NAB ECONOMICS: A POSSIBLE ECONOMIC SCENARIO

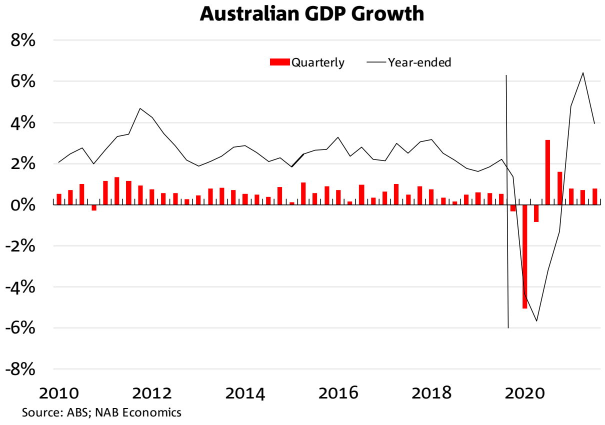
UNEMPLOYMENT TO RISE SHARPLY IN THE NEAR TERM WITH THE ECONOMY CRUNCHED BY CONTAINMENT

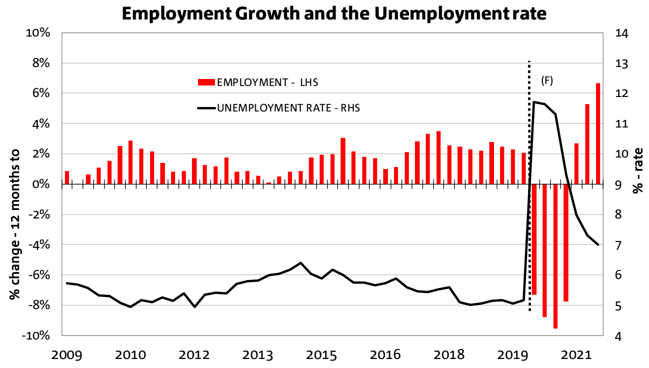
NAB Economics

While we will formally update our forecasts next month, there is much interest in our view of the possible economic outlook. This note provides some guidance as to how we are currently thinking. It is, however, important to stress that almost by definition any forecast will be very dependent on how the virus situation will play out – and hence any forecast will almost certainly be wrong. That said, the economic shock occurring is clearly very large both globally and locally.

We now expect a deep recession. While the situation is very fluid, the type of falls we are seeing offshore of around 5% in GDP in Q2 may well occur in Australia. It could quite easily be larger depending on the extent of containment actions. Alongside this, unemployment is expected to rise very sharply and could well be around 12% by mid-year. The future path of both GDP and unemployment will very much depend on the time taken to bring the virus under control and the Government's economic responses to quarantine its spread (and ultimately relax these measures). Like offshore governments, Australia is increasingly shutting down activity to achieve that outcome. While we appreciate that both monetary and fiscal policy have responded strongly and will likely respond further, these actions are unlikely to fully offset the short-term impact of the large economic shock under way. They will, however, provide significant support in the recovery phase. But clearly Australia faces a massive shock and we will formally update our forecasts following the release of the NAB monthly business survey in mid-April, as per normal practice.

- **The initial impact of COVID-19 was via a collapse in international tourism and education exports. This has spread to consumption and is broadening to most sectors of the economy as containment/lockdown procedures are stepped up.** SMEs and casual/temporary workers are experiencing very significant impacts. Some indication of what we might be looking at would be if we start by reducing Q2 GDP by around 5% and follow up with a further moderate fall in activity in Q3. Thereafter, we could assume that growth resumes sharply from Q4 2020 as containment is hopefully able to be relaxed. Such a profile would see the fastest fall in activity over the next 6 months of any recession in the post-war period. The nature of this shock is of course very different to traditional recessions – in particular, there is hardly any lag between falling output and employment and traditional hoarding of labour is very unlikely given forced shutdowns.
- **Overall GDP in Australia would fall around 3% in year-average terms in 2020 and increase by 3½% in 2021.** Clearly the impact could be larger depending on the spread of the virus and Government actions to contain it. Offshore, activity in most other economies is also likely to contract by 5% or more in Q2 2020 as full lockdowns take effect. Our illustrative scenario would see unemployment rise to nearly 12% by Q2 and stay there till end-2020. Even with strong growth in 2021 the unemployment rate by end-2021 could still have a 7 in front of it. Importantly, this scenario would not see the level of GDP return to its-pre-pandemic level until end-2021.
- **The risks around these forecasts depend on developments in containment measures.** Containment measures have continued to escalate andfull shutdowns would result in a far greater loss in activity and jobs. The duration of shutdowns also affects activity and employment. Further out, the speed and magnitude of recovery will depend on second-round effects both domestically and abroad. While policy is highly stimulatory and will support recovery, persistently weak business and consumer confidence could see ongoing restraint and a slower recovery. Furthermore, structural disruptions such as adjustments to household and business balance sheets could see a slower recovery. While we see softness in the established housing market in the short term, we expect this to recover as the crisis abates. A more significant adjustment in house prices or an increase in household stress triggered by job losses poses the risk of a larger correction in housing construction and sharper falls in house prices.
- **The following charts shows the impact of the scenario for GDP and unemployment.** It is also worth again noting that the rate of fall in activity and the rate of rise in unemployment is unprecedented in the post-war period. And clearly there are serious downside risks if the containment of the virus takes longer than currently expected.





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