EMBARGOED UNTIL 11.30 AM AEST, WEDNESDAY 9 SEPTEMBER 2020

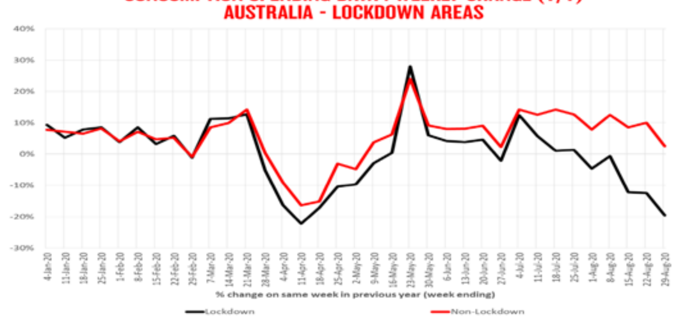
THE FORWARD VIEW: AUSTRALIA SEPTEMBER 2020

VIC virus & lower Government support means flat H2 2020.
Larger falls thru 2020 mean better 2021. But recovery still tough & long.

OVERVIEW

- The larger than expected fall in Q2 GDP has obviously affected our forecasts, but in many ways the big picture remains. That is, we have had a massive recession. The near term outlook has been further complicated by Virus issues in Victoria and the scheduled reductions in Government support – albeit we expect a highly stimulatory Budget with personal tax cuts, accelerated infrastructure spending and attempts to move the focus from "support to survival". On the basis that state lockdowns are finished by end 2020 we now see the prospect of faster growth through 2021 but the labour market outcomes have deteriorated in the near term and will remain very challenging into the medium term.
- As highlighted by yesterday's Business Survey, while the pace of recovery in July was impressive, conditions deteriorated in August. Thus capacity utilisation turned down a touch (and is still 4% below pre-virus levels) as did business conditions and forward orders. While in trend terms Victoria remains the weakest state, the falls in Queensland activity are noticeable – and may point to state border closures as an issue.
- Our own internal data on consumption activity also points to a reasonably strong July but as August continued, the size of the falls in Stage 4 lockdown areas mounted and there was a more general weakening in other states. The following chart is important in understanding the dynamics of the current situation.

CONSUMPTION SPENDING DATA : WEEKLY CHANGE (Y/Y)
AUSTRALIA - LOCKDOWN AREAS



- The above combination suggest that the Victorian virus impact may be spread over both Q3 and Q4 GDP. That also is important given the context of reduced income support and the possibility of faster near term deterioration in the labour market and the probability of more firms (and possibly consumers) defaulting in Q4.
- As a result we see Q3 as likely to record a small positive GDP read but Q4 could well go moderately backwards (around -0.7%). That would mean that the fall during 2020 in GDP could be around 7.6% (we had previously expected declines of around 5.7%). That would also lead to higher levels of unemployment by early 2021 (around 10.0% was 9.6%).

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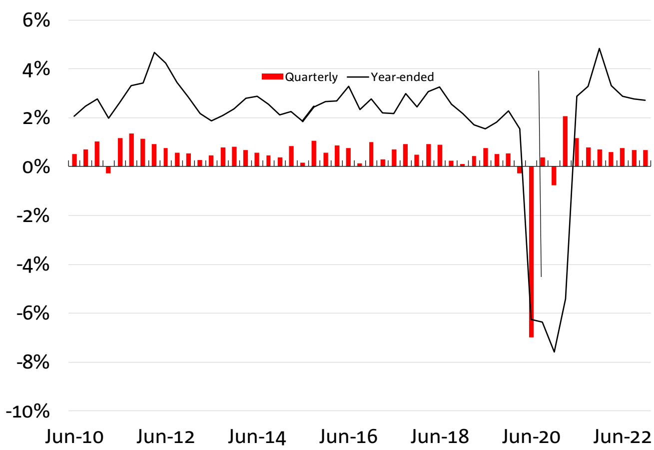
KEY ECONOMIC FORECASTS

	2019	2020-F	2021-F	2022-F
Domestic Demand (a)	1.4	-6.0	0.7	4.3
Real GDP (annual average)	**1.8**	**-4.7**	**1.3**	**2.9**
Real GDP (year-ended to Dec)	**2.3**	**-7.6**	**4.8**	**2.7**
Terms of Trade (a)	5.2	0.7	2.6	1.3
Employment (a)	2.3	-2.9	-0.2	2.9
Unemployment Rate (b)	5.2	9.1	7.9	6.8
Headline CPI (b)	1.8	0.7	1.6	1.7
Core CPI (b)	1.4	1.4	1.2	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

