

NAB Quarterly Business Survey

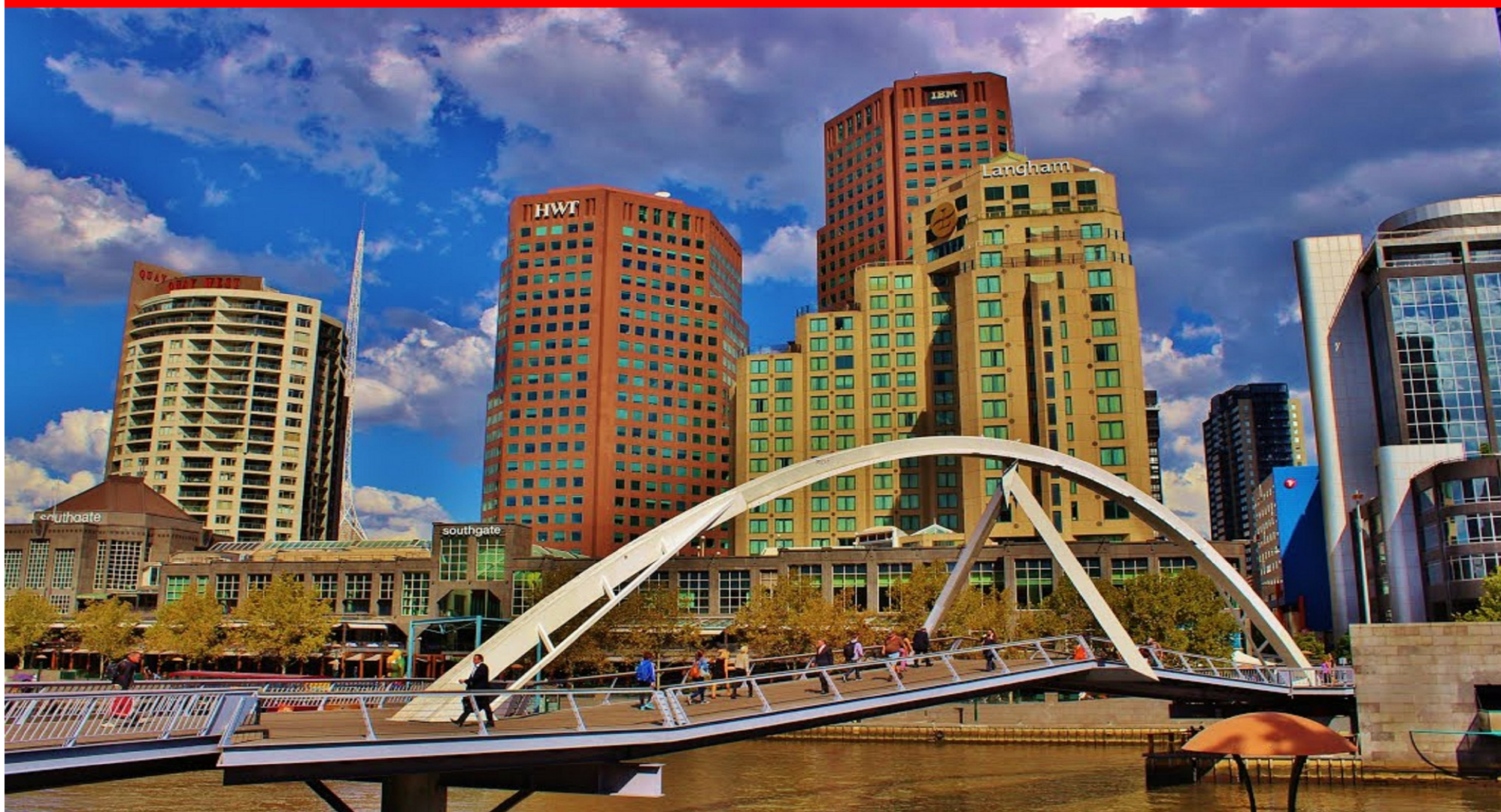
by NAB Group Economics

Embargoed until:
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December Quarter 2014



National
Australia
Bank



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Key Points:

- Business confidence eased back in Q4, dropping back below the long run average level. This is consistent with our monthly survey which showed a noticeable pull back in confidence during November. Nevertheless, conditions held up in the quarter, although this likely reflects a surprisingly strong October result that proved to be short lived. Firms expectations for future activity generally eased.
- Sentiment and business conditions across both states and industries are generally consistent with a 'patchwork' economy. Services and interest rate sensitive sectors such as construction are outperforming, while the downturn in commodity prices and mining investment is evident in the survey responses of mining firms. Construction has been supported by strong investor demand, particularly in medium density housing, driven by low interest rates and foreign buyers. Outside of construction and services, conditions remain soft in all other industries
- Large depreciation in the AUD took place during the survey period in December and was reflected in firms' responses to questions on AUD impacts. When responding, less firms in import competing industries such as manufacturing reported negative effects from the AUD, although the proportions reporting negative impacts are still high in some industries. In contrast, industries with high import costs, such as wholesale, reported a larger impact. The biggest (positive) changes occurred in mining as depreciation helps to cushion the impact of sharp falls in commodity prices. Hedging remains the most common means of managing currency risk.
- Forward orders improved marginally in the quarter despite a number of headwinds, although the level of orders remains subdued. Other leading indicators in the NAB Survey generally softened. Firms expectations for conditions in 3 and 12 months time both eased back, while capacity utilisation and 'bellwether' wholesale conditions deteriorated as well. Spare capacity is a constraint on non-mining investment, although capex expectations for the next 12 months suggest some pick up in spending to come. The most recent ABS Capital Expenditure Survey also suggests an increase in non-mining investment, but not enough to offset the unfolding 'cliff' in mining capex.
- Product price inflation was subdued at an annualised rate of 0.5% (0.1% in the quarter), reflecting softer labour cost growth, which offset stronger purchase cost inflation. Retail prices eased modestly in the survey (in contrast to stronger core inflation reported by the ABS).

Table 1: Key quarterly business statistics*

| | 2014q2 | 2014q3 | 2014q4 | | 2014q2 | 2014q3 | 2014q4 |
|-----------------------|--------------------|--------|--------|---------------------------|--------------------|--------|--------|
| | <i>Net balance</i> | | | | <i>Net balance</i> | | |
| Business confidence | 6 | 6 | 2 | Trading | 5 | 8 | 8 |
| Business conditions | | | | Profitability | 0 | 4 | 5 |
| Current | 2 | 4 | 4 | Employment | -1 | 0 | 0 |
| Next 3 months | 12 | 13 | 8 | Forward orders | 2 | 1 | 2 |
| Next 12 months | 24 | 25 | 22 | Stocks | 2 | 2 | 1 |
| Capex plans (next 12) | 21 | 22 | 21 | Exports | 2 | 1 | 1 |
| | <i>% change</i> | | | | | | |
| Labour costs | 0.5 | 0.5 | 0.4 | Retail prices | 0.0 | 0.2 | 0.1 |
| Purchase costs | 0.3 | 0.3 | 0.5 | | | | |
| Final products prices | 0.2 | 0.2 | 0.1 | Capacity utilisation rate | 80.4 | 80.5 | 80.4 |

** All data seasonally adjusted, except purchase costs and exports. Fieldwork for this Survey was conducted from 25 November to 13 December 2014, covering over 900 firms across the non-farm business sector.

