more give, less take

Global & Australian Forecasts

by NAB Group Economics

June 2015

National Australia Bank

Key Points:

- **There was no evidence of an acceleration in the pace of global growth in early 2015. Weak GDP results in the US, UK and Canada outweighed a pick-up in Japan and the Euro-zone and similarly mixed trends among the big emerging economies saw China slowing, India picking up and Brazil still very weak. The monthly manufacturing output and world trade numbers were soft, particularly the latter, and the business surveys do not show any clear evidence yet of an imminent lift in growth momentum. Our forecast is for more of the same this year with global growth staying around 3¼% in 2015, followed by a modest upturn in 2016 (largely driven by the US).**
- **We have fine tuned but not fundamentally changed our forecasts– 2014/15 2.4%(was 2.3%), 2015/16 2.6%(was 2.9%) and 3.0% (unchanged) in 2016/17. The big picture is still one where the domestic economy is struggling to offset the impact of sharply lower mining investment – as again highlighted in the Q1 National accounts. Subsequently there has been some improvement in recent short term data – especially the May Nab survey which suggests business confidence improved post the Budget and rate cuts – as did business activity, capex spending and capacity utilisation. Against that, capex expectations in the non mining sector has weakened, business remains reluctant to employ and consumers remains cautious. With future domestic demand still weak, unemployment is expected to rise a touch to around 6.4% by end 2015 and remain relatively for some time. Based on our forecasts for activity, the labour market and inflation, we see the RBA as having finished cutting – albeit that depends on (our and the official family's) forecasts being achieved. We see the next move in rates as up – but not till late 2016 (and with a lower end point for the Official Cash rate of 3.5%).**

Key global and Australian forecasts (*% change*)

Country/region	IMF weight	2014	2015	2016	2017
United States	16	2.4	2.3	2.7	2.5
Euro-zone	12	0.9	1.4	1.8	2.1
Japan	4	-0.1	0.8	1.3	1.3
China	16	7.4	7.1	6.9	6.5
Emerging East Asia	8	4.0	3.9	4.1	4.2
New Zealand	0.2	3.3	2.8	2.0	2.0
Global total	100	3.3	3.2	3.4	3.5
Australia	2	2.7	2.5	2.7	3.2
Australia (*fiscal years*)		13/14	14/15	15/16	16/17
Private consumption		2.2	2.5	2.5	2.6
Domestic demand		1.0	0.8	0.9	1.0
GDP		2.5	2.4	2.6	3.0
Core CPI (*% through-year*)		2.8	2.2	2.7	2.4
Unemployment rate (*% end of year*)		6.0	6.3	6.2	5.9

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Global and Australian overview

Global overview

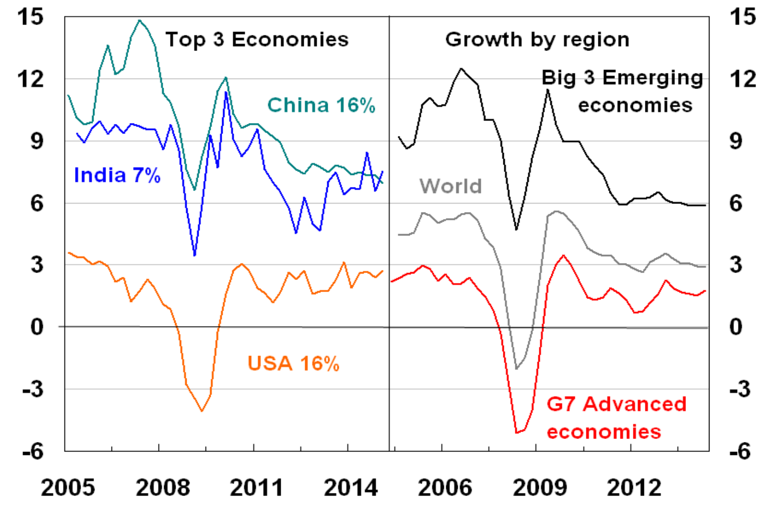
- Hopes for a quickening in global growth in early 2015 have not been realised. Another first quarter dip in US output cut the annualised pace of G7 advanced economy growth to only ½%. A fall in Canadian output and a big slowing in the UK added to the soft tone, outweighing much better growth figures in Japan and Western Europe. Conditions are also mixed across the big emerging market economies with a further slowdown in China, solid growth in India and recession continuing in Brazil (ranked as 1, 3 and 7 in terms of world GDP).
- Trends in industrial output and world trade do not point to an acceleration either. Industrial output fell through early 2015 in both Latin America and across East Asian emerging markets outside China. Export earnings were also declining, although US$ appreciation would have hit earnings. Business surveys do not show growth about to ramp up and we are forecasting global growth to remain around 3¼% in 2015 before rising slightly in 2016.

Australian overview

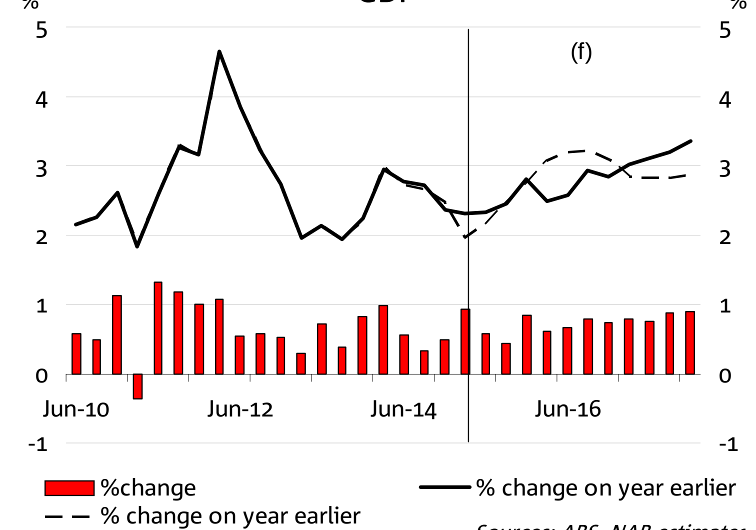
- We have fine tuned but not fundamentally changed our forecasts– 2014/15 2.4%(was 2.3%), 2015/16 2.6%(was 2.9%) and 3.0% (unchanged) in 2016/17. The slightly stronger pace from late 2016 largely reflects faster exports as more resource projects come on stream.
- The Q1 2015 National accounts again highlighted the gap between a struggling domestic economy and rising mining sector exports
- As noted above there is a growing difference between more optimistic short term data and weaker longer run expectations. A further rate cut and a well received Budget (for business) appears to have reflected in improved business confidence– and just as importantly better business activity, increased capex spending and higher capacity utilisation. Against that longer run capex expectations in the non mining sector are weakening, business remains reluctant to employ and the consumer remains cautious. With domestic demand likely to remain weak unemployment will rise a touch to around 6.4% by end 2015 and stay high for some time.
- Based on our forecasts for activity, the labour market and inflation, we see the RBA as finished cutting – albeit they could still cut if our (and their) forecasts are not achieved. We also see the next move in rates as up – but not till late 2016 (and with a lower end point for the cash rate of around 3.5%)

