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THE FORWARD VIEW: AUSTRALIA JULY 2021

LOCKDOWN DISRUPTIONS BUT EXPECT RECOVERY TO CONTINUE

OVERVIEW

- The current virus outbreak in NSW and associated lockdowns/border closures highlights the significant uncertainty around economic forecasting at present. We have made a modest tweak to our forecasts for GDP based on current developments. At this stage we do not see the recovery as having been derailed, given the significant momentum heading into the current disruptions but there are some downside risks to our forecasts if we see material extension to the lockdown.
- We see GDP growth of 5.0% in 2021, 2.5% in 2022 and 2.2% in 2023. With aggregate activity having largely recovered, we see a normalisation in growth from here – and quarterly GDP prints of less than 1%.
- In the near-term we continue to expect GDP to be supported by both dwelling and business investment growth as well as the ongoing recovery in services spending.
- We expect the unemployment rate to continue to decline, reaching 4.8% by end 2021, before shifting down more gradually over the next two years – falling to 4.6% by the end of 2022 and 4.2% at the end of our forecast horizon. While highly uncertain, we see full employment consistent with an unemployment rate in the low 4's. Nonetheless, we do expect wage growth to pick-up from here – tracking by around 3% at end 2023.
- We continue to expect inflation pressures in the near term due to the unwinding of pandemic-related impacts last year as well as isolated cases of wage and inflation pressure due to supply chain disruptions and closed international borders.
- We acknowledge the risk that current set of transitory factors may become more permanent. This could happen in two ways. Firstly, higher inflation outcomes may lead to high inflation expectations in the wage bargaining process, which would see higher wage growth persist. Secondly, high wage growth in some sectors may see spill overs to other sectors. To date, however, there is little evidence of this unfolding and abstracting from the short-term volatility in inflation, the wage/inflation dynamic will only see a gradual building of pressure over time.
- Following the RBA meeting last week, we have affirmed our view that the cash rate will remain on hold until early 2024. We see this as a balanced view and acknowledge that further upward surprises to activity and the labour market, or RBA reverting to being forward-looking, could see the first increase come in late 2023. On QE we expect the RBA to continue to taper gradually with total purchases after September of around $100bn.

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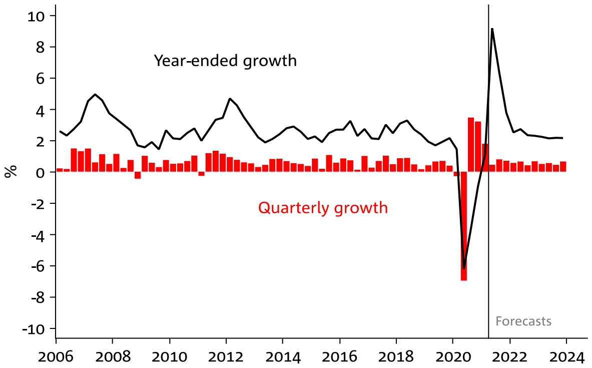
KEY ECONOMIC FORECASTS

	2020	2021-F	2022-F	2023-F
Domestic Demand (a)	-2.5	6.3	3.5	2.6
Real GDP (annual average)	**-2.4**	**5.0**	**2.5**	**2.2**
Real GDP (year-ended to Dec)	**-1.0**	**3.8**	**2.3**	**2.1**
Terms of Trade (a)	-0.5	15.1	1.6	-0.8
Employment (a)	-1.7	4.2	3.0	1.8
Unemployment Rate (b)	6.7	4.8	4.6	4.2
Headline CPI (b)	1.0	1.7	1.9	2.0
Core CPI (b)	1.3	1.4	1.8	2.3
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

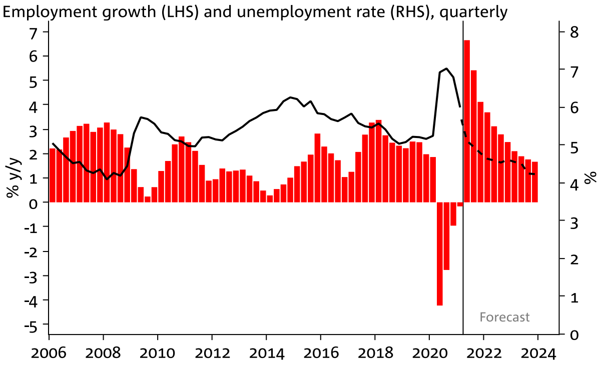
GDP FORECASTS



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

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LABOUR MARKET, WAGES AND CONSUMER

The labour market recovery continues to unfold at a faster than expected pace and anecdotally there are developing pockets of wage pressure.

