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THE FORWARD VIEW: AUSTRALIA AUGUST 2022

REBOUND SET TO FADE AS CONSUMPTION SLOWS IN H2 2022

OVERVIEW

- With high frequency data showing consumption growth beginning to slow, we have further revised down our 2022 GDP growth forecast to 2.2% y/y (previously 2.4%). Further out our forecasts are largely unchanged with growth expected to slow to 1.6% in 2023 and 1.8% in 2024.
- Overall, our view remains that after a strong rebound through the first half of the year, growth will be much softer over the next 12-18 months as high inflation and rapid increases in interest rates weigh on households alongside a slowdown in global growth.
- The Q2 CPI print of 6.1% y/y was in line with our expectations, and we continue to see inflation peaking in Q4 at around 7.5% y/y with trimmed mean CPI reaching 5.6% y/y. In the absence of further significant global shocks, we expect inflation to moderate over 2023 but the level of prices is likely to remain elevated.
- The labour market is now the tightest it has been in 50 years and we expect some further tightening in the near term before slowing GDP growth begins to push the unemployment rate back towards 4% in 2023 and 4.3% in 2024 – around the level of full employment. Wage growth should also pick up to over 3% by 2023.
- In late July we further brought forward our cash rate profile. We expect a fourth straight increase of 50bps at the September meeting, and 25bp follow-ups in October and November - leaving the cash rate at 2.85% by end 2022 (previously 2.60%). We see that as being mildly on the restrictive side of neutral and for now see further increases in 2023 as unlikely given our expectation for slowing growth and moderating inflation.
- Global uncertainty remains high with a series of very large shocks continuing to play out. Global growth remains a key risk as higher inflation weighs on real incomes and central banks rapidly tighten monetary policy to bring inflation back down. The war in the Ukraine also remains a key uncertainty – with a more material disruption to energy supplies likely seeing a significant downturn in Europe. China's zero-COVID strategy also remains a risk.
- Inflation itself remains a key risk – and while partial indicators point to some easing in global price pressures, official measures have not yet peaked. The rebalancing of supply/demand, the recovery in supply chains and correction in commodity prices will all be important, but the timing of these dynamics remains difficult to predict.
- For Australia, global inflation remains a challenge with a high degree of domestic inflation having been driven by these factors. Therefore, their resolution as well as any ongoing pass through domestically will be important as will any depreciation of the exchange rate. Ultimately, domestic pressures are expected to increase in importance as global factors wane – with trends in wage growth and services inflation becoming key factors through 2023.

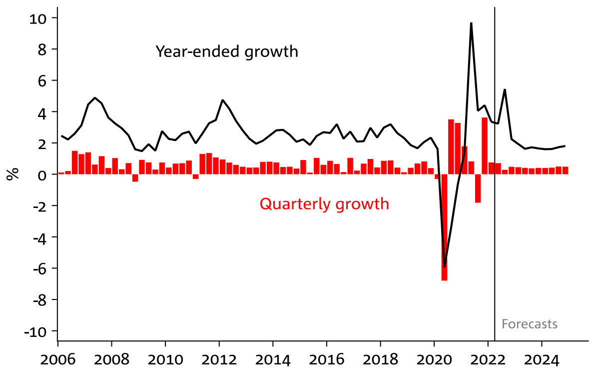
CONTENTS

KEY ECONOMIC FORECASTS

	2021	2022-F	2023-F	2024-F
Domestic Demand (a)	6.0	4.8	1.9	1.8
Real GDP (annual average)	**4.8**	**3.6**	**1.7**	**1.7**
Real GDP (year-ended to Dec)	**4.4**	**2.2**	**1.6**	**1.8**
Terms of Trade (a)	17.6	5.3	-3.9	-5.9
Employment (a)	3.5	3.9	1.6	1.0
Unemployment Rate (b)	4.7	3.6	4.0	4.3
Headline CPI (b)	3.5	7.5	2.9	2.3
Core CPI (b)	2.5	5.3	3.0	2.4
RBA Cash Rate (b)	0.10	2.85	2.85	2.85
$A/US cents (b)	0.73	0.68	0.72	0.77

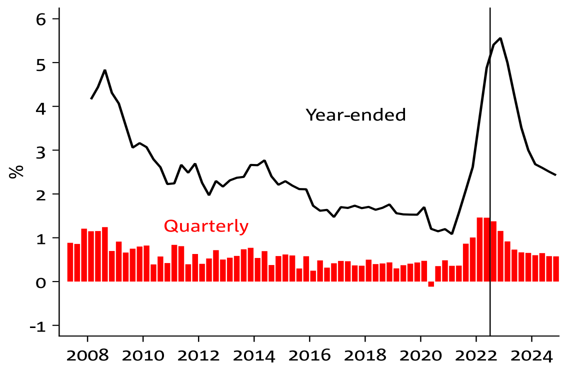
(a) annual average growth, (b) end-period, (c) through the year inflation

GDP FORECASTS



Source: National Australia Bank, Australian Bureau of Statistics

TRIMMED-MEAN 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 unemployment rate fell to a 50-year low in June, bolstering expectations for wage growth, and some further tightening is likely before slowing GDP growth begins to push the rate back towards 4%.

