THE FORWARD VIEW: AUSTRALIA FEBRUARY 2021

GDP GROWTH AND THE LABOUR MARKET CONTINUE TO SURPRISE

OVERVIEW

- The Australian economy continues to outperform our expectations – as shown by both the NAB Business Survey and NAB transactions data. We now expect Q4 GDP to be around 2.5% and 2021 growth to be around 4%, before edging lower in 2022 to around 2.8% - albeit still be above trend.
- Consistent with that growth outcome, the labour market has also improved more strongly than previously expected- with the peak in quarterly unemployment seemingly passed (7.1% in Q3 2020). We have also upgraded our 2021 unemployment forecast. We now see unemployment at 6% by end 2021 and around 5.4% by end 2022 (albeit the latter is not that much changed from previous forecasts).
- We now see GDP reaching late 2019 levels by mid 2021 – albeit the gap from potential output if the virus had not happened is still unlikely to be regained until 2024. Hence the RBA's concern to keep its policy stance as supportive as possible.
- Our outlook for wages and inflation are little changed – we continue to see inflation remaining below the RBA's target to at least the end of 2022 – with an end 2022 core inflation rate of 1.7%. Clearly to have core inflation firmly established in the 2-3% target range will be a 2024 issue at best. All this is very much driven by expectations of very moderate wages growth. A higher AUD is also not helping.
- With a similar growth and inflation outlook it is not surprising that the RBA is providing as much support as possible.
- Also it is highly likely that further fiscal support will be required – especially in areas where the economy is still struggling. It is critical that, while support will be loosened in better performing parts of the economy, the overall stimulus package is not withdrawn too quickly. Further micro reform would also clearly help.
- Equally it is unlikely that the recovery process will be smooth. We are still waiting to see how the economy performs as JobKeeper and restrictions on rents are withdrawn.
- There are uncertainties around the course of the virus and potential vaccines. Global trade is also looking promising but similar uncertainties loom large – including the trade relationship with China.
- As per our recent forecasts there are important virus assumptions. Notably 1) the virus will continue to be contained domestically – without large-scale shutdowns; 2) Around half the population will receive a vaccine by mid-year and the full adult population by year-end; and 3) We should see limited state border closures and the beginnings of a gradual opening of international borders by early 2022.

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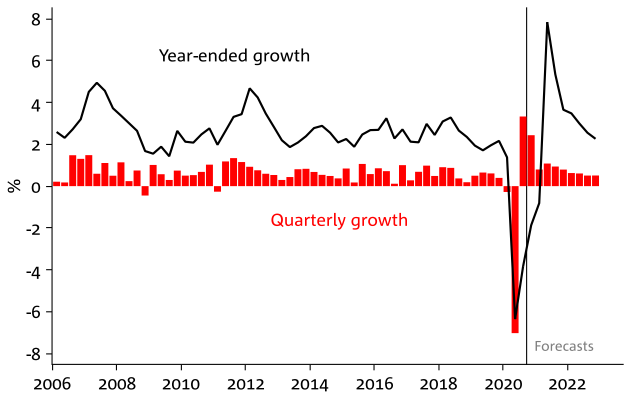
KEY ECONOMIC FORECASTS

	2019	2020-F	2021-F	2022-F
Domestic Demand (a)	1.2	-2.9	5.6	4.1
Real GDP (annual average)	**1.9**	**-2.7**	**3.9**	**2.8**
Real GDP (year-ended to Dec)	**2.2**	**-1.9**	**3.7**	**2.3**
Terms of Trade (a)	5.7	0.3	8.0	1.6
Employment (a)	2.3	-1.7	3.9	3.1
Unemployment Rate (b)	5.2	6.8	5.9	5.4
Headline CPI (b)	1.8	0.9	1.8	1.6
Core CPI (b)	1.4	1.2	1.6	1.7
RBA Cash Rate (b)	0.75	0.04	0.10	0.10
$A/US cents (b)	0.70	0.77	0.83	0.80