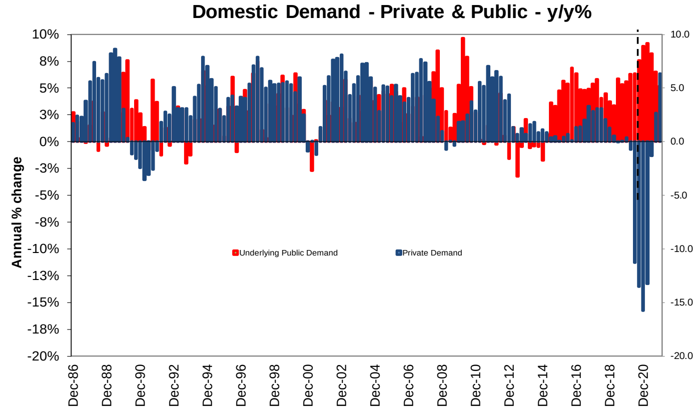
NAB GDP FORECASTS



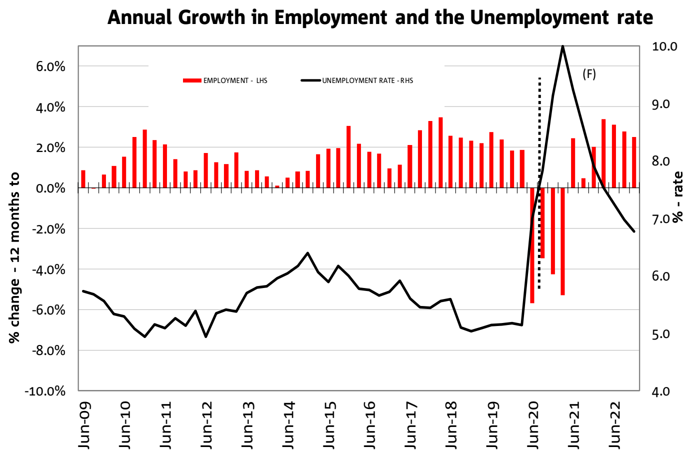
OVERVIEW *(continued)*

- Provided virus developments are as expected (i.e. state borders opened by year end but international borders not until this time next year) and there is a strong stimulus in the October Budget we would expect that the kick up in activity during 2021 would be much stronger than previously expected – an increase of over 4.5%.
- In year average terms that would see GDP falls of around -4.7% (was -1.8%) and around 1.3% in 2021 (was 1.6%). While the out year of 2022 has also been revised up to around 3% (was 2¾%). That said, these forecasts imply that we don't return to the levels of GDP reported in late 2019 till mid 2023. The hit to private demand in our forecasts (as shown by the chart opposite) are unprecedented in the post WW2 era.
- Also the damage to the labour market is even worse given the lower starting point for growth. Thus unemployment peaks at around 10% in early 2021 but unemployment is still around 8% by end 2021 (was 7.8%) and 6.8% by end 2022 (was 6.6%)
- 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. As well as the size of the upcoming Budget stimulus. While the RBA will look to do anything that can help, the main game will be fiscal policy, and in the longer run, structural policy.
- Finally the extra hit to unemployment is likely to have further complications for already struggling firms (the so called zombie firms).

UNPRECEDENTED FALL IN DOMESTIC DEMAND



UNEMPLOYMENT TO PEAK AT AROUND 10%



LABOUR MARKET, WAGES AND THE CONSUMER

The unemployment rate edged up to 7.5% in July, taking the total increase since February to 2.3ppts. While the monthly increase was less than expected, overall the labour force data continue to show that labour market conditions have deteriorated sharply this year, notwithstanding a partial recovery in recent months. Employment rose by a solid 115k – meaning the labour market has recovered around 40% of the jobs lost since February.

The participation rate rose a further 0.6ppts and has risen 2ppts over in the last 2 months. Nonetheless, it remains around 1.3ppt lower than in February. It is likely that participation will continue to increase alongside a slower rate of job creation which will see the unemployment rate continue to rise, even as broader measures of spare capacity in the labour market continue to improve.

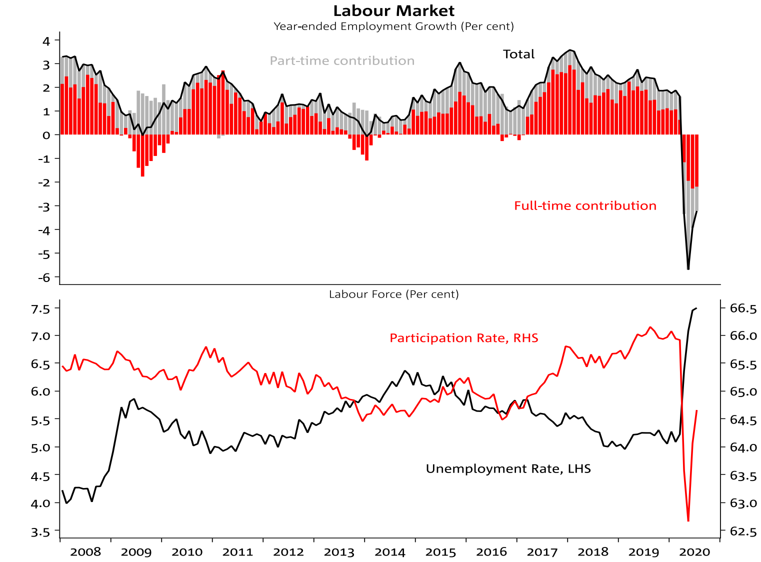
Indeed, broader measures of labour market underutilisation also saw a marginal improvements in the month, but clearly remain elevated. From here we expect the unemployment rate to move higher, peaking at 10% in Q1 2021. From there we expect a gradual recovery in unemployment, but for it to lag the recovery in activity, with unemployment around 8% by end 2021 . This sees unemployment remain well above pre-COVID (and full employment) by the end of our forecast period (end 2022 unemployment still at 6.8%).

