

Australian Markets Weekly

A weekly outlook for Australia, key global economies and markets

21 September 2015

From offshore: Australia is “toast”

In this *Weekly* we have included trip notes and reflections from Ivan Colhoun, Chief Economist, Markets, who has been visiting clients in the UK, Europe and the Middle East. It’s quite enlightening, offshore investors now holding a uniformly negative view on Australia’s prospects.

For the economy and markets for the week ahead, it’s not a big data week but an opportunity for the markets to absorb “what next” for central banks with the Fed putting off lift-off and key ECB speakers over the weekend threatening to ramp up QE further should there see downside risks on inflation.

And there is more central bank speak ahead this week with ECB President Draghi speaks on Wednesday, while in the US, there are several speakers, culminating in Friday’s morning’s speech from Fed Chair Yellen.

Three speeches on Friday reflected again the still wide polarity of views from within the Fed. Two were from well-known monetary hawks, James Bullard who said he would have been a dissenter this month (he isn’t a voter this year, but is next year) and Jeffrey Lacker, who did dissent from last week’s decision. Even John Williams, a centrist and voter this year, and aligned more with Fed Chair Yellen’s views, did acknowledge the uncertainties but worries the Fed might be getting behind the curve.

The one thing he did note that was a little different was the Fed was not out of “ammunition” (i.e. more easing) but didn’t feel they would need it. NAB’s forecast calls for the Fed to commence lift-off at its 17 December FOMC, passing the 29 October meeting.

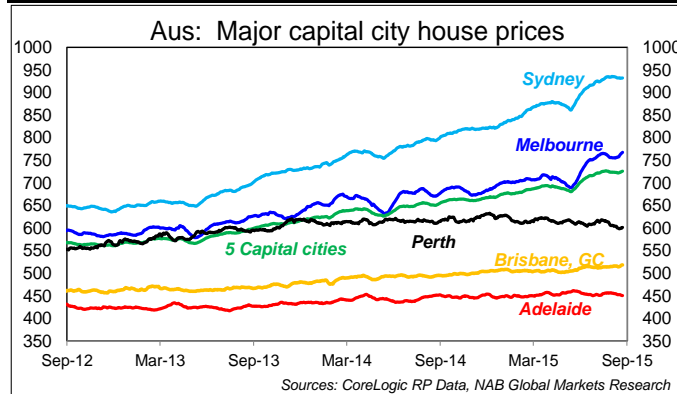
One of the few central bank heads apparently content with the current stance of monetary policy is RBA Governor Stevens. He said Friday in testimony to the House Economics Committee on the RBA’s Annual Report that the question for the RBA is the balance between whether the cash rate is low enough to promote private sector growth without promoting risks in the financial space (read house prices). In his view, he thinks they “have the balance about right”.

Locally, we also start the week with a refashioned Federal Ministry and a new Treasurer Scott Morrison. It’s a light week

for local data (see The Week Ahead below for more detail) with interest in China’s Caixin Manufacturing PMI for September out Wednesday. Friday’s China major cities property price data for August revealed 35 cities where prices are rising again, up from 31 in July, prices overall up 1.7% after -0.4% in July.

Locally, the latest weekly price data show Melbourne residential prices have re-established some momentum into the spring selling season, up 1.6% month to date (and 12.4% ytd), while Sydney prices have not risen further so far this month (-0.3% mtd, +13.6% ytd) after strong rises for several months. Brisbane-Gold Coast prices are increasing somewhat, up 0.7% mtd, +2.9% ytd. Adelaide (-1.2% mtd, -0.8% ytd) and Perth prices (-0.7% mtd, -4.7% ytd) remain soft.

