

AUSTRALIAN MARKETS WEEKLY

Wages key to inflation and monetary policy

In this issue

Wages key to inflation and monetary policy	1
Calendar of economic releases	4
Forecasts	5

- Market volatility steadies last week as equity markets make some gains. The AUD opens the week at 0.79.
- Employment grows further in January, extending the run of continuous employment growth to a record 16 months. Even so, the unemployment rate was 5.5%, still well above the presumed “full employment” rate of ~5%. The labour market still retains a degree of spare capacity, suggesting no immediate undue pressure on wage growth.
- Last week’s NAB Business Survey for January revealed strong business conditions (at near-record levels), building business confidence at above-average levels, and rising capacity utilisation. Despite such still-positive growth metrics, the Survey reported steady annual labour costs growth at 4%, mainly we suspect from increased staffing numbers, confirmed by the ABS Labour Force release. (Employment growth was steady at 3.3% over the year to January.)
- Most attention on the local economy this week will be on wages growth, with the Statistician releasing its Wage Price Index (WPI) for the December quarter. We preview this release in the Weekly as well as discussing the evolving outlook for wages growth, a very important element of the inflation story.
- NAB expects another steady quarter of 0.5% growth in the WPI, for annual growth of 2.0%. Such an annual rate is below the growth rate that would see inflation sustainably move into the middle of the RBA’s 2-3% inflation target range.
- Last quarter saw steady quarterly wages growth at 0.5% q/q, 2.0% y/y, despite the flow through of the 1 July 3.3% Minimum Wage increase. More of that impact could flow through this quarter; then we’d expect a wage increase more than 0.5% q/q. Q3 was below the market’s and RBA expectations. At 2%, wages growth is still well below the RBA’s 3½% wages growth yardstick that’s consistent with 2½% inflation target.
- Also out this week are the RBA Minutes (considered we’ve heard a lot from the RBA recently) and Construction Work Done set for a large fall that’s more statistical in nature as last quarter was bloated by significant LNG platform imports.

RBA looking for 3½% wages growth as consistent with the 2-3% inflation target

The macro growth story continues to unfold positively. That was reflected both by the January NAB Business Survey and Labour Force report released last week. Employment growth remains strong though, to now, wages growth remains contained. RBA Governor Lowe was asked about wages and the Bank’s inflation target at his Parliamentary testimony on Friday. In Dr. Lowe’s view: “If we’re going to deliver average inflation of 2½ per cent we should probably have average wage increases over long periods of time at 3½ per cent, if we can get decent productivity growth. My concern was that we were getting used to - and we didn’t like it - wage increases of two to 2½ per cent. I’ve spoken publicly about the benefits of a pick-up in wage growth, to try to lift wage expectations and to reduce the probability of us getting stuck at this very low equilibrium.” The Bank will be watching data closely though it’s likely early to expect much of a pick-up given elevated unemployment.

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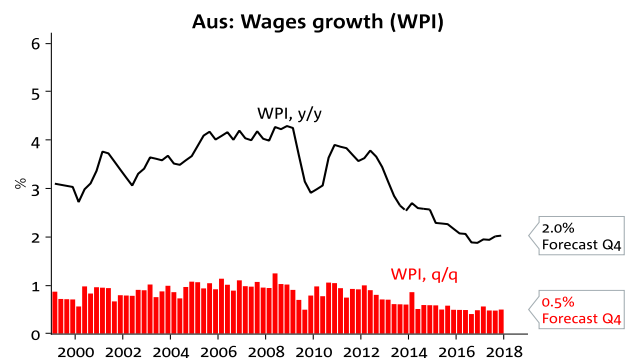
[Ask the Interest Rate Strategists](#)

Key markets over the past week

	Last	% chg week		Last	bp / % chg week
AUD	0.7934	1.3	RBA cash	1.50	0
AUD/CNY	5.03	1.5	3y swap	2.23	3
AUD/JPY	84.2	-1.1	ASX 200	5,934	1.9
AUD/EUR	0.639	0.0	Iron ore	78.4	1.6
AUD/NZD	1.071	-0.9	WTI oil	62.4	5.2