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

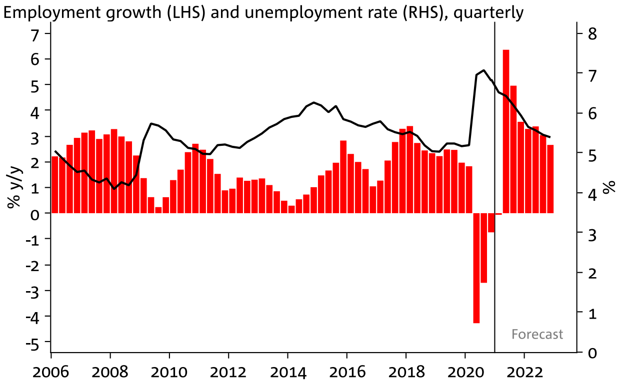
GDP FORECASTS



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

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LABOUR MARKET, WAGES AND CONSUMER

The retail share of consumer spending should remain elevated, even as spending on services rebounds

The rise in retail spending has been a key story for consumer sector throughout 2020. Elevated retail spending reflected large income support, a substitution from services and households buying equipment for remote working.

The ongoing strength in retail can be seen in NAB's cashless retail index, which was very strong at the end of last year, and in the NAB business survey, where retail continues to report the strongest conditions of any industry. The NAB Cashless Retail sales measure released today points to a further solid gain in retail sales in January – up around 1.5%.

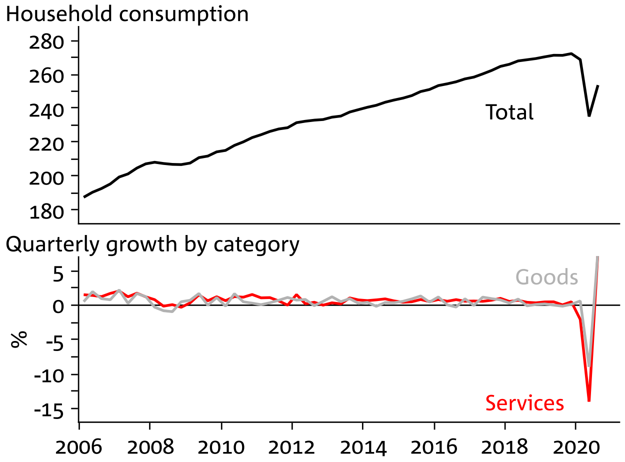
In contrast, spending on services remains subdued, reflecting social distancing restrictions and border closures. In particular, entertainment and hospitality services have been hard hit by the pandemic. However, as restrictions continue to ease given the positive health outlook and upcoming vaccine rollout, services should continue to rebound this year.

We expect overall consumer spending to rise 6.5% over 2021, supporting the recovery in activity to pre-virus levels by mid- year. This will be further supported by the improvement in the labour market, although a full recovery in unemployment remains some time away.

We forecast unemployment to stay above its pre-virus levels through to 2022. This will weigh on wages growth such that, once government income support ends, we expect income growth to slow in 2021. Further, population growth will slow further as the borders remain shut. These factors present a significant headwind to consumer spending, such that we expect spending growth to slow through this year.

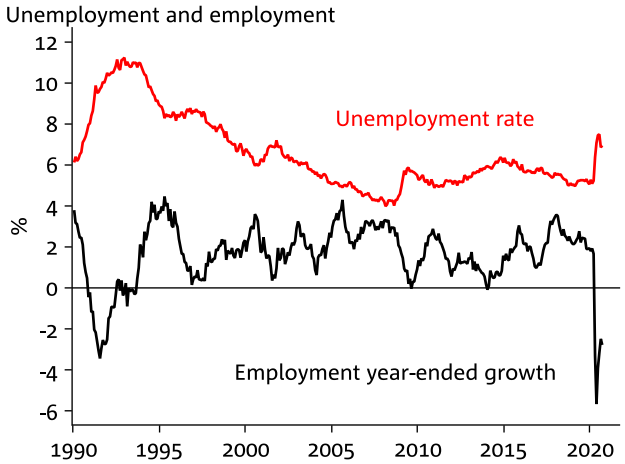
As such, significant policy stimulus continues to be warranted, where the RBA has extended its QE program by another $100bn. Elsewhere, fiscal policy is still best placed to support the recovery – although federal stimulus is being wound down as key emergency supports JobKeeper and the boost to JobSeeker end early this year.

