THE FORWARD VIEW: AUSTRALIA SEPTEMBER 2022

GROWTH TO SLOW AS RATES AND INFLATION BITE

OVERVIEW

- The release of the Q2 national accounts does not fundamentally alter our view of the economy going forward. While base effects see a small revision to 2022, we continue to see below trend growth of around 1.75% over 2023 and 2024 as the impact of the lockdown rebound ends, global growth slows and higher rates and prices begin to weigh domestically.
- That said, higher frequency data suggests that the economy has remained resilient through early Q3 with strength in the NAB Business Survey still evident while the labour market and consumer spending has held up. For now, the impact of rates has come through house prices, lending and building approvals data – reflecting the housing market's sensitivity to interest rates.
- For the labour market, a period of slower growth will see the unemployment rate drift higher over 2023 and 2024 after troughing in the mid-to-low 3% range in late 2022. Still, the unemployment rate is expected to remain broadly consistent with full employment at around 4.3% at end 2024.
- Based on the ongoing strength in the labour market and NAB survey indicators, as well as the minimum wage case, we have revised up our outlook for wage growth – which we now see tracking by 3.2% y/y by end-2022 and 3.4% y/y by end-2023. Wage growth (alongside other domestic factors) will become an increasingly important driver of inflation as international factors wane.
- Alongside this, we have further increased our near-term inflation outlook, based on the ongoing strength in activity and cost and price measures in our business survey. We now see underlying inflation printing at 1.7% q/q in Q3 and 1.5% q/q in Q4 before easing through 2023. That sees headline and trimmed mean inflation peak in Q4 at 7.5% and 6.3%, respectively.
- Our call on the cash rate is unchanged – where we see the RBA lifting the cash rate by a further 25bps at each of the next two meetings, before pausing at 2.85% at the end of the year.
- Uncertainty remains elevated, with a series of overlapping shocks continuing to play out. The global tightening in monetary policy, war in Ukraine and ongoing COVID impacts continue to shape the global growth outlook and how these challenges are resolved is difficult to predict.
- Domestically, the RBA is seeking to follow a 'narrow path' to reducing inflation without a recession but faces a number of challenges. The responsiveness of wage growth to low unemployment and the extent to which inflation expectations shift in a high-inflation environment are key uncertainties for monetary policy.
- How long consumption growth can hold up under high inflation and rising interest rates is also uncertain, with savings and a strong labour market providing buffers for the time being. How long these buffers last will shape how much further interest rates need to rise.

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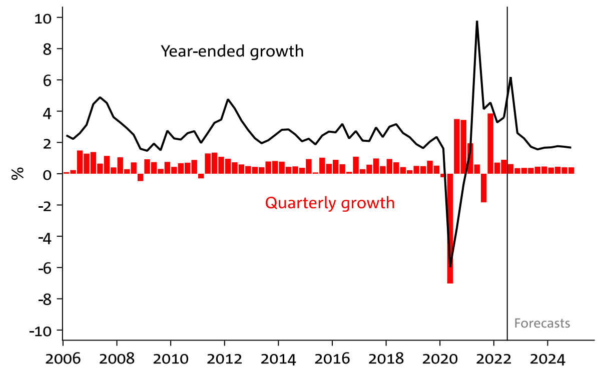
KEY ECONOMIC FORECASTS

	2021	2022-F	2023-F	2024-F
Domestic Demand (a)	6.1	5.3	2.0	1.9
Real GDP (annual average)	**4.9**	**3.9**	**1.8**	**1.7**
Real GDP (year-ended to Dec)	**4.5**	**2.6**	**1.7**	**1.7**
Terms of Trade (a)	17.6	7.4	-4.6	-2.9
Employment (a)	3.5	3.7	1.9	1.0
Unemployment Rate (b)	4.7	3.4	4.0	4.3
Headline CPI (b)	3.5	7.5	3.0	2.4
Core CPI (b)	2.5	6.0	3.2	2.8
RBA Cash Rate (b)	0.10	2.85	2.85	2.85
$A/US cents (b)	0.73	0.68	0.72	0.74

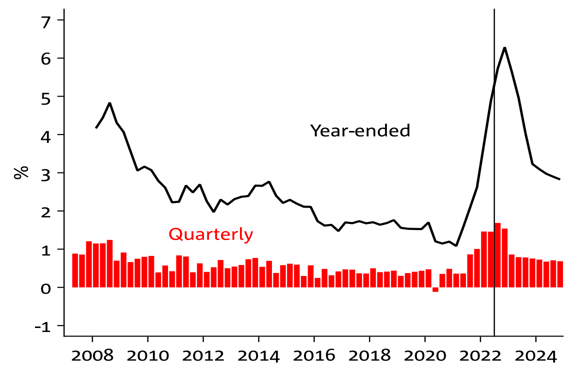
(a) annual average growth, (b) end-period, (c) through the year inflation

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

Unemployment edged lower to 3.4% in July, despite an employment decline (likely driven by sampling volatility). Wages growth continues to accelerate, reaching 2.6% in Q2, while broader measures of labour costs also strengthened.

