September 2021

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

Growth was strong in both advanced economies and emerging markets in Q2 2021 but appears to have slowed in Q3 – in large part reflecting the impact of COVID-19 restrictions (particularly in China). COVID-19 remains the main risk to the global economic outlook, with emerging market economies more exposed, due to their typically lower vaccination rates, than advanced economies. Inflationary pressures have increased globally since late 2020 – in part due to supply chain disruptions, shortages of key inputs and rising commodity prices. This is also acting as a brake on the recovery. Overall, we have revised down our global forecast to 6.0% for 2021 (from 6.2%) while our forecast for 2022 is unchanged at 4.6%.

- **Financial conditions remain broadly positive.** Bloomberg Financial Conditions Indices (covering a range of advanced economies) have remained strongly positive since November 2020, in part reflecting the policy support from central banks. Trends in global equity markets remained divergent in August. US equity markets (US MSCI index) rose to fresh highs in early September while other AE equity markets have broadly tracked sideways since July, while EM equity markets remain below their peaks recorded in mid-February despite some recent improvement.
- **Inflationary pressures** have increased globally since late 2020 – as supply chain disruptions, shortages of key inputs and rising commodity prices flowed through into higher producer prices and then into consumer prices. Although some of the pressure is from transitory factors, such as the temporary shortages of semi-conductors, they may take some time to resolve. Our estimate of global consumer prices rose by 3.8% yoy in July (only down slightly from 3.9% yoy in June) while producer price inflation accelerated in July.
- **Central banks** have generally kept policy rates low since the start of the pandemic and a broad range have implemented unconventional measures. Some emerging market central banks have raised rates recently – including Brazil, Russia and Mexico – but they remain below pre-pandemic levels. Tapering and, in most cases, eventually ceasing asset purchases, will be the first stage towards normalising monetary policy. Some advanced economy central banks (such as the Bank of Canada) have already started to taper asset purchases, with the Fed expected to follow soon. However, it is likely to be some time before the major central banks lift policy rates.
- Global **commodity prices** have continued to trend higher, albeit the rate of increase appears to be slowing and there has been greater volatility in recent weeks – partially reflecting uncertainty around demand due to China's recent COVID-19 outbreak.
- **Major advanced economy** GDP grew strongly in Q2 (1.8% q/q), but with large differences across countries. We expect growth to slow from here but still be strong in H2 2021; however, ongoing supply disruptions and high COVID-19 case numbers point to the risk that some of the forecast growth may be delayed. On the positive side, it appears the most recent COVID-19 wave may have peaked in the major AEs. Q2 growth was strongest in the UK (4.8% q/q), the Euro-zone (2.2% q/q) and the United States (1.6% q/q), largely driven by the easing of COVID-19 activity restrictions and US fiscal stimulus. Growth in Japan was more modest as on-and-off again states of emergency have held the economy back. Canada, where GDP declined -0.3%q/q, also had lockdowns in March/April with a staggered re-opening from late May.
- **Emerging markets (EM)** grew strongly in Q2 2021. Q2 growth of 3.0% which was notably higher than the 0.2% q/q outcome in Q1 was largely driven by China. This strength appears unlikely to continue into Q3. Purchasing manager indices for both manufacturing and services measures are down from recent peaks. The EM manufacturing PMI (including for China) was slightly contractionary in August at 49.6 points. The downturn in the EM services PMI was larger – down to 50.1 points (from 52.9 points in July). China's outcome was particularly negative in August – in response to restrictions introduced to control its recent COVID-19 outbreak – while Brazil was moderately negative.
- We have revised down our forecast for **global economic growth** in 2021 – driven largely by a weaker outlook for the China and India, along with a softer outlook for the United States. Chinese authorities imposed restrictions to control the spread of COVID-19 in mid-July, resulting in a slowdown in industrial production and retail sales. We have revised growth for China to 8.7% in 2021 (9.5% previously). India also recorded weaker than anticipated growth in Q2 2021, due to COVID-19 restrictions. Overall, we have revised down our global forecast to 6.0% for 2021 (from 6.2% in August). Our forecast for 2022 is unchanged at 4.6% and we continue to anticipate global growth easing to its long-term average of 3.5% in 2023.
- 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 downs in Sydney and Melbourne, together with periods of disruption elsewhere, we expect to see a large hit to activity in the September quarter (down -3.5% in Q3 with only a moderate recovery of around 2% into Q4). This implies growth of around 0.8% over 2021, 4.3% over 2022 (the bulk of the rebound) and 2.0% over 2023. The labour market is set to retrace some of its recent gains, although hours worked rather than unemployment will be a better reflection of lockdown impacts. The near-term disruption sees the unemployment rate rise to around 5.2% in late 2021, before resuming its downward trend – reaching 4.4% by end 2022 and 4.0% by end 2023. The dip in activity sees an even longer period of spare capacity persist in the economy, and the partial reversal of recent labour market gains will delay the pickup in wage growth. For policy, expectations of a healthy activity rebound but gradual pickup in inflation sees us still comfortable with a 2024 lift-off for rates. The key risks to our forecasts remain the timing and pace of the easing in restrictions, and further out, the underlying pace of growth as the impact of policy measures fades.