GOODS SPENDING HAS DRIVEN THE REBOUND



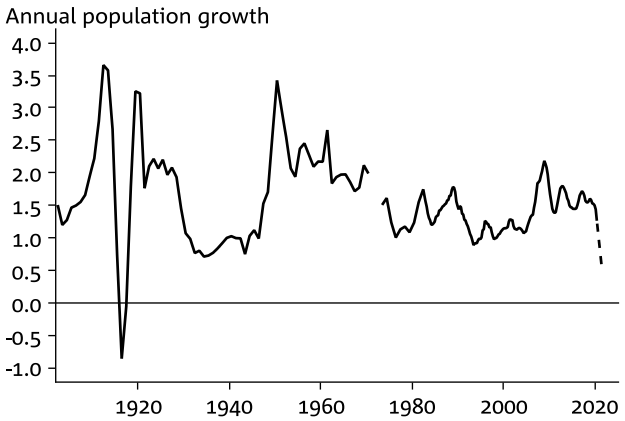
Source: National Australia Bank, Australian Bureau of Statistics

UNEMPLOYMENT WILL REMAIN ELEVATED



Source: National Australia Bank, Australian Bureau of Statistics

WHILE POPULATION GROWTH SLOWS



Note: Quarterly since 1981, historical data is annual. Series break in 1971 when the ABS introduced the concept of estimated resident population.
Source: National Australia Bank, ABS

HOUSING AND CONSTRUCTION

Homebuilder has brought forward the turnaround in residential construction, while prices are back on the rise

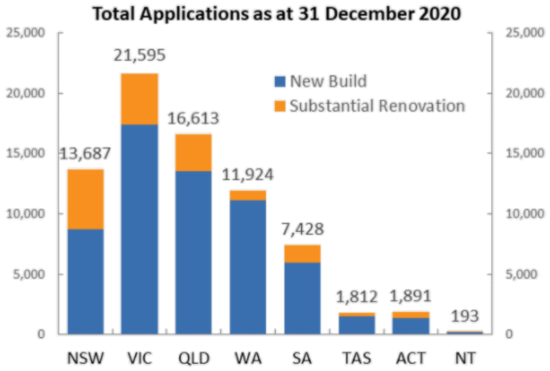
The federal government's HomeBuilder grants have been a significant boost to the pipeline of residential construction work. Over a 75k applications for the grants have been lodged, with 60k of those for building new homes. This represents around one third of the 181k dwelling (houses and units) approvals in 2020.

By state, Victoria, Queensland and WA have seen the greatest applications for HomeBuilder, with WA and Queensland recording very sharp rises in house approvals over the second half of 2020. This boom in the pipeline of residential construction work is likely to see dwelling investment turnaround, rising mid 2021, much earlier than we would have forecast a year ago.

Also supporting construction activity has been the turnaround in dwelling prices, where January data from CoreLogic show prices – as measured by the 8-capital city dwelling price index – rose by a strong 0.7%, to be 1.7% higher over the year. All the 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. Lower rates and the relatively rapid rebound in employment to date has supported this turnaround, where we expect further gains of 7.9% over 2021 and of 5% over 2022.

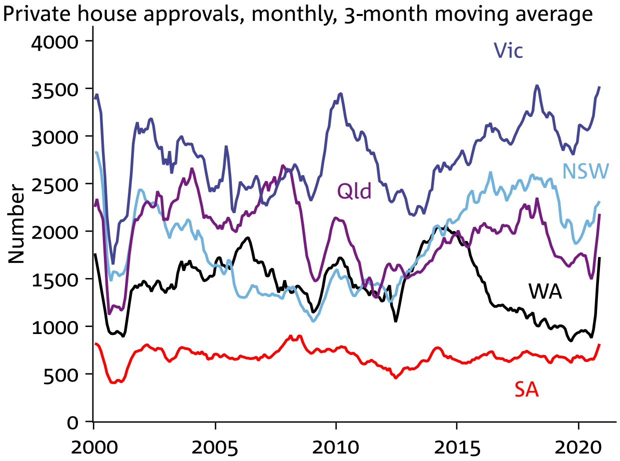
That said, risks to the housing market remain as it faces headwinds of weak population growth and elevated unemployment. Further, it remains to be seen whether the boost to building approvals will be short lived where there could be a substantial dip in approvals once the HomeBuilder program ends.

