end 2021, before appreciating US78c by end 2022, and then paring back slightly to US77c by end 2023.

CASH RATE ON HOLD UNTIL MID-2023



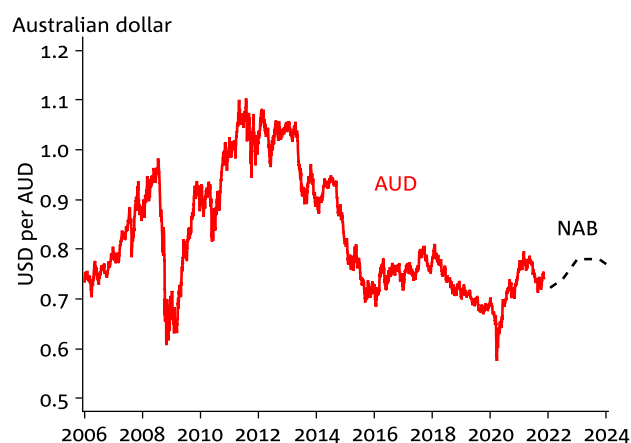
Source: Reserve Bank of Australia, Macrobond Financial AB

CORE INFLATION TO BUILD OVER TIME



Source: ABS, RBA, National Australia Bank

THE AUD TO APPRECIATE FROM HERE



Source: National Australia Bank, Macrobond Financial AB

RISKS TO THE OUTLOOK

COVID-19 remains central to the outlook with risks coming from policy/community reaction if cases rise, changes in population flows, price pressures and the withdrawal of policy support. There is also a risk of further macroprudential policy measures.

The re-opening of NSW and Victoria, while still having community spread of COVID-19, confirms that Australia is moving to 'living with' the virus. However, uncertainties around how this process will play out remain.

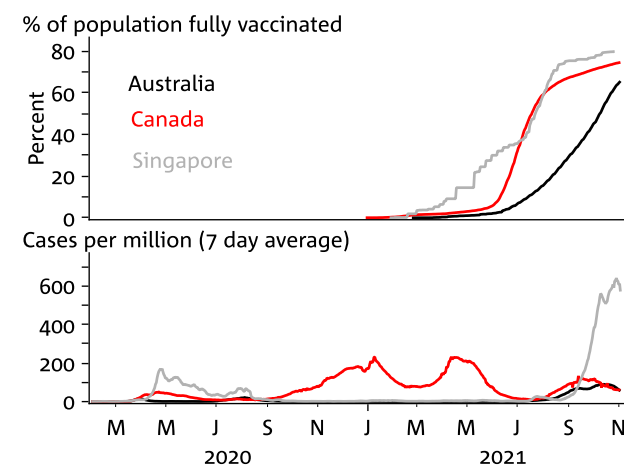
While re-opening plans have been based around high levels of vaccinations overseas experience indicates that this is no guarantee that there will not be a large increase in COVID-19 case numbers at some stage. If this were to occur, even if it is managed through measures which have low economic impact (e.g. masking), households may pull-back from in-person activities. This risk is particularly acute in states and territories which have largely been 'zero-COVID' for an extended time.

With some state governments loosening quarantine requirements for international travellers, and the Federal government also easing border controls, there is the prospect of an earlier than anticipated upturn in immigration. However, as this could also affect outward flows there is considerable uncertainty around the impact on *net* immigration in the near term. Beyond the near term, to what level net immigration returns is unclear with upside and downside risks evident. These dynamics will be important to sectors such as housing, tourism and education as well as to the labour market.

COVID-19, and the response to it (such as a shift to greater goods consumption), has led to global supply bottlenecks and disruptions. This is also affecting Australia, including through higher prices, a lack of product available for sale (e.g. motor vehicles) and delays in delivery times. There is considerable uncertainty around how long these price pressures will persist, to what extent they may unwind in the future, as well as how quickly wages growth will respond to a tightening labour market. As such the risks around our rate call are two-sided (although market pricing is currently focussed on the possibility of rate hikes occurring earlier than we expect).

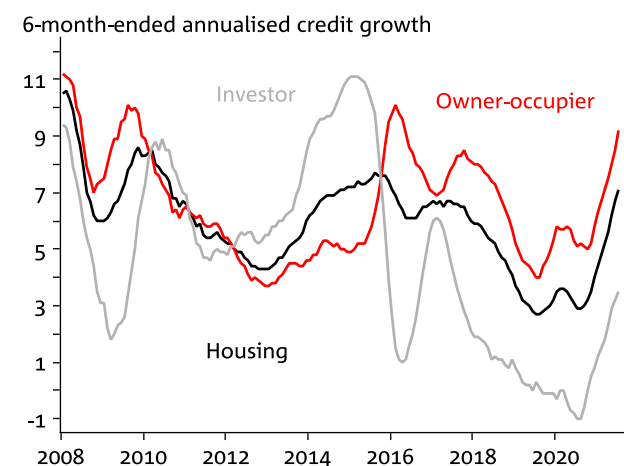
This would clearly impact the housing market. Further, there remains uncertainty around the degree to which the run up in home building construction was due to HomeBuilder bringing forward activity and, as a result, to what level construction indicators such as building approvals may fall back. Moreover, APRA increased the interest rate serviceability buffer on new loans in early October by 50bps to 3.0ppts above the loan's interest rate. While APRA expects only a 'fairly modest' impact (also our view), this remains to be seen. Should credit growth continue to strengthen (relative to income growth) further measures are likely to be introduced, although the timing and extent of any measures is uncertain.

