April 2021

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

High frequency indicators continue to point to a recovery in the global economy in early 2021 –despite slowing trends in emerging market (EM) manufacturing and the resurgence of COVID-19 in a number of regions resulting in the reimposition of restrictions. These disruptions to economic activity, along with delays in the widespread administration of COVID-19 vaccinations, means that the global recovery will continue into 2022, before growth slows to 3.5% in 2023. Advanced economies (AEs) are expected to record weak growth overall in Q1 with COVID-19 continuing to cause disruptions, but growth is expected to accelerate from Q2 onwards on fiscal stimulus and wider vaccine penetration. Trends differ widely among EMs, with EM Asia generally outperforming other regions in part due to the global demand for electronics.

- **Financial market conditions** are generally positive; financial conditions indices point to accommodative conditions in major AEs. Government bond yields rose rapidly from mid-February through to mid-March, due to an improving economic outlook and rising inflation expectations but have since generally tracked sideways. Global equity market trends have differed across markets in recent weeks. A series of MSCI market indices recorded peaks in mid-February, before the EM index fell sharply (almost 11% peak to trough) while the non-US advanced market index declined by just over 5%. In contrast, the US index saw some volatility as it tracked broadly sideways across March, before climbing once again in early April, to a new record high.
- **Commodity prices** broadly eased across March, having risen consistently between early November 2020 and late February 2021. Oil prices have eased from recent peaks – in part due to OPEC+ unwinding some of its earlier production cuts – while several base metals retreated. That said, the overall Refinitiv Core Commodity CRB Index is still above its pre-COVID-19 level.
- Despite rising inflation expectations, consumer prices in a wide range of countries remain below **central bank** target bands, allowing them to tolerate higher inflation in the near term, particularly as some of the pressures are likely to be temporary. The US Federal Reserve intends to keep interest rates close to zero until inflation is moderately above 2% "for some time" and the labour market recovers. In addition, it committed to continue its asset purchase program until substantial progress is made towards these goals. We anticipate central bank rates to generally remain low over the next two years.
- COVID-19 continues to cause disruptions and for the **major advanced economies** (AEs) activity data to-date for Q1, while mixed, are consistent with a subdued rate of growth overall. In particular, we expect GDP to fall in both the Euro-zone and the UK in Q1, and to be close to flat in Japan and these regions have recently a tightening of COVID-19 related restrictions. US data are looking much stronger, despite severe weather disruptions in February, with COVID-19 restrictions being eased across many states and a boost from the December and March fiscal stimulus. Stimulus 'cheques' were sent to many households in the second half of March and, combined with a bounce back from February's weather disruptions, this led to a 9.8% m/m increase in retail sales in March. There is the prospect of additional US fiscal stimulus given the President's proposed infrastructure spending. Growth should accelerate rapidly as vaccinations become more widespread, bringing the virus under control and business surveys showed improvement across all the major AEs in March.
- Trends in the **emerging markets** manufacturing PMI have been softening for several months, with the survey down to a still positive 51.3 points in March (from its recent cycle peak of 53.9 points in November). This mainly reflected falls in India and Brazil and a more modest decline in China. For China this reflects the sector's recovery in the second half of 2020 and the subsequent challenge in increasing organic growth. In contrast, the EM services PMI was stronger in March, primarily driven by China, where services activity fell more sharply than manufacturing during the pandemic and was slower to recover. Trade volumes have continued to recover over recent months although this recovery has been skewed towards demand for electronics from Asia.
- The **global economy** is continuing to recover, with the JP Morgan global composite PMI at its highest level in March for just over six and a half years, albeit with substantial cross-country differences. The COVID-19 pandemic remains a significant risk to the economic outlook. A range of countries and regions have reintroduced measures to limit the spread of the virus and there are substantial differences in the distribution of vaccines globally. AEs generally have greater access to vaccines and have typically administered more doses than EMs. Disruptions to economic activity in early 2021, along with delays in the widespread administration of COVID-19 vaccinations means that the economic recovery will continue into 2022. Our forecast for 2021 remains unchanged at 6.2%, and growth is expected to remain above average at 4.5% (previously 4.6%) in 2022, before slowing back to its long term average – since the early 1970s – of 3.5% in 2023.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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In Australia, the economic recovery continues at a brisk pace and forward looking/high frequency indicators point to ongoing strength in activity and the labour market even as some fiscal support is wound back. While our NAB data shows some softening in consumption growth, the NAB Business Survey showed ongoing strength in March pointing to solid underlying momentum in the economy and the labour market. While employment has now more than recovered its pre-COVID level and we see GDP as fully recovering its pre-COVID level in Q1, a large degree of spare capacity remains in the economy. The unemployment rate remains above its pre-COVID level and the labour market is unlikely to be close to its full employment level (NAIRU) for an extended period. The key implication of ongoing slack in the labour market and the economy more broadly is that wages growth and core inflationary pressure will remain soft. This points to ongoing easy monetary policy, and possibly the need for further fiscal support. That said, the faster than expected rebound in activity and the unfolding recovery in the labour market suggests that the RBA cannot credibly commit to unchanged rates - according to the YCC program - beyond the April 2024 bond. Consequently, we expect an announcement on tapering YCC by August, but for the RBA to enter a 3rd round of QE ($100bn) and for the cash rate to remain on hold until at least early 2024.