The Q2 national accounts showed household consumption declined by 12.1% in the quarter (-12.7% y/y), driven by an 18% fall in services consumption. This is the first annual fall in consumption spending on record. Spending on goods also saw a relatively large decline of 2.8%. The largest falls occurred in transport services (-86%) and hotels, cafes & restaurants (-56.1%). Rec & culture, health (pausing of elective surgery in some jurisdictions and general deferral of health services by households) and other goods & services (a result of the decline in childcare spending) also saw sizeable declines.

However, since then household spending (at least on goods) has recovered despite the deterioration in the labour market. Retail sales rose by 3.2% in June and are now 10.6% above pre-COVID levels. All sub-categories except cafes, takeaways & restaurants have risen above pre-COVID levels. The increase in the month was driven by a driven by an increase in household goods sales which are now 28% above February levels.

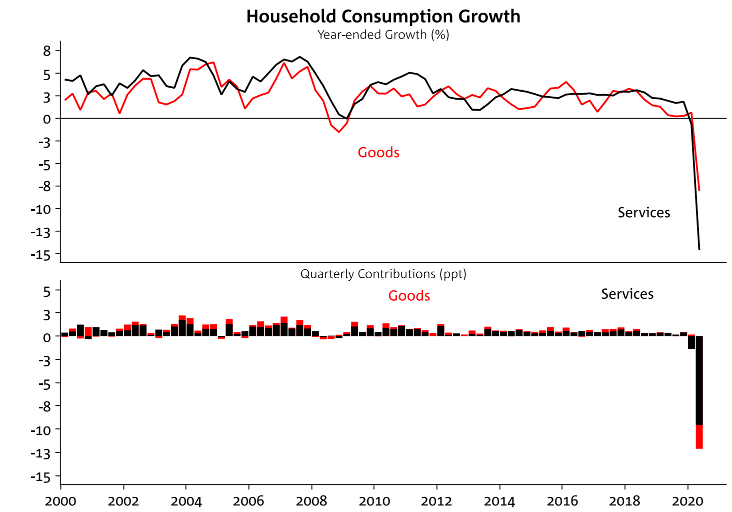
The NAB Cashless Retail Sales Index released today, ahead of the preliminary ABS figures next week, suggests that retail sales pulled-back in August, falling by 2.45%. Going forward, we expect that goods spending may pull-back somewhat, as income inflows from Governments slow and unemployment rises.

UNEMPLOYMENT WILL CONTINUE TO RISE…



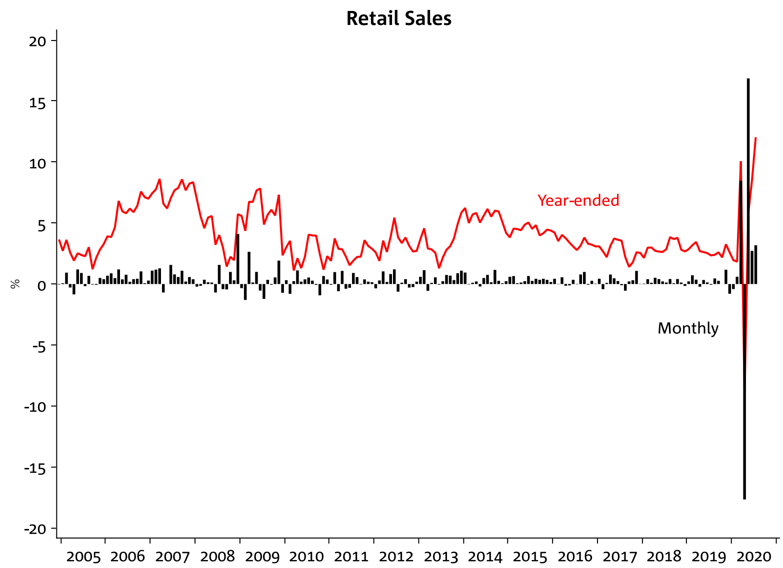
Source: National Australia Bank, Macrobond

CONSUMPTION SAW A RECORD FALL IN Q2…



Source: National Australia Bank, Macrobond

RETAIL SALES HAVE RISEN SHARPLY…



Source: National Australia Bank, Macrobond

HOUSING AND CONSTRUCTION

House prices outside of Melbourne have generally held up better than expected through 2020 but in aggregate have continued to decline. August saw a 4th consecutive decline in the CoreLogic 8-Capital City House Price Index which fell by 0.5% to be 2.1% lower over the last three months.

In the month the declines were led by a 1.2% fall in Melbourne and a 0.5% fall in Sydney. Brisbane, Adelaide, Perth and Hobart were broadly flat in the month. Since the peak in April, prices have fallen by 4.3% in Melbourne and 2.6% in Sydney. Perth is down by 2.2%, while the other capitals have either seen smaller declines or small increases.

Despite the declines over the past 4 months, prices remain well up on a year ago in Sydney (9.8%) and Melbourne (5.9%). This reflects the very rapid turn around in prices early last year which continued into the first quarter of 2020. Overall, we expect prices to decline by around 10-15% as a result of the pandemic – led by weakness in Sydney and Melbourne. The two largest markets are exposed to a larger investor segment which will be affected by slower population growth (as a result of lower net migration) and a relatively high exposure to the high-density segment where significant stock is yet to come on line.

