EMBARGOED UNTIL 11.30 AM AEST, WEDNESDAY 15 JULY 2020

THE FORWARD VIEW: AUSTRALIA JULY 2020

Extent of the fall in Q2 GDP revised sharply down – as is 2020. But pain still large and long lasting. With new virus uncertainties.

OVERVIEW

- While the economy was massively hit by virus and associated lock downs in March / April, activity has rebounded more quickly than expected. Our internal consumption data now suggests that consumption in late June is already back to early 2020 levels. Also, the NAB Monthly June survey saw big improvements in business conditions, forward orders and confidence (which even turned positive). Also the evidence suggests that the worst of the job shedding is probably behind us.
- That suggests that Q2 GDP might now fall by around -5% compared with our previous expectations of an -8.5% fall. Normally that would see Q3 expectations revised up but now we are trying to take on board the extent and length of the Victoria lock down. We are expecting a bounce of around 3% in Q3 (4% without the Victorian virus return).
- As a result our new forecast for 2020 GDP is around -1¾% (revised from -4.3%). For 2021 we are expecting growth of around 1.6% (but 2½% through the year) while 2022 forecasts are unchanged at around 2¾%. That means that GDP gets back to pre-COVID levels by late-2021.
- That also sees a lower peak unemployment rate this year of a touch over 8% but still around 7% by late 2021 and a touch below 6% by late 2022. Nominal wages growth is still expected to be around 1% next year and inflation still around 1½% by late 2022 - and the RBA on hold.
- We continue to expect a gradual phasing out of JobKeeper (or a replacement targeted at poorer performing industries). Also we don't see JobSeeker payments fully scaled back to "Newstart" levels. We also see the October Budget being centred at increasing household incomes (via tax cuts) and increased infrastructure spending (brought forward and increased maintenance). We also assume the banks will continue to act as shock absorbers.
- Obviously much still depends on virus and policy developments. However, we see major structural challenges for some industries – especially as we don't expect international borders to be opened meaningfully until mid-2021 at the earliest. That means population growth will halve to around 0.7% with obvious ramifications for industries such as construction, education, and international travel-related. We also see house prices falling by at least 10% and commercial property much more – with flow on challenges to related SMEs in CBDs.
- While recent developments in Victoria are concerning, Australia still remains much better placed that other countries (eg the USA) to reopen its economy. Clearly we will continue to monitor the Victorian situation closely.

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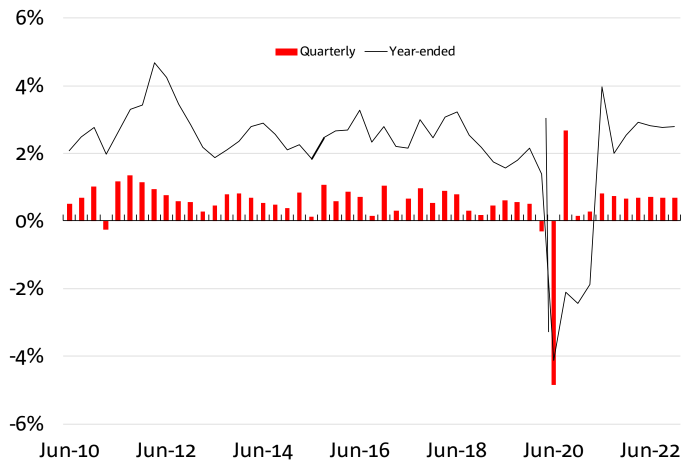
KEY ECONOMIC FORECASTS

	2019	2020-F	2021-F	2022-F
Domestic Demand (a)	1.3	-3.6	0.9	3.9
Real GDP (annual average)	**1.8**	**-1.8**	**1.6**	**2.8**
Real GDP (year-ended to Dec)	**2.2**	**-2.4**	**2.5**	**2.8**
Terms of Trade (a)	5.1	-2.9	-1.0	0.9
Employment (a)	2.4	-4.1	-0.5	1.7
Unemployment Rate (b)	5.2	8.1	6.9	5.8
Headline CPI (b)	1.8	0.5	1.5	1.8
Core CPI (b)	1.4	1.4	1.1	1.5
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 May labour force survey showed a further deterioration in the labour market, following the large hit in April. The unemployment rate rose to 7.1% from 6.2%. Employment declined by a further 228k, taking the decline over the past two months to 835k. The participation rate declined further and is now at its lowest level since 2001. Had the participation rate not declined so substantially over the past 2 months the ABS estimates the unemployment rate would have reached 11.3%.

Hours worked recorded a smaller fall than last month but is now around 10% lower than pre-COVID levels. Broader measures of unemployment were mixed in the month – the underemployment rate fell 0.7ppt to 13.1% while the underutilisation rate was stable at 20.2%. Overall, while the pace of deterioration moderated in the month, these statistics paint a picture of a very weak labour market.

