EMBARGOED UNTIL 11.30 AM AEST, WEDNESDAY 12 AUGUST 2020

# THE FORWARD VIEW: AUSTRALIA AUGUST 2020

*VIC virus shutdown makes the outlook significantly worse with no quick bounce back. Unemployment a big issue as is poor confidence.*

## OVERVIEW

- Virus closedown in Victoria and fears of further spread has led to significant downgrading of our economic outlook. And a modest recovery into 2021 – unlike the RBA's quick bounce-back forecasts (again).
- Interestingly both our internal data and yesterdays NAB Monthly Business survey suggest that consumption and the broader economy was maintaining its recovery momentum until late July. That said capacity levels were still down 4% from late last year, forward orders did not really improve in July and confidence retreated significantly – all before the Victorian stage 4 restrictions.
- While it is very difficult to forecast the impact of Victorian announcements, our analysis suggests that Victorian output could well fall by 15% in Q3 (with further spill overs into Q4). Nationally that would take around 3 percent off Q3 GDP - pointing to only a small increase in Q3 and a relatively flat Q4. That level of activity would also lead to a significantly worse unemployment outcome
- Over the course of 2020 we now see output down around 5.7%, including a fall of 6.25% in Q2. In year average terms we expect a decline of 3.8% (previously we were expecting -1.8%). This would see unemployment rising to around 9.2% by year end but peaking closer to around 9.6% in early 2021.
- Given that outlook and the withdrawal of current fiscal stimulus in early 2021 we don't really see a rebound in growth till mid 2021. As a result we see GDP rising by around 3% through 2021 – but less than 1 per cent in year average terms. In financial year terms that sees a fall in GDP of around -3.5% in 2020/21 (the Government had forecast -2.5%). Finally for 2022 we have kept growth at around 2¾%.
- These forecasts imply that we don't return to the levels of GDP reported in late 2019 till early 2023. Also unemployment stays higher for longer. By late 2021 we now see unemployment at around 7.6% (RBA is at 8½%) and 6½% by end 2022.
- Clearly that set of forecasts means that wages growth will remain lower for longer and inflation equally lower. For inflation by end 2021 we have around 1% in core terms and 1.4% by end 2022. A higher AUD is also not helping but will probably not be as negative as would normally be the case given current circumstances.
- At this stage we still see house prices falling by around 10-15% as a result of the current downturn and much more substantial falls in commercial property prices – especially in retail & office in Sydney / Melbourne CBDs.
- Finally, much still depends on the virus and the confidence effects of non Victorian states. Also the hit to unemployment is likely to have severe implications for already struggling firms (the so called zombie firms).

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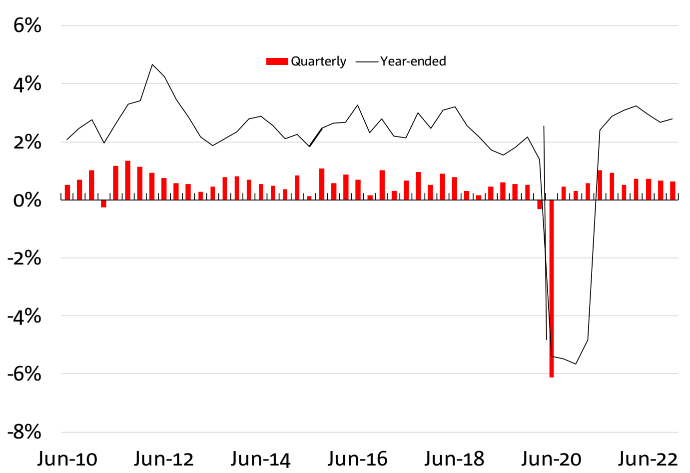
## KEY ECONOMIC FORECASTS

| | 2019 | 2020-F | 2021-F | 2022-F |
|---|---|---|---|---|
| Domestic Demand (a) | 1.3 | -4.8 | -0.5 | 3.6 |
| **Real GDP (annual average)** | **1.8** | **-3.8** | **0.8** | **2.9** |
| **Real GDP (year-ended to Dec)** | **2.2** | **-5.7** | **3.1** | **2.8** |
| Terms of Trade (a) | 5.1 | 0.1 | 2.2 | 1.3 |
| Employment (a) | 2.4 | -3.7 | 0.4 | 3.1 |
| Unemployment Rate (b) | 5.2 | 9.2 | 7.6 | 6.6 |
| Headline CPI (b) | 1.8 | 0.5 | 1.4 | 1.7 |
| Core CPI (b) | 1.4 | 1.1 | 1.1 | 1.4 |
| RBA Cash Rate (b) | 0.75 | 0.25 | 0.25 | 0.25 |
| $A/US cents (b) | 0.70 | 0.74 | 0.78 | 0.80 |

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

## NAB GDP FORECASTS



# LABOUR MARKET, WAGES AND THE CONSUMER

The June labour force survey showed a further deterioration in the unemployment rate which rose to 7.4%. Again this increase in the unemployment rate was driven by a pickup in the participation rate (up 1.3ppt) as workers re-entered the labour force to search for work. Employment rose by 211k in the month and hours worked rose by 4%. The turnaround in employment is encouraging in the sense that as the economy opens up, the labour market recovers. Reflecting the pickup in hours, broader measures of underutilisation showed an improvement in the month. However, there is some way to go before the labour market fully recovers. Employment is still around 660k lower than 3 months ago, while hours worked are 6% below pre-COVID levels.

