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THE FORWARD VIEW: AUSTRALIA APRIL 2021

HEALTHY MOMENTUM LEADING INTO THE JOBKEEPER WIND-UP

OVERVIEW

- Overall, we have made little change to our outlook for GDP but have updated our labour market view as unemployment falls faster than most expected. We have also extended the forecasts to include 2023 – where we are expecting around trend growth but more moderate reductions in unemployment.
- The economic recovery continues to unfold 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. Alongside strong reads for confidence and conditions, capacity utilisation also strengthened further, suggesting that beyond just a rebound in activity, there is likely a solid underlying momentum in the economy.
- We see GDP as having fully recovered its pre-COVID level in Q1 – with another quarterly rise of around 1%. While this is encouraging, a large degree of spare capacity remains in the labour market and the output gap remains positive – and will not likely be closed for an extended period.
- Indeed, employment has now more than recovered its pre-COVID levels and the NAB Business Survey as well as Job ads/vacancies point to ongoing strength in labour demand. However, the unemployment rate remains around ¾ ppt higher than pre-COVID levels implying ongoing slack in the labour market.
- The key implication of ongoing slack in the labour market (as well as the economy more broadly) is that wages growth and hence inflationary pressure will remain soft, despite above trend growth in the near term. This points to ongoing easy monetary policy, and possibly the need for further fiscal support.
- On policy, however, 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. Therefore, we continue to expect an announcement will be made by August that the RBA will begin to wind back this program by limiting purchases to the April 2024 bond.
- That said, the degree of remaining spare capacity in the economy warrants ongoing easy monetary policy for some time. Consequently, while we expect YCC to be tapered, we expect the RBA to continue a 3rd round of QE ($100bn) and for the cash rate to remain on hold until at least early 2024.

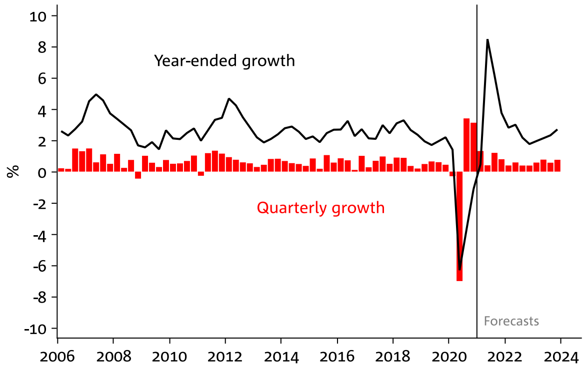
CONTENTS

KEY ECONOMIC FORECASTS

	2020	2021-F	2022-F	2023-F
Domestic Demand (a)	-2.5	6.1	3.5	2.6
Real GDP (annual average)	**-2.4**	**4.6**	**2.4**	**2.2**
Real GDP (year-ended to Dec)	**-1.1**	**3.7**	**1.7**	**2.6**
Terms of Trade (a)	0.2	7.1	1.6	-0.8
Employment (a)	-1.7	3.7	3.0	1.9
Unemployment Rate (b)	6.7	5.1	4.7	4.4
Headline CPI (b)	0.9	1.9	1.7	2.0
Core CPI (b)	1.3	1.4	1.8	2.0
RBA Cash Rate (b)	0.10	0.10	0.10	0.10
$A/US cents (b)	0.77	0.83	0.80	0.75

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

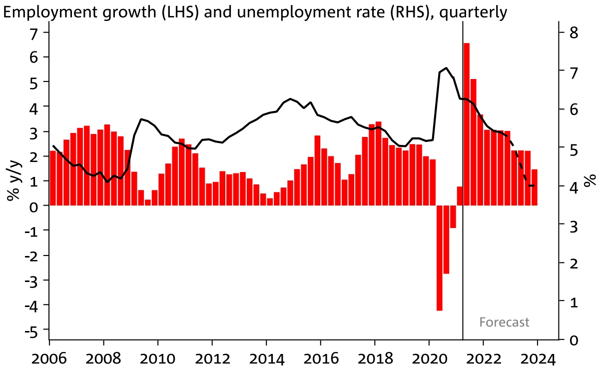
GDP FORECASTS



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 | Antony Kelly, Senior Economist | Gareth Spence, Senior Economist

LABOUR MARKET, WAGES AND CONSUMER

The labour market continues to recover, highlighted by a sharp fall in the unemployment rate in February.

