Global and Australian Economic & Market Outlook

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Prepared on 19 July 2021

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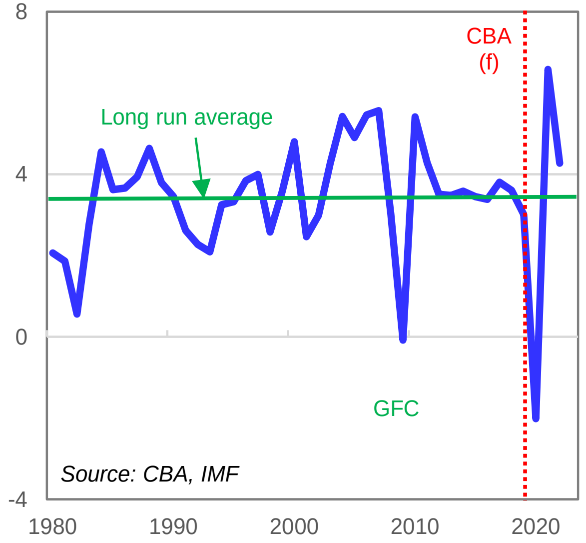
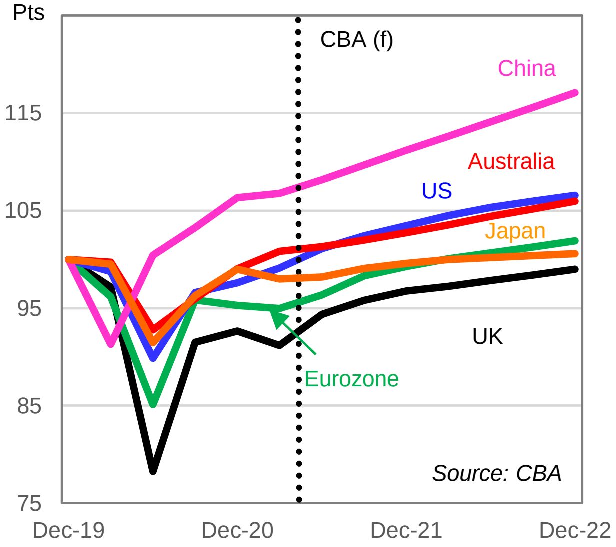
Global Outlook

Global economy to recover in 2021

GLOBAL GROWTH
(annual % change)



CBA GDP FORECASTS
(Index = 100 on December 2019)



We forecast the global economy to expand by a **strong 6.6% in 2021** – after -2.1% in 2020. 2022 growth is forecast at 4.2%.

The global recovery is uneven. China has led the global recovery so far, but the US is improving rapidly. Japan and the EU are lagging.

China growth led by a surge in industrial production and infrastructure – **supportive for iron ore.**

US growth supported by **large-scale fiscal policy support and quick roll-out of vaccines.**

Sources of risk clearly remain – Covid-19 surge in India and growing trade tensions.

Climate change policy development now becoming more widespread.

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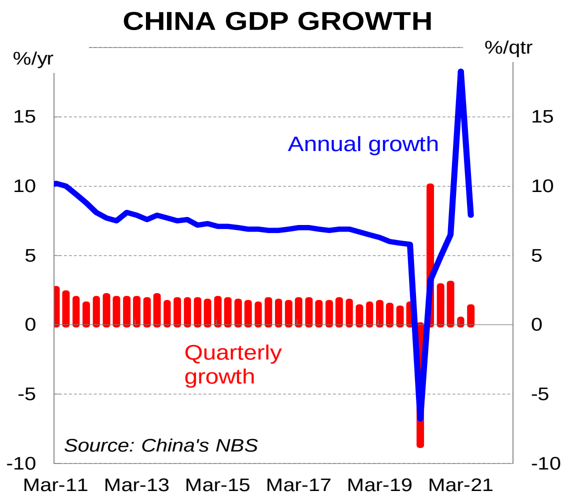
China growth returns to long-run potential

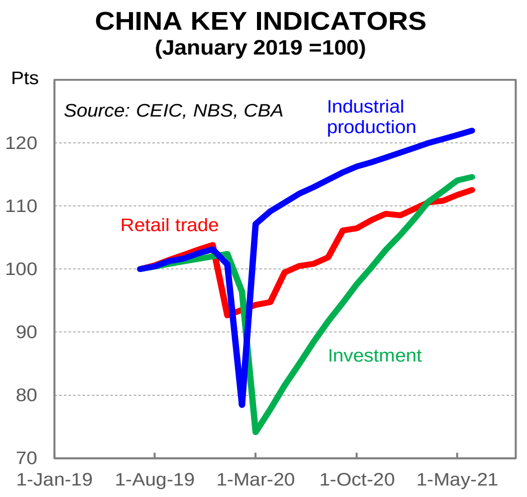
GDP Q2 21 came in at 7.9%/yr, with a step up in quarterly growth from 0.4%/qtr in Q1 21 to 1.3%/yr in Q2 21.

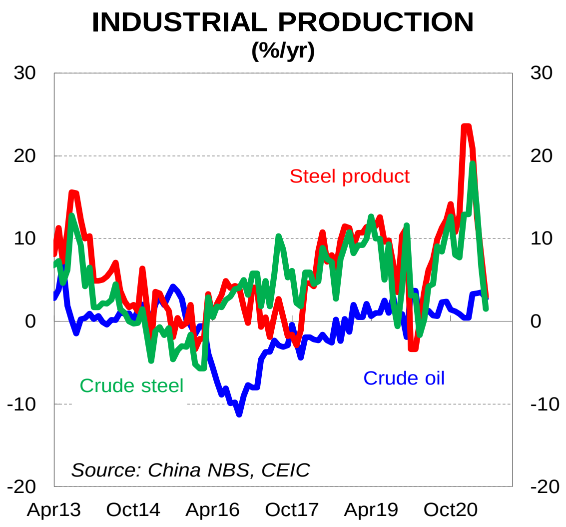
We have downgraded our 2021 and 2022 annual GDP growth forecasts to 8.6% and 5.4%, because of base effects.

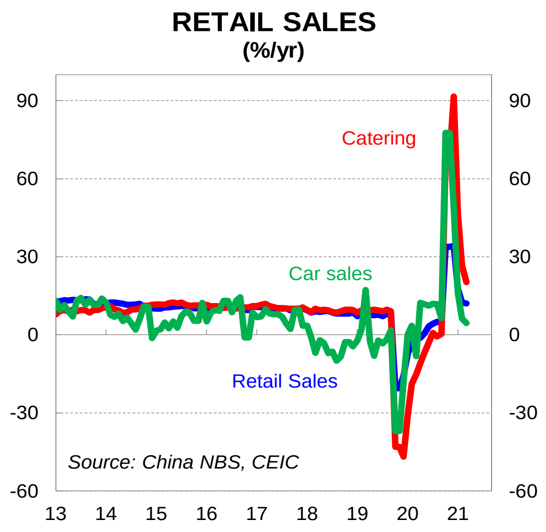
Base effects are impacting the monthly data for industrial production and retail sales, but it is clear that a strong recovery has occurred.

But the risks to China's growth outlook are skewed to the downside – supporting the PBoC decision to cut the RRR by 50bp in early July.

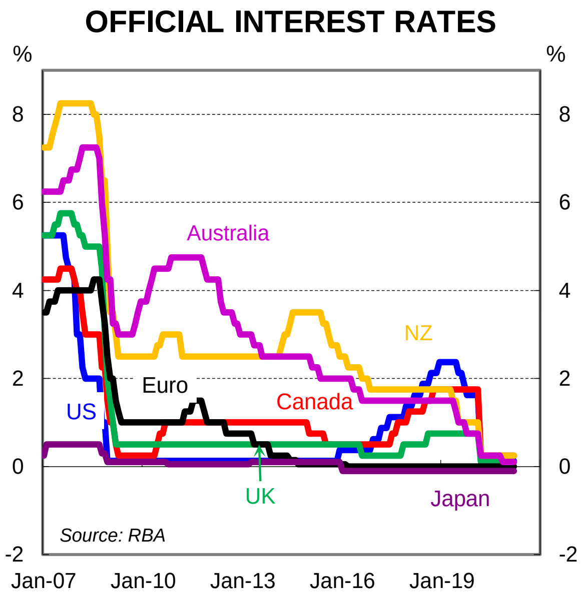


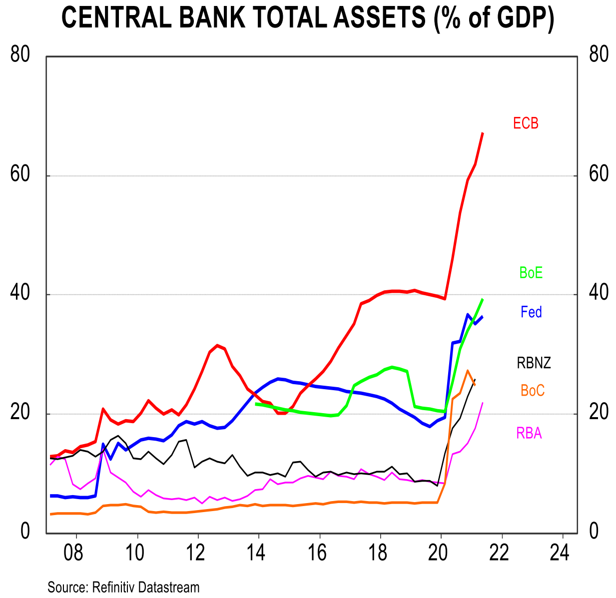






Global monetary policy – Low rates and QE





Major central banks got to ‘whatever it takes’ quickly at the outset of Covid-19.

The focus was on near-zero rates, balance-sheet expansion (QE), funding the banking system and ensuring the smooth functioning and liquidity of financial markets.

Interest rate increases are **still some time off…..except for New Zealand. August 2021 rate hike expected.**

But the pace of **QE expansion is already beginning to slow** in some countries.

