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THE FORWARD VIEW: AUSTRALIA MARCH 2022

UNEMPLOYMENT TO FALL BELOW 4%; INFLATION RISKS BUILD

OVERVIEW

- **Based on recent upside surprises in the data we now expect a lower unemployment rate and higher inflation in the near-term, while our forecasts for activity remain broadly unchanged. As a result, we have also brought forward our cash rate profile.**
- **The Q4 national accounts confirmed that consumption rebounded very strongly as the Delta lockdowns eased. With the savings rate still high but beginning to decline, household consumption will likely be well supported in coming quarters.**
- **The accounts do not materially shift our outlook for the pattern of growth. We expect ongoing strength in overall consumption spending (albeit slightly disrupted in Q1 by Omicron and, more recently, floods). We continue to see dwelling and business investment as well as government spending supporting growth in the near term, while trade is expected to be a small drag on growth.**
- **Overall, that sees growth of 3.4% in 2022 and closer to trend growth of 2.1% in 2023. However, the headline figures will mask a rebalancing in goods and services spending, as well as a recovery in services trade.**
- **The strength in activity and strong labour demand (evident in both the NAB Business Survey and job vacancies/ads) points to the unemployment rate declining further. We now see the unemployment rate falling below 4% by March and reaching 3.5% by mid-2022 – and staying there. This will eventually see a strengthening in the pace of wage growth.**
- **For us, the strength in activity and tighter labour market then shifts the focus squarely to the nominal side of the economy in terms of the RBA entering a phase of rates normalisation as well as key decisions on unwinding the balance sheet.**
- **We expect strong inflationary pressure to persist in the near-term and have revised up our forecasts for the CPI. We now see underlying inflation prints of around 1% in both Q1 and Q2 – taking the year-ended rate to 3.7% by mid-year. Our headline CPI forecasts are also higher, reaching 4.2% by Q3 2022 (on the back of oil prices) before easing to 2.6% by end 2023.**
- **The upgrade to our underlying CPI forecasts alongside an even tighter labour market has brought forward our call for rates "lift-off". We now see the RBA lifting the cash rate by 15bps in August, with 25bp follow ups in September and November.**
- **The key risks for the economy have shifted significantly over the past 6 months or so. Lockdowns and border closures appear to now be in the rear-view mirror and the key uncertainty is how quickly spending patterns, international services trade and population growth normalises. In addition, the war in Europe looms, posing risks on both the activity and nominal sides of the economy. These risks are discussed in more detail on page 6.**

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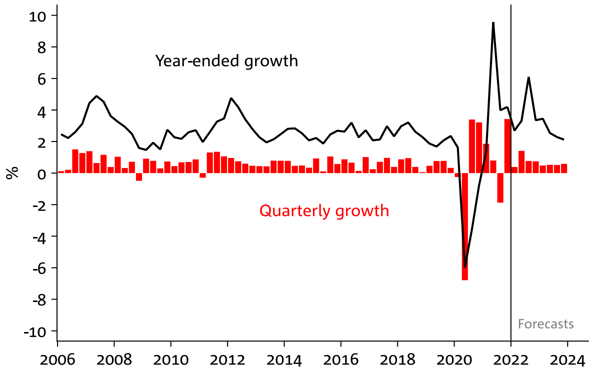
KEY ECONOMIC FORECASTS

	2020	2021-F	2022-F	2023-F
Domestic Demand (a)	-2.5	5.9	4.2	3.2
Real GDP (annual average)	**-2.2**	**4.7**	**3.9**	**2.6**
Real GDP (year-ended to Dec)	**-0.8**	**4.2**	**3.4**	**2.1**
Terms of Trade (a)	-0.2	17.7	-1.6	0.8
Employment (a)	-1.7	3.2	3.3	2.5
Unemployment Rate (b)	6.7	4.7	3.5	3.6
Headline CPI (b)	0.9	3.6	3.4	2.7
Core CPI (b)	1.3	2.6	3.5	2.9
RBA Cash Rate (b)	0.10	0.10	0.75	1.50
$A/US cents (b)	0.77	0.73	0.77	0.77