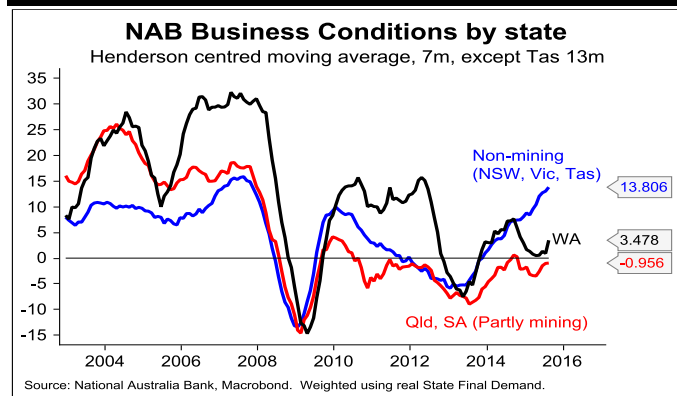
Australian major capital city house prices



From offshore: Australia is “toast”: Ivan’s trip notes

I have never experienced such overwhelming negativity on the outlook for the Australian economy and \$A in all my years marketing the Australian economy offshore! The unanimity of this view suggests investors are short the \$A and highlights the risk of a short-term squeeze higher, even if the medium-term outlook is still for a weaker \$A. To be fair, one investor did say that they were not that negative on Australia! Another described the Australian economy as “toast”.

The Australian transition story at work



Key markets over the past week					
	Last	% chg week		Last	bp / % chg week
AUD	0.7189	0.7	RBA cash	2.00	0
AUD/CNY	4.58	0.8	3y sw ap	2.15	2
AUD/JPY	86.2	0.5	ASX 200	5,043	-1.1
AUD/EUR	0.636	1.0	Iron ore	57.7	-2.2
AUD/NZD	1.126	0.1	WTI oil	44.8	1.9

Source: Bloomberg

The bearishness reflected negativity on the usual culprits, namely mining, China and housing, though on each topic we had a number of qualifications counter to these arguments:

- At the present time, the improvement in the non-mining economy is more than outweighing the drag from mining, particularly in an employment sense;
- Much of the existing weakness in China has been manifesting itself in the most important Australian exports to China (i.e. iron ore exports – 60% of exports to China) for some time (so far mainly in prices, with Australian iron ore volumes actually still increasing in spite of flat Chinese steel output). There was some concern that volume declines may still occur, but a more widespread (though incorrect) view that volumes were already falling. My contention was that developments in Chinese industrial production and housing had already had much of their impact on the Australian economy – effectively resulting in a mining recession – but had not resulted in broader non-mining weakness.
- Non-mining is in fact strengthening, especially in NSW, with housing construction – especially apartments – important in this regard. Other aspects of Chinese demand that have so far been boosting the Australian economy such as apartment demand, tourism arrivals and agricultural exports should be monitored closely in coming months for signs of impact from recent Chinese developments;
- The Australian housing market is currently dividing along the same lines as the broader economy, with non-mining markets improving or strong and mining-related markets tending to soften or fall sharply in the smaller mining towns that were the centre of the construction boom. There is the prospect of over-supply of apartments in inner-city areas, especially if overseas investors do not settle or sell en masse. Part of the broader concern of a number of overseas investors reflected the view that Australian growth was becoming unbalanced/over-reliant on housing.

Australian iron ore volumes increasing market share



The most interesting observations in my opinion were:

- Concerns about there being excess construction of apartments in London. London is Sydney on steroids with cranes everywhere – Dubai also had significant apartment and hotel construction. (I am motivated to understand more

- deeply the extent to which and the probability that foreign investors into Australian apartments may not settle). There were already some stories about some investors not settling in London, owing in part to the strength of sterling and weakness in some emerging market currencies. There was also another anecdotal report of there being few bids for these properties at the present time; and
- The observation that few countries (none?) have managed to make a significant growth transition without a weak currency (a reference to China and the prospect for the CNY to weaken markedly).

There was general confusion about what China was currently trying to achieve, with the recent small devaluation and reported subsequent strong intervention to prevent further weakening. The widespread view among investors was that the CNY would continue to depreciate across time and that this was appropriate.