The unemployment rate saw a further sharp fall in May, declining by 0.4ppts to 5.1% - and is now back around its pre-COVID level. The underemployment rate fell 0.3ppt to 7.4% and is now at its lowest level since 2014.

Employment rose by a large 115k in the month, following a decline last month. Employment is now around 1% above its pre-COVID level.

Overall, the labour market data continues to show little fallout from the end of the government's JobKeeper program or brief periods of lockdown. Measures of labour demand remain strong, with Job Vacancies around 60% above pre-COVID levels and the NAB Survey Measure of employment also high.

We expect unemployment to fall to 4.8% by end 2021 and to be at 4.2% by end 2023. Alongside this gradual tightening in the labour market, we see a rise in wage growth. How quickly this occurs will depend on the true level of full employment, which is highly uncertain, as well as how quickly the labour market tightens from here. Inflation expectations in the wage bargaining process will also be important.

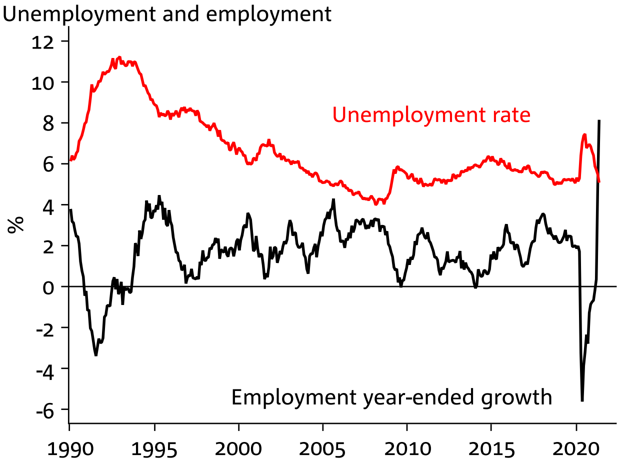
Retail sales increased by 0.4% m/m in May, a slowdown from the over 1% growth seen in each of March and April. There may have been some impact from lockdowns – with WA recording relatively strong growth (perhaps in part a rebound from its short late April lockdown), and sales in Victoria, which entered lockdown late in the month, down almost 1%. NAB's Cashless Retail indicator points to a fall in retail sales in June.

Restaurants, cafes and takeaway food services have grown more quickly than other retail sales since February, consistent with the notion that spending would rebalance back towards services as the recovery continued. However, recent lockdowns are likely to disrupt this process, at least temporarily, given their disproportionate impact on some service sectors – such as transport and hospitality.

The Victorian lockdown for much of the first half of June, will have weighed on June activity. NSW, Queensland, WA, SA and NT areas also imposed COVID-19 related restrictions or lockdowns towards the end of June. While these were mostly short-lived, parts of NSW have been in lockdown since 25 June which will prove to be a headwind for July activity at least. However, a rebound in Victoria, post lockdown, may provide some offset. Activity can bounce back quickly following a lockdown, as illustrated by dining numbers and NAB data on consumer spending.

