THE FORWARD VIEW: AUSTRALIA DECEMBER 2020

A STRONG REBOUND AS CONFIDENCE IMPROVES

OVERVIEW

- **NAB upgraded our forecasts two weeks ago 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.**

NAB recently upgraded our near-term outlook for growth and unemployment. Timely NAB transaction data suggests consumer spending remains strong, after the large rebound in Q3. We expect another strong consumer-driven increase in activity in Q4, where we forecast a rise of 2.1% q/q. Beyond this initial rebound, we forecast growth to moderate but the level of GDP to have fully recovered pre-virus levels by late 2021.

Given the strong near-term outlook, we expect the unemployment rate to peak at 7.4% in Q4 2020, before steadily declining from there to 5.7% at the end of 2022. Even with our strong outlook for activity, unemployment remains well above the pre-virus low of 5.2% to the end of 2022. This 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% for the next couple of years, reaching just 1.7% by the end of 2022.

These forecasts broadly align with the best-case scenario we outlined at the start of the pandemic. Since then, the containment of the virus and large fiscal stimulus have seen downside risks fade, while a vaccine seems likely to be rolled out in 2021. As such, our outlook is notably more optimistic and more confident than 3 to 6 months ago.

However, in the medium term, we expect consumer spending growth to moderate and business investment growth to remain soft, returning to pre-virus trends. In particular, for consumption, high unemployment, record weakness in wages and a sharp slowdown in population growth will be significant headwinds. As such, we expect further stimulus, with the RBA likely to extend its $100bn 6-month QE program. This support will be helpful, but marginal compared to large fiscal stimulus at both the federal and state level, although at present fiscal stimulus is set to be scaled back in 2021/22.

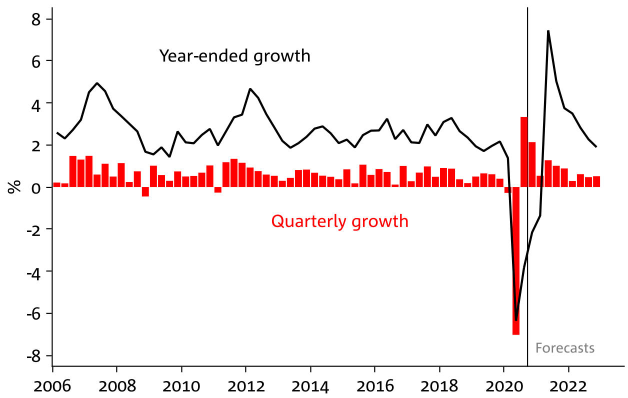
CONTENTS

KEY ECONOMIC FORECASTS

	2019	2020-F	2021-F	2022-F
Domestic Demand (a)	1.2	-2.8	6.2	4.1
Real GDP (annual average)	**1.9**	**-2.7**	**3.6**	**2.6**
Real GDP (year-ended to Dec)	**2.2**	**-2.2**	**3.7**	**1.9**
Terms of Trade (a)	5.7	-0.9	2.5	1.3
Employment (a)	2.3	-1.9	3.0	2.1
Unemployment Rate (b)	5.2	7.4	6.5	5.7
Headline CPI (b)	1.8	0.6	1.8	1.7
Core CPI (b)	1.4	1.2	1.5	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

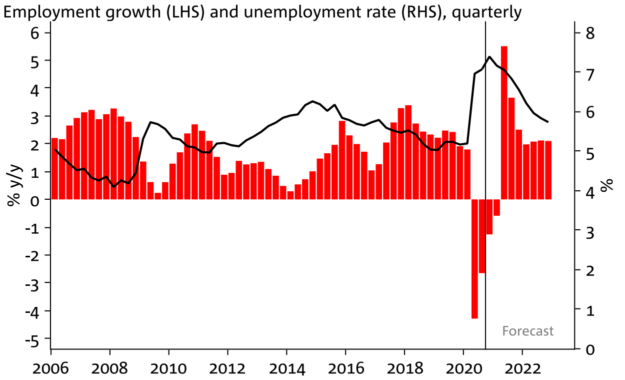
GDP FORECASTS



Source: National Australia Bank, Australian Bureau of Statistics

LABOUR MARKET FORECASTS

Employment growth (LHS) and unemployment rate (RHS), quarterly



Source: National Australia Bank, Australian Bureau of Statistics

Alan Oster, Chief Economist | Gareth Spence, Senior Economist | Kaixin Owyong, Senior Economist

LABOUR MARKET, WAGES AND CONSUMER

Consumer spending has rebounded sharply and we expect a solid recovery in the next year.

