THE FORWARD VIEW: AUSTRALIA APRIL 2022

RATE RISES SET FOR JUNE AS STRONG GROWTH CONTINUES

OVERVIEW

- Our forecasts are broadly unchanged this month though we have tweaked our near-term GDP and inflation outlook and extended to 2024. Overall, we still see the activity growing strongly this year and the labour market strengthening further, but also expect inflation to accelerate faster in the near-term.
- GDP is expected to grow by a strong 3.4% during this year – supported by healthy growth in consumption and ongoing gains in business investment. In 2023 we expect growth to slow to 2.1%, before tracking 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%, reaching 3.5% by mid 2022, and remaining there through 2023. Consequently, wage growth is expected to pick up rising to over 3% y/y in 2023.
- 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. Consistent with the need to begin normalising policy, we see the RBA allowing its holdings of bonds to roll off as they mature with no reinvestment – announced in May.
- While we continue to expect a very strong economic performance in the near-term and the RBA to begin normalising policy at a gradual pace, a number of risks remain. Globally the pandemic remains a risk with new variants a possible disruption to activity as well as supply chains more broadly. The geopolitical tensions in Europe also remain a risk.
- Domestically, it could be that the labour market continues to tighten faster than expected – with the activity outlook and indicators of labour demand still very strong and population growth yet to fully recover. Were that to be the case, the unemployment rate could fall to the low 3s, requiring faster transition to neutral (or above) by the RBA.

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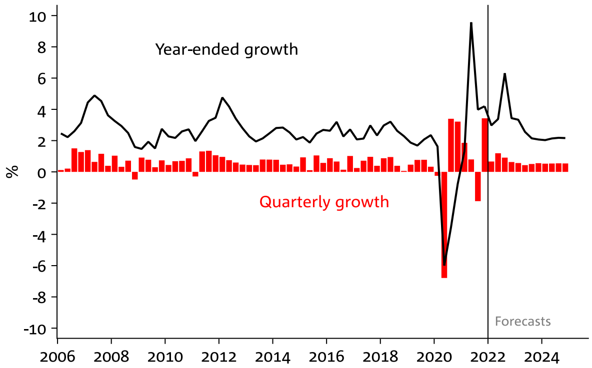
KEY ECONOMIC FORECASTS

	2021	2022-F	2023-F	2024-F
Domestic Demand (a)	5.9	4.5	3.3	2.7
Real GDP (annual average)	**4.7**	**4.0**	**2.5**	**2.1**
Real GDP (year-ended to Dec)	**4.2**	**3.4**	**2.1**	**2.2**
Terms of Trade (a)	17.7	3.7	-3.9	-5.9
Employment (a)	3.2	3.9	2.3	1.1
Unemployment Rate (b)	4.7	3.5	3.5	3.8
Headline CPI (b)	3.6	3.6	2.6	2.6
Core CPI (b)	2.7	3.7	2.8	2.8
RBA Cash Rate (b)	0.10	1.00	1.75	2.25
$A/US cents (b)	0.73	0.80	0.77	0.77

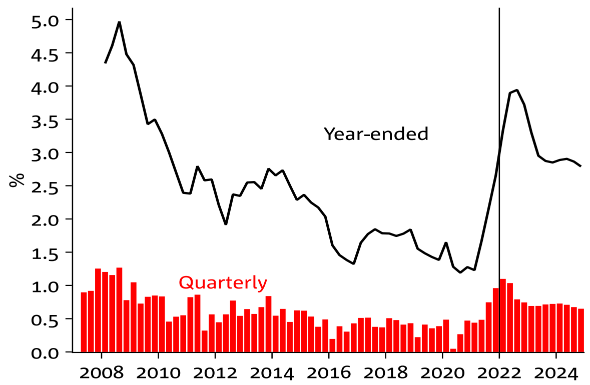
(a) annual average growth, (b) end-period, (c) through the year inflation

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

The labour market continues to outperform, with an unemployment rate of less than 4% imminent and forthcoming wages prints expected to show a pickup.

The economy added another 77,000 jobs in February, pushing through the Omicron outbreak with little sign of slowing down. Hours worked also rebounded by 9% and participation edged higher, now at an all-time record 64.4% with scope to rise further still.

