THE FORWARD VIEW: AUSTRALIA DECEMBER 2021

ACTIVITY SNAPS BACK IN Q4, PRE-DELTA GDP WITHIN REACH

OVERVIEW

- The Q3 national accounts showed a smaller hit to activity than we had expected but we continue to expect a very strong snap back in activity in Q4 with GDP rising 2%. This would see the pre-Delta level of GDP recovered in early 2022.
- We expect above trend growth to continue through 2022 (4.1% through-the-year) before growth slows to around trend in 2023 (2.5%).
- We also expect a rapid recovery in the labour market, with the 330k jobs lost due to shutdowns in mid-2021 recovered by the end of Q4. Beyond this, we see further gains in employment through 2022, enough to see the unemployment rate fall to 4.1% by December 2022 before edging lower to around 3.8% over 2023.
- In the near term, we see the rebound in growth being driven by household consumption as well as the ongoing effects of policy support – both dwelling and business investment are expected to continue to lift. Government spending will also likely support.
- Further out, the opening-up of state and international borders and shift to living with COVID will see the balance between services and goods spending normalise, and the impact of stimulus will wane. Underlying population and productivity growth will then become important drivers of growth.
- On monetary policy, we see the RBA announcing the end of QE at the February meeting. The strong rebound in the labour market, deteriorating liquidity in the bond market and the pullback in stimulus by overseas central banks are likely to drive this decision. We continue to see the RBA lifting rates from mid-2023.
- We have also extended our forecasts for house prices to 2023 – and expect a modest fall of around 7.5% with affordability constraints beginning to bind and rates rising in the second half of the year following growth of 22% in 2021, and 5% in 2022. House price growth has slowed recently, and the risk of further macroprudential tightening remains in play. This could see sooner/sharper falls if lending is curtailed.
- While we are optimistic (as is the RBA) on growth over the next year or so, a number of uncertainties remain, including the risk from the Omicron variant. The tightening in the labour market should lead to a pickup in wage growth and eventually inflation. However, the speed and magnitude of this is a key unknown. The wage setting process is based around long term contracts and dependent on inflation expectations. The level of "full-employment" is highly uncertain as is the sensitivity of wages to labour demand. Further, the ability of businesses to pass on cost pressures and maintain margins will be important. Against this, strong demand and labour shortages may shift the dial in the other direction – at least in the short-term.

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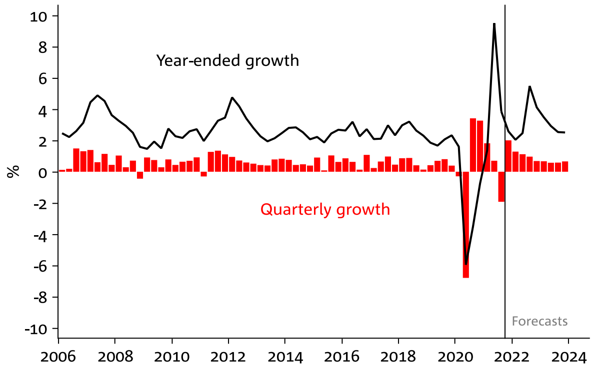
KEY ECONOMIC FORECASTS

	2020	2021-F	2022-F	2023-F
Domestic Demand (a)	-2.5	5.6	4.0	3.6
Real GDP (annual average)	**-2.2**	**4.2**	**3.5**	**2.9**
Real GDP (year-ended to Dec)	**-0.8**	**2.6**	**4.1**	**2.5**
Terms of Trade (a)	-0.2	20.3	6.5	-0.8
Employment (a)	-1.7	3.1	2.5	2.8
Unemployment Rate (b)	6.7	5.0	4.1	3.8
Headline CPI (b)	0.9	3.0	2.3	2.0
Core CPI (b)	1.2	2.1	1.8	2.9
RBA Cash Rate (b)	0.10	0.10	0.10	0.75
$A/US cents (b)	0.77	0.72	0.77	0.77

