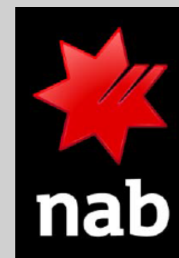
Embargoed until: 11:30am Wednesday 15 September 2021

THE FORWARD VIEW: AUSTRALIA SEPTEMBER 2021



A NEAR TERM HIT TO GDP BEFORE THE RECOVERY CONTINUES

OVERVIEW

- 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). That is very much consistent with falls of around 20% since June in our internal consumption data. The labour market is set to retrace some of its recent gains, with hours worked rather than unemployment a better reflection of the current lockdown impacts.
- This implies growth of around 0.8% over 2021, 4.3% over 2022 (the bulk of the rebound) and 2.0% over 2023. The near-term disruption also 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.
- At a headline level, the Q2 accounts, which largely preceded the current lockdowns, showed a healthy outturn for the economy after the pre-COVID level of GDP was reached in Q1 – leaving GDP around 1.6% higher than in Q4 2019. Services consumption continued to recover, though at a slower pace, while the impact of policy was evident in several areas.
- Business investment saw another solid outturn, while dwelling construction saw further gains as the HomeBuilder pipeline is worked through. Government spending also remains important – with investment in infrastructure, both state and federal, an important boost. Government consumption will also likely be supported by the ongoing vaccine rollout.
- While a true read of the underlying pace of inflation will be difficult over the next year or so, with both transitory and policy driven impacts continuing to play out, the dip in activity sees an even longer period of spare capacity persist in the economy. The partial reversal of recent labour market gains will delay the pickup in wage growth. For policy, expectations healthy activity rebound but gradual pickup in inflation sees us still comfortable with a 2024 lift-off for rates. We continue to see QE tapered from February 2022, likely at a more aggressive pace than previously expected but still seeing a total of around $130bn of purchases from here.
- In our view, the key risks to our forecasts are the timing and pace of the easing in restrictions, determining the initial bounce in activity and pace of recovery. Further out, the underlying pace of growth also remains uncertain. While policy is expected to remain supportive for some time, the impacts of HomeBuilder and the instant asset write-off will wane over time, and potentially see activity weaken more than expected.

CONTENTS

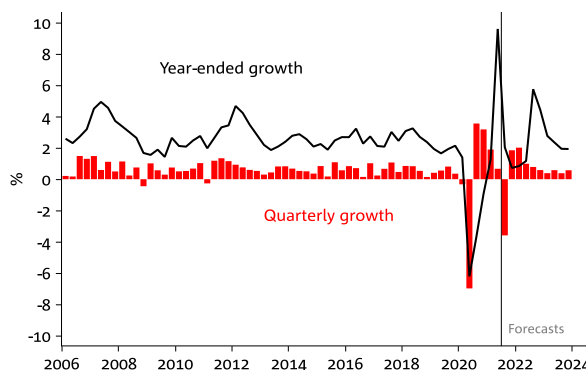
OVERVIEW 1
LABOUR MARKET, WAGES AND CONSUMER 2
HOUSING AND CONSTRUCTION 3
BUSINESS AND TRADE 4
MONETARY POLICY, INFLATION AND FX 5
RISKS TO THE OUTLOOK 6
DETAILED FORECAST TABLE 7

KEY ECONOMIC FORECASTS

	2020	2021-F	2022-F	2023-F
Domestic Demand (a)	-2.6	4.7	2.8	2.9
Real GDP (annual average)	**-2.4**	**3.3**	**2.9**	**2.3**
Real GDP (year-ended to Dec)	**-0.9**	**0.8**	**4.3**	**2.0**
Terms of Trade (a)	-0.6	20.6	3.6	-0.8
Employment (a)	-1.7	3.3	1.2	1.9
Unemployment Rate (b)	6.7	5.2	4.4	4.0
Headline CPI (b)	0.9	2.5	1.7	2.0
Core CPI (b)	1.3	1.8	1.8	2.2
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

