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THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

We now expect the global economy to grow by around 3.4% in 2022 and 2023 (down from 3.7% and 3.5% respectively). The key drivers of the weaker outlook in 2022 are the lower growth rates for China and the United States. For 2024, we see global growth slowing to 3.1% – well below the long run average of 3.5% – reflecting the lagged impacts of monetary tightening and of the large increase in energy prices. A broad range of risks have emerged in recent times. There remains considerable uncertainty around the duration and economic impact of the Russia-Ukraine conflict (with global food prices likely to be affected in coming months). Major central banks have flagged more rapid increases to policy rates than previously expected, which will act to slow growth with the risk of a policy mistake as central banks may need to push rates above "neutral" levels if high inflation persists. With several shocks hitting the global economy at once, the risk of a recession in a major economy is rising.

- **Tighter monetary policy** – and expectations of further rate rises to come – have contributed to weaker trends in **equity markets**. The MSCI US index peaked at the start of January and has trended lower since (despite a brief rally across the second half of March). Emerging market central banks have led the tightening of monetary policy – with our measure of EM policy rates now well above pre-pandemic levels – while advanced economy banks have started to raise rates more recently. Since the start of 2022, the US Federal Reserve (Fed), the Bank of England and the Bank of Canada have increased rates by 75 basis points. The European Central Bank is expected to end asset purchases in June and to start raising rates in July. The Fed has signalled its intention to raise rates 'expeditiously' back to 'neutral' (if not higher). We expect a fed funds target range of 2.25-2.50% by year's end but the risk is that they go higher and more quickly.
- Global **inflationary pressures** have persisted in recent months. Producer prices rose by over 18% yoy in March reflecting a broad range of supply side constraints. These include the fallout from the Russia-Ukraine conflict, commodity price increases, shortages of key inputs (notably semi-conductors, where shortages could persist until 2024) and labour (in different sectors and locations) and disruptions to global logistics. Soaring producer prices have flowed through into consumer prices, which rose by around 7.2% yoy in March. Among the largest advanced economies, prices in March rose at their fastest rates since late 1982 (with Germany's inflation rate at its highest since 1974).
- Of the major **advanced economies** (AEs) US Q1 GDP fell 0.4% q/q, despite solid consumption and strong business investment growth, while Euro-zone growth was soft at 0.2% q/q. Both the US and Euro-zone were affected by a COVID-19 wave in Q1 and for the same reason we expect negative Q1 GDP growth in Japan. In contrast, UK and Canada appear to have had robust Q1 GDP growth. Beyond Q1 the outlook is challenging. The spike in energy prices from the Ukraine/Russia conflict is adding to already high inflation and crunching household income. Monetary policy is also tightening (at a faster than previously expected pace) and there will be spill over impacts from China lockdowns. However, the ongoing return to pre-pandemic 'normal' and savings accumulated by households during the pandemic will support growth. We have lowered our expectations for 2022/2023 growth in the US, Euro-zone and Japan and continue to expect a significant slowdown in the UK.
- The e**merging market** (EM) services PMI fell to 43.6 points with China's measure plunging to 36.2 in April, the second weakest reading on record (after the initial COVID-19 lockdowns of February 2020). The manufacturing index fell more modestly (to 48.1) with a fall in China's PMI again the key driver. This reflects China's Omicron COVID-19 wave as authorities continue to respond to outbreaks with economically damaging lockdowns. There appears to be little appetite for a broad public health policy change among Chinese authorities. We have cut our forecast for growth in China in 2022 to 4.2% (previously 5.0%). The lockdowns are also likely to further disrupt global supply chains as they have impacted factory output, freight movements and port facilities.
- The **global** composite PMI declined further in April – down to 51.0 (from 52.7 in March). Conditions have diverged significantly between AEs – where readings have remained strong – and EMs (which is weighted towards China). In part this reflects the differing stages of the pandemic in these regions as most AEs have a high degree of effective vaccination while many EMs continue to lag in terms of vaccine access and rollout. We now expect the global economy to grow by around 3.4% in 2022 and 2023 (down from 3.7% and 3.5% respectively previously). The key drivers of the weaker outlook in 2022 are the lower growth rates for China and the United States. For 2024, we see growth slowing to 3.1% – below the long run average of 3.5% – reflecting the lagged impacts of both monetary tightening and large increases in energy prices.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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For Australia, we continue to be optimistic on the economy expecting above-trend growth this year and ongoing strength in the labour market. The key changes to our forecast this month include modest markups to both our inflation and cash rate profiles. GDP is still expected to grow by 3.4% this year, slowing to 2.1% over 2023 and then tracking around trend at 2.2% through 2024. Further gains in employment should see the unemployment rate fall below 4% in coming months, reaching a 3.5% low in Q3 and staying there for much of the next year, supporting a gradual pickup in wage growth. We now see slightly stronger inflation prints over the next two quarters, which sees underlying inflation reaching 4.6% y/y by Q3 before moderating over the out years – 4.5% y/y at end 2022, 2.9% y/y at end 2023 and 2.7% y/y by end 2024. We have also adjusted our cash rate profile to account for the slightly larger-than-expected initial rate rise delivered by the RBA in May (25bps rather than 15bps). We expect a series of further hikes over coming months which should see the cash rate target rise to 1.35% by the end of the year, before continuing to rise over 2023 and 2024 – reaching 2.6% by the end of our forecast period. Growing concerns over global growth, renewed lockdowns in China and considerable uncertainty over the normalisation of supply chains and commodity prices remain the major risks to our forecasts, but overall the domestic outlook is fairly positive.

