EMBARGOED UNTIL 11.30 AM WEDNESDAY 11 APRIL 2018

THE FORWARD VIEW: AUSTRALIA APRIL 2018

Still see growth momentum improving

OVERVIEW

Fundamentally we have not changed our core activity and financial forecasts, but have allowed for marginally higher near term commodity prices and a weaker labour market. After a somewhat disappointing 2017, we continue to expect growth to gain more momentum during 2018 – with GDP increasing by around 3% through the year or 2.8% in year average terms. That is very much reflecting increased infrastructure spending by governments (underlying public investment up 7%), some continued improvement in non-mining business (up around 6%) and the increased impact of LNG exports (net exports adding 0.6 percentage to GDP during 2018). However we see little pick up in the speed of consumption growth (around 2.5% in 2018). Recent strength in consumption was very much driven by one-offs and will still see a much weaker Q1 read. While retail has been reasonable in recent months consumers remain cautious in the face of higher electricity prices, low wages growth, stalling house price wealth and high debt levels.

We see these factors continuing into 2019 – with growth of around 2.6% (as net exports fade) and nearer 2.8% in 2020 as higher wages growth eventually feeds into higher consumption growth and domestic demand accelerates above 3%. The negative impact of lower terms of trade (falling commodity prices) should also ease in 2020.

While business conditions remain at very high levels (trend conditions of around +17 vis long run averages of +5.5) business continues to use better profits to pay down debt and balance sheet strengthening – with any spare cash then being directed into investment spend (business credit in that environment is very subdued). Against that the Business Survey continues to point to a strengthening labour market – with growth in jobs around 20k for at least the next 6 months. As a result we continue to see unemployment falling to around 5 per cent by year's end. That of course depends on the participation rate not continuing its "puzzling rise".

A tighter labour market, consistent with a falling underutilisation rate (as employers continue to report increasing difficulty in finding skilled labour) should see some modest improvement in private sector wages growth (to around 2¼% by late 2018). It is also likely that family income growth will be boosted by tax cuts in the upcoming Budget.

We continue to see this environment – together with above trend global growth (see our global forecast update tomorrow) – as consistent with the RBA gradually withdrawing emergency low monetary policy settings from late 2018. However nothing will happen until wages growth accelerates and the RBA will be very cautious and data driven.

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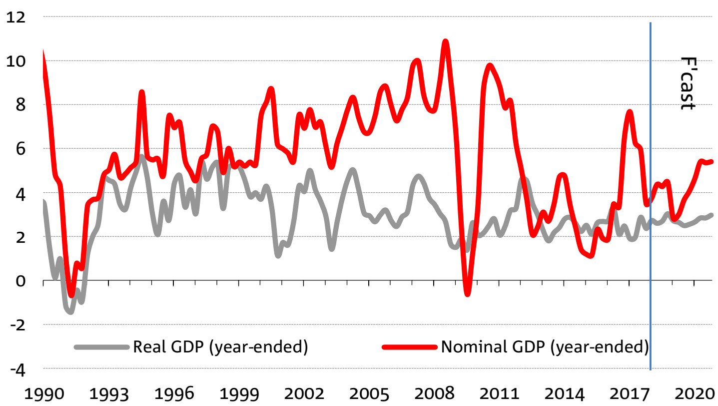
KEY ECONOMIC FORECASTS

	2017	2018-F	2019-F	2020-F
Domestic Demand (a)	2.9	2.6	2.7	3.2
Real GDP (annual average)	**2.3**	**2.8**	**2.6**	**2.8**
Real GDP (year-ended to Dec)	**2.4**	**3.0**	**2.6**	**3.0**
Terms of Trade (a)	11.6	-0.8	-6.4	-0.3
Employment (a)	2.2	2.7	1.8	1.7
Unemployment Rate (b)	5.4	5.1	5.0	5.0
Headline CPI (b)	1.9	2.4	2.4	2.7
Core CPI (b)	1.8	2.0	2.2	2.5
RBA Cash Rate (b)	1.50	1.75	2.25	2.75
$A/US cents (b)	0.78	0.75	0.75	0.73

(a) annual average growth, (b) end-period, (c) through the year inflation

REAL AND NOMINAL GDP GROWTH

y/y % change



CONSUMERS, LABOUR MARKET AND WAGES

The unemployment rate was up slightly in February to 5.6% (s.a.), despite strong employment growth. February saw the 17th straight month of employment growth, but over the past year strong growth in the working age population (up 329,000 over the past year) as well as a higher participation rate have conspired to keep more slack in the labour market than the RBA desired.

Despite declining in March (down 7 to 9 index points), the NAB Monthly Business Survey employment index is still consistent with a solid level of jobs growth - approximately 21k per month over the next 6 months. While this remains below the average monthly employment growth recorded by the ABS over the twelve months to February, it is above the ABS' current trend estimate of 19k.

While leading indicators in the survey softened this month, they remain at solid levels. Capacity utilisation eased slightly (see chart), and forward orders gave up much of last month's spike, but on a trend basis they remain at their highest level since mid-2008 and early 2010 respectively.

