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THE FORWARD VIEW: AUSTRALIA FEBRUARY 2022

STRONG REBOUND SLOWED BY OMICRON AS INFLATION BUILDS

OVERVIEW

- We have revised up the expected rebound in Q4 GDP on the back of stronger than expected partials but have pulled down Q1 2022 as the spread of omicron weighs on the economy through both consumer caution as well as disruption to business.
- Overall, that means we see above-trend growth of 3.7% during 2022 and closer to trend growth of around 2.5% in 2023. Growth will be supported in the near-term by a pick-up in household consumption, and further growth in both business and dwelling investment. Government spending is also expected to continue to support the economy through 2022.
- We see ongoing tightening in the labour market, with strong employment demand continuing to drive the unemployment rate lower from the 4.2% reached in December. Broader measures of labour market capacity have also tightened, with the underemployment rate falling to its lowest level in 13 years. Overall, we see the unemployment rate ending 2022 at 3.8% and 2023 at 3.7%.
- Further tightening in the labour market should see wage growth continue to rise from low levels – though only gradually. An update on the WPI will be released later in February but broader measures of wage pressure will become more important in assessing general inflationary pressure.
- Headline inflation has continued to track well above the target band, rising to 3.5% y/y in Q4. Underlying inflation rose to 2.6% y/y in Q4 – the second print within the target range in 6 years. The CPI continues to be buffeted by a range of temporary factors as a result of disruptions to global supply chains and elevated goods demand. We expect this to eventually resolve, but some of the unwind will be offset by wage growth. That sees underlying CPI around 3.4% by Q3 2022, but 2¾- 3% into late 2022 and 2023.
- On monetary policy, we have brought forward our expectation for rate hikes, with lift-off now likely in late 2022 followed by steady increases through 2023 and 2024 as the RBA moves to normalise policy.
- In the near-term, the key risks continue to be virus-related disruptions and for the labour market, a faster than expected tightening. Further out, the pace and size of the recovery in migration will be important while the rebalancing of goods and services spending will affect trade and consumption.
- Overall, the key themes for 2022 will likely be: 1) the true level of full-employment and how wage growth responds; 2) how quickly the balance between goods and services spending is restored; 3) if and when supply chain pressures begin to abate; and 4) whether the RBA continues to wait for evidence on more sustainable inflation or is pressured to hike sooner by strong headline prints and concern about inflation expectations.

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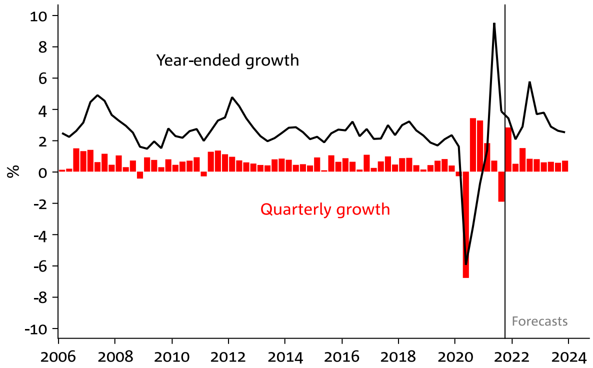
KEY ECONOMIC FORECASTS

	2020	2021-F	2022-F	2023-F
Domestic Demand (a)	-2.5	5.9	4.6	3.8
Real GDP (annual average)	**-2.2**	**4.5**	**3.6**	**2.9**
Real GDP (year-ended to Dec)	**-0.8**	**3.4**	**3.7**	**2.5**
Terms of Trade (a)	-0.2	19.1	1.2	0.8
Employment (a)	-1.7	3.2	3.0	2.6
Unemployment Rate (b)	6.7	4.7	3.8	3.7
Headline CPI (b)	0.9	3.6	3.0	2.0
Core CPI (b)	1.2	2.6	3.2	2.9
RBA Cash Rate (b)	0.10	0.10	0.50	1.50
$A/US cents (b)	0.77	0.73	0.77	0.77

