Global Overview & Australia

COVID, supply chain difficulties and the impact of higher rates. Challenging times ahead.

Alan Oster, Group Chief Economist, March 2023

Global macroeconomic summary

Problems ahead

There are a number of areas of concern on the global economy:

- **Russian responses to Ukraine war (effectively closed off gas supplies to Europe) has seen commodity prices spike**. With Ukraine war likely to continue, commodity prices to stay high for some time.
  - 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.

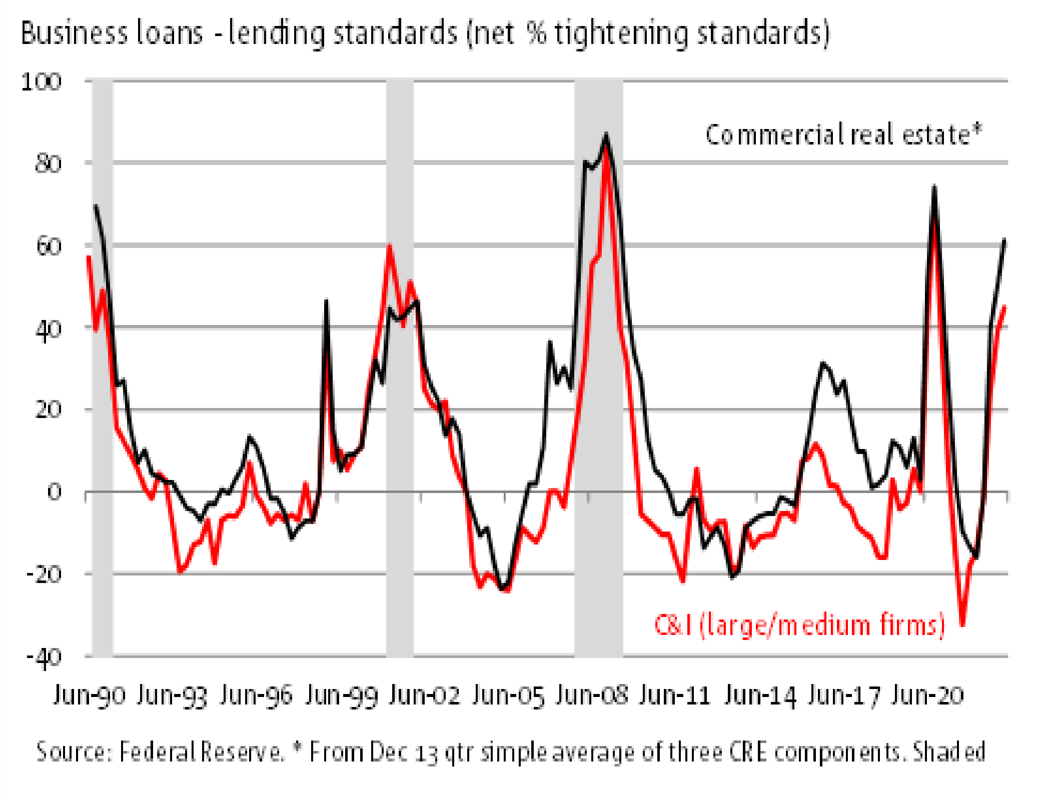
- **In the US (and globally) Central Banks have been aggressive. Lags are important and suggest that the weakness will be based in 2023 (not 2022).**
  - A number of major economies have weakened a lot in 2022 but also have seen weakness in late 2022.
  - US economy particularly looks very exposed to lagged policy effects in 2023. Getting close to the peak in rates now but expect weak activity will force rate cuts in the second half of 2023.
  - NZ (especially) and UK and Europe also look exposed.

- And now getting indirect effects of a fast tightening rate cycle. **Financial stress "as some boats are exposed by outgoing tide". Some badly managed US banks have seen runs (SVB, First Republic etc). Credit Suisse more serious given its size. But authorities have moved fast. Still concerns about who is next and knock on effects of Hybrids etc**. Generally can expect Increases cost of funds, credit tightening and confidence impacts. Rate path less obvious. Needs time to settle but who knows. Australia should be more protected but….

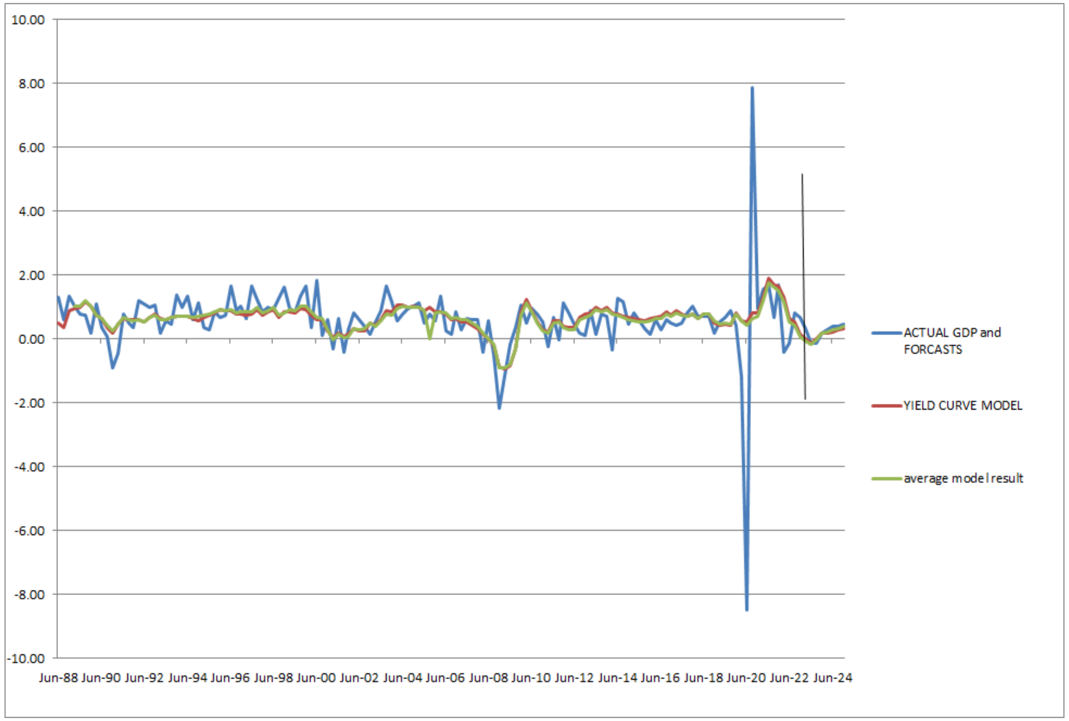
- **China has seen the combination of the virus and problems in the property market dramatically slow growth in 2022 to around 3%.** Has reopened now **has seen an early bump in activity in 2023. But growth prospects still not great** – we expect 5.5% in 2023.
  - Education likely to benefit from new students as will dropping some tariffs.
  - But commodity prices still more driven by global demand than China per se.

Important to realise that that US banks have been tightening well before the recent crisis.

And lags are important



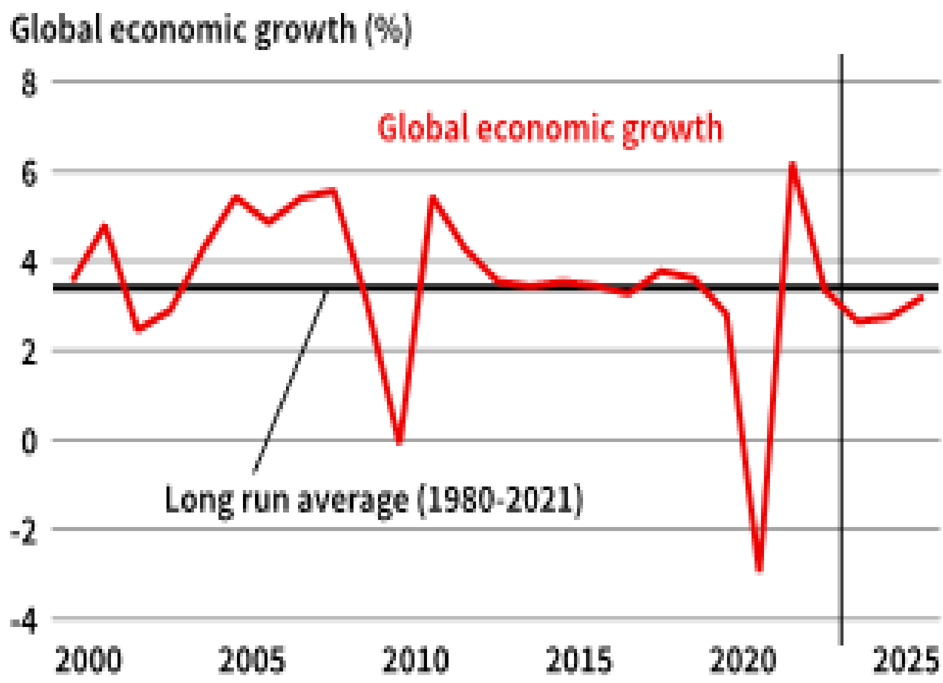
Lags from NAB's models of US Activity – Quarterly



Global economic forecasts

2023, outside of GFC and COVID, the lowest since 2001. We still see a recession in the US in 2023 while Europe, Japan and the UK appear to have narrowly avoided a recession. China to improve further in 2023 but not great. 2024 not a lot better. More normal in 2025.

	2020	2021	2022	2023	2024	2025
US	-2.8	5.9	2.1	1.1	0.9	1.9
Euro-zone	-6.3	5.3	3.5	0.9	0.7	1.2
Japan	-4.3	2.2	1.5	0.8	0.6	0.8
UK	-11.0	7.6	4.0	0.0	0.6	0.9
Canada	-5.1	5.0	3.4	0.8	1.0	1.4
China	2.2	8.1	3.0	5.4	4.5	4.8
India	-6.0	8.9	6.7	5.0	6.0	6.3
Latin America	-7.0	7.0	3.4	0.9	1.3	1.8
Other East Asia	-2.8	4.4	4.2	2.7	3.7	4.3
Australia	-1.8	5.2	3.7	1.5	0.6	1.9
NZ	-1.5	6.0	2.4	0.8	0.2	2.3
Global	**-3.0**	**6.2**	**3.3**	**2.6**	**2.7**	**3.2**



Australia macroeconomic summary

Still robust but will slow a lot

- **GDP growth to slow to less than 1% during 2023 and 2024 respectively - currently 2.7% through 2022**
  - Economy still robust but either slowing now (NAB internal transaction data) or about to (NAB Business Survey). Expect near stalling speed by late 2023 and early 2024.
  - Key drivers: slower global growth and rate rises (including fixed loan maturities in mid 2023).
  - Business investment will slow. House prices down another -11% in 2023 (or more).
  - Growth in 2025 back to around trend (2.25%).

- **Unemployment to remain around current levels (3.5%) for around 6 months**
  - Shortage of skilled labour at record highs.
  - But will rise thereafter to around 4% by end 2023 and 4.7% by late 2024. Around 4.8% by end 2025.
  - That is still a reasonable outcome, but risks are that it could be worse.