75K HOMEBUILDER APPLICATIONS LODGED



APPROVALS HAVE RISEN SHARPLY

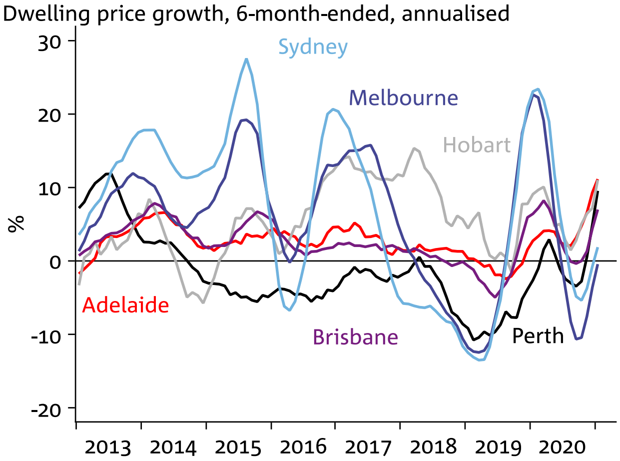
Private house approvals, monthly, 3-month moving average



Source: National Australia Bank, Australian Bureau of Statistics

PRICES ARE RISING BRISKLY

Dwelling price growth, 6-month-ended, annualised



Source: National Australia Bank, CoreLogic

BUSINESS AND TRADE

The business survey shows that the economy continues to recover at a solid clip, but that there is some way to go before a full recovery is reached.

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.

Capacity utilisation edged higher, and is now at its long-run average (and around pre-COVID levels). However, the rebound has been uneven, with capacity utilisation in retail and wholesale strongest (and above average), in contrast to rec & personal where capacity utilisation remains notably below pre-COVID levels.

Reported capex has recovered much more slowly than other areas of the survey – suggesting that the rapid recovery in consumption is yet to flow through to business investment. While fiscal support through the instant asset write-off will likely have supported investment in late 2020 the impact will wane with the program coming to an end in late 2020.

That said, we see investment growth turning positive around the middle of 2021 – but for it to be weak. This sees underlying business investment continuing to track at a relatively low share of GDP in the next few years.

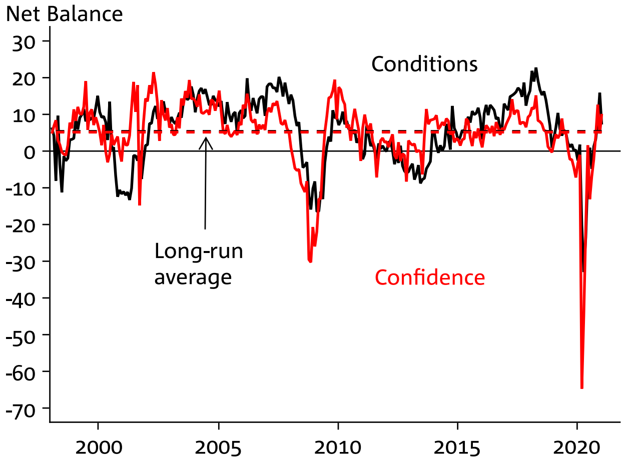
Net exports look to have made another subtraction from growth in Q4 2020, following the large subtraction in Q3.

Based on monthly trade data (and prices), we estimate that trade subtracted around 0.3ppt from growth in Q4, following the 1.9ppt subtraction in Q3.

On a monthly basis (in nominal terms) iron ore exports rose further in December, while exports of cereals and grains also lifted. On the imports side, a fall in the volatile capital imports component saw overall imports decline in the month.

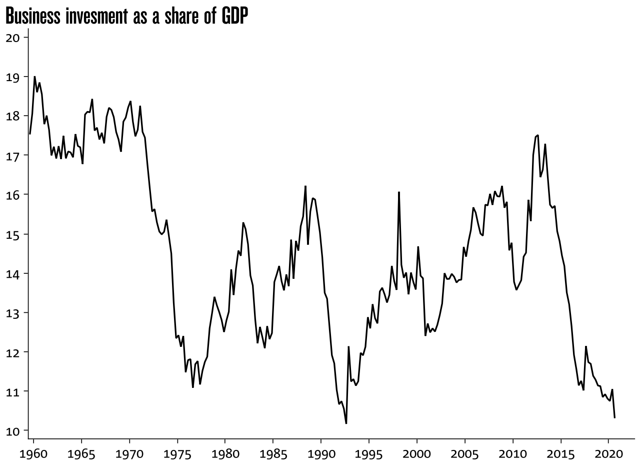
Overall the trade surplus remains around record highs, with Australia's commodities exports driving up the value of goods exports in recent years. However, services trade, particularly education and tourism will continue to be impacted for some time. The substitution of spending domestically towards goods from overseas travel will also likely to see higher imports of consumer goods over the next year.

