EMBARGOED UNTIL 11.30 AM AEST, WEDNESDAY 15 APRIL 2020

THE FORWARD VIEW: AUSTRALIA APRIL 2020

Unprecedented sharp recession coming as a result of COVID-19. Sharp deterioration in employment and prolonged high unemployment.

OVERVIEW

- As set out in our note of 27th March it is becoming increasingly clear that efforts to contain the COVID-19 virus are having a very sharp impact on the economy. Just how serious was highlighted by yesterday's NAB Monthly Business Survey. Already business confidence has plummeted to record lows (around twice as bad as the bottom of the 1990 recession). Similar un-precedented results were reported for falls in forward orders and the level of capacity utilisation. While not quite at record lows, business conditions also collapsed – and no doubt will fall further from here. It is worth stressing that the declines really only dated from mid March.
- Clearly the extent of the falls will depend on how long the virus takes to get under control, the extent of the containment measures and the timing of the phasing back to normal. Given the risks of a second phase of the virus we are expecting a conservative approach by the authorities. Our forecasts essentially adopt the assumption that the economy will be turning the corner by the fourth quarter and bounce back very strongly in growth rate terms.
- As noted above, the Business Survey and other internal NAB data has caused us to revise down our forecasts from those published on 27th March. While the Government has now spent around 10% of GDP trying to cushion the economic hit from COVID-19, the reality is that the economy has suffered a massive hit already. The packages – especially the so called "JobKeeper" package - will help avoid a "depression type result" and will help very much on the "other side".
- We still see Q1 GDP as likely to be a small negative (around -0.3%) with supermarket retail hoarding helping to offset losses elsewhere in services and hospitality. The big hit is in Q2 where we can easily see GDP falling by around 7% (we had previously speculated on a 5% fall) and then falling by another 1% (again further than expected) before bouncing back by around 4% in Q4.
- That type of pattern would see a peak to trough fall of nearly 8% over three quarters and a fall in 2020 GDP of around 4.3%. That would put the economic hit to Australia a touch below that likely to be experienced by countries such as the USA, UK and Europe, but similar to Canada and Japan (our full global forecasts are out tomorrow).
- For 2021 we are expecting a recovery in the order of 7% in the year to Q3 2021 and year average GDP of around 3½%. It is important to stress that even so, these forecasts would still see the level of GDP recorded in Q4 2019 not exceeded till early 2022.

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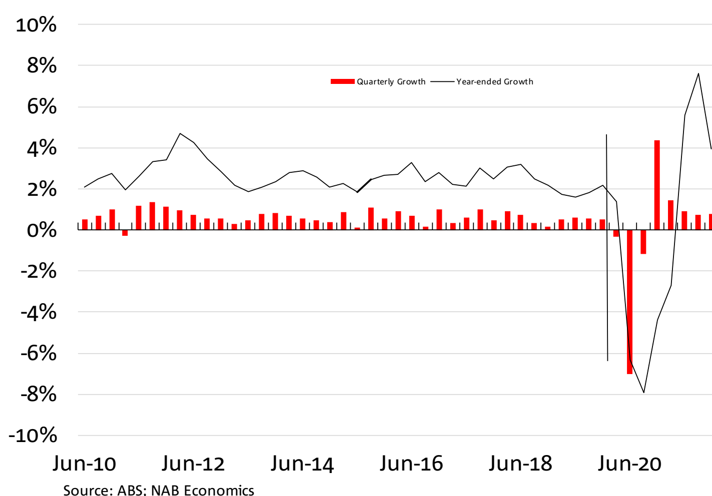
- Also, as stressed previously, the usual lag from growth to unemployment is likely to disappear in current circumstances. Rather, the impact on unemployment is likely to be immediate – and show up first in the April labour market statistics.
- With the fall in GDP quite extreme, unemployment could normally be expected to rise further. However we expect that the "JobKeeper" package will help to contain unemployment at around 11¾% by mid year with little improvement in the back half of 2020. With a weaker growth profile (and longer time to return to previous growth levels) and the expiry of some fiscal packages (e.g. JobKeeper after 6 months, and short term business incentives) we would now see unemployment still at around 7½% by end-2021 (previously around 7%).
- Another important dynamic is that in the forecast environment it is very difficult to see anything much in the way of wage pressure. We now expect wages growth to slow to around 1.3% through 2020 and around 1.5% through 2021. That in turn feeds into a lower rate of inflation. Thus we now expect core inflation to be around 1.5% in the year to Q4 2020 (broadly similar to current forecasts) but a more substantial drop to only 0.2% in the year to Q4 2021.
- That in turn causes some problems in the recovery path, as effectively while nominal rates remain unchanged at 0.25% the real effective rate rises significantly from around -1.25% at present to broadly flat. That suggests that the Government may need to do more on the fiscal front to help the recovery in 2021.