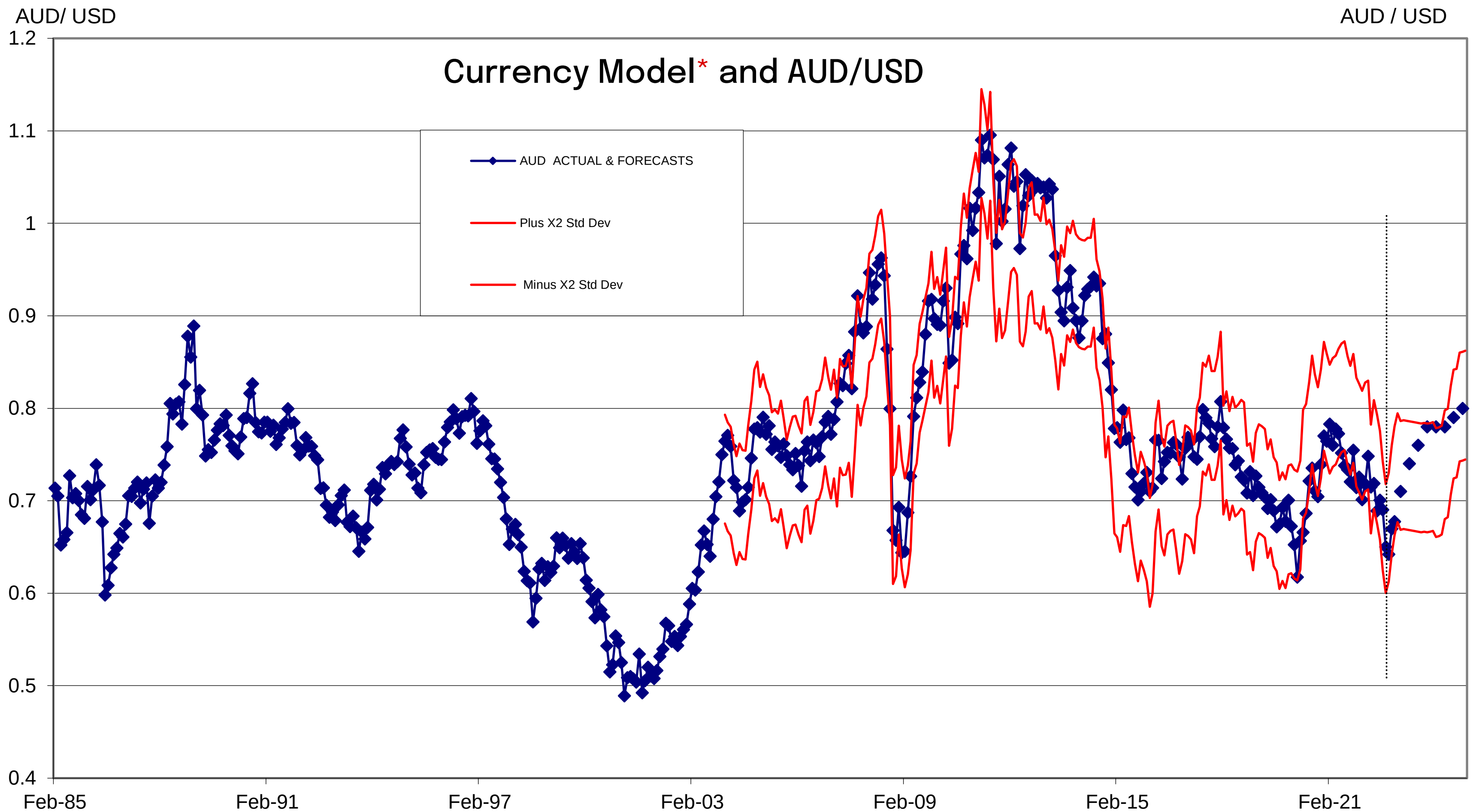
- **Price inflation to peak soon but stay high**
  - Purchase costs still very high and business is fully passing on prices (maintaining profit margins).
  - Headline around 7.8% by end 2022 and around 6.9% in core terms.
  - High energy costs and faster wages growth see only moderate slowing in out years – headline around 3% by end 2024 and core 3.2%.

- **Wages growth to accelerate further from here (currently 3.1%)**
  - National wages case has boosted recent numbers and shortage of labour driving wages higher.
  - We see wages growth of 3.8% to 4% going forward.

- **RBA has more to do in the short term but policy mistake risks rising.**
  - Prior to SVB we saw further 25 point rises in, April, and May. **Now a bit more complicated**. Need to wait and see what happens re financial security. And now Credit Suisse.
  - Could well pause in April but start again in May. **Cash rate at 3.85 - 4.1% by mid 2023**.
  - Rate cuts to start by early 2024. Back to around 3% by mid 2024

Currency model USD 0.70+/- 5c

Recent movements very much reflecting strength/weakness of the USD. Australia a proxy for risk in uncertain world with aggressive central banks. See AUD moving back up as recession hits USD - unemployment moves up and US rates move down.



- 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 2023 = 78c AUD/USD

End 2024= 80c AUD/ USD

Data Insights

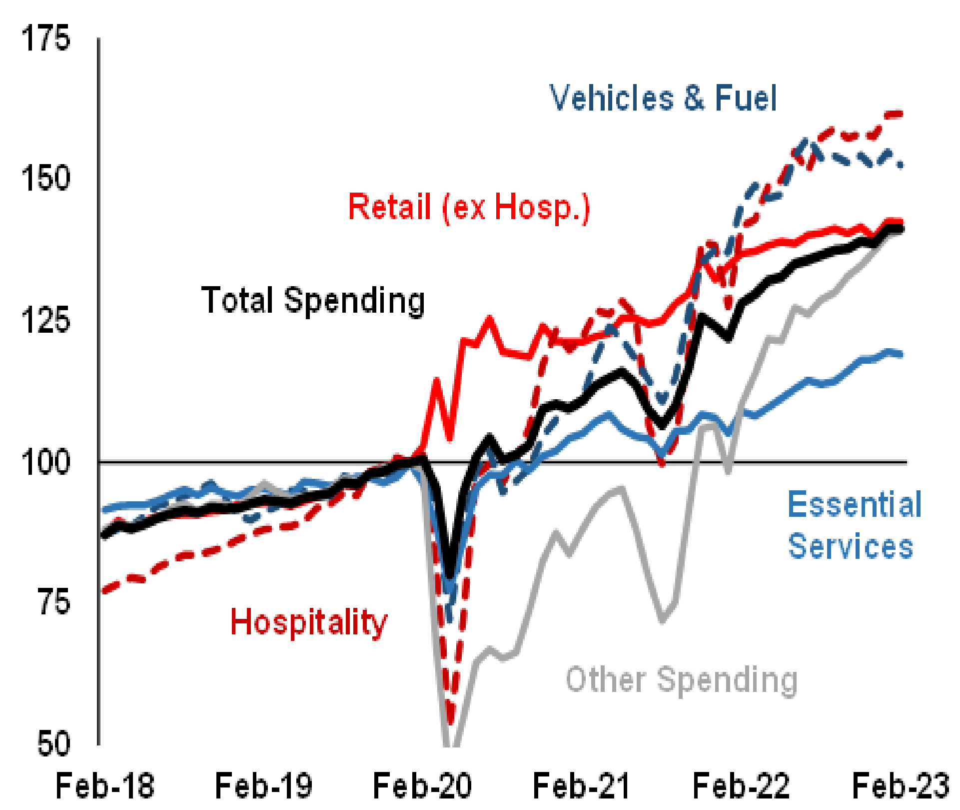
- NAB Data
- Business Survey

NAB transaction data using monthly data and seasonal factors.

national australia bank

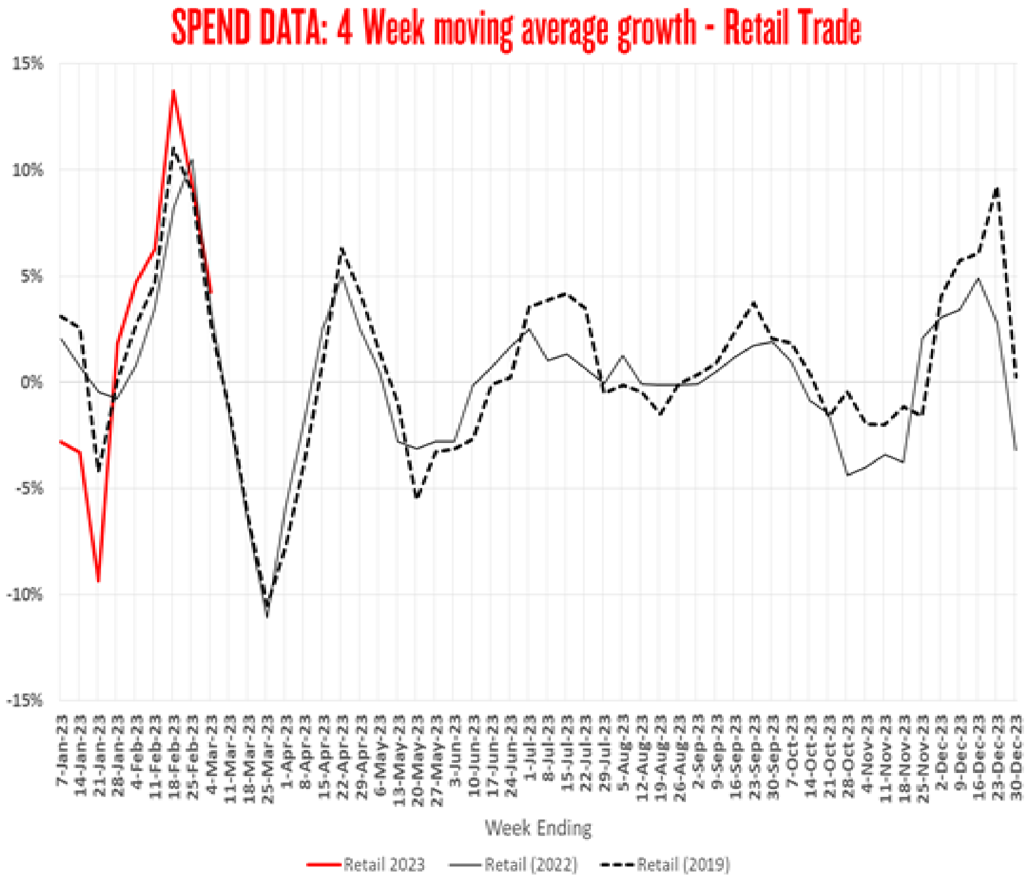
Slowing trend in late 2023. Back Friday offset Xmas sales. Based on the Q4 data looks like very flat to falling real retail and consumption spending.
January retail was strong but February looks surprisingly weak .

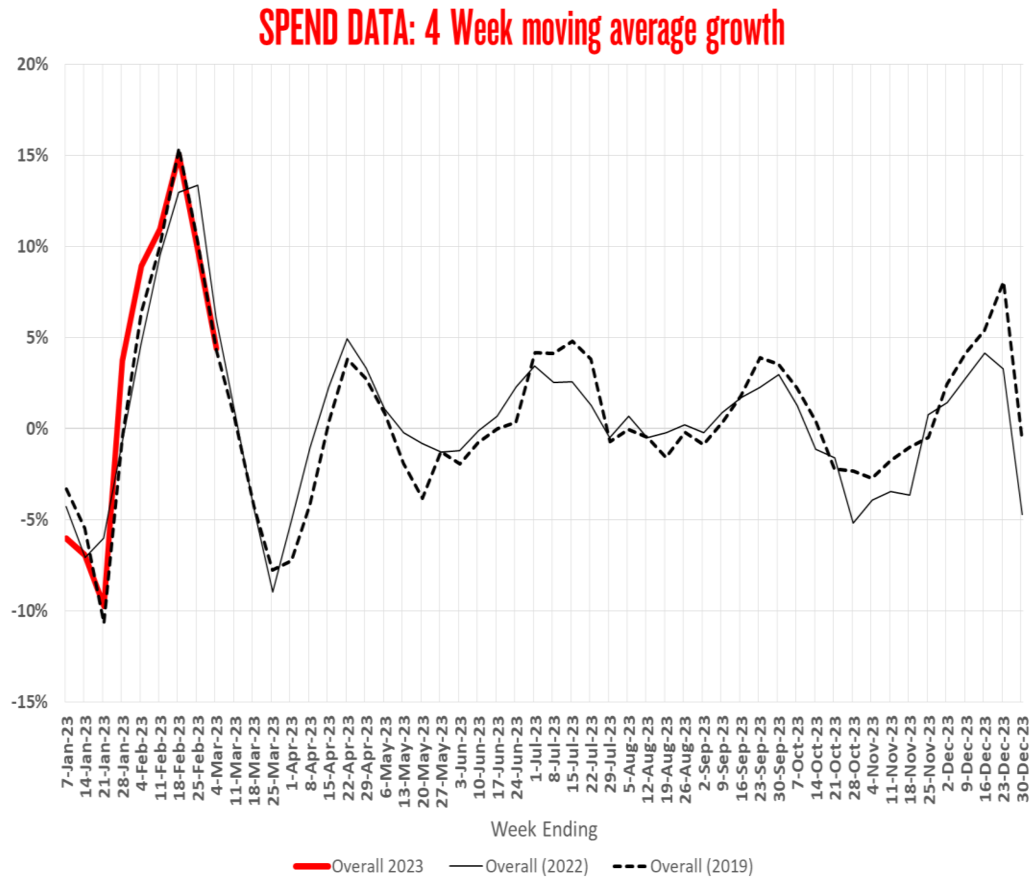
	Dec-22	Jan-23	Feb-23		
	m/m	m/m	m/m	3m/3m	y/y
Goods Retail	-1.3	2.1	-0.1	0.4	4.1
Hospitality	-0.3	2.4	0.2	1.3	14.1
Total Retail	**-1.1**	**2.1**	**0.0**	**0.5**	**5.8**
Vehicles & Fuel	-1.5	1.9	-1.5	-0.5	4.8
Essential Services	0.1	1.1	-0.4	2.4	9.2
Other Spending	1.9	2.0	0.7	5.2	27.8
Total Spending	**-0.4**	**1.9**	**0.0**	**1.7**	**10.3**
Goods	-1.3	2.0	-0.3	0.2	4.2
Services	0.9	1.8	0.3	3.5	18.8
Discretionary	-0.8	2.3	-0.1	1.4	11.7
Non-Discretionary	0.6	1.1	0.1	2.3	7.3



Key findings for consumption transaction data based on weekly data.

Based on previous year's behaviour March is looking very much like previous years so too early to tell what it means. But February was weak.





