more give, less take

Global & Australian Forecasts

by NAB Group Economics

Embargoed until:
11:30am Tuesday 14 April 2015

April 2015

National Australia Bank

Key Points:

- **Global growth remains stuck at a sub-trend pace. After 3.3% in 2014 we now expect only 3.4% in 2015. While the Euro-zone and Japan are experiencing upturns, recent US data has disappointed. We have delayed the Fed starting till September (or later) and reduced US GDP in 2015 to 2.7%. March quarter business surveys do not suggest any acceleration in advanced economy growth – which we require to achieve the 2015 forecast. With Chinese growth slowing and weak outcomes across the rest of East Asia and Latin America, there is no evidence of an upturn in emerging market economy growth either. Emerging market economies make only a minimal contribution to the 2015 forecasts with the Chinese slowdown offsetting faster Indian growth.**
- **We have fine tuned but not fundamentally changed our forecasts– 2014/15 2.3% and 3.0% in 2015/16. The big picture in Australia is still one where the non mining sector is struggling to offset the impact on domestic demand of sharply lower mining investment. Further falls in commodity prices are lowering income flows. A particular concern is the weak medium term outlook for non mining investment, while the consumer remains cautious. As a result we still see unemployment rising to 6.7% by end 2015. While the March business survey was encouraging, business confidence remains weak and business conditions in Q1 were still sub trend – we will need more readings to be sure that tentative signs of better non mining activity are becoming entrenched. We still see another rate cut – most likely May but it is possible that if the economy continues to improve, the cut could be further delayed. We are not forecasting a second cut to below 2% - we see that possibility at 35-40% - significantly below the market's current view (fully priced). We see rate rises starting again by late 2016.**

Key global and Australian forecasts (*% change*)

Country/region	IMF weight	2013	2014	2015	2016
United States	16	2.2	2.4	2.7	2.7
Euro-zone	12	-0.4	0.9	1.4	1.8
Japan	5	1.6	-0.1	0.8	1.3
China	16	7.7	7.4	7.1	6.9
Emerging East Asia	8	4.3	4.0	4.0	4.2
New Zealand	0.2	2.3	3.3	2.9	2.7
Global total	100	3.3	3.3	3.4	3.5
Australia	2	2.1	2.7	2.4	3.2
Australia (*fiscal years*)		13/14	14/15	15/16	16/17
Private consumption		2.2	2.7	2.9	2.7
Domestic demand		1.0	0.9	1.2	1.0
GDP		2.5	2.3	3.0	3.1
Core CPI (*% through-year*)		2.8	1.9	2.6	2.4
Unemployment rate (*% end of year*)		6.0	6.4	6.5	6.2

Contents

Key points 1
Global and Australian overview 2
Global forecasts 7
Australian outlook 8
Australian financial markets 13

For more information contact:
Alan Oster, Chief Economist: (03) 8634 2927 or 0414 444 652
Tom Taylor, Head of International Economics:
(03) 8634 1883

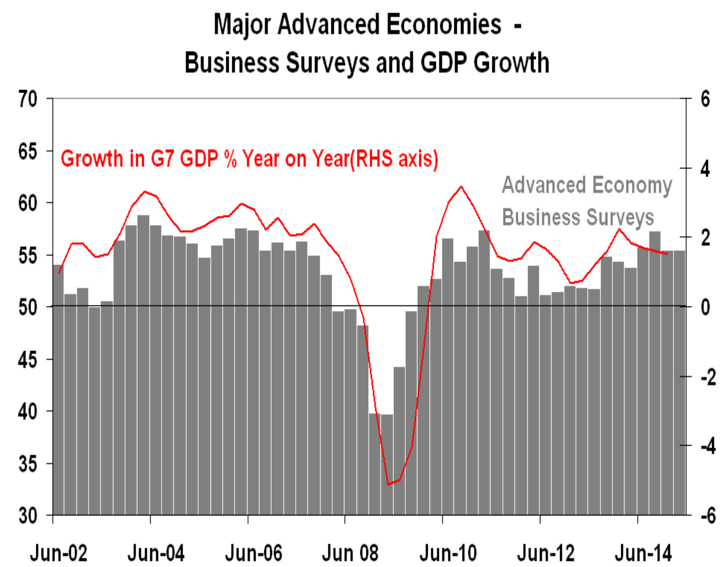
Global and Australian overview

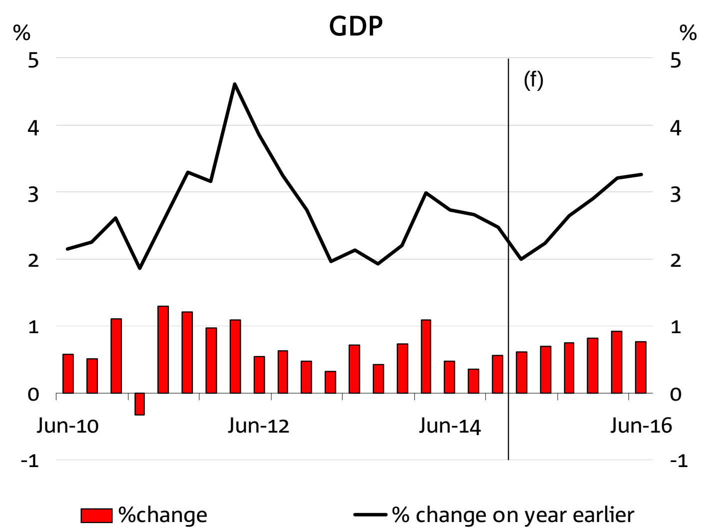
Global overview

- The very modest pick-up in year-average global growth predicted for 2015 relies heavily on faster expansion in India and the big advanced economies (where recovery in the weak Euro-zone and Japanese economies accompanies ongoing moderate expansion in the US). Chinese growth should continue to trend lower alongside ongoing sluggish growth in the other emerging market economies of East Asia and soft conditions in Latin America.
- Economic data for the opening months of 2015 shows moderate expansion continuing but little evidence yet of the pick-up expected in overall growth. Business surveys show the Euro-zone improving but US growth looks soft in early 2015 and the pace of the upturn in Japanese activity remains far from clear. Emerging economies also present a mixed picture with industry and real estate slowing in China, recessionary conditions in Brazil and Indian output picking up after a long disappointing period.

Australian overview

- We have fine tuned, but not fundamentally changed our domestic forecasts – 2.3% in 2014/15 and 3.0% in 2015/16. The big picture is one of an economy still struggling to offset the impact of falling mining investment on domestic demand. Further sharp fall in commodity prices (especially iron ore) are reducing income flows within the economy (now in excess of $50bn per annum) and crunching government finances ($15bn per annum Federally). Ultimately the hit from mining could be bigger than previously feared.
- Against that non mining investment remains surprisingly weak. While early days the March Monthly survey provides some tentative positive signs. With on going growth in the out years (2016/17) expected to be around 3%, unemployment, after peaking at around 6.7% by end 2015, will remain high. Inflation will slow further as domestic demand remains sluggish - with little real wage growth. That together with lower oil prices pushes headline to be around 1% by mid 2015 with core inflation falling to the bottom of the RBA's target range (below) by Q3 2015 – and remain in the bottom half of the target range till H2 2016.
- We still see another rate cut – most likely May but it is possible that if the economy continues to improve, the cut could be further delayed. We are not forecasting a second cut to below 2% - we see that possibility at 35-40% - significantly below the market's current view (fully priced). We see rate rises by late 2016.

