THE FORWARD VIEW: AUSTRALIA AUGUST 2021

GDP TO FALL BUT RECOVERY WILL RESUME AS LOCKDOWNS END

OVERVIEW

- 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.
- That said, the ongoing support from both fiscal and monetary policy as well as healthy momentum leading into the current lockdowns will likely see a rapid rebound as restrictions are removed. A rapid rebound as well as ongoing strong growth will see the economy catch up over 2022 so that the level of GDP is broadly similar to our previous set of forecasts (by end 2022).
- This implies growth of around 2.1% over 2021, 4.5% over 2022 and a moderation to 2.1% in 2023. On the labour market, we see unemployment rising to just over 5.5% in the near term, before resuming its recovery, ending 2022 at around 4.5% and 2023 closer to 4%.
- Alongside the rapid rebound and following expansion in the economy, we see spare capacity continuing to be eroded over the next couple of years, with wage growth beginning to strengthen and underlying inflation returning to the lower part of the target band by early 2023. This would be the first time inflation has sustainably reached the band in a number of years.
- We see monetary policy remaining exceptionally easy for an extended period, as the RBA waits for hard evidence that inflation has returned sustainably to the target band. However, while we expect the cash rate to remain on hold until early 2024, we expect QE to continue to be tapered gradually – with the program eventually wrapping up in mid-to-late 2022.
- While monetary policy is expected to remain easy, fiscal policy is likely to continue to play a key role in supporting the economy in the near term. The last year has shown how effective direct support to both households and business is, in providing a buffer until restrictions are eased. It is likely the budget will remain in deficit for a significant period, and we do not expect the government will move towards a phase of repair until further significant progress has been made in reaching full employment.
- There remains significant ongoing risks around our forecast. On the activity side, further major outbreaks could weigh on growth and therefore see slower progress on reaching full employment. Further, there is likely to have been some pull-forward of investment in both dwellings and businesses as a result of current fiscal policies. How big and how soon a resulting hole emerges remains uncertain. On the inflation front, the level of full employment remains uncertain as does the pass through of greater wage pressure from margins to output prices.

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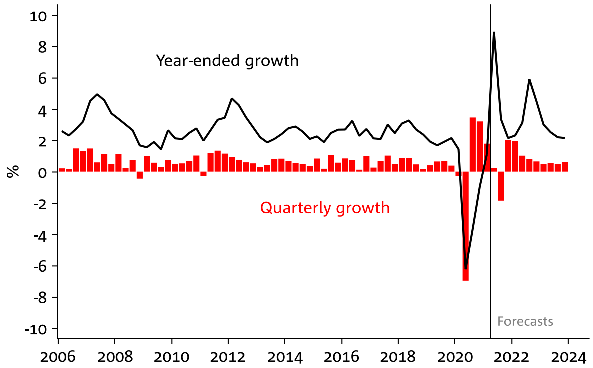
KEY ECONOMIC FORECASTS

	2020	2021-F	2022-F	2023-F
Domestic Demand (a)	-2.5	5.6	4.3	3.1
Real GDP (annual average)	**-2.4**	**3.8**	**3.9**	**2.5**
Real GDP (year-ended to Dec)	**-1.0**	**2.1**	**4.5**	**2.1**
Terms of Trade (a)	-0.5	15.1	1.6	-0.8
Employment (a)	-1.7	3.3	2.9	2.9
Unemployment Rate (b)	6.7	5.5	4.4	4.0
Headline CPI (b)	0.9	2.4	1.6	2.0
Core CPI (b)	1.3	1.7	1.8	2.3
RBA Cash Rate (b)	0.10	0.10	0.10	0.10
$A/US cents (b)	0.77	0.78	0.80	0.75

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

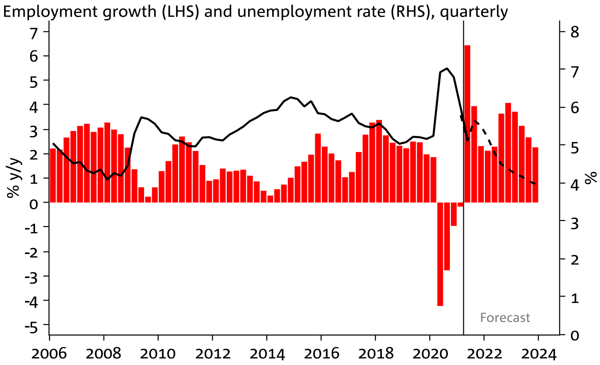
GDP FORECASTS



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 had strong momentum into June but lockdowns will see labour indicators go into reverse.