Both the ABS household COVID0-19 survey and the payrolls release point to a stabilisation in the labour market since May but show some signs of a stalling recovery in recent weeks. We forecast that employment will rise 175k in June, but for the unemployment rate to rise further as individuals re-enter the workforce. Overall we expect the unemployment rate to peak at over 8% this year - less than previously expected – but for it to only recover. gradually over the next two years – reaching 5.8% at end-2022.

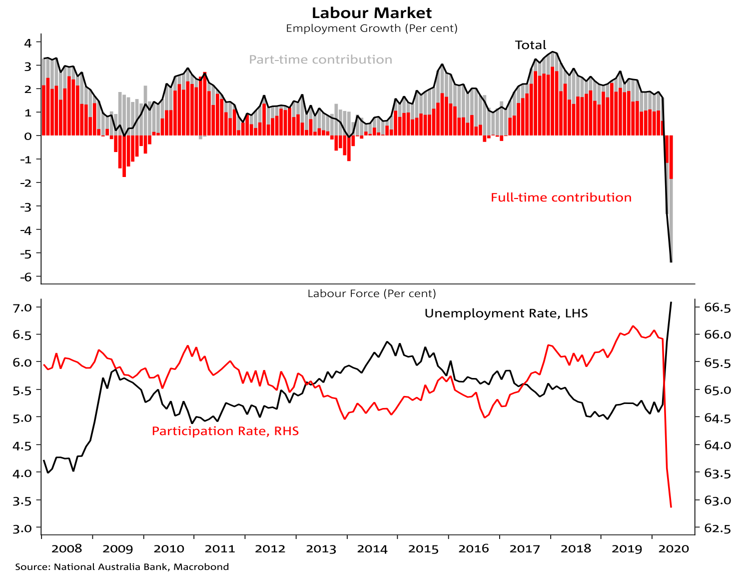
Following the 1.1% decline in consumption in Q1 we expect a larger fall to have occurred in Q2 – where the peak of COVID-19 restrictions is likely to have been felt. We expect a partial rebound in consumption from Q3 and then a return to around average growth over the next two years.

Indeed, monthly retail sales data showed that there was a large rebound in sales of nearly 17% in May following the large fall in April. The NAB Cashless retail sales index released today points to a relatively small fall in June of 2.9% (but possibly a stabilisation in retail sales).

Further our internal spend data suggests while spending in some areas such as retailing has recovered, there are some sectors which remain weak.

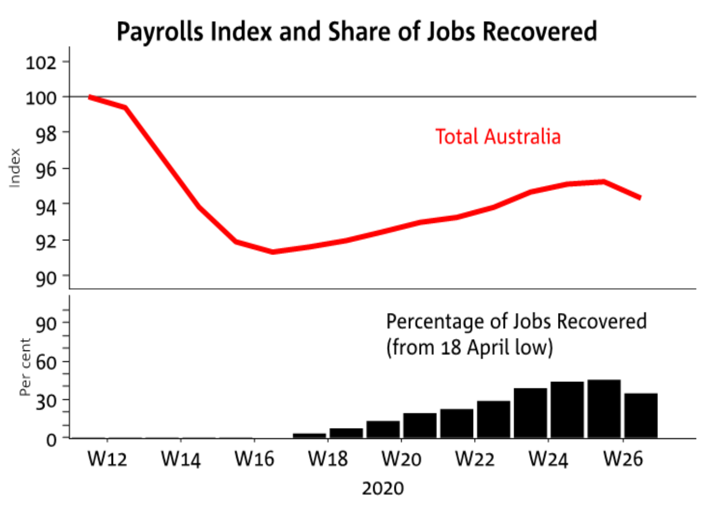
At around 60% of GDP, the outlook for consumption is important. The signs of a rebound in high frequency data is encouraging but it is likely that there is some ongoing impacts of prior hoarding and a shift to different consumption patterns with a larger number of people working from home. There are risks around consumption growth, particularly for services should there be further outbreaks of the coronavirus. Another risk lies with the recovery in the labour market and slower income growth, which could see the household sector weaken further. Debt levels remain high and confidence may be impacted by ongoing domestic and global fallout.

LABOUR MARKET DETERIORATES…



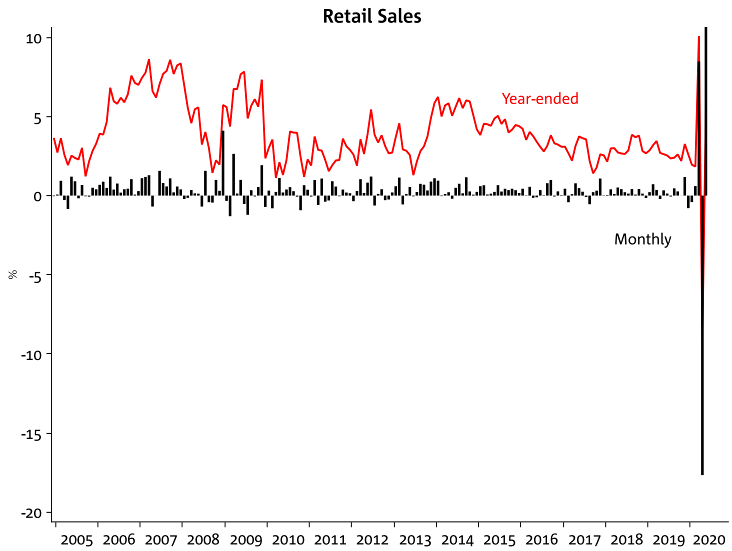
Source: National Australia Bank, Macrobond