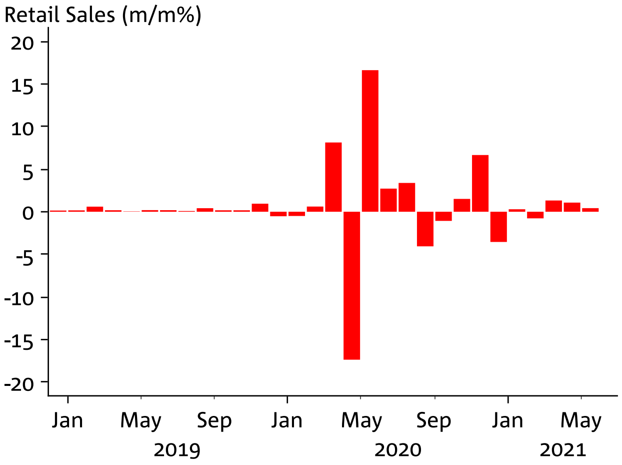
However, beyond the immediate impact of the recent and ongoing Sydney lockdowns, a recovery in consumption over time will be supported by ongoing job gains, an elevated savings rate, and supportive monetary policy.

UNEMPLOYMENT FALLING RAPIDLY



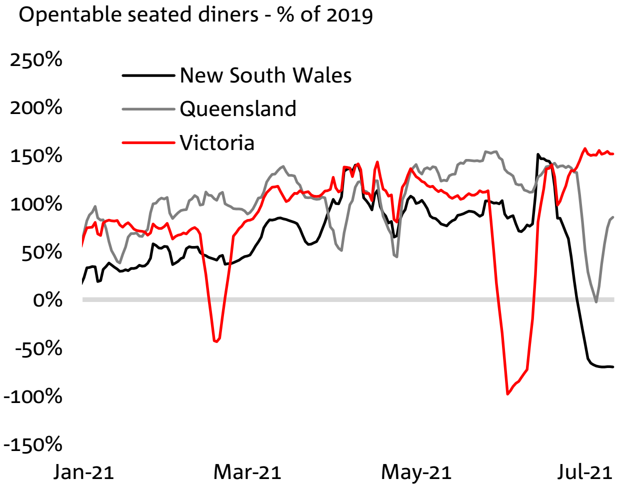
Source: National Australia Bank, Australian Bureau of Statistics

RETAIL SALES – MORE LOCKDOWN VOLATILITY TO COME



Source: National Australia Bank, Macrobond

LOCKDOWN – QUICK HIT AND REBOUND



HOUSING AND CONSTRUCTION

While housing markets remain strong, with dwelling prices showing robust growth, construction indicators appear to have peaked (but are still at high levels).

Dwelling prices continued to grow at a robust pace in June, with the CoreLogic 8-capital city dwelling price index rising 1.9% m/m. While slightly below the May pace, monthly growth remained in the range it has been in since February. This is also true of Melbourne, despite the lockdown over much of the first half of the month (with a partial easing of restrictions in the second half) suggesting that short-lived lockdowns are unlikely to significantly slow the market.

Since September 2020, capital city prices have risen by 14%, leaving them 12% higher than their pre-COVID-19 (February 2020) level. Over this period, price growth outside the capital cities has been even more rapid, but in recent months regional prices have been growing at around the same pace.

New home loans (ex refinancing) again rose strongly in May – up 5.5%, led by a 13% rise in loans to investors. and are at exceptionally high levels. It is possible that the level of investor activity may trigger a policy reaction – see Risks to the Outlook). However, for now, this points to strong growth in sales which will feed into the Ownership Transfer Costs (OTC) GDP component. However, the recent lockdowns in some states – and still in-place in Sydney – may mean that some sales are deferred.

However, in May, new loans to owner-occupiers for the purpose of dwelling construction, while still high, dipped notably, although a partial offset came from further strong growth in new loans for additions and repairs.

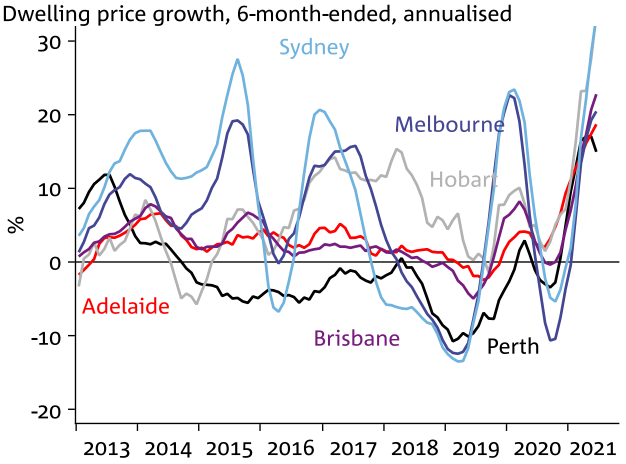
Similarly, building approvals again fell in May (-7.1% m/m). This time around the fall was in house approvals, and likely reflects the lagged impact of the March 2021 end to the Government's HomeBuilder programme.