Source: Bloomberg

Chart of the week: Another quarter of contained wages



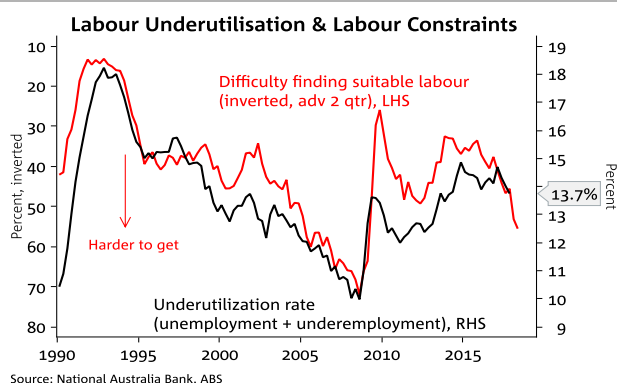
RBA counsels “time and patience” needed before wages growth adjusts higher

The Governor went on to say: “So, lifting wage expectations over time and having the labour market grow sufficiently tightly and strongly so that it creates more pressure with tightness means wages eventually adjust. That basic model still works, but it's taking time and patience is called for here.” At this point, the RBA expects there is time on their side from a monetary policy perspective.

A precondition for wages to increase is to see some further reduction in the economy's spare capacity, especially in the labour market. The unemployment rate was 5.5% in January (down marginally in the month from an upwardly-revised 5.6% in December), but only a moderate 0.2% points lower from 5.7% a year earlier, despite very strong employment growth. Unemployment hardly budged thanks to nearly as fast growth in labour supply as in employment.

NAB's economic growth forecasts call for the unemployment rate to fall to 5.1% by the end of this year, largely we expect establishing that wages acceleration pre-condition.

Chart 1: Increased difficulty finding suitable labour



Businesses reported in the December quarter NAB Business Survey increased difficulty of finding suitable labour, a trend usually associated with a reduction in spare capacity in the labour market. Chart 1 above suggests this increased difficulty is indicating that Australia's under-utilisation rate is likely to fall further in the quarters ahead. (The under-utilisation rate includes under-employment as well as more narrowly-defined unemployment. This broader measure of labour market spare capacity is released quarterly, the next coming with the February Labour Force report, due 22 March.)

The increased difficulty of finding labour was complemented by higher levels of capacity utilisation also reported in the NAB Business Survey. Businesses are asked in the Survey to report on their utilisation of capacity incorporating their use of labour resources, hence the link to spare capacity in the labour market. In January, the capacity utilisation rate was 82.7%, the highest level of capacity utilisation since June 2008, associated then with pre-GFC levels of economic activity.

Chart 2: “Difficulty” the highest since Sept 2008

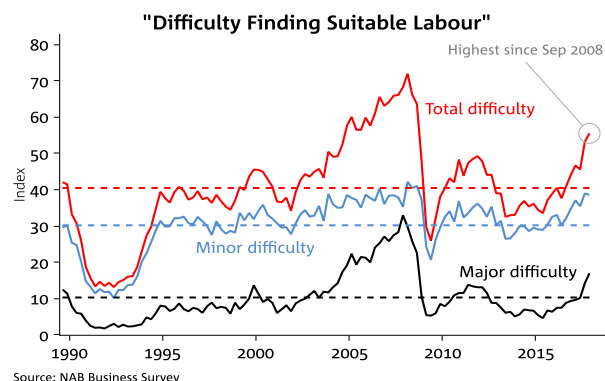
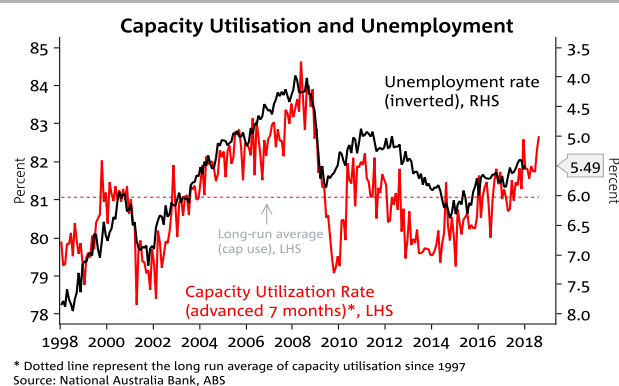