PAYROLLS RECOVERY HAS STALLED…



Source: National Australia Bank, ABS

RETAIL SALES HAVE BEEN VOLATILE…



Source: National Australia Bank, Macrobond

HOUSING AND CONSTRUCTION

We expect a significant impact on both established housing prices as well as new construction as the ongoing impacts of COVID playout. We expect house prices to decline by 10-15% over the next year or so, led by declines in Melbourne and Sydney, but also the other capitals as unemployment is expected to rise everywhere and the labour market fall out will see an increase in stress on households. While we had expected construction to fall prior to COVID we now think the decline and duration will be more significant – with a slowing in population growth and decline in prices.

To date prices have held up relatively well in the established market but have clearly turned. Prices fell across the 8 capital cities for a 2nd consecutive month (with Melbourne falling 3 months in a row). We expect these declines to sharpen and continue for some time. In June the decline in dwelling prices was led by declines in Melbourne (-1.1%) and Perth (-1.1%), followed by Sydney (-0.8%) and Brisbane (-0.4%) and Adelaide (-0.2%). Hobart rose by 0.4% in the month. Over the past two months the largest declines have occurred in Melbourne and Perth.

The turn in house prices comes after a very rapid rise since May last year where prices troughed following the easing of prudential measures and further cuts to the cash rate. Therefore despite the modest declines over the past two months prices remain 13.3% higher over the year in Sydney and 10.3% higher in Melbourne. Perth which saw a later recovery remains weak and is 2.5% lower over the year. Hobart continues to be has also performed relatively well and is around 6.4% higher. Gains in Brisbane and Adelaide have been more moderate.

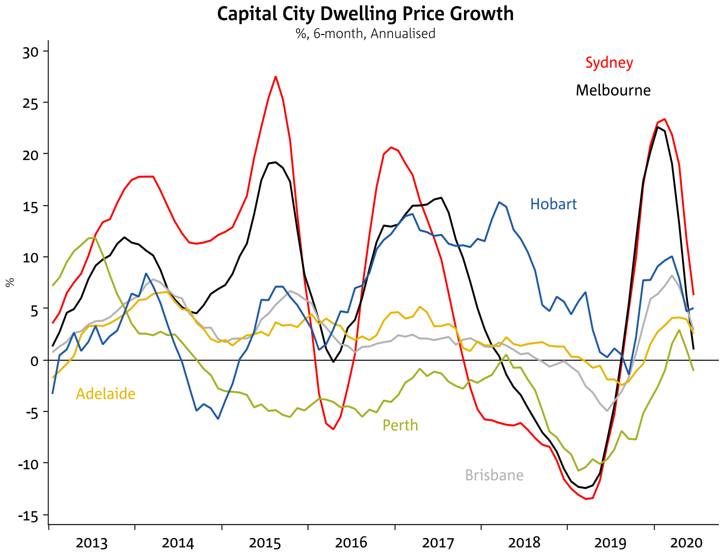
Despite the strong growth in prices in the established market over the past year new construction has continued to decline. The national accounts measure of dwelling investment fell by 1.7% in the March quarter to be about 9.7% lower over the year.

The building activity survey to be released later this month will provide an update on the level of outstanding work and the pipeline of commencements. We expect this to continue to decline with the level of work done – though falling – remaining high, which will see a rapid erosion of the existing pipeline.

Indeed, additions to the amount of work yet to be done are expected to have remained weak with residential building approvals remaining soft despite some improvement over the past year. Indeed, the figures for May showed a very large decline with approvals now at their lowest level in 11 years.

