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THE FORWARD VIEW: AUSTRALIA MARCH 2021

GDP FULLY RECOVERED BY Q1, BUT SPARE CAPACITY REMAINS

OVERVIEW

- The economy continues to recover at a rapid pace. The Q4 national accounts showed GDP rising by 3.1% in December to be 1.1% below its pre-COVID level in Q4 2019. This result was again driven by a pick-up in household services consumption, though dwelling and business investment also rose.
- More recently, the NAB business survey and internal transactions data also point to ongoing strength in the economy for both business and the consumer.
- The better-than-expected outcome for GDP and ongoing strength in our higher frequency indicators, is consistent with the labour market recovering much more quickly than initially expected – with unemployment falling to 6.4% in January.
- Incorporating this stronger starting point into NAB's forecasts, we now see year-average growth of 4.6% in 2021 and 2.5% in 2022. GDP now reaches its pre-COVID level of activity in Q1 2021. For our labour market forecasts, we have tweaked the outlook and now see unemployment falling to 5.8% by end 2021 and 5.3% by end 2022.
- While the recovery to date has unfolded much more quickly than expected, it is important to remember that 1) it has been uneven and 2) that despite recovering to pre-COVID levels by mid-2021, there remains a high degree of spare capacity in the economy.
- We estimate that the output gap – the point at which the economy reaches full capacity – could be closed as soon as early as end-2022. However, our forecasts also point to growth slowing to around trend rate at this point, suggesting that it will take longer for capacity and inflation pressures to build. Also, there are likely to be notable lags between activity and the labour market, and then from the labour market to inflation.
- For policy makers, this suggests any tightening in policy will not be warranted for some time, which is in line with the RBA's own outlook. We continue to expect the cash rate to remain unchanged until 2024 and now expect a full $100bn extension of QE beyond the second round. That said, we continue to expect the RBA will announce that YCC will not be extended past the April 2024 bond, with the RBA no longer able to credibly commit to rates staying at 0.1% beyond this point.
- There are a number of risks around our forecasts. The most immediate is the completion of the JobKeeper wage subsidy program and its impact on the labour market. Further out, the underlying weakness of the private sector is a risk given its notable weakness prior to the pandemic. On the upside, tax cuts and the boom in housing market activity may provide more support than we expect.

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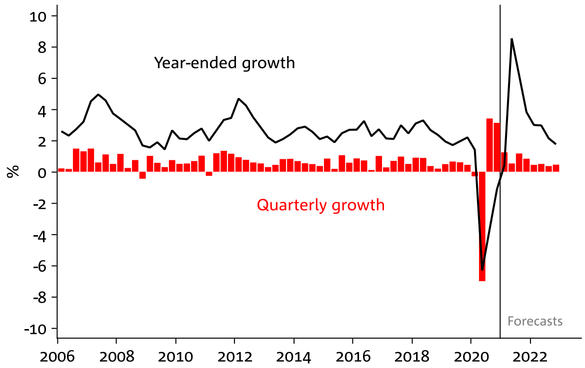
KEY ECONOMIC FORECASTS

	2019	2020	2021-F	2022-F
Domestic Demand (a)	1.2	-2.5	6.3	3.5
Real GDP (annual average)	**1.9**	**-2.4**	**4.6**	**2.5**
Real GDP (year-ended to Dec)	**2.2**	**-1.1**	**3.7**	**1.8**
Terms of Trade (a)	5.7	0.2	7.1	1.6
Employment (a)	2.3	-1.6	3.8	2.9
Unemployment Rate (b)	5.2	6.5	5.8	5.3
Headline CPI (b)	1.8	0.9	1.7	1.6
Core CPI (b)	1.4	1.3	1.5	1.7
RBA Cash Rate (b)	0.75	0.10	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

