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THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

The global economic outlook remains clouded by numerous factors, including lockdowns in a range of major population centres in China, the Russia-Ukraine conflict (and its impact on commodity markets) and the ongoing disruptions to supply chains. Global business surveys suggest that economic activity held up comparatively strongly in March, particularly outside of China and Russia. Our forecasts are unchanged; we expect that the global economy will grow by 3.7% in 2022 and then slow to a trend- like 3.5% in 2023. That said, there is near-term downside risk to our China forecast due to the current lockdowns. In addition, tail risks (such as a recession in a major advanced economy) have risen given the combination of an energy price shock and a tightening of policy by both monetary and fiscal policy makers.

- **Financial markets** continued to be negatively impacted by the Russia-Ukraine conflict in the first half of March, before generally starting to recover. Government bond yields – which declined following the start of the Russia-Ukraine conflict – rose in the second half of the month, as expectations of further monetary policy tightening across 2022 strengthened. Yields for most major advanced economy government bonds now exceed pre-pandemic rates. Equity markets remained volatile in March, with MSCI indices generally declining across the first half of the month, before recovering (albeit to differing degrees) in the second half of March and early April. US markets staged the strongest recovery – returning to levels recorded in early February.
- **Commodity prices** have also been volatile in recent weeks, reflecting both supply and demand concerns (the latter related to China's COVID-19 outbreaks), but have broadly tracked sideways since early March. Oil prices briefly exceeded US$120 a barrel in the early part of March and have subsequently fluctuated around US$100 a barrel.
- **Inflationary pressures** are not just coming from commodity prices. There continues to be shortages of raw materials, key inputs (such as semi-conductors) and labour to varying degrees in different markets, while COVID-19 continues to cause disruptions – most notably in China – which could trigger additional supply chain issues. These issues are particularly reflected in global producer prices, which rose by over 16% yoy in February. Consumer prices also continue to climb – up by just over 6% yoy. For the seven largest advanced economies, consumer prices rose by their strongest rate since late 1982.
- March business surveys were consistent with solid growth in the major **advanced economies** (AEs). In part owing to the COVID-19 wave earlier in the year, we had been expecting broad-based weakness in Q1 GDP growth across the major AEs. However, with strong monthly GDP estimates for the UK and Canada, we now look for solid growth in Q1 for both these countries. Supply disruptions remain a headwind and the recovery in major AE auto production that started last year has stalled. However, as supply bottlenecks are addressed this should support growth. High inflation is likely to constrain consumer activity, although strong labour markets, and the high level of savings accumulated by households over the pandemic, will work the other way. While the continued unwinding of pandemic impacts and resolution of supply chain bottlenecks over time should support growth, from around the second half of 2022 we expect to see a slowdown in major AE growth.
- **Emerging market** (EM) PMIs deteriorated in March reflecting the impact of COVID-19 in China and weaker activity in Russia (due to sanctions). The EM services PMI plunged to 46.2 points despite better readings for Brazil and India. The EM manufacturing PMI also declined – but more modestly. Chinese authorities implemented lockdowns in a range of cities in March and early April – including the economically important centres of Shanghai and Shenzhen. As a result, PMI measures for China turned negative in March, particularly for services. Factory closures and port congestion related to COVID-19 lockdowns in China have the potential to exacerbate existing supply chain disruptions – particularly if lockdowns are prolonged.
- Business surveys suggest that global activity held-up in March despite Russia's invasion of Ukraine and the spike in commodity prices. We expect the **global economy** to grow by 3.7% in 2022 and then slow to around trend at 3.5% in 2023. We have left our China growth forecast unchanged but there is clear near-term downside risk from the current lockdowns. The lockdowns in China are a reminder that COVID-19 remains a risk to the economic outlook, particularly in emerging markets where vaccine protection is generally weaker. Beyond COVID, risks around the outlook are rising with central banks set to tighten policy at a much faster pace than previously expected while, at the same time, the global economy is trying to digest a major commodity price shock and fiscal policy is also tightening.
- For more detail on the global outlook, please see the Forward View – Global, released this morning.