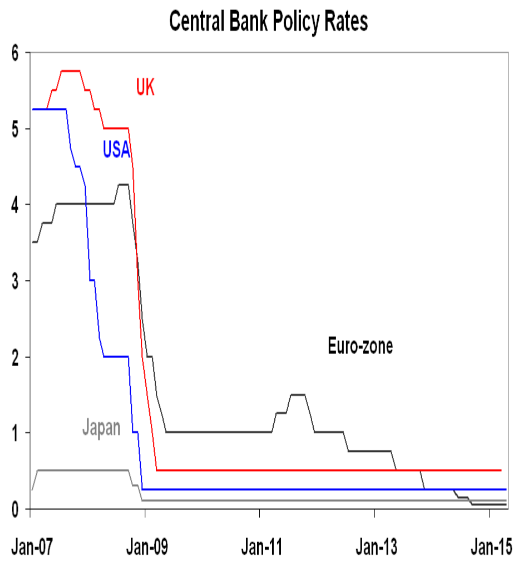


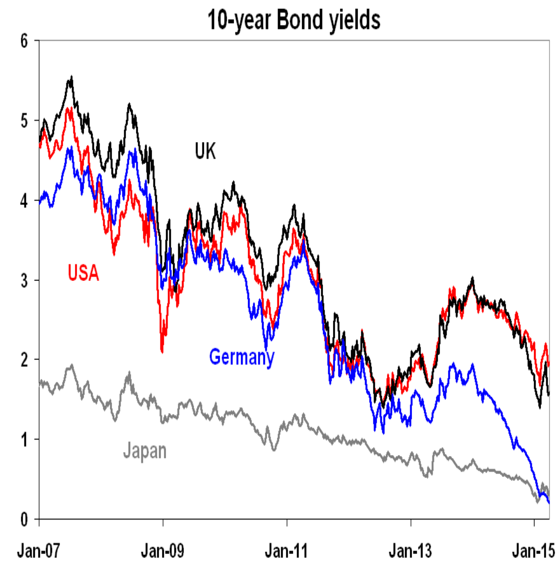


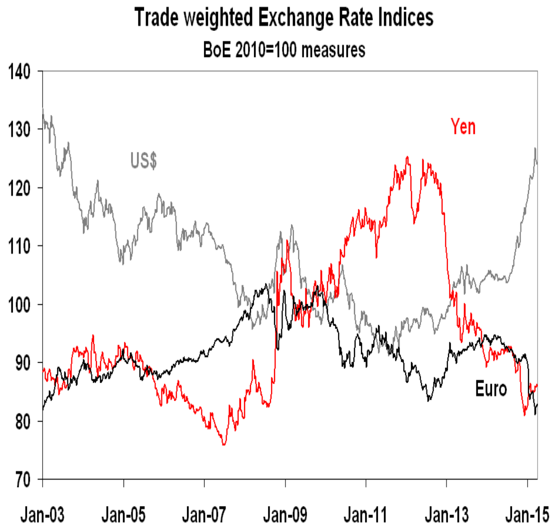
Sources: ABS, NAB estimates

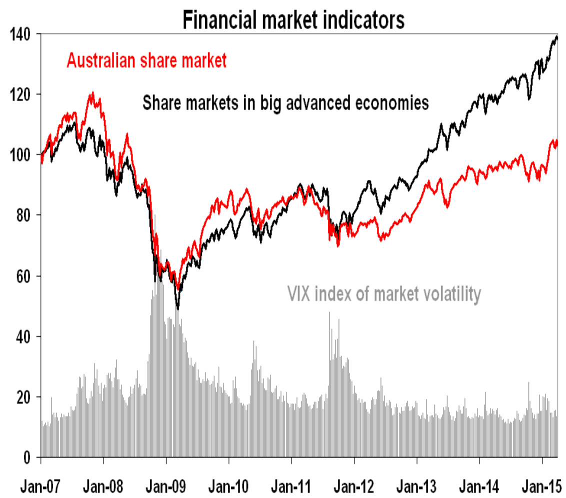
Financial markets

- Divergence in economic conditions between the big advanced economies has been highlighted in recent central bank decisions on monetary policy. The Fed is still preparing the ground for a gradual rise in US policy interest rates but recent soft activity data and an absence of inflation pressures give the Fed discretion over when to start raising rates. We think the first 25 bps rise will come in September with another by year end. The Fed is still saying that it could keep its target rate below its long-run average for some time even if inflation and employment are around target.
- The Bank of Japan's policy remains focussed on promoting inflation and a recovery in output by keeping zero interest rates through boosting the money supply by buying assets (especially government bonds). The central bank remains convinced that trend output is recovering from last year's recession and says that it will keep zero rates and large asset purchases until it is confident inflation has settled at its target 2%.
- With Euro-zone CPI inflation turning negative in late 2014, little growth in output and double-digit unemployment, the ECB stepped up its asset buying policy with the decision to purchase government bonds. Policy interest rates are already near zero but the big depreciation in the Euro against the $US, lower bond yields, easier access to finance by business and rising loan demand should combine with the announced lift in asset buying to boost activity.
- Divergent underlying conditions between the big advanced economies are reflected in the fall in the Yen and Euro and the appreciation of the $US. These currency changes are now shifting global demand toward the weaker Euro-zone and Japanese economies, helping broaden growth.



