

AUSTRALIAN MARKETS WEEKLY



"Inflation will rise" – The Fed Pressure Index

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- The Fed Pressure Index is warning of rising inflationary pressures in the US. In the past, the Index has been a good guide to Fed tightening cycles and is signaling increased risk of more than the two US interest rate increases that NAB currently forecasts for 2017.
- This week, the RBA's forecasts and February Board meeting are the key Australian events. NAB sees no rate cut in February and also expects the Bank to leave its inflation forecasts unchanged. Governor Lowe's speech early Thursday evening will also be an important scene setter for markets.
- There is some debate about whether the RBA's GDP forecasts will be upgraded or downgraded, given the negative Q3 GDP result, which NAB expects to reverse in Q4 when a circa 1% q/q result is expected.
- We expect some base-effect downgrading of the Bank's near-term GDP forecasts, but would not be surprised to see the Bank describe the medium-term outlook a little more favourably due to the higher terms of trade and somewhat improved global outlook.
- NAB continues to hold a slightly less optimistic view for economic growth for 2018 on account of slower housing construction, a waning contribution to growth from the lower \$A and less strength from resource export growth.

Fed Pressure Index Signalling Upside Risks for US inflation and Interest Rates?

The strength of the Prices Paid Index in the Manufacturing ISM last week prompted me to dust off "The Fed Pressure Index" – the creation of a former colleague, Mr. Mark Jolley. The Fed Pressure Index has a great record of signalling trends for US interest rate policy (Chart 1).

This is by virtue of its component series, Prices Paid and Supplier Deliveries, both of which lead US inflation. After a long period signalling disinflation in the US, both supplier deliveries and prices paid have risen in recent months. To be sure, the rise is being driven more so by increases in prices paid than supplier deliveries at this point, likely reflecting rising commodity prices rather than signalling difficulties supplying demand (the latter would likely be more conducive to increased pricing power (Chart 2, next page).

Together, these indexes are now at levels that have the Fed Pressure Index clearly back in tightening territory. As Chart 3 (next page) shows, the Index also suggests that the PCE deflator will continue to evolve towards the Fed's 2% mandate over the course of this year.

These developments give us strong confidence in NAB's forecast that the Fed will raise US interest rates further in 2017, our forecast calling for two rises. And the risks seem now be tilting toward further interest rate increases, given the likely material stimulus to flow

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Key markets over the past week

	Last	% chg week		Last	bp / % chg week
AUD	0.7680	1.7	RBA cash	1.50	0
AUD/CNY	5.28	1.4	3y swap	2.10	2
AUD/JPY	86.4	0.6	ASX 200	5,622	-1.6
AUD/EUR	0.712	0.8	Iron ore	82.2	-1.4
AUD/NZD	1.050	1.3	WTI oil	53.8	1.2