The unemployment rate fell by a sharp 0.5 percentage points to 5.8% in February. The four-month decline (1.2pp) is the largest experienced since the series began in 1978. The unemployment rate is now just 0.6pp above its March 2020 level of 5.2%, but still well above our estimate of around the NAIRU or full employment, around 4.5%.

Employment has now returned to around its pre-COVID level, as has the underemployment rate, while hours worked is just 0.7% lower than in March 2020.

However, labour force growth remains weak by past standards (0.8% y/y in February compared to around 2% pre-COVID-19). This is despite an increase in workforce participation and reflects a collapse in population growth due to international border restrictions.

The end of the Government's JobKeeper wage subsidy scheme in late March is an immediate risk to the progress made to date. However, elevated job vacancies and employment conditions in the NAB survey suggest that an underlying improvement in the labour market remains on track. We have upgraded our outlook and now expect unemployment to fall to 5.1% by end 2021 and to reach 4.4% by end 2023.

This suggests that by the end of 2023, the unemployment rate should be broadly around the NAIRU. As such, wage pressures should be growing, lifting wage growth to 2.8% y/y by the end of 2023, from its current annual pace of 1.4%. This will support spending activity and inflation, although it's possible that wages take a little longer to pick up, given the experience overseas.

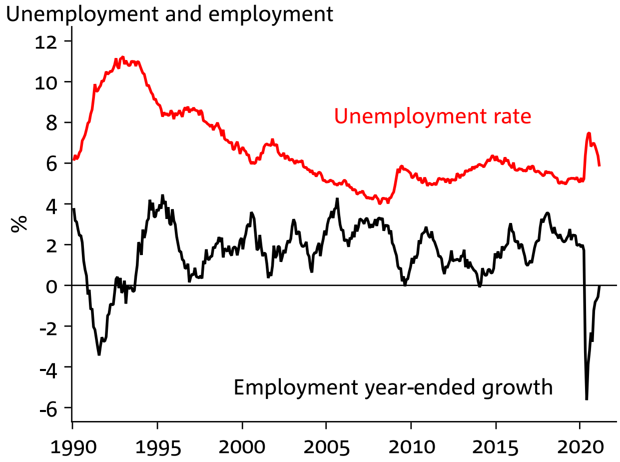
The strength of the labour market recovery should support the outlook for consumer spending although population growth remains weak.

Retail sales (in nominal terms) declined by 0.8% m/m in February and so far in Q1 are tracking slightly below their 2020 Q4 level. NAB's Cashless Retail indicator points to only 0.1% mom growth In March and NAB's weekly index also points to some softening in consumption. Nevertheless, we still expect to see solid growth in household consumption in Q1 as a whole.

Last year there was a significant shift in spending away from services towards goods. Some of this is likely to endure to the extent COVID-19 has permanently changed behaviours (e.g. more work from home).

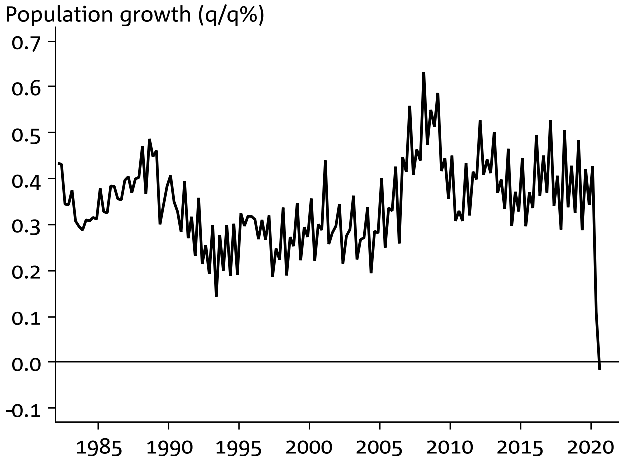
However, in the second half of 2020 services consumption grew more quickly than goods consumption and this should continue into 2021. While retail sales is mainly an indicator of goods consumption, spending on Cafes, restaurants and take-away foods services over January and February was well up on Q4 while the rest of retail sales declined. Moreover, consumption in other service sectors which are not part of retail sales (notably transport and accommodation) have far more scope to grow.