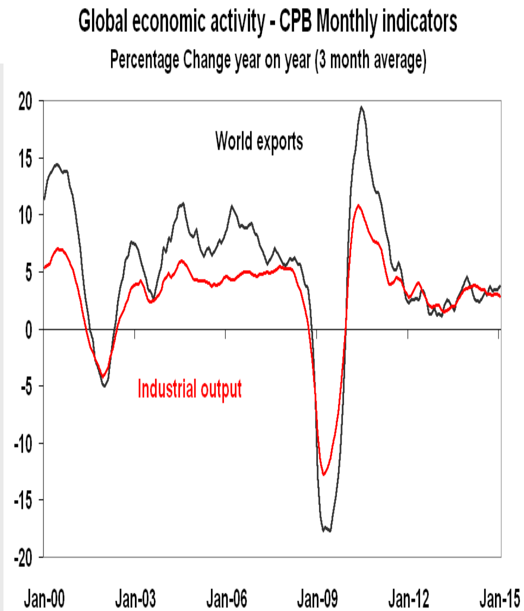


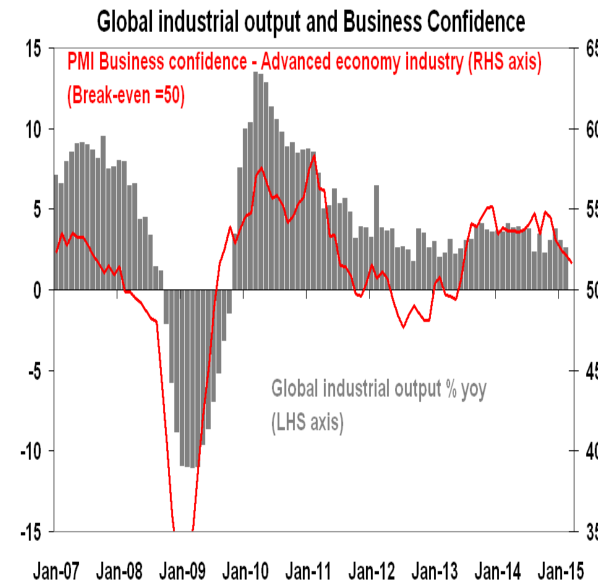


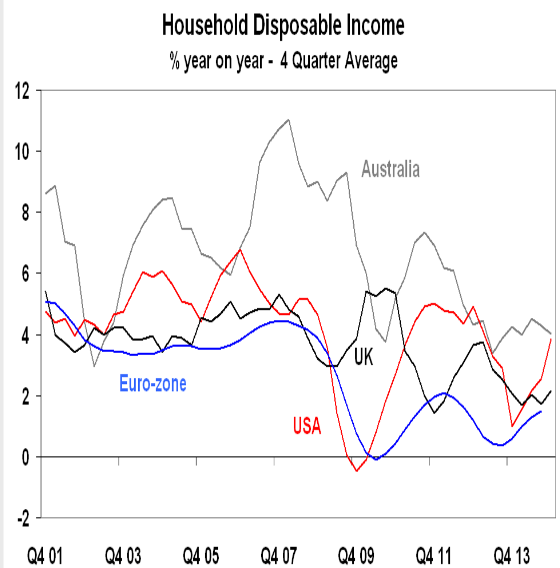


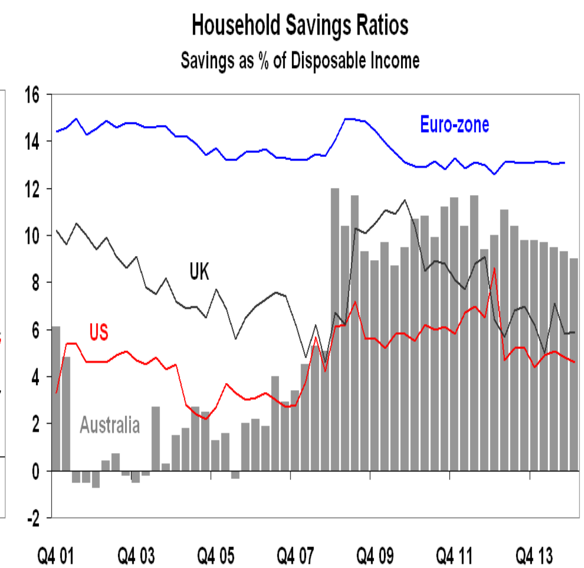
Global Economic Trends

- Global GDP growth continues at a sub-trend pace of just over 3% with comprehensive global data showing industrial output and world exports expanding by 3% to 4% yoy through late 2014 and into January 2015. Partial data available for February shows industrial output growing at just over 3% yoy, around the same rate as averaged over the previous 6 months.
- Advanced economy business survey results for March quarter show a mixed picture. Recent poor results for the US have depressed overall sentiment in the advanced economy industrial sector. Economy-wide surveys show activity growth holding up but not accelerating in the first quarter. Emerging economy conditions also vary with positive results in India (third biggest global economy), soft outcomes across much of East Asia - including China (possibly now the world's biggest economy) and recessionary conditions in Brazil (the seventh biggest global economy).
- Sluggish household income growth is frequently blamed for holding back recovery in big advanced economies. Very low CPI inflation (with an OECD headline rate of only 0.6% yoy and core of 1.8% yoy) plus the legacy of high unemployment have depressed wage growth. Disappointing economic growth has hampered job creation with OECD job numbers in late 2014 only around 2% higher than they were before recession hit.
- Conditions vary across nations with persistent weakness in household income growth in Western Europe, an upturn in the US and Australia slowing toward growth rates seen elsewhere. Savings ratios also vary with the US and UK ratios back around pre-crisis levels, persistently high Euro savings and an Australian rate still well above its pre-GFC level.



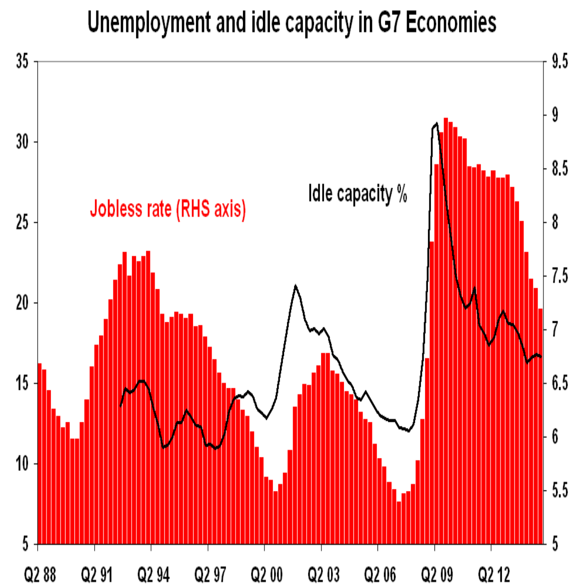


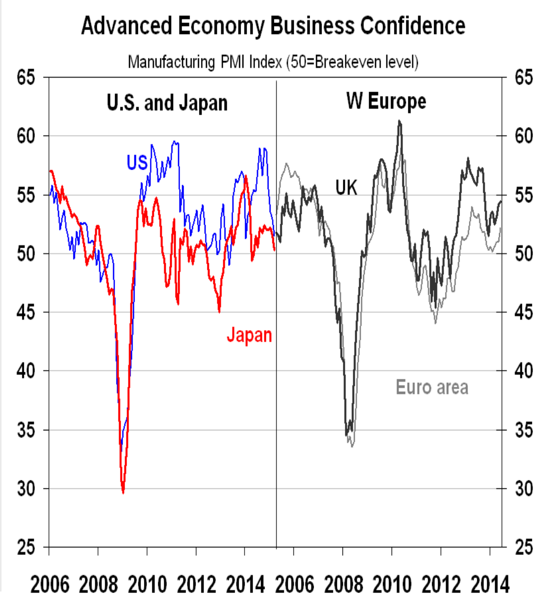


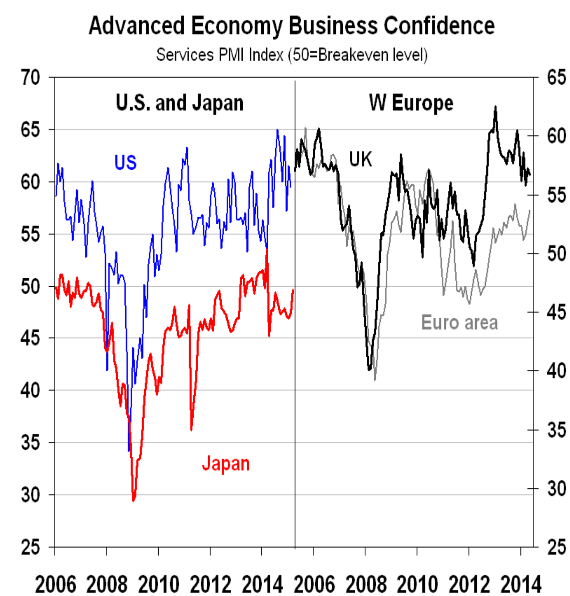


Advanced Economies

- Annualised growth in the big 7 advanced economies accelerated across the first three quarters of 2014, reaching 2½% in September (from virtually nothing in March) before falling slightly in the final quarter to around 2%. The US accounted for most of this slowing in late 2014 as Japanese and Euro-zone growth was faster in late 2014.
- March quarter business surveys show late 2014 trends continuing with measures of manufacturing and services activity trending down in the US, picking up in the Euro-zone and mixed signals in the UK and Japan. The surveys are, however, consistent with solid growth in the UK and US plus continued, albeit still weak, growth in Japan.
- Some of the recent weakness in the US reflects bad weather and port strikes but, as softer than expected data has gradually accumulated through recent weeks, there are concerns that growth could continue to turn out weaker than expected. The stronger $US is now curbing activity with reports of heightened competitive pressure on exports and import competing industry. Elsewhere, the Euro zone seems to have commenced a long awaited economic upturn and there is plenty of scope for catch-up growth as GDP in late 2014 was lower than it was in mid-2007. By contrast, US output in late 2014 was almost 10% above its pre-crisis level.
- Differences in the extent of unused output capacity reflect these divergences in the strength of the recovery from the recession of 2008/9. The jobless rate across the G7 Advanced economies has fallen to around 7%, not far off its 25 year average and the amount of idle industrial capacity has halved. However, although the jobless rates in the UK, US and Japan have fallen heavily to below their 25 year average, Euro-zone unemployment is still 10%.

