THE FORWARD VIEW: AUSTRALIA
NOVEMBER 2020

Forecasts fundamentally unchanged – but large uncertainties remain

OVERVIEW

- **Melbourne's long lockdown has ended as Victoria's second wave is controlled. This will kickstart the recovery in Australia's second largest economy.**
- **However, the recovery in other states is slowing, where NAB's business survey and other timely data show little improvement over the past month.**
- **We have made few changes to our forecasts since the October Federal Budget.**
- **But large uncertainties remain. On the positive side a vaccine may be close. But unemployment will rise and businesses will need to be convinced of a sustainable recovery before increasing investment and hiring. Further fiscal support will be needed.**

NAB's forecasts are little changed from last month. GDP is expected to rise by around 3% in the September quarter, following the large 7% fall in Q2. From there we expect a gradual recovery in output, reaching its pre-COVID level only by early 2022. We still see unemployment rising to a peak around 8% by early 2021. From there, the labour market is expected to recover slowly, with unemployment at around 6% at the end of 2022.

With the labour market remaining well below full employment levels, wage growth will likely remain very soft over the next few years. This will see ongoing weakness in domestic inflationary pressures with stronger competition and weaker demand also a factor.

Weak inflation and significant spare capacity in the labour market will see the RBA hold its exceptionally easy policy stance for an extended period. Indeed, we (and the RBA) do not expect the cash rate to rise for at least 3 years – and probably longer. To the limited extent it can help we see the RBA extending its $100bn QE program.

There are a number of key risks around our forecasts. We assume that state borders are opened by the end of the year (but international borders remain closed until mid-2021) and that future outbreaks of the virus domestically are able to be contained without large scale shut downs. At present it appears this is on track.

A bigger uncertainty is the strength of consumer and business confidence – especially at a time of reduced fiscal support and rising unemployment. With uncertainty remaining high, confidence will likely remain fragile and see restraint in spending by both business and the consumer. For this reason, the evolution of fiscal policy will be important for the speed of the recovery. To date, fiscal policy has been very important in supporting the economy and, while the government has turned its focus to supporting business in the recovery phase, we still think that more will need to be done.

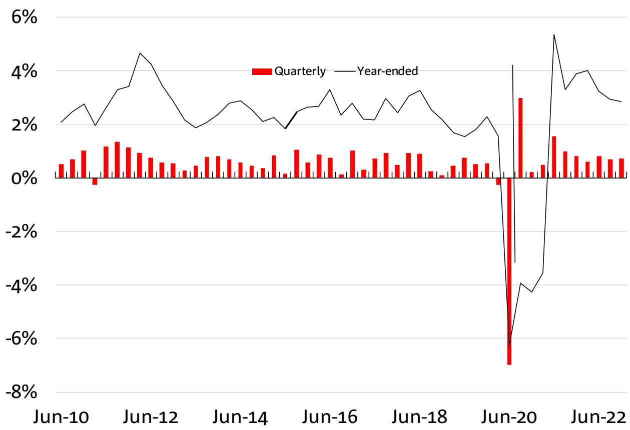
CONTENTS

KEY ECONOMIC FORECASTS

	2019	2020-F	2021-F	2022-F
Domestic Demand (a)	1.4	-3.9	3.4	4.6
Real GDP (annual average)	**1.8**	**-3.2**	**2.2**	**3.3**
Real GDP (year-ended to Dec)	**2.3**	**-4.3**	**3.9**	**2.8**
Terms of Trade (a)	5.2	0.7	2.6	1.3
Employment (a)	2.3	-2.2	1.6	2.5
Unemployment Rate (b)	5.2	7.6	7.0	5.9
Headline CPI (b)	1.8	0.6	1.8	2.0
Core CPI (b)	1.4	1.2	1.4	1.7
RBA Cash Rate (b)	0.75	0.10	0.10	0.10
$A/US cents (b)	0.70	0.74	0.78	0.80

