Global Overview
&
Australia

Recovery from COVID, supply chain difficulties and the impact of higher rates.

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Date: September 2022

Global macroeconomic summary - *problems ahead.*

- **COVID-19 continues to be the main driver of growth** – both in the recovery phase and as the Omicron variant spreads. However big challenges are arising in 2022 and into 2023.

- There are **3 areas of concern** emerging on the global economy:

  1. **China has seen recent data soften as the combination of the virus and problems in the property market have slowed activity. The central bank has started cutting rates and added extra liquidity.** That said, Chinese vaccines are not providing protection against Omicron – so more lockdowns for longer. We have dramatically cut forecasts to 3.25% in 2022 with a recovery in 2023.

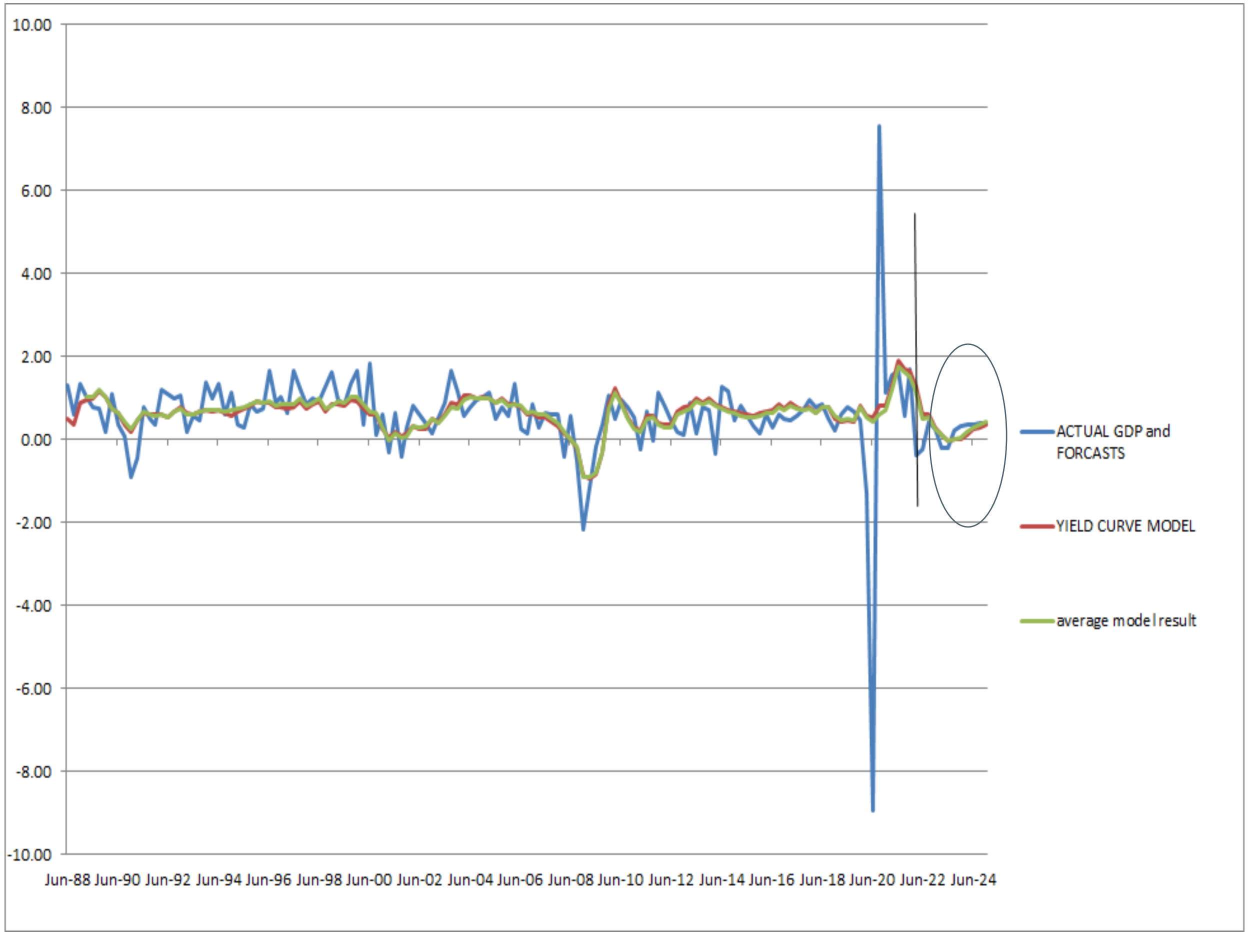
  2. **High commodity prices and Russian responses to Europe banning oil supplies could cause lots of problems by late 2022. What will Russia do in response to Europe and the G7 banning oil exports. Turn off gas supplies. That would massively disrupt European activity in late 2022.**

     - **Japan is also a concern with growth currently going backwards and only weak growth (1.5%) expected in 2022 and beyond. India also slowing. And obviously, Russia collapsing.**

Global macroeconomic summary - *problems ahead.*

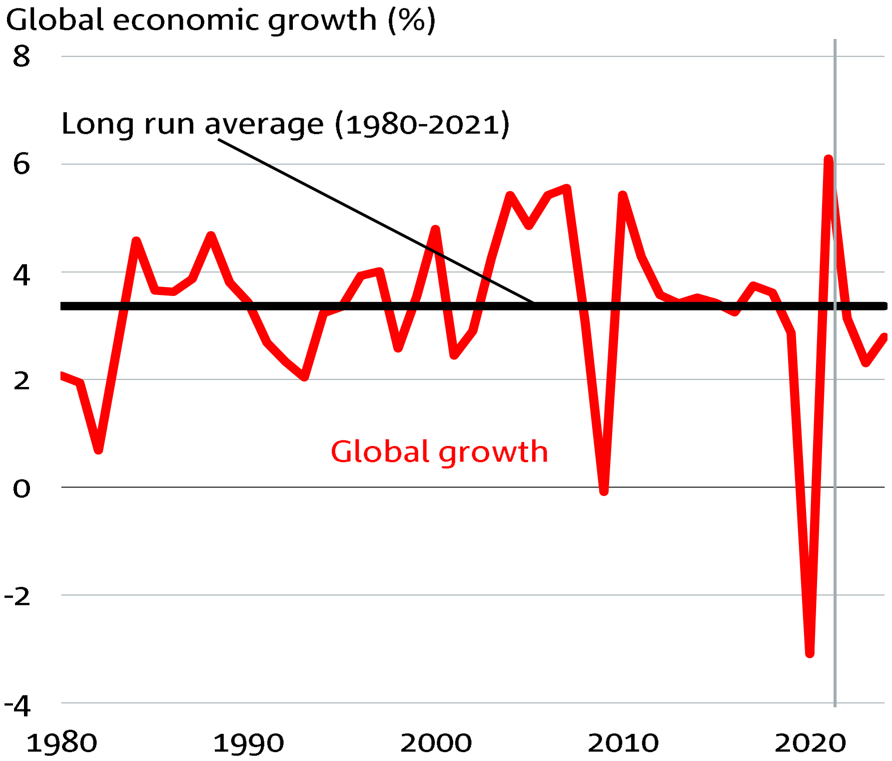
3. **In the US** the domestic economy weakened a lot in Q2. We now have a "technical recession" but I don't put much store in the two quarters of negative growth definition. **But Q2 was recessionary and Q3 looks flatish. This is unlikely to stop the Fed from another series of rate rises. We now see the Fed reaching 4.0- 4.25% by early 2023 and cuts in 2024.**

   A big worry is that the models point to more trouble ahead with declines in activity in early – mid 2023. And no real growth over 2022 or 2023. Unemployment near 4.5% by Dec 2023 and 5% by Dec 2024.



Global economic forecasts - *2023 outside of GFC and COVID the lowest since 1993.*

	2020	2021	2022	2023	2024
US	-3.4	5.7	1.7	0.2	1.2
Euro-zone	-6.2	5.2	3.2	0.0	1.1
Japan	-4.6	1.7	1.5	1.3	0.9
UK	-9.3	7.4	3.5	0.1	0.6
Canada	-5.2	4.5	3.4	1.0	1.0
China	2.2	8.1	3.3	5.0	4.5
India	-6.6	8.3	7.3	4.4	5.6
Latin America	-7.0	6.2	2.6	0.5	1.3
Other East Asia	-2.8	4.3	4.5	3.3	3.7
Australia	-2.1	4.9	3.9	1.8	1.7
NZ	-2.1	5.6	2.1	0.4	1.5
Global	**-3.1**	**6.1**	**3.1**	**2.3**	**2.8**



Australia macroeconomic summary - *still robust but will slow a lot.*

- **Despite floods and Omicron in January, Q1 GDP was reasonable at 0.8% (y/y 3.3%) and 0.9% in Q2 (y/y 3.6%). Unemployment now at 3.5% but will go a touch lower. For 2022** we see rates and fear starting to slow momentum in the second half of 2022 - with growth around 2.7% during 2022 or around 3.9% in year average terms.

- **And for 2023** – growth of around 1.6% (during 2023) or around 1.7% in year average terms and unemployment around 4.0%. **For 2024** we expect growth around 1.8% during 2024 and 1.7% in year average terms with unemployment slightly higher at 4.3%. **Slower global growth and higher rates hurt. As does wealth from falling house prices.**

- **The recovery path to date driven by consumption, post the lockdowns, and trade. Business investment still soft. Global outlook not helping. The big issue is consumer "fear" and liquidity impact of rate rises. Business survey still good.**

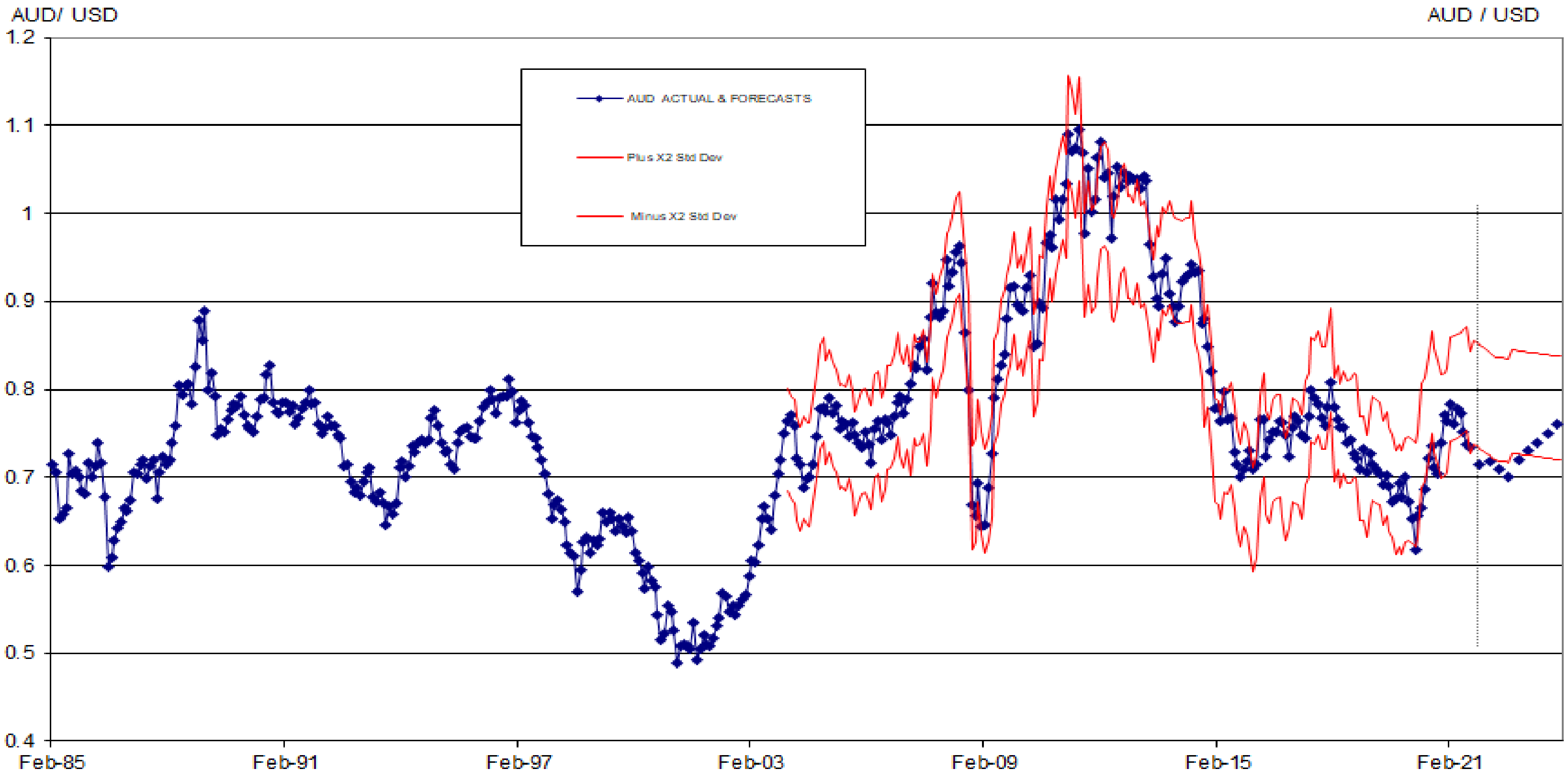
- **Wages and prices forecasts** have been increased significantly. We **now see core (trimmed mean) CPI at 6% by year end. We don't see core back to 3% till early 2024.** Headline around 7.5% by end 2022 and follows core down thereafter. We also see wages picking up to around 3% by end 2022, a peak of 3.5% by end 2023 and similar in 2024.

- **Rate rises have been very aggressive trying to get back to near neutral ASAP. As expected, another 50 points in September, we now expect another 50 points in October followed by 25 points in November taking the cash rate to 3.1% by year end. Then pausing to see impact. Note, monetary policy takes at least 12 months to work on the economy. Our home loan book suggests the big impact is late 2022/early-mid 2023. Not having much liquidity impact till November.**

Currency model. USD .78+/- 5c. So AUD below where you would expect. Australia a proxy in uncertain world with high commodity prices and aggressive central banks.

- See AUD getting back but will take time.

Currency Model* and AUD / USD



- Model driven by: commodity prices; US TWI – as measure of USD strength; long and short run rates; relative unemployment; relative equity markets and VIX.