The July labour force data showed an unexpected 41k fall in employment, and the participation rate also dropped to 66.4%, from a record high of 66.8% recorded in June. However, on net the unemployment rate edged lower, to 3.4%. The shift likely reflected some unusually large sampling volatility which may continue in coming months.

Still, we expect some additional progress with the unemployment rate likely reaching 3.3%. Further out, we continue to see a gradual pickup in the unemployment rate to 4% by end-2023 and 4.3% by end-2024 – broadly consistent with full employment.

The Wage Price Index (WPI) rose 0.7% in Q2 to be 2.6% higher over the year, continuing the gradual pickup in underlying wage growth seen over the past year. The recent Q2 National Accounts release also showed broader measures of labour costs strengthening, with average earnings up 1.4% (from -0.2% in Q1) and nominal unit labour costs rising 1.7% (from 1% in Q1).

Looking ahead, we expect wage growth to strengthen further in the second half of the year as the recent minimum wage decision takes effect and the very low unemployment rate begins to drive wage increases for employees on individual contracts and those covered by EBAs that are rolling over. We now see wage growth around 3.2% y/y by Q4 and 3½% in 2023.

The National Accounts confirmed a strong quarter for consumption in Q2 and retail sales data suggest this strength continued into July. We continue to expect consumption to slow in H2 2022 and into 2023.

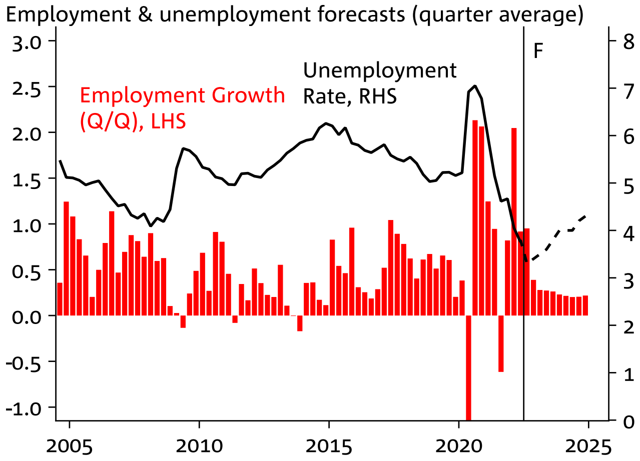
Household consumption increased 2.2% in Q2 (6.0% y/y), driven by a strong rebound in services spending which increased 3.6% as Omicron and flooding effects passed. Hospitality consumption rose 8.8% and transport consumption jumped nearly 40% (from a low base). On the other hand, goods spending moderated to be down 0.1%, led by falls in food, vehicle, and household goods spending – though clothing consumption rose.

Retail trade data for July suggest this strength continued, with nominal spending up 1.3% in the month including strong growth in hospitality, clothing, and department stores. The NAB Monthly Business Survey also shows strong conditions in retail and hospitality across July and August – though NAB's internal spending data shows more mixed results.

While the rebound of recent quarters is now largely complete, the data suggest consumption continues to hold up despite headwinds from elevated inflation and rising interest rates. Built-up savings and a strong labour market are providing support, although real incomes will decline in the near term. Importantly, we expect the main impact of recent rate rises on household balance sheets still lies ahead and as such we continue to expect more modest consumption growth across 2023.

UNEMPLOYMENT RATE NOW BELOW 3.5% BUT LIKELY TO RISE GRADUALLY OVER 2023 AND 2024

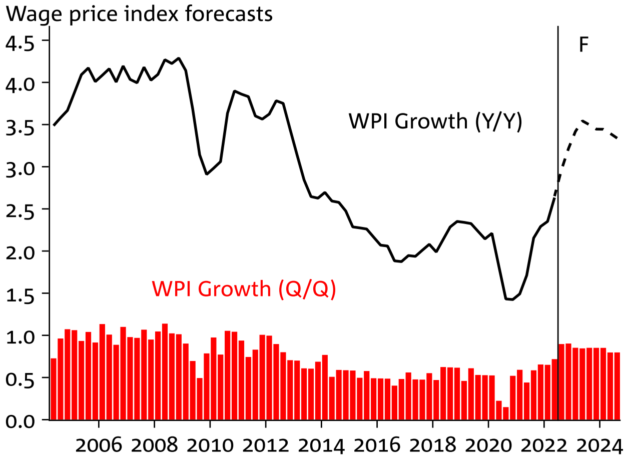
Employment & unemployment forecasts (quarter average)



