# Flash Australian Forecast Update

by NAB Group Economics

5 November 2015

National Australia Bank

- **Based on incoming information, we have modestly reviewed our GDP forecasts to 2.6% in 2015/16 and 3.0% in 2016/17 (annual average).**
- **Overall, NAB Economics remain of the view that the recovery in the non-mining sector is slowly becoming more well entrenched. The RBA also appears cautiously optimistic on this front, pointing to above-average business conditions, growth in services sectors and "respectable growth in employment".**
- **The change to our 2015/16 forecast largely reflects the incorporation of a more volatile quarterly profile – including a relatively strong bounceback in Q3 following a surprisingly weak Q2 due to temporary factors. This may also lead to some upward revision to the RBA's forecasts for the year to Jun-16 in tomorrow's *Statement on Monetary Policy* (see table below).**
- **It is also possible that the RBA will review its high GDP forecast of 3--4½ y/y for Dec-17, in light of Governor Glenn Stevens' stated lower assumption for potential growth of around 2.8%.**
- **The weak Q3 inflation outcome has also reduced our near-term y/y inflation forecasts due to base effects, and we anticipate a similar small downward revision to the RBA's forecasts tomorrow.**
- **More detail underpinning NAB Economics' forecast outlook will be released on Tuesday in the Global & Australian Forecast document.**

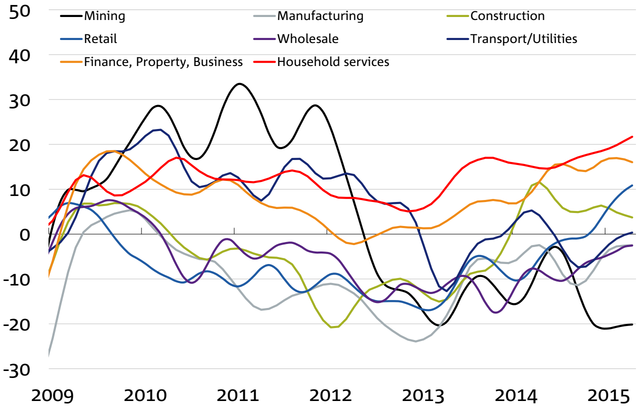
| | Year-ended growth | | | | | |
|---|---|---|---|---|---|---|
| | Jun-15 | Dec-15 | Jun-16 | Dec-16 | Jun-17 | Dec-17 |
| GDP growth | | | | | | |
| Aug SoMP | 2 | 2½ | 2–3 | 2½–3½ | 3–4 | 3–4½ |
| Nov SoMP (expected) | 2.0 | 2½ | 2¼–3¼ | 2½–3½ | 2¾–3¾ | 2¾–4¼ |
| *NAB* | *2.0* | *2.5* | *3.0* | *3.0* | *3.2* | *3.3* |
| Headline CPI inflation | | | | | | |
| Aug SoMP | 1.5 | 2½ | 2–3 | 2–3 | 2–3 | 2–3 |
| Nov SoMP (expected) | 1.5 | 2 | 1¾–2¾ | 2–3 | 2–3 | 2–3 |
| *NAB* | *1.5* | *2.2* | *2.8* | *3.0* | *2.7* | *2.4* |
| Underlying CPI inflation | | | | | | |
| Aug SoMP | 2¼ | 2½ | 2–3 | 2–3 | 2–3 | 2–3 |
| Nov SoMP (expected) | 2.3 | 2¼ | 1¾–2¾ | 2–3 | 2–3 | 2–3 |
| *NAB* | *2.3* | *2.3* | *2.4* | *2.6* | *2.5* | *2.5* |

## Our latest forecasts in summary

NAB's forecasts envisage a gradual economic recovery as the economy navigates considerable challenges (lower commodity prices, falling mining investment, slowing demand from China, consumer caution) while also benefiting from stimulatory financial conditions (low interest rates and currency).