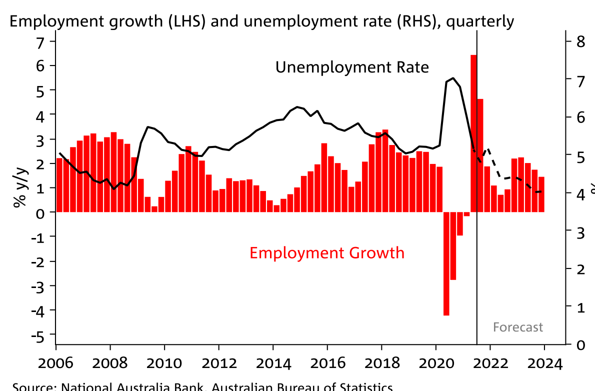
GDP FORECASTS



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

Gareth Spence, Senior Economist | Antony Kelly, Senior Economist | Alan Oster, Chief Economist

© National Australia Bank Limited ABN 12 004 044 937 AFSL and Australian Credit Licence 230686

LABOUR MARKET, WAGES AND CONSUMER

The labour market saw some signs of deterioration in July with participation falling and underemployment rising alongside a fall in hours worked – though the survey reference period likely avoided the major impacts of lockdowns.

That said, the labour market enters the current period of turbulence in a relatively healthy position. Though the 0.3ppt decline in unemployment was a result of declining participation rather than strong employment growth (with employment only increasing 2.2k in the month), even prior to this it had fallen to its lowest level in over a decade.

In the near term, we expect a deterioration in the labour market, driven by a pull-back in NSW and Vic. While interpreting measured unemployment will again be difficult, with a likely fall in participation masking some of the expected increase, we expect the unemployment rate to peak at over 5.2% in the near term. More importantly, the true hit to the labour market will be better reflected in hours worked – which will see a large decline in Q3.

Some of the potential impact on employment is likely to be mitigated by current high levels of job vacancies and the incentive for firms to try and retain staff given their recent difficulties in rehiring workers. When activity rebounds, we expect the labour market to also rebound and for the unemployment rate to resume its prior trajectory. We see the unemployment rate falling to around 4.5% by end 2022 and to near 4.0% by end 2023.

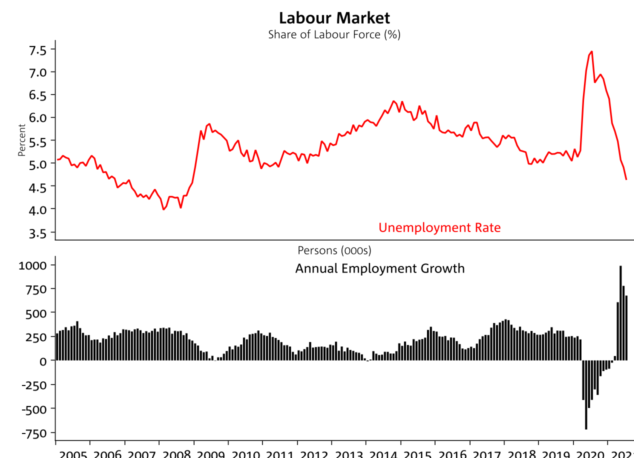
Household consumption patterns continue to see ongoing disruption with the pandemic continuing to weigh on services spending, while retail sales looks to have declined in the first two months of Q3.

The Q2 accounts data showed that alongside a bounce back in goods spending, spending on services continued to recover but remained low across several categories. Spending on travel and hotels, cafes & restaurants saw notable gains, but remained 68% and 18% below their pre-COVID levels respectively.

Q3 will likely see a fall in both goods and services spending with lockdowns having the biggest impact on the household sector. Indeed, nominal monthly retail trade data showed a 2.7% fall in July, driven by large declines in clothing & footwear, department stores and cafes & takeaway. The declines were concentrated in NSW as the lockdowns persisted, though SA also saw a notable decline and QLD was lower. Our measures of cashless retail sales points to a further large fall in August.