Source: National Australia Bank, Australian Bureau of Statistics

MINIMUM WAGE AND LOW UNEMPLOYMENT TO DRIVE PICKUP IN WAGE GROWTH

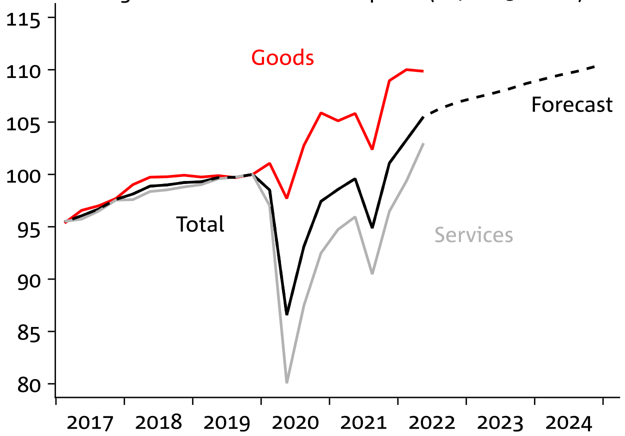
Wage price index forecasts



Source: National Australia Bank, Australian Bureau of Statistics

REBOUNDING SERVICES DROVE CONSUMPTION GROWTH IN Q2; SLOWER GROWTH AHEAD

Household goods & services consumption (Q4 2019 = 100)



Source: National Australia Bank, Australian Bureau of Statistics

HOUSING AND CONSTRUCTION

Housing market conditions continue to weaken – dwelling prices and sales, residential investment as well as housing finance and building approvals have all declined.

Capital city house prices again fell in August. The CoreLogic 8-Capital City Index declined by 1.6% m/m and the capital city PropTrack Home Price Index by 0.4%. The fall in house prices is becoming increasingly broad based – with Adelaide prices falling for the first time this year and prices in Perth either flat (PropTrack) or down slightly (CoreLogic). Prices in regional areas are also now falling at a similar pace to the capital cities.

Dwelling prices are likely to fall further over the rest of this and next year, as higher interest rates continue to bite. Overall, we expect capital city dwelling prices to fall by around 18% from their peak in early 2022.

New housing loan approvals (ex refinancing) fell again in July, by a large 8.5% and are down 15% since January. The decline is consistent with the observed fall in house prices as well as falling turnover.

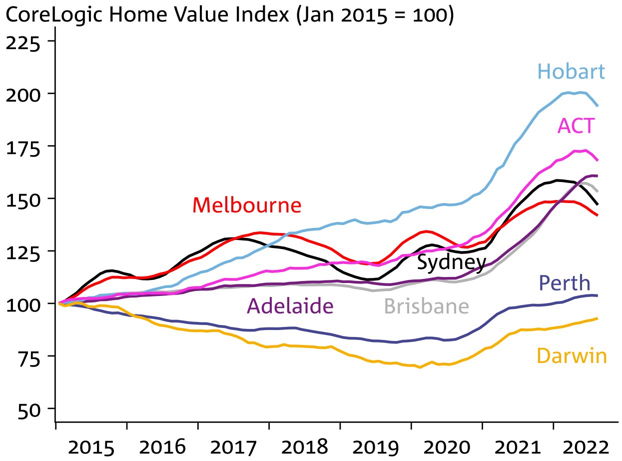
Dwelling investment fell in Q2 (-2.9% q/q), the third consecutive quarterly decline. The fall was reasonably broad based with only South Australia and the territories seeing an increase. Queensland experienced the largest fall, with the ABS citing wet weather as a factor, alongside material and labour shortages (which are a nationwide issue). Nevertheless, the level of investment remained high, particularly for alterations & additions (although they too are off their peak).

There was a large fall in building approvals in July (-17.2% m/m). However, the fall was entirely driven by the volatile non-house approvals category, with house approvals ticking up slightly. Looking through the volatility, the trend continues to be down, although the pace may have slowed. New loans to owner-occupiers for the construction of dwellings have also stabilised in recent months.

That said, housing construction is one of the more interest rate-sensitive sectors and so the downward trend for approvals is likely to continue. Household incomes are also being squeezed by high inflation, although continued strong employment growth is providing some offset (at least for now). The high cost of housing construction is another headwind, although there are some indications that construction costs might be peaking.

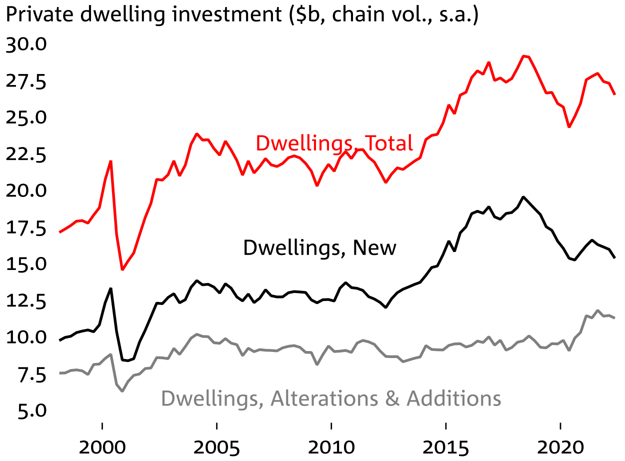
While the decline in approvals points to further pressure on dwelling investment in the national accounts, we still expect the level of investment to remain robust. This reflects the large pipeline of work built up during the pandemic which will take some time to work through. The uptick in population growth following the re-opening of the international border will also help support activity. A risk is that some projects that are in their early stages (or yet to start) are cancelled due to high construction costs or tighter financial conditions; there have been some anecdotal reports of apartment projects being deferred/cancelled.