Economic growth by economy/region

Year-ended percentage change



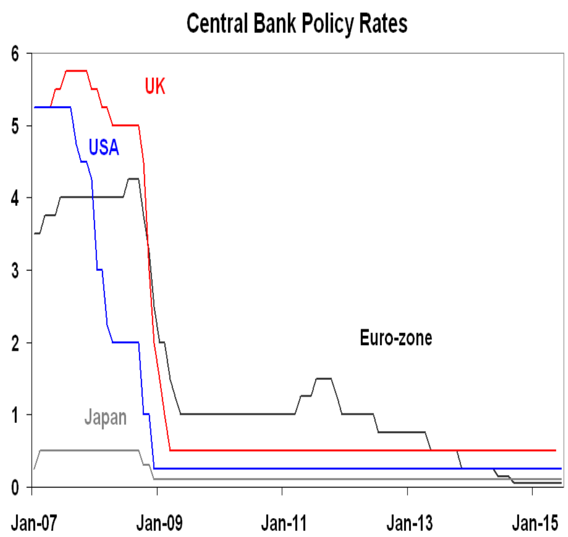
GDP

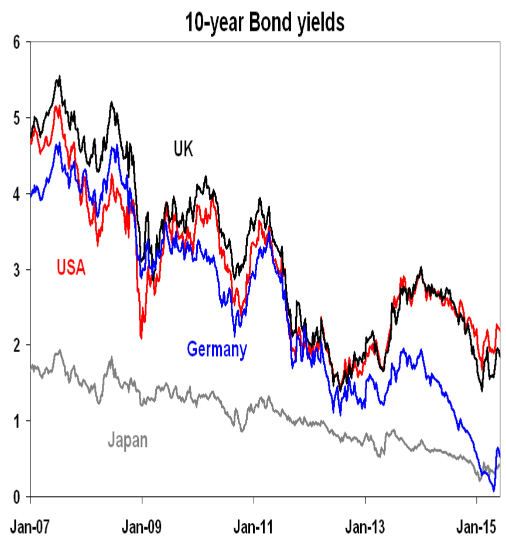


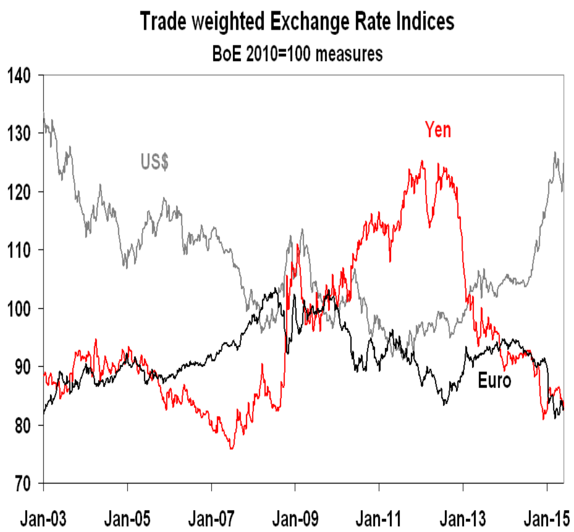
Sources: ABS, NAB estimates

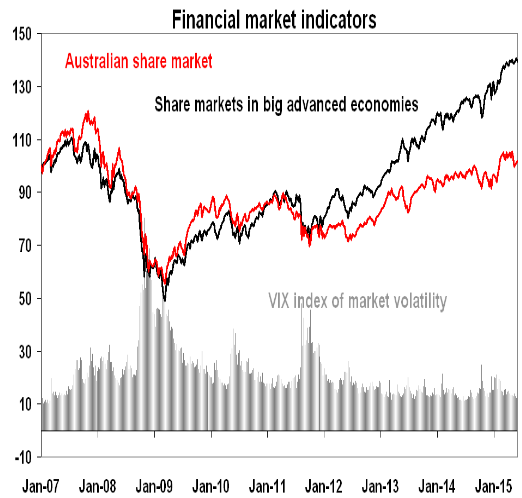
Financial markets

- 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 and we expect the first rise in September. 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%.
- Although Euro-zone headline CPI inflation turned positive in May, the European Central Bank remains committed to its policy of very low interest rates and monthly asset purchases of €60 billion which should continue until September 2016 at the earliest. The Euro-zone recovery is proving weaker than the ECB hoped, adding to the case for it to keep policy stimulatory.
- Divergent underlying conditions between the big advanced economies have been reflected in the fall in the Yen and Euro and the appreciation of the $US. Foreign exchange markets marked the $US down through April and early May but it has since regained ground. These currency changes are now shifting global demand toward the weaker Euro-zone and Japanese economies, helping broaden growth.