The June labour force report saw employment increase by 88k, enough to push the unemployment rate from 3.9% to 3.5%. That was despite a further pickup in the participation rate to a record 66.8%. The sharp fall may reflect official data catching up to gains made over several months but still leaves the labour market tighter than at any point in the past 50 years.

With roughly one job vacancy for every unemployed person at present, further gains are likely. Still, we expect the pace to slow with employers looking ahead to a period of softening consumption growth as high inflation and rising interest rates begin to bite. With below-trend GDP growth expected over the next 12-24 months, the unemployment rate should begin to tick up towards 4% by the end of 2023 and slightly above 4% in 2024.

Regardless, the tightness in the labour market further bolsters our expectation that wage growth will pick up over the coming year. We see a print of around 2.7% y/y for Q2 WPI later this month (up from 2.4% in Q1). However, as indicated in the NAB Quarterly Business Survey, larger wage increases are likely to follow in the year ahead as the minimum wage decision takes effect and contracts and enterprise agreements roll over.

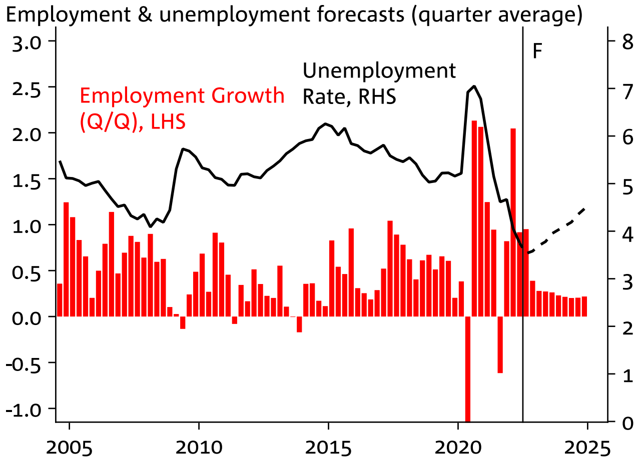
If the unemployment rate remains at its current level, NAB analysis using RBA models suggests wage growth would be expected to fall in the 3¼-4% range. However, the gradual pickup in unemployment in our forecasts should weigh somewhat. As such, we continue to see wage growth of 3% y/y by Q4 of 2022 and around 3½% in 2023.

The rise in retail sales volumes indicates another strong quarter of consumption growth in Q2, but we expect much more modest growth going forward as inflation and interest rate rises weigh on household budgets and goods spending normalises further.

The volume of retails sales was up 1.4% in Q2, although underlying components were more mixed. Hospitality spending grew 8.6%, continuing the strong rebound that began in late 2021, and the resurgence also continued for clothing (up 3.9%) and department stores (up 3%). On the other hand, food spending was down 0.8% as households continued to shift back to eating out, and household goods spending dropped 1.8% as spending patterns normalised. Still, the pickup in sales alongside a wider rebound in services consumption should see total consumption grow strongly in Q2.

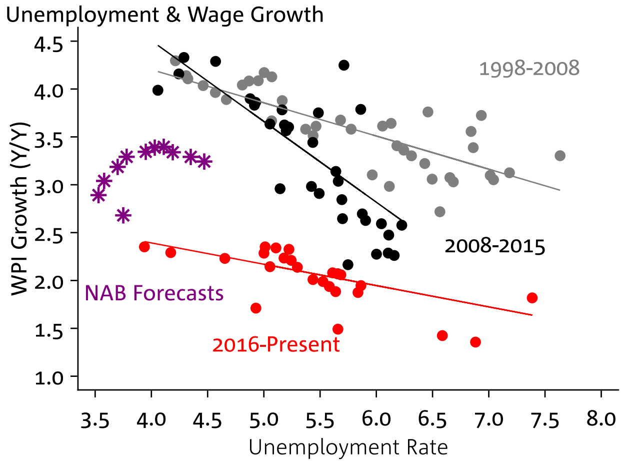
Importantly, much of this growth still reflects the rebound from Omicron and flooding in Q1, and high frequency data including NAB's cashless retail sales index suggests spending growth has slowed in recent months. With consumers facing high inflation and rising interest rates, we expect much more modest consumption growth in Q3 and Q4 and across 2023. Past savings and a strong labour market will provide support, but even with rising wages, real incomes will decline in the near term. As such, consumption will contribute much less to GDP growth going forward.

