THE FORWARD VIEW: AUSTRALIA JUNE 2021

A HEALTHY OUTLOOK FOR THE ECONOMY BEYOND THE REBOUND

OVERVIEW

- **Following the release of the Q1 national accounts we have updated our forecasts for activity and the labour market. We now see year-average GDP growth of 5.1% in 2021, 2.6% in 2022 and 2.2% in 2023. In year-ended terms we see growth of 3.9% this year, 2.4% in 2022 and 2.2% in 2023.**
- **We expect the unemployment rate to continue to decline, reaching 4.9% by end 2021, before shifting down more gradually over the next two years – falling to 4.7% by the end of 2022 and 4.5% at the end of our forecast horizon.**
- **The economy is in a much better position than expected even 6 months ago. The national accounts confirmed that activity has now more than recovered its pre-COVID level and that the sectors that were most impacted by the virus continue to recover.**
- **We expect the key dynamics evident in the Q1 data to continue to play out. Dwelling and business investment are expected to be key supports to growth in the near-term, while services consumption will continue to recover. Goods consumption is expected to normalise over time, but at a pace that is uncertain.**
- **We forecast inflation to spike in the near-term as prices normalise following a range of pandemic-related impacts a year ago. It is also likely that we will see a bout of transitory inflation due to the disruption of some supply chains, pockets of labour shortages as well as the temporary boost to demand for some goods.**
- **With these temporary effects expected to fade over time, wage growth will be a key determinant of inflationary pressure at the current long-term forecast horizon. We see inflation rising to 2% by end 2023 which would broadly see inflation returning to the bottom of the target band. The labour market would likely need to remain tight for some period in order to see wage growth above 3% and a sustainable rise in inflation to between 2-3%.**
- **On monetary policy we expect the RBA to hold back on rolling the YCC target of 0.1% to the Nov-24 bond and to taper the QE program to $75bn over a 6-month period once the current tranche is completed. The RBA will also undertake further QE purchases with the size and shape of following programs to be determined by the final size of the next tranche and the evolution of economic and market conditions through the second half of 2021. Please see our updated monetary policy view released last week for more details.**

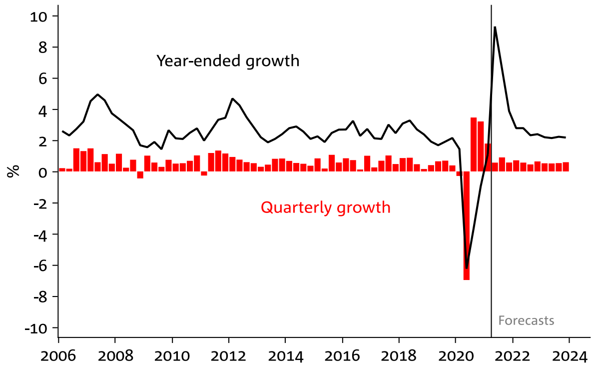
CONTENTS

KEY ECONOMIC FORECASTS

	2020	2021-F	2022-F	2023-F
Domestic Demand (a)	-2.5	6.5	3.7	2.6
Real GDP (annual average)	**-2.4**	**5.1**	**2.6**	**2.2**
Real GDP (year-ended to Dec)	**-1.0**	**3.9**	**2.4**	**2.2**
Terms of Trade (a)	-0.5	15.1	1.6	-0.8
Employment (a)	-1.7	4.0	3.5	2.3
Unemployment Rate (b)	6.7	4.9	4.7	4.5
Headline CPI (b)	1.0	1.7	1.8	2.0
Core CPI (b)	1.3	1.3	1.8	2.2
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

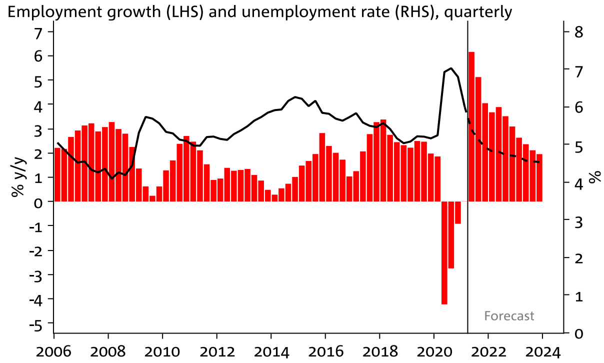
GDP FORECASTS



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 recovery remains on track even with mixed April data, while the outlook remains positive. Household consumption continues to recover.