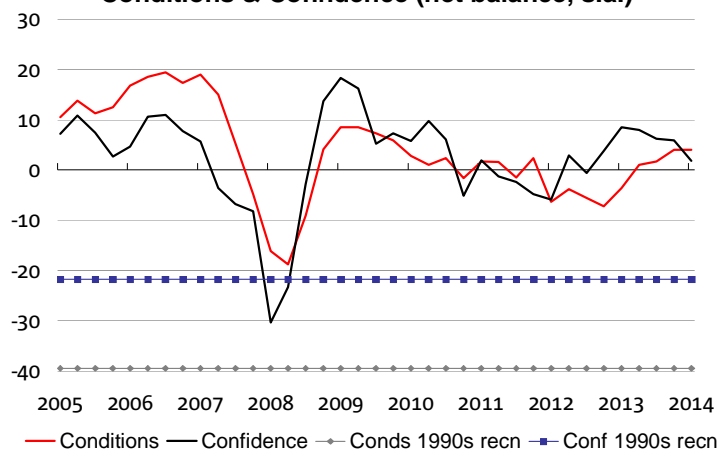
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Analysis

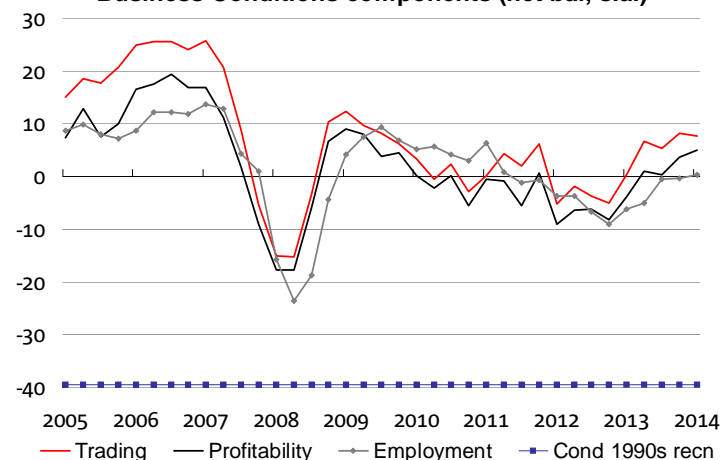
- Business **conditions** were broadly unchanged in the December quarter, remaining at +4 points, although the more timely monthly survey suggests the business environment deteriorated over the course of the quarter following a strong start in October. This outcome for the quarter is a little above the long run average of +1 index point, suggesting that domestic demand growth in Q4 may have been closer to trend. By component, trading and employment were unchanged (the latter at low levels), while profitability improved marginally. However, the business survey continues to show a patchwork economy, with much of the strength restricted to a narrow subset of industries – construction and service sectors were the only industries to record positive business conditions. On a brighter note, **forward orders** improved marginally in the quarter, indicating better momentum for business in the near-term, although other leading indicators from the survey generally softened. Firms' **confidence** eased back 4 points (to +2), which is below the long run average levels (+5).
- The pull back in confidence was not surprising given the more subdued near-term outlook for the economy. Large declines in commodity prices are weighing on incomes and could further erode already soft business and consumer confidence. However, there will be some reprieve via AUD depreciation and significantly lower oil prices that will shore up disposable incomes and reduce inflationary pressures – freeing up the RBA to bolster the economy via an additional rate cut. Lower rates should drive stronger dwelling investment and consumption, although still elevated household savings rates and debt ratios are a concern.



Conditions & Confidence (net balance, s.a.)



Business Conditions components (net bal, s.a.)

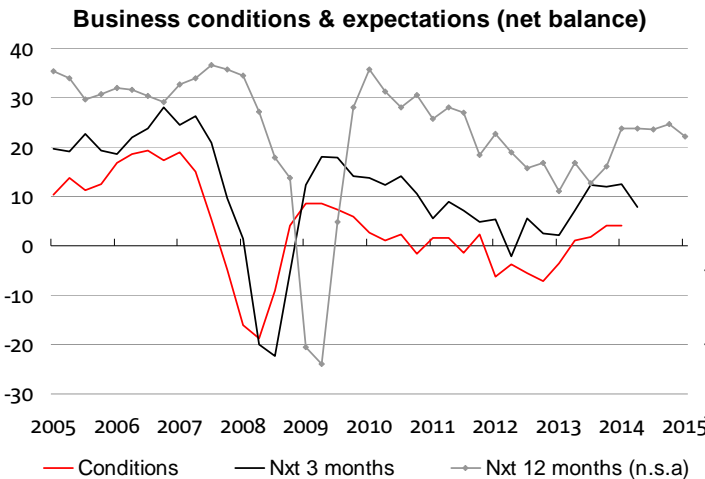


Forward indicators

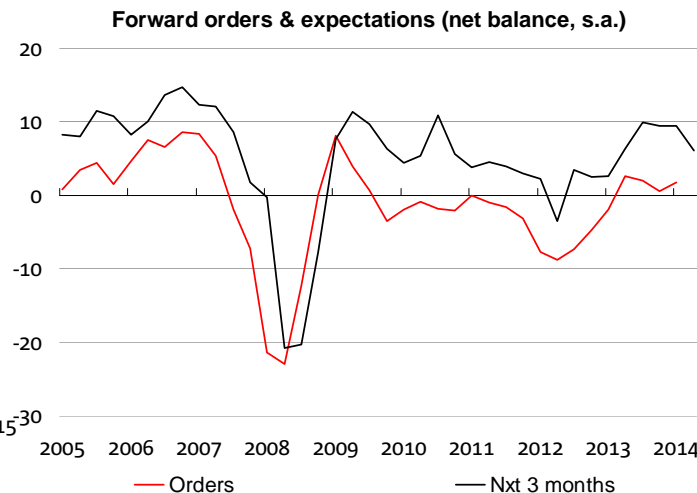
- Consistent with a softer economic outlook for 2015, the positive momentum in firms' expectations for activity in their own business has subsided a little – three and twelve-month expectations have eased. This is consistent with softening confidence levels since the start of 2014. Similarly, other leading indicators such as capacity utilisation and wholesale conditions also weakened. In contrast, forward orders improved modestly (to +2), although they are still soft while expected orders (3 months) pared back.
- Stocks can also be an indicator of near-term activity. Although trading conditions remained positive, the relatively moderate orders index and eroding confidence seems to be discouraging firms from re-stocking more aggressively given limited prospects for stronger demand. Similarly, expectations for stocks (3 months ahead) dipped back below zero, having steadily improved over the past few quarters.



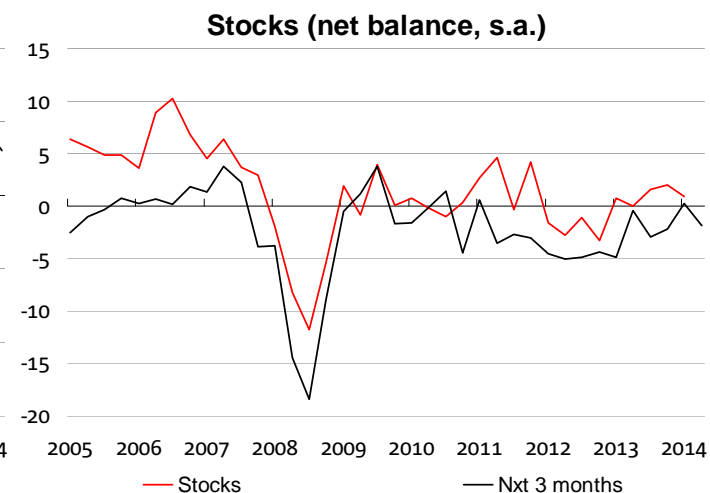
Expectations for 'own business' conditions ebb down



Orders recovery stalls at moderate levels



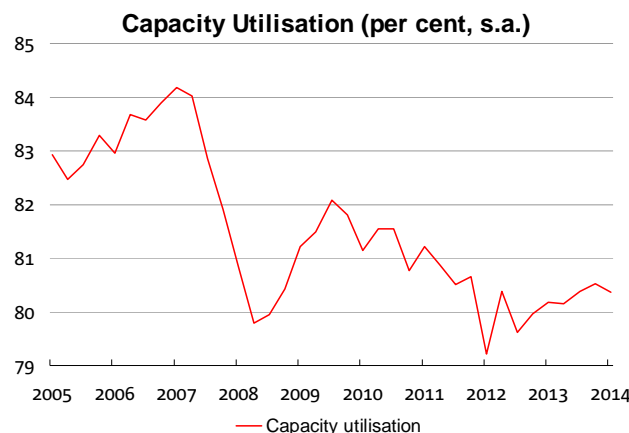
Lacklustre confidence is discouraging more aggressive re-stocking



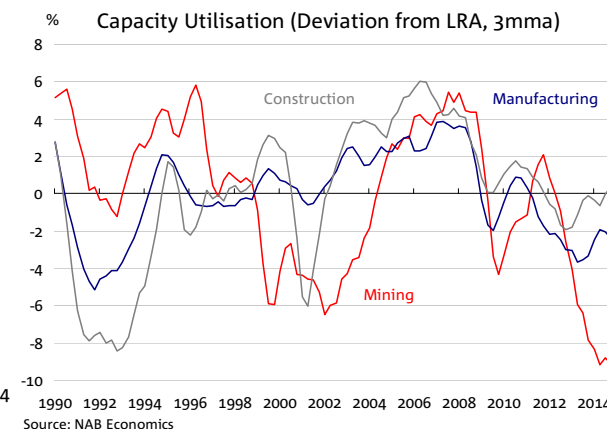
Forward indicators (cont.)