UNEMPLOYMENT RATE DOWN TO 3.5% IN JUNE BUT SET TO RISE ABOVE 4% BY 2024



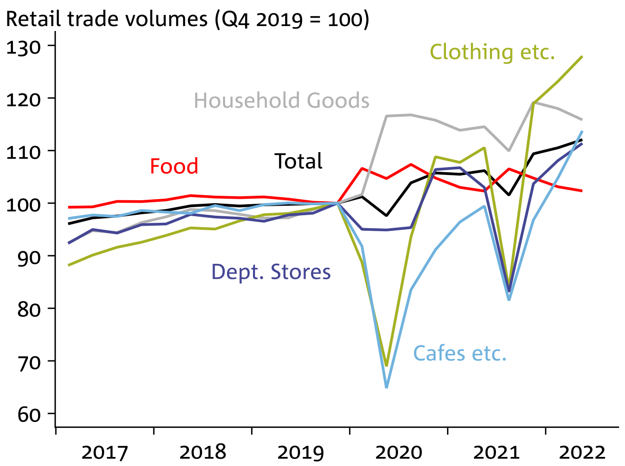
Source: National Australia Bank, Australian Bureau of Statistics

TIGHTEST LABOUR MARKET IN 50 YEARS TO PUSH WAGE GROWTH ABOVE 3%



Source: Macrobond, NAB Economics

RETAIL SALES VOLUMES ROSE 1.4% IN Q2 AS SPENDING REBOUNDED FROM OMICRON



Source: National Australia Bank, Australian Bureau of Statistics

HOUSING AND CONSTRUCTION

Housing market conditions continue to weaken, with both house prices and approvals trending down. With interest rates rising, further falls are likely.

Capital city house prices continued to fall in July. The CoreLogic 8-capital City index fell 1.4% m/m and the capital city PropTrack Home price index declined 0.5%. While Sydney and Melbourne initially led the falls, prices are now falling in most capital cities. Only Perth and Adelaide (on both measures) recorded increases in July but at a slower pace. Prices in regional areas are also now falling with both the CoreLogic and PropTrack indicators down in July.

We expect house prices will fall further over the rest of this year and 2023. While the falls are likely to be greatest in Sydney and Melbourne, higher rates will affect prices across the country. In aggregate, we expect capital city dwelling prices, by end-2023, to have fallen by 18% from their peak.

Sales volumes are also down. Nationally, CoreLogic estimates sales fell 16% over the year to July. With house prices and sales declining, the same is now true of housing loan approvals. New housing loan commencements fell 4.4% m/m in June; while this likely exaggerates the trend, as the previous month was boosted by a clearing of processing backlogs, since January commitments have declined by 7%.

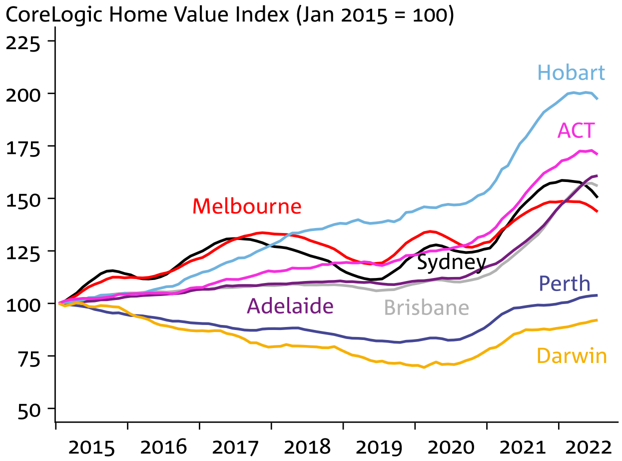
That said, the level of new loan commitments remains at a high level. As a result, the stock of housing credit (which also reflects drawdowns and repayments) has yet to materially slow.

There has been a large fall in residential dwelling building approvals since the end of the Homebuilder scheme in early 2021. After a large rise in May, the downwards trend resumed in June with approvals down 0.7% m/m. Overall, it appears that the pace of decline has slowed. Similarly, new loan commitments to owner-occupiers for the construction of dwellings has stabilised in recent months.

Approvals are likely to come under renewed pressure due to rising interest rates, falling house prices and the squeeze on real household incomes from high inflation. Moreover, due to material and labour shortages, construction costs are high – the output of house construction producer price index rose 6.0% q/q in Q2, to be up 20% over the year. On a more positive note, some offset is likely to come from a further pick up in population growth although it may take several years for net migration to return to its previous level, particularly given low rental vacancy rates.

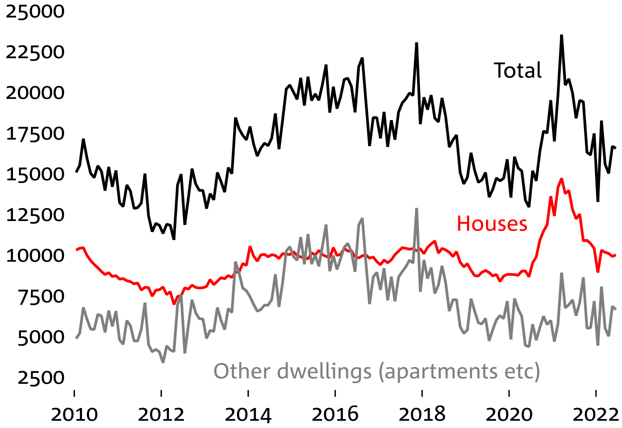
This points to a decline in residential investment over the next year. However, the extent of the fall is likely to be modest as the large pipeline of work to be done should underpin a solid level of investment. A risk around this is that existing projects fall-over or are deferred given the rise in construction costs (particularly where there are fixed price contracts; a number of examples of this occurring have been reported in the press).