The unemployment rate has fallen rapidly. It again declined in April (by 0.2 percentage points) to 5.5% and is now well down from October 2020's 6.9%, and only a little above its February 2020 level of 5.1%.

In contrast, employment fell 31k (or 0.3% m/m). The monthly employment numbers can be volatile (with monthly falls of April's magnitude, even during periods of strong growth, not unusual). Employment remained (marginally) higher than its pre-virus level (up 0.3%), but total hours worked is up more strongly (1.4%). Moreover, the NAB Monthly Business survey employment index has risen strongly in recent months and is at a record high.

Taken overall, the data suggest no major fall-out from the end of the Government's JobKeeper wage subsidy scheme in late March.

With the rapid growth in the economy, we expect unemployment to fall to 4.9% by end 2021 and to be at 4.5% by end 2023. As this should help generate some gradual wage pressure, we expect wage growth (WPI measure) of 2.8% y/y by the end of 2023 up from its current 1.5% y/y.

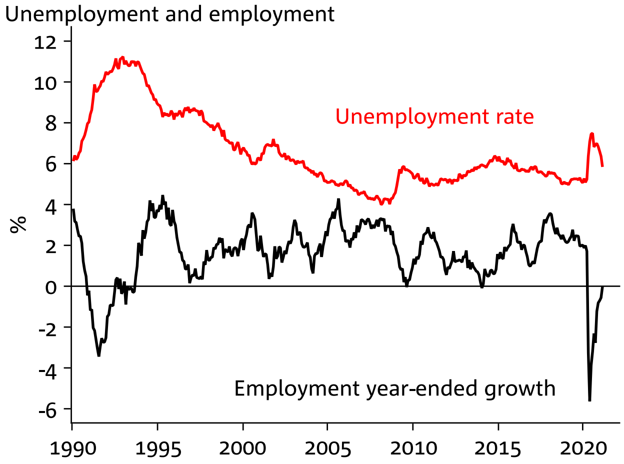
Household consumption continued its rebound in Q1, rising by 1.2% (0.0% y/y), but it remains 1.5% below its pre-pandemic level. Services consumption continued to recover, rising 2.4% q/q, while goods consumption fell 0.5%, pointing to a re-balancing of spending back towards services. The increase in services consumption was driven by hotels, cafes & restaurants (up 14.8%), recreation & personal services (up 3.3%) and transport services (up 8.8%). However, the latter remains 76% below pre-COVID levels, while hotels & restaurants are still down 19%.

The incomplete recovery in consumption is despite solid income growth. Household disposable income is up 6% on its pre-COVID level (5.2% adjusted for inflation). As a result, the savings rate remains elevated although it has declined from its peak and fell slightly in Q1.

This suggests there is considerable scope for further strong consumption growth in coming quarters. While government support is being pulled back (although Victorian lockdown payments show it can be deployed when needed) the ongoing improvement in the labour market will help fill the gap. Indeed, early data for Q1 is positive with nominal retail sales up 1.1% m/m in April, with the strongest growth occurring in the service sector category of Restaurants, cafes & takeaways. However, NAB's Cashless Retail indicator points to only subdued growth in May; including softer hospitality growth, which is a concern as the services sector should be a key driver of growth over the rest of the year.

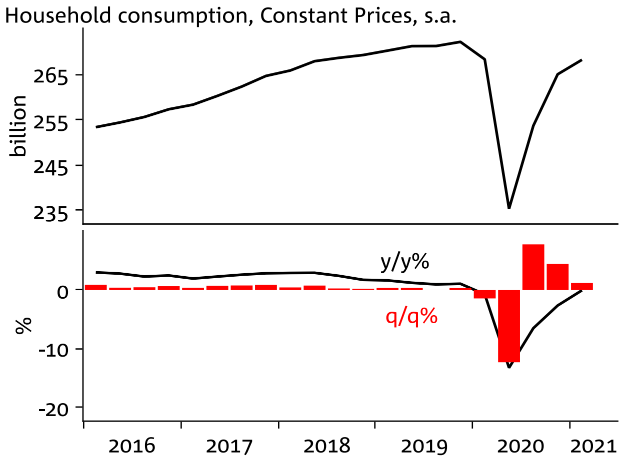
A risk to Q2 consumption growth would be if the current Victorian lockdown were to remain in place for an extended period.

