
Global Overview

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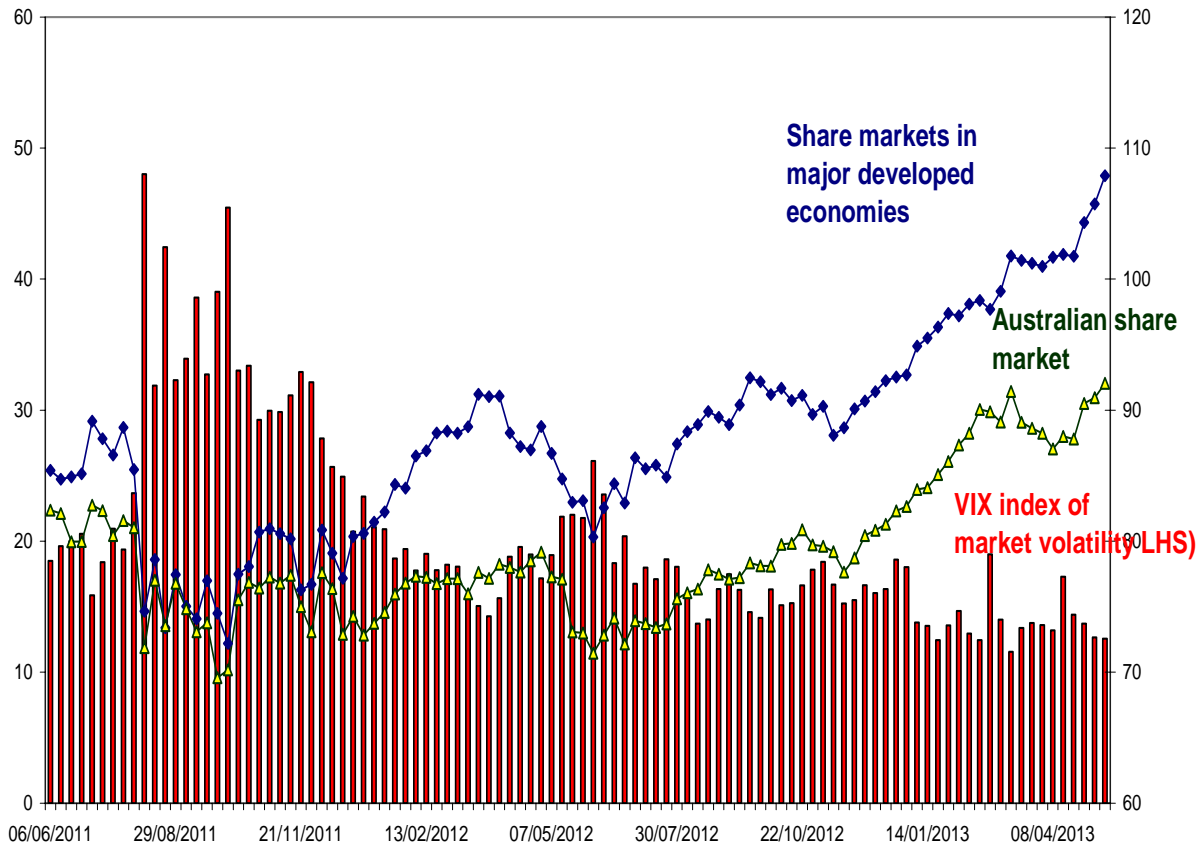
Australia

**– where to now for the multi speed
economy**

Alan Oster – Group Chief Economist

Recently financial markets have turned surprisingly optimistic. Equity markets up fear index down.

FINANCIAL MARKET INDICATORS



- Really reflects lowering of fear of global problems
- Important factors are:
 - Fiscal cliff delayed
 - Less talk of Europe
 - China clearly bottomed
 - And new Govt in Japan pushing expansionary policy
- But economies not much better. Indeed in Q4 2012 worsened. **So what about the globe going forward**

Global outlook:

Cautious optimism but mixed... recent data concerning

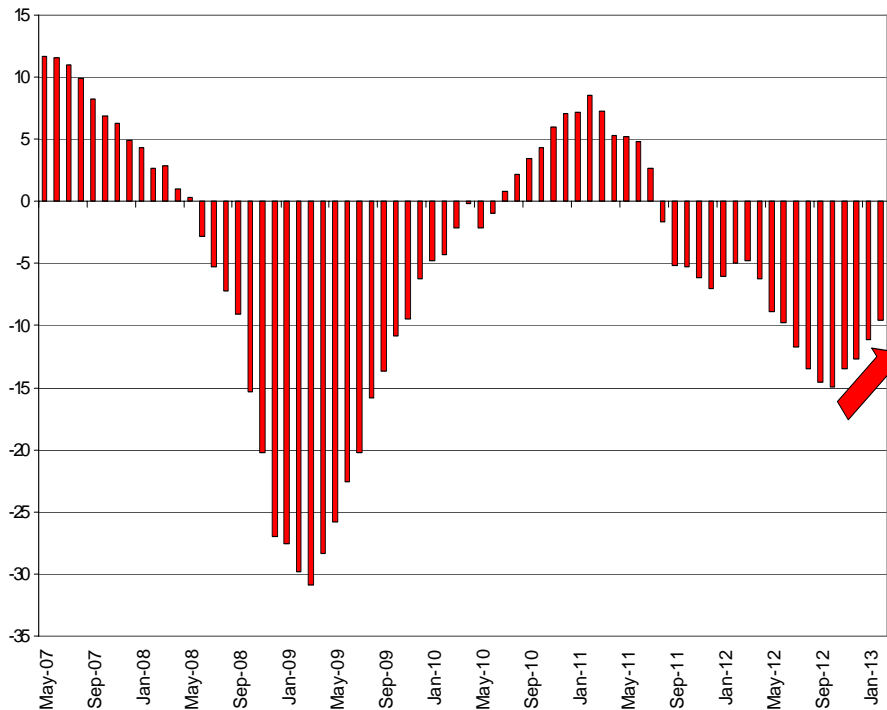
Global growth of around 3% in 2013 and still sub trend (3.7%) in 2014

- **Developed** world a struggle
 - US sluggish but sustainable growth – fiscal cliff delayed and debt debate still coming. Sequester now kicking in. But housing recovery helping
 - Europe back into recession – with sovereign risk still an issue. Five quarters in a row of flat to negative growth. 6th coming
 - Japan with new Govt pushing increased spending and loosening monetary policy (and the Yen) GDP turns up but moderately.
- **Emerging economies** softened in response to trade downturn from developed economies and previous policy tightening (now reversing).
 - China slowed a lot but appears to be stabilising - we expect growth around 8%. Q1 2013 on downside but still expect reasonable growth..
 - India in need of stimulus. Central bank cut despite inflation concerns
 - Non China Asia slowed as world trade softening Growth around 3.6% but weaker if you are more trade exposed (HK, Singapore, Korea)
- Fed and ECB have however **removed tail risk of global meltdown**

European sentiment may be bottoming but not their economy

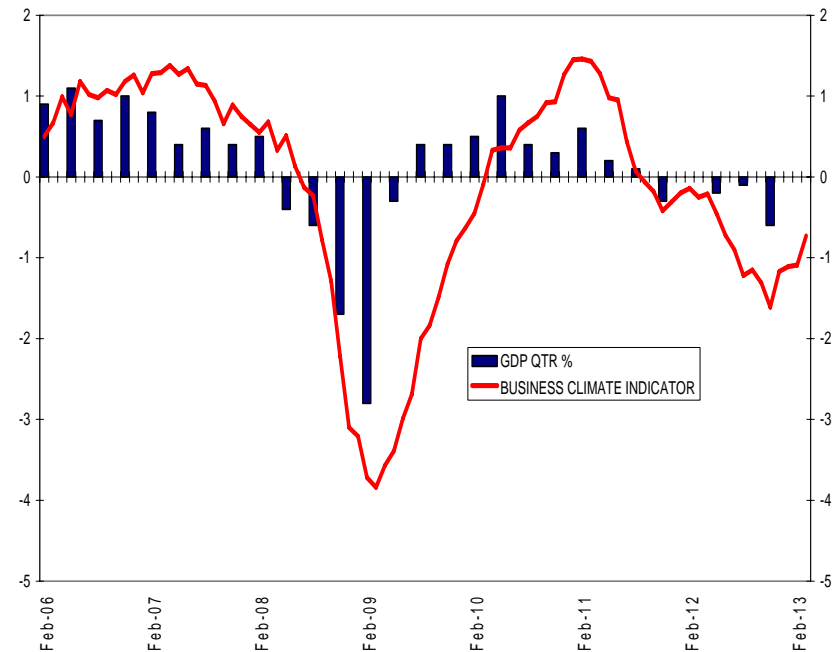
- European confidence still at historic lows
- But looks to have bottomed – re ECB
- Cyprus not yet big issue

European Economic (Consumer and Business) Sentiment
- Measured as Deviation in European Sentiment From Long Run Average



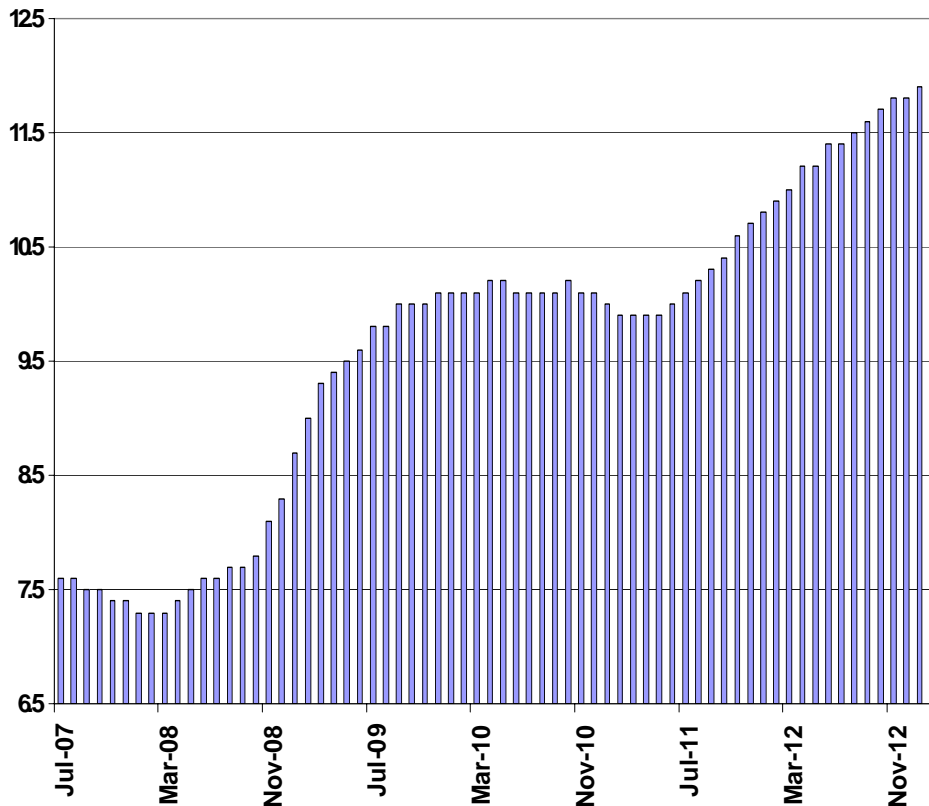
- But can't say the same about their economy
- 5 quarters of flat or negative GDP – about to report a 6th.

EUROPEAN GDP AND BUSINESS CLIMATE INDICATOR

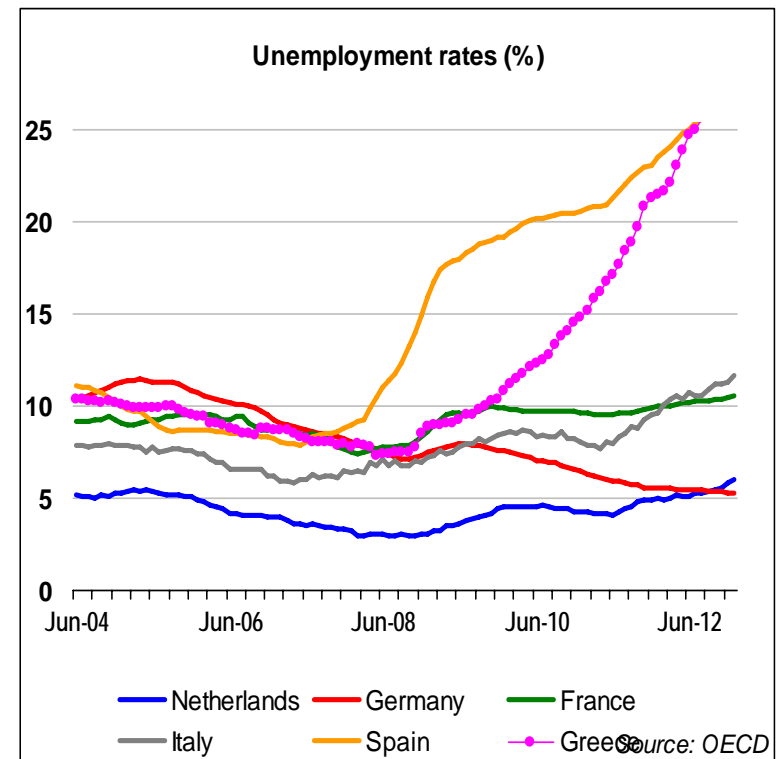


And as a result unemployment across the region continues to deteriorate. Especially in the periphery

EUROPEAN WIDE UNEMPLOYMENT %



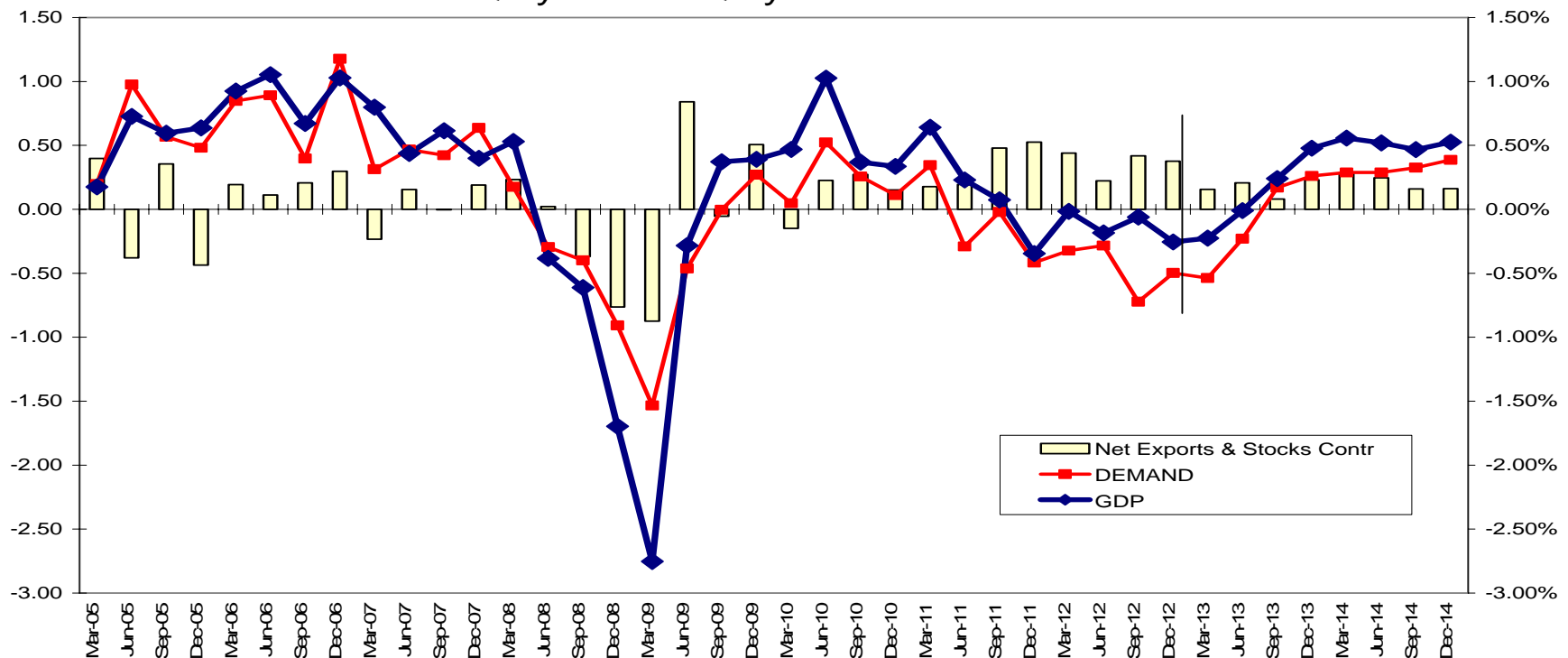
Albeit the crunch is different across regions



Overall we see continuing recession in Euro-land in 2013. No positive quarterly growth till late 2013.