DOWNWARD PRESSURE ON DWELLING PRICE FALLS BROADENING OUT



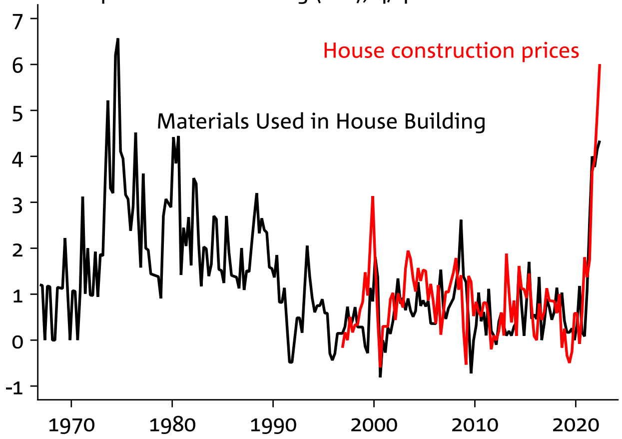
Source: National Australia Bank, CoreLogic, Macrobond

PACE OF HOUSING APPROVAL DECLINES HAS EASED



Source: Macrobond, National Australia Bank

RISING CONSTRUCTION COSTS AN IMPEDIMENT TO NEW AND EXISTING PROJECTS



Source: National Australia Bank, Australian Bureau of Statistics

BUSINESS AND TRADE

Business confidence rallied in July despite a range of headwinds and capacity utilisation reached a new record, supporting expectations for investment to continue to grow over the year.

After softening in June, the latest NAB Business Survey showed confidence back above average in July. The pickup came despite ongoing cost pressures, rising interest rates, and a deteriorating global growth outlook. Importantly, conditions remain at high levels, likely buttressing firms' view of the outlook.

Measures of cost growth accelerated to new record levels, but firms continue to be able to pass through costs to consumers with prices growth measures also at new highs and the profitability index rising. Conditions were strong across industries, with construction bouncing back.

The extended period of growth over their first half of the year has seen capacity utilisation rise to a new record high of 86.7% - well above the previous peak of 85.1% - consistent with the record tight labour market and ongoing supply challenges. This should help drive investment, although higher interest rates and a softer outlook for consumption will weigh on firms' investment plans and supply constraints are also likely to continue to limit non-residential construction.

We still expect underlying business investment to increase across 2022 but the rate of increase is likely to slow and remain modest through 2023 and 2024, in line with the wider outlook for GDP.

Another record trade surplus in June, driven largely by commodity exports, means a positive contribution to GDP from net exports is likely in Q2.

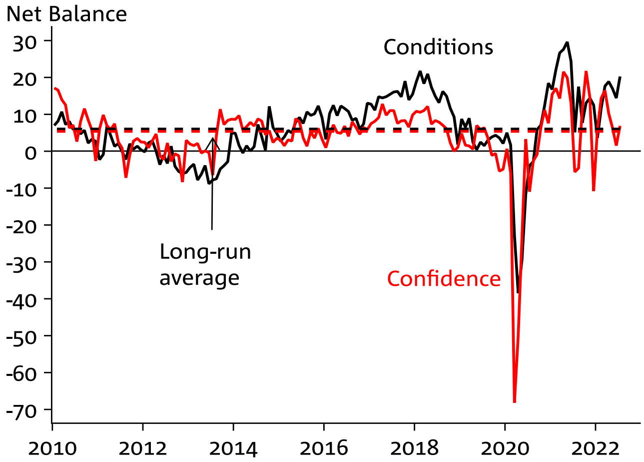
June saw a trade surplus of $17.7bn, up from $15bn in May, driven by a 5.1% increase in export values as iron ore, rural and non-monetary gold exports lifted. Imports also lifted, largely driven by the services side with goods imports flat.

That left the value of exports up almost 15% over Q2 while total import values increased a little over 5%. Much of the increase in export values is price-related, with coal and iron-ore prices significantly higher across the quarter. However, a significant increase in export volumes is still expected, enough to provide a positive contribution to GDP growth from net exports after a significant subtraction in Q1.

There are clear signs of a recovery in services trade, with outbound tourism the first mover. Tourism related imports totalled around $2.5bn in June after falling below $0.1bn in 2020, though the total remains around half of the pre-pandemic level. Services exports did not fall as far and are also rising, now at around 70% of pre-pandemic levels.