Forecasts:

End 2022 = 68c AUD/USD
End 2023 = 68c AUD/USD
End 2024= 74c AUD/ USD

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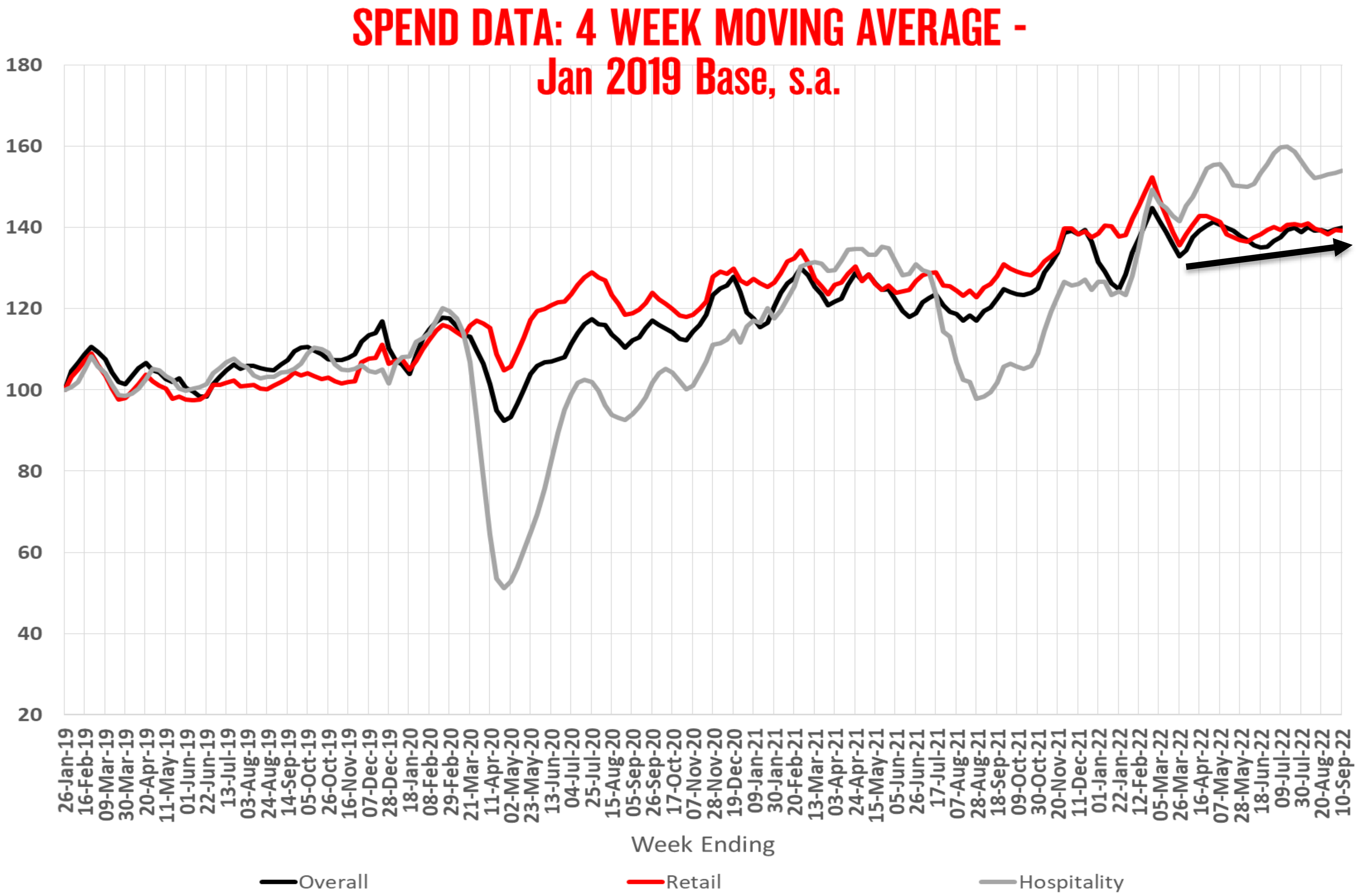
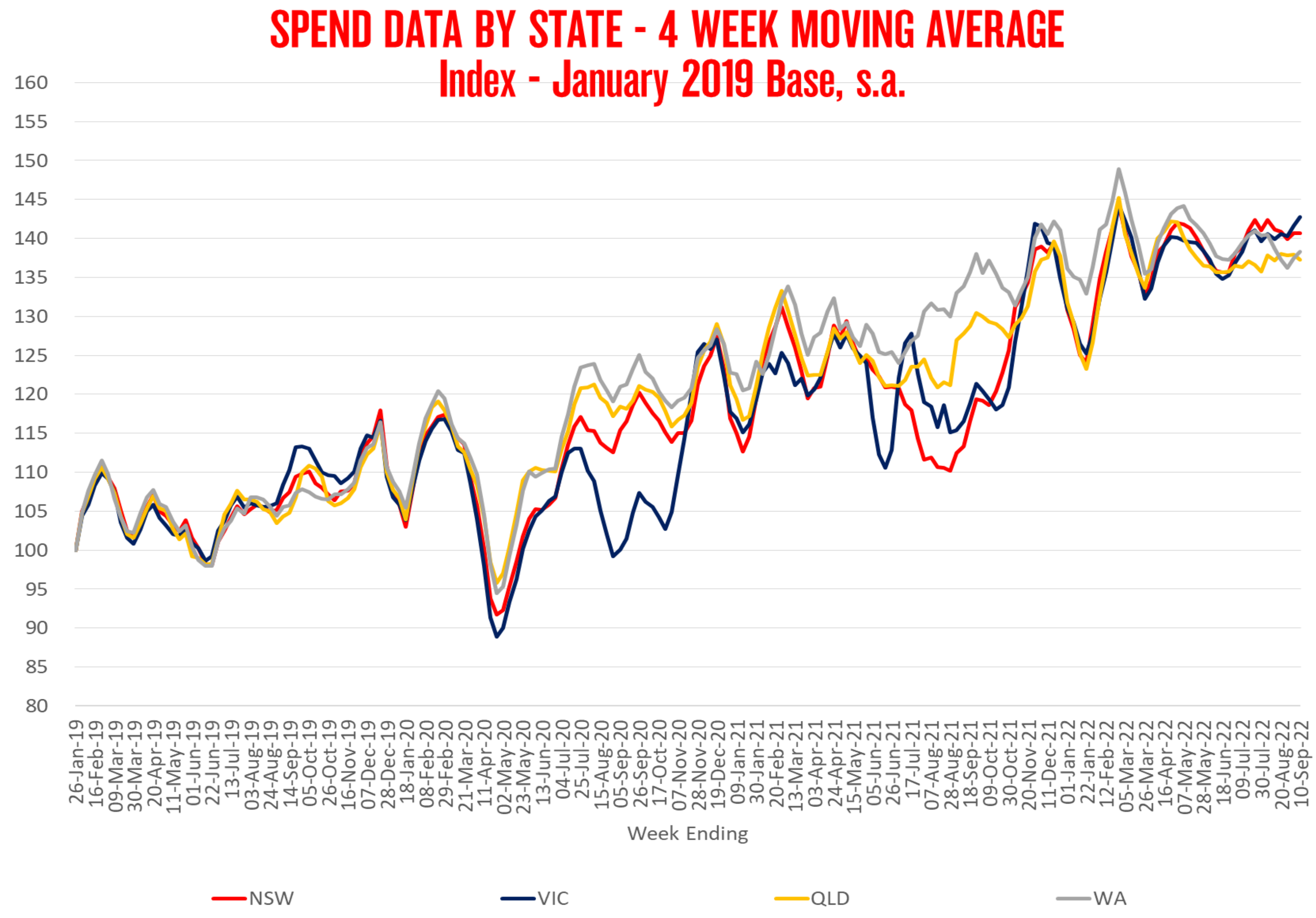
Data Insights

- NAB Data
- Business Survey

On NAB's internal data: Consumption to 10 September. - *Weekly data is bouncy but… not much change from mid April. Hospitality at good levels. Switch from goods to services?*



Generally seeing similar trends across states. – *NSW and Vic the strongest. Recent improvements have seen WA and Qld flatten out.*



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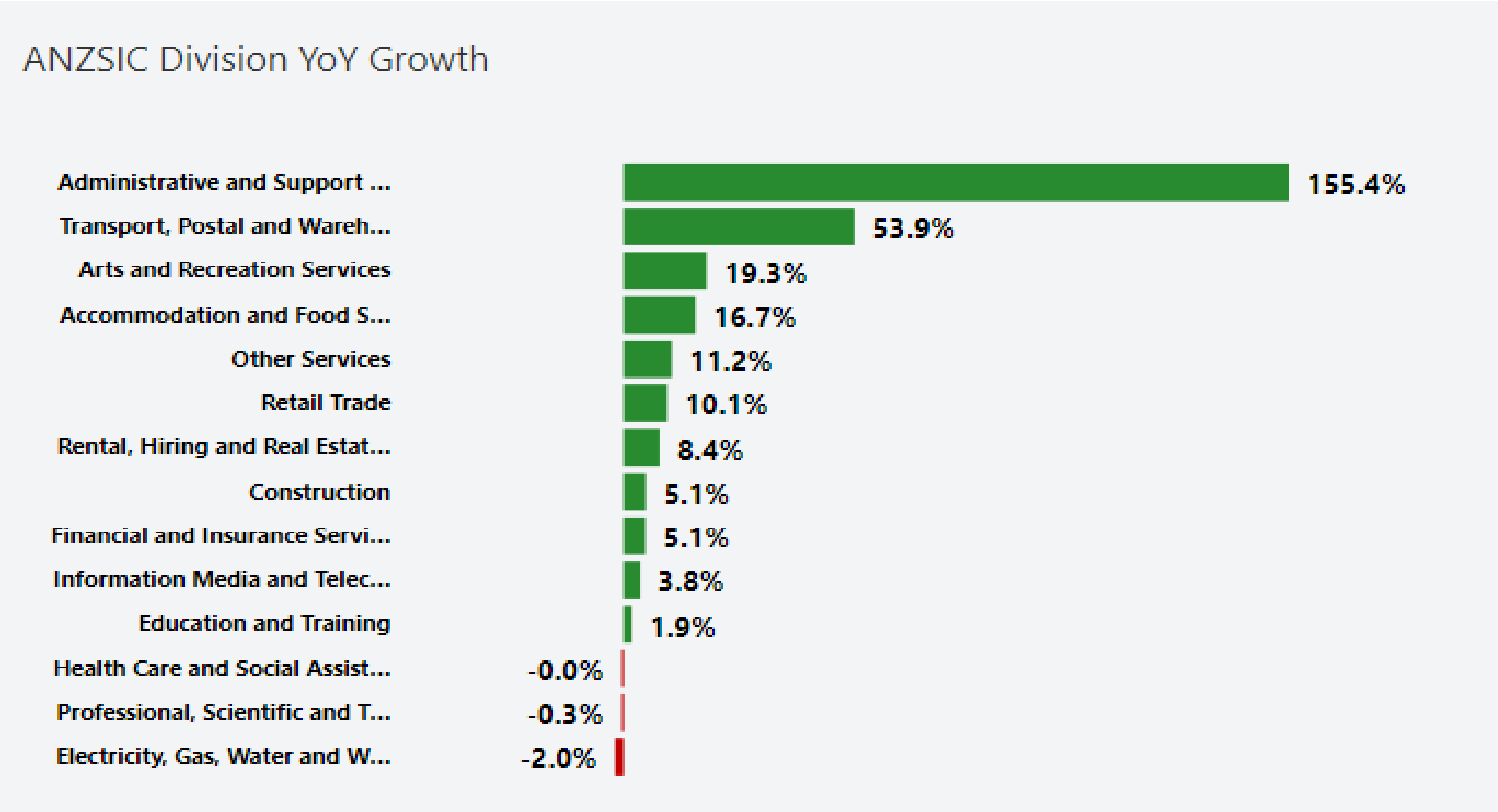
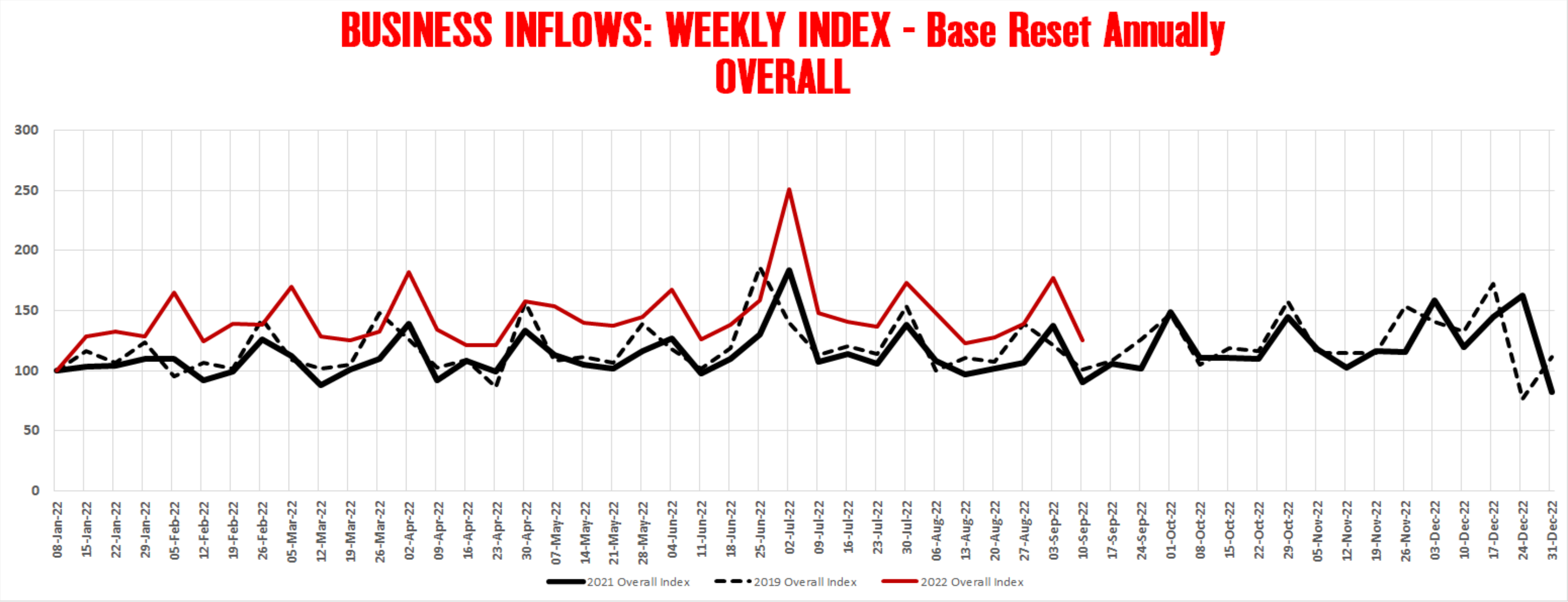
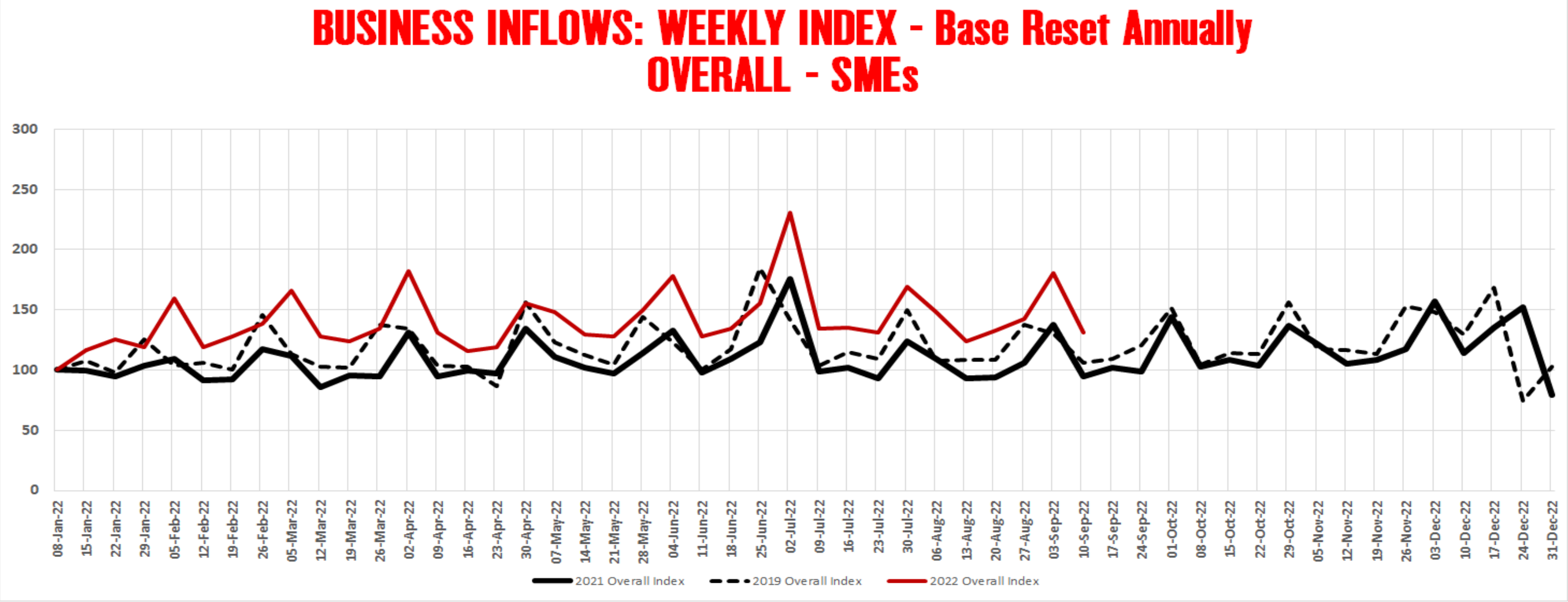
Consumer data based on NAB internal data – *Growth in the year to June Quarter % travel agents and transport. On the negative side health, professional services and electricity etc.*