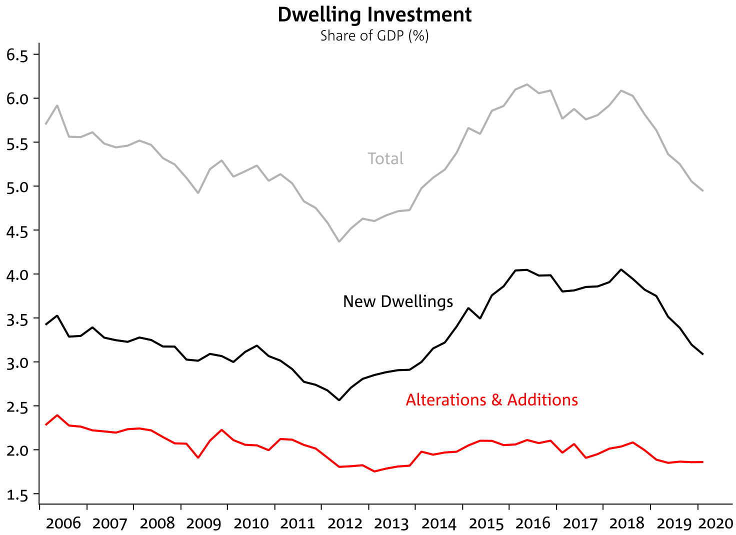
While very low interest rates are likely to support the market, the softening in population growth and rising unemployment are expected to offset this, and see a decline in both prices and new construction over the next year or so.

HOUSE PRICES TO SOFTEN...



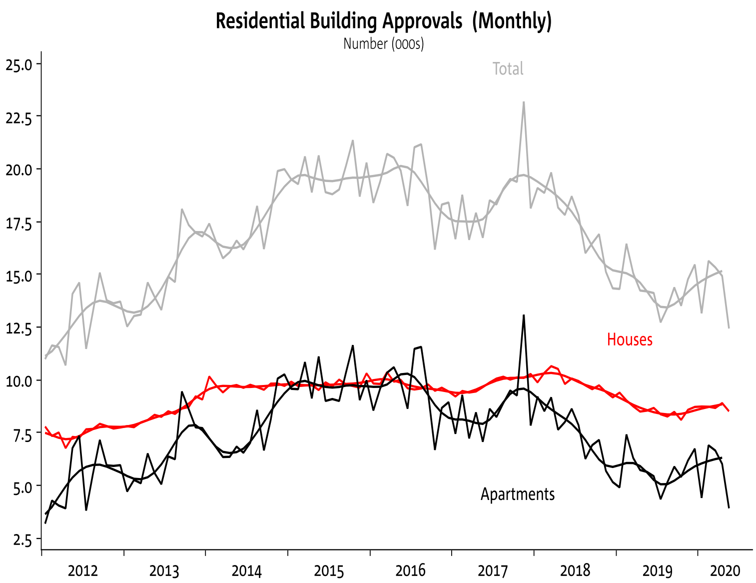
Source: CoreLogic, National Australia Bank, Macrobond

DWELLING INVESTMENT TO FALL FURTHER...



Source: National Australia Bank, Macrobond

BUILDING APPROVALS ARE LOW...



Source: National Australia Bank, Macrobond

BUSINESS AND TRADE

While high frequency indicators indicate somewhat of a bounce back in consumption, it is likely that both the business sector and international trade will see ongoing impacts. Uncertainty, both globally and domestically, will keep business confidence fragile, while international travel restrictions as well as a global downturn will lead to weaker export growth. While commodity demand has remained relatively resilient to date, the impact of reduced international tourism is already being felt in many parts of the economy.

That said the NAB Monthly Business survey for June showed a third consecutive large rise in confidence which is now back in positive territory at +1 index points. However, while the improvement in confidence has been broad-based it likely remains fragile and the survey was conducted before the reintroduction of stage 3 restrictions in Victoria.

While confidence has all but recovered to pre-COVID-19 levels, other indicators remain weak despite also showing significant improvement in the month. Business conditions rose sharply – driven by improvements in all three sub-components - but remain very weak and well below its long-run average of +6 index points.

Capacity utilisation also picked up in the month but remains very low compared with history. All industries remain well below their respective long-run averages. The impact of services industries remains particularly notable. Retail is the only industry to see above average capacity utilisation at present.

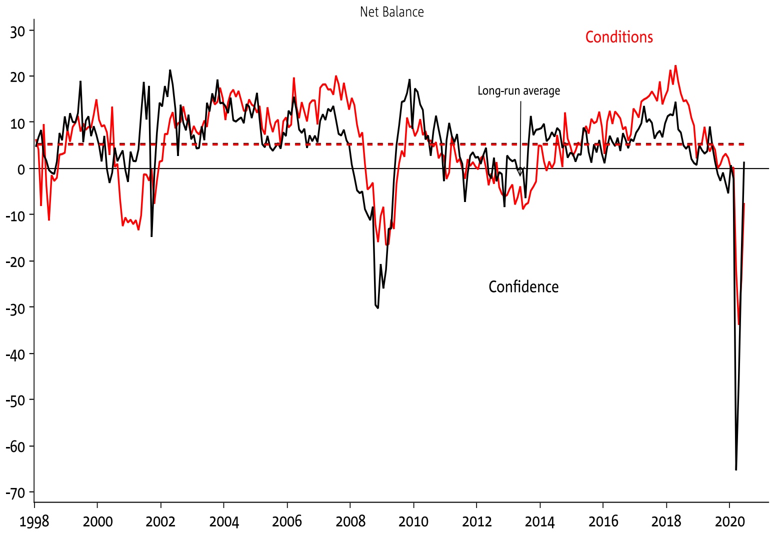
Forward orders rebounded in the month but, like conditions, remain weak – suggesting that while confidence has rebounded, activity may take some time to rebound. Overall, while the survey has shown a very rapid turnaround over the past two months it is important to remember that in a levels sense things remain very weak. Confidence may also again turn negative with further spread of COVID-19 and a return to tighter restrictions on activity.

