EMBARGOED UNTIL 11.30 AM AEDT, WEDNESDAY 12 FEBRUARY 2020

THE FORWARD VIEW: AUSTRALIA FEBRUARY 2020

We have adjusted down 2020 GDP by ½% due to Bushfires & Coronavirus impacts. 2021 adjusted up. RBA forecasts a big stretch.

OVERVIEW

Private demand remained very weak at the end of 2019 and we continue to expect very modest growth in Q4 – mainly due to net exports and public spending. Onto that weak base we have now attempted an early view on what Bushfires and the Coronavirus might do to the forecasts.

For 2020 we now expect a small negative for Q1 2020 growth. Much of that will come from weaker consumption (with significant indirect impacts from confidence) and a hit to tourism, education, commodity prices and incomes. It also seems likely that wage growth momentum has eased into late 2019/early 2020. We make an assumption that most of the negative impacts from the virus and bushfires have passed by Q2 – albeit we don't really expect much in the way of stronger consumption growth till 2021. That could see y/y growth to Q2 2020 slow to around 1%. As context to the above, tomorrow our international forecasts will see the Chinese economy forecasts with no growth in Q1 (currently it has been growing by around 1½- 2% per quarter). In total, even if virus issues are largely sorted by mid year, Chinese growth in 2020 could slow to around 5.5% (previously 5.9%).

By H2 2020, in Australia we are assuming that rebuild effects from Bushfires start to cut in and stabilise the dwelling cycle - with investment in dwellings strengthening markedly in 2021 (up around 7% through the year). By then lower rates should have boosted household balance sheets and consumption, and hopefully business investment.
In summary:

- We have lowered our previous GDP forecasts by around ½% in 2020 to around 1.5%, but boosted 2021 by around 0.3% to 2¾%. Through the year GDP is now put at 1.8% for 2020 and 2.7% for 2021.
- While the RBA will look through the temporary activity effects in early 2020 the reality is that the labour market will also weaken by H2 2020. We still expect the unemployment rate to reach 5.5% in H2 2020 but be maintained at that rate in 2021.
- Inflation forecasts are unchanged with core inflation not back to around 2% (bottom of the band) by end 2021. That reflects weak wage growth and ongoing margin pressures.
- Clearly our forecasts are very different – in 2020 - from those recently published by the RBA.

Clearly the RBA, given its current forecasts, don't see the need for further cuts. But we fear the RBA forecasts will be proved overly optimistic very soon. Hence we still expect two more cuts – the first in April (albeit the exact timing will be data dependent) and another by around mid year. Hopefully fiscal stimulus will also be forthcoming in the next Budget (but we doubt the Surplus will be maintained in 2021/22 in any event).

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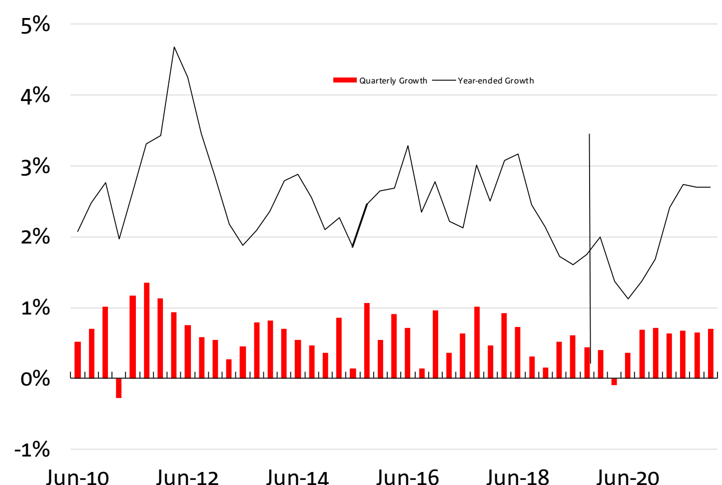
KEY ECONOMIC FORECASTS

	2018	2019-F	2020-F	2021-F
Domestic Demand (a)	2.9	1.1	1.1	2.8
Real GDP (annual average)	**2.7**	**1.8**	**1.5**	**2.6**
Real GDP (year-ended to Dec)	**2.1**	**2.0**	**1.8**	**2.7**
Terms of Trade (a)	1.8	5.1	-7.3	-1.8
Employment (a)	2.7	2.3	1.1	0.6
Unemployment Rate (b)	5.0	5.2	5.6	5.5
Headline CPI (b)	1.8	1.8	2.0	2.4
Core CPI (b)	1.8	1.4	1.7	2.1
RBA Cash Rate (b)	1.50	0.75	0.25	0.25
$A/US cents (b)	0.71	0.70	0.71	0.74

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

NAB GDP FORECASTS



LABOUR MARKET, WAGES AND THE CONSUMER

The unemployment rate edged down to 5.1% in December, with employment growing by 29k (a small fall in full-time was offset by a large increase in part-time workers) in the month. The participation rate was unchanged at 66% - close to its record high. Over the year, employment rose by 2.1%, a strong outcome and a faster rate than that of the working age population. The participation rate also rose 0.3ppt over the year. Therefore, while employment demand has remained robust, there has been a relatively large supply response in the labour market which has seen the unemployment rate remain broadly unchanged over the year.

