

Australian Markets Weekly

House price inflation being remodelled

- RBA cuts again amid signs inflation will remain below target for some time yet
- Measurement of housing inflation in the melting pot as CoreLogic methodology changes
- House price acceleration in recent months now not so worrisome, the RBA finds
- Sydney and Melbourne auction clearance rates up again this weekend after rate cut
- Even so, headwinds lining up against the housing market
- NAB Business Survey (and forecast update) tomorrow; Glenn Stevens delivers his last speech as Governor on Wednesday; consumer sentiment and housing finance Thursday
- Offshore this week: China growth reports Friday; RBNZ highly likely to cut Thursday

Recent developments

Last week's RBA rate cut has strengthened the argument that the RBA is uneasy about the outlook for Australian inflation. In its quarterly Statement on Monetary Policy released on Friday, the Bank stated that "there has been little change to the forecast that underlying inflation will remain around 1½% year-ended terms over 2016 and pick up to around 1½-2½% by the end of the forecast period." The central bank's forecast is of below-target inflation for another 18 months.

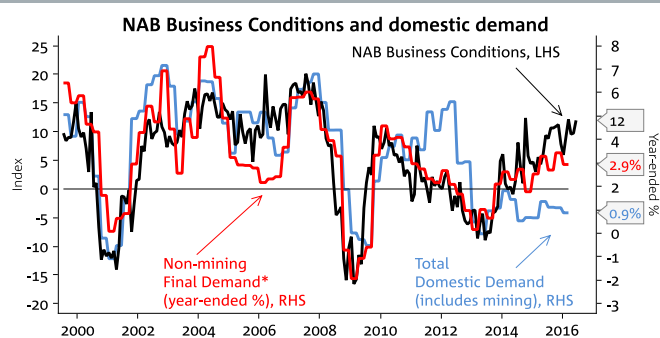
Uncertainties around achieving a projected higher inflation rate continue, and arguably to the downside. Lying behind a return to target inflation are expectations of gradual exchange rate pass-through and, in time, some increase in the rate of wage costs that will feed through to higher consumer prices. As for the wages outlook, the Statement pointed out that growth in the Wage Price Index (WPI) – the next release, the Q2 WPI, is on Wednesday week – is expected to remain around current levels this year before picking up gradually over the forecast period. Broader measures such as national accounts average earnings have been weaker reflecting the end of boom-time wages in the resources sector and, more generally, hiring of workers on lower wages. The Bank expects such effects to dissipate over time. Against those eventual positive forces on inflation the RBA expects heightened competitive pressure on retail markets to persist for some time while the increased supply of housing will keep rental growth low over the next few years.

Key markets over the past week

	Last	% chg week	Last	bp / % chg week
AUD	0.7609	1.0	RBA cash	1.50 -25
AUD/CNY	5.07	0.8	3y swap	1.69 1
AUD/JPY	77.6	0.3	ASX 200	5,537 -0.9
AUD/EUR	0.685	1.0	Iron ore	60.7 2.3
AUD/NZD	1.070	1.6	WTI oil	41.9 4.5

Source: Bloomberg

Chart 1: Non-mining economy doing better through June



* Includes exports
Source: National Australia Bank, ABS

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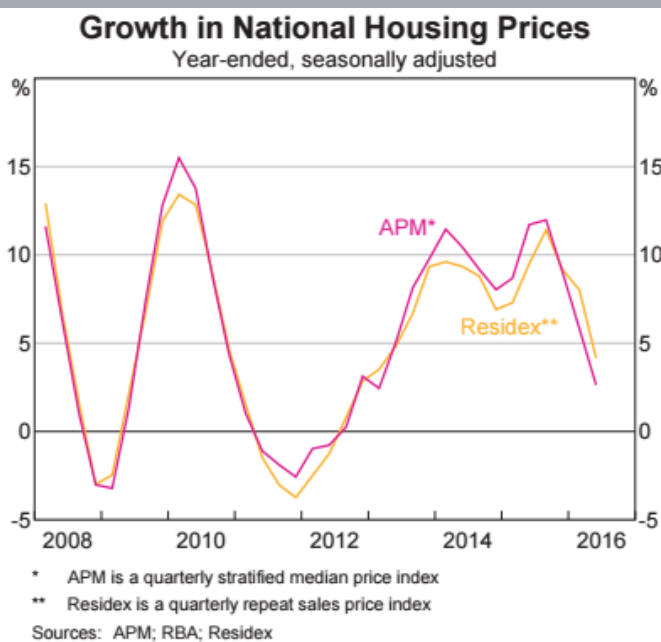
In the meantime, the RBA has seen further scope to support the economy and tilt the odds toward meeting its inflation objective. The Board's decision to cut rates last week is a belief that while the economic outlook remained positive, with inflation forecast to be below 2% over most of the forecast period, "there is room for even stronger growth".

