Global & Australian Forecasts

by NAB Group Economics

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National Australia Bank

Key Points:

- We are not expecting any acceleration in global growth in 2016 - with another year of growth a touch below 3% (very sub-trend). We have modestly cut our 2016 growth numbers to take account of a deeper than expected recession in Brazil. A combination of the winding down of the current phase of market instability – which should limit the scale of the damage caused to household wealth, business appetites for investment and hiring and bank willingness to lend - central bank willingness to support demand , together with lower commodity prices and data that shows the world economy is still growing (modestly) underpin our view that we will see downbeat but continuing growth. However there remains the real risk of further periods of market volatility and hence downside risks to our forecasts. To achieve sustainably faster growth would require serious reforms (for which there appears little appetite). In the near term Australian MTP growth is likely to remain around 4 ¼%.
- In Australia, the recovery across the non-mining economy remains on track despite elevated risks. Q4 GDP figures revealed an economy running at 3% y/y, and our estimates suggest non-mining GDP was growing at near 4% y/y. Meanwhile, business conditions are resilient in the face of an uncertain global backdrop and weak commodity prices, although the divergence between mining and non-mining states is becoming more pronounced. The rotation towards services activity continues, and is supporting the labour market. National income growth however will remain weak as the terms of trade declines and low wages growth will cap household consumption growth. Overall, real GDP forecasts are largely unchanged with a pick up from an average 2.5% in 2015 to 2.7% in 2016 and 2.9% in 2017, although our newly-extended forecasts imply some loss of momentum in 2018 to 2.5%. The unemployment rate will ease gradually to just above 5½% by end-16 and then remain broadly steady. Domestic conditions suggest the RBA is very much on hold but retains an easing bias amidst global risks. Key focus will be on whether the non- mining sector maintains momentum and on the future path of the unemployment rate.

Key global and Australian forecasts (*% change*)

Country/region	IMF weight	2014	2015	2016	2017
United States	16	2.4	2.4	2.2	2.3
Euro-zone	12	0.9	1.5	1.6	1.7
Japan	4	-0.1	0.5	0.5	0.8
China	16	7.3	6.9	6.7	6.5
Emerging East Asia	8	4.1	3.5	3.5	3.7
New Zealand	0.2	3.7	2.4	2.4	2.5
Global total	100	3.3	2.9	2.9	3.2
Australia	2	2.6	2.5	2.7	2.9
Australia (*fiscal years*)		14/15	15/16	16/17	17/18
Private consumption		2.7	3.0	3.0	2.5
Domestic demand		0.8	1.1	1.1	1.3
GDP		2.2	2.9	2.9	2.7
Core CPI (*% through-year*)		2.2	2.0	2.0	2.6
Unemployment rate (*% end of year*)		5.9	5.8	5.8	5.5

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Global and Australian overview

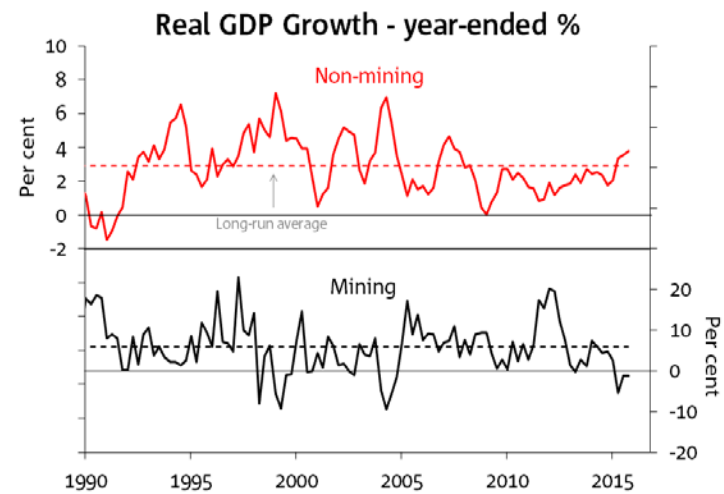
Global overview

- Selling pressure and volatility in financial markets has eased, key commodities and credit spreads have stabilised as the Chinese authorities say they have no plans to sharply devalue their currency and big central banks either look set to continue policy easing (European Central Bank, Bank of Japan, Chinese People's Bank) or are expected to adopt a slower tightening track (US Fed, Bank of England).
- Behind this financial market turbulence, global economic growth remains weak and shows no sign of picking up. We expect sub-trend growth to continue this year and the risks are skewed toward worse outcomes – if the recent bout of market weakness had continued much longer, it risked eroding confidence and wealth, hitting labour hiring and investment plans. Besides the country specific risks of China's deflating equity bubble, highly valued exchange rate and unsustainable debt/investment driven growth model, there are broader concerns. High debt burdens and modest income growth remain serious problems in many economies, while extremely low interest rates ensure that the wheels do not come off the wagon of global economic growth, another round of serious reforms may be needed to produce sustainably faster growth. The upfront costs of reform are proving hard to sell to electorates.

Australian overview

- Q4 GDP figures provided evidence of the resilience of the Australian economy amidst an uncertain global backdrop and weak commodity prices. Both the headline figures (0.6% q/q and 3.0% y/y) and the compositional detail were encouraging. Household consumption was solid despite subdued wages, corporate profits were higher despite the lower terms of trade and business investment did not fall as sharply as expected (implying some growth in non-mining investment). Meanwhile, the rotation towards non-mining sectors continued (see page 8). Indeed, our estimate of non-mining GDP is now running at above its long-run average in year-ended terms at around 4%.
- While surprising the market, the Q4 GDP results were in line with our expectations and hence imply few changes to our forecasts. We continue to expect real GDP growth of 2.7% in 2016, followed by 2.9% in 2017. There will however be some slowing into 2018 as the contribution from LNG exports dissipates and the dwelling construction cycle starts to unwind.
- The strength of GDP in both Q3 and Q4 also corroborates the broad direction of recent employment figures. The transition towards labour-intensive sectors will continue to support employment and we expect the unemployment rate to drift down to 5.6% by end-16 and to 5.5% in 2017 before ticking back up in 2018. That said, the magnitude of the employment gains in H2 imply some possibility of "statistical payback" in coming months. If that were to occur, we (and the RBA) would be careful in interpretation, and be cross-checking against other indicators of the labour market and non-mining activity. Movements in the AUD also bear close watching and we have pushed out our forecast low of USD0.67 to the end of 2016 (see page 13).

Source: Bloomberg (LUCI). Data to 1 March 2016.