China loss of international competitiveness



Most investors did not think the Fed would raise rates in September, but there was a general view that they should move. The broader view was that the Fed could not really tighten much independently of the rest of the world. If it did, the US\$ would likely rise sharply.

Most overseas clients were strongly of the view that the RBA would cut rates again (due to a combination of mining, China and housing). While we acknowledged a significant impact from recent developments in China on housing or the other aspects of Chinese growth still supporting Australian growth (tourism, education) – or from China significantly impacting global growth or causing a renewed global financial crisis – could prompt such a response, current trends did not support this occurrence and in fact the strengthening in non-mining activity argued strongly against the prospect of any near-term move. In addition, the current weak areas of the Australian economy (commodity prices and mining capex) are not interest sensitive, suggesting monetary policy is not a particularly useful tool for macro management at the present time – and of course risks adding to potential excesses in some housing markets.

There were very, very few questions about semi-government securities with most investors focused on Aussie government bonds currently. There was modest questioning about the possibility of Australia being placed on negative outlook or downgraded in the year ahead (after the December mid-year

review or the May budget seen as the most likely times for any action).

There was more focus on trends in Australia’s current account than I remember in the past ten or so years. This mainly came from the perspective of issues currently affecting emerging markets and their currencies, rather than reflecting a concern about Australia’s competitiveness. That said, expected weakness in CNY and Asian currencies had clients thinking the medium-term risk to the \$A remained to the downside.

There was general acknowledgement that markets (including Australian bond markets) had become less liquid in recent times, in part due to the actions of the authorities to reduce proprietary trading.

Most investors were looking for the Australian yield curve to steepen.

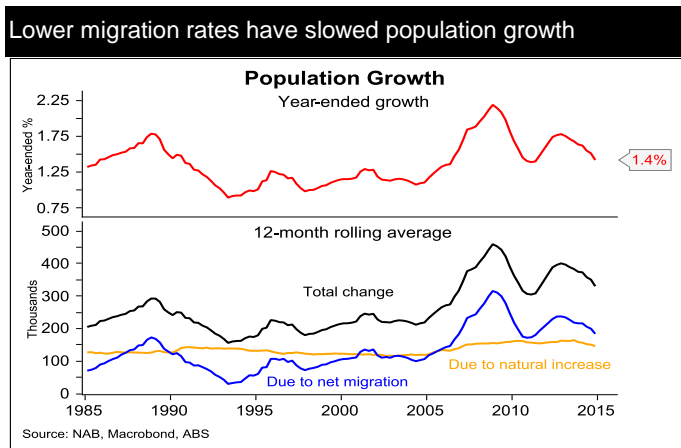
Australia’s Prime Minister changed in the second week of the trip. While this was quite a surprise to offshore investors, this was not seen as a major factor for Australian markets, which will continue to be influenced more by developments in global markets (especially in China’s economy and by trends in the US\$ and US bond markets). There was considerable interest in whether fiscal policy might be tightened more under new PM Turnbull.

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The week ahead

It’s a very light week for the local calendar with only very second tier data, with the ABS Q2 House Prices report (Tuesday), together with the weekly ANZ-Roy Morgan Consumer Sentiment index, the Conference Board’s leading index and skilled vacancies. On Thursday the ABS releases its quarterly population update in Demographic Statistics.

Also on Thursday, the RBA’s Alex Heath, Head of Economic Analysis, is speaking to the Urban Development Institute at a luncheon in Perth. The UDIA’s web site titles her presentation as “Beyond the Data: Behind the Scenes at the RBA; Discover the Process of Making Nation-Impacting Decisions”, though this sounds more like promotion for the event rather than a specific RBA title. She is scheduled to start from 12.00pm AWST/2.00pm AEST. Some words on the property market would be expected, given the event.



As for the data, the weekly ANZ-Roy Morgan Consumer Sentiment Index will likely be watched for any bounce that occurs following the change in Prime Minister to Malcolm Turnbull, a bounce usually occurring after leadership changes.