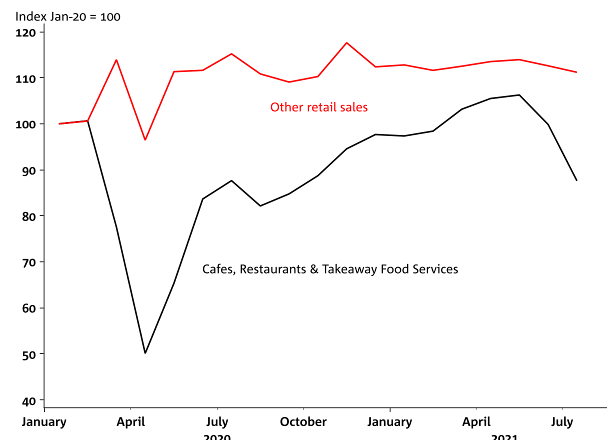
The national accounts also showed a further decline in the savings rate in Q2 as income growth levelled off. This is consistent with a further normalisation of consumption patterns, albeit one that is incomplete. We see household consumption rebounding when restrictions are eased, but there are likely 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.

LABOUR MKT GAINS BEFORE LOCKDOWNS



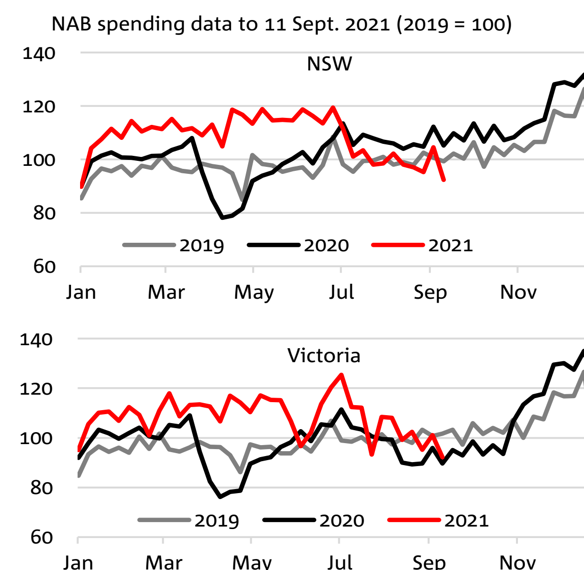
Source: National Australia Bank, Macrobond

RETAIL SALES FALLING IN Q3



Source: National Australia Bank, Australian Bureau of Statistics

LOCKDOWNS: BIG HIT WHILE THEY LAST*



*See NAB Data Insights for details

HOUSING AND CONSTRUCTION

Housing markets are still strong, but house price growth is easing, as are sales (with lockdowns a short-term negative as well), and building approvals are falling.

Dwelling prices continued to grow strongly in August, up 1.5% m/m and 17.5% over the year. The pace of growth has, however, been slowing. This likely reflects a fading boost from the spike in household income and falls in mortgage interest rates last year, as well as affordability constraints. The lockdowns in NSW and Victoria appear to have had little impact on prices.

At the same time, measures of activity in the secondary market have weakened. CoreLogic reports that the number of newly advertised properties has gone from well above its five-year average in May to below it, and home sales have fallen.

New home loans (ex refinancing) are an indirect guide to secondary market turnover and, even ahead of recent lockdowns, pointed to turnover peaking (noting that the latest data for July likely reflect applications in prior months). While the value of new home loans rose slightly in July (+0.2%m/m) they are still down from their May level. While the decline is driven by falls in loans to owner-occupiers for dwelling construction, even abstracting from this growth has slowed appreciably.

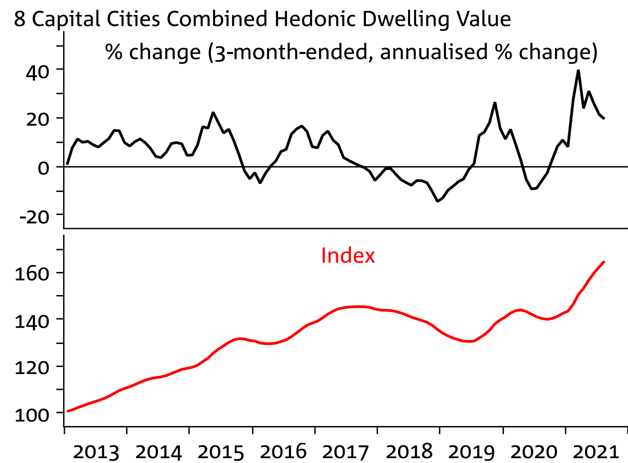
The house finance data, and the impact of lockdowns on sales, suggests that growth in ownership transfer costs – which have contributed 0.2ppts to quarterly GDP growth in each of the last three quarters – will be much weaker in the Q3 accounts.