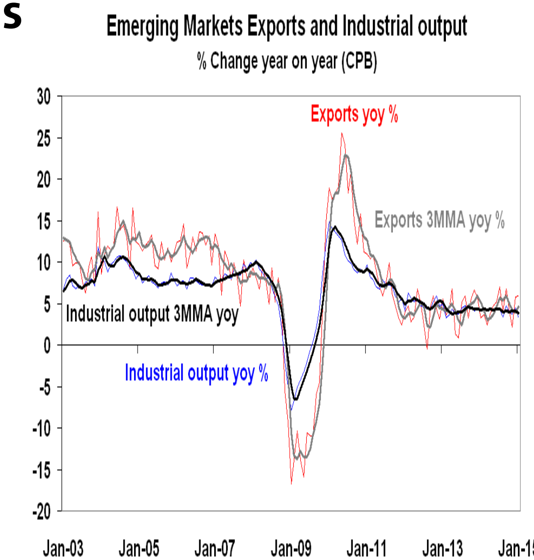


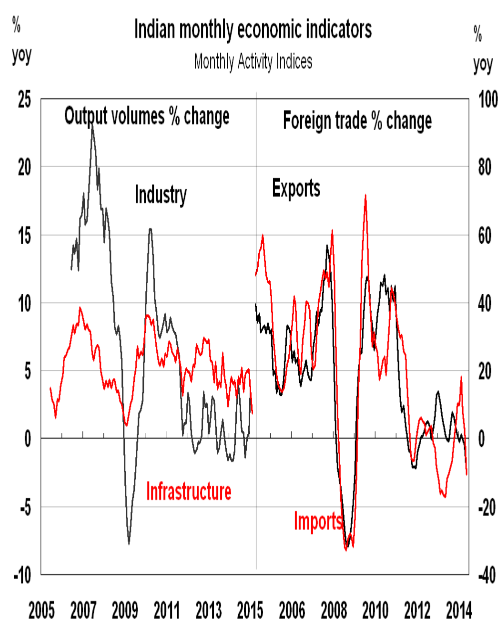


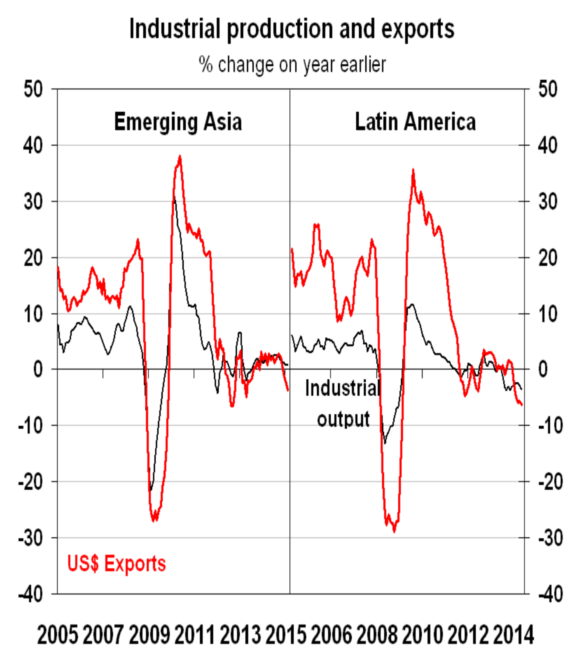


Emerging Market Economies

- Emerging market economy growth remained around 6% yoy through 2014 and, taken overall, neither the business surveys nor the partial data on trade volumes or industrial output suggest that it was picking up toward the end of last year or through early 2015. Industrial output and export volume growth has remained at an annualised rate of around 4% and the business surveys give a mixed picture. Confidence levels in Indian business have picked up but Brazilian surveys are at recession levels and survey readings across East Asia are not very strong.
- The sluggishness in world trade and falling commodity prices have depressed income and activity in many key emerging markets. African and Latin American commodity producers have suffered from lower food and metals prices, the export-oriented industrial economies of East Asia have been hit by the weakness of growth in imports into the big advanced economies. Even allowing for the depressing impact of $US appreciation on trade flows denominated in that currency, export growth out of Emerging East Asia has been slow (around 2% yoy in volume terms).
- Turning to the big economies, early 2015 data on Chinese industrial output and fixed investment spending showed a continuation of the downward trend evident since mid-2011. Retail trade has held up much better, as the authorities would wish, given their policy of re-balancing growth away from investment toward consumption. Indian data on trade and output presents a mixed picture and is not as solid as recent buoyant business surveys might suggest. Both exports and imports have been surprisingly weak since mid-2014, reflecting lower commodity prices rather than $US strength.

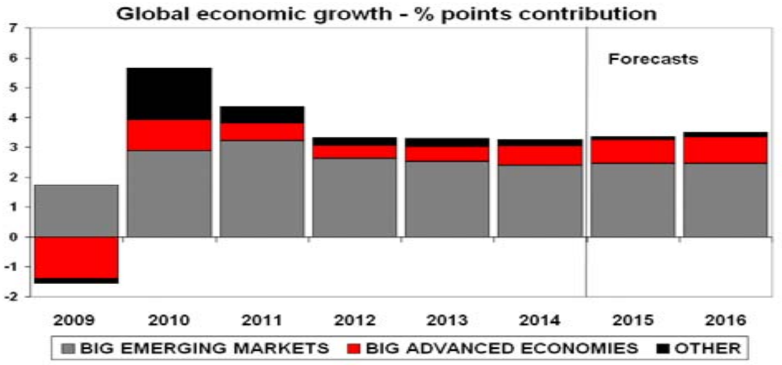






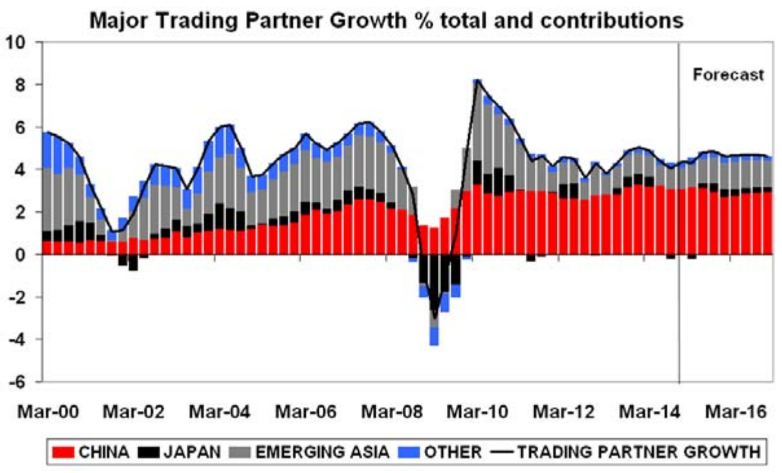
Global forecasts

- Data revisions lifting 2014 growth (especially in India) and a modest downward revision to our 2015 growth forecast (mainly reflecting the poor start to the year in the US) mean that we are now forecasting a more muted upturn in the global economy than was the case a few months ago. Achieving the 3.4% predicted for global growth in 2015 requires a 40 bps upturn in the big advanced economies through the current year. The slowdown in Chinese growth means that emerging markets will not be contributing much to global expansion this year.
- Although our forecasts are below those of the IMF and Consensus, their direction of risk is probably still downwards. This reflects the notable risk that the long awaited acceleration in global growth gets postponed again. Indeed, our tracking indicators of current world economic activity are still not showing much sign of an impending upturn. Some regions are looking better (India, Euro-zone), others look softer than expected (US, Brazil, East Asia) and in yet others (notably Japan) April data suggests that a promising looking upturn might have lost steam recently.
- While growth in the emerging market economies is not expected to pick up this year, they are still driving the bulk of world growth with China and India alone accounting for almost half of the lift in global output in 2015.