Recent Q3 GDP data show that consumer spending rose by a sharp 7.9% in Q3, after a 12.5% collapse in Q2. These data confirm that following the easing of restrictions across much of the country, except Victoria, household spending surged on the back of large pent up demand.

The encouraging rebound in spending was supported by the huge fiscal stimulus deployed at the start of the pandemic. These measures limited job losses and supported household income, enabling households to largely resume spending in Q3. Further, NAB transactional data suggests that spending remains strong, even as the initial boost from reopening wanes. The NAB Cashless Retail Sales Index released today shows a 3% rise in November, supported by Black Friday/Cyber Monday sales.

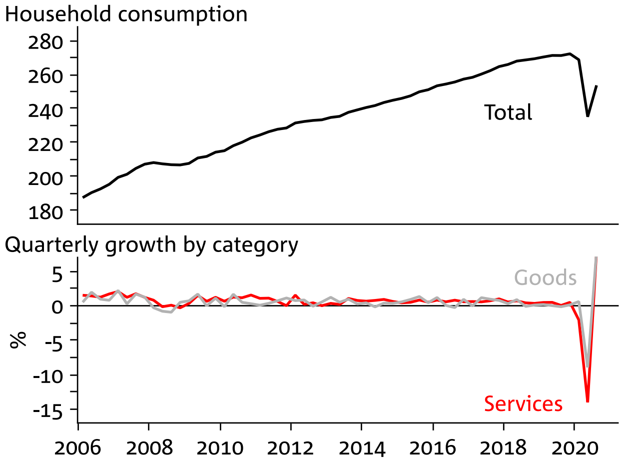
Given consumer spending is over half of activity, our expectation for further gains underlies our recently-upgraded forecast for activity to return to pre-virus levels by the end of 2021. In the near term, additional gains in consumer spending, supported by the end of Victoria's lockdown, should support a healthy recovery in activity. With a stronger rebound in activity expected, we also lowered our forecast peak in the unemployment rate to 7.4%, down from 8%.

As such, our outlook suggests the worst is over for the Australian economy and the recovery is well underway. That said, we note there remain many headwinds to a full recovery for the household sector, where consumer spending is still around 7% below its pre-virus level. As stimulus tapers, elevated unemployment, weak wages growth and weak population growth are likely to see spending growth return to a weak pace, as was the case pre-virus.

Notably, labour market conditions need to improve further for a full recovery. NAB forecasts the unemployment rate to steadily improve, reaching 5.7% by the end of 2022, just 0.5pp above the 5.2% recorded pre-virus in February. However, in the near term, elevated unemployment will weigh on wages. Recent wages data showed wages rose just 0.1% in Q3, with annual wages growth slowing to a record 1.4%.

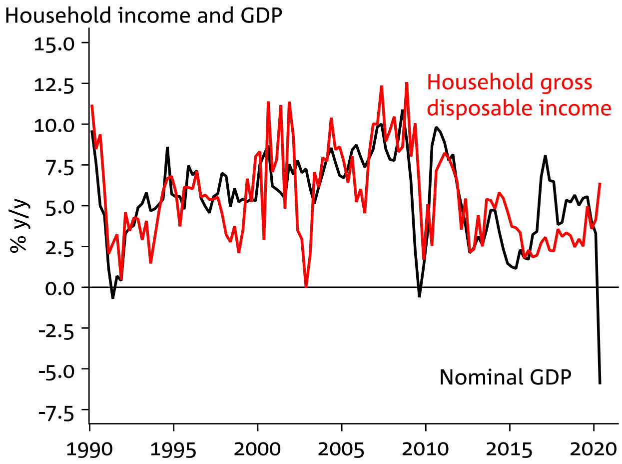
As such, the priority for policymakers continues to be reducing the unemployment rate. On this front, we think government stimulus – both federal and state – will be key for supporting demand and jobs growth. The RBA's substantial policy easing, including our expectation that the RBA extends its QE program, will help, albeit at the margin.