- **The labour market remains strong, with the unemployment rate set to fall below 4% imminently.** March saw employment inch higher (up 0.1%) and participation steady, leaving the unemployment rate at 4%. With job vacancies and job ads still high, we see unemployment reaching around 3.5% by around the middle of the year. Attention is now focused on indicators of wage growth for Q1 with the WPI expected to print at around 0.7% q/q (2.5% y/y) later this month. Unemployment should remain low, causing wage growth to edge higher over the year, likely passing 3% y/y around December.
- **Indicators of consumption growth continue to point to spending holding up through Q1,** though inflation may weigh on real consumption going forward. Nominal retail trade grew by 1.6% in March to leave total retail trade over Q1 2.9% greater than in Q4. However, a significant proportion of this growth was due to price increases with volumes up by a smaller 1.2%. Still, this indicates goods consumption remained strong and, alongside an expected pickup in services consumption, should see strong overall consumption growth for the quarter. Further ahead, household budgets face a somewhat more challenging environment with elevated inflation and rising interest rates, though accumulated savings and rising wages will provide support.
- **The housing market is expected to soften as interest rates rise and pandemic-related stimulus begins to fade.** The CoreLogic capital city dwelling price index grew by 0.3% m/m in April, a similar pace of growth to the previous month, but continued to moderate in annual terms. We expect dwelling prices to begin to decline in aggregate later this year before falling by around 10% in 2023 – though we do not see this as a disorderly adjustment. In terms of activity, building approvals have been volatile over the past two months but are broadly tracking at around pre pandemic levels. We expect work done (construction) to remain elevated through 2022 with the pipeline of work yet to be done still elevated on the back of HomeBuilder and ongoing labour and materials shortages and disruptions.
- **Business conditions have continued to strengthen over recent months,** setting the stage for a likely pickup in business investment. Conditions in the NAB Business Survey rose to +20 index points in April, and while confidence eased, both conditions and confidence are well above their long-run averages. Importantly, the strength is broad based across most industries and states. The strength in conditions should support business investment, with the survey's capex index picking up above its long-run average over the past few months. We expect solid growth in underlying business investment across Q1 and Q2 – around 4% q/q in each – normalising through the second half of the year.
- **Net exports look set to subtract substantially from real GDP growth in Q1.** The nominal trade balance rebounded somewhat in March after a large fall in February, reflecting a partial unwind of the run-up in consumption goods imports. However, looking through volatile price movements, import volumes appear to have lifted significantly over the quarter while export volumes have fallen. Services trade remains subdued with both exports (education and tourism) and imports (outbound tourism) yet to noticeably pick up.
- **The RBA lifted the cash rate target by 25bps to 0.35% in May,** kicking off a new hiking phase after a very high Q1 CPI result (5.1% headline) and ongoing labour market strength. The policy change came alongside a significantly upgraded set of staff inflation forecasts in the May SMP with trimmed-mean inflation now expected to end 2022 at around 4.75% (from 2.75%). We expect a series of further 25bp hikes in June, July, August and November taking the cash rate to 1.35% by end-2022, with additional increases taking the cash rate to 2.10% by end-2023 and 2.60% by end-2024. As expected, the RBA also announced in May that holdings of maturing bonds will not be reinvested.
- **Higher interest rates will flow through a number of channels to impact the real economy.** The most immediate impact will come through the effect on households' cash-flow, and some households will likely need to reduce spending as a result. Higher rates will also weigh on household wealth which will weigh on consumption in turn. More broadly, savings and investment decisions by both households and businesses will be affected by rate rises, discouraging investment by businesses at the margin as well as slowing housing credit. Higher rates will also put some upward pressure on the exchange rate, and should also help control inflation expectations. Importantly, we do not expect the RBA's policy stance will become restrictive in the near-term.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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