From here we expect employment to continue to recover, but that it will take an extended period with the level of GDP not fully recovered until early-2023. This will see a gradual recovery in hours worked and a gradual recovery in the broader measures of underemployment (which will likely decline even as headline unemployment drifts higher).

There are some risks around this outlook as highlighted by ABS payrolls data which shows that the recovery in employment may have stalled in July. The number of 'jobs' was broadly flat in late July – with a decline in Victoria offset by increases elsewhere.

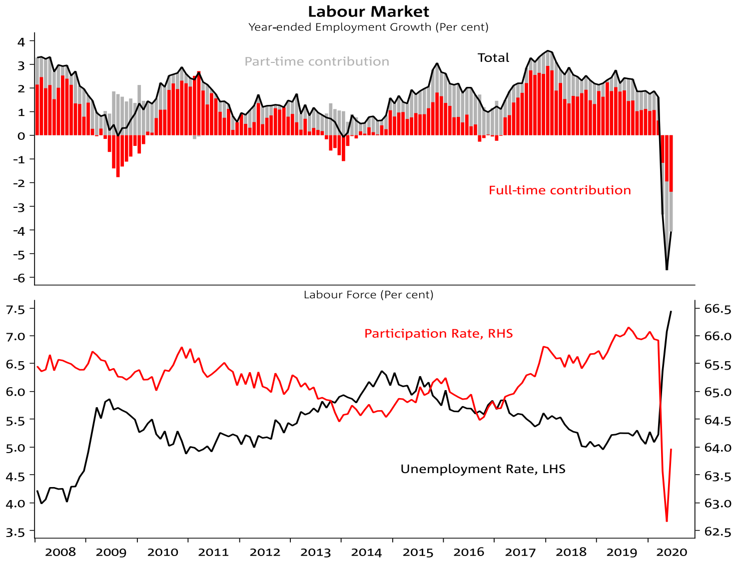
While the impact on the labour market has been significant, it appears that household incomes have held up relatively well due to the unprecedented support provided by the government through the JobKeeper and JobSeeker programs.

Indeed, retail sales continue to track at around 6% above pre-COVID levels. The massive 17% decline recorded in April appears to have been more than offset by the recovery in subsequent months. This is in line with our internal transactions data which showed that consumer spending fell by around 15% and is now back above the levels seen in late February. The NAB Cashless Retail Sales index points to a 0.7% fall in retail sales in July following a 2.9% rise in June.

Overall we expect a large, 7% fall in consumption for Q2 following the 1.1% fall in Q1. The decline is expected to be driven by a fall in both goods consumption as well as services consumption. At present we expect a 1.5% rise in Q3 – with the current stage 4 restrictions in Melbourne having a significant impact.

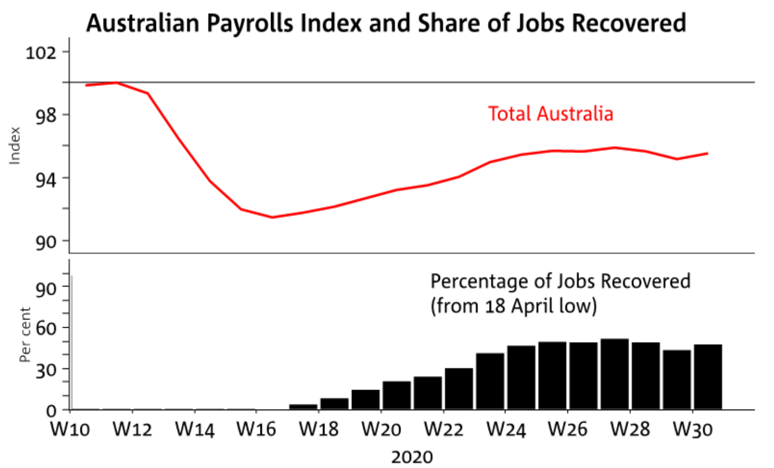
Beyond that, we expect average growth in consumption. While retail sales have shown significant strength in recent months, income has been supported by government transfers. As these wind down, the higher unemployment rate and slowing wage growth is likely to see restraint in the household sector, which continues to carry a significant debt burden.

## LABOUR MARKET DETERIORATES...



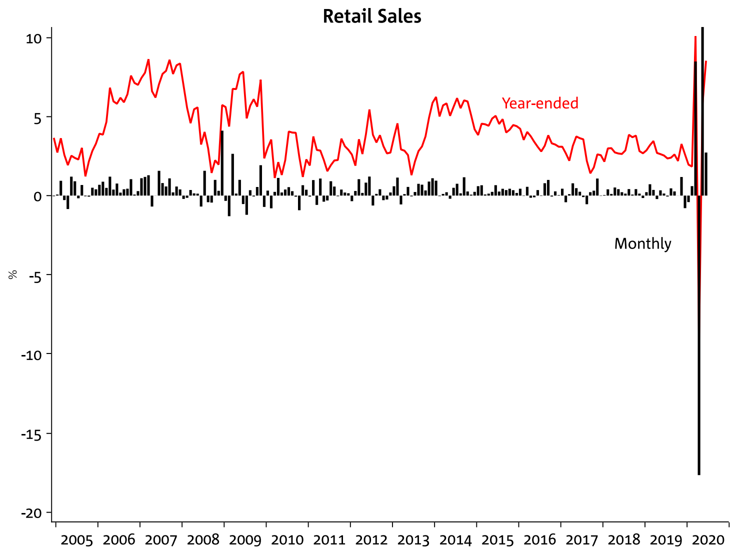
Source: National Australia Bank, Macrobond