Chart 3: Capacity use and unemployment



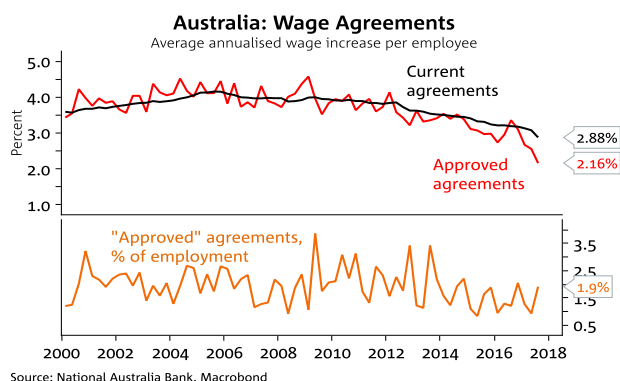
In summary, the economic activity and diminishing spare capacity aspects – pre-conditions for wages growth to rise – are falling into place. But how is this big picture story being translated into wages growth on the ground and, in particular, this Wednesday's Wage Price Index (WPI)? Bear in mind also that the WPI is a synthesized measure of wages designed statistically to abstract from industry, composition and job-change effects on measured wages to try to get to underlying trends in wage costs. It is thus a smoothed measure of wages. The low point of the past two years was the December quarter 2016 at 1.9% y/y; it's been running at around that rate since, at 2.0% by the September quarter.

Minimum wage case – flow through delayed?

NAB expects 2.0% annual growth to again be reported on Wednesday, continuing the “subdued” wages growth theme, incorporating another subdued of 0.5% growth. Note that the flow through of the national Minimum Wage rise of 3.3% from 1 July '17 was a little less than expected in Q3 WPI growth. If some of that increase flows through a little later, there might be some payback in the form of a higher WPI this quarter, something the RBA is also likely alert to.

By the same token, a further decline in the trend of newly-approved wage agreements (cf. existing “current” agreements) through last year (to Q3) will act as a slight headwind to aggregate wages growth until EBAs begin to increase and/or are overtaken by broader macroeconomic forces lifting wages and income growth for the broader workforce.

Chart 4: EBAs still a headwind to wages growth, for now



In general, while the partial indicators suggest continuing demand pressures on the unemployment rate, to date this progress has been slow. Lower unemployment will likely be a prerequisite to any up-tick in wages growth. While we see slight upside risk to the WPI on Wednesday, we'll need to see the unemployment rate heading more convincingly toward 5% and signs of some pick-up in wage growth before the RBA begins to remove policy accommodation.