Crucially, indicators of labour demand remain very strong, with job vacancies in Q1 more than 80% above their pre-COVID levels. That should see employment growth continue and further falls in the unemployment rate, which reached 4% in February, and is expected to fall to 3.9% in March. We see unemployment reaching around 3.5% around the middle of the year.

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.

Wage setting arrangements mean the pickup will likely be gradual, although the next Fair Work Commission minimum wage decision may contribute to faster growth if it responds to higher inflation. Broader labour cost measures in the National Accounts - which reflect bonuses as well as other non-wage costs and labour force composition - are expected to continue outpacing WPI growth in the near-term.

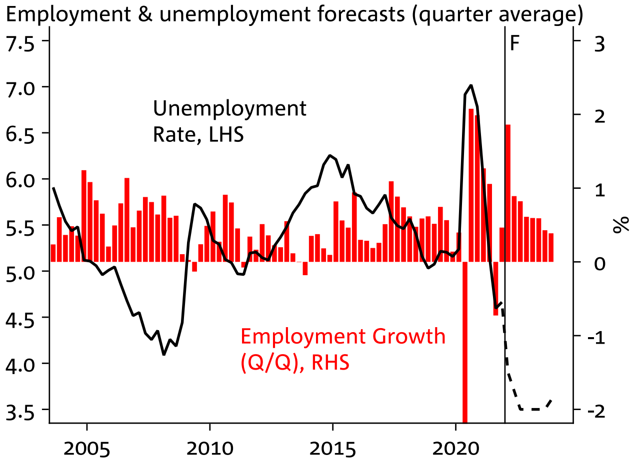
The latest data suggest consumption has remained robust through the start of the year, despite headwinds from Omicron, floods, and higher prices.

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 also strong. Spending on clothing & footwear and at department stores jumped more than 11% in February and cafes & restaurants also saw a near-10% boost to turnover, indicating a strong rebound in sectors that have been most affected by virus-related disruptions. 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 before momentum continues through the middle of the year. Progress on wage growth will support consumption, as will the stock of savings built up through the pandemic, although rising interest rates and elevated inflation will weigh on household budgets.

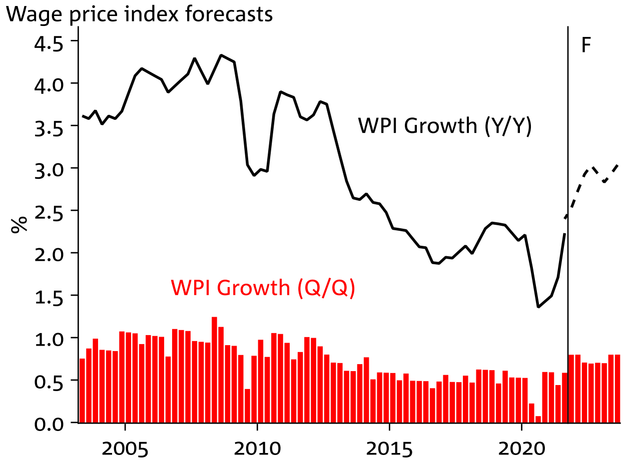
The rebound in spending at cafes & restaurants also suggests that the long-expected rebalancing between goods and services consumption may be beginning to materialise, albeit this will likely continue only gradually over the coming year.

UNEMPLOYMENT RATE PRINTS BELOW 4% IMMINENT, BEFORE FALLING TO 3.5% THIS YEAR



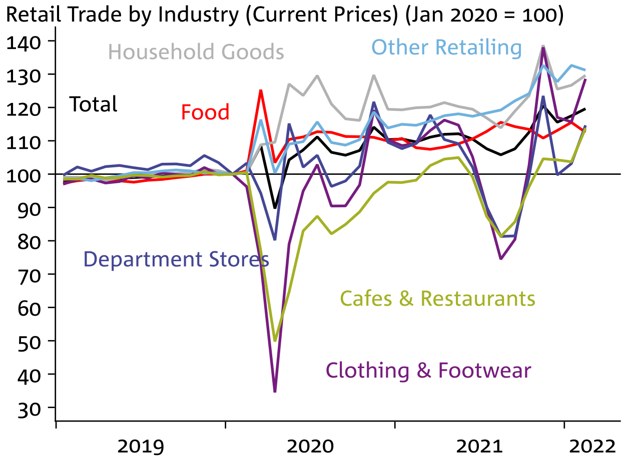
Source: National Australia Bank, Australian Bureau of Statistics