RBA less anxious about housing

With continuing concern about getting inflation back to target, the housing market was always going to get considerably policy attention last week. The RBA made clear last week in its Statement Overview that it has become less anxious about risks in the housing market. "Recent information implies that dwelling prices have been rising modestly over the course of this year and confirms that growth in lending for housing purposes slowed since last year. All this suggests that the risks associated with high and rising household sector leverage and rapid gains in housing prices have diminished." (This view of recently slower growth in housing prices would resolve a recent conundrum between softer recent lending data and a reacceleration in Sydney and Melbourne house prices over recent months.)

Until Friday's Statement on Monetary Policy, the RBA has been relying on the trend in CoreLogic's "hedonic" measure of house prices to assess housing inflation. The Bank has for now shifted its focus away to alternative measures, the APM and Residex indexes. The Bank notes that a recent acceleration in CoreLogic's indexes likely reflected statistical measurement issues than genuine housing inflation. In the RBA's view, "recent information suggests that the (recent) strong increases reported by CoreLogic were overstated as a result of methodological changes affecting growth rates for the June quarter. The most recent data suggests that housing prices declined in most capital cities in July."

Chart 2: RBA less anxious about house price inflation



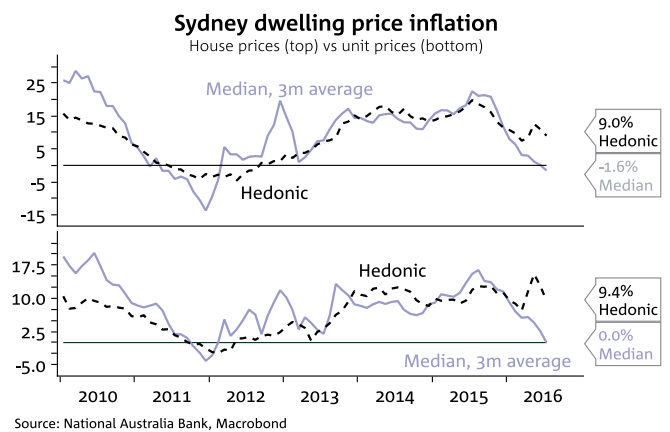
Source: Statement on Monetary Policy, August 2016, RBA

Last week, CoreLogic revealed that it had changed its methodology during April by changing the statistical filters used to construct their hedonic indexes. CoreLogic reported

that as a result of these changes, there was higher than normal intra-month volatility in capital city index readings during April and May, months the hedonic indexes surged in Sydney and Melbourne, and further lifting apparent annual growth rates, stoking concerns of re-accelerating hot markets. Alternative indexes of house prices published by APM and Residex both show slowing rates of house price inflation in the June quarter.

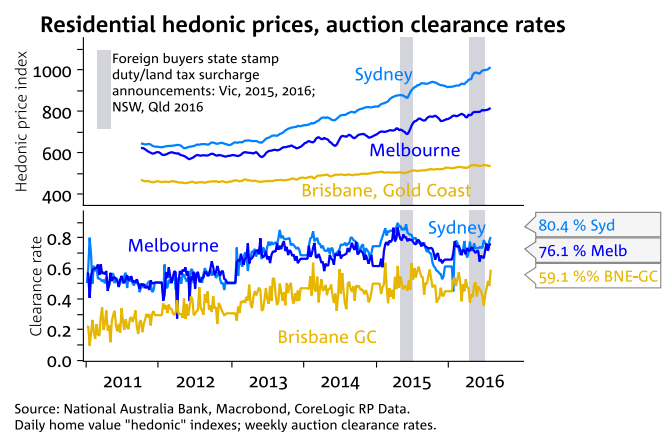
NAB's own analysis shows that use of alternative three month average of CoreLogic's median prices (actual prices and not hedonic indexes) also reveals more temperate house price inflation, especially for Sydney. While the hedonic home values index for Sydney rose by a cumulative 9.1% over the year to July, inflated by the above-mentioned recent rises when the statistical changes took effect, the three-month average of the Sydney median price in year-to terms was virtually flat over the year, rising just by 0.6%. Other major capital city prices reveal much smaller differences.