While little official data (or forward looking data) for Q2 is yet to be released, the release of the NAB Quarterly survey next week will provide an update on expectations for employment and capex going forward. In around a months time the ABS Capex survey will provide an update on investment intentions ahead of the Q2 national accounts which we expect to show a very weak outcome for business investment.

The trade surplus for May was broadly similar to the previous months with broadly offsetting declines across both imports and exports. The decline in goods exports was broad-based while service exports rose on the back of an increase in travel services (education exports).

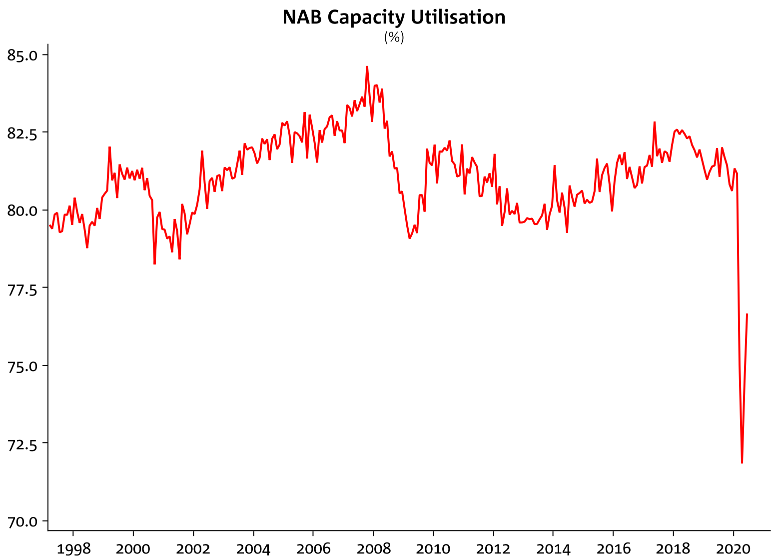
The decline in imports was evident across both goods and services. Car imports fell notably while services imports continue to track at very low levels given border closures.

CONDITIONS RISE BUT REMAIN VERY WEAK...



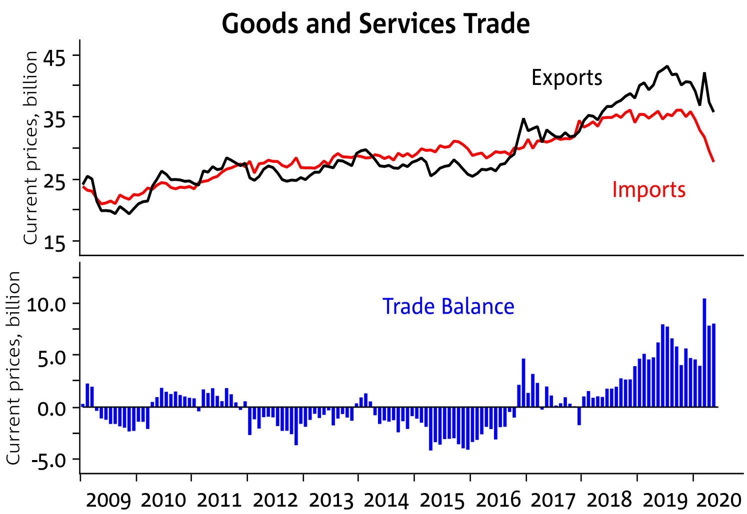
Source: National Australia Bank, Macrobond

CAPACITY UTILISATION IS LOW...



Source: National Australia Bank, Macrobond

TRADE VOLUMES WILL REMAIN SOFT...



Source: National Australia Bank, ABS

COMMODITIES

Spot prices for 62% iron ore were largely range bound in June – trading between US$100 and US$110 a tonne. Concerns around the supply of iron ore from Brazil persist – reflecting the surge in COVID-19 cases in the country – however the impact to date has been unclear. Brazil's iron ore exports fell by 28% yoy in May, but rose by 1.3% yoy in June. On the demand side, global manufacturing PMIs have improved considerably – pointing to a broad recovery in global economic conditions, however second wave outbreaks remain a risk. Our forecasts are unchanged this month, with 62% iron ore to average around US$90 a tonne in 2020, before easing to US$83 a tonne in 2021.