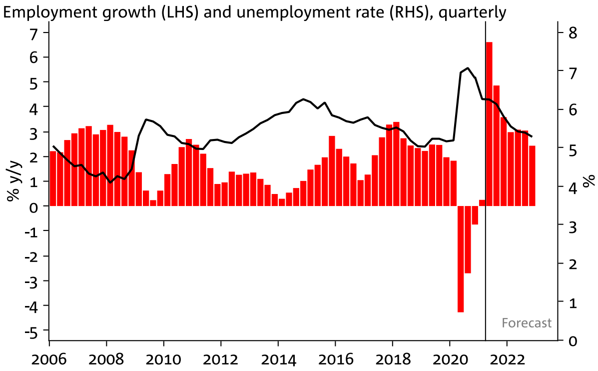
GDP FORECASTS



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

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

LABOUR MARKET, WAGES AND CONSUMER

Household consumption continued to rebound in the December quarter, and high frequency data suggests spending on goods has remained elevated into 2021.

Household consumption rose by a strong 4.3% in Q4, driven by a further rebound in services (up 5.2%) and ongoing strength in spending on goods (up 2.8%). Despite the strong increase, household consumption remains 2.7% below pre-COVID levels, with ongoing impacts to some services such as travel.

On the other hand, goods spending continues to benefit from substitution away from services spending, which remains constrained by restrictions. This has seen motor vehicle sales rise strongly (up over 30% y/y), while alcohol and household goods spending are also up over 10% y/y.

The change to spending patterns will likely continue for some time, with borders remaining closed. Retail sales data showed a further 0.5% rise in January, while the NAB Cashless Retail Sales index points to a 0.3% increase in February.

A key support to household consumption has been the resilience of the labour market through the pandemic, alongside the support to household incomes from fiscal policy.

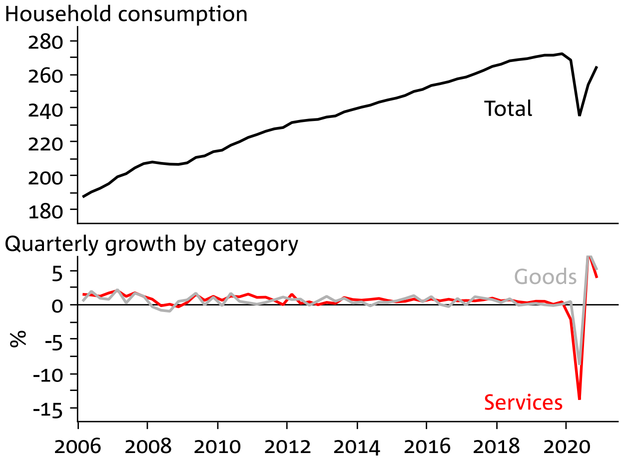
The unemployment rate fell further in January, declining to 6.4% and is now down around 1.1% from its peak of 7.5% in July 2020. Encouragingly, broader measures of labour market underemployent have recovered to their pre-COVID levels.

Employment rose by another 30k in the month to be around 60k lower than pre-COVID levels. Hours worked saw an unseasonably sharp fall in the month, reflecting the impact of ad hoc business shutdowns this year. Nonetheless, while hours worked have lagged the recovery in employment but continue to improve.

That said, there continues to be a significant amount of slack in the labour market, where we estimate the level of full employment to be an unemployment rate of 4.9%. As a result, we expect sluggish wage growth for some time. Indeed, the ABS WPI released for the December quarter showed that underlying wage growth is currently tracking at around 0.3% q/q – well below the annualised rate of 3-3.5% consistent with full employment.

Overall it appears while the labour market took a significant hit during pandemic related shutdowns, as activity has rebounded, the labour market has recovered relatively quickly. This is encouraging and suggests that government supports have played a key role. However, going forward the true pace of employment growth remains uncertain with both demand and supply side impacts from lower migration and ongoing volatility in the data related to the pandemic.