OVERVIEW CONT…

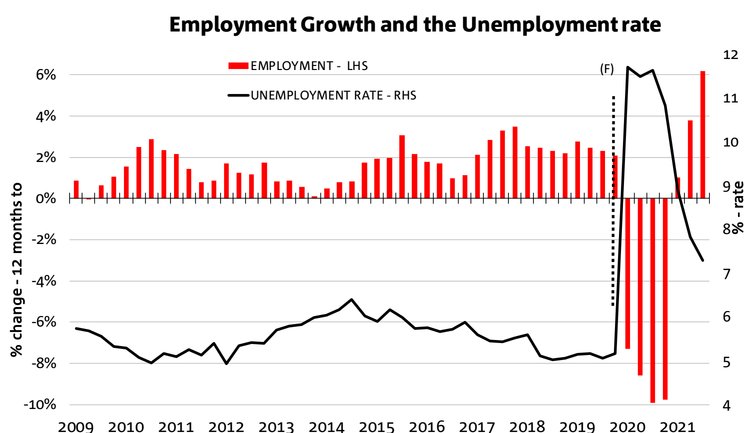
- While we expect the economy to recover in a cyclical sense over time, it is likely that a downturn of the magnitude expected will see ongoing fallout and also structural change in some sectors.
- The commercial property sector is an area likely to see a structural shift. With large corporates making significant investments in technology to enable remote working, it is likely that remote working could become more prevalent. This would serve to reduce the demand for office space. Similarly, the retail segment may be affected with retailers reducing their footprint in CBD areas (though potentially increasing stores in suburban areas).
- Both domestic and international business travel could also see an adjustment with remote meetings taking the place of physical travel. This would see an ongoing reduction in demand for air travel as well as accommodation for business purposes.
- In the near term, the recovery in tourism is likely to be more protracted with restrictions only likely to be gradually removed as the virus is contained world wide. This is a sector we see taking longer to recover. However, an increase in domestic travel as a substitute for international trips could offset some of this weakness.
- Education exports will also likely be hit in the short-term with both direct containment constraints as well as secondary impacts from slower global income growth. That said, a weaker exchange rate will offset some of this impact. Further out, it is likely the sector will focus on diversifying its student base as well as a renewed focus on online learning options. This will also impact the sectors demand for commercial property space.

NAB GDP FORECASTS



Source: ABS; NAB Economics

NAB LABOUR MARKET FORECASTS



KEY ECONOMIC FORECASTS

	2018	2019	2020-F	2021-F
Domestic Demand (a)	2.9	1.2	-5.0	0.9
Real GDP (annual average)	**2.7**	**1.8**	**-4.3**	**3.5**
Real GDP (year-ended to Dec)	**2.2**	**2.2**	**-4.4**	**3.9**
Terms of Trade (a)	1.8	5.2	-11.7	-2.2
Employment (a)	2.7	2.4	-6.0	0.0
Unemployment Rate (b)	5.0	5.1	11.6	7.3
Headline CPI (b)	1.8	1.8	1.8	0.6
Core CPI (b)	1.8	1.4	1.5	0.2
RBA Cash Rate (b)	1.50	0.75	0.25	0.25
$A/US cents (b)	0.71	0.70	0.63	0.71

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

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LABOUR MARKET, WAGES AND THE CONSUMER

The unemployment rate ticked down to 5.1% in February from 5.3% in January. In the month employment rose by 26.7k, led by a 20k increase in part-time workers. Full-time employment increased by a more moderate 6.7k in the month. The participation rate edged lower to 65.9% but remains at a very high level. Hours worked – though volatile – decreased by 0.2% in the month, but were 0.5% higher over the year.

In the month, the underutilisation rate declined by a similar amount to the unemployment rate, but remains elevated – with the trend underutilisation rate unchanged at 13.7%. Indeed, while the unemployment rate is low relative to history, underemployment remains elevated. Overall, both the unemployment and underutilisation rate have remained unchanged for around a year – at a level consistent with spare capacity in the labour market. Consequently wage growth has remained weak.

From here we expect a major deterioration in the labour market. We expect the unemployment rate to rise to almost 12% by mid-year and stay there until year end. As growth recovers next year, we expect the unemployment rate to fall back to around 7½% by end 2021 – a quick but not complete recovery. This will see wage growth slow further, falling to 1.2% in through the year terms.

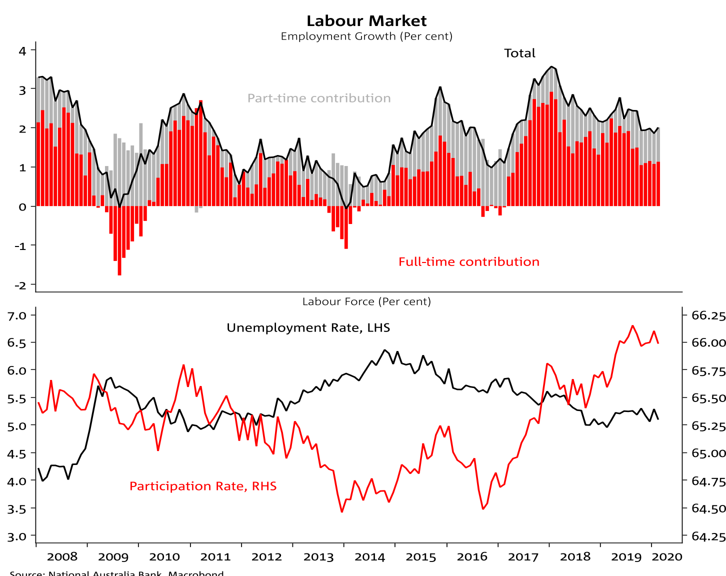
Alongside the deterioration in the labour market, we expect a big hit to consumption in the near term from the effective shut downs of some retailers and the impact that social distancing will have on instore consumption. Further out, the deterioration in the labour market, with weak wage growth and soft consumer confidence, will likely see a continuation of the recent trends in household consumption. That is, we expect growth to mainly occur in the essentials categories with discretionary spending growth falling further.

Indeed, even before the impact of the coronavirus, retail sales growth and broader household consumption (which includes the spend on services) have tracked at low rates. The ABS final estimate of retail sales for February suggests sales rose by 0.5% (up from 0.4% in the preliminary reading).

