EMBARGOED UNTIL 11.30 AM AEST, WEDNESDAY 13 MAY 2020

THE FORWARD VIEW: AUSTRALIA MAY 2020

Our forecasts are broadly unchanged – we still expect a fall of 8.5% in GDP in H1 2020 before a rebound in growth in Q4.

OVERVIEW

- In aggregate our forecasts are broadly unchanged this month albeit with some small tweaks for the release of Q1 CPI and the release of quarterly volumes for retail sales. Internal data suggest the pace of decline in spending across industries has slowed but overall remains very weak. Our estimates of unemployment benefit recipients also points to a significant increase in the unemployment rate over the month.
- We still expect a small decline in GDP for Q1 (-0.2%) – where the ramp up of coronavirus measures came late in the quarter. For Q2 we expect a much larger decline of 8.4% with a much broader impact of containment measures touching most parts of the economy. This sees a total fall in quarterly GDP of around 8.5% over the first half of 2020.
- Our outlook for the labour market is also unchanged. Unemployment is expect to reach 11.7% by mid-year and stay around that level until end-2020. Alongside the rebound in growth we expect the unemployment rate to track lower through 2021 – reaching 7.2% by the end of the year. Therefore, we only see a partial recovery in the labour market by the end of next year reflecting the fact that the level of GDP is not fully recovered until early 2022.
- Overall these outcomes reflect a recession in Australia of unprecedented speed and magnitude. While the removal of containment measures will see a fairly instantaneous bounce back in activity it is likely that there will be some ongoing fallout given the large hit to both business and consumer confidence, weaker wage growth and some possible structural changes with slower population growth and impacts on commercial property. Also as per previous forecasts we don't see the level of GDP returning to the level achieved in late 2019 till early/mid 2022.
- Of course there are risks around this outlook. Australia appears to have been successful in containing the virus, and while the economic impact has been significant – the support from policy makers has also been fast and large. Our forecasts are predicated around the coronavirus remaining contained in Australia and a gradual easing in restrictions from here. Any secondary spread of COVID-19 and a new round of restrictions would see further disruption to economic activity and a different pattern of growth.
- We think it is also likely that in addition to rates remaining low for an extended period that the government will need to provide some ongoing fiscal support as existing measures are wound back and while confidence remains weak. In the medium-term sense there is also likely to be a renewed focus on longer-term structural reforms with a focus on productivity.

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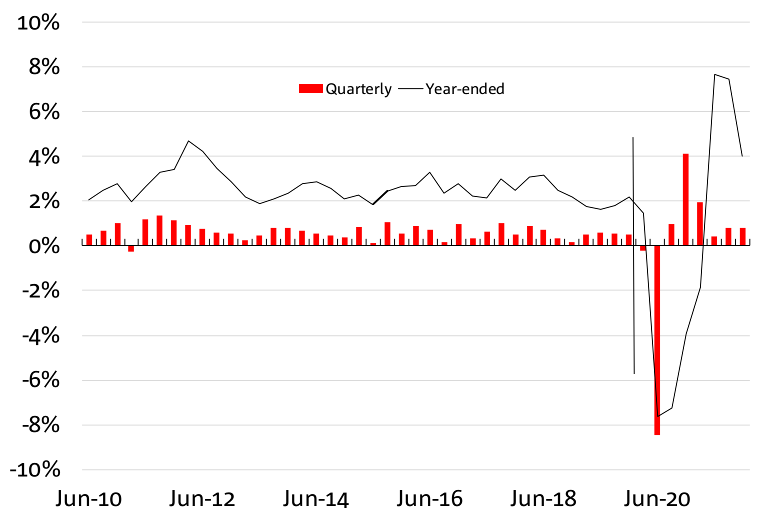
KEY ECONOMIC FORECASTS

	2018	2019	2020-F	2021-F
Domestic Demand (a)	2.9	1.2	-4.7	1.6
Real GDP (annual average)	**2.7**	**1.8**	**-4.3**	**4.2**
Real GDP (year-ended to Dec)	**2.2**	**2.2**	**-3.9**	**4.0**
Terms of Trade (a)	1.8	5.2	-11.9	-2.0
Employment (a)	2.7	2.4	-6.1	0.4
Unemployment Rate (b)	5.0	5.1	11.7	7.2
Headline CPI (b)	1.8	1.8	0.5	0.9
Core CPI (b)	1.8	1.4	1.5	0.4
RBA Cash Rate (b)	1.50	0.75	0.25	0.25
$A/US cents (b)	0.71	0.70	0.68	0.72

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

NAB GDP FORECASTS



LABOUR MARKET, WAGES AND THE CONSUMER

March labour force data showed a marginal uptick in the unemployment rate to 5.2%. Employment rose by 5.9k in the month, with part-time employment rising 6.4k and a small offset from a 0.4k fall in the full-time component. Underemployment edged higher to 8.8%.