CONFIDENCE ABOVE AVERAGE



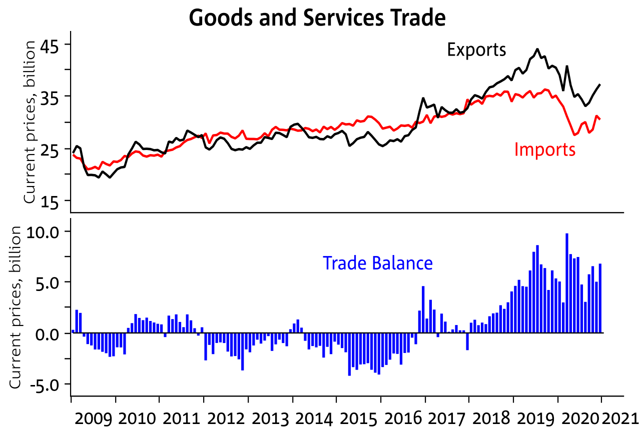
Source: National Australia Bank, National Australia Bank

BUSINESS INVESTMENT WILL REMAIN SOFT



Source: National Australia Bank, Australian Bureau of Statistics

ONGOING IMPACTS TO TRADE



Source: National Australia Bank, ABS

MONETARY POLICY, INFLATION AND FX

The RBA looks to maintain an exceptionally easy stance

At its first meeting of the year the RBA announced an extension to its QE program which was due to expire in April. The RBA will continue to purchase bonds at the same rate of $5bn per week in the 5-10 year range, up to $100bn. While we had expected some tapering over the next 6 months – largely due to a lower supply outlook - a full extension of the program is consistent with our expectations that the economy will continue to need support for some time yet.

The cash rate and yield curve targets were left unchanged at 0.1% and parameters around the term funding facility were also left in place. Therefore, the window for new drawings under the facility will close in June, and borrowings to be repaid within the next 3 years.

During the week the RBA also confirmed that it will need to make a decision on rolling forward the 3-year window on the YCC by buying the Nov-24 AGS or to begin exiting the YCC programming by capping purchases at the current Apr-24 bond – the decision has not yet been made.

We expect the cash rate on hold to 2024, but for the RBA to begin rolling back the YCC program this year.

The RBA confirmed that the exit strategy from YCC when it occurs, will be done by capping purchases at a specific bond on the curve. While the outlook continues to warrant significant policy support, the RBA will eventually be unable to maintain its guidance of an unchanged cash rate on an ongoing basis as the recovery unfolds (in addition to the fact it is unfolding more quickly than expected). Therefore, we expect the RBA to begin winding back YCC sometime this year, dependent on the recovery continuing to unfold at the current pace.

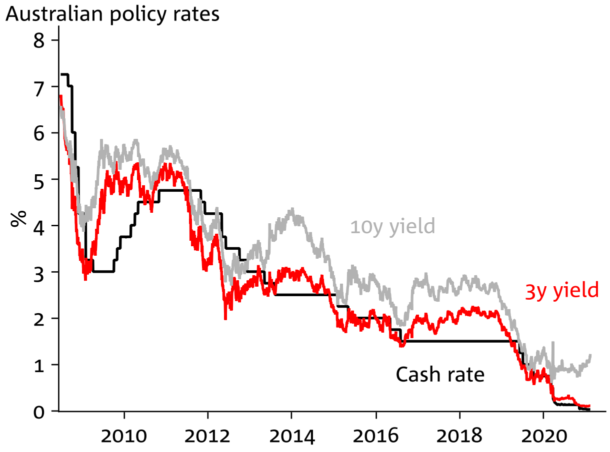
With QE having seen a full extension for the second half of 2021, the focus is now turning to the size of the program beyond the second round. The RBA's forecasts (and ours) are consistent with ongoing support. However, the size of any future programs will be dependent on the uncertain but continuing recovery as well as market developments (including other central bank actions).

While we expect YCC to be wound back, we expect the cash rate to remain firmly on hold into mid-24 but that there is growing risk of the RBA needing to begin policy normalisation shortly after that.

Despite ongoing QE, we expect the Aussie to continue to strengthen into early 2022.