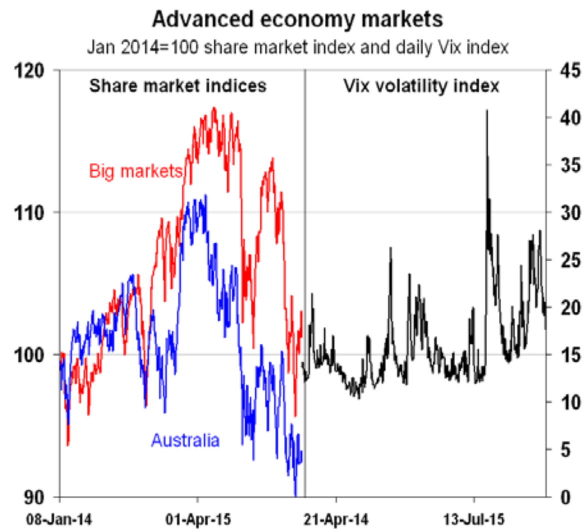


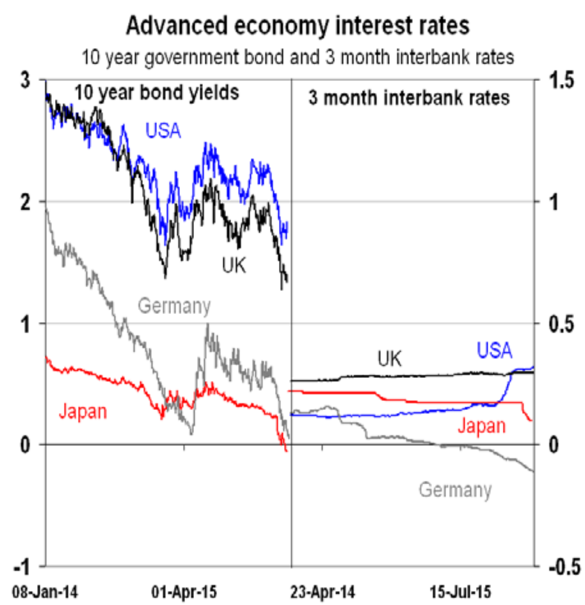
Financial and commodity markets

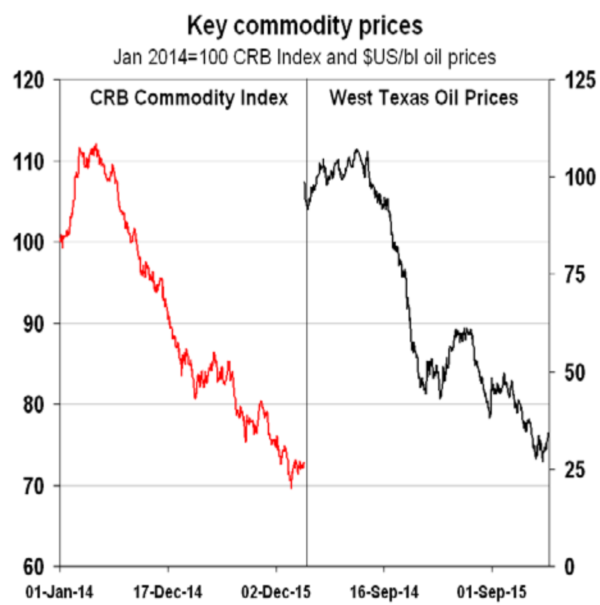
- Financial markets have either stabilised or recovered some of their losses after a very shaky start to the year. Share markets in the big advanced economies have recovered around half their losses but remain over 5% below their end 2015 levels. Chinese share prices have also stabilised, although the market remains skittish. Financial market volatility has subsided back to its end 2015 level and the credit spreads on high yield corporate bonds, while still wider than before the latest round of market jitters, have stabilised and are well below GFC levels.

- Commodity markets have also stabilised after recording big falls through the latter months of 2014, all of 2015 and early 2016. Crude oil is back around $US35/bl, barely a third of its mid-2014 price. The CRB daily commodity basket has gone sideways in the last few weeks but it has fallen by a third since mid-2014. Increases in commodity supply are primarily blamed for this price slump as demand has not fallen sharply for most products, even if the slower pace of economic growth in the emerging markets means raw material consumption is no longer rising rapidly.

- Low commodity prices have played an important role in dragging down advanced economy inflation which - along with monetary policy still aimed at supporting demand and lifting inflation expectations – has underpinned very low interest rates. Policy rates remain near zero, interbank rates are historically low (some are even negative) and government bond yields are similarly low by historical standards. Many bonds in Japan and Germany now trade on negative yields, key policy deposit rates in Japan and several European countries are similarly negative.

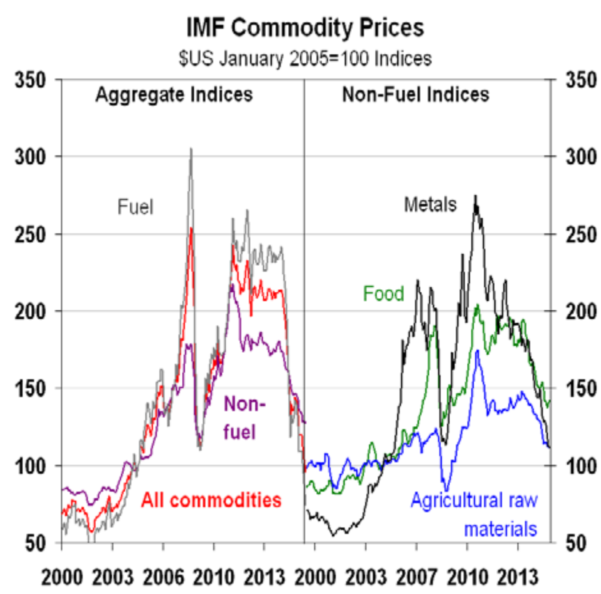


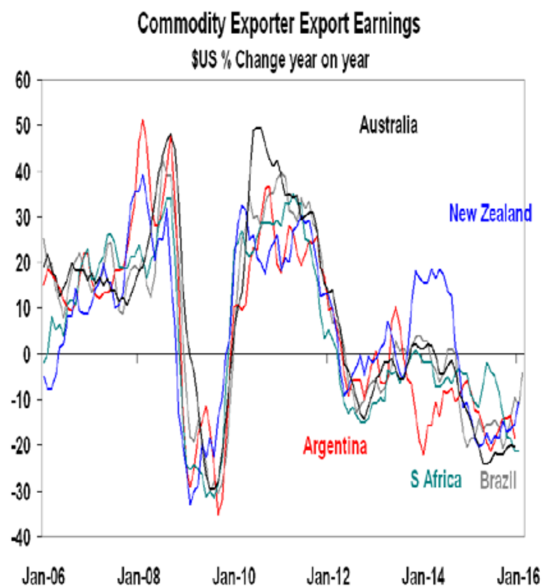




Global Economic Trends

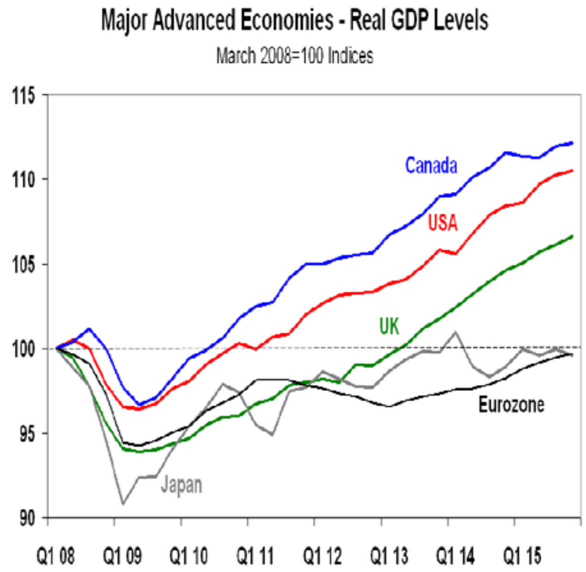
- Global growth dipped just below 3% yoy late last year with a continuation of the trend slowdown in emerging market growth and a softer patch in the pace of advanced economy economic expansion. Measures of global industrial output and trade growth show even weaker outcomes in late 2015 with expansion of only 2¼% and 1¼% respectively. These growth rates are well below long-run averages – indeed world trade and industrial output growth have averaged twice its late 2015 pace while world GDP growth has averaged 3¾% (since 1970). Services are currently the strongest part of the global economy and hence may help explain the very tepid pace of global trade.
- Neither business surveys nor the hard data show much of an acceleration in the pace of expansion in early 2016. The purchasing manager surveys for the first two months shows the industrial sector in the big advanced economies continuing its slowing trend, emerging market surveys do not signal any pick-up in growth and hard data on January industrial output (which is still not available for China) shows continued weak outcomes.
- Incomes and activity in many commodity exporting economies is registering the impact of the broad based fall in global commodity prices – reflected in declining $US export earnings and taxes among both oil producers and the diversified Southern Hemisphere commodity producers. These commodity price falls represent a transfer of purchasing power to the big commodity importers in N Asia, India and W Europe, which should boost their real incomes and spending. The benefit of these real income gains for spending is taking time to appear, which is weighing on short term global growth.