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

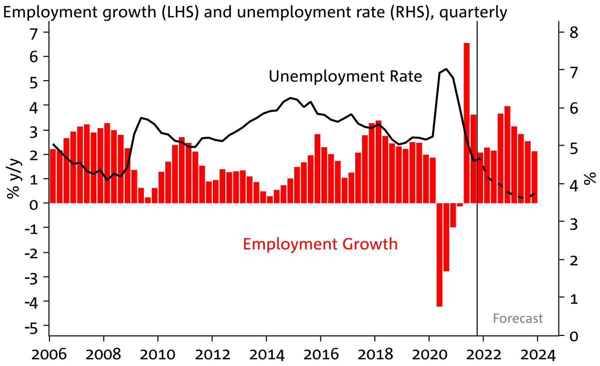
GDP FORECASTS



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 labour market surged at the end of 2021, with the monthly unemployment rate falling to decade-lows. As the Omicron outbreak eases, the unemployment rate should fall further and begin to drive higher wage growth.

Employment rose a record 366k in November and a further 65k in December, more than recovering the jobs lost during the Delta-outbreak lockdowns. The rapid recovery in employment saw the unemployment rate fall to 4.2% in December - the lowest since August 2008 – with the participation rate just short of its pre-Delta level.

The Omicron outbreak is likely to temporarily halt progress, although most of the effects are likely to show up in hours worked. Nonetheless, strength in job ads suggests the labour market momentum seen in late 2021 should carry on in 2022. While the reopening of international borders may ease some of the pressure, we expect the unemployment rate to fall below 4% by the end of 2022 (around 3.8%).

A tightening labour market should begin to translate into higher wage growth as the year goes on. The pickup is likely to be gradual, although broader measures that include bonuses and other payments may respond more quickly. We expect quarterly growth to tick up from its previous 0.6% q/q when the Q4 wage price index (WPI) is released later in February, with wage growth reaching 3% y/y in the second half of 2022.

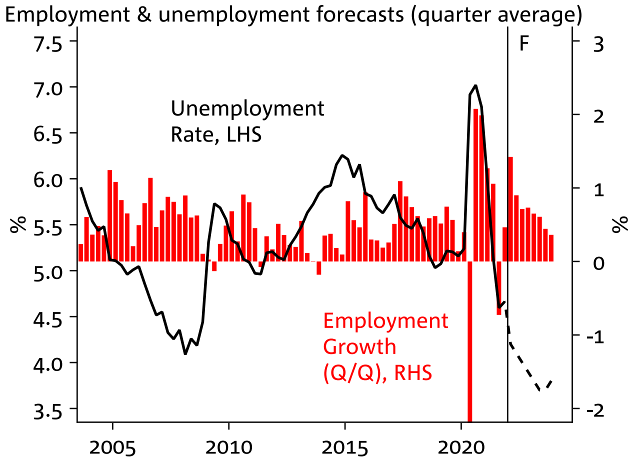
After a fall in consumption in Q3 drove the contraction in GDP, Q4 should see consumption almost fully recover its pre-Delta levels – and while Omicron will weigh on consumption at the start of 2022, the effects should be far more mild than past waves of the virus.

Quarterly retail trade volumes rebounded entirely from their largest fall on record in Q3, rising 8.2% q/q. The result was driven by catch-up spending after lockdowns with large gains in clothing, footwear & accessories, restaurants & takeaway food, household goods, and department stores. Services consumption should also have seen a rebound in the quarter.

The Omicron outbreak weighed on consumption in late December and, particularly, January. High-frequency data show a fall in restaurant bookings and NAB's internal data show a slowdown in hospitality and retail spending, although seasonality is also a factor post-Christmas. Still, the effects of the outbreak on consumption should be far milder than when lockdowns were imposed, and there are already signs that activity is quickly recovering as the virus wave appears to have passed its peak.

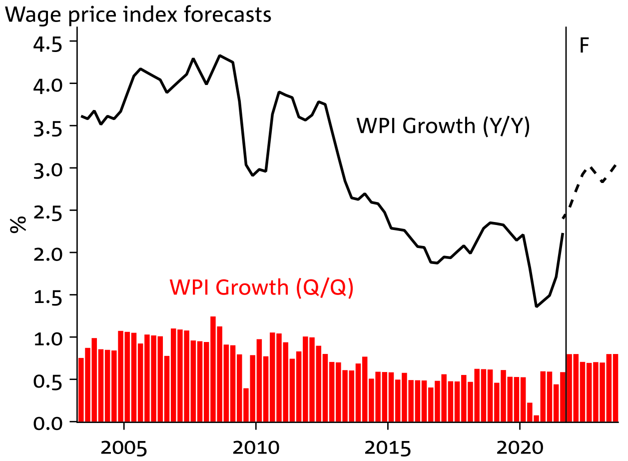
Overall, we expect the post-lockdown rebound to generate consumption growth of around 4.7% q/q in Q4. The slower start to Q1 should see growth of around 1.2%q/q before consumption begins to normalise through the remainder of the year.

