EMBARGOED UNTIL 11.30 AM AEST, WEDNESDAY 10 JUNE 2020

THE FORWARD VIEW: AUSTRALIA JUNE 2020

A small fall in GDP in Q1 expected to be followed by a very large fall in Q2 – followed by an extended period of recovery.

OVERVIEW

- The Q1 national accounts – which showed a decline in GDP of 0.3% - suggest that Australia has all but ended its 29-year run without a 'technical recession'. The result was slightly weaker than we had expected in the lead-up to the release and showed a more significant impact of COVID-19 than we had expected, with a notable decline in the household services consumption.
- In addition to the softness in services consumption, non-mining business investment and dwelling investment declined. Overall, this was a very weak outcome for private domestic demand which subtracted 0.8ppt from growth. Key offsets were government spending and a strong contribution from net exports (where a fall in exports was offset by a larger fall in imports).
- The large decline in services consumption was notable with the most significant lockdown restrictions only occurring the last two weeks of the quarter. Travel and accommodation and food services saw a large decline, while health services also softened.
- Following the integration of the Q1 national accounts our near term forecasts for growth in 2020 are broadly unchanged. We still expect a large fall in activity in Q2 – a decline 8.5% q/q, before an earlier and stronger than previously expected pickup H2 2020 and continued recovery in 2021. We have also included forecasts for 2022 for the first time (around 2.8% expected). That said we still don't have the level of GDP exceeding the level of Q4 2019 GDP until mid 2022.
- We have revised lower our forecasts for the measured unemployment rate. With labour force participation temporarily impacted by definitional changes to Jobseeker payments and the impact of Jobkeeper in supporting jobs it is likely that the unemployment rate will now peak at a much lower rate – around 8½%. Nonetheless, the impact on the labour market has already been large with underutilisation rising to exceptionally high levels and hours worked declining sharply in April. The unemployment rate is expected to remain elevated for sometime, despite the rebound in growth. This reflects the time it will take to fully recover the level of GDP to pre-COVID levels following the large expected fall in Q2.
- While Australia has achieved a better than expected outcome on the health front and restrictions have been eased much sooner than expected we expect the economy will continue to require ongoing support from policy makers – particularly as existing measures naturally end. This will likely come from ongoing fiscal support while we expect the RBA to keep rates very low for an extended period.

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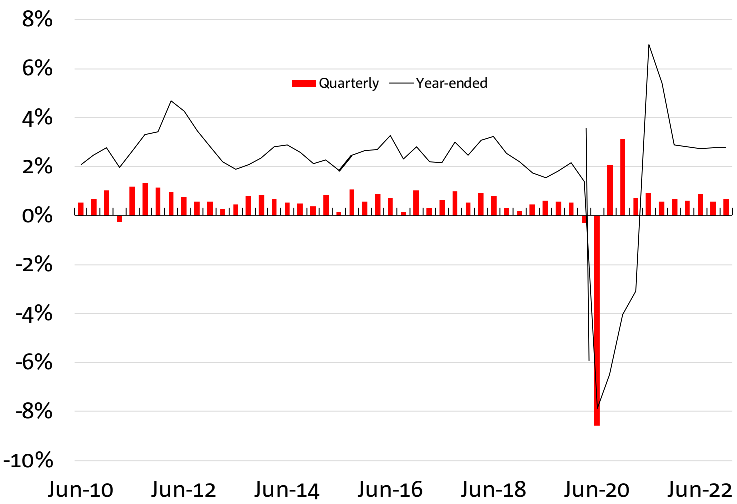
KEY ECONOMIC FORECASTS

	2019	2020-F	2021-F	2022-F
Domestic Demand (a)	1.3	-6.2	1.4	4.0
Real GDP (annual average)	**1.8**	**-4.3**	**2.9**	**2.8**
Real GDP (year-ended to Dec)	**2.2**	**-4.1**	**2.9**	**2.8**
Terms of Trade (a)	5.1	-2.9	-1.0	0.9
Employment (a)	2.4	-4.1	-1.2	1.5
Unemployment Rate (b)	5.2	8.4	6.9	6.2
Headline CPI (b)	1.8	0.6	1.3	1.6
Core CPI (b)	1.4	1.8	0.9	1.2
RBA Cash Rate (b)	0.75	0.25	0.25	0.25
$A/US cents (b)	0.70	0.72	0.75	0.75

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

NAB GDP FORECASTS



LABOUR MARKET, WAGES AND THE CONSUMER

The April labour force survey showed a very large deterioration in labour force conditions. Employment fell by 594k – its largest decline on record – alongside a very large fall in the participation rate. The unemployment rate also saw the largest monthly rise on record, increasing 1ppt to 6.2%. However, the move in the unemployment rate was tempered by the fall in participation (with the requirement of dole recipients to actively search for work temporarily relaxed). The ABS estimates that should this requirement have not been eased the unemployment rate would have reached 9.6% - a staggering result for a monthly move.

Alternative measures of labour market activity – hours worked and the underemployment rate – are a more accurate representation of the deterioration in the labour market at this point. In the month, hours worked fell a record 9% while the underemployment rate rose to 13.7% (from 8.8%) taking the total labour force underutilisation rate to 19.9%.