The official measure of House Prices is unlikely to garner much reaction with the already published CoreLogic RP Data measure to August producing an average rise for the June quarter of 2.5%, the rise we have in mind as our yardstick for the ABS series that would cumulate to growth of 7.5% in annual terms. Neither the Conference Board Leading index nor the Skilled Vacancies series will attract much, if any, market interest.

While we also don’t think Thursday’s Q1 Demographic Statistics will attract any market interest, population growth does have important implications for Australia’s longer term growth prospects, with the RBA recently downgrading potential growth due to slower population growth.

For the local markets, of more interest for the AUD will be the preliminary China Caixin Manufacturing PMI set for release on Wednesday that’s expected to tick higher. Finally, NAB is releasing a special report on Innovation in Australia – most likely on Tuesday – drawing out the extent of innovation across the business sector and across sectors and firm sizes.

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Calendar of Economic Releases

Country	Economic Indicator	Time Period	NAB		Actual	Previous	GMT	AEST
			Forecast	Consensus				
Monday, 21 September 2015								
NZ	WMM Consumer Confidence	Q3				113	22.00	8.00
NZ	Net Migration SA	Aug				5740	22.45	8.45
UK	Rightmove House Prices MoM/YoY	Sep				-0.8%/6.4%	23.01	9.01
CH	MNI Business Indicator	Sep				57.1	1.45	11.45
NZ	Credit Card Spending MoM	Aug				1.7%	3.00	13.00
CA	Wholesale Trade Sales MoM	Jul				1.3%	12.30	22.30
EC	ECB's Coeure speaks						12.45	22.45
CA	Bloomberg Nanos Confidence	Sep-18					14.00	0.00
US	Existing Home Sales	Aug		5.50M/-1.6%		5.59M/2.0%	14.00	0.00
EC	ECB's Nowotny speaks						16.00	2.00
EC	ECB's Praet speaks						16.30	2.30
US	Fed's Lockhart speaks on economy (V)						17.00	3.00
CA	BoC Governor Poloz speaks						18.30	4.30
Tuesday, 22 September 2015								
AU	ANZ Roy Morgan Weekly Consumer Confidence Index	Sep-20				105.3/-1.3%	23.30	9.30
AU	House Price Index QoQ/YoY	2Q	2.5%/7.5%	2.4%/8.0%		1.6%/6.9%	1.30	11.30
AU	NAB Special Report on Innovation in Australia						1.30	11.30
CH	Conference Board Leading Economic Index	Aug					2.00	12.00
EC	ECB's Supervisory Chair Nouy speaks						7.30	17.30
UK	PSNB ex Banking Groups	Aug		9.2B		-1.3B	8.30	18.30
UK	CBI Trends Total Orders	Sep		0		-1	10.00	20.00
US	FHFA House Price Index MoM	Jul		0.40%		0.20%	13.00	23.00
EC	Consumer Confidence	Sep A		-7.1		-6.9	14.00	0.00
US	Richmond Fed Manufact. Index	Sep		3		0	14.00	0.00
Wednesday, 23 September 2015								
US	Fed's Lockhart speaks on economy (V)						22.30	8.30
AU	Conf. Board Leading Index MoM	Jul				-0.2%	0.00	10.00