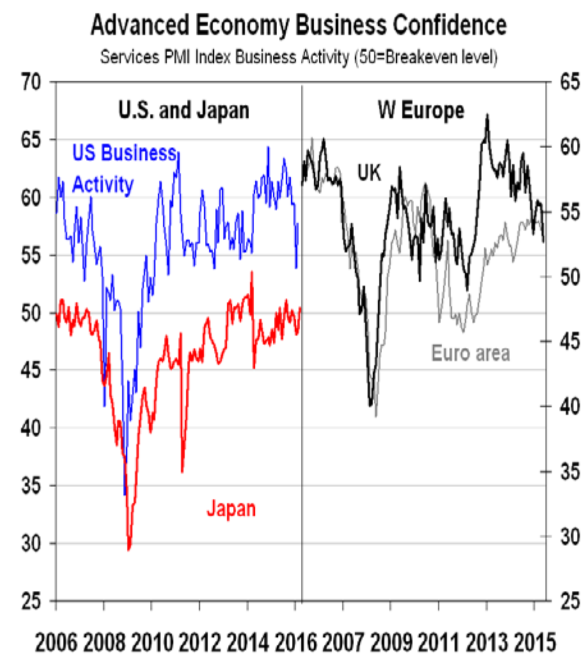




Advanced Economies

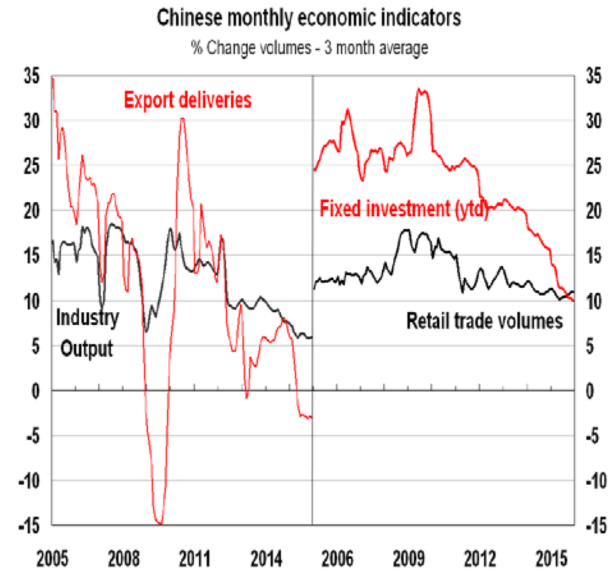
- End 2015 growth was disappointing in the big advanced economies. Quarterly GDP growth slowed to only 0.2%, less than half the rate averaged in the previous four quarters. This disappointing outcome was broadly based with US growth halving (albeit that is likely to be temporary), the Japanese economy recording a big fall in output and the Euro-zone's growth stagnated at 0.3%, despite buoyant business surveys readings in the latter half of last year.
- Highlighting the way that damage caused by the global financial crisis and recession compounded domestic economic problems (Japanese deflation and the long-running Euro-zone crisis), neither Japan nor the Euro-zone economies had regained their early 2008 size by the end of 2015. The outcome has been persistent double digit unemployment in the Euro-zone, whereas ageing has produced a stagnation in Japan's labour force.
- It is not only the recovery in the volume of G7 Advanced Economy output that has been lack-lustre, inflation has run well below forecasts and targets. According to the broadest measure of inflation (the GDP deflator), prices have only been rising by around 1% yoy in the G7 in recent quarters, dragged down by lower commodity prices. This combination of sub-trend growth and sub-target inflation means that the money value of economic activity was only expanding by around 2½% yoy in late 2015. Nominal GDP growth at that rate falls well short of the rate needed to get 2% inflation and satisfactory output growth.
- Although growth should bounce back in both the US and Japan in early 2016, business surveys are not pointing to an acceleration in the underlying pace of growth. The surveys are consistent with manufacturing growth crawling along very slowly and moderate expansion in services.

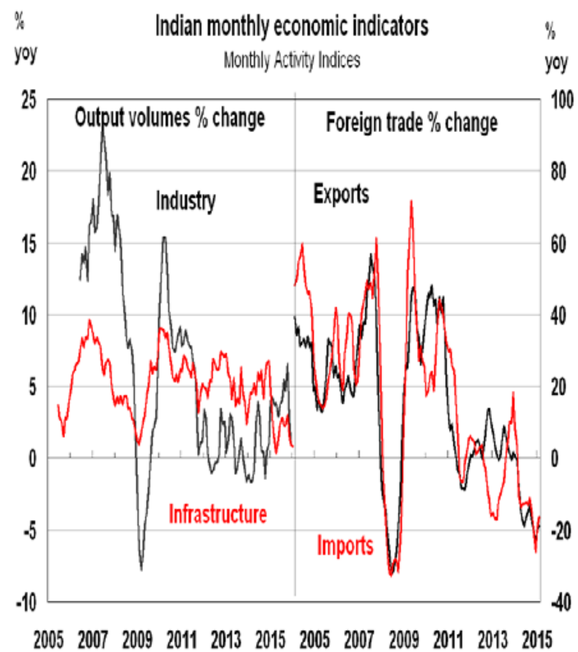




Emerging Market Economies

- The trend slowdown in emerging market growth continued through to the end of 2015 with growth in GDP growth dropping to 5.4% yoy while export volumes and industrial output were even weaker at 4¼% yoy and 2¾% yoy respectively. These growth rates are well below what has been experienced in the last 20 years with the exception of the GFC.
- The softening in emerging market economies has been broad based. The two biggest emerging economies saw modest slowdowns through late last year. Chinese growth eased from 6.9% to 6.8% between the third and fourth quarters while the comparable Indian figures were from 7.7% yoy to 7.3% yoy.
- Russia (the world's 6th biggest economy) was already in deep recession by mid-2015 with GDP down by 3.7% yoy in September while Brazil(the 7th biggest) is experiencing an exceptionally deep recession with GDP down by 6% yoy at the end of the year. Elsewhere growth is generally lacklustre with emerging Asia excluding China (which contains many of Australia and New Zealand's biggest trading partners) growing at 3¼% yoy in the latter half of last year, a modest rate by its historical standards.
- The emerging markets were hit by a perfect storm in 2015 as they faced a combination of slumping commodity prices, slow growth in world trade volumes, expectations of rising US interest rates and an outflow of capital back to the big financial centres and these shocks followed a period in which corporates across several emerging market countries had geared up to expand operations. We are expecting 2016 to be another difficult year with no pick up in growth and the acceleration predicted for 2017 reflects the forecast ending of recession in Brazil rather than a marked pick-up in activity.