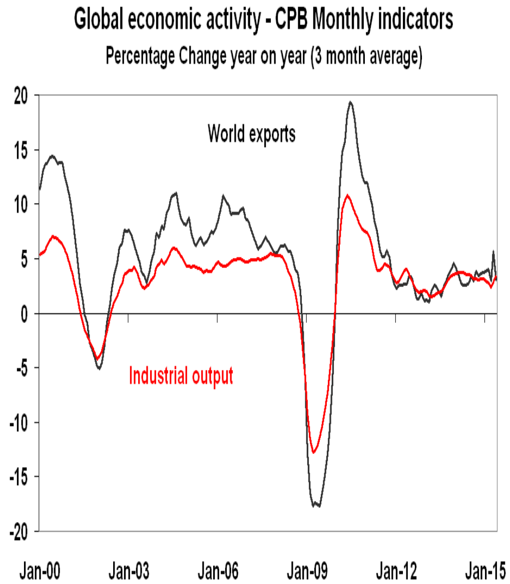


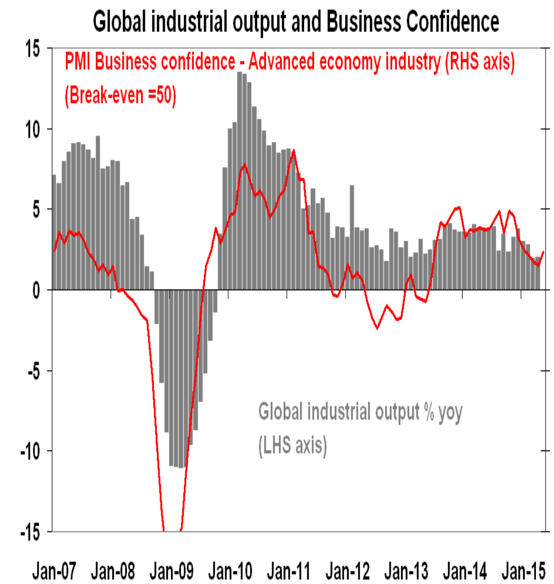


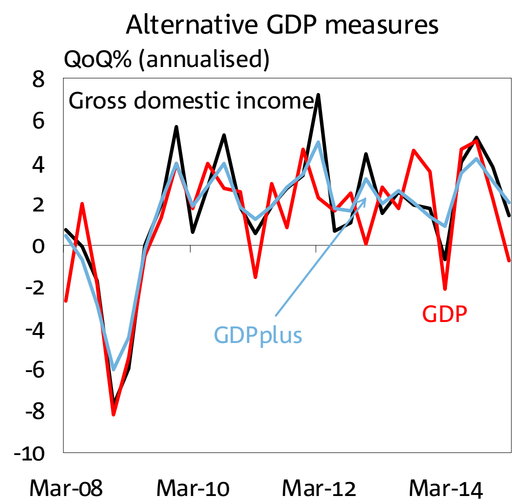


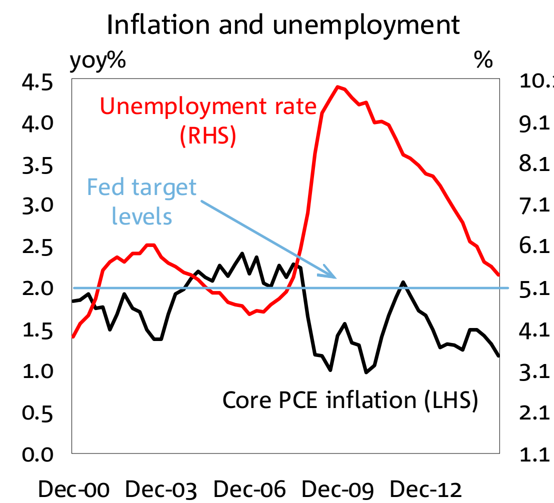
Global Economic Trends

- A ramping up in the recently subdued pace of global growth to around its long run trend has been expected but it has again failed to eventuate. Instead, global growth in early 2015 looks around the sub-trend 3% rate seen since early last year.
- Monthly data on world production and trade flows suggests that quarterly growth in manufacturing output has been losing momentum (slipping from 1% in late 2014 to only 0.3% in March quarter) while the volume of trade shrank by around 1½% quarterly in early 2015. Preliminary data for April shows global manufacturing output growing by around 2% yoy, less than half its long-run trend rate. There was a modest rise in business confidence in advanced economy manufacturing but it is too early (and the data sufficiently volatile) to read much into it.
- Economic cycles in both trade and manufacturing output tend to be larger than is the case in the service industries that form the bulk of GDP. However, the limited information available on service sector activity does not point to an upturn (with the possible exception of Japan, where the economy is gradually recovering from last year's tax rise).
- Output fell in the US in early 2015. While $US strength, the impact of low oil prices on investment and severe weather help explain the poor star. Other indicators (such as the Philly Fed's "GDPplus" and Gross Domestic Income) suggest that headline GDP data exaggerate the extent of the early 2015 US slowdown. There are signs that activity is now turning with the labour market continuing to recover – hardly consistent with an economy where output is falling.



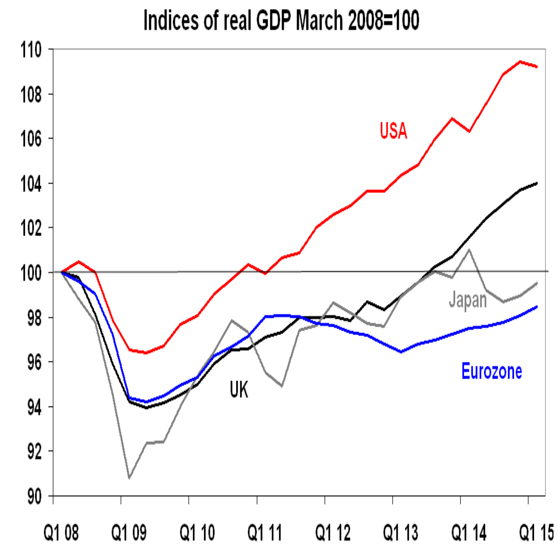


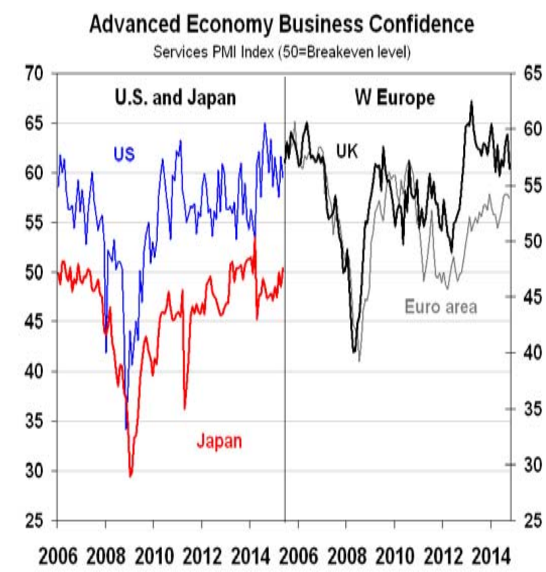




Advanced Economies

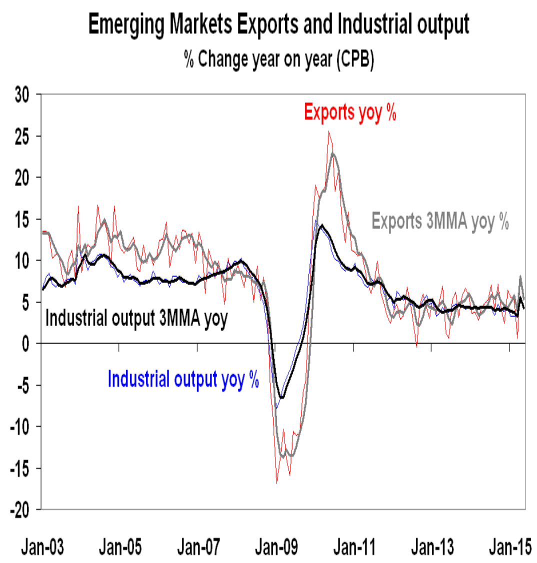
- The March quarter saw falling output in the US and Canada, which along with a halving in the UK growth rate, was sufficient to almost offset solid growth in the Euro-area and Japan. The outcome was a near stagnation in output across the G7 advanced economies in the opening months of 2015 – with annualised growth slipping from the 1¾% seen in late 2014 to only ½% in March quarter. As the US and UK have been the standout performers in the G7 upturn, the early 2015 output figures show a marked shift in the regional composition of global growth.
- Weakness in the US explains a large part of the loss of momentum in advanced economy growth with US GDP contracting by 0.2% in March after showing growth of 0.5% in late 2014. The extent to which this setback in the US recovery is only temporary and due to "special factors" has been much debated. Our forecast lines up with public guidance from the US Federal Reserve that the US upturn has not been de-railed and it will continue through the remainder of the year – making the case for the Fed to lift policy interest rates.
- Monthly surveys of purchasing managers give one of the most accurate and up to date measures of the pulse of economic growth. These show growth continuing across the manufacturing and services sectors across W Europe, the US and Japan – but at widely varying rates. Most of these survey readings are consistent with at most moderate rates of economic expansion but there are a couple of stand-out sectors – especially in the services sector where results across the UK, US and Euro-zone appear more buoyant than for manufacturing. Japan has been the weak link in service sector activity but it appears to be finally picking up.