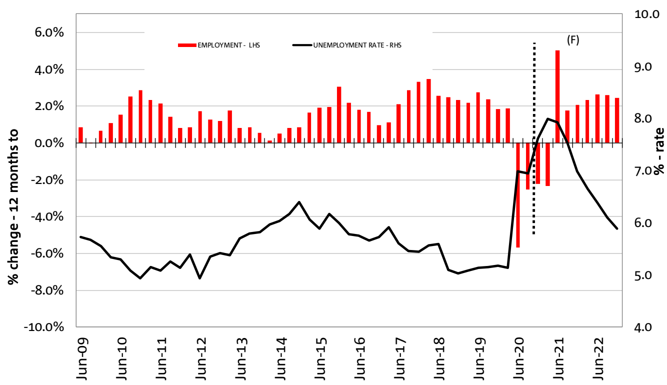
(a) annual average growth, (b) end-period, (c) through the year inflation

GDP FORECASTS



LABOUR MARKET FORECASTS

Annual Growth in Employment and the Unemployment rate



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LABOUR MARKET, WAGES AND CONSUMER

The unemployment rate is key to the economic outlook

Reducing the unemployment rate has been a clear priority for policymakers, with both the government and RBA stressing its importance. To date, government support – notably the JobKeeper wage subsidy – has limited the rise job losses, such that NAB, the government and RBA expect the unemployment rate to peak at around 8%, much lower than the 10 to 12% initially feared.

The latest data shows 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. To date, half of the people who lost work in April and May have regained work, such that employment is now 3.3% below pre-virus levels.

Notably, the jobs recovery is likely 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.

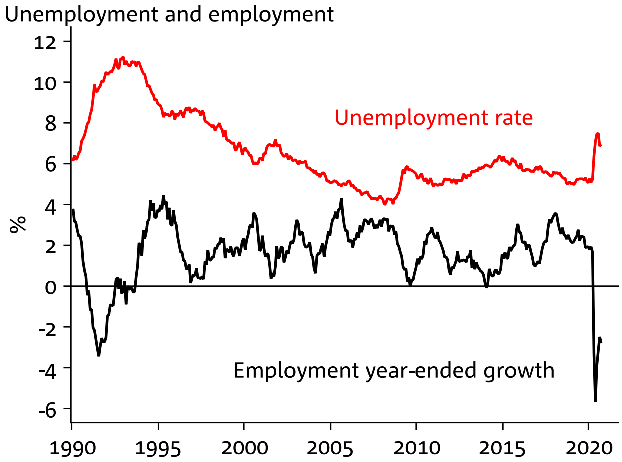
Nevertheless, beyond Q1 2021 NAB expects a gradual recovery in the labour market, supported by government stimulus and, at the margin, the RBA's monetary easing. This should see the unemployment rate steadily decline, although NAB forecasts the unemployment rate to be 5.9% by the end of 2022, well above the 5.2% recorded in February.

The elevated unemployment rate is likely to see wages growth remain very weak (Q3 data is due next week). This, in turn, will limit the recovery in consumer spending although government income support has been helpful in offsetting the blow to household finances.

On this front, Q3 consumer spending data will be released in the National Accounts in early December. NAB forecasts a large 3.1% q/q rise in consumption, after a sharp 12.1% fall in Q2. This should see consumer spending add 3.1pp to GDP, of which 1.2pp is from retail, after subtracting a large 6.7pp in Q2.

