

AUSTRALIAN MARKETS WEEKLY

The Labour Market and Monetary Policy



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- The pace and extent of the reduction in unemployment and underemployment plus the progress of inflation back to the RBA's 2-3% target band are key for when the RBA begins to normalise Australian interest rates. This is unlikely to be this year unless unemployment begins to fall sharply soon.
- RBA Deputy-Governor confirms discussion of neutral rate was of no significance to current monetary policy decision. What is significant is that (i) the RBA's view of the economy continues to shift more favourably; and (ii) from a longer-term perspective, the current 1.5% cash rate is 200bps below the RBA's view of neutral..
- This week's key events include: (i) Fed meeting (no change in rates expected); (ii) Q2 CPI (core inflation expected to have bottomed at around 0.4/0.5% q/q); and (iii) RBA Governor's speech on "The Labour Market and Monetary Policy:" which is likely to underline the importance of a reduction in unemployment and underemployment for the normalisation of Australian interest rates. A good guide post may be when the unemployment rates is at 5.25% headed towards 5.0%, however inroads into underemployment are also likely to be important given this measure has been more elevated relative to unemployment in this cycle.

The Labour Market and Monetary Policy

RBA Governor Phil Lowe speaks on Wednesday at the NAB-ABE-Anika Foundation lunch on "The Labour Market and Monetary Policy". The speech will likely offer further clues that will help inform the market about the likely course of Australian short-term interest rates after a volatile week at the short end of Australian interest rate markets. In this weekly, we review our thinking on the importance of recent developments and comments by the Bank.

The release of the July Board Minutes last Tuesday set the monetary policy hares running for an earlier-than-expected rate hike, largely as a result of the Board's discussion of the neutral rate being 1% real in Australia (or 3.5% nominal). This was read as possibly signalling a change in monetary policy intentions by the RBA, although a subsequent speech by Deputy Governor Debelle revealed that the discussion had no significance to the current monetary policy decision, but was simply one of a number of regular deep-dives undertaken by the Board on medium-term issues relevant to the setting of policy.

That said, the Minutes again reveal a more positive outlook by the RBA on the economy, suggesting the monetary policy pendulum continues to shift away from further easing and toward the next move in rates being upward.

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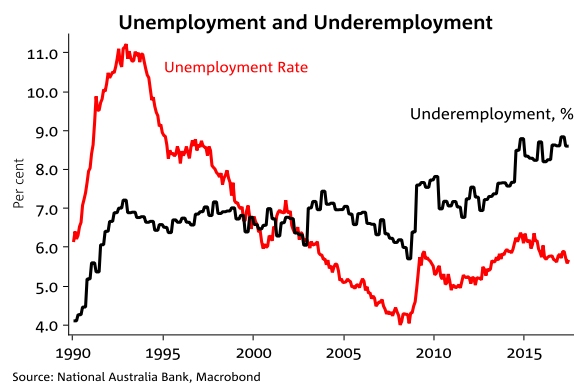
[Ask the Interest Rate Strategists](#)

Key markets over the past week

	Last	% chg week		Last	bp / % chg week
AUD	0.7919	1.5	RBA cash	1.50	0
AUD/CNY	5.36	1.1	3y swap	2.09	1
AUD/JPY	87.9	-0.1	ASX 200	5,665	-1.5
AUD/EUR	0.679	-0.6	Iron ore	67.1	2.1
AUD/NZD	1.064	-0.3	WTI oil	45.7	-1.1

Source: Bloomberg

Chart of the week: Un/underemployment key



The Deputy-Governor also provided a number of other important inputs into the monetary policy discussion noting that: (i) Australia did not have to automatically follow foreign central banks in tightening interest rates because the RBA had not taken interest rates as low as foreign central banks in the aftermath of the Global Financial Crisis; and (ii) Australian monetary policy is primarily focused on domestic policy requirements, though elsewhere the Deputy Governor did note that currency developments had played a role in Australian economic and policy developments.

Thinking about the domestic policy priorities of the Bank and the current stance of policy should give some important guidelines as to how Australian monetary policy may evolve. The domestic policy priorities are clearly: (i) to return inflation to the RBA's 2-3% inflation target across time; (ii) to reduce unemployment and underemployment (something that can arguably receive "greater focus" while inflation is below target); and (iii) to ensure that policy settings do not contribute to medium-term distortions or a build-up in financial risks, though macro-prudential policy has of course been used to complement monetary policy in this regard given the overall requirement for looser Australian policy.