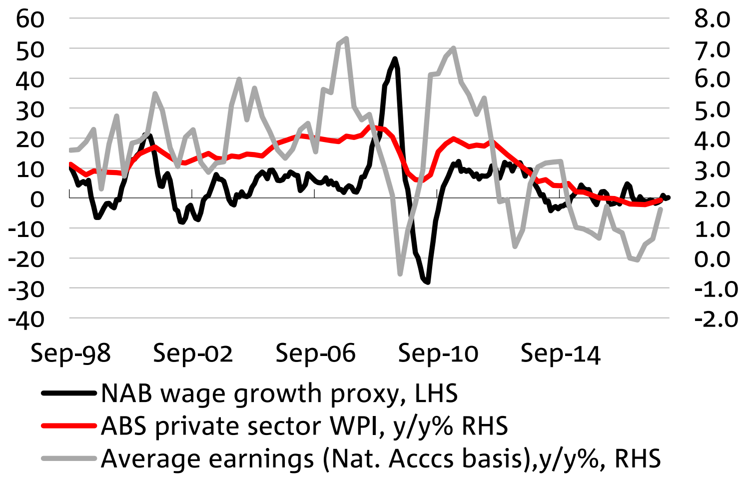
Wage growth remains sluggish, although the ABS wage price index grew by a slightly-better-than-expected 0.6% q/q in Q4, to be 2.1% higher y/y. This is still well below the long run average of 3.3%, but broadly consistent with our expectation that slack in the labour market will lessen and private sector wages will finally begin to rise.

Reflecting lacklustre wage growth, consumer demand signals have been mixed. Our measure of cashless sales – the NAB Cashless Retail Sales Index – saw growth of 9.4% yoy in February, up from 8.8% in January and the fastest rate since mid-2016. Our forecast was for the official ABS measure of retail sales to increase 0.7% m/m. This proved very slightly optimistic, with ABS retail sales printing at 0.6% m/m. A breakdown of our cashless retail data shows that cafes, restaurants & takeaways remain the best preforming category, with spending growing 15.8% y/y. Spending on household goods has also jumped (also reflected in ABS data) and is now the second fastest growing sector in our indicator (up 10.7% y/y). Clothing & footwear sales growth has lagged recently, but has begun to pick up, with the NAB measure rising 4.8% y/y.

That said, it looks likely that consumption growth will be significantly slower in Q1 2018 as one-off effects in Q4 2017 fade. With wages growth still subdued, utility prices high and house prices falling modestly it is hard to see consumer spending picking up from here. We continue to be less optimistic, in both 2018 and 2019, about consumption growth than the RBA (see page 6 for more detail).

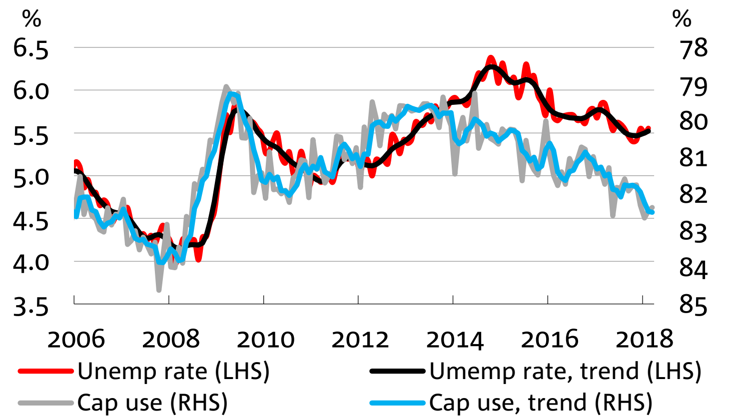
NAB WAGE GROWTH PROXY

y/y % change



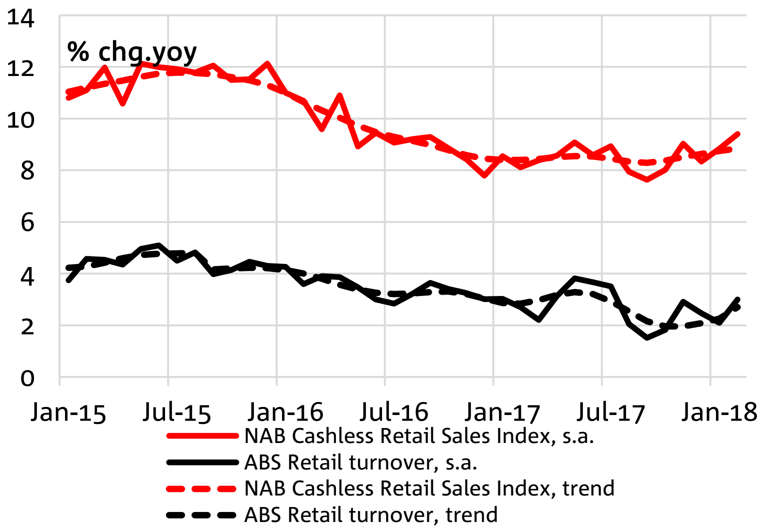
UNEMPLOYMENT AND CAPACITY UTILISATION

ABS (unemployment) and NAB monthly survey



NAB CASHLESS RETAIL AND ABS RETAIL TRADE

y/y % change



Source: ABS, NAB Group Economics

HOUSING AND CONSTRUCTION

Housing market conditions continue to soften with most capital city housing markets seeing price falls or slower growth, and transaction numbers remain lower than year ago levels. Auction clearance rates, while they have picked up from their late 2017 levels, remain below where they were a year ago.

