

AUSTRALIAN MARKETS WEEKLY



NAB delays first rate hike until mid-2019

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- NAB has delayed the timing of when we expect the RBA to start a gradual interest rate hiking cycle.
- The change reflects the fact there is no sign as yet of stronger wages growth and unemployment has been stuck at around 5.5% for the best part of a year.
- While still very data dependent we now have the start of a gradual rate hiking cycle in mid-2019.
- We still expect the economy to strengthen, leading to a declining unemployment rate. This should eventually translate into stronger wages growth and give the RBA confidence that inflation will track back to its 2.5% target. However, we acknowledge there is considerable uncertainty around the timing at which wages growth will strengthen, and the time of the RBA's next move will remain highly data dependent.
- Markets are starting the week with news that the US and China appear to have agreed to cease trade hostilities, with China reportedly committing to purchasing more US agricultural goods and energy, in an attempt to reduce the bilateral trade balance. (Both are significant exports by Australia to China). The \$A is relatively supported as EUR weakens due to Italian political concerns and the JPY weakens as the correlation with rising US yields re-establishes. Despite a pullback at week's end, longer-dated yields generally remained under upward pressure last week.
- This week is a relatively quiet one for Australian events, with Construction Work Done on Wednesday (a partial for Q1 GDP due in early June) the only first tier economic release. We are fractionally above market – the key interest will be the extent to which non-residential construction and infrastructure spending are offsetting a slight moderation in residential construction. Anecdotally, infrastructure spending is becoming more material for the economy.
- There are also two RBA speeches – both after Australian market hours. The Governor speaks Wednesday evening on “Australia’s Deepening Economic Relationship with China: Opportunities and Risks”, while Assistant Governor Bullock is speaking at a Housing Market seminar in Holland on Friday night.
- Offshore, it is also a less hectic calendar, though there will be interest in the FOMC minutes (on Wednesday evening) – along with various Fed speakers throughout the week. The key statistic release of the week is likely to be the European PMIs on Wednesday, with much debate about whether European growth is slowing or largely reflected very cold weather in April. There will also be continuing interest in developments in Italian coalition discussions, which have been impacting on European bond yields.

To contact NAB’s market experts, please click on one of the following links:

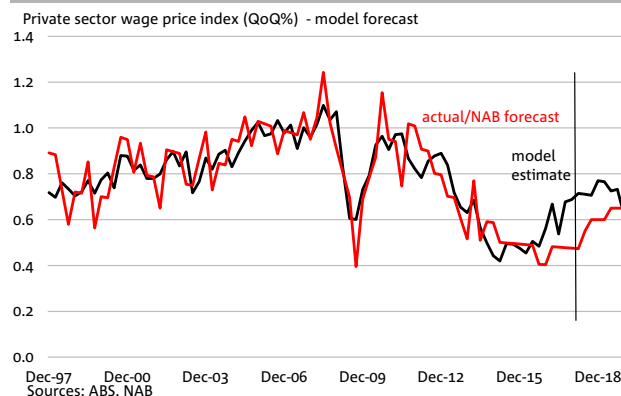
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- [Ask the Interest Rate Strategists](#)

Key markets over the past week

	Last	% chg week		Last	bp / % chg week
AUD	0.7516	-0.1	RBA cash	1.50	0
AUD/CNY	4.79	0.4	3y swap	2.27	3
AUD/JPY	83.4	1.1	ASX 200	6,077	-0.9
AUD/EUR	0.639	1.3	Iron ore	66.9	-0.7
AUD/NZD	1.089	0.0	WTI oil	71.7	1.0

Source: Bloomberg

Chart 1: Private Sector Wage Price Index (QoQ%)



