November 2020

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

Events over the last month demonstrate that COVID-19 remains a major factor influencing the global economy. The resurgence of the virus in parts of the globe – and the re-introduction of COVID-19 restrictions – will weigh on activity, but positive news regarding the development of a vaccine has buoyed markets as it offers the hope of a faster recovery down the track. There was a substantial, but incomplete, rebound in advanced economy activity in Q3 but a resurgence in COVID-19 cases across both Europe in particular, but also North America, will weigh on activity; Euro-zone and UK GDP is expected to decline in Q4. In contrast, economic conditions appear to be improving in Emerging Markets. We expect global GDP to decline by -3.9% in 2020, before rising by 6.1% in 2021. COVID-19 continues to spread and how authorities react remains a key risk to the outlook. Successful development and a speedy roll-out of a vaccine represents an upside risk.

- While volatile, **financial markets** held up in the face of the resurgence in COVID-19 in Europe and North America, before lifting more recently. Advanced economy equity markets broadly tracked sideways between end August and early November, before moving higher following the US election and on positive news on vaccine trials. EM equity markets have continued to recover and by early November had moved above their pre-COVID-19 level. Volatility in equity markets is still high; the US VIX remains elevated, although in recent days has moved towards the lower end of the range it has been in since COVID-19 emerged.
- **Commodity prices** have broadly moved sideways since late August. While in early November the Refinitiv CoreCommodity CRB Index was slightly below its end August level, the volatility in prices makes discerning a clear trend difficult. Energy prices continue to bear the brunt of the fall-out from COVID-19; on an ex-energy basis, the index is now above its pre-COVID-19 level.
- AE **central bank policy rates** are generally at, or close to, their lower bound. However, in response to the deterioration in the economic outlook in the UK, the Bank of England this month increased its government bond purchase program (QE) by £150b. The ECB has flagged that policy easing will occur next month; this is likely to include an increase in asset purchases. While emerging market central banks have generally continued to ease policy rates the pace has slowed, suggesting that that the easing cycle might be close to done. Whether this turns out to be the case or now will depend both on the outlook but also whether EM central banks feel constrained; indeed, Turkey's central bank increased its policy rate in September due to pressure on its currency.
- Incoming GDP data confirm that there was a substantial, but incomplete, rebound in **advanced economy** economic activity in Q3, with GDP growing by 7.4% q/q in the US, 12.7% q/q in the Euro-zone and 15.5% in the UK. Canada and Japan are also likely to see strong Q3 results. However, the spike in COVID-19 cases across much of Europe led to announcements, towards the end of October, of a move to nationwide restrictions. While some were still based around social interaction and curfews, for other countries, such as France and the UK, the restrictions were more sweeping, including closures of 'non-essential' businesses. As a result, we expect a fall in both Euro-zone and UK GDP in Q4. Fiscal policy remains an issue in the US as the fiscal support put in place earlier in the year continues to unwind. The prospect of an additional fiscal package remains unclear, although there have been some positive post-election noises.
- Economic conditions in **Emerging Markets** are improving. Aggregate PMI measures show strengthening in both manufacturing and services. The key drivers of the strengthening in manufacturing conditions in October were India, China and Brazil, while China and India drove services. However, neither India or Brazil have contained COVID-19 so there are concerns around the sustainability of this recovery. China's economic recovery continued in Q3 – with growth of 4.9% – albeit this was somewhat weaker than market expectations and well below the pre-COVID-19 norm. Growth has remained highly dependent on heavy industry – feeding into the construction sector – while growth in household consumption has remained well below pre-COVID-19 rates.
- Global surveys indicate that there was a continued improvement in business conditions until October, with positive readings for both manufacturing and services. In the near term, it is likely that there will be diverging trends by region with key economies in Europe implementing restrictions to slow the spread of COVID-19. These measures highlight the economic risks related to COVID-19 that will remain until an effective vaccine is developed and widely available. It remains to be seen whether the surge in new cases in the US, and the move to a new administration in the near future, will see a shift in its COVID response. We expect the **global economy** to contract by 3.9% in 2020 (previously -4.1%), while growth in 2021 is forecast at 6.1% (6.3% previously). The revisions reflects recent, generally better than expected, data offset by the expected impact of recently introduced COVID-19 restrictions, with the United Kingdom and Euro-zone the most negatively impacted.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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__Australia__: **The RBA has lowered rates to a record low of 0.1% and announced a QE program, committing to buying $100bn of bonds over the next 6 months. This package of monetary easing, unprecedented in Australia, is aimed at reducing unemployment more quickly, a priority shared by the federal government's JobMaker fiscal measures. That said, NAB's forecasts are broadly unchanged since the 6 October Federal Budget, where we had already expected further monetary easing, including QE. For unemployment we continue to forecast a peak at 8.1% in Q1 2021, before declining to 5.9% by the end of 2022. However, large uncertainties remain. As the end of Melbourne's lockdown kickstarts the recovery in Australia's second largest economy, NAB's business survey and other timely data show the recovery in other states is slowing into the Christmas period. Confidence remains fragile and businesses will need to be convinced of a sustainable recovery before increasing investment and hiring. Further fiscal support will be needed.**