## PAYROLLS RECOVERY HAS STALLED...



Source: National Australia Bank, ABS

## RETAIL SALES HAVE BEEN VOLATILE...



Source: National Australia Bank, Macrobond

# HOUSING AND CONSTRUCTION

House prices in the established market have continued to decline – though at a much more gradual rate than initially expected. Loan holidays and substantial government support to the household sector have helped. From here, we expect house prices to decline by 10-15% as a result of the current downturn. Declines are likely to be led by Sydney and Melbourne which will be most impacted by slowing population growth and increased supply. That said, we see softness across all mainland capitals given the widespread deterioration in the labour market.

The CoreLogic 8-Capital City House Price Index declined by 0.8% per cent in July (to be 1.7% lower over the past three months) while combined regional prices were flat. The decline in city prices were led by a 1.2% fall in Melbourne and a 0.9% fall in Sydney. Perth (-0.6%), Brisbane (-0.4%) and Hobart (-0.2%) also saw declines. Prices were 0.1% higher in Adelaide. Over the past three months, Melbourne has now seen a 3.2% decline while Sydney and Perth have also seen declines of over 2%. Despite the recent softening, prices remain well up on a year ago in each of the major capitals reflecting the strength of the run up in the second half of 2019.

The recovery in activity in the established market has stalled recently. Auction clearance rates have again fallen after having previously rebounded strongly from their April lows. New listings growth has slowed but is around 46% higher than a year ago. Overall, total listings are now around 12% lower than a year ago in capital cities.

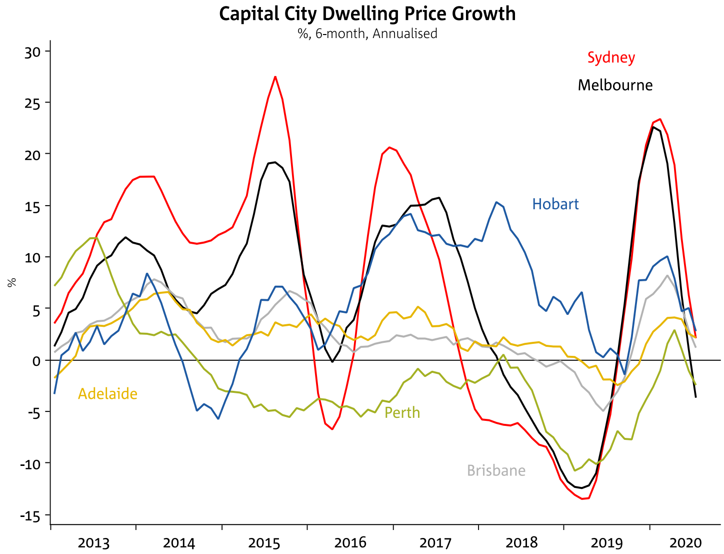
The rental market has also softened, with the vacancy rate elevated in both Sydney and Melbourne and advertised rents falling. This is likely to further weigh on prices in these markets.

In addition to the softness in the established market we expect construction to continue to decline. Following the 1.7% decline in the March quarter, we expect further falls of around 18% over the rest of 2020. The pipeline of work has eased with continued high rates of completions. However, building approvals have fallen to the lowest level in around 12 years led by a decline in approvals for higher-density dwellings.

Alongside the softening in the housing market has been a slowing in housing credit growth. In July housing credit rose 0.2% driven by a 0.3% rise in credit extended to owner-occupiers, while investor credit was flat. In year-ended terms housing credit continues to track at just over 3%, with owner-occupier credit (5.4%) offsetting a 1% decline in investor credit.

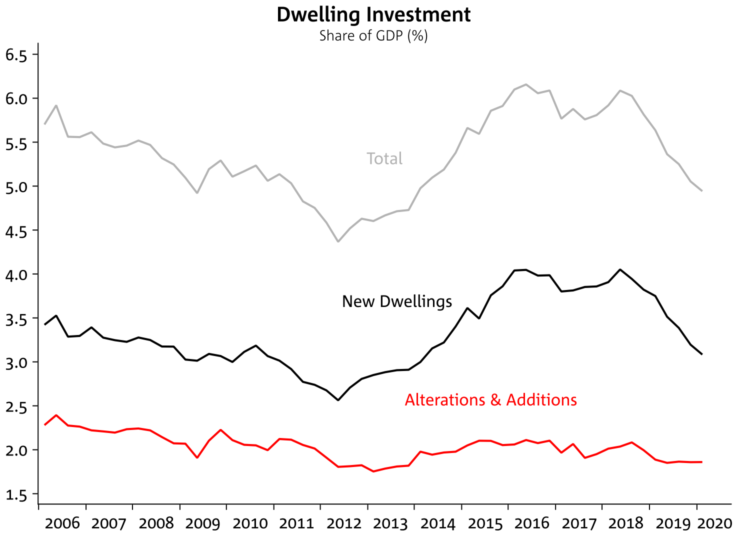
Overall, it is likely conditions in the housing market will remain weak for some time. Households are likely to be impacted by a softer labour market while investor sentiment is likely to remain weak. While we don't see a fundamental oversupply of apartments, the sharp slowing in population growth will weigh on the sector over the next couple of years. The rapid adjustment in supply, via falling construction will support prices, as will record low interest rates.