- Capacity utilisation eased back in Q4 after showing an upward trend since mid 2013. The utilisation rate fell 0.1 ppt to be 80.4%, which is well down on pre-GFC highs and marginally below the long run average. This suggests there is still some way to go to work through the excess capacity in the economy that is constraining non-mining investment. The surge in residential building approvals has had minimal impact on construction utilisation rates (80.9% – slightly below the long run average), which is likely a reflection of the downturn in mining investment. The service sectors have relatively elevated utilisation rates, while all other industries are below long run averages.
- According to the NAB survey measure of business capital expenditure, business investment growth may lift notably in the next 12 months, although expectations did ease modestly in Q4. However, mining investment is under represented in our survey, meaning the degree of offset coming from the mining sector may not be fully captured. Indeed, the mining capex index for Q4 is the worst performing among the major industries, at -8 points. Mining capex expectations 12 month ahead dropped in the Q4 (down 5 to +9 points), although the index remains positive. Manufacturing capex is also negative (-1 point), which is consistent with weak confidence and conditions in the sector. Retail capex remains soft, which is a reflection of low consumer confidence on the sectors outlook. Capex is currently strongest in transport/utilities, and is positive for all industries outside mining and manufacturing.

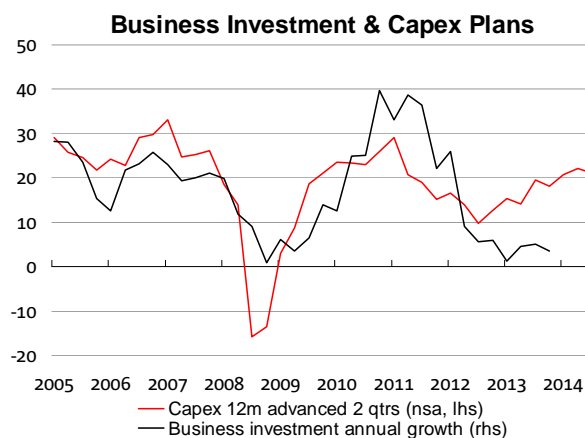
Capacity utilisation are low and eased back in Q4 – limiting capex and inflation pressures



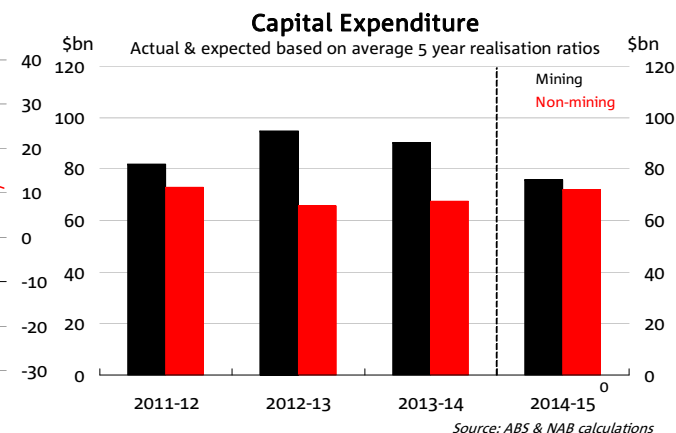
Spare mining capacity rising as investment boom ends



Capex intentions suggests a return of non-mining investment



ABS survey showing insufficient non-mining investment growth



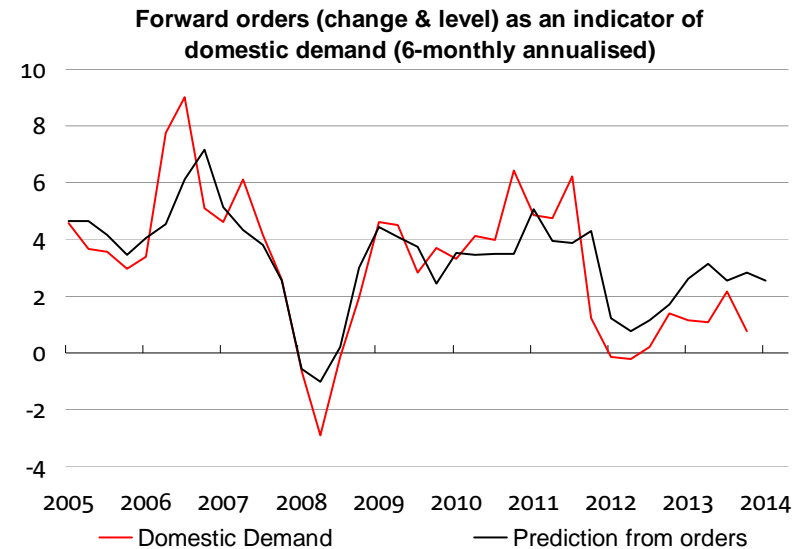
Implications for forecasts

For more information see latest [Global & Australian Forecasts](#)

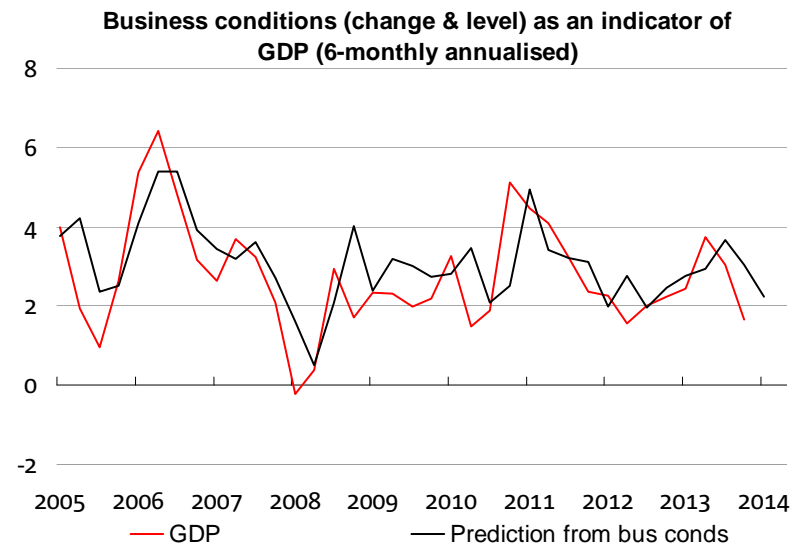
- Our model of 6-monthly annualised demand growth, using forward orders as a predictor, has been suggesting stronger growth than the national accounts in recent quarters. Nevertheless, applying forward orders from the Q4 NAB Business Survey (+2) to our model suggests that predicted demand growth will hold steady at previous (subdued) levels.
- Similarly, business conditions over-predicted GDP growth in Q3, but picked the moderation in growth. Based on business conditions from the Q4 NAB survey, our model implies even softer predicted GDP growth in Q4.
- Looking at business conditions in bellwether industries such as wholesale and transport suggests that conditions could be somewhat softer than these models suggest. Wholesale conditions are currently -6 points, while transport and utilities are also negative at -2 points.