CONSUMER SPENDING HAS REBOUNDED



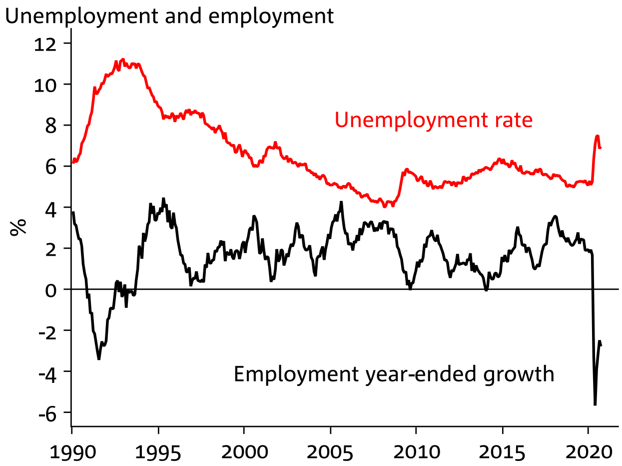
Source: National Australia Bank, Australian Bureau of Statistics

INCOME SUPPORT HAS BEEN IMMENSE



Source: National Australia Bank, Australian Bureau of Statistics

UNEMPLOYMENT WILL REMAIN ELEVATED



Source: National Australia Bank, Australian Bureau of Statistics

HOUSING AND CONSTRUCTION

Dwelling prices have begun to turn following a brief slow down.

Dwelling prices have held up much better than expected since the onset of the pandemic, despite the significant deterioration in the labour market and elevated uncertainty over the pace of population growth over the next couple of years (impacting demand growth).The latest monthly data from CoreLogic show housing prices – as measured by the 8-capital city dwelling price index – 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%. Melbourne also saw a notable gain, rising by 0.7%, following the end of its lockdown.

With house prices appearing to have now turned up, prices appear to have only seen a modest impact during the pandemic, falling 2.8% between April and September. While unemployment has indeed risen sharply (and wage growth has slowed further), the large support to household incomes from the government's JobKeeper and JobSeeker programs appears to have mitigated the impact on households. The rebound also reflects the substantial easing in monetary policy, with many borrowing rates now at record lows.

Consequently, we have revisited our prediction for house prices over the next year. We now expect gains of 5% in 2021 and 6% in 2022, with rises across all capitals. The impact of lower rates and a recovering economy will be key supports. However, the softening in 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.

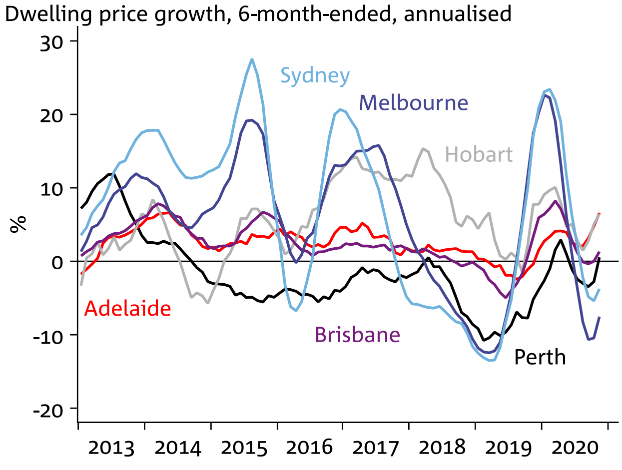
The decline in construction appears to be moderating. The Homebuilder program has boosted building approvals.

Dwelling investment was broadly flat in Q3, with a moderate decline in new construction offset by a notable rise in alterations and additions (ie. renovations).

Dwelling approvals rose by 3.8% in October to be 33% above its July low. Detached housing has driven the rise, where approvals for private houses are now at multi-year highs, having risen strongly through 2020 (32%). In contrast, approvals for apartments remain relatively soft after falling just over 10% in the year to October.

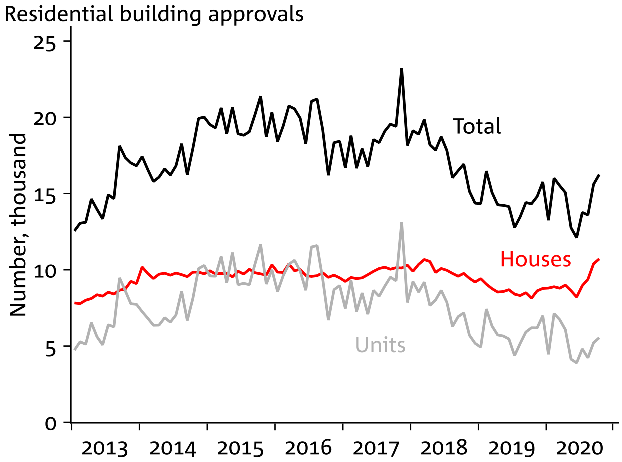
We expect the rise in approvals to feed into new residential construction, such that dwelling investment will turn up around mid-next year, following a protracted period of weakness. The government's HomeBuilder package will also provide support in the near term, where to 20 November 19k applications have been made for new builds.