Given the supply response, growth (and employment demand) has been insufficient to drive down spare capacity in the labour market – resulting in little improvement in wage growth. Only modest outcomes for wage growth are likely to persist while the unemployment rate continues to hover around 0.5-0.75ppt above full employment (recent RBA estimates of unemployment at 4.5%).

While the labour market continues to see favourable conditions, there are some risks. Employment growth has slowed from the rates seen through late 2018 to mid-2019 and the recent decline in the unemployment rate has been associated with a softening in labour force participation. Leading indicators have been mixed, with job ads and the NAB employment index moderating over the year, but ABS Job Vacancies have held up. Further, econometric modelling suggests that the slowing in economic growth will translate into a slowdown in employment demand. This suggests that there are unlikely to be significant gains in unemployment from here.

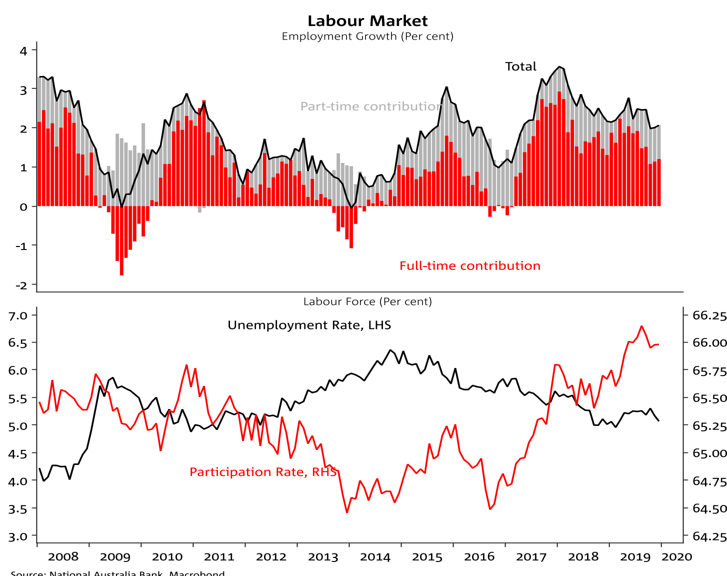
Nominal retail sales declined by 0.5% in December, although this followed strong growth in November (likely reflecting the impact of the Black Friday sales in November). The ABS noted that some retailers reported that December sales were affected by bushfires in NSW, especially in food and eating out. The Coronavirus will be an additional headwind.

An update to our monthly Cashless Retail Sales index will be released next week, providing an early indication of how sales have progressed in the first month of 2020.

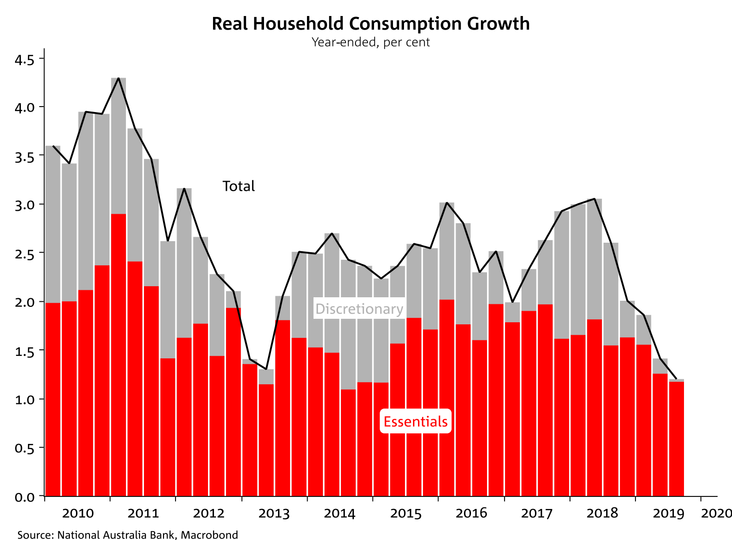
Retail volumes increased by 0.5% q/q in Q4, but were up only 0.4% y/y over the last year (see chart opposite). While the Q4 outcome is the strongest quarterly result since mid-2018, it is not particularly strong by historical standards.

Weak wage growth and associated household caution is likely to see ongoing restraint in consumption growth. Indeed, while price discounting underpinned the jump in real retail sales we suspect that total consumption in Q4 will still be only around 0.4% for y/y growth of around 1.2%. And January looks weak.