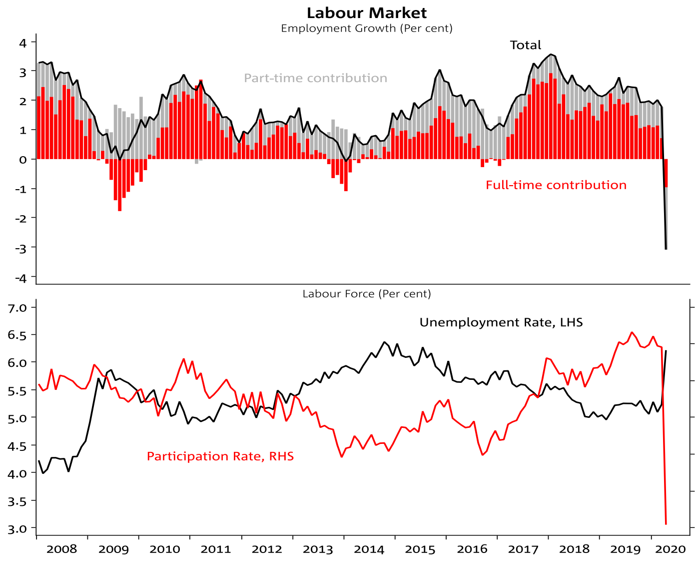
The fall in employment appears to be stabilising, with the ABS payrolls data showing a stabilisation in "jobs" after the large deterioration in mid April. Nonetheless, we expect he unemployment rate to rise from here, reaching 8.6% at its peak (previously 11.7%) as workers re-enter the workforce.

The Q1 national accounts showed that even at an early stage, the impact the coronavirus pandemic was significant. Household consumption declined 1.1% in Q1, with a 2.4% fall in services spending partially offset by the spike in retail sales – related to hoarding. Discretionary spending saw a large fall – with restrictions on travel followed by more significant domestic lockdowns which impacted accommodation and food services late in the quarter. While essentials spending held up, this was supported by the 'goods' component with health expenditure also seeing a significant fall in the quarter.

Q2 is likely to see a much more significant fall in household consumption with restrictions in place for a larger portion of the quarter despite the recent easing. Indeed, nominal retail sales fell by 17.7% in April, more than reversing its 8.5% increase in March. The NAB Cashless retail sales index points to a 5½% rise in May – with the ABS preliminary estimate to be released next week. This suggests that some normalisation in retail sales has occurred but overall consumption is still very weak. Thus while retail business conditions improved in the May Nab Survey to -20, personal and recreational services remain stranded at -44. Overall, we expect household consumption to decline by 10% in Q2.

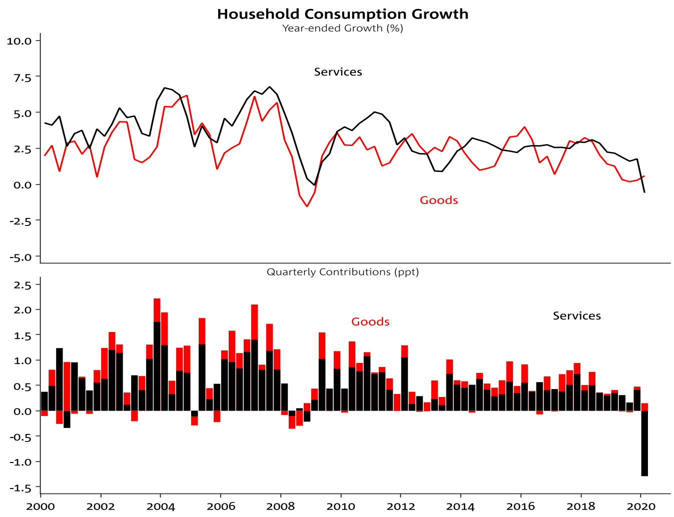
Further out, we expect a rebound in consumption in the second half of the year before returning to a more normal pace of growth in 2021. There is some risk around this forecast, with unemployment remaining elevated for the next two years, and income growth slowing as wages growth softens further.

LABOUR MARKET DETERIORATES...



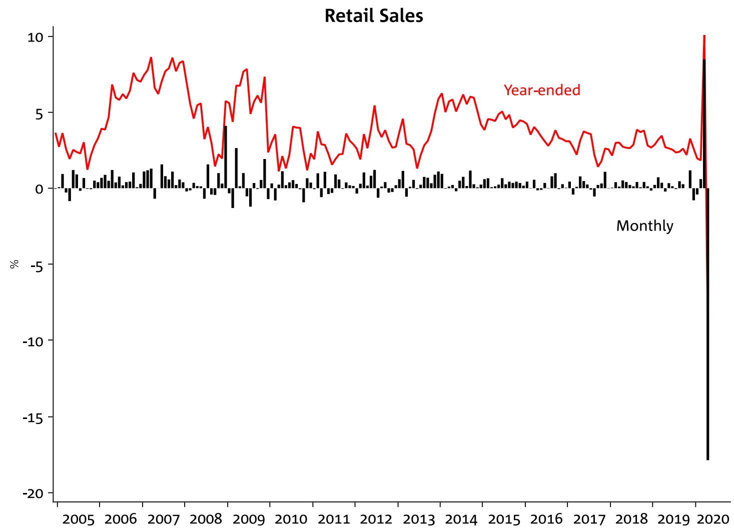
Source: National Australia Bank, Macrobond

SERVICES CONSUMPTION WAS WEAK IN Q1...