Sydney house price momentum has slowed dramatically. Melbourne house prices are also now also weakening and there are early signs of this occurring in Adelaide as well. Brisbane dwelling prices have been broadly flat in recent months while Perth, after a long period of falling prices, appears to have stabilised.

The Melbourne and Sydney housing markets have been affected by falling overseas demand. The NAB Residential Property Survey indicates that the foreign share of new property purchases reached a six year low at the end of 2017, although there was a small increase in foreign interest in the March 2018 quarter.

In addition to lower foreign demand, policy changes have affected the investor market. This can be seen in housing finance approvals data; the value of investor finance approvals in January was down 12% on the same time last year. The weakening in investor finance was offset for a while by rising approvals for owner-occupiers, but even this has turned negative recently. As a result, in January 2018 the number of housing finance approvals (owner-occupier, ex refinancing) was almost the same as a year ago, after showing double digit growth in mid-2017.

We have slightly lowered our house price forecasts for 2018 and now expect a small fall in house prices (now -0.8% was +0.7%), largely due to continuing weakness in the Sydney market and a softer Melbourne market. For 2019, the house price forecasts remain broadly unchanged at +0.8% with only Sydney expected to fall (albeit modestly). Apartment forecasts are broadly unchanged (-0.8% in 2018 & -1.8% in 2019) reflecting large stock additions and a soft outlook for foreign demand. More details are available in the NAB Residential Property Survey.

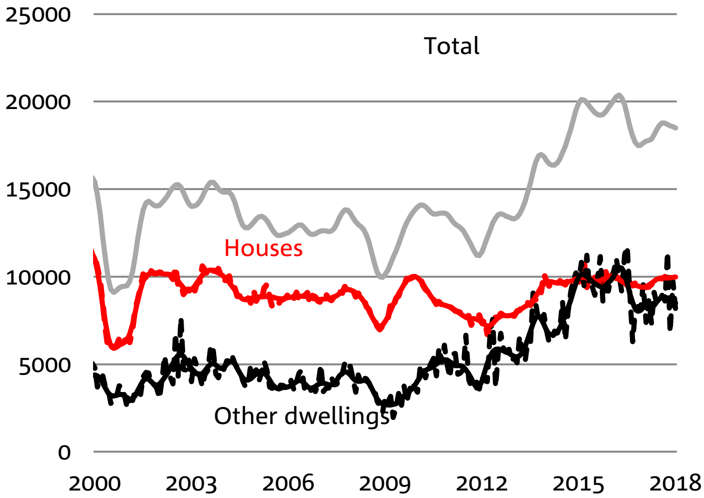
Dwelling investment has been trending down since Q3 2016. This can be seen in building approvals data, particularly for 'other dwellings' (principally apartments but also semi-detached dwellings). However, while building approvals remain off their peaks, there is little sign at this stage of further downwards momentum, and they remain relatively high by historical standards. Still strong population growth means that even as a large stock of apartments come onto the market over the next few years, we are unlikely to see a major correction.

Nevertheless, we still see further small declines in dwelling investment in 2018 and 2019 before stabilising in 2020.

Source: ABS, NAB, Core Logic, APRA.

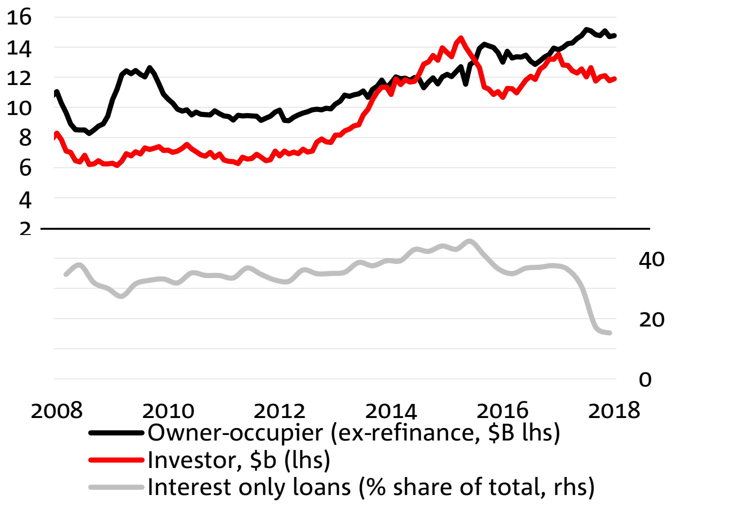
PRIVATE RESIDENTIAL BUILDING APPROVALS

Number, s.a. (dashed line), trend (solid line)