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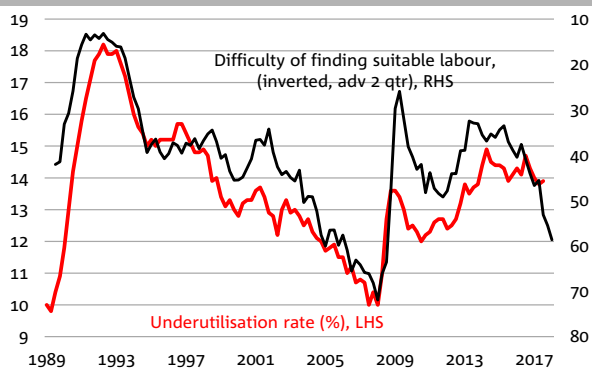
For some time NAB has been forecasting that if the economy were to improve as expected, then the RBA would at some point feel confident enough with the economic outlook to start the process of raising the cash rate from its current low level of 1½%. In particular, our view has been that economic growth will strengthen over the coming year and that, with the pace of jobs growth already solid, this would lead to a declining unemployment rate and as a result upwards pressure on wages growth and inflation.

We still consider that this is the most likely trajectory for the economy and RBA policy. However, this week’s data on wages and the labour market indicate that November 2018, our previous forecast for the first rate rise, is too early and we now expect the RBA to be on hold through the rest of this year.

The unemployment rate ticked up 0.1ppt in April to 5.6%, and while the monthly data can bounce around, it adds to the evidence that progress in reducing the unemployment rate has stalled. The ABS measure of the trend unemployment rate has been at 5.5% since August last year; while jobs growth has been solid over this period, this has been offset by further increases in workforce participation. On the wages front, the Wage Price Index (WPI) for the March quarter 2018 was unchanged at 2.1% y/y, with private sector wages growth also unchanged at a slightly weaker 1.9% y/y and showing no signs of accelerating.

The RBA’s view on the outlook for the Australian economy is similar to NAB’s, in that it expects growth to strengthen, and for unemployment to decline leading to a pick-up in wages. The Bank continues to expect progress on unemployment, wages and inflation to be only gradual and has made clear that there is not a strong case for a near-term change in the cash rate. This week’s wage and unemployment data clearly will have done nothing to change this view. Quite reasonably, the RBA does not see 2% wages growth as consistent with 2.5% inflation over time and wants to see some pick-up in wages before lifting rates.

Chart 2: Labour underutilisation and constraints



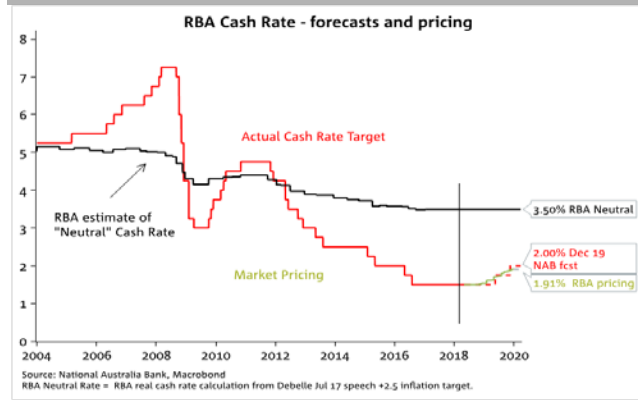
Sources: ABS, NAB Quarterly Business Survey

We still believe that conditions are in place for wages growth to rise in the future. Our modelling of factors that affect wages – inflation, labour market

underutilisation, productivity and the terms of trade – suggest that we would already have expected to see stronger wages growth. Clearly this has not happened and may reflect the need for the unemployment rate to get closer to its long-term ‘neutral’ rate of 5% or lower, before sufficient wage pressures emerge. This has been the experience of other countries in recent years. With the unemployment rate stuck around 5.5% recently, we now don’t expect the unemployment rate to get close to the 5% mark until mid-2019. That said, businesses continue to indicate – through our Quarterly Business Survey – that they are finding it increasingly difficult to find suitable labour; historically this has been associated with a decline in the unemployment rate, as well as the underutilisation rate and, ultimately, wages growth.