Source: National Australia Bank, Macrobond

RETAIL SALES PULL BACK IN APRIL...



Source: National Australia Bank, Macrobond

HOUSING AND CONSTRUCTION

As the broader economic downturn continues to play out the impact on the housing market is becoming clearer. Capital city dwelling prices recorded their first monthly fall since June 2019 with the CoreLogic 8-capital city house price index falling 0.5% in May. Nonetheless, the slowing in house prices has been gradual and prices are still up 0.6% since 3 months ago.

In the month, the decline was broad-based across the capital cities, led by a decline of 0.9% in Melbourne, with Sydney declining 0.4% and Perth falling 1.6%. Hobart and Adelaide rose by 0.8% and 0.4% respectively.

We continue to expect falls of 10-15% over the next 12-18 months. Higher unemployment, slower wage growth and falls in overseas migration will weigh on prices in capital cities while new supply continues to come online. Offsetting this will be impact of lower interest rates – with mortgage rates at historical lows – and a pullback in construction seeing a rapid adjustment on the supply side.

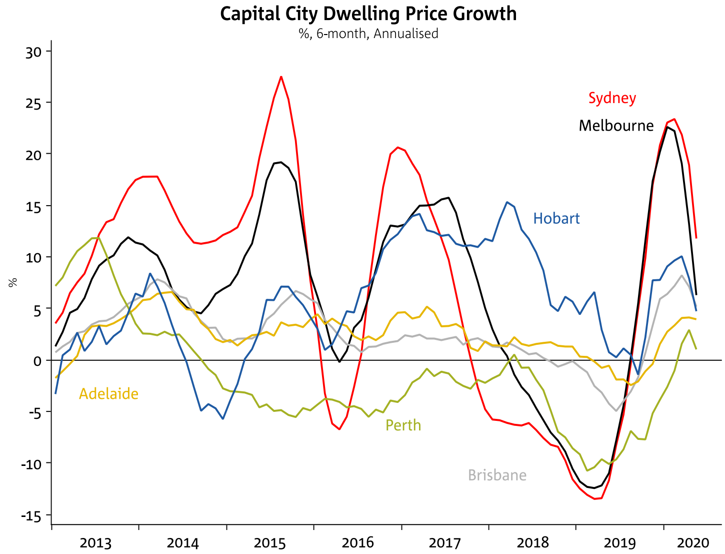
Indeed, the Q1 national accounts showed that residential dwelling investment continued to fall in early 2020. investment in new building declined 1.7% and has fallen 15.4% over the past year. Investment in alterations and additions rose by 0.4% in the quarter. The largest declines in new building were in NSW and WA, though SA and Vic also saw declines.

Going forward we see dwelling investment declining by around 15% over the next year or so before levelling out in mid-2021. High rates of completion are likely to rapidly erode the pipeline of new dwellings while uncertainty in the housing market will see caution in new commitments going forward.

Indeed, while approvals have trended slightly higher since the trough in house prices last year (up 4.5%) they remain around 30% below their peak in late-2015. Monthly data for April saw private residential building approvals decline by 2.4% driven by a 8.9% decline in approvals for apartments; approvals for detached houses rose 2.7% in the month.

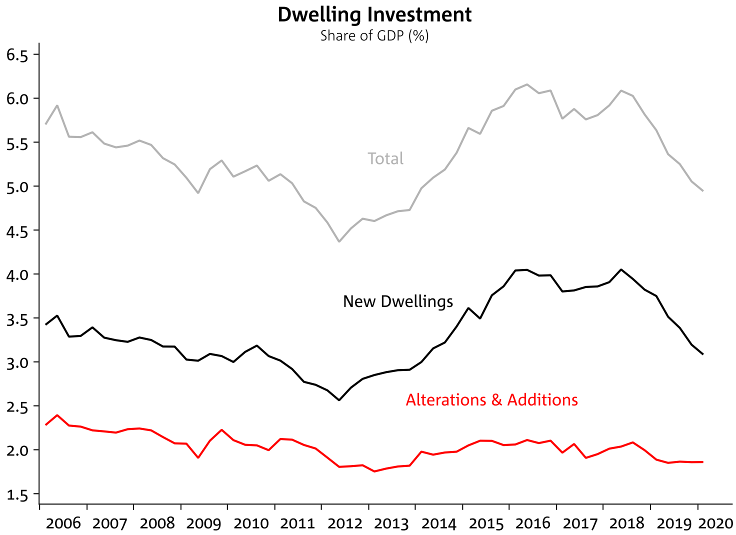
A more significant improvement in approvals will be needed going forward to see a return to growth in dwelling investment. However, as noted the impact of softer prices in the established market and uncertainty about the level of migration going forward may weigh on the development process going forward.