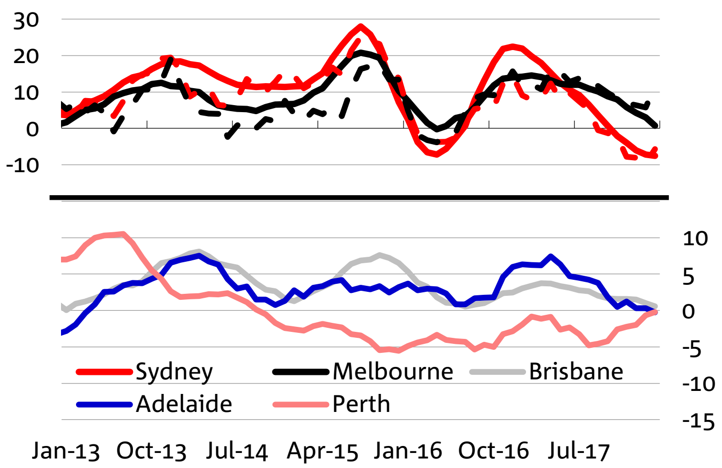
INVESTORS UNDER PRESSURE

Housing Finance approvals, $ b (lhs), % share (rhs)



HOUSE PRICE GROWTH

Dwelling price growth (%, 6-month annualised)



* Solid lines are hedonic prices. Dotted lines represent simple median prices.

BUSINESS ACTIVITY AND INVESTMENT

Business conditions declined in the March NAB Monthly Business Survey although they remain at a high level by historical standards. Business Survey leading indicators – forward orders and capacity utilisation – on a trend basis remained at their highest level since mid-2008 and early 2010 respectively.

Moreover, solid company profitability should provide a supportive backdrop to business investment. Following the GFC, non-mining business investment eased over several years, in contrast to a rising trend for company profits. However, in recent years the relationship between non-mining investment and profits has reasserted itself, and non-mining investment has been increasing.

Against this backdrop, the strength in the NAB Monthly Business Survey profitability index is not only a positive sign for non-mining sector profits but also supports our view that business fixed investment is on a rising trend. Moreover, the ABS survey of capital expenditure intentions also points to rising non-mining investment.

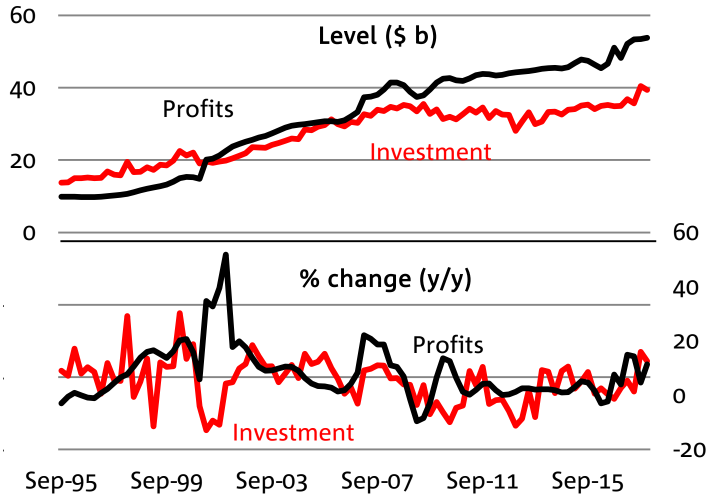
Actual indicators of capex have been mixed recently. The NAB business survey measure of actual capital expenditure declined in March, but on a trend (three month average) basis it remains elevated. The value of non-residential approvals has also come off its recent peak, but it remains at a high level and in February it was still 6% higher than a year ago.

With a large public sector investment pipeline already in place, underlying public investment growth should also be robust in coming years. As many projects are delivered in partnership with the private sector, the large scale of public sector works will be an additional support to private business sector investment.

As a result, with the drag from mining investment likely to fade further over time, we expect underlying business investment to grow by around 5-6% annually between 2018 to 2020, with growth in underlying public investment set to be even stronger.