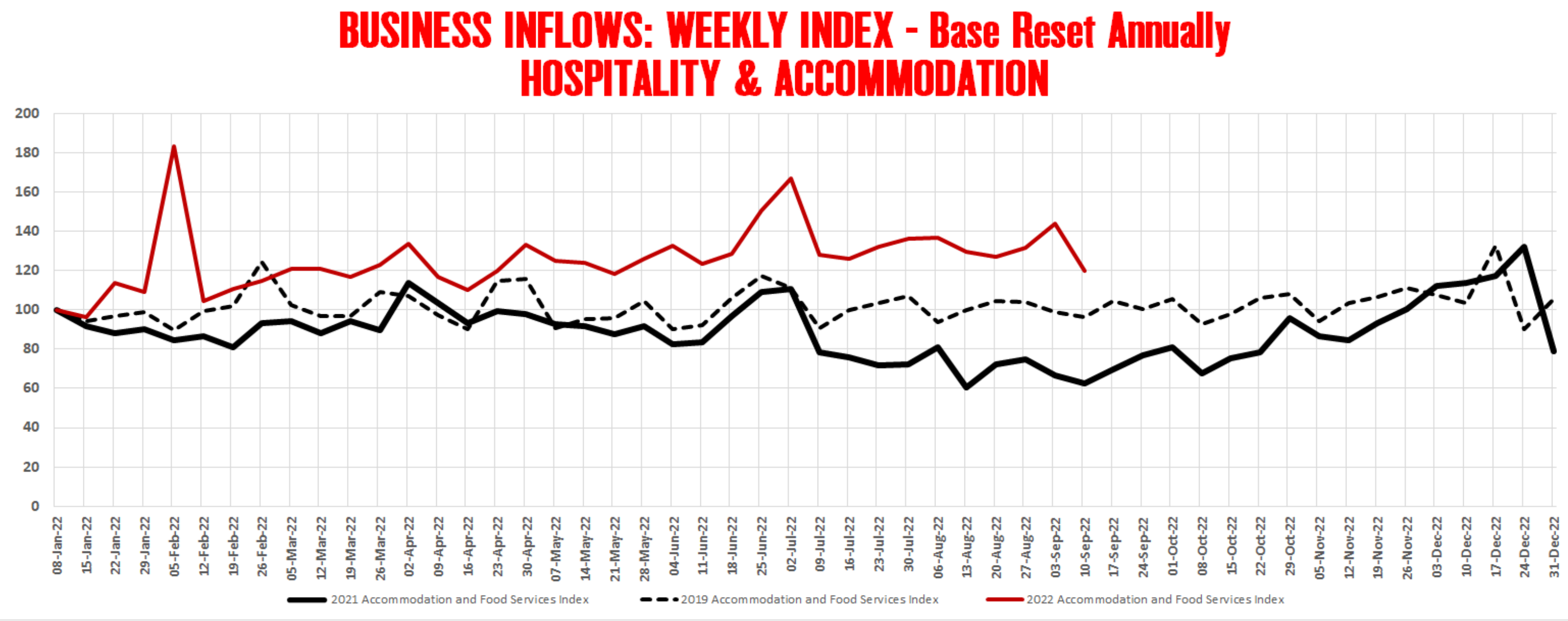


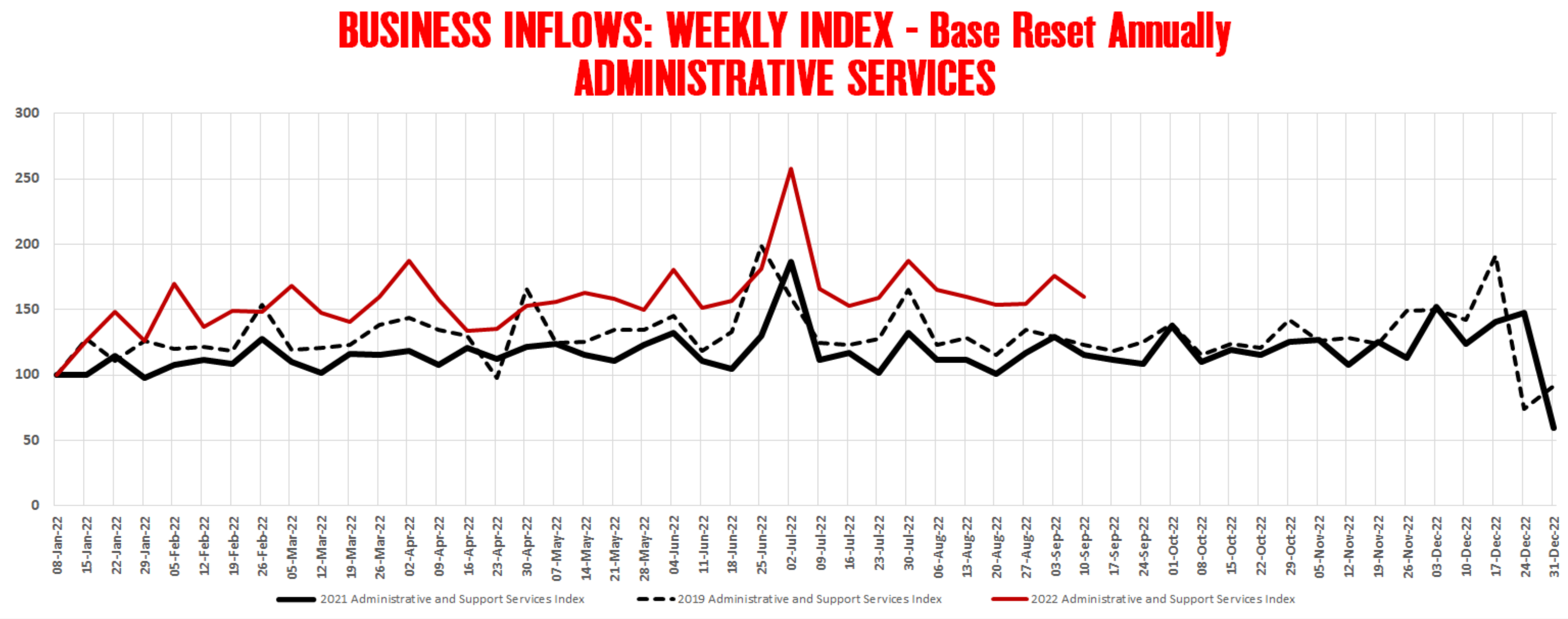
Business inward credits (business revenues) – *Recent trends are encouraging. By early September above 2019 benchmark. Firms find sufficient demand to pass through cost pressures. 2022 in red. Overall up 10% from this time last year.*



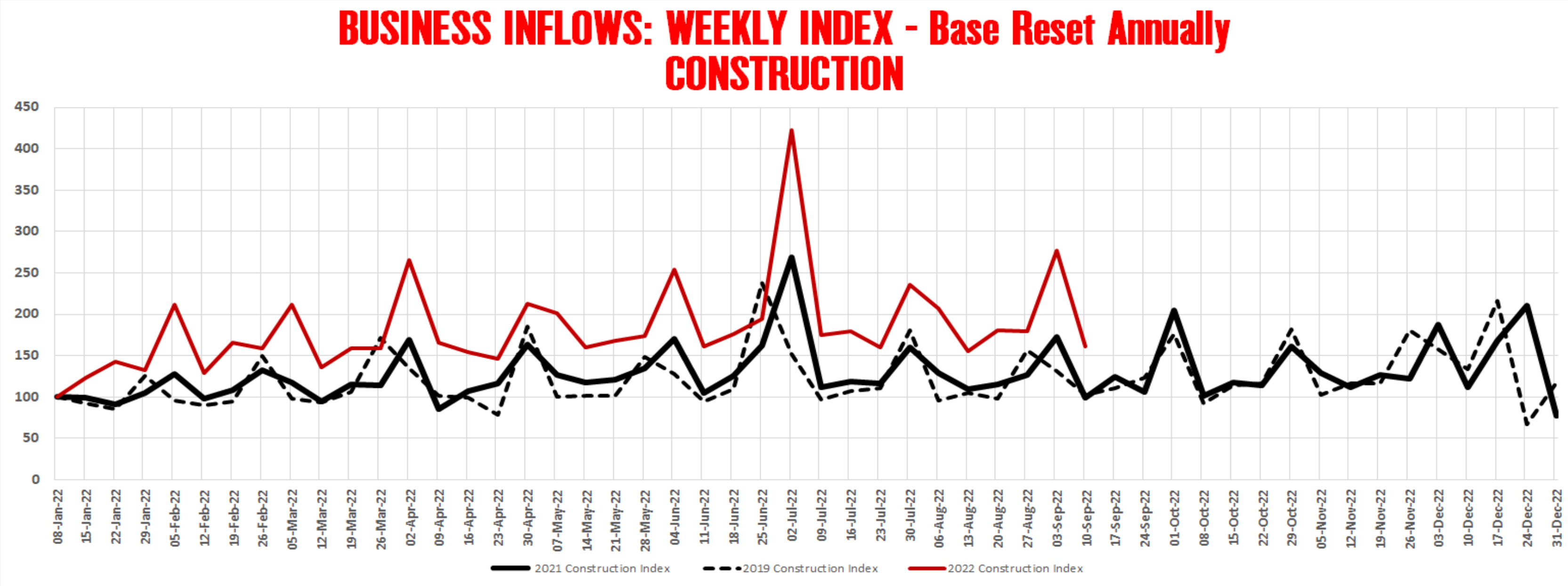


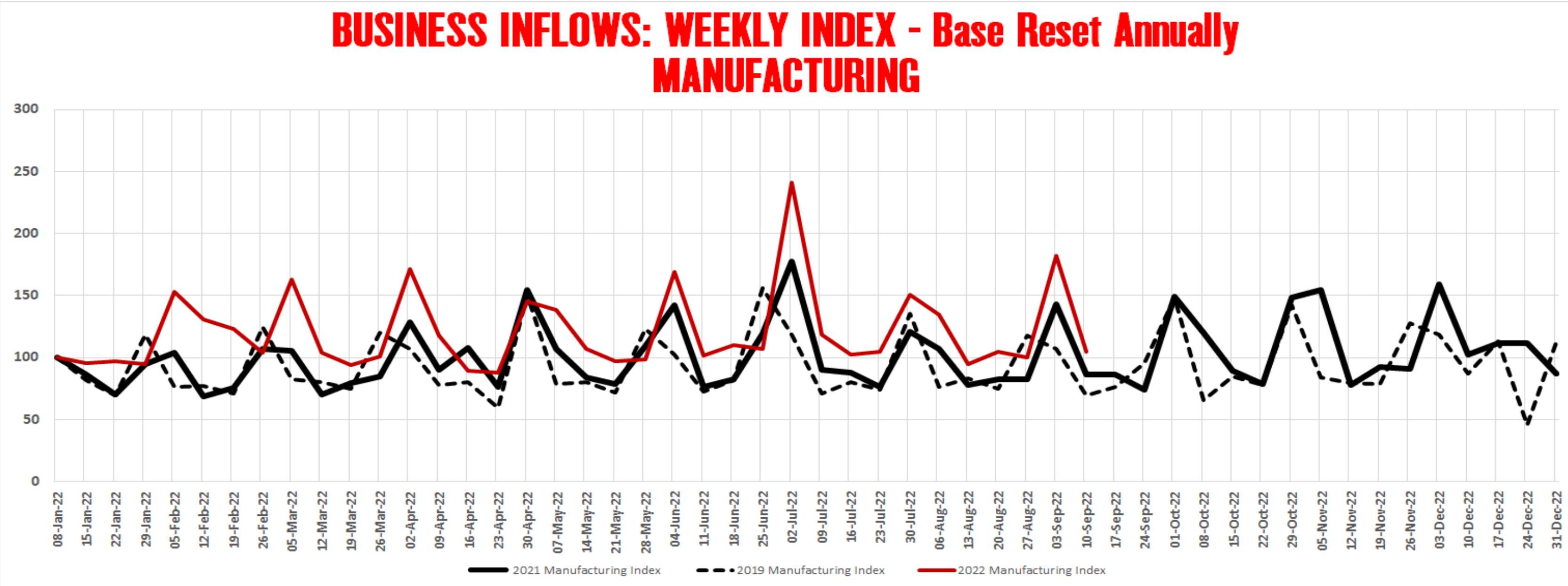
Some industries are doing relatively better on revenue inflows. Interestingly the core parts of the economy are leading the surge - *especially hospitality and admin services (travel agents). Mining also robust.*





So far construction hanging in there. But we are worried re margins and profitability, NAB has been “lucky” so far but worried. *- Manufacturing also good.*