Dwelling investment rose 1.7% q/q in Q2 – its fourth consecutive increase – to be 15.7% higher over the year. The rise was driven by an increase in both renovations (+1.9%) and new construction (+1.6%).

Forward indicators of dwelling investment are, however, now falling. Loans to owner-occupiers for new dwelling construction has been falling since February; in July it was 42% below its February level. This points to further falls in building approvals for detached houses, which have declined 24% since April. In large part these falls reflect the end to the HomeBuilder scheme. However, the scheme ended in March, so the ongoing declines indicates support for dwelling investment from other factors (lower rates, higher household incomes and a more work-from-home induced shift in spending towards housing) may also be fading.

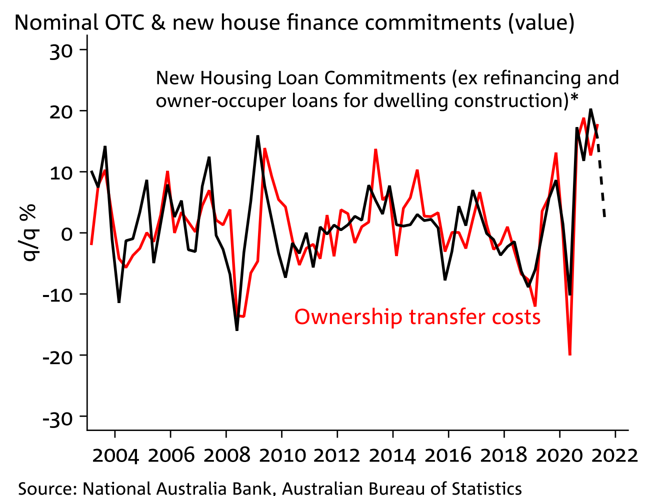
Nevertheless, we still expect dwelling investment to grow over coming quarters, albeit at a more modest pace than over the last year. This reflects the large pipeline of work (for detached houses) in place and reported capacity constraints by builders which could drag this work out over a longer period of time than normal. Lockdown impacts on construction, particularly in Sydney, will add to this dynamic (but introduce some downside risk to Q3).

HOUSE PRICES STILL GROWING STRONGLY



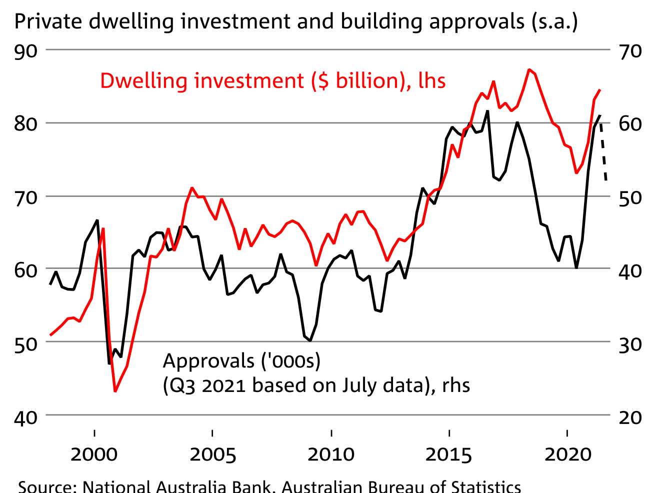
Source: National Australia Bank, CoreLogic

NEW HOME LOANS – ALSO PEAKING?



Source: National Australia Bank, Australian Bureau of Statistics

HOMEBUILDER END SEES APPROVALS FALL



Source: National Australia Bank, Australian Bureau of Statistics

BUSINESS AND TRADE

Business investment saw a relatively healthy outturn in the June quarter, while investment intentions in the ABS capex survey remained healthy.