HOUSE PRICES SOFTENING...



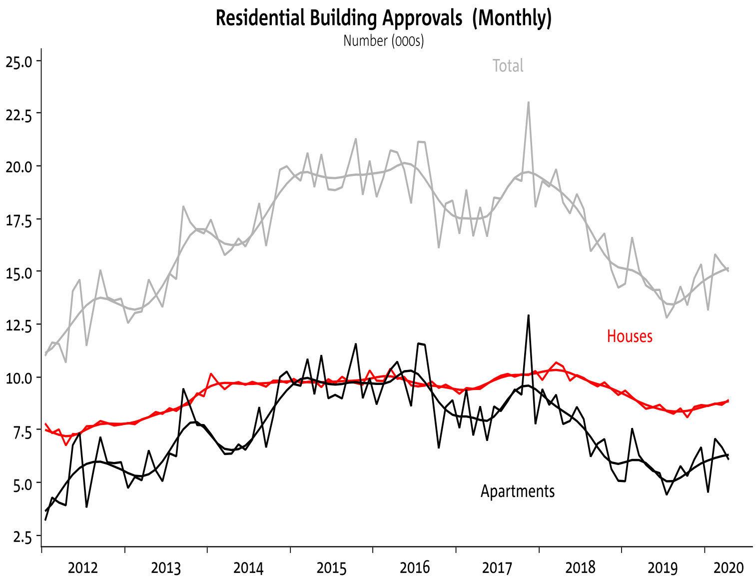
Source: CoreLogic, National Australia Bank, Macrobond

DWELLING INVESTMENT TO FALL FURTHER...



Source: National Australia Bank, Macrobond

APPROVALS REMAIN WEAK...



Source: National Australia Bank, Macrobond

BUSINESS AND TRADE

The NAB Monthly business survey for May saw an improvement both the business conditions and confidence indexes. There was a broad-based improvement in conditions across industries but conditions remain negative across all sectors and states. Overall, the conditions index remains around a level last seen coming out of the GFC. The improvement in confidence was also broad-based and overall showed a large improvement, but remains around GFC lows following the large hit in March. The services sectors continue to be the most impacted – in line with the major impacts we have seen with coronavirus containment measures in other data.

Forward orders improved slightly but remain very negative and continue to point to negative conditions in the near-term. Capacity utilisation recorded a sizable increase in the month, but is still low given its record falls last month. The capex index improved but also remains negative – and along with the employment index which also saw only modest improvement, points to ongoing restraint in the business sector.

The Q1 national accounts showed a 0.8% fall in underlying business investment. Non-mining was again weak, falling by 2.5% q/q which was partially offset by a 6.5% increase in mining investment. This was the strongest quarterly outcome for mining since 2012, which was around the peak of the mining boom. By asset, there were declines in machinery & equipment and non-residential buildings, while engineering investment rose (consistent with the strength in mining). Looking forward, we see a large decline in business investment in Q2 and ongoing softness over the next 18 months or so.

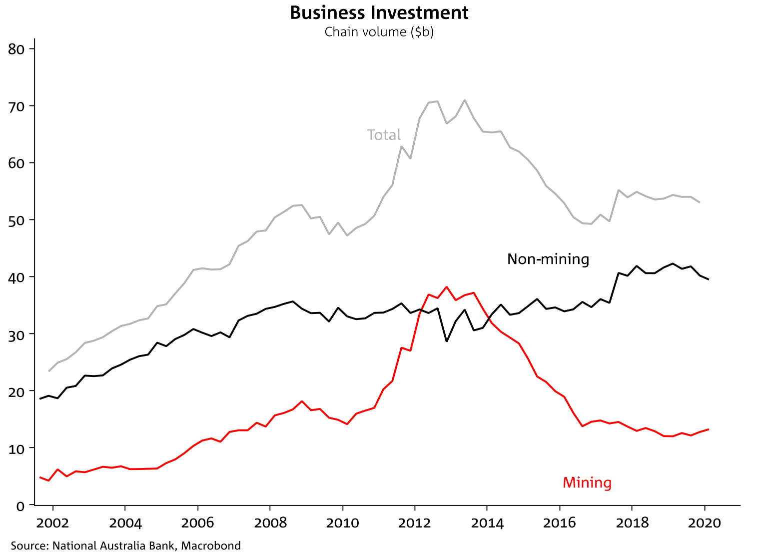
Trade again provided a significant boost to the economy in Q1. Both imports and exports declined on the back of COVID-19 impacts with travel restrictions and disruptions to supply chains playing a part. The fall in exports was more than offset by the decrease in imports in the quarter, which saw a large 0.5ppt contribution from net exports to GDP.

More recent monthly trade data showed a further sharp fall in exports (drive by declines in iron ore, gold and services trade) as travel restrictions took full impact in April. Imports also declined in the month which offset some of the decline in exports and was also driven by a drop-off in services (again impacted by border closures).