PROGESS ON WAGE GROWTH TO CONTINUE, PASSING 3% BY DECEMBER



Source: National Australia Bank, Australian Bureau of Statistics

RETAIL TURNOVER NOW WELL ABOVE PRE-COVID LEVELS IN ALL SECTORS



Source: Macrobond, NAB Economics

HOUSING AND CONSTRUCTION

The slowdown in house prices is set to continue, while building approvals are also likely to fall further. Even so we expect the level of residential investment to remain solid.

The CoreLogic Capital city dwelling price index grew by 0.3% m/m in March, matching its February pace. REA's PropTrack HPI showed a similar rate of growth for March. While the two measures vary month-to-month they both point to an ongoing slowing in national dwelling price growth since early-to-mid 2021. Regional dwelling prices continue to grow at a faster rate.

The slowdown in house price growth likely reflects a number of factors. These include affordability constraints, an easing in household income growth (which had been boosted by COVID-19 fiscal transfers), weak population growth (while dwelling construction lifted) and increases in fixed mortgage rates. We now expect the RBA to start to raise rates in June which will only reinforce this dynamic. As a result, we expect dwelling price growth to ease before eventually turning negative later this year.

Similarly, new housing loan commitments growth has also eased notably since mid-2021. In February, loan approvals declined 3.7% m/m partially reversing recent gains, with recent ups and downs likely influenced by the timing of COVID-19 disruptions. Higher rates for fixed-term mortgages have led to a decline in the fixed-rate share of new loans.

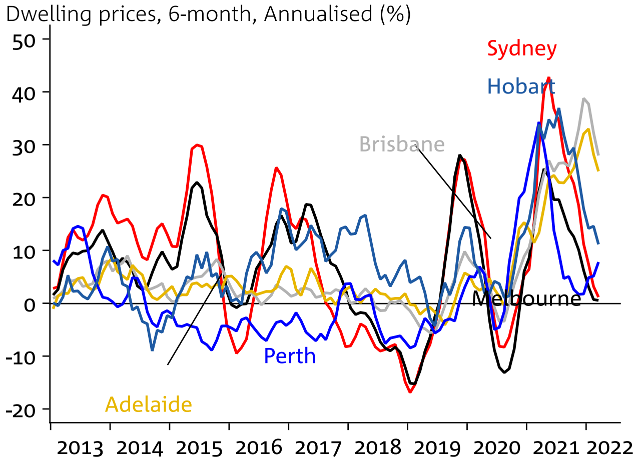
While loan commitments to owner-occupiers for the purpose of new construction were up 3.1% m/m in February, they have been broadly unchanged since late 2021. They are around 50% below their 2021 peak although they remain well above pre-COVID-19 levels (this is also true in terms of the number of commitments so it is not just due to higher construction costs).

Building approvals surged in February, rising by over 40% m/m. The increase was largely accounted for by 'other dwellings' (which doubled). Approvals of houses also increased by 16% m/m but this was not sufficient to recover the January drop. COVID-19 related disruptions are likely contributing to the swings in what is, even in normal times, a volatile series (particularly 'other dwellings').

With HomeBuilder likely to have pulled forward some demand, construction costs high, and the RBA soon expected to start raising rates, further falls in building approvals are likely. Population growth has also been weak although the re-opening of international borders may see this become a positive factor in time and an increasingly low level of unemployment should also put a floor under the extent of any downturn.

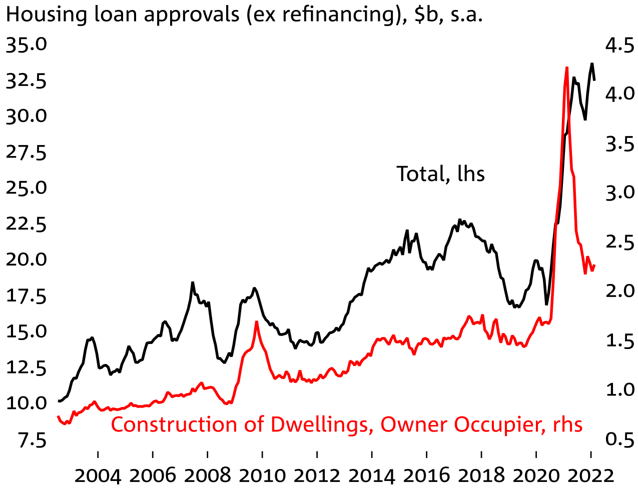
Due to labour and material shortages, as well as periodic COVID-19 disruptions, there is still a large pipeline of work. As a result, we only expect to see modest falls in residential investment this year, with the level of activity to remain solid as the backlog of work is processed.