Global growth forecasts % change year on year

	2011	2012	2013	2014	*NAB Forecasts* 2015	2016
US	1.6	2.3	2.2	2.4	2.7	2.7
Euro-zone	1.7	-0.8	-0.4	0.9	1.4	1.8
Japan	-0.4	1.8	1.6	-0.1	0.8	1.3
UK	1.6	0.7	1.7	2.8	2.6	2.3
Canada	2.5	1.7	2.0	2.4	2.3	2.1
China	9.3	7.8	7.7	7.4	7.1	6.9
India	7.7	4.8	6.3	7.2	7.7	7.9
Latin America	4.9	2.5	2.5	0.9	1.2	1.6
Emerging East Asia	4.4	4.5	4.3	4.0	4.0	4.2
New Zealand	1.8	2.4	2.3	3.3	2.9	2.7
World	*4.4*	*3.3*	*3.3*	*3.3*	*3.4*	*3.5*
memo						
Advanced Economies	1.7	1.2	1.4	1.8	2.2	2.3
Emerging Economies	7.0	5.3	5.5	5.1	5.1	5.2
Major trading partners	4.6	4.2	4.5	4.4	4.7	4.7



Australian outlook

- We have fine tuned, but not fundamentally changed our forecasts – with GDP of 2.3% in 2014/15 and 3.0% in 2015/16. The big picture is one of an economy still struggling to offset the impact of falling mining investment on domestic demand. Further sharp fall in commodity prices (especially iron ore to below $50 per tonne) are crunching income flows within the economy (now in excess of $50bn per annum) and government finances. Ultimately the hit from mining may be bigger than previously expected. In that context the first read of non mining investment intentions for 2015/16 were concerning.
- Against that the March Survey did show some encouraging improvements in non mining – especially in the construction and consumer services space. Also the degree of negativity in manufacturing and wholesale eased back. Rising house prices, while complicating monetary policy considerations, does seem to helping economic performance in the bigger non mining states (NSW and Victoria).
- That said , signs of improved business conditions are very much a recent development – and would need to be repeated for a number of months before we could put more weight on them. In the interim, business confidence remains low, non mining investment expectations worryingly weak and business conditions over the Q1 below trend.
- With GDP not expected to significantly exceed 3% in the forecast horizon (2016/17), unemployment - after peaking at 6.7% by end 2015 - will remain stubbornly high (above 6%).
- Inflation will slow significantly as domestic demand remains sluggish with flat real wages growth. That together with lower oil prices pushes headline to be around 1% by mid 2015 with core inflation falling to the bottom of the RBA's target range (below) by Q3 2015. And is likely to remain in the bottom half of the target range till H2 2016.
- We still see another rate cut – most likely May but, if the economy continues to improve, the cut could be further delayed. We are not forecasting a second cut to below 2% - we see that possibility at 35-40% - well below the market view (fully priced). Rate rises are expected by late 2016.

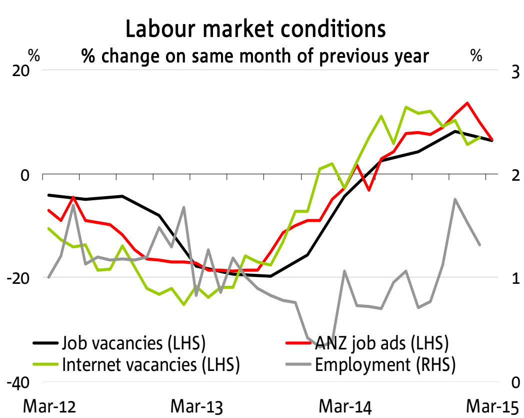
Australian economic and financial forecasts (a)

	Fiscal Year			Calendar Year		
	2014-15 F	2015-16 F	2016-17 F	2015-F	2016-F	2017-F
Private Consumption	2.7	2.9	2.7	2.8	2.9	2.4
Dwelling Investment	6.5	10.7	6.2	8.4	9.2	3.5
Underlying Business Fixed Investment	-6.8	-10.2	-11.1	-8.5	-10.1	-12.3
Underlying Public Final Demand	-0.1	0.9	1.4	0.2	1.1	1.6
Domestic Demand	**0.9**	**1.2**	**1.0**	**1.0**	**1.3**	**0.6**
Stocks (b)	0.1	0.0	-0.1	-0.1	0.0	0.0
GNE	**1.0**	**1.2**	**0.9**	**0.9**	**1.3**	**0.6**
Exports	7.0	6.9	8.2	6.5	7.8	8.4
Imports	-2.4	-1.8	-1.7	-2.9	-1.0	-2.7
GDP	**2.3**	**3.0**	**3.1**	**2.4**	**3.2**	**3.0**
– Non-Farm GDP	2.5	3.0	3.1	2.5	3.2	3.0
– Farm GDP	-3.4	1.6	2.0	-0.9	2.0	2.0
Nominal GDP	1.8	4.0	5.1	2.2	5.1	4.8
Federal Budget Deficit: ($b)	40	30	30	NA	NA	NA
Current Account Deficit ($b)	47	39	6	49	23	-11
(-%) of GDP	2.9	2.3	0.4	3.0	1.3	-0.6
Employment	1.1	1.5	2.3	1.2	2.0	2.3
Terms of Trade	-10.2	-4.3	-0.7	-8.5	-1.2	-1.6
Average Earnings (Nat. Accts. Basis)	1.7	2.2	2.8	1.7	2.6	2.8
End of Period						
Total CPI	1.1	3.1	2.7	2.2	2.8	2.5
Core CPI	1.9	2.6	2.4	2.1	2.5	2.7
Unemployment Rate	6.4	6.5	6.2	6.7	6.3	6.1
RBA Cash Rate	2.00	2.00	3.00	2.00	2.50	3.50
10 Year Govt. Bonds	2.60	3.30	3.60	2.85	3.60	3.40
$A/US cents :	0.75	0.73	0.77	0.74	0.75	0.79
$A - Trade Weighted Index	59.9	58.4	0.0	59.2	59.6	0.0

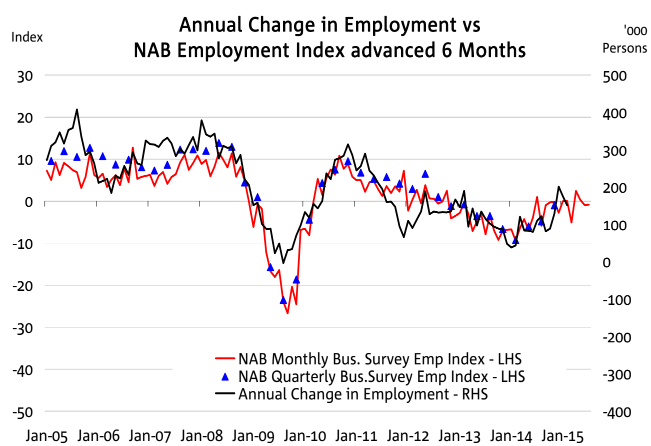
(a) Percentage changes represent average annual growth, except for cash and unemployment rates. The latter are end June. Percentage changes for CPI represent through
(b) Contribution to GDP growth