Even with the recent declines, approvals remain at high levels. A risk is that HomeBuilder and other state government programmes have simply brought forward activity (rather than increased it over time) which would mean that approvals may fall sharply in coming months to relatively low levels. Another risk is the fall away in population growth; this risk will only grow larger the longer the international border remains largely closed, although at this stage it appears to be only impacting some segments of the property market.

Moreover, approvals tend to lead actual construction activity and the large pipeline of work that has been put in place should mean that dwelling investment continues to grow over much of 2021. Low interest rates and an improving labour market should also provide ongoing support to the sector.

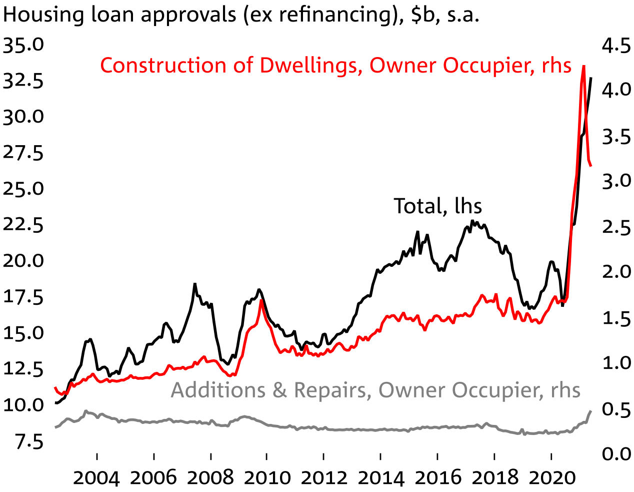
As a result, we expect to see robust growth in dwelling investment over much of 2021, but for residential investment to ease in 2022 albeit to a still solid level.

DWELLING PRICE GROWTH ROBUST

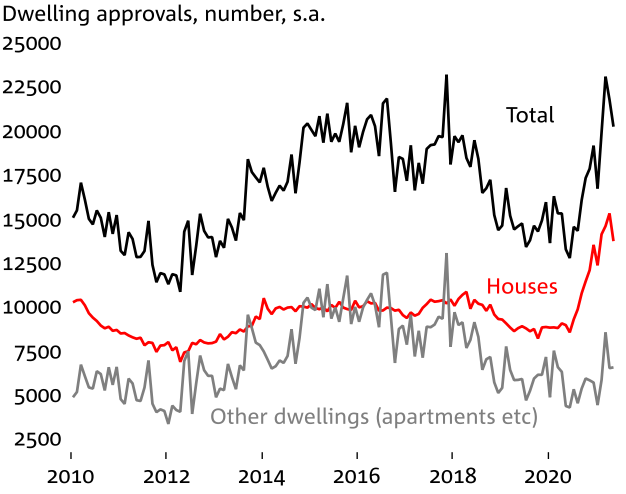


Source: National Australia Bank, CoreLogic

NEW HOME LOANS STILL EVELVATED



HOME LOAN APPROVALS MAY HAVE PEAKED



BUSINESS AND TRADE

Both business confidence and conditions saw a hit from virus-related lockdowns in the month, but both remain elevated.

The decline in confidence was driven by large falls in NSW and Qld but was evident across all states – likely reflecting the spill overs of border closures and disruptions to activity as a result. The impact was also evident on personal & recreation, which is the industry most likely impacted by social distancing and lockdowns. That said, confidence remains around twice its long-run average given the strength seen in recent months and remains elevated across the other states.

Conditions were down sharply in Vic likely reflecting the impact of the recent lockdown – though they were softer across the board except for WA. Alongside the decline in confidence, forward orders (the pipeline of work) and capacity utilisation were lower but still elevated. Experience to date shows that there is a relatively rapid rebound in confidence and conditions following short lockdowns. Therefore, while capex and employment were lower in the month, they will hopefully hold at a high level going forward.