DWELLING PRICE GROWTH SLOWING

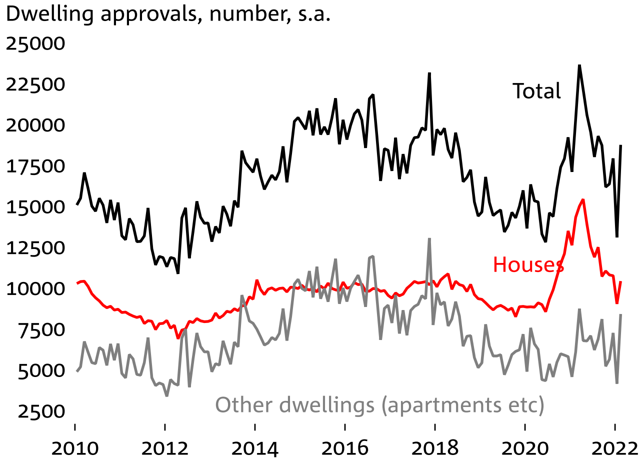


Source: CoreLogic, National Australia Bank, Macrobond

HOUSING LOAN APPROVALS STILL ELEVATED BUT NO LONGER GROWING RAPIDLY



DWELLING APPROVALS BOUNCED IN FEB BUT TOO EARLY CALL END OF DOWNWARDS TREND



Source: Macrobond, National Australia Bank

BUSINESS AND TRADE

The NAB monthly business survey showed further gains in March – with conditions rising sharply and confidence also rising further.

The gains in March follow February's rebound from an Omicron impacted January read. Conditions rose to 18 index points – 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. By state the gains were broad-based but driven by Vic and WA.

Forward orders and capacity utilisation also strengthened further reflecting the ongoing strength in demand in the economy.

The strength in aggregate demand amidst severe supply disruptions and higher commodity prices continues to be reflected in the survey. In fact, the key measures of price growth all rose further in the month. Both labour costs and input costs rose sharply and are tracking at their highest rate on record, while output prices continue to follow a similar pattern. The NAB Quarterly survey released in late March showed that difficulty finding suitable labour and the availability of materials as constraints remained elevated.

Encouragingly, 12-month Capex expectations also strengthened to high levels in Q1, pointing to a rise in business investment over the next year, following long period of weak growth in the non-mining sector. The outlook for business investment remains a key dynamic for growth going forward and will also be an important factor in productivity growth.

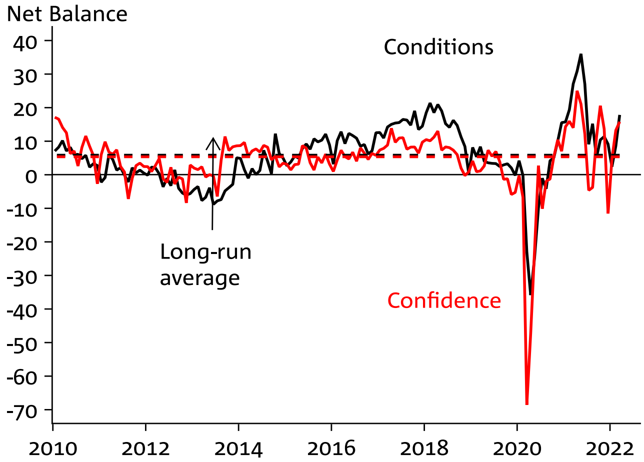
The trade balance narrowed sharply (down $4.3bn) in February to $7.5bn on the back of significantly higher imports.

The strength in import values (up 12%) was evident across categories with intermediate goods up 17% (mainly fuels & lubricants and processed industrial supplies) likely driven by higher commodity prices. Consumption goods imports were also up 17% in the month – likely reflecting some impact of higher prices but also ongoing strength in goods demand.