UNEMPLOYMENT SET TO FALL TO RECORD LOWS, BELOW 4% BY END-2022



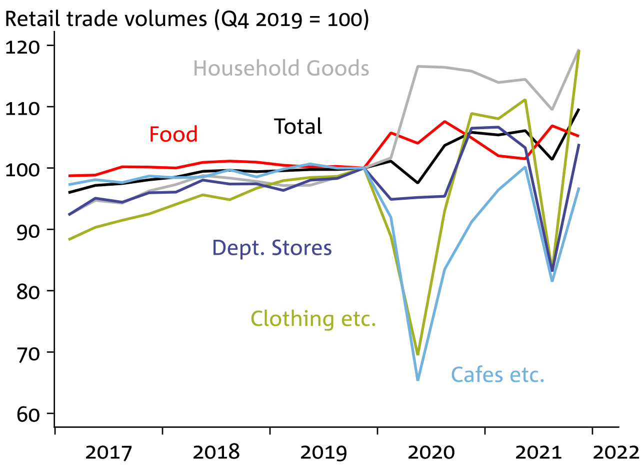
Source: National Australia Bank, Australian Bureau of Statistics

WAGE GROWTH SHOULD PICK UP TOWARDS 3% BY THE SECOND HALF OF 2022



Source: National Australia Bank, Australian Bureau of Statistics

RETAIL TRADE REBOUNDED TO RECORD LEVELS IN LATE 2021 (PRE-OMICRON)



Source: National Australia Bank, Australian Bureau of Statistics

HOUSING AND CONSTRUCTION

House price growth is still solid but slowing, and we expect prices to start falling from late 2022. A large pipeline of work should mean that residential investment continues growing into next year despite leading indicators trending down.

Capital city dwelling price monthly growth moved below the 1% level in December (0.6% m/m) and continued at similar pace in January (0.8% m/m). Price growth has eased across most capitals, but has accelerated in Brisbane and Adelaide. Outside of the capital cities, growth has been robust at around a 2% m/m rate.

Last week we updated our capital city house price forecasts, and now expect to see an earlier downturn in dwelling prices. We expect price growth will continue to ease through 2022 before prices start falling late in the year as affordability constraints begin to bite and the RBA starts hiking. This trend is expected to continue through 2023 with prices projected to fall by around 10%.

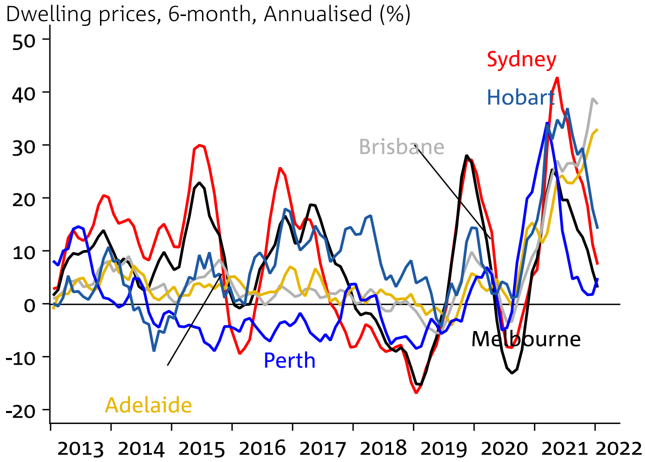
The value of new housing loan commitments remains elevated and reached a new high in December. While commitments have risen by more than 10% over the last two months, they are not significantly different to their May level, with lockdowns (and their end) possibly explaining the recent volatility. Regardless, it is clear that the rapid growth in new loans seen earlier is well behind us. While new loans are more directly linked to turnover, a slower rate of growth is generally also consistent with more moderate (future) house price growth.