GOODS SPENDING HAS DRIVEN THE REBOUND

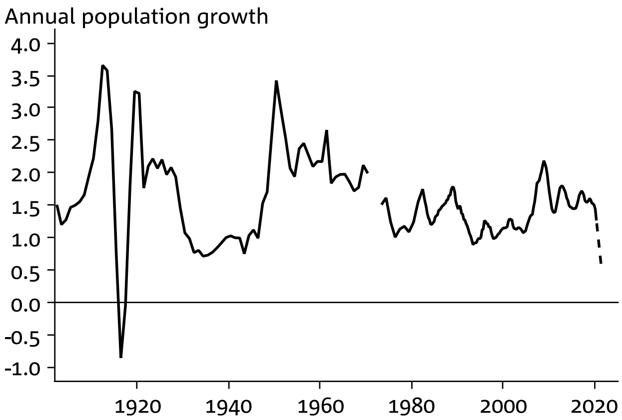


Source: National Australia Bank, Australian Bureau of Statistics

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

Housing market activity is taking off, with strong price rises forecast for 2021 and leading indicators pointing to a pickup in construction activity.

Conditions in the established housing market have has turned up, sharply, with prices, clearance rates and loan approvals rising sharply in late 2020 and into early 2021.

Dwelling prices rose by a large 2.0% in the month of February – as measured by the 8-capital city dwelling price index – to be 2.6% higher over the year. The sharp rise was driven by prices in Sydney, Melbourne and Hobart, although all capital cities recorded strong gains. Regional house prices continue to grow strongly too, marking a 2.1% rise in the month. Likewise, lending data shows both owner-occupier and investor loan approvals jumped in January, up 11 and 9% respectively. Owner-occupier loans are at record highs and 52% higher than a year ago.

This sharp turnaround rises reflect the impact of fiscal and monetary stimulus on the housing market. Lower rates, HomeBuilder grants, stamp duty discounts and a solid rebound in economic recovery have been key supports. This appears to have been enough to offset the impact of pandemic-driven job losses, weak rents and a fall in migration, at least in the year ahead. As such, NAB forecasts dwelling prices will rise 7.9% over 2021 and of 6% over 2022.

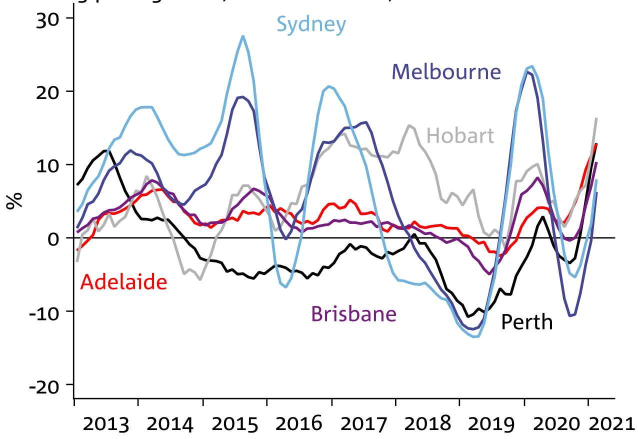
Residential construction activity is now rising after having fallen in recent years, with a substantial boost to demand from the government's HomeBuilder grants. Building approvals are at historical highs for most state and territories – a stark turnaround from the multi year lows reached in 2020.

The national accounts measure of dwelling investment showed that in Q4 2020, dwelling investment rose by 3.1% - with new construction rising by 3.4% and alterations and additions (renovations) recording a large 5.2% increase. This marks the first increase in new construction since early 2018. All states saw an increase in dwelling investment in the quarter, though QLD and WA saw outsized gains. Dwelling investment is likely to rise further over 2021, with prices continuing to rise and the large pipeline of work from the homebuilder program the key supports.

That said, downside risks to the housing market remain as it faces headwinds of weak population growth and elevated unemployment. Further, with HomeBuilder set to cease at the end of March, it remains to be seen whether demand for new homes collapses shortly after, where many buyers would have brought forward their new home building plans.