- The **labour market continued to deteriorate in August with a sharp fall in hours worked (-3.7%) and employment (-146k) alongside a decline in the participation rate.** We expect further deterioration with the unemployment rate to peak at over 5.2% in the near term and a large decline in hours worked in Q3. Still, the strength of the labour market in prior months may mitigate some impacts. When activity rebounds, we expect the unemployment rate to resume its prior trajectory, falling to near 4.0% by end 2023.
- **Household consumption patterns continue to see disruption** with the pandemic continuing to weigh on spending. The Q2 accounts data showed increases in goods and services spending, but both are likely to fall in Q3. Nominal monthly retail trade data showed a 2.7% fall in July with the decline concentrated in NSW, and our measures of cashless retail sales point to a similar sized fall in August. We see household consumption rebounding when restrictions are eased, but there are likely to be slightly different dynamics this time around. We may well see less pent-up demand as well as some caution as the economy reopens.
- **Housing markets are still strong, but house price growth and sales volumes are easing.** Dwelling prices were up 1.5% m/m in August and 17.5% over the year with little apparent impact from lockdowns. However, the pace of growth is slowing as the boost from higher household income and falls in mortgage interest rates fades, and the numbers of advertised properties and home sales have fallen. Forward indicators of dwelling investment are also down, including loans for new dwelling construction and building approvals. We still expect the large pipeline of work to see dwelling investment to grow over coming quarters, but at a more modest pace than over the past year.
- **Businesses continue to be impacted by lockdowns, but there are signs of some resilience** and investment intentions remain healthy. The NAB Monthly Business Survey showed a rebound in conditions in August, led by NSW and SA, with conditions generally holding up better than in during the lockdowns imposed in 2020. Confidence also improved slightly, although it remains well into negative territory, and forward orders saw a significant improvement in the month. Business investment rose in Q2, and despite ongoing uncertainty around the timing and pace of easing of restrictions, the forward-looking ABS Capex Survey suggests there is still a healthy outlook for investment over the next year.
- As expected, **the RBA this month carried out its planned tapering of weekly QE purchases**, while the cash rate remained unchanged. However, the weekly rate of purchases will now be reviewed in February, rather than November as previously outlined. This sees a relatively large tranche of bond purchases, totalling ~$85bn to mid-February. The RBA expects a rapid rebound in activity once lockdowns end, but its central scenario for inflation continues to see the first rate hike in 2024 and the Governor continues to reiterate that the decision to lift rates will be dependent on actual inflation outcomes, with inflation having to be near the middle of the band for some time and an outlook that sees inflation maintained around that pace. In our view, we do not see these conditions being met until early 2024, with the now longer period of spare capacity balancing the risk around our prior outlook.
- **The Aussie dollar traded into the US71c range in mid-to-late August,** around the same level as a month ago and slightly higher than at the time of the announcement of QE in late 2020. Our forecasts for the Aussie are unchanged this month and we continue to expect the pair to appreciate over the second half of 2021, reaching around US80c by early 2022 and staying around that level for the duration of the calendar year. Over 2023 we expect a pull-back to around US75c. We see the strength in the terms of trade as the support to the Aussie over the next year, before both rates and the terms of trade normalise over coming years.
- The **major risks to the outlook continue to relate to COVID-19**. These include the timing and pace of the easing of restrictions in NSW, Victoria and the ACT, the risk of restrictions in other jurisdictions, as well as how the pandemic, policy responses, and behaviour evolve once lockdowns are no longer the primary policy response to transmission. Vaccination targets appear to be on track for late October (70%) and mid-November (80%), and governments have begun to outline what will be possible when they are met, but considerable uncertainty remains. Another question is around the impact on the economy as assistance measures are withdrawn. Further out, the underlying pace of growth also remains uncertain.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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