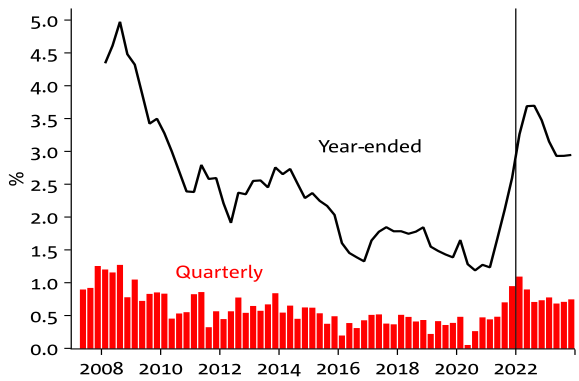
(a) annual average growth, (b) end-period, (c) through the year inflation

GDP FORECASTS



Source: National Australia Bank, Australian Bureau of Statistics

UNDERLYING CPI FORECASTS



Source: National Australia Bank

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

LABOUR MARKET, WAGES AND CONSUMER

January data showed the labour market remained strong through the Omicron outbreak, despite significant disruptions, setting up a potentially record-breaking year ahead as focus turns to wages.

Employment edged up 0.1% in the month after a strong end to 2021. That result masked a significant fall in hours worked – down 8.8% - largely attributable to the surge in COVID case numbers and large numbers of workers required to isolate. With case numbers now falling, hours worked should rebound in February.

Participation also rose in January – despite higher virus spread – offsetting the employment rise and keeping the unemployment rate at 4.2%. With labour demand still strong, borders reopening, and some states still below pre-COVID participation rates, both the labour force and employment should have further to run in coming months. We now expect unemployment to fall below 4% by March and reach around 3.5% in the second half of the year.

Focus now turns to wages and whether record low unemployment and a strong inflation outlook will combine to drive wage growth higher. The December quarter WPI showed solid gains with annual wage growth back around pre-COVID levels, but it remains short of the 3% annual growth achieved the last time the labour market was this tight. We expect gradual progress, with the WPI reaching around 3% in the second half of 2022 and broader labour cost measures also strengthening.

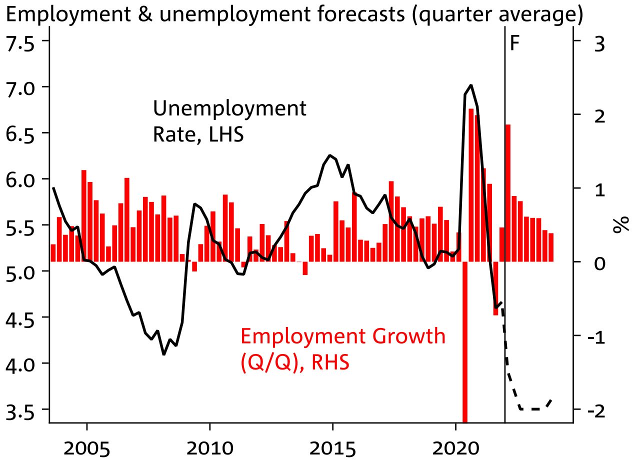
Last week's national accounts showed a dramatic rebound in household consumption in the December quarter, pushing consumption above pre-COVID levels for the first time. We expect a softer start to 2022 but the large stock of savings should position consumers to keep spending over the year.

Services consumption rose 6.3% in the quarter as restrictions were lifted, with consumers in NSW, Vic, and the ACT flocking back to hotels, restaurants & cafes (up 24.3%), recreation & culture (up 17.1%) and healthcare (up 7.9%). Goods spending also rose 6.3% as in-person retail spending came back, with some evidence of pent-up demand for items such as clothing and footwear.

High frequency data suggest that, while the Omicron outbreak slowed spending in January, the impact on consumption quickly passed and NAB's internal data suggest consumption was strong through February. Along with flood impacts, that should result in more modest consumption growth of around 1% in the March quarter.

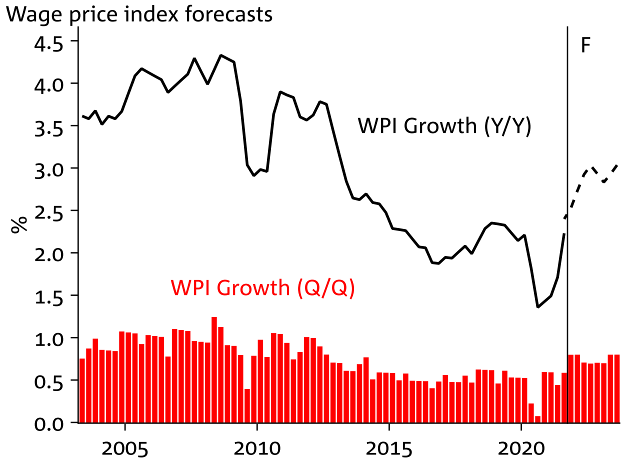
While the savings ratio came down in December, it remains elevated at 13.6% and households have built up a considerable savings buffer through the pandemic, which will support consumption across 2022. Weighing against will be the threat of higher prices including, potentially, some dampening impact from higher petrol prices, especially if global events further constrain oil supplies. Currently elevated spending on goods is also likely to moderate, while services spending likely has further to run as consumption behaviour normalises.