Source: Bloomberg

Chart 1: Fed Pressure Index

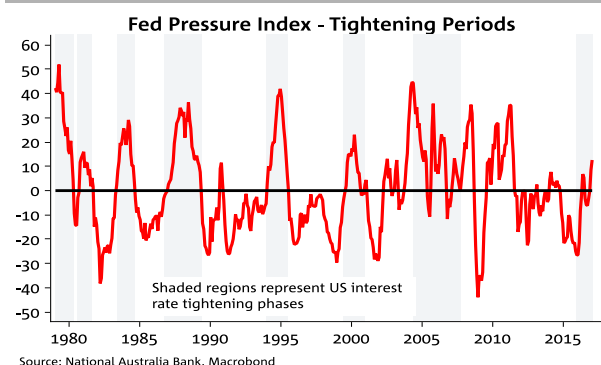


Chart 2: Fed Pressure Index Components

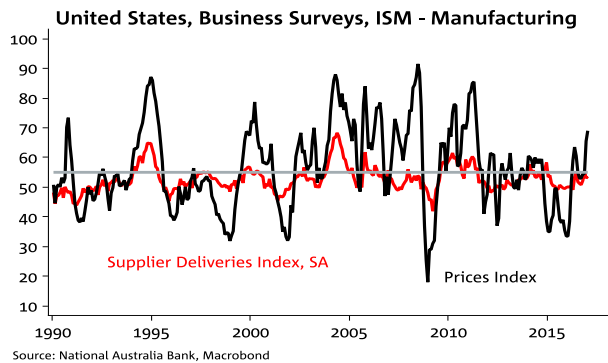
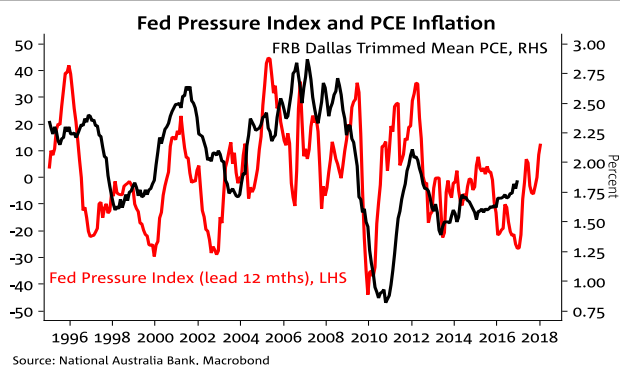


Chart 3: Fed Pressure Index suggesting PCE >2%



to the US economy from President Trump’s proposed company and income tax cuts and infrastructure spending plans.

Fed Chair Yellen’s Taylor Rule

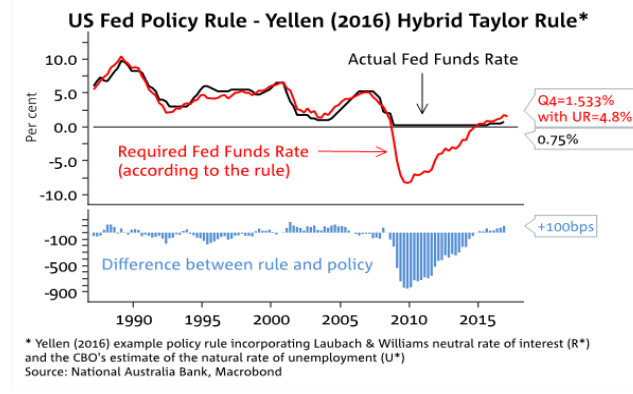
Indeed a number of senior Fed members – including the Chair – have three rate increases as the base case for US interest rate policy this year. This includes San Francisco Fed President Williams (a non-voter this year but seen as a key influencer), who opined that there were some arguments for a March rate rise in the wake of January’s stronger than expected non-farm payrolls release (+227,000) and with the knowledge of the reported downshift in earnings, that runs counter to other similar labour market readings.

Partial indicators of employment such as the Manufacturing and Non-Manufacturing ISM employment questions and the NFIB Small Business Hiring Plans Index, all suggest that non-farm payrolls are likely to print above 200,000 per month over the next few months. This rate of job creation should be sufficient to see the unemployment rate continue to trend down and wages growth strengthen, notwithstanding contrary results for both in the January data. (Rising participation in the January payrolls report might well have reflected more “on the ground” confidence about the improving trend in job opportunities, as reported in last week’s Consumer Confidence Jobs Plentiful Index.

Last year, Fed Chair Yellen introduced a version of the Taylor Rule (technically, based on the CBO’s natural rate of unemployment, currently around 4.8%) and Laubach & Williams neutral rate of interest, currently estimated at 0.2% real). This rule gave a good guide to Fed policy in

the 1990s and 2000s. More importantly, Chair Yellen’s rule implies that the Fed Funds Rate is currently around 75bps lower than it should be! While a little simplistic and theoretical perhaps, it’s a sign that they are not ahead of the curve with the tightening to date.