While the labour market enters the looming recession in a relatively healthy position – following a number of years of strong employment growth, participation at very high levels and unemployment relatively low compared with history – we expect a significant deterioration from here. Indeed, the March labour force survey was conducted prior to the escalation of coronavirus containment measures.

We expect that the unemployment rate will rise sharply over the next couple of months to around 11.7% - much faster than would normally be the case in a downturn. This will be driven by a fall in the number of employed with job losses most significant in the industries directly effected by the slowdown – hospitality, recreational and other services. That said, the decline in confidence and magnitude of the slowdown will see an impact across all industries.

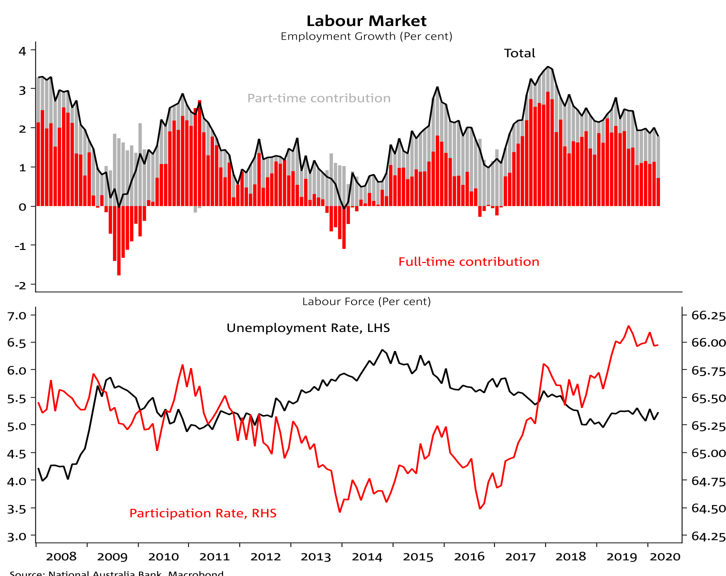
Indeed, the ABS's newly published payrolls data shows that the number of jobs has fallen substantially over the last 5 weeks – by 7.5%. While there are definitional differences between the labour force measure of employment and this survey it suggests that there has been a sharp impact on the labour market – pointing to a marked decline in April. While we expect a recovery in the labour market in 2021, the unemployment rate will have only declined to 7.2% by the end of that year, reflecting the fact that activity would still not have fully recovered. We see wage growth slowing sharply, falling to as low as 1.2% y/y. This will see ongoing restraint in consumption growth.

We expect consumption to rise by 0.5% in Q1 – with the impact of household hoarding offsetting weakness elsewhere. However, we expect a large fall by over 9% in Q2 on the back of direct and confidence effects of containment measures. From there we expect only modest growth in consumption.

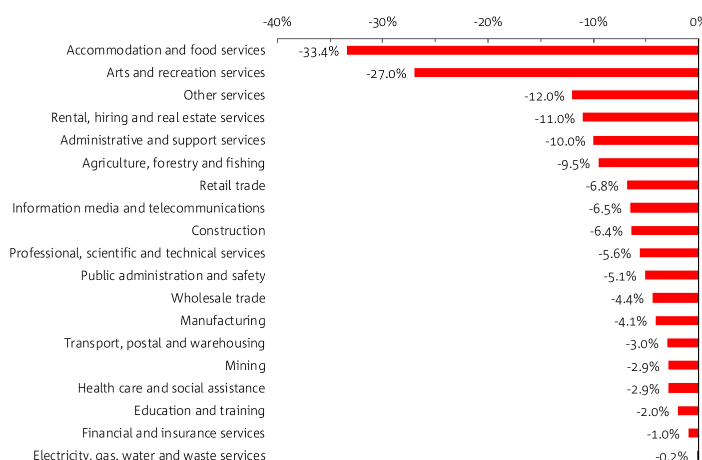
Nominal retail sales rose by 8.5% in March driven by a surge in spending on groceries. However, there appears to have been price impacts of hoarding with quarterly volumes rising by a more modest 0.7% in the quarter. It is likely that there will be some payback in coming months.

This is already evident with the NAB Cashless Retail sales index pointing to a decline of 5.3% in the month of April. As per the March result much of the change was in food and other retail services. Clothing and footwear remained weak but household goods were strong (possibly reflecting sales associated with accommodating more working from home).

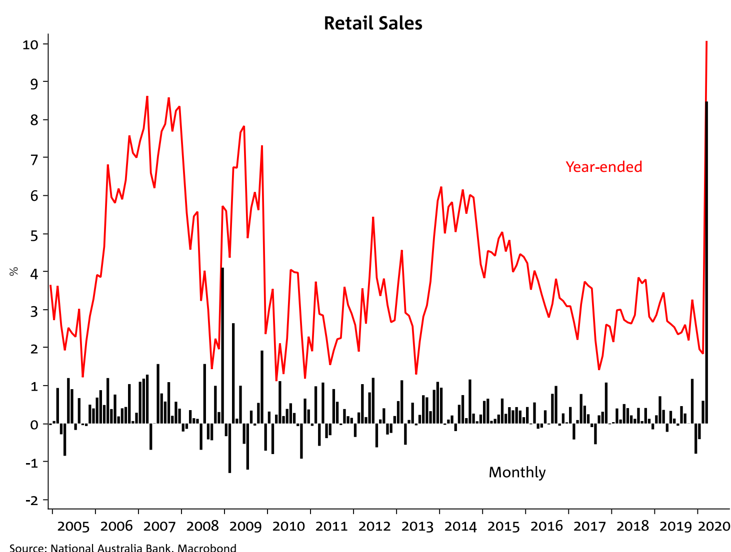
LABOUR MARKET TO DETERIORATE...