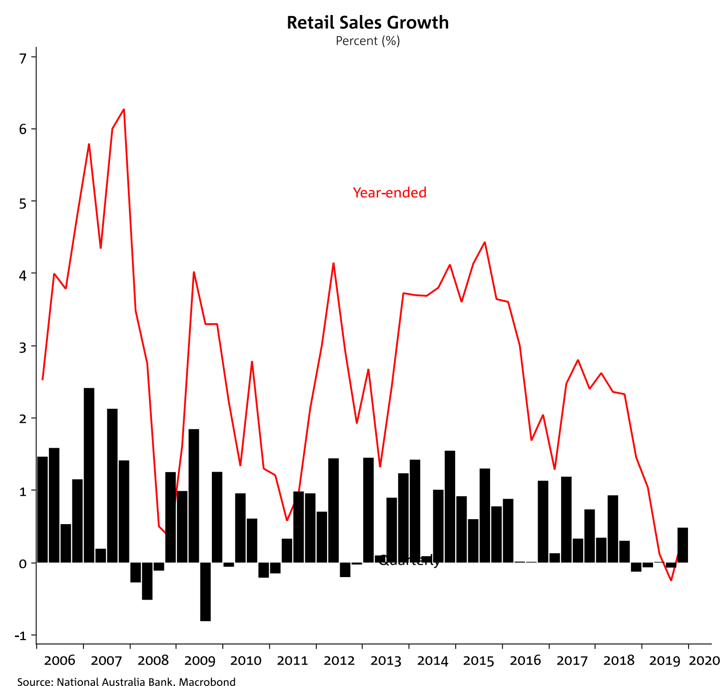
HEALTHY LABOUR MARKET...



WEAK CONSUMPTION GROWTH...



RETAIL SALES GROWTH HAS BEEN WEAK...



HOUSING AND CONSTRUCTION

The CoreLogic 8-Capital City dwelling price index saw a rise of 0.9% in January, driven by a 1.1% rise in Sydney and 1.2% rise in Melbourne. The other capitals also experienced increases in the month.

Overall, dwelling prices in Sydney and Melbourne have continued to recover strongly in recent months after having fallen 15% and 11% respectively. Since reaching a trough in May, prices in each city have risen by over 10% and are now 5% and 2% below their prior peaks. Outcomes across the other capitals have been more mixed in this time though are generally higher over the past 6 months. The exception has been Perth, which continues to decline and is now around 22% lower than its peak in late 2014.

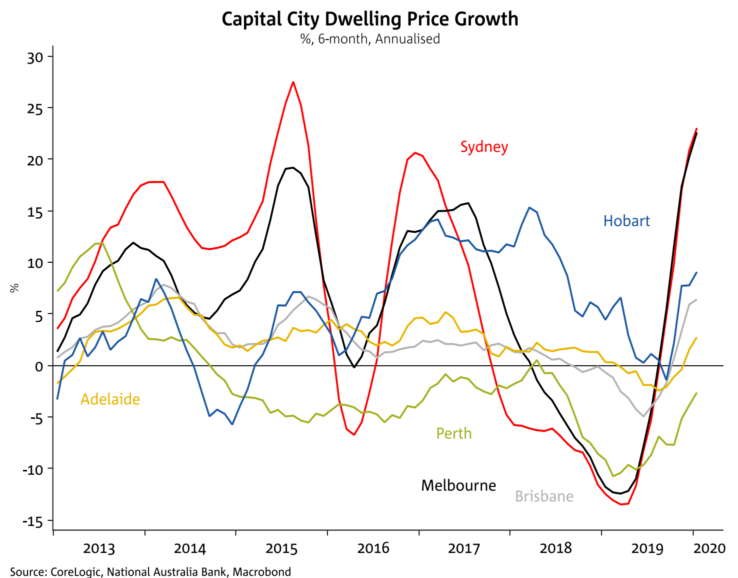
Lower interest rates, in addition to the easing in macro prudential policy in mid-2019, have been key supports. Ongoing healthy population growth and a rapid adjustment to supply (with more to come) is likely to have also provided support. We do not see a fundamental oversupply in the market and renewed optimism is likely to see further gains in Sydney and Melbourne. Low unemployment in these states is likely to have also provided support The other capitals are clearly more impacted by state specific factors but appear to have seen at least some support from lower interest rates and an easing in macroprudential controls.

Going forward, we expect further gains in Sydney and Melbourne in 2020, though at a slower rate. Prices are expected to continue to rise in 2021 – though again slowing. Prices will be broadly flat across the other capitals.

While the established market continues to perform relatively well, new construction appears to have remained weak. We expect dwelling investment (and building work done) to continue to decline this year, falling by another 7% before levelling out in 2021. This will be driven by a fall in activity in Sydney and Melbourne which saw large run-ups in high rise residential construction. While, the decline in approvals looks to have bottomed, applications for new building remain low, and imply ongoing weakness in new construction. Further, while the pipeline of work remains elevated, the high rate of completions is likely to see this eroded relatively quickly.

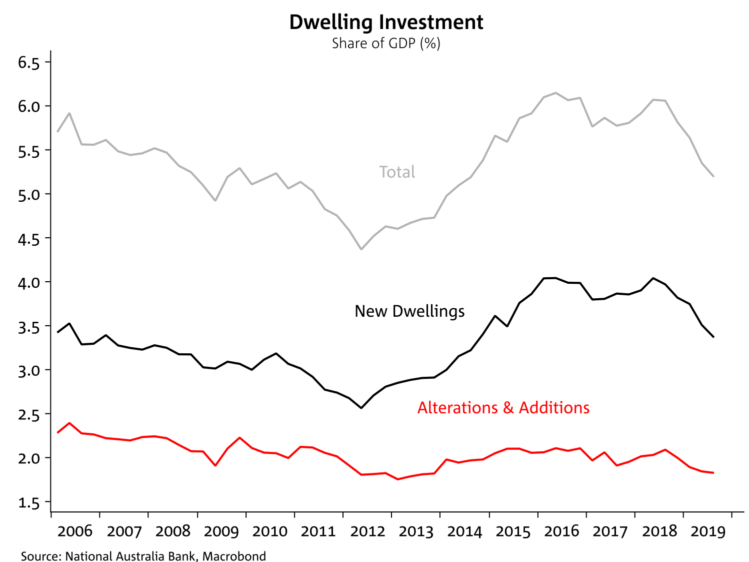
The softness in the housing market, notwithstanding the sharp increased in prices for Sydney and Melbourne has been reflected in credit growth. Housing credit has fallen to 3.1% y/y. Investor credit has remined weak and is 0.3% lower over the year. Credit to owner-occupiers has held up better but has also slowed, rising by 5.0% over 2019.