Bank of Canada was the first central bank to **taper asset purchases**, as has the RBNZ, BoE and RBA (in September).

US Fed expected to begin to taper QE in Q4 2021 and begin to lift the Fed Funds rate in Q1 23.

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Australian Outlook

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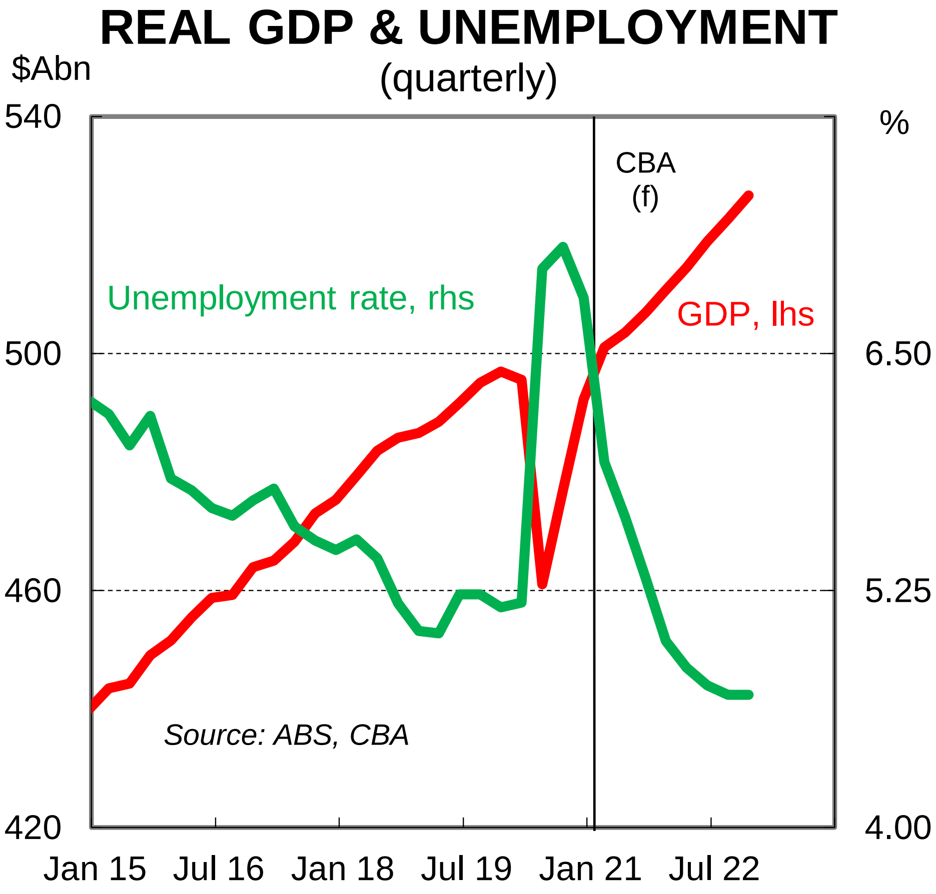
Australian economy growing strongly – before lockdowns



Source: ABS, CBA

We were early in expecting the **Australian economy to recover strongly**. Growth was being supported by a number of factors:

1. Control of Covid-19 and roll-out of the vaccines – **this is now under threat.**
2. Sharp rise in consumer confidence.
3. A surge in household savings – that will more than offset reduced government income support.
4. Improving housing market – prices, lending and construction.
5. A jump in domestic tourism.
6. Strong resource (iron ore) exports.
7. An increase in public sector infrastructure spending.

Q1 21 GDP 1.8%/qtr and 1.1%/yr. **GDP is f/c +5% in 2021 and by a further +3.0% in 2022. But there are now substantial risks of negative Q3 21 GDP as a result of the Sydney and Melbourne lock-downs.**

From 4.9% in June 2021, we now expect the **unemployment rate to be 4.5% at end-2021 and 4.0% at end-2022.**

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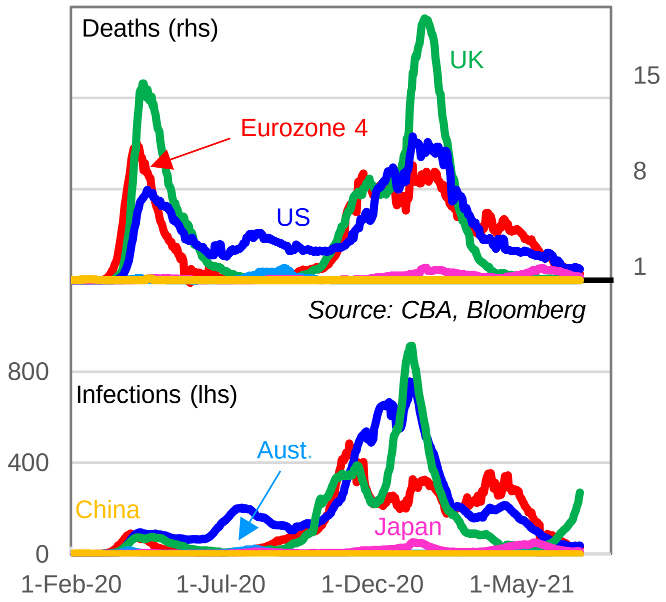
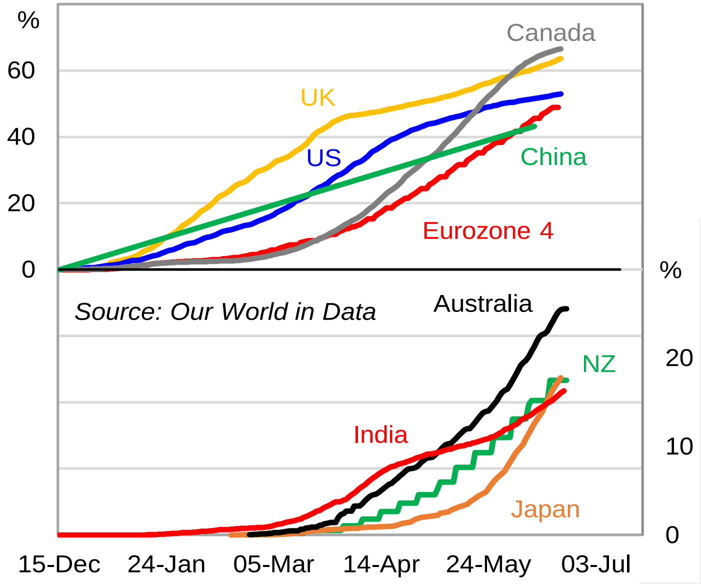
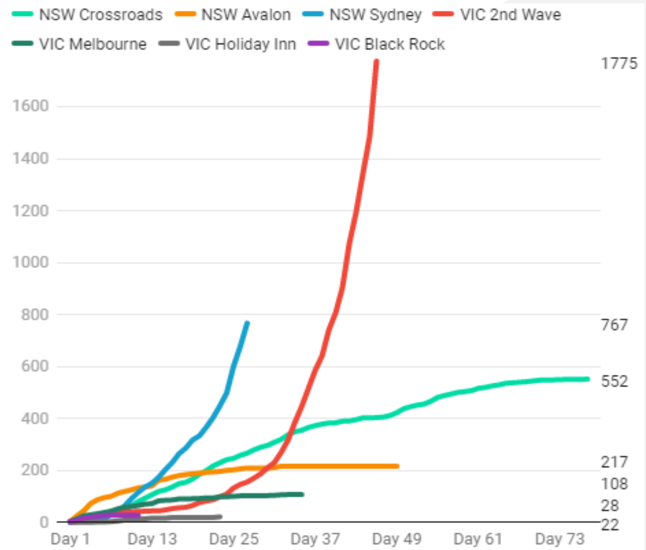
Covid-19 and Australia

DAILY INFECTIONS & DEATHS
(per million of population)



VACCINATION
(% of population received at least one dose)





Day 1 is the first identified case in each outbreak. Dates: NSW Crossroads: 10 July 2020; NSW Avalon: 17 Dec 2020; NSW Bondi: 17 June 2021; VIC 2nd Wave: 27 May 2020 (Rydges on Swanston index case); VIC Black Rock: 31 Dec 2020; VIC Holiday Inn: 4 February 2021 (Grand Hyatt case); VIC Melbourne: 25 May 2021. Notes: Avalon curve includes Berala; Holiday Inn curve includes Grand Hyatt; VIC Melbourne curve includes West Melbourne; VIC 2nd wave cut off at 1,775, reached 18,608.

- Australia has (had) done a very good job in limiting the number of Covid-19 cases.
- But the vaccine roll-out has been poor.
- The current lockdowns in Greater Sydney (and Melbourne) are a significant risk to the ongoing economic recovery.
- CBA data shows spending bounces back after lock-downs are lifted