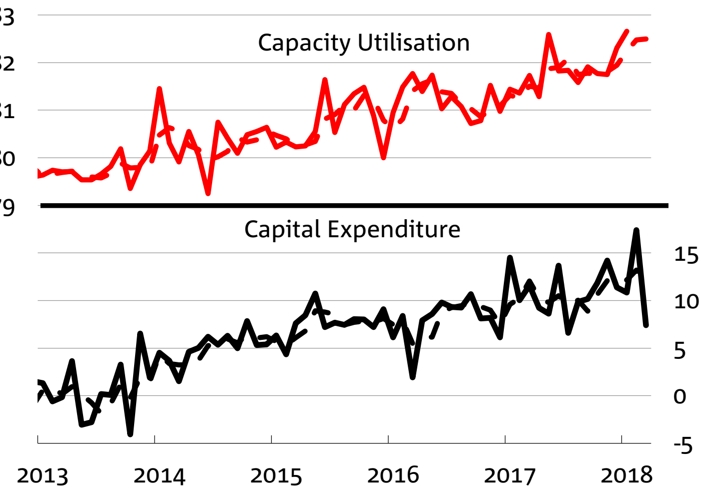
NON-MINING PROFITS AND INVESTMENT

Gross company oper. profit & fixed investment



NAB SURVEY INVESTMENT INDICATORS*

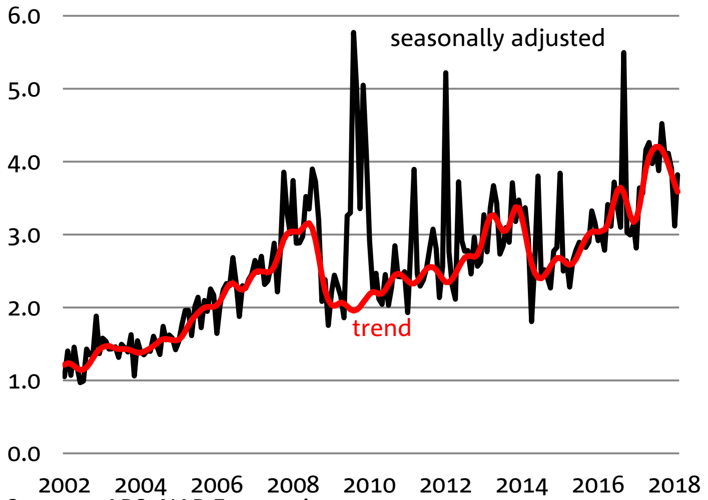
% of capacity; Net balance



* Dotted lines represent the 3mma

NON-RESIDENTIAL APPROVALS

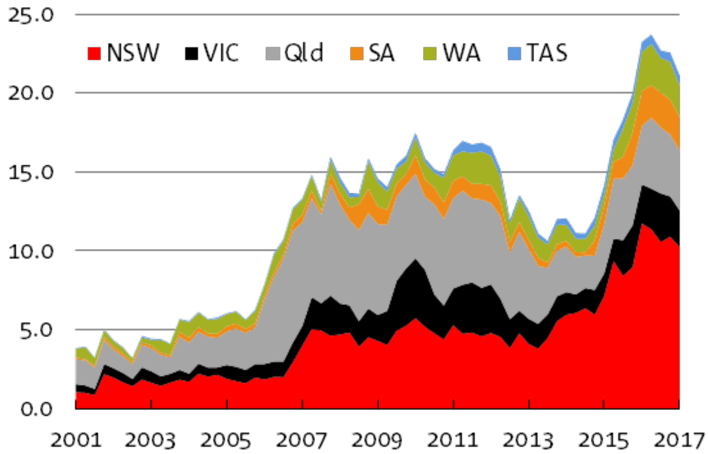
Value of non-residential building approved, Aust.



Sources: ABS, NAB Economics

LARGE PUBLIC SECTOR INVESTMENT PIPELINE

Value of work yet to be done ($b)*



* Work yet to be done on commenced public projects (transport, water, energy, telecomms)

COMMODITIES AND TRADE

Commodity prices have been mixed of late. Iron ore has been lower on expectations of weaker Chinese demand due to pollution restrictions as well as the spectre of a possible trade war. We see spot iron ore prices falling to the low 60s range later this year. Meanwhile, metallurgical coal has proven resilient to Chinese steel demand concerns, although we still expect prices to fall in the year ahead.

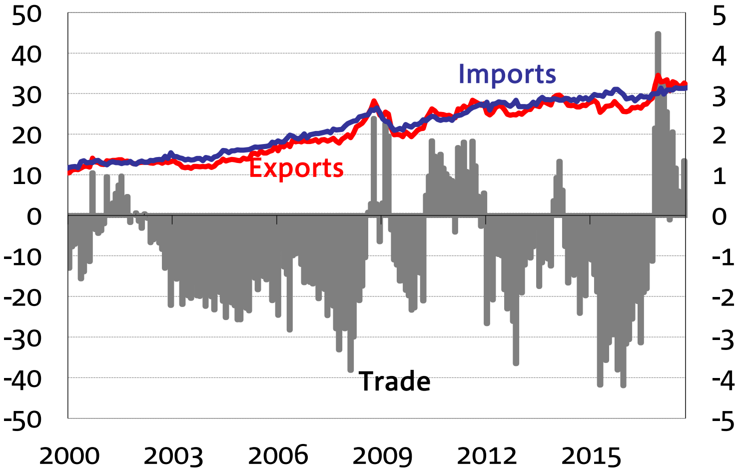
Oil has risen significantly from its nadir, with Brent establishing a seemingly sustainable high 60s range recently. However, it is difficult to see significant upside, given that higher prices will bring more US shale drillers into the market. Overall, we expect the NAB non-rural commodity price index to be temporarily higher before falling, largely reflecting pressure on iron ore and coal. Our commodity price forecasts are listed in detail on page 7.

Rural commodities have likewise been mixed, although overall the NAB Rural Commodities Index rose in March, reflecting favourable cotton, cattle, grain and horticultural prices. While parts of Queensland have received a drenching, the break is yet to come in key cropping regions, with many areas much drier than average. Winter crop planting is less than a month away, so producers will be hoping for good rain soon.

In February, the trade surplus declined on a seasonally adjusted basis, down 13% to an $825m surplus for the month. Rural goods exports rose 17% after a very weak January print, offsetting falls in non-rural goods and non-monetary gold exports. While there was little change in total imports, consumption imports were stronger in February. Net exports detracted 0.5 ppts from GDP growth in Q4 2017, so these surpluses in January and February may point to a small upside in Q1.