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

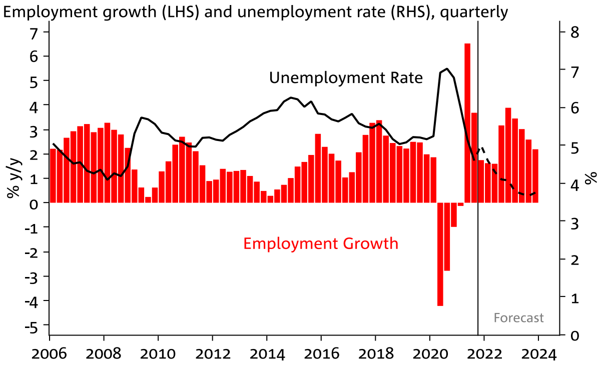
GDP FORECASTS



Source: National Australia Bank, Australian Bureau of Statistics

LABOUR MARKET FORECASTS

Employment growth (LHS) and unemployment rate (RHS), quarterly



Source: National Australia Bank, Australian Bureau of Statistics

Gareth Spence, Senior Economist | Antony Kelly, Senior Economist | Brody Viney – Senior Economist | Alan Oster, Chief Economist

LABOUR MARKET, WAGES AND CONSUMER

The tail end of lockdown effects saw employment fall in October, pushing the unemployment rate briefly back above 5% - but a strong rebound is assured over the remainder of the year.

An early data collection period meant the October labour force report missed most of the month's reopening milestones, resulting in employment edging down 46,000. That, combined with a slight rise in participation, was enough to see unemployment jump up to 5.2%.

Those data are now well and truly out of date with all signs pointing to a rapid labour market recovery. NAB's Business Survey has the employment index up 11pts from September, while job ads have risen for three months straight and payrolls jobs are up 3.4% since the start of October. Employment fell 330,000 over the most recent lockdown cycle and it is possible that all those jobs and more will be regained by the end of December.

In quarter-average terms, much of the volatility will disappear, leaving employment little changed from the September quarter result. With participation also rebounding, the unemployment rate should peak at around 5% for the quarter before falling rapidly as recovery momentum builds to reach around 4.1% by the end of 2022 and 3.8% the following year.

Consumption fell sharply in the September quarter but the impact of lockdowns was less severe than expected, paving the way for a strong rebound in December.

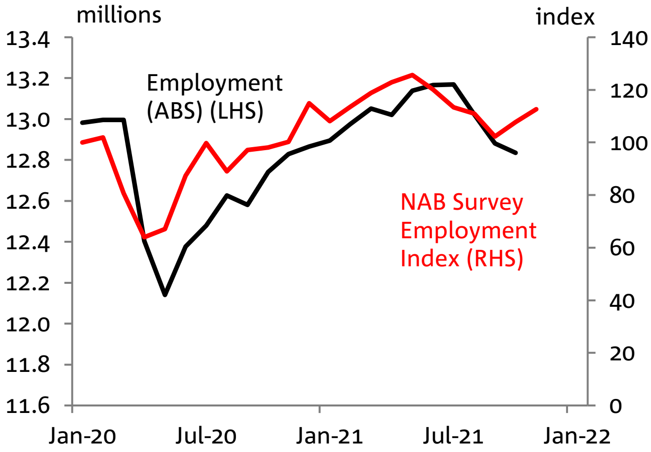
Overall household consumption was down 4.8% - the second largest fall on record, but well short of the fall in June 2020 – detracting 2.5ppts from GDP growth and driving the overall fall in GDP seen in the quarter.

As expected, the fall in services consumption was greatest at 5.8%, with very large falls in spending on lockdown-affected sectors such as transport services, hotels, cafes and restaurants, and recreation. Goods consumption was down 3.3%, weighed primarily by spending on clothing and footwear as retail was also impacted by COVID-19 related-measures.

More recent data confirms that a strong rebound is underway. Monthly nominal retail sales rose 4.9% in October, led by large gains in clothing, department stores, and cafes & restaurants as pent-up demand was released, and there should be more improvement with reopening progressing through November. NAB's internal data for November confirmed spending was powering ahead, with NSW and Victoria strongest.