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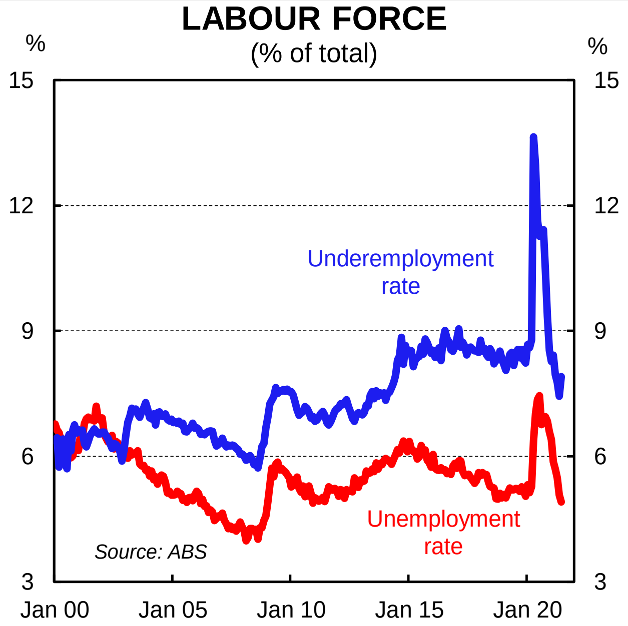
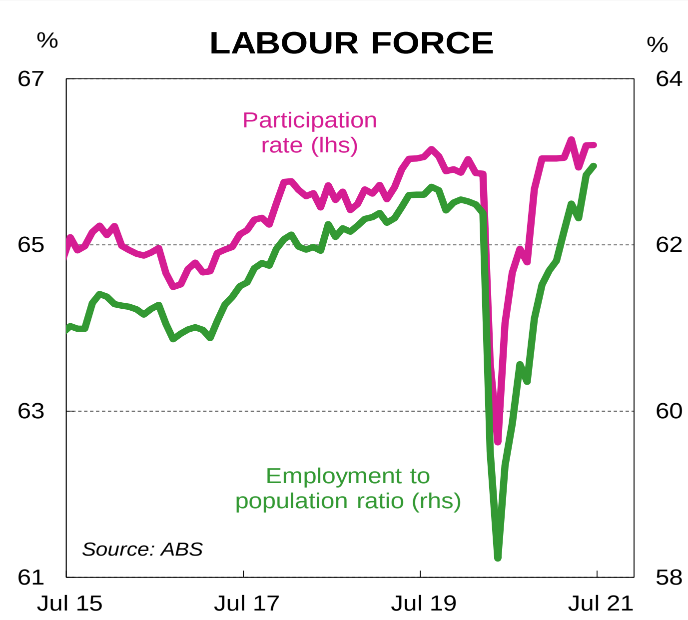
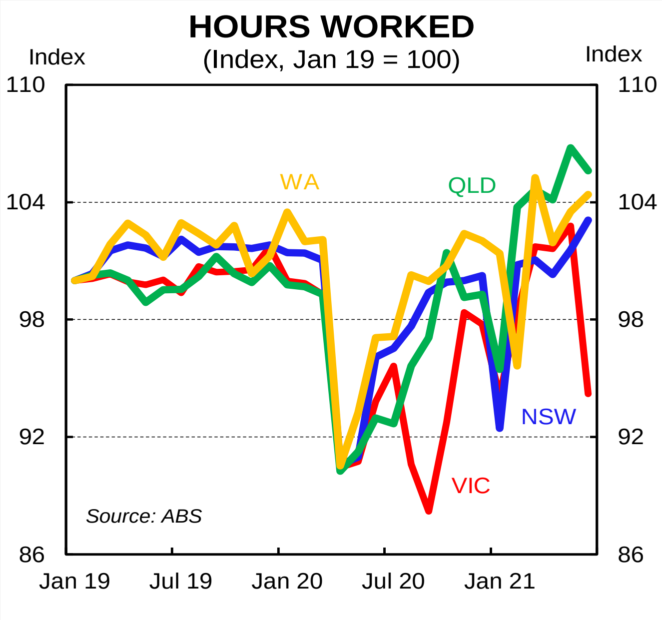
Labour market recovery has been remarkable







The **improvement in the labour market** has been remarkable

After 857.1k jobs were lost in March-May, 1,016.4k jobs returned in June 2020-June 2021 – there are now **more Australian employed that before Covid hit**

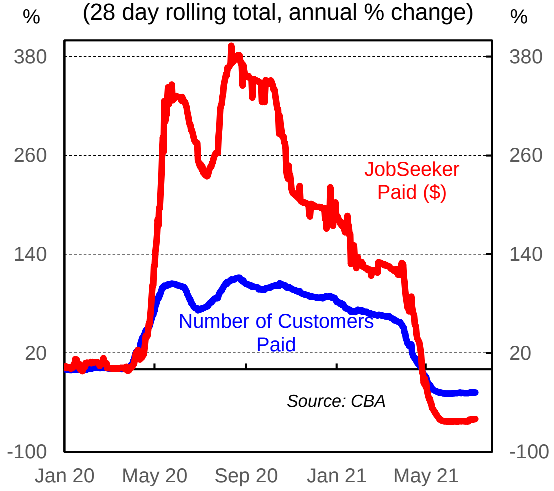
The unemployment rate peaked at 'just' 7.5% in July 2020 and is **down at 4.9% as at June 2021 – the lowest rate in 10 years!**

The participation rate surged back to its **pre-Covid levels at 66.3% in March 2021** - a remarkable recovery as employment and confidence recover, but a touch lower at 66.2% in June.

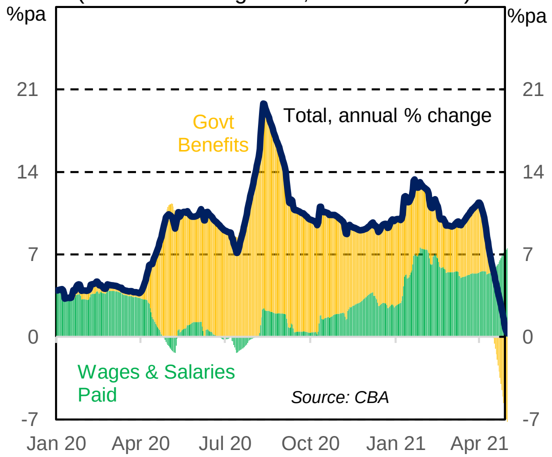
This supports our expectation of a 4.5% unemployment rate by year-end 2021 and **4.0% year end-2022**

JobKeeper and government payments supported income

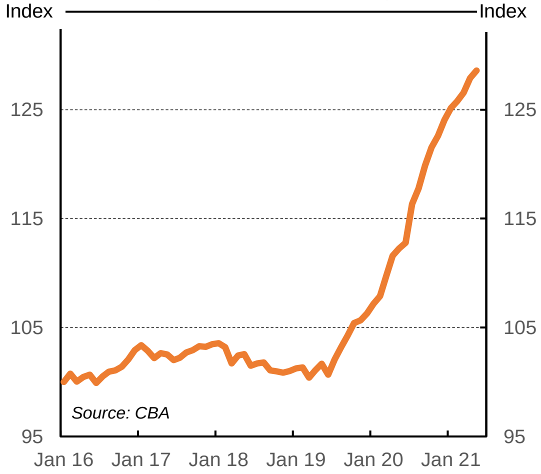
JOBSEEKER
(28 day rolling total, annual % change)



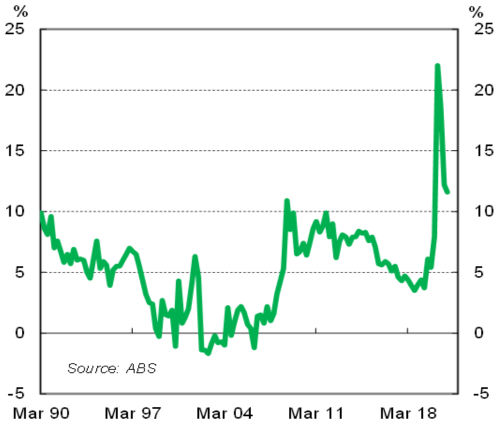
WAGES & GOVT BENEFITS PAID
(contribution to growth, 4wk smoothed)



CBA CASH SAVINGS INDICATOR
(Index, Jan 2016 = 100)



Household savings ratio



- As Covid-19 hit, income arriving into CBA bank accounts **surged on the back of government payments**
- The number and value of **JobSeeker payments coming into bank accounts has now stablised** – as people return to employment
- **Wages & salary payments** (which included JobKeeper up to end March 2021) is rising again.
- There was no discernible **impact on income from the end of JobKeeper**

- Total income flowing into CBA bank accounts **increased during the Covid-19 recession!**
- The value of savings in **CBA bank accounts has risen sharply**
- We estimate that Australians saved an excess of **$A140bn over 2020 and Q1 2021**.
- **This high savings rate** will support consumer spending through 2021 and beyond

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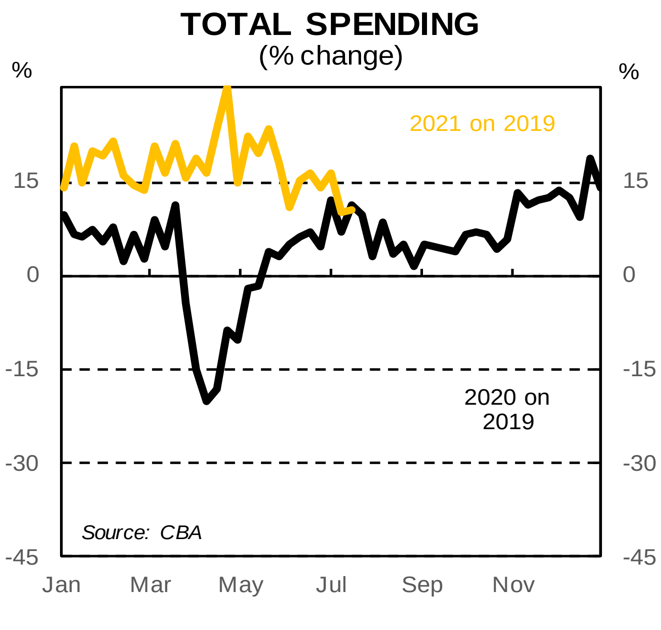
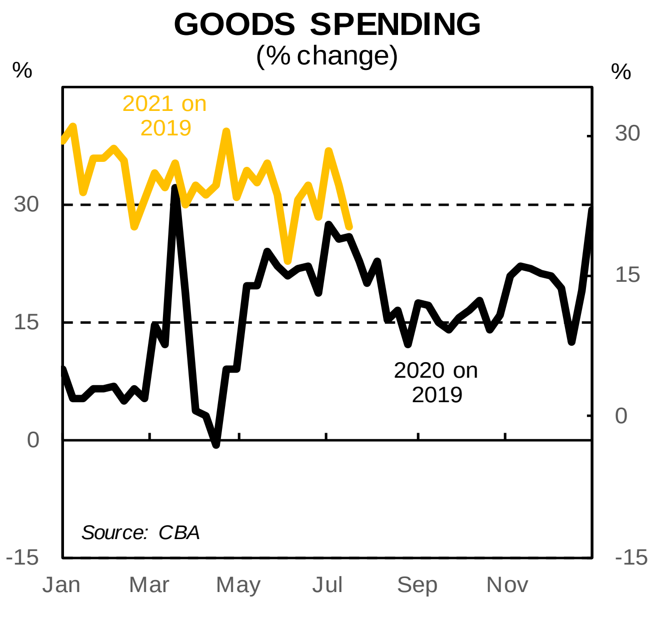
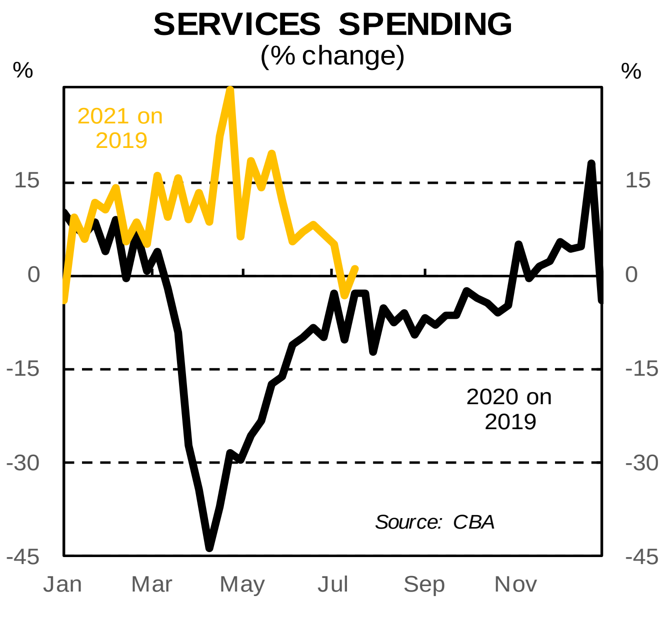
CBA weekly credit/debit card spend