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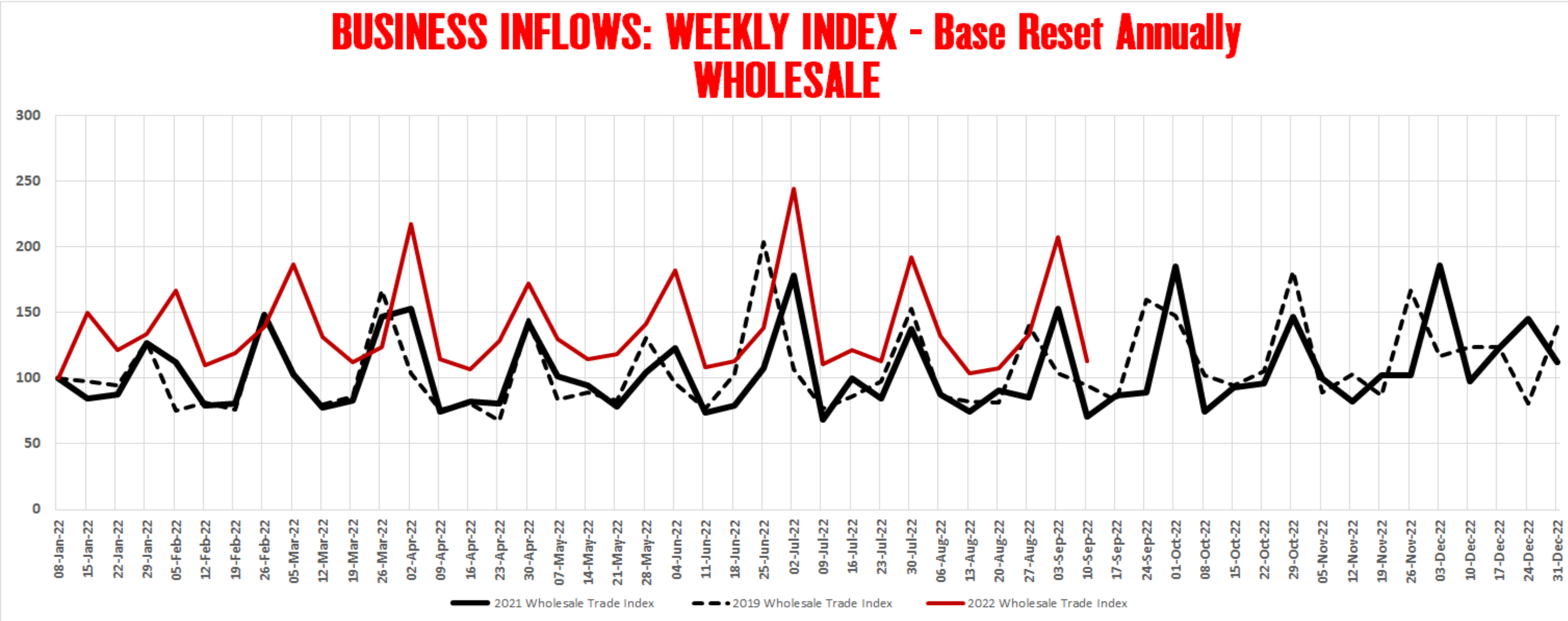
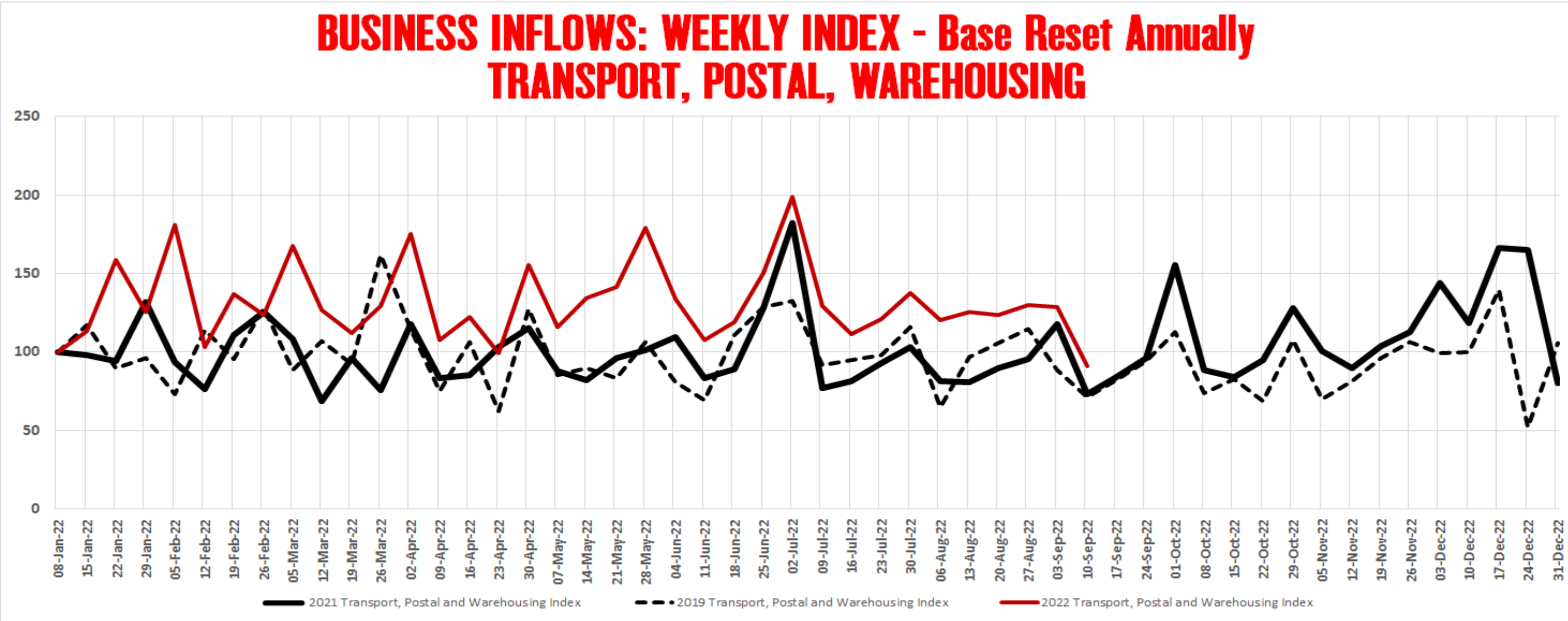
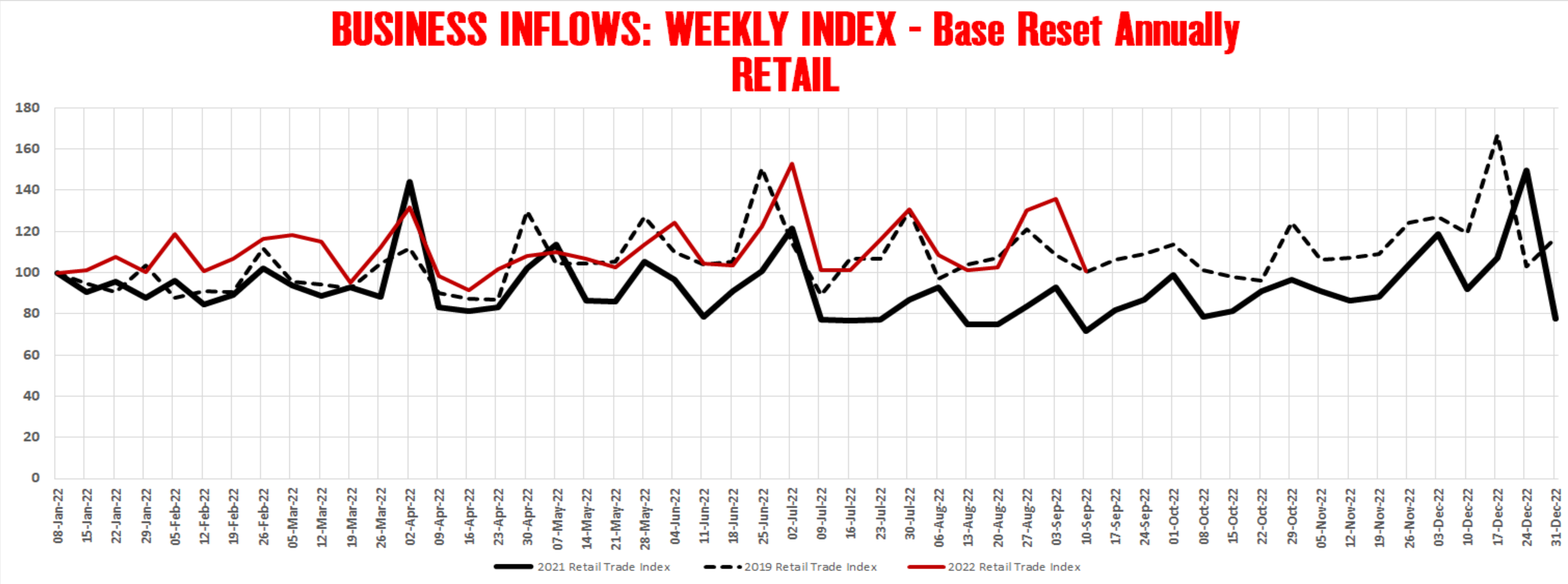
Wholesale as a leading indicator is also good *- as is transport (but less so).*

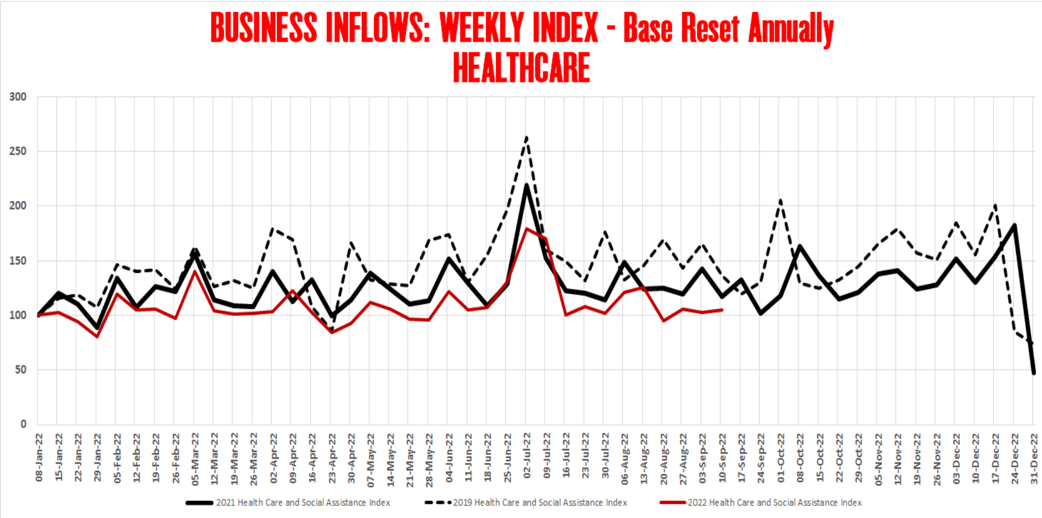


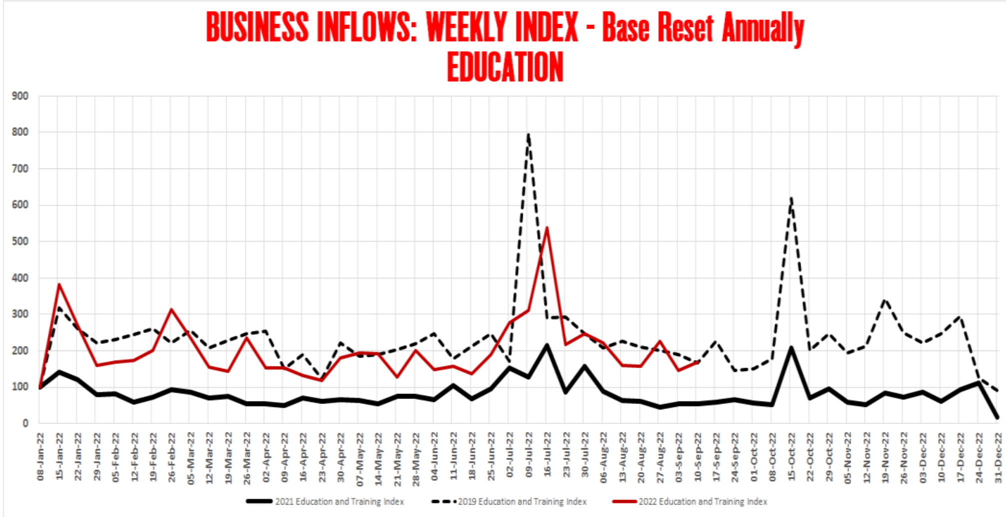


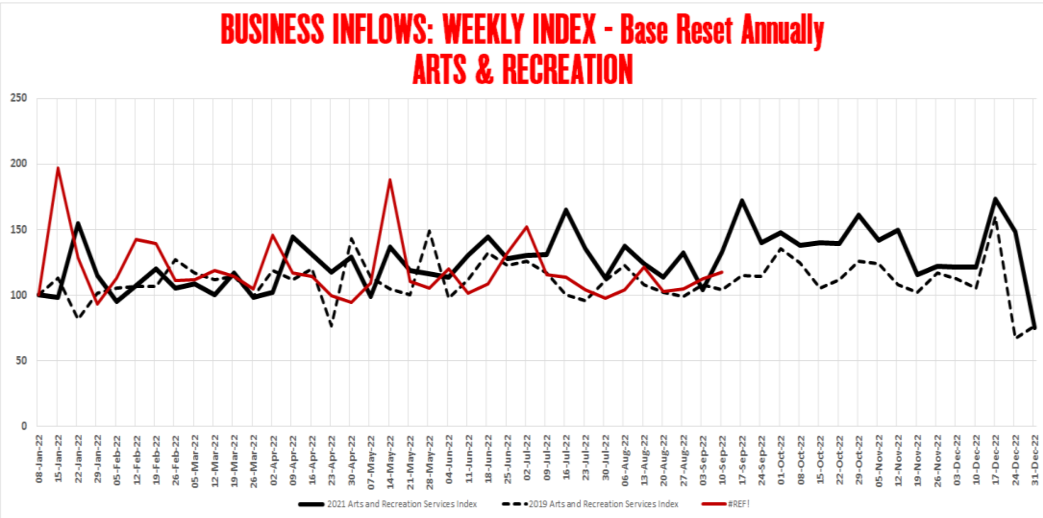
Retail hasn't been great – *improved recently but back to 2019 benchmark now.*

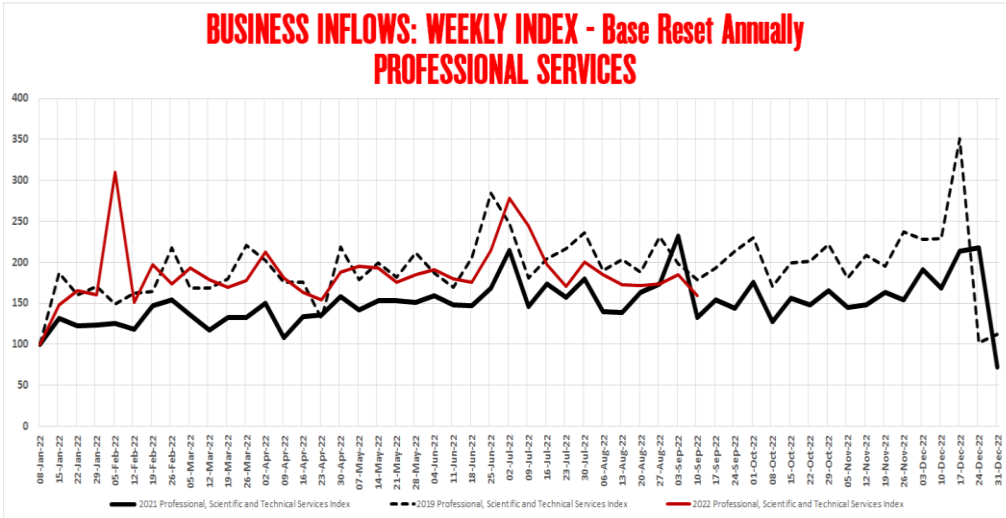


But there are some sectors that continue to struggle. Health still very sluggish (elective surgery bans). Education *- and now professional services and arts & rec services.*