UNEMPLOYMENT FALLING RAPIDLY



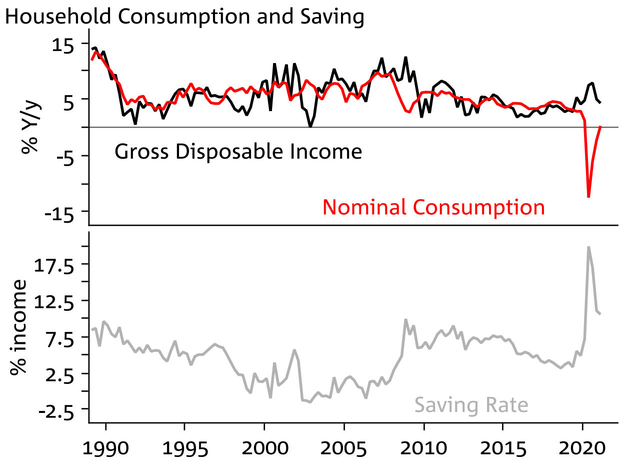
Source: National Australia Bank, Australian Bureau of Statistics

CONSUMPTION RECOVERY NOT COMPLETE



Source: National Australia Bank, Australian Bureau of Statistics

HOUSEHOLD INCOMES SOLID, SAVINGS HIGH



Source: National Australia Bank, Australian Bureau of Statistics

HOUSING AND CONSTRUCTION

Housing markets continue to grow strongly, with turnover, construction and prices all rising strongly.

Dwelling price growth remains rapid. The CoreLogic 8-capital city dwelling price index grew 2.3% m/m in May. This was below the growth seen in March, but slightly higher than in April. Since September 2020, capital city prices have risen by 12%, and are 10% higher than their pre-COVID-19 (February 2020) level.

Sales activity is also at high levels. This is reflected in the Ownership Transfer Costs (OTC) GDP component which covers things like real estate agent commissions and stamp duty. OTC, in volume terms, increased by 11% q/q in Q1 and is up over 25% since Q4 2019. Over time there is a reasonable correlation between OTC and new home loan commitments (ex refinancing), although OTC also includes costs relating to non-residential transfers. April loan data (if maintained over Q2) points to nominal OTC growth decelerating in Q2 but remaining strong.

Dwelling investment has grown over the last three quarters, and increased by 6.4% q/q (7.9% y/y) in Q1. Alterations & additions drove the increase (up 10.8% q/q), though new dwelling investment (up 4.0%) was also solid.

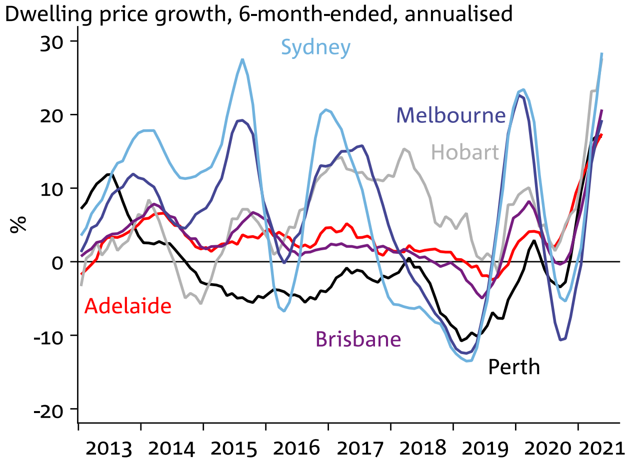
Building approval data for April point to dwelling investment increasing further into Q2 2021. While building approvals fell 8.6% m/m in April (due to a large fall in the volatile apartment sector) they were still well above the Q1 average. Moreover, approvals tend to lead actual investment. The strength in approvals has been driven by private detached house approvals, which were up 4.6% m/m in April, to a new record high.

A factor supporting residential construction has been the Government's homebuilder program (along with other State based programs). The Homebuilder program ran between June 2020 and March 2021, although applications for contracts signed by March could be submitted through to mid-April. It received over 120,000 applications. By comparison, total building approvals over this period were around 170k. Of course, many projects would have gone ahead without the program so the net effect on activity is less clear. Moreover, the program has likely brought forward the timing of some projects.