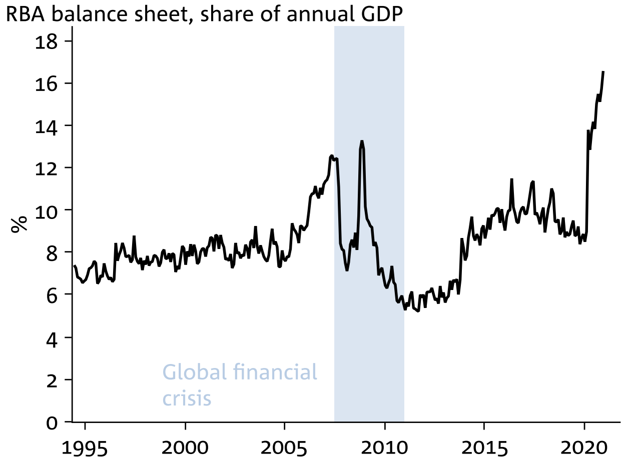
The AUD/USD has traded around US76c in recent days, and is around 1.5% higher than mid-December and now around 37% higher than the 17-year low reached last March. We expect the Aussie to strengthen from here rising to US83c by the end of 2021 with a relative outperformance of the domestic economy, before a small depreciation to around US80c by end-2022 as conditions in the US normalise.

INTEREST RATES ARE AT HISTORIC LOWS



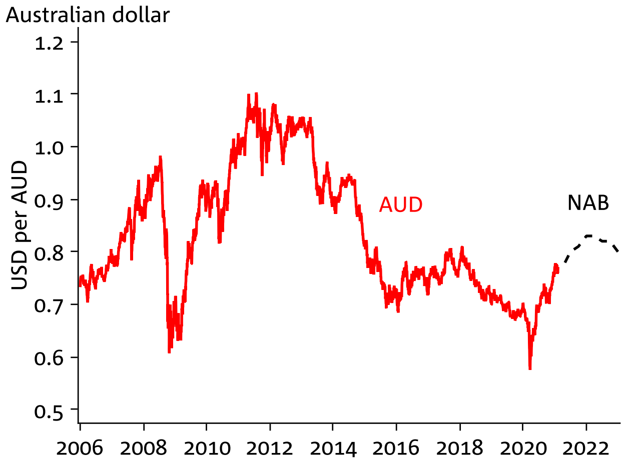
Source: Reserve Bank of Australia, Macrobond Financial AB

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

RISKS TO THE OUTLOOK

The outlook remains highly uncertain

The outlook for the year ahead remains highly uncertain, and relative to the economic performance over recent months, the balance of risk may be tilted to the downside. Australia has, to date, recorded a remarkable recovery and we continue to characterise this as a "best-case scenario". However, a number of headwinds remain in place, where these could be a bigger drag on growth than we forecast.

First, we caution that viral outbreaks remain a risk until the vaccine is rolled out. At present, the plan is for vaccinations in Australia to begin in late February and, optimistically, for Australia to be fully vaccinated by October. It's possible that this could take longer and, in the meanwhile, another outbreak could occur – plunging parts of the country into lockdown.

Relatedly, with COVID still circulating in other countries, global growth is likely to remain weak. In combination with the closed international border and Australia-China tensions, it's likely Australia's trade sector – including tourism and education – will remain under pressure.

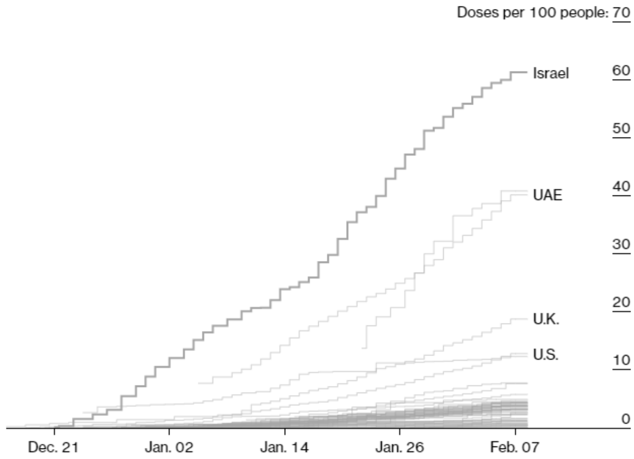
The closed border also weighs on domestic demand, through extremely weak population growth. Alongside extraordinarily weak wages growth, these factors suggest underlying demand for goods, services and housing has softened substantially from its already-mediocre pre-virus pace. As such, the risk is that these factors come to the forefront as stimulus tapers, derailing the economic recovery.