HOUSE PRICES HAVE STARTED TO TURN



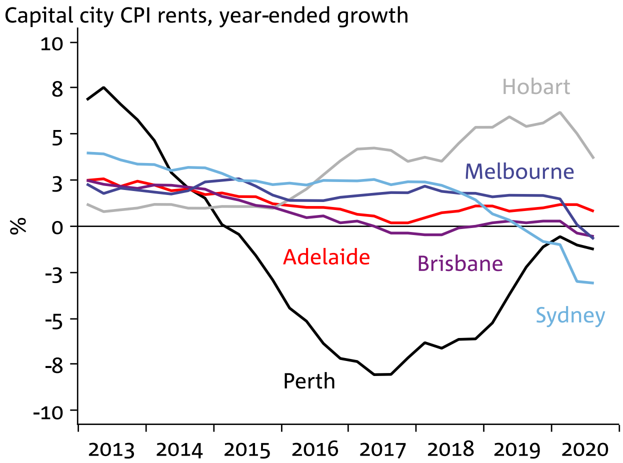
Source: National Australia Bank, CoreLogic

BUILDING APPROVALS ARE RISING



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

Business investment remains weak, with the national accounts showing further falls in Q3.

New business investment fell by 4.1% in Q3 with declines across machinery & equipment, engineering and non-residential building. The weakness in business investment pre-dated the onset of the pandemic but the risk appears to have shifted further to the downside with uncertainty around the economy remaining high.

Indeed, while activity has rebounded strongly so far, leading indicators of investment are mixed. The ABS Capex Survey points to a fall in nominal terms of around 7.7% in 2020/21. In contrast the ABS Business COVID-19 Impacts Survey reports that of the 20% of firms that have investment plans, around 75% have plans that are higher than the previous year.

The NAB Monthly Business Survey also suggests that despite a rebound in conditions and confidence, as well as an almost complete recovery in capacity utilisation, capex remains in negative territory. Alongside the weakness in the employment index this suggests that despite the opening up of the economy, businesses will need to see more of sustained recovery before new investment and hiring plans arise.

The NAB Survey now shows conditions across most states above the readings reported prior to the pandemic, with the exception of Victoria (still recovering from strict lockdowns) and Tasmania (somewhat volatile).

Retail continues to be the standout across industries – somewhat in contrast to conditions in the sector prior to the pandemic, reflecting the sheer support provided by the government to households.

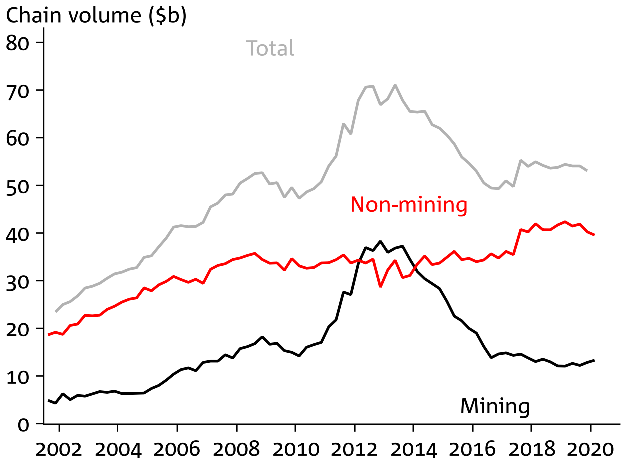
Trade was a drag on activity in Q3 but is expected to turn around in Q4. Services trade is likely to see ongoing impacts for some time, while global trade tensions are rising.

Net exports subtracted 1.9ppts from Q3 GDP with exports recording another large fall in the quarter, while imports saw a significant rebound as domestic demand returned.

Services exports remain around 50% lower with ongoing border restrictions which are expected to remain in place for the foreseeable future. Goods exports were also lower with a fall in rural exports as well as non-monetary resource exports.