The end to Homebuilder is likely to lead to a weakening in indicators such as building approvals. The value of new home loans to owner-occupiers for construction purposes is still very high but fell 11% in April. Nevertheless, the large pipeline of work that has been put in place should mean that residential construction remains strong for a while. Continued low interest rates and the broader recovery in the economy should provide ongoing support to the sector. In contrast, the fall-away in population growth poses a downside risk, which will only grow the longer the international 'border closure' remains in place.

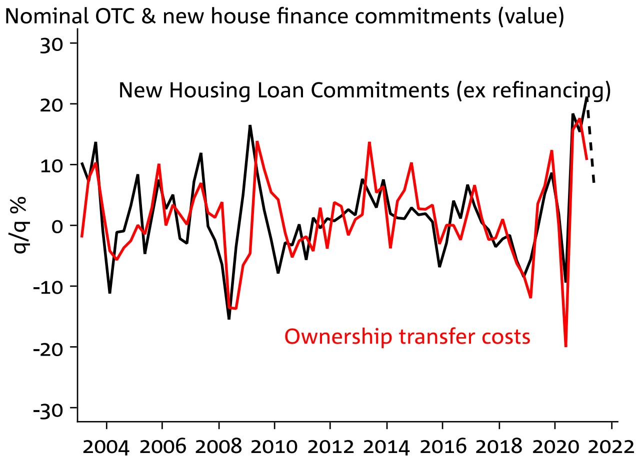
Accordingly, while we expect to see robust growth in dwelling investment over much of 2021. In 2022 we expect new construction to ease, albeit to a still solid level.

DWELLING PRICE GROWTH STILL RAPID



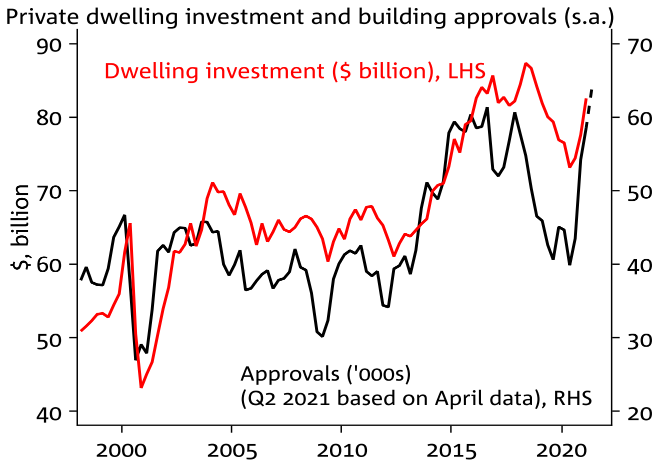
Source: National Australia Bank, CoreLogic

OTC INDICATES ROBUST SALES ACTIVITY



Source: National Australia Bank, Australian Bureau of Statistics

HOME LOAN APPROVALS VERY HIGH



Source: National Australia Bank, Australian Bureau of Statistics

BUSINESS AND TRADE

The national accounts confirmed that the optimism in the business sector may be materialising with a second solid gain in business investment.

The rise in investment continued to be driven by spending on machinery & equipment which rose by 11.6% in the quarter. Engineering investment also saw a gain, though investment in non-residential construction continued to show weakness, falling a further 3.8% to be around 16% lower over the year. The smaller components of business investment - R&D, exploration and software also saw gains. By sector, both mining and non-mining rose.

The rise in business investment is encouraging, with investment in the non-mining sector having fallen to low levels in recent years. The outlook for investment remains relatively bright, with both ABS and NAB Quarterly Survey measures of capex showing the strongest reads for some time.

Indeed, the NAB Monthly Business survey suggests that activity remains strong in Q2. Business conditions rose further in May, resetting he record high set in April. Conditions rose 5pts to +37 index points – driven by further increases in trading, profitability and employment. Business confidence was slightly weaker in the month but remains elevated after reaching a record high last month.

Capacity utilisation edged lower but remains well above average, while forward orders held at an exceptionally high level in the month. Healthy activity levels combined with high capacity utilisation and a growing pipeline of work appear to be feeding into capex decisions – with the survey measure of capex seeing further gains in the month and also reaching a record high level.

