NAB ECONOMICS: FORECAST UPDATE, NOVEMBER 2020

STRONGER ACTIVITY AND A SMALLER HIT TO UNEMPLOYMENT IN THE NEAR TERM

NAB Economics

We have upgraded our near-term forecasts for GDP and unemployment ahead of the national accounts Q3 GDP release in early December. We now expect GDP growth of around 4% in Q3 driven by a strong rebound (around 7.5%) in consumption. We also see a smaller hit to the labour market with the unemployment rate to peak at 7.4% in late 2020, down from 8% (in early 2021). The key driver of our forecast upgrade has been a marked improvement in high frequency data, in particular, NAB's transaction data have shown a rapid rebound across states once restrictions are removed.

However, we have downgraded our growth outlook from late 2021 onwards. Despite expecting a stronger near-term rebound, the private-sector weakness that was in place pre-virus will likely reassert itself. In particular, high unemployment will weigh on already-weak income growth and this, in combination with weak population growth, will see consumer spending slow into 2022. As such, at the end of 2022 we expect unemployment to remain around 0.5ppt higher than its pre-COVID level despite GDP having recovered a year earlier. Inflation will therefore remain weak at 1.7% - a little below the RBA's target. The outlook remains highly uncertain and the pace of recovery could be uneven.

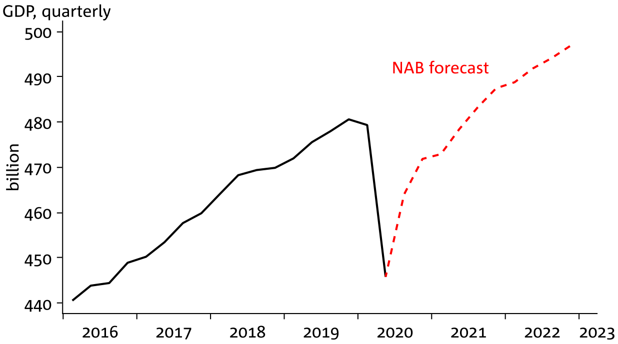
- **As the recovery gets underway, we have upgraded our near-term outlook for growth and unemployment.** The COVID-19 pandemic has seen large impacts on activity, where widespread restrictions and confidence impacts saw GDP fall sharply in Q2. In particular, consumer spending collapsed 12%, where spending is almost 60% of GDP. Timely NAB transaction data shows a sharp rise in card spending in Q3, indicating a strong rebound in spending activity in growth in the quarter. As such, we have upgraded our near-term growth forecasts and expect Q3 GDP to rise around 4% q/q, following the 7% fall in Q2. We see a further recovery in consumption in Q4 and business and dwelling investment to trough around mid-2021. As a result, we forecast the level of GDP to have fully recovered pre-virus levels by late 2021.
- **However, in the medium term, we expect consumer spending growth to moderate and business investment growth to remain soft.** Private-sector activity, namely consumer spending and business investment, were already weak pre-virus. Weak income growth had been weighing on consumer spending, while businesses were unwilling to expand amid lacklustre demand growth. We expect these forces will reassert themselves once the initial recovery stage has passed. In particular, for consumption, high unemployment, record weakness in wages growth and a sharp slowdown in population growth will be significant headwinds.
- **The unemployment rate is likely to peak at a lower level of 7.4% and sooner.** We now expect the unemployment rate will peak at 7.4% in Q4 2020, down from our previous forecast of 8% in Q1 2021, on the back of a stronger rebound in activity. Despite the better near-term forecast, we continue to expect unemployment to only gradually improve over the next two years: to 6.7% by end 2021 and 5.7% by end 2022. This is despite substantial support from fiscal and monetary policy, including our forecast that the RBA will expand its QE program. The outlook for unemployment reflects our expectation that growth will moderate, once the initial rebound in activity fades.
- **High unemployment points to weak wages and inflation.** We continue to expect core inflation to stay below the RBA's target of 2 to 3% into 2022. With unemployment well above pre-virus levels for the next few years, wages are likely to remain exceptionally weak. This will limit inflationary pressure for some time.
- **We now expect house prices to rise moderately over the next couple of years.** Alongside this upgrade to our forecasts (and following the improving outlook) over recent month we have reassessed our outlook for the housing market. We next expect house prices gains of around 5% and 6% in each of the next two years, respectively. Sydney prices are expected to increase by 4.4% over 2021 and 6% over 2022 while Melbourne is expected to rise by slightly less (3.6% and 5.4% in 2021 and 2022). Lower interest rates will be a key support to prices going forward, while the impact of a weaker labour market appears to have been mitigated by government support (to date). However, the largest markets will no doubt be impacted by slower population growth, and therefore we expect stronger growth in prices across the other capitals. See our Q3 Residential Property Survey also released today for further detail.
- **Both fiscal and monetary policy have been significant supports to the economy.** We credit unprecedented fiscal policy with limiting the hit to households from the pandemic and moderating the increase in unemployment. In particular, the government's JobKeeper wage subsidy and boost to JobSeeker unemployment benefits helped support jobs and household income. However, these programs are tapering