Orders point to stable domestic demand



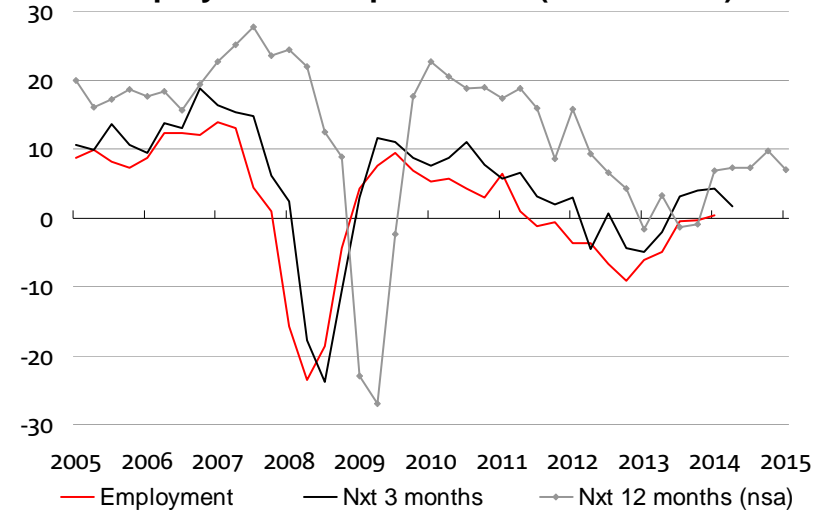
Conditions suggest softer GDP



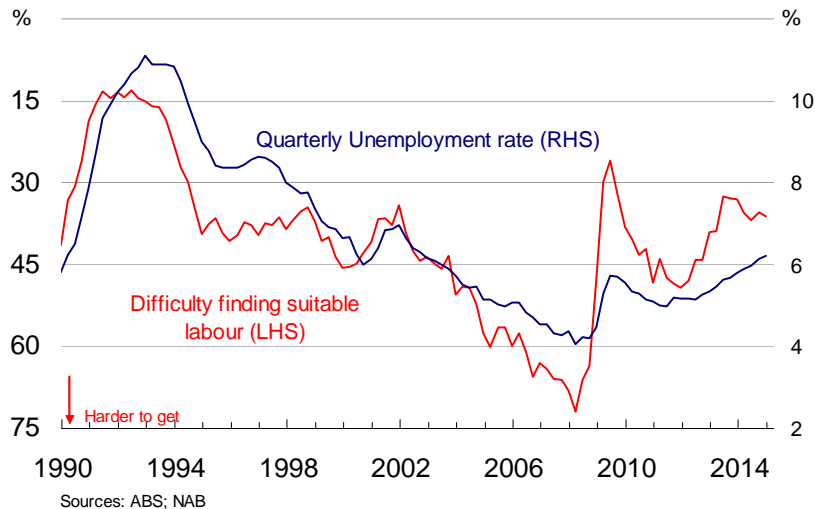
Labour Market

- The employment index was unchanged in the December quarter (at 0 index points), suggesting relatively modest rates of employment growth. These levels are consistent with some additional slack in the labour market that will see the unemployment rate lift a little further from its current level, which was 6.1% in December. On a more positive note, average hours worked lifted slightly to 40 hours (from 39.9 hours) in the December quarter; in contrast, average hours work fell in Q4 according to ABS statistics.
- Near-term employment expectations are positive, but eased back to a soft +2 index points. Longer-term expectations also softened. These outcomes are somewhat consistent with our forecast for the labour market to deteriorate further due to weak domestic demand, but is counter to recent trends in ABS statistics. Official labour force data for the December quarter showed better employment growth, although statistical peculiarities suggest the data should be viewed with caution. The unemployment rate eased to 6.1% in December after hitting it highest level in more than 10 years in October (6.3%).
- Firms continue to report relative ease finding suitable labour.

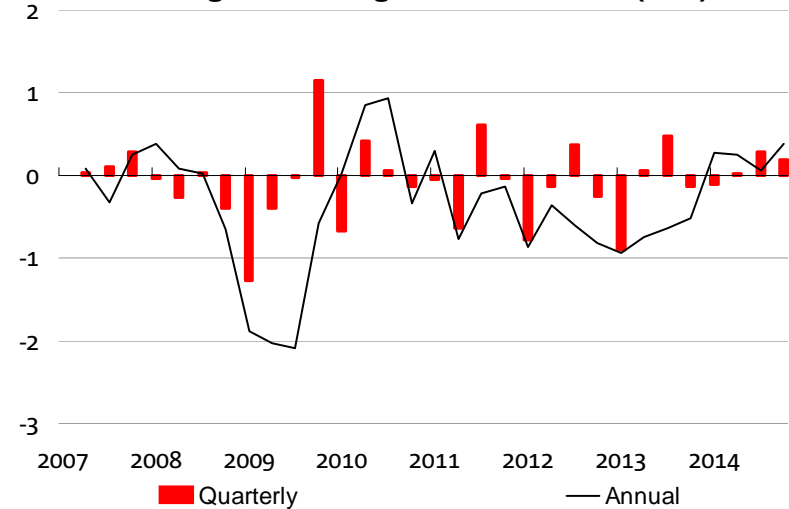
Longer-term employment expectations ease Employment & expectations (net balance)



Labour still relatively easy to find Unemployment rate & labour constraints

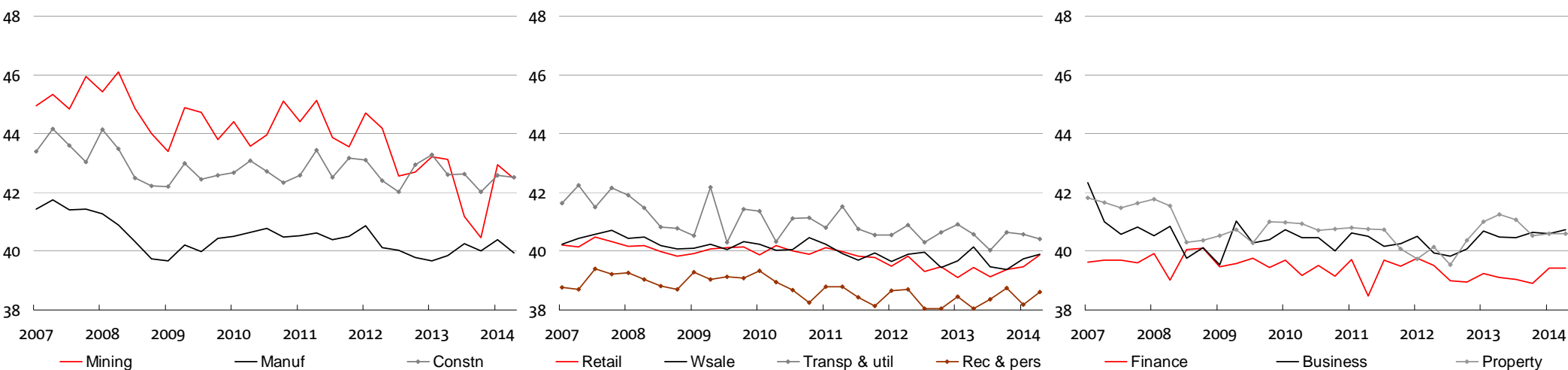


Average hours marginally higher Change in average hours worked (nsa)

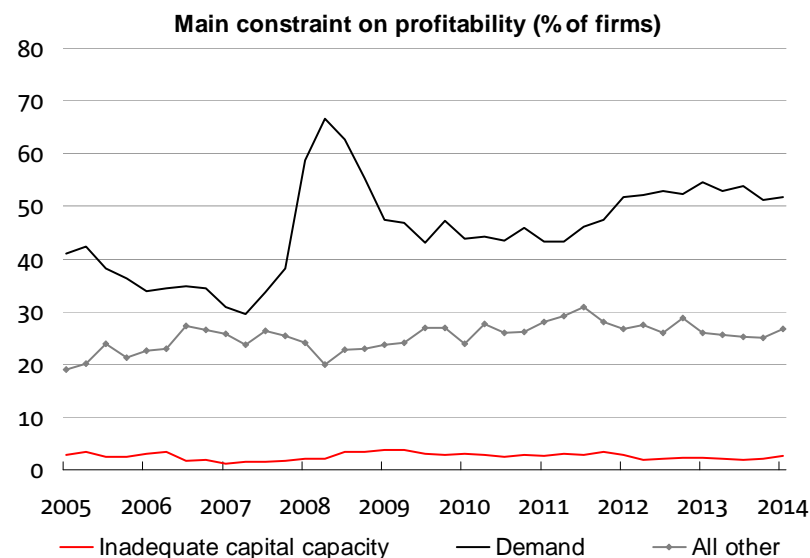
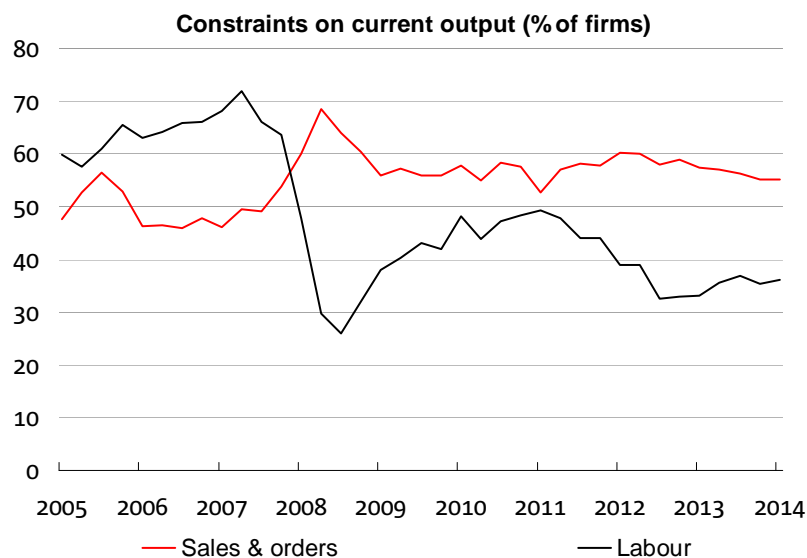


Labour Market (cont.)