Annual growth in CBA household credit and debit card spending had been broadly tracking sideways in early 2021. We are now measuring spending relative to 2019 as the base-year.

The annual pace of change in spending become very volatile, if we compare 2021 spending to the onset of the pandemic in 2020.

Total spending was up 10.5% to 16 July 2021 – relative to 2019. This is well below the 2021 average of 17% to date in 2021 and reflects the lockdown in NSW.

Goods spending was rising by 20% to 16 July 2021 v 2019. Services spending is now up just 1% to 2019.

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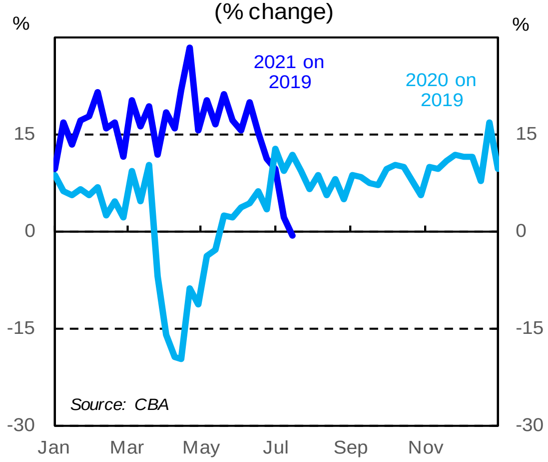
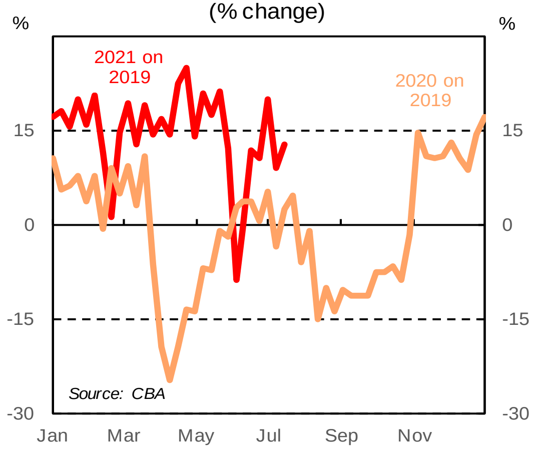
CBA weekly credit/debit card spend

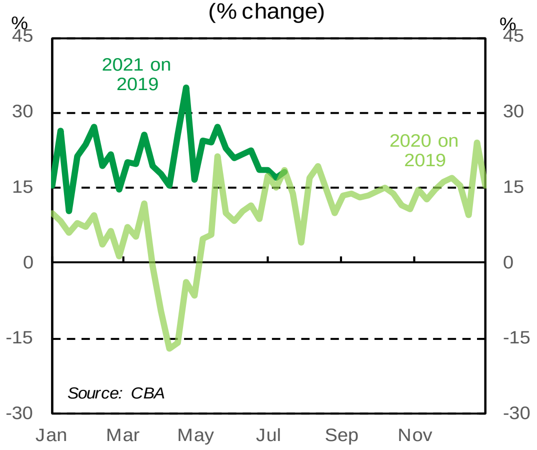
NSW SPENDING
(% change)



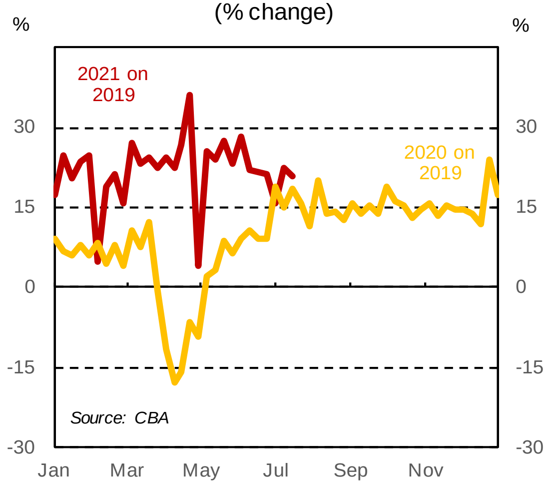
VIC SPENDING
(% change)



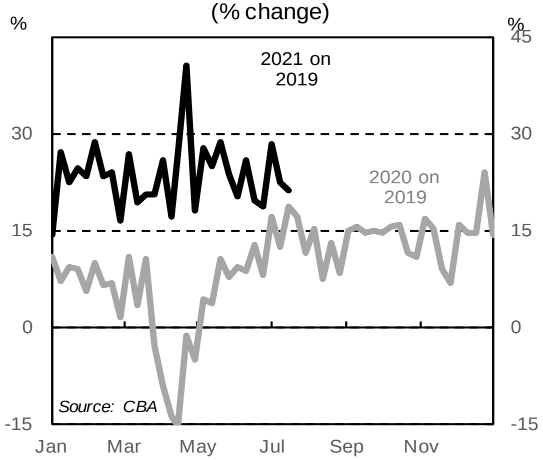
QLD SPENDING
(% change)



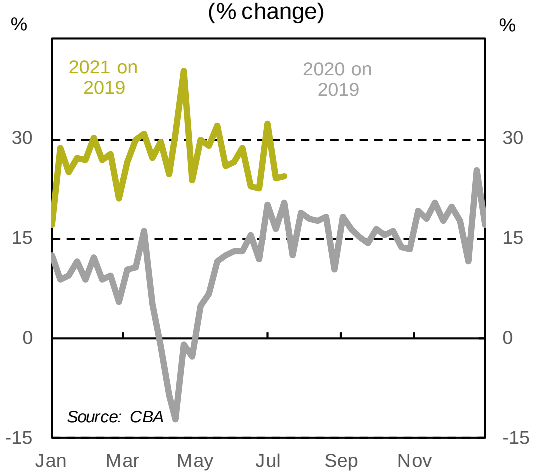
WA SPENDING
(% change)



SA SPENDING
(% change)



TAS SPENDING
(% change)



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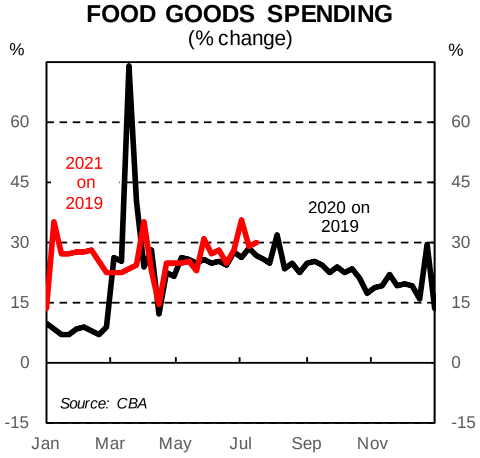
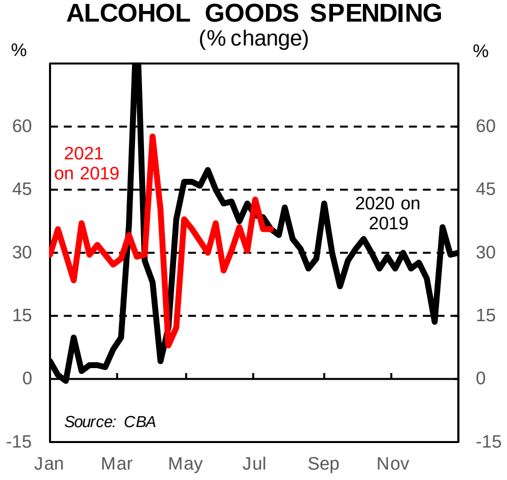
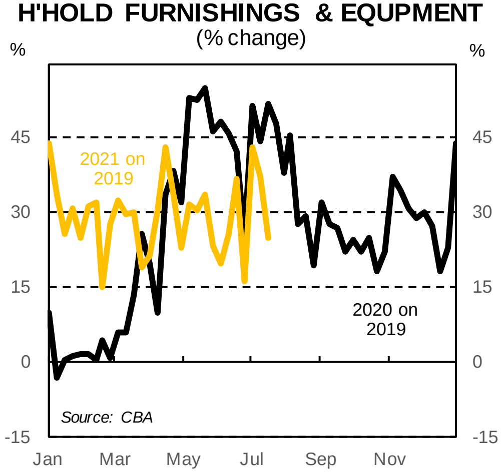
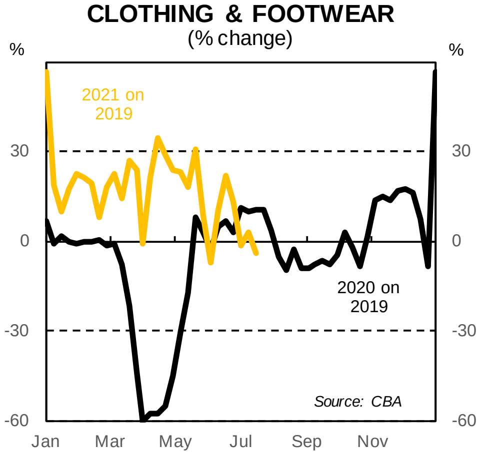
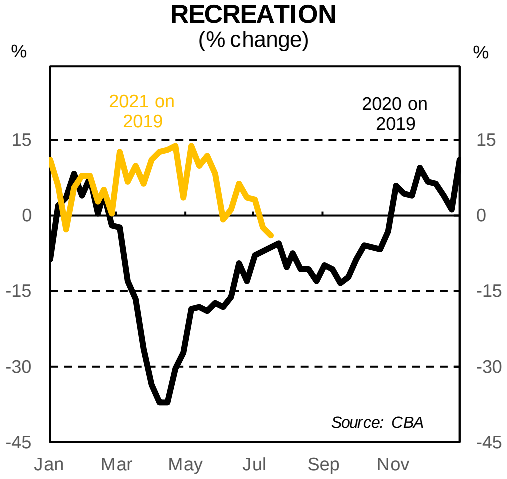
CBA weekly credit/debit card spend