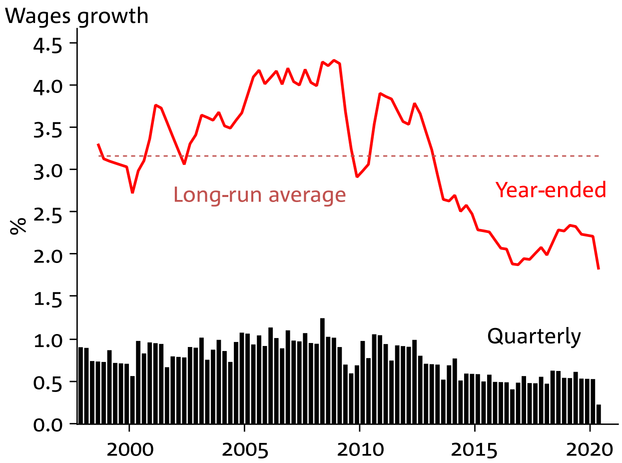
Going forward, consumer spending faces headwinds from elevated unemployment, weak wages growth, tapering income support and weak population growth. As consumer spending is a key driver of economic activity this highlights the importance of reducing unemployment to support the economy.

UNEMPLOYMENT WILL REMAIN ELEVATED



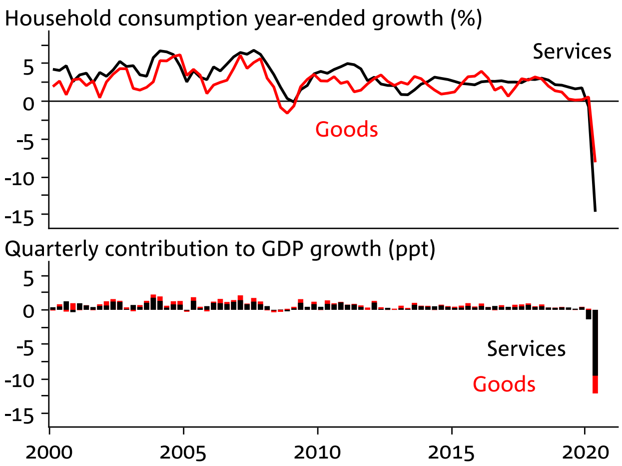
Source: National Australia Bank, Australian Bureau of Statistics

WAGES GROWTH SHOULD WEAKEN



Source: National Australia Bank, Australian Bureau of Statistics

CONSUMER SPENDING WILL REBOUND IN Q3



Source: National Australia Bank, Australian Bureau of Statistics

HOUSING AND CONSTRUCTION

Dwelling prices have remained resilient despite the hit to the labour market and expectations of weaker population growth.

Dwelling prices rose by 0.4% in October, driven by increases across all capitals except Melbourne which fell by 0.2%. Prices rose by over 1% in Hobart, Adelaide and Darwin, while Perth and Brisbane also saw moderate gains of 0.6% and 0.5% as well.

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 ongoing weakness in demand and a relatively large pipeline of new supply being built.

The resilience of dwelling prices (and established market activity) to date is likely to have been supported by record low interest rates, income support from the government through the JobSeeker and JobKeeper programs as well as loan deferrals by banks.

We continue to expect a decline in prices over the next year or so, driven by weakness in Sydney and Melbourne where weaker population growth and supply increases will weigh most. That said, ongoing weakness in the labour market and softer income growth will likely weigh everywhere.

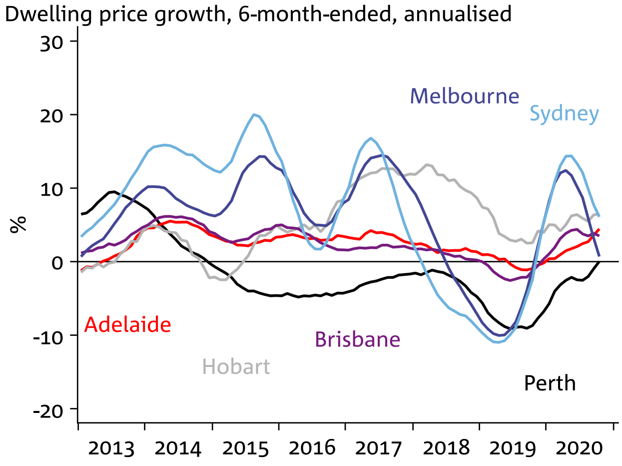
On the construction side, building approvals have risen in recent months, driven by pickup in the detached houses component. Approvals for high density have also risen but by less. The turnaround in building approvals, has likely been supported by the Government's HomeBuilder scheme which provides $25,000 grants to build a new home (or substantially renovate an existing property) spurring demand for new homes. To date, 14.6k HomeBuilder applications have been made.