PRICES ARE RISING BRISKLY

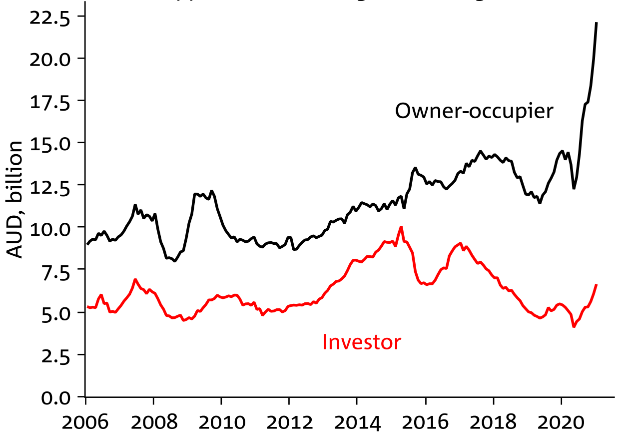
Dwelling price growth, 6-month-ended, annualised



Source: National Australia Bank, CoreLogic

HOME LOAN APPROVALS ARE UP SHARPLY

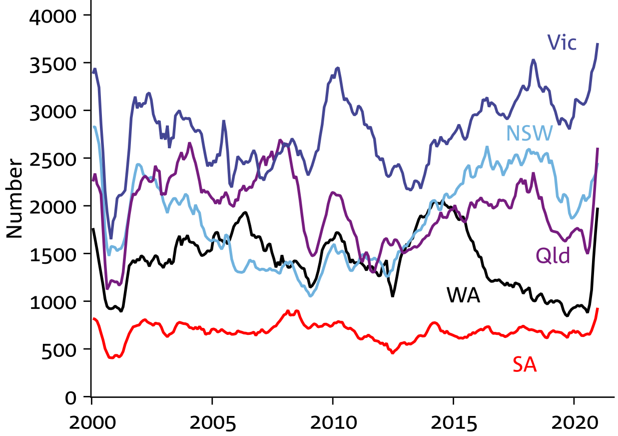
New home loan approvals, excluding refinancing



Source: National Australia Bank, Australian Bureau of Statistics

BUILDING APPROVALS HAVE RISEN SHARPLY

Private house approvals, monthly, 3-month moving average



Source: National Australia Bank, Australian Bureau of Statistics

BUSINESS AND TRADE

Businesses continue to report strong conditions and confidence in the NAB business survey – a positive sign the recovery remains robust

The February business survey showed a rebound in conditions and a further rise in confidence, with both at well-above average levels. Business confidence rose further in February to reach 16 index points, its highest level since early 2010. Business conditions bounced to return to around multi-year highs at 15 index points, after slipping in the month prior, with trading, profitability and employment conditions all marking solid improvements.

Notably, improved conditions have seen an increase in capacity utilisation. In February, utilisation rose to 81.8% – its highest level since mid-to-late 2019 – and 9.7ppts above its April 2020 trough. By industry, retail and wholesale trade continue to outperform, while lagging behind is mining, construction and recreation & personal services (which continues to see ongoing restrictions).

With capacity utilisation rising for some months now, businesses are now reporting increased capital expenditure (capex). The NAB survey's measure of capex is now at its highest level since mid 2019, led by well-above average capex in retail and manufacturing. While part of this likely reflects fiscal support through the instant asset write-off, these data also suggest sustained above-average confidence is feeding into increased investment.