Export values were largely unchanged in the month with a small increase in rural goods and non-monetary gold offset by a fall in non-rural exports.

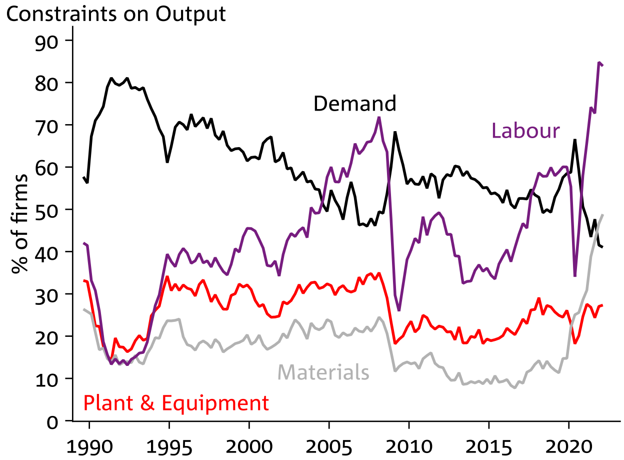
The balance of the recovery in services trade will be important for growth over the coming year. Both imports (outbound tourists etc) and exports (education and inbound tourists) remain depressed – though as is evident in the February data, it appears that imports have begun to recover more quickly. This is consistent with the view that tourism will respond more quickly to open borders while education will take longer to recover. Indeed, we forecast imports to rise more rapidly than exports over the coming year, though this should transform into a tailwind as education exports eventually recover.

CONFIDENCE AND CONDITIONS HAVE STRENGTHENED FURTHER



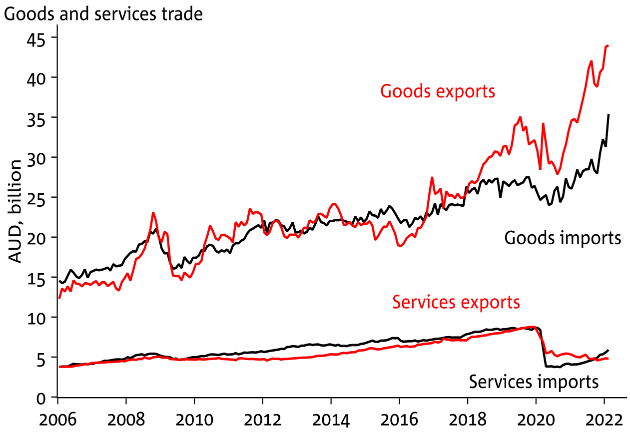
Source: National Australia Bank, National Australia Bank

MATERIALS AND LABOUR SHORTAGES CONTINUE TO CONSTRAIN OUTPUT



Source: National Australia Bank

SERVICES TRADE REMAINS DEPRESSED, THOUGH IMPORTS ARE PICKING UP.



Source: National Australia Bank, Australian Bureau of Statistics

MONETARY POLICY, INFLATION AND FX

While the RBA left rates unchanged in April, the post meeting statement dropped references to “patience” and highlighted a strengthening inflation trajectory – signalling that upcoming inflation and wage data will likely trigger the first rate rises.

The statement also highlighted the strong rebound underway following the Omicron disruptions earlier the year – and noted that the overall strength in the economy has been reflected in a strong labour market.

Despite the strength in the labour market official measures of wage growth are not yet tracking at a pace consistent with inflation “sustainably” in the band. However, the RBA notes that business liaison points to broadening and strengthening wage growth – and the Board expects this to be confirmed in the upcoming WPI and national accounts releases in late May/early June.

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.

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, instead letting these securities roll off the balance sheet naturally as they mature. The maturities of bonds over the next year are relatively small but will increase in size through 2023 and 2024.