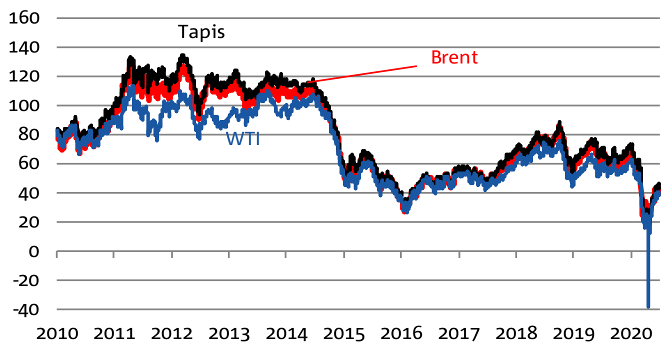
Coal markets remained relatively subdued in June. Prices for thermal coal have remained around the mid-US$50 range since mid-May, in an environment of lower demand (due to COVID-19 countermeasures) and excess supply of natural gas (including LNG) as a substitute fuel for electricity generators. Prices for hard coking coal edged a little higher, but remain well below pre-COVID-19 levels. Our forecasts are unchanged, with hard coking coal forecast to average 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.

The benchmark Brent has been trading around the low US$40s/bbl in recent weeks, with the price largely supported by cuts from OPEC+. OPEC+ will cut output by 9.7 million bpd until July, with a decision on further cuts beyond this period expected soon. Production cuts have also taken place in the United States; the Baker Hughes Rig count has fallen to a low of 258, 73% less than the same time last year. There were positive signs about a nascent economic recovery from indicators such as the US nonfarm payrolls. However, further lockdown measures due to a further flare-up in COVID-19 infections has stoked demand worries. For example, in California, the authorities rolled back some re-opening measures relating to bars, cafes and restaurants.

LNG prices in Asia have remained broadly steady, with the benchmark Japan Korea Marker (JKM) relatively steady at US$2.2/mbtu. Despite an easing of lockdowns in parts of the world, demand continues to remain weak, with a number of US export cargo cancellations in August. The re-emergence of the COVID-19 pandemic in Victoria, parts of the United States, Asia and Latin America will continue to constrain demand and production. Consultancy Rystad Energy is expecting global LNG output to decline by 2.6% in 2020, driven largely by the virus impacts. The value of Australian LNG exports will decline sharply, largely driven by weaker export prices, with the most acute impact being felt in the 2020-21 financial year.

GLOBAL OIL PRICES

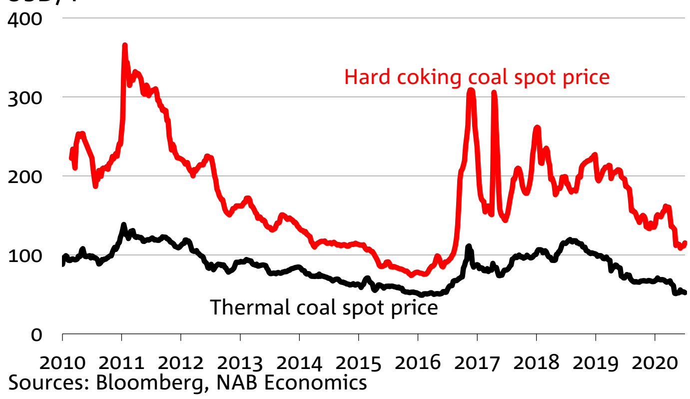
USD/bbl, daily



Source: Refinitiv, NAB Economics

COAL SPOT PRICES

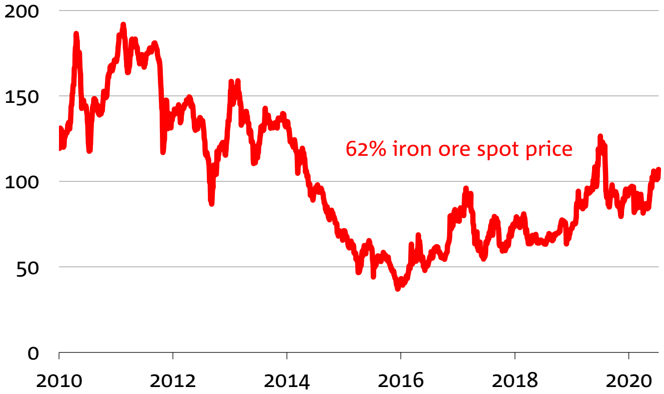
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

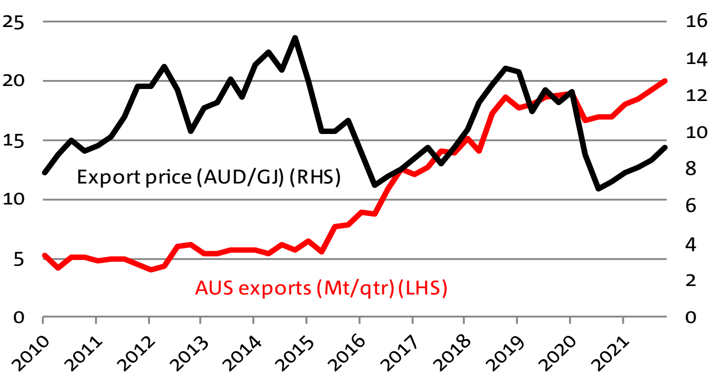
US$/t (incl. cost of freight)



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 July with the cash rate and 3-year yield target of 0.25% maintained and the bank standing ready to again purchase bonds in the secondary market in order to achieve these targets and ensure adequate function of bond markets. This action has not been required over the past few weeks with yields having stayed low.