Chart 3: Sydney housing inflation measures



So far in August and since the rate cut, auction clearance rates have pushed higher. Sydney's clearance rate rose last weekend to 80.4% (the highest since July last year) while Melbourne's clearance rate also rose to 76.1%, the equal highest since February. Of course, higher clearances are reflection of the market clearing at a mutually acceptable price and does not necessarily mean higher prices if vendor expectations are becoming less ambitious.

Chart 4: Auction clearance rates up further in early August



It will be interesting to observe how the various residential property markets evolve in the months and years ahead, not

only across capital cities, but even within capital cities in the face of a tightening in finance conditions for borrowers and developers, the announcement (or in the case of Victoria increases) in State taxes for foreign buyers, and the large increases in supply now in the construction and completion pipeline.

NAB Business Survey, Stevens, RBNZ, and China this week

The key risk events this week include tomorrow's NAB Business survey ahead of Glenn Stevens' speech to the Anika Foundation on Wednesday, his last as Governor. There is no title as yet, though we wouldn't be surprised if the address had some reflections from his time at the RBA and as Governor. Then there is the RBNZ rate announcement on Thursday – when a further cut in their cash rate is expected – and key Chinese industrial production, retail sales and fixed assets investment reports on Friday.

Of course we offer no prospective views on the July NAB Business Survey, just a reminder that the June Survey was undertaken amidst the uncertainty around the Brexit referendum, and ahead of the Australian federal election but improved further. Business confidence jumped in June to +6 index points, consistent with long-run confidence levels. Business conditions also lifted from already elevated levels in prior months to +12 index points in June, around its highest since the GFC. In short, the overall narrative of the survey did not change. It's improved, even in the light of the then evident disruptions.

Note that along with the Survey, NAB will be releasing its latest forecasts for the economy, including views on the RBA in the wake of last week's RBA action and the economic outlook. (The forecasts on page 5 reflect our pre-RBA views.)

Also on the local data front this week is the monthly Westpac-Melbourne Institute Consumer Sentiment survey polled before and after the rate cut, set for release Wednesday along with the June ABS report on Housing Finance Approvals. While the market pays very little attention to Thursday's survey of consumer inflationary expectations, this one for August, it is certainly something that the RBA tracks. In July, the expected inflation rate actually picked up from 3.5% to 3.7%.

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Calendar of Economic Releases