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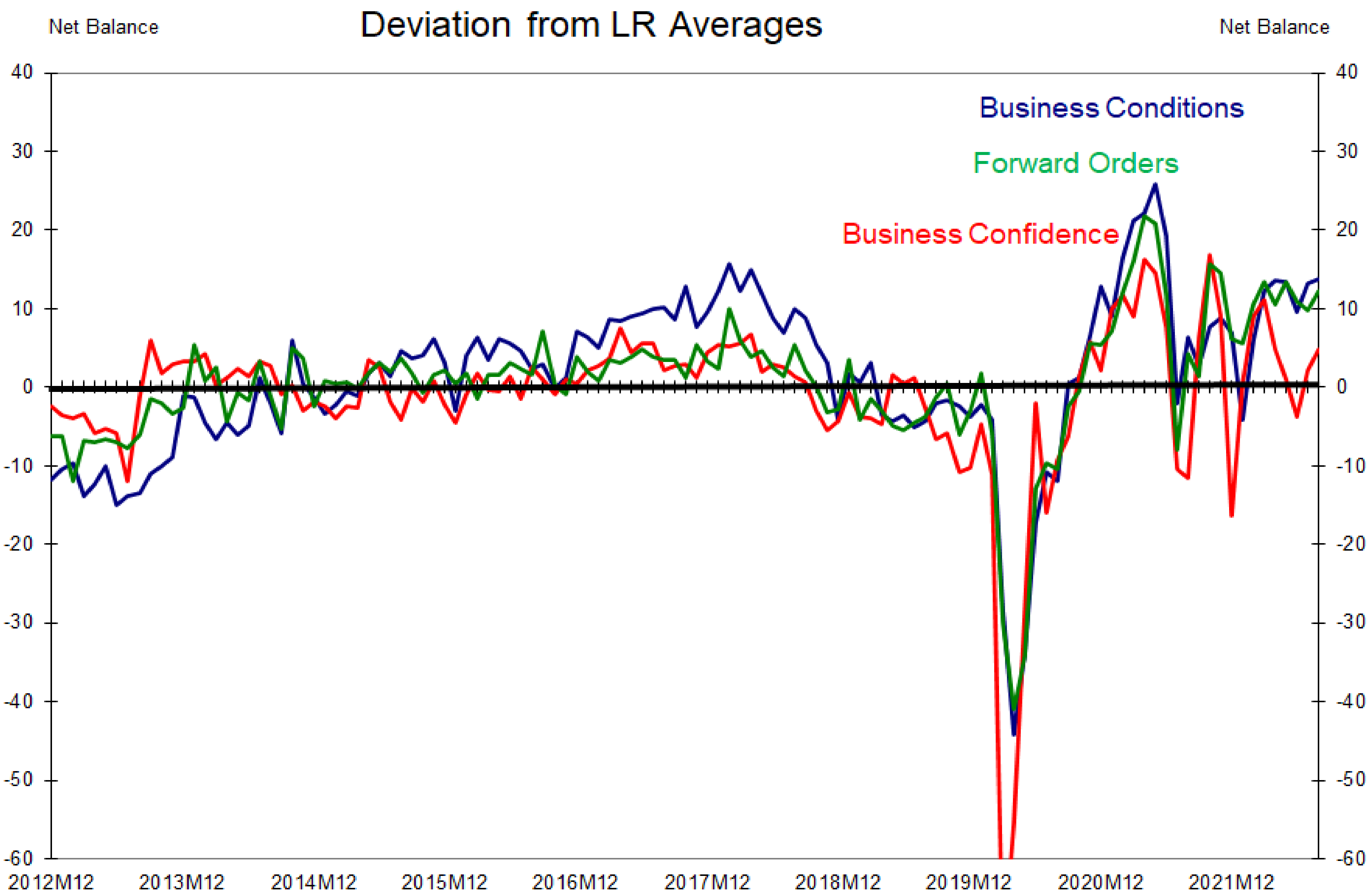
Obviously Omicron crunching confidence and conditions during the pandemic. But conditions and forward orders still very strong in July/August. But confidence slipped a touch but better now. - *Purchase costs, supply difficulties and rates.*



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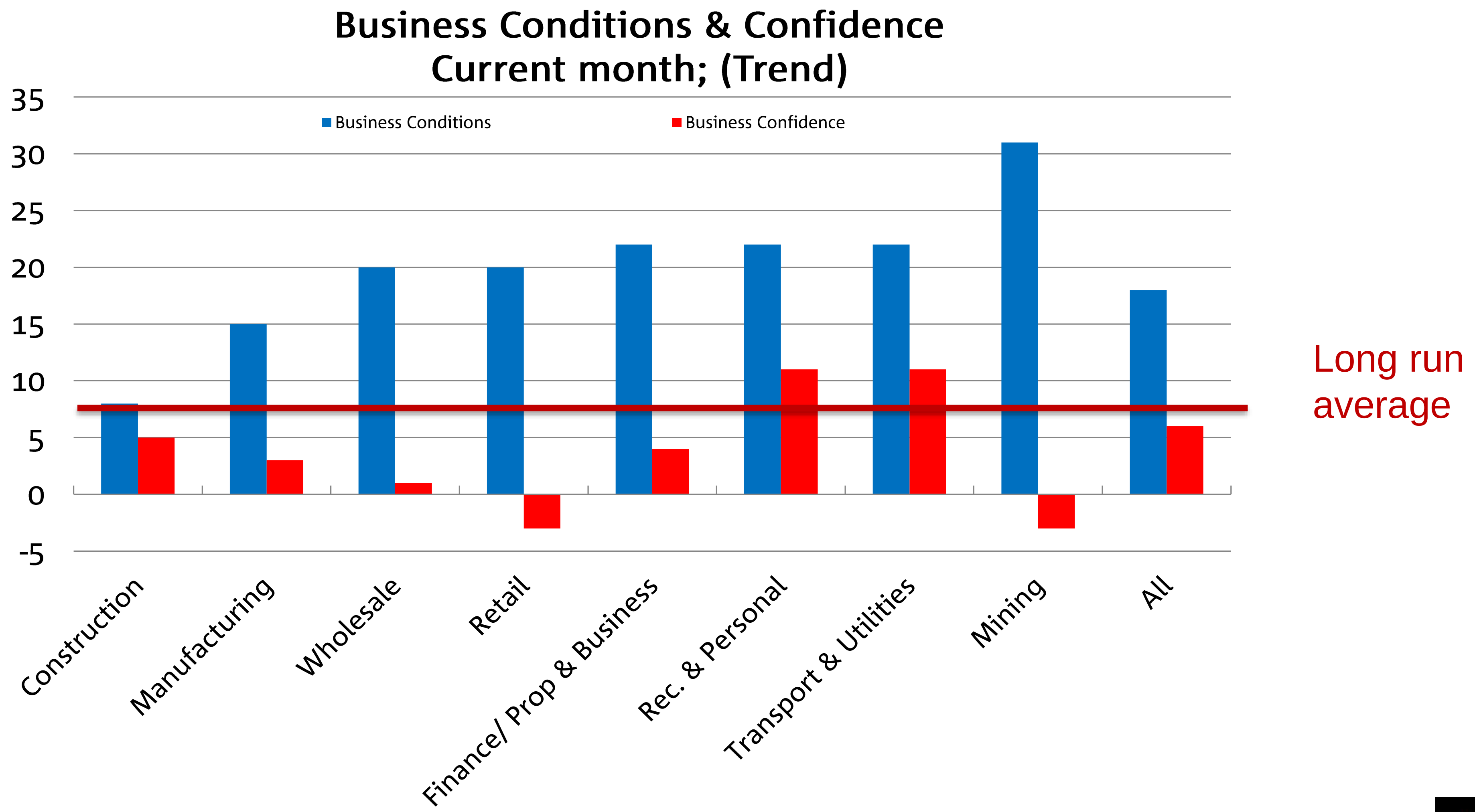
By industry, have seen big improvements in hospitality (personal & rec services). Now middle of the pack. And mining. Construction relatively soft - profitability.
– *Mining (especially) and retail/wholesale outcomes stronger but confidence an issue.*

Business Conditions & Confidence in August



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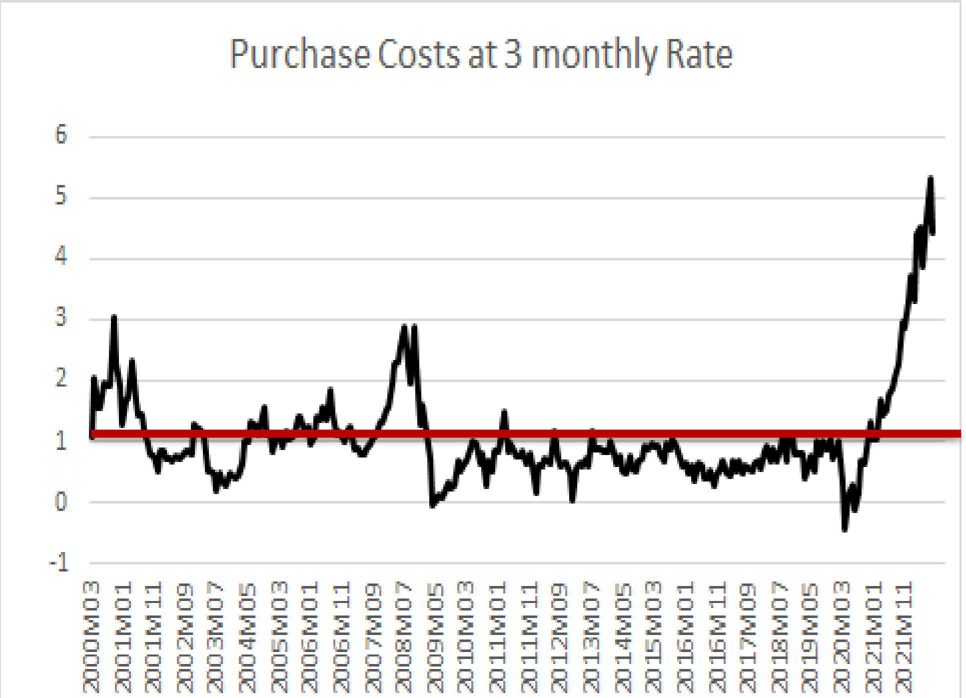
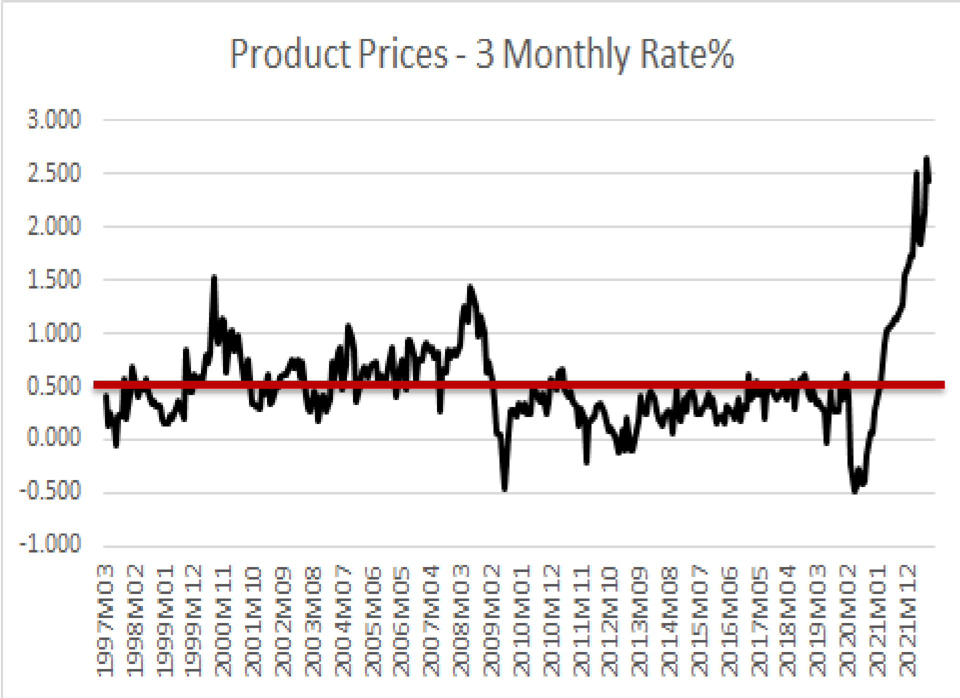
NAB Survey clearly showing soaring purchase costs *– especially construction, manufacturing, wholesale & transport. A touch lower in August but… General prices still very strong and not much down in August. Basically all at record levels.*

Purchase Costs – August NAB Survey



Goods Costs – August NAB Survey



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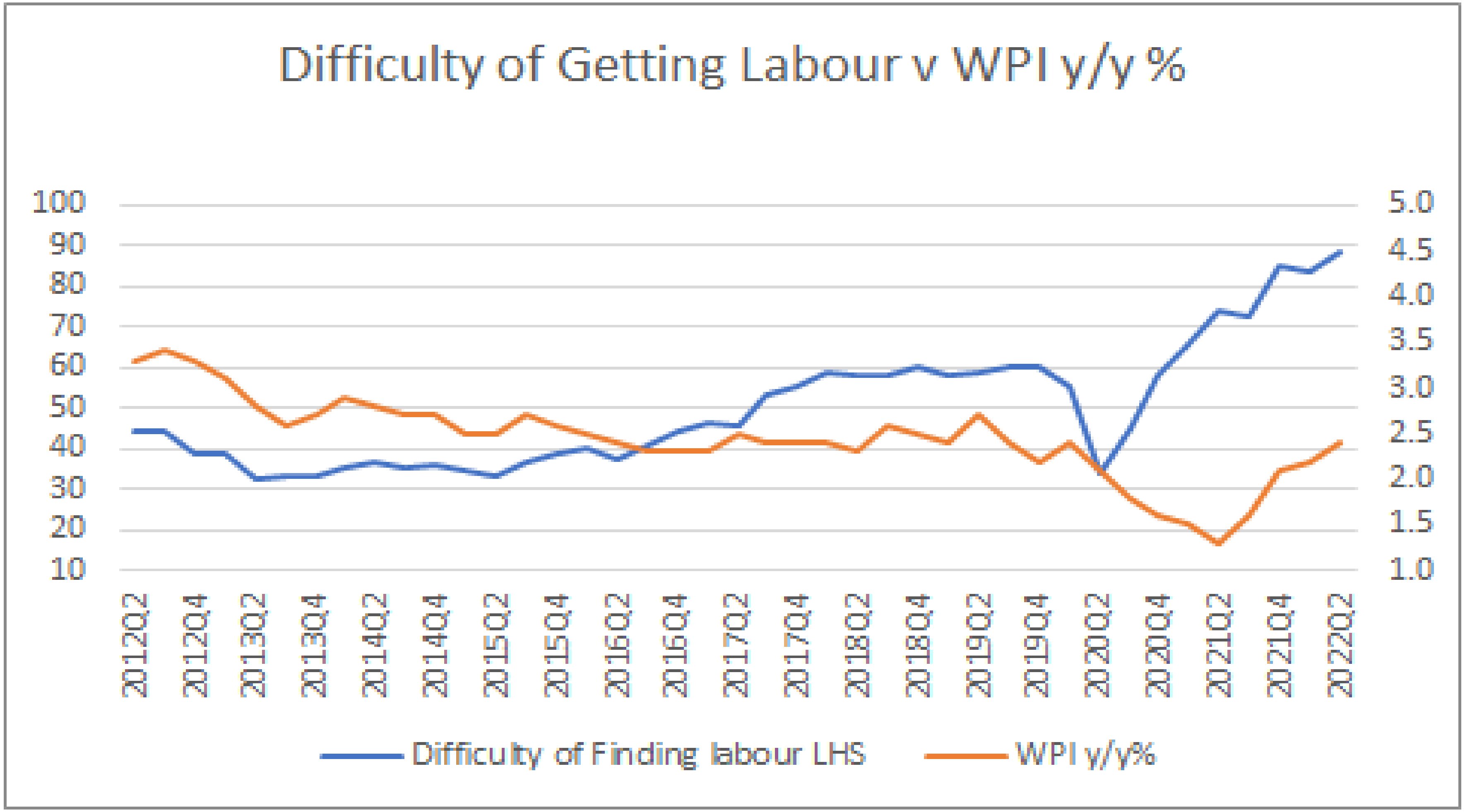
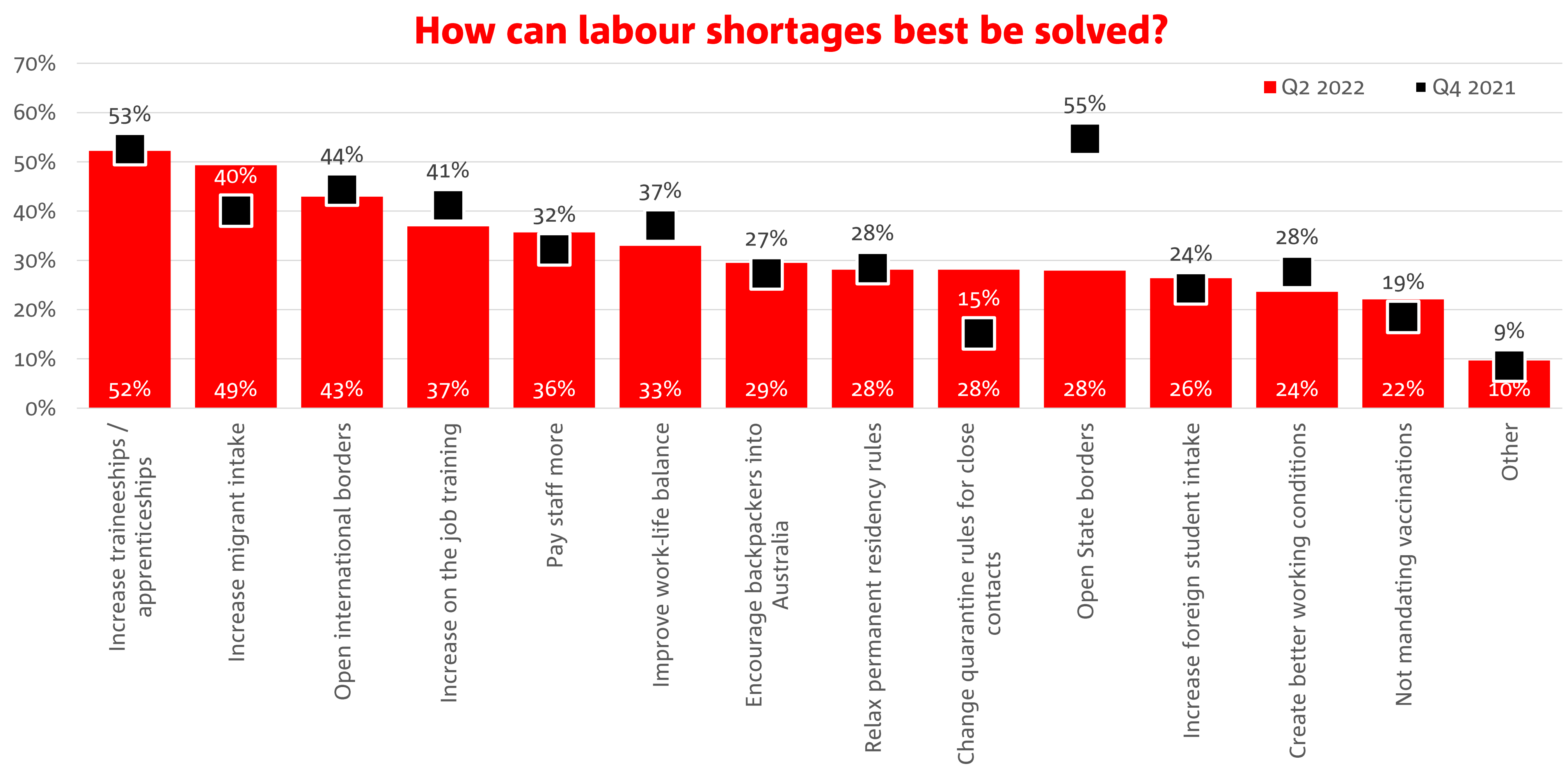
Obviously labour shortages are a huge issue for business now. Interesting that the link from labour shortages to wages growth – *hasn't been as strong as it used to be.*