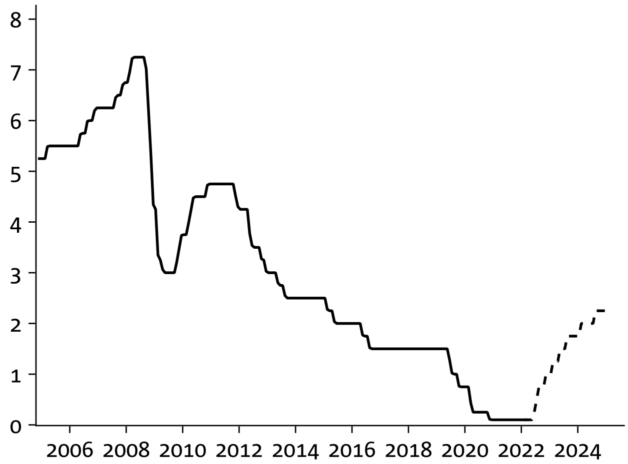
Our forecasts for inflation have been revised up in the near-term, with core inflation hitting almost 4.0% (and headline well above that) by Q2. While the transitory drivers of both headline and core inflation should eventually unwind, we expect wage pressure to begin to build, offsetting some of this normalisation. While WPI printed at rates similar to the pre-pandemic period at the end of 2021, our outlook for the unemployment rate and ongoing healthy growth in the economy sees wage growth picking up to above 3.0% by mid 2023.

The AUD/USD has risen slightly over the past month, despite the ongoing tensions in Europe and a stronger outlook for the Fed rate track.

The Aussie is currently trading around US74c after reaching above US76c in early April, up around 3% on early January. Stronger commodity prices on the back of Russian sanctions and disruptions to Ukrainian supply have pushed up the prices of a number our key exports.

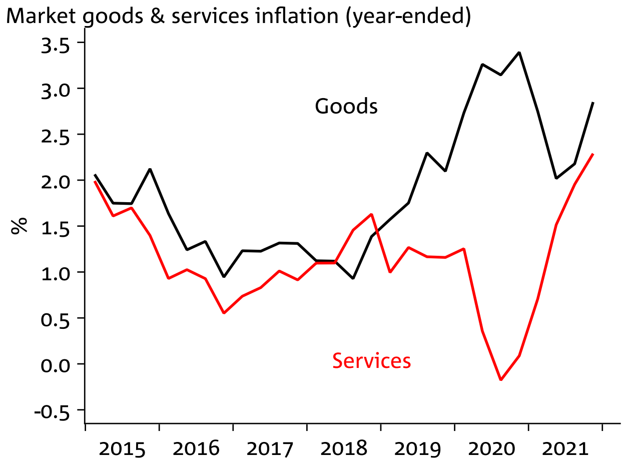
We have revised up our outlook for the Aussie in the near-term – to be around US3c higher than previously forecast through the end of 2022. That sees the AUD/USD end 2022 at US80c before edging down to US77c by the end of 2023.

RBA TO BEGIN HIKING IN JUNE



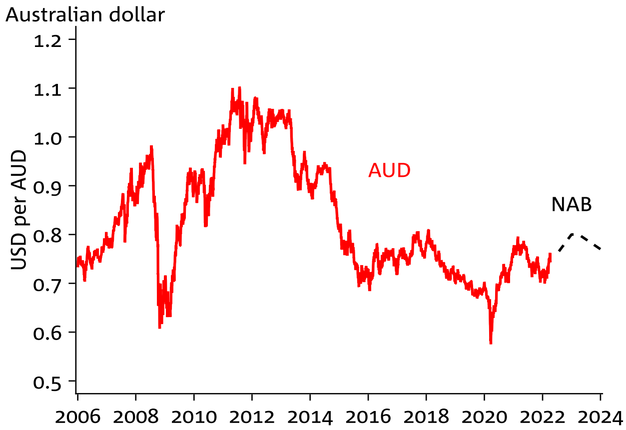
Source: Macrobond, NAB Economics

GOODS INFLATION HAS BEEN STRONG DURING COVID



Source: National Australia Bank, Australian Bureau of Statistics

AUD/USD TO APPRECIATE IN THE NEAR TERM



Source: National Australia Bank, Macrobond Financial AB

THEME OF THE MONTH: THE 2022/2023 BUDGET

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. 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.

The Budget sees unemployment at around 3¾% in the out years, slightly above NAB's call of 3.5%. Importantly, this would be below the Treasury's estimate of the NAIRU (the long-run unemployment rate), helping to drive wage growth. In terms of population, net overseas migration is expected to become positive at 41,000 persons in 2021-22, rising to 235,000 by 2024-25 and helping to lift population growth to 1.2% in 2022-23 and 1.3% in 2023-24.