UNEMPLOYMENT SET TO FALL BELOW 4% IN MARCH, REACHING RECORD LOWS THIS YEAR



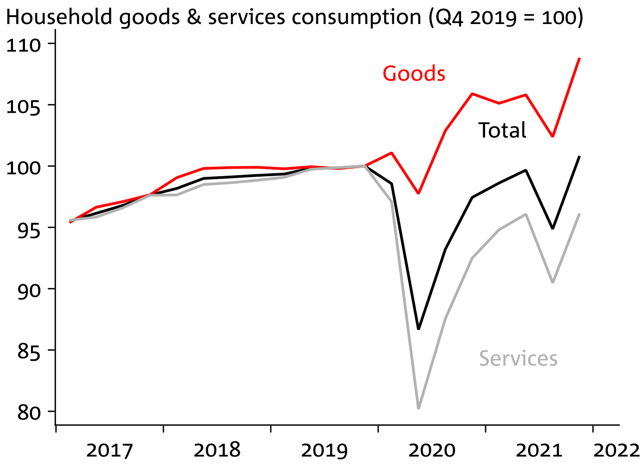
Source: National Australia Bank, Australian Bureau of Statistics

Q4 WAGE GROWTH WAS SOLID WITH GRADUAL PROGRESS TOWARDS 3% EXPECTED



Source: National Australia Bank, Australian Bureau of Statistics

HOUSEHOLD CONSUMPTION REBOUNDED IN Q4 TO BE ABOVE PRE-COVID LEVELS FOR THE FIRST TIME



Source: National Australia Bank, Australian Bureau of Statistics

HOUSING AND CONSTRUCTION

House price growth continues to slow. Dwelling investment fell in Q4 and there was a large fall in building approvals in January, but the large backlog of work should support dwelling investment.

Capital city dwelling prices grew by 0.3% m/m in January, the slowest rate of growth since late 2020. There was a small fall in Sydney prices while Melbourne was flat. Prices continued to rise at a rapid pace in Brisbane (1.8% m/m) and Adelaide (1.5% m/m) but this represents a slower pace than in recent months. Similarly, regional dwelling price growth remained strong (1.6% m/m) but is also showing signs of slowing.

Our expectation remains for capital city price growth to ease in 2022 ahead of falls later in the year and into 2023; with an overall price decline (to end-2023) of around 10%. The rapid deceleration in price growth in January, coupled with a bring forward of when we expect the RBA to start hiking rates (to August), raises the possibility that the correction in house prices may occur sooner, although we remain comfortable with the likely magnitude of the correction embodied in our current forecasts.

Dwelling investment fell in Q4 2021 by 2.2% q/q, although it was still up 5.3% y/y. The result was disappointing given our expectation that investment would increase in the quarter, particularly given the impact of lockdowns on Q3 activity. Indeed, dwelling investment increased in NSW and ACT as restrictions were lifted, but this was not enough to offset falls elsewhere.

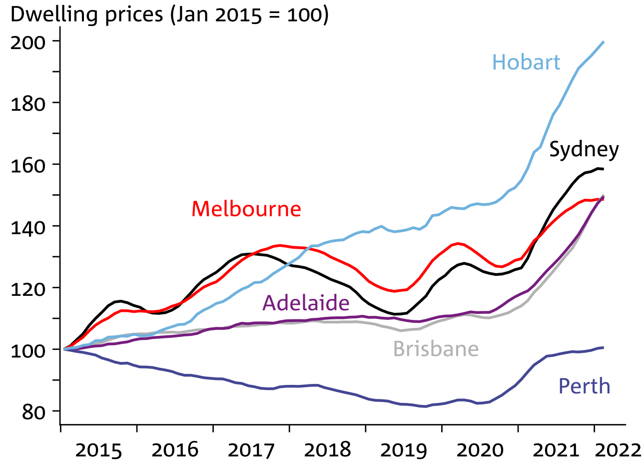
Based on historical experience, dwelling investment has been weaker than implied by building approvals. Labour and materials shortages, as well as disruptions from lockdowns, are likely the key factors explaining the gap.