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. However, while Victoria's unemployment rate also fell (as a fall in employment was offset by a fall in participation), the toll of the lockdown in the first part of the month was evident. Hours worked in Victoria fell 8.4% m/m (compared to a rise for the rest of Australia).

With parts of NSW having been in lockdown since late June, and SE Qld and Victoria currently in lockdown there is likely to be a notable impact on labour market indicators in coming months. While, prone to revision (and not seasonally adjusted) this was the message from the ABS weekly payroll jobs which fell 2.4% in the fortnight to 17 July 2021, and by 4.4% in NSW.

We expect that the main impact of the current lockdowns will be 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. This will enable a modest rise in wage growth, although other factors, such as inflation expectations will also be important.

Retail sales volumes increased by 0.8% q/q in Q2, reversing the fall in Q1. Ahead of the recent lockdowns we had been expecting consumption to rotate back towards services. Consistent with this, the services category Café & restaurant sales volumes again increased strongly (3.9% q/q); a positive sign for overall Q2 consumption.

However, nominal retail sales for June (-1.6% m/m) showed that the quarter ended on a weak note. The decline was largest in Victoria (-4.0% m/m), which had the most days affected by COVID restrictions, but there were also declines elsewhere, including NSW and Queensland. This weakness will intensify in Q3 given current and recent lockdowns. NAB's Cashless Retail indicator points to a large fall in retail sales in July (-3.3% m/m).

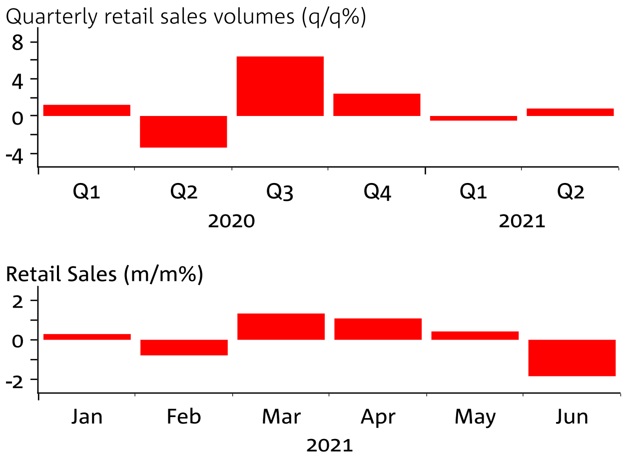
Our broader spending data also shows that lockdowns continue to have a significant impact when in place. Victorian spending recovered quickly following the late May to mid-June lockdown but dipped again on the subsequent one. We expect a bounce back in consumption in Q4 and into next year, assuming that lockdowns outside NSW are short-lived and that NSW restrictions start to gradually ease ahead of Q4.

Fiscal support to households has ramped up with an increase in the size of COVID Disaster Support Payments from 2 August. While it will not prevent a contraction in activity, it should limit its size and facilitate the recovery once restrictions ease. Moreover, the high level of savings since COVID began represents a substantial buffer for the household sector to draw on to support spending.