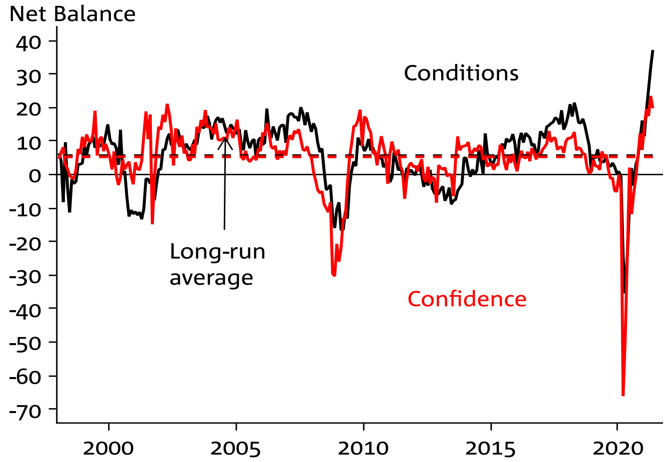
We forecast business investment to grow strongly this year, rising by around 14% over the year to December, with ongoing budget support and healthy conditions.

Net exports made a notable subtraction to GDP in Q1 and continue to reflect the impact of closed borders with services exports still very soft while goods imports showed strength.

Growth in imports (3.6% q/q) outpaced the growth in exports (0.5% q/q), supported by goods imports. Agricultural and iron ore were key supports on the exports side – with services exports remaining soft. Imports picked up in the quarter.

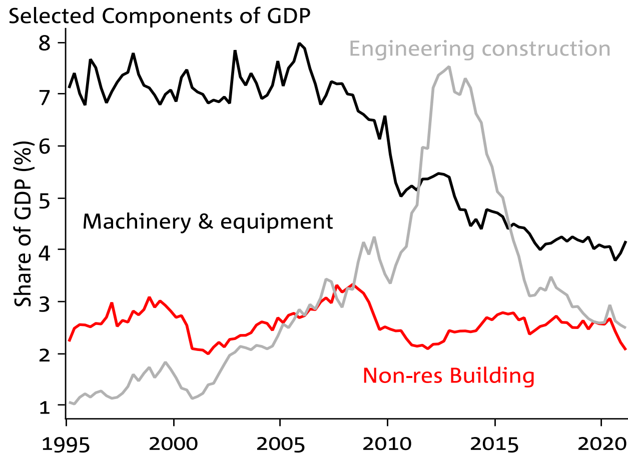
More recent nominal monthly trade data show a widening in the trade surplus to $8bn in April. The increase in the trade surplus was driven by a 3% increase in exports – driven by a broad-based pick-up across components. Imports declined by 3%. Both consumption and capital goods imports declined in the month pointing to some weakness in further restocking of inventories in the wholesale and retail sectors which was evident in Q1 GDP.

BUSINESS CONDITIONS ARE VERY HIGH



Source: National Australia Bank, National Australia Bank

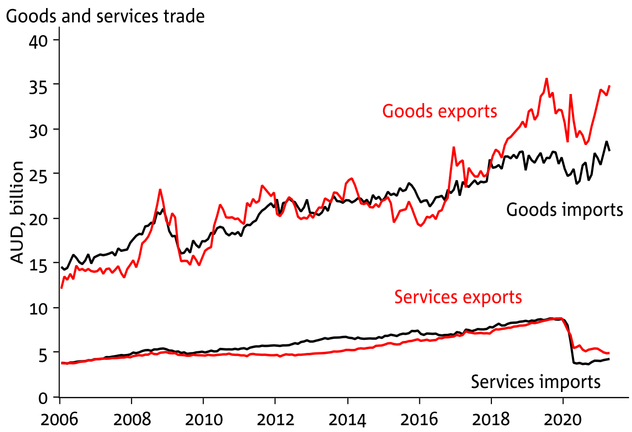
INVESTMENT IS LOW AS A SHARE OF GDP



Source: National Australia Bank, Australian Bureau of Statistics

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 June – with little new information provided in the post meeting statement.

The RBA's post meeting statement highlighted the rapid but unevenly unfolding global recovery. The RBA's central forecast for GDP is 4.5% during this year and 3.5% in 2022 which is higher than our current expectations. The bank also acknowledged the faster than expected recovery in the labour market to date, highlighting the "progress" that has been made in reducing unemployment.

The statement again highlighted the focus on reducing unemployment against a backdrop of weak underlying inflationary pressure. Wages are not expected to materially pick-up until further capacity has been eroded and the unemployment rate falls further – suggesting the need for exceptionally easy policy is ongoing. The statement reiterated that an announcement regarding the extension of the YCC target and the shape of further QE purchases will be made at the next board meeting. The TFF will close as planned at the end of June.