Business inward credits (business revenues)

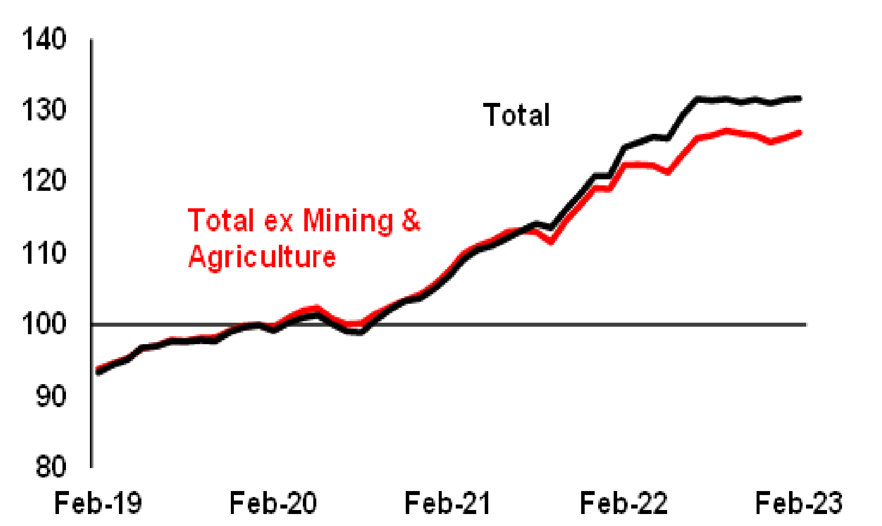
Recent trends see a softer trend in inward credits from late 2022 into early 2023. Basically flat over the 3 months to February

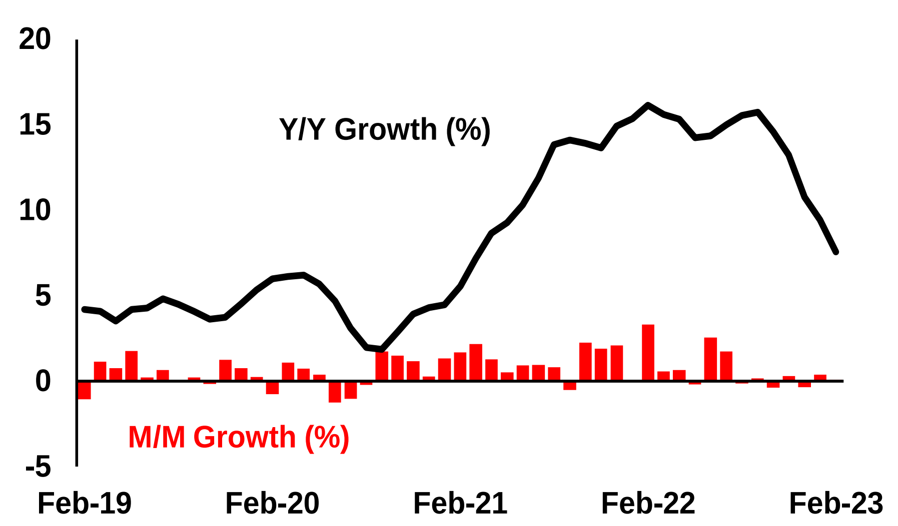
	Dec-22	Jan-23	Feb-23				Dec-22	Jan-23	Feb-23		
	m/m	m/m	m/m	3m/3m	y/y		m/m	m/m	m/m	3m/3m	y/y
Accom & Food	-0.6	-1.4	-1.7	-3.6	14.1	Mining	3.3	0.5	-4.3	5.1	41.0
Admin & Support	-1.8	0.4	2.6	-1.0	8.2	Other Services	0.4	3.1	-0.3	4.1	13.6
Agriculture	-0.8	-1.5	0.2	-1.1	3.9	Professional Services	-3.8	-0.6	-0.4	-4.9	-2.1
Arts & Rec.	1.4	1.1	0.9	5.7	4.1	Rental & Real Estate	-1.9	0.2	1.5	-4.3	-3.3
Construction	2.2	0.7	0.9	4.4	16.6	Retail Trade	0.1	-0.4	0.9	0.2	6.2
Education	1.2	-1.3	3.1	1.5	15.0	Transport & Postal	-4.5	3.4	-1.7	-3.5	8.0
Utilities	4.8	6.8	0.2	11.8	43.9	Wholesale Trade	-1.9	-0.6	-0.1	-3.2	-0.4
Health	3.1	1.2	1.9	5.3	5.8						
Info & Media	2.0	4.8	-0.8	5.8	27.4	**Total**	**-0.4**	**0.4**	**0.1**	**0.0**	**7.6**
Manufacturing	0.6	-0.4	1.5	0.8	-1.6	Total ex Mining & Agri	-0.7	0.5	0.6	-0.5	5.0

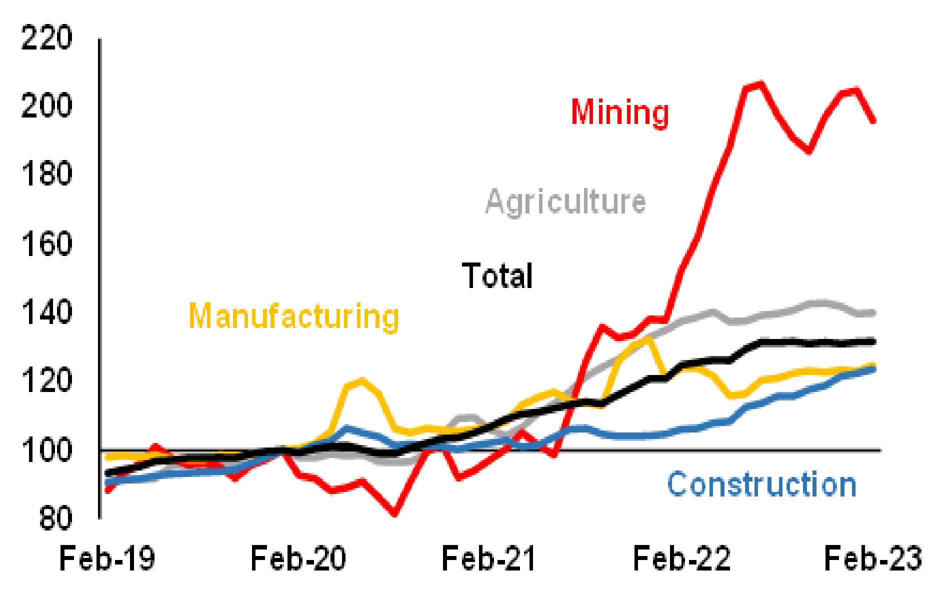
All data calculated as a three month moving average of seasonally adjusted monthly data.

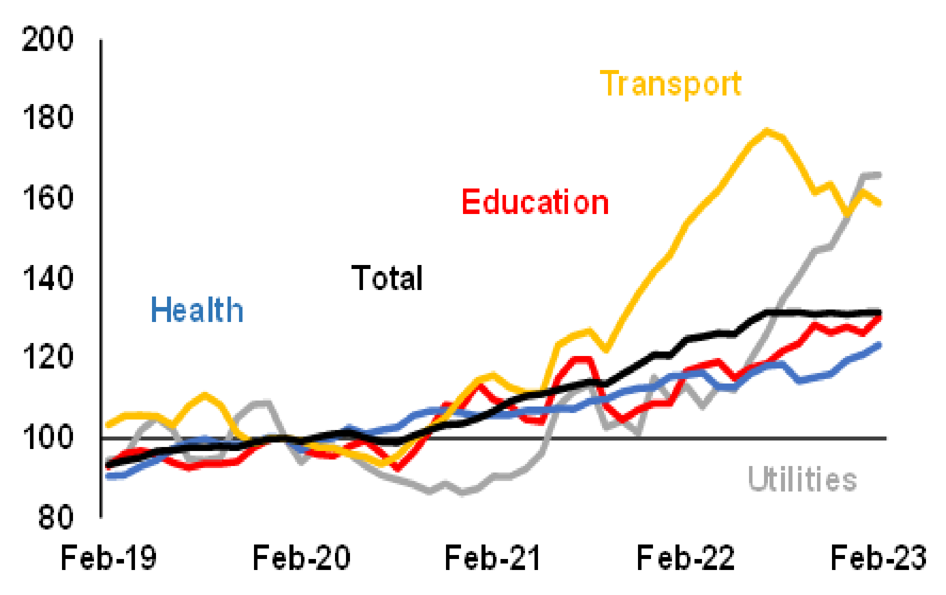
Softness in inward credits has become more evident recently – especially vis-à-vis last year.

Mining levelling off as has Agri. Transport a similar story. Services much stronger.