The national accounts showed a 2.4% rise machinery & equipment in Q2 which is now up 7.8% since Q4 2019 – a very strong rate of growth considering that this component had been very soft prior to the pandemic, with the non-mining sector yet to lift following the end of the mining boom. This outcome likely reflects the ongoing support from budget measures including the government's instant asset write-off. However, non-dwelling construction also saw a rebound from last quarter's fall, while the smaller components of business investment – R&D and mining exploration – also saw healthy rises. These data in large part precede the current lockdowns, though the ABS Capex Survey which is forward looking, suggests there is still a healthy outlook for investment over the next year.

Indeed, the NAB Monthly business survey showed a rebound in both confidence and conditions in August and has showed less of an impact from the current lockdowns than in early 2020. Conditions rebounded in both NSW and SA in the month – following the sharp declines in July. Confidence improved slightly, but remains well into negative territory, reflecting the ongoing uncertainty in the economy around the timing and pace of easing in restrictions. That said, forward orders saw a significant improvement in the month, and are back above average – pointing to a solid pipeline of work for now.

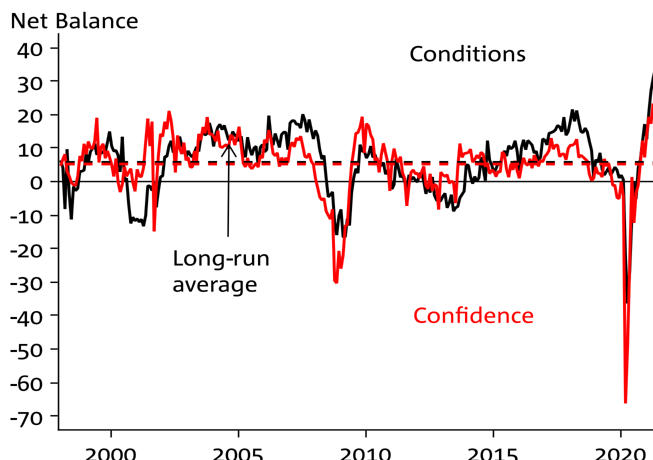
The survey has pulled back from the high levels seen in early 2021 but has generally held up better than early 2020. While the current lockdowns are less widespread, conditions in Victoria and NSW remain well above average and confidence has not deteriorated to the extent seen in 2020. That said, capacity utilisation has pulled back from the high levels seen in May and is now below average but well above the level seen last year.

Net exports made a notable subtraction from GDP in Q2 but is expected to rebound in Q3.

We expect the hit to resource exports (and the volatile non-monetary gold component) to reverse in Q3, and for imports to continue to grow modestly. Indeed, monthly trade data for July (in nominal terms) saw another record trade surplus – exports rose 5%, more than offsetting a 3% increase in imports. Goods exports – both rural and non-rural – drove the pickup in the month while intermediate goods imports was the key driver on the imports side.

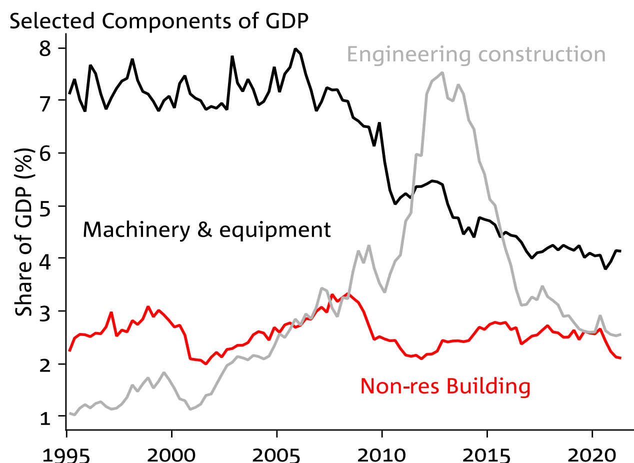
The composition of trade is likely to remain heavily impacted by closed international borders in the near-term. Services exports – both tourism and education related – continue to see disruption. Education (travel services) will likely continue to decline for some time, with students continuing to leave once courses end and are not replaced by new enrolments.