UNEMPLOYMENT HAS FALLEN RAPIDLY



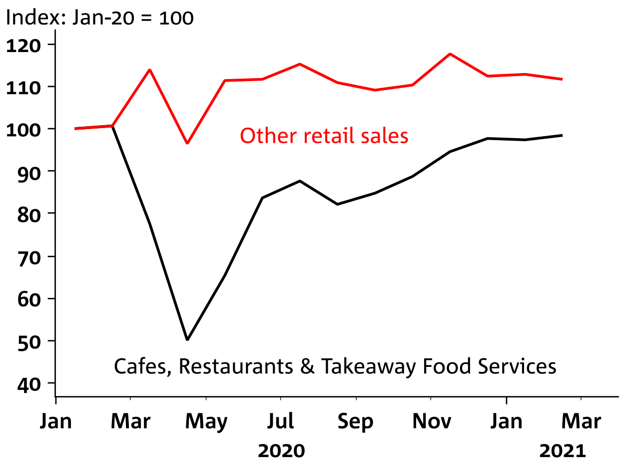
Source: National Australia Bank, Australian Bureau of Statistics

POPN GROWTH HAS COLLAPSED



Source: ABS

SPENDING ON GOODS HAS BEEN STRONG



Source: National Australia Bank, Australian Bureau of Statistics

HOUSING AND CONSTRUCTION

Housing markets continue to show signs of strength, with price growth accelerating and construction indicators pointing to a robust level of activity.

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. Prices rose in all eight capital cities, with the largest growth in Sydney. Regional house prices are no longer outpacing capital city growth, but continued to grow strongly too, increasing 2.5% mom.

New housing finance (excluding re-financings) fell slightly in February (-0.4% m/m) but remained at an exceptionally high level. This is particularly the case for owner-occupiers, although new loans for investors are also well up on a year ago.

Amongst loans for owner-occupiers, the most rapid growth has been in the loans for dwelling construction segment. The Q4 2020 national accounts indicated that dwelling investment rose by 3.1% q/q ending the downwards trend evident since mid-2018.

Building approval data also point to this continuing into 2021. The large fall in approvals in January (-19% m/m) was more than fully reversed in February (+22% m/m). Looking through the monthly noise, approvals have risen sharply since mid-2020 to a reasonably high level by historical standards. All the growth has been in the housing segment, with approvals of other dwellings (apartments) down on their pre-COVID level.

The strength of the recovery in housing markets (both prices and construction) in part reflects government policy measures such as HomeBuilder and stamp duty discounts.

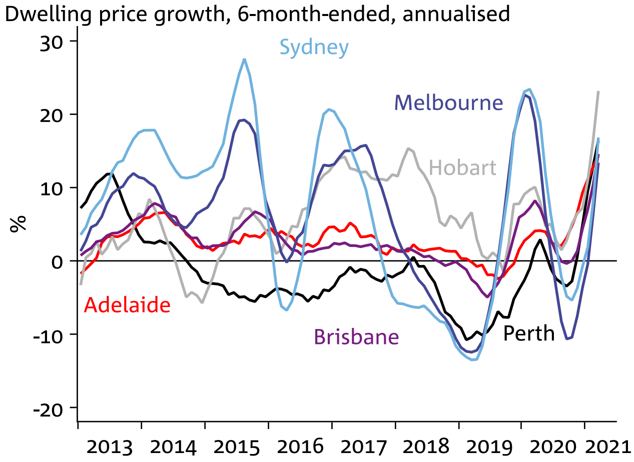
The unwinding of policy measures will likely take some of the heat out of the construction market. The Federal Government's HomeBuilder program ended on 31 March. The program requires that work commence within six months of the contract being signed.