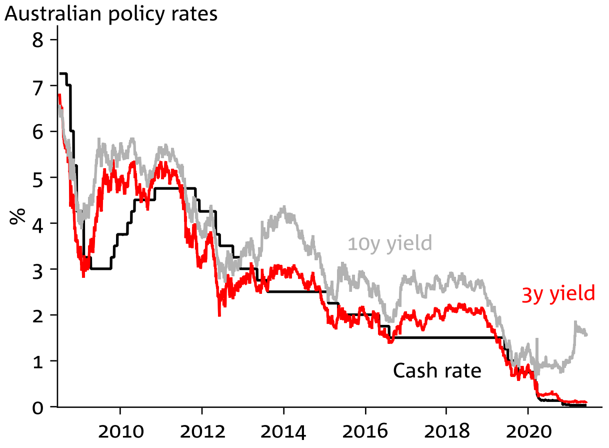
Our view on monetary policy is unchanged, with underlying inflation not expected to sustainably return to the target band alongside its commitment to keeping rates low until 2024 still in play.

However, we expect that the RBA will not roll the YCC target to the Nov-24 bond – effectively beginning pull-back on the rolling 3-year guidance for unchanged rates. While it is likely the cash rate will remain unchanged well into 2024, the faster than expected recovery suggests the RBA cannot credibly commit to unchanged rates until almost 2024. Further, we see a tapering of the rate of QE purchases to better match current issuance flows. Continuing to purchase at current rates would see the bank owning a substantial proportion of outstanding government bonds. Recent communication suggests the RBA sees the overall holdings as the best measure of easing and that it has eased substantially more quickly than other central banks. We do not see the 'taper' as a tightening in policy, rather a slight deceleration in the easing of policy. For more details please see our updated view on monetary policy release last week.

The Aussie has largely traded in a narrow band over the past month, but we expect it to appreciate further over the next 6 months.

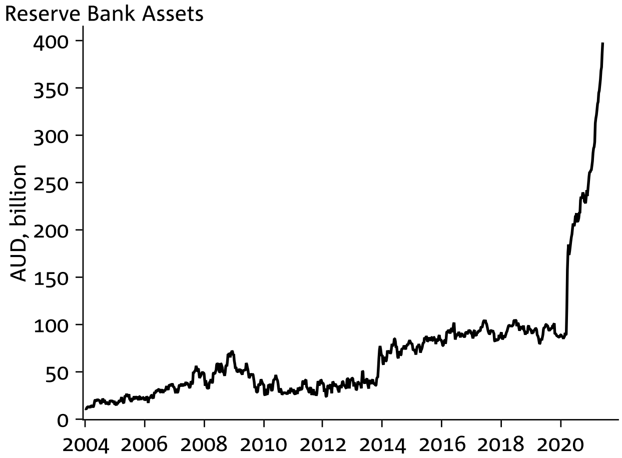
After trading as low as US75.5c in early April, the Aussie has largely tracked in the US77.0c to US78.0c range. The exchange rate remains around 10% above its October level, when the RBA first flagged QE, but has remained a little softer than the 'fair value' estimate consistent with the significant pick-up in iron ore prices. 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



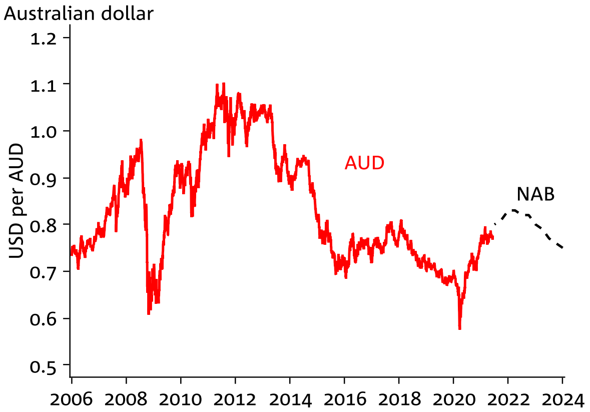
Source: Reserve Bank of Australia, Macrobond Financial AB

QE PURCHASES HAVE CONTINUED



Source: National Australia Bank, Reserve Bank of Australia

AUD TO RISE ON POSITIVE OUTLOOK



Source: National Australia Bank, Macrobond Financial AB

RISKS TO THE OUTLOOK

Lockdowns – if lengthy – remain a risk to the recovery; vaccine roll-out may reduce this risk in time.

