October 2021

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

We have revised our global economic forecasts lower – to 5.9% for 2021 (6.0% previously) and to 4.5% for 2022 (4.6% previously). That said, we expect quarterly growth in Q3 to be similar to that of Q2, helped by India where activity has recovered as COVID-19 countermeasures have eased. The downward revisions to the outlook are in part driven by the persistence of supply bottlenecks in the global economy; most recently this includes energy shortages and spikes in energy prices, which have led to production cuts, including in China. Higher energy prices will also weigh on consumers' spending power. At this stage it is unclear how long these shortages will persist. Supply bottlenecks, along with shortages of key inputs and rising commodity prices, have contributed to inflationary pressures. Concerns over China's property market have put downwards pressure on global equity markets and iron ore prices.

- Global equity markets trended lower from the second week of September, as markets were spooked by the likely default of the highly indebted Chinese property giant Evergrande (one of the few companies identified by the People's Bank of China that could cause systematic risk for the country's financial sector) and fears of a 'Lehman Brothers' event which could trigger further defaults and severely affect financial markets. The PBoC has addressed these concerns by pumping liquidity into interbank markets, but a lack of clarity from Chinese authorities around the future of Evergrande has added to concerns.
- There are also concerns that Evergrande's default could have a negative impact on the broader property sector, leading to weaker demand for a broad range of **commodities** – particularly metals. Excluding energy, the Refinitiv CoreCommodity CRB Index has tracked broadly sideways since late July, while spot prices for iron ore have retreated considerably over the same period. In contrast, energy prices have risen considerably – with spot prices for crude oil, thermal coal and liquefied natural gas trending higher. At this stage it is unclear how long these shortages will persist. That said, this has the potential to further interrupt already disrupted supply chains.
- Supply disruptions, along with shortages of key inputs and rising commodity prices, have contributed to **inflationary pressures**. This has been most evident in global producer prices – which rose by an estimated 12.2% yoy in August – which has also flowed through into high consumer price growth – estimated at 3.9% yoy in August, albeit the growth rate has been relatively stable over the past three months.
- We expect the **US Fed to start tapering in November**, but it will be a while before it hikes rates. That said, market expectations of the timing of rate hikes for some major advanced economy central banks have been brought forward (with markets pricing a rate hike by the Bank of England this year). In recent months, a range of emerging market central banks have lifted their policy rates, led by Brazil, Russia and Mexico, although our aggregate emerging market central bank policy rate measure remains well below its pre-COVID-19 levels.
- GDP growth in the **major advanced economies** was very strong in the June quarter and well up on the prior two quarters' pace. We expect there to be slower but still robust growth, in aggregate, in each of the two final quarters of 2021 in part due to the full effects of past easing in COVID related restrictions coming through (UK, Canada, Euro-zone) and the more recent easing in restrictions (Japan), and falling COVID-19 cases in the US. Consistent with this, business survey indicators have come off their peaks but generally remain at solid levels. However, there are risks around this outlook. Supply-chain bottlenecks are yet to show any material sign of improvement, and recent spikes in energy prices are an additional headwind.
- Aggregate measures of **Emerging Market** (EM) manufacturing and services PMIs were stronger in September. The improvement in the services PMI was primarily driven by China, likely reflecting a reduction in COVID-19 restrictions. Key contributors to the better manufacturing PMI were Indonesia, Russia and China. In contrast, China's official manufacturing PMI turned negative; this survey contains a larger share of traditional heavy industry where conditions are less favourable (including the country's power shortages in late September) and there is downside risk around the China outlook. A positive in Q3 is likely stronger growth in India where activity recovered as COVID-19 countermeasures have eased.
- Our **global economic forecasts** have been revised marginally lower this month – to 5.9% for 2021 (down from 6.0% previously) – largely driven by a downward revision to our outlook for the United States (along with some downgrades in the Euro-zone, Japan and Canada). Our outlook for 2022 is also slightly weaker – at 4.5% (from 4.6% previously). We have not changed our forecast for China, despite the energy and property market issues, as we will review it following the Q3 GDP release next week. COVID-19 remains the primary risk to our global economic outlook, particularly for EMs as they typically have lower vaccination rates. Supply bottlenecks, highlighted by energy shortages and price spikes in several regions, are also a growing risk.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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For Australia, a very sharp fall in activity in Q3 is locked in – we expect a fall of around 3.5% – concentrated in NSW and Victoria which were in lockdown for most of the quarter. We continue to expect a solid rebound in Q4 with both states on track to reopen early-to-mid quarter, and strong growth continuing into early 2022 such that the Q2 2021 level of GDP is recovered by Q2 2022. That sees through-the-year growth of just 0.8% this year, before a solid 4.3% rebound in 2022 and normalisation to around 2.0% in 2023. In the near-term, the unemployment rate may drift higher but will likely be a less reliable indicator with large fluctuations in both employment and labour force participation. We expect the labour market to resume its prior trajectory with unemployment declining to around 4.5% in 2022 and 4.0% In 2023. Still, we see a more gradual pickup in inflation due to the soft starting point for wage growth and lag in the pass through to consumer prices. Therefore, we continue to see rates on hold until 2024. However, the recovery will see the RBA taper bond purchases at a more aggressive pace after the next review in Feb-22. Risks remain primarily related to the pace of reopening, as well as the impacts of potential new macro-prudential policies.