Schemes such as HomeBuilder, as well as encouraging new activity, bring forward activity that would otherwise have occurred, and so a dip in approvals in coming months would not be a surprise. However, the broader recovery in the economy, as well as low interest rates, should underpin a solid level of activity over the forecast period. Moreover, the increase in dwelling building approvals that has occurred means that there will be a substantial pipeline of work for a while to come.

Accordingly, while we expect to see robust growth in dwelling investment over much of 2021, heading into 2022 we expect to see some easing back, albeit to a still solid level.

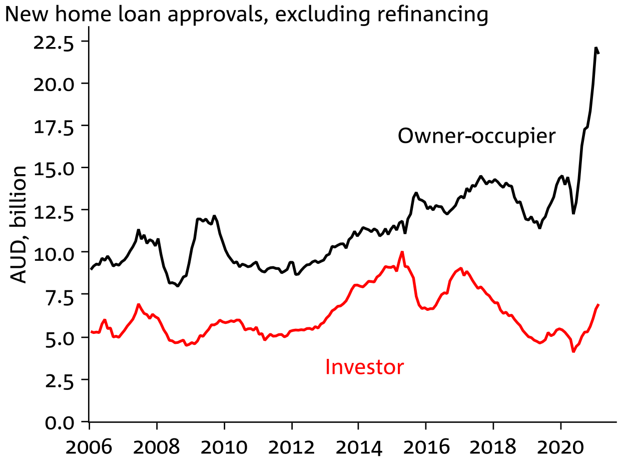
Another risk around the housing outlook is how long population growth remains muted by international border restrictions, and whether there is a return to more typical levels of net migration as the border re-opens as assumed in our projections.

HOUSE PRICE GROWTH ACCELERATING



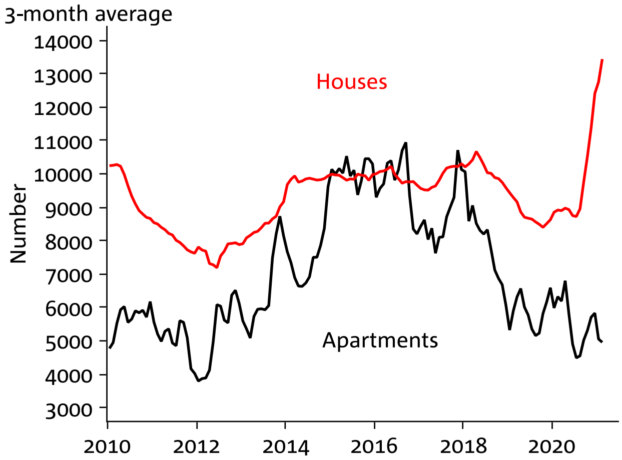
Source: National Australia Bank, CoreLogic

HOME LOAN APPROVALS VERY HIGH



Source: National Australia Bank, Australian Bureau of Statistics

DWELLING APPROVALS HAVE RISEN SHARPLY



Source: National Australia Bank, Australian Bureau of Statistics

BUSINESS AND TRADE

The business survey strengthened further in March – an encouraging signal as the JobKeeper program is phased out.

Business conditions rose to a new record high (even considering the longer time series in the NAB Quarterly Survey) in March. Conditions rose to +25 index points, driven by increases across trading, profitability and employment. Each of these components is also now at a record high. The increase in these variables 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 – with all states and territories firmly in positive territory. Forward orders have also risen to their highest level on record – pointing to ongoing strength in the pipeline of work. Taken together, these forward-looking indicators suggest that the improvement in activity is likely to continue in the near term.

Encouragingly, alongside the ongoing improvement in activity, capacity utilisation has risen to above average levels. The recovery from the hit to activity in early 2020 is evident across all industries with most having fully recovered (and now report above average utilisation rates).