PAYROLLS SHOW A SHARP FALL IN "JOBS"...



RETAIL SPIKES, BUT EXPECTED TO SOFTEN...



HOUSING AND CONSTRUCTION

House price growth has slowed in recent months following the rapid growth seen in the second half of 2019. However, to date house prices have held up relatively well despite the looming impacts on the property market of the coronavirus related deterioration in the labour market and activity more broadly.

The monthly CoreLogic 8-capital city house price index rose 0.4% in April to be 2.1% higher over the quarter (and 9.7% higher over the year). In the month, the gains were led by Sydney, Adelaide and Brisbane. Perth increased by 0.2% while Melbourne and Hobart were lower. Reflecting the strength in prices growth since May last year, Sydney is 14.3% higher over the year while, Melbourne is 12.4% higher. Outside of Perth, the other capitals have seen more modest gains, but they did not see as much of a pronounced correction with the earlier credit restrictions.

From here we expect a broad-based fall in house prices across the capital cities – with the impact of the coronavirus downturn felt across the country and most industries. We expect the declines to be led by Sydney and Melbourne and expect to see an overall peak-to-trough fall of 10-15%.

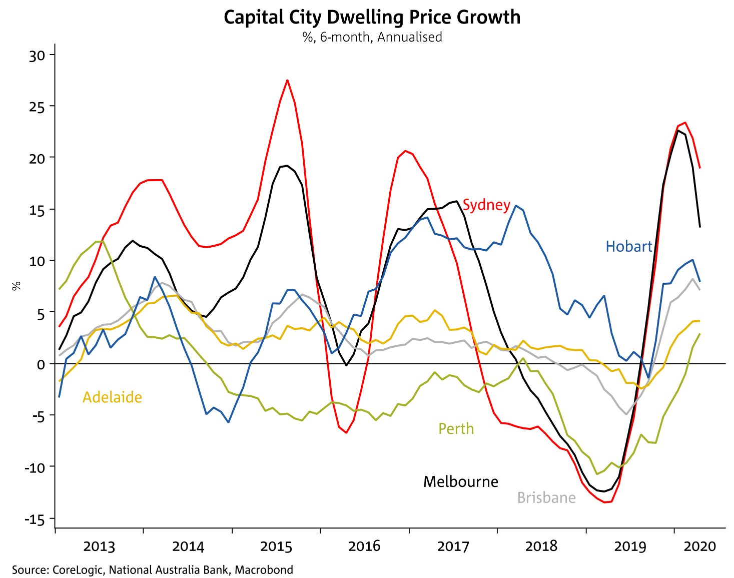
While interest rates are low and will support prices, the near term rise in unemployment and weaker wage growth both in the short-run and long-run will weigh on prices. For now we expect an orderly correction and while there is still a large pipeline of work to come online, we do not see a fundamental oversupply. That said, population growth is likely to slow substantially with restrictions on international movements for the foreseeable future which will put downward pressure on the demand for housing.

Indeed, we expect construction of new dwellings to decline, particularly in the high-density segment (concentrated in Sydney and Melbourne). For now the pipeline of work remains elevated, but so does the rate of work done. This means that the pipeline of work will quickly be eroded with building approvals remaining low.

Approvals have trended slightly higher from mid last year but are still 24% lower than their peak in 2016 (in trend terms) and around 2012 levels. The pickup over the past year or so has been driven by a pickup in apartment approvals with houses tracking sideways. With ongoing uncertainty, the adjustment in house prices, the slowing in population growth and the rise in unemployment we expect approvals to remain weak and for construction to continue to decline into 2021.