New loans to owner-occupiers for purposes of new construction did fall in December, but this followed a rise in November. Similarly, dwelling approvals have stabilised in recent months. While this points to a moderation in the downwards trend evident for much of last year, with population growth still depressed, construction costs rising rapidly, and some lingering HomeBuilder hangover, some further falls in approvals in coming months would not be a surprise.

The falls in building approvals we have seen since around mid-2021 would normally suggest a decline in residential investment. However, due to capacity constraints (including labour and access to building materials) as well as the delays to work from lockdowns, a big gap has opened between the value of approvals/work commenced and the value of work done. This resulting pipeline will take a while to work through although how quickly this will be done is highly uncertain.

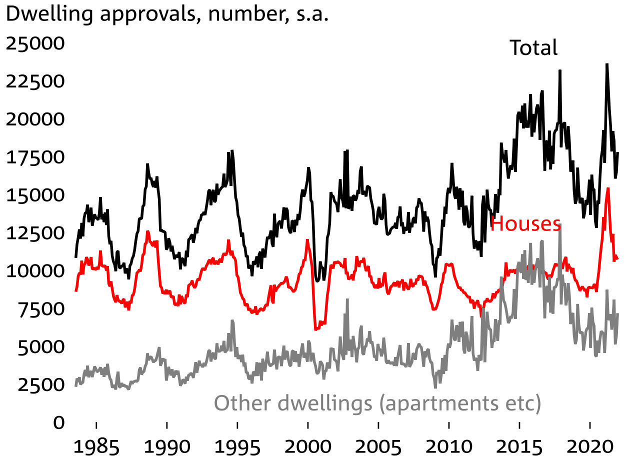
As a result, we expect residential investment in the national accounts to rise through to mid-2022 (including a post-lockdown bump in Q4 2021). The subsequent pull back in activity is expected to accelerate heading into 2023 following the start of RBA rate hikes. While housing is one of the more interest sensitive sectors of the economy, if the labour market also holds up (as projected) and population growth recovers, this will limit the downturn. Indeed, at the end of 2023 we still have a solid (by historical standards) level of construction.

HOUSE PRICE GROWTH EASING OVERALL – BUT BIG DIVERGENCES BY STATE



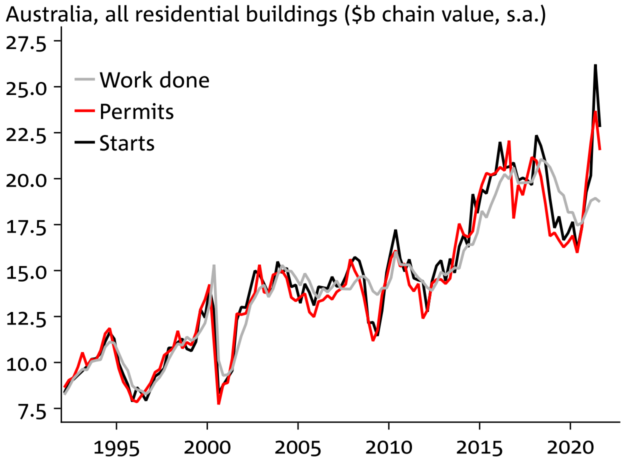
Source: CoreLogic, National Australia Bank, Macrobond

APPROVALS HAVE STABILISED IN RECENT MONTHS - TOO EARLY TO SAY DOWNTURN IS OVER



Source: Macrobond, National Australia Bank

EVEN WITH APPROVALS WELL DOWN; LARGE AMOUNT OF WORK IN THE PIPELINE



Source: National Australia Bank, Australian Bureau of Statistics

BUSINESS AND TRADE

Though continuing to face many pandemic-related challenges, the business sector has held up relatively well through the latest outbreak.

Business conditions fell in December and January but remain in positive territory. The declines were led by a fall in the employment index. Conditions declined in all states and in most industries.

Overall, however, the decline in conditions has been modest when compared with previous lockdowns, and confidence rebounded into positive territory in January (after a sharp fall in December). Further, capacity utilisation rebounded and is now just above average.

More broadly, both the Quarterly and Monthly surveys continue to reflect the cost pressures faced by business. Growth in input costs and the wage bill continues to track at elevated rates. Businesses have been able to pass on some of this cost pressure, with output prices also tracking at solid rates, though they also report a deterioration in margins.