LABOUR MKT GAINS BEFORE LOCKDOWNS

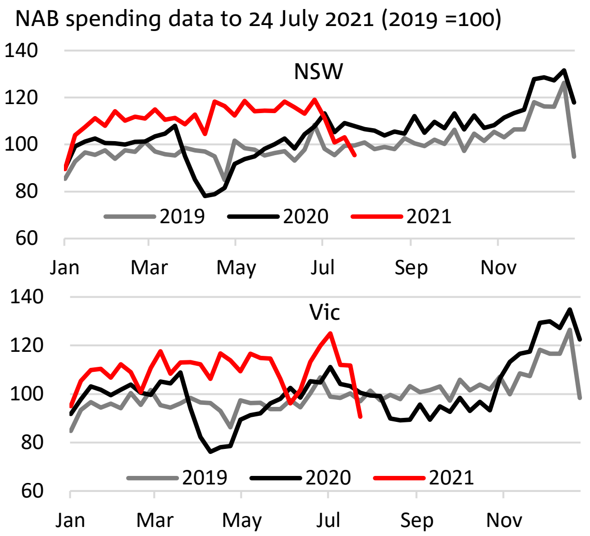
Source: National Australia Bank, Australian Bureau of Statistics

RETAIL SALES UP IN Q2 BUT WEAK AT END



Source: National Australia Bank, Macrobond

LOCKDOWNS: BIG HIT WHILE THEY LAST*



*See NAB Data Insightsfor details

HOUSING AND CONSTRUCTION

Housing markets are still strong but coming off the boil - price growth starting to ease, and building approvals are falling. However, a large pipeline of work and lockdown delays should see investment increase into next year.

Dwelling prices growth was again strong in July, but there are signs it might be decelerating. 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. How much this reflect lockdowns is unclear; growth is unsustainably high and with mortgage interest rates having largely bottomed out and affordability constraints likely starting to bite, we had expected a slowdown in any event. That said, its hard to see lockdowns as being anything other than a headwind while they persist.

New home loans (ex refinancing) fell in June (-1.6% m/m), for the first time since October, ending a period of very rapid growth, even if the level remains very high. The decline largely reflected another fall in loans to owner-occupiers for dwelling construction, but owner-occupier loans for existing dwellings levelled off as well. There is some evidence that the recent and current lockdowns have led to a deferral of sales which may also weigh on new lending in coming months.

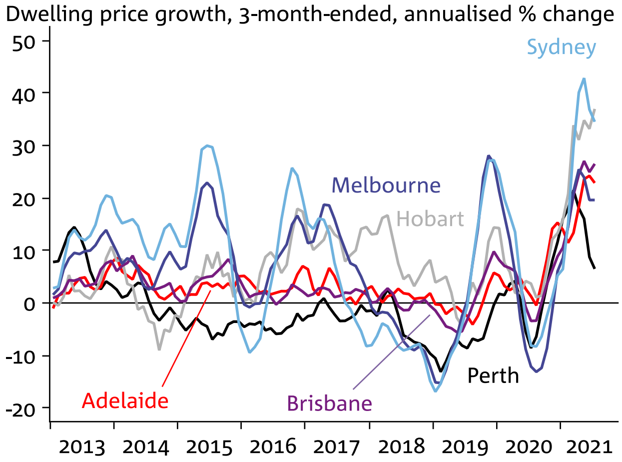
Loans for new dwelling construction have fallen 39% since February reflecting the end of the HomeBuilder scheme (in March) and other state schemes.

The end of Homebuilder can also be seen in building approvals, which fell by 6.7% m/m in June, to be 18% below their March level. The fall has been concentrated in house approvals. Even with this fall off, approvals are still at a reasonably solid level and they are still well above their pre-pandemic level.

The pipeline of work (work yet to be done and work approved but not yet commenced) increased almost 6% between 2020 Q3 and 2021 Q1 and most likely further again in Q2 2021. Low interest rates and (post lockdowns) a continuation of the recovery should also help underpin activity. The lockdowns underway are also likely to delay some construction work into later in the year or the next, particularly in Sydney where there was a two week construction shut down, and work in certain LGAs still remains restricted (and labour issues, resulting from movement restrictions, are affecting other areas as well).