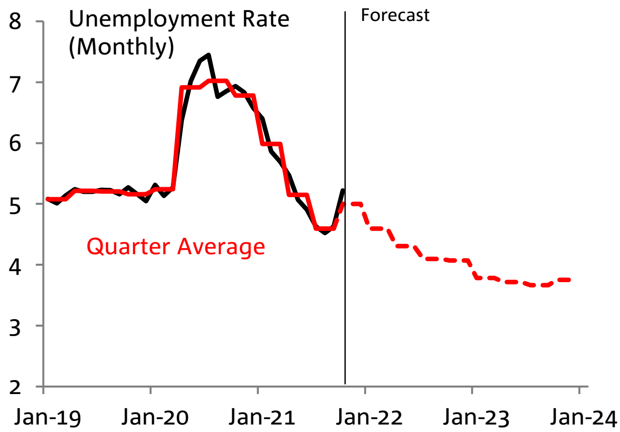
With that in mind, our forecast is for household consumption to rebound 2.6% in the December quarter – again contributing significantly to overall GDP growth for the quarter – and for sustained, steady growth through 2022 before normalizing in 2023. That should see consumption back around its pre-COVID level by the middle of next year.

NAB SURVEY AND SEEK JOB ADS INDICATING A STRONG REBOUND IN EMPLOYMENT



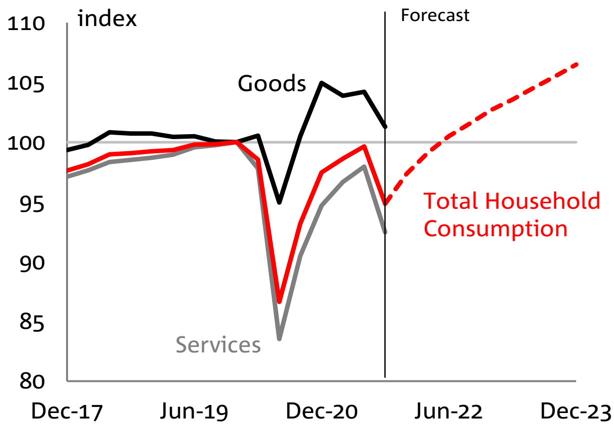
Source: NAB, ABS, SEEK

UNEMPLOYMENT PEAKING AT 5% IN QUARTER-AVERAGE TERMS



Source: NAB, Australian Bureau of Statistics

HOUSEHOLD CONSUMPTION POISED TO QUICKLY REGAIN PRE-COVID LEVELS



Source: NAB, ABS

HOUSING AND CONSTRUCTION

House price growth is slowing and this will continue into 2022 with falls likely in 2023. Despite approvals falling, the large pipeline of work should sustain dwelling investment into 2022 before it declines later in that year.

Capital city dwelling price growth continues to ease. Prices grew 1.1% m/m in November, down from 1.4% m/m in October. This includes sub 1% m/m growth in Sydney and Melbourne, though considerable variation across markets has started to emerge over recent months, with growth in Brisbane and Adelaide accelerating.

Over the year to November prices are up by 21% y/y. We expect to see a marked slowdown in house price growth over 2022. The impetus from the various factors that led to the run-up in prices are fading. The fall in mortgage rates can explain a shift up in the level of prices but not growth as eventually affordability constraints start to bite (and deposit requirements rise). Rates on fixed-term mortgages have already lifted, and APRA has tightened lending standards (by raising the mortgage serviceability buffer) albeit only modestly. On-going solid levels of new building construction at a time when population growth has stalled is also not supportive of strong price growth, although as borders re-open population growth should recover.

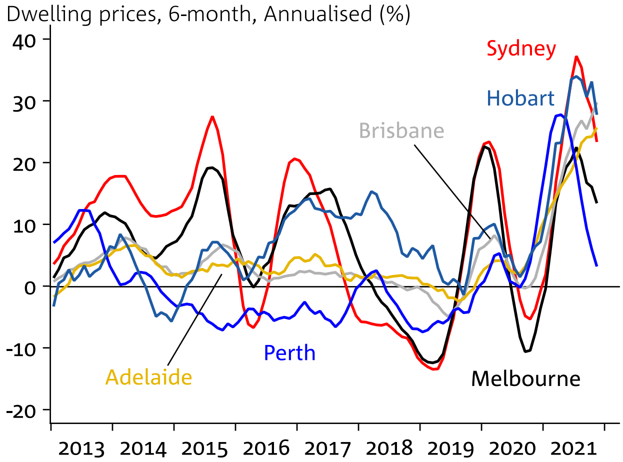
Over 2022, we expect capital city dwelling prices to grow by around 5%, but with growth stronger in the first half of the year than the second half. This will set up a weak 2023 and if, as we expect, the RBA lifts the cash rate in H2 2023, we would expect to see a fall in house prices of around 7.5% over that year.