By sector, the survey also continues to reflect the impact on recreation & personal services which, despite the broad-based deterioration in the month, is the only sector to remain in negative territory in trend terms.

The outlook for business investment remains important, with weak non-mining capex for much of the past decade seeing investment as a share of GDP fall to very low levels. Pandemic-related government supports have seen some boost to investment but whether this is sustained on an ongoing basis is yet to be seen. The Q4 NAB Quarterly survey showed capex plans for the next 12 months strengthening (albeit pre-Omicron outbreak) and an increasingly tight labour market should also encourage investment. The next ABS Capex Survey will be released at the end of the month.

Monthly trade data in combination with trade price releases points to a solid subtraction from GDP by net exports in Q4.

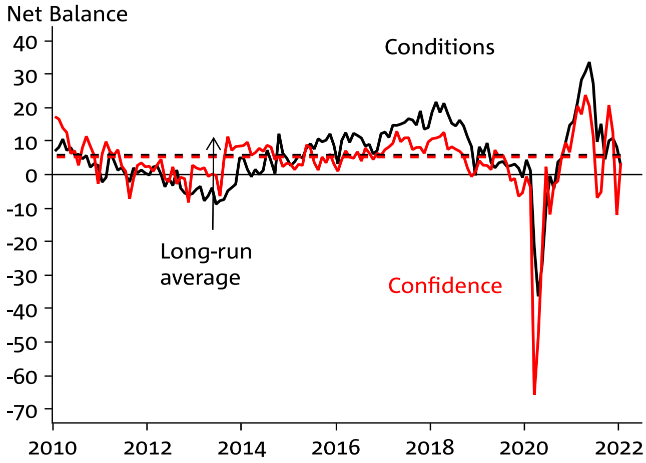
The monthly trade surplus narrowed by $1.4bn to $8.4bn in December, as a 5% rise in imports more than offset a 1% increase in exports.

On the exports side, a rise in metal ores & minerals was broadly offset by a fall in coal exports, while other mineral fuels declined slightly. Rural goods declined by 3% in the month.

Import values rose by a solid 6% in the month led by an 8% increase in consumption goods, though intermediate and capital goods imports also rose in the month. Services imports rose by a more modest 1%.

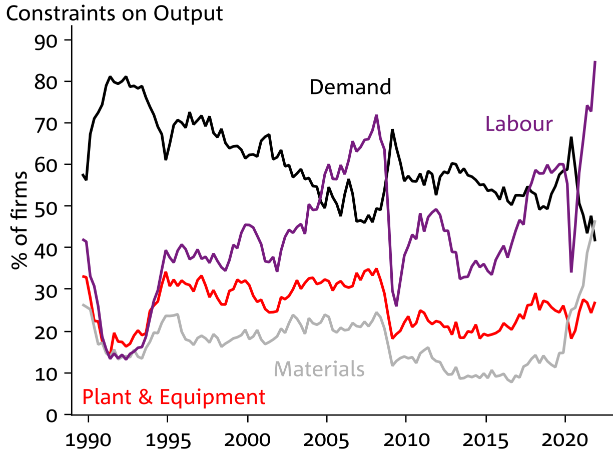
In the medium term we expect net exports to continue to subtract from GDP with the growth in imports continuing to outpace exports.

CONFIDENCE AND CONDITIONS HAVE HELD UP



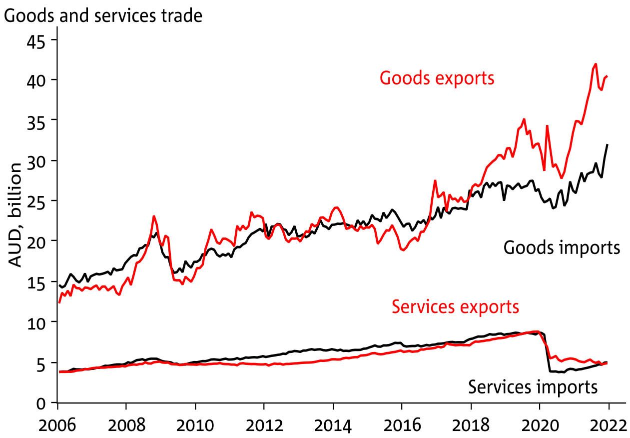
Source: National Australia Bank, National Australia Bank