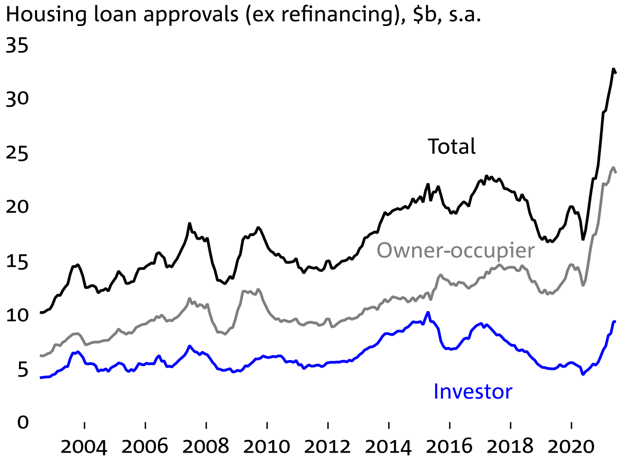
As a result, we expect residential investment to continue growing into 2022, but will come under pressure as the year progress. HomeBuilder and other state government programmes, while they encourage additional work, will have brought some work forward, leading to a dip in activity down the track. This is particularly so given that the lack of any meaningful population growth means that it will be difficult to sustain a high level of residential investment for long.

HOUSE PRICE GROWTH MAY HAVE PEAKED



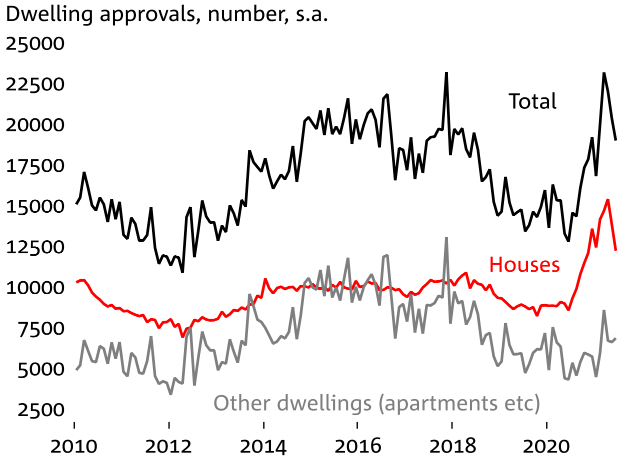
Source: National Australia Bank, CoreLogic

NEW HOME LOANS – ALSO PEAKING?



Source: Macrobond, National Australia Bank

HOMEBUILDER END SEES APPROVALS FALL



Source: Macrobond, National Australia Bank

BUSINESS AND TRADE

The magnitude of current lockdowns will likely see some impact on business investment in the near term, but the underlying strength in the economy will hopefully see strong investment intentions maintained.

That said, the risk of protracted lockdowns and ongoing elevated uncertainty remains. Indeed, 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.

However, the decline in conditions was evident across the mainland and non-mining sector. Conditions generally remain positive across states and industries, despite the pull-back over the past two months, reflecting the solid momentum seen in the survey in early-to-mid 2021.

The decline in forward orders – which are now back in negative territory - points to ongoing weakness in conditions in the near term. The shutdowns have also resulted in a sharp fall in capacity utilisation over the past two months, but it remains around average after reaching very high levels earlier in the year.

Capex which had also been high, pulled back in the month but remains positive. An updated set of investment intentions from both the ABS and NAB Quarterly business survey will be released over the next two months. These are likely to be impacted by current lockdowns but prior to the recent lockdowns the outlook for business investment had brightened significantly. Government tax concessions have been a key support to equipment investment over the past year while investment in non-residential building has been weak. We see solid outcomes for capex over the coming quarters and ongoing growth in the out years of our forecasts. This should see investment rise as a share of GDP from relatively low levels at present.