Dwelling investment only edged up in Q3 rising by 0.1% q/q but was still 11.4% higher than a year ago. Alterations & additions continue to be the strongest segment and more than offset a fall in new building investment in the quarter. Lockdowns were a headwind with a 5% q/q fall in NSW and by 20% in the ACT, but dwelling investment rose in Victoria - its two-week construction lockdown started late in Q3 and carried into Q4.

Building approvals again fell in October, down 12.9% m/m although this reflected a large fall in volatile non-house (including apartments approvals). While house approvals rose 4.5% m/m it is too early to call and end to the downwards trend seen since the end of HomeBuilder. Indeed, new owner-occupier loan commitments for building construction fell again (by 6.9% m/m) in October, suggesting further building approval declines are likely.

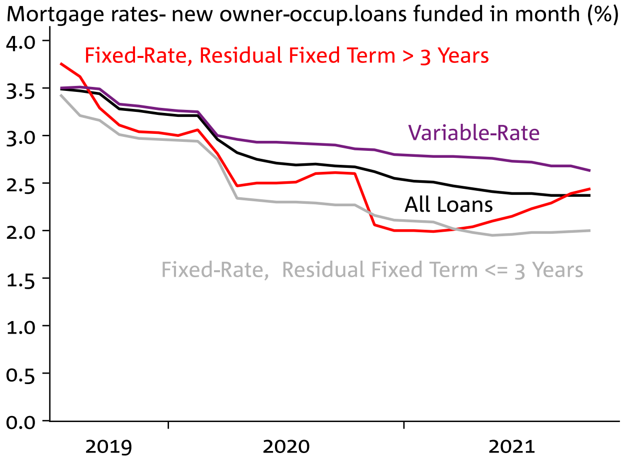
The decline in building approvals points to a decline in dwelling investment down the track, but we expect it will take longer than normal before the national accounts record a decline in dwelling investment. This reflects catch-up due to lost construction during lockdowns as well as capacity constraints (both materials and labour) which mean it will take longer than normal to work through the large pipeline of work that has been built up, but we expect to see investment tail off from the second half of 2022 and into 2023.

HOUSE PRICE GROWTH SLOWING OVERALL BUT DIVERGING TRENDS ACROSS CITIES EVIDENT



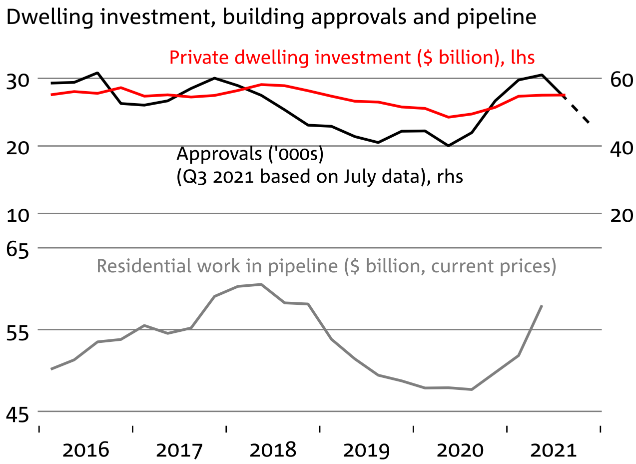
Source: CoreLogic, National Australia Bank, Macrobond

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



Source: National Australia Bank, Reserve Bank of Australia

APPROVALS STILL TRENDING DOWN – BUT A LARGE PIPELINE OF WORK SHOULD SUSTAIN INVESMENT



Source: National Australia Bank, Australian Bureau of Statistics

BUSINESS AND TRADE

Business investment declined in the September quarter but the outlook for business activity is improving, which should see investment strengthen into 2022.

After a strong first half of the year, underlying business investment fell 1.1% in the September quarter. Machinery & equipment investment was well down, and new engineering construction also fell, although non-dwelling construction rose in the quarter. Lockdowns weighed on construction in NSW and the ACT, but investment rose in Vic and Qld, boosted investments in renewables.

Since then, the NAB Business Survey suggests capacity utilisation has risen considerably from the lockdown induced dip (78.2%) in September to a well above average 83.2% in November. Forward orders are also at a high level, pointing to ongoing strength in activity, and the survey measure of capital expenditure has also risen as the economy has opened up.