AVAILABILITY OF LABOUR AND MATERIALS HAVE POSED SIGNIFICANT CONSTRAINTS FOR BUSINESS



Source: National Australia Bank

TRADE SURPLUS TO SUBTRACT FROM Q4 GDP



Source: National Australia Bank, Australian Bureau of Statistics

MONETARY POLICY, INFLATION AND FX

As expected, the first RBA meeting of the year marked the end of the QE program and opened to the door to a possibility of a late 2022 rate hike.

The RBA also noted that a decision on reinvestment of maturing bonds will be made at the May meeting, ahead of around $4.2bn of maturities in July and November. The maturities in the near term are unlikely to have a significant impact on the bond market or liquidity in the cash market, nor are they likely to matter in a policy sense. However, they may be more consequential in future years when there are larger maturities to manage. The RBA has noted the starting point for reinvestment will depend on economic conditions at the time and signalled they are yet to make a decision as they work through the options. While the RBA will be pre-disposed to normalising the balance sheet, the cash rate will likely remain the primary tool once the RBA looks to tighten policy.

On the cash rate, the RBA has acknowledged the possibility of rate rises in 2022 after significantly upgrading its forecasts for the labour market and inflation, which is now projected to move beyond the top of the target band in "coming quarters" before easing back to target in 2023. For now, the RBA continues to look through transitory drivers of higher inflationary outcomes but has increased the flexibility in its communication. The SMP, the Governor's recent speech and post meeting minutes all suggest the RBA is willing to remain "patient" as it assesses whether inflation is sustainably within the target band but will likely be challenged by inflation rising above 3% in underlying terms in the near-term.

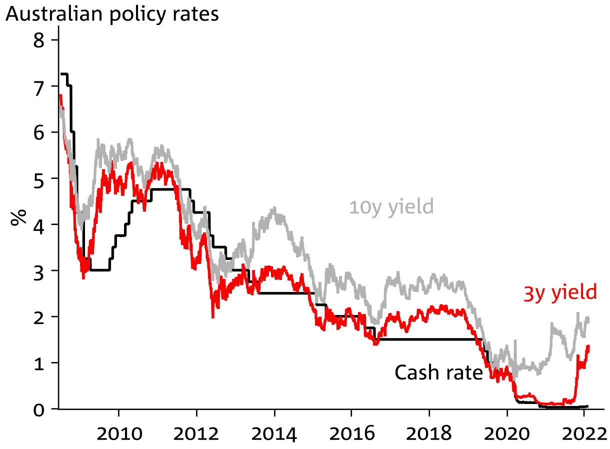
We expect the RBA to begin lifting he cash rate from November, with the target rising to 0.75% by February.

We expect inflation to peak a little above the RBA's central forecast in the near term (3.4%) but see inflation starting to normalise by late 2022 as transitory factors wane. Ultimately the RBA remains an inflation targeting bank, and so will be challenged by short-term inflation prints, though will likely focus most on the risk to inflation expectations – particularly in the wage bargaining process – as transitory factors play out. We see broader wage growth showing enough evidence that the tightening in the labour market is flowing through to prices more broadly by November, with the RBA beginning a steady series of rate hikes that will see the cash rate around 1.5% by end 2023 and continuing into 2024.

The AUD/USD has continued to hover in the low US70c range over the past month.

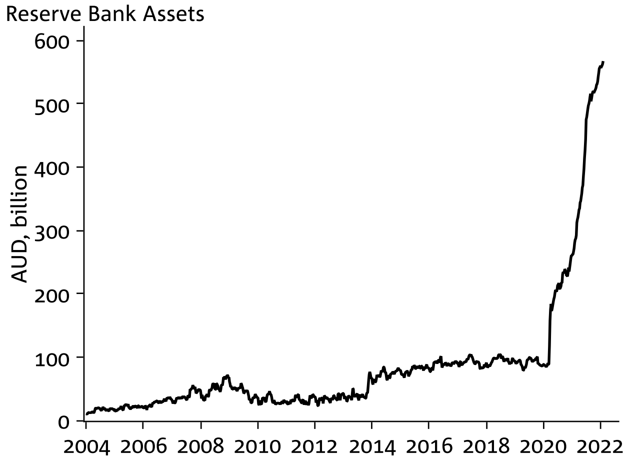
Our forecasts remain unchanged, and we still expect a small appreciation over the next 2 years. Overall, we see the AUD/USD around 77c by end 2022 and staying around that level until end 2023.