While approvals have recovered somewhat in recent months, they remain low compared with recent history. As such high rates of work done are likely to continue to erode the pipeline of work and we expect dwelling investment to continue to fall in the near term before stabilising.

There are significant risks around our forecasts for dwelling prices at present. Upside risks include the significant impact lower rates will play in supporting prices.

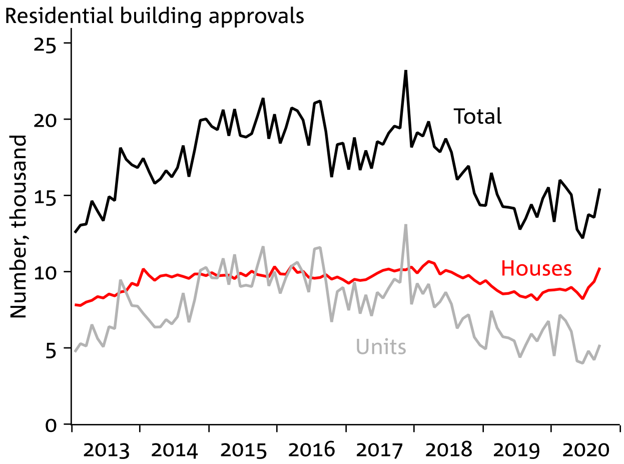
On the downside, the deterioration in the labour market, phasing out of income support from the government and ongoing weak wage growth present a risk. As does the slowing in population growth to a rate not seen in a century.

HOUSE PRICE FALLS DRIVEN BY MELBOURNE AND SYDNEY



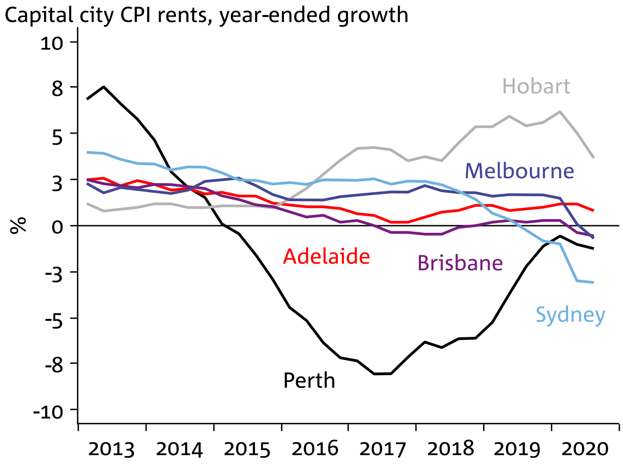
Source: National Australia Bank, CoreLogic

BUILDING APPROVALS ARE TURNING AROUND



Source: National Australia Bank, Australian Bureau of Statistics

RENTS ARE FALLING IN THE BIG CITIES



Source: National Australia Bank, Australian Bureau of Statistics

BUSINESS AND TRADE

The outlook for business investment remains highly uncertain – but there is some policy support

The outlook for business investment remains highly uncertain. Business investment growth was weak prior to the pandemic but it is likely that plans for new investment have been disrupted and even some planned investment delayed. 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.

An update of official indicators for business investment Q3 will come at the end of November in the ABS Capex Survey as well as the National Accounts in early December – though even these will be dated, given the shifts in activity and sentiment over the past few months.

The NAB Monthly business survey for October showed further improvement in the month. Business confidence rose to its highest level since mid-2019, while conditions and capacity utilisation edged higher. The small tick-up in conditions was driven by ongoing improvement in the trading and profitability sub-indexes. The recovery in the employment (and Capex) indexes shows a much more muted and lagged response.