PRICES ARE STABILISING...



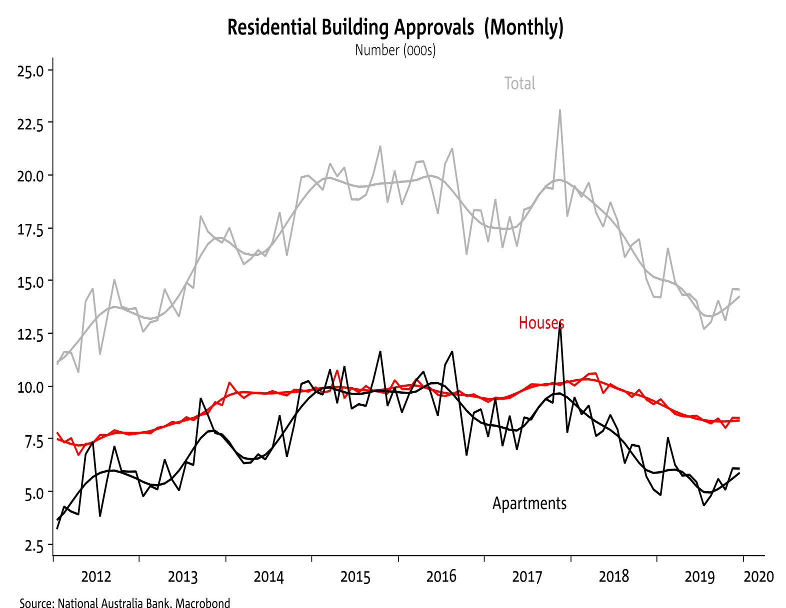
Source: CoreLogic, National Australia Bank, Macrobond

DWELLING INVESTMENT TO FALL FURTHER...



Source: National Australia Bank, Macrobond

APPROVALS SUGGEST MORE WEAKNESS...



Source: National Australia Bank, Macrobond

BUSINESS AND TRADE

In the context of a weak household sector – where consumption growth is weak and dwelling investment continues to decline – the outlook for business investment and trade is important.

Overall, business investment has remained weak over the past year. Investment in the mining sector has edged lower, but the post-boom decline appears to have tailed off. From here we do not expect a significant pickup in investment in the sector beyond earlier planned expansions and a higher level of sustaining capex.

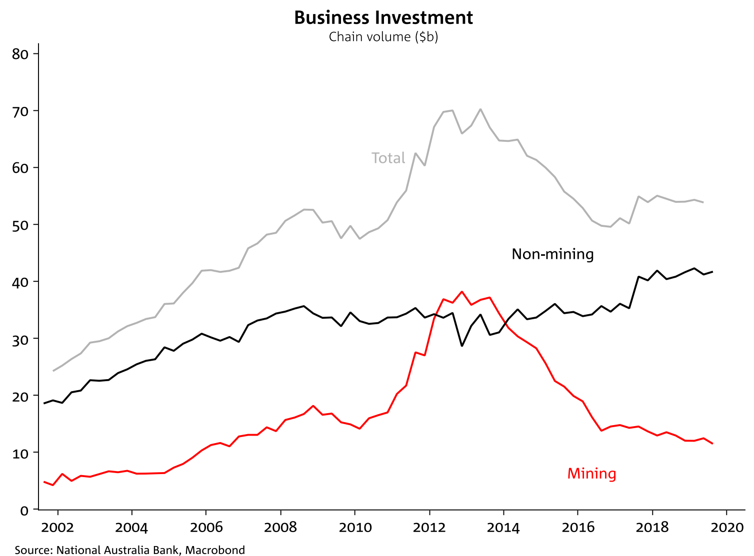
Of more concern is the softness in the non-mining sector. Investment has tracked sideways over the past two years despite record low interest rates and a significant pipeline of public infrastructure work – which is largely completed by the private sector. It appears that soft consumption growth and weakness in construction and housing related manufacturing have weighed on investment.

Indeed, the monthly business survey suggests that there has been a broad-based deterioration in conditions since early 2018. Conditions in the goods distribution sectors are weakest, while manufacturing is also weak. This is in contrast to the services sectors which have held up better and currently see the best conditions by some margin. The past few surveys have seen conditions stabilise but at a below average level. This implies ongoing weakness in private sector demand. Confidence is also low (and negative) suggesting firms do not expect a significant improvement from here.