In particular, the government's JobKeeper program is set to end early this year, where the program has been successful in supporting jobs and household income growth through the pandemic. With the end of JobKeeper in sight, it's possible once this boost to income ends, spending growth will slow materially, making it difficult for activity to recover further.

Further, some parts of the economy continue to face sector-specific headwinds. Tourism and education businesses geared towards international visitors and students remain impacted by border closures. Hospitality, personal services and the entertainment industry remain limited by restrictions. The office market, particularly in Sydney and Melbourne, faces a collapse in demand as workers increase working at home.

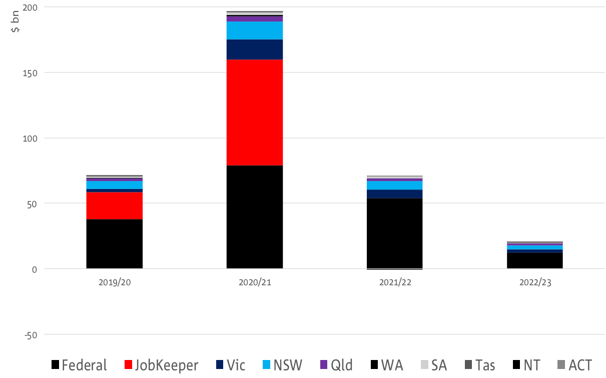
On the upside, we see potential that the pickup in housing market activity spurs more jobs and increased spending – though the wealth effect – than we anticipate. However, we already forecast a strong 7.9% rise in dwelling prices in 2021 and a turnaround in residential construction.

VIRAL OUTBREAKS REMAIN A RISK



Note: Two doses are needed for full protection with the vaccines currently in use. Data from Bloomberg's Covid-19 Vaccine Tracker

END OF JOBKEEPER LOOMS



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	0.7	6.3	2.5	1.2	-5.9	7.2	3.7
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	-10.0	2.5	0.5	-2.3	-7.4	-4.8	5.9
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**	**1.2**	**5.5**	**2.7**	**1.2**	**-2.9**	**5.6**	**4.1**
Stocks (b)	-0.2	-0.3	0.4	0.1	0.1	-0.3	-0.1	0.4	0.0
GNE	**1.3**	**-1.3**	**1.6**	**5.6**	**2.9**	**0.9**	**-3.0**	**6.0**	**4.1**
Exports	4.0	-1.8	-10.6	-4.1	5.1	3.3	-10.4	-5.2	-5.0
Imports	0.2	-7.4	-4.8	3.7	4.0	-1.0	-13.1	4.4	1.2
GDP	**2.2**	**-0.2**	**0.2**	**3.9**	**2.8**	**1.9**	**-2.7**	**3.9**	**2.8**
Nominal GDP	5.6	1.6	2.0	6.4	5.2	5.3	-1.8	6.8	4.6
Current Account Balance ($b)	14	-35	-51	-40	-40	13	49	48	30
(%) of GDP	0.7	-1.8	-2.5	-1.9	-2.1	0.7	2.5	2.3	1.4
Employment	2.4	0.1	1.0	3.7	2.7	2.3	-1.7	3.9	3.1
Terms of Trade	5.6	1.1	5.9	5.1	1.8	5.7	0.3	8.0	1.6
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	3.2	1.6	1.8	1.8	0.9	1.8	1.6
Core CPI	1.4	1.2	1.6	1.6	1.8	1.4	1.2	1.6	1.7
Unemployment Rate	5.1	7.0	6.4	5.6	5.0	5.2	6.8	5.9	5.4
RBA Cash Rate	1.25	0.14	0.10	0.25	1.50	0.75	0.04	0.10	0.10
10 Year Govt. Bonds	1.32	0.87	1.40	1.35	2.32	1.37	0.97	1.50	2.00
$A/US cents :	0.70	0.69	0.80	0.75	0.71	0.70	0.77	0.83	0.80
$A - Trade Weighted Index	60.1	60.0	63.1	62.1	60.7	60.3	63.4	64.0	62.2

(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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