August 2021

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

Our global growth forecast for 2021 is marginally weaker this month –6.2% compared with 6.3%, previously. For 2022 and 2023 we continue to expect growth of 4.6% and 3.5%, respectively. There is an emerging divide between advanced economies (AEs) and emerging markets (EMs). This is in part related to generally higher COVID-19 vaccination rates in AEs. There is a downside to our China forecast following a Delta variant COVID-19 outbreak; mass testing and travel restrictions have been introduced, along with localised measures, but the risk is harsher measures will be needed. This could further disrupt global supply chains – where shortages, combined with rising commodity prices, are flowing through into inflation.

- **Global equity markets** showed considerable divergence in July. The US MSCI index reached another record high in late July, before easing marginally from this peak. In contrast, the equity index for other AEs has drifted lower since late June, while emerging markets (EMs) have fallen more significantly. This largely reflects a sell-off in Chinese equity markets in response to a regulatory crackdown on the technology sector but reports also suggest international investors are increasingly favouring AE equity markets.
- **Commodity prices** have pushed higher once again. In late July, the Refinitiv CoreCommodity CRB Index rose to its highest level since December 2014. This is also being reflected in higher global producer prices, which rose by around 11.3% y/y in June, unchanged from May. Rising producer prices have flowed through into higher **consumer prices** – our global measure rose by 3.9% y/y in June. Given China's critical role in these markets – as the largest consumer of most commodities – the current COVID-19 outbreak in the country presents downside risk to commodity prices in the near term but it could also further disrupt global supply chains.
- Despite the inflationary pressures, the **major AE central banks** appear unlikely to raise policy rates in the near term, with monetary policy adjustments to initially come through adjustments to asset purchases. The Bank of Canada started to taper asset purchases in April, while the US Federal Reserve is expected to start this process in either late-2021 or early-2022. The European Central Bank's Pandemic Emergency Purchase Program is scheduled to end in March 2022, although asset purchases, at least to some degree, will continue beyond this time. In contrast, a few EM central banks (most notably Russia and Brazil) have increased rates – with a further large increase expected in Brazil in August – in response to inflationary pressures.
- **Major advanced economy** GDP growth in Q2 looks to have been strong overall. There was very-to-exceptionally strong growth reported for the UK +4.8% q/q), US (1.6% q/q) and the Euro-zone (2.0% q/q), while we expect growth in Canada to be more moderate and weak in Japan. The differences in large part reflect the timing into and out of COVID restrictions. New COVID cases in the UK have dropped from recent highs, have levelled off in the European Union, but they are still rising rapidly in the US and Japan. So far, there hasn't been a material re-introduction of restrictions in the US, but parts of Japan remain in a 'quasi state-of-emergency'. There have been some restrictions introduced in parts of Europe but their impact appears limited. Business survey readings generally remain at a high level, suggesting the AE recovery is on track. Supply bottlenecks are a factor that has held back growth, but this should turn into a tailwind as they are addressed.
- PMIs for **emerging markets** were mixed in July – with a further easing in the manufacturing measure in contrast with a stronger services reading. Both China and India recorded strong increases in their services measures – however the China reading was ahead of a fresh COVID-19 outbreak in mid-July which could dent the sector. In response, Chinese authorities have introduced mass testing and travel restrictions, along with localised closures of events and businesses, but if harsher restrictions are needed it could slow economic activity. COVID-19 outbreaks have impacted also East Asia. Mobility data show a sharp downturn in movements in Vietnam, Thailand and Indonesia in recent times, as these countries attempt to control spread of the virus.
- Our global forecast for 2021 is only marginally weaker this month – with growth of 6.2% (6.3% previously) due to downgrades to our forecasts for the United States, Japan, the United Kingdom and Canada, marginally offset by an upgrade of our Euro-zone forecast. Our global forecasts for 2022 and 2023 are unchanged (at 4.6% and 3.5% respectively). The aggregate global PMI remained historically strong, albeit a little softer in July. COVID-19 remains the most significant risk to our global outlook, with emerging markets generally more vulnerable to COVID-19 outbreaks than advanced economies, due to typically lower vaccination rates.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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As a result of the ongoing lock down in Sydney and periods of disruption elsewhere, we expect to see a large hit to activity in the September quarter and for the labour market to retrace some of the recent gains. However, we expect that ongoing support from both monetary and fiscal policy will see a rapid rebound, and a catchup for lost growth over 2022. That sees growth of 2.1% during 2021 (around 3.8% in year average terms) and 4.5% in 2022. Alongside this, we see the unemployment rate rising to over 5.5% in the near term but then returning to a path of recovery and ending 2022 at around 4.5% and 2023 around 4%. That said, most of the hit to the labour market will likely be reflected by a large fall in hours worked and rise in underemployment. Our outlook for wages and inflation are broadly unchanged and, in our view, continue to point to the first-rate rise occurring in early 2024 on the back of the RBA's requirement for inflation to be "sustainably" back in the target band. The duration of the current lockdowns remains uncertain and present some downside risk both the magnitude of the decline in activity as well as the timing of the rebound.