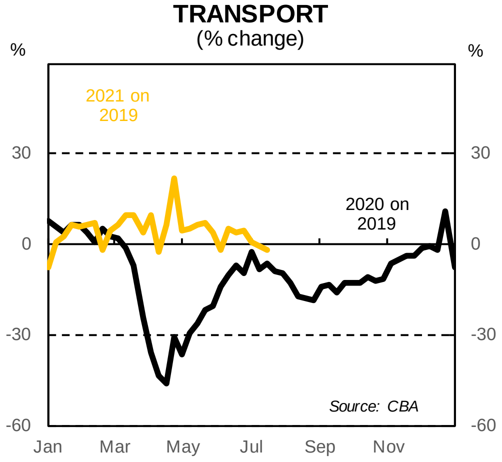












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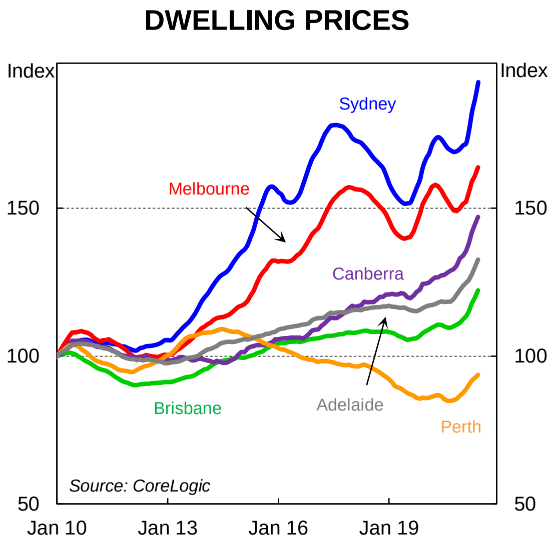
Home prices and lending rising strongly again

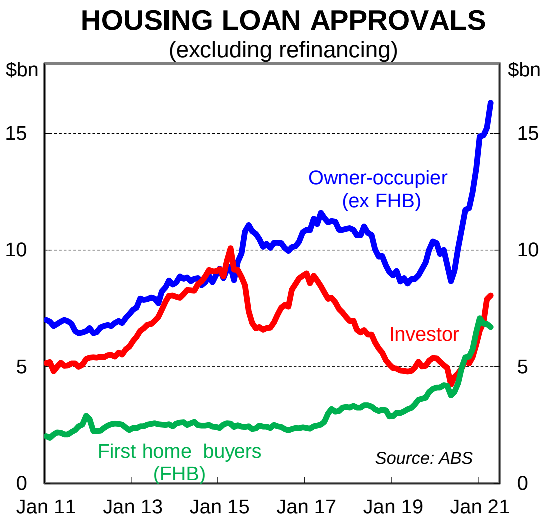
The housing market is being driven by low interest rates (especially fixed rates) and the recovery in employment and confidence.

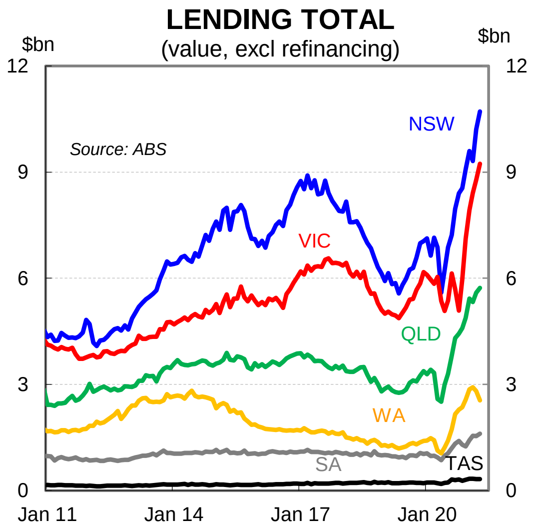
We expect residential prices to be up 14% for the two years ending 2022. We expect house prices to rise faster than apartments. New lending for housing was lower in April, partly reversing a large increase in March. Over the year lending is up by over 50%.

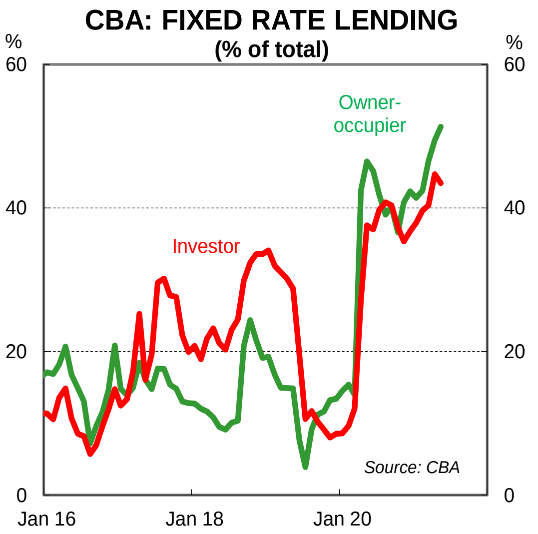
Driven by an increase in owner-occupier lending, including new home buyers and now also investors.

Investor lending is rising, but remains below its peaks of 2015-2017.









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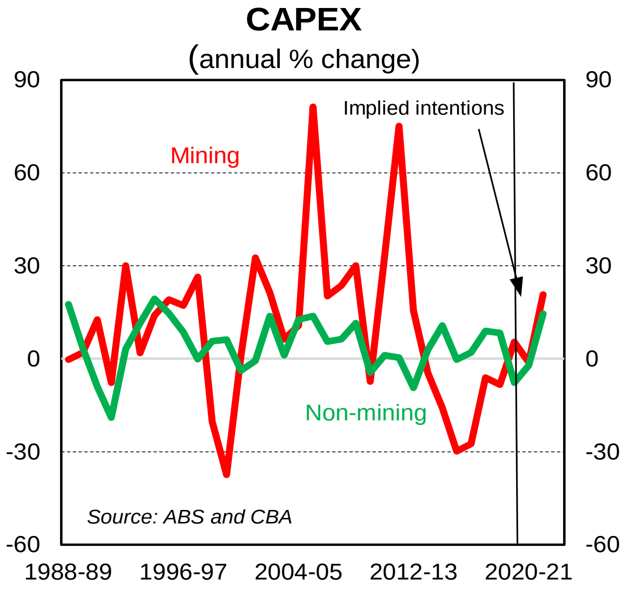
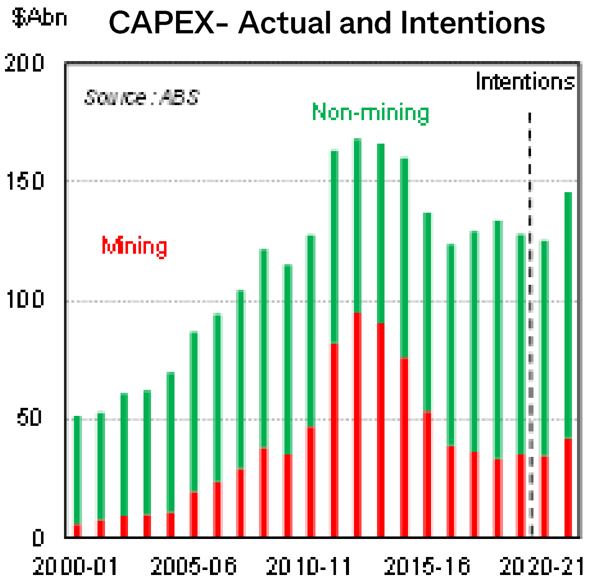
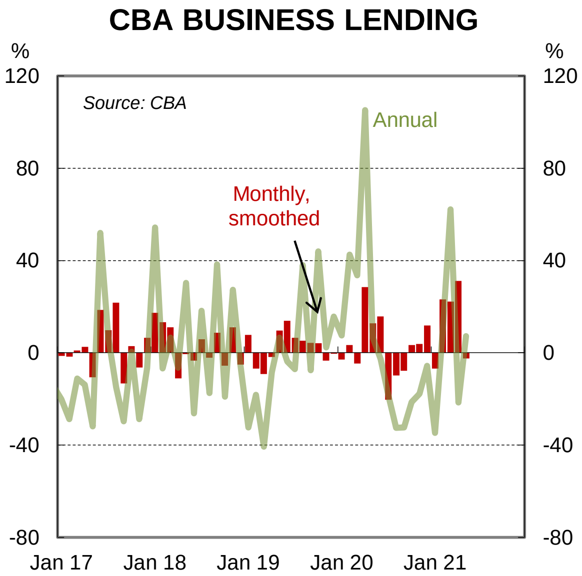
Business investment set to recover







Business capex rose by a solid 6.3% in Q1 21. Mining investment rose by 4.1%/qtr., while non-mining investment rose by a strong 7.1%/qtr.