In January 2022 building approvals plunged (-27.9% m/m), returning to around pre-pandemic levels. Loan approvals for the construction of new dwellings by owner-occupiers have held up better, but the broad message is that leading indicators are trending downwards. In addition to the end of HomeBuilder in March 2021, rising construction costs, depressed population growth, and increases in fixed-rate mortgages have weighed on the sector.

This makes for a murky outlook for dwelling investment, even in the short-term. Falling building approvals would normally suggest a fall in coming quarters. However, the large pipeline of work to be completed should support activity, although how quickly supply constraints will ease is uncertain, with construction work in Q1 also likely negatively affected by the Omicron wave. The re-opening of borders, and the likely boost to population growth, will also help underpin activity, but the expected start of RBA rate hikes later this year will act the other way.

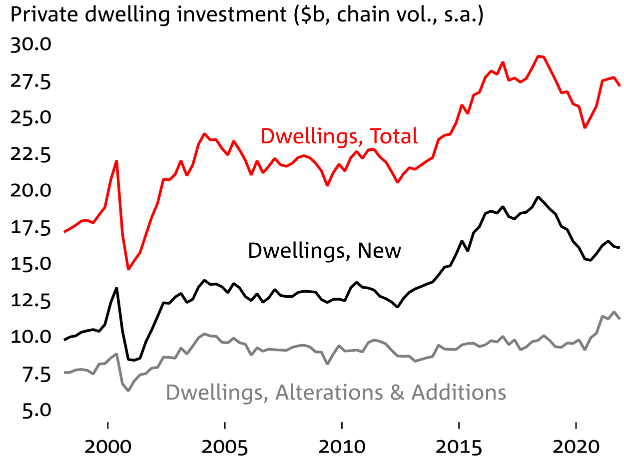
As a result, we don't expect residential investment to fall significantly below its end 2021 level over our forecast horizon, although there will likely be some more quarters of negative growth over 2022 and 2023.

HOUSE PRICES HAVE FLATTENED OUT IN SYDNEY/MELB; DECELERATING ELSEWHERE



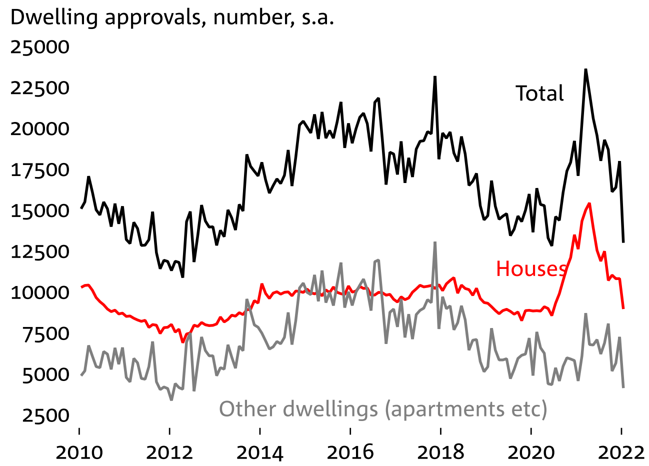
Source: National Australia Bank, CoreLogic, Macrobond

DWELLING INVESTMENT DECLINED IN Q4



Source: National Australia Bank, Australian Bureau of Statistics

A LARGE FALL IN DWELLING APPROAVLS IN JAN; NOW BACK AT AROUND PRE-PANDEMIC LEVELS



Source: Macrobond, National Australia Bank

BUSINESS AND TRADE

The NAB monthly business survey for February showed a solid rebound in confidence and conditions following the Omicron-impacted January read.

Business conditions rose to be back above average – led by gains in NSW and Vic. Australia wide, there were gains across all non-mining industries. In trend terms, all industries remain in positive territory with the exception of recreation & personal services which has remained in negative territory despite the easing in restrictions and opening of state borders.

Forward-looking indicators also saw positive outcomes in the month, with a broad-based pickup in confidence and a rebound in forward orders. The survey again reflects the resilience in the economy built up through the pandemic, with disruptions to activity short lived.