That said, we expect all states to be impacted by the labour market (and household income) impacts of the pandemic. Unemployment is expect to remain high across the states for an extended period and wage growth is expected to slow to very low rates.

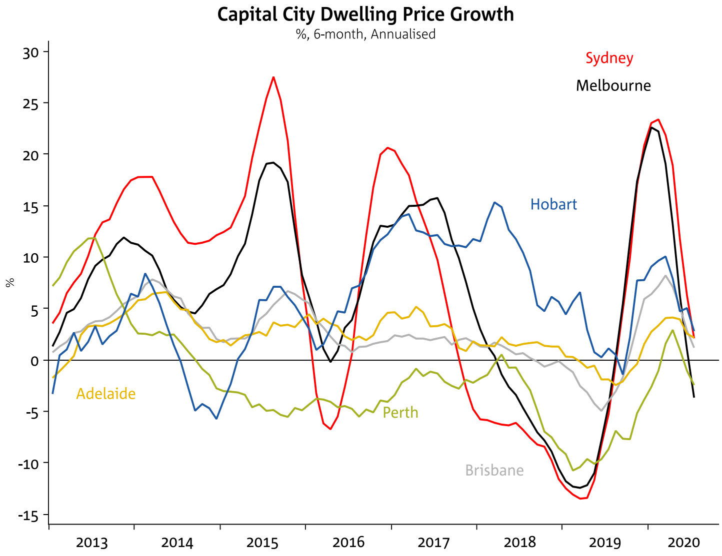
Alongside the softening in the established market, we expect construction will continue to fall. The Q2 national accounts showed a large 6.8% fall in dwelling investment, driven by a 7.3% decline in new construction and a 6.0% fall in alterations & additions. From here we expect construction to continue to decline. To date, NSW and Vic have seen the largest declines.

This decline in construction will lead to a rapid adjustment in supply, with the current pipeline eroded by relatively high (though falling) rates of work done. The building activity data to be released later in the month will provide an update on the pipeline of work.

However, while building approvals having trended lower in recent months they bounced by 12% in July. In the month the rise was driven by a 22.7% increase in the volatile high-density segment and an 8.5% rise in houses.

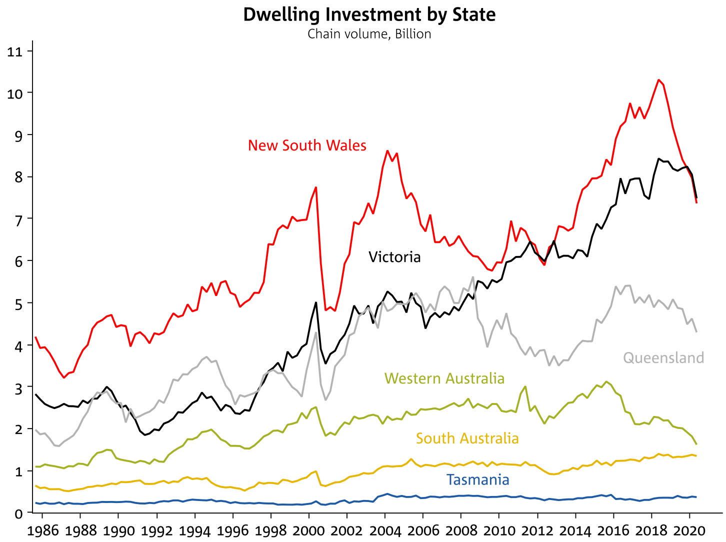
Along side the downturn in the housing market, housing credit growth has continued to track around 3.0% y/y in recent months. Investor credit was 0.7% lower over the year to July, while credit extended to owner occupiers has held up better at 5.4% y/y.

HOUSE PRICES HAVE SOFTENED...



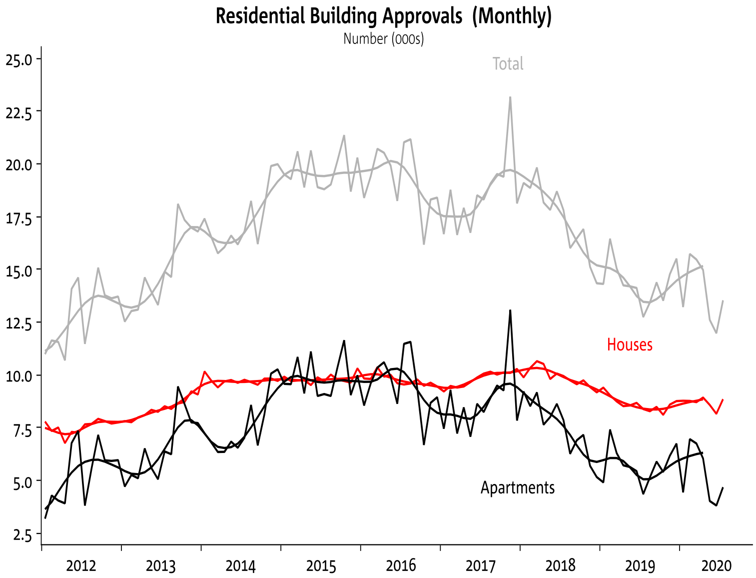
Source: CoreLogic, National Australia Bank, Macrobond

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. Domestic 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.