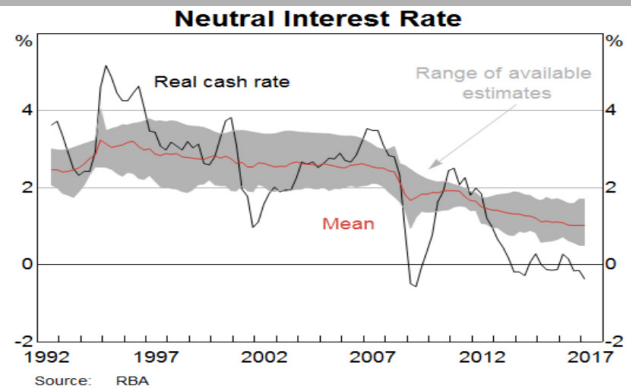
This week's Q2 CPI is likely to support the view that core inflation in Australia has bottomed at around the 0.4/0.5% q/q rate, which will be pleasing for the RBA. These core rates may well rise a little in coming quarters given sharply higher energy prices from Q3. However, a sustainable rise in wages and therefore core inflation is likely to require a reduction in unemployment and more importantly in underemployment as the latter has been elevated relative to unemployment in this cycle (see Chart of the Week on the front page).

NAB suspects that the pace and extent of reduction in unemployment and underemployment will likely prove important in assessing when the RBA will begin to remove monetary policy accommodation. As reported in a recent AMW, IMF Research found that underemployment had accounted for much of the moderation in wages growth in this cycle]. Last week's employment data reports employment growth of around 26,000 per month in trend terms. If sustained, this should be sufficient to reduce the unemployment rate across time, especially if population ageing reduces the participation rate a little each year as we suspect.

The degree of accommodation is also a relevant consideration. As inflation moves back towards target and underemployment falls, the RBA, like other central banks, will want to shift interest rates back to a more neutral setting. The July Minutes provided the information that the RBA currently sees policy around 2% accommodative (being the difference between the Bank's nominated 3.5% neutral nominal cash rate and the current 1.5% cash rate). [NAB would see the neutral rate a little lower than this and therefore assess policy as a little less accommodative, but acknowledges that these estimates are not precise] (see Chart 1).

Two important conclusions then: (i) it seems increasingly likely that the next move in interest rates will be an increase; (ii) the pace and extent of the reduction in unemployment and underemployment – along with the progress of core inflation back in to the 2-3% target band – are likely to be key in assessing when the RBA will

Chart 1: RBA sees Australian neutral real cash rate 1%



begin to normalise Australian interest rates. This seems most unlikely to be this year unless the unemployment rate begins to fall sharply soon and clear signs wages growth has bottomed.

Week ahead: CPI, Lowe speaks, Fed meets, US and UK GDP

There's yet more RBA focus this week with Governor Lowe speaking on the labour market and monetary policy on Wednesday at the NAB-ABE-Anika Foundation lunch in Sydney. Very policy relevant. Australia's Q2 CPI is also due on Wednesday.

The CPI is expected to be close to both last quarter's year-to readings and also within close sight of the RBA's May Statement on Monetary Policy forecasts. NAB estimates headline inflation of 0.4%/2.1%, the same as market expectations, with core inflation expected to print at 0.5% q/q/1.6% y/y, again right in line with the consensus and the RBA's May forecast of 1.75%.

Holding back headline inflation has been a 2.6% decline in automotive fuel prices, still subdued growth in rents (though these are higher than previous quarters which reduces the risk of a downside core surprise), flat to declining Recreation and Culture prices with cuts to audio visual, computing, and domestic holiday travel. Against those drags, Food prices are expected to have risen 0.8% overall, fruit and vegetable prices sharply higher on the back of lower post-Cyclone Debbie supplies.

Second on Wednesday is the speech from RBA Governor Lowe, speaking on "The Labour Market and Monetary Policy" at the NAB-ABE-Anika Foundation lunch in Sydney. This is presumably another opportunity to draw out the RBA's assessment of how much slack there is in the labour market and hence the medium-term outlook for policy, wages and inflation.