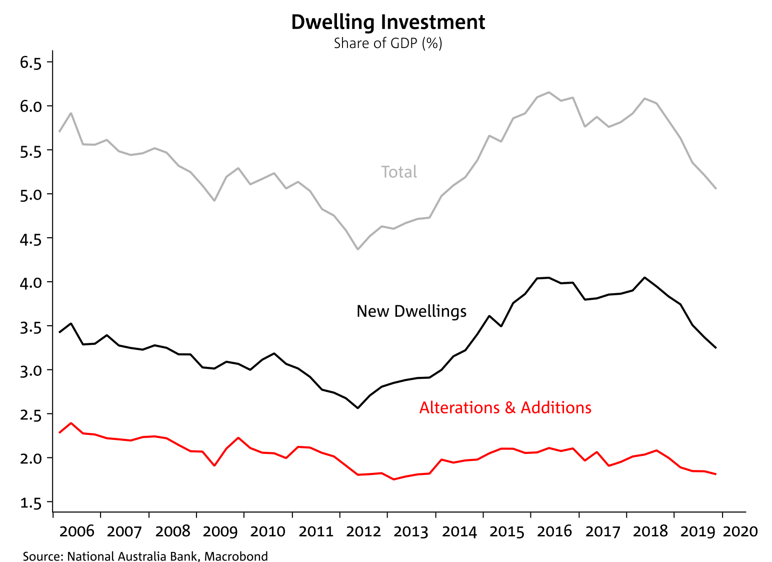
Overall, we expect the national accounts measure of dwelling investment to continue to fall this year falling by another 17.5% before reaching its trough in Q1 2021. This will weigh on growth overall and likely only recover slowly in the out year.

PRICES GROWTH HAS SLOWED...



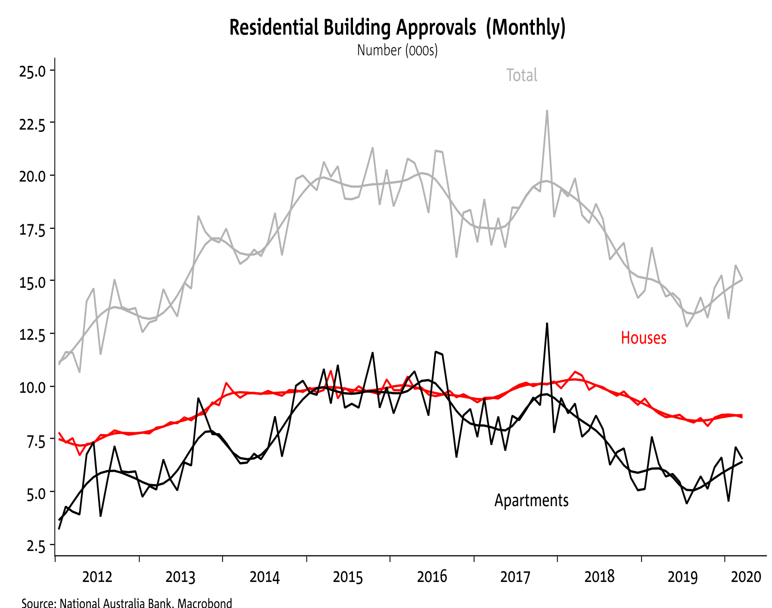
Source: CoreLogic, National Australia Bank, Macrobond

DWELLING INVESTMENT TO FALL FURTHER...



Source: National Australia Bank, Macrobond

APPROVALS SUGGEST MORE WEAKNESS...



Source: National Australia Bank, Macrobond

BUSINESS AND TRADE

The NAB Monthly business survey showed a further deterioration in activity in April. Business conditions saw another relatively sharp fall, with a decline across almost all of the non-mining industries. Conditions are now negative in all industries and weakest in recreation & personal services. Confidence rebounded somewhat in the month but remains deeply negative – and around twice as bad as the trough in the 1990s.

Looking forward, leading indicators suggest there is some risk of a further pull-back in activity with forward orders declining further and now at a very low level. Capacity utilisation also recorded another large full in the month and is now well below its previous trough (based on the quarterly survey). While this is unsurprising given the sharp downturn in conditions, it suggests that there will need to be a substantial increase in activity before business moves back to an expansion phase. Indeed, the monthly measure of Capex has declined sharply and is at a low level. An update of expected capex will be available with the Q2 NAB quarterly survey. An update to the ABS capital expenditure survey also be available at the end of the month.

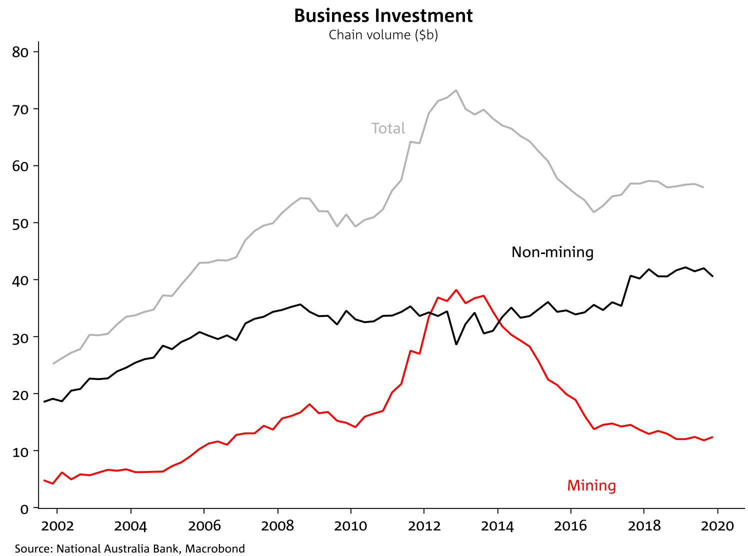
Nonetheless, we are expecting a sharp fall in business investment this year. The disruption to the non-mining sector is likely to hurt confidence for an extended period and with the level of output not fully recovered until early 2022 we are only likely to see a gradual recovery in capacity utilisation and therefore see little new expansion. While measures of expectations had previously pointed to an uptick in mining investment this is likely to moderate with a much weaker outlook for global growth and commodity prices. With investment already at its lowest share of GDP since the early 1990s, it is likely we will see investment fall to an even lower share of GDP.