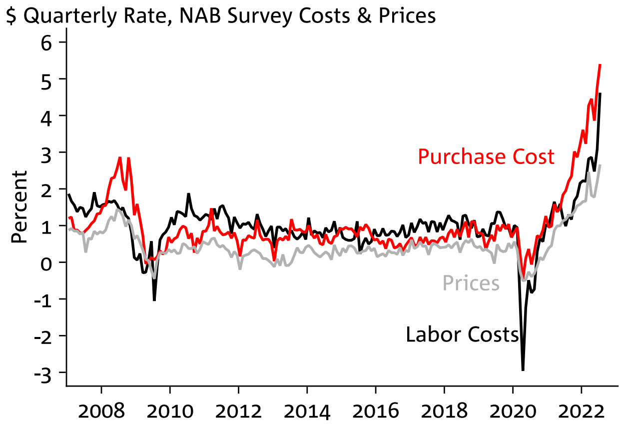
Looking further ahead, we expect further normalisation in services trade including a pickup in education-related exports. Easing of supply chain issues should also support goods exports although the looming slowdown in global growth and growth challenges in China may limit demand for non-rural commodities.

CONFIDENCE AND CONDITIONS ARE BOTH BACK ABOVE AVERAGE



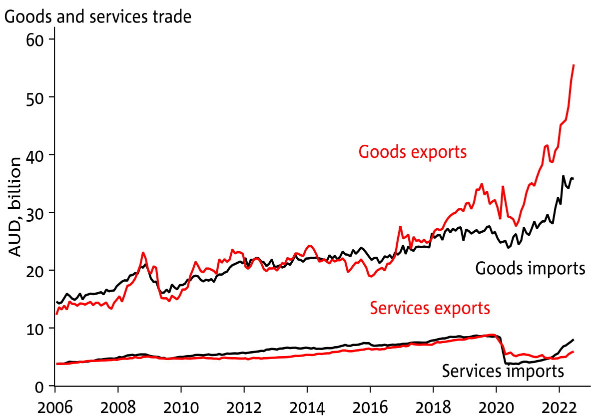
Source: National Australia Bank, National Australia Bank

COST PRESSURES AND PRICE GROWTH HIT NEW RECORDS IN JULY



Source: National Australia Bank, National Australia Bank

JUNE SAW ANOTHER RECORD TRADE SURPLUS, DRIVEN BY EXPORT VALUES



Source: National Australia Bank, Australian Bureau of Statistics

MONETARY POLICY, INFLATION AND FX

The RBA lifted the cash rate by 50bps in August to 1.85% and continued to signal an ongoing normalisation of policy while highlighting the uncertainty around the level of 'neutral' interest rates.

While the August decision was widely expected, the emphasis on returning inflation to 2-3% over time 'while keeping the economy on an even keel' was interpreted slightly more dovishly. Indeed, the Board explicitly recognized that there was a "narrow" path to returning inflation back to the 2-3% target band while maintaining the gains we have seen in the labour market.

The post meeting statement continued to highlight that a significant degree of inflation has been "imported" but that there are pockets of capacity constraints and evidence of domestic inflation pressure in some sectors.

The RBA also released an updated set of forecasts at the August meeting which see stronger inflation in the near-term – peaking at 7.75% in Q4 - and below trend growth over the next two years. The RBA then sees inflation rapidly correcting but remaining well above the target band, ending 2023 at 4% and 2024 at 3%.

The RBA now sees wage growth accelerating to 3.9% y/y by the end of the forecast period which, assuming productivity growth of around 1%, would see inflation settle around the upper end of the target band.

Our interpretation remains that the RBA will continue to focus on normalising policy over coming months and likely enter a modestly 'tight' stance.

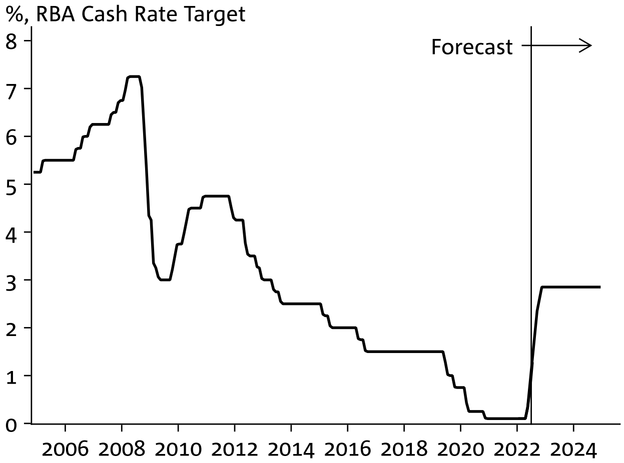
We tweaked our rate track in late July and continue to see the RBA making a 4th consecutive 50bp increase at the September meeting, followed by 25bp increases in October and November, before the RBA pauses to assess the impact of the rapid increase in rates through mid-2022. We expect rates to hold there as inflation pressure begins to abate with softer consumer demand growth (and broader riskers around global growth).

We have also lifted our expectations for both the headline and underlying inflation measures in the near-term – and expect inflation to peak in Q4 before moderating in 2023. A peak of 7.5%, while high, remains lower than inflation rates seen in many other countries but there remains a risk that we see ongoing passthrough to domestic prices from previous price increases or that global inflation is yet to peak. Our Monthly Business survey certainly continues to point to the ongoing build up of price pressures on the cost side, and the pass through to final products prices as activity remains strong.