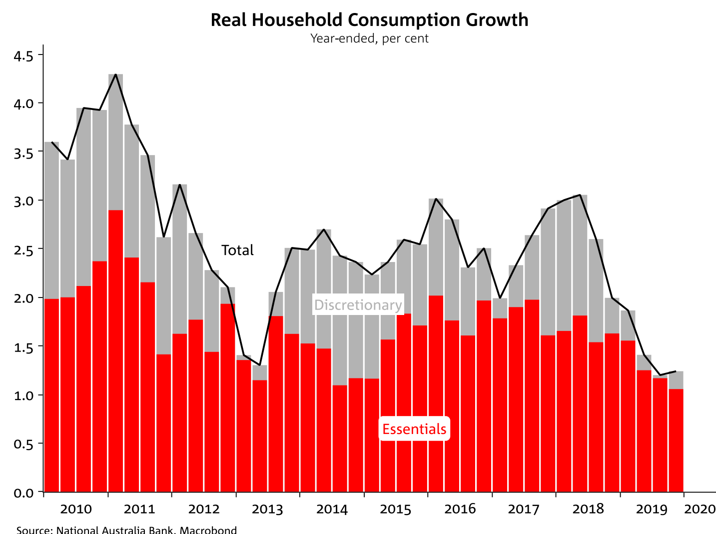
In the month, gains were led by increases in food, department stores and household goods – reflecting a strong increase in spending on non-discretionary items. We expect the surge in sales for some items from household hoarding to moderate going forward – but will likely see elevated periods of expenditure on items such as home office supplies.

The NAB cashless retail sales index released next week will provide an early indication of how sales tracked in March.

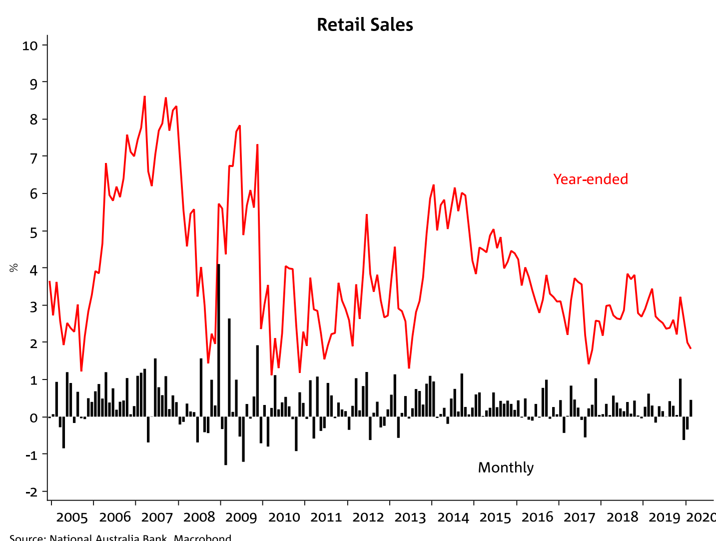
LABOUR MARKET TO DETERIORATE…



CONSUMPTION GROWTH REMAINS WEAK…



RETAIL SALES STILL WEAK IN Q1…



HOUSING AND CONSTRUCTION

While house prices in the established housing market have recovered strongly in Sydney and Melbourne since reaching a trough in May last year we now expect a significant fall in dwelling prices over the next year or so. The decline in prices is expected to be wide spread across states with the impact of coronavirus containment measures likely to significantly impact all areas of the economy. While interest rates are at very low levels, and credit remains available to quality borrowers, the expected sharp rise in unemployment across the country will weigh.

While we expect a return to growth in 2021 and a partial recovery in unemployment, we do not expect a strong recovery in house prices. With unemployment remaining well above current levels even after a year of recovery, and wage growth now forecast to be slower, we do not see significant increases in demand for housing as has been the case in recent years. Further, population growth which has been a key support to the housing market will also slow as migration falls away in the near term, before recovering in 2021.

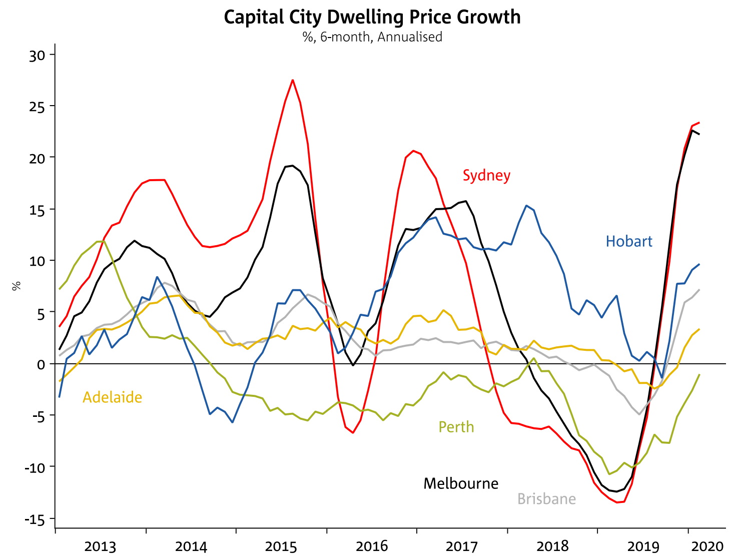
The impact of containment measures and the sharp fall in confidence has already been felt in the housing market – even before we have observed the likely sharp deterioration in the labour market. Auction clearance rates have fallen sharply - to low levels, volumes have eased and house price growth has slowed.