Our surveys suggest that SMEs think apprenticeships, migration and open borders are the best way to solve labour shortages. *- But wages growth not that high.*



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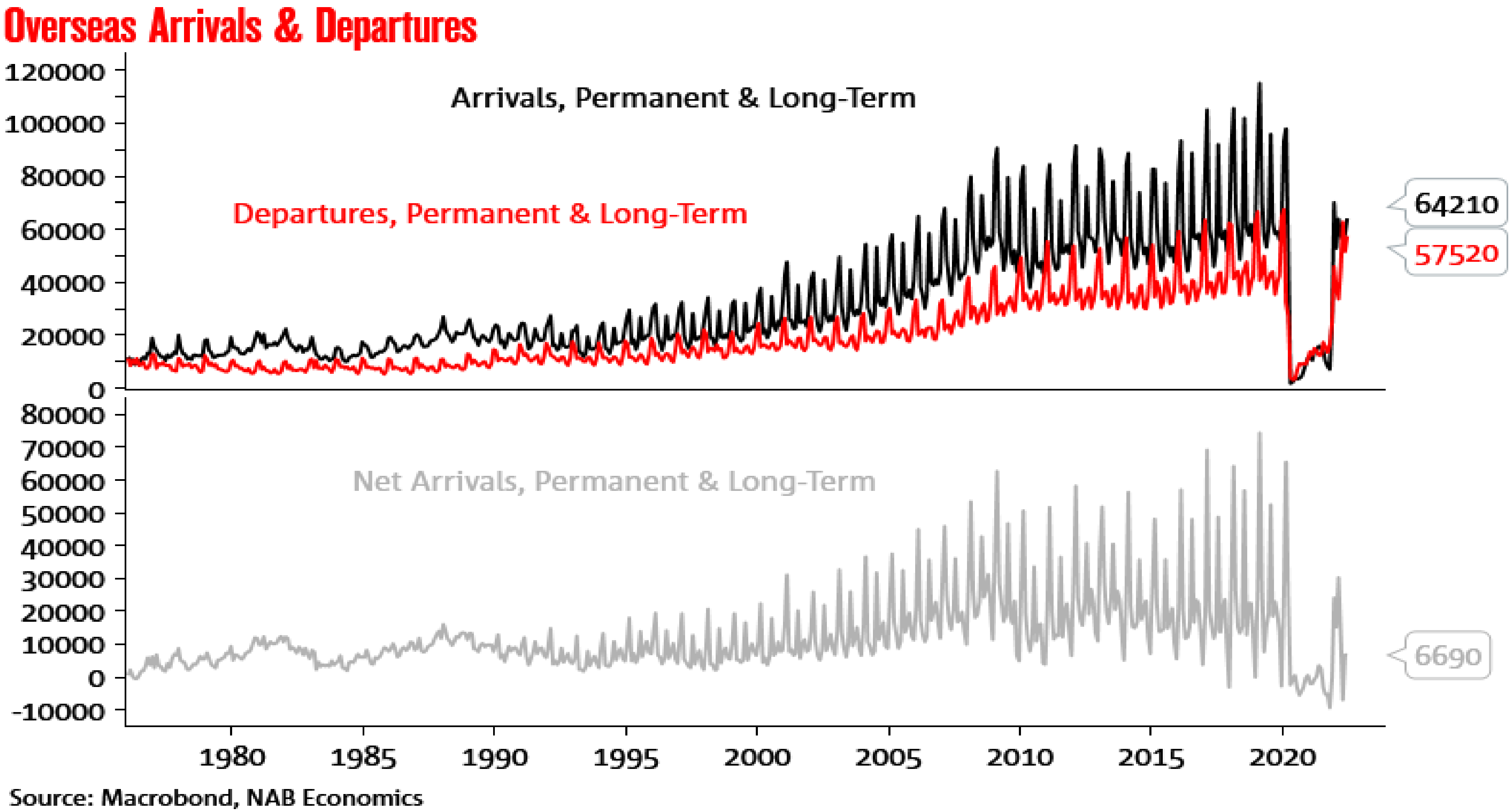
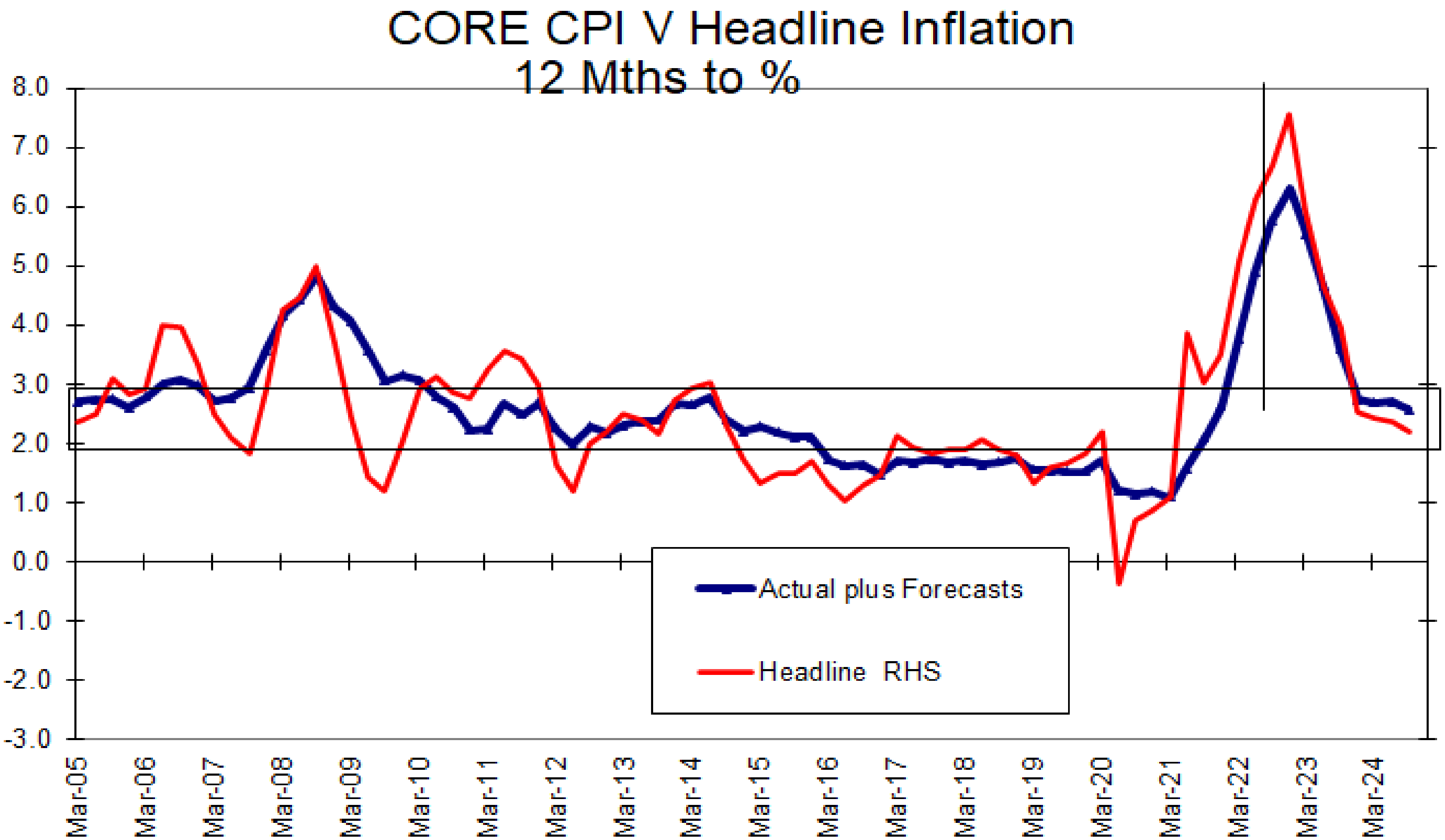
But while borders are relatively open, net migration still a long way off.

- That is arrivals have picked up but more than matched by departures.



Core inflation hit by supply side problems and higher commodity prices (Russia).

– Soon trimmed mean core inflation will jump to around 6% by end 2022. Core at 3% by end 2023 and 2.7% in 2024. Headline even higher… around 7.5% by end 2022.



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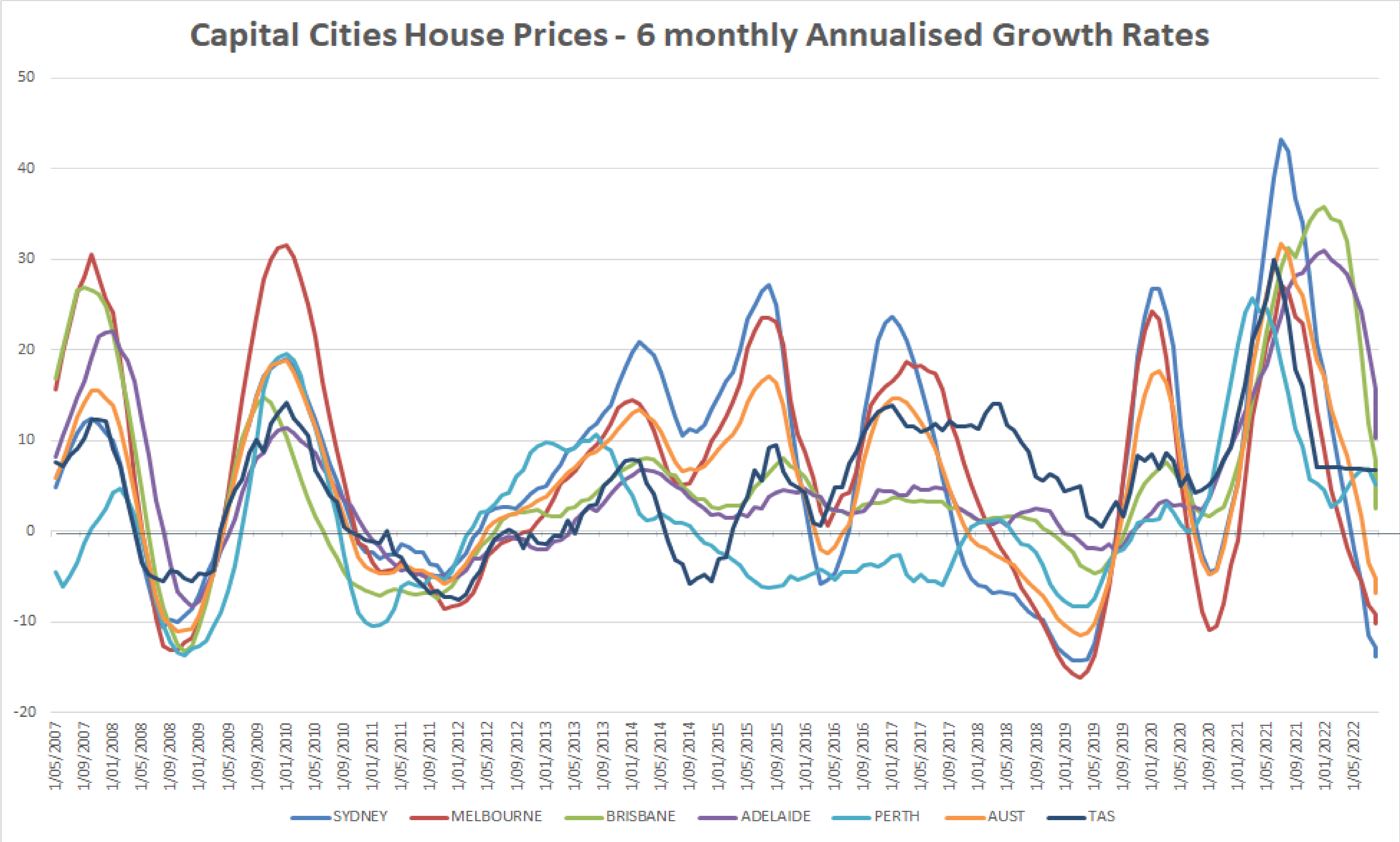
House prices have started to edge down in Sydney/Melbourne. Are stronger in Adelaide and Brisbane but turning down also. *– Overall annualised 6 monthly rate down -6.7%. To September. Falling faster than we expected. But more to come*