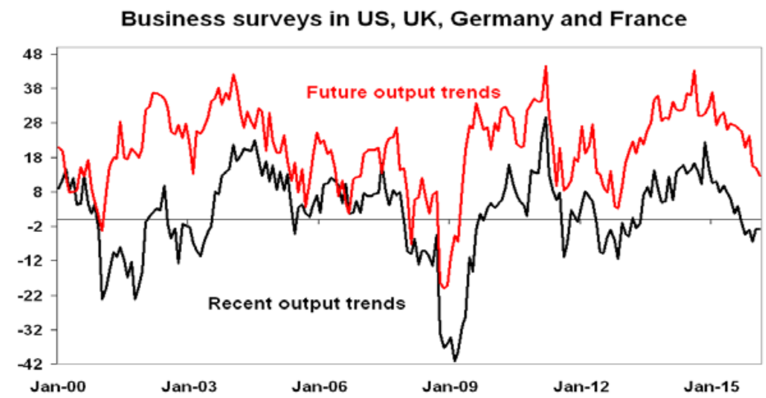


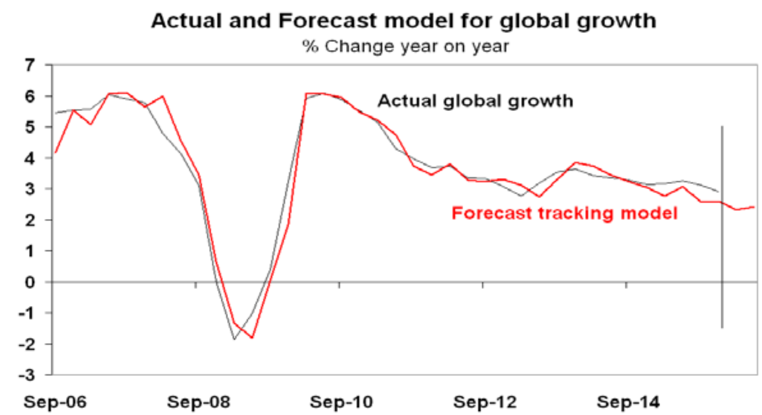
Global forecasts

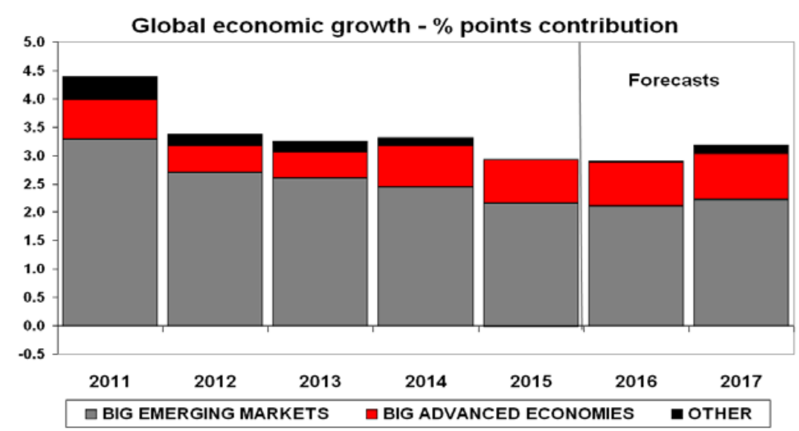
- We are not expecting any acceleration in global growth in 2016 with another year of growth around 3%, well below trend. Neither the business surveys nor our tracking model are pointing to an imminent lift in the pace of output expansion, if anything the trend is still a gradual loss of momentum through early 2016. Hard data and business surveys from late 2015 and the opening months of this year are still proving disappointing and we have modestly cut our 2016 growth numbers to take account of a deeper than expected recession in Brazil.
- Fortunately global financial and commodity markets have settled down recently after a very weak and volatile start to the year. This should limit the scale of the damage caused to household wealth, business appetites for investment and hiring and bank willingness to lend. Surveys showed some pullback in lending attitudes among US banks but the scale of the retrenchment was comparatively modest and there has been nothing on the scale of the credit squeezes seen in some previous risk off periods.
- A combination of the winding down of this phase of market instability, central bank willingness to support demand by either loosening monetary policy or scaling back plans to tighten and a run of data that shows the world economy is still growing – albeit modestly – means we are sticking to our forecast of rather downbeat growth punctuated by further periods of volatility through the next few years rather than predicting any global recession. There are, however, still plenty of risks.

Global growth forecasts % change year on year

	2011	2012	2013	2014	2015	NAB Forecasts 2016	2017
US	1.6	2.2	1.5	2.4	2.4	2.2	2.3
Euro-zone	1.6	-0.8	-0.3	0.9	1.5	1.6	1.7
Japan	-0.4	1.7	1.4	-0.1	0.5	0.5	0.8
UK	2.0	1.2	2.2	2.9	2.2	2.2	2.2
Canada	3.1	1.8	2.2	2.5	1.2	1.4	1.8
China	9.3	7.8	7.7	7.3	6.9	6.7	6.5
India	7.9	4.9	6.4	7.1	7.5	7.6	7.4
Latin America	4.9	2.6	2.6	0.9	-0.6	-0.8	1.0
Emerging East Asia	4.4	4.6	4.2	4.1	3.5	3.5	3.7
New Zealand	1.8	2.4	2.4	3.7	2.4	2.4	2.5
World	*4.4*	*3.4*	*3.3*	*3.3*	*2.9*	*2.9*	*3.2*
memo							
Advanced Economies	1.7	1.2	1.2	1.8	1.9	1.9	2.0
Big Emerging Economies	7.0	5.4	5.6	5.1	4.4	4.3	4.7
Major trading partners	4.7	4.3	4.2	4.1	3.8	3.7	3.8







Australian outlook

- Q4 GDP figures provided reassurance that the recovery across Australia's non-mining economy continues. Real GDP expanded by 0.6% q/q in Q4 following growth of 1.1% q/q in Q3 (revised up from 0.9% q/q). This saw year-ended growth of 3.0%, the strongest rate since Q1 2014.
- The composition of the figures was also encouraging. Household consumption was strong at 0.8% q/q and consumer caution appeared to dissipate coming into the latest period of financial market volatility – the household savings ratio dipping to 7.6%, the lowest since before the GFC. Also notable was the smaller-than-expected decline in business investment. While mining investment continued to drag, machinery & equipment and non-residential building investment were positive. Net exports meanwhile disappointed, although the expected surge in LNG exports was apparent.
- The industry and state patterns in Q4 were in line with the NAB business survey. Output in labour-intensive services industries such as real estate, IT, financial services, health, public administration and arts & recreation were strong. By state, NSW, Victoria and Tasmania continued to outperform, while the downturn in state final demand in WA and the NT was more pronounced, and will remain so as low commodity prices and the retreat in mining investment continue. State final demand growth in SA was running behind the national average, but ahead of Queensland.
- Going forward, low income growth will remain a challenge, although in Q4 income measures such as gross domestic income were surprisingly stable given the 3.2% decline in the terms of trade. Corporate profits were positive in Q4 despite lower mining profitability, with low oil prices likely assisting. The main area of weakness was wages, a trend which will continue, capping future growth in household consumption (see pages 9 and 10).
- The bounce in business conditions and the Q4 GDP suggest the Australian economy continues to evolve in line with our expectations. As such, our real GDP forecasts are broadly unchanged at 2.7% in 2016 and 2.9% in 2017, with some slowing in 2018 to 2.5%.. The unemployment rate is forecast to track down to 5.6% by end-16 and then broadly stabilise, despite some near-term risk of statistical payback (see pages 2 and 10 for detail). This is not to play down considerable challenges for this small open economy amidst a troubled global backdrop and low commodity prices. The risks will remain tilted to the downside until there is more conclusive evidence of stabilisation across the global economy. These forecasts are based on our judgement that the RBA will remain in hold through 2016 (page 13) and our revised forecast for the AUD to hold broadly steady in coming months before easing to USD0.67 by year-end.