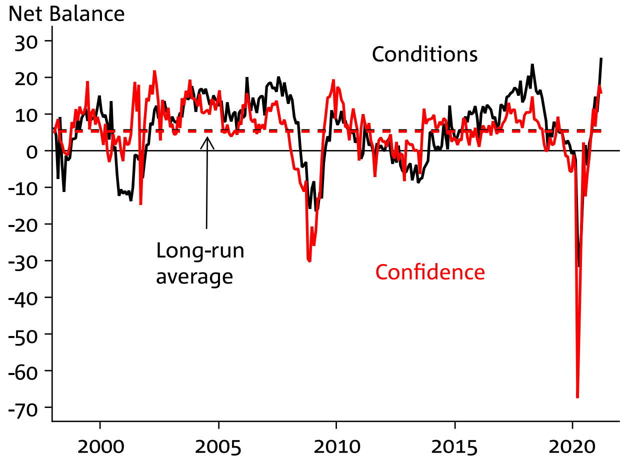
While still early, these factors point to a pick-up in business investment and ongoing increases in employment – two factors which will drive the handover of economic growth back to the private sector as fiscal support tapers off. While some sectors will no doubt continue to see the impact of closed borders and the pullback in JobKeeper support – for now it appears that the economy in aggregate will not suffer significant fallout.

Trade will likely continue to be impacted, with borders continuing to remain closed – but strength in mining exports and weak service imports will continue to see a sizeable trade surplus.

The trade surplus narrowed to $7.5bn in February from the record high reached in January. The fall was driven by weaker exports (including resources), while imports increased – partially driven by strength in merchandise imports.

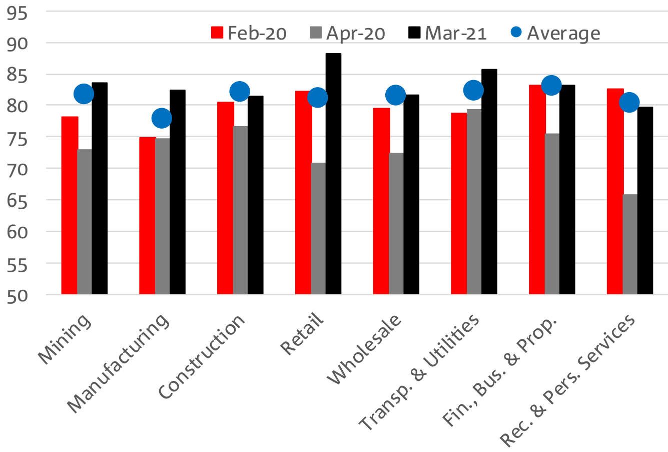
With the vaccine rollout still occurring gradually, it is likely that the pattern of trade will continue to see significant impacts. Services trade will likely remain very weak, with the border closures most heavily impacting tourism. On the imports side, strong domestic consumption will likely continue to see a boost to merchandise imports – notwithstanding some disruptions to supply chains.

CONDITIONS AND CONFIDENCE ARE STRONG



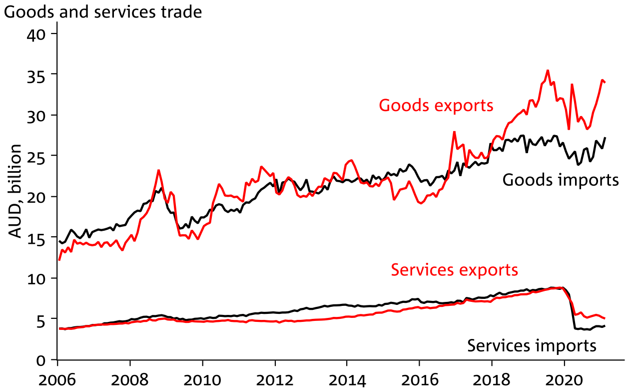
Source: National Australia Bank, National Australia Bank

CAPACITY UTILISATION IS HIGH



Source: NAB Business Survey

SERVICES TRADE REMAINS DEEPLY IMPACTED



Source: National Australia Bank, Australian Bureau of Statistics

MONETARY POLICY, INFLATION AND FX

Monetary policy settings were left unchanged in April, with the cash rate and YCC targets left unchanged and no changes to the TFF and QE programs.

The post meeting statement acknowledged that both globally and locally, the recovery had continued to unfold faster than expected, albeit unevenly. This has resulted in an upgrade of the central scenario for growth and the labour market but that price pressures remain weak.