Chart 4: Taylor rule suggests Fed 75bps behind

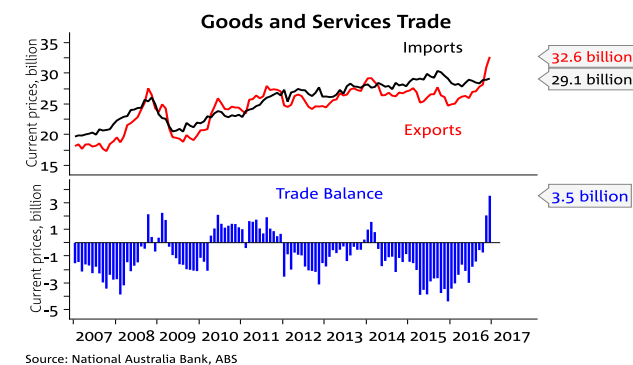


The past week

The highlight of the past week in Australia was the publication of a record monthly trade surplus (Chart 5). This saw the \$A rise sharply on the day and resulted in market talk of stronger Australian growth and reduced chance of further interest rate cuts. The record result reflected the combination of recent higher commodity prices alongside record export volumes.

In offshore economic news, both the Manufacturing and Non-Manufacturing ISMs printed strongly as did January non-farm payrolls. Labour market partials suggest the prospects are broadly for continuing strong non-farm payrolls prints over the months ahead, although we do have to allow for around 20,000 fewer government workers a month in the near-term on account of the new President’s announced hiring freeze.

Chart 5: Record Trade Surplus



This week

The Australian calendar will be RBA-focused this week, with the first Board meeting of the year tomorrow, the RBA Governor speaking at 8pm on Thursday evening and the Bank’s updated forecasts released on Friday in the Quarterly Statement on Monetary Policy.

The main action is the quarterly Statement on Monetary Policy on Friday and what the RBA will do with its growth

and inflation forecasts. These forecasts will be presented at the February Board Meeting tomorrow to inform the Board's monetary policy decision, with some broad comment likely in tomorrow's post meeting Statement.

There is a deal of debate about whether the Bank will downgrade or upgrade its growth forecast and downgrade its inflation forecast or extend the time taken for inflation to return to the band.

The debate on the growth forecasts is on account of: (i) the negative Q3 GDP outcome; (ii) the rise in Australia's terms of trade; and (iii) softer than expected retail sales data. NAB's expectation is that the Bank may revise down its near-term forecasts of GDP due to the base effect of the weak Q3 outcome, however the RBA's medium-term growth outlook may actually be described in slightly more favourable terms due to the higher terms of trade and stronger global outlook, even though NAB's own medium-term forecasts are more pessimistic than the RBA's.

And while the latest wages data was slightly softer than the RBA expected, the Q4 CPI result was at RBA expectations, which together with slightly higher global CPI outcomes and the stronger terms of trade, should allow the Bank's CPI forecasts to remain broadly unchanged. This strongly suggests no cut in interest rates at the February Board Meeting, something that continuing reasonable gains in house prices also argue against.

CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEDT
Monday, 6 February 2017								
NZ	<i>National Holiday – Waitangi Day</i>							
JN	Labor/Real Cash Earnings YoY	Dec		0.4		0.2/-0.2	1.00	11.00
AU	Melbourne Institute Inflation MoM/YoY	Jan				0.5/1.8	1.00	11.00
AU	Retail Sales MoM/ex-Inflation QoQ	Dec	0.4/1.0	0.3/0.9		0.2/-0.1	1.30	11.30
AU	ANZ Job Advertisements MoM	Jan				-1.9	1.30	11.30
GE	Factory Orders MoM/YoY	Dec		0.7/4.2		-2.5/3.0	8.00	18.00
EC	Sentix Investor Confidence	Feb		16.8		18.2	10.30	20.30
EC	ECB's Smets, BIS's Caruana Speak at Conference in Brussels							
CA	Bloomberg Nanos Confidence	Feb 3				56.1	16.00	2.00
US	Fed's Harker Speaks About Payment Systems in San Diego						22.30	8.30
EC	ECB's Draghi speaks to Parliament in Brussels followed by Q&A							
							15.00	1.00
Tuesday, 7 February 2017								
AU	AiG Perf of Construction Index	Jan				47.0	23.30	9.30
AU	ANZ Roy Morgan Weekly Consumer Confidence Index	Feb 5				118.1	23.30	9.30
UK	BRC Sales Like-For-Like YoY	Jan		0.9		1.0	1.10	11.10
CH	Caixin China PMI Services/Composite	Jan		/		53.4/53.5	2.45	12.45
NZ	RBNZ Inflation expectations survey; 2Yr Expectation	1Q				1.7	3.00	13.00
CH	Foreign Reserves	Jan		3000		3010.5	3.45	13.45
AU	RBA Cash Rate Target	Feb 7	1.5	1.5		1.5	4.30	14.30
JN	Leading Index CI	Dec P		105.5		102.8	6.00	16.00
GE	Industrial Production SA MoM/YoY	Dec		0.3/2.5		0.4/2.2	8.00	18.00
UK	Halifax House Prices MoM/YoY	Jan		0		1.7/6.5	9.30	19.30
NZ	GDT Dairy auction, GDT-weighted price index					0.6	<i>early am NZT</i>	
US	Trade Balance	Dec		-45		-45.2	14.30	0.30
CA	Int'l Merchandise Trade	Dec		0.2		0.5	14.30	0.30
CA	Building Permits MoM	Dec		-3		-0.1	14.30	0.30
US	JOLTS Job Openings	Dec		5569		5522.0	16.00	2.00
CA	Ivey Purchasing Managers Index SA	Jan				60.8	16.00	2.00
US	Consumer Credit	Dec		20		24.5	21.00	7.00
Wednesday, 8 February 2017								
NZ	ANZ Truckometer Heavy MoM	Jan				-0.1	22.00	8.00
JN	BOJ Summary of Opinions at Jan. 30-31 Meeting							
JN	BoP Current Account Adjusted	Dec		1709.4		1799.6	0.50	10.50
JN	Eco Watchers Survey Current SA	Jan		51.8		51.4	6.00	16.00
CH	BoP Current Account Balance	4Q P				69.3	8.15	18.15
US	MBA Mortgage Applications	Feb 3				-3.2	13.00	23.00
CH	<i>Foreign Direct Investment YoY CNY</i>							
UK	BoE's Cunliffe speaks in Birmingham			2.75		5.7	<i>8-18 Feb release</i>	
CA	Housing Starts	Jan		200		207.0	14.15	0.15
NZ	RBNZ Official Cash Rate	Feb 9		1.75		1.8	21.00	7.00