Australian economic and financial forecasts (a)

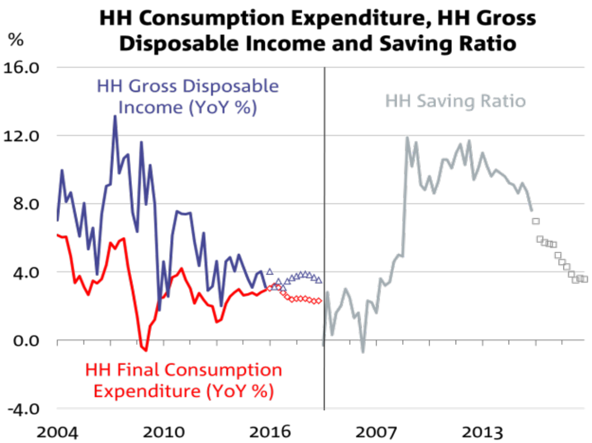
	Fiscal Year			Calendar Year			
	2015-16 F	2016-17 F	2017-18 F	2015	2016-F	2017-F	2018-F
Private Consumption	3.0	2.5	2.5	2.8	2.9	2.3	2.5
Dwelling Investment	8.5	2.2	-1.9	9.5	5.4	-0.6	-2.6
Underlying Business Investment	-11.6	-7.0	-2.6	-10.1	-8.8	-5.9	0.9
Underlying Public Final Demand	2.5	2.3	2.6	1.9	2.0	2.5	2.6
Domestic Demand	**1.1**	**1.3**	**1.6**	**1.0**	**1.3**	**1.3**	**2.0**
Stocks (b)	0.0	0.1	0.1	0.0	0.2	0.0	0.0
GNE	**1.2**	**1.4**	**1.7**	**1.1**	**1.5**	**1.3**	**2.0**
Exports	6.5	9.1	7.9	6.1	7.4	9.5	5.8
Imports	0.1	2.2	3.3	1.0	1.3	2.2	4.2
GDP	**2.8**	**2.7**	**2.8**	**2.5**	**2.7**	**2.9**	**2.5**
– Non-Farm GDP	3.0	2.8	2.8	2.5	2.8	2.9	2.5
– Farm GDP	-2.6	0.4	2.0	0.3	-2.3	1.6	2.0
Nominal GDP	2.7	4.5	4.7	1.8	3.5	4.9	4.4
Federal Budget Deficit: ($b)	-37	-34	-23	NA	NA	NA	NA
Current Account Deficit ($b)	85	76	72	75	84	72	76
(-%) of GDP	5.1	4.4	4.0	4.6	5.0	4.1	4.1
Employment	2.5	2.2	2.0	2.0	2.3	2.1	1.9
Terms of Trade	-10.5	-3.0	-2.7	-11.4	-6.9	-2.5	-2.1
Average Earnings (Nat. Accts. Basis)	0.7	1.8	2.4	0.6	1.2	2.3	2.4
End of Period							
Total CPI	1.8	3.0	2.5	1.7	2.7	2.6	2.3
Core CPI	2.1	2.6	2.4	2.0	2.5	2.5	2.3
Unemployment Rate	5.8	5.5	5.5	5.9	5.6	5.5	5.6
RBA Cash Rate	2.00	2.50	3.50	2.00	2.00	3.00	3.50
10 Year Govt. Bonds	3.30	3.65	3.65	2.88	3.35	3.65	3.65
$A/US cents :	0.71	0.70	0.75	0.73	0.67	0.73	0.76
$A - Trade Weighted Index	63.8	62.5	65.6	62.7	60.2	64.5	65.9

(a) Percentage changes represent average annual growth, except for cash and unemployment rates. The latter are end June. Percentage changes for CPI represent through the year inflation.

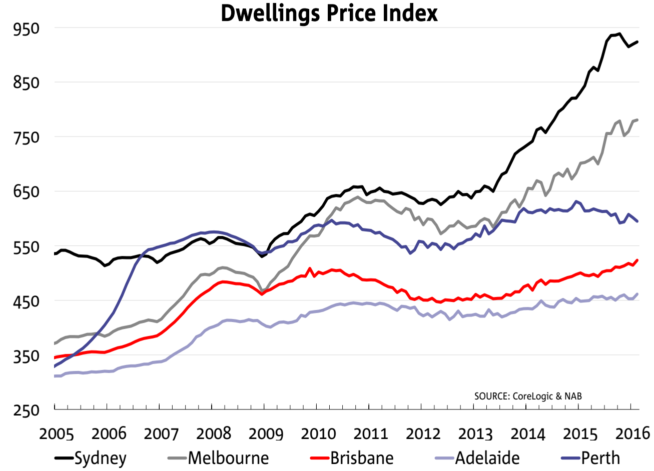
(b) Contribution to GDP growth

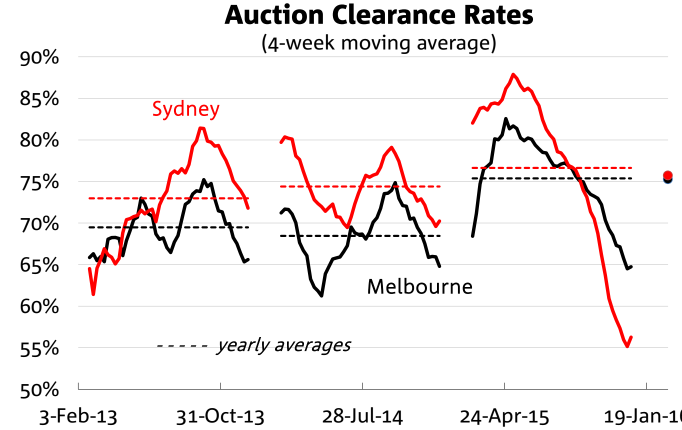
Australian consumer demand and housing market

- According to the Q4 National Accounts, household consumption growth was solid at 0.8% which represents a very strong outcome relative to recent history, possibly a reflection of the sustained improvement in employment growth over 2015. That said, growth in household income has remained very weak of late, suggesting a compositional shift in the labour market towards lower-paid jobs. Total compensation of employees (a measure of the national wage bill) only rose by a relatively muted 0.4% in the quarter. As such, the strength in household consumption was supported by a notable decline in the household savings rate, which fell to 7.6% from 8.7% in Q3, to be below 8% for the first time since the GFC.
- The fundamentals for household consumption looks mixed going forward. Wage growth is likely to remain tepid on the back of the ongoing transition towards non-mining sectors (which are more labour-intensive but offer lower-paying jobs) and the falling terms of trade. Meanwhile, aggregate household income growth, which is more pertinent for overall household spending, is likely to grow slightly more strongly owing to relatively resilient employment and population growth. At the same, we are likely to witness fading impetus from the housing market on household spending. Amidst subdued expectations for income growth, we expect a modest pick-up in consumer spending growth through to 2018, driven by a gradual decline in the household savings rate.
- The housing market is returning to full swing following the summer break. Auction clearance rates have picked up sharply in recent weeks, although remain below year ago levels in Sydney and Melbourne, supporting our view of a more subdued market in 2016. That said, dwelling prices in Sydney rose in the past two months, to be 1% above end-2015 levels – albeit still below recent highs. Interestingly, the median price in Sydney has actually fallen steadily in the past three months, suggesting the rise in the more closely watched hedonic measure has been due to adjustments for the quality of housing. Consistent with growing supply, Sydney unit prices have declined in the past two months, but were more than offset by the rise in house prices. In Melbourne, prices also rose in the past two months – including a rise in unit prices despite supply concerns. Prices have also risen further across most other capital cities except Perth, where prices are down 2% from end-2015 levels and are 3% lower over the year. Housing credit growth remained at 0.5% in January, now primarily driven by owner occupier loans.
- Despite price rises in recent months, we have not revised our expectation for a considerable moderation in property price growth in 2016. Housing fundamentals suggest there is now limited room for more significant gains in Sydney and Melbourne, with affordability providing a considerable constraint, while new housing supply should be starting to have an impact (especially for apartments). Restrictions on investors and uncertainty over potential policy changes are additional considerations. House price growth is expected to slow in 2016 (to 1%), but expectations for unit prices are even weaker (-1.2%) – for more details, see our recent housing survey at the following link.