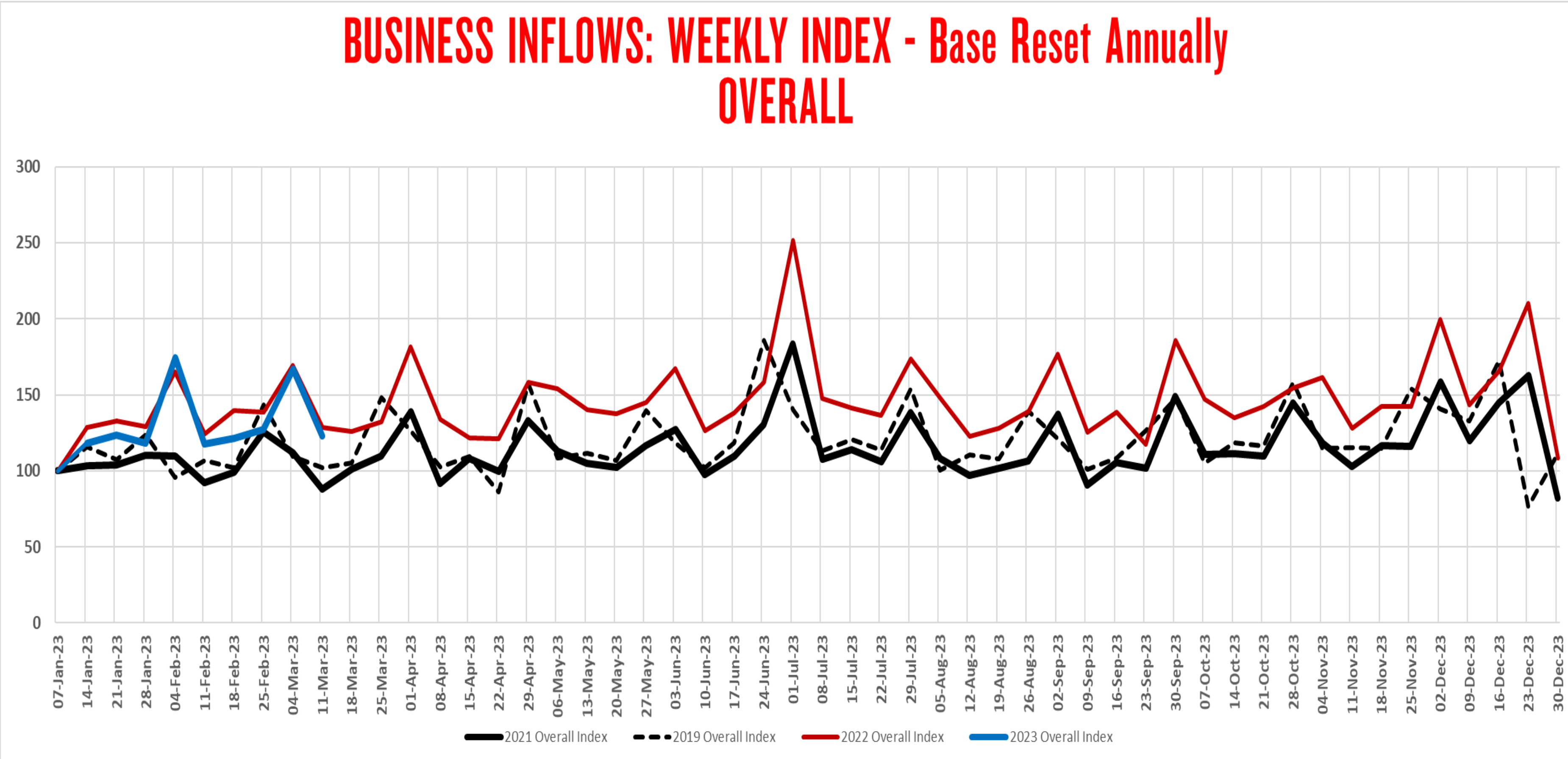






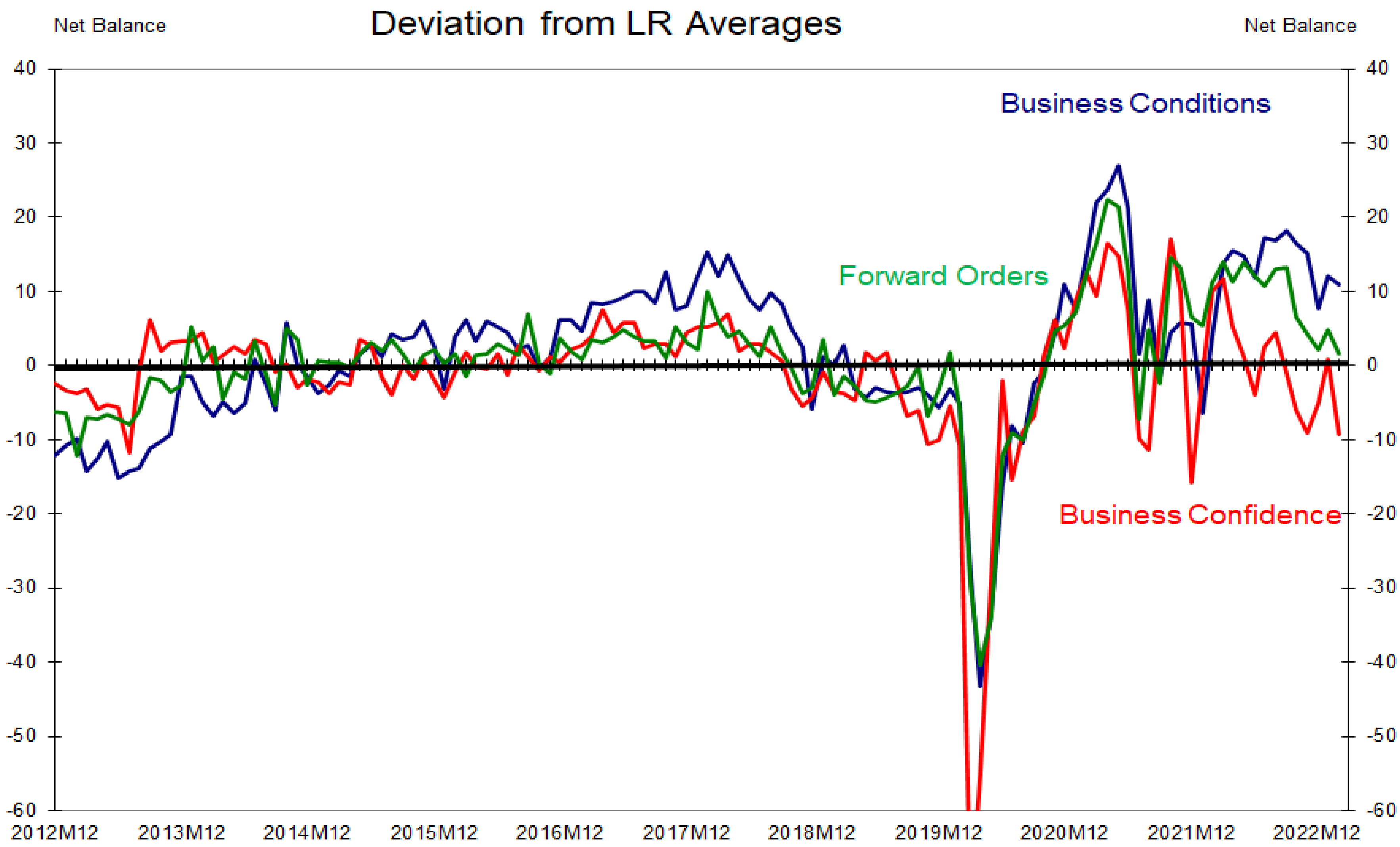
Business inward credits (business revenues)

Annual reset data. 2019 benchmark to avoid y/y distortions. Has been weaker than the last year including in early March. In blue in the chart below.



Business Survey shows slowing growth momentum into the end of 2022.

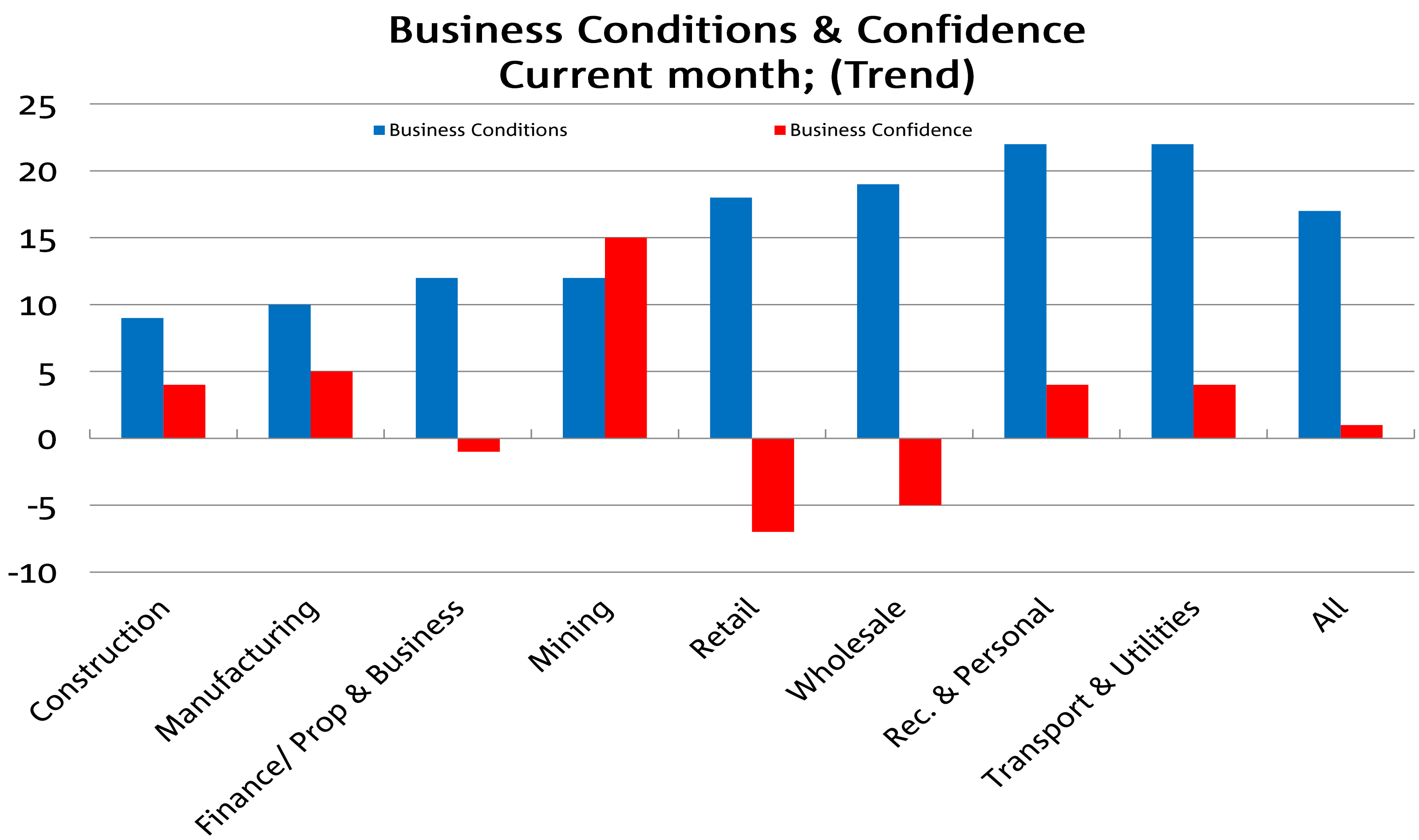
January Feb better – but confidence fragile.



By industry. Overall big differences between confidence and actual outcomes.

Transport still strong as are services (personal & rec services). Overall economy still good Construction, finance and property ok, but weaker than the rest. Mining surprisingly confident. But big difference from conditions to confidence in retail/wholesale.

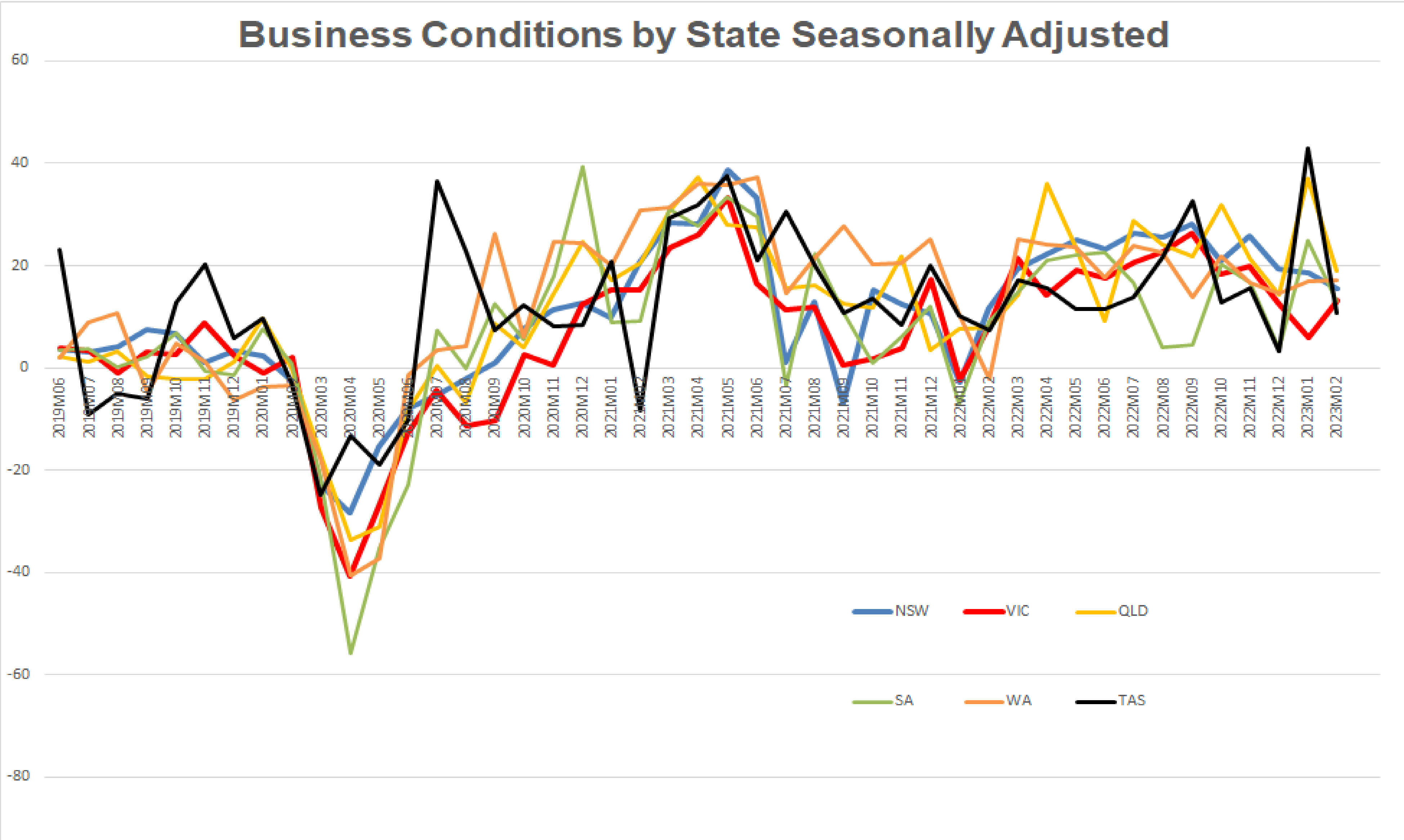
February



Trends across the states.

Data has been volatile - especially in Tassie and Qld.

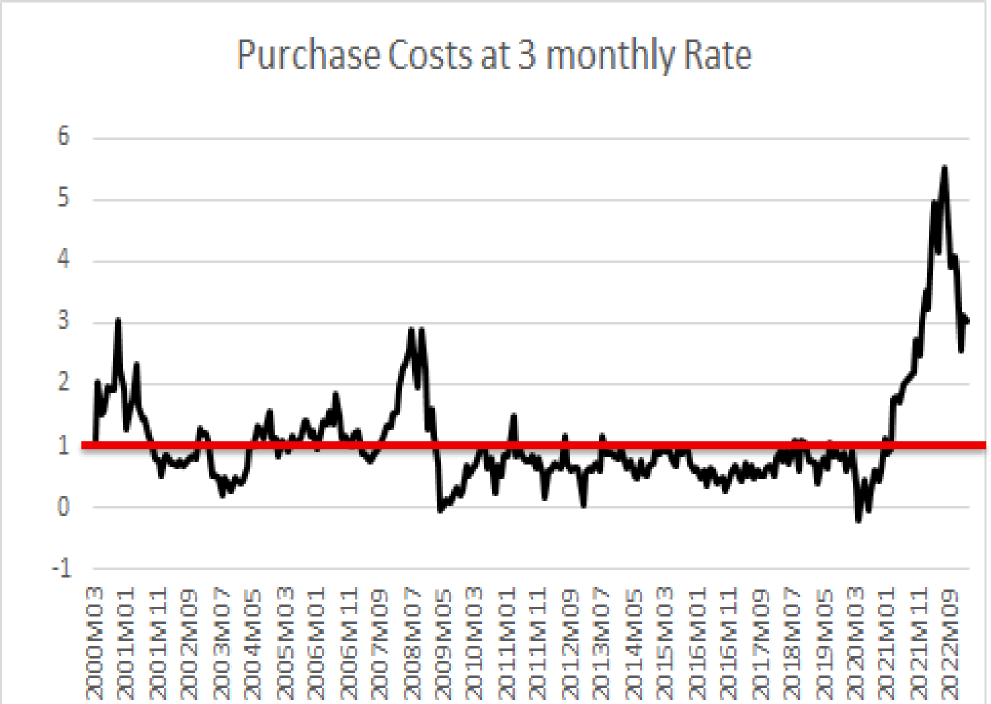
NSW and Vic more steady.