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEST
Monday, 8 August 2016								
NZ	REINZ Housing Report	Jul						release pending
JN	BoP Current Account Adjusted	Jun		1600		1414.5	23.50	9.50
AU	ANZ Job Advertisements MoM	Jul				0.5	1.30	11.30
JN	Bankruptcies YoY	Jul				-7.4	4.30	14.30
JN	Eco Watchers Survey Current/Outlook	Jul		42.5		41.2/41.5	5.00	15.00
GE	Industrial Production SA MoM/YoY	Jun		0.7		-1.3/-0.4	6.00	16.00
CH	Trade Balance CNY	Jul		311.85		311.2	7.00	17.00
CH	Exports/Imports YoY CNY	Jul		2.3		1.3/-2.3	7.00	17.00
CH	Trade Balance	Jul		47.3		48.1	7.30	17.30
CH	Exports/Imports YoY	Jul		-3.5		-4.8/-8.4	7.30	17.30
EC	Sentix Investor Confidence	Aug		3		1.7	8.30	18.30
CH	Foreign Direct Investment YoY CNY	Jul		6.25		9.7	8.45	18.45
CA	Building Permits MoM	Jun		1.5		-1.9	12.30	22.30
CA	Bloomberg Nanos Confidence	Aug 5				59.5	14.00	0.00
US	Labor Market Conditions Index Change	Jul				-1.9	14.00	0.00
Tuesday, 9 August 2016								
NZ	ANZ Truckometer Heavy MoM	Jul				4.7	22.00	8.00
NZ	Electronic Card Transactions MoM	Jul	0.3	0.1		1.2	22.45	8.45
UK	BRC Sales Like-For-Like YoY	Jul		-0.7		-0.5	23.10	9.10
AU	ANZ Roy Morgan Weekly Consumer Confidence Index	Aug 7				118.0	23.30	9.30
AU	NAB Business Conditions/Confidence	Jul				12/6	1.30	11.30
CH	CPI/PPI YoY	Jul		1.8		1.9/-2.6	1.30	11.30
NZ	RBNZ Household Inflation Expectations. 1y ahead median Q3	Jul				2.0	3.00	13.00
JN	Machine Tool Orders YoY	Jul P				-19.9	6.00	16.00
GE	Current Account Balance	Jun		23		17.5	6.00	16.00
UK	Industrial Production MoM/YoY	Jun		0.1		-0.5/1.4	8.30	18.30
UK	Manufacturing Production MoM/YoY	Jun		-0.2		-0.5/1.7	8.30	18.30
UK	Trade Balance	Jun		-2550		-2263.0	8.30	18.30
US	NFIB Small Business Optimism	Jul		94.5		94.5	10.00	20.00
US	Nonfarm Productivity/Unit Labour Costs	2Q P		0.5/1.8		-0.6/4.5	12.30	22.30
CA	Housing Starts	Jul		190		218.3	12.15	22.15
UK	NIESR GDP Estimate	Jul		0.4		0.6	14.00	0.00
US	Wholesale Inventories/Trade Sales MoM	Jun		0/0.5		0.1/0.5	14.00	0.00
US	IBD/TIPP Economic Optimism	Aug				0.0	14.00	0.00
Wednesday, 10 August 2016								
JN	Housing Loans YoY	2Q				1.9	23.50	9.50
JN	Machine Orders MoM/YoY	Jun		3.3		-1.4/-11.7	23.50	9.50
JN	PPI MoM/YoY	Jul		-0.1		-0.1/-4.2	23.50	9.50
AU	Westpac Consumer Conf Index/MoM	Aug				99.1/-3.0	0.30	10.30
AU	Home Loans/Investment lending MoM	Jun	2.1/ ..	2.3/		-1.0/3.9	1.30	11.30
AU	RBA Governor Stevens Speech in Sydney	Jul					3.05	13.05
JN	Tertiary Industry Index MoM	Jun		0.3		-0.7	4.30	14.30
CH	New Yuan Loans/Aggregate financing CNY	Jul		850/1000		1380/1630	10-15 Aug	release
US	MBA Mortgage Applications	Aug 5				-3.5	11.00	21.00
NZ	REINZ House Sales YoY	Jul				6.0		
US	JOLTS Job Openings	Jun		5675		5500.0	14.00	0.00
US	Monthly Budget Statement	Jul		-124		6.3	18.00	4.00
Thursday, 11 August 2016								
NZ	RBNZ Official Cash Rate	Aug 11	2.00	2.00		2.25	21.00	7.00
NZ	Food Prices MoM	Jul	0.7			0.4	22.45	8.45
UK	RICS House Price Balance	Jul		6		16.0	23.10	9.10
AU	Consumer Inflation Expectation	Aug				3.7	1.00	11.00
US	Import Price Index MoM	Jul		-0.4/-4.3		0.2/-4.8	12.30	22.30
US	Initial Jobless Claims	Aug 6		265		269	12.30	22.30
CA	New Housing Price Index MoM	Jun		0.4		0.7/2.7	12.30	22.30
US	Bloomberg Consumer Comfort	Aug 7				43.0	13.45	23.45
Friday, 12 August 2016								
NZ	BusinessNZ Manufacturing PMI	Jul				57.7	22.30	8.30
NZ	Retail Sales Ex Inflation QoQ	2Q	1.1	1		0.8	22.45	8.45
CH	Industrial Production YoY/YTD YoY	Jul		6.2/6		6.2/6.0	2.00	12.00
CH	Retail Sales YoY/YTD YoY	Jul		10.5/10.3		10.6/10.3	2.00	12.00
CH	Fixed Assets Ex Rural YTD YoY	Jul		8.9		9.0	2.00	12.00
GE	CPI EU Harmonized MoM/YoY	Jul F		0.4/0.4		0.4/0.4	6.00	16.00
GE	GDP SA QoQ/YoY	2Q P		0.2/1.4		0.7/1.6	6.00	16.00
UK	Construction Output SA MoM/YoY	Jun		-1		-2.1/-1.9	8.30	18.30
EC	Industrial Production SA MoM/YoY	Jun		0.5		-1.2/0.5	9.00	19.00
EC	GDP SA QoQ/YoY	2Q P		0.3		0.3/1.6	9.00	19.00
US	Retail Sales Advance/Ex Autos and Gas MoM	Jul		0.4		0.6/0.7	12.30	22.30
US	PPI Final Demand MoM/YoY	Jul		0.1/0.3		0.5/0.3	12.30	22.30
CA	Teranet/National Bank HPI MoM/YoY	Jul				2.3/10.0	12.30	22.30
US	Business Inventories	Jun		0.1		0.2	14.00	0.00
US	U. of Mich. Sentiment/5-10 Yr Inflationary Expectations	Aug P		91.5/		90.0/2.6	14.00	0.00
Upcoming Central Bank Interest Rate Announcements								
New Zealand, RBNZ		11-Aug	2.00%	2.00%		2.25%		
Canada, BoC		7-Sep				0.50%		
Australia, RBA		6-Sep	1.50%			1.50%		
Europe ECB		8-Sep				0.00%		
UK BOE		15-Sep				0.25%		
Japan, BoJ		21-Sep				-0.1% to +0.1%		
US Federal Reserve		22-Sep				0.25-0.50%		