Data for March saw the trade surplus widen to a record $10.6b. A rebound in iron exports and a sharp increase in gold more than offset a 14% decline in tourism exports. Imports fell 4% in the month. Overall, we estimate that the external sector will make a modest contribution to growth in the Q1 national accounts.

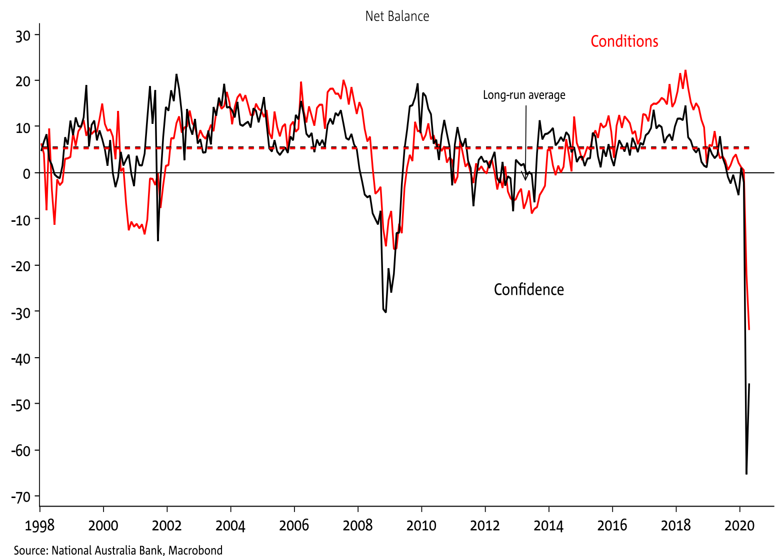
Trade will likely be an important swing variable as 2020 plays out. Slower global growth is likely to see weaker demand for our exports while at the same time LNG production would all else equal have hit full capacity. Partially offsetting this will be the depreciation of the dollar which will serve to boost exports, especially those priced in Australian dollars, including tourism and education. However, for now these sectors will continue to face coronavirus-related travel restrictions.

A weaker dollar may also see a moderation in imports in addition to travel restrictions which are likely to see little international travel by Australians. Again this is likely to be significantly impacted by travel restrictions in the near term.

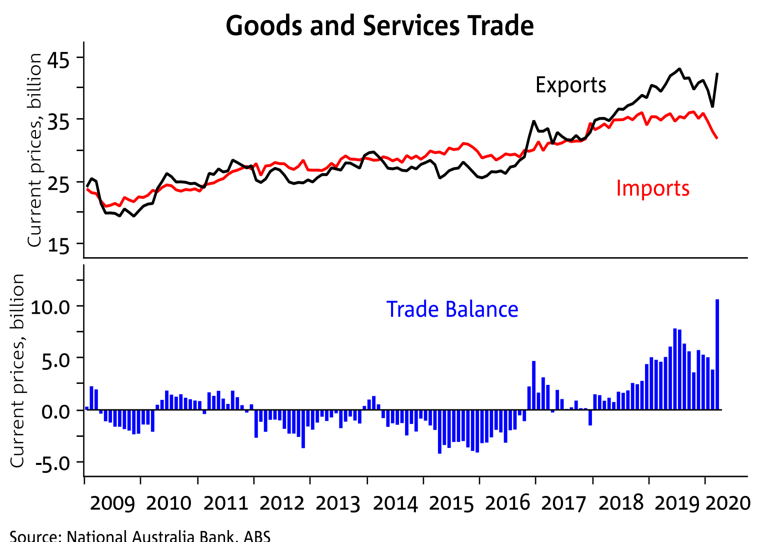
INVESTMENT TO REMAIN WEAK..



CONDITIONS FALL FURTHER...



EXPORTS AT RISK...



COMMODITIES

Spot prices eased between late March and early April, but have subsequently remained range bound in the mid-US$80s. Demand prospects for steel remain mixed – with hopes of a boost to Chinese infrastructure development countered by weakness in manufacturing. However, concerns around Brazilian iron ore supply have risen, as parts of the country's key production regions have entered COVID-19 lockdowns. We have raised our forecast for the next twelve months, averaging US$84 a tonne in 2020 (with recent strength in prices presenting some upside risk) and US$74 a tonne in 2021.