As a result our forecasts for WPI growth are more conservative than the model projections but we still expect to see some acceleration in wages growth. We are projecting that by mid-2019 WPI growth will reach the 2½% y/y mark. At that time, with unemployment close to its full-employment level, growth above trend and wages growth gradually accelerating, we expect the RBA would have sufficient confidence that inflation will move back towards target and so start to gradually lift the cash rate off its current very low level. We expect once the tightening cycle starts, further rate increases will be very gradual. We are now expecting the first move to be in mid (May) 2019, with the next move after that not until late in the year (November 2019).

Chart 3: NAB forecast now more in line with market



However we acknowledge that there is considerable uncertainty around the timing of the RBA’s next move. The divergence of wages growth from what is suggested by the models makes this uncertainty greater than usual. The RBA will remain heavily data dependent and will want to see sustained signs of a pick-up in wages growth before moving, even if the rest of the economy moves in line with expectations.

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CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEST
Monday, 21 May 2018								
NZ	Net Migration SA	Apr			4930	5480	21.45	8.45
NZ	Retail Sales Ex Inflation QoQ	1Q	0.8	1	0.1	1.7	21.45	8.45
JN	Trade Balance	Apr		440	626	797.346	22.50	9.50
NZ	Credit Card Spending YoY	Apr				7.2	2.00	13.00
US	Chicago Fed Nat Activity Index	Apr		0.475		0.1	11.30	22.30
US	Fed's Bostic Speaks to Atlanta Economics Club						15.15	2.15
US	Fed's Harker Speaks in New York						17.05	4.05
US	Fed's Kashkari Speaks at Moderated Q&A in Escanaba, MI						20.30	7.30
Tuesday, 22 May 2018								
UK	Public Sector Net Borrowing	Apr		7.05		-0.3	7.30	18.30
UK	PSNB ex Banking Groups	Apr		8.5		1.3	7.30	18.30
CA	Wholesale Trade Sales MoM	Mar		0.9		-0.8	11.30	22.30
US	Richmond Fed Manufact. Index	May		8		-3	13.00	0.00
Wednesday, 23 May 2018								
JN	Nikkei Japan PMI Mfg	May P				53.8	23.30	10.30
AU	Westpac Leading Index MoM	Apr				-0.22	23.30	10.30
AU	Construction Work Done	1Q	1.5	1.3		-19.4	0.30	11.30
JN	All Industry Activity Index MoM	Mar		0.1		0.4	3.30	14.30
JN	Machine Tool Orders YoY	Apr F				22	5.00	16.00
GE	Markit/BME Germany Manufacturing PMI	May P		57.9		58.1	6.30	17.30
GE	Markit Germany Services PMI/Composite PMI	May P		53.1/54.6		53/54.6	6.30	17.30
EC	Markit Eurozone Manufacturing PMI	May P		56		56.2	7.00	18.00
EC	Markit Eurozone Composite PMI	May P		55.1		55.1	7.00	18.00
AU	RBA's Lowe Speaks at Aust-China Relations Institute in Sydney						7.00	18.00
UK	CPI MoM/YoY	Apr		0.5/2.5		0.1/2.5	7.30	18.30
UK	CPI Core YoY	Apr		2.2		2.3	7.30	18.30