AU	Skilled Vacancies MoM	Aug				0.1%	1.00	11.00
CH	Caixin China PMI Mfg	Sep P		47.8		47.3	1.45	11.45
GE	Markit/BME Manufacturing/Services PMI	Sep P		52.8/54.5		53.3/54.9	7.30	17.30
EC	Markit Manufacturing/Services PMI	Sep P		52.2/54.2		52.3/54.4	8.00	18.00
UK	BBA Loans for House Purchase	Aug					8.30	18.30
US	MBA Mortgage Applications	Sep-18					11.00	21.00
CA	Retail Sales/Ex Autos MoM	Jul				0.6%/0.8%	12.30	22.30
EC	ECB's Draghi quarterly hearing in Brussels						13.00	23.00
US	Markit US Manufacturing PMI	Sep P		53.2		53	13.45	23.45
EC	ECB's Weidmann speaks						16.00	2.00
US	Fed's Lockhart speaks on economy (V)						16.30	2.30
Thursday, 24 September 2015								
NZ	Fontterra Announces 2014/15 Results, Prev. \$4.40/20-30 cents/\$3.85 (milk price 2014/15, dividend 2014/15, milk price 2015/16), 8-9am NZT							
NZ	Trade Balance	Aug	-\$780M	-\$875M		-\$649M	22.45	8.45
JN	Nikkei Japan PMI Mfg	Sep P		51.2		51.7	1.35	11.35
NZ	New residential lending	Aug				27.9%	3.00	13.00
US	RBA's Alex Heath speaks at Urban Development Institute, Perth						4.00	14.00
JN	All Industry Activity Index MoM	Jul		0.0%		0.3%	4.30	14.30
GE	GfK Consumer Confidence	Oct		9.8		9.9	6.00	16.00
GE	IFO Business Climate	Sep		107.9		108.3	8.00	18.00
GE	IFO Current Assessment/Expectations	Sep		114.8/101.6		114.8/102.2	8.00	18.00
UK	BBA Loans for House Purchase	Aug				46033	8.30	18.30
US	Chicago Fed Nat Activity Index	Aug				0.34	12.30	22.30
US	Initial Jobless Claims	Sep-19				264K	12.30	22.30
US	Durable Goods Orders/core orders	Aug		-2%/-0.1%		2%/2.2%	12.30	22.30
US	Bloomberg Consumer Comfort	Sep-20					13.45	23.45
US	New Home Sales	Aug		515K/1.6%		507K/5.4%	14.00	0.00
US	Kansas City Fed Manf. Activity	Sep				-9	15.00	1.00
Friday, 25 September 2015								
US	Fed Chair Yellen delivers lecture						21.00	7.00
JN	Natl CPI/Ex Fresh Food & Energy YoY	Aug		0.1%/0.7%		0.2%/0.6%	23.30	9.30
JN	Tokyo CPI/Ex Fresh Food & Energy YoY	Sep		-0.1%/0.5%		0.1%/0.4%	23.30	9.30
JN	PPI Services YoY	Aug		0.5%		0.6%	23.50	9.50
EC	ECB's Weidmann takes part in Florence conference						7.00	17.00
EC	M3 Money Supply YoY	Aug		5.4%		5.3%	8.00	18.00
US	GDP Annualized QoQ (later vintage)	2Q T		3.70%		3.70%	12.30	22.30
US	Fed's Bullard speaks on Monetary Policy (NV)						13.15	23.15
US	Markit US Services/Composite PMI	Sep P		55.7/..		56.1/55.7	13.45	23.45
US	U. of Mich. Sentiment	Sep F		87.0		85.7	14.00	0.00
Upcoming Central Bank Interest Rate Announcements								
Australia, RBA		6-Oct	2.00%	2.00%		2.00%		
Japan, BoJ		7-Oct	0.0%-0.1%	0.0%-0.1%		0.0%-0.1%		
UK BOE		8-Oct				0.50%		
Europe ECB		22-Oct				0.05%		
Canada, BoC		22-Oct				0.50%		
US Federal Reserve		29-Oct				0-0.25%		
New Zealand, RBNZ		29-Oct	2.50%	2.50%		2.75%		