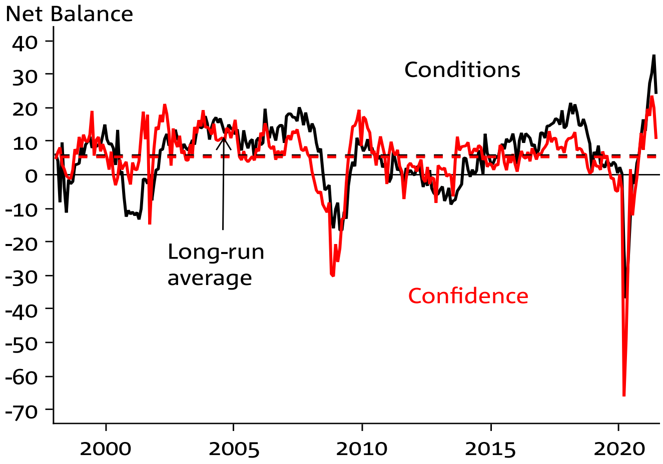
Indeed, we forecast ongoing strength in business investment over the next two quarters, before growth slows but remains positive going into 2022. The impact of the instant asset write-off will likely see continued support for investment in machinery & equipment in the near term while non-residential building investment may remain soft. Critically, we expect a pickup in business investment which has fallen to record lows as a share of GDP in recent years to continue to lift.

The trade balance widened in May, with growth in exports outpacing that of imports. At 9.7bn the trade surplus remains relatively large.

The growth in exports was broad-based across categories – but metal ores saw a particularly large boost in the month. Services exports picked up slightly in the month but remain at a very low level. The rise in imports in the month was driven by a rise in capital goods, though consumption and intermediate goods also saw small gains.

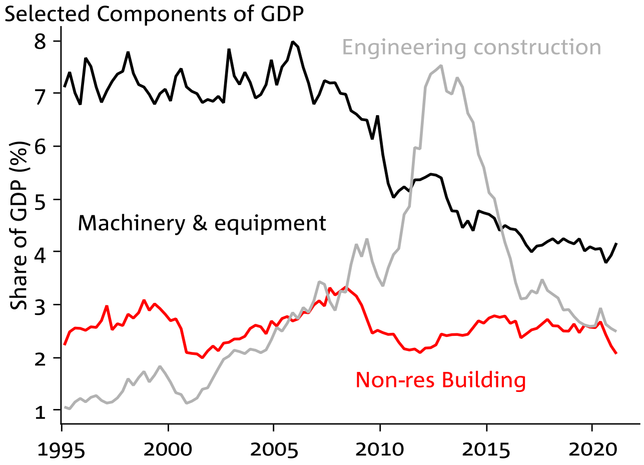
For now, we pencil in a small subtraction from net exports in the June quarter following the notable drag in Q1. We will firm up our estimate for the contribution of trade with next week's trade data for June. More broadly, we see next exports remaining soft for some time with service imports beginning to recover. However, it will likely take a substantial period for the composition of international trade to normalise. We expect borders to remain closed until mid-next year and it is likely that even once borders reopen, there will be a period of adjustment.

BUSINESS CONDITIONS ARE VERY HIGH



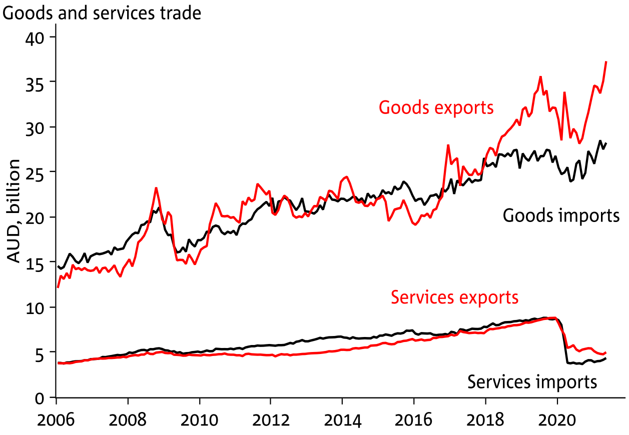
Source: National Australia Bank, National Australia Bank

INVESTMENT IS LOW AS A SHARE OF GDP



Source: National Australia Bank, Australian Bureau of Statistics

SERVICES TRADE REMAINS DEEPLY IMPACTED



Source: National Australia Bank, Australian Bureau of Statistics

MONETARY POLICY, INFLATION AND FX

As expected, in July the RBA pulled back slightly on the unconventional components of policy.