In the post meeting statement the RBA noted the better than expected health (and economic) outcome domestically but acknowledged the ongoing degree of uncertainty and the risk of further virus spread domestically as well as the impact of the global downturn underway.

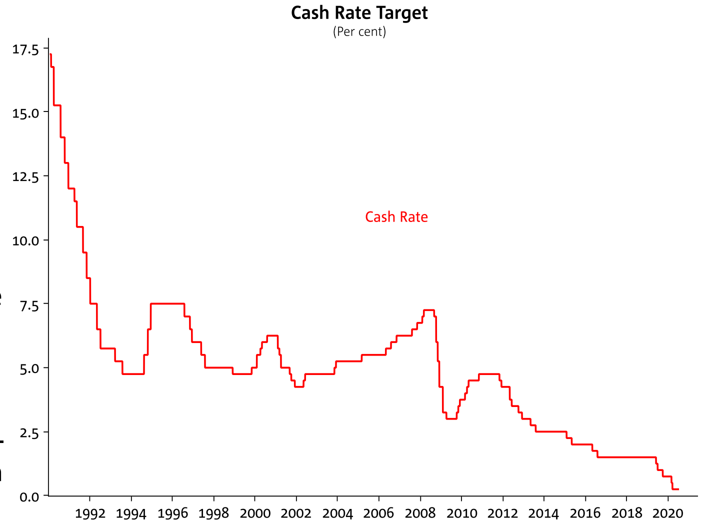
We think – as the RBA has stated – that the current policy settings will remain in place for an extended period. With the goals of full-employment and inflation sustainably within the 2-3% target band someway off based on our forecasts for growth and the labour market, we do not see a tightening in policy within our forecast horizon (currently December 2022). While growth will see a recovery, the substantial hit to activity in Q2 is not fully recovered on our forecasts until December 2021. However, with the recovery in the labour market to lag this rebound in activity the unemployment rate is expected to remain well above the 5.2% seen pre-COVID – as well as, well above 4.5% which is currently considered full employment.

This will likely see very soft wage outcomes for some time and see little inflationary pressure on output prices. Indeed, while we expect a spike in headline inflation in Q3 (unwinding the deflationary impact of childcare subsidies in Q2) that sees inflation remain within the band for the better part of the next year, core inflation is expected to soften further. This will see inflation continue to track below the lower part of the target for an extended period after having undershot since around 2015.

With consumer demand remaining soft, labour market pressure all but dissipated and international inflation likely to be softer than before – there is little signs that policy will need tightening for an extended period. Indeed, while the RBA still has room to move on unconventional policy, the cash rate is now at its lower bound meaning that fiscal policy will have a larger role to play in active economic management. Fiscal policy has been a key support throughout the crisis and we think more will be required. It is likely that JobKeeper in its current form will be wound back, but will become more targeted towards industries that continue to see impacts. A permanently higher unemployment benefit is also possible.

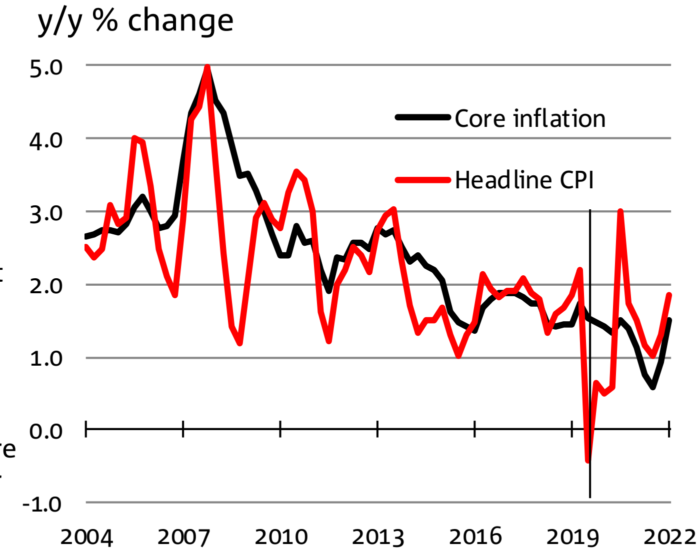
The exchange rate will remain an important automatic stabiliser but this impact may be muted in the short run with restrictions on travel and other services exports. Commodity prices to date have held up and have likely been a support to the exchange rate that has continued to track around US68c. We have left our forecasts unchanged and expect the AUD/USD to appreciate from here, reaching 72c by end 2020 and 75c by end-2021.