However, the survey also highlights the disparity in the pace of recovery across states and industries. WA, SA and Qld have generally rebounded more quickly than Vic and NSW (notwithstanding a small reversal of this trend in the month).

Overall, while they have rebounded somewhat, the pipeline of work (forward orders) and capex are still in negative territory, while capacity utilisation is still notably below its pre-COVID level.

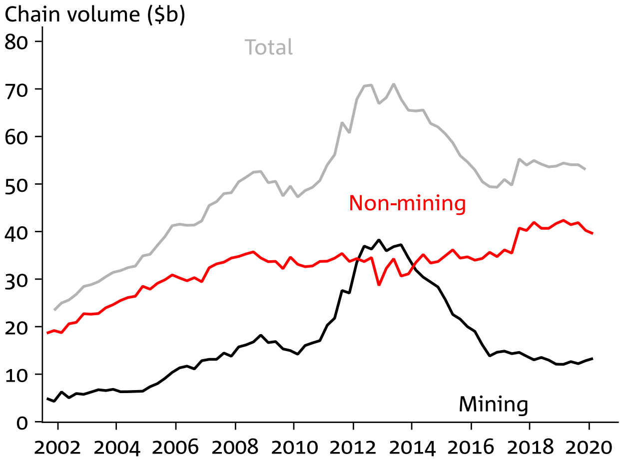
There will likely be impacts to services trade for some time, but goods trade has held up.

Trade data for September showed the trade surplus widened to $5.6bn in the month with a 4% rise in exports combined with a 6% fall in imports. The movements on both the imports and exports side were driven by the volatile non-monetary gold component in the month.

Overall, monthly trade data combined with the trade prices release point to a subtraction of around 2% from net exports in the Q3 GDP figures (due next month).

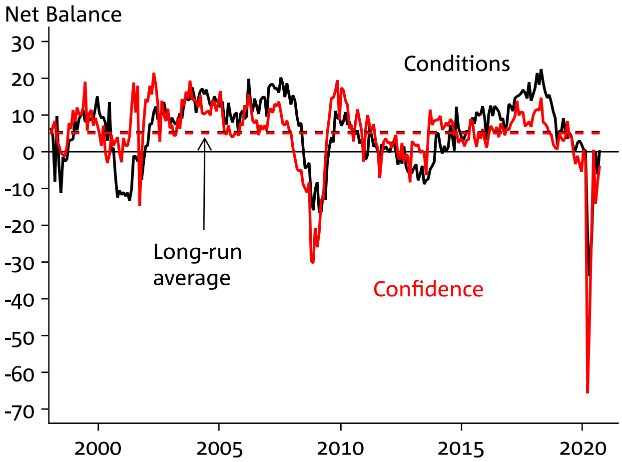
International services trade (most importantly for Australia, tourism and education exports) will continue to be impacted by border closures for some time. Goods exports have held up with demand for our commodities remaining strong. Since February, service exports have fallen by 31% (likely reflecting that a significant amount of international students have remained in the country) while services imports (primarily international tourism) are down around 55%.

THE OUTLOOK FOR BUSINES INVESTMENT REMAINS UNCERTAIN



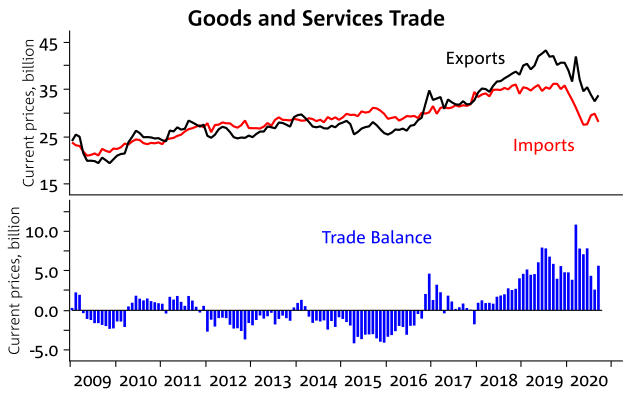
Source: National Australia Bank, ABS

CONFIDENCE AND CONDIITONS CONTINUE TO IMPROVE



Source: National Australia Bank, National Australia Bank

ONGOING IMPACTS TO TRADE



Source: National Australia Bank, ABS

MONETARY POLICY, INFLATION AND FX

The RBA embarks on QE as it cuts rates to 0.1%

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, while leaving the door open to further QE should the labour market require additional support.