- **Our view on monetary policy is unchanged,** with the slow process of returning to inflation sustainably within the RBA's target band alongside its commitment to keeping rates low until 2024 still in play. While our outlook for inflation and the labour market continues to warrant significant ongoing support from monetary policy – including an extension of QE - we do not see the RBA rolling the YCC program to the November 2024 bond. The pace of recovery suggests that the RBA will not be able to credibly commit to unchanged rates to near the end of 2024. So, while we expect the cash rate to remain unchanged through to end 2023 (and into 2024), we also expect an announcement to be made on the trimming of YCC by August by limiting purchases to the April 2024 bond.
- **The labour market continues to recover. The unemployment rate fell by** 0.2pp in March, leaving it just 0.4pp above its March 2020 level. Employment and hours worked are now above their pre-COVID level, and the underemployment rate below it. However, labour force growth remains weak by past standards (1.0% y/y compared to around 2% pre-COVID-19) reflecting the substantial fall in adult population growth and despite an increase in workforce participation. While the end of the Government's JobKeeper program poses a risk, elevated job vacancies and employment conditions in the NAB survey suggest that an underlying improvement in the labour market remains on track. We expect the unemployment rate to fall to 4.4% by end 2023 (broadly around the NAIRU) enabling a pick-up in wage growth.
- **Household consumption is expected to show solid growth in** Q1 although there has been some softening in consumer spending indicators. NAB's Cashless Retail indicator points to only 0.1% mom growth in March and NAB's weekly consumption index also points to some softening. Nominal retail sales declined 0.8% m/m in February and so far in Q1 are tracking slightly below their 2020 Q4 level. Last year there was a significant shift in spending away from services towards goods, however, in the second half of 2020 services consumption grew more quickly than goods consumption and this should continue into 2021.
- **The NAB Business Survey shows business conditions rose to a new record high,** driven by increases across trading, profitability and employment. This suggests that firms see ongoing improvements in activity even as the economy moves beyond the rebound phase following the earlier easing of restrictions. While business confidence eased slightly in the month it remains at a high level and capacity utilisation has risen to above average levels. These factors point to a pick-up in business investment and ongoing employment gains – two factors which will drive the handover of economic growth back to the private sector as fiscal support tapers off. **Trade will likely continue to be impacted**, with borders remaining closed – but strength in mining exports and weak service imports will continue to see a sizeable trade surplus.
- **Housing markets continue to show signs of strength.** Dwelling price growth continues to accelerate - the 8-capital city dwelling price index increased by 2.8% m/m in March, the highest monthly gain since 1988, to be 4.8% higher over the year. New housing finance fell slightly in February (-0.4% m/m) but remained at an exceptionally high level, with the fastest growing segment being loans for dwelling construction segment. House building approvals have also risen sharply (although partly offset by a decline in apartment approvals). The Federal Government's HomeBuilder program ended last month which will take some heat off the construction market but the substantial pipeline of work, the broader recovery in the economy, as well as low interest rates, should underpin a solid level of activity over the forecast period.
- **The AUD/USD** has traded lower over the last month, falling to around US76c. The drivers of the exchange rate have included 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 US83c before paring back over the next two years – US80c end 2022 and $75c by end 2023.
- **In addition to the uncertain impact of the end of the JobKeeper and Homebuilder programs, there are other risks to the outlook.** These include the possibility of COVID-19 outbreaks and delays to the vaccination roll-out, particularly with limitations recently put on the use of some vaccines. There is also uncertainty around migration patterns (a key driver of population growth) even when borders re-open.
- For more detail on the Australian outlook, please see the [Forward View – Australia], released on Wednesday.

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