The YCC target has now been pegged at the Apr-24 bond and effectively the rolling forward guidance for 3 years of unchanged rates has ended. The YCC program will continue to provide support until such time as the program fully rolls off or is abandoned.

The weekly rate of QE purchases was also tapered to $4bn per week, to be reviewed in November –a move away from the previous 6-month tempo. The RBA emphasised that this was not a tightening in policy with the overall stock of purchases representing the easing. A softer government bond issuance outlook, and the rapid accumulation of holdings compared to other central banks has allowed a small slowing in the rate of purchases to ease the foot off the accelerator slightly on stimulus.

The RBA also sought to emphasise that its forward guidance is firmly conditions based, with the cash rate not to be lifted until inflation is "sustainably" back within the target band – on their view, likely in 2024.

We continue to expect the cash rate target will remain unchanged until early 2024 and for there to be a further $100bn of QE purchases from September, with the weekly rate of purchases tapered gradually before the program ends in mid-to-late 2022.

While the economic recovery has unfolded at a rapid pace, we see the need for ongoing support for some time with unemployment still likely around 1ppt above the level consistent with full employment.

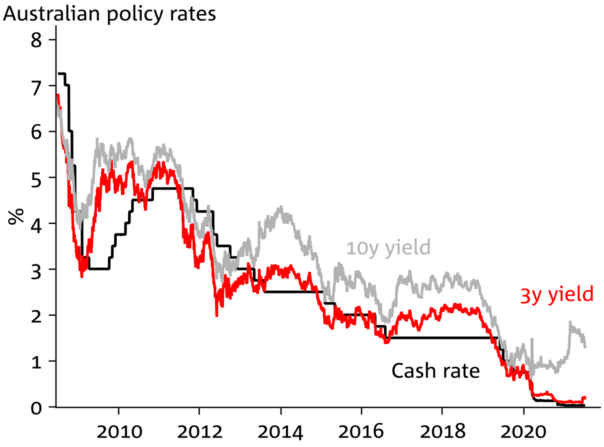
On our forecasts we have core inflation returning to the RBA's target band by early 2023 but wage growth not reaching 3% until much later in the year. With the RBA reiterating that inflation would need to sustainably be in the target band, and allowing for it to take some time to make such an assessment, we see some risk of a rate rise in late 2023 but more likely for the first hike to occur in 2024.

We see QE rising to just over 35% of outstanding issuance alongside a gradual tapering in 2022. The pace of the tapering is likely to depend on continued progress on reducing unemployment as well as economic and financial conditions – and the impact of any tapering by international central banks.

The Aussie traded lower over the last month but remains around 5% higher than October/November last year.

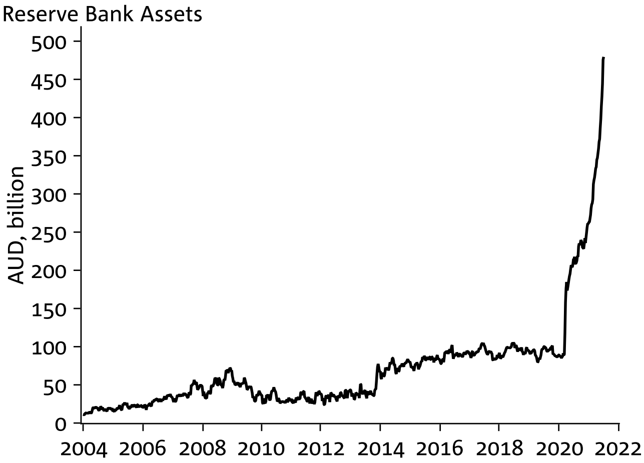
We continue to expect the Aussie to trade up to around $US83c by end 2021 before pulling back to around $US80c by end 2022. While the US Federal reserve looks to be moving towards a tapering in asset purchases – the strength in commodity prices warrants a higher value for the AUD. More broadly the Australian dollar TWI has appreciated by less, up by around 3% since October/November 2020.