The latest capital spending survey for 2020/21 now imply a small fall of just -2.1% for the year.

The second estimate for 2021/22 implies a much more impressive increase in capex of 15%/yr.

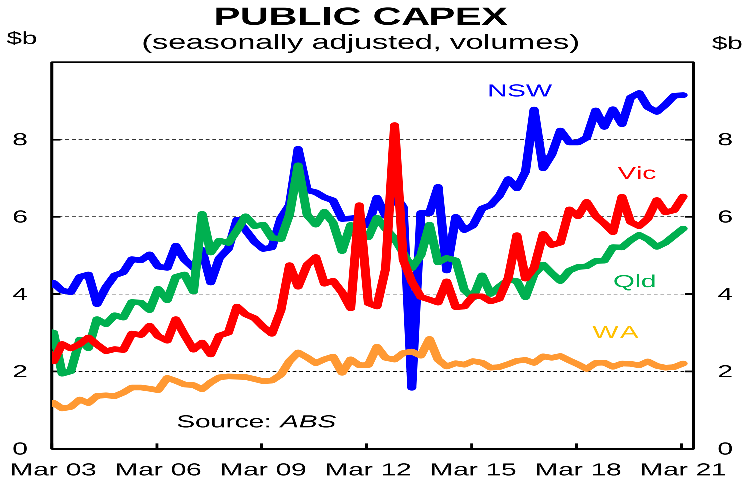
Business lending showed a solid and promising lift in both February and March 2021. Stronger business investment would help to support the economic recovery.

Infrastructure boom is ongoing

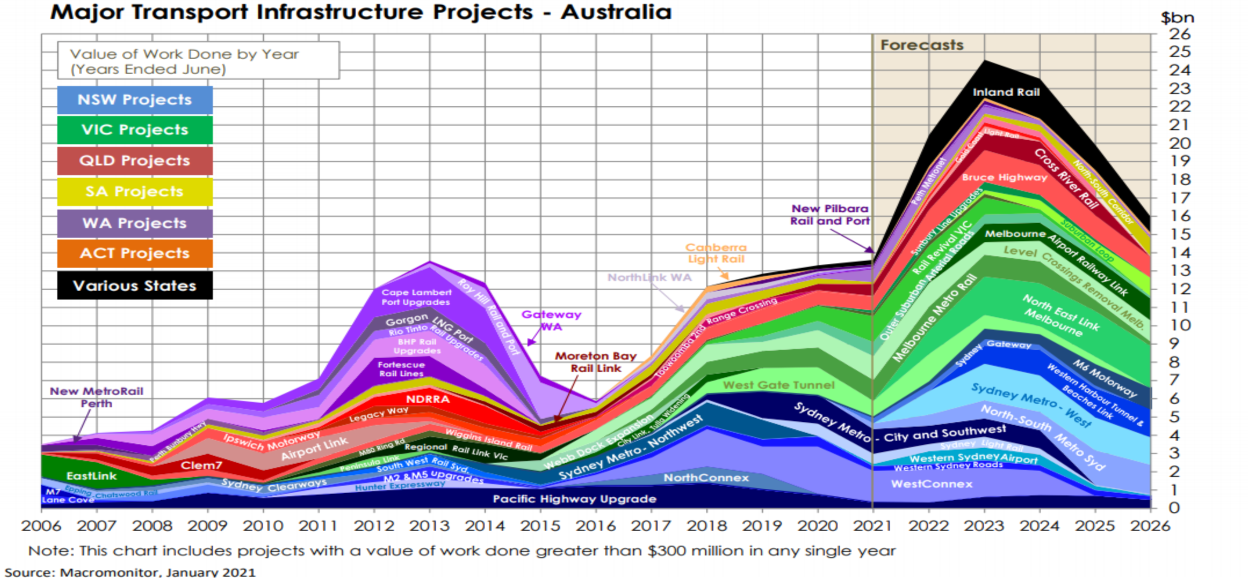
Australia has been experiencing a strong infrastructure spending boom for a number of years.

The Budget announcement of an extra $A15.2bn on infrastructure spending is a welcome development.

Increased infrastructure spending (bringing forward some activity) will be a critical part of the economic recovery and expected to be reinforced in State budgets.



Australian transport infrastructure projects – market opportunities



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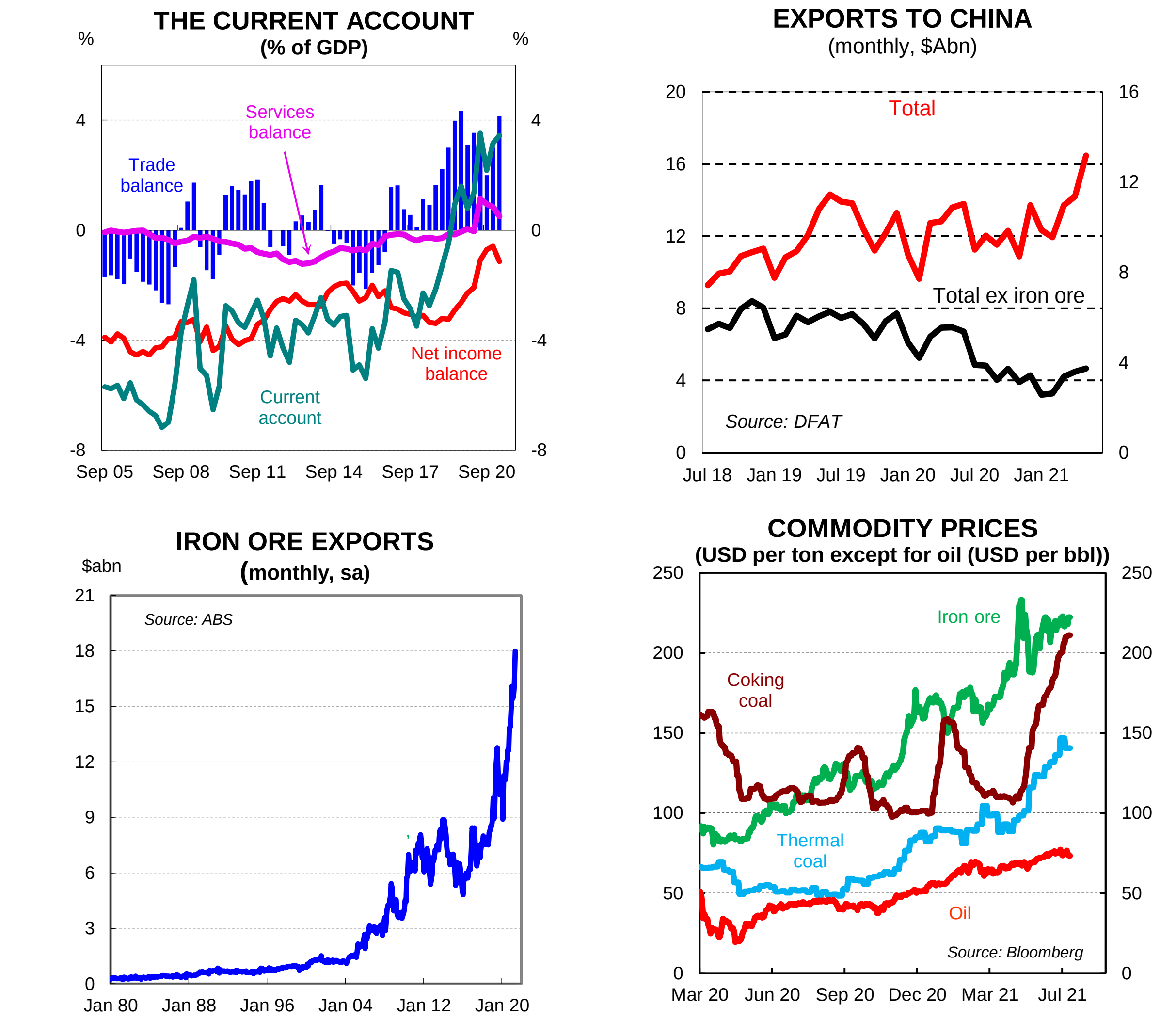
External sector is performing well

Exports to China have remained strong due to iron ore. Exports of other goods such as wine, barely, wood, coal and crustaceans have fallen due to trade sanctions

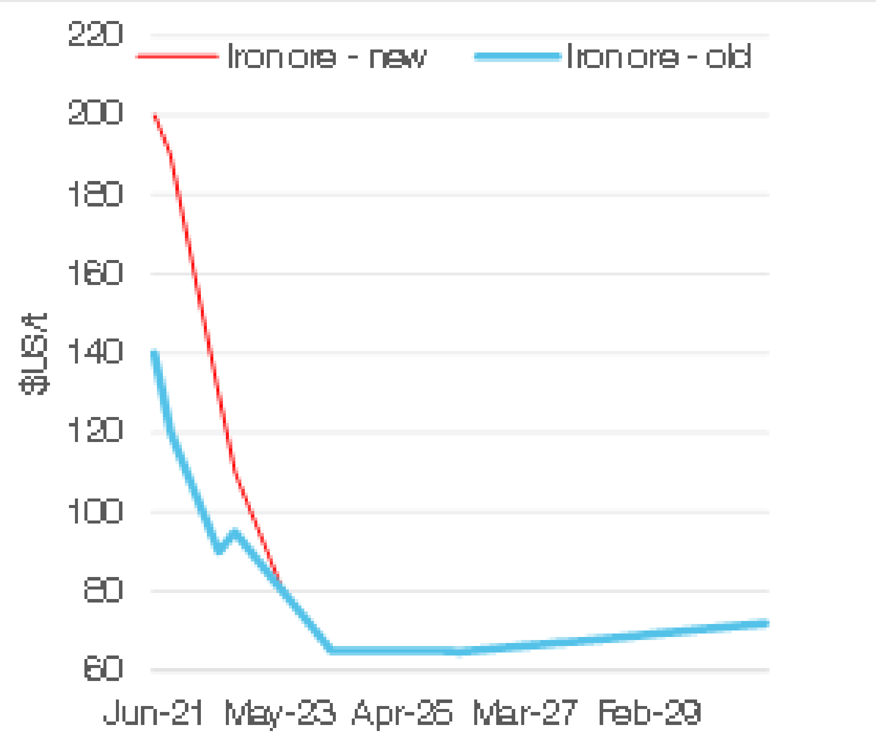
China remains heavily dependent on Australia for iron ore. Australia exports 80% of its iron ore to China. China gets 60% of its iron ore from Australia.