Offshore, the US and UK both release first looks at Q2 GDP. While the FOMC is almost certain to leave rates on hold, there is going to be interest in whether the post-meeting statement makes explicit that the beginning of the normalisation of the balance sheet is expected to be "relatively soon" (the phrase Fed Chair Yellen used at here press conference) or even "soon" as opposed to "this year", the phrase in the formal June Statement. This will not only indicate likely timing (at the 20 September meeting) but also the Fed's reading of the economy's progress and outlook. Its summary of inflation and characterisation of its medium term outlook will also be important aspects to follow.

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CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEST
Monday, 24 July 2017								
JN	Nikkei Japan PMI Mfg	Jul P				52.4	1.30	10.30
IMF	IMF releases World Economic Outlook forecasts for IMF Spring meetings held in Kuala Lumpur, Malaysia						4.00	13.00
JN	Leading Index CI	May F				104.7	6.00	15.00
GE	Markit/BME Germany Manufacturing PMI	Jul P		59.2		59.6	8.30	17.30
GE	Markit Germany Services/Composite PMI	Jul P		54.3/56.3		54.0/56.4	8.30	17.30
EC	Markit Eurozone Manufacturing PMI	Jul P		57.2		57.4	9.00	18.00
EC	Markit Eurozone Services/Composite PMI	Jul P		55.4/56.2		55.4/56.3	9.00	18.00
OPEC	OPEC/Non-OPEC Monitoring Committee meets in St. Petersburg to discuss progress with production cuts							
CA	Wholesale Trade Sales MoM	May		0.5		1.0	13.30	22.30
CH	Conference Board Leading Economic Index	Jun					14.00	23.00
US	Markit US Manufacturing PMI	Jul P		52.2		52.0	14.45	23.45
US	Markit US Services/Composite PMI	Jul P		54/		54.2/53.0	14.45	23.45
CA	Bloomberg Nanos Confidence	Jul 21				58.2	15.00	0.00
US	Existing Home Sales, #/MoM	Jun		5.57/-0.89		5.6/1.1	15.00	0.00
EC	ECB's Director General for Economics Frank Smets Speaks in Munich on the ECB's Monetary Policy since 2014						17.00	2.00
Tuesday, 25 July 2017								
AU	ANZ Roy Morgan Weekly Consumer Confidence Index	Jul 23				112.5	0.30	9.30
JN	BOJ Minutes of June 15-16 Meeting						0.50	9.50
GE	IFO Business Climate	Jul		114.9		115.1	9.00	18.00
GE	IFO Current Assessment/Expectations	Jul		123.8/106.5		124.1/106.8	9.00	18.00
UK	CBI Business Optimism	Jul		0		1.0	11.00	20.00
UK	CBI Trends Total Orders/Selling Prices	Jul		12/20		16.0/23.0	11.00	20.00
US	FHFA House Price Index MoM	May		0.5		0.7	14.00	23.00
US	S&P CoreLogic CS 20-City MoM SA/YoY	May		0.3/5.8		0.3/5.7	14.00	23.00
US	Conf. Board Consumer Confidence	Jul		116		118.9	15.00	0.00
US	Richmond Fed Manufact. Index	Jul		7		7.0	15.00	0.00
Wednesday, 26 July 2017								
NZ	Trade Balance NZD	Jun		100		103	23.45	8.45
JN	PPI Services YoY	Jun		0.8		0.7	0.50	9.50
AU	Skilled Vacancies MoM	Jun				1.2	2.00	11.00
AU	CPI QoQ/YoY	2Q	0.4/2.1	0.4/2.2		0.5/2.1	2.30	11.30
AU	CPI Trimmed Mean QoQ/YoY	2Q	0.5/1.7	0.5/1.8		0.5/1.9	2.30	11.30
AU	CPI Weighted Median QoQ/YoY	2Q	0.4/1.6	0.5/1.7		0.4/1.7	2.30	11.30