- We don't expect positive overall growth till Q3 2013
- Domestic demand is even more depressed
- Europe has benefited from better exports – mainly Germany

EUROPEAN GDP Demand and Net Exports
Qtrly % and Qtrly Contribution

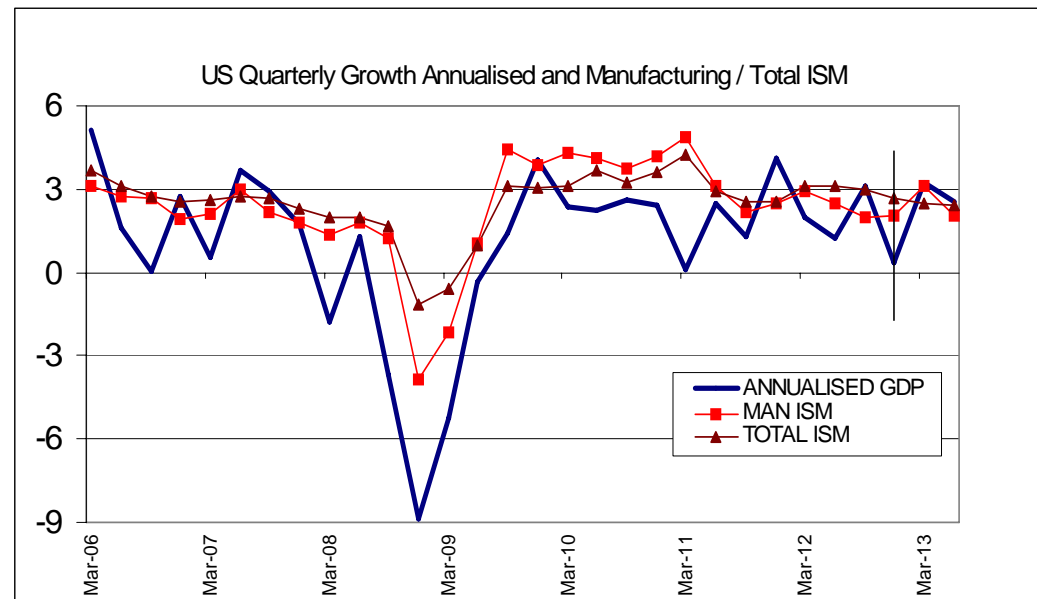
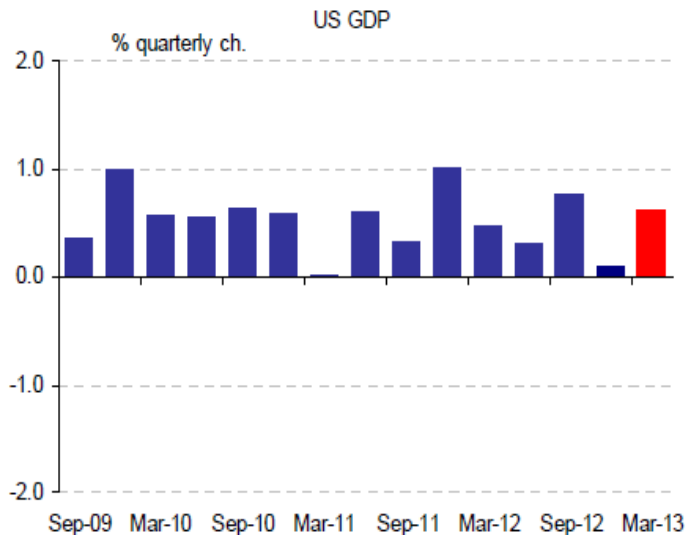


US economy numbers bouncy

But fundamentals seem reasonable – but modest

- US GDP increased by 2.5% annualised in Q1 after a flat (defence cutback) Q4 2012
- Growth mainly reflecting consumption and investment (dwellings)

- Key survey of manufacturing and services also around 3% (annualised) in Q1 2013
- Data a bit weaker in March month and if continues implies growth around 2 to 2 ½ % in Q2 2013



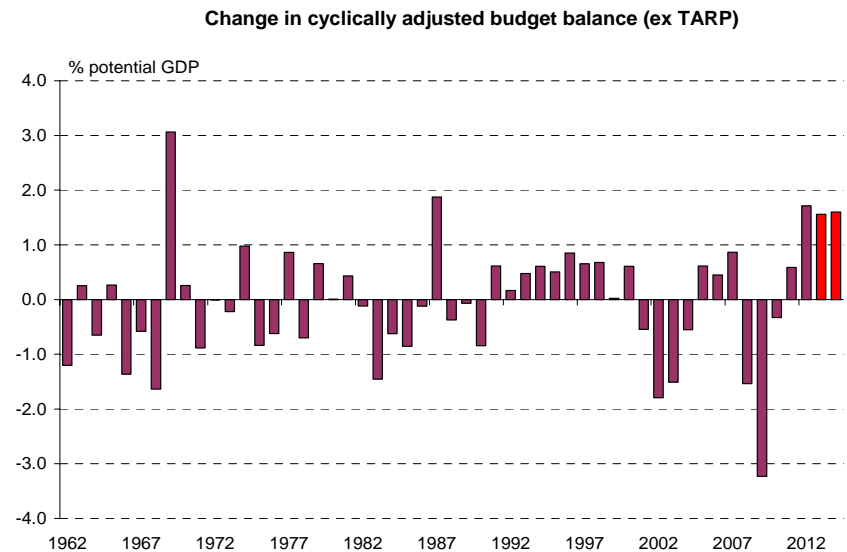
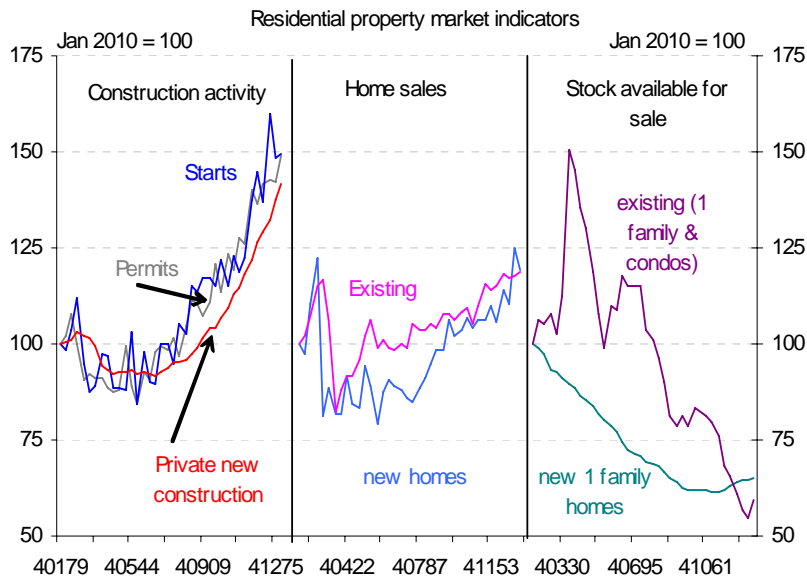
On the positive side..... Housing

On the negative..... Fiscal restraint

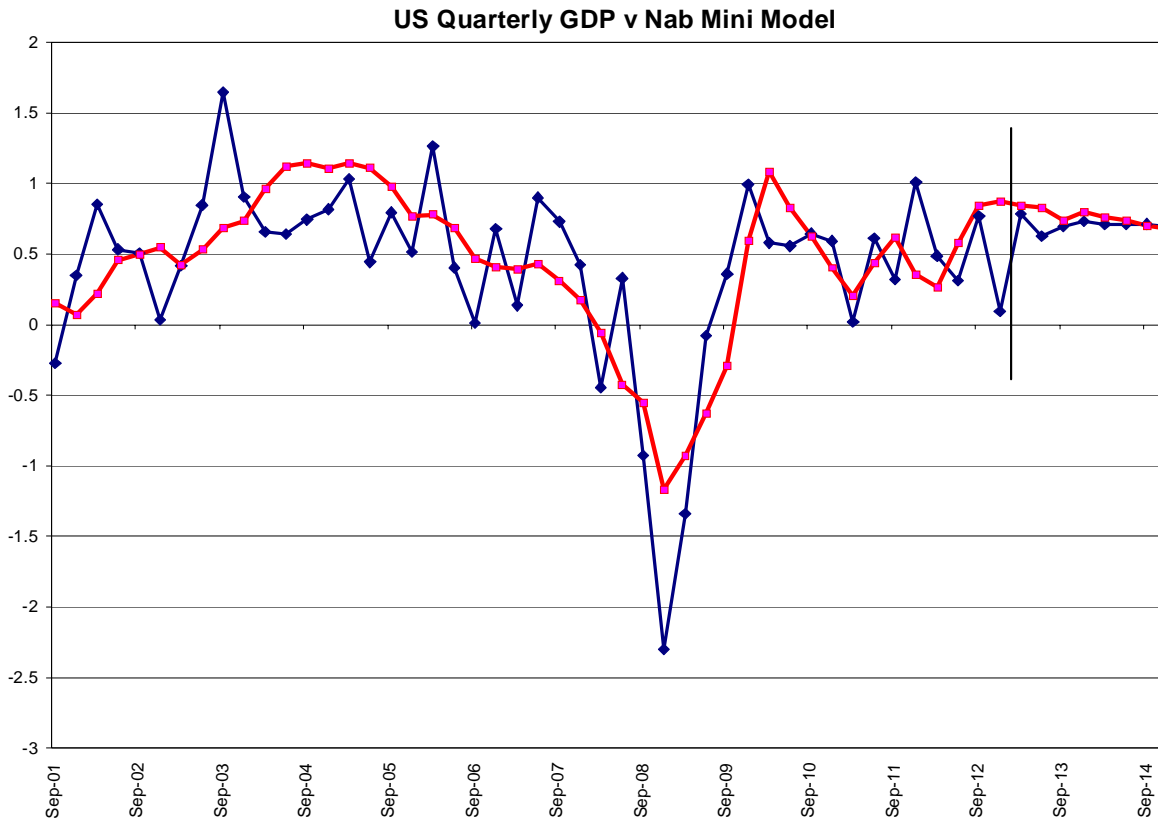
- Housing construction (and prices up)
- And overbuild over

- But fiscal policy likely to take out around 1% in 2013 and 2014 (similar to 2012)

- And debt ceiling still there..... politics



Our forecast suggests moderate on-going US growth



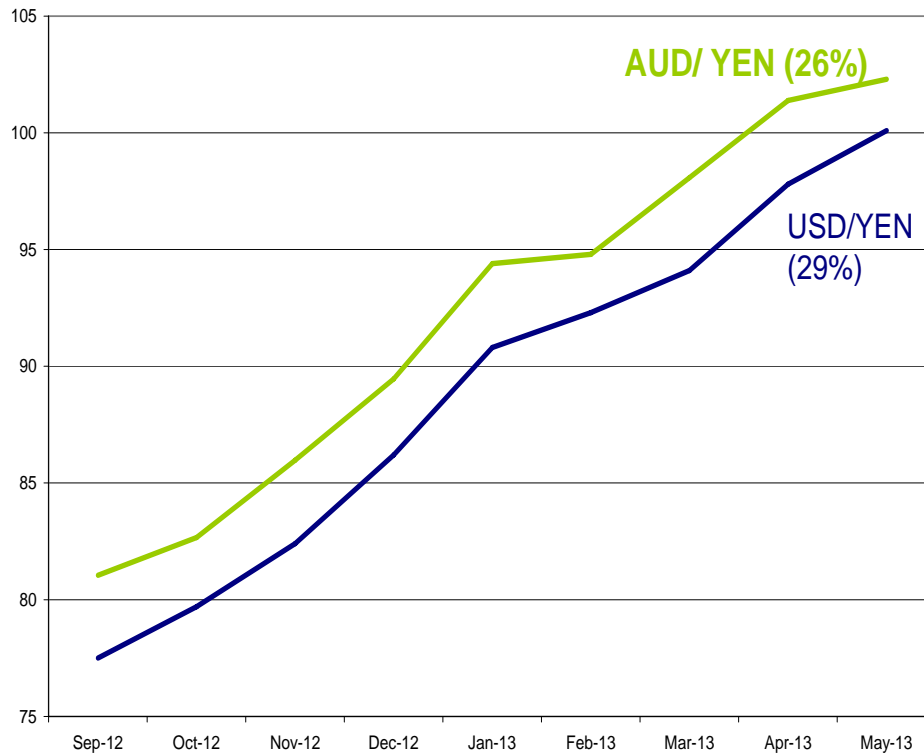
- Overall we expect growth of only around 2.1% this year and near 3% in 2014
- That means hard to lower unemployment in the near term
- Fed wont raise rates till unemployment is below 6 ½% (say late 2015)
 - But QE will probably stop late 2013 or early 2014.

Model based on : Real interest rates, House prices, Equity prices, Oil prices, TWI (currency), Commodity prices, Credit rationing and lags.

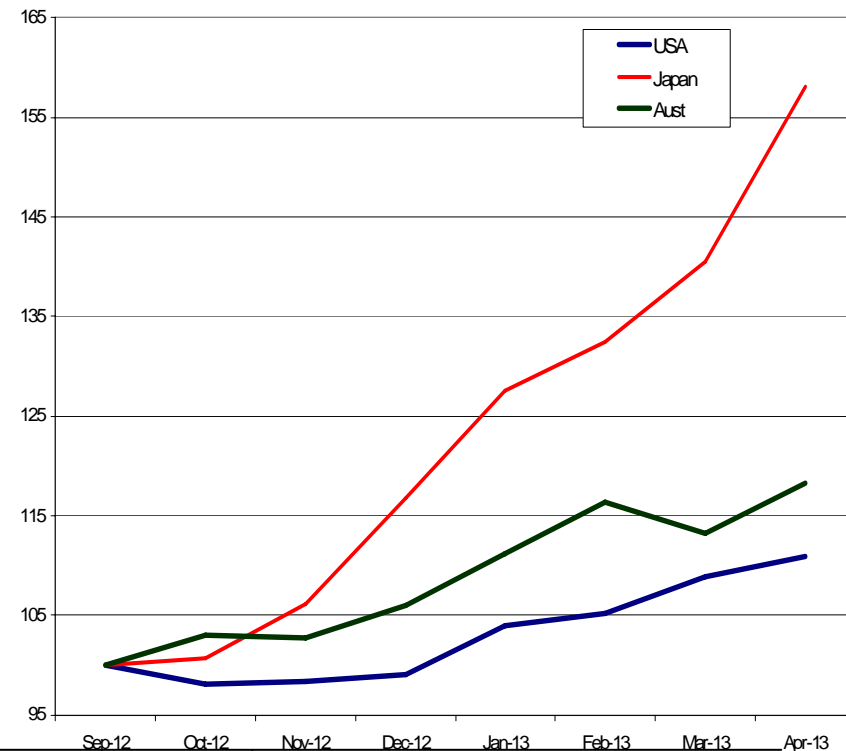
Japanese outlook: Policy change has had a large financial impact ...