CASH RATE LIKELY TO RISE IN LATE 2022



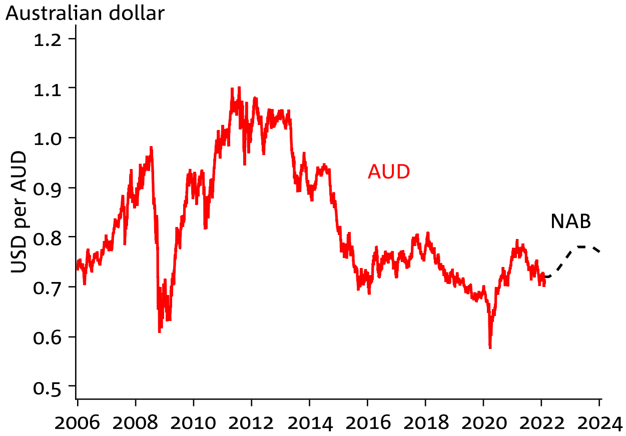
Source: Reserve Bank of Australia, Macrobond Financial AB

RBA BALANCE SHEET TO PEAK IN FEBRUARY



Source: National Australia Bank, Reserve Bank of Australia

AUD TRACKING IN THE LOW US70C RANGE



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	2.0	5.6	0.9	-5.8	4.4	4.5	4.2
Dwelling Investment	-8.1	3.2	6.5	-2.2	-7.1	-5.6	10.2	1.7	-4.9
Underlying Business Investment	-2.7	-2.4	5.9	10.6	-2.3	-5.5	5.7	6.4	9.5
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**	**4.3**	**4.9**	**1.2**	**-2.5**	**5.9**	**4.6**	**3.8**
Stocks (b)	-0.3	0.8	-0.5	0.1	-0.3	0.0	0.5	-0.3	0.0
GNE	**-1.3**	**3.3**	**3.8**	**4.9**	**0.8**	**-2.5**	**6.5**	**4.3**	**3.8**
Exports	-1.7	-8.3	-0.4	1.7	3.4	-9.8	-1.7	0.3	1.9
Imports	-7.7	-2.9	4.5	6.5	-1.4	-13.1	6.8	5.0	6.0
GDP	**0.0**	**1.5**	**3.0**	**4.0**	**2.0**	**-2.2**	**4.5**	**3.6**	**2.9**
Nominal GDP	1.8	4.4	8.4	6.2	5.3	-1.4	10.5	6.6	4.9
Current Account Balance ($b)	-37	-70	-68	-59	12	52	81	60	51
(%) of GDP	-1.9	-3.4	-3.0	-2.5	0.6	2.6	3.7	2.6	2.1
Employment	0.2	1.1	2.3	3.4	2.3	-1.7	3.2	3.0	2.6
Terms of Trade	1.0	10.2	9.9	1.2	5.4	-0.2	19.1	1.2	0.8
Average Earnings (Nat. Accts. Basis)	3.4	2.6	2.6	2.9	3.0	3.6	1.6	3.2	3.0
End of Period									
Total CPI	-0.3	3.8	3.6	2.6	1.8	0.9	3.6	3.0	2.7
Core CPI	1.2	1.6	3.4	2.8	1.4	1.2	2.6	3.2	2.9
Unemployment Rate	8.2	4.9	4.0	3.6	5.1	6.7	4.7	3.8	3.7
RBA Cash Rate	0.25	0.10	0.10	1.00	0.75	0.10	0.10	0.50	1.50
10 Year Govt. Bonds	0.88	1.51	2.25	2.50	1.37	0.98	1.68	2.50	2.50
$A/US cents :	0.69	0.75	0.73	0.78	0.70	0.77	0.73	0.77	0.77
$A - Trade Weighted Index	60.0	62.7	59.9	63.6	60.3	63.4	61.1	63.5	62.3

(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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