HOUSE PRICES NOW FALLING IN MOST CAPITAL CITIES



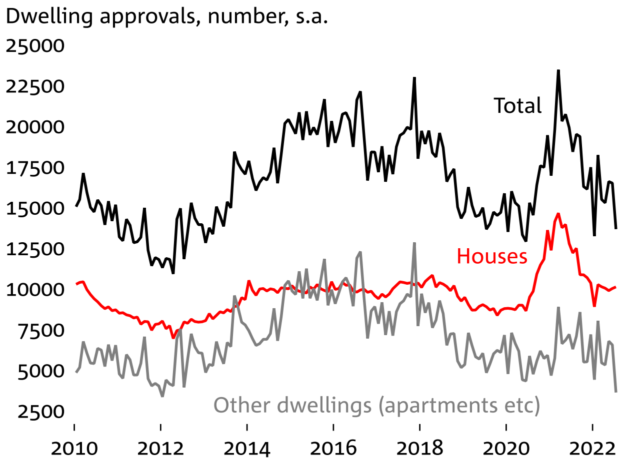
Source: National Australia Bank, CoreLogic, Macrobond

DWELLING INVESTMENT AGAIN EASED IN Q2 BUT REMAINS HIGH



Source: National Australia Bank, Australian Bureau of Statistics

BUILDING APPROVALS STILL TRENDING DOWN



Source: Macrobond, National Australia Bank

BUSINESS AND TRADE

Underlying business investment rose in Q2, driven by non-mining investment in machinery & equipment. Business conditions have remained strong through August, likely supporting further modest investment growth.

Underlying investment increased 0.8% in Q2 (1.1% y/y), entirely driven by non-mining investment with mining investment falling over the past year. The growth came from machinery and equipment (up 3.9% q/q in underlying terms), offsetting a fall in non-dwelling construction.

The most recent NAB Business Survey showed conditions and confidence remained strong through August, with conditions well above average at +20 index points. Capacity utilisation is also well above its historical average at 86.3% and forward orders are also elevated.

Cost growth measures eased a little in the month but remain very high, with firms continuing to pass through costs to consumers by raising prices. Retail prices rose 3.3% in quarterly average terms, while personal & recreation prices (a proxy for services) rose 2.0%.

The ongoing strength in business conditions as well as the tightness in the labour market should support further modest investment growth in Q3 and beyond. Still, despite solid investment intentions we don't expect a major increase in investment.

Net exports rebounded in Q2 contributing 1ppt to GDP growth, with a large rise in export volumes outpacing the increase in imports. We expect further increases in both services exports and imports, though the pace of normalisation is uncertain.

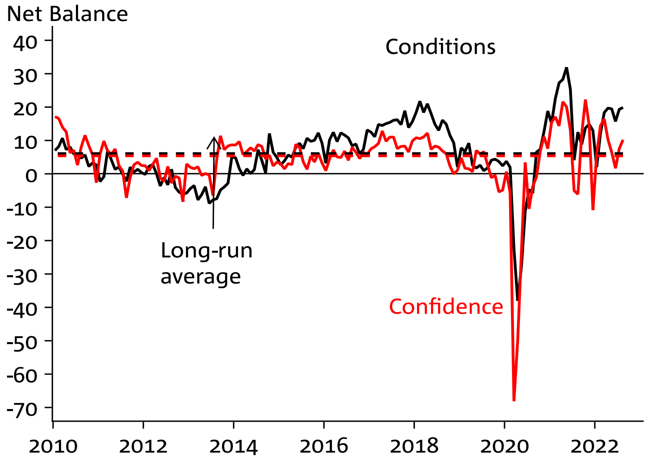
Export volumes increased 5.5% q/q, mainly driven by a lift in rural goods (up 5.9%) and non-rural commodities (up 5%) as well as a large rebound in transport, travel and other services exports (up 13.7%, building on a 5.3% increase in Q1). Imports rose by a more modest 0.7% q/q, with the Q1 surge in goods imports partially unwinding (down 1.6%), offset by a large increase in services imports (14.3% q/q).

The significant growth in service credits and debits largely reflects the ongoing normalisation of inbound and outbound travel as borders have reopened, although both travel services credits and debits were still only around 40% of their pre-COVID levels in Q2.

Nominal trade data for July showed a considerable narrowing of the trade surplus, from $17.1b to $8.7b, largely driven by falls in coal and iron ore exports as commodity prices declined from recent peaks. Imports also rose in the month as spending on outbound travel continued to increase.

