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# THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

**The resurgence of COVID-19 in many parts of the world towards the end of 2020, as well as the re-introduction of mobility restrictions to bring it back under control, has had a negative impact on the global recovery. The Euro-zone economy went backwards in Q4, as did the UK's in November, and in the US and Canada employment has fallen in recent months. GDP growth in Q1 2021 is also likely to be negative or weak in the major advanced economies. Similarly, there has been a softening in emerging market (EM) conditions at the start of 2021. That said, the impact of restrictions on activity has been far more muted than was the case in the first round of lockdowns early in 2020. Our global forecast for 2021 remains unchanged at 5.8%, although this masks a switch from weaker early 2021 growth to stronger growth as the year unfolds. As a result, we now expect global GDP growth in 2022 of 4.6% (up from 3.9%). This more bullish view going forward rests on the roll out of the COVID-19 vaccine currently underway and expectations of further large scale fiscal stimulus in the US.**

- The run up in equity prices evident in most markets since March was disrupted in late January due to the 'short squeeze' caused by retail traders. Nevertheless, after a small dip, prices subsequently recovered and are well above their pre-COVID-19 level. Equity market volatility also spiked but has since largely retreated although it remains above its pre-COVID-19 level. More broadly **financial conditions** remain favourable with credit spreads generally around (and, in some cases, below) their pre-COVID-19 level. There has been some upward movement in longer dated bond yields; particularly in the US, reflecting stronger growth and inflation expectations.
- As the global economy recovers, there has been an associated upward trend in **commodity prices**. Since April, the RBA's USD indices for rural, base metal and bulks prices have risen and they are well above their pre-COVID-19 levels. In contrast, while improving, oil prices have yet to fully recover reflecting the impact of travel restrictions on demand.
- Policy rates for the **major central banks** are likely to be unchanged (at least no upwards movement) over the next two years. Instead, the focus is largely on how their asset purchase programmes are adjusted. The ECB increased its planned total asset purchases (and time over which they will occur) in December, while the Fed Chair recently said it was too early to discuss when the Fed might begin to taper its purchases. On the face of it, **EM central banks** have more scope to cut rates; however, while a few have recently cut rates (e.g. Indonesia), Turkey tightened late in 2020 and others, such as Brazil, are under pressure to do so. China's authorities are moving towards unwinding support given the well-advanced recovery and concerns over high corporate debt.
- COVID-19 and associated restrictions impacted the **major advanced economies** (AEs) late in 2020. Q4 Euro-zone GDP declined 0.7% q/q and UK November GDP also fell (-2.6% m/m) and, while the US economy continued to grow in Q4 (1.0% q/q), consumption declined over November and December. With the tightening or extension of restrictions in the UK, Japan and some Euro-zone economies since our December report, we have revised down our 2021 forecasts for these countries/regions. However, over a two-year period (2021 and 2022) we have lifted our AE forecasts as: the roll out of vaccines offers the prospect of the virus being brought under control; while it will take time before there is widespread vaccination, cases are already falling in some AEs (including the US, Japan & Germany); and due to continued fiscal support. In late 2020, a large stimulus package (over 4% of GDP) was passed in the US and the new President is pushing for a much larger follow up.
- Conditions in **emerging market** (EM) economies softened at the start of 2021. Both the EM manufacturing PMI and, in particular, the services PMI eased in January, with China a key driver of the decline but with India one exception. Most EM economies contracted in 2020, with China the key exception. China's economy grew by 2.3% in 2020 – the weakest rate of growth since 1976 – however the economy recovered from Q2 onwards, with more typical rates of growth evident in Q4. We expect growth momentum to slow across 2021 – particularly as authorities attempt to unwind policy support – however base effects (given the scale of the contraction in Q1 2020) means that we forecast growth of 9.5% in 2021.
- Our **global** forecast for 2021 remains unchanged at 5.8%. However, this masks some changes in AEs – with a stronger outlook for the US and Canada offset by softer expectations for the Euro-Zone, UK and Japan. In 2022, we forecast global growth of 4.6%, compared with 3.9% previously, reflecting the boost to growth prospects from the vaccine roll-out and fiscal policy support (particularly in the US). The spread of COVID-19 remains a key **risk** around the global economic outlook. While vaccines are currently being rolled out in a range of major economies rates of new infections remain high. It will take some time for a sufficient proportion of the global population to be vaccinated for COVID-19 to be effectively controlled. Most AEs are not expected to see widespread coverage until late 2021, while middle income economies are unlikely to achieve this until late 2022.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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**In Australia, economic activity continues to rebound strongly – as shown by both NAB's Business Survey and transactions data. We expect GDP to have risen by a strong 2.5% in the December quarter and the recovery to continue into 2021 – albeit at a slower pace than H2 2020. This should see the level of GDP reach pre-virus levels by mid-2021. Alongside the rebound in activity, the unemployment rate has come down more quickly than expected and we now appear to have passed the peak (7.5%) in unemployment for this recession. We expect unemployment to decline further from here, reaching 5.9% by end-2021 and 5.4% by end-2022. However, despite this rapid recovery, unemployment remains relatively high and we continue to forecast weak inflation, with the underlying measures tracking at just 1.7% by the end of 2022. This warrants ongoing easy monetary policy and fiscal support – particularly if we see further economic shocks. While there is growing optimism around the unfolding recovery, uncertainty remains elevated and at present risks are likely tilted to the downside. Over the next few months, the impact of the expiration of JobKeeper wage subsidy will begin to flow through the economy as will the reversal of the JobSeeker payment. Beyond that, the risk of further virus spread and shutdowns remain a possibility until the vaccine is successfully rolled out.**