Importantly, capacity utilisation also picked up in the month and is now back above average. A sustained level of capacity utilisation will be an important indicator of a potential lift in business investment which disappointed in Q4. The national accounts showed a decline in investment in both machinery & equipment and buildings & structures. This follows an encouraging rise in equipment investment earlier in 2021, on the back of government incentives put in place during the pandemic. Investment remains at a relatively low share of GDP.

The ABS Capex Survey points to a pickup in investment – with the first set of intentions for 2022/2023 pointing to a 10% rise, but early estimates are usually revised significantly. Also, supply chain disruptions and the impact on prices of capital goods and building construction costs may well weigh on overall investment in the near-term.

Trade will likely be an important swing factor in our overall GDP forecasts over the next year or so, with the return of international travel expected to allow education exports to begin recovering.

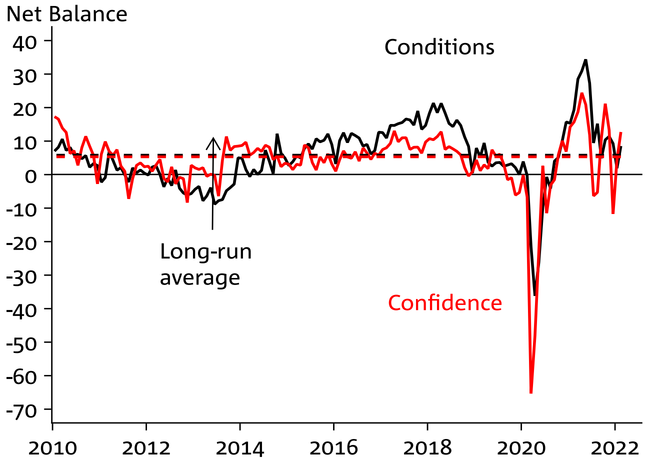
Still, data for the December quarter showed that services trade, which has been heavily impacted by the pandemic, remains depressed. Overall, net exports subtracted 0.2ppts from growth in Q4 with a 1.5% fall in exports more than offsetting a 0.9% decline in imports.

On the exports side, the decline was broad-based with resources (down 2.5%) weaker on wet weather disruptions and larger declines in manufactured and services exports.

On the imports side, consumption and capital imports were weaker, though intermediate goods picked up.

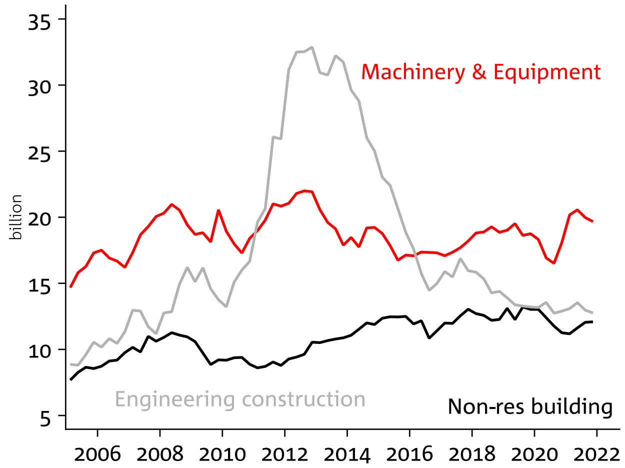
Going forward, we expect services trade to recover with the international border now fully opened. The relative pace of the recovery in goods and services imports remains uncertain. Education exports may recover more slowly – with courses generally beginning at the start of the year. For now, we have pencilled in a slightly faster recovery in imports (and also see consumption growth supporting imports) with net exports subtracting 0.4ppts from growth in 2022.

CONFIDENCE AND CONDITIONS HAVE HELD UP



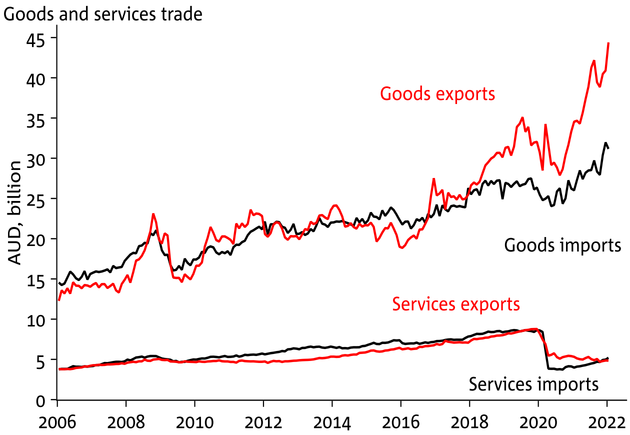
Source: National Australia Bank, National Australia Bank

BUSINESS INVESTMENT WAS SOFTER IN Q4



Source: National Australia Bank, Macrobond

TRADE SURPLUS TO SUBTRACT FROM Q4 GDP



Source: National Australia Bank, Australian Bureau of Statistics

MONETARY POLICY, INFLATION AND FX

The RBA's March post-meeting statement continued to emphasise a wait and see approach as evidence accumulates on whether inflation has sustainably returned to the target band.