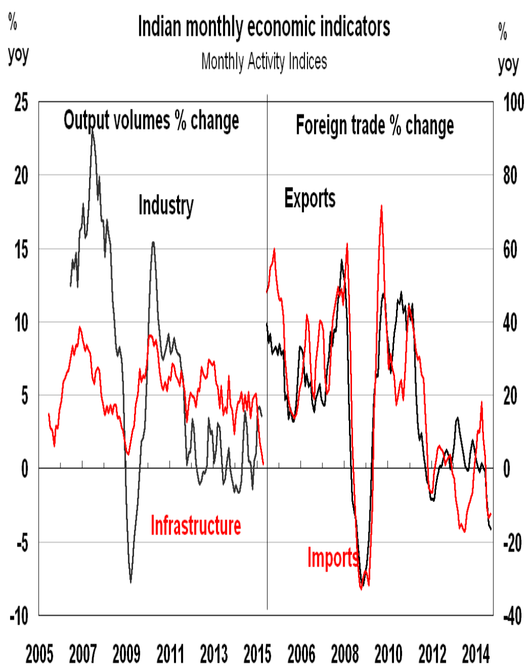




Emerging Market Economies

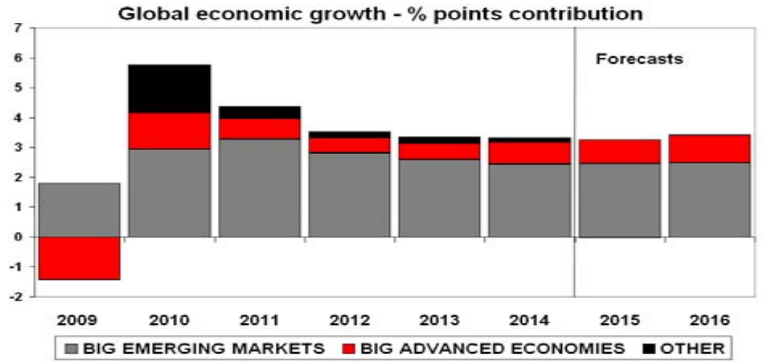
- There is no evidence of an acceleration in growth in the main emerging market economies in the opening months of 2015. Growth in the big emerging economies of Asia and Latin America has been around 6% yoy since early 2014.
- The monthly trends in trade and manufacturing output volumes do not show evidence of any pick-up either. Year on year growth rates remain in the 3½ to 3¾% range of the last few years but the quarterly growth rates look considerably weaker. Industrial output grew by only 0.2% in Q1, well below the 1.2% seen in late 2014. Export volumes fell quite heavily in the quarter and export receipts were even more depressed as commodity prices softened, hitting incomes in the big commodity producing countries across Latin America, Africa and SE Asia.
- Chinese growth is gradually slowing with GDP up by just after 7% yoy in March 2015 and quarterly GDP expansion slipping to only 1.3%. The monthly partial economic indicators show a mixed picture but most are consistent with a softening in growth. Trend industrial output growth was around 6% in April, down from around 9½% yoy in early 2014. Trade data has been volatile but export deliveries seem to have experienced a big slowdown in early 2015. Real fixed investment growth in March quarter 2015 was growing by around 14½% yoy, down on the 16¼% yoy seen in the corresponding period of last year. Recent retail sales numbers show a modest fall in the pace of trend growth as well.
- The weakness shown in world trade is reflected in exports from big emerging economies in Latin America and East Asia. Lower commodity prices have eroded receipts in major economies like Brazil, Argentina and Indonesia.





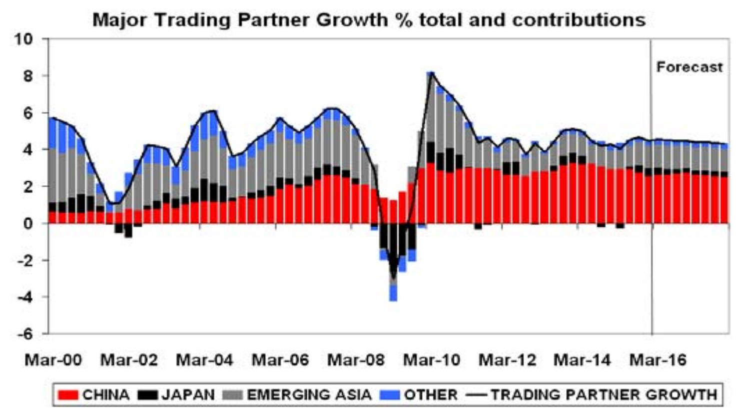
Global forecasts

- We have revised our forecasts downwards to take account of the weak first quarter US results and the longer than expected downturn in Brazil. We expect global growth in 2015 to remain at much the same sub-trend pace as was seen last year with upturns in India (worth 10 bps to global expansion) as well as a rotation in advanced economy growth toward Japan and the Euro-zone standing out as the main positives. Faster growth in the US accounts for half of the pick-up in global growth predicted for 2016 (from 3.2 to 3.4%).
- China and India combined are driving around half of the total expansion in global output. The emerging economies as a group contribute almost three quarters of the total output increase, marking a continuation of the falling share of the big advanced economies in the world economy. Given their high growth in commodity demand, this continued shift is good news for primary product exporters oriented toward Asian trade like Australia and New Zealand.
- Although our forecasts are below those of the IMF and Consensus, their direction of risk is probably still downwards. This reflects the risk that the long awaited acceleration in global growth gets postponed again.