CONFIDENCE AND CONDITIONS TICK UP



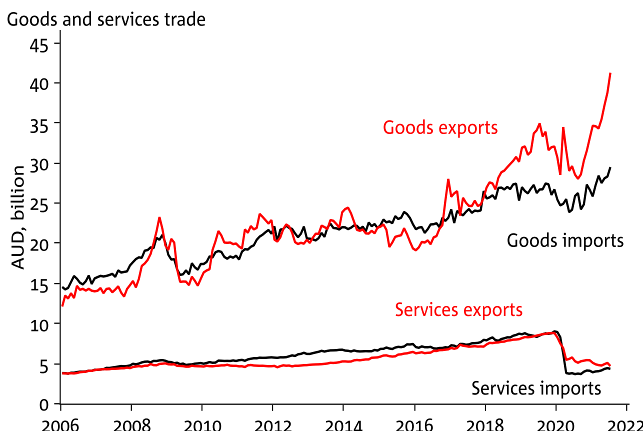
Source: National Australia Bank, National Australia Bank

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

As we had expected, this month the RBA carried out its planned tapering of weekly purchases to $4bn a week from $5bn. 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 purchases of ~$85bn to mid-February. Other policy settings – the cash rate target and YCC – were left unchanged.

The post meeting statement, while acknowledging the large hit to activity in Q3, remained upbeat about the economy in the medium term. The RBA expects another rapid rebound in activity with the Q2 2021 level of GDP recovered by Q2 2022.

The RBA's central scenario for inflation continues to see the first rate hike in 2024. More importantly, however, 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 with an outlook that sees inflation sustained within the target range. This condition will not be met when inflation first ticks over 2%.

We expect QE to be tapered further in February, and for the program to wind up around mid-2022. We continue to see the cash rate on hold until early 2024 based on our inflation forecasts.

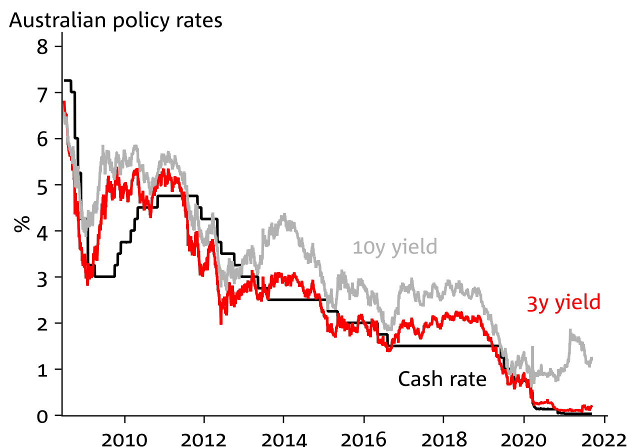
That said, if the economy rebounds as quickly as expected, it could well be that QE is tapered more aggressively from we had expected – but combined with a higher purchases rate in the interim still seeing around $130bn of purchases from here.

While we expect a rapid rebound in activity the near-term fall and then recovery sees an even longer period of spare capacity in the economy, and the unemployment rate above 5%. We see inflation "sustainably" at target in 2024 – according to the RBAs current guidance. From there, we see a constant normalisation of policy with the cash rate target set at around 2% by the end of 2025. It is important to note that financial conditions will tighten a little ahead of this, as the yield curve will steepen as RBA holdings of bonds mature.

The AUD/USD traded into the US71c range in mid-to-late August. This is broadly around the same level as a month ago and remains slightly higher than at the time of the announcement of QE in late 2020. The TWI was unchanged over the month.