Trade will likely see impacts of coronavirus for sometime time. In the near term, travel restrictions will continue to impact international tourism as well as education. Further out, a weak global economy (as well as the composition of growth) will affect demand for our commodity exports as well as education and tourism on an ongoing basis

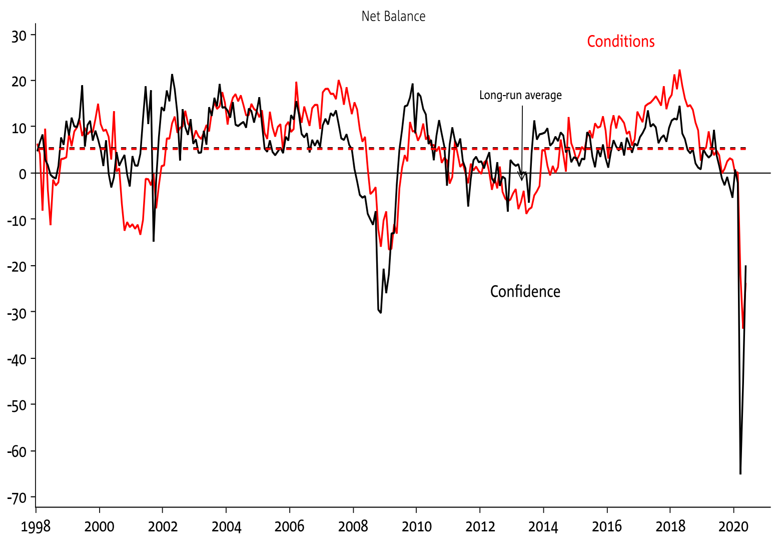
Therefore the currency will continue to be an important automatic stabiliser and the timing of the development of a coronavirus vaccine will be important before international trade can return to normal.

NON-MINING INVESTMENT WEAKER IN Q1..



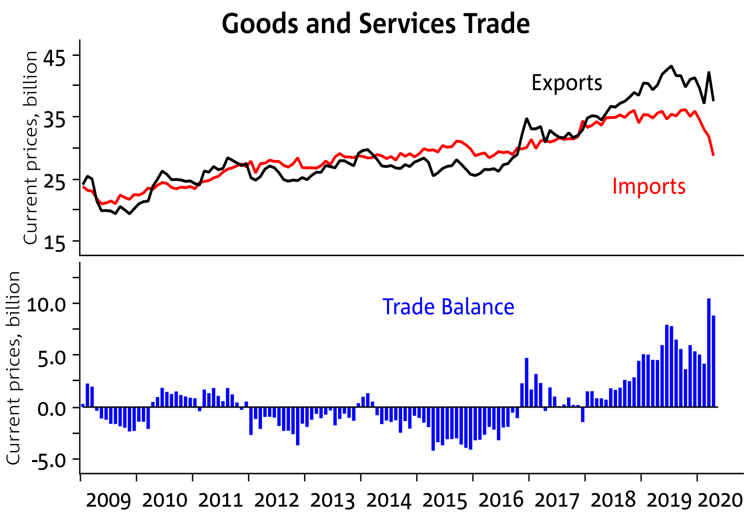
Source: National Australia Bank, Macrobond

CONDITIONS RISE BUT REMAIN VERY WEAK...



Source: National Australia Bank, Macrobond

TRADE VOLUMES WILL REMAIN SOFT...



Source: National Australia Bank, ABS

COMMODITIES

Spot prices for iron ore rose across May, pushing up from the mid-US$80s a tonne, to over US$100 a tonne by the end of the month. Supply side concerns have been a key driver – particularly as the COVID-19 outbreak has worsened in Brazil. The duration and severity of such a supply disruption is inherently uncertain, however this will add upside pressure in the short term. On the demand side, weakness in global demand for manufactured goods – given the global recession – is likely to constrain the upside for prices. Reflecting the supply pressures, we have revised our forecasts higher, with 62% ore landed in China forecast to average US$90 a tonne in 2020 (from US$84 a tonne previously) and US$83 a tonne in 2021 (from US$74).

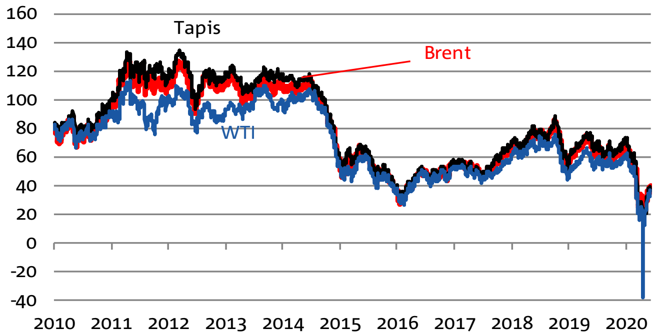
Weakness in coal markets has persisted – with prices for hard coking coal continuing to fall to under US$110 a tonne in early June. In contrast, thermal coal prices have stabilised at around US$55 a tonne – having dropped from over US$70 a tonne in January. Supply pressures have eased in recent months – as Chinese coal production resumed following COVID-19 constraints – while demand across Asia has weakened, due to the impact of COVID-19 countermeasures. Our hard coking coal forecast is US$126 a tonne in 2020, before edging up to US$133 a tonne in 2021, while thermal coal prices are forecast to average US$60 a tonne in 2020 and US$62 a tonne in 2021.