The RBA Board noted that the focus continues to be driving down the unemployment rate while inflation remains of little constraint. It noted that despite the rapid recovery to date in the economy, a large degree of spare capacity remains and that inflationary pressure – particularly that from wage growth remains someway off. The focus continues to be on actual inflation outcomes as a trigger for policy normalisation.

The bank also acknowledged the increase in yields both overseas and domestically on the better than expected outlook, but suggested that it believes its QE and YCC programs are working to hold both the exchange rate and yields lower than they would have been in the absence of these actions. The RBA completed its first round of $100bn QE purchases last week and has moved into the second $100bn this week as announced earlier in the year. There were no purchases under the YCC program over the past month – which is not uncommon – with 3-year yields tracking at the target of 0.1%.

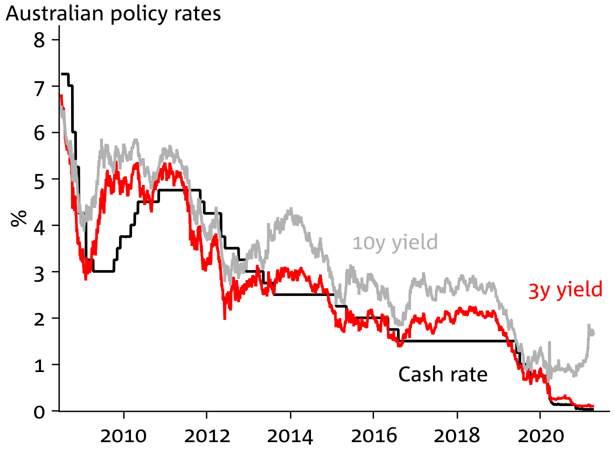
Our view on monetary policy is unchanged, with the slow process of returning to inflation sustainably within the RBA's target band alongside its commitment to keeping rates low until 2024 still in play.

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. We expect an announcement to be made on the trimming of YCC by August.

We continue to see the Aussie appreciating over this year and next, with strong commodity demand and a relative outperformance of the local economy dominating.

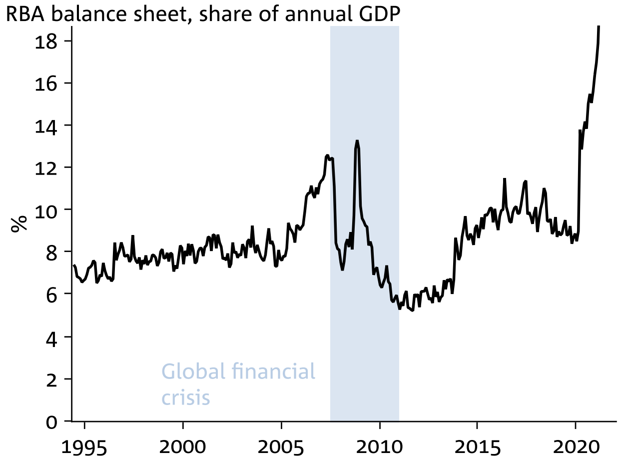
The AUD/USD has traded lower over the last month, falling to around US76c. The exchange rate remains notably above the levels seen at the time of the announcement of the QE program but likely lower than it would have been otherwise. The drivers of the exchange rate have included significant gains in 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.

INTEREST RATES ARE AT HISTORIC LOWS



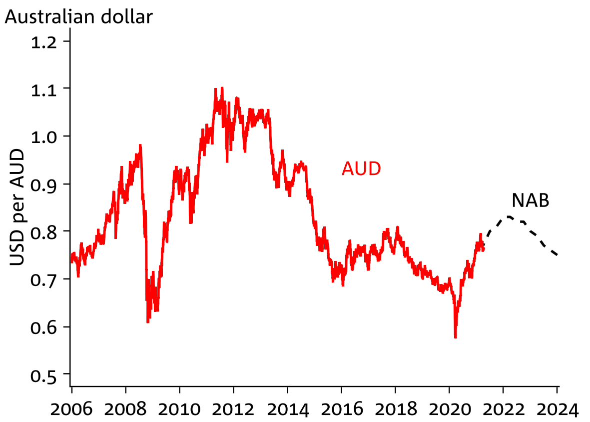
Source: Reserve Bank of Australia, Macrobond Financial AB

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

Data in the few months should reveal the impact of the end of JobKeeper.