Thursday, 9 February 2017								
NZ	RBNZ OCR		1.75	1.76		1.78	21.00	7.00
NZ	Building Permits MoM	Dec				-9.2	22.45	8.45
JN	Housing Loans YoY	4Q				2.7	0.50	10.50
JN	Machine Orders MoM/YoY	Dec		3		-5.1/10.4	0.50	10.50
AU	HIA New Home Sales MoM	Dec				6.1	1.00	11.00
NZ	RBNZ's Wheeler speaks at Parliament on Monetary Policy Statement							
UK	RICS House Price Balance	Jan		22		24.0	1.10	11.10
AU	NAB Business Confidence	4Q				5	1.30	11.30
JN	Machine Tool Orders YoY	Jan P				4.4	7.00	17.00
AU	RBA Governor Lowe Speech in Sydney							
CA	New Housing Price Index MoM/YoY	Dec		0.15		0.2/3.0	14.30	0.30
US	Initial Jobless Claims	Feb 4		249		246.0	14.30	0.30
US	Fed's Bullard (nv) Speaks in St. Louis						15.10	1.10
US	Wholesale Trade Sales/Inventories MoM	Dec		/1		0.4/1.0	16.00	2.00
CA	BOC's Schembri speaks at Western University						17.20	3.20
US	Fed's Evans (v) Speaks on Economy and Policy in Chicago						19.10	5.10
UK	BoE's Carney speaks in London						19.30	5.30
Friday, 10 February 2017								
JN	PPI MoM/YoY	Jan		0.2/0		0.6/-1.2	0.50	10.50
AU	Home Loans, Owner Occupied #/Investment \$, MoM	Dec	-0.1	1		0.9/4.9	1.30	11.30
AU	RBA Statement on Monetary Policy							
CH	Trade Balance	Jan		48.85		40.8	3.45	13.45
CH	Exports/Imports YoY	Jan		3/9.6		-6.1/3.1	3.45	13.45
JN	Tertiary Industry Index MoM	Dec		-0.2		0.2	5.30	15.30
UK	Trade Balance	Dec		-3500		-4167.0	10.30	20.30
UK	Industrial Production MoM/YoY	Dec		0.2/3.2		2.1/2.0	10.30	20.30
UK	Construction Output SA MoM/YoY	Dec		1		-0.2	10.30	20.30
CH	<i>New Yuan Loans/Aggregate financing CNY</i>							
NZ	REINZ House Sales YoY	Jan		2380/3085		1040/1630	<i>10-15 Feb release</i>	
US	Import Price Index/ex Petroleum MoM	Jan				-10.7	<i>10-14 Feb release</i>	
US	Net Change in Employment/Unemployment Rate	Jan		-5/6.9		53.7/6.9	14.30	0.30
UK	NIESR GDP Estimate	Jan				0.5	16.00	2.00
US	U. of Mich. Sentiment/5-10 Yr Inflation Expectations	Feb P		97.8		98.5/2.6	16.00	2.00
US	Monthly Budget Statement	Jan		40		-27.5	20.00	6.00
Saturday, 11 February 2017								
US	Fed's Fischer (v) addresses Economic Conference in the UK							
							13.30	23.30
Upcoming Central Bank Interest Rate Announcements								
Australia, RBA		7-Feb	1.50%	1.50%		1.50%		
New Zealand, RBNZ		9-Feb	1.75%	1.75%		1.75%		
Canada, BoC		2-Mar	0.5%	0.5%		0.5%		
Europe ECB		9-Mar	-0.4%	-0.4%		-0.4%		
US Federal Reserve		16-Mar	0.5-0.75%	0.5-0.75%		0.5-0.75%		
Japan, BoJ		16-Mar	-0.1%	-0.1%		-0.1%		
UK BOE		16-Mar	0.25%	0.25%		0.25%		