From sub-US$20/bbl during April, the benchmark Brent has risen to around US$40/bbl. May saw OPEC+ initiate a 9.7m bbl/day cut in supply. This level of reduction will be extended into July, after Saudi Arabia and Russia secured commitments from countries such as Iraq to curb their output. It remains to be seen how long these reductions can be sustained. Russian oil producers have indicated these cuts crimp their ability to supply to their regular customers on long-term contracts. Also, there are indications that this price level is inducing key shale producers to reverse their production cuts and increase supply, something OPEC+ would be wary of. We expect the benchmark Brent indicator to rise to US$45/bbl by the end of 2020.

Weak demand due to COVID-19, and solid supply have negatively impacted the LNG sector. Asian and European importers have cancelled over 20 US cargoes for June and July, with more cancellations anticipated. Demand in key Asian markets remains subdued. Even in China, which is showing early signs of recovery, LNG imports are expected to show a very modest increase in 2020, according to consultancy Rystad Energy. Japan and South Korea are expected to record moderate declines in LNG imports. Further, with the exception of Qatar Petroleum, new orders for LNG ships have plummeted due to low charter rates for LNG cargoes. We expect continued downward pressure on Australian LNG export prices, with a gradual recovery in 2021.

GLOBAL OIL PRICES

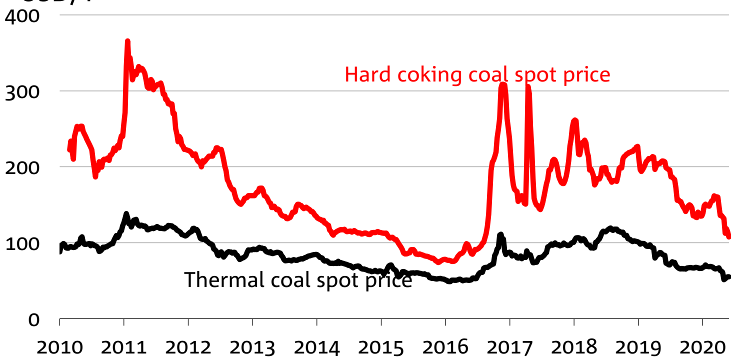
USD/bbl, daily



Source: Refinitiv, NAB Economics

COAL SPOT PRICES

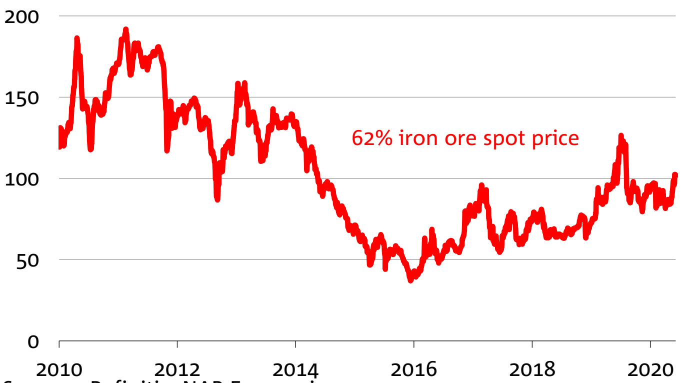
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

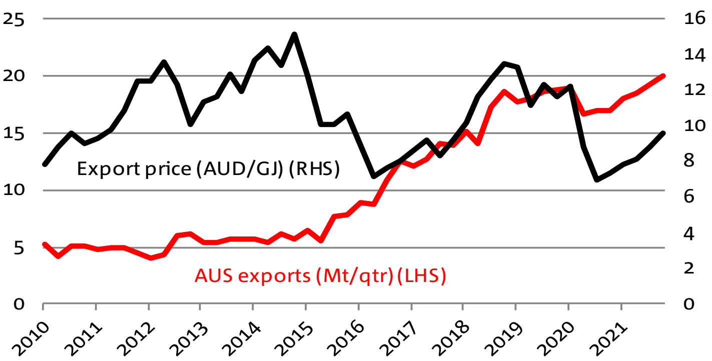
US$/t (incl. cost of freight)



Sources: Refinitiv, NAB Economics

LNG OUTLOOK

Export volume (LHS) export price (RHS)



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

Source: Refinitiv, ABS, Bloomberg, Thomson Reuters, BREE, Poten & Partners and NAB Economics.

MONETARY POLICY, INFLATION AND FX

The RBA left monetary policy settings unchanged in June – the cash rate target remains at 0.25% and the three year AGS yield target of 0.25% remains in place. Bond purchases have wound back as yields continue to track at target while the functioning of markets further out along curve has been restored.

Overall monetary policy remains very stimulatory, with end user rates very low across the economy. Lending rates to both households and business have fallen to low levels and are likely to remain there for sometime.