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CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEDT
Monday, 19 February 2018								
NZ	Performance Services Index	Jan				56	21.30	8.30
JN	Japan Merchandise Trade Balance SA	Jan		143.9		86.8	23.50	10.50
UK	Rightmove House Prices MoM/YoY	Feb		/		0.7/1.1	0.01	11.01
EC	ECB Current Account SA	Dec				32.5	9.00	20.00
EC	Construction Output MoM/YoY	Dec		/		0.5/2.7	10.00	21.00
Tuesday, 20 February 2018								
NZ	PPI Input QoQ/Output QoQ	4Q		/		1/1	21.45	8.45
AU	RBA's Bullock (AG Financial System) Gives Speech in Sydney						22.15	9.15
AU	ANZ Roy Morgan Weekly Consumer Confidence Index	Feb-18				119.5	22.30	9.30
AU	RBA February Meeting Minutes						0.30	11.30
NZ	RBNZ Survey of Household Inflation Expectations	1Q				3	2.00	13.00
JN	Machine Tool Orders YoY	Jan F				48.8	6.00	17.00
GE	PPI MoM/YoY	Jan		0.5/1.8		0.2/2.3	7.00	18.00
GE	ZEW Survey Current Situation/Expectations	Feb		94/16		95.2/20.4	10.00	21.00
EC	ZEW Survey Expectations	Feb				31.8	10.00	21.00
UK	CBI Trends Selling Prices/Total Orders	Feb				40/14	11.00	22.00
CA	Wholesale Trade Sales MoM	Dec		0.4		0.7	13.30	0.30
EC	Consumer Confidence	Feb A		1		1.3	15.00	2.00
Wednesday, 21 February 2018								
NZ	Dairy Auction					5.9		
AU	Westpac Leading Index MoM	Jan				0.27	23.30	10.30
AU	Skilled Vacancies MoM	Jan				0.2	0.00	11.00
AU	Construction Work Done	4Q	-15.5	-10		15.7	0.30	11.30
AU	Wage Price Index QoQ/YoY	4Q	0.5/2	0.5/2		0.5/2	0.30	11.30
JN	Nikkei Japan PMI Mfg	Feb P				54.8	0.30	11.30
JN	BOJ Funo speaks for 100 years anniversary of Matsue Branch							
JN	All Industry Activity Index MoM	Dec		0.4		1	4.30	15.30
GE	Markit/BME Germany Manufacturing PMI/Composite PMI	Feb P		60.5/58.5		61.1/59	8.30	19.30
GE	Markit Germany Services PMI	Feb P		57		57.3	8.30	19.30
EC	Markit Eurozone Manufacturing PMI/Composite PMI	Feb P		59.2/58.4		59.6/58.8	9.00	20.00
EC	Markit Eurozone Services PMI	Feb P		57.6		58	9.00	20.00
UK	Average Weekly Earnings 3M/YoY	Dec		2.5		2.5	9.30	20.30
UK	Employment Change 3M/3M / ILO Unemployment Rate 3Mths	Dec		180/4.3		102/4.3	9.30	20.30
UK	Public Sector Net Borrowing	Jan		-11.35		1	9.30	20.30