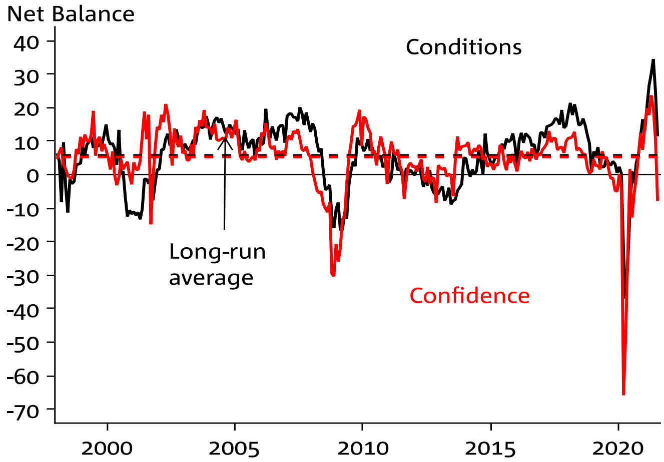
The trade balance widened further in June, reaching a fresh record high at $10.5bn.

Exports rose 4% in the month driven by a rise in both rural (+7%) and non-rural (+2%). Notably, exports of metal ores reached a fresh record high of $18.5bn. Imports rose by a more modest 1% in the quarter, with an increase in capital goods offset by a fall in consumer goods.

The June reading rounds out the trade data for Q2, and in combination with the quarterly trade prices release suggests a large subtraction from net exports in the quarter. While monthly values have risen strongly, prices rose by a very strong 15% in the quarter. A crude seasonal adjustment of this data suggests that net exports will subtract a large 1-1.5ppt from GDP.

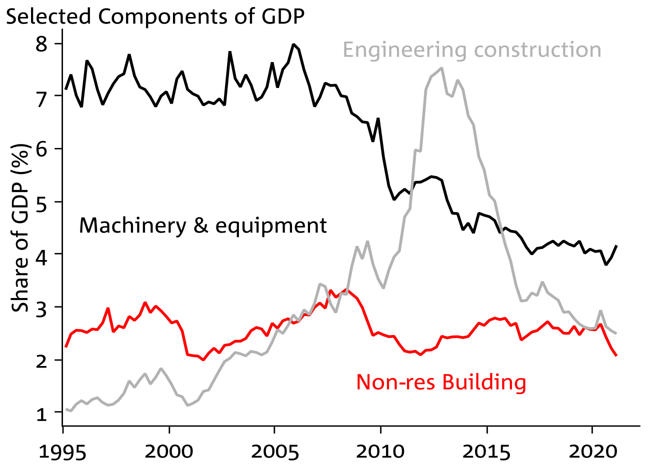
Going forward, we expect net exports to continue to make small subtractions from growth with exports normalising and imports (particularly for services) beginning to recover. However, there remains considerable uncertainty with borders still closed and how quickly confidence in global travel recovers is unclear.

CONFIDENCE AND CONDITIONS HAVE FALLEN



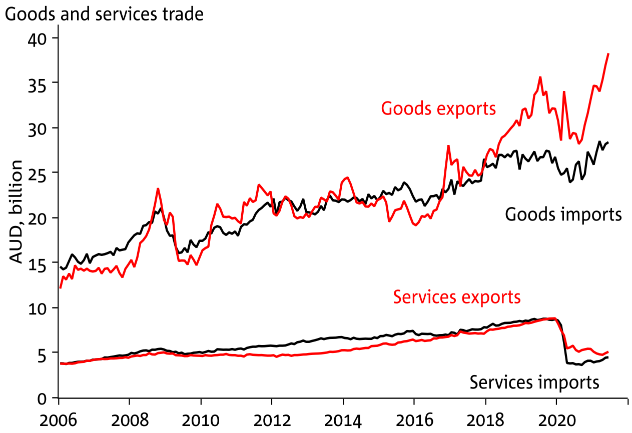
Source: National Australia Bank, National Australia Bank

INVESTMENT IS LOW AS A SHARE OF GDP



Source: National Australia Bank, Australian Bureau of Statistics

TRADE SURPLUS HITS A NEW RECORD



Source: National Australia Bank, Australian Bureau of Statistics

MONETARY POLICY, INFLATION AND FX

The RBA left all policy settings unchanged at the August meeting, including the decision to begin tapering bond purchases under the QE program from mid-September.

While we had expected the RBA to reverse the decision to taper bond purchases – albeit largely a symbolic one – the RBA decided against maintaining purchases with QE not seen as the best tool addressing the current shock.