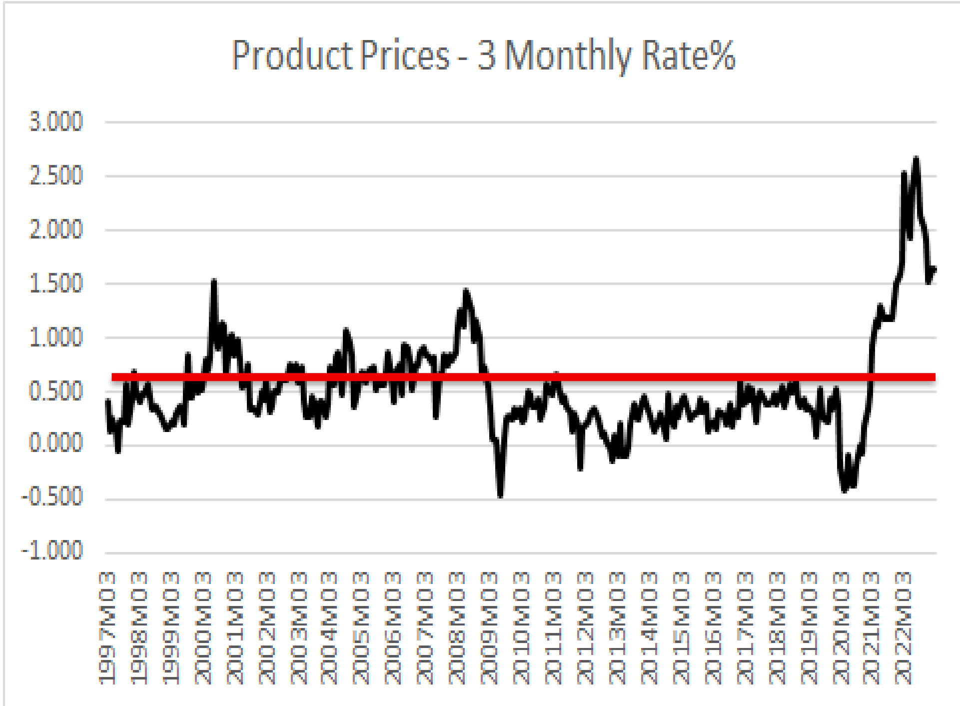
NAB Business Survey

Clearly showing very high purchase costs. Have come off recently but still elevated in early 2023. General inflation pressures also still elevated .

Purchase Costs – February NAB Survey



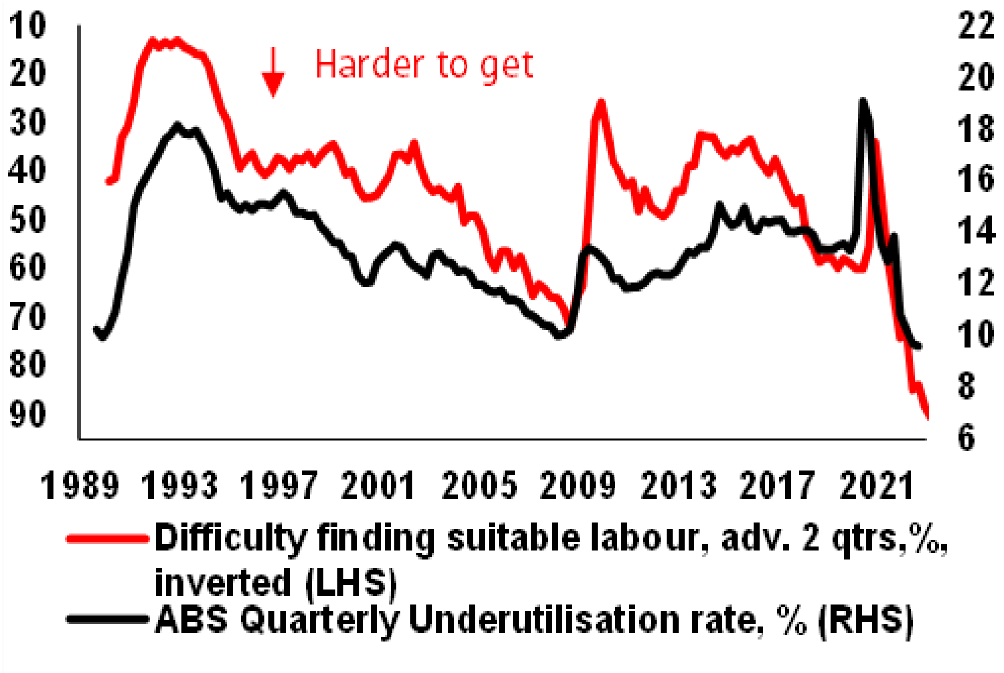
Goods Costs – February NAB Survey

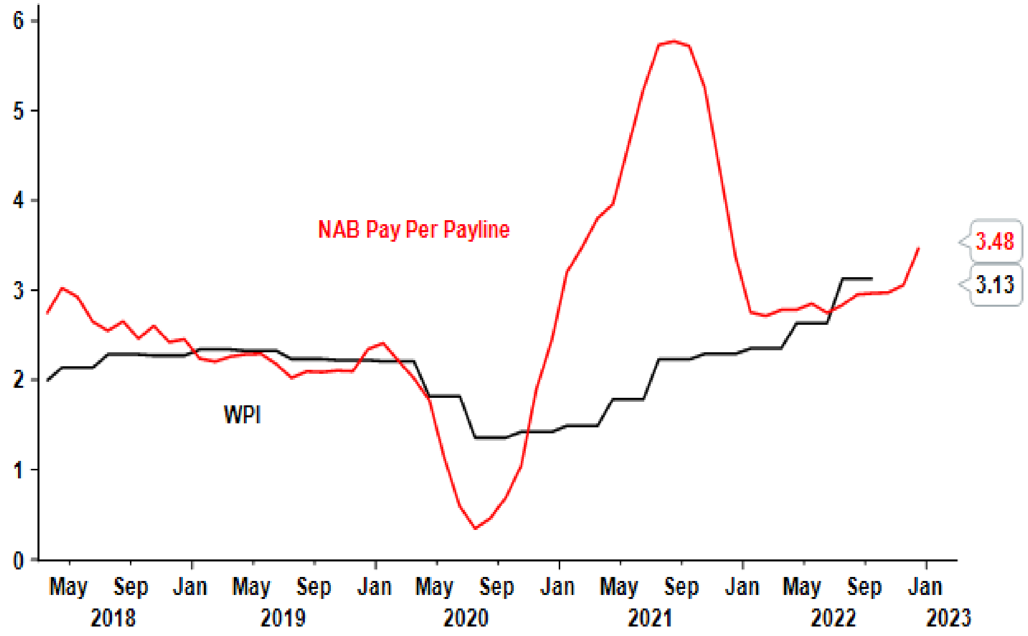


Obviously labour shortages are a huge issue for business now.

Interesting that the link from labour shortages to broader measures of unemployment.

And our internal data says wages growth to Q4 was around 3.5% (up from 3.1% in Q3).