Global growth forecasts % change year on year

	2011	2012	2013	2014	2015	2016	2017
					NAB Forecasts		
US	1.6	2.3	2.2	2.4	2.3	2.7	2.5
Euro-zone	1.7	-0.7	-0.4	0.9	1.4	1.8	2.1
Japan	-0.4	1.7	1.6	-0.1	0.8	1.3	1.3
UK	1.6	0.7	1.7	2.8	2.2	2.4	2.3
Canada	3.0	1.9	2.0	2.4	2.3	2.2	2.0
China	9.3	7.8	7.7	7.4	7.1	6.9	6.5
India	7.7	6.8	6.4	7.1	7.8	8.0	8.1
Latin America	4.9	2.5	2.5	0.9	0.6	1.1	1.4
Emerging East Asia	4.4	4.6	4.2	4.0	3.9	4.1	4.2
New Zealand	1.8	2.4	2.3	3.3	2.8	2.0	2.0
World	*4.4*	*3.5*	*3.3*	*3.3*	*3.2*	*3.4*	*3.5*
memo							
Advanced Economies	1.7	1.2	1.4	1.8	1.9	2.2	2.2
Emerging Economies	7.0	5.6	5.5	5.1	4.9	5.0	5.0
Major trading partners	4.6	4.3	4.6	4.5	4.4	4.5	4.4



Australian outlook

- The Q1 National accounts highlight much of the current dilemmas facing the economy. Reasonable growth but heavily reliant on increasing mineral exports – non rural commodities up 6.1% in the quarter. Stocks also contributed but the high contribution from retail stocks could well involve an involuntary element. Domestic demand on the other hand was flat – with large falls in engineering construction (mainly mining) offsetting only moderate consumption growth (in the face of falling wages), strong growth in investment in dwellings (mainly apartment building) and relatively flat public sector demand.
- Consistent with this, stronger house prices (especially Sydney) and less reliance on mining, have seen relatively strong economic performance in NSW and Victoria, while state demand and business conditions remain weak to negative in WA, NT and to a lesser extent QLD.
- The May Nab survey – the first since the Budget – is encouraging in that it suggests business confidence has kicked up (especially in the retail & wholesale space, as well as the finance, property & business services sectors). Importantly business outcomes also improved as did capital spending and capacity utilisation. All of this is consistent with the idea that the Budget, rate cuts and a lower AUD may finally be gaining some traction in the non mining sector – albeit it is early days.
- Against that longer run capex expectations in the non mining sector are weakening, business remains reluctant to employ (even in the May Survey) and the consumer remains cautious.
- We have fine tuned but not fundamentally changed our forecasts– 2014/15 2.4%(was 2.3%), 2015/16 2.6%(was 2.9%) and 3.0% (unchanged) in 2016/17. That would still see unemployment rising a touch to around 6.4% by end 2015 and staying high for a long time.
- Based on our forecasts for activity, the labour market and inflation, we see the RBA as finished cutting – albeit they could still cut if our (and their) forecasts are not achieved. We also see the next move in rates as up – but not till late 2016 (and with a lower end point of around 3.5%).

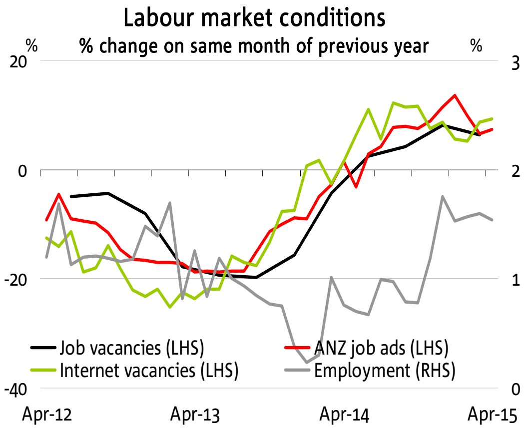
Australian economic and financial forecasts (a)

	Fiscal Year			Calendar Year		
	2014-15 F	2015-16 F	2016-17 F	2015-F	2016-F	2017-F
Private Consumption	2.5	2.5	2.6	2.5	2.6	2.5
Dwelling Investment	8.7	10.8	3.6	11.7	6.5	2.0
Underlying Business Fixed Investment	-7.4	-11.4	-9.6	-10.2	-10.3	-9.1
Underlying Public Final Demand	-0.3	0.8	1.4	0.0	1.1	1.6
Domestic Demand	**0.8**	**0.9**	**1.0**	**0.8**	**1.0**	**1.0**
Stocks (b)	0.2	-0.1	0.1	0.0	0.0	0.1
GNE	**1.0**	**0.8**	**1.1**	**0.8**	**1.0**	**1.1**
Exports	8.7	9.7	9.3	10.6	8.6	9.8
Imports	0.1	1.9	1.2	2.4	1.2	1.1
GDP	**2.4**	**2.6**	**3.0**	**2.5**	**2.7**	**3.2**
– Non-Farm GDP	2.5	2.6	3.0	2.5	2.7	3.2
– Farm GDP	-2.3	2.9	2.0	2.0	2.0	2.0
Nominal GDP	1.5	3.2	4.5	1.6	4.5	4.4
Federal Budget Deficit: ($b)	40	30	30	NA	NA	NA
Current Account Deficit ($b)	48	43	28	50	34	20
(-%) of GDP	3.0	2.6	1.6	3.1	2.0	1.1
Employment	1.4	1.8	2.3	1.7	2.1	2.4
Terms of Trade	-10.9	-6.0	-3.3	-10.7	-2.1	-4.4
Average Earnings (Nat. Accts. Basis)	1.2	1.6	2.8	0.6	2.6	2.8
End of Period						
Total CPI	1.4	3.2	2.7	2.5	3.0	2.4
Core CPI	2.2	2.7	2.4	2.4	2.6	2.5
Unemployment Rate	6.3	6.2	5.9	6.4	6.0	5.7
RBA Cash Rate	2.00	2.00	3.00	2.00	2.50	3.50
10 Year Govt. Bonds	2.75	3.05	3.40	2.80	3.35	3.40
$A/US cents :	0.78	0.73	0.77	0.74	0.75	0.79
$A - Trade Weighted Index	60.3	59.1	0.0	60.0	60.4	0.0

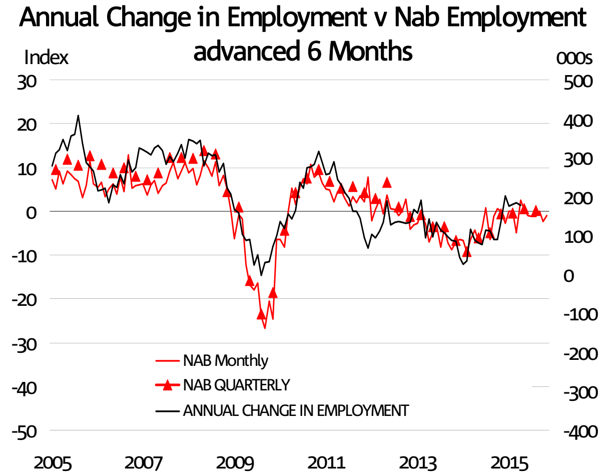
(a) Percentage changes represent average annual growth, except for cash and unemployment rates. The latter are end June. Percentage changes for CPI represent through
(b) Contribution to GDP growth