Average weekly hours worked by industry (nsa)



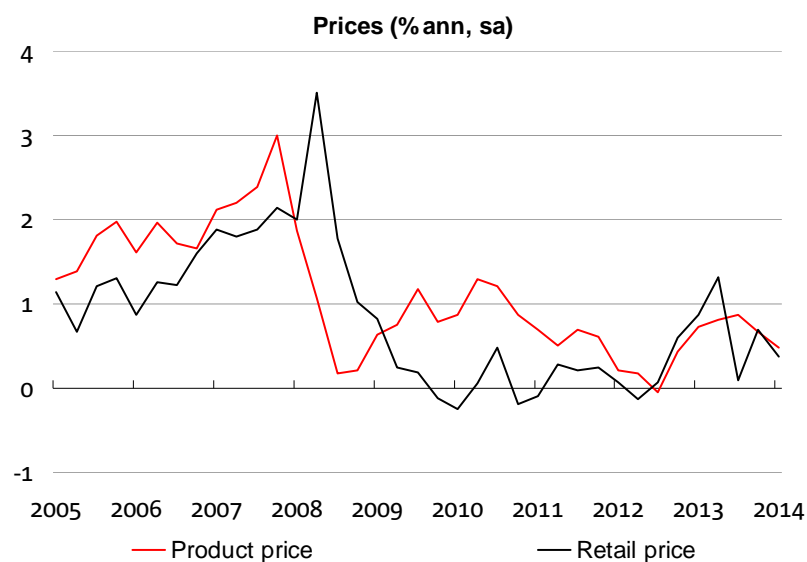
Major constraints on firm output & profits



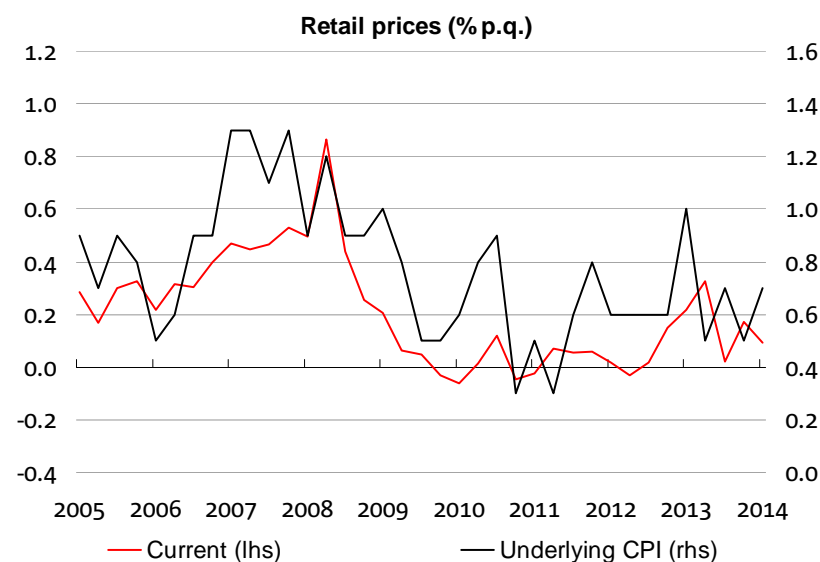
Inflation pressures

- Trading conditions are positive implying better demand, but the prevailing slack in the economy (evidenced by below average capacity utilisation in most industries) and falling oil prices are helping to keep inflationary pressures well contained. Final product prices growth eased slightly to a modest 0.5% annualised (down from 0.7%). Higher purchase cost growth was offset by softer labour cost inflation.
- Only wholesale price inflation rose in the quarter, while mining price deflation accelerated (from -0.7% to -1.5% at a quarterly rate) – consistent with drops in commodity prices. Final product price inflation also eased in manufacturing, retail, transport/utilities and recreation & personal services (to 0.2%, 0.1%, 0.1 and 0.3% respectively, at a quarterly rate), while the remaining industries were unchanged. Quarterly prices growth was strongest in recreation & personal services and wholesale (0.3% in the quarter).
- Labour and purchase costs have continued to outstrip growth in firm's final product prices, with the spread to purchase costs widening in the quarter – consistent with the survey's very weak, albeit improving, profit margins index. Purchase cost inflation overtook labour costs in Q4. Slack in the labour market is keeping labour costs very subdued, while depreciation of the AUD may be contributing to firms purchase costs – with some offset likely coming from lower oil prices. With the AUD expected to continue on a downward track over 2015, importing firms are likely to experience renewed pressure from purchase costs. However, lower oil prices (as well as already soft global inflation pressures) will eventually have flow on effects for imported goods, which should providing some relief for firms and households.

Price growth eases further, consistent with softer core CPI



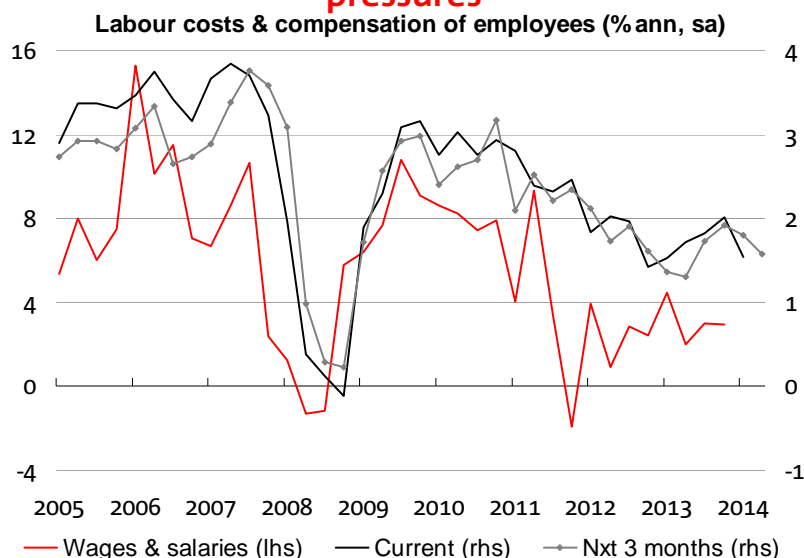
Retail price growth eased, but ABS core CPI surprised to the upside



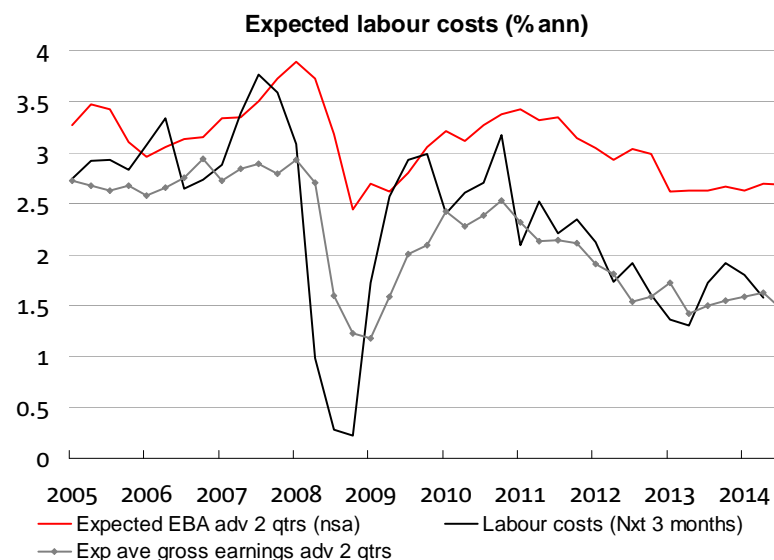
Labour costs (details) and market expectations

- Annualised labour costs growth eased down to 1.5% in the quarter, which is well below the series average of 3.0% since 1989. The subdued pace of growth is consistent with soft employment conditions, with the ABS labour force survey posting an elevated unemployment rate 6.1% (following a decade high of 6.3% in October). Wage pressures are likely to remain fairly benign, with wage increases under EBAs expected to average just 2.7% over the next year, or 1.6% after allowing for productivity offsets.
- On average, businesses revised down their expectation for a rise in short-term interest rates to its lowest since Q3 2013, at 6 bps. This is in contrast to the recent cut by the RBA, as well as market and NAB Economist expectations for a further cut – although market pricing was lower than present at the time of the survey. Exchange rate expectations (6-months-ahead) eased in the quarter to US\$0.85, from US\$0.92, with firms apparently not anticipating the additional depreciation that followed the survey period –driven by USD strength and commodity price declines.
- Medium-term inflation expectations remained soft, with 59% of respondents expecting inflation to remain below 3% (up notably from the previous quarter) and 35% expecting inflation of 3-4% (was 41%). Only 2% of firms believe inflation is a serious problem (unchanged), while 27% believe it is a minor problem (28% previously).