The Budget sees strong consumption growth of 3½% in 2021-22 and 5¾% in 2022-23, marginally above our expectations. Elevated inflation will weigh on consumers and, as has been widely noted, the Budget contained a number of temporary measures to address the rise in the cost of living.

Business investment is expected to be strong, with growth of 5½% in 2021-22, rising to 9% in 2022-23, similar to NAB, although our expectations for dwelling investment diverge. The Budget forecast a rise of 3.5% in 2022-23, followed by a fall of ½% in 2023-24, whereas we see dwelling investment declining slightly in 2022-23 as interest rates rise before an offsetting increase the following year.

Overall, the Budget puts annual average GDP growth for 2021-22 at 4¼% (NAB: 3.6%). Lingering base effects contribute to another strong figure of 3½% in 2022-23 (NAB: 3.9%), normalising to 2½% in 2023-24 (NAB: 2.1%).

A dramatic rise in the terms of trade on the back of elevated commodity prices will see significant nominal GDP growth in 2021-22 (we see 9.4%, Budget: 10¾%). The Budget assumes a rapid fall in the terms of trade will follow, leaving nominal GDP largely flat.

The Budget's fiscal impulse was broadly as we had expected, with only gradually tightening in fiscal policy so far and little forecast improvement in the structural budget position outside of the effect of automatic stabilisers. On balance, the Budget did little to change our view on monetary policy, which has been shaped much more by the evolution of statements from the RBA Board in recent weeks and ongoing strength in the economy.

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. As a share of GDP, total Australian government net debt (including the states) remains low by international standards.

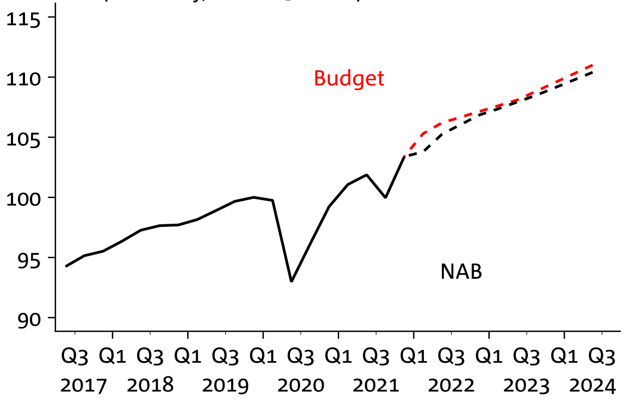
NAB VS. BUDGET FORECAST PARAMETERS

	2021-22		2022-23		2023-24	
	Budget	NAB	Budget	NAB	Budget	NAB
Private Consumption	3.5	3.2	5.75	5.1	3.3/4	2.3
Dwelling Investment	5	1.6	3.5	-2.1	-0.5	2.4
Business Investment	5.5	4.3	9	9.5	1	4.3
Public Final Demand	7.25	5.4	1.25	2.5	1.5	2.1
Exports	2	-0.6	5	1.1	6	1.8
Imports	4.5	0.9	12.5	4.4	7	4.8
Real GDP	**4.25**	**3.6**	**3.5**	**3.9**	**2.5**	**2.1**
Nominal GDP	10.75	9.4	0.5	7.4	3	3.1
Employment Growth	2.75	2.7	1.5	3.3	1.5	1.5
Unemployment Rate*	**4**	**3.7**	**3.75**	**3.5**	**3.75**	**3.6**
Wage Price Index*	2.75	2.7	3.25	3.3	3.25	3.3
Underlying CPI*	n.a	3.9	n.a	3.0	n.a	2.9

Figures are annual average growth except those marked *, which are end of period.