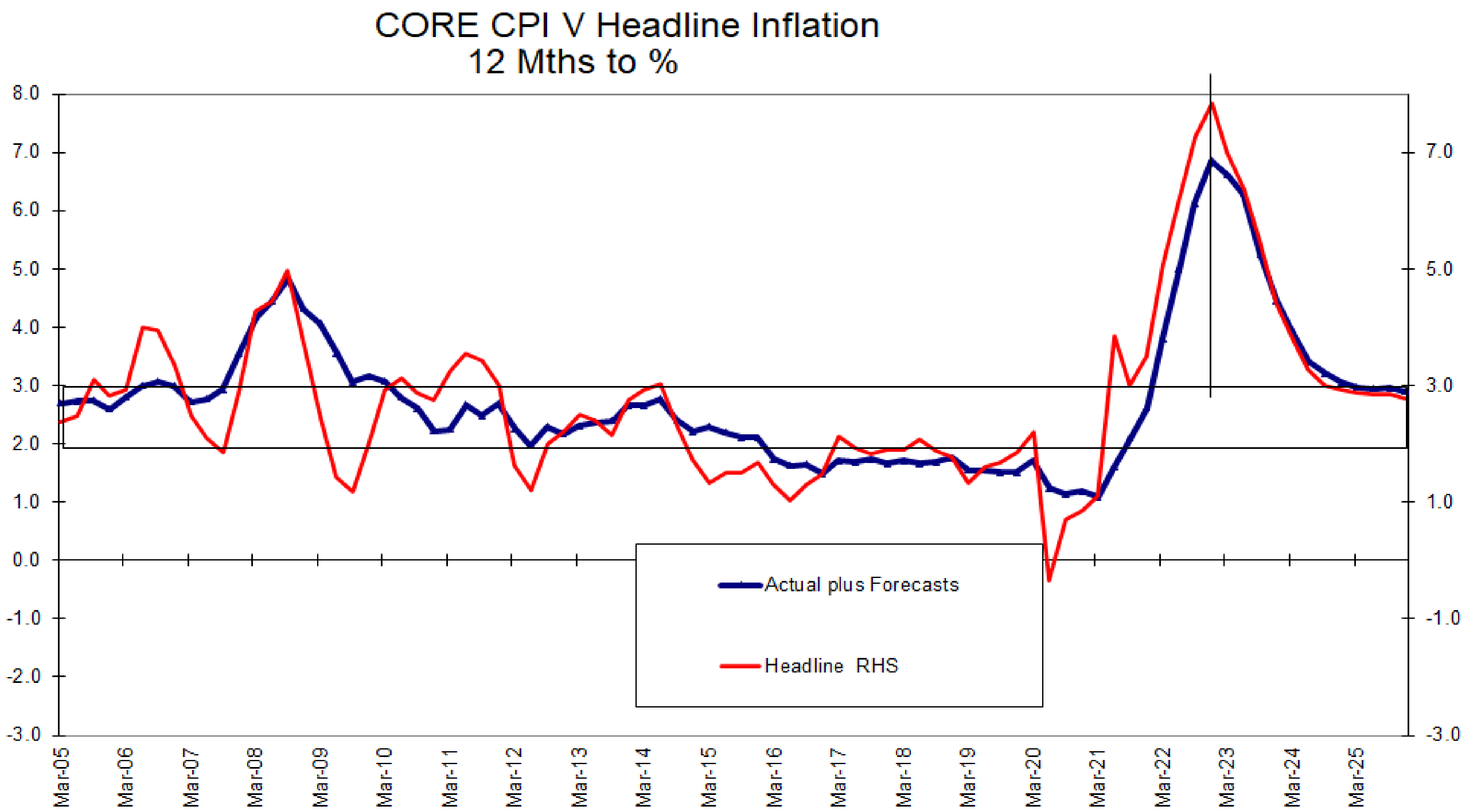




Source: Macrobond, NAB Economics

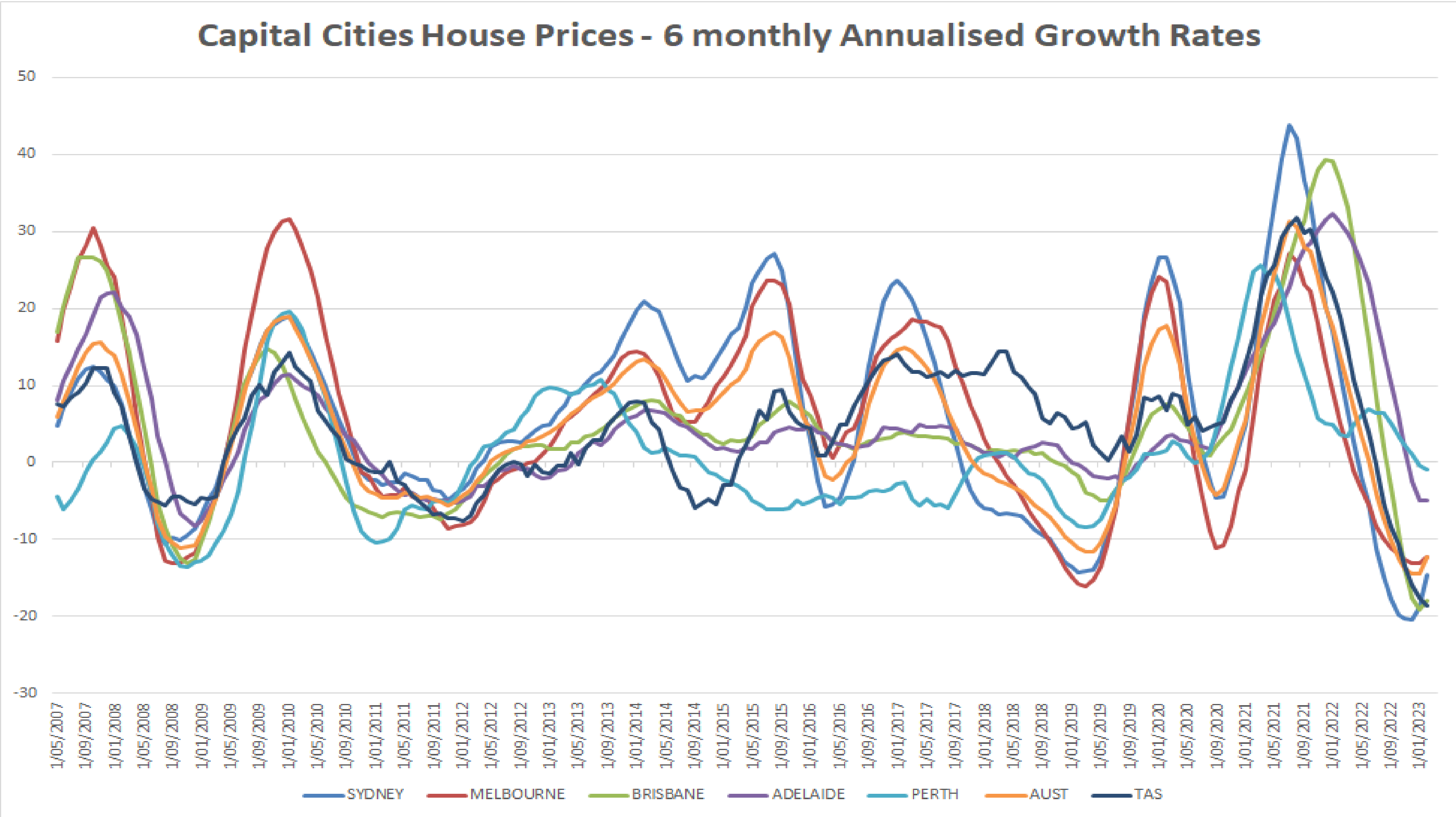
Core inflation

Hit by supply side problems and higher commodity prices (Russia). Trimmed mean core inflation now at around 6.8% by end 2022. Core a touch above 3% by end 2024. Headline even higher at 7.8% by end 2022 and slowing to similar rate as core by late 2024. Into target by 2025.



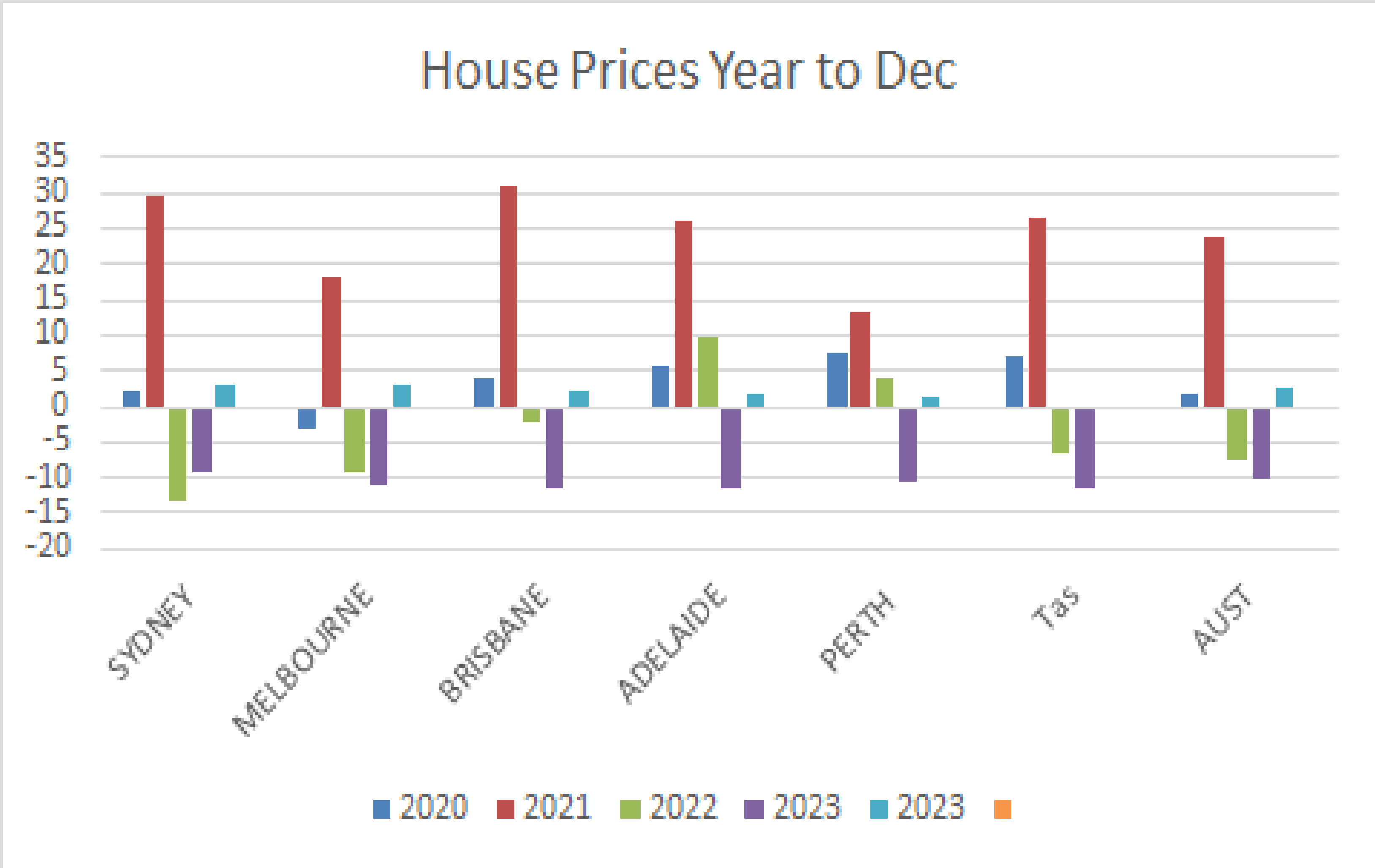
House prices

Maybe seeing a bottoming in Sydney (-12% at a 6 monthly annualised rate). While other cities still falling. Across Australia down around 12% in the last 6 months (at annualised rate).



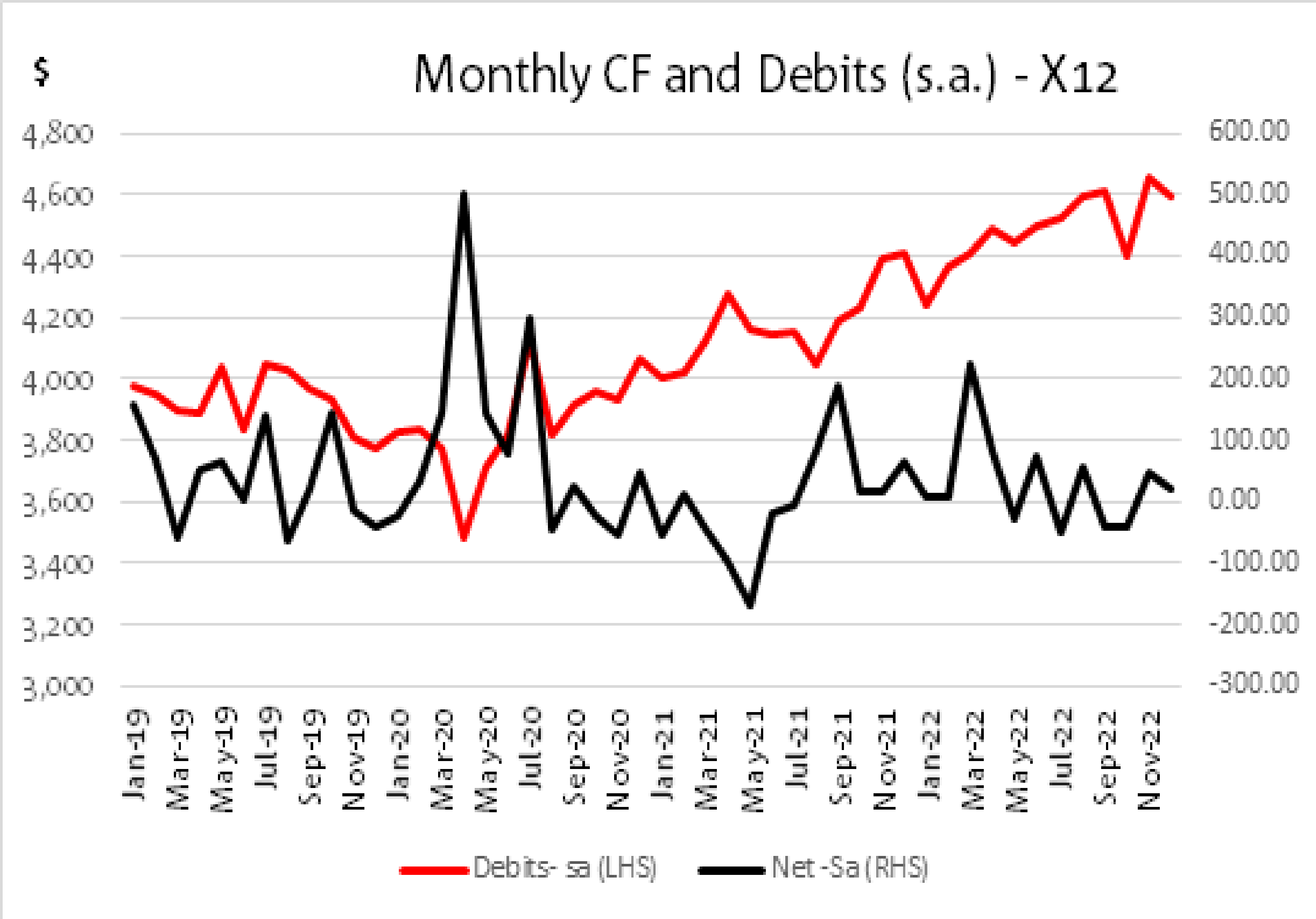
House price forecasts

After increasing by around 23% house prices to be down around -7.3% in the year ending 2022. And fall by around 11% during 2023 on the back of rate rises and falling affordability. For 2024 expect 3-5% increase.



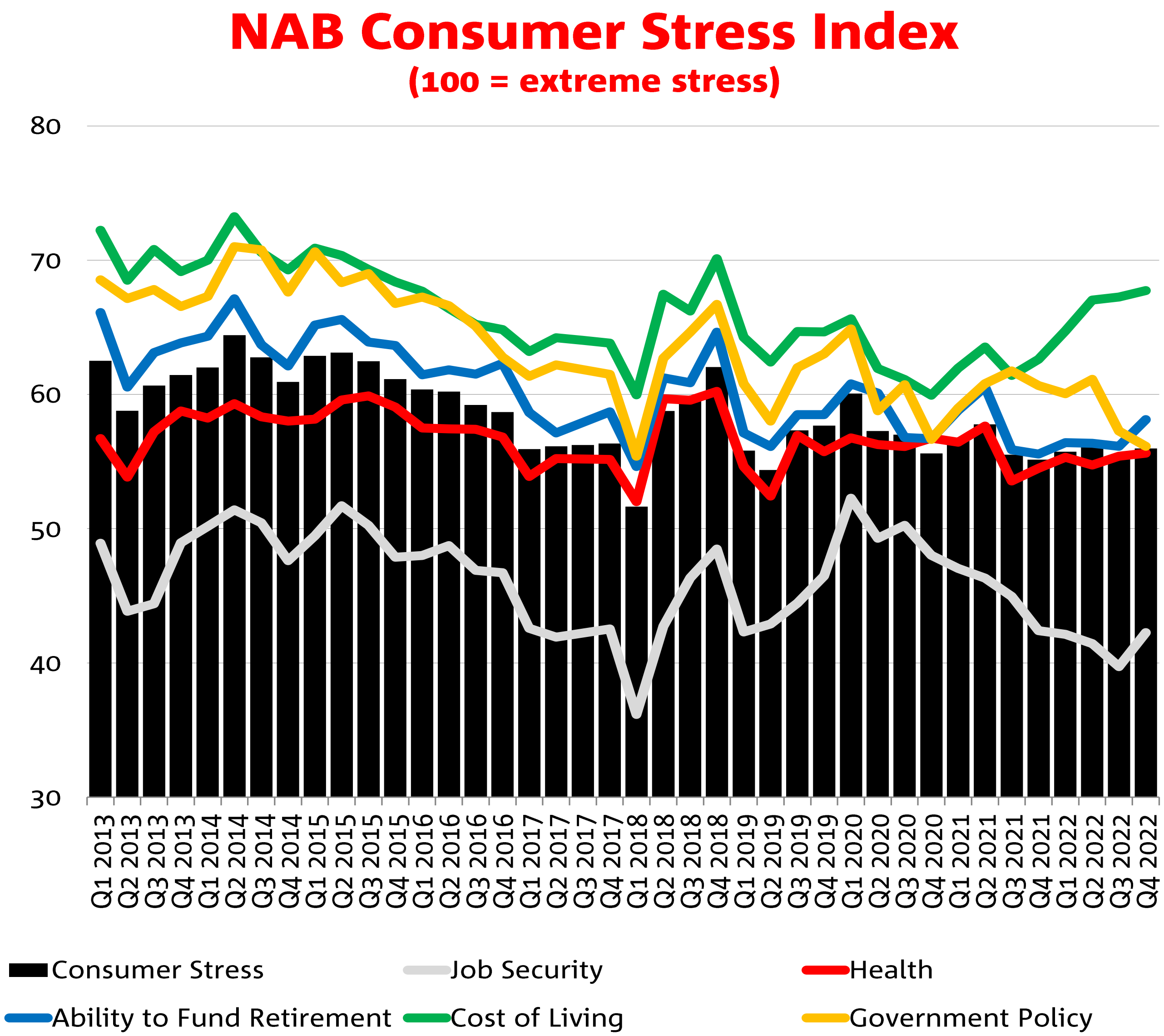
The combination of falling house prices and global weakness could well see the consumer getting scared.