INTEREST RATES TO REMAIN LOW



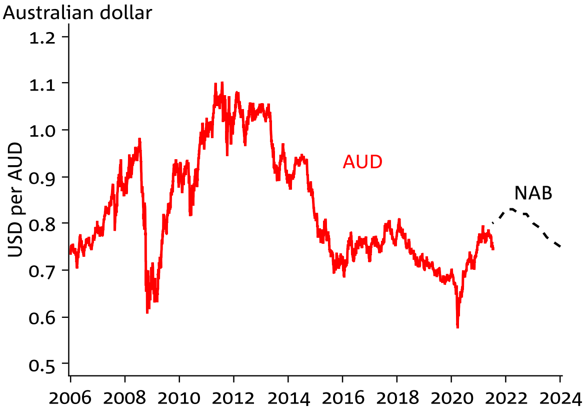
Source: Reserve Bank of Australia, Macrobond Financial AB

QE TO TAPER BUT CONTINUE FOR NOW



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

Current events demonstrate that the risk of lockdowns will remain a key risk – particularly if they are lengthy – remain a risk to the recovery at least until vaccinations reach a sufficiently high level

Recent lockdowns or COVID-19 restrictions in (or parts of) Victoria, NSW, Queensland, the Northern Territory and South Australia, and associated restrictions on interstate travel, highlight that COVID-19 remains a risk.

While short-lived lockdowns are unlikely to have a material impact on the economy a long-lived lockdown (such as that experienced by Victoria in H2 2020) risks having a more enduring affect.

In time, the roll-out of vaccinations should reduce the risk of further lockdowns. National Cabinet has agreed to a four stage transition plans that will eventually see the end of further lockdowns, with vaccination rate targets to be used to determine when to move from one phase io the next. We are currently in phase A and phase B still allows lockdowns in extreme circumstances, and it is not until phase C that the risk of lockdowns would be removed.

The Prime Minister has said that he hoped to be in Phase B next year. However, vaccination targets have not yet been set, and there is uncertainty about the how quickly any target will be achieved; so this is a source of upside and downside risk to our forecasts. A related risk is if a COVID variant were to emerge which the vaccines were ineffective against which could see a change to the plan.

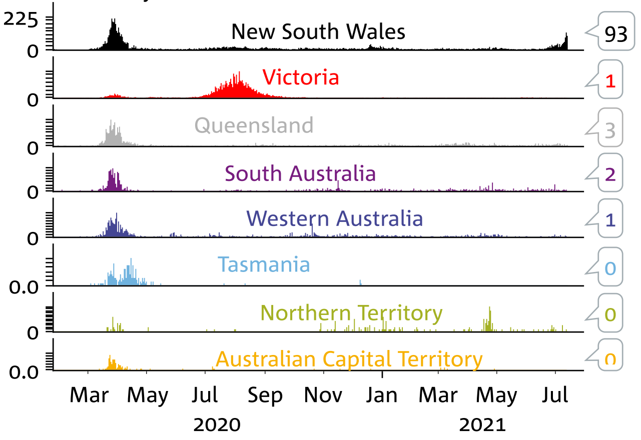
The plan also allows for an easing in international border restrictions but to start the Government will cut the international arrivals cap by 50%. With arrivals already very low and largely returning residents the cut is unlikely to affect tourism but may lead to further downward pressure on population growth while it remains in place. 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.

At this stage the housing sector, which would be expected to be population sensitive, has largely weathered the fall in population growth – outside of some segments it is showing considerable strength. However, the longer international border restrictions remain in place, the larger this drag will get.