In line with an improving outlook, the ABS capex survey for the September quarter (released at the end of November) showed long-term expectations for capex improving despite the short-term decline. Our expectation remains for business investment to strengthen through 2022 as the effect of policy support continues to flow through and momentum builds in the economy more broadly.

Both exports and imports contributed positively to GDP growth in the September quarter – a reversal from the June quarter – but the trade surplus should gradually narrow as trade and border arrangements normalise.

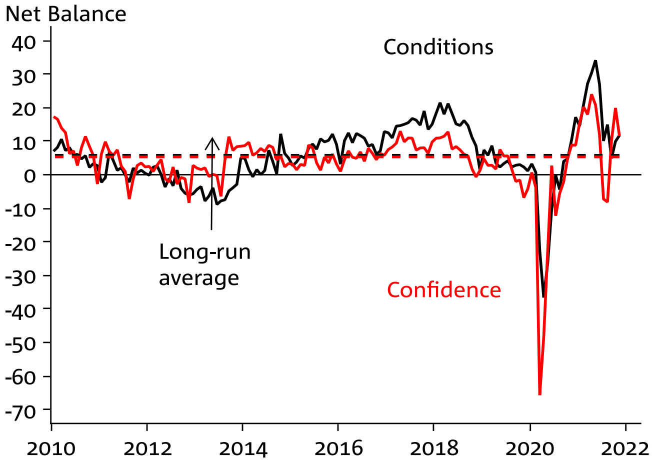
Export volumes rose 1.2% in the quarter, supported by a lift in commodities exports which offset declines in manufacturing and services exports, with inbound travel falling again after a slight rise in the prior quarter.

Import volumes fell 4.0%, with both goods and services imports down. There was a large fall in consumption goods imports, with supply chain issues a factor, and global auto production constraints also weighing on automotive imports. Overall, net exports contributed 1ppt to GDP growth.

In nominal terms, the most recent data from October showed the trade surplus narrowing slightly. Falls in 2both iron ore volumes and prices weighed on goods exports while goods imports also edged down further and services trade was little changed as travel restrictions remained in place.

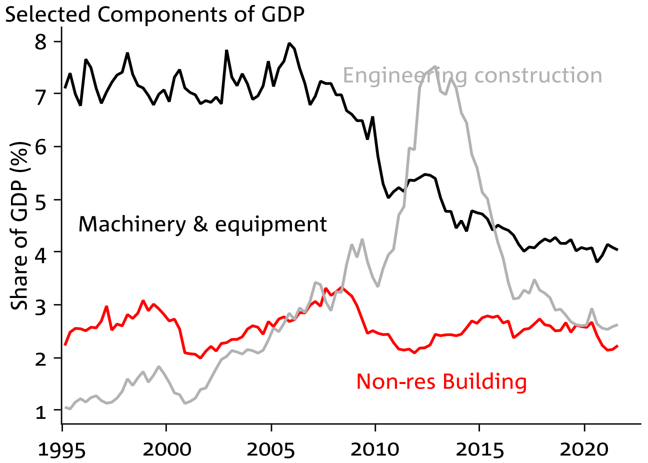
Looking ahead, the return of international students was postponed in early December but will go ahead. The normalisation of travel should also see inbound and outbound tourism eventually resume, normalising services trade across 2022. The pace of global recovery will also determine demand for goods exports, while the timing of the resolution of supply chain issues will matter for goods imports. We expect to see the trade surplus gradually narrow, detracting slightly from GDP across 2022 and 2023.

CONFIDENCE AND CONDITIONS STABILISING POST-LOCKDOWN



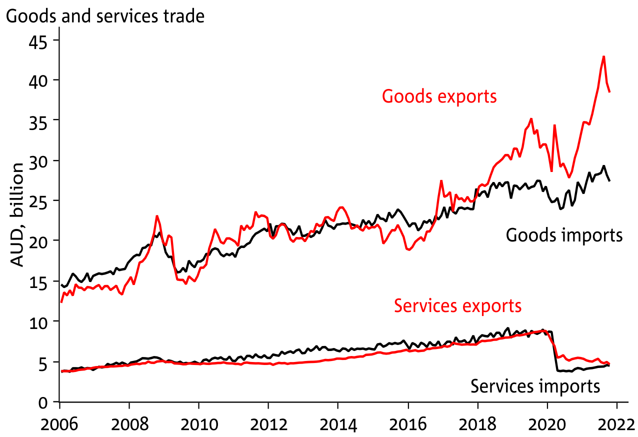
Source: National Australia Bank, National Australia Bank