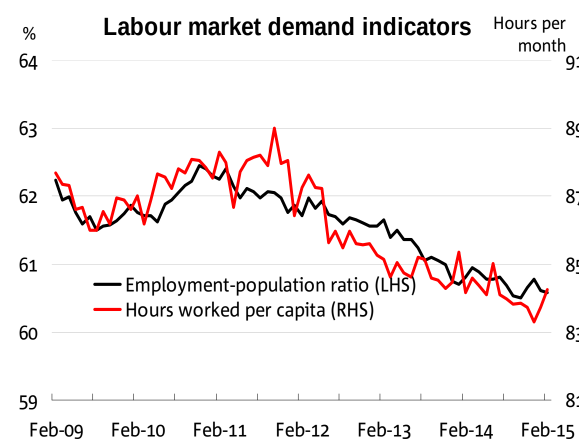
Australian labour market

- While there is still considerable noise in the labour market indicators, recently some partials such as job adds and vacancies appear to have marginally softened – see chart below left hand panel. That said there is still somewhat of a gap between the partials and the official employment series, which has also weakened.
- Another perspective can be seen from a comparison between the NAB employment series (from the Survey) and the annual growth in employment. This comparison has two main advantages: a strong statistical relationship going back to the late 1980s; and the fact that the NAB series leads annual employment growth by around 6 months (see chart below – middle panel). The key messages are:
  - the series also suggests some statistical noise around end 2014 where employment growth appears too strong;
  - currently the series suggests some near term softness (reflecting very weak Nab employment outcomes around 6 months ago; but
  - fundamentally the comparison suggests that for the next 6 months employment growth should be around 180k jobs per annum or around 15k per month – a rate of employment growth that, at the margin , might be insufficient to stabilise the unemployment rate unless the participation rate falls
- Overall demand indicators such as the e employment to population ratio continues to trend down, while the hours worked per population ratio, after recovering from very low levels recently, is still at weak levels – see chart below right hand panel.
- Going forward what really matters for employment is the activity outlook. While the March survey certainly point to better profits and trading outcomes, it was notable that there was little improvement in the Nab employment series – which continues at below long run average levels. Clearly confidence will need to improve before business is prepared to significantly hire. With little fundamentally changed in our growth and demand forecasts we continue to expect a gradual deterioration in the unemployment rate during 2015 – reaching around 6.7% by end 2015. Thereafter the unemployment rate is expected to remain stubbornly high – with unemployment still above 6% by end 2016/17.



Sources: ABS, Datastream, Department of Employment

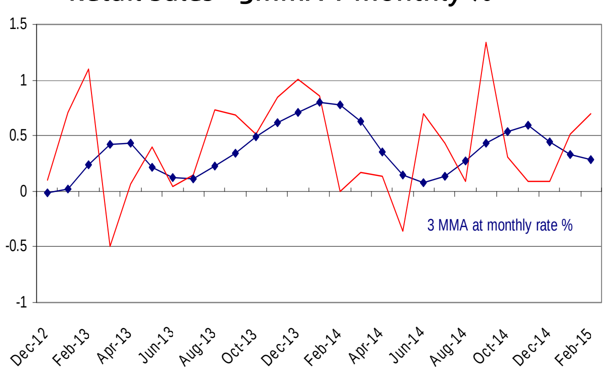




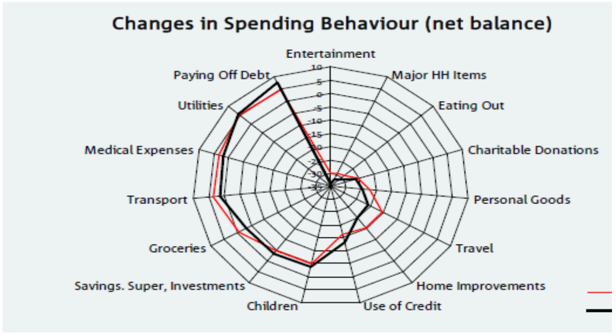
Australian consumer demand and housing market

- The pattern of retail sales has been volatile, affected by special events – such as the release of the iphone 6 in September 2015. As a result the underlying pattern of real growth has been distorted. Thus much of the strength in Q4 real consumption reflected the iphone base effect. Similarly despite better nominal sales in early 2015, Q1 2015 consumption will be lowered by base effects of very weak retail sales in late 2015. See chart below LHS panel. To date reasonable retail sales growth in January / February is encouraging. That said the strong increase in retail prices in March in the Business survey suggests that real consumption growth may be somewhat lower. Certainly it is noticeable that retail trading in the Business survey did not improve – indeed it fell a touch to -4 points and confidence turned negative.
- Online retail has also been somewhat volatile. After a very poor November, online sales in December were strong. The latest reading for February were also strong - up 1.7% on a 3 monthly trend basis. See NAB Online Retail Sales – Feb 2015. Looking through recent volatility the annual growth rate in February was little changed at 8.7%. Generally consumer anxiety has increased in early 2015 with all components of the index deteriorating. Interestingly government policy has for the first time overtaken the cost of living as the key concern identified by consumers. More importantly consumers remain very much focussed on what might be called non discretionary purchases (such as utility costs, transport, medical expenses and paying off debt) – see chart below middle panel and NAB Consumer Anxiety Report – March 2015.
- According to RP Data-Rismark dwelling prices in Australia have risen 7.4% in the year to March – with the strongest markets very much Sydney (up 13.9%) with the next best Melbourne (up 5.6%). Outside of Sydney it appears that the heat is coming out of the housing market. In contrast it appears that the February rate cut has lifted Sydney prices in year on year terms – see chart below right hand panel. Clearly the investor market in Sydney is driving this momentum and based on loan approval data is unlike to pull back any time soon. Our forecasts for national house price growth are for increases of 4.4% in 2015 and 3.4% in 2016.
- On credit, housing credit growth continues to run at 0.5% per month or 7.2% in the year to February. However investor credit is much stronger at 0.7% per month or 10.1% annually. The latter is still above APRA's maximum growth rate. Business credit has continued to strengthen increasing by 0.6% in February and 5.6% over the year (but nearer 8% on a 3 monthly annualised rate). Personal credit on the other hand has weakened. . Elsewhere equity markets were mixed in March with the ASX 200 down 0.6% - with banks up 2.5% more than offset by a 7.7% fall in resources during the month (now down 21.2% from the peak in mid 2014).