These factors were reflected in the Q2 national accounts. New business investment declined by 3.5% in the quarter (but did continue a run of weakness seen over the previous 4 quarters). Spending on machinery & equipment fell by a large 6.8% while new construction also fell 2.3%. Mining investment rose in the quarter, but could well weaken given the impacts of the virus on the global economy and the 15% fall in exploration in the quarter. The non-mining sector is likely to remain weak for some time, as private demand remains weak and uncertainty high.

Indeed, the NAB Monthly business survey for August showed a deterioration in conditions that almost entirely reversed last months gains. While the impact of the stage 4 lockdowns in Melbourne were evident in the Victorian numbers, there were even larger declines in conditions in Tasmania, Queensland and South Australia.

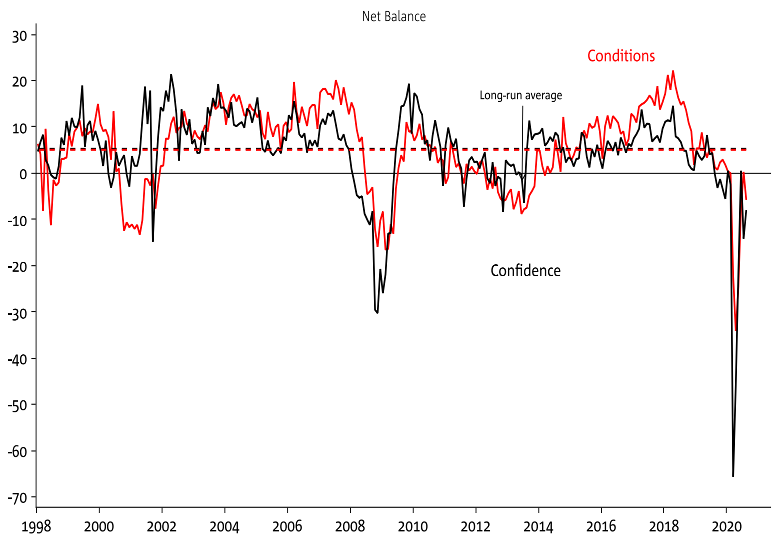
Confidence rose after deteriorating sharply last month but is still deeply negative. It remains negative in all industries, despite improvements outside of mining and recreational & personal services in the month. The two largest states, NSW and VIC continue to see the weakest confidence overall.

In addition to the ongoing weak read for confidence, forward orders deteriorated (and are deeply negative) while capacity utilisation also edged lower from an already weak level. Capacity utilisation has mirrored the changes in activity. It has partially recovered from the initial very sharp fall but is still at levels well below the trough of the 1990s recession, and remains around 4ppt below pre-COVID levels.

Only WA and Tasmania have seen a full recovery in capacity utilisation, while NSW, QLD and SA have seen partial rebounds. Victoria is broadly around the level seen in April. All industries remain below their long-run average levels.

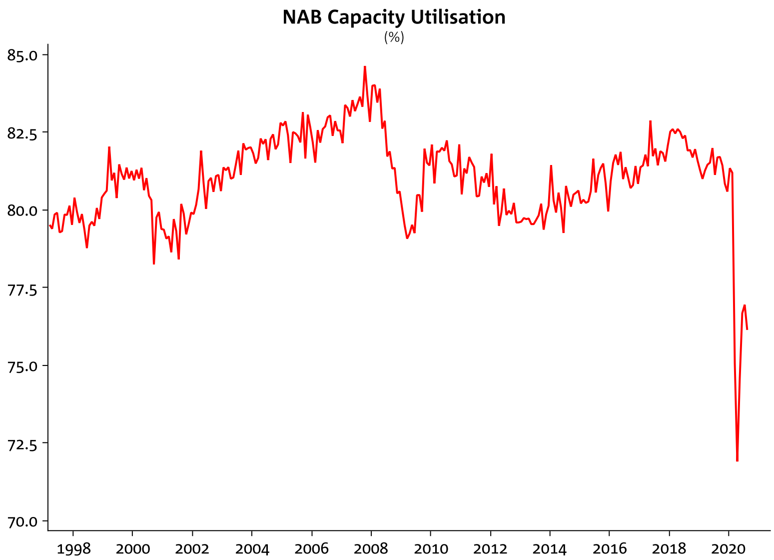
Net exports contributed 1.0ppts to quarterly GDP growth. As in Q1, there were large falls in both exports and imports, particularly for services due to international travel restrictions. Exports fell by 6.7% q/q, including large falls in rural and manufacturing exports (and a smaller fall in resource exports) but the largest falls were in service exports with travel credits down 25% q/q and transportation 47% q/q. The fall in imports was even greater (-12.9% q/q) led by services debits which declined 51% mainly due to the near total collapse of travel debits (-99% q/q) which, unlike the credits side, does not have a large international student contribution.