However, as we enter this correction we begin from a relatively healthy starting point. While house prices have risen strongly over the past year, this follows a significant prior contraction. We do not see a fundamental oversupply in the market with population growth having remained healthy over recent years, and a rapid adjustment on the supply side underway. Price declines are likely to be a result of softer confidence and slower income growth. The ongoing decline in construction (new supply) will also support prices in the long run. That said a fall in house prices of 10 to 15% over the next year or so seems likely. That would see house prices down around 9% this year and around 4% in 2021 (albeit prices should stabilise by mid 2021).

We expect dwelling investment to continue to decline this year, following the 9.7% decline over 2019. Despite the recovery in prices, approvals have remained weak, and a high rate of work done has seen a significant reduction in the pipeline of outstanding work, particularly in the high density segment. We expect construction to level out later this year before rising somewhat in 2021.

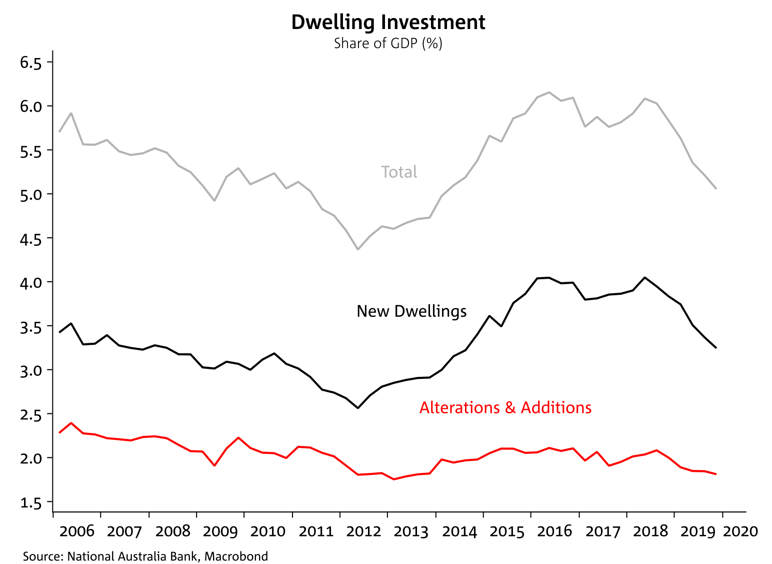
However, disruptions to construction activity due to coronavirus containment measures could see a sharper fall in activity in the near term. Further out, the pipeline could be significantly impacted by delays to planning and funding processes for new projects. It is unlikely that we will see a significant uptick in construction before approvals increase materially. For now it appears the high rate of work completed continues to erode the pipeline of work built up in recent years.

PRICES GROWTH HAS SLOWED...



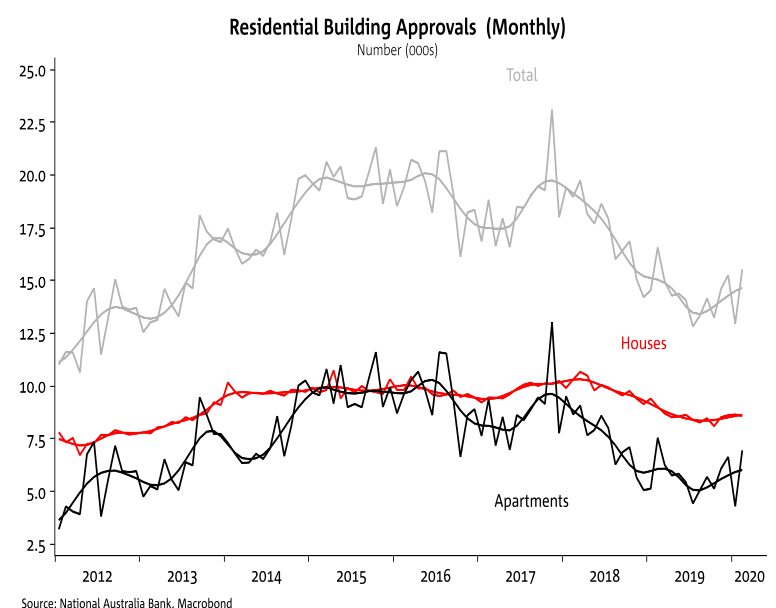
Source: CoreLogic, National Australia Bank, Macrobond

DWELLING INVESTMENT TO FALL FURTHER...



Source: National Australia Bank, Macrobond

APPROVALS SUGGEST MORE WEAKNESS...



Source: National Australia Bank, Macrobond

BUSINESS AND TRADE

Both the business sector and international trade are likely to be significantly impacted by the downturn in the global and domestic economies. Business investment (particularly in the non-mining sector) has been weak in recent years despite continual optimism of a pickup. Trade on the other hand has been a significant boost to GDP with the ramp up of production by the last of the LNG mega projects which have now finished construction. However, both are likely to be severely impacted by the unfolding downturn caused by disruptions to activity as a result of the coronavirus.

While now dated, business investment fell in Q4 – led by a decline in the non-mining sector. By asset, there was a fall in non-dwelling construction (both engineering and buildings) which was partially offset by an increase in spending on equipment. The ABS capex points to a 6.5% increase in nominal terms for 2020/21 – an improvement but still weak outcome.

The NAB business survey suggests that capex has declined sharply in recent months as the outlook has deteriorated – and expectations in the quarterly survey have also moderated even before the large hit from coronavirus containment measures.