The AUD/USD has strengthened slightly over the past month but is still trading below US70c.

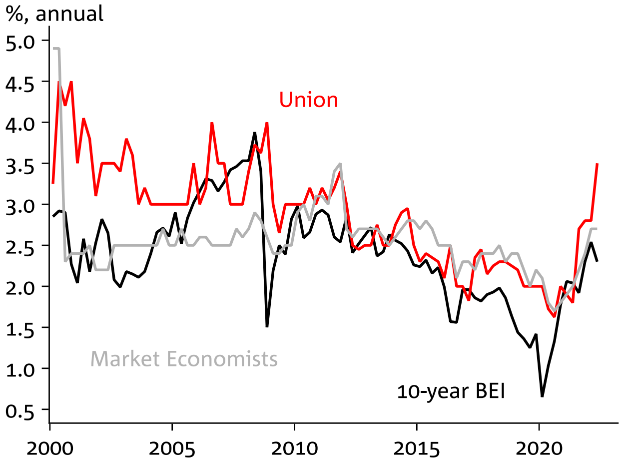
We have pulled back our expectations for the currency, expecting the Aussie to end the year around US67.5c before it strengthens to US72c by end 2023 and US74c by end 2024.

THE CASH RATE IS EXPECTED TO RISE TO 2.85% BY NOVEMBER



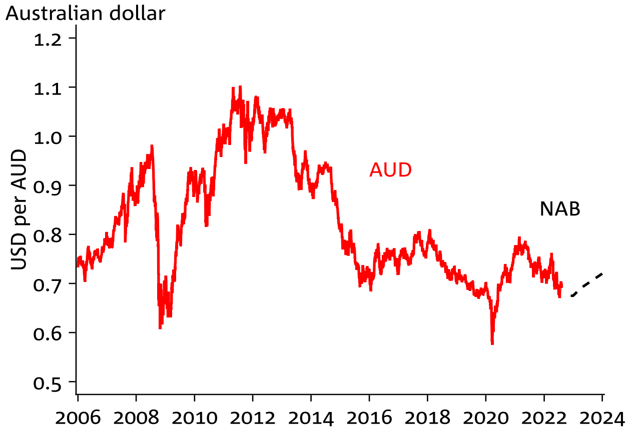
Source: Macrobond, NAB Economics

INFLATION EXPECTATIONS REMAIN ANCHORED BUT ARE A RISK



Source: National Australia Bank, Reserve Bank of Australia

AUD/USD TRACKING BELOW US70C



Source: National Australia Bank, Macrobond Financial AB

THEME OF THE MONTH: INFLATION

Global inflation remains high and continues to be passed through to domestic prices, with domestic inflation yet to peak despite early indications of price pressures easing globally.

A raft of forces has seen inflation strengthen to levels not seen in decades across many countries as the global economy continues to recover from the pandemic.

The impact of supply chain disruptions and elevated freight costs continues to have a lingering impact even as many backlogs appear to be clearing. Goods demand also remains elevated globally, after consumers shifted away from services spending during the pandemic and while this is now rebalancing, we are yet to see a correction in prices.

Very high energy and food prices (and commodity prices more generally) have been a more recent factor on the back of the Russia's invasion of the Ukraine.

Tight labour markets in some advanced economies have also seen wage growth strengthen to well above pre-pandemic levels, which can feed back through to output prices, highlighting the risk that inflation may become entrenched at a relatively high level.

The increase in global inflation has directly flowed through to Australia through the cost of imported goods, materials and commodities. In addition, many of the factors that spurred global inflation – such as labour shortages, easy monetary policy settings and large government transfers to the private sector, are also evident in Australia.

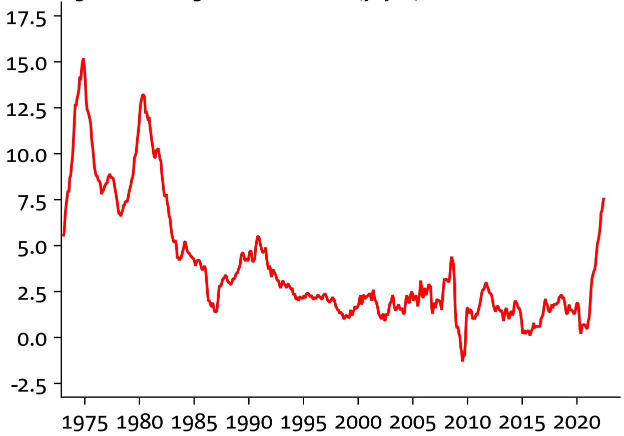
Against this backdrop, the Q2 CPI release showed annual inflation at its highest rate since the early 1990s. Headline CPI inflation rose to 6.1% y/y (1.8% q/q) in Q2 while the trimmed-mean measure of underlying inflation rose by 4.9% y/y (1.5% q/q). The result was the highest since the RBA adopted a formal inflation target.

The impact of global factors was again highlighted in Q2. The bulk of inflation continued to be driven by petrol (up 4.2% in Q2) prices and new home construction costs (up 5.6% in Q2). Overall, tradables inflation (items in the CPI basket with a significant proportion of their price determined by overseas factors) strengthened further in the quarter, rising to 8% y/y.