Source: ABS, NAB

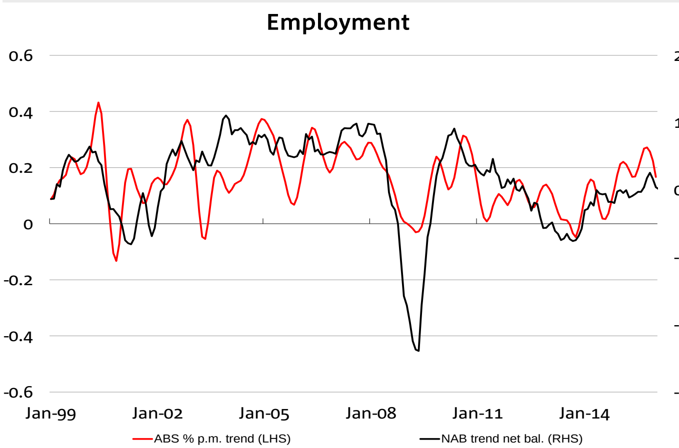


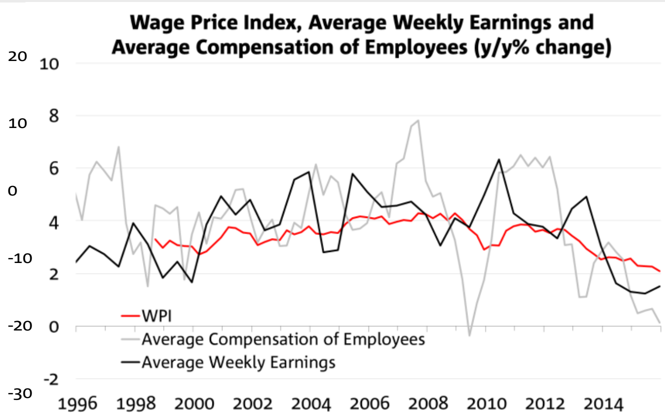


SOURCE: CoreLogic
* Dots represent the average for the first 5 weeks of the year

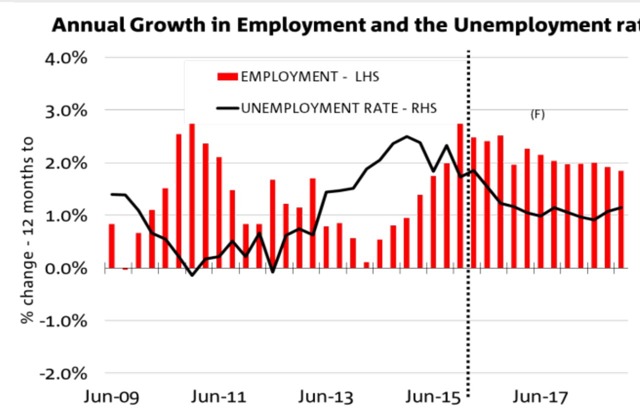
Australian labour market

- Employment was softer than expected in January (-7.9k in seasonally-adjusted terms compared to market expectations of +13k). In trend terms, however, employment growth was relatively solid at close to 20k a month (or 2.6% y/y), exceeding the 14 to 15k needed to keep the unemployment rate constant. Despite the loss in momentum in the month, other indicators of labour market health, such as employment to population ratio and the participation rate, continued to suggest solid underlying conditions. As a result of weaker employment growth, the unemployment rate rose to 6.0% in seasonally adjusted terms in January, but trend unemployment fell by 0.1ppt to 5.8%.
- By state, employment growth continued to be dominated by NSW and VIC, with the recent pick-up in QLD a welcome development, offering evidence that activity in non-mining sectors is gaining traction. The broadening improvement in the labour market is further demonstrated by a greater number of states showing a sustained amelioration in unemployment: NSW, Victoria, Queensland, Tasmania, and more recently SA. Meanwhile, unemployment appears to have stabilised somewhat in NT, but continues to rise in WA and ACT. The divergent trends between mining and non-mining states are also apparent in some of the leading indicators, the SEEK job ads series shows WA falling further behind other major states and increasingly dragging on national results, while NSW continues to be the standout performer, driven largely by job ads in the housing construction sector.
- Solid GDP outcomes in Q3 and Q4 2015 give more substance to the strength in employment over the same period. That said, the magnitude of the increases (gains of 32K per month on average through H2 2015) suggest some possibility of statistical payback in coming months. If that were to occur, we (and the RBA) would be careful in interpretation, and be cross-checking this with other indicators of the labour market and non-mining activity. At this stage however, the employment index from the NAB business survey suggests on going employment gains (of 15k per month) which would be sufficient to see unemployment stabilize and edge down over the course of 2016.
- Short-term risks aside, our expectation remains that employment growth will continue to be underpinned by a shift towards more labour-intensive sectors, and continue to forecast further improvements in unemployment rate. Our forecasts are largely unchanged, with the unemployment rate expected to ease gradually to 5.6% by end-16 and 5.5% by end-17, before returning to 5.6% by end-18. Slower population growth (currently 1.4% y/y, down from 1.6% at the start of 2014) also suggests a slightly lower rate of job creation will be necessary to keep up with population growth.
- Overall wage growth remains tepid despite the pick-up in employment, with compensation of employees up by only 0.4% in Q4, while average compensation of employees actually declined 0.6% q/q and continued to run at a slower rate than the wage price index. Wages growth is either slowing or remaining weak in most industries, reflecting both the compositional shift towards lower-paid services jobs and greater labour supply (participation rate has been trending upwards) which act to suppress broader measures of the wage bill.