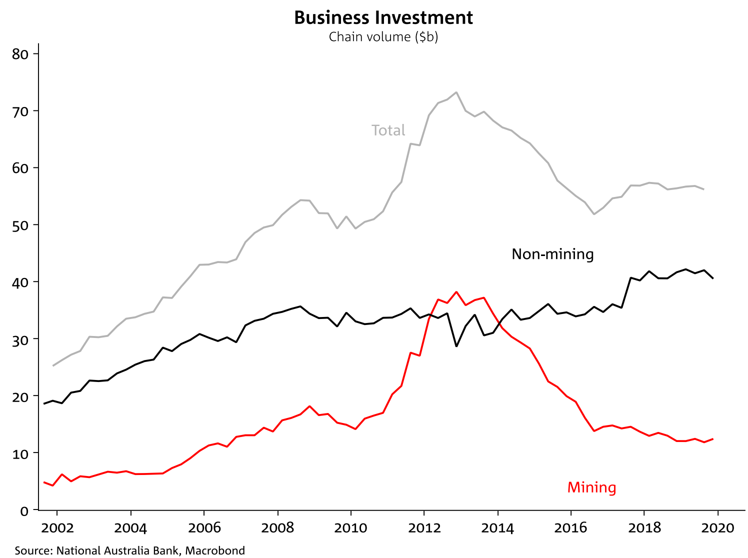
More broadly, the NAB monthly business survey suggests the government's containment measures have seen a widespread and sharp impact on the business sector. In March, both business confidence and conditions saw their largest declines on record. Confidence is around a level twice as weak as the 1990s recession, while conditions (which may deteriorate further) are now around GFC levels. Capacity utilisation saw its largest ever single month decline and is around the levels seen at the lows of the 1990s recession. With forward orders also falling away it could well be that capacity utilisation falls further.

The trade balance narrowed for the third straight month in February with the decline in exports more than offsetting the decline in imports in the month. The decline in exports was driven by a fall in metal ores and tourism.

Going forward it is likely we will see further impacts on trade. Restrictions on non-resident movements will all but see the tourism sector remain shut – and while containment measures may be gradually eased domestically, it is likely that international movements will be limited for some time. Indeed, containment measures were tightened much more significantly in March and will likely see a further notable fall for this month.

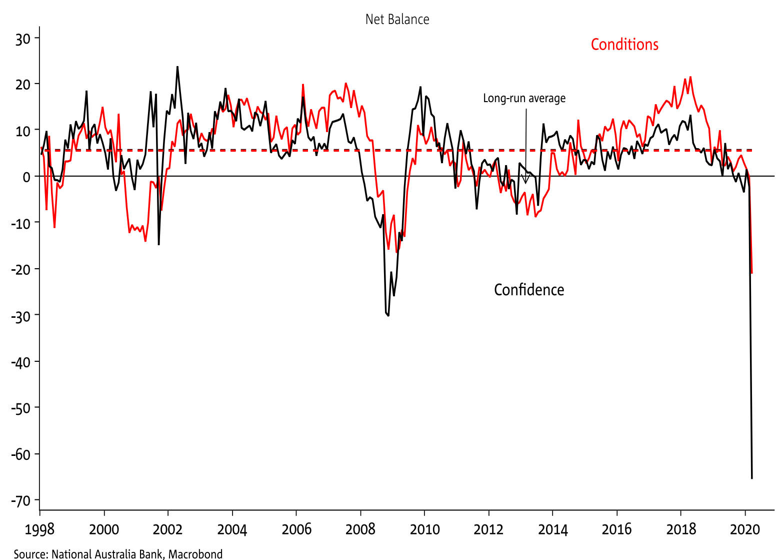
On the imports side we may also well see a decline due to both demand and supply factors. International travel abroad is likely to soften as will the demand for some products as consumption falls. Further, interruptions to supply chains could also see the availability of some goods for import reduced.

NON-MINING INVESTMENT IS WEAK..



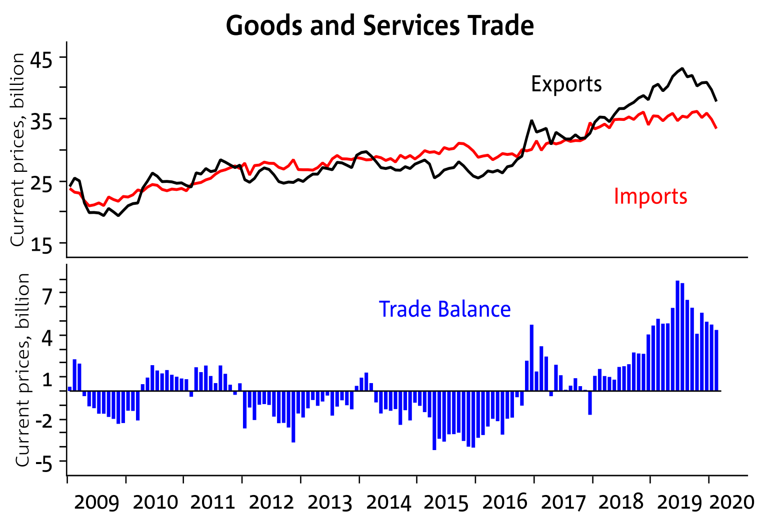
Source: National Australia Bank, Macrobond

CONFIDENCE AND CONDITIONS FALL...



Source: National Australia Bank, Macrobond

EXPORTS AT RISK...