Government support has been critical to enabling the economy to weather the peak of the pandemic's economic impact. This has allowed the economy to rebound rapidly, following the containment of the virus.

However, some parts of the economy continue to face significant issues. Most clearly, ongoing international border closures mean that tourism and education providers continue to be heavily impacted. Other sectors face a slow recovery, hospitality, personal services and the entertainment industry remain limited by restrictions, while CBD offices and periphery businesses will be affected by increased rates of working at home.

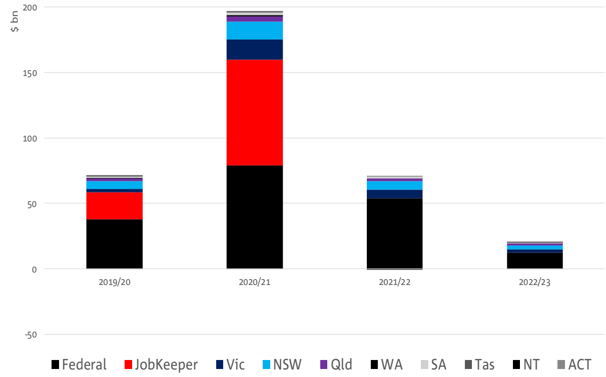
As such, there is a risk that the pull back in fiscal support prompts job losses in these industries. Most notably, in March the federal government ended: the JobKeeper wage subsidy, the boost to JobSeeker unemployment benefits and HomeBuilder grants. Data published in the coming months should reveal any drag from the end of these programmes.

Our forecasts assume little impact from the removal of these programs, where we expect further strong gains in unemployment and activity over the year ahead. That's despite other downside risks from weak population growth with uncertainty around migration patterns (a key driver of population growth) even when borders re-open. Ongoing outbreaks in other countries continue to weigh on global growth although US fiscal stimulus offers the prospect of rapid growth and as vaccines roll-out the risks are not all downside. The other risk on the external front is a further escalation in Australia-China tensions.

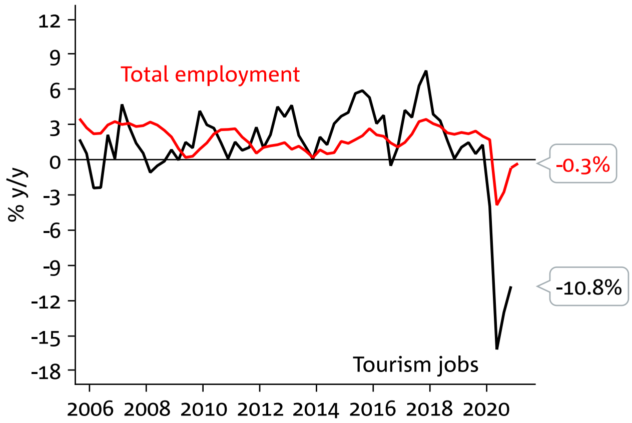
In contrast, we see some upside risks that the pickup in housing market activity spurs more jobs, construction and spending than we anticipate. That said we already have a strong 6.3% rise in dwelling investment forecast for 2021 and relatively flat outcome for 2022. Overall, we see robust growth in spending and employment. Nevertheless, with a sharp 2.8% rise in house prices over the past month, it appears that there are upside risks to our strong house price forecast of around a 14% rise over the next two years. Note the housing boom will be monitored closely by the RBA and regulators; signs that financial stability risks are growing could prompt the reintroduction of macroprudential measures.

Last, we caution that viral outbreaks remain a risk until the vaccine is rolled out, although at this stage the risk appears to be very small. At present, the rollout faces some delays, with the AstraZeneca vaccine now to be used in a more limited way while the Government is sourcing other vaccines. Lengthy delays increase the chance of another outbreak occurring, which would prompt a localised snap lockdown.