## HOUSE PRICES TO FALL FURTHER...



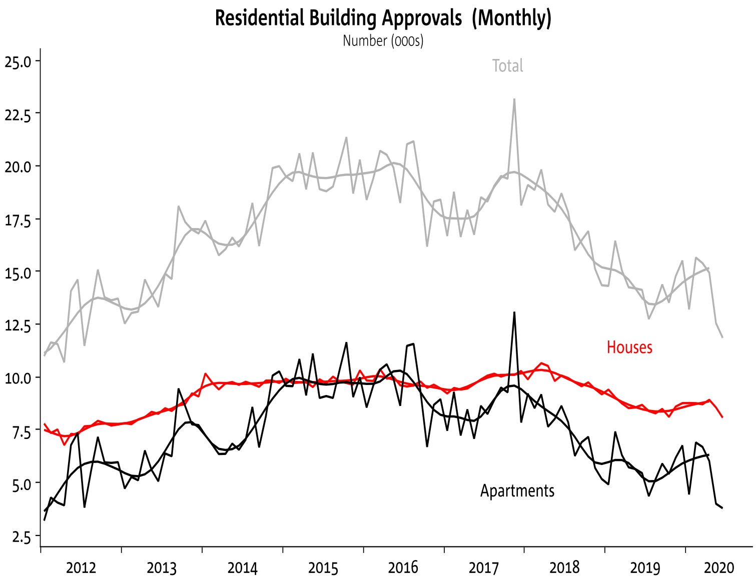
Source: CoreLogic, National Australia Bank, Macrobond

## DWELLING INVESTMENT TO FALL FURTHER...



Source: National Australia Bank, Macrobond

## BUILDING APPROVALS ARE LOW...



Source: National Australia Bank, Macrobond

# BUSINESS AND TRADE

Business and trade will continue to see large disruptions as a result of the pandemic. Business activity will see further impacts in the near term from containment measures and state border closures, while trade will see a likely longer impact from closures to the international border. Elevated global uncertainty may also weigh on business planning and decisions going forward.

The fragility of business confidence was reflected in the NAB Monthly Business Survey for July which saw confidence deteriorate sharply even before the announcement of stage 4 lockdowns in Melbourne. While the escalation in restrictions was yet to be announced at the time of the survey there had been growing concerns about the spread in both Victoria and NSW. This saw a broad-based deterioration across industries and most states.

At the same time, however, activity continued to recover in July – albeit from a low base. Business conditions continued their recovery, rising 8pts to 0 index points. That is, the index now lies at the threshold of improving and deteriorating conditions in aggregate. The improvement in conditions was driven by a significant improvement in recreation & personal services – but are most favourable in retail and wholesale. Conditions were softest in construction by some margin, but also negative in transport & utilities and finance, business & property.

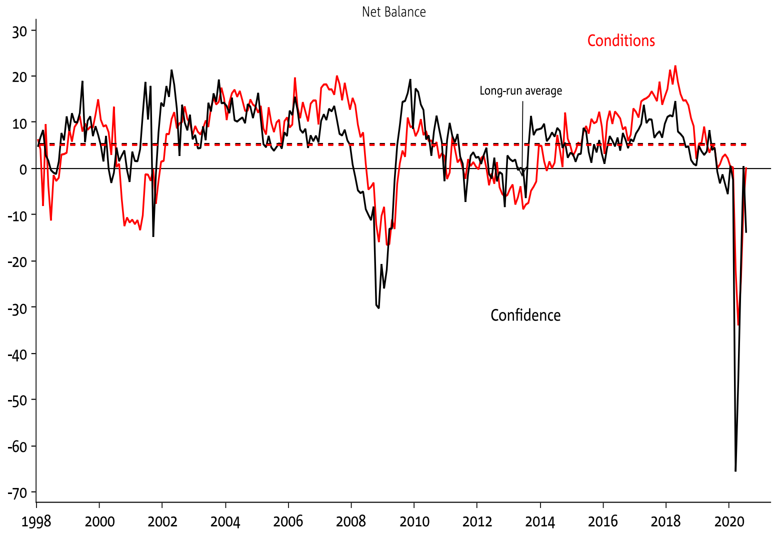
While the rapid recovery in conditions over the past three months is encouraging, it is important to note that the improvement comes off a low base. The survey measure of capacity utilisation suggests that while activity is improving it remains weak. Forward orders which saw a marginal improvement in the month also points to ongoing weakness in the pipeline of demand. Thus while both of these forward looking indicators suggest that there has been some improvement, there needs to be an ongoing lift in overall activity before businesses can return to normal.