GMT: Greenwich Mean Time; AEST: Australian Eastern Standard Time

Forecasts

Economic Forecasts

	Annual % change				Quarterly % change											
	2013	2014	2015	2016	2013				2014				2015			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Australia Forecasts																
Household Consumpt	1.7	2.5	2.8	3.1	0.3	0.4	0.8	0.6	0.5	0.7	0.5	0.8	0.5	0.8	0.8	0.7
Underlying Business I	-4.5	-6.4	-10.2	-9.6	-4.9	-1.5	0.8	-3.5	-2.4	-0.9	-1.0	-1.5	-4.6	-2.2	-3.5	-3.3
Residential Constructi	0.5	7.9	13.7	9.7	-2.7	3.0	0.3	1.3	4.3	1.7	-1.2	3.9	4.7	3.7	4.3	3.1
Underlying Public Spei	0.4	0.8	0.2	1.4	2.7	-0.2	-0.5	1.3	0.3	0.5	-1.4	0.1	0.2	0.4	0.3	0.3
Exports	6.3	6.8	8.0	8.3	0.9	3.7	-0.6	1.7	4.1	-1.6	3.1	1.6	5.0	-1.8	2.4	2.7
Imports	-1.8	-1.6	1.7	0.8	-3.3	2.8	-1.4	-0.5	-2.5	3.1	-1.2	-1.6	3.1	-0.6	0.3	0.2
Net Exports (a)	1.6	1.7	1.3	1.7	0.9	0.1	0.2	0.4	1.4	-0.9	0.9	0.7	0.5	-0.3	0.5	0.6
Inventories (a)	-0.3	0.0	0.2	-0.1	-0.2	0.3	-0.3	-0.2	-0.3	0.9	0.1	-0.7	0.5	0.0	-0.1	-0.1
Domestic Demand - qtr%					-0.1	0.2	0.5	0.2	0.3	0.6	-0.4	0.5	0.0	0.5	0.4	0.3
Dom Demand - ann %	0.5	1.1	1.1	1.6	0.5	0.0	0.6	0.7	1.1	1.5	0.7	1.0	0.8	0.8	1.5	1.3
Real GDP - qtr %					0.3	0.7	0.4	0.8	1.0	0.6	0.3	0.5	0.9	0.6	0.7	0.7
Real GDP - ann %	2.1	2.7	2.6	3.0	2.0	2.1	1.9	2.2	2.9	2.8	2.7	2.4	2.3	2.3	2.7	2.9
CPI headline - qtr %					0.4	0.4	1.2	0.8	0.6	0.5	0.5	0.2	0.2	0.7	0.8	0.9
CPI headline - ann %	2.4	2.5	1.8	3.1	2.5	2.4	2.2	2.7	2.9	3.0	2.3	1.7	1.3	1.5	1.8	2.6
CPI underlying - qtr %					0.5	0.6	0.7	0.9	0.6	0.6	0.4	0.6	0.7	0.5	0.6	0.7
CPI underlying - ann %	2.4	2.5	2.4	2.6	2.4	2.4	2.3	2.7	2.7	2.7	2.5	2.2	2.4	2.3	2.5	2.5
Wages (Pvte WPI -ann	2.9	2.5	2.2	2.2	3.1	3.0	2.8	2.5	2.6	2.4	2.4	2.5	2.2	2.2	2.2	2.2
Unemployment Rate (%)	5.7	6.0	6.1	6.1	5.6	5.7	5.7	5.9	5.8	6.0	6.2	6.1	6.2	5.9	6.2	6.2
Terms of trade	-3.8	-7.4	-10.4	-2.0	1.0	-0.3	-1.3	0.4	-1.9	-4.6	-2.9	-1.5	-2.9	-5.6	-0.4	1.2
G&S trade balance, \$A	-10.4	-9.2	-26.6	-10.3	-3.0	-2.8	-3.3	-1.3	2.7	-5.1	-4.0	-2.7	-3.7	-9.4	-8.2	-5.3
% of GDP	-0.7	-0.6	-1.6	-0.6	-0.8	-0.7	-0.9	-0.3	0.7	-1.3	-1.0	-0.7	-0.9	-2.3	-2.0	-1.3
Current Account (% GE	-3.3	-2.8	-3.4	-2.3	-3.3	-3.4	-3.6	-3.1	-1.9	-3.6	-3.1	-2.5	-2.7	-4.1	-3.8	-3.0