INVESTMENT REMAINS LOW AS A SHARE OF GDP



Source: National Australia Bank, Australian Bureau of Statistics

TRADE SURPLUS CONTRIBUTES TO GDP IN SEPTEMBER



Source: National Australia Bank, Australian Bureau of Statistics

MONETARY POLICY, INFLATION AND FX

As expected, the RBA left the cash rate on hold in December. The Bank continues to be optimistic about the rebound in Q4 and through 2022, but remains cautious in its outlook for wages growth and inflation.

The post meeting statement acknowledged the risk around the news of the Omicron variant (but the Bank remained optimistic this would not derail the recovery) and the role policy support is playing in supporting growth. It also highlighted that leading indicators of the labour market point to a strong recovery in employment which should see a further strengthening in wage growth as the labour market tightens, but notes the weak starting point with Q3 WPI pointing to pre-pandemic levels of wage growth – a rate considered too slow.

Overall, while the RBA remains positive on growth it expects only a gradual pick-up in inflation, driven by a slow rise in wage increases.

In addition, the framework for deciding on QE was reiterated as: 1) what other central banks are doing; 2) the functioning of the bond market; and 3) progress towards the Bank's goals on full employment and inflation.

We expect the QE program to be wound up in February which would see the current and final tranche of bond purchases total around $85bn, taking total purchases to around $350bn since November 2020.

The drivers of this decision will likely be a faster taper by the Fed and the fact that the RBA has likely expanded its balance sheet significantly more than expected by not tapering in November (against the backdrop of a smaller-than-expected hit to activity and faster rebound), and the fact we think the unemployment rate will have returned to the mid 4's by the time of the February meeting.

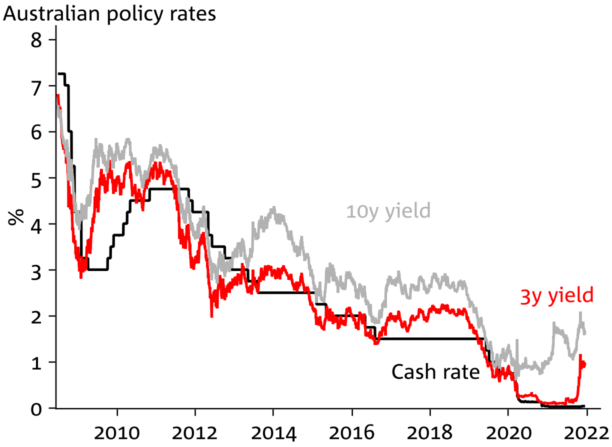
On the cash rate, we continue to see the first hike occurring in mid-2023. By then we see unemployment around 4% and wage growth having begun to flow through enough for the RBA to be confident that inflation has returned "sustainably" to the target band while many of the COVID induced transitory factors are likely to have waned.

The AUD/USD has depreciated slightly over the past month on renewed fears around the virus, with the emergence of the omicron variant.

We have revised down our forecasts slightly in the near-term – around US1c lower through 2022. Overall, we see the AUD/USD around 77c by end 2022, before appreciating to a peak of US78c by Q4 2023, and then paring back slightly over 2024.

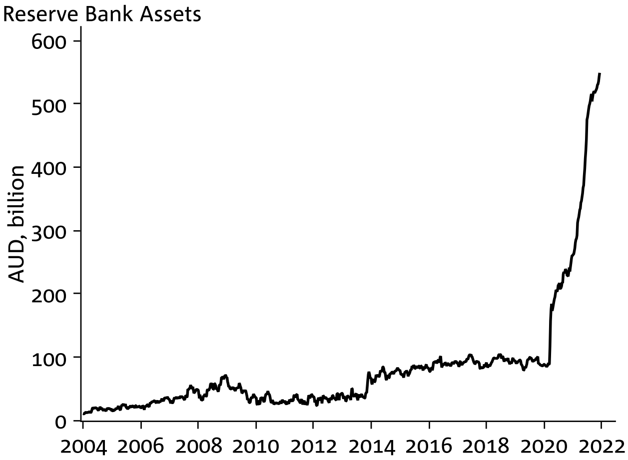
Importantly, the exchange rate in both USD and trade-weighted terms remains below the level at the time of the QE announcement adding support to the decision to end the program as we expect in February.