Source: National Australia Bank, ABS

COMMODITIES

Iron ore prices were relatively elevated across the first half of March – with prices around US$90 a tonne. In the latter part of the month and early April, spot prices retreated back towards US$80 a tonne. The downturn driven by Covid-19 containment measures has weakened global demand prospects and weighed on commodity markets generally – despite the gradual reopening of China's economy and the prospect of steel intensive infrastructure activity as part of the country's stimulus. Prices were above our forecast for Q1, meaning we have raised our 2020 forecast to US$78.7 a tonne (previously US$75), while our forecast for 2021 is unchanged at US$70 a tonne.

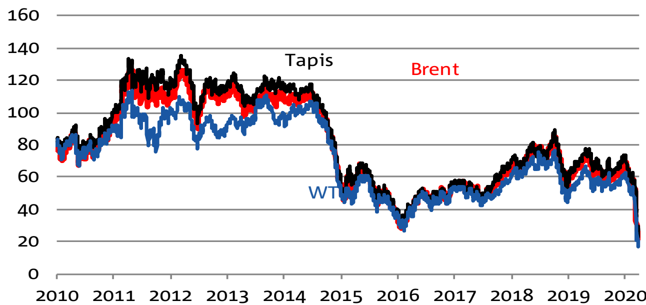
Coal prices were comparatively elevated in March, as China's Covid-19 containment measures restricted domestic supply. As China has commenced its process of reopening (including its mining sector), prices for both coking and thermal coal have fallen – with hard coking coal dropping from over US$160 a tonne in late March to almost US$130 a tonne in early April. Weakness in global manufacturing and electricity demand – due to efforts to contain the spread of Covid-19 – are likely to see further weakness in coal prices in the near term. We forecast hard coking coal to average US$144 a tonne in 2020, while thermal coal is forecast to average US$62.5 a tonne.

With pressure from President Trump, OPEC+ (including Russia) committed to cut 10 million bpd till June, with a gradual easing in production cuts up until April 2022. This has helped offset some of the demand destruction due to Covid-19. Besides, OPEC+, other countries (e.g. Norway and Canada) are also likely to cut production. The fall in demand has led increasingly to fuel being stored offshore on tankers, although further storage capacity is limited. Concomitantly, refiners have cut their production runs. Even if there is an agreement, it might not be sufficient to compensate for falling demand of around 30millon bpd. We have further lowered our forecasts with Brent at US$35/bbl in the June quarter, rising to US$46/bbl by year end (previously US$58/bbl).

Covid-19 continues to crimp LNG demand. India's Petronet recently invoked a Force Majeure on its LNG imports, citing India's lockdowns. Moreover, a number of buyers are exercising a Discount Quantity Tolerance clause which allows them to cut purchases by as much as 10%. Major purchasers, such as those in North East Asia are benefitting from both weaker contract (linked to oil) and spot prices. Moreover, the LNG market had issues of excess supply prior to Covid-19. A number of projects such as Woodside Petroleum's Scarborough and Browse projects have been put on hold. We have further lowered our export volume and, more so price forecasts, although a weaker AUD should help. Agriculture is a strong performer, with our rural Commodities Index up 5.8% in March and seasonal conditions looking good.

GLOBAL OIL PRICES

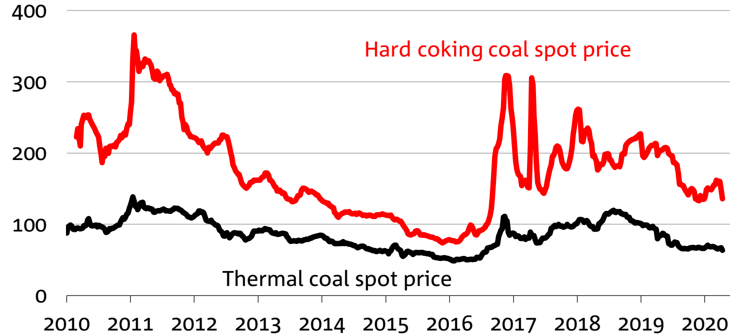
USD/bbl, daily



Source: Refinitiv, NAB Economics

COAL SPOT PRICES

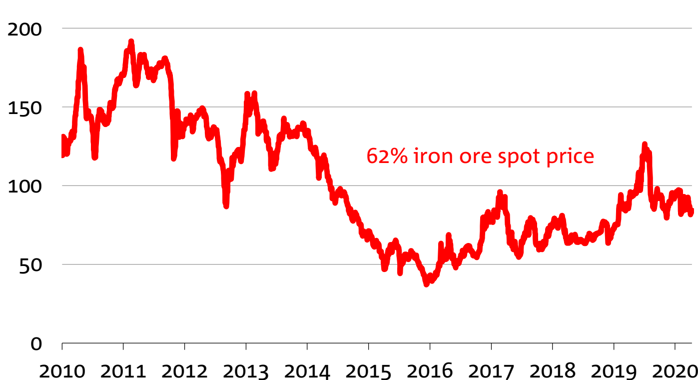
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

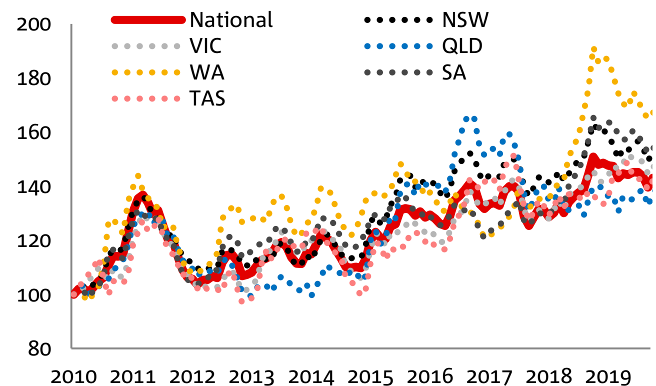
US$/t (incl. cost of freight)