- New Government has announced stimulus package and Bank of Japan has activated QE
- QE in Japan broadly similar in size to what the Fed is doing
- Has weakened the Yen and driven up equities

Yen v AUD & USD From Sept 2012 to Mid May 2013



USA Japan and Aust Equity Prices
From Sept 2012 (Sept =100)

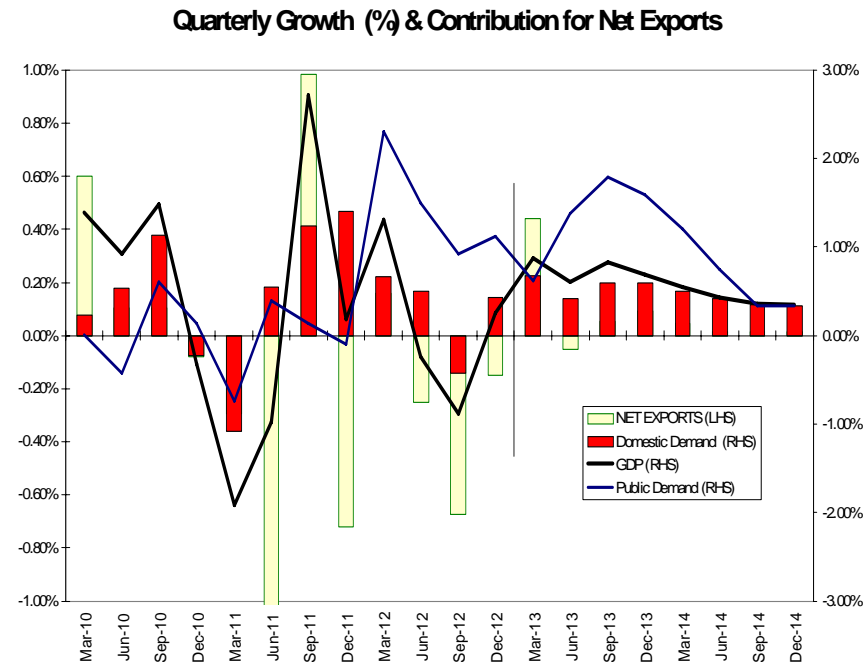
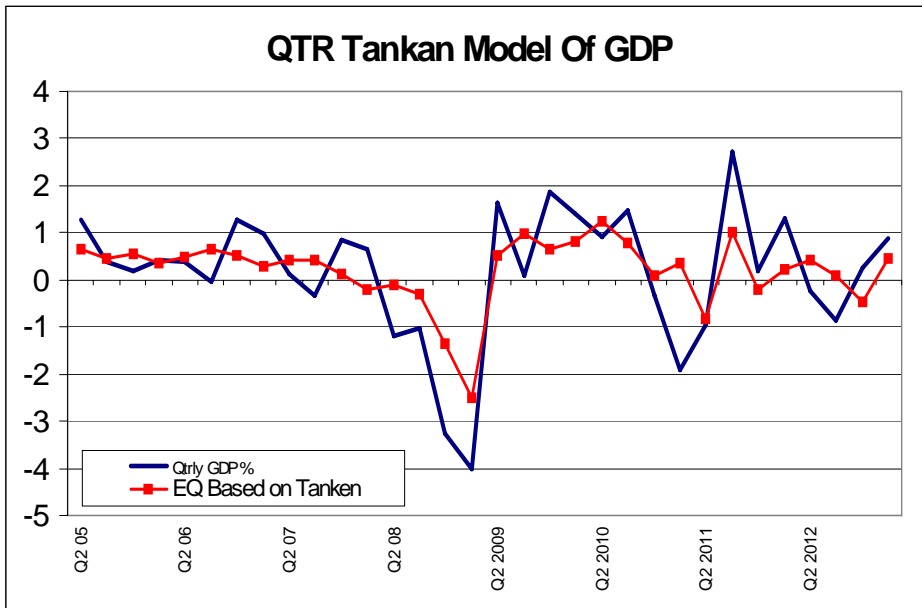


Japanese outlook: Better but still not great ...

Overall around 1.7% in 2013 and 2.2% in 2014

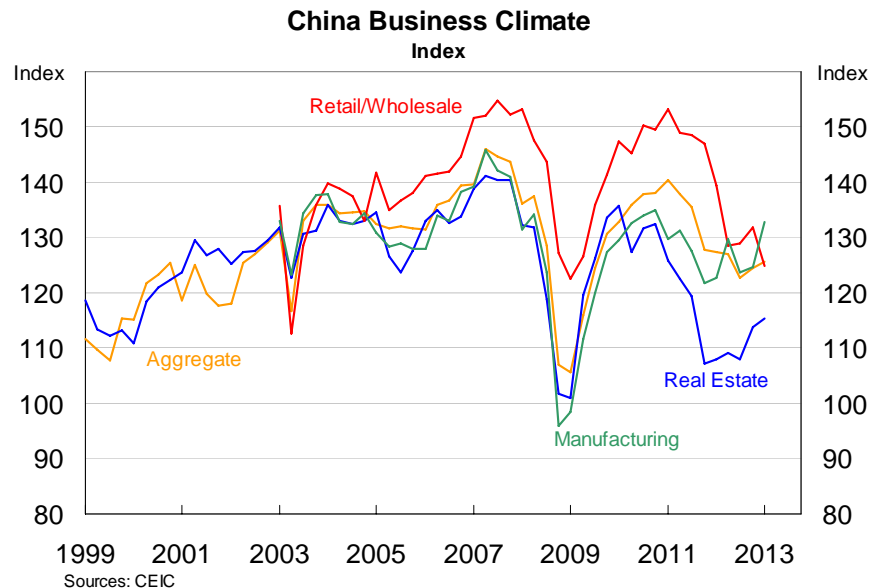
- Tankan Survey pointing to better growth
- And it has showed up in GDP

- Expect ramp up in public spending
- And better net exports
- Also increased wealth helps consumer



China: National accounts disappointed in Q1 2013, but robust growth expected to continue in 2013

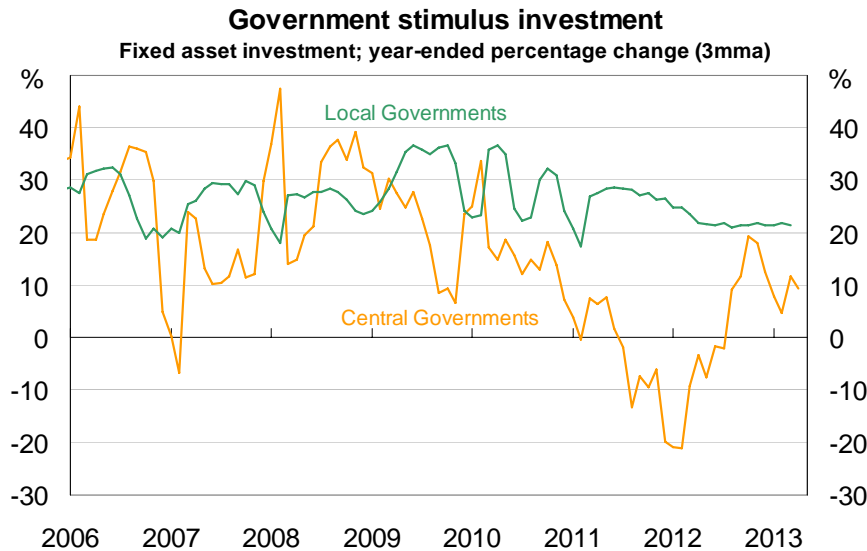
- GDP disappointed in Q1 2013, but growth to remain robust
- But, rapid pace of previous years is behind us
- Authorities see growth as “stable”, while composition is improving
- Business sentiment indicators point to a (tentative) bottom in late 2012
- Albeit different across industries



* Data prior to Q22010 are estimated by NAB.
Source: CEIC Database, NAB

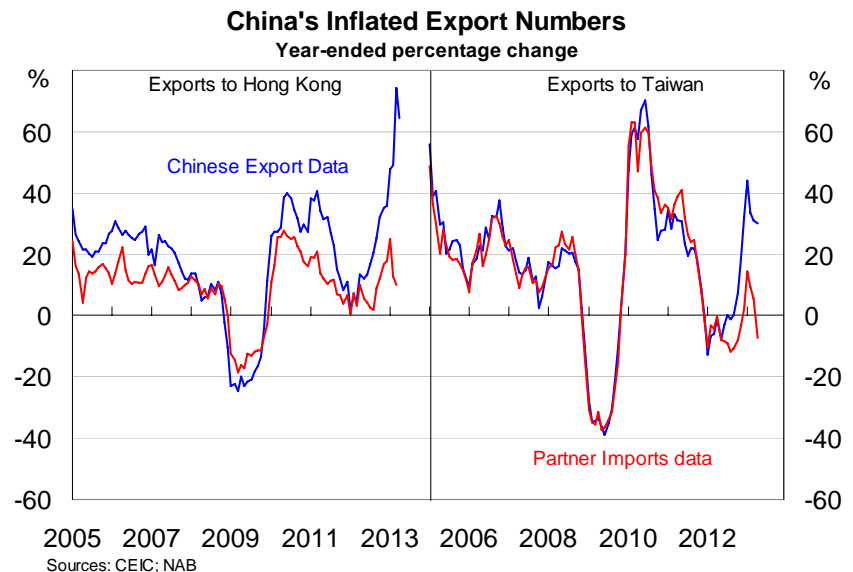
Of course government policy important, but export slowdown may bottom as global growth improves

- Central government spending has supporting investment growth, but impact fading
- Real estate investment recovery on shaky ground following property controls



Sources: Thomson Reuters

- China's exports generally outperformed expectations this year (15% yoy in April)
- Exports to HK have risen sharply, but inconsistencies suggest that actual export demand may be overstated.



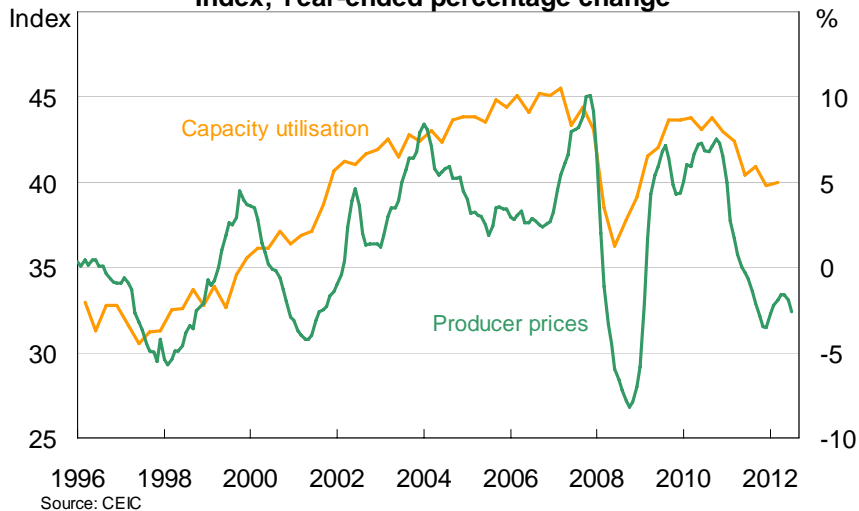
Sources: CEIC; NAB

As a result industrial production has turned. Retails strengthening from good levels.

- Industrial production is steady, but with more subdued growth (up around 9¼% yoy in April)
- Industrial sector battling with over capacity in certain segments

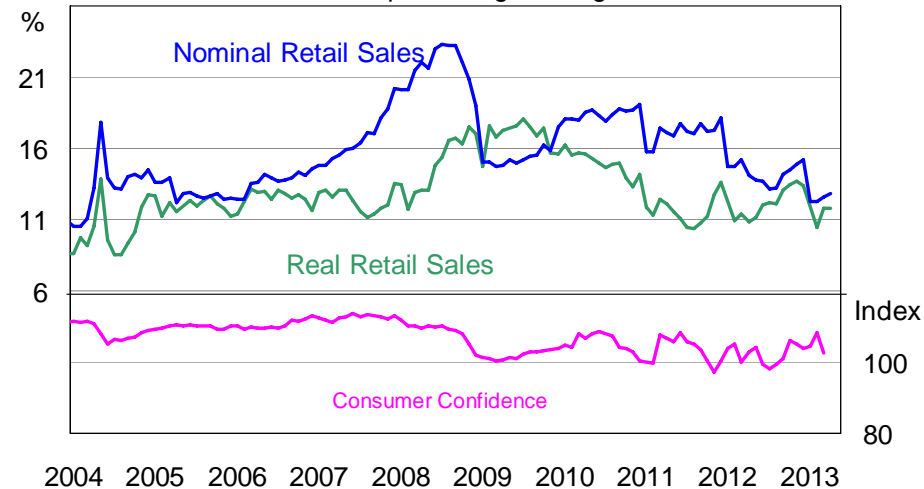
- Retail sales up 12.8% in year to April.
- Implying real growth around 11.8%
- Consumer confidence has weakened, reflecting slower income growth.

Deflation of the Industrial Sector
Index; Year-ended percentage change



China - Retail Sales

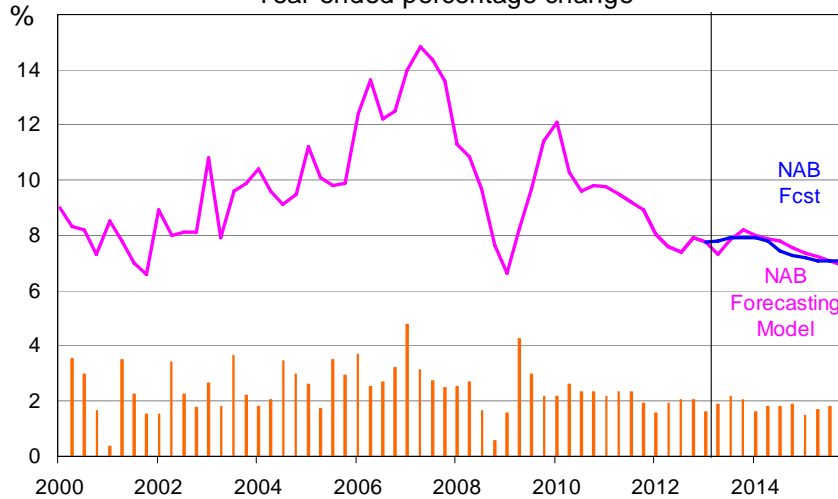
Year-ended percentage change; index



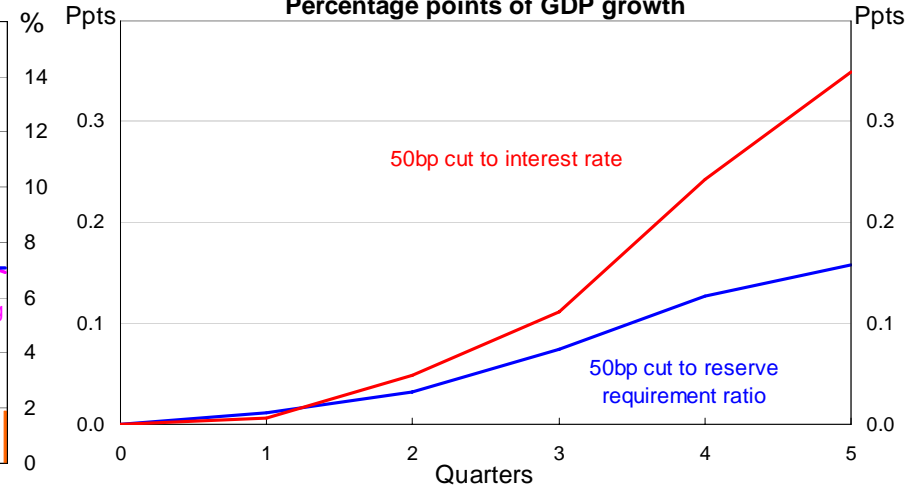
* No observation is shown for January due to the effect of Chinese New Year; February shows the average of January and February compared to December.