This significant monetary easing will lower the structure of interest rates further across the economy. This should, at the margin, help consumer and business spending, provided business can be convinced of the sustainability of the recovery. That said, we continue to view fiscal policy as the key driver of stimulus and economic recovery.

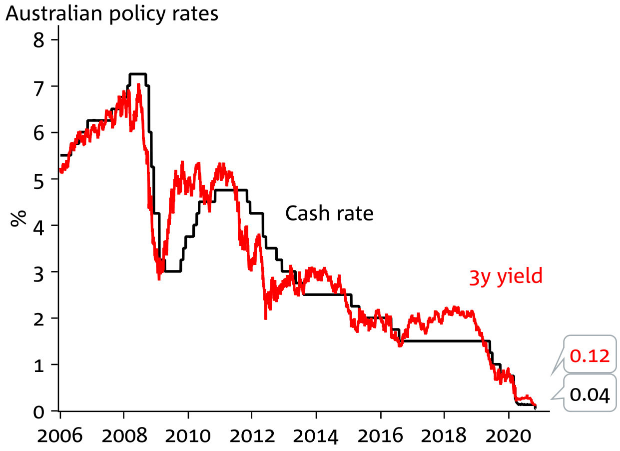
Going forward, we expect rates to remain unchanged for at least three years, in line with the RBA's view that negative rates are "extraordinarily unlikely" and its guidance that it will not raise rates until the unemployment rate is at full employment levels and inflation is back within the 2-3% target. The RBA does not expect this to happen for at least three years – and in our view probably longer. We expect unemployment to gradually decline from a peak of 8.1% to 5.9% by the end of 2022. This is well above 5%, our current estimate of full employment. Consistent with gradual progress on unemployment, we expect inflation to remain below target until at least the end of 2022.

That said, we think it is likely the RBA will ease further through additional QE. The RBA has made it clear it wants to see unemployment fall. As such, as jobs growth continues to slow and the unemployment rate does not fall as the RBA forecasts, we think the RBA will expand its QE program.

Additional bond buying from the RBA may help put downward pressure on the exchange rate. The RBA would view this as a "helpful depreciation", where its recent analysis shows that unconventional policy may derive more of its impact through lowering the exchange rate than traditional monetary easing through cash rate cuts.

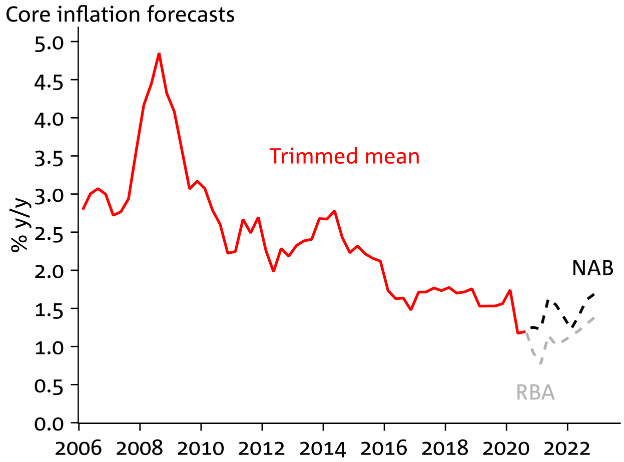
While this is a risk, our forecasts for the AUD have been unchanged since July. We continue to expect the AUD/USD to end the year at 0.74 USD before rising to 0.78 USD by the end of 2021. We expect the exchange rate to rise, despite the RBA's QE program, as risk sentiment improves and the global recovery gets underway.