The Victorian lockdown that commenced in late May is a reminder that COVID-19 remains a risk to the recovery. Data on mobility in Victoria have experienced a similar fall to that which occurred in the state's extended lockdown last year. That said, there was little obvious, sustained, impact from the short-term lockdowns that have occurred previously in other states. At the time of writing, restrictions are on track to ease at 11:59pm on Thursday. However, there will be a staged reduction and Melbourne residents will not be permitted to travel outside the city over the long weekend.

Moreover, COVID-19 transmission (and a lockdown policy response) remains a risk in all states, particularly given the emergence of more transmissible variants.

Overtime, this risk might be expected to decline as the number of people vaccinated rises. However, vaccinations are unlikely to lead to an eradication of the virus globally, although they should substantially reduce the risk of a major outbreak and the health risks of those that contract the virus. In this evolving environment it is uncertain for how long policy makers will continue to take a very strict approach to instances of transmission but, while they do, the risk of lockdowns will remain as will border controls.

The international border controls that have been put in place, have led to a major disruption to global travel and have weighed heavily on certain sectors (tourism, education) and limited the ability to address domestic labour shortages. It has also led to a collapse in population growth due to the impact on net migration. A persistent slowdown in population growth will have significant follow on impacts to sectors such as construction and retail (fewer people = fewer customers).

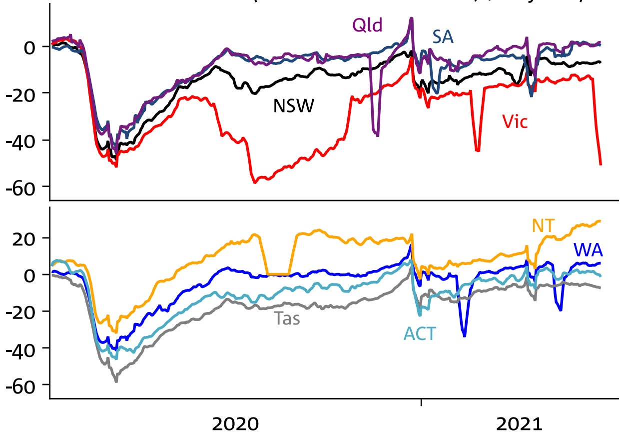
We are assuming the international border is largely re-opened in 2022. Even when the international border is 're-opened' it is unclear what will happen to migration flows and whether they will settle at, or lower or higher than, pre-virus levels.

Another downside risk to the outlook is the extent to which the recent ramp-up in activity has been supported by policy incentives; either for home construction or business investment. To the extent work has simply been pulled forward then the risk is that in future there will be a substantial retracement of activity. For housing construction, due to the substantial pipeline of work, this is not an immediate concern but may show up in 2022.

There are also some upside risks. For example, the lift in household savings might mean that in the future consumer spending grows more strongly than expected as households draw down on the accumulated (extra) funds. Also forward expectations for business investment are historically very strong and may see business spend more than currently forecast- especially in the next 12-18 months.

VIC LOCKDOWN EVIDENT IN MOBILITY

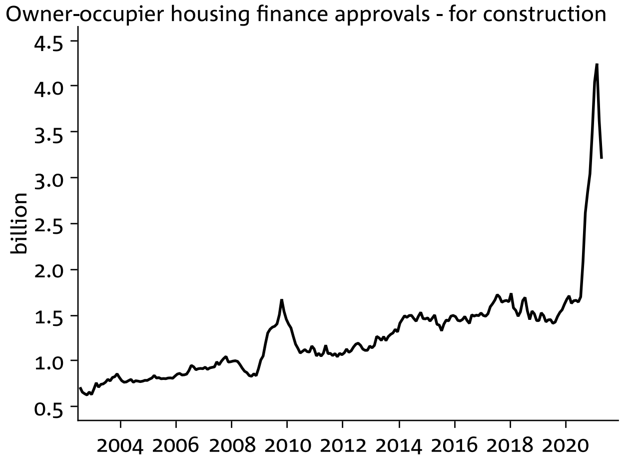
Recreation & retail visits (% devn from baseline, 7 day ave)



Source: National Australia Bank, Google

WHAT GOES UP COMES DOWN - HOW FAR?