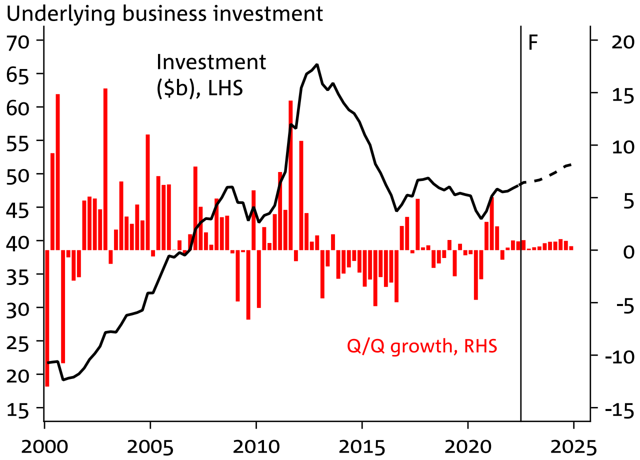
Looking ahead, the relative pace of normalisation of inbound vs outbound travel is a key risk for our forecasts. For now we expect a more rapid recovery in outbound travel although education exports are likely to pick up fairly quickly. Demand for commodity exports may also ease as global growth slows, particular given ongoing challenges in China. On balance we see limited upside in net exports, albeit with considerable uncertainty.

CONFIDENCE AND CONDITIONS REMAINED STRONG THROUGH AUGUST



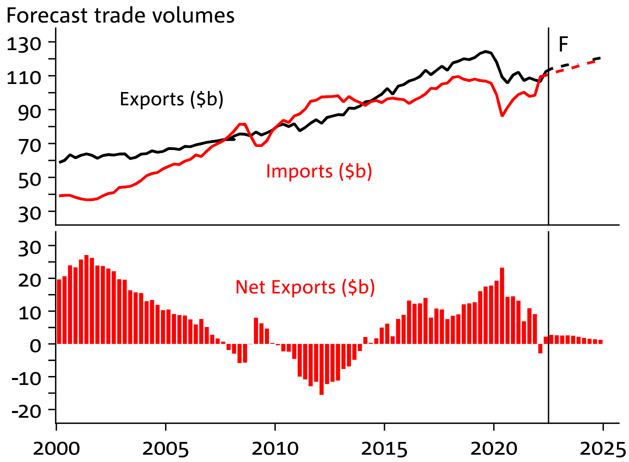
Source: National Australia Bank, National Australia Bank

CONDITIONS SHOULD SUPPORT FURTHER MODEST INVESTMENT GROWTH



Source: Macrobond, NAB Economics

NET EXPORTS REBOUNDED IN Q2, WITH THE PATH AHEAD UNCERTAIN



Source: Macrobond, NAB Economics

MONETARY POLICY, INFLATION AND FX

The RBA lifted the cash rate by 50bps in September to 2.35% and, while suggesting there are further increases to come, dropped references to "normalisation" of rates.

The post meeting statement contained little new information – other than dropping references to the "ongoing normalisation" of rates, while continuing to signal further increases to rates over coming months. The RBA also continued to emphasise that it is not on a pre-set path with the dataflow and evolution of risks to determine how high the cash rate rises and how quickly.

The Governor's recent speech reiterated similar statements around the outlook for rates. He also emphasised the importance of containing wage growth to rates consistent with target inflation and stated that medium-term inflation expectations remain anchored but important.

Nonetheless, after increasing rates by 2.25ppt over a 5-month period, the post meeting statement and the Governor's speech acknowledged that the full impact of recent rate increases are yet to be seen and that "all else equal, the case for a slower pace of increase in interest rates becomes stronger as the level of the cash rate rises." This suggests that the RBA will become more cautious as rates continue to track higher, by reverting to the standard 25bp increments as they enter restrictive territory.

Indeed, we continue to expect the RBA will increase the cash rate by 25bps at both the October and November meetings taking the cash rate to 2.85% - its highest level since 2013. We expect the RBA to pause there to allow an assessment of the impact on the economy of the rapid increase in rates over recent months, as well as the outlook for both the labour market (particularly wage growth) and how quickly current inflation pressures may resolve.

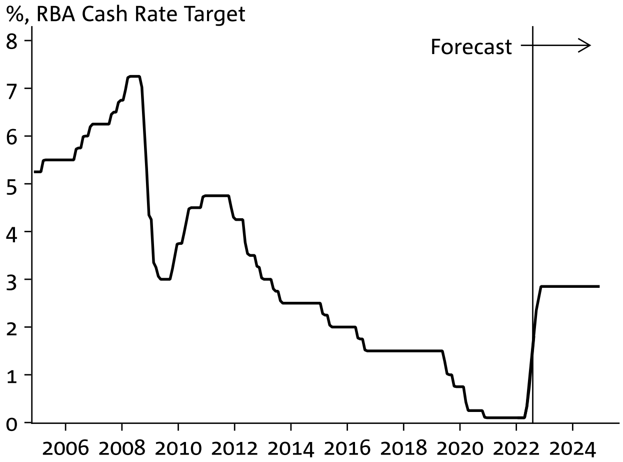
We have further lifted our expectations for both the headline and underlying inflation measures in the near-term. While supply chain pressures have continued to ease in most areas, and food and petrol prices have eased in Q3, the NAB Monthly Business Survey continues to point to strength in cost pressures and indicates businesses are passing these pressures onto final consumer prices.