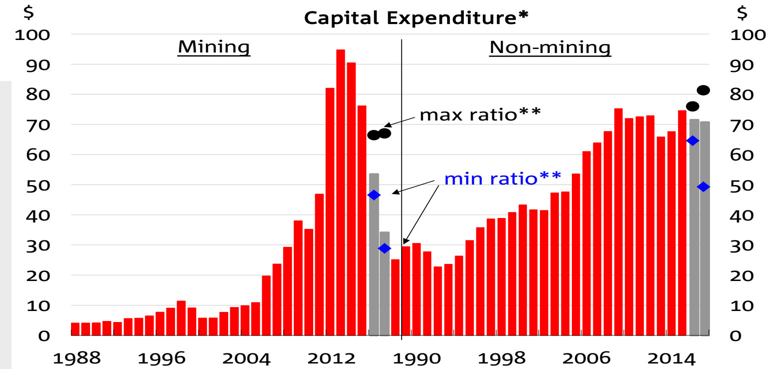
Source: ABS, NAB Group Economics



Source: ABS, NAB Group Economics

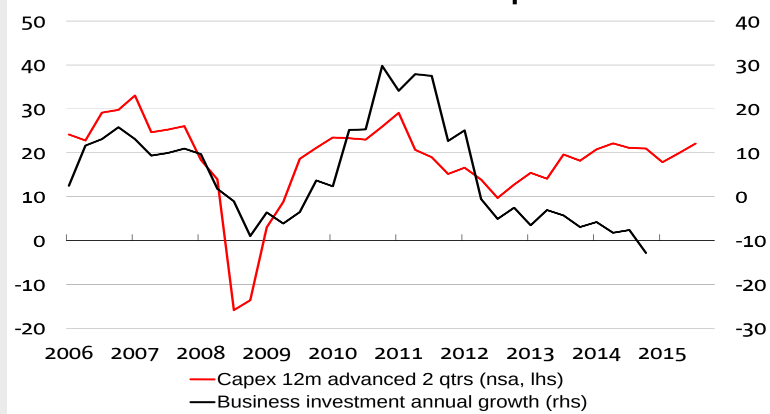
Australian investment

- Non-mining investment remains critical to the longer-term economic outlook. Unfortunately, despite a lift in non-mining activity, the effect on firms investment intentions has been limited. This has been particularly apparent in the ABS's Private New Capital Expenditure (Capex) Survey, which provided the first indication of investment intentions for 2016/17 in the Q4 2015 release this month.
- The Capex Survey shows a further contraction in mining investment plans, coinciding with weak commodity prices and growing concerns over emerging market demand for commodities going forward. However, a weak result was to be expected. What was more disappointing was the lack of any pick up in investment intentions from the non-mining sectors, with firms actually expecting to cut back on capital spending next year.
- However, expectations from the Capex survey can be somewhat misleading. A major limitation stems from the coverage of the Survey itself. In particular, the Capex survey has a relatively limited scope in terms of the industries it covers – excluding firms classified to agriculture, forestry and fishing, education, and health and community services industries. The omissions are significant given that other partial indicators tend to suggest that some of these industries have been outperforming. This was apparent in the Q4 National Accounts, where the fall in new business investment (-3.2%) was somewhat better than that suggested by the ABS Capex and Construction Work Done releases (closer to a -4½%).
- Meanwhile, alternative indicators of business investment have been somewhat mixed, but generally more upbeat. Capex expectations for the next 12 months in the NAB Business Survey improved in Q4, while capacity utilisation in the monthly NAB Survey improved notably in February – after showing signs of softening in previous months. Commercial property market sentiment also hit a new high in the NAB Commercial Property Survey during Q4. In contrast, non-residential building approvals have remained quite muted.
- Dwelling investment was solid in Q4 (up 2.2% q/q; 9.8% y/y), consistent with record high numbers of dwellings in the construction pipeline. Given the large pipeline, residential construction is expected to continue making a positive contribution to growth over 2016, even as the housing market continues to cool. The flow of new projects, however, has clearly pulled back given lower expectations for prices and growing concerns of a potential oversupply (primarily in the apartment market).
- The profile of dwelling construction is expected to remain volatile given the large share of apartment construction. Nevertheless, given the state of market over-supply, approvals should remain soft, suggesting that overall contribution of dwelling investment to GDP should begin to diminish over the course of 2017.
- Overall, business investment is forecast to decline by around 9% in 2016 and 6% 2017. Positive dwelling investment is providing some offset (up over 5% in 2016), but only accounts for around 5% of GDP versus 12% for business investment.

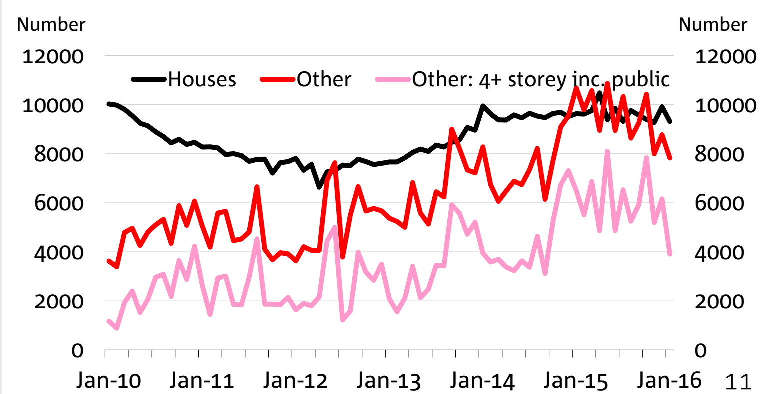


* Grey bars are the latest expectations adjusted by the previous year's realisation ratio measure
** The max and min estimates based on historical max-min realisation ratios
Source: NAB, ABS

Business Investment & Capex Plans



Private dwelling units approved

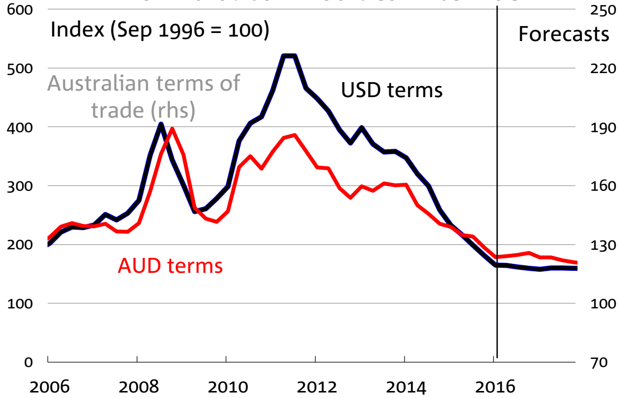


Source: ABS

Australian commodities, net exports and terms of trade

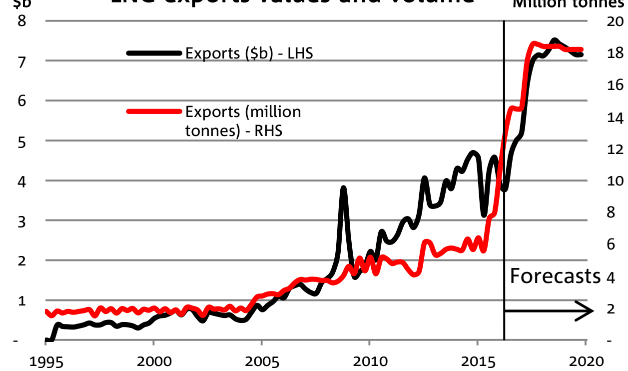
- Net exports made a flat contribution to overall GDP growth in Q4, with both exports and imports increasing by 0.6%. Larger than expected falls in iron ore and coal exports were a drag on export growth, although a strong increase in LNG exports was somewhat offsetting. Going forward, export volumes will continue to ramp up on the back of strong LNG exports (see below), while imports will accelerate but at rates of growth much slower than exports. We expect net exports to add 1.5 and 1.4 ppt to GDP growth in 2016 and 2017 respectively, but a lower 0.3 ppt in 2018.
- Some large scale LNG projects have started exporting and LNG export volumes are forecast to increase by 64% in 2016, 55% in 2017 and 21% in 2018. In addition, while iron ore and coal exports have suffered from subdued demand growth and lower prices, volumes are expected to hold up. Significantly lower commodity prices (see below) will however weigh on export earnings. As such while export volumes overall are forecast to grow by 7.4% in 2016 and 9.5% in 2017, export values will only expand by 1.3% and 7.8%. This will still see some improvement in Australia's trade deficit to 2.3% of GDP by end-16 (but a return to surplus is not expected) and weigh on associated income and government revenue.
- The NAB non-rural commodity index denominated in USD fell 29% in 2015 and is forecast to fall by another 20% in 2016, but only a further 2% in 2017 - with iron ore and energy prices leading the way (see NAB Minerals & Energy Commodities Outlook). Weak steel demand will see iron ore spot prices stabilising at an average of US$42/tonne in 2016, while hard coking coal contract prices are expected to average US$80.8 a tonne. Thermal coal price is forecast at US$58 a tonne. Oil prices are to remain below US$40/bbl for most of 2016 before rising to US$50 by end 2017. Despite stalling of late, USD appreciation will partially offset price declines in AUD terms for 2016 – reversing in 2017 (see page 13 for AUD outlook). Overall, these trends suggest the terms of trade will continue to trend lower, although at a slower pace than in recent years.
- On the import side, intermediate and consumption goods imports have been growing in volume terms on the back of solid household consumption and residential market activity – while AUD depreciation has increased the cost, limited domestic production has restricted substitution towards domestic sources. Capital goods imports have declined as large scale mining constructions finish and non mining investment is more subdued. Services imports are also down, especially travel and other services, as the lower AUD encourages more locals to travel domestically.
- Our forecasts point to Australian agricultural prices trending mostly higher in Australian dollar terms in 2016, despite challenging international conditions. We expect cattle prices to remain high in 2016 on account of domestic demand as producers look to restock, but slaughter to be well down on previous highs. Australian Wheat growers are likely to plant enthusiastically, although the dry start to autumn may temper sentiment somewhat. Overall we expect the NAB Rural Commodities Index to increase 11.5% in 2015-16 and 2.9% in 2016-17 (in AUD terms). This month we released our latest Australian agricultural exports update, which outlines our detailed forecasts for major agricultural exports to 2016-17.