CONDITIONS AND CONFIDENCE WEAK…



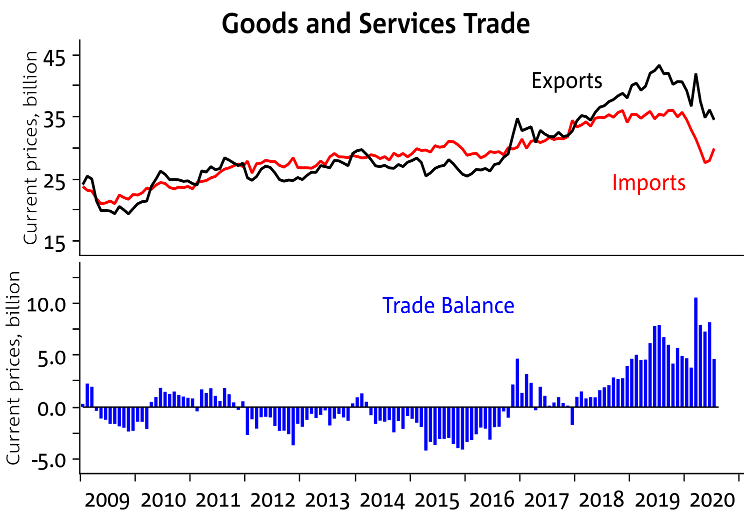
Source: National Australia Bank, Macrobond

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 continued to climb higher across August, rising up to around US$130 a tonne at the time of writing. This was the highest price since January 2014. China's crude steel production rose to a record level in July, with strong investment in the country's housing and infrastructure construction sectors helping to underpin demand. On the supply side, the spread of COVID-19 in Brazil presents risk for the country's exports, adding some upward pressure. Reflecting the recent strength in spot prices, we have made some preliminary revisions to our forecasts, with iron ore averaging US$103 a tonne in 2020, before easing to US$95 a tonne in 2021 (a more comprehensive forecast will be available next month).

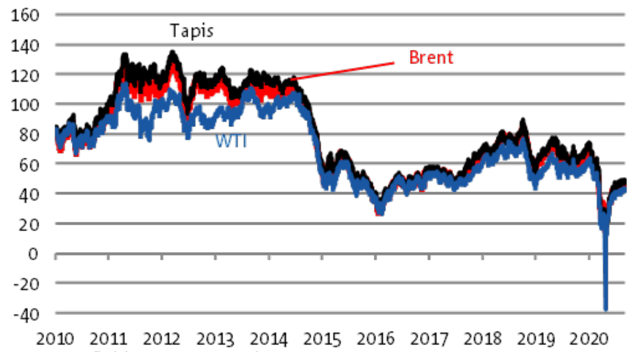
Coal markets have remained subdued in recent months, with spot prices drifting gradually lower on weak demand. This is particularly the case for thermal coal, where weaker demand and ready supply of Liquefied Natural Gas (LNG) in Asian markets has put downward pressure on energy markets. Thermal coal prices recently dropped to their lowest level since January 2016. Demand for coking coal has been constrained by weak steel output outside China – with Indian and Japanese production well below pre-COVID-19 level. Thermal coal prices are forecast to average US$60 a tonne in 2020 and US$62 in 2021, while hard coking coal prices are forecast to average US$126 a tonne in 2020 and US$133 in 2021.

While oil prices have partially recovered from recent COVID-19 related weakness, benchmark Brent crude has remained around US$42/bbl (well below pre-COVID levels) due to continued weak demand, lower prices from Saudi Arabia offered to Asian buyers and a slowdown in imports from China (following a high level of imports in prior months). The upcoming refinery maintenance season in the US will limit also demand. On the supply side, OPEC+ is reducing its production cuts to 7.7 million barrels per day (previously 9 million), with increased compliance from countries such as Iraq. This will increase global supply, although US oil production has been negatively impacted by Hurricane Laura.

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

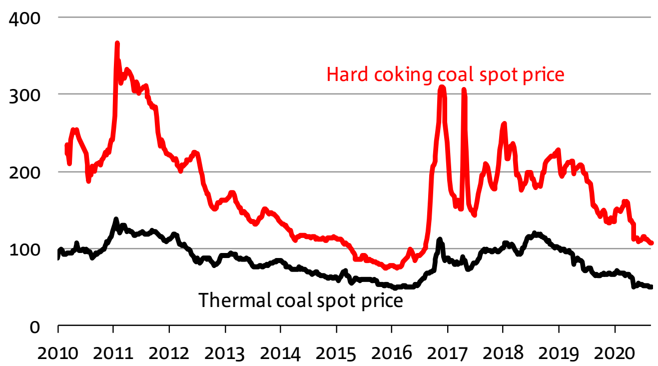
USD/bbl, daily



Source: Refinitiv, NAB Economics

COAL SPOT PRICES

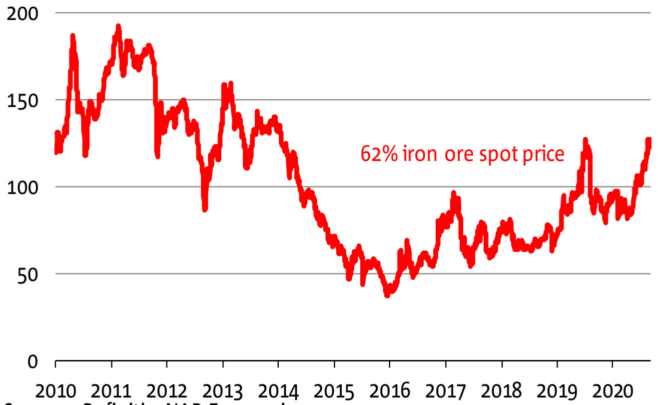
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