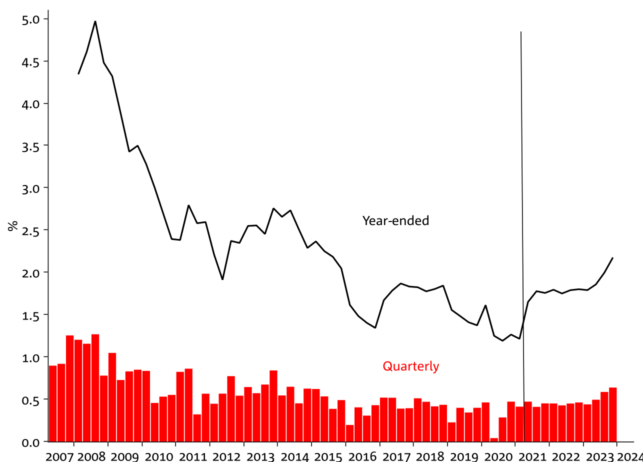
Our forecasts for the Aussie are unchanged this month and we continue to expect the pair to appreciate over the second half of 2021, reaching around US80c by early 2022 and staying around that level for the duration of the calendar year. Over 2023 we expect a pull-back to around US75c. We see the strength in the terms of trade (which is at a very high level) as the support to the Aussie over the next year, before both rates and the terms of trade normalise over coming years.

CASH RATE ON HOLD UNTIL 2024



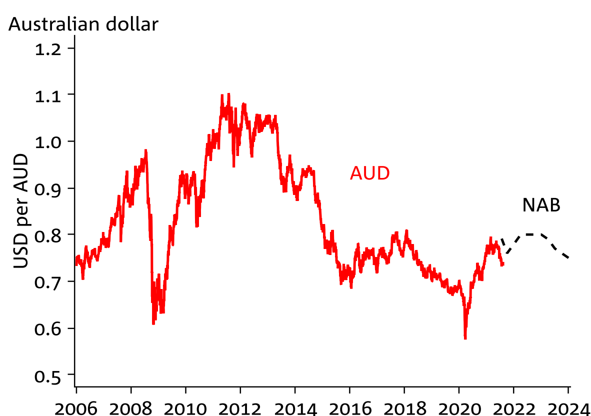
Source: Reserve Bank of Australia, Macrobond Financial AB

CORE INFLATION TO BUIILD OVER TIME



Source: National Australia Bank, <Property Source not found.>

THE AUD TO APPRECIATE FROM HERE



Source: National Australia Bank, Macrobond Financial AB

RISKS TO THE OUTLOOK

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, what happens to the rate of transmission of the virus (and hospitalisations) when lockdowns are no longer the preferred policy tool - and how individuals and governments respond to changes in case numbers - and the impact of policy supports.

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. These targets appear to be on track for late October (70%) and mid-November (80%) but it could be sooner or later.

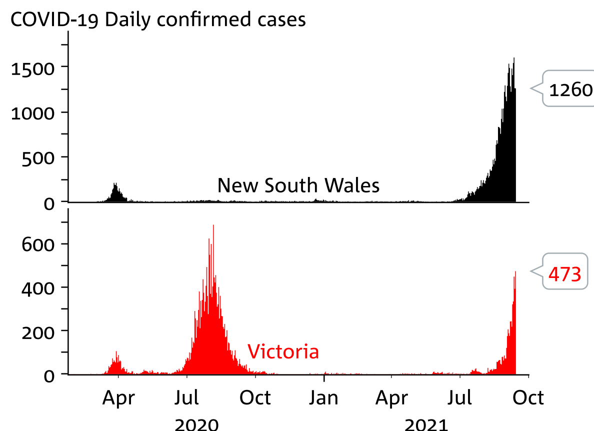
State governments are starting to put some flesh around what this entails. NSW has released a roadmap that sees a partial re-opening (including of hospitality and retail but only accessible by fully vaccinated individuals) when 70% of the 16+ population is fully vaccinated with additional easing at 80%. Victoria has already flagged some easing of restrictions – mainly around social contact - when 70% of the population has at least one dose. A more detailed blueprint is expected soon.

However, there is considerable uncertainty around what will happen to the spread of the virus, particularly as the policy approach changes. If, in states such as NSW and Victoria where the virus is currently circulating around the community, the number of cases was to increase materially slower or faster than expected, it is possible full re-opening will be brought forward or delayed. It is also unclear how states that have seen little or no COVID for many months now will react to seeing community transmission. Even if they were to follow the National Cabinet agreement, 'fewer' or 'highly targeted lockdowns' leaves some discretion to Premiers. Moreover, how individuals will react in this environment (for example by pulling back on in-person activities) is also unclear.