Growth outlook: We expect growth to hold up at around 7.8% in 2013 – with policy remaining accommodative

China Real GDP Growth
Year-ended percentage change



China - Monetary Policy Response
Percentage points of GDP growth



Economic Forecasts

	Year Average Chng %			Year-ended Chng %					2014			
	2012	2013	2014	2012 Q4	2013 Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP	7.8	7.8	7.6	7.9	7.7	7.8	7.9	7.9	7.9	7.8	7.4	7.3
Exchange Rate (USD/CNY)	6.3	6.1	6.1	6.4	6.2	6.1	6.1	6.1	6.1	6.1	6.1	6.1
Monetary Policy (end of period)												
Benchmark Lending Rate	6.00	6.0	7.0	6.00	6.00	6.00	6.00	6.00	6.25	6.50	6.75	7.00
Reserve Ratio Requirement*	20.0	21.0	21.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0

Sources: CEIC; NAB Group Economics

* For large depository institutions

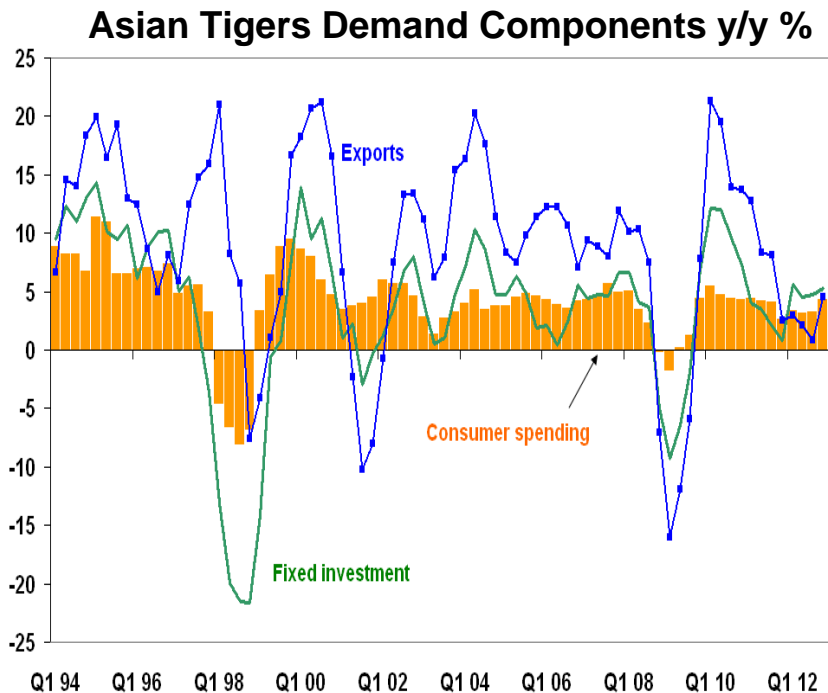
In Non Japan Asia data has been a bit soft – hopefully a temporary issue

- But are seeing a similar trends in Latin America – so likely to reflect softness in global demand



Overall we see modest growth going forward in Asian tigers

- But growth stronger in near term where there is less reliance on global growth e.g. Indonesia
- But worse where open to trade (HK & Singapore)
- Or to competitiveness via currency (e.g. South Korea)



Average annual growth in GDP (%)

	2011	2012	2013	2014
Hong Kong	4.9	1.4	2.7	3.6
Indonesia	6.5	6.2	6.2	5.9
Singapore	5.2	1.3	2.3	3.6
Taiwan	4.1	1.2	3.3	4
Thailand	0	6.8	4.6	5
Malaysia	5.1	5.6	5.4	5.6
S Korea	3.7	2.0	1.8	2.8
Philippines	3.9	6.6	4.4	4.8
Tigers	4.2	3.8	3.7	4.3

Global economic forecasts: Key theme

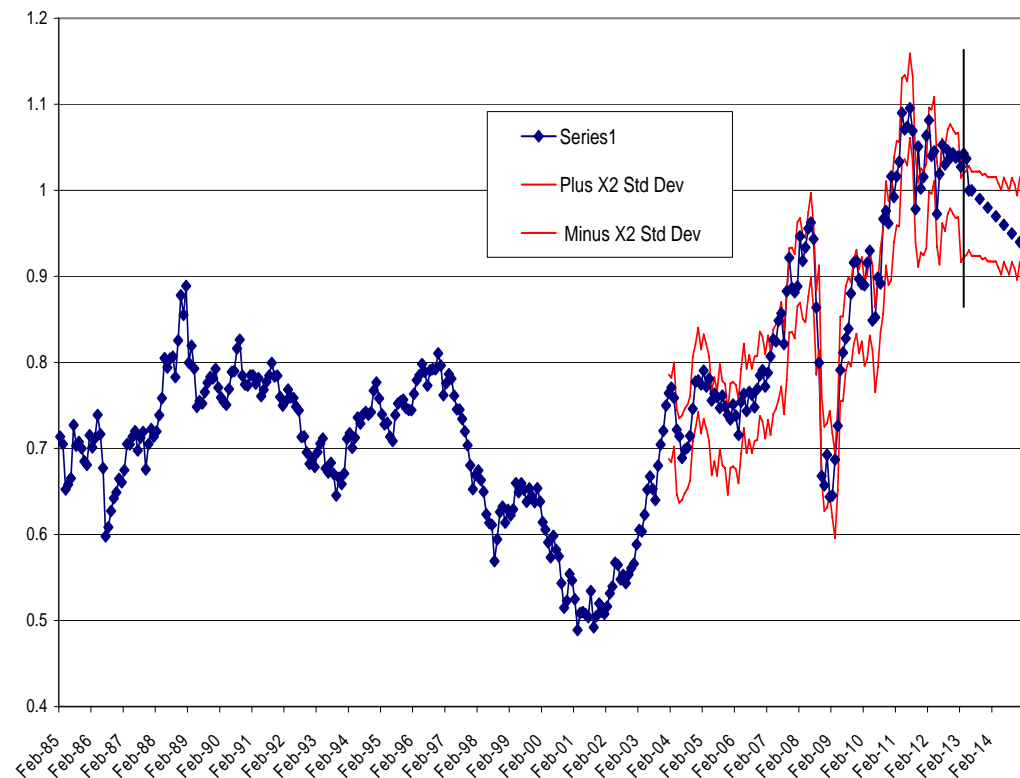
Trend growth returns in 2014 but recent weakness...

	<i>IMF weight</i>	2012	2013	2014
World		3.1	3.1	3.7
United States	20	2.2	2.1	2.9
Euro zone	15	-0.5	-0.6	1.1
Japan	6	2.1	1.6	2.2
China	14	7.5	7.8	7.6
Asian Tigers	8	3.7	3.6	4.3
India	6	5.1	5.7	6.4

AUD a proxy for global risk appetite and commodities. And of course China

- Our model says AUD good value USD 98c (+/- 5c). So not radically over valued
- That probably reflects foreign demand for AUD in foreign central bank reserves – diversification a key driver. Hedge funds less involved
- Not a lot RBA can do – rates matter but not a lot
- We see AUD around parity (a touch below) for rest of 2013 then easing to mid to lower 90c by late 2014.

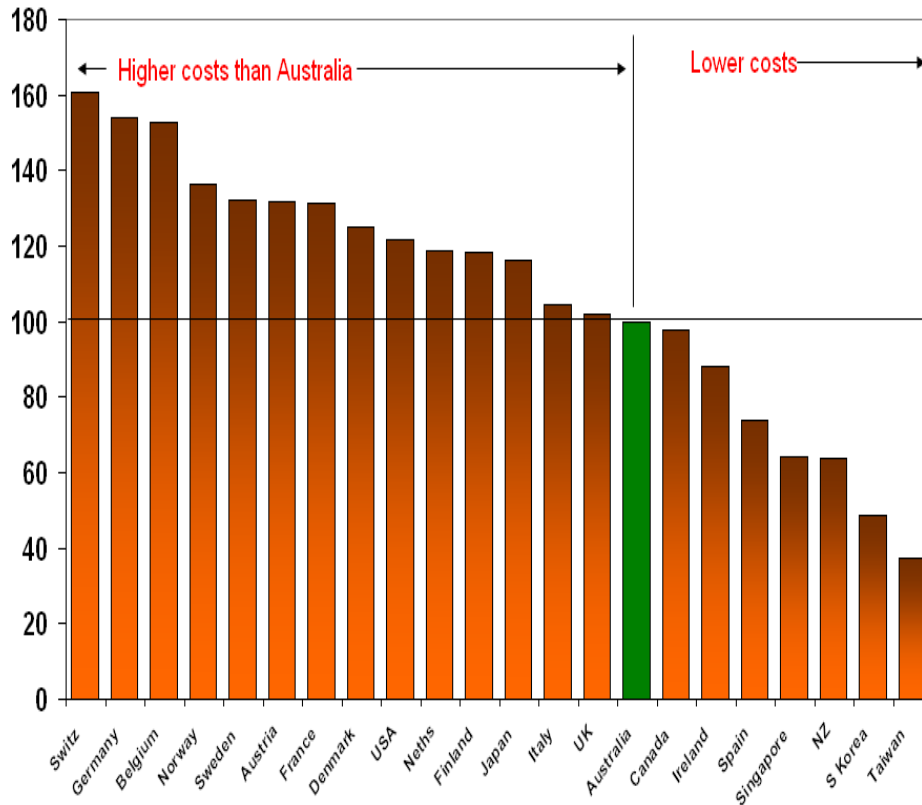
Model AUD and Forecasts v Actuals



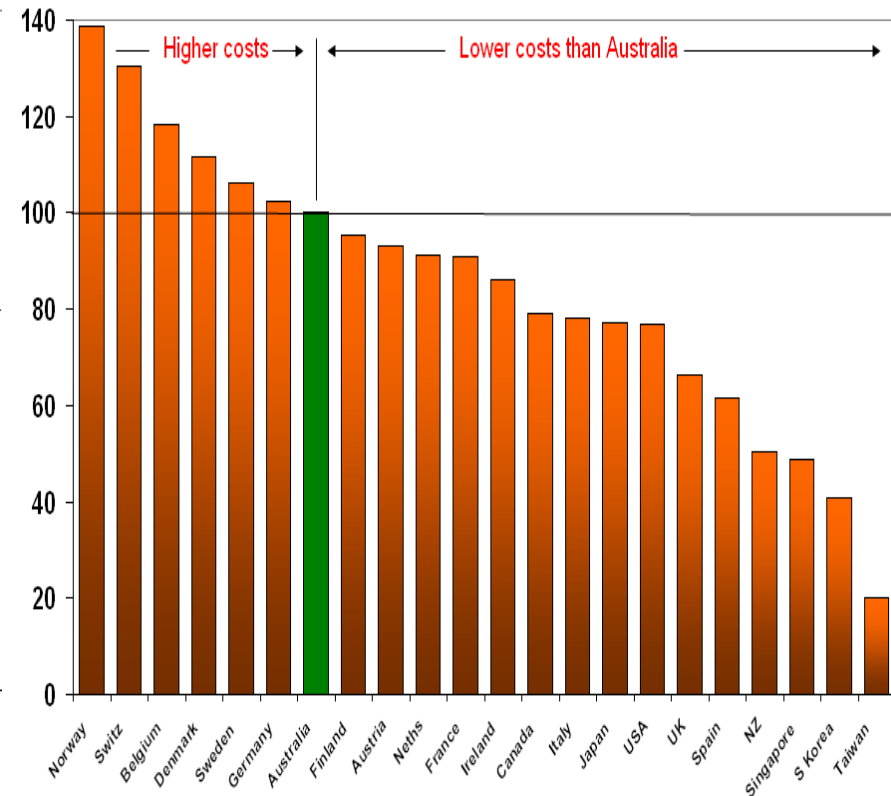
Model driven by: commodity prices; US TWI – as measure of USD weakness; long and short run rates; relative unemployment; relative equity markets and VIX.

Australian industry shifted up the global cost curve – especially against other advanced economies

Hourly labour costs in US\$ in manufacturing Australia =100 index 1997



Hourly labour costs in manufacturing in US\$ Australia=100 index 2011



Iron ore cost curves important – Aust low cost

And a longer term perspective interesting.

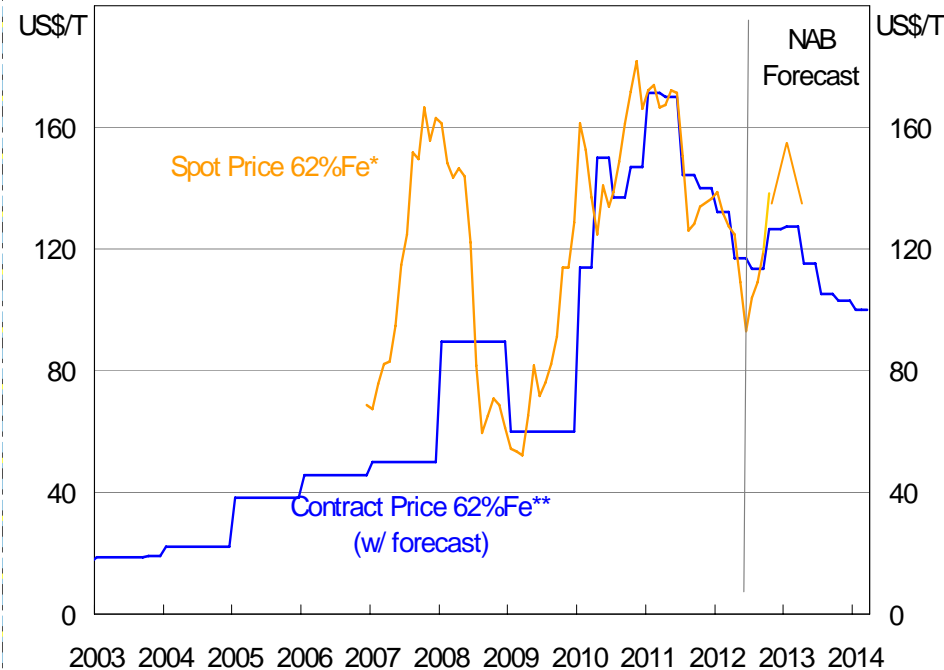
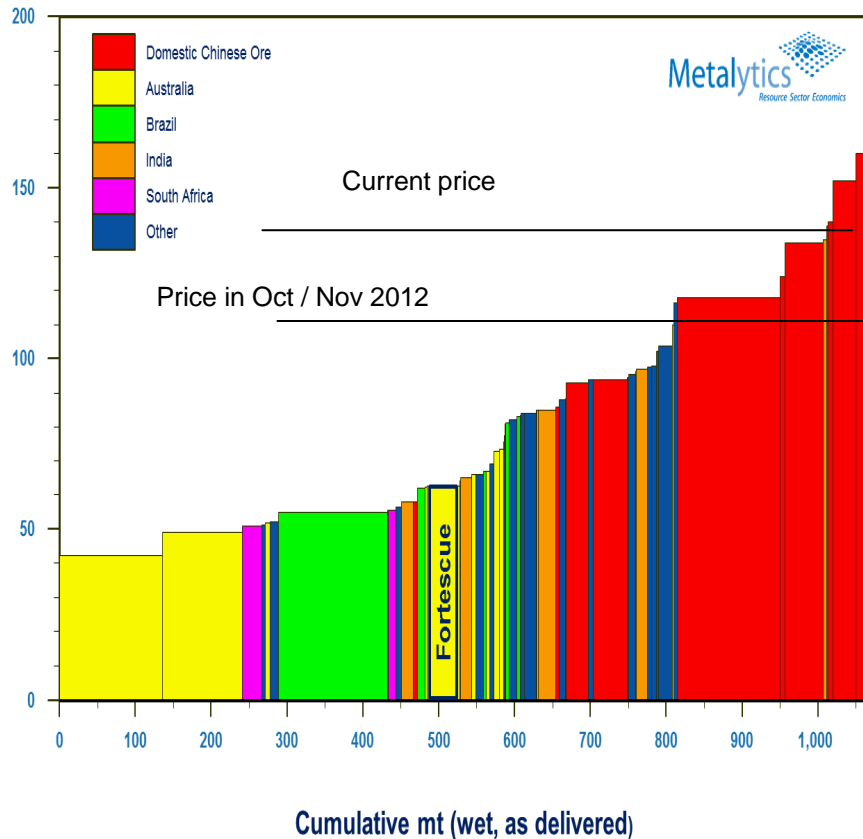
Australia a low cost provider