Already their cash flow is not great. Currently spending as much as they are getting. Not enough to sustain growth in 2023.



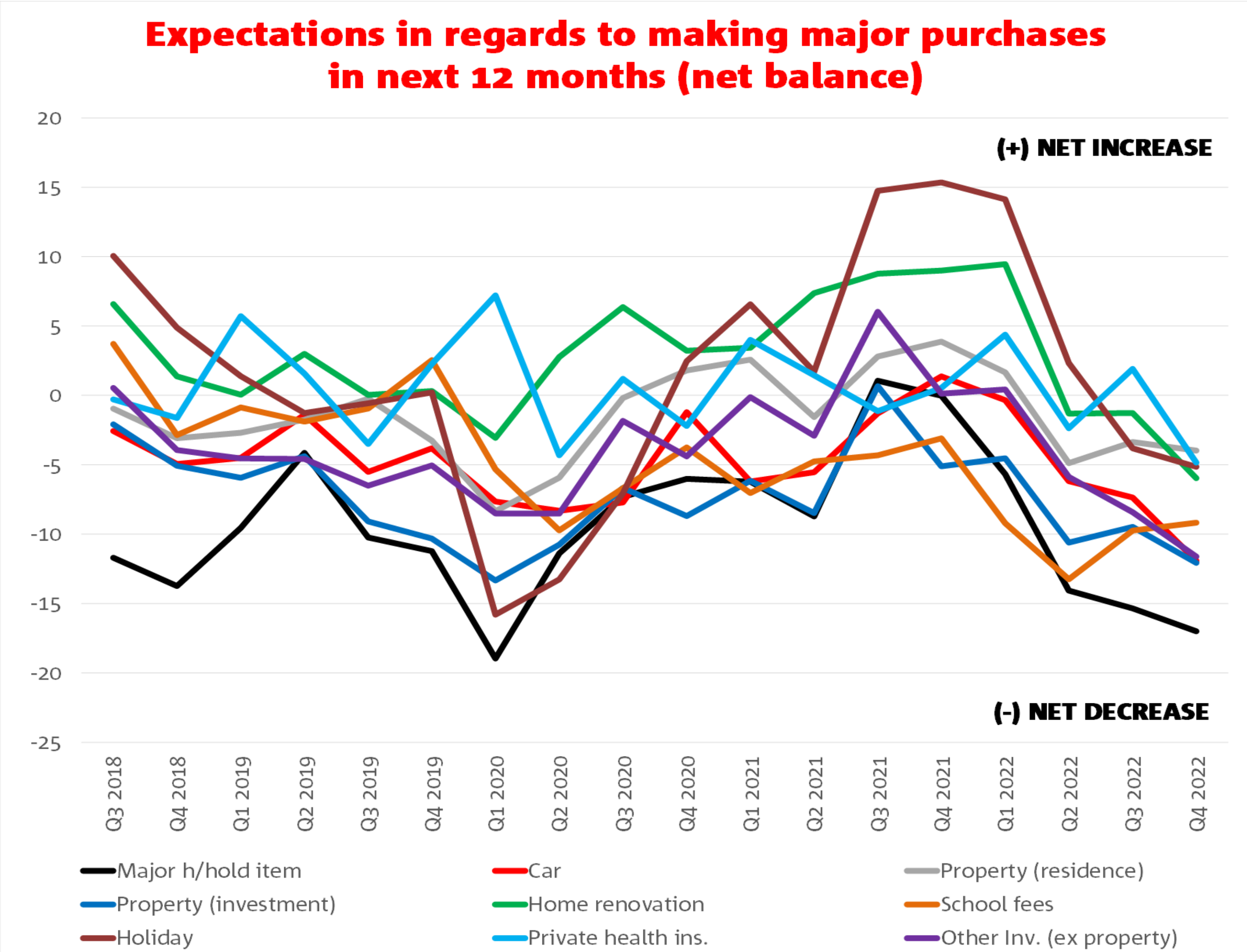
Consumers are very worried about cost of living

But that is being tempered by the ease of getting a new job



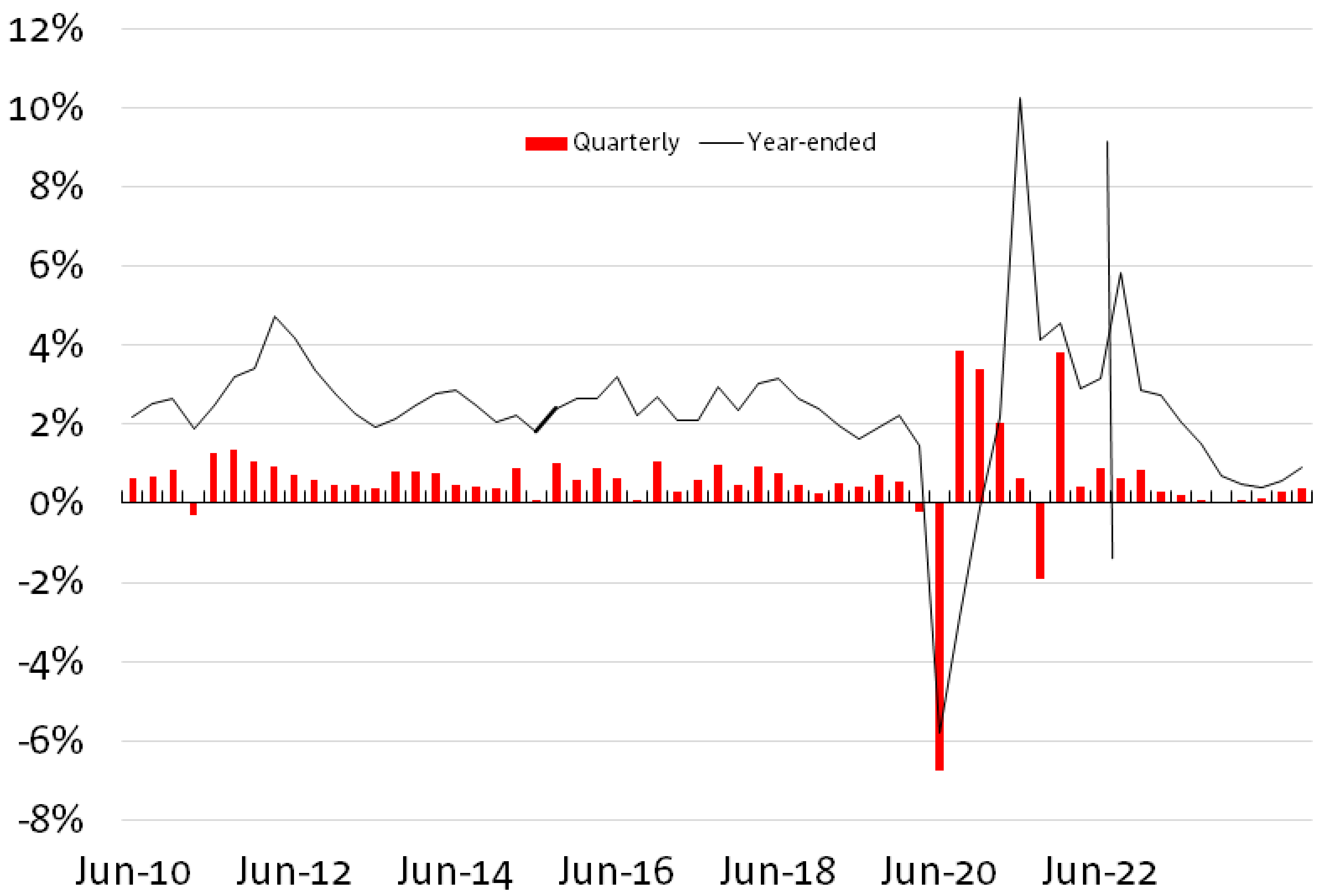
But they are adjusting plans

Liquidity impact from rate rises to hit from late 2022 and early/mid 2023.
Especially household goods and holidays.



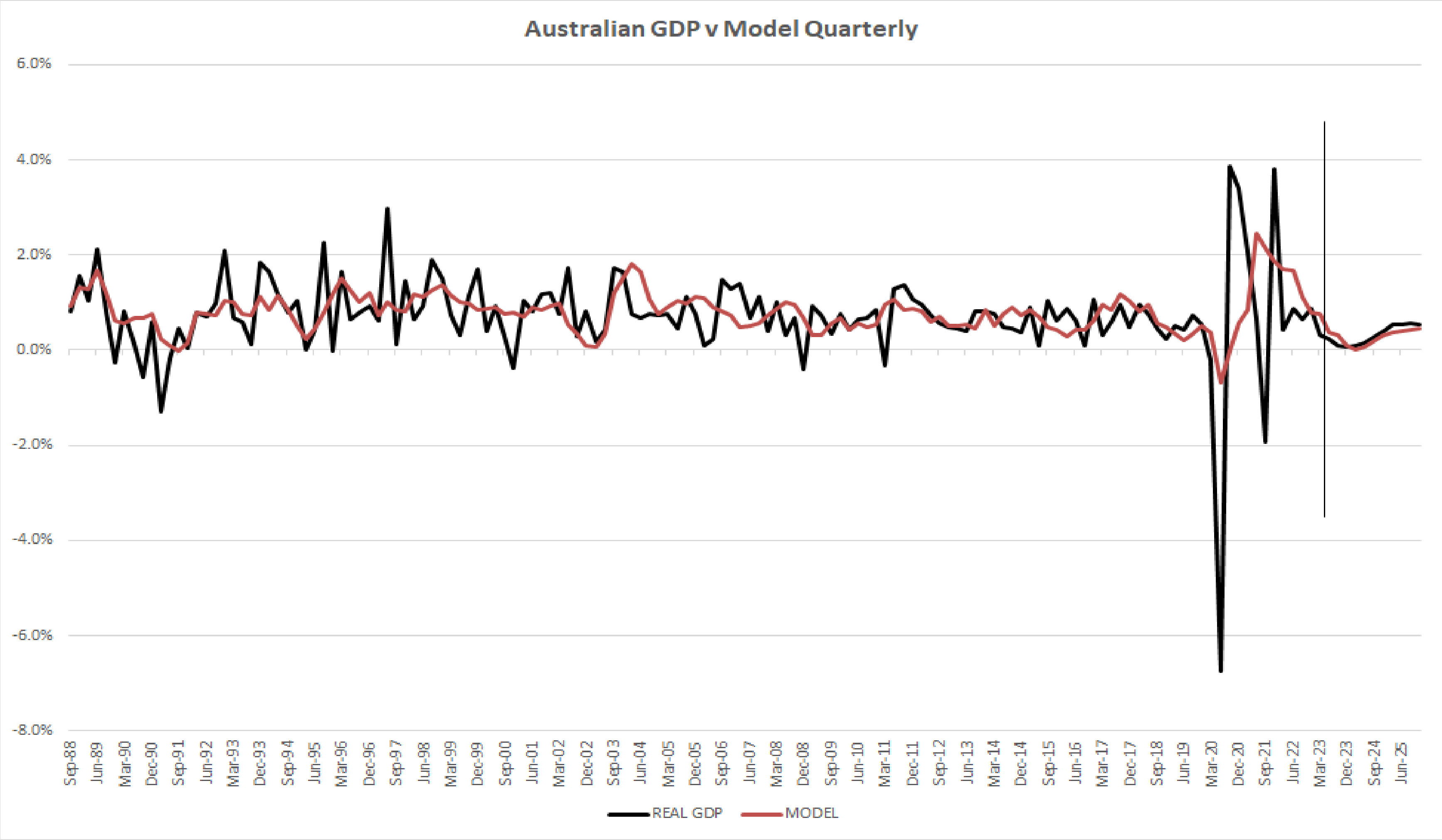
Our growth expectations.