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For Australia, our forecasts are broadly unchanged this month, though we have tweaked our near-term GDP and inflation outlook and extended the forecast horizon to 2024. GDP is expected to grow by a strong 3.4% this year – supported by healthy growth in consumption and ongoing gains in business investment. In 2023 we expect growth to slow to 2.1%, with growth at around trend rates at 2.2% in 2024. Similarly, the labour market has been strong and is expected to strengthen further. We expect the unemployment rate to fall below 4% in coming months, reaching 3.5% by late 2022, and remain there through 2023. Wage growth is expected to pick up with the labour market at its tightest in half a century. We have slightly strengthened our near-term inflation outlook ahead of the Q1 CPI release. We see a core print of around 1.1% q/q (3.3% y/y) for Q1 which will see underlying inflation above the RBA's target band for the first time in 12 years. We now expect a print of a similar magnitude in Q2 which would see underlying inflation peak at a very high 3.9% in the middle of the year. Notably, these forecasts and the RBA's change in tone have seen us bring forward the first expected cash rate hike to June with follow-ups in July, August and November. We see a slower pace of increase in 2023 and 2024 but expect the cash rate target to reach 2.25% by the end of our forecast horizon. Overall, we continue to expect a very strong economic performance in the near-term, though the pandemic and conflict in Europe continue to pose risks.

- **The labour market remains strong with elevated demand and wages set to gradually pick up.** Unemployment reached 4% in February and remained there in March with employment continuing to edge upwards in the month. Labour demand is elevated with job vacancies well above their pre-pandemic levels, indicating an unemployment rate below 4% is imminent – in fact the unrounded March number was 3.95. We expect the strength in the labour market to begin to show up when data on labour costs for Q1 become available over the coming months. We see hourly wage growth (as measured by the WPI) picking up to around 2.5% y/y and continuing to edge higher over the year, with wage growth likely to pass 3% by December.
- **Household consumption has remained robust through the start of the year,** despite headwinds from Omicron, floods, and higher prices. Nominal retail trade increased 1.8% in February, backing up a 1.6% increase in January, and while some of this growth likely reflects price movements it's clear that underlying demand is still strong. Importantly, all sectors are now well above their pre-COVID levels. Still, after a near-record increase in real household consumption through the reopening period in Q4 2021, we expect a more modest result for Q1 overall. Wage growth will support consumption, as will the stock of savings built up through the pandemic, although rising interest rates and elevated inflation will begin to weigh on household budgets.
- **The slowdown in house prices is set to continue, but the level of residential investment should remain solid.** The CoreLogic Capital city dwelling price index grew by 0.3% m/m in March, matching its February pace and continuing the slowing in national dwelling price growth since early-to-mid 2021. We expect price growth to eventually turn negative later this year. New housing loan approvals growth has also eased notably since mid-2021, and while building approvals surged in February it is too early to call the end of the recent downward trend. Still, labour and material shortages as well as periodic COVID-19 disruptions mean there is still a large pipeline of work to be done. As a result, we only expect to see modest falls in residential investment this year.
- **Business conditions rose sharply in March and confidence also rose further.** Conditions rose to 18 index points in the NAB Monthly Business Survey for March – a little below the level reached prior to the delta outbreak, but strong in an historical context. The rise was driven by large improvements in retail, rec & personal and finance, business & property, while by state the gains were broad-based but driven by Vic and WA. Key prices measures all rose further in the month, indicating demand is strong enough for businesses to pass on cost pressures. The recent NAB Quarterly Business Survey also showed that 12-month expected Capex strengthened to high levels in Q1, pointing to a rise in business investment over the next year.
- **We have brought forward our rate track, now expecting the first hike to come in June,** followed by hikes in July, August and November which would take the cash rate to 1.0% by December. The RBA left rates unchanged in April, but the post meeting statement dropped references to "patience" and signalled that upcoming inflation and wage data will likely trigger the shift to normalise policy. We see the RBA continuing to lift rates – though at a slower pace – in 2023 and 2024 taking the target cash rate to 2.25% by the end of 2024. Our expectation remains that the RBA will not reinvest or actively sell its holdings of bonds, with the RBA to let these securities roll off the balance sheet naturally as they mature.
- **The trade balance narrowed sharply in February on the back of significantly higher imports.** The strength in imports (up 12%) was evident across categories with intermediate goods up 17%. Consumption goods imports were also up 17% in the month. Goods export values were largely unchanged in the month and services imports (outbound tourists etc) and exports (education and inbound tourists) remain depressed.
- **The recent Federal Budget saw the Treasury forecast a strong rebound for real GDP across 2021-22 and 2022-23, largely in line with NAB's expectations.** The Budget put unemployment at around 3¾% in the forecast years, slightly above NAB's call of 3.5%. With only gradual tightening of fiscal policy expected, the Budget did little to change our monetary policy view which has largely been shaped by the RBA's recent statements. Net debt is expected to peak at 33.1% of GDP in 2024-25 – a lower peak than expected at MYEFO – with a reduction in expected debt issuance.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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