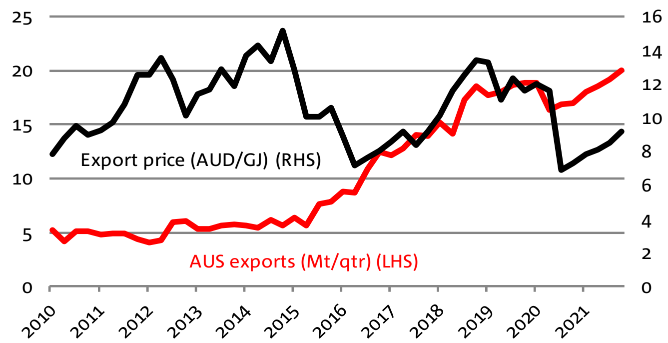
US$/t (incl. cost of freight)



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 tweaked its current package of monetary policy settings in September. The cash rate and 3-year AGS targets were left unchanged at 0.25%. However, the Bank expanded and extended the term funding facility (TFF). The expansion of the TFF means ADIs will be able to borrow up to an additional 2% of outstanding credit at 0.25% for three years, until June 2021. As noted in the minutes of the September meeting, this will allow ADIs to access the TFF after September when the initial window for drawing under the initial allowance of 3% of outstanding credit closes. The key mechanism by which this $200bn package is expected to support the economy is ensuring that there is the free flow of credit through banks to the economy and to ensure banks have the confidence that they will have access to funding at very low cost.

Overall, the package of monetary measures has been effective at face value. There is a large amount of liquidity in the system, the cash rate continues to trade well below target, and the 3-year yield continues to track around 0.25%. Around $52bn has been drawn down to date of the TFF with more expected in coming weeks.

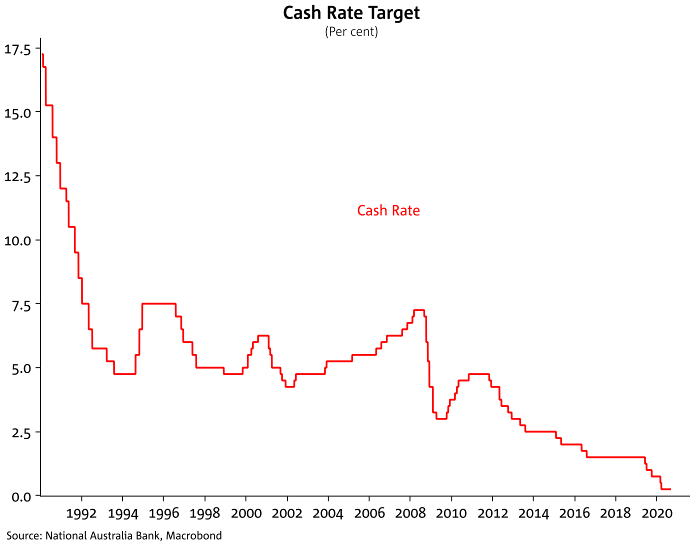
We expect that the RBA will maintain this position for an extended period. We do not see rates rising within our forecast horizon, and the cash rate will not increase before the yield curve target is removed. Our forecasts are consistent with this outlook where inflation will pose no constraint to easy policy – tracking well below the RBA's target of 2-3% over the next two years. Unemployment (and the labour market more broadly) is expected to improve eventually, but we expect it to remain well above pre-COVID levels and well above the NAIRU at the end of 2022.

We acknowledge the risk that the RBA may seek to do more should it be disappointed by its forecasts – that is, unemployment comes down more slowly than expected or further rounds of lockdowns eventually see a prolonged downturn in activity. To the extent the RBA can find measures to help they will.

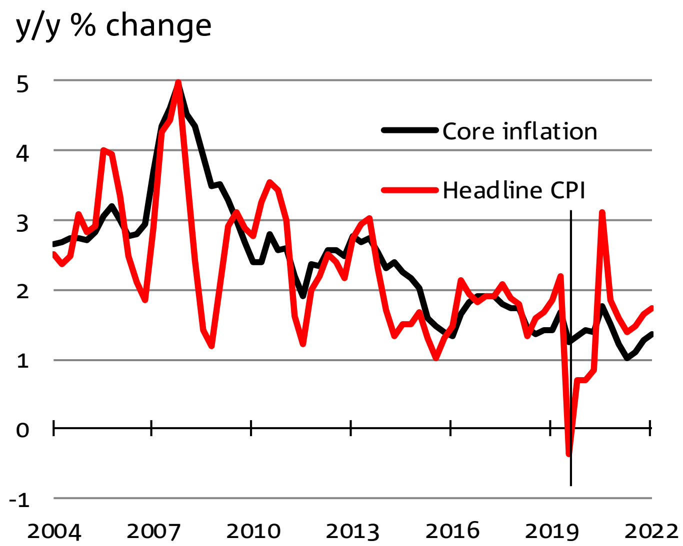
On the policy front, however, the bulk of the heavy lifting will be done elsewhere – especially fiscal and structural policy. Fiscal policy – which has also provided unprecedented support – will continue to have a key role in the recovery phase. We expect policy makers will (and need to) do more. Likely in the form of ongoing wage subsidies, unemployment benefit supplements and possibly the bring-forward of tax cuts in the October budget. There is also scope to bring forward spending on infrastructure and for a greater focus on structural reforms.