and set to send in Q1 2021, after which the focus will be on the government's incentives for business investment and hiring. Income tax cuts will also provide some relief to households alongside 1record low rates. On monetary policy, we continue to expect the RBA to keep rates low at its self-imposed limit of 0.1% for years to come. However, we expect the RBA to expand its QE program beyond the $100bn already announced as it seeks to spur a faster recovery in the labour market.

- **Uncertainty around the outlook remains high and further rounds of COVID-19 outbreaks pose a risk until a widely available vaccine is available.** We have assumed that while there may further domestic outbreaks of the virus, that these do not result in protracted lockdowns and that any further outbreaks are effectively contained with little impact on aggregate activity. Beyond the pandemic risk, confidence for both consumers and business remains an important factor for a sustainable recovery in the private sector, where we continue to view the recent improvement in confidence as fragile – depended on activity continuing to rebound strongly. The outlook for population growth is also uncertain where we assume that the international border will remain closed until mid-to-late 2021. In recent years, population growth has been a key driver of demand and had an important influence in the housing market. Slower population growth will weigh on demand as well as reduce labour supply growth, but how significantly remains unclear.

GDP FORECAST

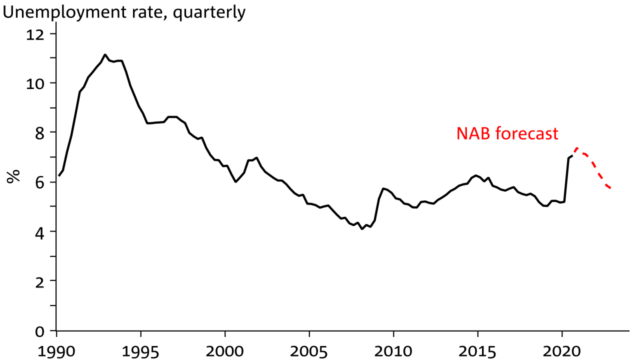
GDP, quarterly



Source: National Australia Bank, Australian Bureau of Statistics

UNEMPLOYMENT FORECAST

Unemployment rate, quarterly



Source: National Australia Bank, Australian Bureau of Statistics

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APPENDIX 1: DETAILED FORECASTS

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	1.4	6.8	2.7	1.5	-5.4	8.2	3.4
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	-11.6	2.0	1.4	-1.5	-7.9	-7.2	6.6
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**	**0.6**	**5.6**	**2.9**	**1.4**	**-2.9**	**5.3**	**4.1**
Stocks (b)	-0.2	-0.3	1.0	-0.4	0.1	-0.2	0.3	0.1	-0.1
GNE	**1.6**	**-1.1**	**1.7**	**5.2**	**3.0**	**1.1**	**-2.6**	**5.4**	**4.0**
Exports	4.0	-1.6	-11.8	-5.8	5.0	3.5	-10.3	-7.6	-6.1
Imports	0.3	-7.1	-3.9	4.3	4.0	-0.9	-12.4	5.3	1.4
GDP	**2.0**	**-0.2**	**0.2**	**3.4**	**2.8**	**1.8**	**-2.4**	**3.3**	**2.6**
Nominal GDP	5.3	1.7	1.5	5.1	5.0	5.0	-1.4	5.0	4.3
Current Account Balance ($b)	14	-36	-21	12	-40	12	42	2	-22
(%) of GDP	0.7	-1.8	-1.0	0.6	-2.1	0.6	2.1	0.1	-1.0
Employment	2.4	0.1	0.4	2.3	2.7	2.3	-2.0	2.9	1.9
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	1.0	1.5	2.6	3.5	1.7	1.0
End of Period									
Total CPI	1.6	-0.3	3.0	1.6	1.8	1.8	0.6	1.8	1.7
Core CPI	1.4	1.3	1.5	1.4	1.7	1.4	1.2	1.5	1.6
Unemployment Rate	5.1	7.0	7.1	6.1	5.0	5.2	7.4	6.7	5.7
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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