Recent price spike not likely to be maintained

But still very profitable

Iron Ore Prices

FOB Basis



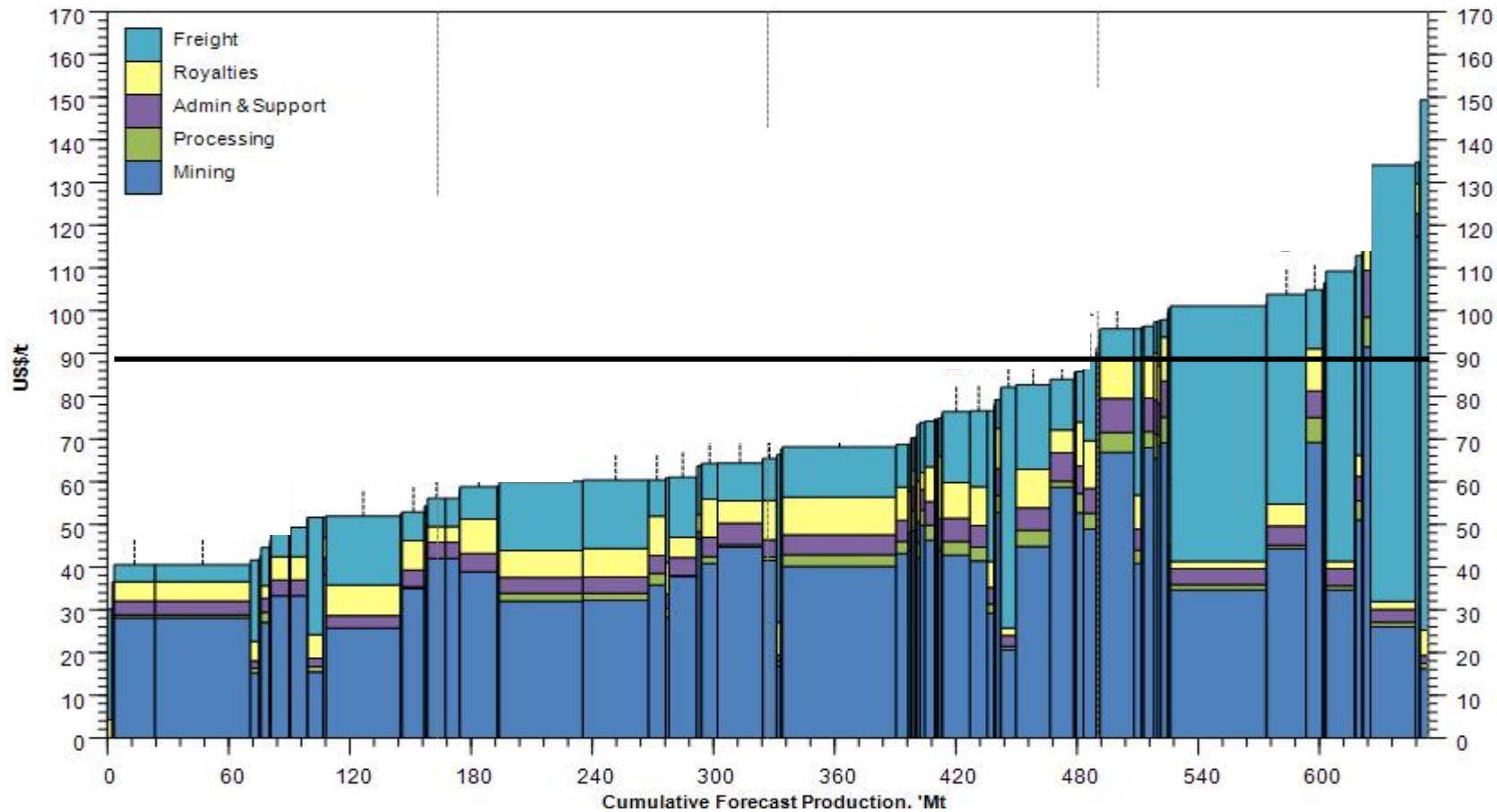
* Spot price is calculated on an FOB basis by subtracting Port Dampier to Qingdao shipping rates from the cost and freight price. 62% Fe spot price is an estimate from published 63.5% price.

** Up to Q3 2011, based on formulation that quarterly contract price equals previous quarters average spot price, lagged one month (eg. DQ = Average(Jun-Aug spot price)). Estimated using spot from Q4 2011.

Source: ABARE, Bloomberg, Thomson Datastream, NAB

Source: Metalytics prepared March 2012

Thermal coal story not so good

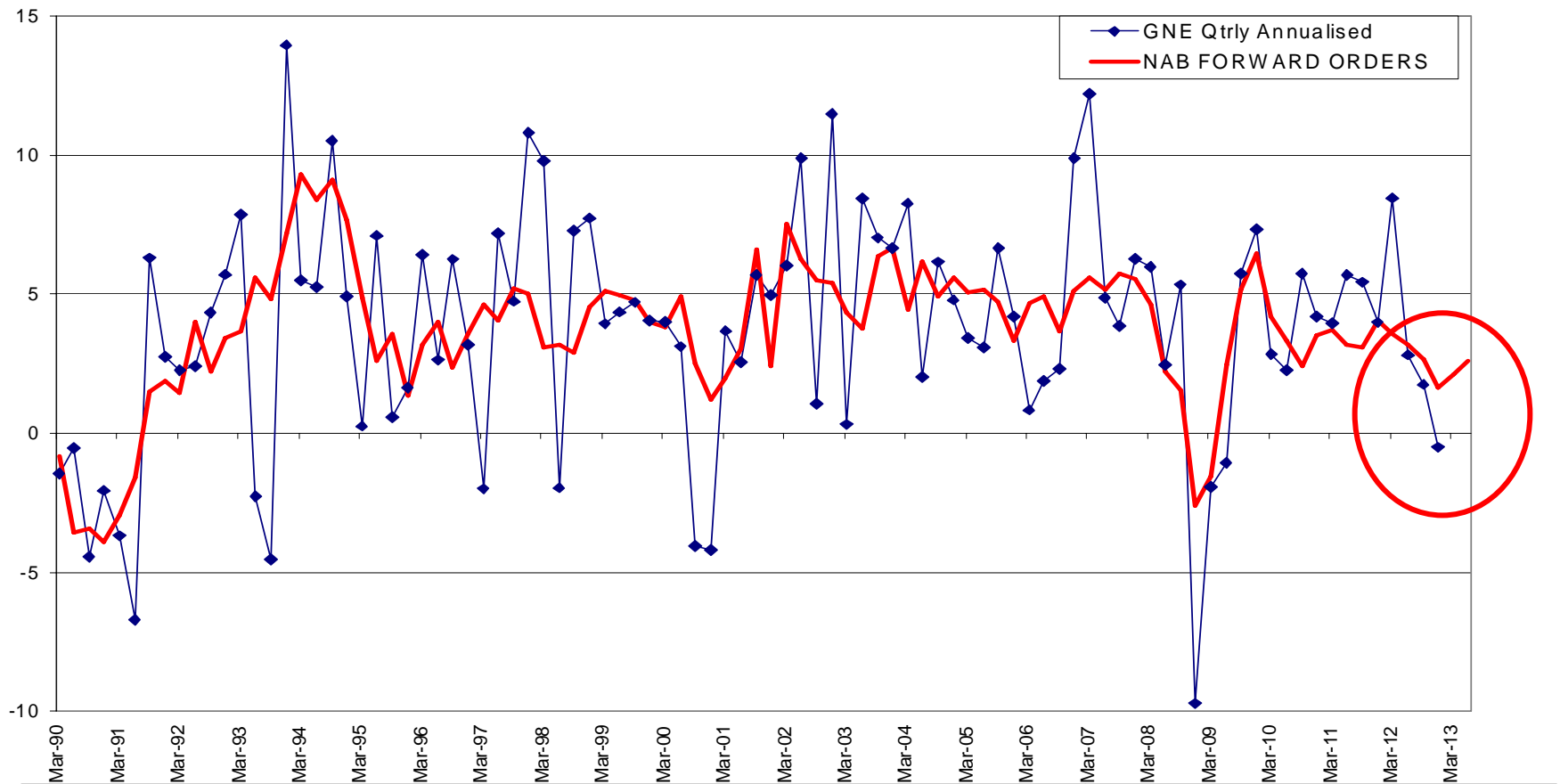


Some key themes on Australia

- Domestic economy very mixed and in our view has hit a softer patch that has continued into the first part of 2013.
- House prices and equity markets helping wealth and consumer. But big offsets in lack of non mining investment as mining turns down, weaker commodity prices and high currency.
 - Multi-speed nature continuing – with the weak getting worse. Mining investment continuing but will slow and go backwards as export boom replaces it as a key driver of growth. But employment demand will weaken (less miners to run v build a mine)
 - Currency stays high and may be having larger expectation impacts on activity.
- With economy still struggling in H1 2013, growth in 2013 will be a around 2.3 %
So unemployment to rise by late year (around 5¾ - 6%)
- Structural adjustment challenge massive. Another cut (s) required (25 points)

Our survey suggests domestic economy quite weak. Survey has tracked local economy well for 20 years

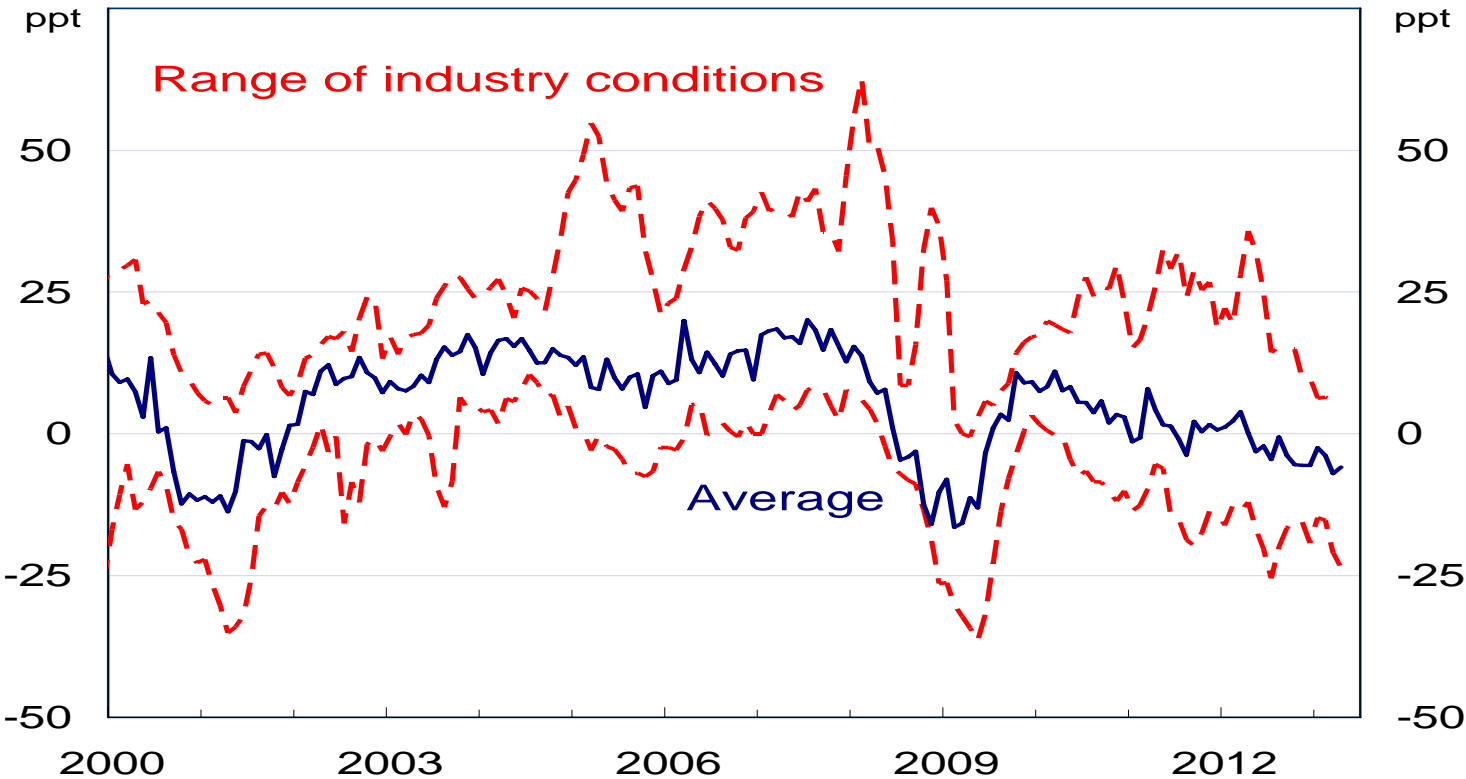
Quarterly Change in GNE v NAB Indicator Based on Forward Orders



A concern is that appears stronger industries are now weakening as well – especially, but not just, mining...

Monthly Business Conditions by Industry

Net balance, deviation from industry average since 1989



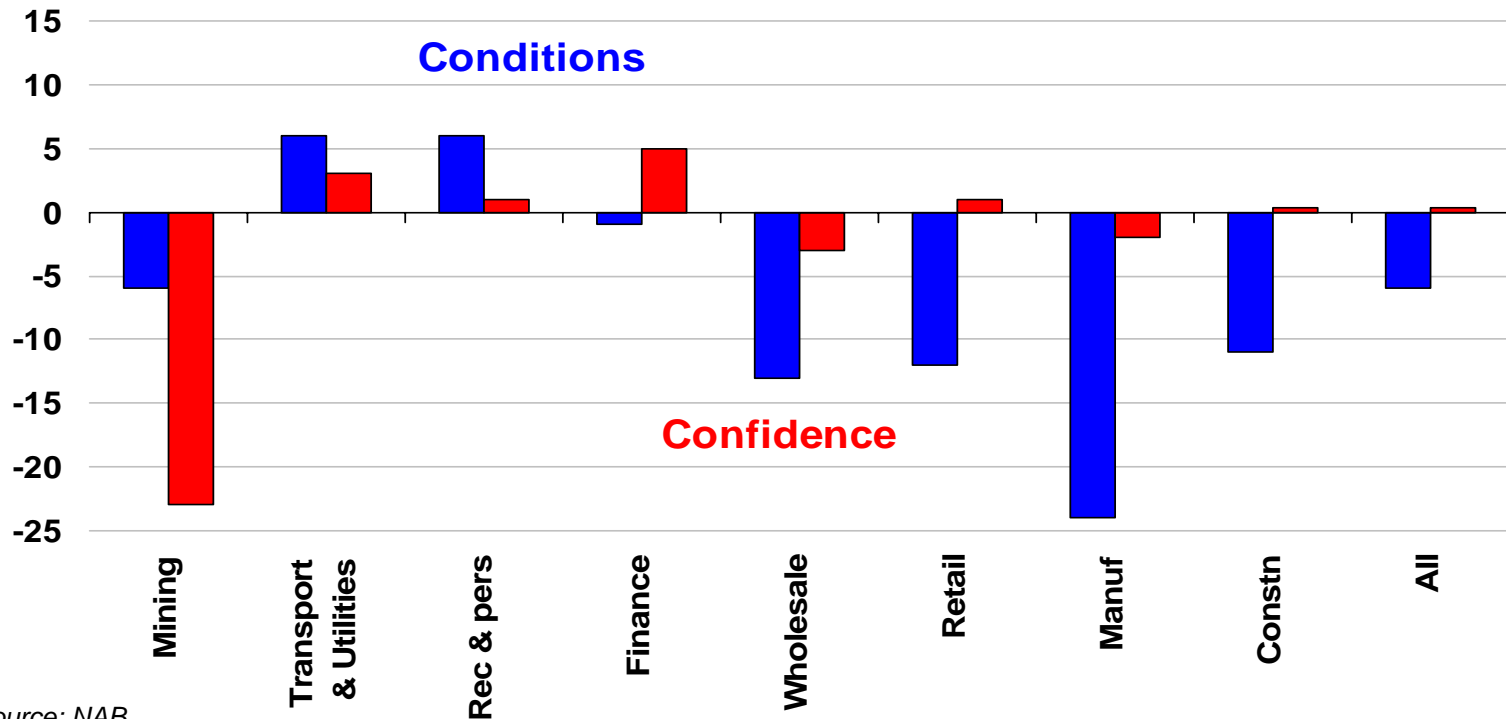
Source: NAB

Still big divergence of conditions and confidence across industries. But mining scared and weakening

- Mining conditions deteriorating rapidly. Manufacturing very poor. Retail not good
- Personal services and transport & utilities reasonable. Finance confidence global.