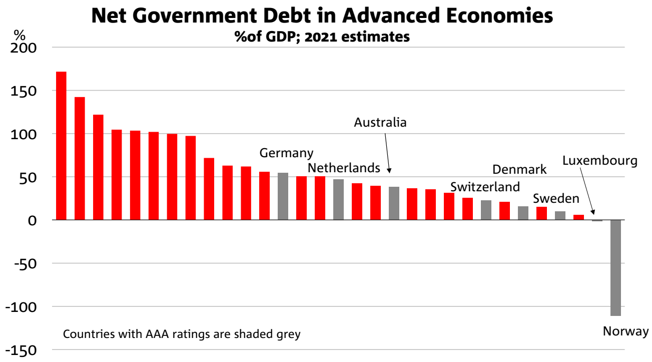
NAB VS. BUDGET GDP FORECASTS

Real GDP (Quarterly, Q1 2019 = 100)



Source: National Australia Bank, Australian Bureau of Statistics

AUSTRALIAN NET DEBT REMAINS RELATIVELY LOW



Source: IMF World Economic Outlook Database, October 2021

FORECAST TABLES

	Fiscal Year				Calendar Year				
	2020-21	2021-22 F	2022-23 F	2023-24 F	2020	2021-F	2022-F	2023-F	2024-F
Private Consumption	1.0	3.2	5.1	2.3	-5.8	4.8	5.4	2.8	2.3
Dwelling Investment	3.2	1.6	-2.1	2.4	-5.7	9.2	-4.3	1.0	3.2
Underlying Business Investment	-2.4	4.3	9.5	4.3	-5.6	4.6	5.9	7.0	3.6
Underlying Public Final Demand	5.9	5.8	2.5	2.1	6.0	6.0	3.8	2.5	2.0
Domestic Demand	**2.5**	**4.3**	**4.5**	**2.7**	**-2.5**	**5.9**	**4.5**	**3.3**	**2.7**
Stocks (b)	0.8	-0.5	0.0	-0.1	0.0	0.5	-0.3	-0.1	0.0
GNE	**3.3**	**3.8**	**4.6**	**2.7**	**-2.5**	**6.5**	**4.2**	**3.2**	**2.6**
Exports	-8.3	-0.6	1.1	1.8	-9.8	-1.6	-0.7	1.9	1.8
Imports	-2.8	0.9	4.4	4.8	-13.0	5.8	0.6	5.3	4.5
GDP	**1.5**	**3.6**	**3.9**	**2.1**	**-2.2**	**4.7**	**4.0**	**2.5**	**2.1**
Nominal GDP	4.4	9.4	7.4	3.1	-1.4	10.5	8.7	4.4	3.6
Current Account Balance ($b)	-69	-79	-85	-26	51	77	91	56	10
(%) of GDP	-3.4	-3.5	-3.5	-1.0	2.6	3.5	3.9	2.3	0.4
Employment	1.1	2.8	3.8	1.5	-1.7	3.2	3.9	2.3	1.1
Terms of Trade	10.3	9.5	1.7	-7.7	-0.2	17.7	3.7	-3.9	-5.9
Average Earnings (Nat. Accts. Basis)	2.6	3.3	3.4	3.4	3.6	1.9	4.0	3.3	3.3
End of Period									
Total CPI	3.8	4.7	2.3	2.7	0.9	3.6	3.6	2.6	2.6
Core CPI	1.7	3.9	3.0	2.9	1.3	2.7	3.7	2.8	2.8
Unemployment Rate	4.9	3.7	3.5	3.6	6.7	4.7	3.5	3.5	3.8
RBA Cash Rate	0.10	0.25	1.50	2.00	0.10	0.10	1.00	1.75	2.25
10 Year Govt. Bonds	1.51	2.90	3.25	–	0.98	1.68	3.25	3.25	–
$A/US cents :	0.75	0.76	0.79	–	0.77	0.73	0.80	0.77	–
$A - Trade Weighted Index	62.7	59.9	63.6	–	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

Group Economics

Alan Oster
Group Chief Economist
+(61 0) 414 444 652

Jacqui Brand
Executive Assistant
+(61 0) 477 716 540

Dean Pearson
Head of Behavioural & Industry Economics
+(61 0) 457 517 342

Australian Economics and Commodities

Gareth Spence
Senior Economist
+(61 0) 436 606 175

Brody Viney
Senior Economist
+(61 0) 452 673 400

Phin Ziebell
Senior Economist
+(61 0) 475 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 0) 477 723 769

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 0) 455 052 520

Steven Wu
Economist – Behavioural & Industry Economics
+(61 0) 472 808 952

International Economics

Tony Kelly
Senior Economist
+(61 0) 477 746 237

Gerard Burg
Senior Economist – International
+(61 0) 477 723 768

Global Markets Research

Ivan Colhoun
Global Head of Research
+(61 2) 9293 7168

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