The fragility of confidence and the weakness in forward looking indicators suggest that the sector will require ongoing support.

Exports rose in June driven by a rise in iron ore exports (to China). This more than offset the increase in imports in the month (due to a rise in consumption imports). The trade surplus has hovered at around $8bn per month over the past three months, reflecting the sharp decline in imports since the onset of the global pandemic which has more than offset the decline in exports.

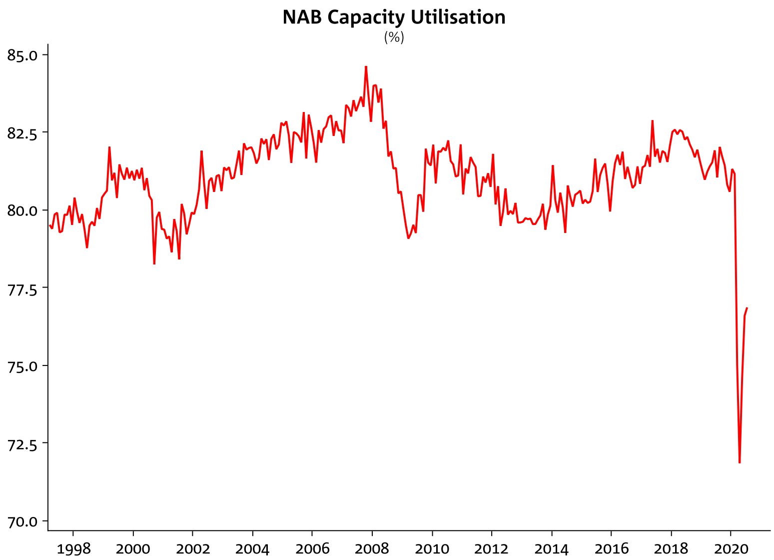
We estimate, based on monthly trade data, that net exports made a 1.3ppt contribution to growth in Q2 – a solid result by historical standards but one that is likely to be swamped by the moves in other components. The impact on trade is likely to be ongoing with international borders to remain closed to travel for sometime and the impacts of a global recession still playing out.

## CONDITIONS RISE BUT CONFIDENCE FRAIL...



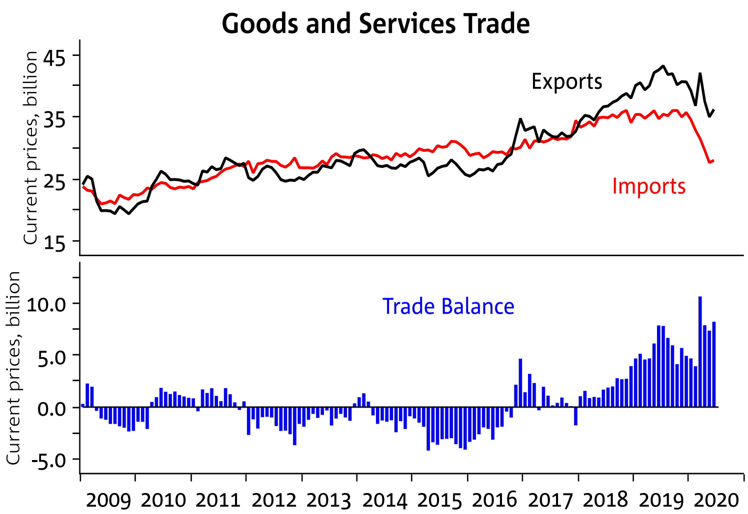

Source: National Australia Bank, Macrobond

## CAPACITY UTILISATION IS STILL LOW...




Source: National Australia Bank, Macrobond

## TRADE VOLUMES WILL REMAIN SOFT...




Source: National Australia Bank, ABS

# COMMODITIES

Spot prices for iron ore trended higher in early August, pushing close to US$120 a tonne, having previously been range bound between US$100-US$110 a tonne. Chinese steel mills have ramped up purchases in recent weeks – anticipating strong steel demand in coming months – while the spread of COVID-19 in Brazil continues to present some supply side concerns. That said, Brazilian producer Vale argues that the COVID-19 impact to its workforce peaked in April. Current strength in spot prices suggest upside risk to our forecasts, which have iron ore averaging US$90 a tonne in 2020 before easing to US$83 a tonne in 2021.

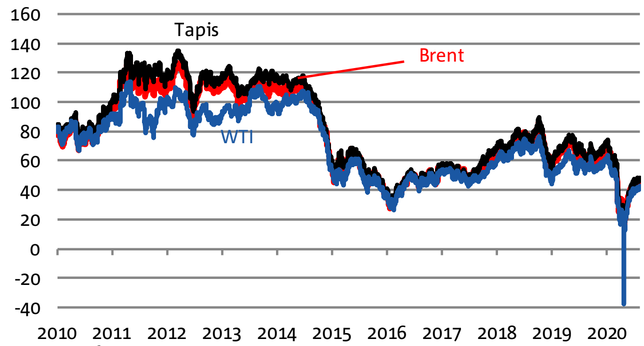
Coal prices have remained subdued in recent months, largely as a consequence of weak demand due to COVID-19 countermeasures (particularly outside China). In addition, excess supply of alternative fuels in the energy sector, such as Liquefied Natural Gas (LNG), have weighed on markets – prompting some coal producers to cut output. Similarly, demand from steel mills outside of China has been muted. 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.