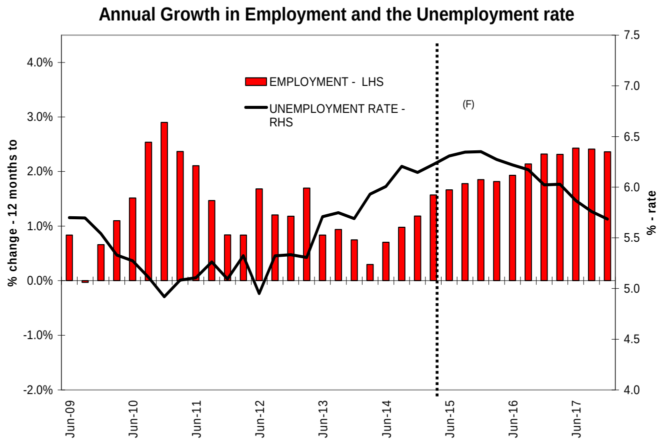
Australian labour market

- Looking through the monthly noise in the labour market indicators, it appears that moderate growth in employment is continuing and that there is some flattening out of labour market partials (see chart below left hand panel).
- Obviously employment changes by sector are continuing to reflect activity trends. It is interesting to see that over the last 12 months the falls in direct mining employment is roughly the same as the jobs added in the construction industry – a fall of 49k jobs in the year to March vis a vis a rise of 45k jobs in construction (year to March 2015).
- Looking at the employment series in the Nab survey – which provides a strong 6 month lead on annual employment growth – the current reading, as shown in the middle panel below, would be consistent with annual growth in employment of around 170k per annum (in the year to November 2015) or around 15k jobs per annum over the next 6 months
  - Unless the participation rate started to fall – that rate of employment growth would not be enough to stabilise unemployment
  - On a more encouraging front it appears that there has in recent months been a significant increase in hours worked per employee – albeit with no real change in the employment to population ratio. That type of pattern is consistent with turning points where initially at least, in the face of rising levels of demand, employers respond by working their workforce longer. And in that context both increased business confidence and conditions – as per the May Business survey – could well lead to an acceleration in future employment growth.
- Our growth and domestic demand forecasts (like the Nab Survey results) suggest on going growth of employment of around 15k per month for the rest of 2015. That would see the unemployment rate edge up marginally to around 6.4% by years end. Thereafter employment growth edges higher and the unemployment rate starts to move down but at a very moderate rate –unemployment remains above 6% till mid 2017 (see chart below right hand panel).



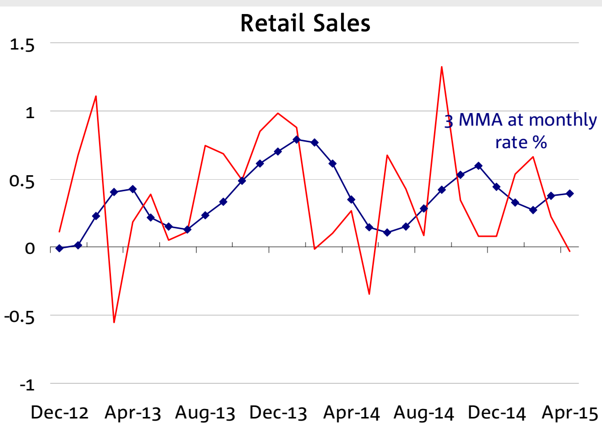
Sources: ABS, Datastream, Department of Employment



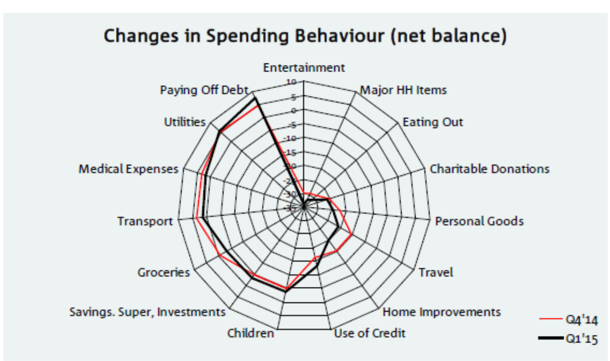


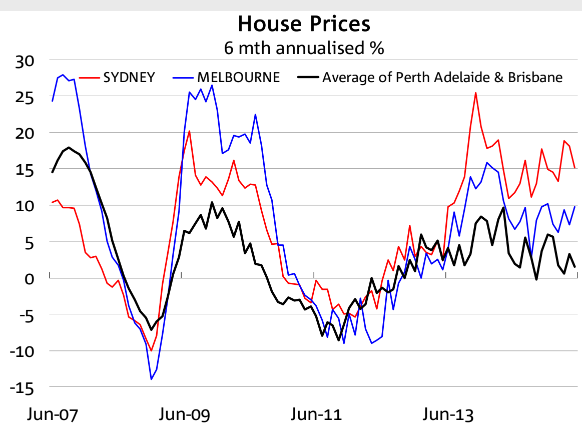
Australian consumer demand and housing market