- **Monetary policy is expected to remain exceptionally easy for the next few years**. The RBA announced a full extension of QE, announcing the purchase of another $100bn of government and semi-government bonds following the completion of the initial program in April. The TFF is slated to end in June as planned, while the RBA has maintained the YCC 3-year target, but has signalled the continuation of the program will need to come under consideration as the recovery unfolds. Going forward we expect that the RBA will wind back on YCC around the middle of the year but that that cash rate will main unchanged until mid-2024. Based on current forecasts, QE is likely to be extended again, but will depend on the evolution of economic and market conditions.
- **Fiscal measures have been a key support, but are facing a significant tapering at the end of March.** The end of JobKeeper marks a significant reduction in fiscal support and we think additional packages will be needed to support the areas of the economy hardest hit by the pandemic. That said, a large amount of stimulus remains in place, and monetary policy remains highly stimulatory.
- **We expect the unemployment rate to continue trending down from here,** with the unemployment rate reaching 5.4% by the end of 2022, a little above the 5.2% recorded pre-virus – meaning the peak in unemployment for this episode was around 7.5%. That said, while unemployment is expected to continue falling, wage growth will likely remain soft with a significant degree of spare capacity remaining in the labour market.
- **Consumer spending has remained strong.** Retail sales fell in December, but were likely impacted by the increasing popularity of Black Friday sales in November. Nonetheless retail sales remain around 10% higher over the year and spending on retail goods appears to have added around 0.5ppt to GDP in the December quarter. On the services side, it is likely that consumption continued to recover with the reopening in Melbourne late last year, which should see an overall solid rise in December following the large rebound in Q3. More recently it appears that retail sales have held up with the NAB Cashless Retail Sales index pointing to around a 1.5% rise in January. It is likely that this shift in the pattern of consumption will continue for some time, with substitution to domestic (in particularly goods spending) ongoing while services will continue to be impacted by border closures and physical distancing requirements.
- **The NAB Business Survey shows confidence continues to improve, even as conditions pulled back in January.** Business confidence saw a broad-based improvement in January increasing 7pts to +10 index points. Conditions pulled-back to November 2020 levels after reaching a multi-year high in December. In trend terms, conditions are strongest in retail and wholesale, while construction and recreation & personal services continue to lag. Most survey variables are now at or around long-run averages and, despite the pull-back in conditions in the month, point to ongoing recovery in the economy.
- **The housing market continues to heat up.** Prices have resumed growth at a brisk pace, while lending and building approvals have also risen notably. The 8-capital city dwelling price index rose by a strong 0.7% in January, to be 1.7% higher over the year. All capitals recorded solid growth in the month, with the cities outside of Sydney and Melbourne seeing rises of 0.9 to 2.3%. Regional house prices outpaced cities again, rising 1.6% in the month. We expect further gains of 7.9% over 2021 and of 5% over 2022. We also note the federal government's HomeBuilder grants have been a significant boost to the pipeline of residential construction work. Over 75k applications for the grants have been lodged, with 60k of those for building new homes. This represents around one third of the 181k dwelling (houses and units) approvals in 2020.
- **Our forecasts for the exchange rate have been lifted.** We expect the AUD/USD to end 2021 at 0.83 USD before declining to 0.80 USD by the end of 2022. This largely reflects Australia's economic outperformance, 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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