Benchmark Brent has been trading around the mid US$40s/bbl in recent weeks, with oil largely rangebound on mixed cues. In the US, Department of Energy data has shown declines in crude and gasoline inventories, but increases in inventories of middle distillates (such as diesel). Demand has been hit by the resurgence of COVID-19 cases across the United States. Elsewhere, the market will be closely observing the impacts on oil prices from both a rise in US production (up to 11 million bb/d) and OPEC+ boosting supply from August. That said, the decision by Iraq to cut production by 400,00 bb/d, might be somewhat of a mitigant. Clearly, the impact on oil demand from this pandemic bears close scrutiny.

Gas prices in Asia have shown a steady improvement, with the benchmark Japan Korea Marker (JKM) improving to US$2.8/mbtu, the highest since mid-April but well below year ago levels (~40%). While LNG exporters will no doubt welcome this modest improvement in the spot market, they will likely bear the brunt of weaker gas prices from oil-linked contracts in the September quarter. Separately, the International Gas Union estimates that the volume of LNG production globally will decline by 4.2% in 2020, following a sharp 13% jump in 2019. Here in Australia, major producers in the LNG sector have written off more than AUD20bn worth of assets. Weak demand, low oil and gas prices and high construction costs were key factors cited.

## GLOBAL OIL PRICES

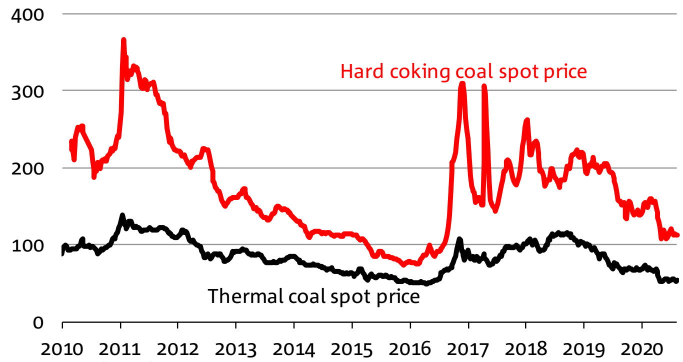
USD/bbl, daily




Source: Refinitiv, NAB Economics

## COAL SPOT PRICES

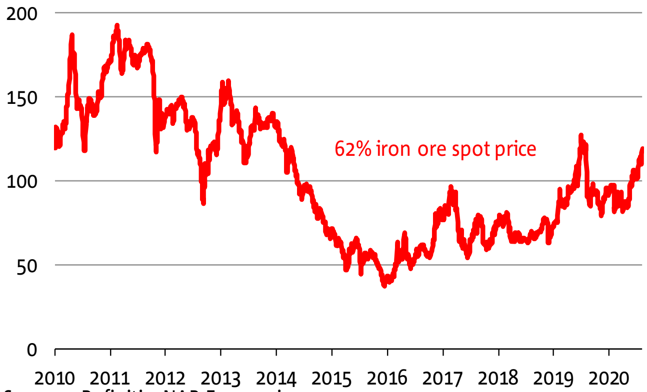
USD/T




Sources: Bloomberg, NAB Economics

## IRON ORE SPOT PRICE

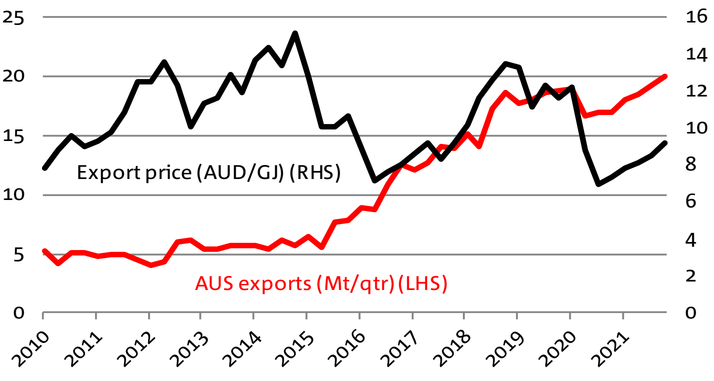
US$/t (incl. cost of freight)




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 August with the cash rate and 3-year yield target remaining at 0.25%. However, the bank announced its intention to undertake bond purchases in the secondary market the following day as, although the 3-year AGS had broadly tracked the target, it had drifted a little higher in recent weeks.

The post meeting statement (and the SoMP) include an updated set of staff forecasts – again in the form of three scenarios. The central scenario maintained a similar GDP forecast as the May SMP, but downgraded the unemployment forecast, which is now expected to peak at around 10% and saw an upward revision of 0.5-1ppt across the forecast horizon. A key result of this was a downward revision to wage growth and consequently a 0.25ppt downgrade to the forecast underlying inflation at end 2020 and 2021.