Consequently, we expect another very strong print for the trimmed mean measure in Q3 and Q4 before pressures begin to ease. That sees inflation peaking in Q4 at very high rates for both headline and underlying measures.

The AUD/USD is around 2% lower than a month ago, though has traded within a 3-cent range over the month.

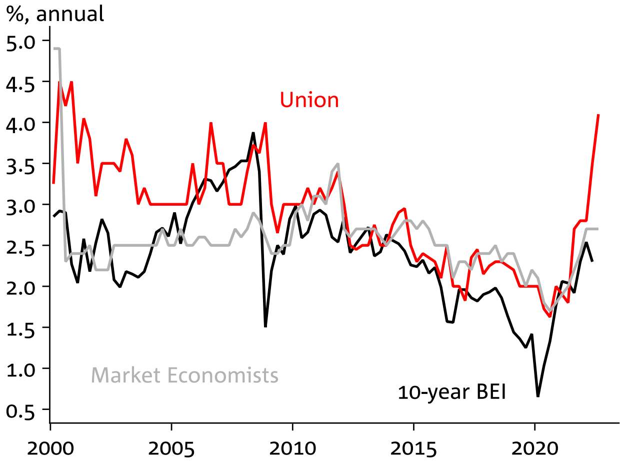
USD strength continues to be the driver of a weaker Aussie, with the record high terms of trade continuing to support a stronger local currency. Our forecasts for the pair are unchanged, expecting the Aussie to end the year around US67.5c before it strengthens to US72c by end 2023 and US74c by end 2024. The AUD/USD is currently trading around US68.5c.

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



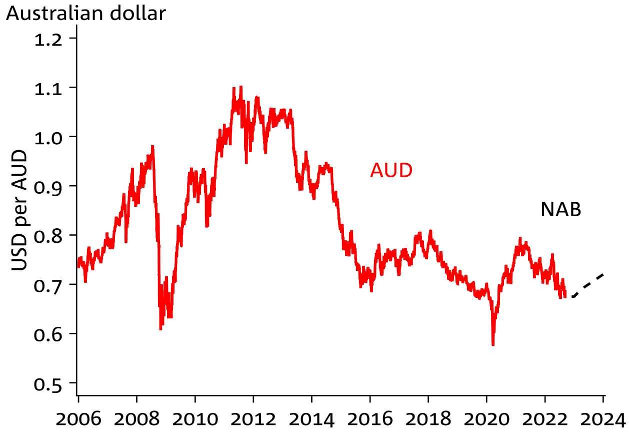
Source: Macrobond, NAB Economics

INFLATION EXPECTATIONS REMAIN ANCHORED BUT ARE A RISK



Source: National Australia Bank, Reserve Bank of Australia

AUD/USD TO TRADE BELOW US70C IN THE NEAR TERM



Source: National Australia Bank, Macrobond Financial AB

THEME OF THE MONTH: RISKS OUTSIDE THE 'NARROW PATH'

Considerable global and domestic uncertainty surrounds the economic outlook, with risks that rates go higher or lower depending how events unfold.

In his Anika Foundation speech in early September, RBA Governor Lowe again described a 'narrow path' ahead for policy makers to successfully bring down inflation while keeping the economy on an 'even keel' (out of a recession). The speech highlighted three main sources of uncertainty: the global economy, domestic inflation expectations, and household consumption.

So far, the RBA remains confident that – with the help of further interest rate increases and some improvement in global supply side issues – it will be able to tread this narrow path. This outlook aligns closely with NAB's view that rates will rise to around 2.85% by year-end, consumption will slow and inflation will begin to moderate in 2023, and unemployment will gradually rise but remain around the level of full employment with wages growing around 3½%.

However, the risks around these forecasts are considerable, raising the question of what lies in wait if the economy strays outside the narrow path.

One possibility is that global growth slows more rapidly than currently forecast. A recession is already expected in Europe and the US, and NAB's forecast for Chinese growth is also highly uncertain given the ongoing COVID-related measures and issues in the Chinese property market (see tomorrow's Global Forward View for additional details). A more severe global downturn would impact demand for Australia's exports and flow through to business and consumer confidence, weighing on GDP.

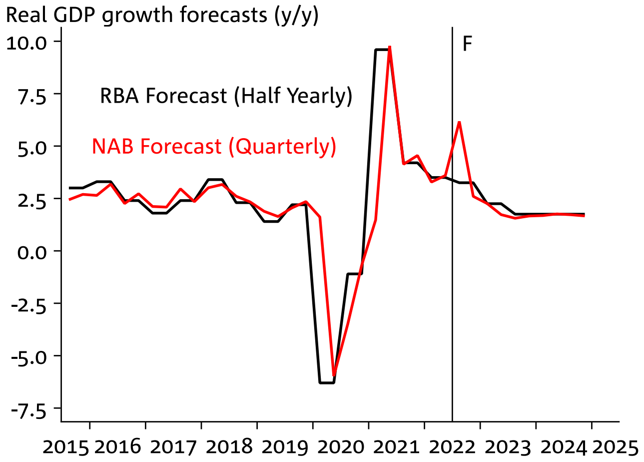
On the other hand, any further trade or energy market disruptions would exacerbate the inflation challenge. As shown by events over past two years, such disruptions are extremely difficult to predict.