Business Conditions and Confidence

Three Months to April; sa



Source: NAB

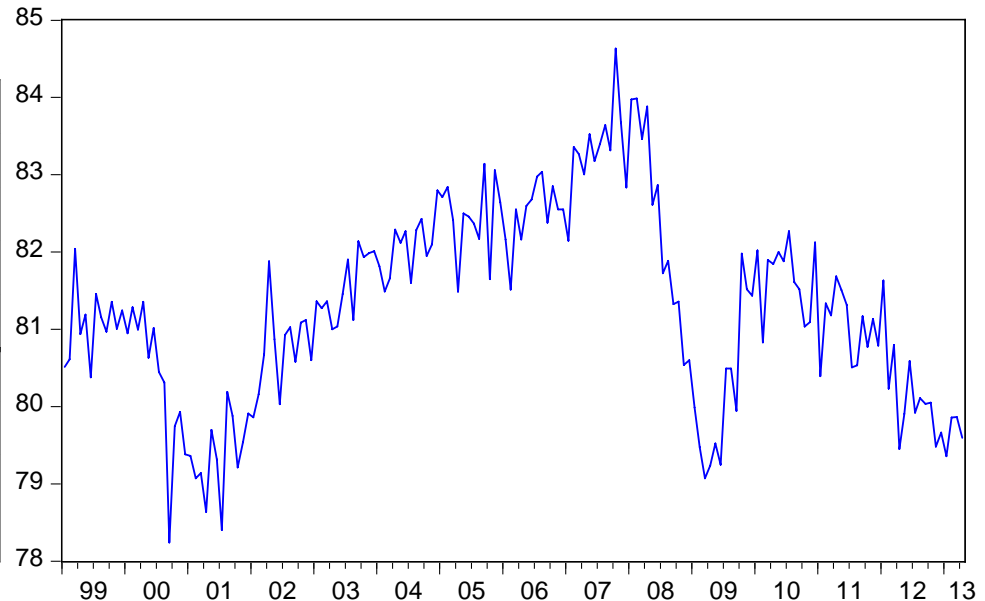
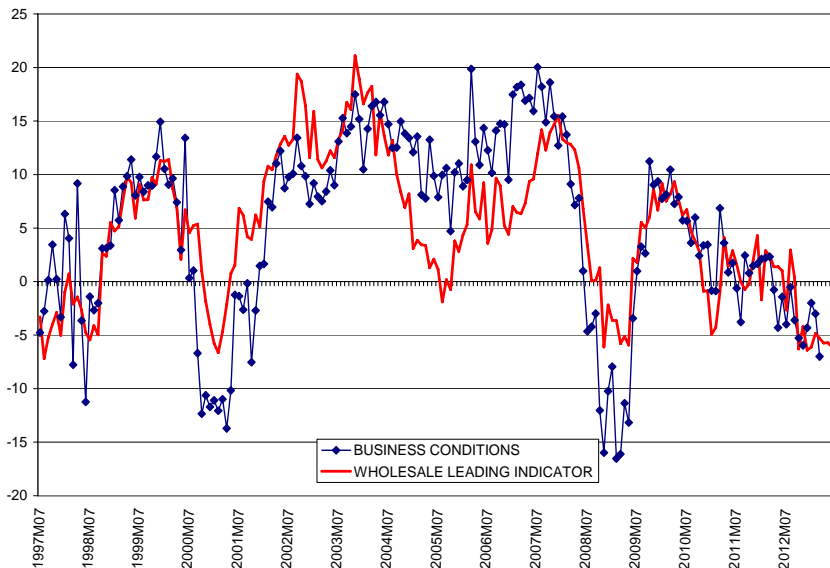
Forward indicators a real concern

As is low level of capacity utilisation

- We have a **new forward indicator based on wholesale conditions** leading general conditions by 3 to 4 months
- Implies still weak Q2 2013 – i.e. **if anything a weakening in growth momentum**

- And **capacity utilisation** rates getting **very low**
- **Not a great incentive to invest – especially in non mining** CAPUM_SA

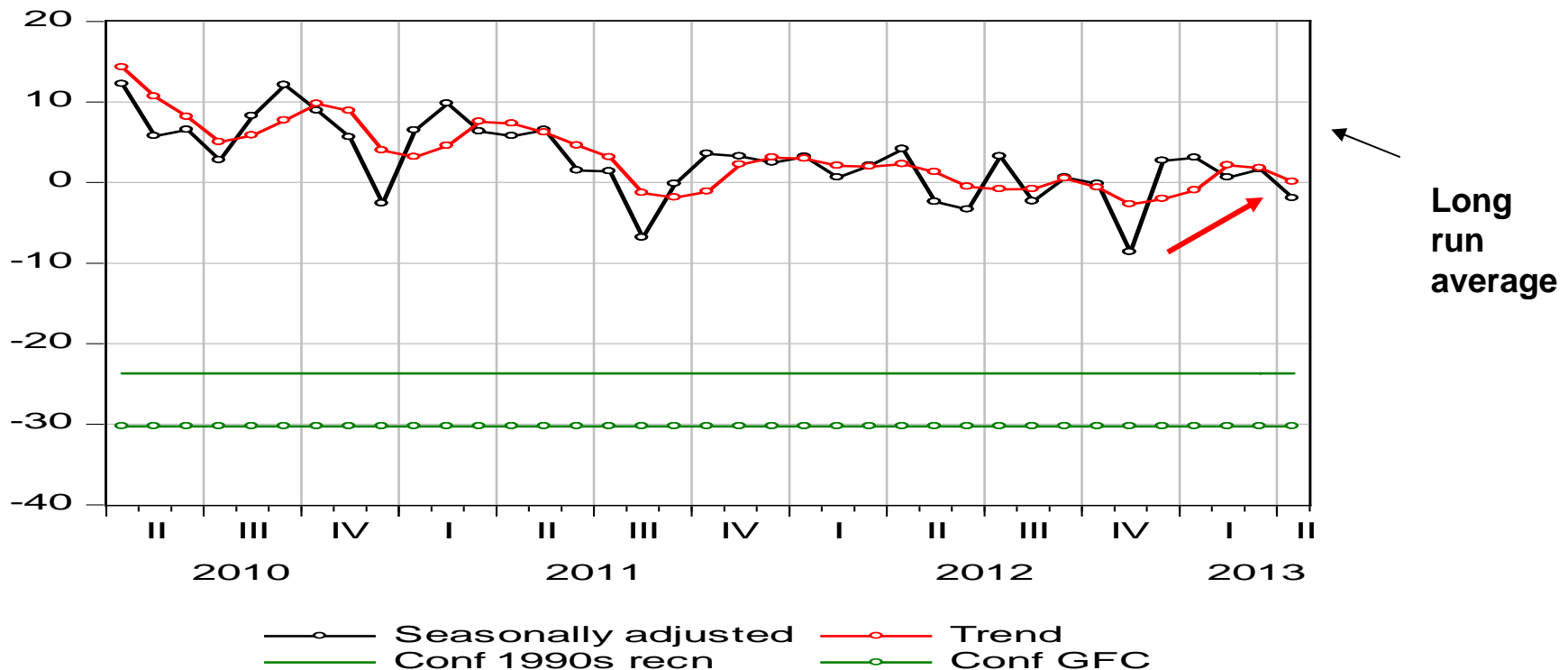
Business Conditions v Wholesale As a Leading Indicator



Confidence improved on global sentiment in early 2013 But below long run average and a touch weaker in April.

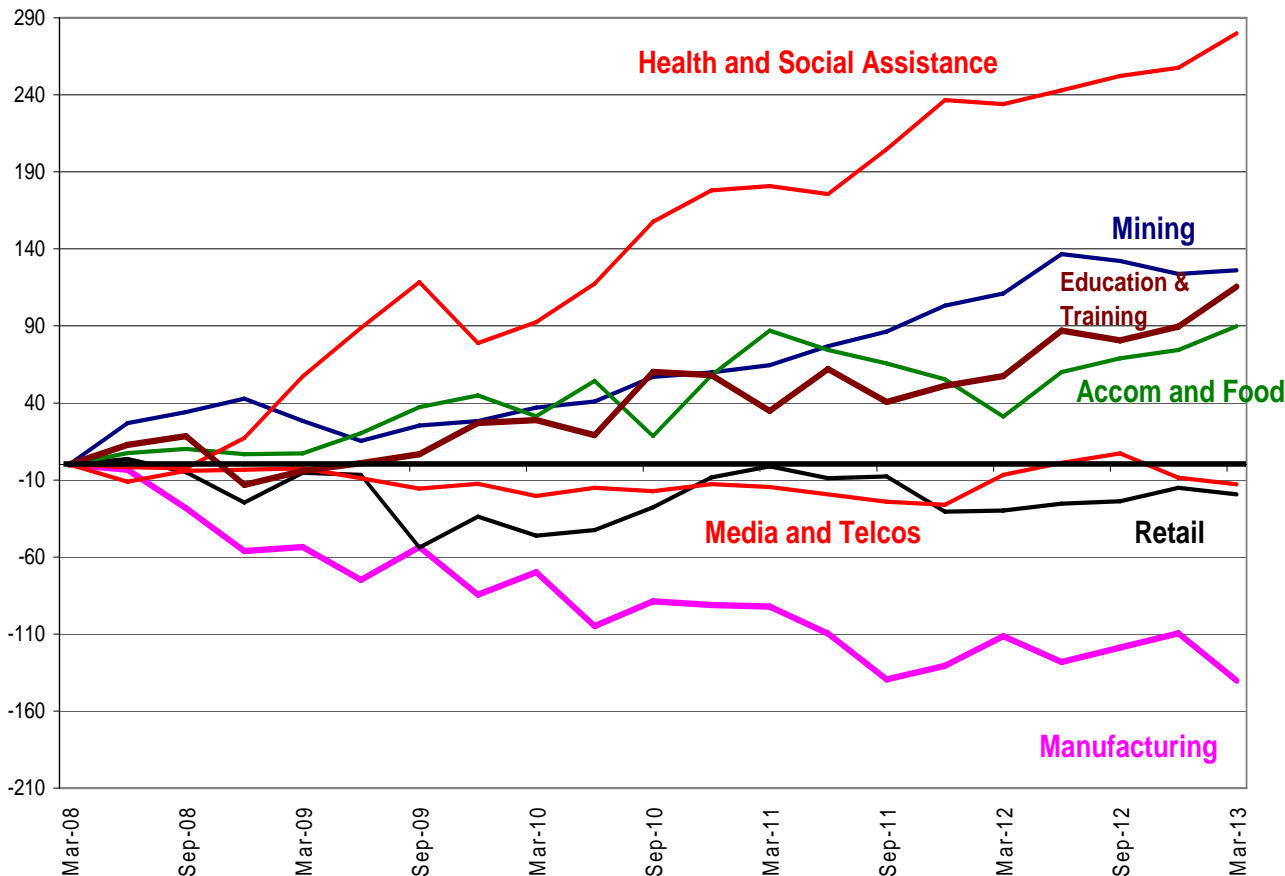
- Confidence better in early 2013 (fiscal cliff avoided, better China data & rates)
- But still a touch below long run average. April weaker on mining gloom

Business confidence (net balance)



Re-inventing the Australian economy. The challenge

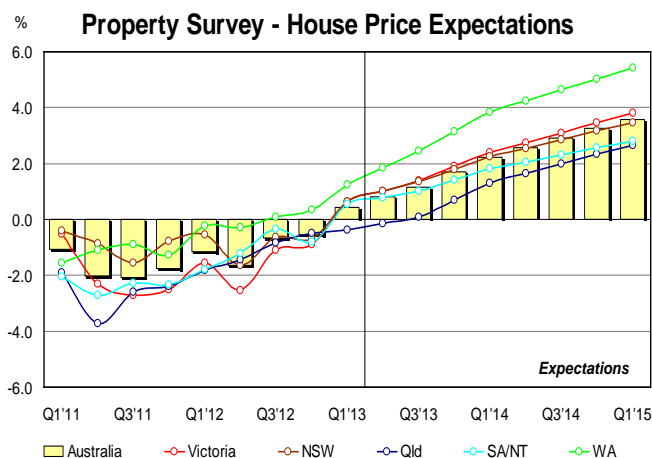
Employment - Changes since March 2008



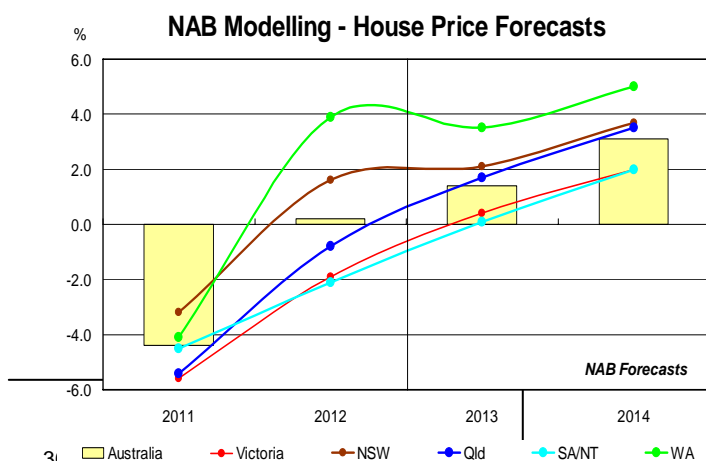
- Health care and social security the biggest employer and where the growth is largest (280k)
- Miners and Education are **both** employing around 125k nearly as many as manufacturing fired (140k)
- These trends not recognised in the debate or at least in the press
- But still real and represent a big policy challenge. Its not going away

Better equity markets and turning house prices have helped perceptions of wealth. But we remain cautious

- House price expectations turning increasingly positive – Nab Property Survey

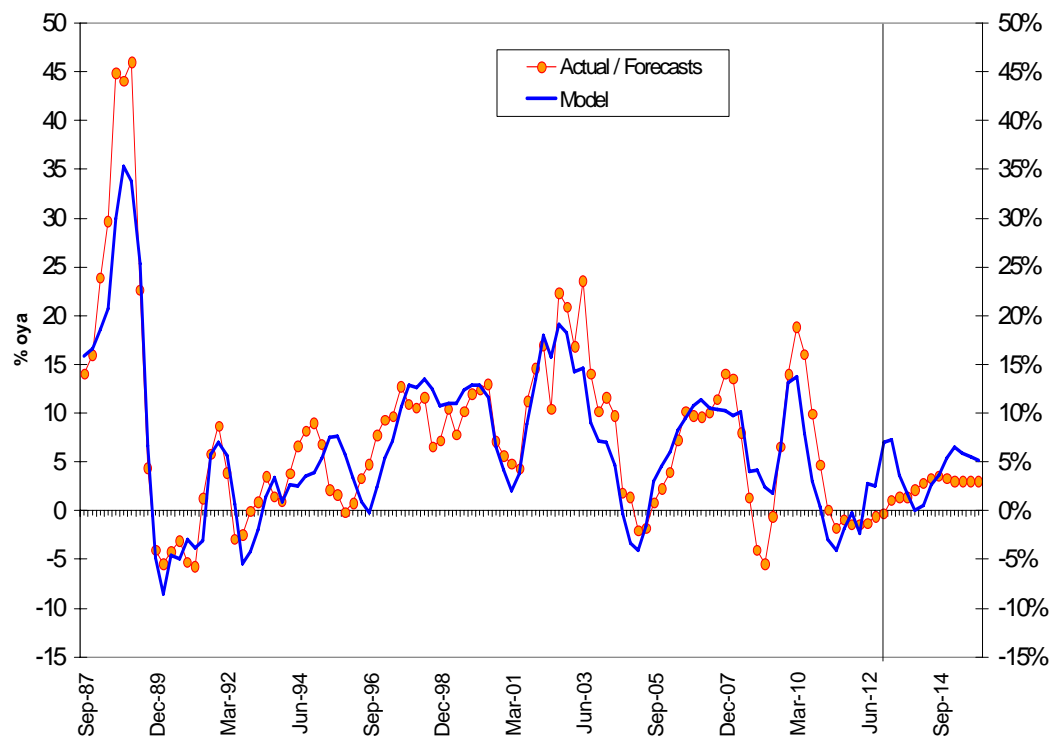


- And reflected in our state forecasts



- Over the medium term our **Australian model wants moderate growth.**
- Accelerating in near term but then flattens out by end 2013 as unemployment rises

Australian House Prices - 12 Mth %

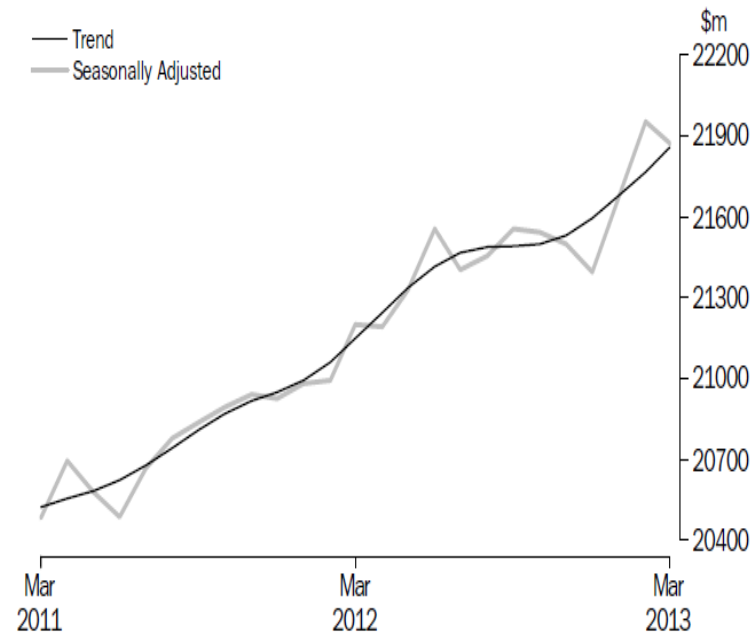


Recent ABS data suggest a surge in retail sales. More strength but are technical issues here.