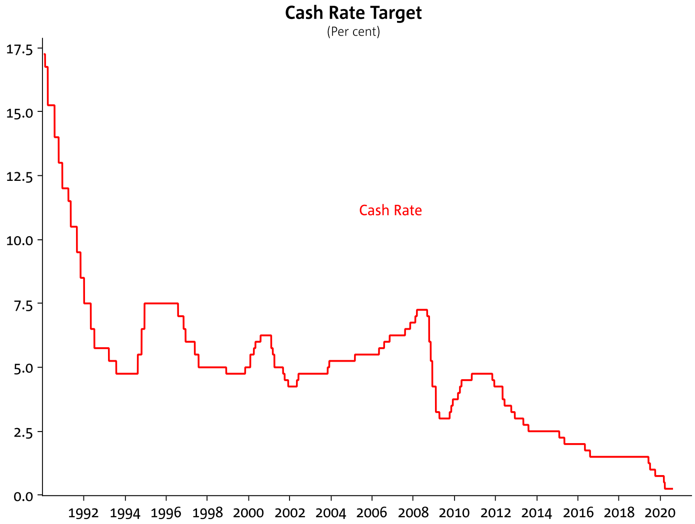
We see a slightly less sharp deterioration in GDP, but a more gradual recovery in growth. However, our profile for unemployment is slightly more optimistic. Nonetheless, both the RBA forecasts as well as our own outlook point to very expansionary policy remaining in place for some time – with unemployment remaining well above the NAIRU by end-2022 and inflation well below the bottom end of the target range.

We see a risk in the medium term that the RBA will need to take further policy action should they be disappointed by their forecast peak in unemployment or should the recovery in activity and the labour market take longer than expected. Both factors will take some time to identify. Further policy action would likely take the form of extending the yield curve target to longer tenors and potentially cutting the target for the cash rate and 3-year yields further. To do this may require further bond purchases in the market. It appears very unlikely that the RBA will attempt to intervene in the exchange rate nor will it move to negative rates.

Inflation outcomes in the near-term will likely have little impact on policy, with the CPI impacted by a range of temporary factors and is subject to significant measurement error at present. Indeed, the Q2 CPI saw inflation print at -2% q/q. This was driven by falls in childcare prices and petrol. These impacts are expected to unwind in Q3. Underlying measures softened further and continue to track well below the RBA's target band. We expect inflation to remain muted for an extended period ending 2021 at around 1.0% y/y.

We have revised up our forecasts for the exchange rate slightly on the back of USD weakness. We now expect the AUD/USD to end the year at US74c before rising to US78c by the end of 2021. We expect the exchange rate to be around US80c by the end of the forecast horizon. This will see tradables inflation remain weak as will domestic inflationary pressures. The exchange rate will play a key role as an automatic stabiliser over the next couple of years as the global and domestic economies recover from the pandemic fallout. In the near term, the impact on commodity exports will be muted, while services exports will continue to be constrained by border closures.

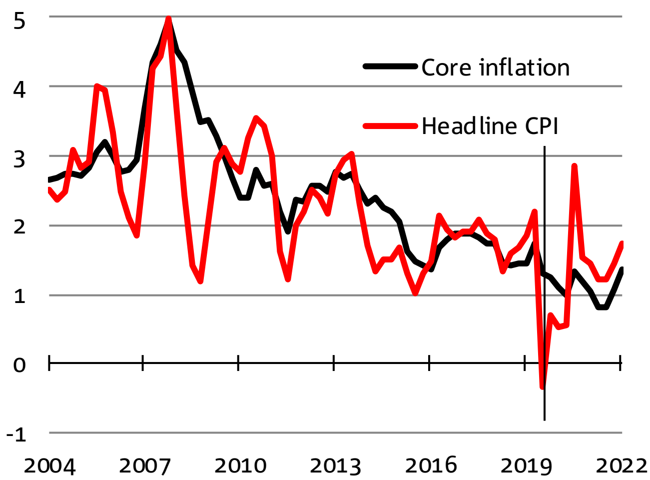
## CASH RATE TO STAY LOW...