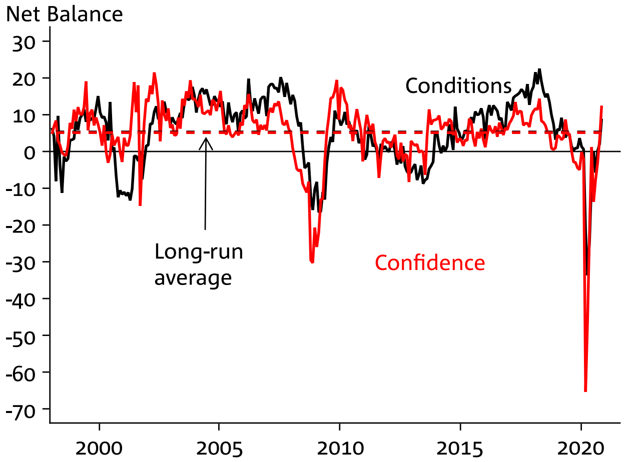
Trade data for October suggest that the trade balance rebounded (in nominal terms) early in Q4. The trade surplus widened by $1.6bn in the month to $7.5bn. The widening was drive by a 5% increase in exports in the month (with metal ores and minerals increasing as well as a sharp rise in the volatile non-monetary gold component) while imports rose by a more modest 1%.

THE OUTLOOK FOR BUSINES INVESTMENT REMAINS UNCERTAIN



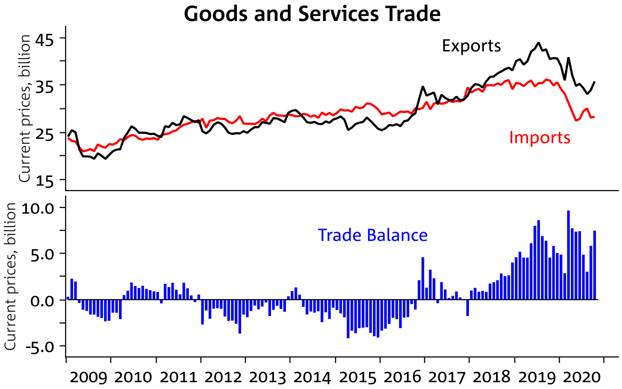
Source: National Australia Bank, ABS

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 remains prepared to do more

In December, the RBA kept monetary policy unchanged at its last meeting for 2020. The cash rate target, 3-year yield target and term funding facility (TFF) rate are at the RBA's self-imposed lower bound of 0.1%. The RBA will continue to buy bonds as part of its $100bn, 6-month, QE program.

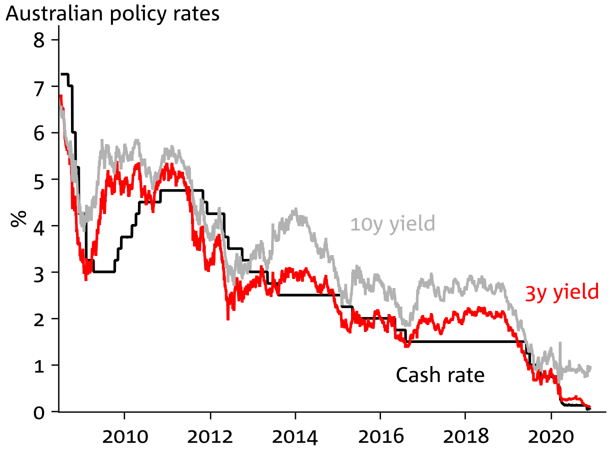
While we continue to view fiscal policy – both federal and state – as the key driver of the economic recovery, monetary policy has been helpful. The RBA's measures have lowered interest rates across the economy. This has placed downward pressure on the exchange rate, helped households pay off debt and supported housing activity and prices. This should, at the margin, support activity as confidence in the economic recovery improves, which in turn will help reduce unemployment.

Reducing the unemployment rate is the focus for the RBA, where it continues to stress this is a "national priority". As such, near term inflation data is unlikely to shift policy – the RBA expects inflation will be weak until wages growth picks up materially. This requires materially lower unemployment – the RBA expects the unemployment rate need to fall below 5%, and neither the RBA or NAB forecast this to occur by the end of 2022.

As such, we think it is likely the RBA will extend its QE program next year as it seeks a faster improvement in unemployment. At Governor Lowe's recent parliamentary testimony he stressed the RBA has an "open mind" to further QE and that the RBA would consider "three issues: the outlook for jobs, what other central banks are doing and how markets are functioning." On the actions of other central banks, Governor Lowe noted the RBA would be watching the exchange rate, where the bank has previously emphasised the boost to economic activity from a lower Australian dollar.