JN	BOJ Nakaso speaks in Hiroshima						2.30	11.30
AU	RBA's Lowe Speech in Sydney: "The Labour Market and Monetary Policy"						4.05	13.05
JN	Small Business Confidence	Jul		49.8		49.2	6.00	15.00
UK	BBA Loans for House Purchase	Jun		39900		40347.0	9.30	18.30
UK	GDP QoQ/YoY	2Q A		0.3/1.7		0.2/2.0	9.30	18.30
UK	Index of Services MoM/ 3M/3M	May		0.1/0.4		0.2/0.2	9.30	18.30
US	Donald Trump Jr and Trump campaign advisor Paul Manafort appear before Senate Judiciary Committee							
US	New Home Sales, #/Mom	Jun		615/0.8		610/2.9	15.00	0.00
US	FOMC Rate Decision (Lower/Upper Bound)	Jul 26	1.00/1.25	1/1.25		1.00/1.25	19.00	4.00
Thursday, 27 July 2017								
NZ	Household Living Cost Index	2Q						
CH	Swift Global Payments CNY	Jun				1.6	2.00	11.00
AU	Export/Import Price Index QoQ	2Q		-5.5/0.7		9.4/1.2	2.30	11.30
CH	Industrial Profits YoY	Jun				16.7	2.30	11.30
GE	GfK Consumer Confidence	Aug		10.6		10.6	7.00	16.00
UK	CBI Retailing/Total Dist. Reported Sales	Jul		10/15		12/17	11.00	20.00
US	Durable Goods Orders	Jun P		3.5/0.3		-0.8/0.2	13.30	22.30
US	Initial Jobless Claims	Jul 22		240		233.0	13.30	22.30
US	Advance Goods Trade Balance	Jun		-65		-65.9	13.30	22.30
US	Wholesale/Retail Inventories MoM	Jun P		0.3/		0.4/0.6	13.30	22.30
US	Chicago Fed Nat Activity Index	Jun		0.35		-0.3	13.30	22.30
US	Bloomberg Consumer Comfort	Jul 23				47.6	14.45	23.45
US	Fed nominee Quarles confirmation hearing at Senate Banking						15.00	0.00
CA	CFIB Business Barometer	Jul				60.9		
US	Kansas City Fed Manf. Activity	Jul		11.5		11.0	16.00	1.00
Friday, 28 July 2017								
UK	GfK Consumer Confidence	Jul		-11		-10.0	0.10	9.10
JN	Jobless Rate/Jobs-To-Applicants Ratio	Jun		3/1.5		3.1/1.5	0.30	9.30
JN	Overall Household Spending YoY	Jun		0.5		-0.1	0.30	9.30
JN	Natl CPI YoY	Jun		0.4		0.4	0.30	9.30
JN	Natl CPI Ex Fresh Food/Ex Fresh Food, Energy YoY	Jun		0.4/-0.1		0.4/0.0	0.30	9.30
JN	Tokyo CPI YoY	Jul		0.1		0.0	0.30	9.30
JN	Tokyo CPI Ex-Fresh Food/Ex Fresh Food YoY	Jul		0.1/-0.1		0.0/-0.2	0.30	9.30
JN	BOJ Summary of Opinions at July 19-20 Meeting						0.50	9.50
JN	Retail Sales MoM/YoY	Jun		0.4/2.3		-1.6/2.0	0.50	9.50
AU	PPI QoQ/YoY	2Q		/		0.5/1.3	2.30	11.30
EC	Business Climate Indicator	Jul		1.14		1.2	10.00	19.00
GE	CPI EU Harmonized MoM/YoY	Jul P		0.3/1.4		0.2/1.5	13.00	22.00
US	Employment Cost Index	2Q		0.6		0.8	13.30	22.30
US	GDP revised from 2014-16; reference yr remains 2009						13.30	22.30
US	GDP Annualized QoQ	2Q A		2.5		1.4	13.30	22.30
CA	GDP MoM/YoY	May		0.2/4.2		0.2/3.3	13.30	22.30
US	U. of Mich. Sentiment/5-10 Yr Inflation Expectations	Jul F		93.1/		93.1/2.6	15.00	0.00
US	Fed's Kashkari Speaks at Townhall Event						18.20	3.20
Upcoming Central Bank Interest Rate Announcements								
US	Federal Reserve	27-Jul	1.00-1.25%	1.00-1.25%		1.00-1.25%		
Australia, RBA		1-Aug	1.50%	1.50%		1.50%		
UK	BOE	3-Aug				0.25%		
New Zealand, RBNZ		10-Aug	1.75%	1.75%		1.75%		
Canada, BoC		6-Sep				0.75%		
Europe	ECB	7-Sep	-0.4%	-0.4%		-0.4%		
Japan, BoJ		21-Sep	-0.1%	-0.1%		-0.1%		