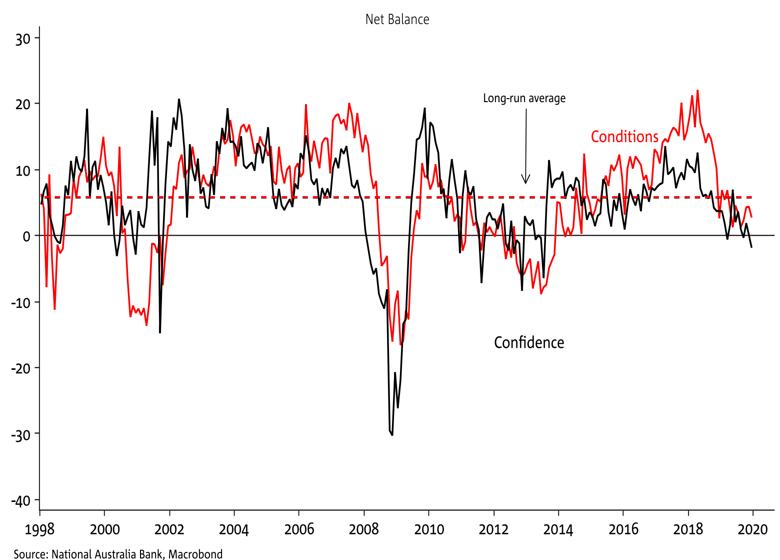
Indeed, while forward indicators across both the monthly and quarterly surveys have been mixed, in a levels sense they point to ongoing soft business conditions. Capacity utilisation has softened and is broadly around average, as has capex suggesting that the weakness in activity and lack of confidence around the outlook has cut into firms expansion plans. Importantly this month the employment index softened suggesting that it may also be impacting labour demand. We will closely watch this series to see if this decline is sustained.

Net exports looks like contributing around 0.2% to GDP growth in Q4, for an annual contribution to growth of nearly 1½%. These increases have been driven by the ramp up of LNG production as the last of the mega-projects inters production. Going forward we expect exports to make a contribution in the near term to growth but that this will level off with little further expansion in the mining sector underway. Growth in exports will likely come from services such as tourism and education going forward, but this will depend on the exchange rate, world income growth and how long the coronavirus crunches China.

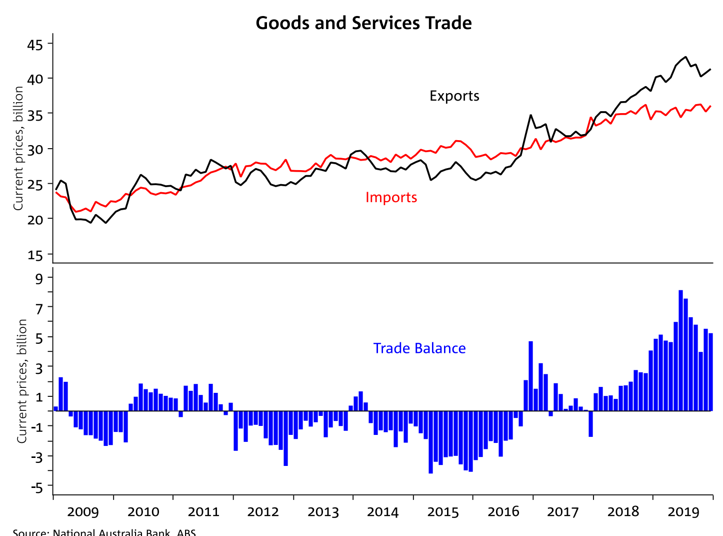
NON-MINING INVESTMENT IS WEAK..



CONFIDENCE AND CONDITIONS WEAK...



EXPORTS CONTINUE TO RISE...



COMMODITIES

Spot prices for iron ore trended higher across much of December 2019 and January 2020 – pushing up above US$95 a tonne prior to the Chinese new year market closures. However, fears around the impact of the Coronavirus on steel demand in China's construction and manufacturing sectors drove prices sharply lower in early February – back below US$85 a tonne at the time of writing. In the short term, this is likely to be a larger issue than potential supply disruptions in both Brazil and Western Australia (the easing of which should add additional downward pressure to prices later in the year). Iron ore is forecast to average US$75 a tonne in 2020, a decrease of 19% from the 2019 average.

Spot prices for metallurgical coal rose in early 2020 – in line with the strength in iron ore markets – up above US$150 a tonne in mid January. However, prices have dropped back below this level at the time of writing – reflecting steel sector demand fears related to the Coronavirus outbreak. In contrast, price movements in thermal coal markets have (to date) been more moderate – with prices just below US$70 a tonne. Coal prices are expected to fall in 2020 – hard coking coal is forecast to average US$146 a tonne (down around 18% from 2019), while thermal coal is forecast to average US$67.50 a tonne (a decrease of almost 14%).