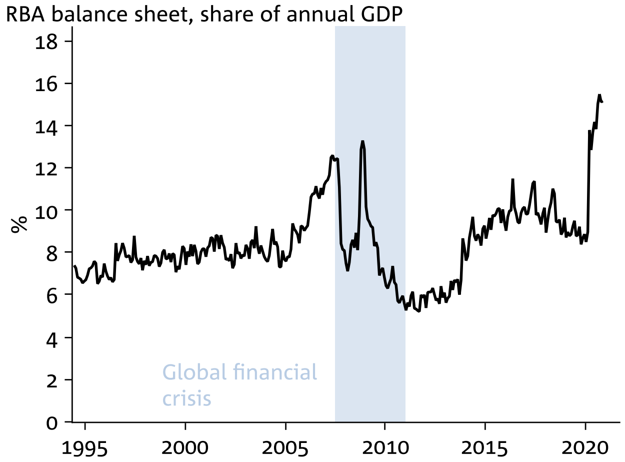
On that note, our forecasts for the AUD remain unchanged since July. We continue to expect the AUD/USD to end the year at 0.74 USD before rising to 0.78 USD by the end of 2021. This largely reflects the improvement in risk sentiment and the global recovery getting underway, particularly amid positive developments in the race to deploy a COVID-19 vaccine.

INTEREST RATES ARE AT HISTORIC LOWS



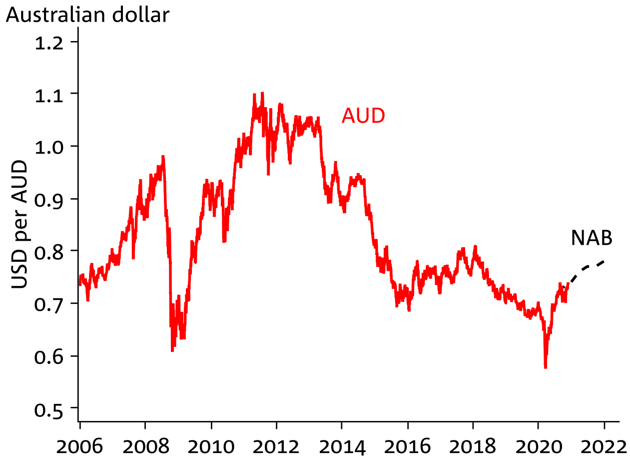
Source: Reserve Bank of Australia, Macrobond Financial AB

QE HAS INCREASED THE RBA BALANCE SHEET TO A RECORD SHARE OF GDP



Source: National Australia Bank, ABS, 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	1.8	-3.0	1.4	6.9	2.5	1.2	-5.8	8.3	3.5
Dwelling Investment	-0.8	-8.2	-5.6	3.0	4.3	-7.1	-7.5	-1.5	5.4
Underlying Business Investment	-3.1	-3.0	-10.8	4.1	0.5	-2.3	-7.8	-4.7	7.2
Underlying Public Final Demand	5.0	5.8	7.2	4.8	4.8	5.5	6.4	6.7	3.4
Domestic Demand	**1.6**	**-1.0**	**1.4**	**6.0**	**2.7**	**1.2**	**-2.8**	**6.2**	**4.1**
Stocks (b)	-0.2	-0.3	0.6	-0.1	0.1	-0.3	0.0	0.4	-0.2
GNE	**1.3**	**-1.3**	**2.1**	**5.9**	**2.9**	**0.9**	**-2.8**	**6.7**	**4.0**
Exports	4.0	-1.8	-12.6	-5.0	5.1	3.3	-11.1	-7.4	-5.3
Imports	0.2	-7.4	-3.4	5.1	4.0	-1.0	-12.8	6.7	1.4
GDP	**2.2**	**-0.2**	**-0.1**	**3.8**	**2.8**	**1.9**	**-2.7**	**3.6**	**2.6**
Nominal GDP	5.6	1.6	0.9	5.5	5.2	5.3	-2.1	5.3	4.3
Current Account Balance ($b)	14	-35	-21	11	-40	13	39	2	-19
(%) of GDP	0.7	-1.8	-1.0	0.5	-2.1	0.7	2.0	0.1	-0.9
Employment	2.4	0.1	0.5	2.5	2.7	2.3	-1.9	3.0	2.1
Terms of Trade	5.6	1.1	1.7	1.6	1.8	5.7	-0.9	2.5	1.3
Average Earnings (Nat. Accts. Basis)	2.3	3.1	3.2	1.0	2.0	2.8	3.5	1.8	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	1.2	1.6	1.4	1.8	1.4	1.2	1.5	1.7
Unemployment Rate	5.1	7.0	7.1	6.0	5.0	5.2	7.4	6.5	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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