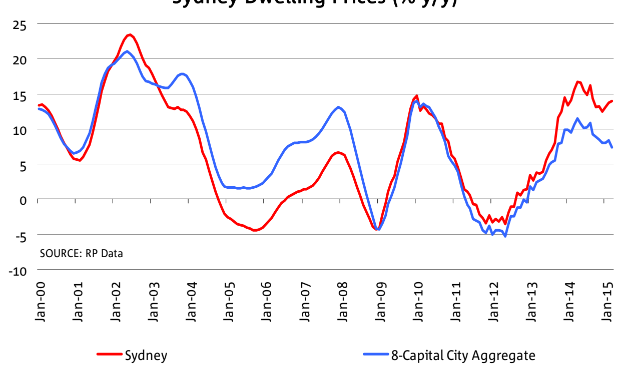
Retail Sales - 3MMA v Monthly %



Consumer Spending Intentions

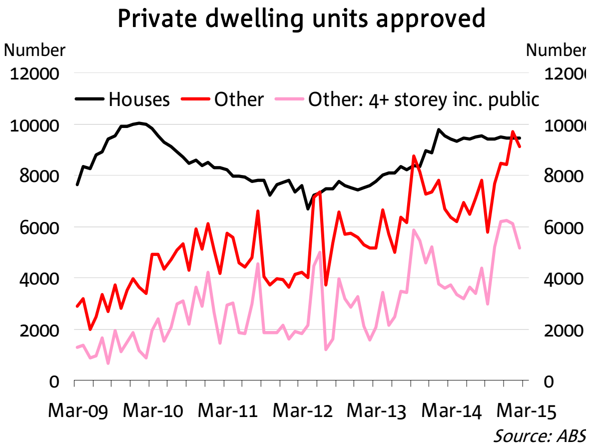


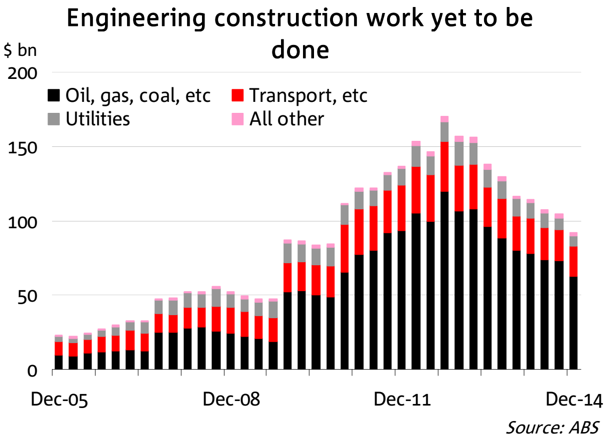
Sydney Dwelling Prices (% y/y)

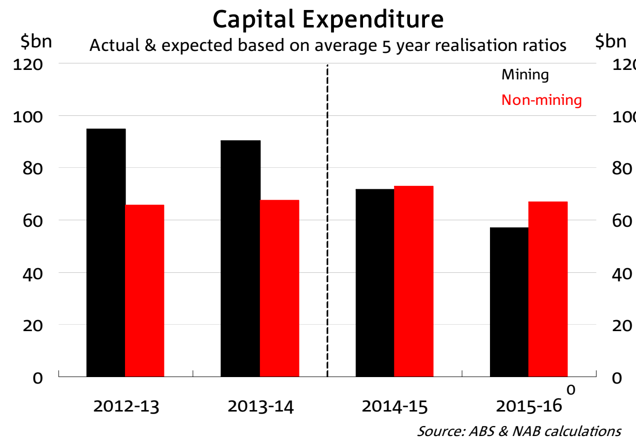


Australian investment

- As expected dwelling investment increased by 2.6% in Q4 2016. With very high approvals in the dwellings – especially apartments – we expect to see similar or stronger growth in dwelling investment over the next year – we are forecasting much stronger growth of around 11% and 7% growth over 2015 and 2016 respectively.
- As can be seen from the chart below – left hand panel – most of the growth in approvals are in the other (apartment) sector and very heavily concentrated in the more than 4 story category. A significant driver of that demand has come from foreign investors. Indeed property developers estimate around 16% of new sales are to foreigners with much higher concentrations in Melbourne (around 30%). See NAB Quarterly Australian Residential Property Survey – Q4 2014. While recent attempts to tighten foreign investment rules may slow demand eventually, the reality is that the existing approvals will be built – and contribute to the reallocation of resources from mining to the non mining sector
- With mining work yet to be done falling, the expected declines in mining investment are well underway – as reflected in the mining expectations data – see charts below
- Ongoing falls in resource prices (iron ore, oil and by association gas prices in LNG contracts) and very weak confidence levels are likely to further dampen prospects for new mining exploration and investment activity and may well see projects delayed or cancelled.
- The latest Nab monthly survey points to some rises in near term non mining investment and business credit, as noted earlier, is now significantly stronger (around 8% on an annualised 3 monthly basis). That said it is difficult to be sure if the trend will be short lived or not. Certainly the medium term expectations data is much more concerning.
- Indeed a standout from the latest ABS Capital Expenditure Survey was the surprise weakening in non mining expectations for 2015/16 (see chart below – right hand panel). The fall in mining investment intentions was somewhat larger than expected but not surprising. Overall we are now forecasting falls of around 9% in underlying business investment in 2015 increasing to around 11% in 2016 (and beyond).

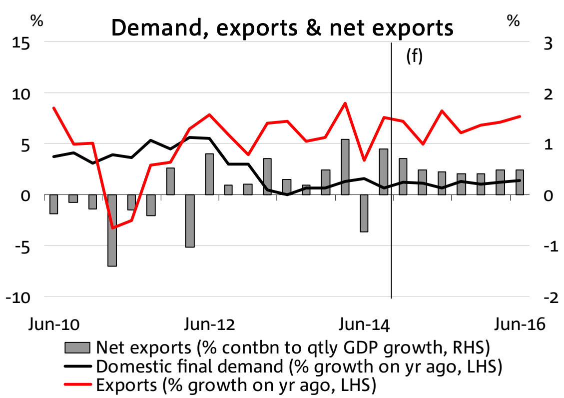




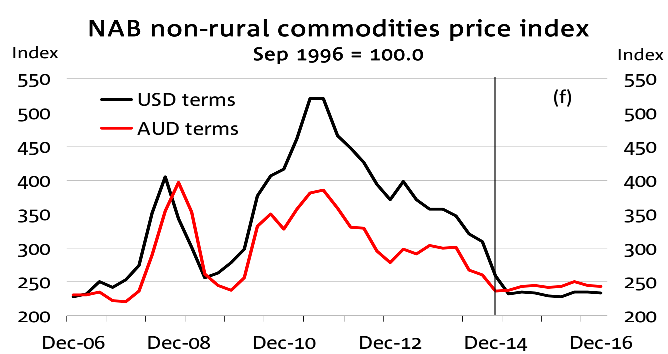


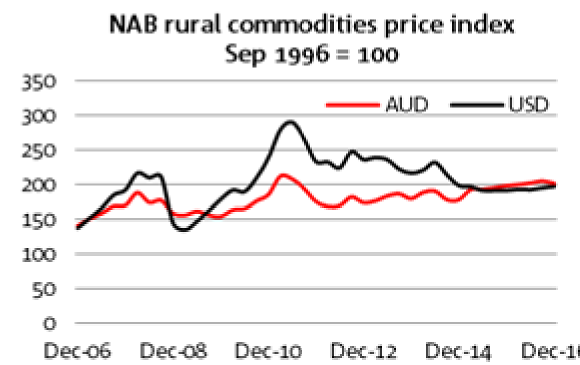
Australian commodities, net exports and terms of trade