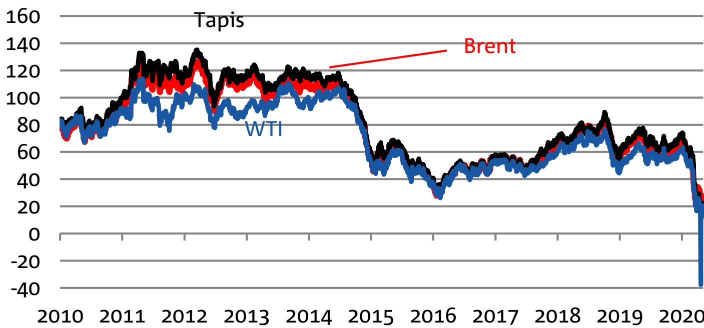
Weakness in global electricity consumption – due to widespread global countermeasures to COVID-19 – has severely impacted thermal coal demand. This also coincided with a ramp up in Chinese coal production (as COVID-19 constraints have been removed). This is led to benchmark Newcastle coal dropping close to US$50 a tonne in early May, while hard coking coal prices dropped below US$110 a tonne. Our forecasts are unchanged, with hard coking coal to average US$138 a tonne in 2020 and thermal coal to forecast US$62 a tonne – however current weak prices highlight downside risk.

During late April, the May WTI contract fell deep into negative territory, due to demand destruction and lack of storage. Consequently, a number of ETFs have rolled over their near-month contracts to a few months further out. However, conditions in the oil market have since stabilised somewhat, albeit at low levels. A re-opening of the Chinese economy, an easing in the lockdown in parts of the United States and Europe is raising demand. Supply too is being restricted due to the OPEC+ deal kicking in, and lower production in the United States. Also, concerns about the lack of US storage space appears less than previously thought. We have trimmed our forecasts, with Brent at US$43/bl in the December quarter (previously US$46/bl). A further outbreak of the virus might pose downside risks to our forecasts.

The demand destruction wrought from the ongoing COVID-19 pandemic has prompted some buyers to cancel their LNG cargoes. This led to an increase in LNG tenders flooding the spot market. The Japan Korea Marker, a North Asian benchmark maintained by Platt's, is currently tracking around US$2/million Btu. It was trading around US$7/million Btu as recently as October, 2019. Weak conditions have led to cancellations or deferrals of projects, both in Australia and overseas. We have sharply revised down our LNG export price forecasts, and expect a trough of 6.8 AUD/Gj in the September, quarter, 2020. It typically takes a quarter for oil prices to feed into LNG prices.

GLOBAL OIL PRICES

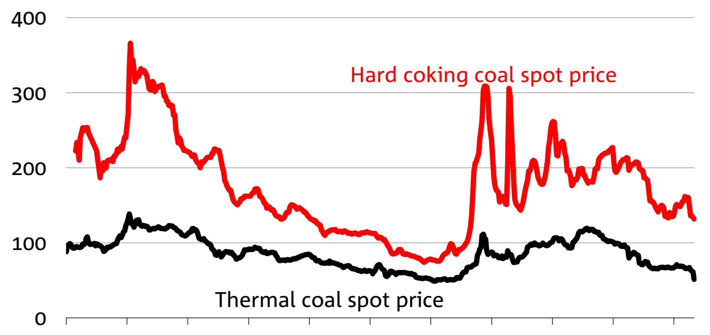
USD/bbl, daily



Source: Refinitiv, NAB Economics

COAL SPOT PRICES

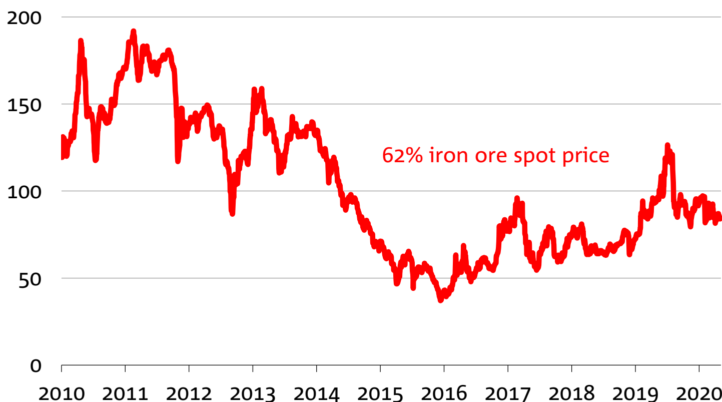
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

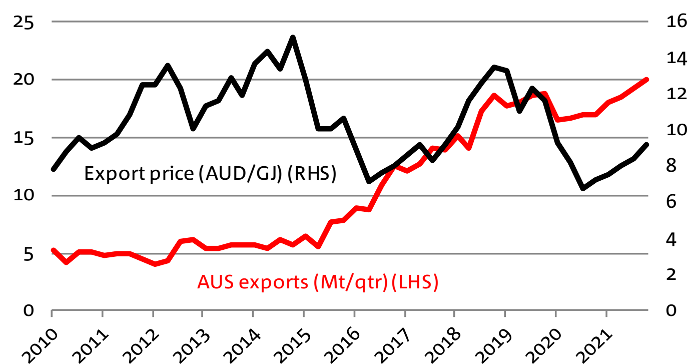
US$/t (incl. cost of freight)