Domestically, short-term inflation expectations have risen in line with surging CPI results, and while longer-term expectations remain anchored, even the RBA's own forecasts for CPI only reach 3% at the end of 2024. The longer inflation remains elevated, the greater the risk that expectations become de-anchored.

For now, Australia is a long way from a wage-price-spiral – but if higher inflation expectations feed into wage negotiations over the coming years, wage growth could push well above NAB's forecasts of 3½% y/y for 2023. The need to offset high inflation has already contributed to a large increase in the minimum wage for 2022. There is also considerable uncertainty around the path of the unemployment rate, and the responsiveness of wages in a very tight labour market.

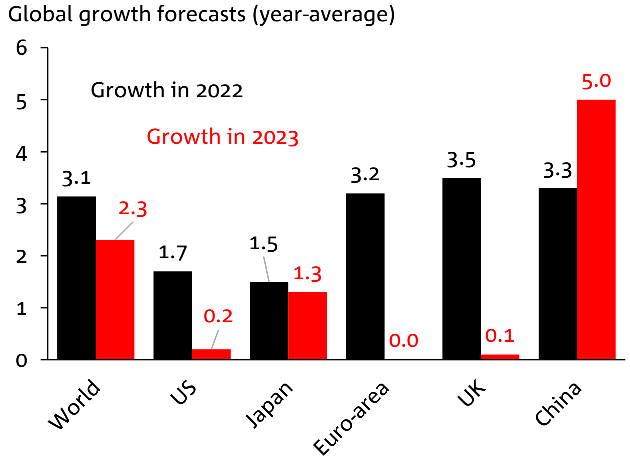
Faster-than expected wage growth would put upward pressure on inflation, likely requiring more contractionary monetary policy even if global inflation pressures ease.

RBA AND NAB FORECASTS FOR GDP ARE CLOSELY ALIGNED FOR 2023 AND 2024



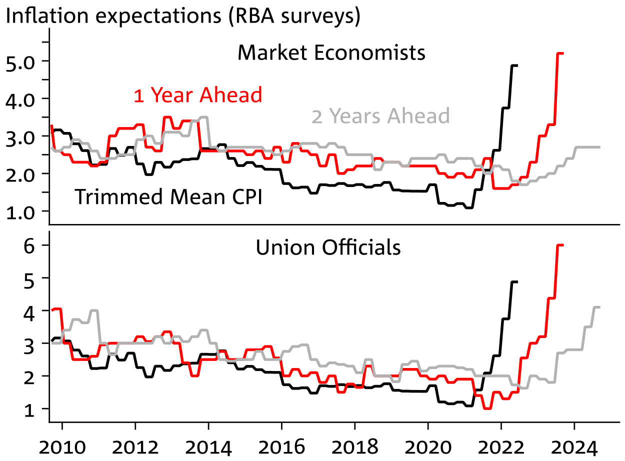
Source: Macrobond, NAB Economics

GLOBAL GROWTH IS SLOWING AS RECESSIONS LOOM IN KEY ECONOMIES



Source: NAB Economics (see September Global Forward View).

SHORT TERM INFLATION EXPECTATIONS HAVE RISEN AS INFLATION HAS SURGED



Source: Macrobond, NAB Economics

The resilience of consumption growth to high inflation and rising interest rates remains the largest source of uncertainty around the economic outlook. Consumption is critical to the outlook not only because it makes up 70% of GDP, but also because the relative strength in demand affects whether businesses can pass on price increases to consumers.

High inflation has substantially impacted real incomes with average earnings declining 2.5% in real terms over the year to June. At the same time, interest rates have risen more than 200bps since May, the equivalent of almost $1,000 per month in payments on a $500k loan.

NAB expects these headwinds to begin to weigh on household consumption – but the timing and intensity of this effect is highly uncertain.

Importantly, lags in the financial system mean that recent interest rate rises will only be felt by households later in the year – and the effects may not show up until official data is released in early 2023.