The RBA acknowledged the geopolitical tensions in Europe have elevated uncertainty for the global economy, noting that for Australia, energy prices are likely to be the most significant impact. In addition, the RBA highlighted the ongoing impacts on the CPI in the near term from petrol prices and other supply side issues, alluding to the difficulty in assessing whether inflation is sustainably back within the 2-3% band as the impact of supply chain issues wanes or even reverses.

Importantly in terms of domestic inflationary pressure, the RBA notes that while wages growth has risen slightly, it remains broadly around the pre-pandemic rate. However, as the labour market tightens, wage growth is expected to lift – albeit gradually. The RBA continues to emphasise the importance of overall growth in labour costs with non-wage benefits potentially growing faster in a low unemployment rate environment.

Overall, the RBA reiterated that it is willing to be patient in assessing the evidence of inflation sustainably in the target bad. Indeed, the RBA appears willing to accept the risk of a period of inflation above the target band (especially considering transitory factors).

Nonetheless, we have brought forward our call for the first RBA hike to August, on the back of our updated forecasts for unemployment and CPI. We also expect the RBA to allow its bond holdings to mature without reinvestment.

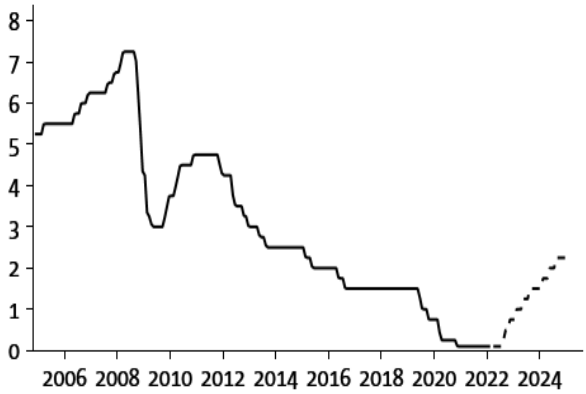
We expect the trimmed-mean measure of CPI for both Q1 and Q2 to print around 1% which would see underlying inflation tracking around 3.5%. We also now see the unemployment rate at around 3.5% by mid-year. Importantly, wage growth has lifted and while not yet materially stronger than the pre-pandemic era, it is expected to pick-up from here. An unemployment rate of around 3.5% would provide some comfort to the RBA that a tight labour market will eventually feed through to faster wage growth – with August providing an opportunity to hike following the Q2 CPI.

The AUD/USD has strengthened over the past month, currently trading around US73c after hovering around US71c for the early part of 2022.

While the currency initially weakened on risk off sentiment as Russia invaded Ukraine, the currency has strengthened in recent days on the back of stronger commodity prices. The trade weighted index is currently at 62.0 – down around 3% on this time last year.

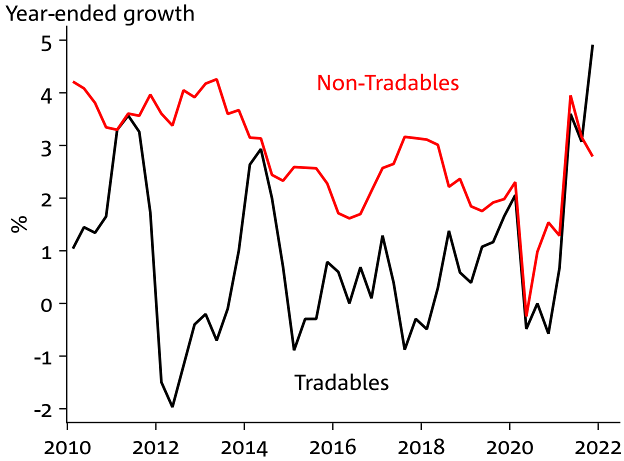
Our forecasts remain unchanged, and we still expect a small appreciation over the next 2 years. Overall, we see the AUD/USD around 77c by end 2022 and staying around that level until end 2023.