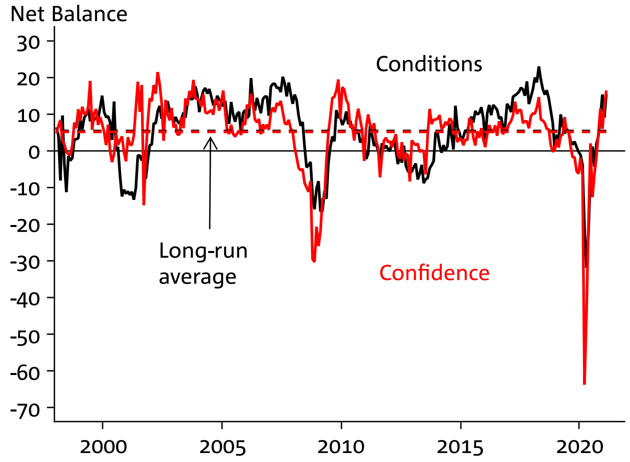
These positive signs have prompted us to upgrade our investment outlook – we forecast 3.0% rise in 2021 and 6.4% in 2022 – although we caution the risks are on the downside. While we are optimistic on the rebound in investment, soft growth in business capex since the GFC has seen investment fall to a relatively low share of GDP. It's quite possible that as fiscal stimulus continues to taper, some of the optimism on the outlook and incentives to invest fade and see sluggish investment return.

Trade balance remains large, even as services trade remains restricted by the border closure.

The trade surplus remains around record highs. Commodities exports continue to drive up the relative value of goods exports, while service imports have been more impacted than service exports by the pandemic.

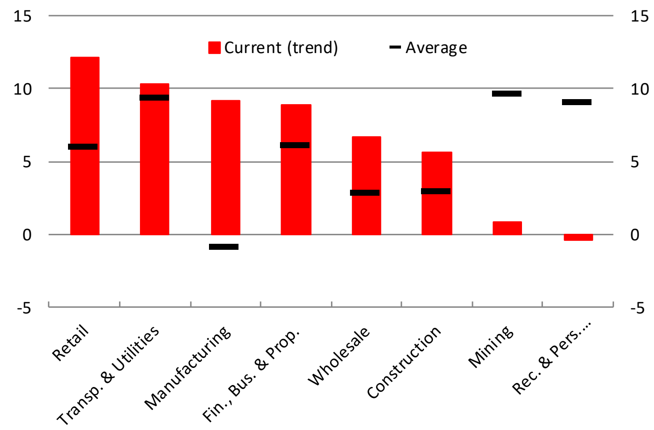
As the border remains shut, services exports will continue to be extremely weak for some time, where education and tourism were Australia's fourth and fifth largest exports pre-virus. For goods trade, Australia-China tensions remain a risk, where an increasing number of Australia exports have been impacted.

CONDITIONS AND CONFIDENCE ARE STRONG



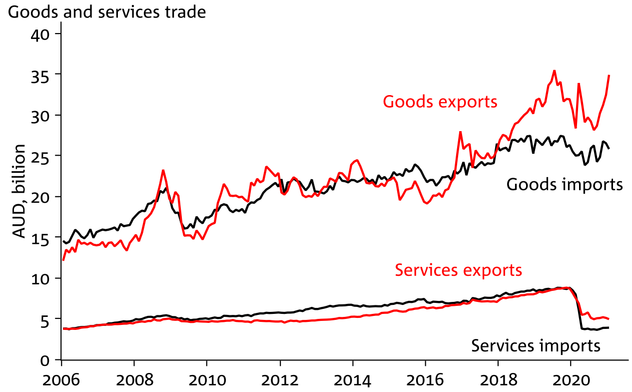
Source: National Australia Bank, National Australia Bank

CAPEX IS ABOVE AVG IN MOST INDUSTRIES



Source: NAB Business Survey

SERVICES TRADE REMAINS DEEPLY IMPACTED



Source: National Australia Bank, Australian Bureau of Statistics

MONETARY POLICY, INFLATION AND FX

No change to monetary policy in March

The RBA left policy setting unchanged at the March meeting, maintaining the cash rate and YCC target at 0.1% and leaving the QE and TFF programs in place.

The post meeting statement acknowledged the recent movement in bond yields and the better backdrop for the economy as the recovery unfolds. However, the RBA board noted again that it does not expect to lift rates until at least 2024, with the outlook for wages and, therefore, inflation still very weak.

The statement also noted the bring forward of bond purchases earlier in the week, to assist with market functioning and reiterated the stance it stands ready to extend the QE program further should conditions warrant.