- The **RBA maintained its plan to taper the weekly rate of QE purchases** from mid-September despite the likely near-term reversal in the recovery. We see a further $130bn of purchases with a gradual taper profile seeing the program wrapping up in mid-late 2022. On the cash rate we continue to expect lift-off to occur in early 2024. This is consistent with our forecasts for inflation to return to the target band in mid-2023 and the Governor's stated reaction function that the bank will not lift rates until inflation is sustainably in the band.
- The **unemployment rate fell again in June**, by 0.2ppts to 4.9%, which is slightly below the level seen prior to the pandemic. There was a solid increase in employment as well (+29k) following on from May's big increase. We expect some of the recent gains to be reversed as a result of the current lockdowns. The key impacts will come via a large reduction in hours worked (and a rise in underemployment). That said, employment is also likely to fall and result in the unemployment rate rising to just over 5.5%. Beyond the lockdowns, we expect to see the unemployment rate return to its downwards path, reaching around 4% by end 2023.
- **Household consumption will likely see a hit in Q3.** While, retail sales volumes increased by 0.8% q/q in Q2, reversing the fall in Q1, nominal monthly data for June showed a 1.6% fall, driven by a decline in Victoria which saw the most significant restrictions in the month, though QLD and NSW also saw declines. Our measure of cashless retail suggests sales declined by around 3.3% in July. Prior to the recent outbreaks we had been expecting consumption to rotate back towards services spending, though closed borders will likely see an ongoing substitution of spending. Retail sales remain elevated despite the recent fall and we expect them to normalise, though the precise timing remains uncertain – ongoing disruptions to services spending are likely to continue for some time.
- **The NAB Monthly Business Survey showed a further deterioration in both conditions and confidence** in July, with the latter now back in negative territory (-8 index points). The impact of the protracted NSW lockdown was evident with the state leading the declines in both in the month. That said, conditions were weaker across all mainland states in the month. Forward orders declined sharply, and capacity utilisation pulled back further – but it is around average after reaching high levels in mid-2021. While we expect a reopening in the economy to see a rebound in confidence and conditions, the protracted nature and elevated level of uncertainty may see some near-term pull-back in the high level of investment intentions. For now, we expect solid business investment growth to continue in the near term, boosted by tax incentives and to continue growing through the out years of our forecasts. This would see investment lift from its currently low share of GDP.
- **Housing markets remain strong although both price and activity indicators have pulled back somewhat**. The CoreLogic 8-capital city dwelling price index increased 1.6% m/m. This is an annualised rate of over 21% so still high, but it is the lowest month-on-month growth rate since January. We expect house prices to continue to rise through the second half of 2021 and over 2022, but for the pace of growth to slow. On the activity side both lending and building approvals have eased from their high levels but remain elevated. The Homebuilder program has seen a build-up of a large pipeline of work which will see dwelling investment continue to rise into next year. The bring forward of work may see a hole in work done as the pipeline tails off, but this remains highly uncertain with other policy factors also providing support.
- **The Aussie dollar traded slightly lower over the past month to be around US73.5c.** We have slightly revised down our forecasts for the Aussie, particularly in the near term but still expect the AUD/USD to appreciate. We now expect the Aussie to end 2021 at around US78c (previously US83c) before lifting to around US80c over the 2022. The rise in the exchange over the past year has been relatively muted when compared to the sharp rise in commodity prices. The impact of domestic QE, as well as USD strength has weighed. The dollar is currently around 2% higher than its level in mid-October when QE was foreshadowed. The TWI has risen by a smaller 0.5%.
- The duration and magnitude of **current lockdowns remain a significant risk**. We have assumed that NSW gains more control over the virus by the end of Q3, and that lockdowns elsewhere are short-lived – this remains highly uncertain with daily case numbers still high in NSW and a number of other regions now having entered lockdown. The transmissibility of the Delta variant presents a significant risk to gaining control over the virus. The vaccine rollout has continued to roll out and the government has announced a set of thresholds before lockdown strategies will become less prevalent. The timing of when these thresholds will be met also remains uncertain as they depended on both the supply and take-up of vaccines.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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