Alongside, the monthly board meeting the RBA released an updated set of staff forecasts which see a relatively small hit to activity and the labour market in the September quarter and a rapid rebound in subsequent quarters. With a higher starting base than the previous set of forecasts in the May SMP, GDP now reaches a higher level by the end of the forecast period, and inflation and wage growth has been revised up slightly.

While the RBA remains optimistic that the economy will rebound rapidly once current restrictions are eased, guidance on the outlook for rates remains dovish. Inflation is expected to be tracking just above the 2% lower threshold by end-2023 but the post meeting statement continued to suggest that the lift-off for rates would occur in 2024. Further, Governor Lowe noted in the semi-annual parliamentary testimony that the banks reaction function would not likely see rates lifted at the first tick above 2%.

We continue to see a lift-off for rates occurring in early 2024 and for QE to continue to be tapered following the next review in November.

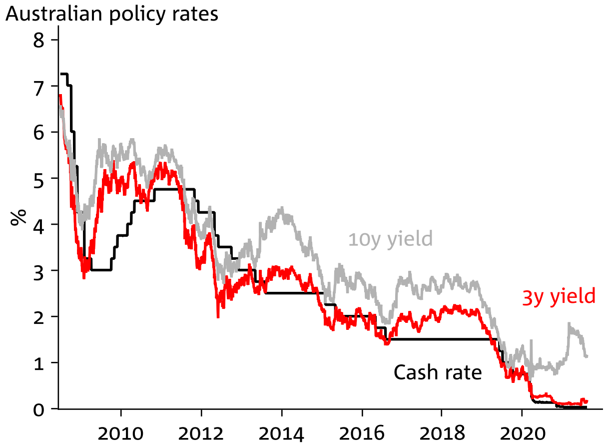
Overall, we expect QE to total around $130bn following the conclusion of the current tranche in September, with the program winding up in mid-to-late 2022.

On our forecasts we have core inflation returning to the RBA's target band by mid 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 should the economy continue to surprise strongly to the upside but based on our central scenario it remains more likely for the first hike to occur in 2024.

The Aussie traded slightly lower over the past month to be around US73.5c.

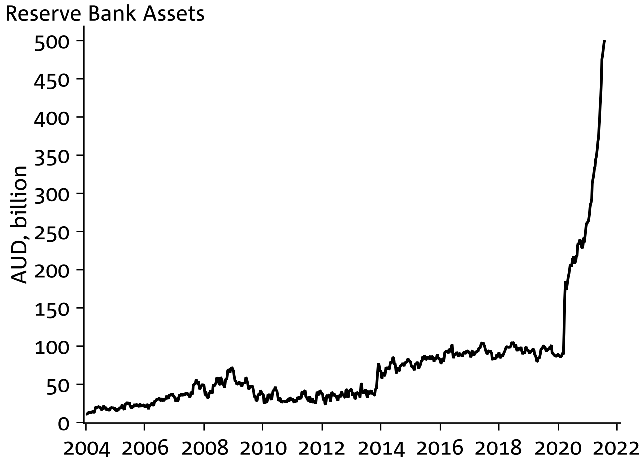
We have slightly revised down our forecasts for the Aussie, particularly in the near term but still expect the AUD/USD to appreciate. We now expect the Aussie to end 2021 at around US78c (previously US83c) before lifting to around US80c over the 2022. The rise in the Aussie over the past year has been 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%.

INTEREST RATES TO REMAIN LOW



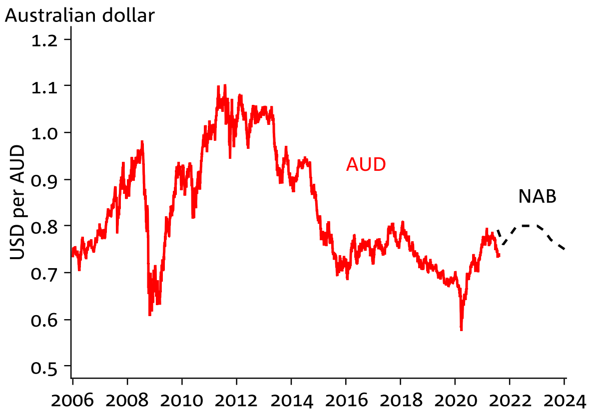
Source: Reserve Bank of Australia, Macrobond Financial AB