The RBA is likely to keep the cash rate on hold at 0.25% for an extended period and the cash rate target will not be lifted before removal of the yield curve target. This economy is likely to require support for an extended period despite the better than expected health outcomes, with the large fall in activity taking some time to be recovered. The labour market will continue to be a key focus of policy makers – and while in a measured sense the unemployment rate has not deteriorated as sharply as feared, the level of underemployment has risen substantially.

They RBA has stated that it will not begin tightening policy before sustained progress has been made towards tis goals of full-employment and inflation sustainably within the target band. On our forecasts this does not occur in the next two years with unemployment continuing to average above 6% in 2022 on the back of still recovering activity. This will impact inflation as well with spare capacity in the labour market seeing further downward pressure on wage growth. Thus, we see core inflation continuing to track well below target for an extended period.

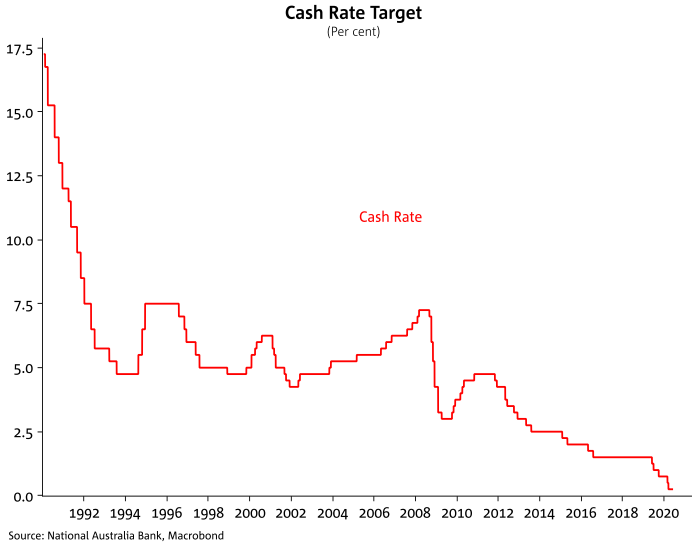
Indeed we still expect the CPI to fall by around 2% in Q2 with the impacts of softer petrol prices and childcare subsidies weighing. While this is expected to unwind somewhat in Q3, softer wage growth, weak demand and competition are likely to see underlying inflation remain below target.

We see inflation softening to around 1% in 2021 before pressure begins to build and rises to around 1¼% by end 2022. This will have seen inflation undershoot the RBA's target of 2-3% since around 2016.

With the baseline for monetary policy to stay where it is we believe that fiscal policy will have to take a more active role in managing the economic cycle over the next few years. The government has already provided unprecedented support through the jobkeeper and jobseeker payments as well as a range of other stimulus measures. It will be important that ongoing support is provided as these measures are unwound until the labour market has recovered and both business and consumer confidence have been restored.

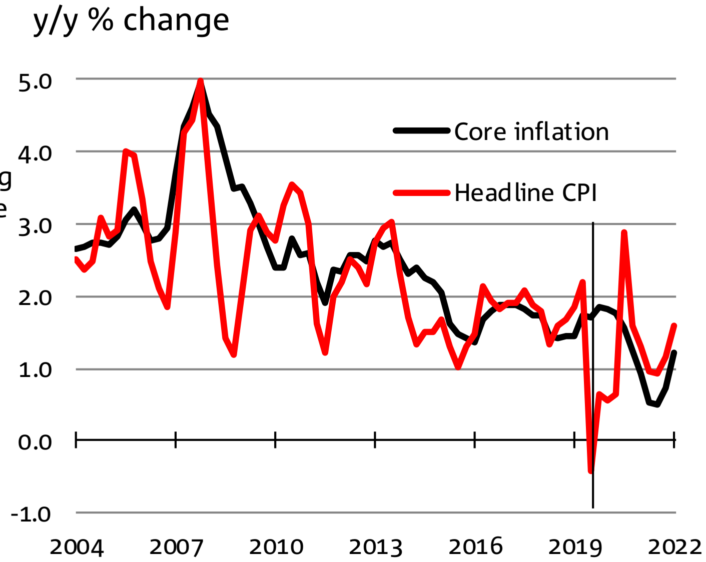
The exchange rate will continue to play an important role as a stabiliser for activity, though some of the impact may be muted by outright restrictions on trade – particularly on the services side where passenger movements will continue to be hampered for some time. However, the Aussie has rallied relatively strongly recently from its lows in April to around US70c. We have revised up our forecast profile for the exchange rate and now see the AUD/USD at US72c at end-2020 and US75c at end-2021.

CASH RATE TO STAY LOW...