Through the most recent lockdowns, the Federal and state governments have continued to provide considerable support to individuals and businesses affected by COVID. However, changes to program details and the level of assistance, means there is some uncertainty around how effective they will be this time around.

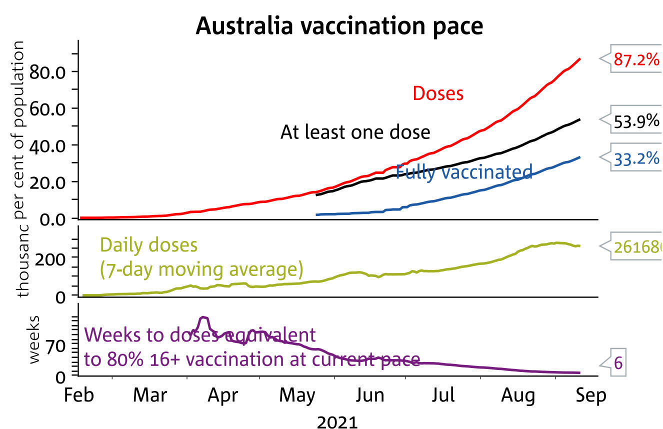
Another question is around the impact on the economy as assistance is withdrawn. Measures such as HomeBuilder and the instant asset write-off work, at least in part, by bringing forward activity, with risk of a subsequent hole. For example, house building approvals have been falling since the end of HomeBuilder, but how low they will go (particularly given the current minimal population growth) is hard to determine.

CURRENT LOCKDOWNS – HOW LONG?



Source: National Australia Bank, Australian Department of Health

VACCINATION ROLL OUT



Source: National Australia Bank, Our World in Data

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	1.1	-2.2	4.5	1.2	-5.8	2.6	1.4	3.0
Dwelling Investment	-8.1	4.4	10.2	-5.1	-7.1	-5.3	13.6	1.9	-8.3
Underlying Business Investment	-2.8	-2.6	5.5	9.3	-2.2	-5.7	5.0	6.2	7.8
Underlying Public Final Demand	5.7	5.8	4.4	2.8	5.5	6.0	5.0	3.5	2.4
Domestic Demand	**-1.0**	**2.5**	**1.6**	**4.1**	**1.2**	**-2.6**	**4.7**	**2.8**	**2.9**
Stocks (b)	-0.3	0.7	-0.3	0.1	-0.3	-0.1	0.5	0.0	-0.2
GNE	**-1.3**	**3.2**	**1.3**	**4.1**	**0.9**	**-2.7**	**5.2**	**2.8**	**2.8**
Exports	-1.8	-9.1	-0.1	2.5	3.4	-10.1	-2.8	1.9	1.9
Imports	-7.5	-3.1	1.6	4.2	-0.9	-13.4	6.0	1.7	4.1
GDP	**-0.2**	**1.4**	**1.2**	**3.8**	**1.9**	**-2.4**	**3.3**	**2.9**	**2.3**
Nominal GDP	1.6	4.2	6.0	5.5	5.4	-1.7	8.8	5.7	3.9
Current Account Balance ($b)	-36	-68	-109	-109	14	52	92	112	106
(%) of GDP	-1.8	-3.3	-5.0	-4.7	0.7	2.7	4.3	4.9	4.5
Employment	0.2	1.1	1.9	1.8	2.3	-1.7	3.3	1.2	1.9
Terms of Trade	0.8	10.8	13.6	-0.2	6.1	-0.6	20.6	3.6	-0.8
Average Earnings (Nat. Accts. Basis)	3.0	2.6	2.0	2.7	2.8	3.2	1.6	2.7	2.9
End of Period									
Total CPI	-0.3	3.8	1.8	1.7	1.8	0.9	2.5	1.7	2.0
Core CPI	1.2	1.7	1.7	1.9	1.4	1.3	1.8	1.8	2.2
Unemployment Rate	8.2	5.1	4.4	4.2	5.1	6.7	5.2	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

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

Important Notice

This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances.
NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it.

Please click here to view our disclaimer and terms of use.