Australia – China trade tensions are unlikely to disappear and we are just part of the larger US-China trade tensions.



Source: ABS

China and iron ore



Source: CBA estimates

Iron ore price outlook has been revised higher – due to ongoing demand and tighter-than-expected supply.

But prices are still expected to decline on slower Chinese demand and increase global supply.

In the near-term, China has very little option than to buy iron ore from Australia, given its 50%+ reliance on Australian iron ore.

Over the medium/long-term China could reduce its reliance on Australian iron ore.

China could: i) increase imports from other countries, ii) boost domestic supply, iii) increase scrap steel usage, iv) reduce steel production.

Reducing steel-related carbon emissions will likely be essential for China to meet its net-zero emissions target by 2060.

Inflation to move gradually into 2%-3% target

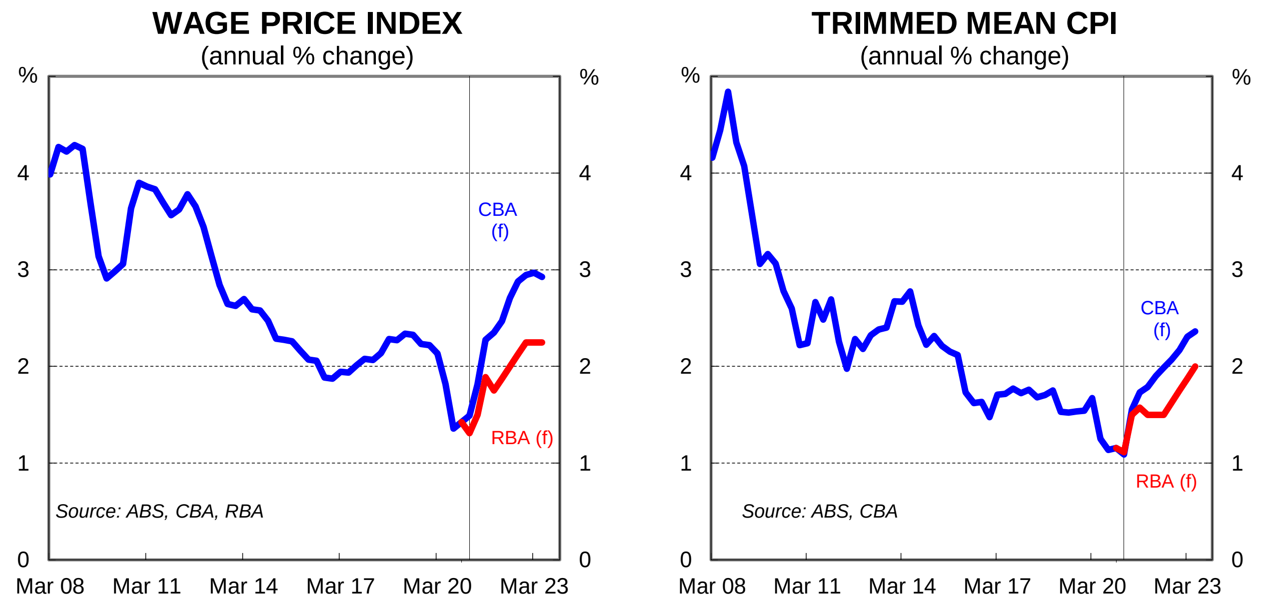
Wage growth rose to 1.5%/yr in Q1 21, up from the 22 year low of 1.4%/yr in Q4 20.

Wage growth is expected to rise to 2.9% at year-end 2022 as the labour market recovery continues.

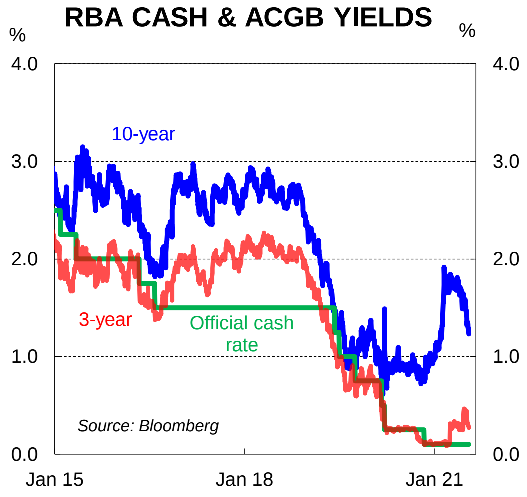
Headline inflation was **lower-than-expected** at 1.1%/yr in Q1 21, but partly due to government Covid-19 support policies in education and housing

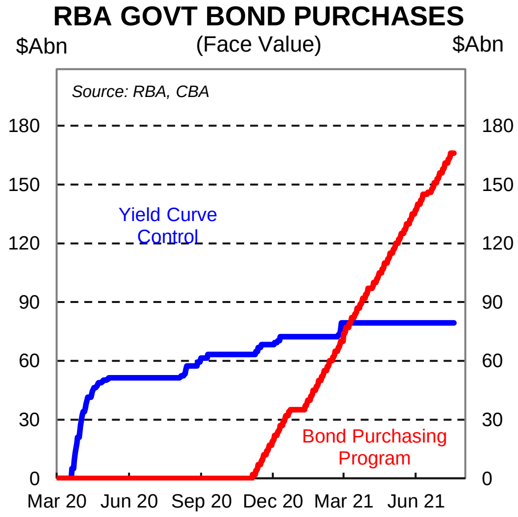
Headline inflation will **jump to 3.5% in Q2 21**, but is forecast back down at 1.9%/yr in Q4 21 and then 2.3% by year-end 2022.

Underlying inflation is expected to **move up gradually to 2.2% by year-end 2022.**



RBA – Policy transition underway





The RBA eased monetary policy in 2020 across a suite of measures and provided support to the economy, the Commonwealth and State governments and the banking system. **In July the RBA begun the journey to unwind its unconventional monetary policy – maintaining YCC at the Apr-24 bond and 'tapering' the QE program.**

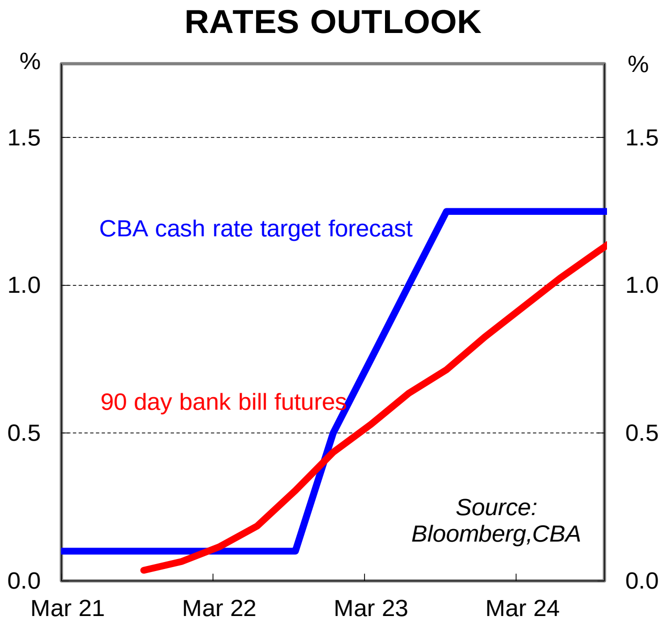
1. Cash rate at 0.1% and ES rate at 0%. RBA says that the inflation and wages condition needed to raise the cash rate "will not be met before 2024." **But the economic recovery and significant fiscal policy support challenge this view – and we expect the first rate hike in November 2022.**

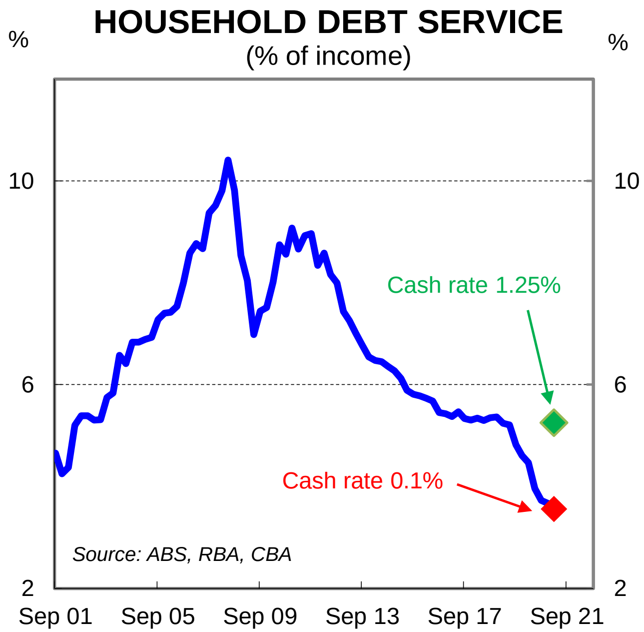
2. The Term Funding Facility (TFF) for Australian banks, provided funds for a fixed 3yr term at 0.1%. **The TFF ended on 30 June 2021 – with a total of around $A188bn drawn from this facility.**