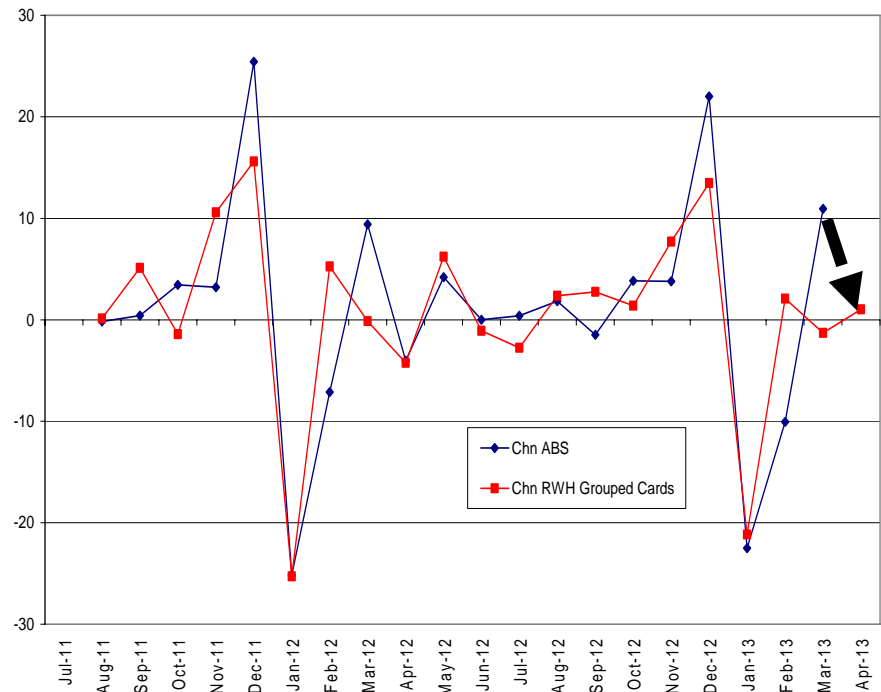
- ABS Nominal retail trade strong but bouncy

- Our credit card data (\$3bn per month) suggests recent moves overstated and hence March negative
- April up around ½%

RETAIL TURNOVER, Australia

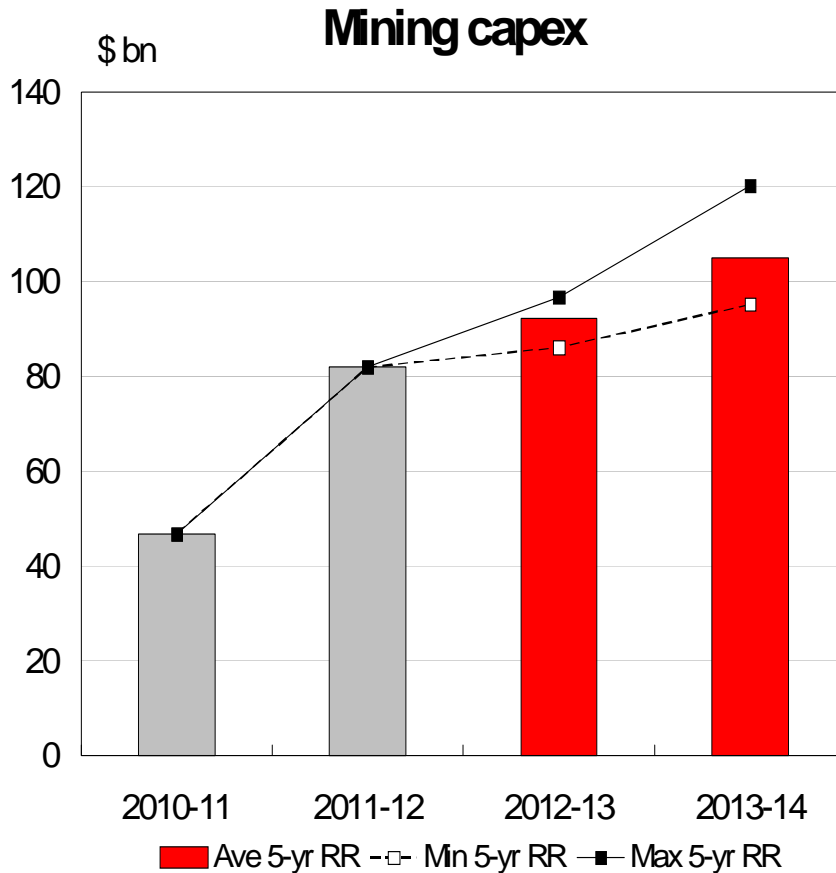


Grouped RWH v ABS

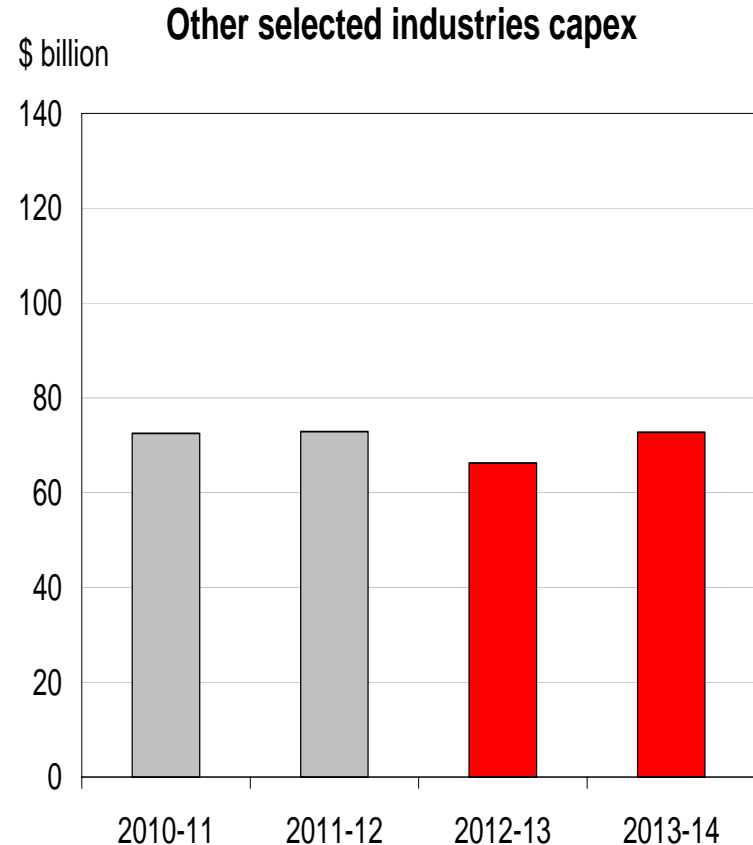


Investment – a tale of mining v the rest

- Mining investment now exceeds investment in the rest of economy combined

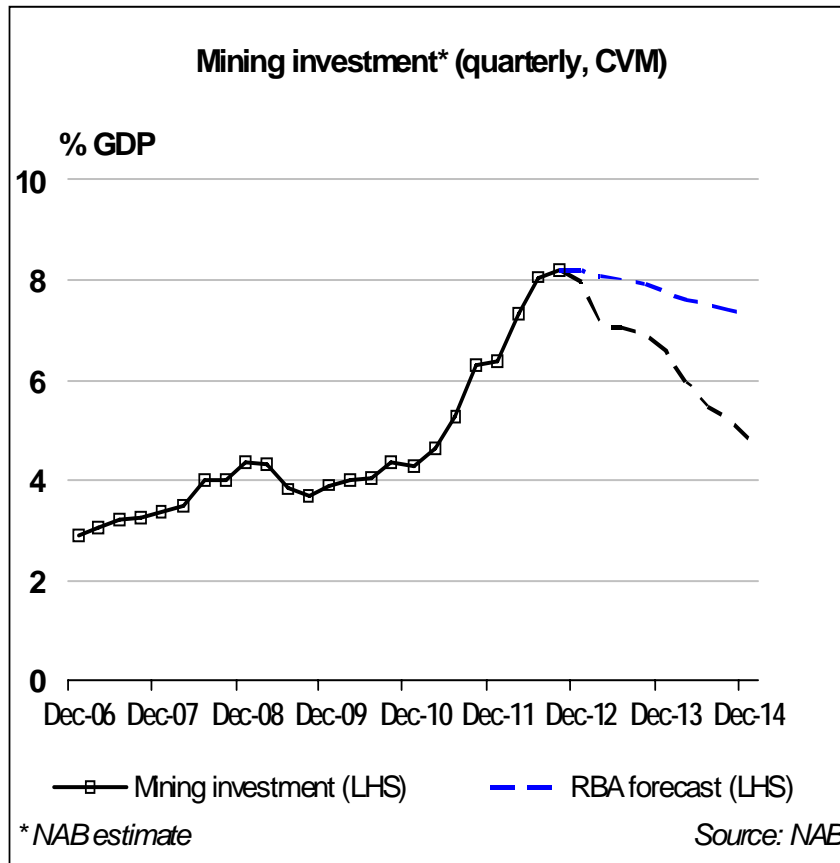


Source: ABS & NAB calculations



Source: ABS & NAB calculations

Its not that mining investment wont be really strong for ages. Rather its moving out of the growth phase

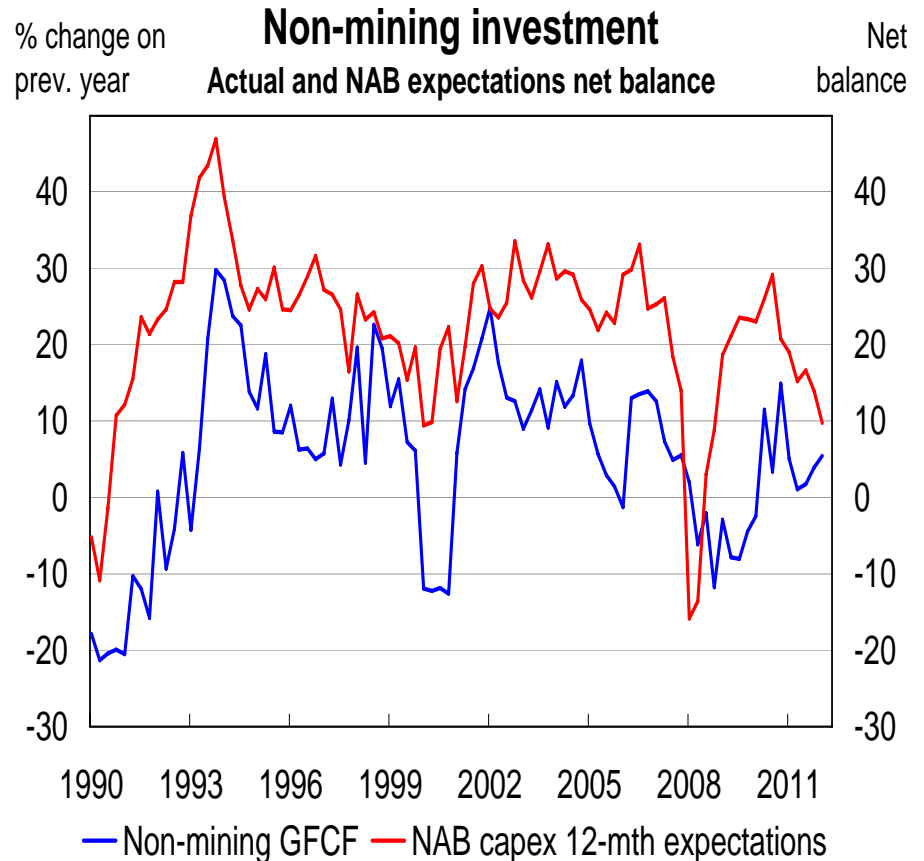
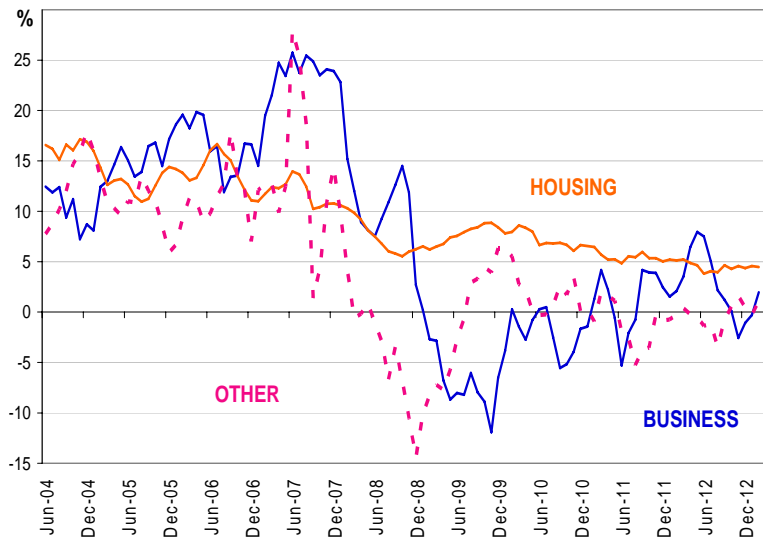


- Also a critical point is that mining is moving from investment to exports
- Good for productivity and hopefully neutral for growth
- But will lower demand for employment
 - 8 people to build an LNG platform 1 to run it
 - 4 to build a mine 1 to run it
- Hence critical for non mining investment to help offset the slack

Critical issue is will non mining investment offset slowing mining. Nothing in credit data and investment intentions

- Personal (credit card) and business credit currently around flat to negative
- Home loans at 5% a 30 year low