US	MBA Mortgage Applications	16-Feb				-4.1	12.00	23.00
US	Fed's Harker Speaks on the Economic Outlook						14.00	1.00
UK	BOE's Carney, Broadbent, Haldane and Tenreyro Speak in London						14.15	1.15
US	Markit US Manufacturing PMI/Composite PMI	Feb P		55.5/		55.5/53.8	14.45	1.45
US	Markit US Services PMI	Feb P		54		53.3	14.45	1.45
US	Existing Home Sales millions/MoM	Jan		5.62/0.9		5.57/-3.6	15.00	2.00
US	FOMC Meeting Minutes	1-Feb					19.00	6.00
Thursday, 22 February 2018								
NZ	Productivity Statistics	1978-2017					21.45	8.45
NZ	Credit Card Spending MoM/YoY	Jan		/		0.6/6.3	2.00	13.00
US	Fed's Quarles to Speak on Global Economy						5.15	16.15
GE	IFO Business Climate	Feb		117		117.6	9.00	20.00
GE	IFO Current Assessment/Expectations	Feb		127/107.9		127.7/108.4	9.00	20.00
UK	GDP QoQ/YoY	4Q P		0.5/1.5		0.5/1.5	9.30	20.30
UK	Index of Services MoM/3m-on-3m	Dec		0/0.5		0.4/0.4	9.30	20.30
UK	CBI Retailing Reported Sales/Total Dist. Reported Sales	Feb		13.5/		12/14	11.00	22.00
EC	ECB Publishes Account of Jan. 24-25 Policy meeting						12.30	23.30
CA	CFIB Business Barometer	Feb				62.7		
US	Initial Jobless Claims	17-Feb		230		230	13.30	0.30
CA	Retail Sales MoM	Dec		-0.1/0		0.2/1.6	13.30	0.30
US	Fed's Dudley to Speak at New York Fed Briefing on Puerto Rico						15.00	2.00
US	Leading Index	Jan		0.7		0.6	15.00	2.00
US	Kansas City Fed Manf. Activity	Feb		18		16	16.00	3.00
US	Fed's Bostic Speaks at Banking Conference in Atlanta						17.10	4.10
Friday, 23 February 2018								
NZ	Retail Sales Ex Inflation QoQ	4Q	1.7	1.4		0.2	21.45	8.45
JN	Natl CPI YoY	Jan		1.3		1	23.30	10.30
JN	Natl CPI Ex Fresh Food YoY/Ex Fresh Food, Energy YoY	Jan		0.8/0.3		0.9/0.3	23.30	10.30
JN	PPI Services YoY	Jan		0.8		0.8	23.50	10.50
GE	GDP SA QoQ/WDA YoY	4Q F		0.6/2.9		0.6/2.9	7.00	18.00
EC	CPI MoM/YoY	4Q F		-0.9/1.3		0.4/1.4	10.00	21.00
EC	CPI Core YoY	4Q F		1		1	10.00	21.00
Upcoming Central Bank Interest Rate Announcements								
Australia, RBA		6-Mar		1.5%		1.5%		
Canada, BoC		8-Mar		1.25%		1.25%		
Europe, ECB		8-Mar				-0.4%		
Japan, BoJ		9-Mar				-0.1%		
US, Federal Reserve		22-Mar		1.5-1.75%		1.25-1.5%		
New Zealand, RBNZ		22-Mar		1.75%		1.75%		
UK, BOE		22-Mar				0.5%		