Sources: Refinitiv, NAB Economics

LNG OUTLOOK

Export volume (LHS) export price (RHS)



Sources: ABS, Poten & Partners, Bloomberg, NAB Economics

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

MONETARY POLICY, INFLATION AND FX

As expected the RBA left rates unchanged at 0.25% in May and maintained its yield curve target of 0.25% at the 3-year horizon. The rate of bond purchases along the curve have slowed as functioning of markets has improved. However, the Bank broadened its scope of eligible repurchase agreement collateral to include investment grade corporate bonds. Ultimately this can been seen as an action to smooth the functioning of these markets by adding liquidity at the margin. It could also serve to continue the flow credit to these corporates.

At present policy is exceptionally easy, with 3-year rates anchored around 0.25% and 10-year government bond rates below 1%. Mortgage rates are at very low levels, while credit to both households and business appears to be flowing smoothly.

We expect these policy settings to be maintained for an extended period. The cash rate will remain unchanged until the yield curve target is removed. The Bank has stated that these settings will remain in place until progress has been made on achieving full employment and inflation returning to the target band. We don't expect either of these things to occur for an extended period – with unemployment still above 7% by end-2021 and wage growth slowing, this will see inflation soften further.

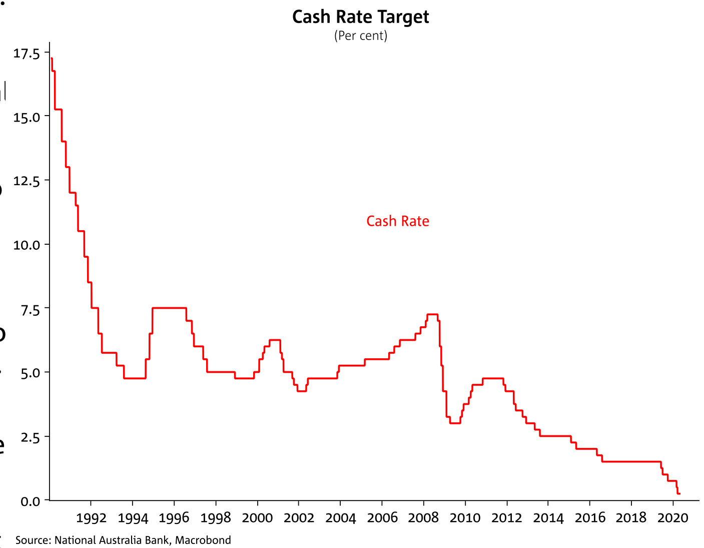
Indeed Q1 CPI data saw headline inflation at 2.2% with core unchanged 1¾%. Virus related issues however will significantly affect headline CPI in Q2. Thus we expect a large fall in CPI in Q2 with lower oil prices and a sharp decline in childcare costs with the governments subsidy to the sector.

More important going forward will be a significant slowing in wages growth in the high unemployment environment. With wages not likely to grow much above 1% in 2021 core inflation is likely to fall to around 0.4% through 2021 – and essentially stall in H2 2021. That would effectively see real rates rise by over 1% in 2021- another headwind to a rapid recovery.

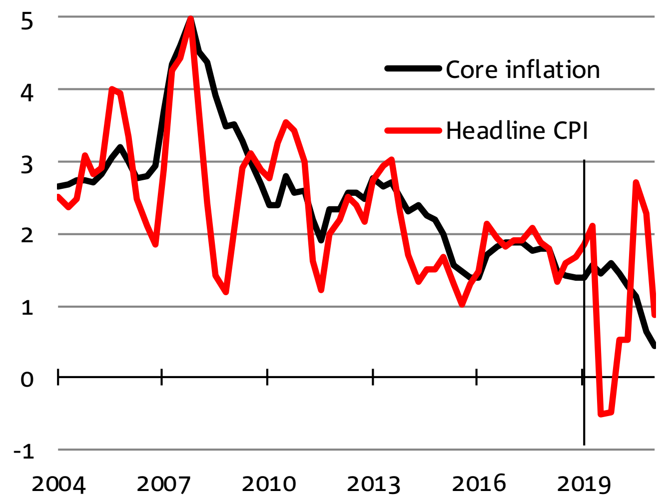
The depreciation in the exchange rate this year will place upward pressure on tradables prices but this pass through is long and variable. It may also be muted through compressed margins with weak demand. However, some of the depreciation this year has been offset by the recent rally in the AUD since troughing at US57c in early April.

Nonetheless, the exchange rate will remain an important shock absorber going forward. It is a key channel of monetary policy and in part a lower exchange rate is a goal of the unprecedented action taken by the RBA. We expect the exchange rate to end the year at US68c before drifting slightly higher over 2021, reaching US73c by end-2021. Risks around this view include developments in commodity prices which could soften on the back of weaker global growth, periods of heightened risk aversion with ongoing economic fallout of coronavirus containment efforts and importantly the relative pace of recovery and the speed at which interest rates are normalised by international central banks.