- **The October NAB Business Survey showed further improvement in the month, driven by gains in Victoria.** Business confidence rose to its highest level since mid-2019, while conditions and capacity utilisation edged higher. Over the past few months, the gains in overall conditions have been driven by trading and profitability conditions; employment conditions remain weak. This suggests ongoing headwinds to the jobs recovery, even with significant stimulus underway.
- **The RBA has begun QE as it cuts rates to 0.1%, seeking to reduce unemployment more quickly**. The RBA eased policy further on 3 November, cutting the cash rate target, 3-year yield target and lending rate on new drawings under the term funding facility by 15bps to 0.1%. In addition, the RBA announced a QE program, committing to buying $100bn of bonds – both AGS and semis – over the next 6 months. Going forward, we expect rates to remain unchanged for at least three years, in line with the RBA's view that negative rates are "extraordinarily unlikely" and its guidance that is will not raise rates until the unemployment rate is at full employment levels and inflation is back within the 2-3% target. That said, we think it is likely the RBA will ease further through additional QE, to provide additional, marginal, support to the labour market.
- **NAB forecasts unemployment to peak at 8.1% in Q1 2021 as the jobs recovery slows.** The unemployment rate edged up to 6.9% in September, alongside a 29.5k fall in employment. While the unemployment rate is still lower than the 7.5% recorded in July, we expect unemployment to trend higher until Q1 2021, as more people restart their search for work and the jobs recovery slows. We expect the jobs recovery to slow as the initial rebound sparked by reopening in most states, except Victoria, loses steam. Further, since the end of September the JobKeeper payments have been reduced materially. This is likely to prompt some additional job losses, where timely payrolls data suggests employment edged lower in October. Nevertheless, beyond Q1 2021 NAB expects a gradual recovery in the labour market, supported by government stimulus and, at the margin, the RBA's monetary easing. This should see the unemployment rate steadily decline to be 5.9% by the end of 2022, although this is well above the 5.2% recorded in February.
- **Elevated unemployment is a headwind to consumer spending.** Q3 consumer spending data will be released in the National Accounts in early December. NAB forecasts a large 5.7% q/q rebound in consumption, after a sharp 12.1% fall in Q2. This should see consumer spending add 3.0pp to GDP, of which 1.2pp is from retail, after subtracting a large 6.7pp in Q2. However, going forward, consumer spending faces headwinds from elevated unemployment, weak wages growth, tapering income support and weak population growth. As consumer spending is a key driver of economic activity this highlights the importance of reducing unemployment to support the economy.
- **House prices have remained resilient despite the hit to the labour market** and expectations of weaker population growth, rising 0.4% in October. Overall, the impact of the pandemic on house prices has been relatively modest with only Sydney and Melbourne prices having declined over the past quarter. This is despite the large deterioration in the labour market and expectations of a sharp slowing in population growth over the next two years. Rents in the large capital cities have also continued to fall and will likely remain soft given the ongoing weakness in demand and a relatively large pipeline of new supply being built. Offsetting these headwinds is likely the impact of record low interest rates, income support from the government through the JobSeeker and JobKeeper programs as well as loan deferrals by banks.
- **Business confidence remains fragile amid heightened uncertainty**. Business investment was weak even prior to the pandemic and will continue to be heavily impacted by the high degree of uncertainty. The opening of state borders and continued control over the virus will allow business to operate in a more normal way, but global confidence impacts and closed international borders may continue to weigh until a vaccine is available. Businesses will need to be convinced of a sustainable recovery before increasing investment and hiring and, in our view, further fiscal support will be needed.
- **Our forecasts for the exchange rate have been unchanged since July.** We continue to expect the AUD/USD to end the year at 0.74 USD before rising to 0.78 USD by the end of 2021 and then to 0.80 USD by the end of 2022. We expect the exchange rate to rise, despite the RBA's QE program, as risk sentiment improves and the global recovery gets underway.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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