RBA TO BEGIN HIKING IN AUGUST



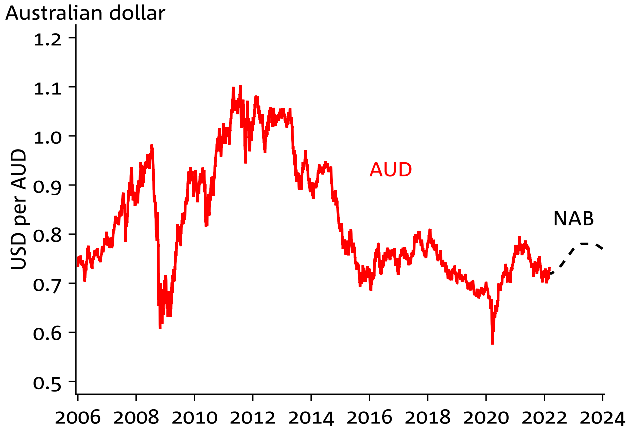
Source: Macrobond, NAB Economics

TRADABLES INFLATION HAS SPIKED



Source: National Australia Bank, Australian Bureau of Statistics

AUD TRACKING IN THE LOW US70C RANGE



Source: National Australia Bank, Macrobond Financial AB

RISKS TO THE OUTLOOK

Russia's invasion of Ukraine, apart from its humanitarian toll, will also impact the global economy. Due to Australia's role as major commodity exporter, the net economic impact is uncertain. Ultimately how long the conflict lasts (and whether there is any further escalation), as well as the impact of sanctions on global activity and financial markets, will have a large bearing on the economic impact to Australia.

Australia's direct trade with both Russia and the Ukraine is very limited; around 0.2% of total goods and services trade in 2020. Even looking at the broader Eastern Europe region – which will be most affected by expected severe downturn in the Russian and Ukraine economies – doesn't change this perspective.

However, Australia's economy will be affected by the increase in energy (and likely also food) costs, trade and finance disruptions from sanctions, risk aversion due to the high degree of uncertainty and wealth impacts from falling equity prices. At this stage we expect around a ½ppt reduction in global growth which, for the major economies, represents a slowing in growth rather than a major downturn. Financial conditions have also tightened and there is considerable uncertainty around the full implications of the sanctions on Russia, and its banks, on the financial system.

Russia and the Ukraine are major exporters of energy (gas and oil) and agriculture (wheat, barley) as well as metals (e.g. nickel, aluminium, palladium), fertilisers, and gases (e.g. neon). Reflecting this, there have been steep rises in oil, gas, coal and other commodity prices.

These price rises will be felt by Australian consumers and businesses, reducing spending power and compressing margins where costs are not passed on. Past modelling suggests a 10c per litre increase in petrol prices reduces consumption by around 0.2% over a 12-18 month period. However, during the pandemic Australian households accumulated savings well above typical levels which should help cushion any impact.

Supply chains are as much, if not more, of a constraint on growth right now, and the conflict may worsen global supply disruptions. European car makers have already announced some factory closures.

A factor that will help limit fallout is that Australia is a major commodity producer. The higher prices will see a boost to national income (albeit heavily concentrated in certain sectors) which, if sustained, could see an increase in investment. Where there is spare capacity, there may be an increase in export volumes as countries try to replace energy and food imports previously sourced from Russia.

How central banks, including the RBA, react to a commodity price shock is also important. Typically, CBs will 'look through' the (temporary) inflation rise with the impact on growth more of a concern. Market expectations of central banks have been volatile. It is likely that advanced economy central banks that are clearly behind the curve (the Fed and RBNZ) will continue to, or start to, raise rates. Others, such as the ECB, may sit and watch. The RBA is still expected to move on rates this year - especially if higher inflationary expectations become more embedded.