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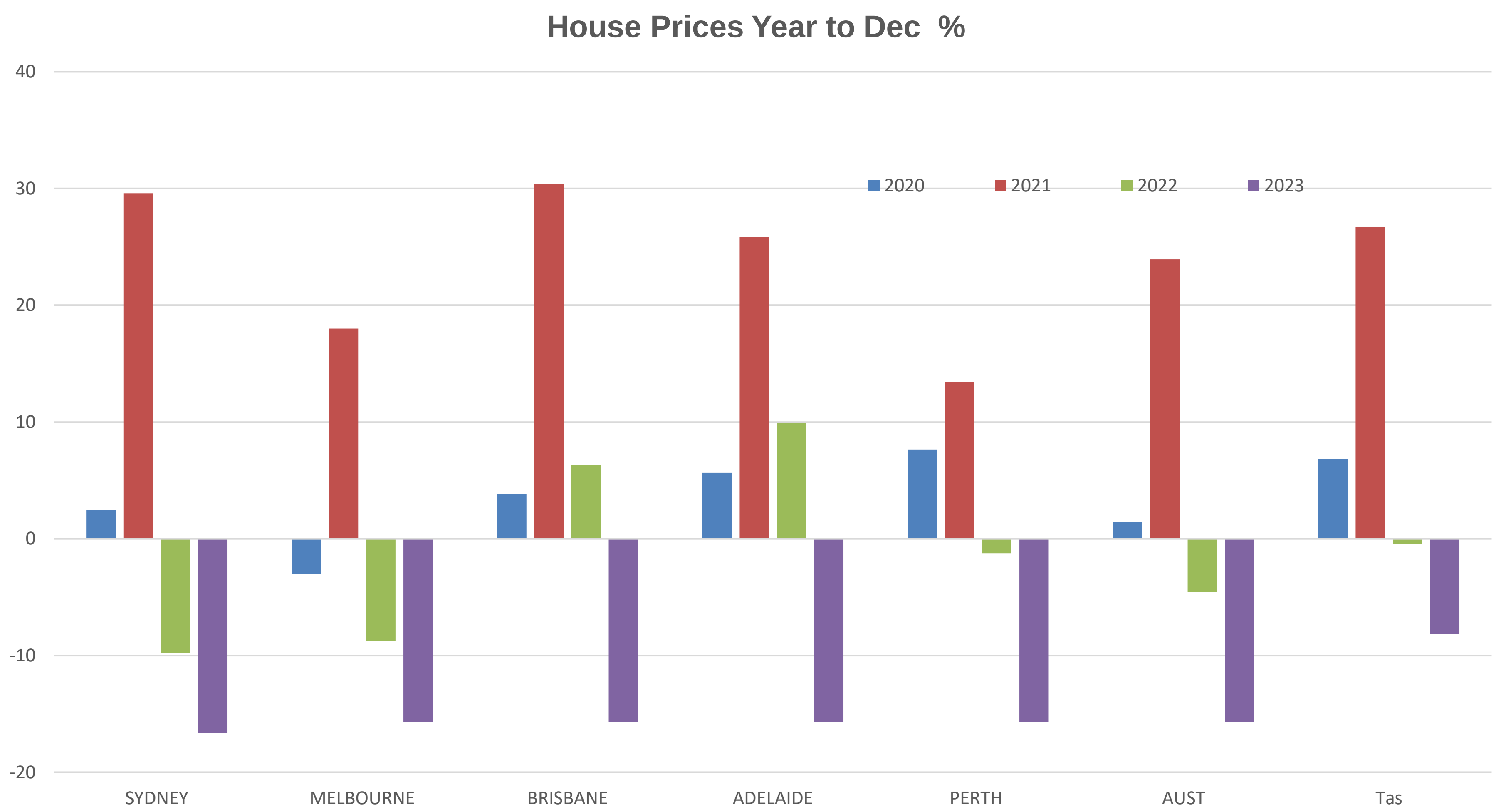
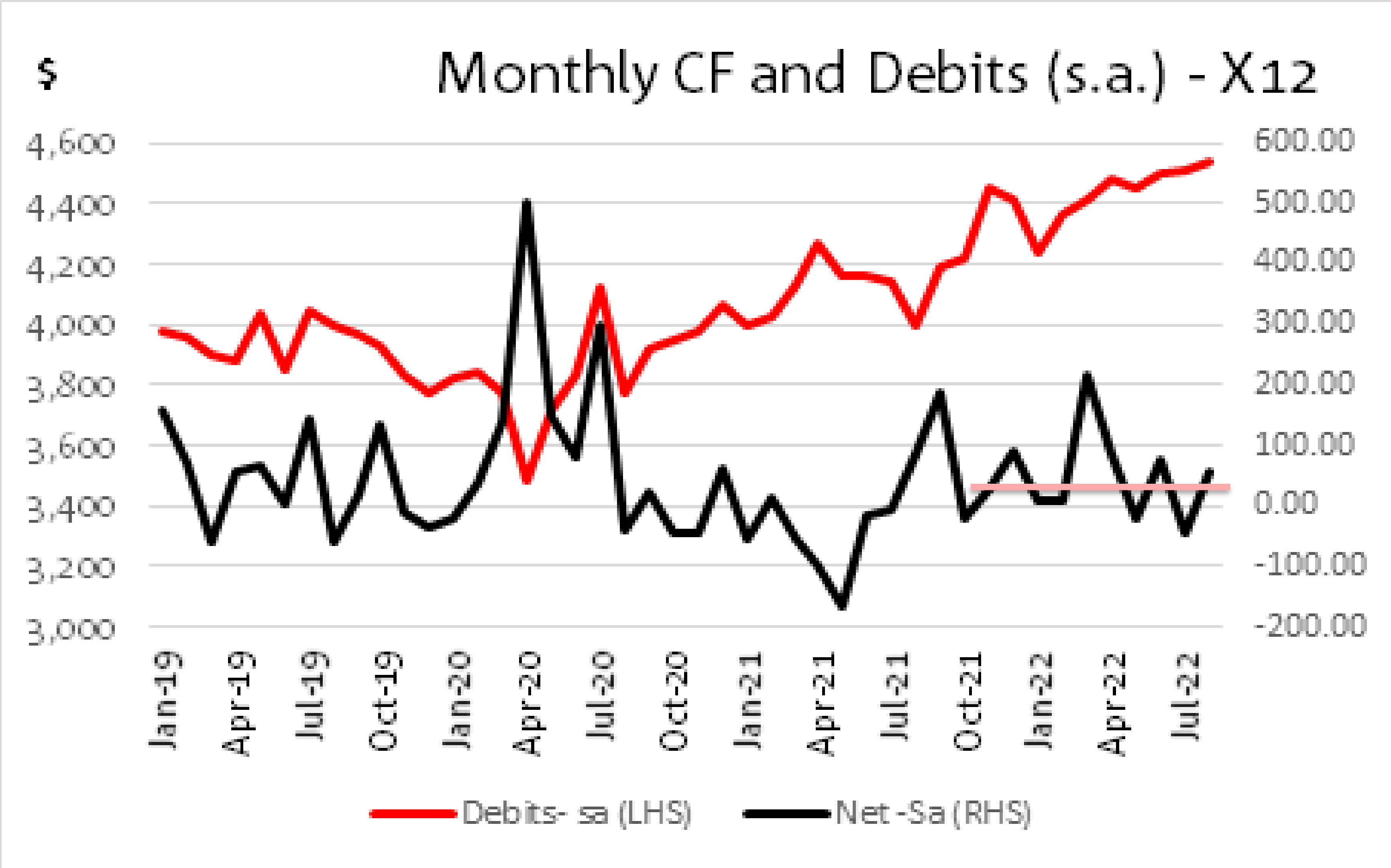
House price forecasts. After increasing by around 23% we now expect house prices to be down around -4.5% in the year ending 2022 (with downside risks).

- And *fall by around 15% during 2023 on the back of rate rises and falling affordability.*



The combination of falling house prices and global weakness could well see the consumer getting scared. Already their cash flow is not great. – *Currently spending as much as they are getting. Probably enough to sustain growth in 2022 but beyond that ???*



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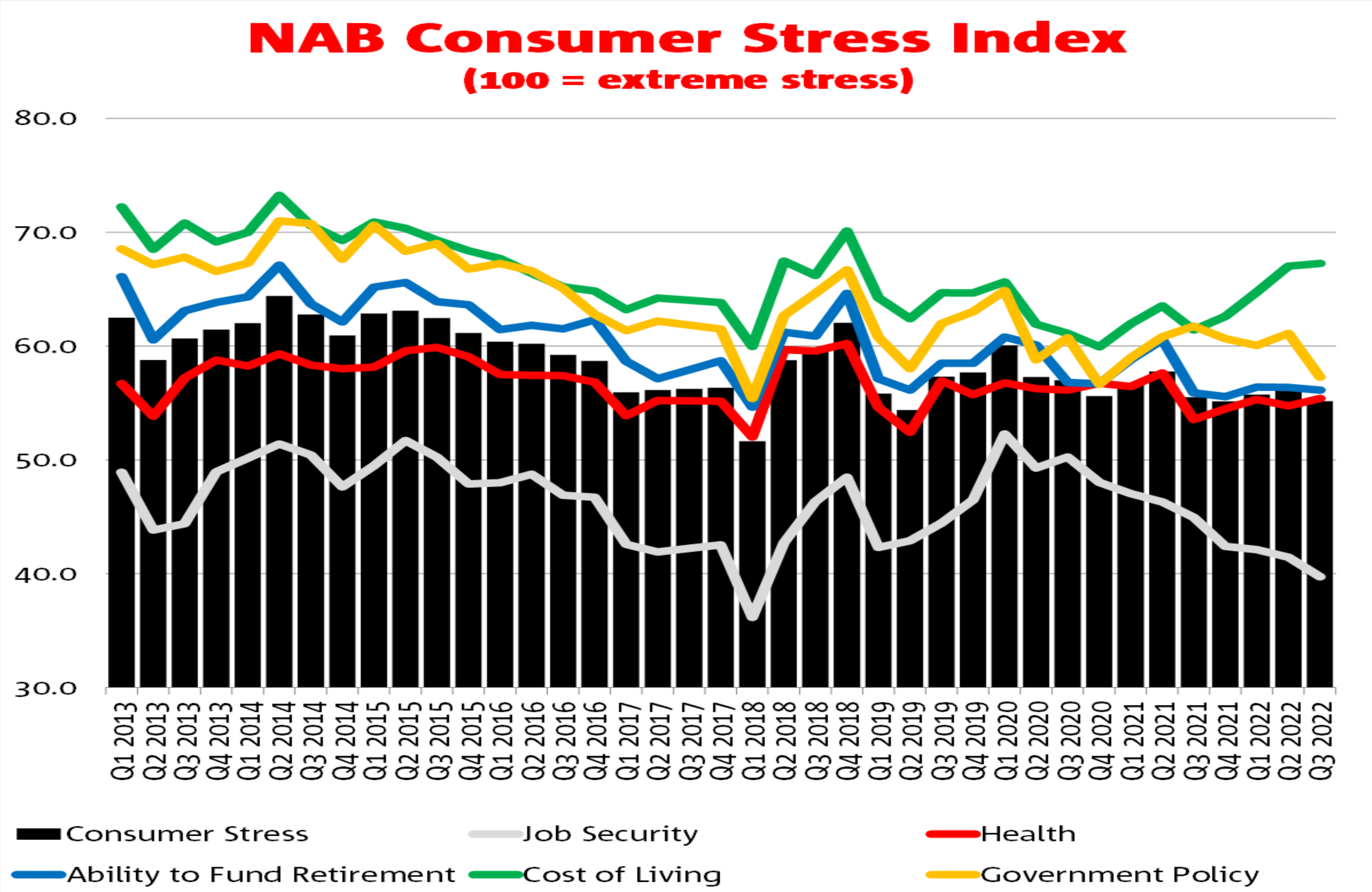
Consumers are very worried about cost of living
- but that is being tempered by the ease of getting a new job.



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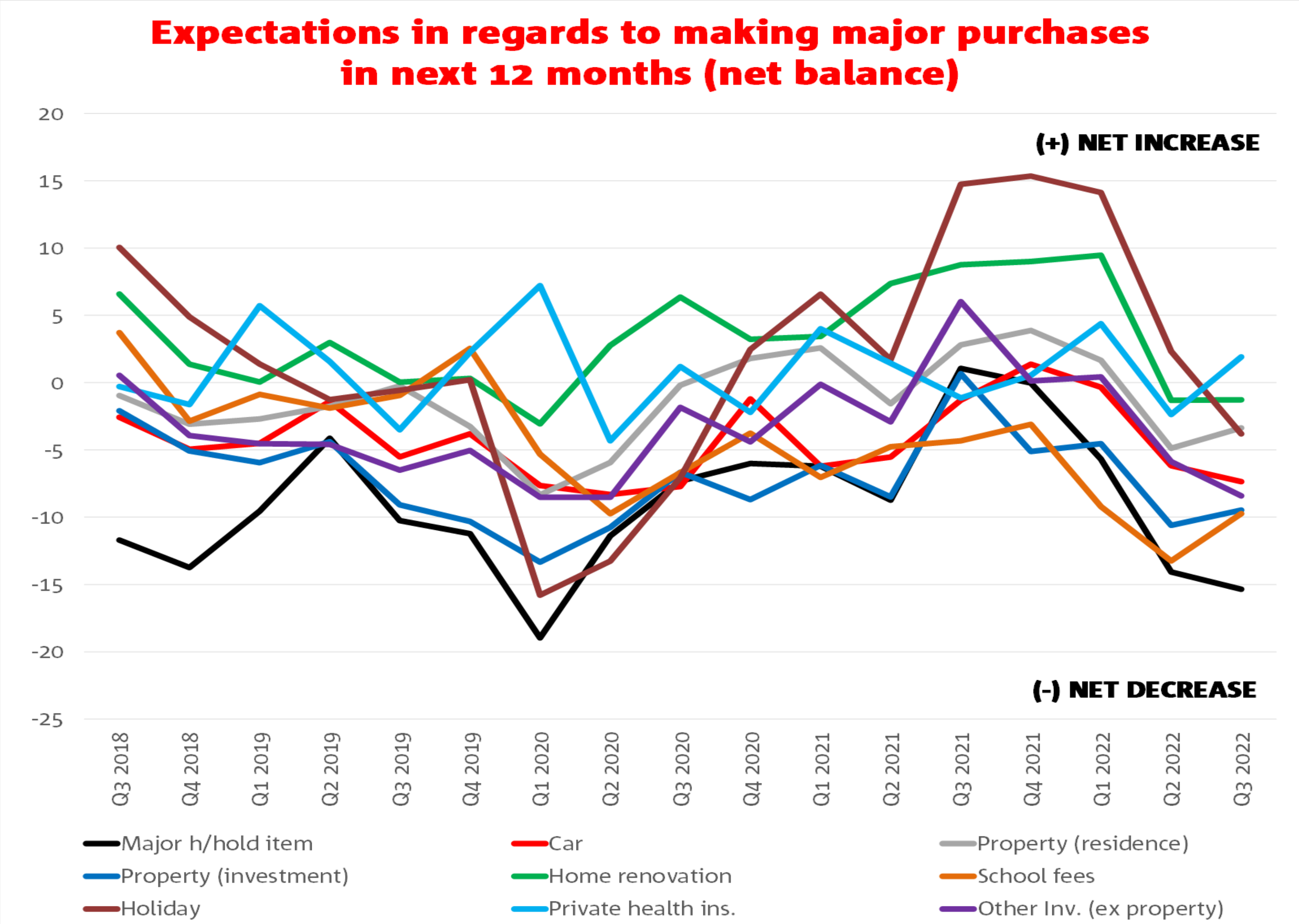
But they are adjusting plans. Liquidity impact from rate rises *- to hit from October.*