QE EXPECTED TO TAPER FROM HERE



Source: National Australia Bank, Reserve Bank of Australia

A SLIGHTLY SOFTER OUTLOOK FOR THE AUD



Source: National Australia Bank, Macrobond Financial AB

RISKS TO THE OUTLOOK

There are a number of risks relating to COVID which have the potential to materially shift the economic outlook, both short-term and over time.

There is uncertainty around how long the current lockdowns will last. We assume that current lockdowns, other than in NSW, are short-lived and that NSW's restrictions start to gradually ease ahead of Q4. While the prior experience has been that lockdowns will ultimately return cases to near zero, whether this is still the case given more transmissible variants (Delta) is unclear, particularly for a large outbreak such as in Sydney. There is also still a risk of future lockdowns. In this environment, even short-lived lockdowns may have an enduring impact as decisions are deferred (e.g. such as plans for interstate travel) till things settle down. This risk seems weighted to the downside.

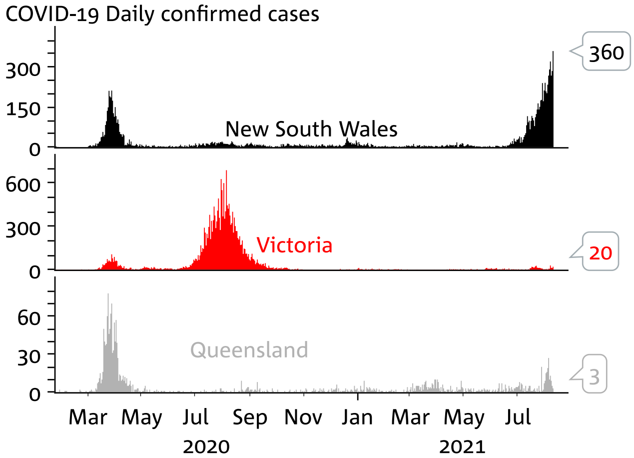
National Cabinet has agreed to vaccination thresholds for the transition to living with the virus. A 70% adult vaccination rate is needed for fewer lockdowns, a restoration of the inbound passenger cap to previous levels and only 'low level' ongoing restrictions. At 80% there should only be 'highly targeted' lockdowns and an easing of international border restrictions. The Government's COVID Shield plan sees these vaccination targets being reached by November and December respectively. There is upside and downside risk around this. It is plausible that it could be sooner (October/November) assuming a high vaccine uptake. A downside risk would emerge If there were a high level of vaccine hesitancy.

Even when these vaccination targets are met, there is the risk that the agreed settings will not hold. Overseas experience is that even highly vaccinated populations can see high levels of case numbers. While vaccines should limit the health implications of this, modelling by the Doherty Institute suggests that with 80% vaccination of those aged 16+ there could be over 2000 deaths. If this were to eventuate, there is a risk that the planned policy approach at 80% adult vaccination would change, representing a downside risk. Similarly, if it were determined booster shots were needed then the possible timing of when lockdowns are behind us could shift out.

COVID is not the only risk to the outlook. For housing construction, the degree to which HomeBuilder has simply pulled forward activity (leading to a future hole) is unclear and it might be greater or smaller than expected.

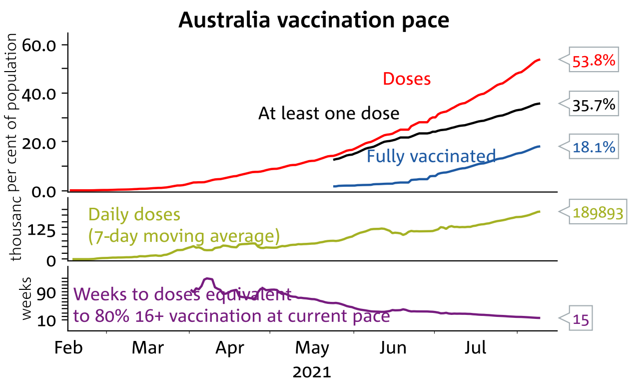
Longer term a more consequential consideration is population growth. We expect that population growth will eventually return to around its previous growth rate. However, this might settle at a lower level (downside risk). Alternatively, it may be that migration plans have just been deferred, and that there is a bounce back (with a temporary high spike).