We expect the cash rate on hold to at least 2024, but for the RBA to begin rolling back the YCC program around the middle of the year but continuing QE at the full rate for another 6 months beyond September.

Our forecasts imply the need for very easy monetary policy to continue, where we expect wage growth (and hence inflation) to remain weak. This is because, while we forecast a relatively quick recovery in activity and the labour market, it will take time to work through the significant degree of spare capacity in the economy.

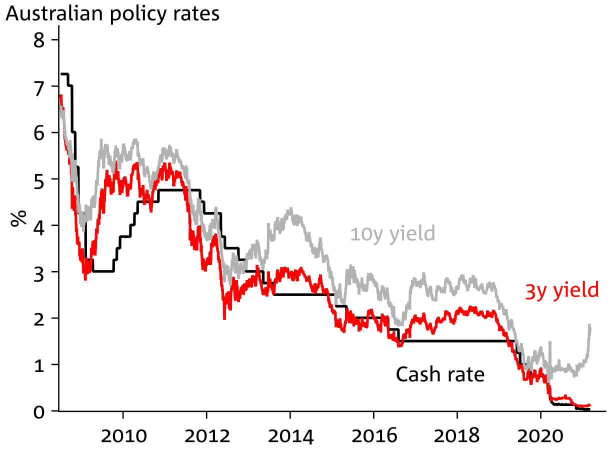
As such, it is likely the cash rate will remain unchanged until at least 2024. We also expect the RBA to extend QE by $100bn for a 3rd successive round, where any tapering would be tantamount to a defacto tightening in policy, something that will not be warranted in early 2022.

That said, as outlined in mid-January, we expect the RBA to end the YCC program by halting purchases under the program at the April 24 bond. This is because, as our analysis on spare capacity highlights, it is plausible inflation will be at-target in 2024.[1] As such extending YCC and committing to a 3-year yield of 0.1% beyond mid 2024 becomes less credible for the RBA. This is likely to be announced around the middle of the year.

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

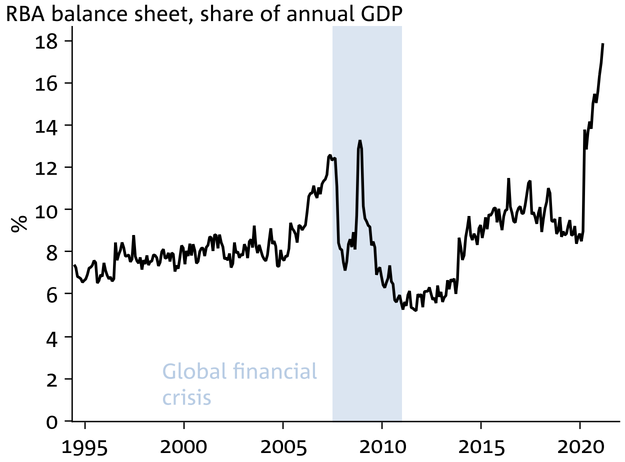
The AUD/USD has traded higher over the last month, reaching as high as US80c before paring back to around US77c currently. The currency is now around 2% higher than the formal announcement of QE in November. The drivers of the exchange rate have significant gains in commodity prices but also the expectation of an outperformance of the Australian economy. We expect these factors to continue and for the AUD to end 2021 at around US80c before rising to US82c by end 2022.