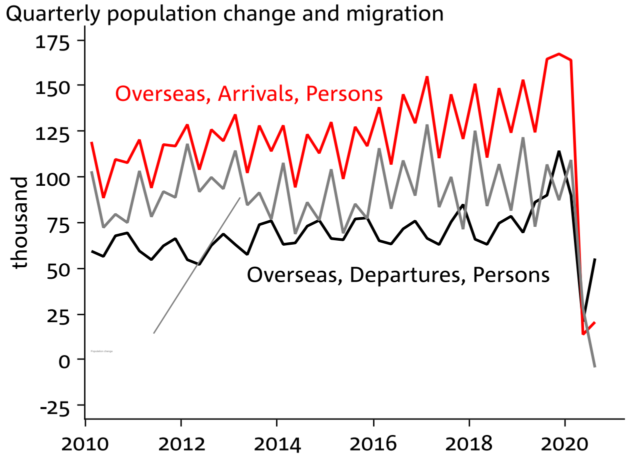
Owner-occupier housing finance approvals - for construction



Source: National Australia Bank, Australian Bureau of Statistics

NET MIGRATION COLLAPSE

Quarterly population change and migration



Source: National Australia Bank, Australian Bureau of Statistics

FORECAST TABLES

	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	0.9	3.9	2.5	1.2	-5.8	5.9	2.6	2.5
Dwelling Investment	-8.1	4.6	10.4	-7.5	-7.1	-5.2	14.6	-0.8	-8.2
Underlying Business Investment	-2.8	-3.0	12.7	7.7	-2.2	-5.7	7.6	10.1	6.2
Underlying Public Final Demand	5.7	5.5	3.6	2.8	5.5	6.0	4.1	3.3	2.4
Domestic Demand	**-1.0**	**2.2**	**5.5**	**2.8**	**1.2**	**-2.5**	**6.5**	**3.7**	**2.6**
Stocks (b)	-0.3	0.6	-0.3	0.0	-0.3	-0.1	0.4	-0.2	0.0
GNE	**-1.3**	**2.9**	**5.2**	**2.8**	**0.9**	**-2.6**	**7.0**	**3.5**	**2.6**
Exports	-1.8	-8.0	2.1	1.8	3.3	-10.0	0.2	1.4	1.9
Imports	-7.5	-2.5	9.0	4.6	-1.0	-13.2	10.0	5.9	4.1
GDP	**-0.2**	**1.3**	**4.0**	**2.3**	**1.9**	**-2.4**	**5.1**	**2.6**	**2.2**
Nominal GDP	1.6	3.5	6.9	3.8	5.4	-1.7	8.9	4.4	3.7
Current Account Balance ($b)	-36	-64	-70	-61	14	50	73	65	57
(%) of GDP	-1.8	-3.1	-3.2	-2.7	0.7	2.5	3.4	2.9	2.4
Employment	0.2	1.0	4.0	2.9	2.3	-1.7	4.0	3.5	2.3
Terms of Trade	0.9	9.0	8.4	-0.5	6.1	-0.5	15.1	1.6	-0.8
Average Earnings (Nat. Accts. Basis)	3.0	2.6	1.3	2.1	2.8	3.2	1.4	1.8	2.5
End of Period									
Total CPI	-0.3	3.4	1.7	1.8	1.8	1.0	1.7	1.8	2.0
Core CPI	1.3	1.4	1.6	1.9	1.4	1.3	1.3	1.9	2.2
Unemployment Rate	8.2	5.4	4.8	4.6	5.1	6.7	4.9	4.7	4.5
RBA Cash Rate	0.25	0.10	0.10	0.10	0.75	0.10	0.10	0.10	0.10
10 Year Govt. Bonds	0.87	1.90	2.50	–	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

Group Economics

Alan Oster
Group Chief Economist
+(61 0) 414 444 652

Jacqui Brand
Executive Assistant
+(61 0) 477 716 540

Dean Pearson
Head of Behavioural & Industry Economics
+(61 0) 457 517 342

Australian Economics and Commodities

Gareth Spence
Senior Economist
+(61 0) 436 606 175

Phin Ziebell
Senior Economist
+(61 0) 475 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 0) 477 723 769

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 0) 455 052 520

Steven Wu
Economist – Behavioural & Industry Economics
+(61 0) 472 808 952

International Economics

Tony Kelly
Senior Economist
+(61 0) 477 746 237

Gerard Burg
Senior Economist – International
+(61 0) 477 723 768

Global Markets Research

Ivan Colhoun
Global Head of Research
+(61 2) 9293 7168