- The **labour market deteriorated further in September, with employment falling 138,000 after a similarly large fall in August.** Unemployment edged up to 4.6% with further falls in participation offsetting the employment decline. Whether the unemployment rate rises or falls when activity rebounds will likewise depend on the relative strength of employment and participation rate responses. Regardless of the initial adjustment, we expect the unemployment rate to resume its prior trajectory, falling to near 4.0% by end 2023.
- **Household consumption also continues to be weighed down by lockdowns**. Nominal monthly retail trade fell 1.7% in August, backing up a 2.7% fall in July, driven primarily by clothing and footwear, department stores, and cafes and takeaway. We see household consumption rebounding in the coming months as lockdowns end in NSW in October and in Victoria in November.
- **Housing markets are still strong, with prices still growing rapidly and approvals off their peak but still high.** Dwelling prices grew by 1.5% m/m in September, unchanged from August, which was a step down from rates seen earlier in 2021 but still equivalent to 20% annualised. Forward indicators were mixed as loan commitments declined but building approvals increased, ending a run of four consecutive monthly falls. The past month also saw APRA increase the minimum interest rate buffer used by banks to assess serviceability, and while APRA expects only a modest impact on credit growth, it has not ruled out further macro-prudential tightening. Still there is a large pipeline of work and we expect dwelling investment to grow into 2022.
- **Lockdowns have continued to impact the business sector but we continue to expect activity to bounce back as restrictions are eased.** the NAB Monthly Business Survey for September showed a broad-based rebound in confidence after reopening roadmaps were announced, with large gains in NSW and the recreation & personal services industry. Still, business conditions, forward orders and capacity utilisation all saw notable falls, highlighting the drag on activity while lockdowns have been in place. With reopening now underway, we remain optimistic the healthy hiring and capex plans seen prior to the recent lockdowns will re-emerge.
- **The RBA left policy settings unchanged at its October meeting, while remaining upbeat about the rebound in activity when restrictions ease.** We continue to expect a gradual build-up of inflationary pressure from here, only rising above the bottom end of the inflation target sometime in H2 2023. That accords to a rates "lift-off" in 2024 However, in the near-term we expect the RBA to continue to taper the QE program – likely at a more aggressive pace than previously expected. With a tranche of over $80bn in new purchases to be completed by February, we see a further tapering to $2bn a week for around 3 months at the next review before winding up the program by mid-2022 (totalling up to $130bn from here).
- **The Aussie has remained range bound, trading between US71.5c and US72.6c over the past month – well below our estimates of "fair-value".** Our forecasts for the exchange rate were recently updated to reflect the better than expected strength in the USD – especially in the face of strong commodity prices. We now see the AUD around 72c by end 2021. Thereafter we see the AUD moving up to around US78c by late 2022 and around US77c by end 2023.
- **Despite the ongoing disruption to services trade, the trade surplus (in nominal terms) continues to set new records.** Driven by a 5% rise in goods exports, a 4% rise in exports and a 1% fall in imports saw the trade surplus reach $15bn in August. In the near-term, the trade surplus is likely to remain elevated with ongoing strong energy demand and a quarterly rebound in iron ore volumes. In the medium term, as borders reopen, there will likely be a gradual normalisation in services trade with outbound international travel and education exports important to Australia.
- The **major risks to the outlook continue to relate to COVID-19 and reopening, as well as the impacts of potential new macro-prudential policy**. The pace of reopening, return of international travel, and consumer behaviour in a 'living with COVID' scenario remain uncertain. On the macro-prudential side, the higher interest rate serviceability buffer introduced by APRA follows increasing commentary by regulators around the potential build up of financial stability risks arising from higher household debt. While the current assessment of regulators is that lending standards remain strong, further measures are likely to be introduced if credit growth continue to outstrip income growth with the potential for more significant impacts on the housing market.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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