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

FORECASTS

Economic Forecasts

	Annual % change				Quarterly % change															
	2016	2017	2018	2019	2016				2017				2018				2019			
Australia Forecasts					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Household Consumption	2.8	2.3	2.4	2.5	0.9	0.5	0.3	0.9	0.4	0.8	0.1	1.0	0.4	0.6	0.5	0.6	0.6	0.6	0.7	0.7
Underlying Business Investment	-11.9	2.9	5.0	4.4	-3.4	-2.4	-5.5	1.7	3.2	0.2	2.6	4.0	1.0	0.5	1.5	1.4	0.9	0.5	1.7	1.2
Residential Construction	8.6	-2.3	-2.2	-3.1	4.4	1.4	-0.9	2.6	-3.4	-0.5	-1.0	0.5	-0.9	-0.6	-0.8	-0.7	-1.3	-0.6	-0.3	-0.7
Underlying Public Spending	5.2	4.4	3.8	3.8	1.9	2.0	0.8	0.7	1.1	1.2	1.5	0.9	0.8	0.8	0.8	0.9	1.0	1.0	1.0	1.0
Exports	6.8	4.0	5.5	5.2	2.7	1.3	0.9	2.7	-1.6	3.3	1.9	-2.6	2.2	2.6	2.0	1.7	1.0	0.8	0.6	1.0
Imports	0.2	7.3	4.1	4.1	-0.8	2.6	0.7	2.4	2.7	0.5	1.9	1.2	0.7	0.8	0.9	1.1	0.9	0.9	1.4	1.1
Net Exports (a)	1.2	-0.8	0.2	0.1	1.1	-0.3	0.0	0.0	-0.9	0.5	0.0	-0.8	0.3	0.3	0.2	0.1	0.0	0.0	-0.2	-0.1
Inventories (a)	0.1	-0.1	-0.1	0.0	-0.1	0.3	0.1	-0.3	0.3	-0.6	0.2	0.2	-0.2	0.0	0.1	-0.1	0.0	0.0	0.1	0.0
Domestic Demand - qtr%					0.1	0.6	-0.2	1.0	0.7	0.8	0.6	1.0	0.5	0.5	0.6	0.7	0.6	0.6	0.8	0.7
Dom Demand - ann %	1.8	2.7	2.6	2.6	1.5	1.8	1.5	2.3	2.2	2.4	3.2	3.1	2.9	2.6	2.6	2.3	2.4	2.5	2.7	2.7
Real GDP - qtr %					1.0	0.8	-0.3	1.1	0.4	0.9	0.6	0.7	0.6	0.9	0.9	0.7	0.6	0.6	0.7	0.6
Real GDP - ann %	2.6	2.3	2.9	2.8	2.7	3.3	2.1	2.4	1.8	1.9	2.8	2.7	2.8	2.7	3.0	3.1	3.1	2.8	2.7	2.6
CPI headline - qtr %					-0.2	0.4	0.7	0.5	0.5	0.2	0.6	0.6	0.5	0.5	0.6	0.7	0.5	0.5	0.6	0.8
CPI headline - ann %	1.3	1.9	2.2	2.4	1.3	1.0	1.3	1.5	2.1	1.9	1.8	1.9	2.0	2.3	2.3	2.4	2.4	2.4	2.4	2.4
CPI underlying - qtr %					0.2	0.5	0.3	0.4	0.5	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.6	0.6
CPI underlying - ann %	1.5	1.8	1.9	2.2	1.5	1.5	1.4	1.5	1.7	1.8	1.9	1.8	1.8	1.8	1.9	2.0	2.1	2.2	2.2	2.3
Wages (Pvte WPI - qtr %)					0.5	0.5	0.4	0.4	0.5	0.5	0.5	0.7	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7
Wages (Pvte WPI - ann %)	1.9	1.9	2.3	2.5	2.0	2.0	1.9	1.8	1.8	1.8	1.9	2.2	2.2	2.3	2.4	2.3	2.4	2.5	2.5	2.6
Unemployment Rate (%)	5.7	5.6	5.2	5.2	5.8	5.7	5.7	5.7	5.9	5.6	5.5	5.4	5.3	5.2	5.2	5.1	5.1	5.1	5.2	5.2
Terms of trade	0.5	12.2	-1.1	-0.8	-1.9	2.5	4.1	11.2	5.5	-6.1	-0.4	0.8	1.8	-1.8	-3.2	-1.4	-1.7	-2.3	0.3	0.3
G&S trade balance, \$Abn	-14.3	13.5	9.2	-12.2	-8.4	-7.4	-4.1	5.7	6.8	3.4	3.1	0.3	3.5	3.6	1.4	0.7	-1.0	-3.5	-3.9	-3.8
% of GDP	-0.8	0.8	0.5	-0.6	-2.0	-1.8	-1.0	1.3	1.5	0.8	0.7	0.1	0.8	0.8	0.3	0.1	-0.2	-0.7	-0.8	-0.8
Current Account (% GDP)	-2.9	-2.0	-2.3	-3.4	-3.7	-3.9	-2.9	-1.1	-1.3	-2.2	-2.0	-2.6	-2.0	-2.0	-2.5	-2.6	-3.0	-3.5	-3.6	-3.5

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

Exchange Rate Forecasts

	19-Feb	Mar-18	Jun-18	Sep-18	Dec-18	Jun-19	Dec-19
Majors							
AUD/USD	0.7934	0.79	0.78	0.77	0.75	0.76	0.75
NZD/USD	0.7391	0.73	0.72	0.71	0.70	0.71	0.70
USD/JPY	106.22	110	110	109	109	107	105
EUR/USD	1.2419	1.25	1.28	1.30	1.30	1.27	1.30
GBP/USD	1.4037	1.44	1.45	1.47	1.48	1.45	1.46
USD/CNY	6.3415	6.28	6.25	6.20	6.18	6.23	6.24
USD/CAD	1.2552	1.23	1.22	1.24	1.25	1.21	1.22
USD/CHF	0.9274	0.93	0.92	0.90	0.91	0.93	0.92