- The pattern of retail sales continues to be volatile. That said, real growth of consumption of 0.5% in Q1 (and only 2.6% over the year) continues to disappoint – indicative of a still wary consumer, who at present is also facing falls in average earnings per employee (according to the National accounts). More recently retail sales have slowed with relatively weak March and April readings – implying the need for a relatively strong May reading to maintain the trend rate of only 0.4%- see chart below left hand panel. The Nab survey does however suggest retail improved in May (trading up 7 to +4 index points).
- Online retail has also been volatile. In trend terms, on line retail has been running around 0.6% per month - but April sales were much stronger. In April on line retail was up 1.5% in seasonally adjusted terms. enough to raise the annual rate to 9.6% from 8.2% in the year to March. Generally on line sales are maturing with annual growth rates slowing to below 10% as local traditional retailers fight back. For more details see NAB Online Retail Index – In Depth report- April 2015. Consumer anxiety has increased in Q1 2015 and remains relatively high. More generally consumers spend is primarily focussed on non discretionary purchases – see middle panel of the chart below.
- According to RP Data-Rismark dwelling prices in Australia have risen 9.6% in the year to May - but with radically different outcomes across Australia. Thus Sydney was up 16.4% in the year to May, Melbourne 9.8%, Brisbane 3.1%, Adelaide 3.4%, Perth 1.0% and Hobart a fall of 1%. See chart below right hand panel. The Sydney market in particular is facing severe undersupply issues as well as low interest rates – with similar issues evident in Melbourne. These markets have been driven by investor activity which is difficult to restrain in the face of low interest rates and high tax rates. With this in mind APRA is attempting to limit the growth in investor credit supply (to less than 10%). Our expectations are that these measures may help at the margin but the primary reason to expect slower house price rises is via higher unemployment. Overall we see Australian house price increases to be around 6.4% in 2015 and 3.8% in 2016. There will however continue to be radical differences across states – with Sydney (increases of 10 and 5%); Melbourne (6.2 and 3.5%); Brisbane (3 and 5%) still strong but further falls in Perth.
- On credit, housing credit growth continues to run around 0.5% per month or 7.2% in the year to April. However investor credit is much stronger at 0.8% per month or 9.9%% annually – just below APRA's maximum growth rate. Business credit eased back a touch – flat in April but is still up 5% over the year. Personal credit remains flat – up just 0.6% in the year. Elsewhere equity markets were mixed in May (the ASX 200 down 0.2%) - with banks down 4.9% offset by rises of 1.5% in industrials and 0.5% in resources (albeit the latter is still down 17.5% for mid 2014 highs).



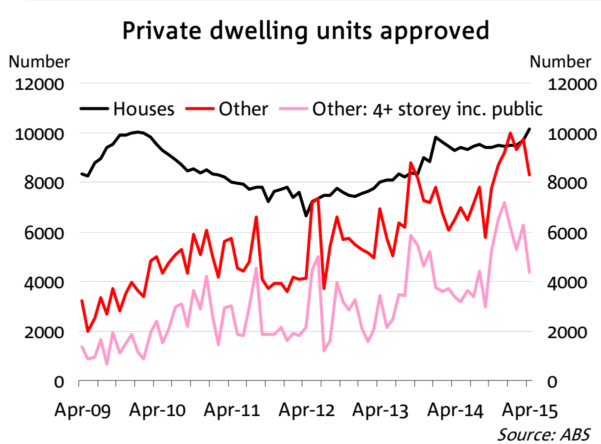
Consumer Spending Intentions

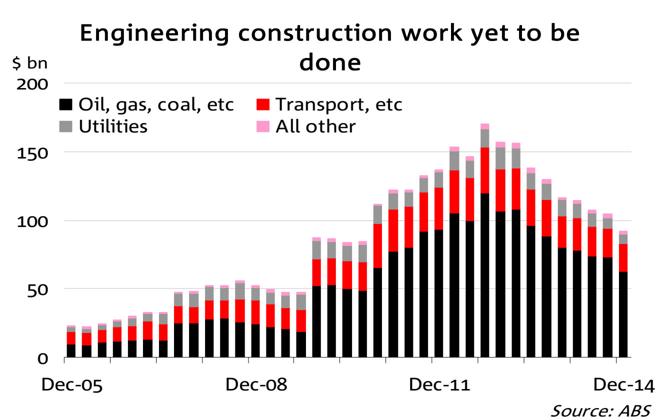


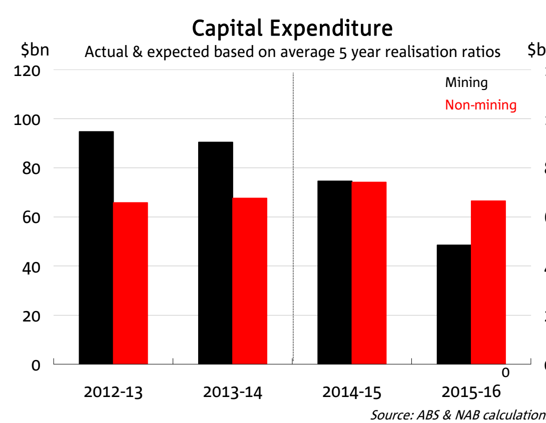


Australian investment

- As expected dwelling investment increased by 4.7% in Q1 2015 or 9.2% over the past year. With very high approvals in the dwellings – especially apartments – we expect to see similar or stronger growth in dwelling investment over the forecasting horizon - with growth of 11.7% and 6.5% growth over 2015 and 2016 respectively.
- As can be seen from the chart below – left hand panel – most of the growth in approvals has come 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 15% of new sales are to foreigners with much concentrations in both Melbourne and Sydney (around 30%). See NAB Quarterly Australian Residential Property Survey – Q1 2015. Indeed anecdotal reports point to numbers nearer 60% in the CBD regions of these cities. 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 is now well underway – as reflected in the mining activity data – see chart below middle panel
- Ongoing falls in resource prices (iron ore, oil and by association gas prices in LNG contracts) and very weak confidence levels (mining confidence in the May Monthly was -30 points) are likely to further dampen prospects for new mining exploration and investment activity and may well see projects delayed or cancelled. If the falls in mining investment accelerate even more rapidly than currently expected then it will be very important that non mining investment helps share the adjustment burden.
- Unfortunately the standout from the latest ABS Capital Expenditure Survey was the surprise further weakening (an improvement from the first estimate published in January was expected) in non mining expectations for 2015/16 (see chart below – right hand panel). Against that, the May Nab monthly survey suggested some improvement in actual capex spend and capacity utilisation. Also the full Q1 Nab Business survey capital expectations for the next 12 months suggested some moderate improvement in non mining capital spending. Clearly much depends on non mining investment – and our forecasts do not incorporate the type of falls suggested by the ABS capex series. We currently expect falls of around 10% in underlying business investment in each year going forward (i.e. 2015, 2016 and 2017).