Soft labour market restrain labour cost pressures



Labour cost expectations stable

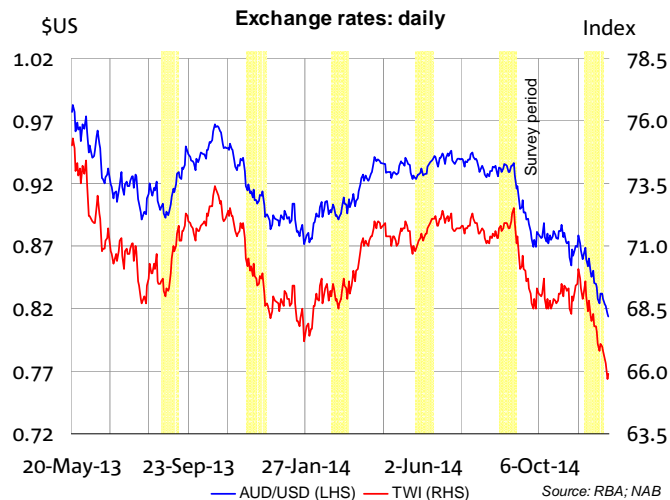


| | Mining | Manuf | Const | Retail | Wsale | Trans | Rec. & pers. | Fin. prop. & bus. | Aust. |
|---------------------|--------|-------|-------|--------|-------|-------|--------------|-------------------|-------|
| Expected EBA growth | 1.3 | 2.6 | 2.9 | 2.7 | 3.0 | 3.0 | 2.7 | 3.0 | 2.7 |
| Productivity offset | 1.8 | 1.1 | 0.9 | 1.1 | 1.7 | 1.1 | 1.1 | 0.9 | 1.1 |
| Net EBA growth | -0.5 | 1.5 | 2.1 | 1.6 | 1.3 | 1.9 | 1.6 | 2.1 | 1.6 |

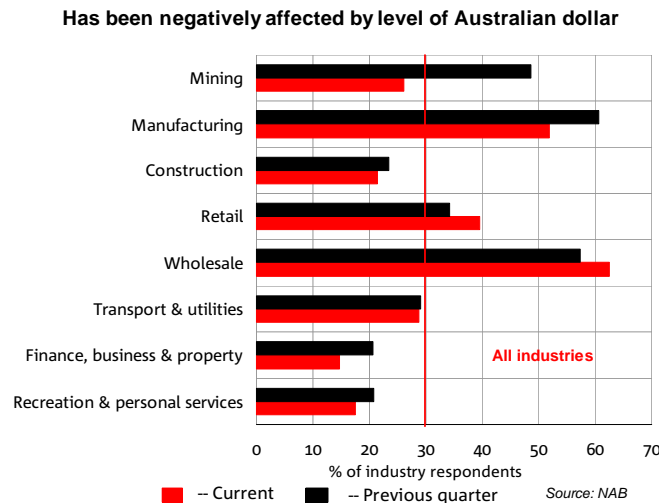
Business & the AUD

- In NAB's Quarterly Business Survey, we have asked businesses how they have been affected by the level of the Australian dollar, and what strategies they have been using to mitigate the negative impacts. The interviews for this question were conducted between 24 November and 12 December, when the exchange rate averaged \$US 0.84 and 67.9 on a TWI basis. These levels are well down from the September survey period (\$US 0.93 and 71.8 on a TWI basis), but above current rates (around \$US 0.78).
- According to the survey, less than 30% of non-farm businesses reported an adverse impact from the AUD (down from Q3 2014), which is to be expected given the notable depreciation of the AUD since the last survey. A majority of industries recorded more positive impacts from the AUD in the quarter – the biggest changes occurring in mining as depreciation helps to cushion the impact of sharp falls in commodity prices. Commodities tend to be bought and sold in USD, limiting the direct impact AUD has on volumes, but a falling AUD will support mining profitability by lowering costs of Australian operations.
- Unsurprisingly, the implications for import costs is having a negative impact on wholesale, with flow on effects to retailers – despite helping competitiveness against overseas online retailers. Retail is the industry where firms are most uncertain over how to manage their currency risk (p3). Wholesale, followed by manufacturing, are still most negatively affected by the AUD, while Fin/ bus/ prop and rec/personal services appear to be most insulated from the AUD, reflecting less import competition and few foreign input costs.
- In terms of how businesses are responding to the negative effects, hedging remains the most common strategy used by affected firms, especially in wholesale and manufacturing, although the strategies employed by these industries are quite diverse. As the currency depreciates, more firms are looking towards import substitution while ramping up their focus on overseas markets. Downsizing and cost reduction strategies may be reaching their limits, although reducing overheads is still an important strategy in manufacturing and transport/utilities.

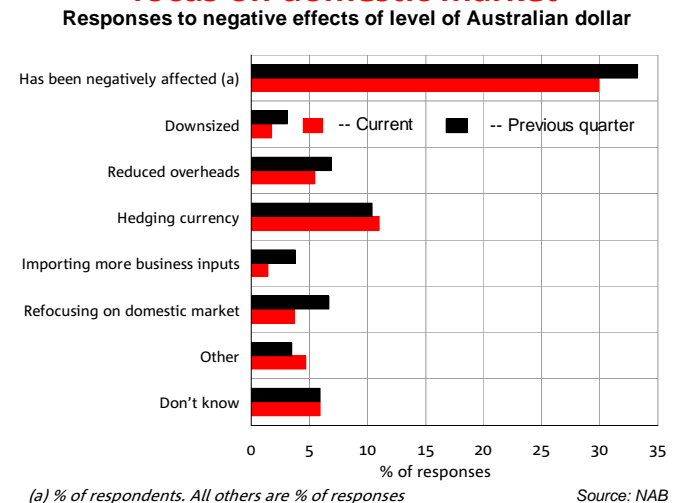
Exchange rate weakened over survey



Most industries less affected



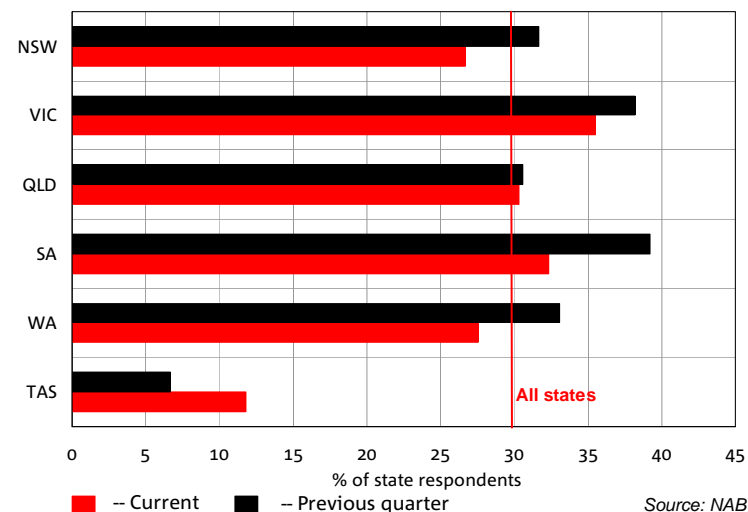
More firms focus on hedging. Less focus on domestic market



Business & the AUD (cont.)

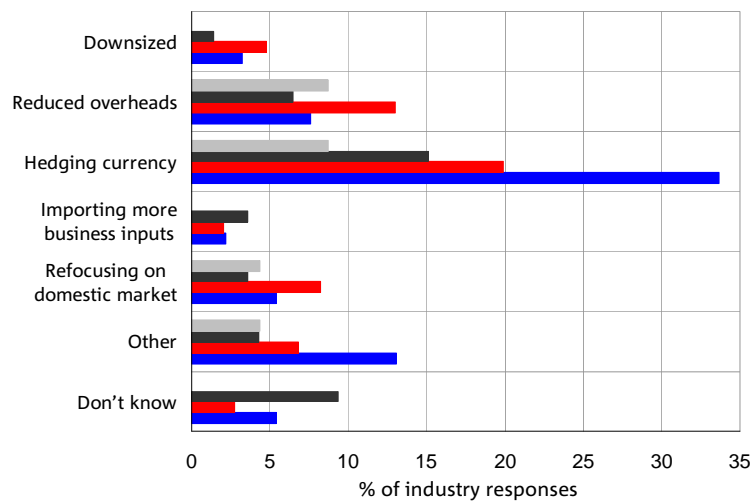
- Negative exchange rate effects declined for all mainland states. Nevertheless, negative impacts are most prevalent in Victoria despite some pull back. Both Victoria and South Australia continue to show the most negative response to the AUD, probably reflecting the relative importance of manufacturing.
- Surprisingly, Queensland recorded only a marginal improvement from AUD depreciation despite the benefits for the mining sector as commodity prices fall, as well as other currency sensitive industries like tourism.
- In contrast, the improvement in WA is more consistent with the expected implications for the mining industry.
- Hedging was important for wholesalers and manufacturers; downsizing and cost reduction are very prevalent in these industries, although still only employed by a relatively small proportion of firms.