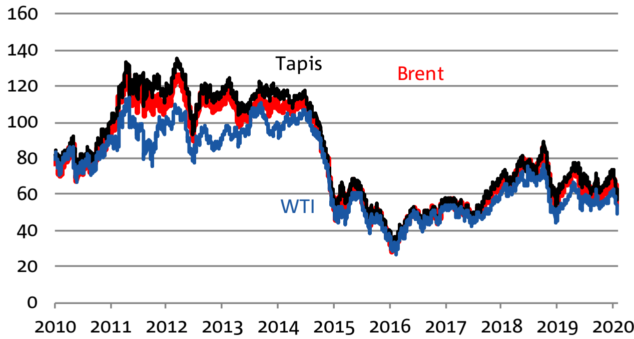
The outbreak of the Coronavirus in China, and subsequent restrictions on travel and activity, are expected to reduce oil demand and prices in the short term. The benchmark Brent fell to a low of around US$54/bbl (from US$65 in mid-January), before recovering modestly. On the supply side, OPEC+ (including Russia) are mulling extending their 1.7 million barrels/day cut in supply beyond March. Oil futures markets have reversed and are now in contango, with contracts further out dearer than near-terms ones. We are forecasting the Brent benchmark to be around US$54-58 in the first half of 2020, rising to US$62/bbl by end 2020.

The LNG market has been affected by a potential oversupply due to increased global production. Despite increased supply, a more pressing concern is the likely deterioration in Chinese demand stemming from the Coronavirus outbreak, with Chinese customer CNOOC adopting force majeure provisions to refuse LNG cargo shipments scheduled for February and March. We expect some weakness in both export volumes and prices, particularly in the March and June quarters of 2020. We have lowered our AUD export price forecasts, and are not ruling out even further cuts.

Agricultural prices – particularly cattle – have risen in the new year, largely in response to high rainfall.

GLOBAL OIL PRICES

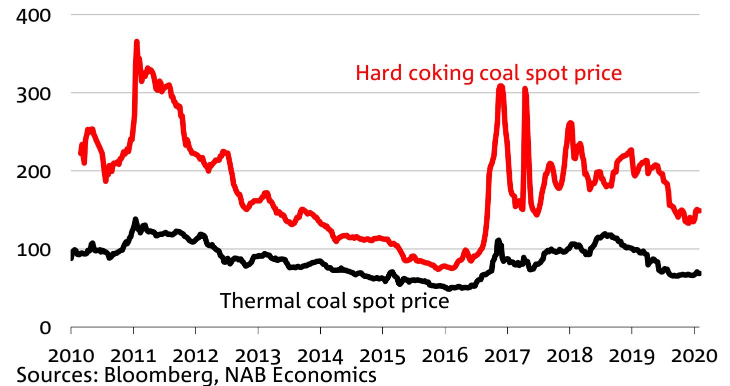
USD/bbl, daily



Source: Refinitiv, NAB Economics

COAL SPOT PRICES

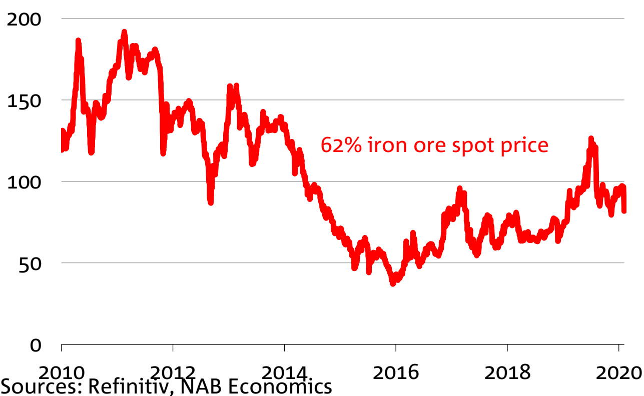
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

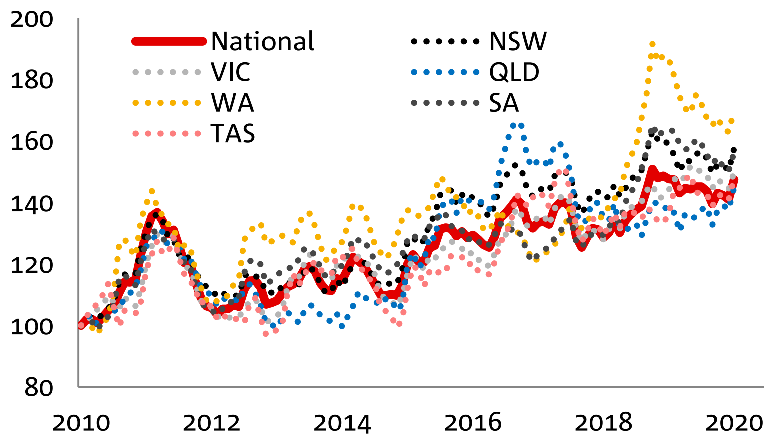
US$/t (incl. cost of freight)



Sources: Refinitiv, NAB Economics

NAB RURAL COMMODITIES INDEX

Jan 2010 = 100



Source: ABARES, Meat and Livestock Australia, Australian Pork, Ausmarket, ABS, Bloomberg, Thomson Reuters, BREE and Profarmer

MONETARY POLICY, INFLATION AND FX

As noted above the RBA continues to have a much more positive view on the outlook for the economy. For 2020 in particular the idea that the combination of the Bushfires and the Coronavirus will only detract a total of 0.2 percentage points over the December and March quarters combined is at best heroic.

To-date the NAB Survey has not really shown much bushfire effect but the Survey still is indicating no growth in private sector demand. We are also in the field for a special Bushfire Survey (on a similar vein to that done on the Queensland floods in early 2011), with the results to be published in a few weeks.