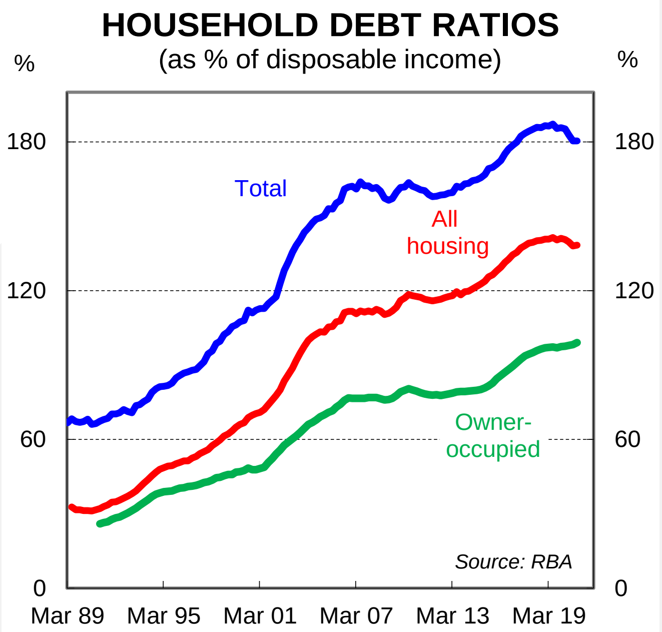
3. The bond purchase or QE program. QE1 was $A100bn from Nov 20-April 21. QE2 is $A100bn ($A5bn/week) from April-August 2021. **QE3 will 'taper' to $A4bn/week for 10 weeks from Sept-11 Nov 21. We expect further tapering in QE3 to May 2022 – could be delayed by lockdowns!**

4. Yield Curve Control (YCC). Targeting the 3yr bond (April 2024) at 0.1%. **RBA has announced YCC will remain with the April 24 bond and not shift to new 3yr benchmark of Nov 24.**

RBA to hike in November 2022; stopping point 1.25%





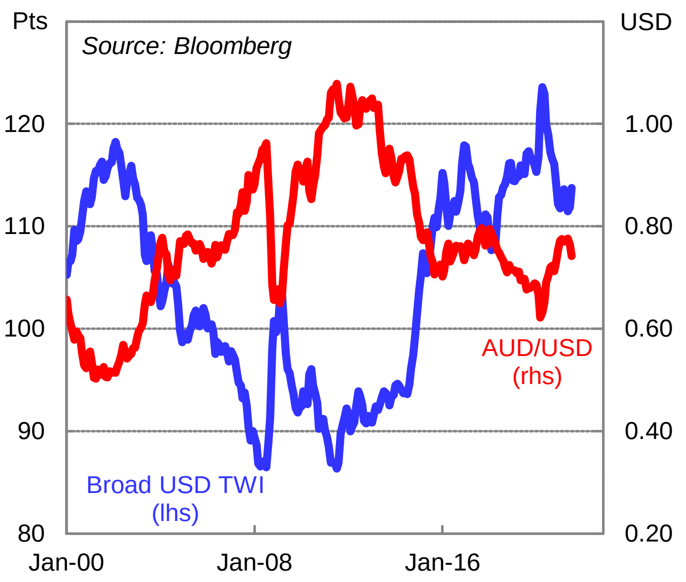


- We expect the conditions to be met for a rate hike in November 2022, with a 15bp move to 0.25%.
- By end-2022 we have wages growth close to 3% and inflation back in the 2%-3% target range.
- Cash rate expected to be 0.5% by end-2022.
- Neutral interest rate peak of 1.25% expected by year-end 2023.

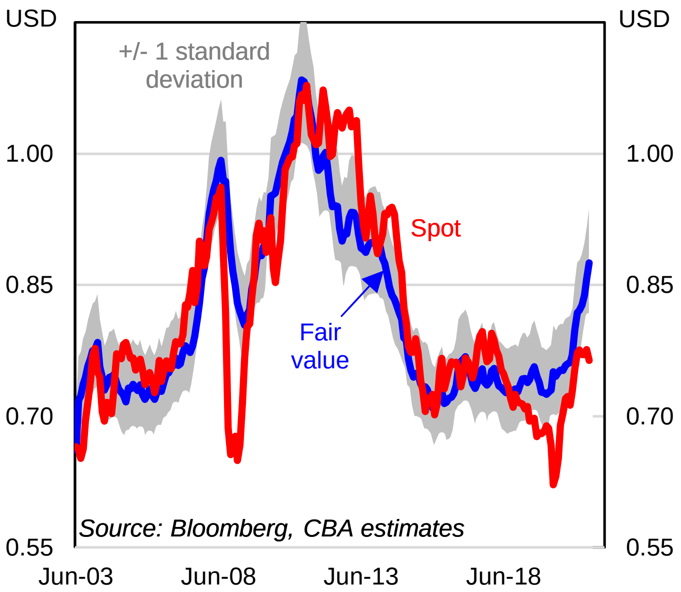
Commonwealth Bank of Australia

AUD to stay undervalued

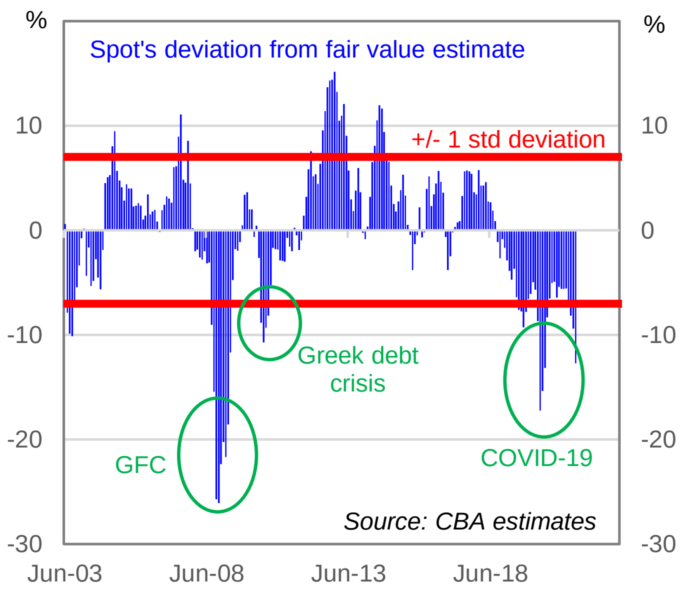
USD TWI & AUD/USD



AUD/USD FAIR VALUE ESTIMATE



DEVIATION FROM FAIR VALUE



- At $US0.73-$UD0.74, AUD/USD is well below the fair value range.
- More US rate hikes can be priced in, supporting further gains in the USD and weigh on AUD/USD.
- We expect AUD/USD to fall deeper into undervaluation this year because of temporary USD strength.
- AUD is forecast at $US0.72 at year-end 2021, but then back up at $US0.80 ay year-end 2022.

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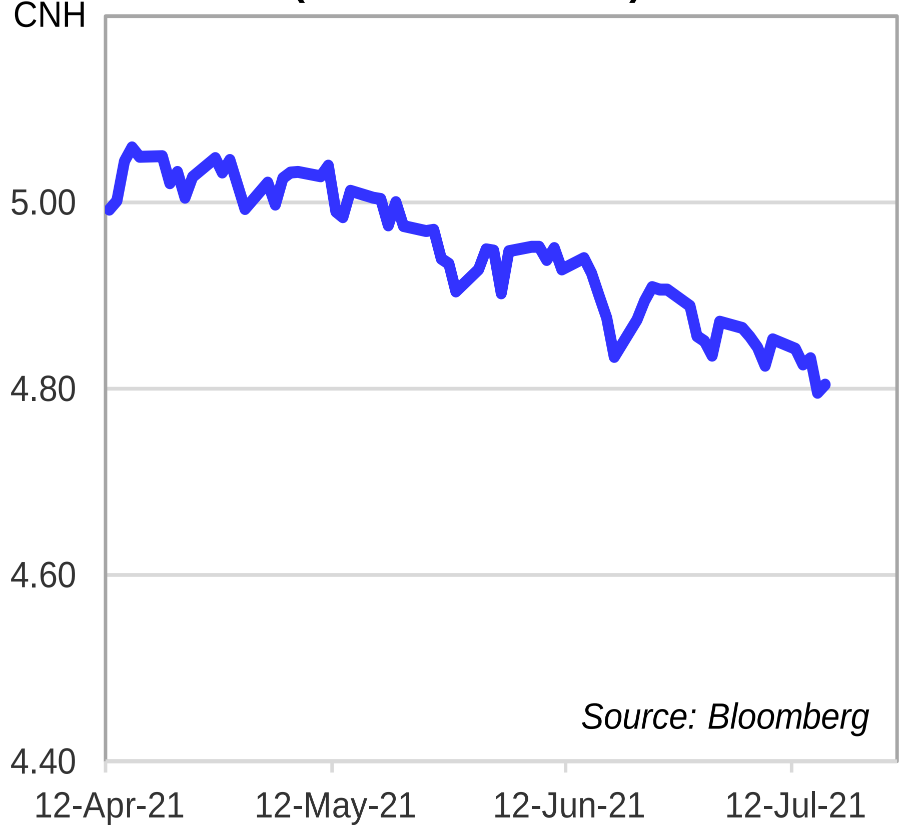
AUD/CNH

- We forecast AUD/CNH to decline over the next few quarters to 4.68, driven by AUD weakness.
- But as economies outside the US recovers, we expect AUD/CNH to return to its uptrend over 2022.
- In the near term, we expect broad USD strength to weigh more on AUD than CNH. Weaker Australian commodity prices and the RBA's dovish policy stance will also bear down on AUD.
- Easing economic momentum in China is a key downside risk to AUD/CNH.

AUD/CNH EXCHANGE RATE
(last three months)



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