Key System Credit Aggregates
3 mths at annual rate - saar

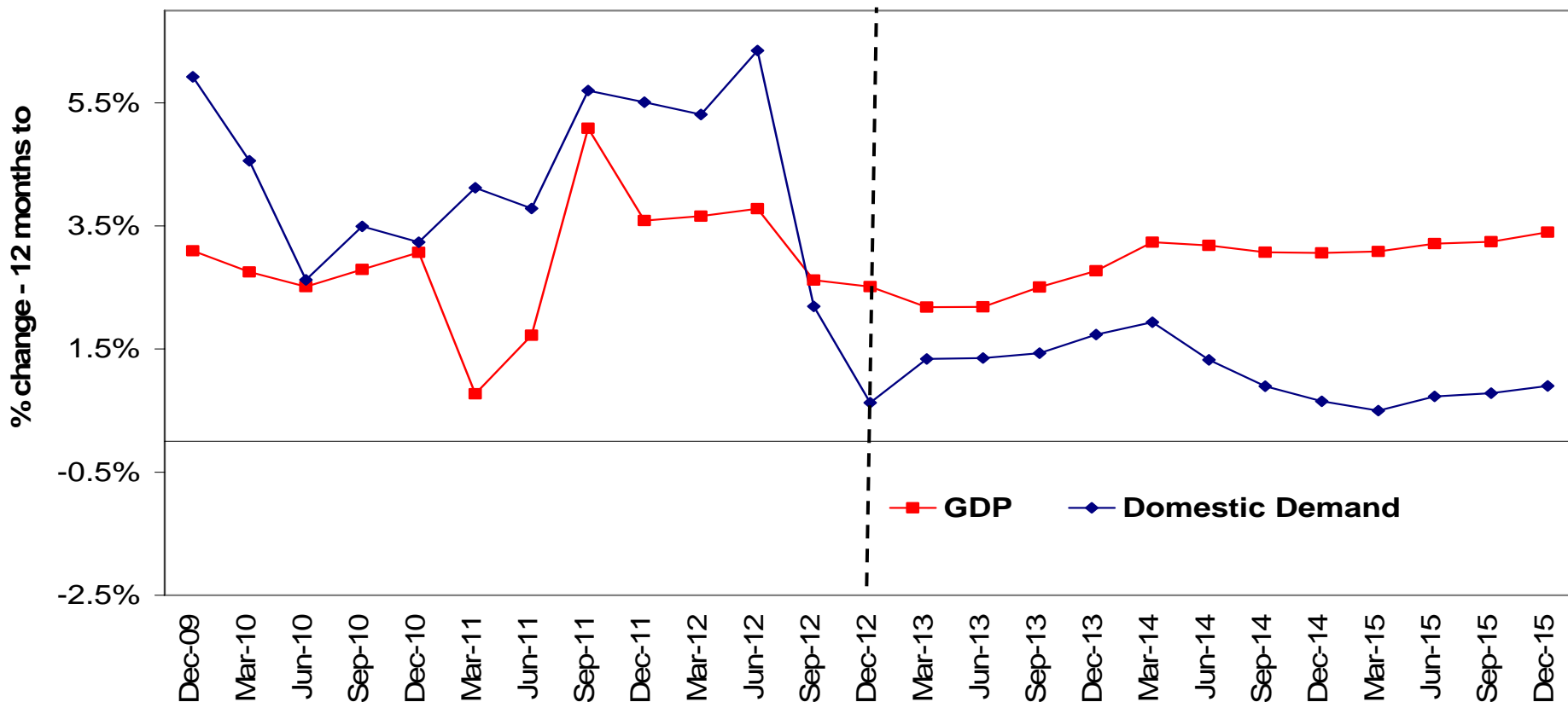


Sources: ABS, NAB

Quarterly non-mining GFCF estimated by NAB

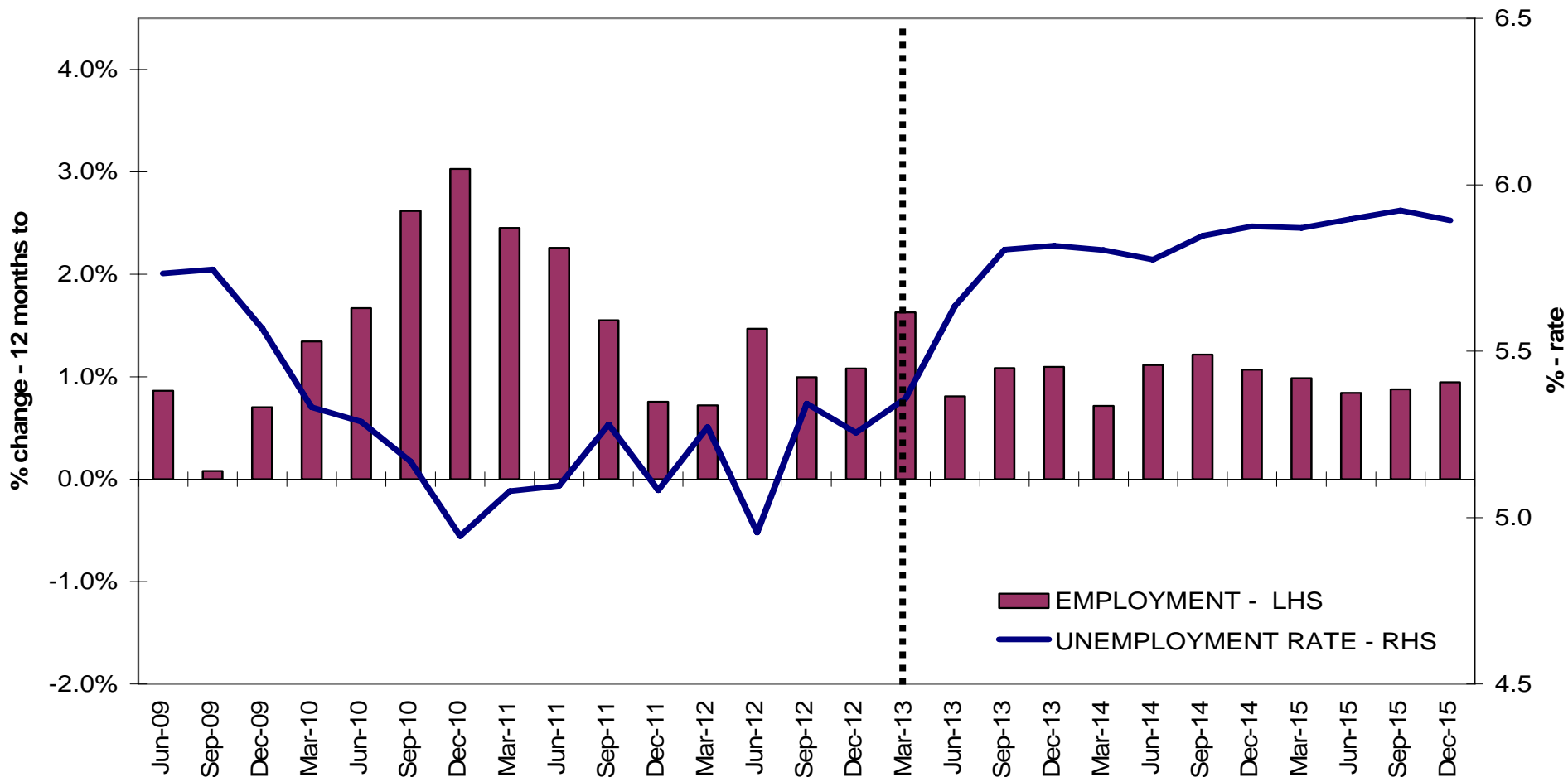
GDP loses momentum— we expect 2.3 % in 2013.
Slightly better in 2014 on rate cuts but mining boom has big impacts on demand v GDP (esp in 2015)

Australian GDP and Domestic Demand : At a 6monthly Annualised Rate



For labour market lower growth raises unemployment And phasing of mining boom keeps it there

Australian Labour Market



RBA to cut by another 25 points in 2013 – to 2½ %

- Economy hitting a soft patch
- Inflation not an issue
- **RBA took the opportunity to go early – in May we expected June**
 - Its about helping competitiveness of struggling parts of the economy
 - We still are very worried re non mining investment
 - At the margin we have lower growth expectations for 2013
 - But very similar inflation outlook
- We expect RBA to have to respond again as unemployment rises to 5¾-6% by mid late 2013. Accelerating house prices on the other hand could complicate the timing process
- We have a final cut in late 2013 as mining phasing heralds further labour market weakness (say November).

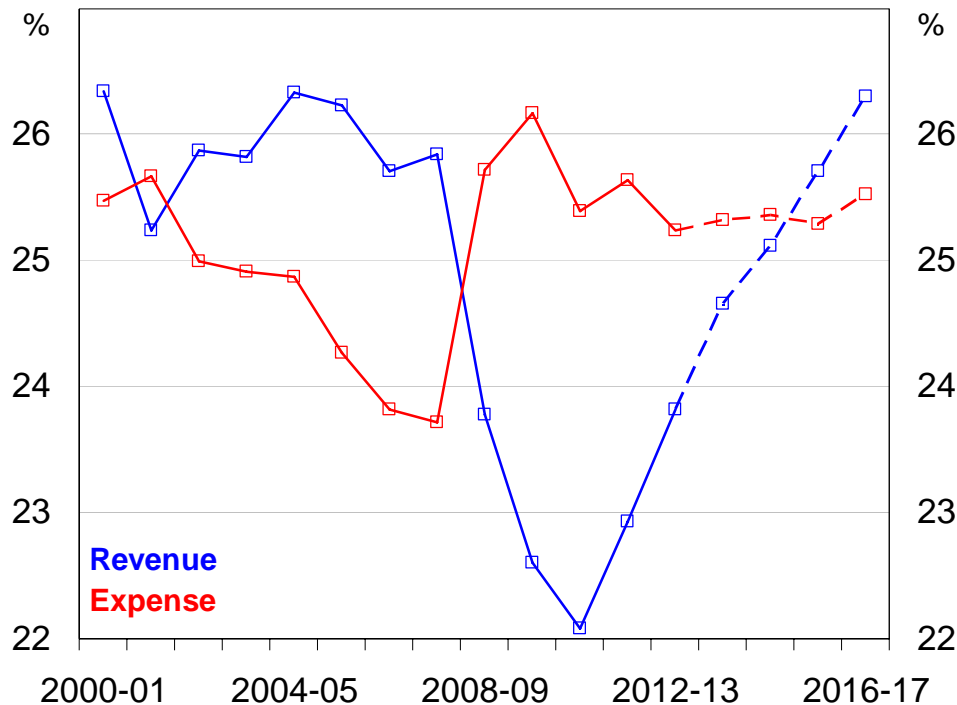
Overall reaction to the Budget.

What a difference a year makes!!!

- This is a very political document - with last years rhetoric about the need to get back to surplus for global credibility ditched
- But path of progress back to surplus is much slower than expected – involving less pain to the economy than we expected. Indeed the impact is practically nothing in 2014/15 building through time to around ½% in the out years
- The budget is helping to repair some structural problems via scrapping last years welfare increases (spreading the benefits of the boom) and the baby bonus, increasing the medicare levy to help fund national disability reform, tightening offshore tax arrangements and acknowledging lower carbon price
- Overall a budget more in keeping with a weaker economy
- Forecasts at 2.7% for 2013/14 and 3% reasonable (we are a touch lower). But we have lower start in 2012/13 More importantly we have a much weaker nominal economy – important re budget outcomes re profit and taxes.
- We still see need for another 25 point cut in rates to get 2013/14 forecasts. And we still see November as the most likely timing,

In corporate speak, Budget has “negative jaws” Mainly fixed on revenue side – and after a few years

Commonwealth revenue & expenses*
% of GDP



Sources: ABS; Commonwealth Treasury; NAB calculations; RBA

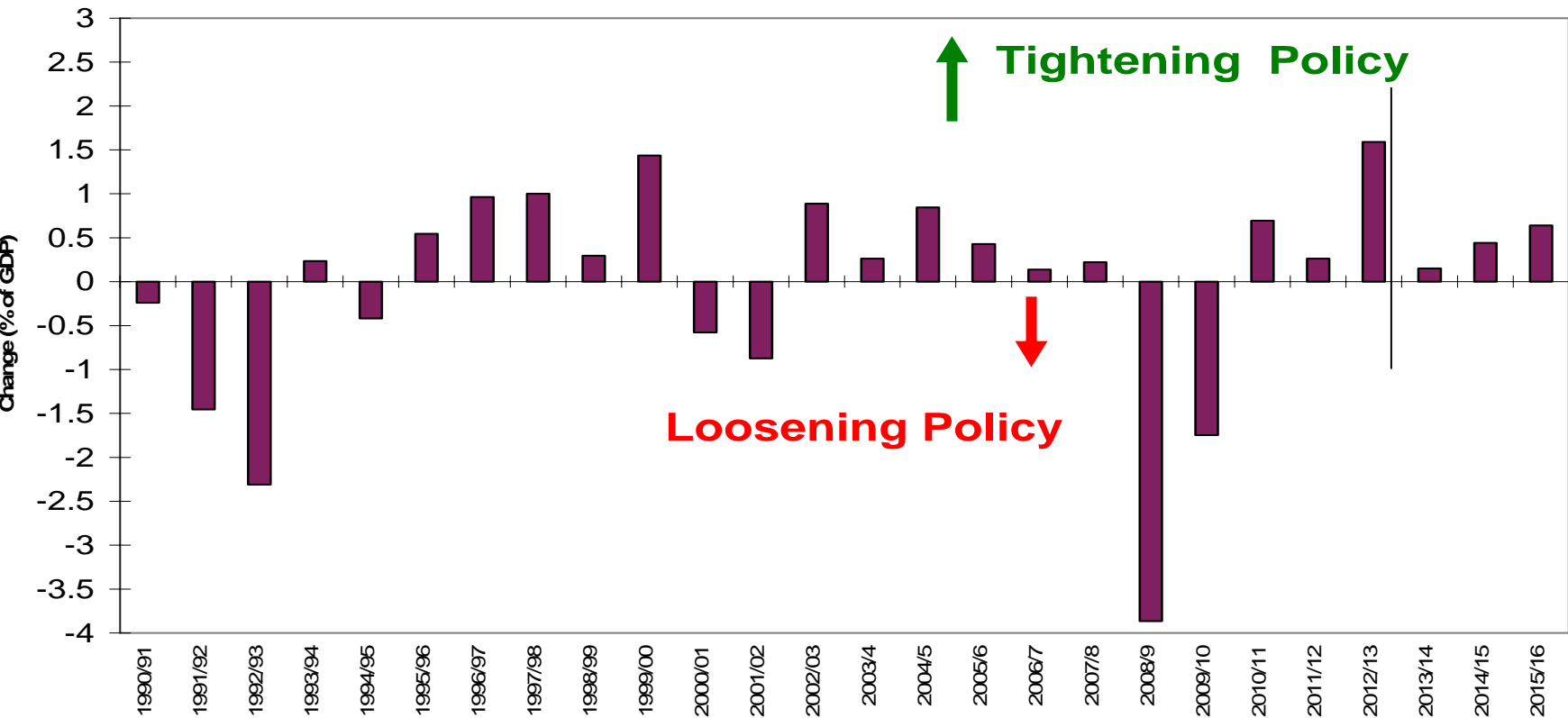
* GST classified as Commonwealth tax & expense

- Fixing “jaws” is the key to fiscal sustainability
- Clearly main driver is the fall in revenues
- But expenses (after shooting up during GFC) have remained at higher levels

Fiscal impact – Nothing like last year

Nothing much to out years and then only around ½%

Structural Impulse
- Annual Movement % of GDP



➤ Analysis based on OECD methodology;

The uncertainties

- How much of the package will get ever see the light of day post the election.
- Lots of the action re expenses kicks in late in the period – especially Gonski and National Disabilities. That of course is where the forecasting uncertainties are greatest.
- Need to be careful re future election commitments – not a lot of scope for “election goodies” if fiscal outcomes are to be achieved.
- Even in the near term revenue forecasts have been terrible. At present we are more bearish than Government re the current nominal outcomes.
- The world. We are weaker and nervous.

Australian economic forecasts

	2012-13		2013-14		2014-15	
	NAB	Treasury	NAB	Treasury	NAB	Treasury
Real GDP	2.7	3	2.6	2 ¾	3.1	3
Employment	1.0	1 ¼	0.9	1 ¼	0.9	1 ½
Unemployment rate*	5.7	5 ½	5.9	5 ¾	6.1	5 ¾
CPI underlying**	2.3	(1)2 ½	2.7	(1)2 ¼	2.6	(1)2 ¼
RBA cash rate*	2.75	NA	2.50	NA	3.25	NA
\$US/\$A*	1.03	(2)1.03	0.96	(2)1.03	0.91	(2)1.03
Nominal GDP	2.1	3 ¼	4.2	5	4.9	5

*at end of period; ** through-year growth; (1) headline rate; (2) technical assumption

Currency forecasts in more detail

	13-May	Jun-13	Sep-13	Dec-13	Jun-14	Dec-14
Majors						
AUD/USD	0.9987	1.00	0.99	0.98	0.96	0.94
NZD/USD	0.8281	0.84	0.84	0.85	0.82	0.76
USD/JPY	102.05	100	104	105	110	112
EUR/USD	1.2964	1.29	1.27	1.27	1.22	1.18
GBP/USD	1.5351	1.51	1.49	1.48	1.44	1.40
USD/CNY	6.1417	6.14	6.12	6.10	6.10	6.10
USD/CAD	1.0114	1.03	1.03	1.02	1.02	1.01
Australian Cross Rates						
AUD/JPY	101.9	100	103	103	106	105
AUD/EUR	0.7704	0.78	0.78	0.77	0.79	0.80
AUD/GBP	0.6506	0.66	0.66	0.66	0.67	0.67
AUD/NZD	1.2060	1.20	1.18	1.15	1.17	1.24
AUD/CNY	6.1337	6.14	6.06	5.98	5.86	5.73
AUD/CAD	1.0101	1.03	1.02	1.00	0.98	0.95
AUD/CHF	0.9583	0.97	0.97	0.95	0.98	1.00