GMT: Greenwich Mean Time; AEDT: Australian Daylight Savings Time

FORECASTS

Economic Forecasts																					
	Annual % change				Quarterly % change																
	2015	2016	2017	2018	2015				2016				2017				2018				
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Australia Forecasts																					
Household Consumption	2.7	2.7	2.3	2.1	0.6	0.6	0.9	0.8	0.8	0.5	0.4	0.7	0.6	0.6	0.5	0.5	0.5	0.6	0.5	0.4	0.4
Underlying Business Investment	-10.1	-11.7	-3.9	4.8	-3.3	-2.0	-5.6	-2.1	-3.4	-2.1	-4.5	-1.1	-0.7	-0.6	0.7	1.3	1.5	1.6	0.9	1.7	1.7
Residential Construction	10.0	9.0	2.8	-1.3	5.1	-1.2	3.6	1.8	4.1	2.6	-1.4	2.3	0.2	0.5	0.9	0.5	-0.8	-1.1	-1.0	-0.8	-0.8
Underlying Public Spending	2.4	4.0	2.5	2.6	1.3	1.9	-0.9	1.8	0.7	2.8	-0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7
Exports	6.1	7.0	8.6	6.5	3.4	-2.8	4.2	0.8	2.6	2.1	0.3	2.0	2.8	2.2	2.3	2.1	1.5	1.2	0.8	0.9	0.9
Imports	2.0	0.5	5.6	5.5	2.5	0.8	-1.6	0.5	-0.8	2.9	1.3	1.4	1.1	1.1	1.5	1.5	1.3	1.4	1.1	1.3	1.3
Net Exports (a)	0.8	1.3	0.6	0.3	0.1	-0.7	1.2	0.1	1.0	-0.1	-0.2	0.1	0.4	0.2	0.2	0.1	0.1	0.0	-0.1	-0.1	-0.1
Inventories (a)	0.1	0.1	0.0	-0.1	0.6	-0.4	0.1	0.0	-0.1	0.2	0.2	-0.1	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Domestic Demand - qtr%					0.5	0.5	-0.3	0.6	0.1	0.8	-0.5	0.6	0.4	0.5	0.6	0.6	0.5	0.6	0.4	0.5	0.5
Dom Demand - ann %	1.3	1.5	1.7	2.2	1.1	1.4	1.2	1.3	1.3	1.6	1.5	1.5	1.4	1.0	2.1	2.1	2.3	2.4	2.2	2.1	2.1
Real GDP - qtr %					1.1	0.1	0.8	0.6	1.0	0.6	-0.5	0.9	0.7	0.7	0.7	0.9	0.6	0.6	0.3	0.4	0.4
Real GDP - ann %	2.4	2.4	2.4	2.5	2.1	2.0	2.4	2.6	2.5	3.1	1.8	2.0	1.8	1.8	3.0	3.0	2.9	2.8	2.4	1.9	1.9
CPI headline - qtr %					0.2	0.7	0.5	0.4	-0.2	0.4	0.7	0.5	0.5	0.6	0.7	0.6	0.4	0.6	0.6	0.7	0.7
CPI headline - ann %	1.5	1.3	2.4	2.3	1.3	1.5	1.5	1.7	1.3	1.0	1.3	1.5	2.3	2.5	2.4	2.4	2.3	2.3	2.3	2.4	2.4
CPI underlying - qtr %					0.7	0.5	0.3	0.5	0.2	0.5	0.4	0.4	0.5	0.5	0.5	0.4	0.4	0.5	0.5	0.6	0.6
CPI underlying - ann %	2.2	1.5	1.8	1.9	2.4	2.2	2.1	2.0	1.5	1.5	1.5	1.6	1.8	1.8	1.9	1.9	1.8	1.8	1.8	2.0	2.0
Wages (Pvte WPI - ann %)	2.1	1.9	1.9	2.2	2.2	2.2	2.1	2.0	2.0	2.0	1.9	1.9	2.0	2.0	1.9	1.9	2.0	2.1	2.3	2.4	2.4
Unemployment Rate (%)	6.0	5.7	5.7	5.7	6.2	6.0	6.1	5.9	5.9	5.7	5.6	5.7	5.7	5.7	5.7	5.7	5.6	5.7	5.7	5.8	5.8
Terms of trade	-11.6	-0.6	10.2	-1.8	-2.6	-4.3	-2.6	-3.7	-1.9	2.3	4.5	7.7	6.9	-4.4	-2.8	-3.5	-1.9	-1.8	-2.0	-1.4	-1.4
G&S trade balance, \$Abn	-36.7	-18.5	23.0	-10.7	-4.8	-11.3	-9.0	-11.7	-8.4	-7.4	-4.7	1.9	9.6	6.5	4.8	2.1	0.4	-1.6	-3.9	-5.7	-5.7
% of GDP	-2.2	-1.1	1.3	-0.6	-1.2	-2.8	-2.2	-2.8	-2.0	-1.8	-1.1	0.4	2.2	1.5	1.1	0.5	0.1	-0.3	-0.8	-1.2	-1.2
Current Account (% GDP)	-4.8	-2.8	-0.3	-2.2	-3.3	-5.1	-5.0	-5.6	-3.6	-3.8	-2.7	-1.1	0.6	-0.1	-0.5	-1.1	-1.5	-1.9	-2.4	-2.8	-2.8