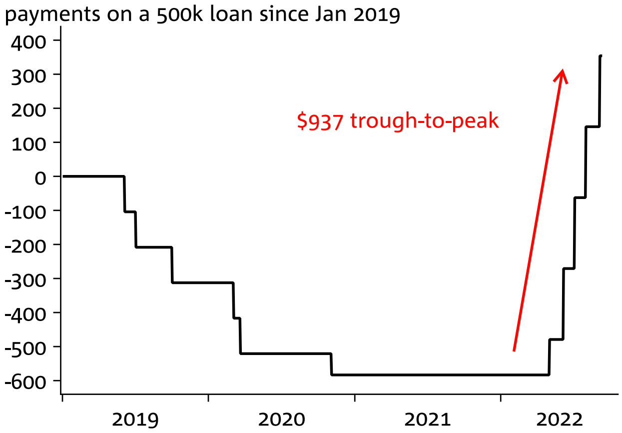
The recent national accounts showed households have so far been able to maintain consumption by reducing their rate of saving, and households also have scope to draw on the stock of savings build up through the pandemic. The strong labour market also means that real income is increasing aggregate (up 0.7% over the year to June), even if individuals are facing a real-income squeeze, supporting overall spending in the economy.

How far these buffers can go to support consumption is unclear. In theory, if unemployment remains low and households draw down on savings, consumption growth could be sustained at a robust rate for the foreseeable future. Strong consumption growth will help to sustain inflation, potentially necessitating further rate hikes into 2023.

However, it is also possible consumption will slow more sharply than expected when interest rate rises begin to impact household balance sheets, slowing GDP growth in turn. With rates rising at their fastest rate since 1992 – a monetary policy shift that resulted in a severe recession – the path ahead is narrow indeed.

RATE RISES HAVE ADDED ALMOST $1,000 TO MONTHLY PAYMENTS ON A $500K LOAN

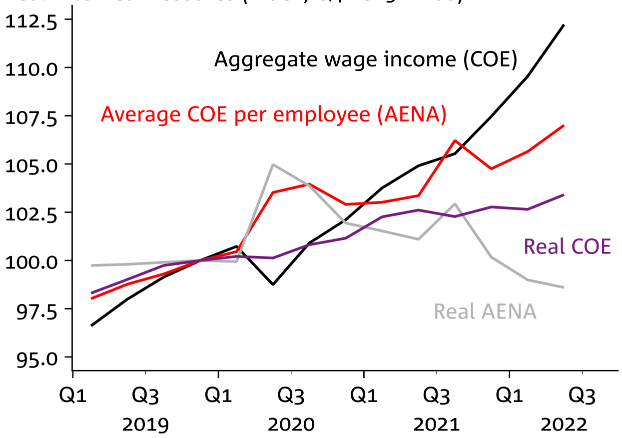
Cumulative effect of cash rate changes on monthly interest payments on a 500k loan since Jan 2019



Source: Macrobond, NAB Economics

REAL INCOMES ARE RISING IN AGGREGATE DESPITE DECLINES FOR INDIVIDUALS

Real incomes measures (Index, Q4 2019 = 100)



Source: Macrobond, NAB Economics

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	4.1	5.8	1.7	-5.8	4.9	7.1	2.3	1.6
Dwelling Investment	3.6	2.8	-1.5	0.5	-5.5	9.8	-2.7	-0.2	1.6
Underlying Business Investment	-1.7	4.8	2.5	2.4	-5.3	5.7	2.4	1.9	3.2
Underlying Public Final Demand	5.9	6.8	2.7	2.1	6.0	6.1	5.2	2.1	2.0
Domestic Demand	**2.6**	**5.1**	**3.9**	**1.8**	**-2.4**	**6.1**	**5.3**	**2.0**	**1.9**
Stocks (b)	0.8	0.1	-0.3	0.0	0.0	0.6	0.2	-0.4	0.0
GNE	**3.4**	**5.2**	**3.6**	**1.8**	**-2.5**	**6.8**	**5.5**	**1.6**	**1.9**
Exports	-8.4	0.0	6.0	2.5	-9.8	-1.8	2.9	4.3	2.3
Imports	-2.7	7.7	8.3	3.1	-13.0	6.3	12.1	3.2	3.1
GDP	**1.6**	**3.9**	**3.2**	**1.7**	**-2.1**	**4.9**	**3.9**	**1.8**	**1.7**
Nominal GDP	4.5	11.1	9.4	3.4	-1.4	10.6	12.1	4.9	3.8
Current Account Balance ($b)	-64	-50	-57	-15	47	68	53	36	13
(%) of GDP	-3.1	-2.2	-2.3	-0.6	2.4	3.1	2.2	1.4	0.5
Employment	1.1	3.2	3.2	1.3	-1.7	3.5	3.7	1.9	1.0
Terms of Trade	10.4	12.1	1.6	-6.0	-0.2	17.6	7.4	-4.6	-2.9
Average Earnings (Nat. Accts. Basis)	2.6	2.3	3.4	3.4	3.6	1.8	2.9	3.7	3.4
End of Period									
Total CPI	3.8	6.1	4.9	2.6	0.9	3.5	7.5	3.0	2.4
Core CPI	1.5	4.5	5.0	3.0	1.3	2.5	6.0	3.2	2.8
Unemployment Rate	5.2	3.8	3.6	4.0	6.8	4.7	3.4	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	3.40	0.98	1.68	3.40	3.40	3.40
$A/US cents :	0.75	0.69	0.70	0.72	0.77	0.73	0.68	0.72	0.74

(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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