While we agree that it is very early to be assessing the impact of the Coronavirus it clearly could be quiet significant. Anything that takes around ½% off China's economy will clearly impact here. We are already seeing impacts on tourism, education, commodity prices and agricultural products – especially those delivered by airfreight. In our view the virus's impact could well be more significant than the bushfires. Again how long it lasts in anybody's guess but to ignore it in the forecasts seems not to be the right option.

Beyond that we are still much more worried about the consumer than the RBA. Internal data suggests consumer cashflow deteriorated further in the December quarter and retail sales in December were very soft.

One area that we do agree with the Governor is that 2019 rate cuts have helped – if nothing else via its impact on helping strengthen consumer balance sheets. The problem however now seems to be that wages growth has slowed into late 2019 and probably early 2020. To us that means the consumer, while improving in H2 2019, will not really significantly strengthen until 2021.

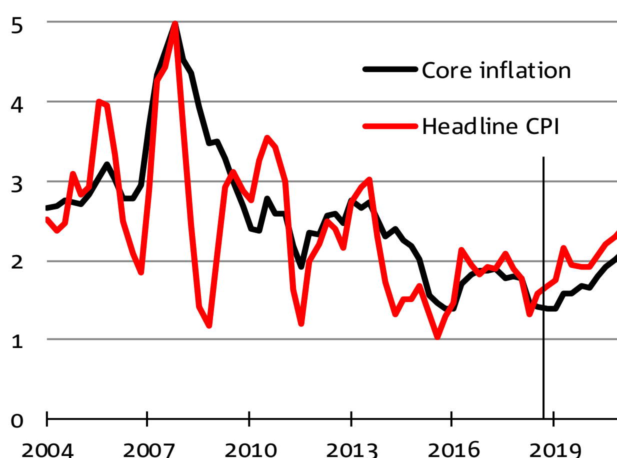
As noted above, on the basis of the RBA's forecasts, there could well be no case to expect any movement in rates for a long time. Unfortunately we worry that the RBA's optimism will very quickly prove to be misplaced. Hence we still expect two more cuts – the first in April (albeit the exact timing will be data dependent) and the second around mid year. Hopefully fiscal stimulus will also be forthcoming in the next Budget (but we doubt the Surplus will be maintained in 2021/22).

On the question of how the transmission mechanism of monetary policy has changed in a low rate environment our judgment continues to be that it has probably weakened or the lags might well be longer – especially in household cashflow terms (as households opt not to pay less on mortgages and strengthen their balance sheets- which could well lengthen the traditional lags of monetary policy). Also interest rates so far have not really been effective in increasing business willingness to invest. That may be partly explained by lags, but also by the use of high and relatively sticky hurdle rates..

The exchange rate is however still an important channel of monetary policy and a mechanism by which global developments will impact the domestic market. Recent weakening of the AUD due to fears of what the Coronavirus might do to China is clearly a help in Australia's adjustment to recent shocks. That said, we have not changed our currency forecast of around 0.70c by end 2020 and 0.74c by end 2021.

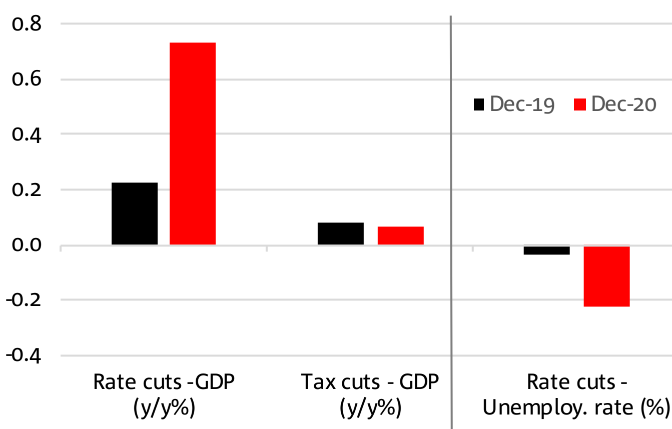
HEADLINE AND CORE INFLATION...

y/y % change



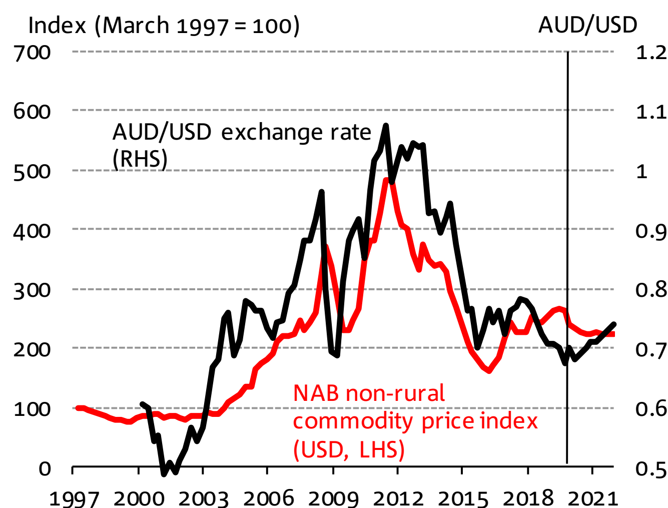
IMPACT OF FISCAL STIMULUS AND RATE CUTS ON ACTIVITY FORECASTS...