Still, there was also a pickup in non-tradables inflation (those items where domestic factors such as wages are key drivers of price), strengthening to 5.3% y/y. Non-tradeables inflation is now tracking at its highest rate since prior to the GFC.

GLOBAL INFLATION IS HIGH AND YET TO PEAK

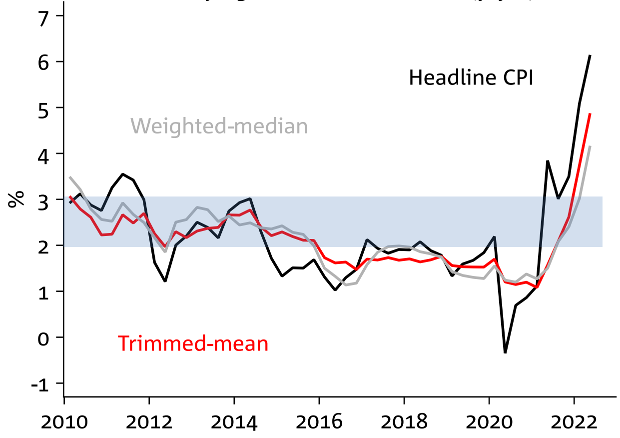
G7 weighted average inflation rate (y/y%)



Source: National Australia Bank, <Property Source not found.>

AUSTRALIAN INFLATION ROSE TO 6% IN Q2 - AND UNDERLYING MEASURES STRENGHEN FURTHER

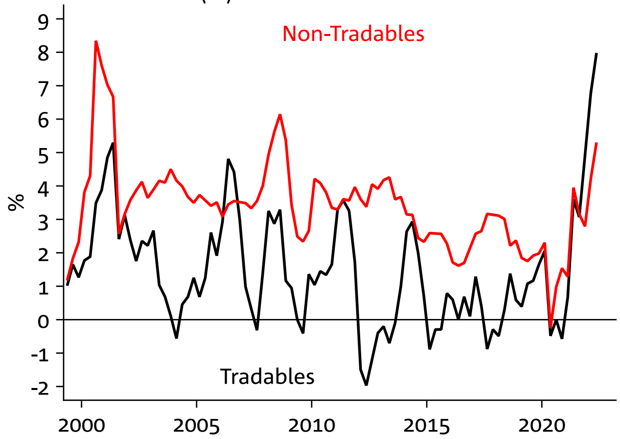
Headline and underlying measures of inflation (y/y%)



Source: National Australia Bank, Australian Bureau of Statistics

TRADEABLES INFLATION IS HIGH BUT NON-TRADABLES HAVE ALSO STRENGTHENED

Year-ended Growth (%)



Source: National Australia Bank, Australian Bureau of Statistics

Splitting the CPI basket into goods and services components (based on those items where prices are determined by market forces) also highlights the impacts of global factors. Goods price inflation rose above 7% y/y (including petrol, furniture and new construction amongst others). This is in stark contrast to the pre-pandemic decade when goods prices had tracked at a relatively soft rate as goods were produced more cheaply internationally (the rise of China) and intense domestic retail competition (including the rise of international online shopping etc.) also restrained prices.

Market services inflation also strengthened in Q2 and has not been this strong since 2012, when wage growth rebounded out of the GFC (alongside the recovery in the unemployment rate). This also follows a prolonged period of weak services inflation as unemployment hovered above a level considered 'full-employment' and wage growth softened to well below 3%.

Looking ahead, while some indicators indicate an easing in price pressures further up the production chain, official measures of consumer price inflation are unlikely to have peaked with strong demand allowing ongoing passthrough to consumers of previous cost increases.

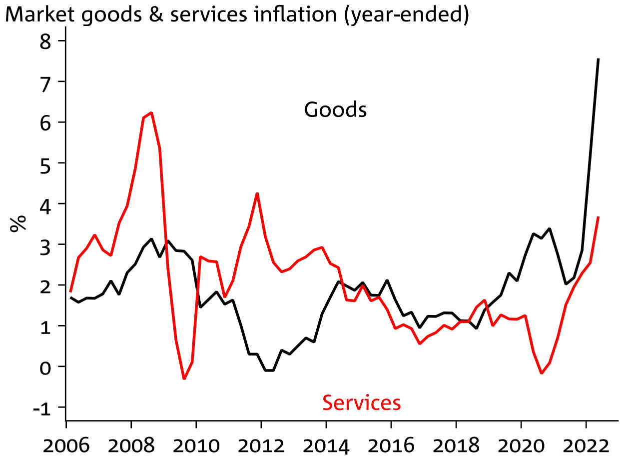
The global rebalancing from goods demand to services should reduce price pressure but the timing of this process is uncertain. Whether recent falls in commodity prices are sustained, as well as an ongoing recovery in freight costs, also remains unclear.