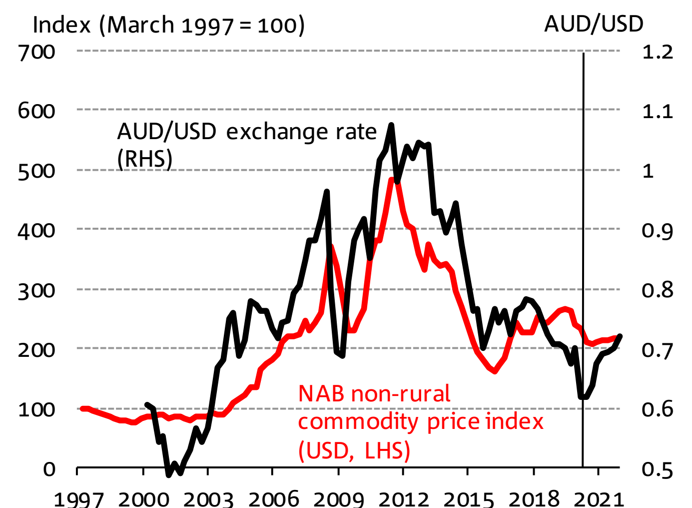
CASH RATE TO STAY LOW…



CORE INFLATION TO SOFTEN…



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	-1.1	-3.9	2.5	2.7	1.4	-5.3	2.2
Dwelling Investment	0.5	0.0	-10.4	-14.5	-2.2	4.7	-7.1	-14.3	-4.3
Underlying Business Investment	6.9	-1.9	-9.9	-21.5	3.8	1.3	-2.0	-22.4	-8.1
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**	**-0.8**	**-3.8**	**3.0**	**2.9**	**1.2**	**-4.7**	**1.6**
Stocks (b)	0.0	-0.2	-0.7	0.5	-0.1	0.1	-0.2	-0.8	1.0
GNE	**3.6**	**1.5**	**-1.5**	**-3.3**	**2.9**	**2.9**	**1.0**	**-5.5**	**2.6**
Exports	4.1	3.9	2.9	-1.8	3.4	5.1	3.2	1.3	-4.0
Imports	7.2	0.2	-5.2	-10.0	7.8	4.0	-1.2	-12.0	-1.3
GDP	**2.9**	**2.0**	**-0.6**	**-1.5**	**2.5**	**2.7**	**1.8**	**-4.3**	**4.2**
Nominal GDP	4.9	5.3	0.7	-2.4	6.2	5.0	5.1	-5.3	4.8
Current Account Deficit ($b)	51	14	-19	-5	46	39	-10	-17	6
(-%) of GDP	2.8	0.7	-1.0	-0.2	2.6	2.1	-0.5	-0.9	0.3
Employment	3.0	2.4	-0.1	-7.0	2.3	2.7	2.4	-6.1	0.4
Terms of Trade	1.8	5.6	-3.2	-10.1	11.7	1.8	5.2	-11.9	-2.0
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	-0.5	2.7	1.9	1.8	1.8	0.5	0.9
Core CPI	1.8	1.4	1.5	1.1	1.9	1.8	1.4	1.5	0.4
Unemployment Rate	5.6	5.1	11.7	8.7	5.4	5.0	5.1	11.7	7.2
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	0.91	1.15	2.63	2.32	1.37	0.95	1.35
$A/US cents :	0.74	0.70	0.62	0.70	0.78	0.71	0.70	0.68	0.72
$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	11/05/2020	Jun-20	*Sep-20*	*Dec-20*	*Mar-21*	*Jun-21*	*Sep-21*	*Dec-21*
WTI oil	US$/bbl	24	27	31	36	41	45	51	53
Brent oil	US$/bbl	26	34	38	43	48	52	58	60
Tapis oil	US$/bbl	28	36	40	45	50	54	60	62
Gold	US$/ounce	1696	1680	1690	1700	1710	1710	1720	1720
Iron ore (spot)	US$/tonne	89	84	81	80	78	75	73	70
Hard coking coal*	US$/tonne	n.a.	130	145	148	151	147	145	140
Thermal coal (spot)	US$/tonne	61	55	62	65	67	63	61	59
Aluminium	US$/tonne	1461	1425	1525	1600	1700	1725	1750	1775
Copper	US$/tonne	5224	4950	5100	5300	5400	5500	5750	6000
Lead	US$/tonne	1652	1625	1750	1725	1700	1725	1700	1675
Nickel	US$/tonne	12290	11500	12250	12100	12300	12500	12750	13000
Zinc	US$/tonne	2027	1875	1850	1900	2000	2200	2150	2150
Aus LNG**	AU$/GJ	n.a.	8.2	6.8	7.2	7.5	8.0	8.4	9.2

* 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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