CASH RATE ON HOLD UNTIL MID-2023



Source: Reserve Bank of Australia, Macrobond Financial AB

RBA BALANCE SHEET TO PEAK IN FEBRUARY



Source: National Australia Bank, Reserve Bank of Australia

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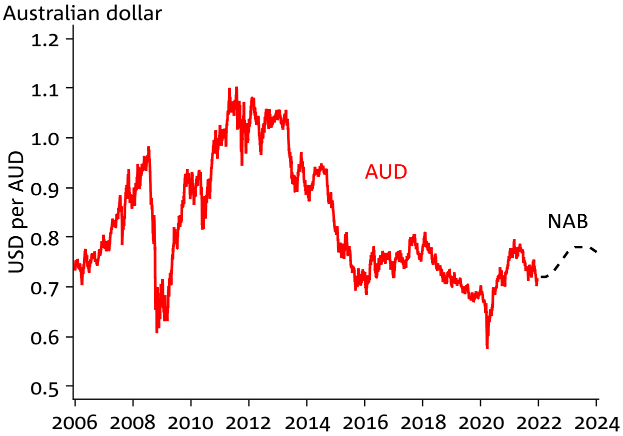

Source: National Australia Bank, Macrobond Financial AB

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	-3.1	1.0	0.7	5.3	0.9	-5.8	3.9	3.4	4.0
Dwelling Investment	-8.1	3.2	6.5	-2.1	-7.1	-5.6	10.2	1.7	-4.8
Underlying Business Investment	-2.7	-2.4	5.0	9.2	-2.3	-5.5	5.1	5.5	8.5
Underlying Public Final Demand	6.0	6.0	6.6	2.8	5.9	6.0	6.3	4.6	2.5
Domestic Demand	**-0.9**	**2.5**	**3.5**	**4.6**	**1.2**	**-2.5**	**5.6**	**4.0**	**3.6**
Stocks (b)	-0.3	0.8	-0.5	0.1	-0.3	0.0	0.4	-0.2	0.0
GNE	**-1.3**	**3.3**	**3.0**	**4.7**	**0.8**	**-2.5**	**6.0**	**3.8**	**3.6**
Exports	-1.7	-8.3	0.1	1.9	3.4	-9.8	-1.6	0.8	1.9
Imports	-7.7	-2.9	2.0	5.2	-1.4	-13.1	5.8	2.6	5.3
GDP	**0.0**	**1.5**	**2.7**	**4.0**	**2.0**	**-2.2**	**4.2**	**3.5**	**2.9**
Nominal GDP	1.8	4.4	8.8	6.1	5.3	-1.4	10.4	7.3	4.5
Current Account Balance ($b)	-37	-70	-99	-98	12	52	89	103	94
(%) of GDP	-1.9	-3.4	-4.4	-4.1	0.6	2.6	4.1	4.4	3.8
Employment	0.2	1.1	1.9	3.4	2.3	-1.7	3.1	2.5	2.8
Terms of Trade	1.0	10.2	15.0	1.2	5.4	-0.2	20.3	6.5	-0.8
Average Earnings (Nat. Accts. Basis)	3.4	2.6	2.5	2.9	3.0	3.6	1.6	3.1	3.0
End of Period									
Total CPI	-0.3	3.8	2.6	2.2	1.8	0.9	3.0	2.3	2.7
Core CPI	1.2	1.6	2.5	2.4	1.4	1.2	2.1	2.4	2.9
Unemployment Rate	8.2	4.9	4.3	3.7	5.1	6.7	5.0	4.1	3.8
RBA Cash Rate	0.25	0.10	0.10	0.10	0.75	0.10	0.10	0.10	0.75
10 Year Govt. Bonds	0.88	1.51	2.25	2.50	1.37	0.98	1.80	2.50	2.50
$A/US cents :	0.69	0.75	0.73	0.78	0.70	0.77	0.72	0.77	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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