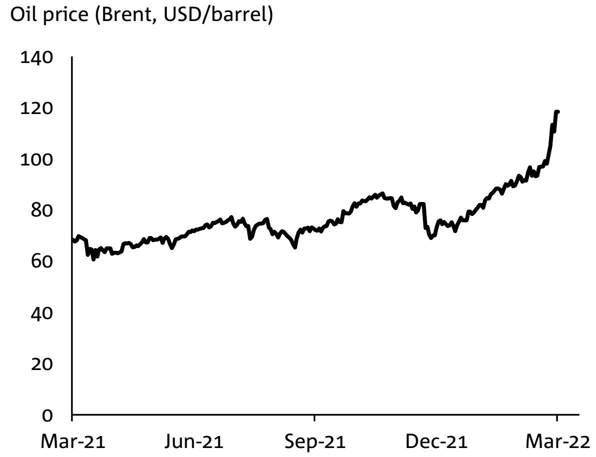
MINIMAL DIRECT TRADE LINKS TO RUSSIA/UKR

Australia - exports of goods & services, 2020

	$b	% of total exports	% of GDP
Russia	0.7	0.2	0.0
Ukraine	0.0	0.0	0.0
Other East/Sth-East Europe	1.0	0.2	0.1
Other Europe	40.9	9.4	2.1
China	160.3	36.7	8.1
Japan	46.4	10.6	2.4
Other Asia	125.4	28.7	6.4
US	27.5	6.3	1.4
All other	34.2	7.8	1.7

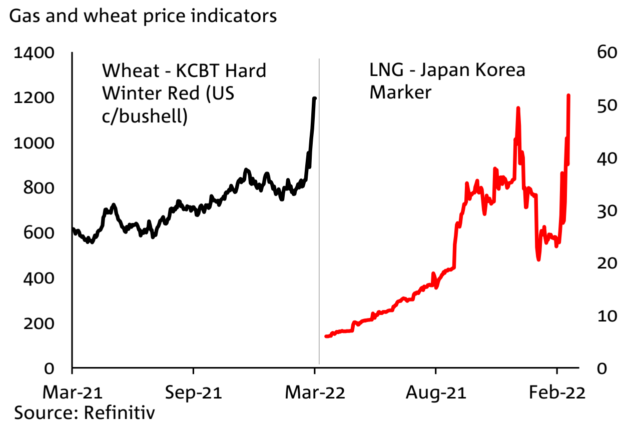
Source: DFAT, NAB

RISING OIL PRICES TO HIT & BUSINESS COSTS



Source: Refinitiv

RISING COMM. PRICES A BOOST FOR PRODUCERS



Source: Refinitiv

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	3.0	4.9	0.9	-5.8	4.8	5.0	2.7
Dwelling Investment	-8.1	3.2	1.6	-2.1	-7.1	-5.7	9.2	-4.3	1.0
Underlying Business Investment	-2.7	-2.4	3.6	8.1	-2.3	-5.6	4.6	4.1	7.4
Underlying Public Final Demand	6.0	5.9	5.8	2.5	5.9	6.0	6.0	3.8	2.5
Domestic Demand	**-0.9**	**2.5**	**4.1**	**4.3**	**1.2**	**-2.5**	**5.9**	**4.2**	**3.2**
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**	**3.6**	**4.3**	**0.8**	**-2.5**	**6.5**	**3.8**	**3.2**
Exports	-1.7	-8.3	-0.5	1.2	3.4	-9.8	-1.6	-0.4	1.9
Imports	-7.7	-2.8	0.5	3.4	-1.4	-13.0	5.8	-0.4	4.7
GDP	**0.0**	**1.5**	**3.5**	**3.8**	**2.0**	**-2.2**	**4.7**	**3.9**	**2.6**
Nominal GDP	1.8	4.4	8.7	6.9	5.3	-1.4	10.5	7.2	5.5
Current Account Balance ($b)	-36	-69	-60	-53	12	51	77	52	49
(%) of GDP	-1.8	-3.4	-2.7	-2.2	0.6	2.6	3.5	2.2	2.0
Employment	0.2	1.1	2.5	3.5	2.3	-1.7	3.2	3.3	2.5
Terms of Trade	0.9	10.3	6.6	0.3	5.2	-0.2	17.7	-1.6	0.8
Average Earnings (Nat. Accts. Basis)	3.4	2.6	3.3	3.3	3.0	3.6	1.9	3.9	3.1
End of Period									
Total CPI	-0.3	3.8	4.5	2.3	1.8	0.9	3.6	3.4	2.7
Core CPI	1.3	1.7	3.7	2.9	1.4	1.3	2.6	3.5	2.9
Unemployment Rate	8.2	4.9	3.7	3.5	5.1	6.7	4.7	3.5	3.6
RBA Cash Rate	0.25	0.10	0.10	1.25	0.75	0.10	0.10	0.75	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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