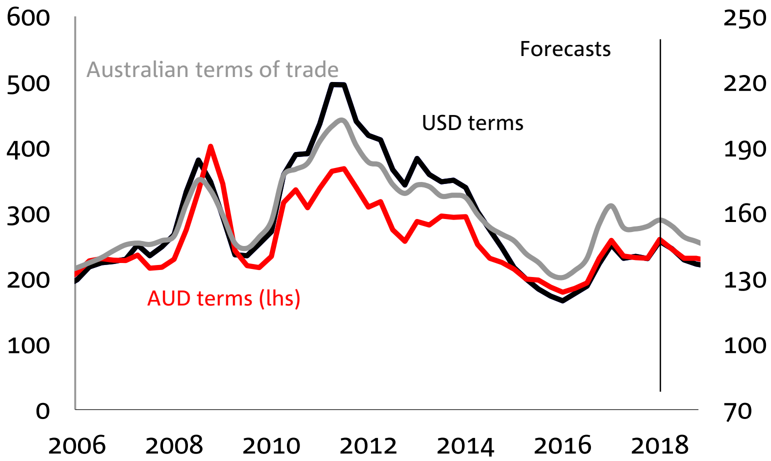
TRADE BALANCE

Trade balance, values, monthly, $billions



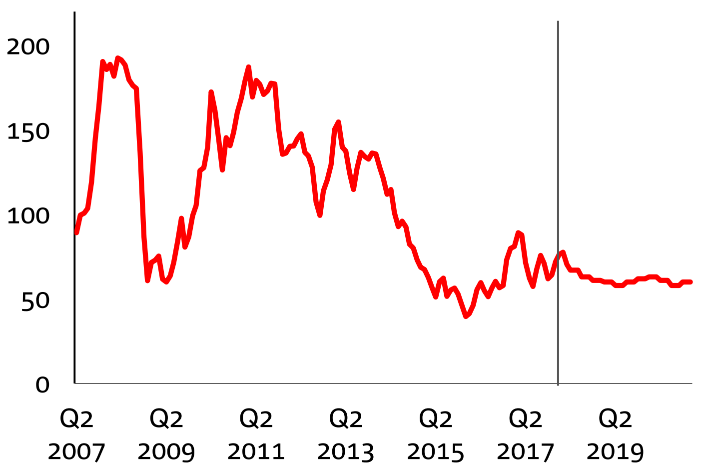
NAB NON-RURAL COMMODITIES PRICE INDEX

Sept 1996 = 100



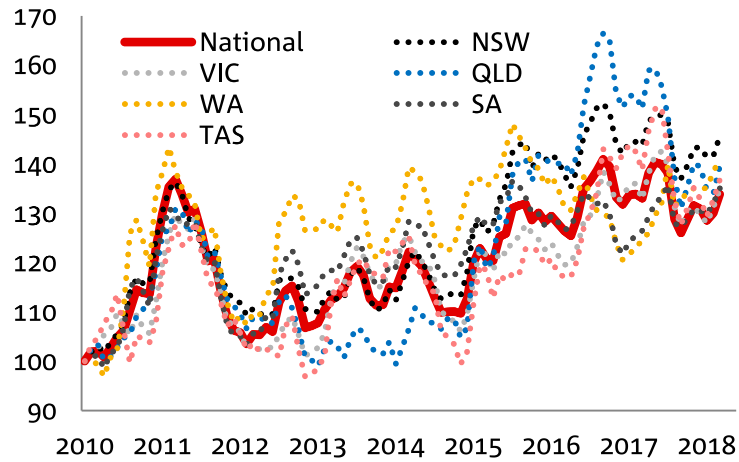
IRON ORE SPOT PRICE FORECASTS

US$/t (incl. cost of freight)



NAB RURAL COMMODITIES INDEX

Jan 2010 = 100



Source: ABARES, Meat and Livestock Australia, Australian Pork, Ausmarket, ABS, Bloomberg, Thomson Reuters, BREE and Profarmer

MONETARY POLICY, INFLATION AND FX

With wages growth likely to remain low, supermarket wars to continue (including a faster rollout of Aldi stores) and significant on line competition squeezing margins, we don't see a fundamental increase in core inflation for some considerable time. Our models are suggesting that core inflation, at best, will be back at the bottom of the RBA's target by late 2018. The RBA doesn't see such an outcome until mid-2019. Clearly inflation (even headline which will be more affected by tax and gas /electricity prices) is not a near term concern.

As part of the process we do not see much change in the currency. Our USD/ AUD model currently has a fundamental value estimate of 77c +/- 5c. We have maintained our forecast that the AUD may move down to around 75c by late 2018 as the interest rate differential moves in the USD favour and commodity prices come off by around 5% during the year. For 2019 we see the AUD as hovering around the mid 70s. Of course this forecast does not include the outbreak of a real trade war between the USA and China – which would see a significantly lower AUD.

On monetary policy the RBA is very relaxed. We agree that inflation is unlikely to be a problem and the more important risks revolve around the consumer. Our forecasts see the slack in the labour market gradually improving and private sector wages starting to finally move up. However the reality is that so far this has not happened - despite employers signalling that they are finding suitable labour harder to find.