NAB Non-Rural Commodities Price Index



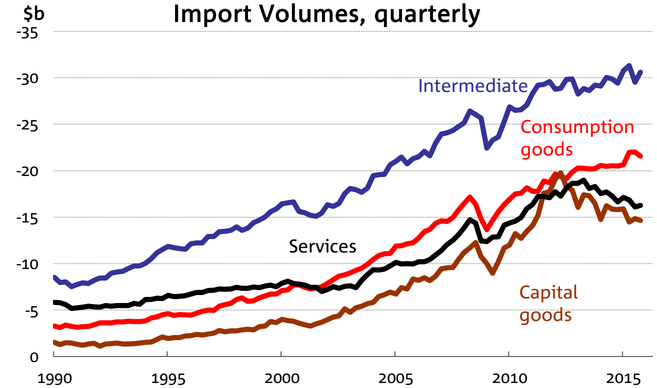
source: ABARES, ABS, Bloomberg, Thomson Datastream, NAB

LNG exports values and volume



source: ABS, Bloomberg, NAB

Import Volumes, quarterly



source: ABS

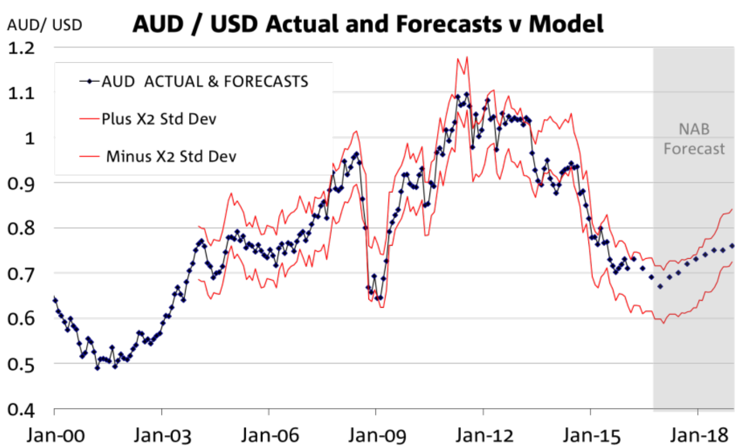
Australian financial markets

Exchange rate

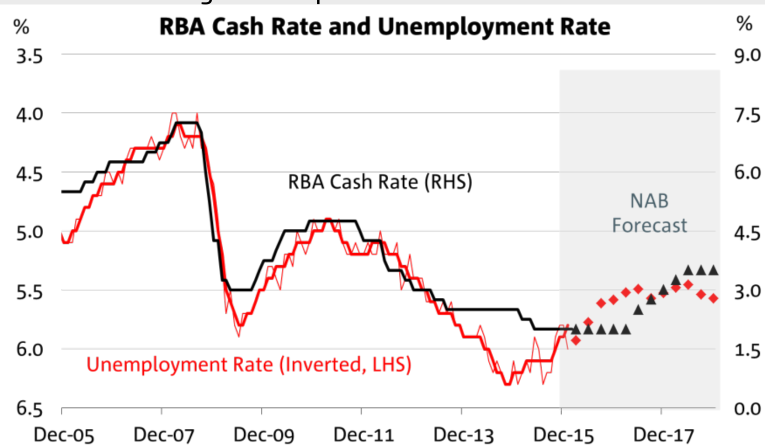
- After dropping below USD 0.69 in mid-January, the AUD has re-appreciated to over USD 0.74, underpinned by USD weakness as Fed rate hike expectations have been pared back, some recovery in commodity prices (particularly iron ore), and some improvement in global risk appetite. More recently, solid Q4 GDP figures (which surprised the market but not us) have also supported the AUD as market pricing for rate cuts diminished. NAB's revised forecasts see the AUD bottom at around 67 US cents by late 2016, and then stabilising at around the mid-70s by late 2017. This is largely because we now expect the Fed to be on hold for an extended period - through H1 2016 at least - with tighter financial conditions doing some of the work for Fed. This is one factor likely to at least delay a return of AUD/USD to below 70 cents. In trade-weighted terms however, the Aussie is forecast to be broadly steady through 2016, largely because the Chinese Yuan comes under more downward pressure than the AUD.

Interest rates and inflation

- The RBA is expected to remain on the sidelines through 2016. While heightened global risks will maintain an easing bias, NAB sees little domestic case for further easing – the non-mining economy continues to recover as evidenced by resilience in business conditions. In addition, even lower rates are unlikely to provide much support to weak sectors such as mining and related services. The RBA continues to watch the labour market closely, although we note that it would be highly unusual for the RBA to ease rates while the unemployment rate is trending down as per our forecasts (chart below). The main risk to market pricing in the near term however is some possibility of statistical payback in the official labour market data in coming months following exceptionally strong figures in H2 2015 (see page 10), although the RBA would look through this if other indicators of the labour market and non-mining activity held up. The RBA is also watching for evidence that financial market strains are impacting on global and domestic demand, although evidence of any substantive domestic effects is notably absent at present.
- Inflation is forecast to remain near the middle of the RBA's 2 to 3% target band in 2016 and 2017, neither too high nor too low to prompt an interest rate change, but also affording the RBA flexibility to adjust policy should activity or labour market indicators deteriorate. Q4 inflation was slightly higher than expected, with headline inflation at 0.4% q/q and 1.7% y/y and underlying inflation at 0.5% q/q and 1.9% y/y. Fuel prices declined further and are expected to keep downward pressure on tradeables inflation in the near term. Tradeables excluding volatile items rose 0.8% in the quarter, showing tentative signs of an exchange rate pass-through, however ongoing competition between retailers may temper the rise in final consumer prices for some time. Non-tradeables inflation remained subdued at 0.4% q/q and is expected to remain weak, amidst spare capacity in the labour market and subdued wages growth. Residential rent inflation has also declined, consistent with the general upward trend in rental vacancies.



Source: ABS, NAB



Source: ABS, NAB

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