INTEREST RATES ARE AT HISTORIC LOWS



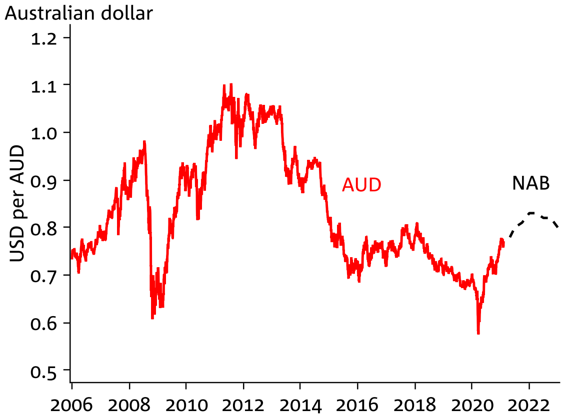
Source: Reserve Bank of Australia, Macrobond Financial AB

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

[1] See: NAB Economic Insights: Spare capacity and the long road to 2-3% inflation – March 2021

RISKS TO THE OUTLOOK

The outlook remains highly uncertain and in the near term the end of JobKeeper will be a headwind

Australia has undergone a remarkable start to its a recovery, with activity and jobs rebounding sharply from its mid 2020 lows. However, ongoing strength is not guaranteed and, in our view, the balance of risks are tilted to the downside.

In the near term, we highlight the risk from the pull back in fiscal support – most notably the federal government's JobKeeper wage subsidy, which stops at the end of March. There are a range of other federal and state fiscal supports too, that end soon: the boost to JobSeeker unemployment benefits (End in Mar), HomeBuilder (Mar), SME loan guarantees (Jun). Our forecasts assume only a small drag from the removal of these programs, such that employment and consumer spending continue to rise, albeit at a slower pace. However, the clear risk is that once key supports are removed, the economic recovery falters.

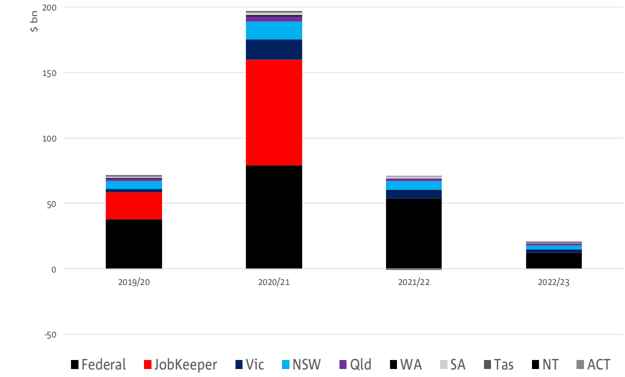
Further, some parts of the economy continue to face sector-specific headwinds. Tourism and education businesses geared towards international visitors and students remain impacted by border closures. Hospitality, personal services and the entertainment industry remain limited by restrictions. The office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

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.

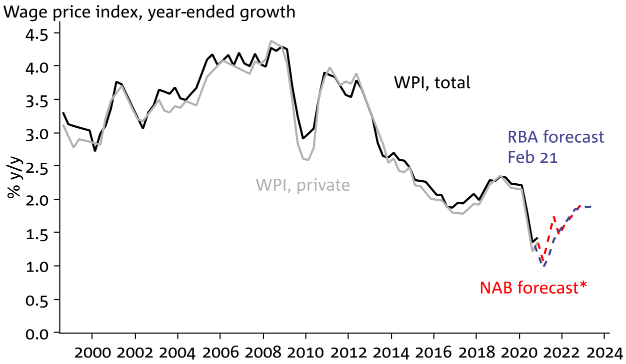
Last, we caution that viral outbreaks remain a risk until the vaccine is rolled out. At present, the plan is for vaccinations in Australia to begin in late February and, optimistically, for Australia to be fully vaccinated by October. It's possible that this could take longer and, in the meanwhile, another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

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. NAB forecasts house prices will rise by a strong 7.9% over 2021 and of 6% over 2022. However, with prices up 2% in the past month, it's possible that a record housing boom is underway. This should directly support residential construction activity and jobs, while turnover supports demand for household goods (already boosted through 2020) and higher prices boost overall spending. That said, the RBA and regulators will be monitoring the boom carefully, where fears of financial stability risks from a housing bubble remain.