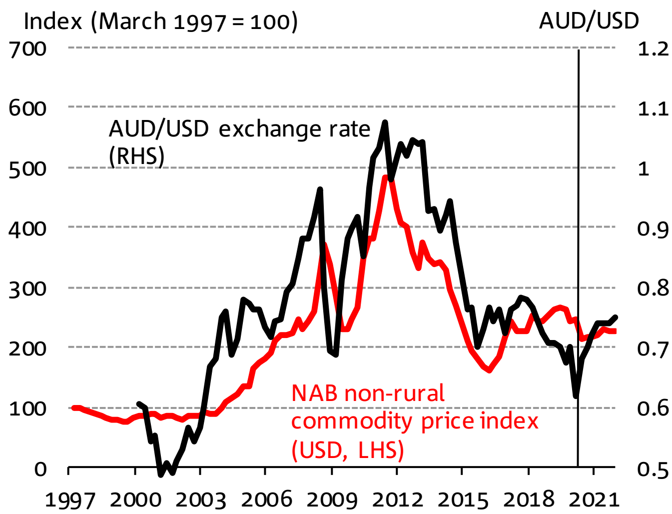


Source: National Australia Bank, Macrobond

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				
	2018-19	2019-20 F	2020-21 F	2021-22 F	2018	2019	2020-F	2021-F	2022-F
Private Consumption	2.0	-2.4	-4.7	4.1	2.7	1.4	-7.8	2.8	3.2
Dwelling Investment	0.0	-10.2	-14.8	8.6	4.7	-6.9	-14.4	-4.4	12.8
Underlying Business Investment	-1.8	-8.2	-26.9	6.0	1.3	-1.7	-22.3	-11.6	7.9
Underlying Public Final Demand	4.4	5.1	4.2	3.3	4.5	4.9	4.7	3.8	3.1
Domestic Demand	**1.8**	**-1.4**	**-5.0**	**4.2**	**2.9**	**1.3**	**-6.2**	**1.4**	**4.0**
Stocks (b)	-0.2	-0.7	0.7	0.4	0.1	-0.2	-0.8	1.3	0.0
GNE	**1.6**	**-2.1**	**-4.3**	**4.6**	**3.0**	**1.0**	**-7.0**	**2.8**	**3.9**
Exports	4.0	0.2	-4.7	-4.8	5.1	3.2	-3.9	-4.4	-5.1
Imports	0.3	-8.4	-14.9	0.8	4.1	-1.2	-18.7	-2.8	-0.4
GDP	**2.0**	**-0.6**	**-1.9**	**3.4**	**2.8**	**1.8**	**-4.3**	**2.9**	**2.8**
Nominal GDP	5.3	1.3	-0.8	4.9	5.1	5.0	-3.1	4.1	4.3
Current Account Balance ($b)	14	-41	-68	-49	-39	11	71	56	40
(%) of GDP	0.7	-2.1	-3.5	-2.4	-2.0	0.6	3.7	2.8	1.9
Employment	2.4	0.4	-5.2	1.3	2.7	2.4	-4.1	-1.2	1.5
Terms of Trade	5.6	0.1	-2.6	1.3	1.8	5.1	-2.9	-1.0	0.9
Average Earnings (Nat. Accts. Basis)	1.8	2.3	0.8	1.6	1.5	2.6	1.1	1.2	2.0
End of Period									
Total CPI	1.6	-0.4	3.0	0.9	1.8	1.8	0.6	1.3	1.6
Core CPI	1.4	1.7	1.6	0.5	1.7	1.4	1.8	0.9	1.2
Unemployment Rate	5.1	6.8	7.7	6.5	5.0	5.2	8.4	6.9	6.2
RBA Cash Rate	1.25	0.25	0.25	0.25	1.50	0.75	0.25	0.25	0.25
10 Year Govt. Bonds	1.32	0.90	1.25	1.35	2.32	1.37	1.05	1.35	1.35
$A/US cents :	0.70	0.68	0.74	0.75	0.71	0.70	0.72	0.75	0.75
$A - Trade Weighted Index	60.1	58.8	62.0	62.1	60.7	60.3	61.5	62.1	62.1

(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	8/06/2020	Mar-20	Jun-20	*Sep-20*	*Dec-20*	*Mar-21*	*Jun-21*	*Sep-21*	*Dec-21*
WTI oil	US$/bbl	38	52	26	37	42	43	44	45	46
Brent oil	US$/bbl	41	59	33	40	45	47	48	49	50
Tapis oil	US$/bbl	44	62	35	42	47	49	50	51	52
Gold	US$/ounce	1690	1580	1710	1730	1730	1750	1780	1800	1850
Iron ore (spot)	US$/tonne	106	91	91	93	85	85	90	80	75
Hard coking coal*	US$/tonne	n.a.	154	118	113	118	123	138	133	138
Thermal coal (spot)	US$/tonne	52	68	56	55	59	59	61	62	65
Aluminium	US$/tonne	1566	1692	1480	1510	1530	1550	1560	1570	1580
Copper	US$/tonne	5669	5640	5250	5750	6000	6250	6500	7000	6000
Lead	US$/tonne	1758	1844	1625	1750	1725	1700	1725	1700	1675
Nickel	US$/tonne	12920	12708	12200	13000	13500	13900	14100	14200	14300
Zinc	US$/tonne	2048	2126	1875	1850	1900	2000	2200	2150	2150
Aus LNG**	AU$/GJ	n.a.	12.2	8.8	6.9	7.3	7.8	8.1	8.8	9.6

Source: Thomson Reuters Datastream, ABS, Econdata DX, RBA, NAB Economics

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