Australian Cross Rates

AUD/NZD	1.0735	1.08	1.08	1.08	1.07	1.06	1.07
AUD/JPY	84.3	87	86	84	82	81	79
AUD/EUR	0.6389	0.63	0.61	0.59	0.58	0.59	0.58
AUD/GBP	0.5652	0.55	0.54	0.52	0.51	0.52	0.51
AUD/CNY	5.0313	4.96	4.88	4.77	4.64	4.70	4.68
AUD/CAD	0.9959	0.97	0.95	0.95	0.94	0.91	0.92
AUD/CHF	0.7358	0.73	0.72	0.69	0.68	0.70	0.69

Interest Rate Forecasts

	19-Feb	Mar-18	Jun-18	Sep-18	Dec-18	Jun-19	Dec-19
Australia Rates							
RBA Cash rate	1.50	1.50	1.50	1.75	2.00	2.25	2.50
3 month bill rate	1.77	1.75	2.00	2.25	2.25	2.50	2.75
3 Year Swap Rate	2.22	2.5	2.9	3.0	3.1	3.1	3.4
10 Year Swap Rate	3.05	3.3	3.6	3.7	3.7	3.6	3.9
Offshore Policy Rates							
US Fed funds	1.50	1.75	2.00	2.00	2.25	2.50	2.50
ECB deposit rate	-0.40	-0.40	-0.40	-0.40	-0.20	0.00	0.00
BoE repo rate	0.50	0.50	0.50	0.50	0.75	0.75	1.00
BoJ excess reserves rate	-0.10	-0.10	-0.10	-0.10	-0.10	1.90	3.90
RBNZ OCR	1.75	1.75	1.75	1.75	1.75	2.25	2.75
China 1yr lending rate	4.35	4.35	4.35	4.35	4.35	4.35	4.35
China Reserve Ratio	17.0	16.0	16.0	16.0	16.0	16.00	16.00
10-year Benchmark Bond Yields							
Australia	2.89	2.95	2.95	3.00	3.05	3.15	3.25
United States	2.87	2.75	2.75	2.75	2.75	2.75	2.75
New Zealand	2.97	2.95	3.10	3.15	3.40	3.45	3.40

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP

Dec year	2014	2015	2016	2017	2018	2019	20 Yr Ave
Australia	2.6	2.5	2.6	2.3	2.9	2.8	3.4
US	2.6	2.9	1.5	2.3	2.7	2.3	2.6
Eurozone	1.4	2.0	1.8	2.5	2.5	2.4	1.5
UK	3.1	2.3	1.9	1.8	1.8	1.5	2.4
Japan	0.3	1.4	0.9	1.8	1.4	0.9	0.8
China	7.3	6.9	6.7	6.8	6.5	6.3	9.2
India	7.0	7.5	7.9	6.4	7.1	7.3	6.6
New Zealand	3.6	3.5	4.0	2.9	2.8	3.0	3.0
World	3.5	3.4	3.2	3.6	3.8	3.6	3.5
MTP Top 5	4.0	4.1	3.7	4.2	4.0	3.7	5.0

Commodity prices (\$US)

	19-Feb	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
WTI oil	62.37	60	61	61	60	59	60	61	62
Gold	1350	1330	1320	1330	1360	1380	1370	1380	1390
Iron ore	76.9	73	67	63	61	60	58	60	62
Hard coking coal	231	215	175	130	110	101	99	100	100
Thermal coal	105	85	90	90	90	90	65	65	65
Copper	7192	6760	6690	6630	6630	6630	6630	6630	6630
Aust LNG (*)	6.51	10.5	11.2	11.5	11.8	11.7	11.3	11.7	11.8

(*) Implied Australian LNG export prices.

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