CASH RATE TO STAY LOW...

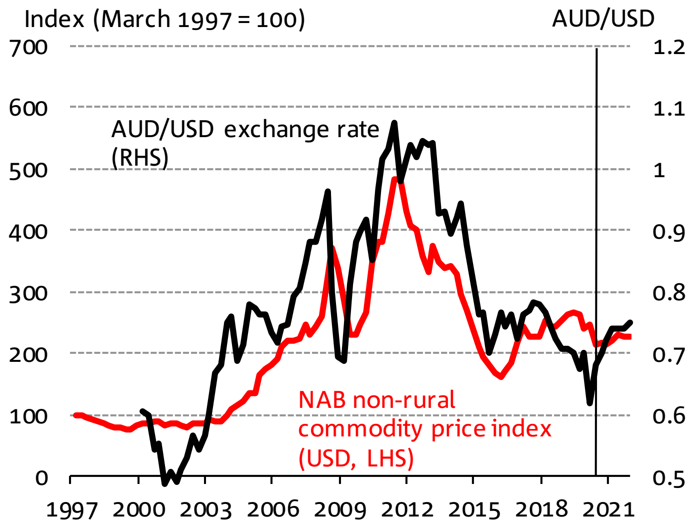


Source: National Australia Bank, Macrobond

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	-1.2	-0.5	3.5	2.7	1.4	-3.5	3.1	3.0
Dwelling Investment	0.0	-10.8	-17.4	9.7	4.7	-6.9	-16.0	-6.9	17.2
Underlying Business Investment	-1.8	-6.9	-27.7	-1.5	1.3	-1.7	-20.2	-17.8	5.1
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**	**-0.6**	**-2.8**	**3.4**	**2.9**	**1.3**	**-3.6**	**0.9**	**3.9**
Stocks (b)	-0.2	-0.5	0.6	0.2	0.1	-0.2	-0.3	0.6	0.1
GNE	**1.6**	**-1.1**	**-2.2**	**3.5**	**3.0**	**1.0**	**-3.9**	**1.6**	**3.9**
Exports	4.0	0.2	-4.7	-4.8	5.1	3.2	-3.9	-4.4	-5.1
Imports	0.3	-7.0	-10.8	-0.8	4.1	-1.2	-14.1	-3.5	-0.4
GDP	**2.0**	**0.3**	**-0.7**	**2.6**	**2.8**	**1.8**	**-1.8**	**1.6**	**2.8**
Nominal GDP	5.3	2.2	0.2	4.1	5.1	5.0	-0.8	2.8	4.4
Current Account Balance ($b)	14	-35	-46	-33	-39	11	52	39	23
(%) of GDP	0.7	-1.8	-2.3	-1.6	-2.0	0.6	2.6	1.9	1.1
Employment	2.4	0.2	-4.5	1.6	2.7	2.4	-4.1	-0.5	1.7
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	1.0	1.8	1.8	0.5	1.5	1.8
Core CPI	1.4	1.5	1.5	0.6	1.7	1.4	1.4	1.1	1.5
Unemployment Rate	5.1	7.1	7.2	6.2	5.0	5.2	8.1	6.9	5.8
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	10/07/2020	Jun-20	*Sep-20*	*Dec-20*	*Mar-21*	*Jun-21*	*Sep-21*	*Dec-21*	*Mar-22*	*Jun-22*
WTI oil	US$/bbl	40	26	37	42	43	44	45	46	46	47
Brent oil	US$/bbl	43	33	40	45	47	48	49	50	50	51
Tapis oil	US$/bbl	47	35	42	47	49	50	51	52	52	53
Gold	US$/ounce	1801	1710	1730	1730	1750	1780	1800	1850	1850	1880
Iron ore (spot)	US$/tonne	107	92	93	87	85	90	80	75	80	75
Hard coking coal*	US$/tonne	n.a.	118	113	118	123	138	133	138	148	153
Thermal coal (spot)	US$/tonne	54	56	55	59	59	61	62	65	66	64
Aluminium	US$/tonne	1659	1498	1620	1680	1740	1760	1770	1780	1790	1800
Copper	US$/tonne	6419	5351	5750	6000	6250	6500	6750	7000	7100	7000
Lead	US$/tonne	1842	1678	1800	1875	1950	2025	2025	2048	2072	2095
Nickel	US$/tonne	13473	12233	13000	13500	13900	14100	14200	14300	14400	14400
Zinc	US$/tonne	2184	1968	2100	2125	2150	2175	2175	2200	2225	2250
Aus LNG**	AU$/GJ	n.a.	8.8	6.9	7.3	7.8	8.1	8.5	9.2	9.3	9.4

* 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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