We see slower growth in late 2022. Economy very flat by late 2023/early 2024. Better in 2025
Not a recession but no room for error.



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.

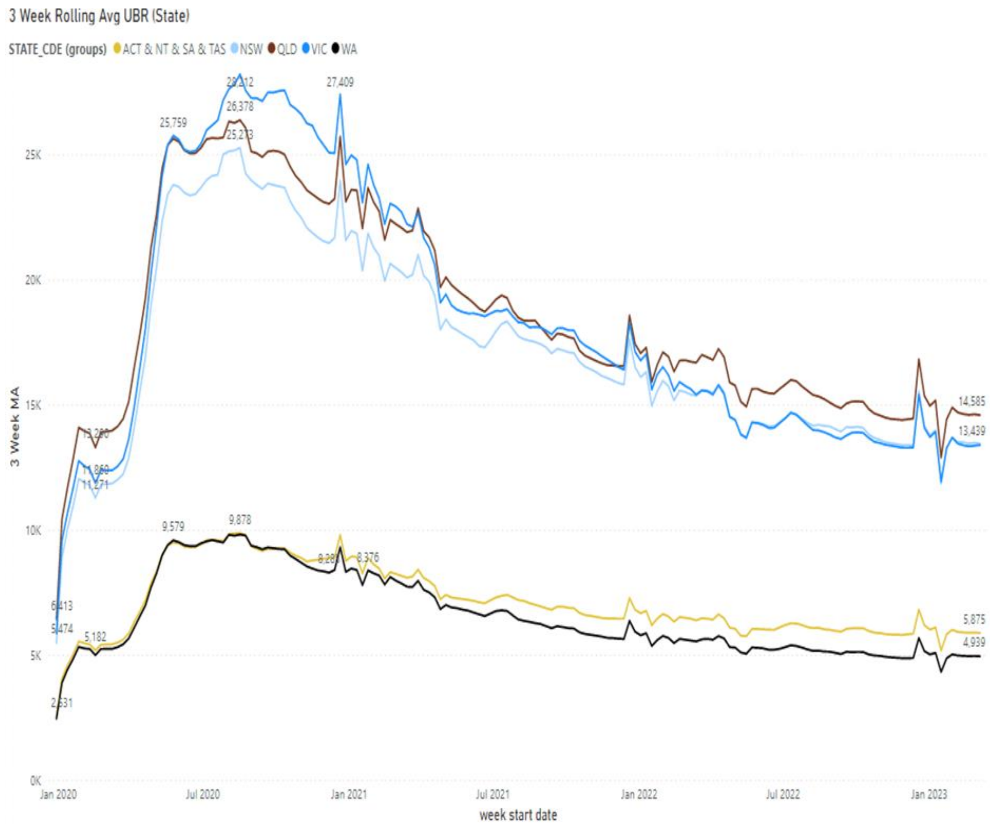


- Model driven by change in real rates (or yield curves), asset prices (house prices and equities), commodity prices, and US growth.
- Quarterly modelled.

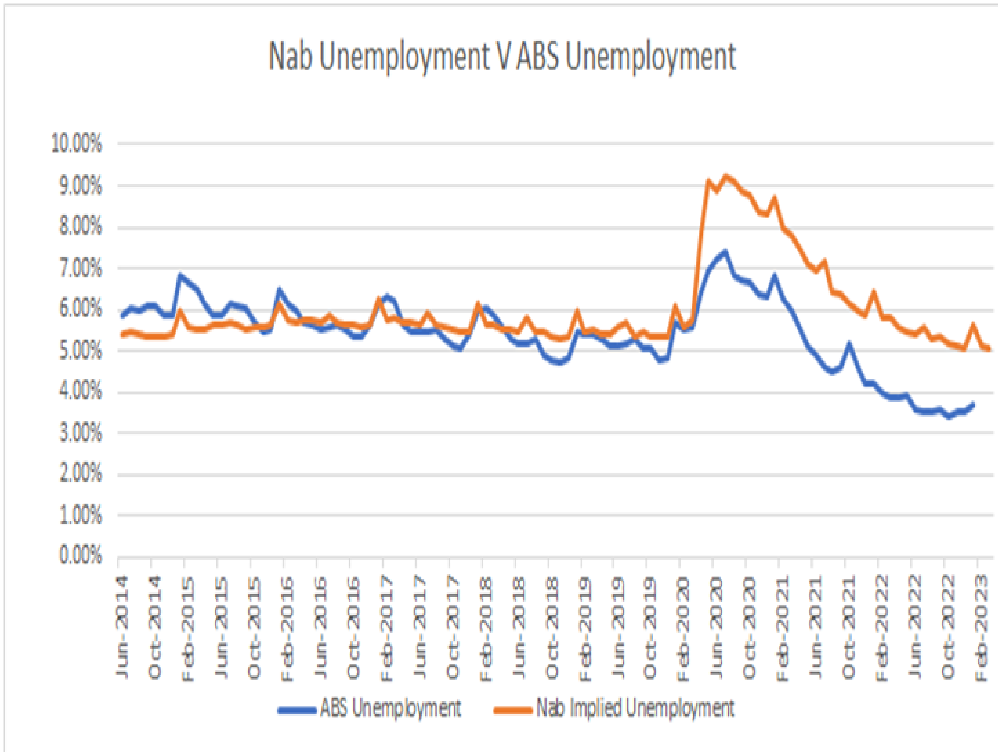
NAB data on the Claimant Count

(NAB customers receiving JobSeeker). Up in January but really reflects problems around seasonality. By early March Claimant count back a bit below December. **Fundamentally market still strong**.

3 Week Moving Average of NAB Claimant Count

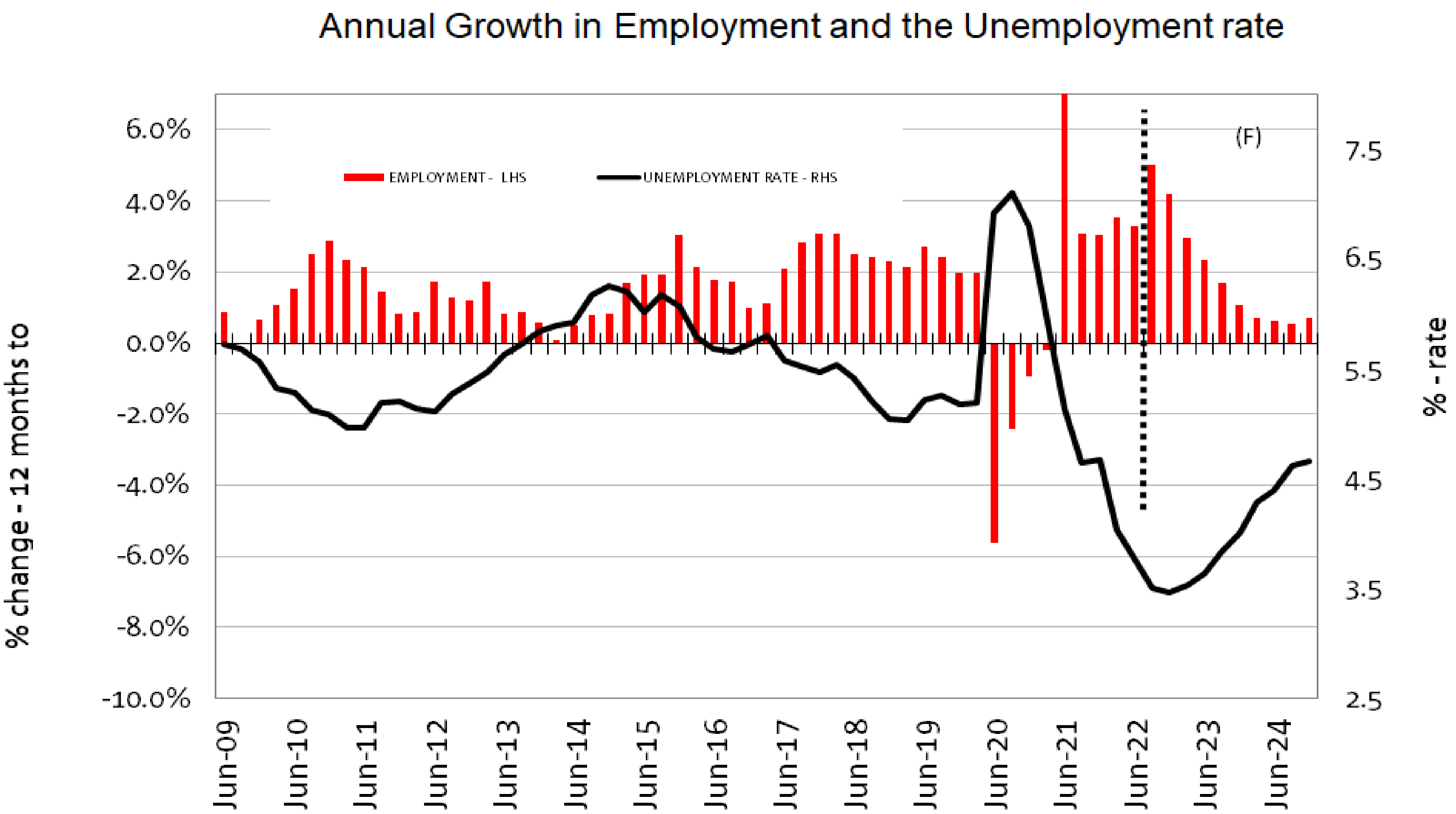


NAB Implied Economy wide Claimant Count



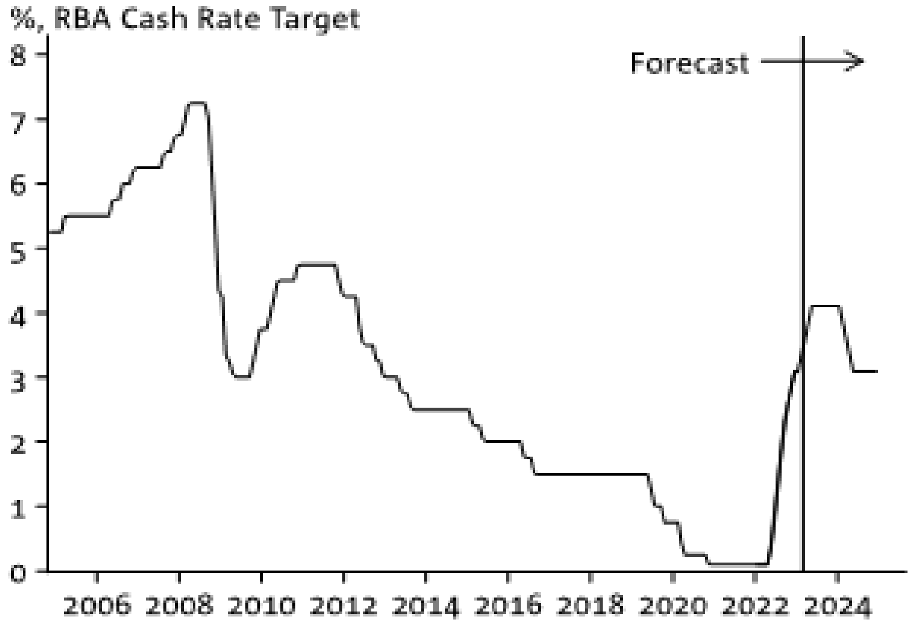
Labour market very impressive

While Omicron hasn't helped, unemployment has fallen to around 3.5% and likely to stay there for another 6 months or so. But as economy fades, unemployment moderately moving up to around 4.5% by end 2024. And around 4.7% by end 2025



On RBA

- RBA has signalled that it wants to get more restrictive:
  - Fundamentally reflects still high inflation in near term at least;
  - And stronger economy still. **Timing of the slowing critical re rates view**.
  - Consumers look flat in February after a better than expected January. Q1 consumption looks positive but small.
  - **SVB a new important complication and now CS. Markets are in panic mode. Need to focus on the economy and fundamentals.**
- After a run of rate rises:
  - Prior to SVB we had further 25 points in April and again in May; **So a cash rate at 3.85 to 4.1% by mid 2023;**
  - **RBA will now look to the fall out from SVB & CS. Could well pause in April before restarting in May.**
  - **We see rate cuts from early 2024 as the economy struggles. Around 3% by mid 2024.**
- **SVB/CS has probably ruled out excessive tightening by RBA.** But cuts this year unlikely unless SVB/CS effects spread – **which we doubt**. Markets are too pessimistic at present.



Source: Macrobond, NAB Economics