We have left our forecasts for the AUD unchanged over the past month – where the currency has tracked around US74c. We continue to 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.

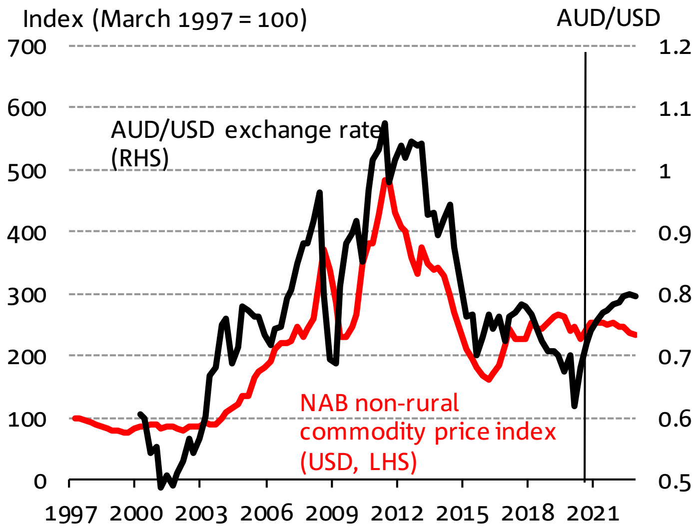
CASH RATE TO STAY LOW...



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	-2.6	-9.5	5.9	2.7	1.5	-10.5	1.3	3.7
Dwelling Investment	0.0	-8.8	-15.9	1.8	4.7	-6.7	-12.4	-10.3	11.0
Underlying Business Investment	-1.8	-3.1	-20.4	-1.5	1.4	-1.5	-11.0	-16.6	6.7
Underlying Public Final Demand	4.4	5.9	8.5	4.8	4.5	5.1	7.3	7.2	3.4
Domestic Demand	**1.8**	**-0.8**	**-6.2**	**4.8**	**2.9**	**1.4**	**-6.0**	**0.7**	**4.3**
Stocks (b)	-0.2	-0.3	0.3	0.3	0.1	-0.2	-0.4	0.8	-0.1
GNE	**1.6**	**-1.1**	**-5.9**	**5.1**	**3.0**	**1.1**	**-6.4**	**1.5**	**4.2**
Exports	4.0	-1.6	-9.6	-5.6	5.0	3.5	-9.2	-6.3	-5.9
Imports	0.3	-7.1	-16.5	1.7	4.0	-0.9	-17.7	-4.1	0.0
GDP	**2.0**	**-0.2**	**-4.2**	**3.6**	**2.8**	**1.8**	**-4.7**	**1.3**	**2.9**
Nominal GDP	5.3	1.7	-2.9	5.2	5.0	5.0	-3.7	3.0	4.6
Current Account Balance ($b)	14	-36	-80	-57	-40	12	70	67	49
(%) of GDP	0.7	-1.8	-4.1	-2.8	-2.1	0.6	3.6	3.4	2.4
Employment	2.4	0.1	-2.7	2.2	2.7	2.3	-2.9	-0.2	2.9
Terms of Trade	5.5	1.2	2.9	1.6	1.8	5.2	0.7	2.6	1.3
Average Earnings (Nat. Accts. Basis)	1.8	3.2	3.1	1.2	1.5	2.6	3.5	1.7	1.6
End of Period									
Total CPI	1.6	-0.3	3.1	1.5	1.8	1.8	0.7	1.6	1.7
Core CPI	1.4	1.3	1.8	1.1	1.7	1.4	1.4	1.2	1.4
Unemployment Rate	5.1	7.0	9.2	7.3	5.0	5.2	9.1	7.9	6.8
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	7/09/2020	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
WTI oil	US$/bbl	41	19	42	46	49	51	51	52	52	53
Brent oil	US$/bbl	42	26	45	49	53	55	55	56	56	57
Tapis oil	US$/bbl	46	20	47	51	55	57	57	58	58	59
Gold	US$/ounce	1929	1710	1960	2030	2050	2100	2200	2300	2300	2200
Iron ore (spot)	US$/tonne	128	93	118	110	105	100	90	85	80	75
Hard coking coal*	US$/tonne	n.a.	118	113	118	123	138	133	138	148	153
Thermal coal (spot)	US$/tonne	50	56	55	59	59	61	62	65	66	64
Aluminium	US$/tonne	1760	1498	1620	1680	1740	1760	1770	1780	1790	1800
Copper	US$/tonne	6811	5351	5750	6000	6250	6500	6750	7000	7100	7000
Lead	US$/tonne	1946	1678	1800	1875	1950	2025	2025	2048	2072	2095
Nickel	US$/tonne	15142	12233	13000	13500	13900	14100	14200	14300	14400	14400
Zinc	US$/tonne	2479	1968	2100	2125	2150	2175	2175	2200	2225	2250
Aus LNG**	AU$/GJ	n.a.	10.5	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

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

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