END OF JOBKEEPER LOOMS



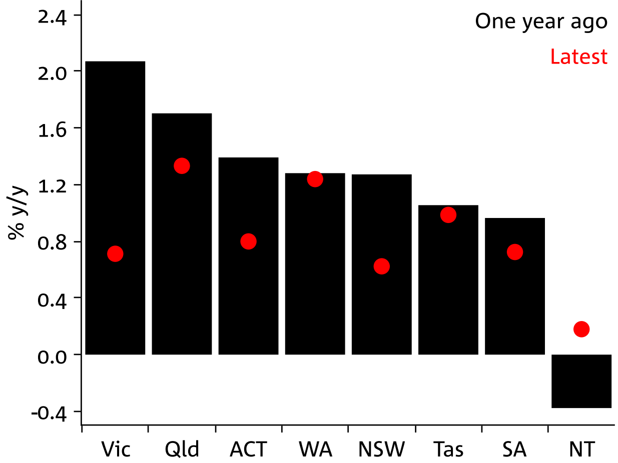
TOURISM JOBS HAVE BEEN HIT HARD



Note: 'Jobs' differ from 'employment', as an employed person can have multiple jobs.
Source: National Australia Bank, Australian Bureau of Statistics

POPULATION GROWTH HAS SLOWED SHARPLY

Annual population growth by state, Q3 2020 vs Q3 2019



FORECAST TABLES

Australian economic and financial forecasts (a)

	Fiscal Year				Calendar Year				
	2019-20	2020-21 F	2021-22 F	2022-23 F	2019	2020	2021-F	2022-F	2023-F
Private Consumption	-3.0	1.1	5.8	2.2	1.2	-5.8	7.2	3.5	2.0
Dwelling Investment	-8.1	1.4	3.1	-3.3	-7.1	-5.4	6.3	-2.1	-0.9
Underlying Business Investment	-2.9	-5.2	4.5	5.9	-2.3	-5.5	0.1	5.6	6.2
Underlying Public Final Demand	5.8	5.9	4.0	2.7	5.5	6.1	5.0	3.1	2.4
Domestic Demand	**-1.0**	**2.0**	**5.2**	**2.6**	**1.2**	**-2.5**	**6.1**	**3.5**	**2.6**
Stocks (b)	-0.3	0.3	0.1	0.0	-0.3	-0.1	0.2	0.1	0.0
GNE	**-1.3**	**2.4**	**5.3**	**2.6**	**0.9**	**-2.6**	**6.4**	**3.6**	**2.6**
Exports	-1.8	-9.4	0.0	0.6	3.3	-10.3	-2.2	-0.2	1.9
Imports	-7.4	-3.7	7.3	4.0	-1.0	-13.0	7.1	5.3	3.9
GDP	**-0.2**	**0.9**	**3.9**	**1.9**	**1.9**	**-2.4**	**4.6**	**2.4**	**2.2**
Nominal GDP	1.6	2.5	6.3	3.5	5.3	-1.6	7.2	4.3	3.8
Current Account Balance ($b)	-36	-51	-42	-29	13	49	49	35	26
(%) of GDP	-1.8	-2.5	-2.0	-1.3	0.7	2.5	2.3	1.6	1.1
Employment	0.2	1.1	3.4	2.5	2.3	-1.7	3.7	3.0	1.9
Terms of Trade	1.1	5.2	4.7	-0.5	5.7	0.2	7.1	1.6	-0.8
Average Earnings (Nat. Accts. Basis)	3.0	2.6	1.3	2.1	2.8	3.2	1.5	1.8	2.5
End of Period									
Total CPI	-0.3	3.5	1.6	1.7	1.8	0.9	1.9	1.7	1.9
Core CPI	1.3	1.5	1.5	1.8	1.4	1.3	1.4	1.8	2.0
Unemployment Rate	8.2	5.6	4.9	4.5	5.2	6.7	5.1	4.7	4.4
RBA Cash Rate	0.25	0.10	0.10	0.25	0.75	0.10	0.10	0.10	0.10
10 Year Govt. Bonds	0.87	1.90	2.50	1.35	1.37	0.97	2.25	3.00	–
$A/US cents :	0.69	0.80	0.82	0.77	0.70	0.77	0.83	0.80	0.75
$A - Trade Weighted Index	60.0	63.6	63.6	61.8	60.3	63.4	64.8	63.1	60.4

(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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