As noted earlier we see consumers remaining cautious in the face of higher electricity prices, low wages growth, stalling house price wealth and high debt levels. Indeed late last week we lowered our house price forecasts (especially in Sydney and Melbourne and hence Australia).

As such we are more cautious about consumption growth than the RBA. Against that we are more optimistic than the RBA re unemployment.

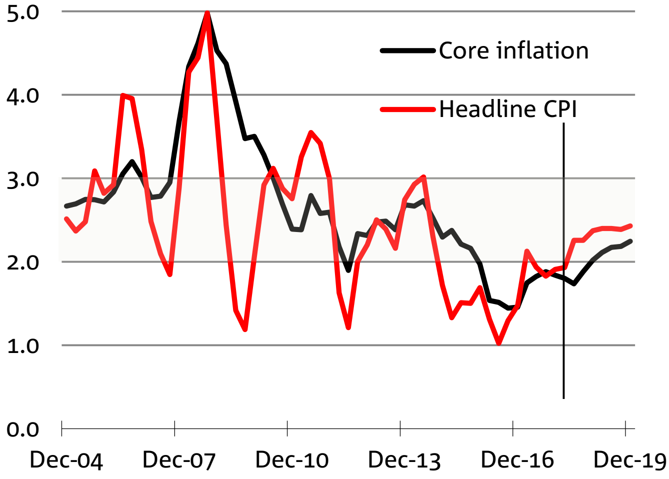
Clearly the critical ingredient for the RBA will be signs that consumer incomes growth starts to pick up – either endogenously via wages or by tax relief (which looks increasingly likely in the upcoming Budget). That, inturn, could see the consumer balance sheets in a better situation and GDP accelerating faster than we currently expect.

While the global environment will see other central banks removing emergency stimulus the RBA will be very focussed on the local economy. They would not be concerned if current settings see some downside to the AUD from interest rate differentials.

Clearly until the consumer shows more strength the RBA will be on hold. Currently the markets have only priced 7 points of hikes by end 2018. That said our forecasts (and a Taylors rule analysis) still point to the possibility of a very cautious start by the RBA to move rates higher by late 2018. Clearly the risks are that the timing will be delayed. Also going forward the RBA will be very cautious and very data driven. We have however maintained our view that two additional rate rises are likely in 2019.

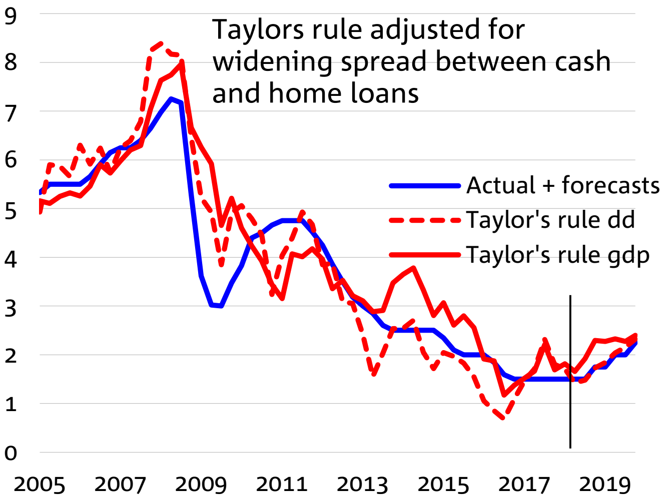
HEADLINE AND CORE INFLATION

y/y % change



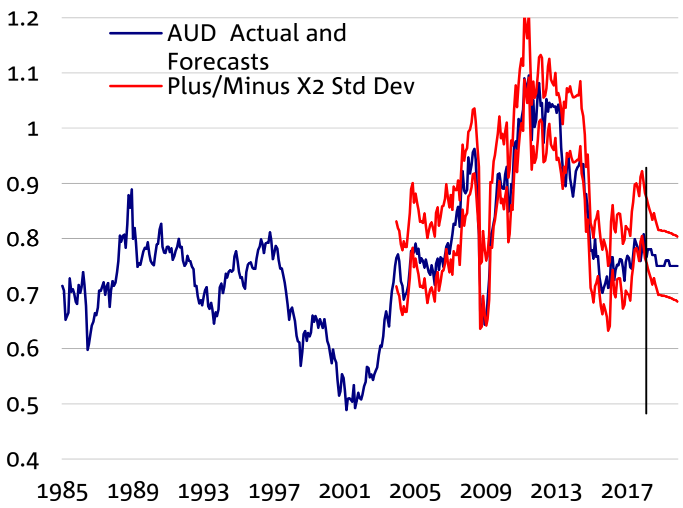
TAYLORS RULE AND RATE FORECASTS

y/y % change



FX MODEL AND FORECASTS

AUD/USD



Sources: Econdata DX, RBA, ABS, NAB Economics

APPENDIX A: FORECAST TABLES

DETAILED ECONOMIC FORECASTS (ANNUAL AVERAGE)

Australian economic and financial forecasts (a)