Impact of \$A mixed across states
Has been negatively affected by level of Australian dollar

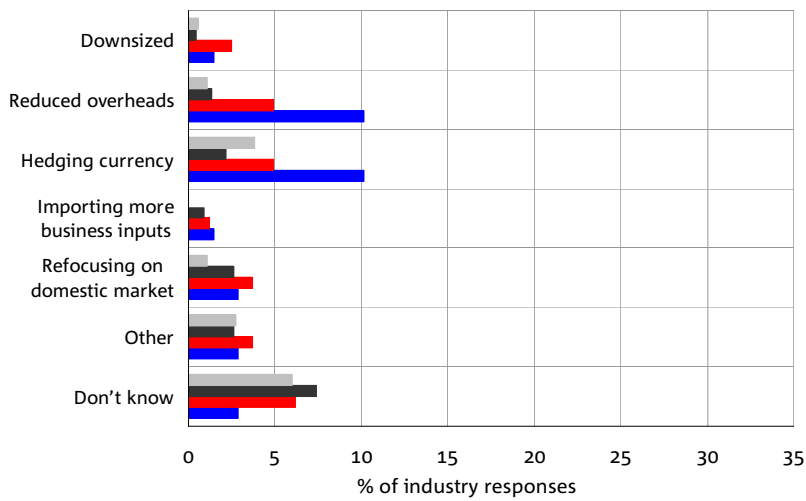


Hedging preferred in wholesale and manufacturing

Responses to negative effects of level of Australian dollar

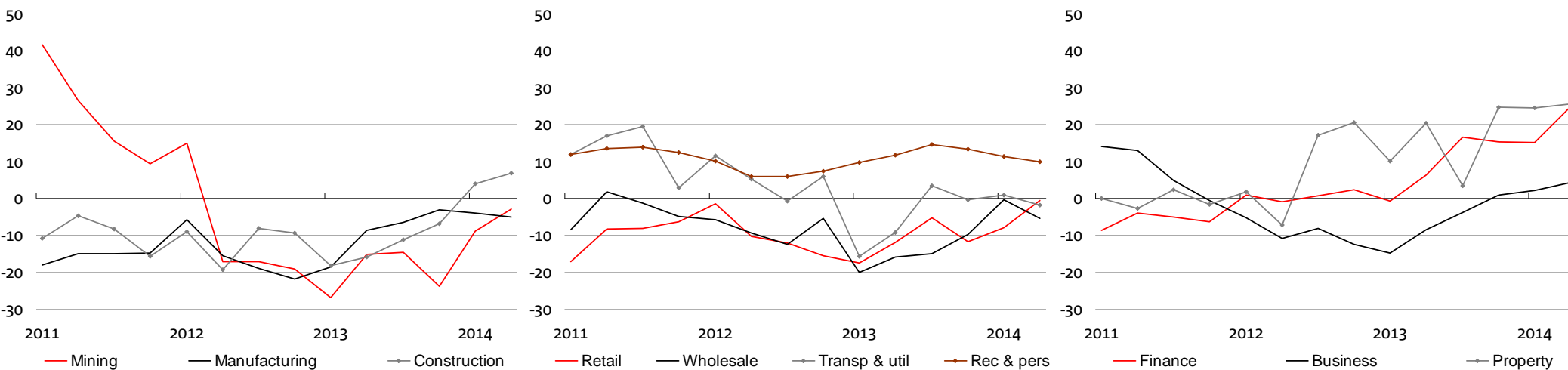


Responses to negative effects of level of Australian dollar

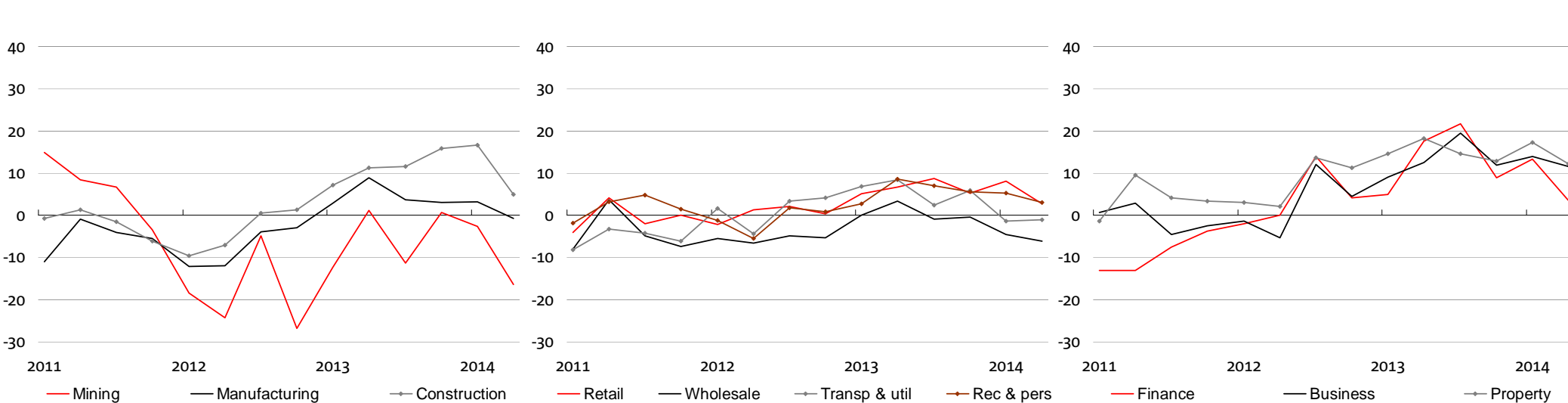


More details on industries

Business conditions by industry (net balance)

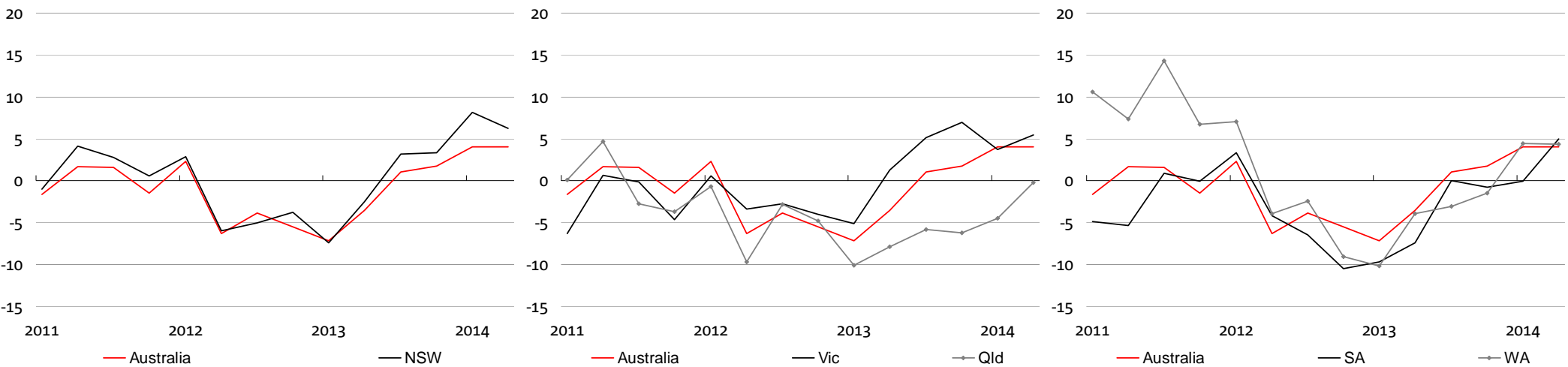


Business confidence by industry (net balance)