Sources: Refinitiv, NAB Economics

NAB RURAL COMMODITIES INDEX

Jan 2010 = 100



MONETARY POLICY, INFLATION AND FX

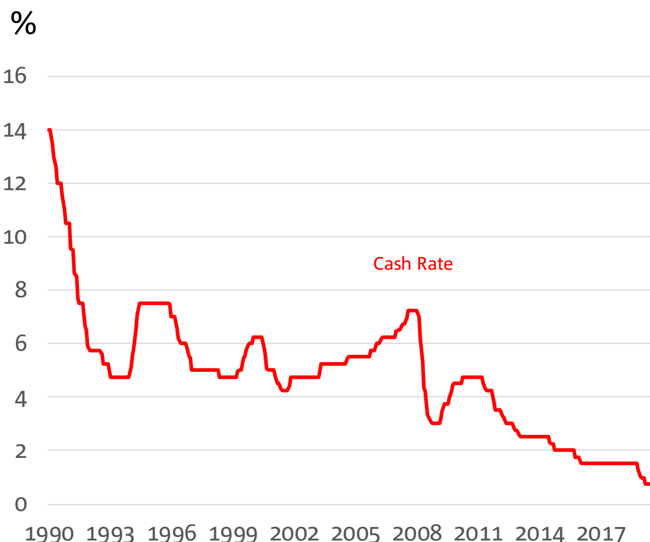
The RBA left the cash rate unchanged at 0.25% in April, following the emergency 0.25bp cut and move to yield curve control at an out of cycle meeting in mid-March. Effectively the RBA has now reached the "zero lower bound" for Australia and it will be very unlikely that we see any more cash rate cuts in this cycle. In fact, the RBA narrowed the bottom of the cash rate corridor – lifting the remuneration paid on deposits with the RBA to 0.1%. From here the RBA will focus on yields further out along the curve, the flow of credit and end user interest rates. As part of the 'package' of policy announcements following this meeting the RBA announced a target of 0.25% for 3 year government bond yields – to be achieved by purchases of government bonds along the curve and a term funding facility for banks to provide business credit.

The cash rate will remain at 0.25% while the target for 3-year yields remains in place. Given the size of the downturn in the economy underway, it is likely the RBA will keep the current policy measures in place for some time before gradually unwinding the yield curve target and eventually raising the cash rate as the recovery takes hold. The Bank has stated low rates will remain in place until progress has been made towards its objectives of full employment and inflation between 2-3%. Given the starting point, our view is that interest rates will remain low for an extended period.

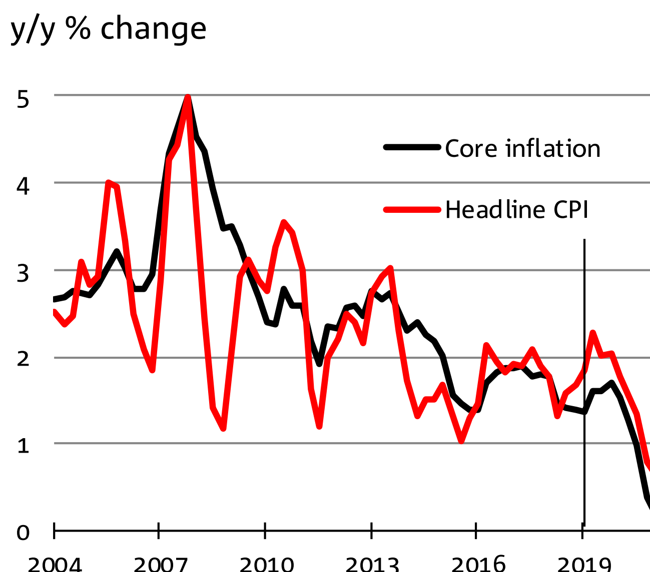
Indeed, we expect inflation to remain below target for an extended period – having now tracked below the target since 2016 and unlikely to rise any time soon. While in the medium to long-term there may be an inflationary impact of supply chain adjustments (part of the supply-side shock underway) the near term is likely to see downward pressure from weak consumer demand and less pressure on margins from slower wage growth. With the unemployment rate rising sharply and remaining well above full employment for an extended period we expect wage growth to fall to around 1¼% in year-ended terms. There have also been a number of mooted public sector wage freezes which will see further softness in wage growth. This level of wage growth sees inflation fall to just 0.25% by end-2021. In the near-term, the decline in oil prices will see a significant easing of inflation, weighed against price rises for groceries with the impact of bushfires on fresh produce and lower discounting. The depreciation in the exchange rate this year will see some offsetting increase in inflationary pressure.

The exchange rate continues to be an important 'economic stabiliser'. Since early January the exchange rate has fallen by 11%, trading as low as US56c in late March before rising to a touch above US60c recently. The easing in commodity prices, lower domestic rates and increasing risk aversion have all contributed to this devaluation. On a trade-weighted basis, the exchange rate is now 9% lower than end-December. From here much will depend on how the virus effects the global and domestic economies, as well as how long it lasts. At this stage we see the USD gradually weakening bringing the AUD back to where our models suggests at around 70c by end-2020 and a touch above that by end-2021 as the Australian economy recovers more quickly. Our formal forecast for the AUD/USD by end 2021 is US71c.