Impact of policy stimulus (deviation from baseline)*



*Rate cuts: 25bp cut in each of Q2, Q3, Q4 2019; annual tax cut of $7.2b starting Q3 2019. NAB estimates utilsing AUS-M model

AUD AND COMMODITY PRICES...



Sources: Econdata DX, RBA, ABS, NAB Economics

APPENDIX A: FORECAST TABLES

DETAILED ECONOMIC FORECASTS (ANNUAL AVERAGE)

Australian economic and financial forecasts (a)

	Fiscal Year				Calendar Year				
	2017-18	2018-19 F	2019-20 F	2020-21 F	2017	2018	2019-F	2020-F	2021-F
Private Consumption	2.9	2.0	1.0	1.6	2.5	2.7	1.4	1.1	1.9
Dwelling Investment	0.5	0.0	-9.1	-1.7	-2.2	4.7	-7.1	-7.0	4.1
Underlying Business Investment	6.9	-1.9	-5.3	1.3	3.8	1.3	-3.1	-3.5	3.9
Underlying Public Final Demand	5.0	4.1	5.2	4.1	5.0	4.4	4.8	4.6	3.8
Domestic Demand	**3.5**	**1.7**	**0.8**	**2.1**	**3.0**	**2.9**	**1.1**	**1.1**	**2.8**
Stocks (b)	0.0	-0.2	-0.2	0.2	-0.1	0.1	-0.3	0.0	0.1
GNE	**3.6**	**1.5**	**0.6**	**2.3**	**2.9**	**3.0**	**0.7**	**1.2**	**3.0**
Exports	4.1	3.9	3.6	1.5	3.4	5.1	3.7	2.2	1.8
Imports	7.2	0.2	-1.2	2.3	7.8	4.1	-1.4	0.3	3.4
GDP	**2.9**	**2.0**	**1.6**	**2.1**	**2.5**	**2.7**	**1.8**	**1.5**	**2.6**
Nominal GDP	4.9	5.3	3.3	2.9	6.2	5.0	5.0	1.8	4.3
Current Account Deficit ($b)	51	14	-10	18	46	39	-14	8	23
(-%) of GDP	2.8	0.7	-0.5	0.9	2.6	2.1	-0.7	0.4	1.1
Employment	3.0	2.4	1.9	0.4	2.3	2.7	2.3	1.1	0.6
Terms of Trade	1.8	5.6	-2.0	-5.2	11.7	1.8	5.1	-7.3	-1.8
Average Earnings (Nat. Accts. Basis)	1.4	1.8	2.9	2.7	0.9	1.5	2.5	2.7	2.8
End of Period									
Total CPI	2.1	1.6	2.1	2.2	1.9	1.8	1.8	2.0	2.4
Core CPI	1.8	1.4	1.6	1.9	1.9	1.8	1.4	1.7	2.1
Unemployment Rate	5.6	5.2	5.2	5.5	5.4	5.0	5.2	5.6	5.5
RBA Cash Rate	1.50	1.25	0.25	0.25	1.50	1.50	0.75	0.25	0.25
10 Year Govt. Bonds	2.63	1.32	0.80	1.00	2.63	2.32	1.37	0.80	1.20
$A/US cents :	0.74	0.70	0.69	0.72	0.78	0.71	0.70	0.71	0.74
$A - Trade Weighted Index	62.6	60.1	58.7	60.2	64.9	60.7	60.3	59.9	61.1

(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

COMMODITY PRICE FORECASTS

		Spot	Actual	Forecasts							
	Unit	5/02/2020	Dec-19	*Mar-20*	*Jun-20*	*Sep-20*	*Dec-20*	*Mar-21*	*Jun-21*	*Sep-21*	*Dec-21*
WTI oil	US$/bbl	51	55	50	53	55	57	57	57	58	60
Brent oil	US$/bbl	56	61	55	58	60	62	62	62	63	65
Tapis oil	US$/bbl	59	63	57	60	62	64	64	64	65	67
Gold	US$/ounce	1558	1480	1560	1540	1560	1580	1580	1590	1590	1600
Iron ore (spot)	US$/tonne	84	89	85	76	72	68	71	69	71	69
Hard coking coal*	US$/tonne	n.a.	140	135	152	150	148	151	147	145	140
Thermal coal (spot)	US$/tonne	69	67	68	68	65	70	70	66	63	61
Aluminium	US$/tonne	1691	1758	1700	1750	1765	1775	1800	1825	1850	1875
Copper	US$/tonne	5704	5900	5650	5725	5750	5850	5900	5950	6000	6020
Lead	US$/tonne	1826	2039	1850	1800	1750	1725	1700	1725	1700	1675
Nickel	US$/tonne	13080	15395	12750	12500	12250	12100	12300	12500	12750	13000
Zinc	US$/tonne	2215	2384	2200	2400	2425	2450	2300	2200	2150	2150
Aus LNG**	AU$/GJ	n.a.	10.7	10.2	10.4	10.9	10.9	11.0	10.9	10.9	10.5

* Data reflect NAB estimates of US$/tonne FOB quarterly contract prices, based on quarterly average spot prices.
** Implied Australian LNG export prices

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