A housing specific risk relates to the end of policy supports such as HomeBuilder which may have simply dragged activity forward. Now that they have ended, this could see activity fall even more than we are allowing for. Another risk for housing, is the potential for macroprudential policy measures (such as debt-to-income limits) to be introduced. In June, the Council of Financial Regulators indicated that it had discussed the risks if household were to grow faster than income as well as “…potential policy options to address these risks.”

LOCKDOWN RISK REMAINS

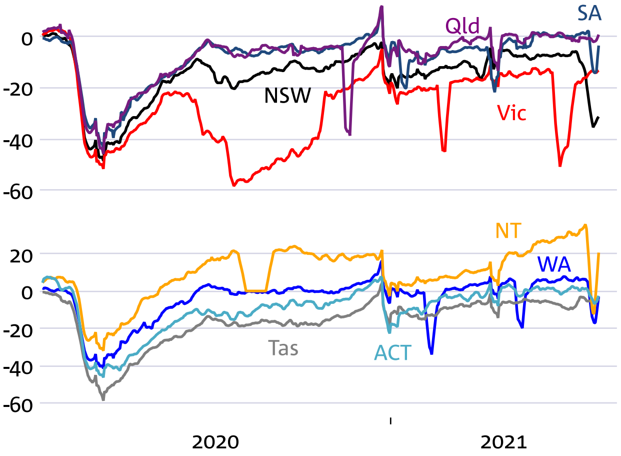
COVID-19 Daily confirmed cases



Source: National Australia Bank, Australian Department of Health

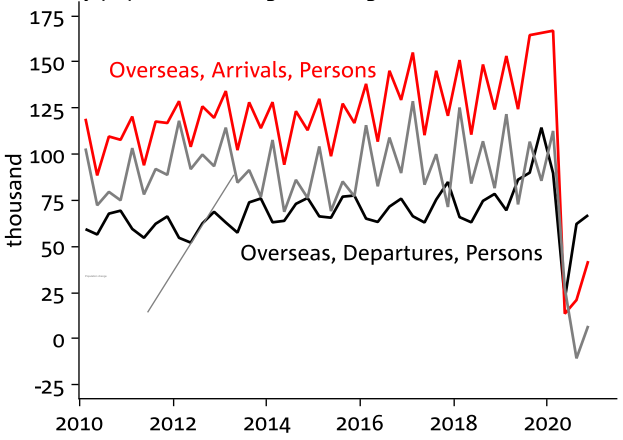
WHICH CAN WEIGH ON SERVICES

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



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	0.8	3.5	2.4	1.2	-5.8	5.7	2.4	2.4
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	-3.2	11.8	7.6	-2.2	-5.7	7.0	9.5	6.3
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**	**5.2**	**2.8**	**1.2**	**-2.5**	**6.3**	**3.5**	**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**	**2.8**	**4.9**	**2.8**	**0.9**	**-2.6**	**6.8**	**3.3**	**2.6**
Exports	-1.8	-8.0	2.1	1.8	3.3	-10.0	0.2	1.4	1.9
Imports	-7.5	-2.6	8.3	4.5	-1.0	-13.2	9.6	5.5	4.0
GDP	**-0.2**	**1.3**	**3.8**	**2.2**	**1.9**	**-2.4**	**5.0**	**2.5**	**2.2**
Nominal GDP	1.6	3.4	7.0	3.9	5.4	-1.7	8.8	4.5	3.8
Current Account Balance ($b)	-36	-64	-73	-64	14	50	75	68	60
(%) of GDP	-1.8	-3.1	-3.3	-2.8	0.7	2.5	3.5	3.0	2.6
Employment	0.2	1.1	3.8	2.3	2.3	-1.7	4.2	3.0	1.8
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	2.7	2.4	2.7	2.8	3.2	1.9	2.9	2.9
End of Period									
Total CPI	-0.3	3.3	1.8	1.9	1.8	1.0	1.7	1.9	2.1
Core CPI	1.3	1.4	1.7	2.1	1.4	1.3	1.4	2.0	2.3
Unemployment Rate	8.2	5.1	4.6	4.5	5.1	6.7	4.8	4.6	4.2
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	1.53	2.50	–	1.37	0.97	2.25	3.00	–
$A/US cents :	0.69	0.75	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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