The key forces shaping the outlook are broadly unchanged from recent months, although incoming information suggests a greater degree of resilience across the non-mining economy. These include the high level of business conditions (+9 compared with a long-run average of +4 in September) with particular strength in services sectors, which appears to be generating enough jobs (particularly in household and business services) to keep the unemployment rate stable at around 6¼%. Greater risks around the East Asian economy outlook (especially China) meanwhile, and further volatility in financial markets, raise the downside risks emanating from offshore.

NAB Business Conditions by Industry*

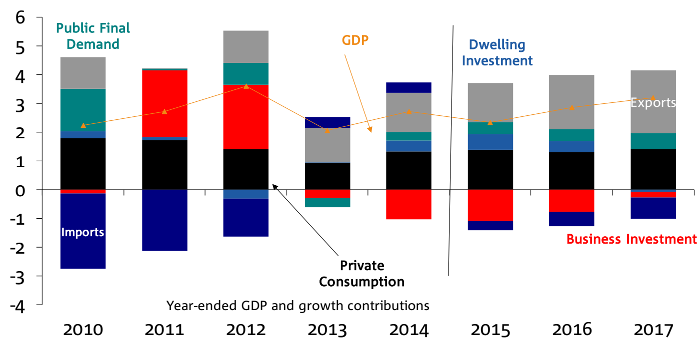



* 13 period Henderson trend

Our forecast profile continues to envisage weak domestic demand, and a large contribution from net exports – mostly from resource exports (particularly LNG) as well as stronger tourism and other services exports in response to the weak AUD. Domestic demand meanwhile remains weak. The decline in mining investment is only about half way through, government spending will be limited given budgetary constraints and consumer spending is expected to growth at slightly below average (assuming a gradual decline in the household savings ratio).

We have included a somewhat weaker dwelling investment profile in 2016 and 2017, although this is mostly offset by slightly higher (though still weak) non-mining business investment given the gradual trend improvement in capacity utilisation.

Australia's growth outlook (NAB forecasts)




Source: NAB, ABS

The slightly higher forecast for 2015-16 largely reflects base effects after incorporating the recent volatility in the quarterly GDP profile. This includes the weaker than expected Q2 outcome (0.2% q/q) which was largely driven by a surprise contraction in exports rather than a fundamental deterioration. It also includes a forecast bounceback in Q3 (preliminary forecast of 0.8% q/q) due to a very large contribution from net exports (+1.0ppt in Q3 following -0.6ppt in Q2) according to the monthly data released to date. These changes raise the year-ended and year-average figures through 2015/16.

## RBA forecast expectations

We expect the RBA's Statement on Monetary Policy tomorrow to contain similar flavour in terms of the key drivers. The RBA also appears slightly more confident that the recovery in the non-mining economy is taking hold. There may be some near-term changes to their GDP and inflation forecasts for the year to Jun-17 to reflect base effects (as per the table above), but we would not read too much into those changes. The underlying assumptions for the A$TWI and Brent are slightly different (A$TWI of 61 vs 62 in August SoMP, Brent of US$49/bbl vs US$53/bbl). It may also include current market pricing for one 25 bp cut.

In sum however, these changes do not appear significant enough to make a material change to the forecast outlook.

Perhaps more importantly, the RBA may flow through a revision to its assumptions for potential growth. Governor Glenn Stevens is now on the record stating that potential growth is now estimated at around 2.8%, as compared with previous estimates of around 3¼%. This would likely have the biggest impact on forecasts for 2017 where the current RBA forecasts appear exceptionally strong at 3--4½% - while some of this represents the large contribution from LNG exports, it is reflects a forecast profile which envisages that the economy needs to operate at above-potential growth to absorb spare capacity in the economy. With estimates of potential growth lower, so are estimates of spare capacity, which suggest the economy would not grow quite as strongly. We expect the forecast ranges for 2017 to be lowered by around ¼ppt – this would bring them more into line with our forecasts.

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