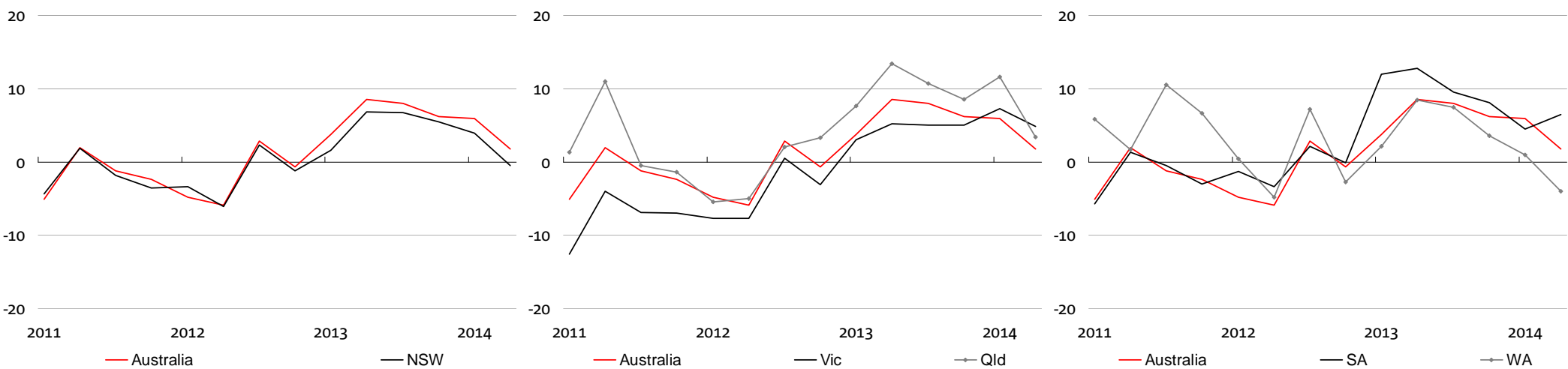


More details on states

Business conditions by state (net balance)



Business confidence by state (net balance)



Data appendix

| | Quarterly | | | | | Monthly | | | | |
|------------|-----------|--------|--------|--------|--------|---------|---------|---------|---------|---------|
| | 2013q4 | 2014q1 | 2014q2 | 2014q3 | 2014q4 | 2014m08 | 2014m09 | 2014m10 | 2014m11 | 2014m12 |
| Confidence | 8 | 8 | 6 | 6 | 2 | 7 | 6 | 5 | 1 | 2 |
| Conditions | -4 | 1 | 2 | 4 | 4 | 5 | 0 | 12 | 5 | 4 |

| | Quarterly | | | | | Monthly | | | | |
|---------------|-----------|--------|--------|--------|--------|---------|---------|---------|---------|---------|
| | 2013q4 | 2014q1 | 2014q2 | 2014q3 | 2014q4 | 2014m08 | 2014m09 | 2014m10 | 2014m11 | 2014m12 |
| Trading | 0 | 7 | 5 | 8 | 8 | 8 | 8 | 19 | 11 | 9 |
| Profitability | -4 | 1 | 0 | 4 | 5 | 4 | -1 | 14 | 5 | 4 |
| Employment | -6 | -5 | -1 | 0 | 0 | 0 | -5 | 2 | 0 | -1 |

| | Quarterly ^(a) | | | | | Monthly | | | | |
|----------------|--------------------------|--------|--------|--------|--------|---------|---------|---------|---------|---------|
| | 2014q3 | 2014q4 | 2015q1 | 2015q3 | 2015q4 | 2014m08 | 2014m09 | 2014m10 | 2014m11 | 2014m12 |
| Conditions | 4 | 4 | | | | 5 | 0 | 12 | 5 | 4 |
| Conds. next 3m | 12 | 13 | 8 | | | | | | | |
| Conds. nxt 12m | 16 | 24 | 24 | 25 | 22 | | | | | |
| Orders | 1 | 2 | | | | 1 | -3 | 4 | 5 | -1 |
| Orders next 3m | 9 | 9 | 6 | | | | | | | |

(a) Quarter to which expectation applies. Business conditions next 12 months not seasonally adjusted.

| | Quarterly ^(a) | | | | | Monthly | | | | |
|------------------|--------------------------|--------|--------|--------|--------|---------|---------|---------|---------|---------|
| | 2013q4 | 2014q1 | 2014q2 | 2014q3 | 2014q4 | 2014m08 | 2014m09 | 2014m10 | 2014m11 | 2014m12 |
| Capacity utilis. | 80.2 | 80.4 | 80.5 | 80.4 | | 80.6 | 80.2 | 80.4 | 80.5 | 80.6 |
| Stocks current | 0 | 2 | 2 | 1 | | 2 | -2 | 5 | 2 | 1 |
| Stocks next 3m | 0 | -3 | -2 | 0 | -2 | | | | | |

(a) Quarter to which expectation applies. All data are seasonally adjusted.

| | 2013q4 | 2014q3 | 2014q4 | | 2013q4 | 2014q3 | 2014q4 |
|-------------------------------------|--------|--------|--------|---|--------|--------|--------|
| Constraints on output (% of firms)* | | | | Main constraints on profitability (% of firms)* | | | |
| Sales & orders | 56.3 | 55.1 | 55.2 | Interest rates | 1.7 | 2.3 | 2.8 |
| Labour | 36.9 | 35.3 | 36.1 | Wage costs | 13.4 | 14.6 | 9.7 |
| Premises & plant | 21.5 | 18.2 | 19.3 | Labour | 3.9 | 4.8 | 6.3 |
| Materials | 9.4 | 8.7 | 9.8 | Capital | 2.0 | 2.1 | 2.6 |
| | | | | Demand | 53.9 | 51.3 | 51.8 |
| | | | | All other | 25.1 | 25.0 | 26.8 |

* not s.a.

Data appendix (cont.)

| | Quarterly ^(a) | | | | | Monthly | | | | |
|--------------|--------------------------|--------|--------|--------|--------|---------|---------|---------|---------|---------|
| | 2014q3 | 2014q4 | 2015q1 | 2015q3 | 2015q4 | 2014m08 | 2014m09 | 2014m10 | 2014m11 | 2014m12 |
| Empl current | 0 | 0 | | | | 0 | -5 | 2 | 0 | -1 |
| Empl next 3m | 4 | 4 | 2 | | | | | | | |
| Empl nxt 12m | -1 | 7 | 7 | 10 | 7 | | | | | |

(a) Quarter to which expectation applies. Employment conditions next 12 months not seasonally adjusted.

| | Mining | Manuf | Const | Retail | Wsale | Trans | Rec. & pers. | Fin. prop. & bus. | Aust. |
|---------------------|--------|-------|-------|--------|-------|-------|--------------|-------------------|-------|
| Expected EBA growth | 1.3 | 2.6 | 2.9 | 2.7 | 3.0 | 3.0 | 2.7 | 3.0 | 2.7 |
| Productivity offset | 1.8 | 1.1 | 0.9 | 1.1 | 1.7 | 1.1 | 1.1 | 0.9 | 1.1 |
| Net EBA growth | -0.5 | 1.5 | 2.1 | 1.6 | 1.3 | 1.9 | 1.6 | 2.1 | 1.6 |

State Tables

| | Quarterly | | | | | Monthly | | | | |
|---------------------|-----------|--------|--------|--------|--------|---------|---------|---------|---------|---------|
| | 2013q4 | 2014q1 | 2014q2 | 2014q3 | 2014q4 | 2014m08 | 2014m09 | 2014m10 | 2014m11 | 2014m12 |
| Business conditions | | | | | | | | | | |
| NSW | -3 | 3 | 3 | 8 | 6 | 10 | 0 | 17 | 5 | 5 |
| VIC | 1 | 5 | 7 | 4 | 5 | 3 | 10 | 8 | 5 | 7 |
| QLD | -8 | -6 | -6 | -4 | 0 | -3 | -6 | 5 | 1 | -1 |
| SA | -7 | 0 | -1 | 0 | 5 | -6 | 5 | 10 | 9 | 0 |
| WA | -4 | -3 | -1 | 4 | 4 | 12 | 1 | 13 | 9 | 3 |

| | Quarterly | | | | | Monthly | | | | |
|---------------------|-----------|--------|--------|--------|--------|---------|---------|---------|---------|---------|
| | 2013q4 | 2014q1 | 2014q2 | 2014q3 | 2014q4 | 2014m08 | 2014m09 | 2014m10 | 2014m11 | 2014m12 |
| Business confidence | | | | | | | | | | |
| NSW | 7 | 7 | 5 | 4 | -1 | 7 | 4 | 4 | 1 | 2 |
| VIC | 5 | 5 | 5 | 7 | 5 | 7 | 9 | 6 | 6 | 2 |
| QLD | 13 | 11 | 9 | 12 | 3 | 14 | 2 | 8 | 3 | 4 |
| SA | 13 | 10 | 8 | 4 | 6 | 4 | 2 | 3 | 1 | 5 |
| WA | 8 | 7 | 4 | 1 | -4 | 2 | -6 | 1 | 0 | -4 |

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