July 2020

National Australia Bank

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

The recovery in the global economy that started in May continued through June. We expect that the trough in global economic activity will be in Q2, with a substantial rebound likely in Q3 barring a significant re-introduction of COVID-19 countermeasures. Nevertheless, we still expect to see the biggest contraction in annual growth since at least the early 1950s and most likely since the Great Depression. The global economy is forecast to contract by 3.5% in 2020 (previously -3.7%), before increasing by 6.0% (was 6.2%) in 2021, and 3.9% in 2022 A key risk to this outlook is renewed outbreaks of COVID-19 (as is occurring in the US) or uncontained outbreaks (e.g. Latin America, India) and re-imposition of restrictions or delays in their removal. A reimposition of at least some restrictions has already occurred in some countries, such as in parts of the US, India and China although there has not yet been a repeat of the (essentially) nationwide shutdowns seen earlier. The uncertainty over the outlook will weigh on business and consumer confidence, and is one reason we expect that a full recovery from the global recession will take time for many countries.

- The broadly improving trends for the global economy have generally resulted in stronger conditions in global **financial markets**. Financial condition indices for major advanced economies deteriorated sharply between mid-March and mid-April, but have subsequently improved, although they are not yet back to pre-COVID-19 levels. This recovery is relatively broad-based – with equity market indices in the United States and Emerging Markets showing increases in excess of 40% from the late March lows, while the increase in other advanced economy indices was slightly below this rate.
- **Commodity prices** have trended higher from their April trough, however the CRB Index remains well below pre-COVID-19 levels. In particular, energy prices have been weaker – reflecting the impact of sharply weaker demand for oil, as COVID-19 has disrupted global transportation. While OPEC+ has agreed to production cuts, these measures have only restored prices to the low US$40 range – a low level by recent historical standards. The recovery in non-energy commodity prices has been muted, despite improving global manufacturing indicators.
- After the massive declines in activity in many **advanced economies** (AEs) over March and April, incoming data point to a strong rebound over May and June. However, the average level of activity in Q2 is still well below that seen in Q1, so our expectation of very large GDP falls in the quarter remains in place. We continue to expect that a full recovery will take an extended period, and the speed of recovery will be uneven particularly if there are further outbreaks of the virus as in the US currently. More recently, some high frequency data indicators for the US have either plateaued or fallen slightly as the virus has taken off in some states and as some restrictions have been re-imposed and re-opening plans delayed. Japan has also seen an upturn in cases recently but it has yet to lead to a shift in COVID-19 policy measures.
- **Emerging markets** (EM) activity declined by an estimated 2.2% yoy in Q1, the weakest rate of growth since at least early 1995. The sharp downturn in China – due to its COVID-19 countermeasures – was the primary driver. While China likely recorded a stronger than expected recovery in Q2, the downturn in other major EMs during this period is likely to result in a larger slowdown in the quarter. PMI surveys for EM economies were considerably improved in June and we expect the broad recovery in EMs to commence in Q3. There remains considerable uncertainty, particularly given the unchecked spread of COVID-19 in a number of these economies. The weakness in global trade is likely to remain a constraint on the emerging market recovery in the near term – with economic growth in the region more highly dependent on trade than advanced economies.
- The **global economy** is continuing to recover from the extremely deep downturn caused by measures to reduce the spread of COVID-19. The JP Morgan Global PMI improved further in June with broad based gains across most countries and for both manufacturing and services. While a wide range of countries have eased their restrictions, the virus remains a key risk to the outlook. Some countries have already re-imposed (some) restrictions at the local/state level (e.g. India, US, China). Another uncertainty is how governments manage the unwinding of the large fiscal programs put in place. Not surprisingly measures of policy uncertainty are extremely high and financial markets continue to exhibit considerable volatility. These factors will weigh on business and consumer confidence, and is one reason we expect that a full recovery from the global recession will take time for many countries.
- We expect the global economy to contract by 3.5% in 2020 (previously -3.7%), before increasing by 6.0% (was 6.2%) in 2021. In 2022 we expect the recovery to continue, with growth of 3.9%, modestly above its (pre-COVID) average of recent decades.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday. Subsequently our China forecast was changed following the release of China Q2 GDP data; see China's economy at a Glance.