In addition, many businesses' prices are not reset instantaneously and often set at discrete intervals. Therefore, while global prices may rise quickly, prices through the supply chain are only reset over time and as such may only now be catching up to the upstream cost increases seen over recent months. While partial indicators do show some easing, they generally remain elevated suggesting that pricing decisions in the near term will continue to see upward adjustments as firms fight to maintain margins amid strong consumer demand.

How these dynamics play out will be key for how rapidly inflation corrects. We see inflation peaking in Q4 at around 7.5%, followed by a relatively rapid normalization in prices in 2023.

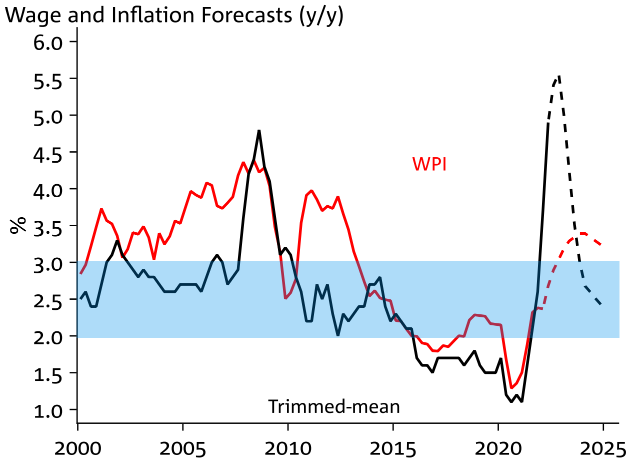
From there, the impact of domestic factors will become more important. A tight labour market is expected to see wage growth accelerate to a pace not seen in a decade – and there are risks of a larger-than-expected response with the unemployment rate not having fallen this low for many years. The current bout of inflation will also likely feed back into higher wage claims. However, the speed and magnitude of these effects also remain uncertain. For now we see wages rising to around 3.5% y/y – a rate broadly consistent with inflation within the RBA's 2-3% target.

BOTH GOODS AND SERVICES INFLATION STRENGTHENED IN Q2



Source: National Australia Bank, Australian Bureau of Statistics

DOMESTIC WAGE PRESSURE WILL BECOME INCREASINGLY IMPORTANT AS GLOBAL FACTORS FADE.



Source: National Australia Bank, Australian Bureau of Statistics

FORECAST TABLES

	Fiscal Year				Calendar Year				
	2020-21	2021-22 F	2022-23 F	2023-24 F	2020	2021	2022-F	2023-F	2024-F
Private Consumption	1.0	3.5	4.4	1.3	-5.8	4.9	5.6	1.7	1.4
Dwelling Investment	3.6	3.2	-2.1	0.2	-5.5	9.7	-2.4	-1.0	1.8
Underlying Business Investment	-1.8	4.5	2.7	1.2	-5.3	5.3	2.6	1.5	1.4
Underlying Public Final Demand	5.9	6.8	3.5	2.1	6.0	6.0	5.8	2.5	2.0
Domestic Demand	**2.6**	**4.8**	**3.6**	**1.6**	**-2.4**	**6.0**	**4.8**	**1.9**	**1.8**
Stocks (b)	0.8	0.1	-0.2	0.1	0.0	0.5	0.3	-0.3	0.0
GNE	**3.4**	**4.8**	**3.4**	**1.7**	**-2.5**	**6.6**	**5.1**	**1.6**	**1.8**
Exports	-8.4	-0.3	3.9	2.3	-9.8	-1.8	1.3	3.3	2.0
Imports	-2.7	6.1	6.7	2.6	-13.0	6.2	9.2	2.7	2.8
GDP	**1.6**	**3.8**	**2.8**	**1.6**	**-2.1**	**4.8**	**3.6**	**1.7**	**1.7**
Nominal GDP	4.4	10.1	7.8	2.7	-1.4	10.5	9.9	4.2	2.9
Current Account Balance ($b)	-69	-55	-60	-14	51	76	55	38	2
(%) of GDP	-3.3	-2.4	-2.4	-0.5	2.6	3.5	2.3	1.5	0.1
Employment	1.1	3.2	3.3	1.0	-1.7	3.5	3.9	1.6	1.0
Terms of Trade	10.4	10.1	2.5	-7.7	-0.2	17.6	5.3	-3.9	-5.9
Average Earnings (Nat. Accts. Basis)	2.6	2.4	2.7	3.4	3.6	1.8	2.4	3.3	3.3
End of Period									
Total CPI	3.8	6.1	4.9	2.5	0.9	3.5	7.5	2.9	2.3
Core CPI	1.5	4.5	4.2	2.6	1.3	2.5	5.3	3.0	2.4
Unemployment Rate	5.2	3.8	3.8	4.1	6.8	4.7	3.6	4.0	4.3
RBA Cash Rate	0.10	0.85	2.85	2.85	0.10	0.10	2.85	2.85	2.85
10 Year Govt. Bonds	1.51	3.69	3.40	–	0.98	1.68	3.40	3.40	–
$A/US cents :	0.75	0.69	0.70	–	0.77	0.73	0.68	0.72	–

(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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