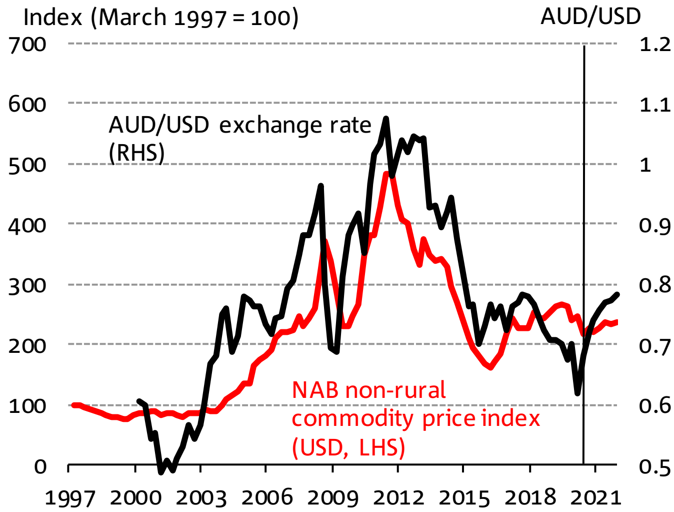

Source: National Australia Bank, Macrobond

## CORE INFLATION TO SOFTEN...

y/y % change




## 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 | -1.3 | -3.1 | 3.3 | 2.7 | 1.4 | -5.0 | 1.7 | 2.9 |
| Dwelling Investment | 0.0 | -10.8 | -17.4 | 6.5 | 4.7 | -6.9 | -16.0 | -7.9 | 14.5 |
| Underlying Business Investment | -1.8 | -7.3 | -35.5 | -6.1 | 1.3 | -1.7 | -23.6 | -26.5 | 3.2 |
| 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** | **-0.7** | **-5.0** | **2.9** | **2.9** | **1.3** | **-4.8** | **-0.5** | **3.6** |
| Stocks (b) | -0.2 | -0.5 | 0.5 | 0.3 | 0.1 | -0.2 | -0.5 | 0.8 | 0.1 |
| **GNE** | **1.6** | **-1.2** | **-4.5** | **3.2** | **3.0** | **1.0** | **-5.3** | **0.3** | **3.7** |
| Exports | 4.0 | -1.0 | -8.2 | -5.2 | 5.1 | 3.2 | -7.3 | -5.9 | -5.5 |
| Imports | 0.3 | -7.2 | -14.9 | -2.3 | 4.1 | -1.2 | -16.1 | -6.7 | -1.6 |
| **GDP** | **2.0** | **0.0** | **-3.5** | **3.0** | **2.8** | **1.8** | **-3.8** | **0.8** | **2.9** |
| Nominal GDP | 5.3 | 2.0 | -1.9 | 4.6 | 5.1 | 5.0 | -2.4 | 2.4 | 4.6 |
| Current Account Balance ($b) | 14 | -33 | -61 | -53 | -39 | 11 | 55 | 58 | 47 |
| (%) of GDP | 0.7 | -1.7 | -3.1 | -2.6 | -2.0 | 0.6 | 2.8 | 2.9 | 2.2 |
| Employment | 2.4 | 0.1 | -3.6 | 3.1 | 2.7 | 2.4 | -3.7 | 0.4 | 3.1 |
| Terms of Trade | 5.6 | 0.9 | 2.2 | 1.5 | 1.8 | 5.1 | 0.1 | 2.2 | 1.3 |
| 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 | -0.3 | 2.9 | 1.2 | 1.8 | 1.8 | 0.5 | 1.4 | 1.7 |
| Core CPI | 1.4 | 1.3 | 1.3 | 0.8 | 1.7 | 1.4 | 1.1 | 1.1 | 1.4 |
| Unemployment Rate | 5.1 | 7.1 | 8.9 | 7.1 | 5.0 | 5.2 | 9.2 | 7.6 | 6.6 |
| RBA Cash Rate | 1.25 | 0.14 | 0.25 | 0.25 | 1.50 | 0.75 | 0.25 | 0.25 | 0.25 |
| 10 Year Govt. Bonds | 1.32 | 0.87 | 1.25 | 1.35 | 2.32 | 1.37 | 1.05 | 1.35 | 1.55 |
| $A/US cents : | 0.70 | 0.68 | 0.77 | 0.75 | 0.71 | 0.70 | 0.74 | 0.78 | 0.80 |
| $A - Trade Weighted Index | 60.1 | 58.8 | 62.8 | 62.1 | 60.7 | 60.3 | 61.8 | 63.3 | 64.1 |

(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 | 7/08/2020 | Jun-20 | *Sep-20* | *Dec-20* | *Mar-21* | *Jun-21* | *Sep-21* | *Dec-21* | *Mar-22* | *Jun-22* |
| WTI oil | US$/bbl | 42 | 26 | 37 | 42 | 43 | 44 | 45 | 46 | 46 | 47 |
| Brent oil | US$/bbl | 44 | 33 | 40 | 45 | 47 | 48 | 49 | 50 | 50 | 51 |
| Tapis oil | US$/bbl | 48 | 35 | 42 | 47 | 49 | 50 | 51 | 52 | 52 | 53 |
| Gold | US$/ounce | 2039 | 1710 | 1960 | 2030 | 2050 | 2100 | 2200 | 2300 | 2300 | 2200 |
| Iron ore (spot) | US$/tonne | 119 | 92 | 93 | 87 | 85 | 90 | 80 | 75 | 80 | 75 |
| Hard coking coal* | US$/tonne | n.a. | 118 | 113 | 118 | 123 | 138 | 133 | 138 | 148 | 153 |
| Thermal coal (spot) | US$/tonne | 52 | 56 | 55 | 59 | 59 | 61 | 62 | 65 | 66 | 64 |
| Aluminium | US$/tonne | 1664 | 1498 | 1620 | 1680 | 1740 | 1760 | 1770 | 1780 | 1790 | 1800 |
| Copper | US$/tonne | 6570 | 5351 | 5750 | 6000 | 6250 | 6500 | 6750 | 7000 | 7100 | 7000 |
| Lead | US$/tonne | 1807 | 1678 | 1800 | 1875 | 1950 | 2025 | 2025 | 2048 | 2072 | 2095 |
| Nickel | US$/tonne | 13651 | 12233 | 13000 | 13500 | 13900 | 14100 | 14200 | 14300 | 14400 | 14400 |
| Zinc | US$/tonne | 2235 | 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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