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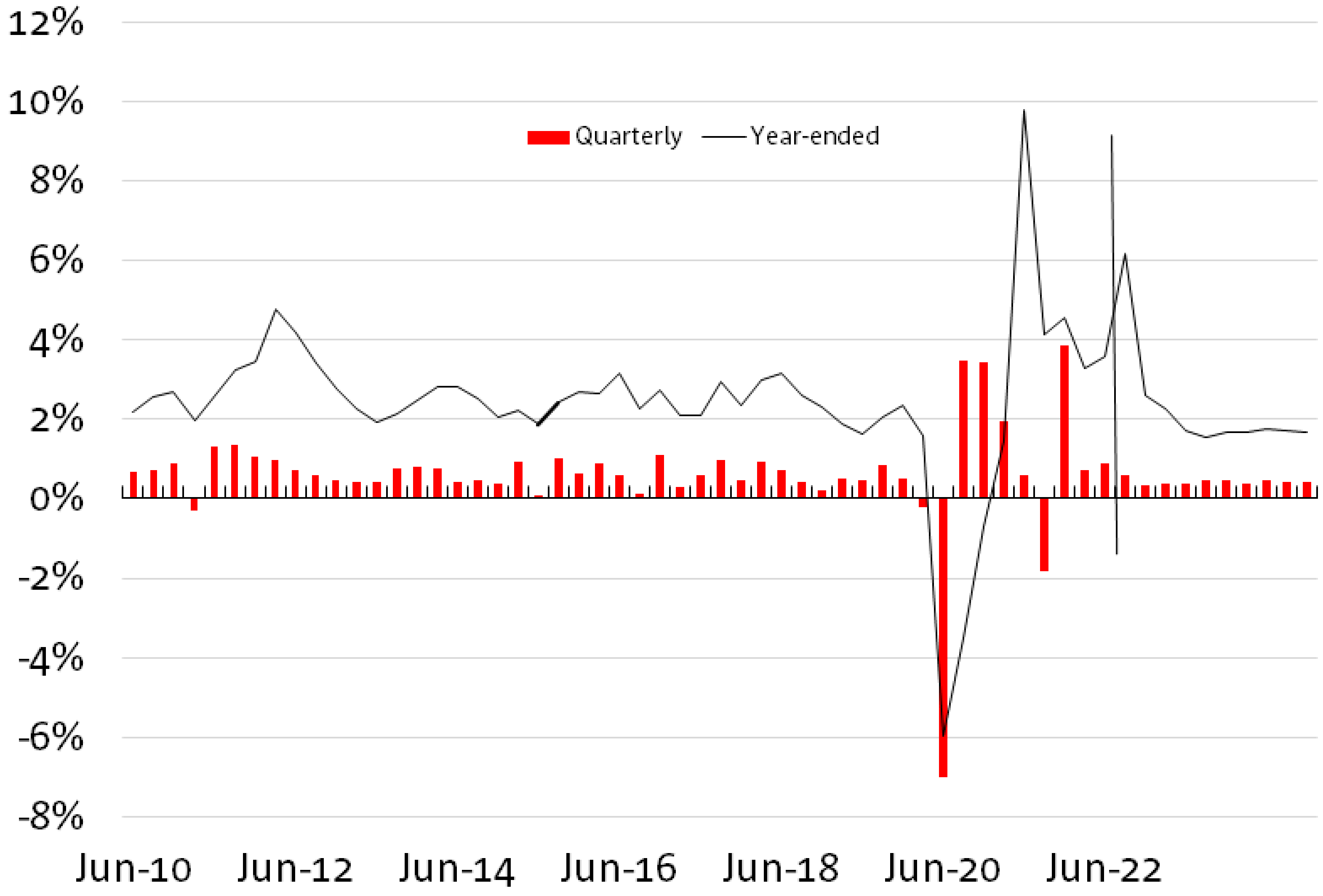
Our growth expectations. – *We see strong growth as consumption comes back but also investment. Fading a touch in H2 2022 and then sub trend thereafter –1.6% during 2023 and 1.8% through 2024.*



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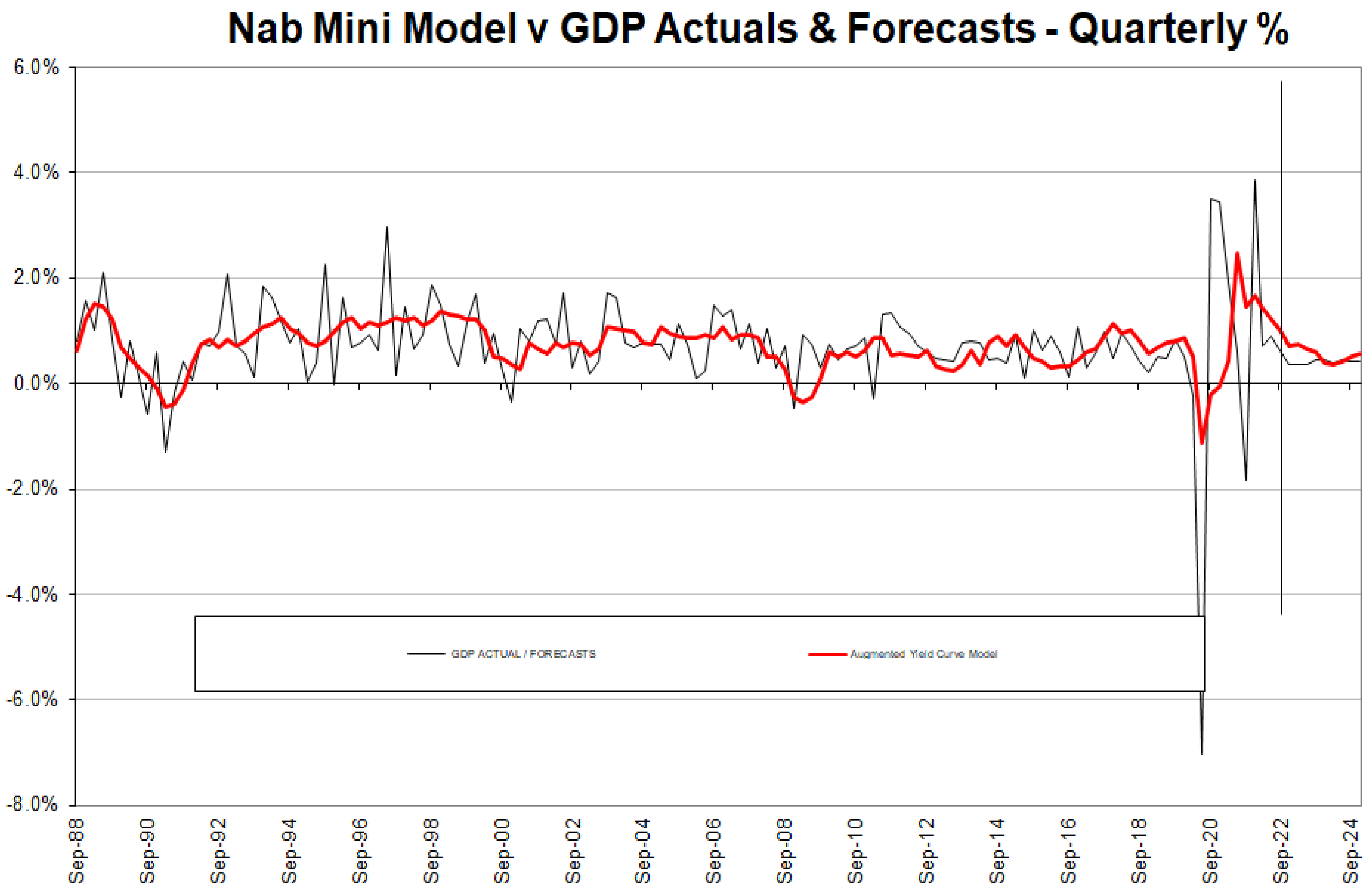
My enhanced yield curve equation - *obviously can't cope with COVID but as we move out of the virus, general trend consistent with the model.*



- Model driven by yield curves (or real rates), asset prices (house prices and equities), commodity prices, and US growth.
- Quarterly modelled.

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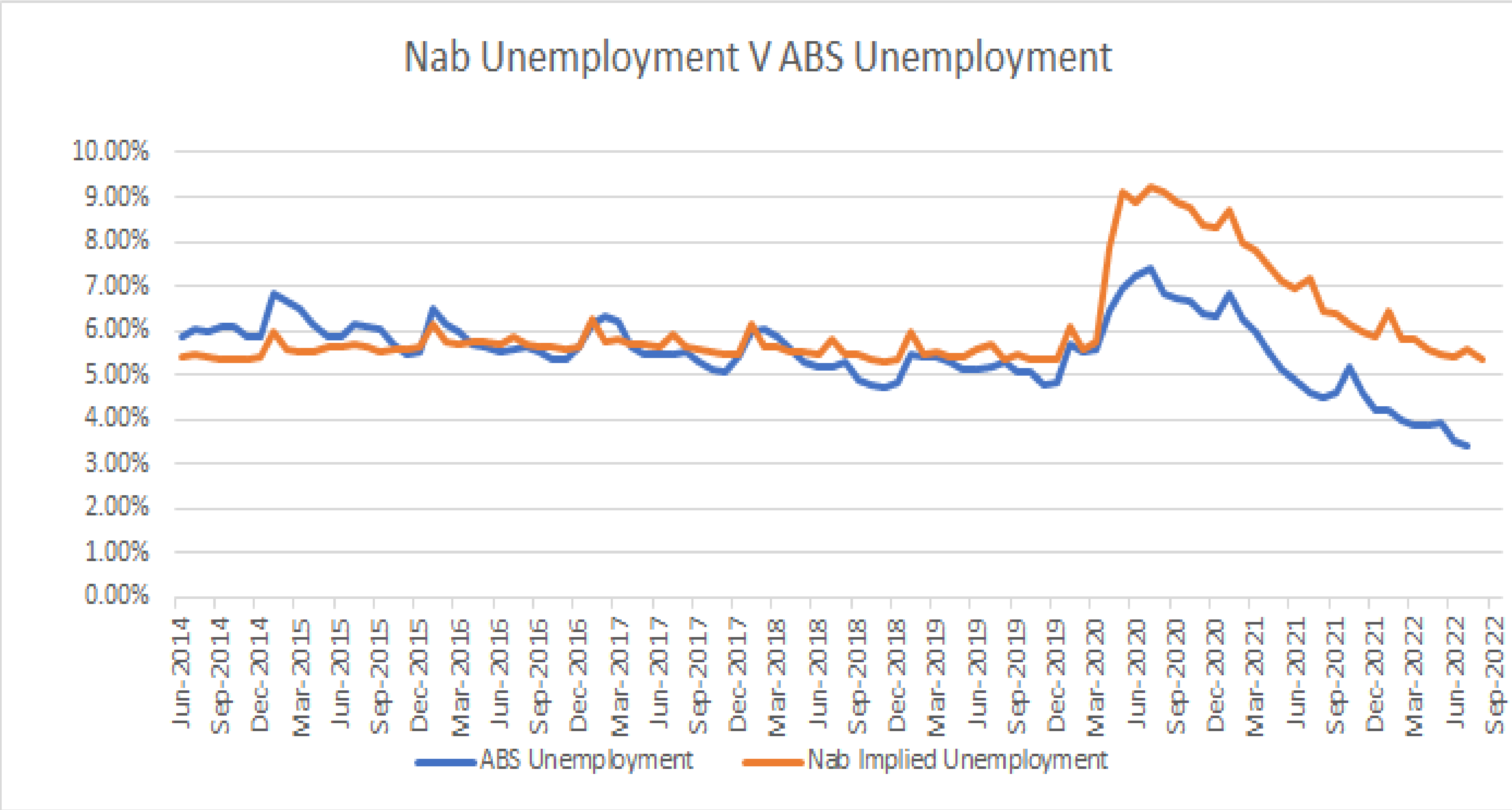
NAB data on the Claimant Count (NAB customers receiving JobSeeker)

– started to head up in July. But has reversed in August. May be getting harder to make more progress.



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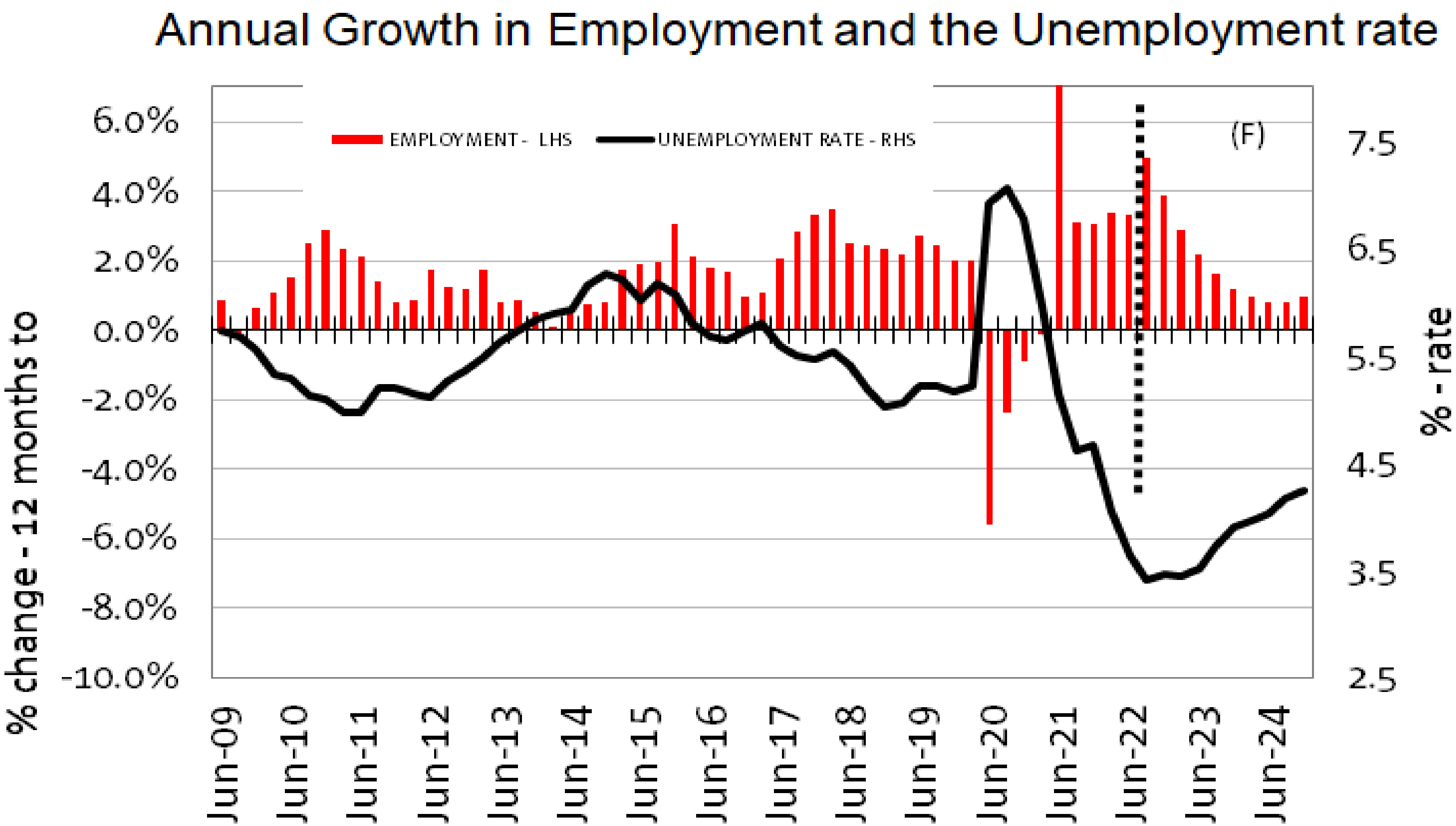
Labour market very impressive. While Omicron hasn't helped, unemployment has fallen to around 3.4% by mid year and could edge lower… But as economy fades, unemployment moderately moving up – *to around 4.3% by end 2024.*



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On RBA

- **RBA has signalled that it wants to get closer to normal:**
  - Fundamentally reflects higher inflation in near term at least.
- After a run of rate rises:
  - **As expected another 50 point move in September – bringing the Cash rate to 2.35% - so near normal;**
  - Then another 50 points in October and 25 points in November as the peak in near term inflation is reached in Q4 – trimmed mean at 6%. Headline around 7.5%;
  - **So at 3.1% by year end.**
- **RBA will then probably pause and look at reactions in H1 2023:**
  - Monetary policy takes around 12 months to impact;
  - But by then loan repayments will be up around $450 per month at least and the fixed loans will be rolling off;
  - **Likely to be a peak at that rate but data dependent – both up and down.**
- **That said, markets still look too aggressive (cash to 3.5% by mid 2023) and hard landing not impossible.**