AUSTRALIAN GDP PREVIEW

Q3 2021 – Large fall sets up "W-shaped" recovery

NAB Economics

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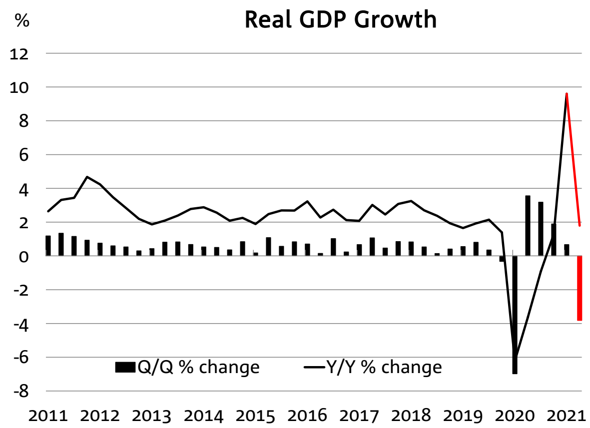
<u>Bottom line</u>: NAB expects that GDP fell by 3.8% q/q (up 1.8% y/y) in Q3 as lockdowns in NSW, Victoria and elsewhere significantly curbed consumption and disrupted investment activity (after strong outcomes in the previous quarter). Dwelling investment and net exports look to have provided some support and while the partials for government spending are yet to be released, we expect some support there. While the fall in consumption is likely to have been around half that observed in 2020, its weight in GDP (around 60%) will ultimately drive the overall result.

While the GDP release will provide confirmation of the depth of the impact of lockdowns, these data are dated. Higher frequency data suggests a strong rebound in activity is underway and consequently, we expect a strong rebound in Q4, with GDP rising by around 3% as activity rebounds. Further ahead, the normalisation of borders, withdrawal of policy supports, resolution of supply chain issues, and the pickup in wages and inflation will be key factors shaping the recovery and the normalisation of monetary policy settings, with our expectation being for a first rate rise in mid-2023.

- **GDP is expected to have fallen by 3.8% in Q3 (up 1.8% y/y).** While there are few partial indicators for services consumption, real retail trade (largely goods) fell 4.4% in the quarter. Spending on travel and health as well as other household services is likely to have seen further disruption, but the magnitude of this impact remains highly uncertain. That said, we expect the overall fall in consumption to be far less severe than the 12% fall in private consumption recorded in Q2 2020. Partial indicators of Q3 business investment were mixed with investment in buildings & structures rising modestly, while spending on equipment was softer. Dwelling investment likely saw a small gain, with strength in renovation activity offsetting softness in new construction – reflecting the ongoing impact of the HomeBuilder program. International trade continues to be heavily impacted by restrictions on travel, but we expect a notable 0.8ppt contribution from net exports, partially reversing the decline in Q2.
- **Looking forward**, we expect a strong rebound in Q4 as major states follow reopening plans, consumption and employment quickly make up lost ground, and business activity begins to recover. We expect Q4 growth of around 3% (1.6% y/y), almost enough to bring GDP almost back to its Q2 2021 level and creating a unique "W-shaped" recovery pattern. That would see year-average growth of around 3.5% for 2021, ultimately a strong result given the significance of the Delta outbreak. Growth should continue into the new year as international borders reopen and major events return, with March likely to be another strong quarter before growth begins to normalise over the year.
- **The key risks for our forecasts for Q3** relate to the scale of the fall in consumption. While retail trade data provides a guide on goods, lockdown impacts on services consumption (outside of restaurants and cafes) remain uncertain. Lockdown effects on business investment based on the partials appear less than expected- especially in private construction. In terms of risks beyond Q3, the likelihood of more cautious consumer behaviour in a 'living with COVID' environment appears to be receding but it is still possible that new restrictions will be imposed in the future if vaccine effectiveness wanes or new variants emerge. The withdrawal of policy supports – including accommodative monetary policy – will also be a factor, with the timing of interest rate hikes and the potential for new macroprudential policy measures likely to shape dwelling investment in particular. The net effect of normalisation of trade and international travel flows is also difficult to predict, as services exports (inbound education and tourism) and imports (outbound tourism) resume. Overall, however, we still expect a strong rebound of around 4% in GDP through the course of 2022.
- **Policy implications**: The data will provide confirmation of the depth of the impact of lockdowns, but with a large rebound already underway they will have little policy impact. The key factors for policy going forward will be the pace of recovery in the labour market, how fast wages growth picks up, and the pass through to inflation. We expect unemployment to resume the trajectory it was on prior to the recent lockdowns, with wages growth putting upward pressure on prices as temporary supply chain-related price pressures abate in 2022. That should see the RBA begin to raise interest rates in mid-2023, with rates to normalise rapidly from there.



Real GDP Forecasts

	Q/Q		Y/Y	Contribution to Q/Q
	Jun-21	Sep-21	Sep-21	Sep-21
Household Consumption	1.1	-7.4	-0.8	-4.0
Dwelling Investment	1.7	1.9	15.9	0.1
Underlying Business Investment	2.3	-1.4	8.6	-0.1
Underlying Public Final Demand	1.9	1.2	4.7	0.3
Domestic Final Demand	1.7	-3.7	3.2	-3.6
Stocks (a)	-0.2	-1.1	0.4	-1.1
GNE	1.4	-4.8	2.4	n.a.
Net exports (a)	-1.0	0.8	-1.0	0.8
Real GDP	0.7	-3.8	1.8	n.a.

(a) Contribution to GDP growth

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