THE CASH RATE IS TRADING BELOW 0.1%



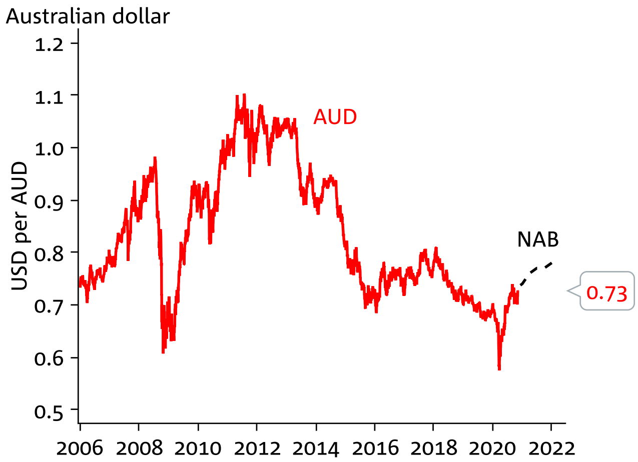
Source: Reserve Bank of Australia, Macrobond Financial AB

CORE INFLATION TO REMAIN BELOW TARGET



Source: National Australia Bank, Australian Bureau of Statistics, RBA

AUD TO RISE ON POSITIVE OUTLOOK



Source: National Australia Bank, Macrobond Financial AB

FORECAST TABLES

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	-2.1	6.5	2.7	1.5	-6.9	5.4	4.4
Dwelling Investment	0.0	-8.8	-15.8	2.2	4.7	-6.7	-12.4	-10.1	11.3
Underlying Business Investment	-1.8	-3.1	-15.3	0.0	1.4	-1.5	-9.5	-10.8	6.1
Underlying Public Final Demand	4.4	5.9	8.1	4.7	4.5	5.1	7.1	7.1	3.4
Domestic Demand	**1.8**	**-0.8**	**-1.7**	**5.3**	**2.9**	**1.4**	**-3.9**	**3.4**	**4.6**
Stocks (b)	-0.2	-0.3	0.7	-0.1	0.1	-0.2	0.1	0.2	0.0
GNE	**1.6**	**-1.1**	**-1.0**	**5.2**	**3.0**	**1.1**	**-3.7**	**3.6**	**4.7**
Exports	4.0	-1.6	-11.8	-5.8	5.0	3.5	-10.3	-7.6	-6.1
Imports	0.3	-7.1	-7.2	3.2	4.0	-0.9	-13.6	2.1	1.3
GDP	**2.0**	**-0.2**	**-1.7**	**3.6**	**2.8**	**1.8**	**-3.2**	**2.2**	**3.3**
Nominal GDP	5.3	1.7	-0.4	5.4	5.0	5.0	-2.2	3.9	5.0
Current Account Balance ($b)	14	-36	-34	-5	-40	12	47	19	-5
(%) of GDP	0.7	-1.8	-1.7	-0.2	-2.1	0.6	2.4	0.9	-0.2
Employment	2.4	0.1	-0.6	2.2	2.7	2.3	-2.2	1.6	2.5
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	1.8	1.8	1.8	0.6	1.8	2.0
Core CPI	1.4	1.3	1.6	1.4	1.7	1.4	1.2	1.4	1.7
Unemployment Rate	5.1	7.0	7.9	6.4	5.0	5.2	7.6	7.0	5.9
RBA Cash Rate	1.25	0.14	0.10	0.25	1.50	0.75	0.10	0.10	0.10
10 Year Govt. Bonds	1.32	0.87	0.90	1.35	2.32	1.37	0.85	1.10	1.10
$A/US cents :	0.70	0.69	0.77	0.75	0.71	0.70	0.74	0.78	0.80
$A - Trade Weighted Index	60.1	60.0	62.2	62.1	60.7	60.3	60.9	62.7	63.2

(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

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