Source: NAB Group Economics; (a) Contributions to GDP growth

Exchange Rate Forecasts

	21-Sep	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
Majors						
AUD/USD	0.7188	0.70	0.68	0.69	0.70	0.70
NZD/USD	0.6385	0.62	0.60	0.60	0.61	0.62
USD/JPY	119.82	125	126	126	127	127
EUR/USD	1.1306	1.05	1.03	1.03	1.04	1.06
GBP/USD	1.5542	1.52	1.51	1.51	1.53	1.54
USD/CNY	6.3630	6.55	6.60	6.62	6.65	6.70
USD/CAD	1.3217	1.35	1.37	1.36	1.34	1.34

Australian Cross Rates

	21-Sep	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
AUD/JPY	86.1	88	86	87	89	89
AUD/EUR	0.6358	0.67	0.66	0.67	0.67	0.66
AUD/GBP	0.4625	0.46	0.45	0.46	0.46	0.45
AUD/NZD	1.1258	1.13	1.13	1.15	1.15	1.13
AUD/CNY	4.5737	4.59	4.49	4.57	4.66	4.69
AUD/CAD	0.9500	0.95	0.93	0.94	0.94	0.94
AUD/CHF	0.6961	0.69	0.69	0.72	0.73	0.00

Interest Rate Forecasts

	21-Sep	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
Aust rates						
RBA Cash rate	2.00	2.00	2.00	2.00	2.00	2.00
3 month bill rate	2.19	2.15	2.15	2.15	2.20	2.40
3 Year Swap Rate	2.12	2.1	2.4	2.4	2.6	2.9
10 Year Swap Rate	3.05	3.1	3.5	3.5	3.5	3.7
Offshore Policy Rates						
US Fed funds	0.25	0.25	0.50	0.75	1.00	1.25
ECB refi rate	0.05	0.05	0.05	0.05	0.05	0.05
BoE repo rate	0.50	0.50	0.50	0.75	1.00	1.25
BoJ overnight call rate	0.10	0.10	0.10	0.10	0.10	0.10
RBNZ OCR	2.75	2.75	2.50	2.50	2.50	2.50
China 1yr lending rate	4.60	4.60	4.60	4.60	4.60	4.60
China Reserve Ratio	18.0	18.0	17.5	17.0	17.0	17.0
10 Year Benchmark Bond Yields						
Australia	2.74	2.8	3.1	3.1	3.1	3.3
United States	2.13	2.25	2.50	2.5	2.5	2.8
Europe/Germany	0.66	0.8	0.9	1.0	1.2	0.0
UK	1.83	2.2	2.2	2.4	2.6	0.0
New Zealand	3.30	3.2	3.4	3.5	3.6	3.7

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP

Dec year	2013	2014	2015	2016	20 Yr Ave
Australia	2.1	2.7	2.6	3.0	3.4
US	2.2	2.4	2.5	2.5	2.6
Eurozone	-0.3	0.9	1.3	1.7	1.5
UK	1.7	3.0	2.6	2.4	2.4
Japan	1.6	-0.1	0.7	1.2	0.8
China	7.7	7.4	7.1	6.9	9.2
India	6.4	7.1	7.4	7.5	6.6
New Zealand	2.2	3.3	2.4	1.9	3.0
World	3.4	3.3	3.1	3.2	3.5

Commodity prices (\$US)

	21-Sep	Sep-15	Dec-15	Jun-16	Dec-16
WTI oil	44.82	46	49	54	58
Gold	1137	1090	1050	990	970
Iron ore	58	55	54	53	50
Hard cok. coal	112	88	90	94	99
Thermal coal	62	68	68	62	62
Copper	5271	5360	5330	5280	5330
Japan LNG	8.4	10.1	10.2	11.1	11.3

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