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

Exchange Rate Forecasts

	6-Feb	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Majors						
AUD/USD	0.7680	0.73	0.72	0.70	0.70	0.69
NZD/USD	0.7314	0.70	0.68	0.67	0.67	0.68
USD/JPY	112.59	115	115	118	118	120
EUR/USD	1.0783	0.98	1.00	1.02	1.04	1.05
GBP/USD	1.2488	1.18	1.16	1.18	1.20	1.20
USD/CNY	6.8672	7.20	7.24	7.18	7.17	7.18
USD/CAD	1.3021	1.33	1.35	1.37	1.37	1.37

	6-Feb	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Australian Cross Rates						
AUD/JPY	86.5	84	83	83	83	83
AUD/EUR	0.7122	0.74	0.72	0.69	0.67	0.66
AUD/GBP	0.6150	0.62	0.62	0.59	0.58	0.58
AUD/NZD	1.0500	1.04	1.06	1.04	1.04	1.01
AUD/CNY	5.2740	5.26	5.21	5.03	5.02	4.95
AUD/CAD	1.0000	0.97	0.97	0.96	0.96	0.95
AUD/CHF	0.7622	0.71	0.69	0.74	0.74	0.73

Interest Rate Forecasts

	6-Feb	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Aust rates						
RBA Cash rate	1.50	1.50	1.25	1.00	1.00	1.00
3 month bill rate	1.77	1.50	1.25	1.25	1.25	1.25
3 Year Swap Rate	2.11	2.0	2.0	2.1	2.2	2.5
10 Year Swap Rate	3.03	3.0	3.0	3.0	3.0	3.3
Offshore Policy Rates						
US Fed funds	0.75	0.75	1.00	1.00	1.25	1.25
ECB deposit rate	-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
BoJ excess reserves rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
RBNZ OCR	1.75	1.75	1.75	1.75	1.75	1.75
China 1yr lending rate	4.35	4.35	4.10	4.10	4.10	4.10
China Reserve Ratio	17.0	17.0	16.5	16.5	16.5	16.5
10 Year Benchmark Bond Yields						
Australia	2.79	2.75	2.80	2.75	2.70	2.70
United States	2.46	2.40	2.50	2.50	2.50	2.50
New Zealand	3.39	3.25	3.30	3.35	3.30	3.30

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP

Dec year	2013	2014	2015	2016	2017	2018	20 Yr Avg
Australia	2.1	2.8	2.4	2.4	2.4	2.5	3.4
US	1.7	2.4	2.6	1.6	2.1	2.4	2.6
Eurozone	-0.3	1.1	1.9	1.6	1.5	1.6	1.5
UK	1.9	3.1	2.2	2.0	1.3	1.6	2.4
Japan	2.0	0.3	1.2	1.0	0.8	0.6	0.8
China	7.7	7.3	6.9	6.6	6.5	6.3	9.2
India	6.3	7.0	7.2	7.4	7.5	7.5	6.6
New Zealand	2.4	3.8	2.5	3.4	3.2	2.4	3.0
World	3.4	3.4	3.1	2.9	3.2	3.3	3.5
MTP Top 5	4.1	3.9	4.0	3.7	3.7	3.6	5.0

Commodity prices (\$US)

	6-Feb	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
WTI oil	53.83	54	56	58	59	60
Gold	1219	1170	1150	1140	1130	1110
Iron ore	82.2	66	63	60	58	56
Hard cok. coal	168	215	180	150	125	115
Thermal coal	83	65	65	65	65	60
Copper	5760	5670	5620	5620	5620	5620
Aust LNG (#N/A Invalid Security)		7.9	8.3	8.5	8.9	9.2

(*) Implied Australian LNG export prices.

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