GMT: Greenwich Mean Time; AEST: Australian Eastern Standard 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	
Australia Forecasts																	
Household Consumption	2.7	2.6	2.6	2.1	0.6	0.6	0.9	0.6	0.8	0.5	0.3	1.0	0.5	0.8	0.6	0.6	0.5
Underlying Business Investment	-10.0	-11.5	-1.3	3.4	-3.2	-1.8	-5.1	-2.6	-3.4	-2.1	-4.9	1.3	0.4	-0.5	0.8	0.9	1.2
Residential Construction	10.1	7.6	-2.0	0.7	4.9	-1.3	4.8	0.7	4.0	1.4	-1.2	1.9	-4.4	1.5	0.2	0.2	0.4
Underlying Public Spending	2.6	4.6	2.7	2.7	1.1	1.9	-0.8	2.3	0.5	2.9	-0.3	0.9	0.5	0.7	0.5	0.8	0.7
Exports	6.0	7.9	6.7	6.1	3.3	-2.9	4.8	0.3	2.7	2.0	1.4	3.7	-1.6	2.6	3.5	2.2	0.8
Imports	2.0	0.2	6.3	4.0	2.1	1.1	-1.2	0.1	-0.8	3.4	0.8	1.9	1.6	1.4	1.1	1.1	1.0
Net Exports (a)	0.7	1.5	0.1	0.5	0.2	-0.8	1.2	0.0	1.1	-0.3	0.1	0.4	-0.7	0.3	0.5	0.3	0.0
Inventories (a)	0.1	0.1	0.0	-0.1	0.7	-0.3	-0.1	0.0	-0.1	0.3	0.2	-0.4	0.5	-0.4	0.0	0.1	0.0
Domestic Demand - qtr%					0.5	0.6	-0.1	0.6	0.1	0.8	-0.5	1.1	0.3	0.7	0.5	0.6	0.6
Dom Demand - ann %	1.3	1.5	2.1	2.3	1.1	1.4	1.3	1.4	1.4	1.6	1.2	1.8	1.7	1.6	2.7	2.2	2.5
Real GDP - qtr %					1.0	0.2	0.9	0.5	0.9	0.7	-0.4	1.1	0.3	0.5	1.1	0.9	0.5
Real GDP - ann %	2.4	2.5	2.3	2.7	2.5	2.0	2.5	2.6	2.5	3.1	1.8	2.4	1.7	1.5	3.0	2.8	3.1
CPI headline - qtr %					0.2	0.7	0.5	0.4	-0.2	0.4	0.7	0.6	0.4	0.4	1.1	0.7	0.5
CPI headline - ann %	1.5	1.3	2.3	2.5	1.3	1.5	1.5	1.7	1.3	1.0	1.3	1.5	2.1	2.1	2.4	2.6	2.6
CPI underlying - qtr %					0.6	0.5	0.4	0.5	0.2	0.5	0.4	0.5	0.4	0.5	0.5	0.4	0.5
CPI underlying - ann %	2.2	1.6	1.8	2.0	2.4	2.2	2.2	2.0	1.6	1.6	1.6	1.6	1.9	1.8	1.9	1.8	1.9
Wages (Pvte WPI - ann %)	2.1	1.9	1.9	1.9	2.2	2.2	2.1	2.0	2.0	2.0	1.9	1.8	2.0	2.0	1.9	1.8	1.8
Unemployment Rate (%)	6.0	5.7	5.6	5.5	6.1	6.0	6.2	5.9	5.8	5.7	5.7	5.6	5.9	5.5	5.5	5.5	5.5
Terms of trade	-11.7	0.1	9.2	-1.4	-2.0	-4.3	-2.8	-4.1	-1.9	2.5	4.3	9.5	6.6	-6.6	-4.1	-1.7	-1.6
G&S trade balance, \$Abn	-36.6	-12.6	17.9	-7.0	-4.4	-11.2	-9.0	-12.1	-8.0	-7.3	-3.4	6.1	9.2	4.1	2.6	2.0	0.3
% of GDP	-2.2	-0.7	1.0	-0.4	-1.1	-2.8	-2.2	-2.9	-1.9	-1.7	-0.8	1.4	2.1	0.9	0.6	0.5	0.1
Current Account (% GDP)	-4.7	-2.6	-1.9	-3.5	-3.2	-5.1	-5.0	-5.6	-3.5	-3.8	-2.6	-0.8	-0.7	-2.0	-2.4	-2.5	-3.0

