December 2020

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

GDP rebounded strongly across all the major advanced economies in Q3, but the pace of recovery is expected to slow markedly, and in some cases there may be a reversal, in Q4 due to the re-introduction of restrictions to control COVID-19. There was also a sizeable economic recovery in Emerging Markets in Q3, and more timely data point to a continued improvement in economic conditions in Q4. The spread of COVID-19 remains a key risk to the outlook. Despite the impact of the COVID-19 related restrictions in Europe and elsewhere, the global PMI survey showed relatively little change in November, with the services reading easing a little but manufacturing up, pointing to the global recovery continuing. Nevertheless, we expect there to be a slowdown in the global recovery in Q4 2020 (with downside risks around Q1 2021). Ongoing economic disruption is likely until an effective COVID-19 vaccine has been widely deployed. On this front, news continues to be positive, supporting financial markets. Our global forecast for 2020 is unchanged at -3.9% but we have lowered our forecast for 2021 to 5.8% (from 6.1%).

- Progress on vaccines has supported **financial markets**. Major equity market indices have continued to strengthen, with US markets hitting record highs in late November while, at the same time, other advanced economies and emerging market indices were at their highest levels since early 2018. Volatility in equity markets has also declined recently, although it has remained above the typical levels seen in the post-GFC period. Financial condition indices, which combine a range of market indicators, for the US and Euro-zone deteriorated slightly between mid-October and early November but have subsequently improved.
- At an aggregate level, **commodity prices** have also trended higher from late October (having plateaued from the start of September). However, excluding energy commodities, commodity prices have generally trended higher from April 2020 onwards, as China's comparatively earlier economic recovery boosted demand for resources. At the time of writing, the CRB index (excluding energy) was at its highest levels since June 2018.
- While monetary authorities have worked to keep financial markets functioning, major advanced economy **central banks** have largely exhausted conventional policy room and many have reimplemented unconventional policies (such as asset purchases). The US Fed is considering how its QE programme could provide extra support if needed and the ECB this month expanded its pandemic asset purchase programme. Central bank policy rates are likely to stay low for a considerable time.
- GDP increased strongly in Q3 across the major **advanced economies** (AEs), but growth is expected to slow markedly, and in some cases go into reverse, in Q4 due to the re-introduction of restrictions to control COVID-19. GDP increased by between 5% q/q (Japan) and 15 q/q% (UK) in Q3 across the major AEs, but it is still well below its pre-COVID levels. High frequency data points to some downturn in activity over October/November, particularly in Europe where some countries moved back into lockdown (and we expect a decline in Euro-zone and UK GDP in Q4), but also in Canada and the US. The number of new cases in Europe is falling, enabling a gradual easing in restrictions (but Germany is an exception and it recently extended its COVID-19 restrictions).
- There was a sizeable economic recovery in **Emerging Markets** (EMs) in Q3, with the five largest economies growing by 0.4% yoy (compared with a 4.9% contraction in Q2). China was one of the few economies to record year-on-year growth in Q3, while India had a partial recovery, with sizeable quarter-on-quarter growth (of over 15%). A less negative trend was also evident in East Asia – where there was an overall contraction of 3.2% yoy in the third quarter, compared with a 7.5% decline in Q2. Business surveys point to a continued improvement in economic conditions in Q4. The aggregate Emerging Market manufacturing PMI edged higher in November, while the services indicator was stable (at a high level).
- COVID-19 continues to have a major influence on the **global economy**; while new cases in Europe are falling they have picked up elsewhere. Despite this, the global business PMI showed little movement in November, pointing to an ongoing global recovery. With many of the recent restrictions targeting hospitality and social interaction, the services sector global PMI eased a little, but, at the same time, the manufacturing PMI moved higher. We expect there to be a slowdown in the global recovery in Q4 2020 (with downside risks around Q1 2021) and ongoing economic disruption is likely until an effective COVID-19 vaccine has been widely deployed. On this front, news continues to be positive; the UK this month approved a vaccine for use and US regulators are expected to make a decision soon. A rapid roll-out of a vaccine (in scale) represents upside risks to our forecasts. Our global forecast for 2020 is unchanged at -3.9% and we have lowered our forecast for 2021 to 5.8% (from 6.1%) largely due to revising down our forecast for India.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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Australia: NAB recently upgraded our forecasts prior to the Q3 national accounts to expect a stronger near-term recovery in activity and a lower peak in unemployment. Driving our change in view has been the continued strength in NAB's transactional data and the solid turnaround in business conditions and confidence recorded in the NAB survey. Our outlook now resembles the best-case scenario we outlined at the start of the pandemic. That said, while we expect activity to return to pre-virus levels by the end of 2021, it will take years for unemployment to recover, even in this best-case scenario. Further, large uncertainties remain, even with a vaccine seemingly close to being rolled out. As such, federal and state fiscal support will be key for a sustained recovery, while monetary policy will assist, at the margins, by keeping the cost of credit low.