END OF JOBKEEPER LOOMS

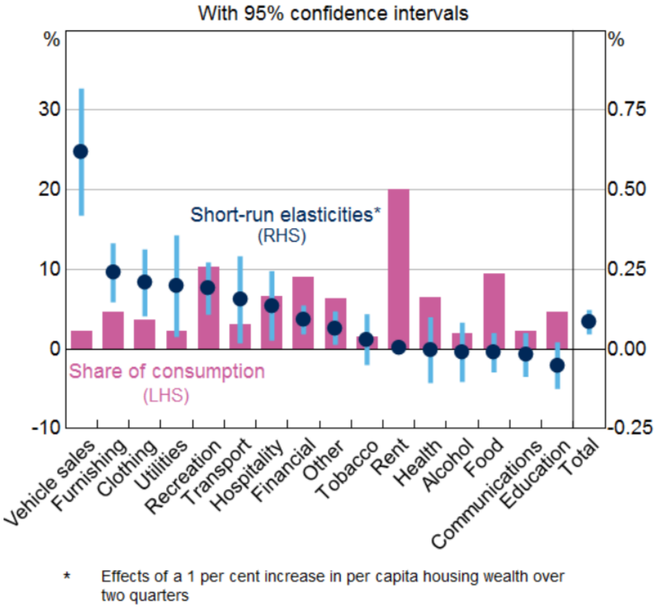


WAGES GROWTH REMAINS WEAK



* NAB forecasts private sector wages growth, which drives total wages growth.
Source: National Australia Bank, Australian Bureau of Statistics, Reserve Bank of Australia

WEALTH EFFECTS FOR HOUSING



Source: RBA Bulletin March 2019 Wealth and Consumption

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	1.3	6.0	2.5	1.2	-5.8	7.6	3.5
Dwelling Investment	-0.8	-8.1	1.4	3.1	4.3	-7.1	-5.4	6.3	-2.1
Underlying Business Investment	-3.1	-2.9	-5.1	4.8	0.5	-2.3	-5.5	0.3	5.9
Underlying Public Final Demand	5.0	5.8	5.9	4.0	4.8	5.5	6.1	5.0	3.1
Domestic Demand	**1.6**	**-1.0**	**2.1**	**5.4**	**2.7**	**1.2**	**-2.5**	**6.3**	**3.5**
Stocks (b)	-0.2	-0.3	0.3	0.1	0.1	-0.3	-0.1	0.3	0.1
GNE	**1.3**	**-1.3**	**2.5**	**5.5**	**2.9**	**0.9**	**-2.6**	**6.6**	**3.6**
Exports	4.0	-1.8	-9.4	0.0	5.1	3.3	-10.3	-2.2	-0.2
Imports	0.2	-7.4	-3.5	7.7	4.0	-1.0	-13.0	7.6	5.3
GDP	**2.2**	**-0.2**	**0.9**	**3.9**	**2.8**	**1.9**	**-2.4**	**4.6**	**2.5**
Nominal GDP	5.6	1.6	2.5	6.4	5.2	5.3	-1.6	7.2	4.3
Current Account Balance ($b)	14	-36	-51	-40	-40	13	49	47	33
(%) of GDP	0.7	-1.8	-2.5	-1.9	-2.1	0.7	2.5	2.2	1.5
Employment	2.4	0.2	1.3	3.3	2.7	2.3	-1.6	3.8	2.9
Terms of Trade	5.7	1.1	5.2	4.7	1.8	5.7	0.2	7.1	1.6
Average Earnings (Nat. Accts. Basis)	2.3	3.0	2.6	1.3	2.0	2.8	3.2	1.5	1.8
End of Period									
Total CPI	1.6	-0.3	3.2	1.6	1.8	1.8	0.9	1.7	1.6
Core CPI	1.4	1.3	1.5	1.5	1.8	1.4	1.3	1.5	1.7
Unemployment Rate	5.1	7.0	6.2	5.4	5.0	5.2	6.5	5.8	5.3
RBA Cash Rate	1.25	0.25	0.10	0.25	1.50	0.75	0.10	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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