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

Exchange Rate Forecasts

	24-Jul	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
Majors						
AUD/USD	0.7919	0.73	0.70	0.70	0.70	0.70
NZD/USD	0.7442	0.71	0.68	0.68	0.68	0.69
USD/JPY	110.99	114	118	120	120	122
EUR/USD	1.1670	1.17	1.15	1.17	1.18	1.20
GBP/USD	1.3009	1.28	1.27	1.28	1.28	1.26
USD/CNY	6.7643	6.81	6.82	6.81	6.81	6.80
USD/CAD	1.2544	1.33	1.37	1.35	1.34	1.33
USD/CHF	0.9463	0.97	0.96	1.06	1.01	0.97

Australian Cross Rates

	24-Jul	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
AUD/NZD	1.0641	1.03	1.03	1.03	1.03	1.01
AUD/JPY	87.9	83	83	84	84	85
AUD/EUR	0.6786	0.62	0.61	0.60	0.59	0.58
AUD/GBP	0.6087	0.57	0.55	0.55	0.55	0.56
AUD/CNY	5.3566	4.97	4.77	4.77	4.77	4.76
AUD/CAD	0.9934	0.97	0.96	0.95	0.94	0.93
AUD/CHF	0.7494	0.71	0.67	0.74	0.71	0.68

Interest Rate Forecasts

	24-Jul	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
Australia Rates						
RBA Cash rate	1.50	1.50	1.50	1.50	1.50	1.50
3 month bill rate	1.69	1.75	1.75	1.75	1.75	1.75
3 Year Swap Rate	2.09	2.0	2.3	2.6	2.6	2.5
10 Year Swap Rate	2.87	2.9	3.1	3.4	3.4	3.3
Offshore Policy Rates						
US Fed funds	1.25	1.25	1.50	1.75	2.00	2.00
ECB deposit rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30
BoE repo rate	0.25	0.25	0.25	0.50	0.50	0.50
BoJ excess reserves rate	-0.10	-0.10	-0.10	-0.10	-0.10	0.90
RBNZ OCR	1.75	1.75	1.75	1.75	2.00	2.25
China 1yr lending rate	4.35	4.10	4.10	4.10	4.10	4.10
China Reserve Ratio	17.0	16.5	16.5	16.5	16.5	16.5
10-year Benchmark Bond Yields						
Australia	2.67	2.65	2.85	3.10	3.05	2.95
United States	2.23	2.50	2.75	3.00	3.00	3.00
New Zealand	2.91	2.90	3.10	3.35	3.40	3.50

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	2.5	2.3	2.7	3.4
US	1.7	2.4	2.6	1.6	2.1	2.3	2.6
Eurozone	-0.2	1.3	1.9	1.7	2.0	1.9	1.5
UK	1.9	3.1	2.2	1.8	1.6	1.6	2.4
Japan	2.0	0.2	1.1	1.0	1.2	1.0	0.8
China	7.7	7.3	6.9	6.7	6.5	6.3	9.2
India	6.1	7.0	7.5	7.9	7.3	7.2	6.6
New Zealand	2.2	3.4	2.5	3.1	2.5	3.1	3.0
World	3.4	3.5	3.2	3.1	3.3	3.5	3.5
MTP Top 5	4.1	3.9	4.0	3.8	3.8	3.7	5.0

Commodity prices (\$US)

	24-Jul	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
WTI oil	45.73	54	56	58	59	60
Gold	1254	1210	1220	1230	1240	1260
Iron ore	67.1	65	61	60	58	60
Hard cok. coal	164	210	160	140	120	110
Thermal coal	86	81	81	81	81	65
Copper	5983	5610	5550	5550	5550	5550
Aust LNG (*)	6.99	7.9	8.3	8.5	8.9	9.2

(*) Implied Australian LNG export prices.

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