- **Q3 GDP rose by a strong 3.3% to be 4.2% below pre-virus levels.** Early in the month, Q3 GDP data showed a strong rebound of 3.3%, following the sharp 7% fall in Q2. This marks a strong start to the economic recovery, where NAB expects a further strong rise of 2.1% in Q4, as Victoria exits lockdown. That said, the level of activity remains 4.2% below pre-virus levels and down 3.8% from a year ago. In our view, beyond the initial rebound, economic growth is likely to moderate over 2021 such that it will take until the end of next year for activity to recover to pre-virus levels.
- **Consumer spending drove the rebound in activity.** Encouragingly, spending rose by a sharp 7.9% in Q3, after a 12.5% collapse in Q2, following the easing of restrictions across much of Australia, except Victoria. The strength of the rebound in consumer spending suggests consumer confidence remains resilient and household balance sheets are in a reasonable shape, both of which will be important for a sustained recovery. The Christmas shopping period will be another important gauge of consumer confidence – NAB's timely transaction data shows a record Black Friday/Cyber Monday sales period.
- **NAB forecasts a lower peak in unemployment of 7.4% in Q4 2020,** down from our previous forecast of an 8% peak. That said, while the consumer-driven rebound in activity should see GDP recovered by the end of 2021, the recovery in unemployment will take longer. Even in this "best-case scenario" outlook, NAB expects the unemployment rate to reach 5.7% by the end of 2022, above the 5.2% recorded pre-virus. As such, elevated unemployment will remain a headwind to household income and spending, and therefore overall activity for some time.
- **The November NAB Business Survey showed further gains in the month, but hiring and investment are yet to rise.** Both confidence and conditions are now above average, and stronger than the period right before the pandemic – albeit this partly reflects some "snapback" following the containment of the virus. Conditions rose 7pts in the month, to an above-average 9 index points; confidence rose 9pts to +12 index points. Encouragingly, other lead indicators improved in the month: capacity utilisation saw a large gain and forward orders turned positive, the latter suggesting that the pipeline of work has begun to build. That said, employment and capex indicators remain weak. This suggests that even with the significant improvement in trading conditions and profitability, businesses will need to see a sustained improvement in forward orders and a complete recovery in capacity utilisation before renewed hiring and investment plans are put in place.
- **House prices have held up much better than expected since the onset of the pandemic**, despite the significant deterioration in the labour market and weaker population growth amid closed borders. The latest data show housing prices rose by a strong 0.7% in November, to be 2.4% higher over the year. All the capitals recorded solid growth in the month, with the smaller cities seeing rises of well over 1%. We now expect gains of 5% in 2021 and 6% in 2022, with rises across all capitals, where lower rates and the recovery in demand will be key supports. However, softening rents in the largest cities and uncertainty over population growth will likely temper some of the increase for Sydney and Melbourne – particularly the apartment segment. Therefore, we expect stronger gains for the smaller cities. On residential construction, we expect the recent sharp rise in approvals, boosted by HomeBuilder grants, to see dwelling investment turn up around mid-next year.
- **Fiscal measures – both federal and state – remain the key driver of the economic recovery,** although monetary policy has been helpful at the margin. The RBA's package of measures (lower cash rate, term funding facility, yield-curve control and QE) have lowered interest rates across the economy. This has placed downward pressure on the exchange rate, helped households pay off debt and supported housing activity and prices. With policy rates at the RBA's self-imposed floor of 0.1%, we think it is likely the RBA will ease further through additional QE, to provide additional, marginal, support to the labour market.
- **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. This largely reflects the improvement in risk sentiment and the global recovery getting underway, particularly amid positive developments in the race to deploy a COVID-19 vaccine.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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