HIGH VACCINATION LEVELS NO GUARANTEE OF LOW COVID-19 CASE NUMBERS



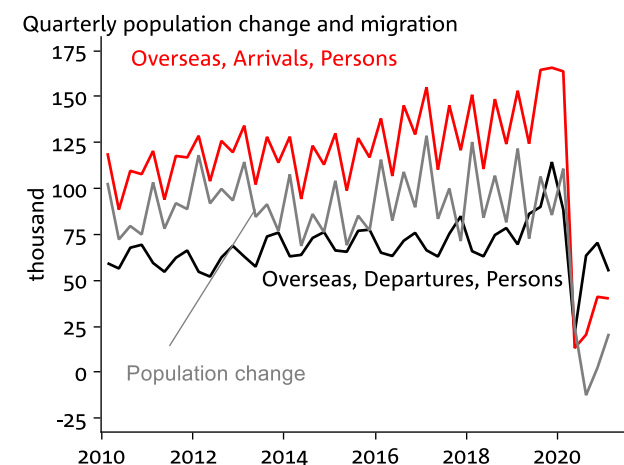
Source: National Australia Bank, Our World in Data

HOW FAR AND HOW QUICKLY WILL POPN GROWTH REBOUND AS BORDER RE-OPENS?



Source: RBA, National Australia Bank

RIISING CREDIT GROWTH POINTS TO RISK OF FURTHER MACRO-PRUDENTIAL MEASURES



Source: National Australia Bank, Australian Bureau of Statistics

FORECAST TABLES

	Fiscal Year				Calendar Year				
	2019-20	2020-21 F	2021-22 F	2022-23 F	2019	2020	2021-F	2022-F	2023-F
Private Consumption	-3.0	1.1	-1.5	5.1	1.2	-5.8	2.7	2.5	3.5
Dwelling Investment	-8.1	4.4	10.2	-5.0	-7.1	-5.3	13.6	1.9	-8.3
Underlying Business Investment	-2.8	-2.6	6.1	9.8	-2.2	-5.7	5.4	6.5	8.5
Underlying Public Final Demand	5.7	5.8	4.4	2.8	5.5	6.0	5.0	3.5	2.4
Domestic Demand	-1.0	2.5	2.0	4.5	1.2	-2.6	4.7	3.4	3.2
Stocks (b)	-0.3	0.7	-0.2	0.0	-0.3	-0.1	0.5	0.0	-0.1
GNE	-1.3	3.2	1.8	4.5	0.9	-2.7	5.3	3.4	3.1
Exports	-1.8	-9.1	-0.1	2.5	3.4	-10.1	-2.8	1.9	1.9
Imports	-7.5	-3.1	2.6	5.1	-0.9	-13.4	6.2	3.1	4.8
GDP	-0.2	1.4	1.6	4.0	1.9	-2.4	3.5	3.3	2.5
Nominal GDP	1.6	4.2	6.7	5.7	5.4	-1.7	9.1	6.2	4.2
Current Account Balance (\$b)	-36	-68	-106	-101	14	52	91	106	97
(%) of GDP	-1.8	-3.3	-4.8	-4.3	0.7	2.7	4.2	4.6	4.1
Employment	0.2	1.0	2.3	2.1	2.3	-1.7	3.3	1.9	1.8
Terms of Trade	0.8	10.8	13.6	-0.2	6.1	-0.6	20.6	3.6	-0.8
Average Earnings (Nat. Accts. Basis)	3.0	2.6	2.0	2.9	2.8	3.2	1.6	2.8	3.0
End of Period									
Total CPI	-0.3	3.8	2.7	2.2	1.8	0.9	3.0	2.1	2.5
Core CPI	1.2	1.7	2.6	2.4	1.4	1.3	2.2	2.3	2.7
Unemployment Rate	8.2	5.2	4.2	4.0	5.1	6.7	4.7	4.2	3.8
RBA Cash Rate	0.25	0.10	0.10	0.10	0.75	0.10	0.10	0.10	0.75
\$A/US cents :	0.69	0.75	0.74	0.78	0.70	0.77	0.72	0.78	0.77
\$A - Trade Weighted Index	60.0	62.7	60.6	63.2	60.3	63.4	59.8	63.0	61.9

(a) Percentage changes represent average annual growth, except for cash and unemployment rates. The latter are end June. Percentage changes for CPI represent through the year inflation.

(b) Contribution to GDP growth

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