- We continue to expect the external sector to perform the bulk of the heavy-lifting in Australia's activity this year and next, with net exports forecast to contribute 1.8 percentage points to GDP growth in 2015 and 2.1% in 2016. Meanwhile domestic demand is only expected to grow at a modest rate of 0.9% in 2015 and 1.2% in 2016, which is below population growth.
- Reflecting our expectations of a weaker exchange rate against the backdrop of falling global commodity prices, the non-rural commodity index denominated in USD, after falling 27% in 2014 is expected to fall by around 11% during 2015. The AUD is now expected to soften to around US74c by the end of 2015, thereby broadly offsetting the fall in in AUD terms. Implicit in these forecasts are iron ore prices remaining near current lows, trending down from around US$60 a tonne in late 2015 to US$54 a tonne at the end of 2016 (with some downside risk). Oil prices are expected to stay in the current range till mid year and then increase marginally to around $USD 65 a barrel by late 2015 – and around $USD 75 by end 2016.
- The NAB Rural Commodities Index is expected to fall 10.9% in USD terms in 2015, as an appreciating USD combined with favourable grain supply conditions and muted dairy demand push prices lower. However a falling AUD is forecast to provide support to local prices, with the index expected to increase 6.0% in AUD terms in 2015. In 2016, we expect to see a stabilisation of prices in USD terms (up 0.9%) and a moderate increase in AUD terms (up 3.7%).
- As noted earlier, mining investments have been more resilient than anticipated in recent quarters as mining projects ran down the construction work pipeline at a rapid rate. As the pipeline of work reduces, mining-related imports are expected to wind down more quickly in the coming quarters, weighing on overall imports growth. Hence, we expect the current account deficit for 2014/15 to be 2.9% of GDP (or around $46bn), slightly lower than the 3.0% for 2013-14, before easing notably during 2015/16 to around 2.3% of GDP (or around $38bn) on further mining-related imports weakness.



Sources: ABS, NAB forecasts





Source: ABS; ABARES; Bloomberg; NAB; Thomson Datastream

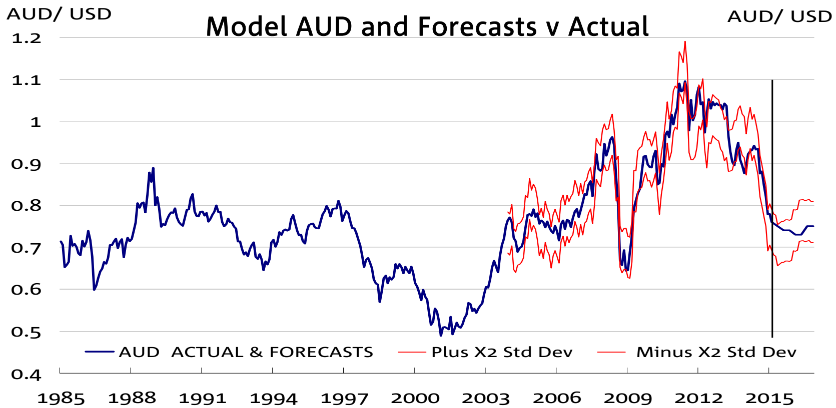
Australian financial markets

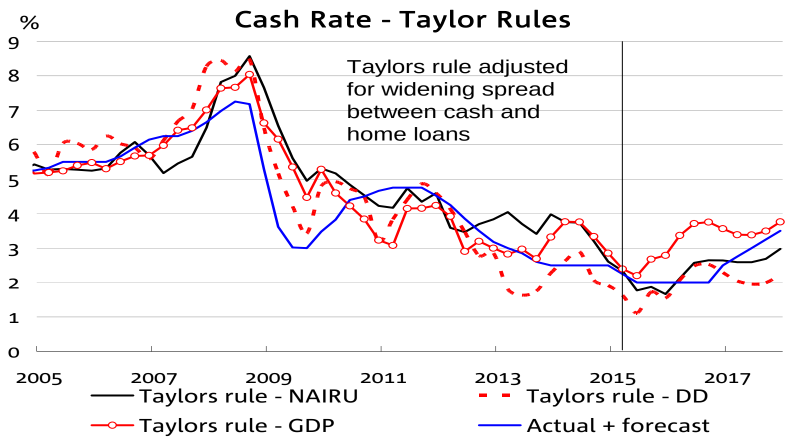
Exchange rate

- At this stage we have kept our currency forecasts unchanged at around $USD 74c by late 2015 and moving a touch lower during 2016 before ending a touch higher (75c) end 2016. As can be seen from the chart (below left) these forecasts are broadly consistent with our fundamental model – albeit the forecasts imply ongoing USD strength.

Interest rates

- We have not changed our interest rate forecasts
- We still see the need for another rate cut in coming months – most likely May but it could be delayed if the domestic economy shows further signs of strength in coming months. Having passed on rate cuts in March and April (as we expected) the RBA will get more data on the impact of its February cut and the inflation outlook. While the March Survey business conditions results will be seen as encouraging, business confidence still remains around levels reported in January.
- Just as the RBA will be looking for signs of stronger performance in the non mining sector it will equally be very sensitive to any further weakness in the labour market – rising unemployment. Finally any acceleration of house price growth (beyond Sydney) would also require a rethink by the RBA Board
- We are not forecasting a second cut to below 2% in 2015. We have not changed our view that the chances of two cuts to 1.75% are around the 35-40% probability. However we see the current market view (fully priced) as significantly overpriced. Rate rises are expected to begin by late 2016 with the cash rate increasing reality moderately and to lower rates than previously expected . Our forecasts are for the cash rate to reach 3.5% by late 2017
- Interestingly the Taylors rule analysis (in the chart below right) suggest the possibility of a sub 2% cash rate – following the domestic demand and NAIRU rules. Those rules also see rates rising from mid 2016 to around 2. 5% by late 2016 (as per our forecasts). Our cash rate forecast of a peak by end 2017 of 3.5% is towards the top of the various rules (but that clearly is a long time away).





Group Economics
Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities
Vacant
Head of Australian Economics
+61 3 8634 1663

James Glenn
Senior Economist – Australia
+(61 3) 9208 8129

Phin Ziebell
Economist – Agribusiness
+(61) 0 475 940 662

Vyanne Lai
Economist
+(61 3) 8634 0198

Amy Li
Economist
+(61 3) 8634 1563

Industry Analysis
Dean Pearson
Head of Industry Analysis
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Industry Analysis
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Industry Analysis
+(61 3) 8634 3837

Karla Bulauan
Economist – Australia
+(61 3) 86414028

International Economics
Tom Taylor
Head of Economics, International
+61 3 8634 1883

Tony Kelly
Senior Economist – International
+(61 3) 9208 5049

Gerard Burg
Senior Economist – Asia
+(61 3) 8634 2788

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

Global Markets Research
Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia
Economics
Ivan Colhoun
Chief Economist, Markets
+61 2 9273 1836

David de Garis
Senior Economist
+61 3 8641 3045

FX Strategy
Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848

Emma Lawson
Senior Currency Strategist
+61 2 9237 8154

Interest Rate Strategy
Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Rodrigo Catril
Interest Rate Strategist
+61 2 9293 7109

Credit Research
Michael Bush
Head of Credit Research
+61 3 8641 0575

Simon Fletcher
Senior Credit Analyst – FI
+61 29237 1076

Equities
Peter Cashmore
Senior Real Estate Equity Analyst
+61 2 9237 8156

Distribution
Barbara Leong
Research Production Manager
+61 2 9237 8151

New Zealand
Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Markets Economist
+64 4 474 6923

Kymberly Martin
Senior Market Strategist
+64 4 924 7654

Raiko Shareef
Currency Strategist
+64 4 924 7652

Yvonne Liew
Publications & Web Administrator
+64 4 474 9771

Asia
Christy Tan
Head of Markets Strategy/Research, Asia,
+ 852 2822 5350

UK/Europe
Nick Parsons
Head of Research, UK/Europe,
and Global Co-Head of FX Strategy
+ 44207710 2993

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

Derek Allassani
Research Production Manager
+44 207 710 1532