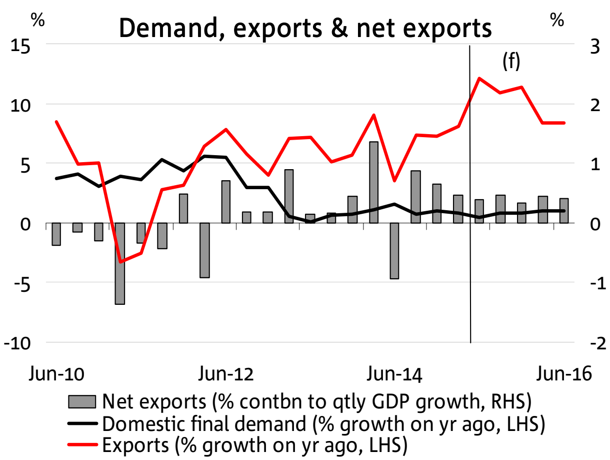




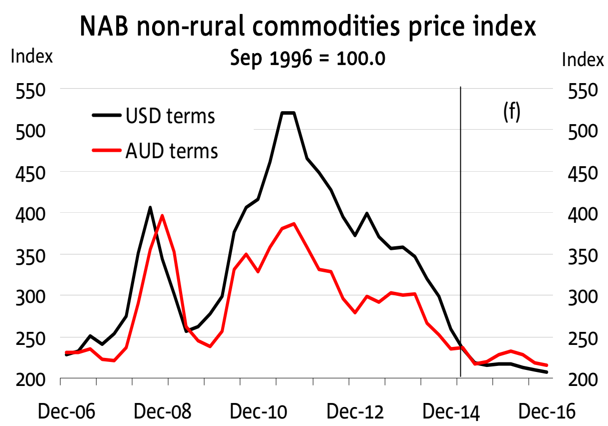


Australian commodities, net exports and terms of trade

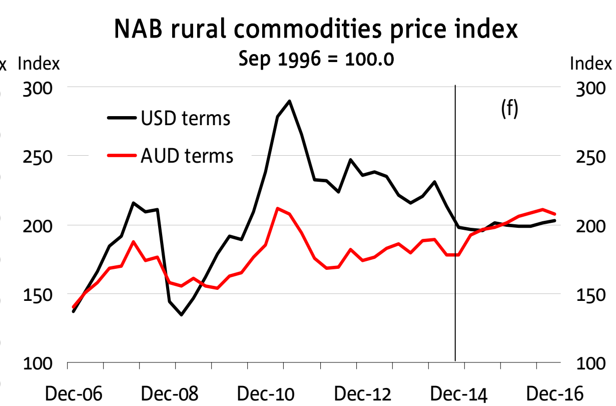
- We continue to expect the external sector to perform the bulk of the heavy-lifting in Australia's growth this year and next, with net exports forecast to contribute 1.6 percentage points to GDP growth through 2015, 1.9% through 2016 and 2.2% during 2017. Indeed in the out year we have stepped up the contribution from exports as more capacity comes on stream. Meanwhile domestic demand is only expected to grow by 0.8% in 2015, 1.0% during 2016 and 1.2% during 2017 - which, in each year, 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 16% during 2015 and a further 4% fall during 2016. 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 remain around the mid to high $USD 60s a barrel by late 2015 – and around the mid $USD 70s by end 2016.
- The NAB Rural Commodities Index is expected to be relatively flat in USD terms during 2015, however a falling AUD combined with higher beef prices is forecast to provide support to local prices, with the index expected to increase 7.6% year on year in AUD terms to Q4 2015. In 2016, we also expect to see only moderate gains in USD prices (up 1.0%) and a moderate increase in AUD terms (up 5.7%).
- As mining investment slows and exports accelerate there is likely to a significant improvement in Australia's trade account. Allowing for income flows we expect the current account deficit for 2014/15 to be 3.0% of GDP (or around $48bn), to around 2.6% of GDP (or around $43bn) in 2015/16 and to 1.6% of GDP in 2016/17 (or around $28bn).



Sources: ABS, NAB forecasts



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



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

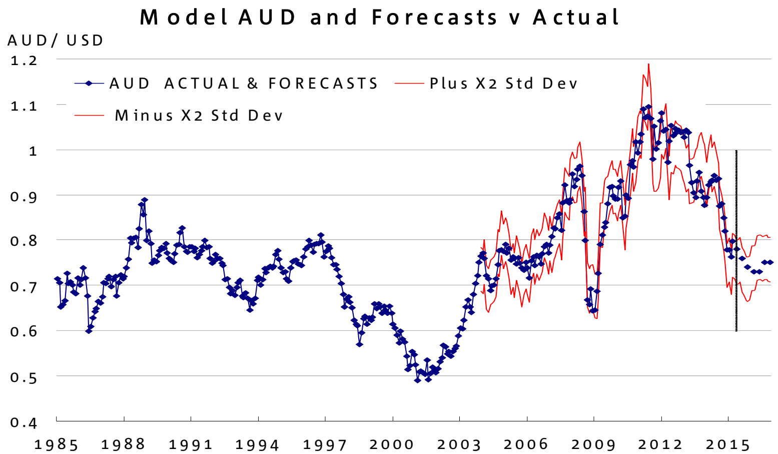
Australian financial markets

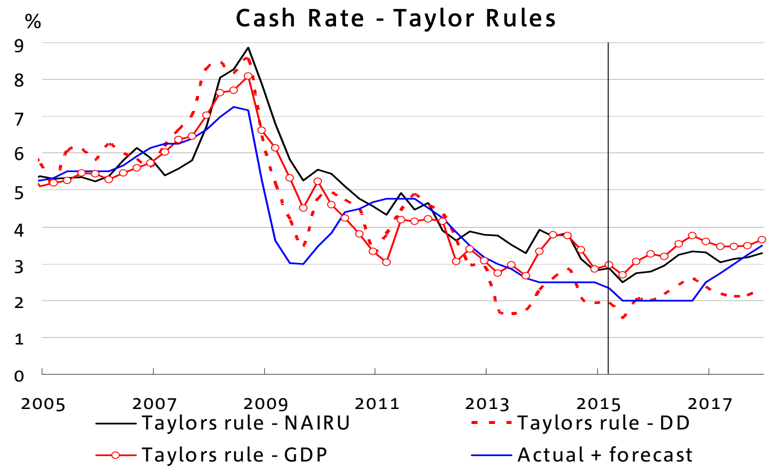
Exchange rate

- At this stage we have kept our currency forecasts unchanged at around $USD 74c by late 2015 and moving a touch lower during early 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 USD strength in light of a move to increase US interest rates in the second half of 2015.

Interest rates

- We have not changed our interest rate forecasts
- In light of recent improved conditions the RBA opted to “water the green shoots” by cutting in May. They are now very much in the phase of waiting to see the results of their previous actions and the impact of the Federal Budget. As seen in Nab’s May Monthly survey there appears to have been something of a boost to business confidence on the back of these policy announcements – and just as importantly improved business outcomes together with increased capital spending and capacity utilisation.
- However it is early days. Business isn’t yet convinced enough to accelerate their employment intentions and the official capital expenditure expectations (if not Nab’s) are very gloomy. There is also the question of whether APRA’s approach to restricting supply of credit to investors will actually do much in the near to medium term – especially in Sydney where supply constraints loom large.
- In the near term the hurdle to another cut is very high. Based on our forecasts for activity, the labour market and inflation, we see the RBA as having finished its cutting phase – albeit they could still cut if our (and their) forecasts are not achieved. We also see the next move in rates as up – but not till late 2016 (and with a lower equilibrium rate of around 3.5%)
- Interestingly the Taylors rule analysis (in the chart below right) is not really looking for 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).





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