AUSTRALIAN GDP PREVIEW

Q2 2020 – COVID-19 causes a very large decline

NAB Economics

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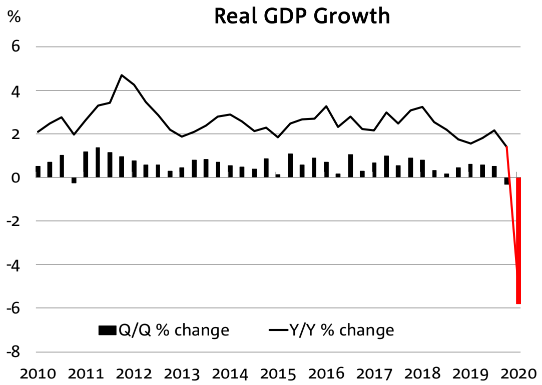
Bottom line: GDP is expected to decline by 5.8% (-5.1% y/y) in Q2 – the largest quarterly fall on record. This reflects nationwide lockdowns that heavily impacted the early part of the quarter, where timely indicators such as labour force, retail sales, payrolls and the COVID-19 household survey have already shown a very large hit to activity in Q2. We expect the decline in activity to be driven by a sharp fall in household consumption – particularly in services where we know the virus containment measures had the most significant impact. The partial indicators released this week suggest that residential construction and business investment also saw sizeable falls, though not as severe as we had feared. Going forward we expect a broadly flat outcome for the September quarter with the second round of lockdowns in Victoria offsetting a partial rebound in economic activity elsewhere. Overall, we expect growth to recover from here, but gradually – with the level of GDP not fully recovered until early 2023.

- **We expect next week's GDP print for Q2 to show the largest quarterly fall on record at -5.8% q/q (-5.1%y/y).** This outcome will confirm the first technical recession in Australia since the early 1990s, though will not come as a surprise given the peak impact of coronavirus containment measures occurred in April. The decline will be led by a fall in household consumption, particularly for services which were most heavily impacted by the containment measures. Key partials for dwelling and business investment released this week point to sizeable – though not as severe as expected – falls. However, these declines are likely to be an order of magnitude smaller than the decline in consumption. Net exports looks to have made a solid 1.2ppt contribution to growth in the quarter, with a decline in exports more than offset by a fall in imports. On a production basis we expect to see significant variation between industries – with those related to household services and export services (tourism and education) most significantly impacted.
- **Looking forward**, we expect a recovery in activity but it will be gradual, with GDP not reaching pre-virus levels until early 2023. We expect a fall in activity in Victoria to broadly offset a rebound in growth elsewhere in the September quarter before an aggregate improvement across the states in Q4. This would see GDP fall by 3.8% in year-average terms this year and rise by 0.8% in 2021. From there we see growth rising to around trend. This gradual recovery in activity will also see the labour market improve but with a lag. Therefore, after peaking at over 9% this year the unemployment rate is expected to fall to 7.6% by end 2021 and 6.6% at the end of 2022.
- The **key risks for our forecasts** for the quarter are around services consumption. Based on key partials, goods consumption looks to have declined by around 3.4%. However, with the pandemic having a direct impact via shut downs on a range of services – where little advance information is available – it is difficult to quantify the likely impact on services, though it is expected to be large. Outside of the obvious risks around the future spread of the virus, medium term risks to the recovery lie around the rebound in both consumption and business investment. There is likely to be some pent-up demand by households but the deterioration in the labour market is likely to weigh on consumption going forward and how quickly confidence recovers will be important. Business confidence is fragile so how well it holds up will also be important.
- **Policy implications**: There are few policy implications of this release with both fiscal and monetary policy makers already having acted on the knowledge of a large fall in activity. This release will just confirm that fact. We think that further out there will likely be further support on the fiscal side, particularly for households as the labour market recovery will take time. There is also the potential for further support to businesses. The RBA could also tweak its current package should it be disappointed by the pace of recovery or if the spread of the virus was to worsen, leading to even weaker economic outcomes.



Real GDP Forecasts

	Q/Q		Y/Y	Contribution to Q/Q
	Mar-20	Jun-20	Jun-20	Jun-20
Household Consumption	-1.1	-9.2	-9.7	-5.2
Dwelling Investment	-1.7	-5.4	-11.4	-0.3
Underlying Business Investment	-1.0	-2.8	-6.9	-0.3
Underlying Public Final Demand	1.5	1.1	4.8	0.3
Domestic Final Demand	**-0.5**	**-5.6**	**-5.5**	**-5.6**
Stocks (a)	-0.2	-1.4	-0.5	-1.4
GNE	**-0.7**	**-7.1**	**-6.8**	**n.a.**
Net exports (a)	**0.5**	**1.2**	**1.7**	**1.2**
Real GDP	**-0.3**	**-5.8**	**-5.1**	**n.a.**

(a) Contribution to GDP growth

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