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

Forecasts

Economic Forecasts

	Annual % change				Quarterly % change											
					2015				2016				2017			
	2015	2016	2017	2018	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Australia Forecasts																
Household Consumption	2.8	2.8	2.5	2.4	0.6	0.6	0.9	0.8	0.7	0.6	0.7	0.5	0.6	0.6	0.7	0.6
Underlying Business Investment	-10.5	-13.2	-8.0	1.4	-3.3	-2.4	-6.0	-2.7	-3.4	-2.0	-3.2	-3.2	-1.8	-1.8	-1.1	0.1
Residential Construction	9.8	5.5	0.4	-3.5	4.3	1.0	1.5	2.8	1.4	0.6	0.6	0.1	0.2	0.2	-0.8	-0.6
Underlying Public Spending	2.1	2.5	2.6	2.6	1.0	2.4	-0.9	1.4	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Exports	5.9	8.2	9.0	5.4	3.2	-3.4	5.3	0.4	4.4	-0.3	2.3	2.5	2.4	2.3	2.3	1.5
Imports	1.5	-2.3	1.2	3.3	3.4	0.0	-1.7	0.5	-0.8	-1.3	-0.1	0.1	0.5	0.6	0.7	0.8
Net Exports (a)	1.0	2.3	1.8	0.7	0.0	-0.8	1.5	0.0	1.1	0.2	0.6	0.6	0.5	0.4	0.4	0.2
Inventories (a)	0.1	0.0	-0.1	0.0	0.4	0.0	-0.2	0.0	0.1	0.0	0.0	-0.1	0.0	0.0	0.0	0.1
Domestic Demand - qtr %					0.3	0.6	-0.3	0.5	0.1	0.3	0.2	0.1	0.3	0.4	0.4	0.5
Dom Demand - ann %	1.1	0.9	1.2	1.9	0.7	1.4	1.1	1.1	0.9	0.6	1.2	0.8	1.0	1.1	1.2	1.6
Real GDP - qtr %					0.8	0.3	1.0	0.7	1.1	0.3	0.6	0.7	0.8	0.8	0.8	0.8
Real GDP - ann %	2.5	2.9	2.9	2.5	2.3	2.1	2.7	2.9	3.1	3.2	2.8	2.7	2.4	2.9	3.1	3.2
CPI headline - qtr %					0.2	0.7	0.5	0.4	-0.2	0.7	0.9	0.7	0.9	0.5	0.8	0.5
CPI headline - ann %	1.5	1.6	2.9	2.6	1.3	1.5	1.5	1.7	1.3	1.4	1.8	2.1	3.1	2.9	2.8	2.6
CPI underlying - qtr %					0.6	0.5	0.3	0.5	0.2	0.5	0.5	0.5	0.5	0.5	0.4	0.4
CPI underlying - ann %	2.2	1.6	1.9	1.9	2.3	2.2	2.1	2.0	1.5	1.5	1.7	1.7	2.0	1.9	1.9	1.8
Wages (Pvte WPI - ann %)	2.1	1.9	1.9	2.5	2.3	2.2	2.1	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Unemployment Rate (%)	6.0	5.7	5.7	5.8	6.2	6.0	6.2	5.9	5.9	5.7	5.7	5.6	5.6	5.6	5.7	5.7
Terms of trade	-11.5	-6.6	-3.9	-0.6	-2.7	-4.1	-2.8	-3.2	-1.9	2.1	-2.1	-1.8	-1.0	-0.5	-0.4	-1.8
G&S trade balance, \$Abn	-35.9	-24.2	-13.6	-17.6	-5.3	-11.4	-8.3	-10.9	-8.1	-5.7	-5.4	-5.0	-4.4	-3.4	-2.4	-3.4
% of GDP	-2.2	-1.4	-0.8	-1.0	-1.3	-2.8	-2.0	-2.7	-2.0	-1.4	-1.3	-1.2	-1.0	-0.8	-0.5	-0.8
Current Account (% GDP)	-4.8	-4.5	-3.8	-4.0	-3.5	-5.3	-4.8	-5.5	-5.0	-4.4	-4.3	-4.2	-4.1	-3.8	-3.6	-3.8