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***Australia**: We have revised up our forecasts for activity – now expecting a decline of around 4% in GDP for Q2 (from -8.5%). Our internal transactions data suggest that while there was a deep dip in activity in early April, there has been a rapid rebound in activity. Overall our forecasts in annual terms are now for a decline of 1.8% in 2020, followed by growth of 1.6% and 2.8% in 2021 and 2022 respectively. We still expect the unemployment rate to peak at over 8% in the near term and for only a gradual recovery over the next two years – with unemployment around 6% at end-2022. Like our internal data, the NAB Monthly Business Survey for June showed a continued rebound in conditions and confidence (which turned positive in the month) but it is important to remember that despite the much faster than expected turnaround in survey measures, all measures bar confidence remain historically low. In particular, capacity utilisation remains below average across all industries except for retail. Overall, while we have revised up our forecasts, it is important to remember that the economy has undergone a very large shock and, while there are some encouraging signs of a recovery, that significant risks remain. Some industries will face longer term fallout, while confidence may remain fragile as both global and domestic uncertainty remains elevated.*

- The RBA left current policy settings in place in July – as we expect it to do for some time. The cash rate remains at 0.25% as does the target for 3-year AGS yields. While the RBA staff forecasts are likely to see an upgrade in the August SMP – almost all likely scenarios will see inflation continuing to track below the target band for an extended period and unemployment remaining elevated for some time. Our forecasts certainly paint a picture of easy policy for some time. More broadly on the policy front we expect that the government will continue to provide significant support beyond September – with a likely more targeted JobKeeper program and an ongoing form of the higher unemployment benefit. We also think there will be some consideration of household tax cuts and other reforms. Next week's budget update will likely shed some light on the shape of future policy, but we think the economy will require ongoing support and with monetary policy options very limited, fiscal policy will need to play a more active role.
- The **unemployment rate** rose further in June, on the back of more individuals searching for work, to 7.4%. The participation rate rose 1.3ppt but remains well below the record high 66% reached prior to the pandemic. On the positive side, employment rose by 211k and hours worked rose 4%. Underemployment and underutilisation – broader measures of unemployment – edged lower in the month. We expect unemployment to rise further in coming months, peaking at over 8% as workers return to the labour market. From there were expect a continued recovery in hours worked and employment but for this to be a gradual process with the unemployment rate around 6% by end-2022.
- Household **consumption** has fared better than initially expected. Following the 1.1% decline in Q2, we expect a 6.5% decline in Q2 (compared with our previous forecast of -15%). Retail sales appear to be stabilising after large swings in recent months but based on the NAB Cashless Retail Sales measure we expect a fall of around 2.8% in June. High frequency internal data shows that retail sales have rebounded sharply – but areas such as accommodation remain weak. Going forward we see risks around the sustainable rate of consumption growth with unemployment remaining elevated, wage growth softening further and the debt burden still high.
- The **NAB monthly business survey** for June saw the rebound in both confidence and conditions continue. Confidence turned positive and appears to have recovered just as fast as it deteriorated – with an improvement across all industries in the month. However, while the survey has shown encouraging signs in the business sector, the activity side remains weak. Conditions saw a broad-based improvement but remain at low levels. These moves have been mirrored in other variables such as forward orders, capex and capacity utilization. The latter will need to recover substantially before business can once again move into an expansion phase. Next week's Quarterly survey will provide an update on reported expectations for key variables such as capex and employment – though our forecasts for business investment remain pessimistic.
- According to the CoreLogic 8-Capital City **House Price** index decline for a second consecutive month. The declines were led by falls in Melbourne, Perth and Sydney, though Qld and SA also so declined. We continue to expect a 10-15% decline in house prices over the next year or so. While interest rates are at very low levels, the deterioration in the labour market and slowing population growth will weigh. Alongside the softness in the established market, we expect dwelling construction to decline further – with the pipeline of work rapidly eroded on the back over very low building approvals.
- **Net exports** will see ongoing impacts from the disruption to the global economy and ongoing international border movements. We expect the contribution to growth from the external sector to fade going forward. In May the trade balance was broadly stable at $8bn. Both exports and imports declined in the month.
- Our forecasts for **commodity prices** including, iron ore, thermal and coking coal and oil are broadly unchanged. Iron ore continues to trade between $100-$110 per tonne while thermal coal continues to hover around $50. Coking coal prices edged higher in the month.
- The **exchange rate** continues to track around the US69c mark. From hear we expect an appreciation of the Aussie, reaching 72c by end-2020, 75c by end-2021 and 78c by end-2022.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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