	Fiscal Year				Calendar Year				
	2016-17	2017-18 F	2018-19 F	2019-20 F	2016	2017	2018-F	2019-F	2020-F
Private Consumption	2.6	2.8	2.3	2.7	2.9	2.7	2.6	2.4	2.7
Dwelling Investment	2.8	-3.9	-2.6	-0.9	8.5	-2.4	-3.3	-2.0	0.6
Underlying Business Investment	-6.7	6.4	4.6	5.7	-12.0	2.8	4.6	5.2	6.3
Underlying Public Final Demand	5.0	4.6	3.4	3.9	5.3	4.5	3.9	3.7	3.8
Domestic Demand	**2.3**	**3.1**	**2.5**	**3.0**	**1.9**	**2.9**	**2.6**	**2.7**	**3.2**
Stocks (b)	0.1	-0.2	0.0	0.0	0.1	-0.1	-0.1	0.0	0.0
GNE	**2.4**	**2.9**	**2.5**	**3.0**	**2.0**	**2.8**	**2.5**	**2.7**	**3.2**
Exports	5.5	3.7	5.1	3.2	6.8	3.8	4.9	3.7	3.7
Imports	4.9	6.0	3.7	4.9	0.2	7.6	4.1	4.3	5.3
GDP	**2.1**	**2.6**	**2.8**	**2.6**	**2.6**	**2.3**	**2.8**	**2.6**	**2.8**
Nominal GDP	5.9	4.4	3.6	4.4	3.8	5.8	4.2	3.4	5.2
Federal Budget Deficit: ($b)	-37	-34	-23	-22	NA	NA	NA	NA	NA
Current Account Deficit ($b)	37	44	64	83	52	42	47	78	89
(-%) of GDP	2.1	2.4	3.4	4.2	3.1	2.3	2.5	4.0	4.4
Employment	1.3	3.0	2.2	1.6	1.6	2.2	2.7	1.8	1.7
Terms of Trade	14.5	2.2	-5.4	-2.3	0.1	11.6	-0.8	-6.4	-0.3
Average Earnings (Nat. Accts. Basis)	0.3	1.3	2.1	2.6	0.9	0.7	1.7	2.4	2.7
End of Period									
Total CPI	1.9	2.3	2.4	2.6	1.5	1.9	2.4	2.4	2.7
Core CPI	1.8	1.7	2.2	2.4	1.5	1.8	2.0	2.2	2.5
Unemployment Rate	5.6	5.4	5.0	5.0	5.7	5.4	5.1	5.0	5.0
RBA Cash Rate	1.50	1.50	2.00	2.25	1.50	1.50	1.75	2.25	2.75
10 Year Govt. Bonds	2.60	2.80	3.40	3.65	2.77	2.63	3.10	3.65	3.80
$A/US cents :	0.77	0.78	0.76	0.74	0.72	0.78	0.75	0.75	0.73
$A - Trade Weighted Index	65.5	59.8	62.9	60.8	63.9	64.9	60.3	62.1	58.8

(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

COMMODITY PRICE FORECASTS

		Spot	Actual	Forecasts										
	Unit	2/04/2018	Mar-18	*Jun-18*	*Sep-18*	*Dec-18*	*Mar-19*	*Jun-19*	*Sep-19*	*Dec-19*	*Mar-20*	*Jun-20*	*Sep-20*	*Dec-20*
WTI oil	US$/bbl	63	65	62	63	62	62	60	61	62	62	63	64	64
Brent oil	US$/bbl	70	69	68	69	68	68	66	67	68	68	69	70	70
Tapis oil	US$/bbl	69	70	69	70	69	69	67	68	69	69	70	71	71
Gold	US$/ounce	1339	1330	1330	1340	1360	1380	1370	1380	1390	1400	1400	1410	1420
Iron ore (spot)	US$/tonne	n.a.	75	67	63	61	60	58	60	62	63	61	58	60
Hard coking coal*	US$/tonne	n.a.	230	180	130	110	101	99	100	100	105	100	95	100
Semi-soft coal*	US$/tonne	n.a.	167	130	94	79	73	71	72	72	76	72	69	72
Thermal coal*	US$/tonne	104	85	90	90	90	90	65	65	65	65	60	60	60
Aluminium	US$/tonne	1987	2130	2040	1980	1920	1900	1890	1880	1880	1880	1880	1880	1880
Copper	US$/tonne	6679	6920	6860	6830	6830	6830	6830	6830	6830	6830	6830	6830	6830
Lead	US$/tonne	2395	2520	2470	2440	2410	2410	2410	2410	2410	2410	2410	2410	2410
Nickel	US$/tonne	13253	12130	12790	12470	12220	12210	12210	12210	12210	12210	12210	12210	12210
Zinc	US$/tonne	3284	3290	3190	3190	3210	3220	3220	3220	3220	3220	3220	3220	3220
Aus LNG**	AU$/GJ	n.a.	10.30	11.40	11.41	11.87	11.72	11.64	11.41	11.56	11.72	11.87	12.03	12.35

* Data reflect NAB estimates of US$/ tonne FOB quarterly contract prices (thermal coal is JFY contract). Actual data represent most recent final quarterly contract price.
** Implied Australian LNG export prices

Source: Thomson Reuters Datastream, ABS, Econdata DX, RBA, NAB Economics

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