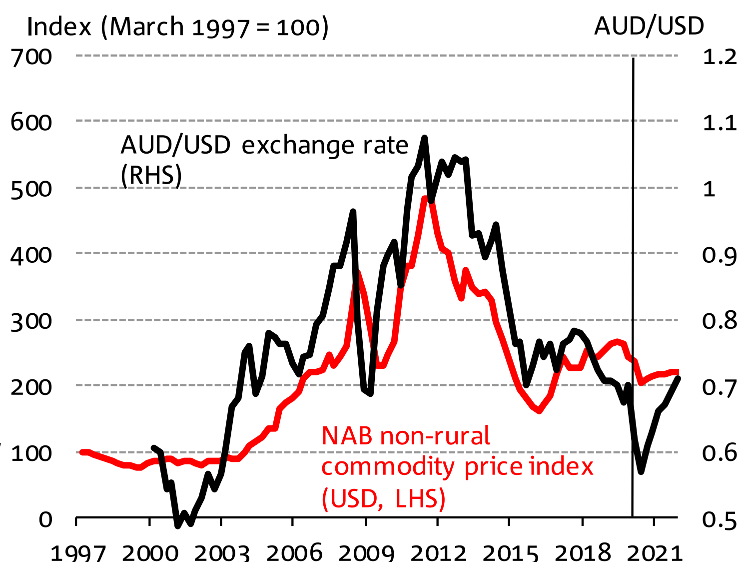
CASH RATE TO STAY LOW...



HEADLINE AND CORE INFLATION...



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	2020-F	2021-F
Private Consumption	2.9	2.0	-0.8	-7.7	2.5	2.7	1.4	-6.6	-0.1
Dwelling Investment	0.5	0.0	-10.4	-9.1	-2.2	4.7	-7.1	-13.0	5.3
Underlying Business Investment	6.9	-1.9	-8.3	-17.9	3.8	1.3	-2.0	-18.1	-7.7
Underlying Public Final Demand	5.0	4.3	4.8	3.8	5.0	4.5	4.9	4.0	3.8
Domestic Demand	**3.5**	**1.7**	**-0.4**	**-5.3**	**3.0**	**2.9**	**1.2**	**-5.0**	**0.9**
Stocks (b)	0.0	-0.2	-0.5	0.3	-0.1	0.1	-0.2	-0.6	0.8
GNE	**3.6**	**1.5**	**-0.9**	**-5.0**	**2.9**	**2.9**	**1.0**	**-5.6**	**1.7**
Exports	4.1	3.9	1.8	-2.8	3.4	5.1	3.2	-0.7	-4.1
Imports	7.2	0.2	-4.2	-13.7	7.8	4.0	-1.2	-12.3	-3.5
GDP	**2.9**	**2.0**	**-0.3**	**-2.5**	**2.5**	**2.7**	**1.8**	**-4.3**	**3.5**
Nominal GDP	4.9	5.3	1.0	-3.3	6.2	5.0	5.1	-5.2	4.0
Current Account Deficit ($b)	51	14	-10	-8	46	39	-10	-10	6
(-%) of GDP	2.8	0.7	-0.5	-0.4	2.6	2.1	-0.5	-0.5	0.3
Employment	3.0	2.4	-0.1	-7.0	2.3	2.7	2.4	-6.0	0.0
Terms of Trade	1.8	5.6	-3.3	-9.9	11.7	1.8	5.2	-11.7	-2.2
Average Earnings (Nat. Accts. Basis)	1.4	1.8	2.7	1.2	0.9	1.5	2.5	2.0	1.2
End of Period									
Total CPI	2.1	1.6	2.0	1.3	1.9	1.8	1.8	1.8	0.6
Core CPI	1.8	1.4	1.6	1.0	1.9	1.8	1.4	1.5	0.2
Unemployment Rate	5.6	5.1	11.7	8.9	5.4	5.0	5.1	11.6	7.3
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	0.60	0.90	2.63	2.32	1.37	0.70	1.20
$A/US cents :	0.74	0.70	0.57	0.67	0.78	0.71	0.70	0.63	0.71
$A - Trade Weighted Index	62.6	60.1	50.4	57.5	64.9	60.7	60.3	54.6	59.9

(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	13/04/2020	Dec-19	*Mar-20*	*Jun-20*	*Sep-20*	*Dec-20*	*Mar-21*	*Jun-21*	*Sep-21*	*Dec-21*
WTI oil	US$/bbl	25	55	52	27	33	41	47	51	55	56
Brent oil	US$/bbl	32	61	59	35	40	46	52	56	60	61
Tapis oil	US$/bbl	29	63	62	34	40	48	54	58	62	63
Gold	US$/ounce	1682	1480	1580	1610	1620	1630	1640	1650	1650	1660
Iron ore (spot)	US$/tonne	85	89	91	78	74	72	71	69	71	69
Hard coking coal*	US$/tonne	n.a.	140	154	130	145	148	151	147	145	140
Thermal coal (spot)	US$/tonne	68	67	68	55	62	65	67	63	61	59
Aluminium	US$/tonne	1441	1758	1692	1375	1765	1775	1800	1825	1850	1875
Copper	US$/tonne	4993	5900	5640	4750	5750	5850	5900	5950	6000	6020
Lead	US$/tonne	1703	2039	1844	1625	1750	1725	1700	1725	1700	1675
Nickel	US$/tonne	11600	15395	12708	10500	12250	12100	12300	12500	12750	13000
Zinc	US$/tonne	1887	2384	2126	1875	2425	2450	2300	2200	2150	2150
Aus LNG**	AU$/GJ	n.a.	11.7	9.4	9.2	9.3	9.5	9.6	9.8	10.0	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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