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

Exchange Rate Forecasts

	8-Aug	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
Majors						
AUD/USD	0.7613	0.72	0.70	0.69	0.69	0.69
NZD/USD	0.7118	0.68	0.66	0.66	0.65	0.66
USD/JPY	102.07	105	105	103	103	102
EUR/USD	1.1103	1.08	1.06	1.05	1.05	1.06
GBP/USD	1.3085	1.28	1.25	1.22	1.20	1.22
USD/CNY	6.6659	6.73	6.80	6.78	6.76	6.74
USD/CAD	1.3168	1.33	1.40	1.40	1.42	1.42

Australian Cross Rates

	8-Aug	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
AUD/JPY	77.7	76	74	71	71	70
AUD/EUR	0.6857	0.67	0.66	0.66	0.66	0.65
AUD/GBP	0.5818	0.56	0.56	0.57	0.58	0.57
AUD/NZD	1.0695	1.06	1.06	1.05	1.06	1.05
AUD/CNY	5.0747	4.85	4.76	4.68	4.66	4.65
AUD/CAD	1.0025	0.96	0.98	0.97	0.98	0.98
AUD/CHF	0.7455	0.72	0.68	0.68	0.70	0.69

Interest Rate Forecasts

	8-Aug	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Aust rates							
RBA Cash rate	1.50	1.75	1.75	1.75	1.75	1.75	1.75
3 month bill rate	1.79	1.95	1.95	1.95	1.95	1.95	1.95
3 Year Swap Rate	1.69	1.7	1.8	1.8	1.8	1.8	2.0
10 Year Swap Rate	2.17	2.1	2.3	2.3	2.4	2.4	2.7
Offshore Policy Rates							
US Fed funds	0.50	0.50	0.75	0.75	1.00	1.25	1.50
ECB deposit rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40
BoE repo rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25
BoJ excess reserves rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
RBNZ OCR	2.25	2.00	1.75	1.75	1.75	1.75	2.00
China 1yr lending rate	4.35	3.85	3.85	3.60	3.60	3.60	3.60
China Reserve Ratio	17.0	16.0	16.0	16.0	16.0	16.0	16.0
10 Year Benchmark Bond Yields							
Australia	1.95	1.95	2.10	2.10	2.25	2.25	2.45
United States	1.59	1.50	1.75	1.75	2.00	2.00	2.25
New Zealand	2.20	2.25	2.35	2.55	2.65	2.75	2.95

Global GDP

Dec year	2013	2014	2015	2016	2017	2018	20 Yr Ave
Australia	2.0	2.7	2.5	2.9	2.9	2.5	3.4
US	1.5	2.4	2.4	1.8	2.1	1.9	2.6
Eurozone	-0.3	0.9	1.5	1.3	1.3	1.5	1.5
UK	2.2	2.9	2.3	1.2	0.6	1.2	2.4
Japan	1.4	-0.1	0.6	0.5	0.6	0.6	0.8
China	7.7	7.3	6.9	6.7	6.5	6.3	9.2
India	6.3	7.0	7.2	7.7	7.7	7.5	6.6
New Zealand	2.4	3.7	2.5	2.9	2.9	1.9	3.0
World	3.3	3.3	3.0	2.8	3.0	3.1	3.5
<i>MTP Top 5</i>	3.9	3.8	3.8	3.6	3.6	3.4	5.0

Commodity prices (\$US)

	8-Aug	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
WTI oil	41.88	45	52	54	56	58	60
Gold	1343	1320	1300	1250	1210	1170	1120
Iron ore	61	44	41	40	41	41	40
Hard cok. coal	89	93	85	83	84	85	85
Thermal coal	65	62	62	62	58	58	58
Copper	4779	4650	4750	4790	4840	4890	4940
Japan LNG	5.9	6.8	7.1	8.0	8.3	8.5	8.6

Under review

Sources: NAB Global Markets Research; Bloomberg; ABS

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