CURRENT LOCKDOWNS – HOW LONG?



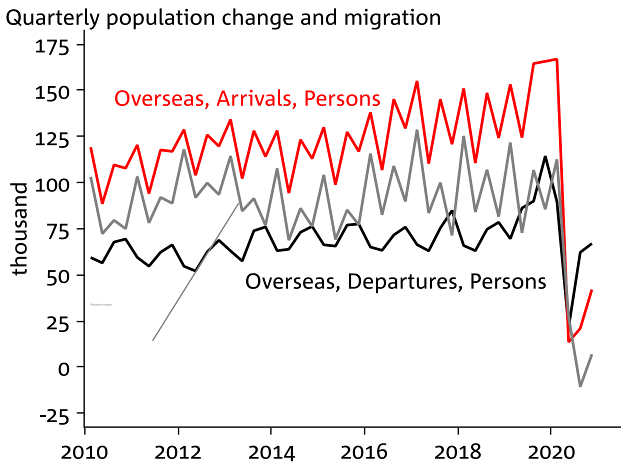
Source: National Australia Bank, Australian Department of Health

VACCINATION ROLL OUT



Source: National Australia Bank, Our World in Data

WILL POPULATION GROWTH BOUNCE BACK?



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	1.0	1.7	4.7	1.2	-5.8	4.4	3.6	3.3
Dwelling Investment	-8.1	4.7	10.3	-5.4	-7.1	-5.2	13.8	1.8	-8.7
Underlying Business Investment	-2.8	-3.1	9.4	9.9	-2.2	-5.7	5.7	9.8	7.4
Underlying Public Final Demand	5.7	5.6	3.9	2.8	5.5	6.0	4.4	3.4	2.4
Domestic Demand	**-1.0**	**2.3**	**4.0**	**4.4**	**1.2**	**-2.5**	**5.6**	**4.3**	**3.1**
Stocks (b)	-0.3	0.6	-0.4	0.1	-0.3	-0.1	0.3	0.1	-0.2
GNE	**-1.3**	**3.0**	**3.7**	**4.5**	**0.9**	**-2.6**	**5.9**	**4.4**	**3.0**
Exports	-1.8	-8.8	2.2	2.6	3.3	-10.0	-1.3	2.9	1.9
Imports	-7.5	-2.4	7.9	4.8	-1.0	-13.2	9.7	5.2	4.4
GDP	**-0.2**	**1.2**	**2.7**	**4.0**	**1.9**	**-2.4**	**3.8**	**3.9**	**2.5**
Nominal GDP	1.6	3.4	6.0	5.6	5.4	-1.7	7.7	6.1	4.1
Current Account Balance ($b)	-36	-59	-70	-63	14	50	67	68	59
(%) of GDP	-1.8	-2.9	-3.2	-2.7	0.7	2.5	3.2	3.0	2.5
Employment	0.2	1.1	2.4	3.6	2.3	-1.7	3.3	2.9	2.9
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	3.8	1.7	1.6	1.8	0.9	2.4	1.6	2.1
Core CPI	1.2	1.7	1.6	1.8	1.4	1.3	1.7	1.6	2.3
Unemployment Rate	8.2	5.1	4.8	4.2	5.1	6.7	5.5	4.4	4.0
RBA Cash Rate	0.25	0.10	0.10	0.10	0.75	0.10	0.10	0.10	0.10
$A/US cents :	0.69	0.75	0.80	0.77	0.70	0.77	0.78	0.80	0.75
$A - Trade Weighted Index	60.0	62.7	63.4	61.9	60.3	63.4	62.5	63.7	60.6

(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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