UK	Retail Price Index MoM/YoY	Apr		0.5/3.4		0.1/3.3	7.30	18.30
UK	PPI Output NSA MoM/YoY	Apr		0.3/2.3		0.2/2.4	7.30	18.30
US	Markit US Manufacturing PMI	May P		56.5		56.5	12.45	23.45
US	Markit US Composite PMI	May P				54.9	12.45	23.45
US	New Home Sales	Apr		679		694	13.00	0.00
EC	Consumer Confidence	May A		0.5		0.4	13.00	0.00
US	FOMC Meeting Minutes	2 May					17.00	4.00
Thursday, 24 May 2018								
NZ	Trade Balance NZD	Apr		198		-86	21.45	8.45
AU	NAB Consumer Behaviour (Spending) Survey	1Q					0.30	11.30
JN	Leading Index CI	Mar F				105	4.00	15.00
GE	GDP SA QoQ/WDA YoY	1Q F		0.3/2.3		0.3/2.3	5.00	16.00
GE	GfK Consumer Confidence	Jun		10.8		10.8	5.00	16.00
US	Fed's Dudley Speaks on Reference Rate Reform at BoE Event						7.15	18.15
UK	Retail Sales Inc Auto Fuel MoM/YoY	Apr		0.8/0.2		-1.2/1.1	7.30	18.30
US	Initial Jobless Claims	19 May		220		222	11.30	22.30
US	FHFA House Price Index MoM	Mar				0.6	12.00	23.00
US	Fed's Harker Speaks About Technology's Impact on Labor Market						17.00	4.00
Friday, 25 May 2018								
JN	Tokyo CPI YoY/Ex Fresh Food YoY	May		0.5/0.6		0.5/0.6	22.30	9.30
GE	Ifo Business Climate/Current Assessment	May		102/105.5		102.1/105.7	7.00	18.00
UK	GDP QoQ/YoY	1Q P		0.1/1.2		0.1/1.2	7.30	18.30
AU	RBA's Bullock Speaks at Housing Seminar in Amsterdam						11.00	22.00
US	Durable Goods Orders	Apr P		-1.4		2.6	11.30	22.30
US	Cap Goods Orders Nondef Ex Air	Apr P		0.6		-0.4	11.30	22.30
US	Fed's Powell Joins Riksbank's 350th Anniversary Conference						12.00	23.00
US	U. of Mich. Sentiment/Expectations	May F		98.8/		98.8/89.5	13.00	0.00
US	Fed's Kaplan, Evans and Bostic Speak at Dallas Fed						14.45	1.45
Upcoming Central Bank Interest Rate Announcements								
Canada, BoC		30-May	1.375%	1.25%		1.25%		
Australia, RBA		5-Jun	1.5%	1.5%		1.5%		
US, Federal Reserve		13-Jun	1.75-2%	1.75-2%		1.5-1.75%		
Europe, ECB		14-Jun	-0.4%	-0.4%		-0.4%		
Japan, BoJ		15-Jun	-0.1%	-0.1%		-0.1%		
New Zealand, RBNZ		28-Jun	1.75%	1.75%		1.75%		
UK, BOE		21-Jun	0.5%	0.5%		0.5%		

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

FORECASTS

Economic Forecasts					Quarterly % change																
Annual % change					2016				2017				2018				2019				
	2016	2017	2018	2019	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Australia Forecasts																					
Household Consumption	2.9	2.7	2.8	2.4	1.0	0.6	0.5	0.8	0.4	0.9	0.5	1.0	0.8	0.5	0.5	0.6	0.6	0.6	0.7	0.7	0.7
Underlying Business Investment	-11.9	3.0	4.0	5.4	-3.4	-2.4	-5.4	1.6	3.2	0.3	4.0	-1.2	0.6	1.6	1.3	1.3	1.1	1.5	1.4	1.5	1.5
Residential Construction	8.6	-2.4	-3.2	-2.0	4.6	1.5	-1.0	2.5	-3.0	0.2	-1.7	-1.3	-0.4	-1.0	-0.6	-0.3	-1.0	-0.2	0.0	-0.5	-0.5
Underlying Public Spending	5.3	4.5	3.9	3.7	1.8	2.0	1.0	0.7	1.0	1.1	1.6	1.1	0.8	0.8	0.8	0.9	1.0	1.0	1.0	1.0	1.0
Exports	6.8	3.9	4.9	4.3	2.5	1.2	0.8	3.2	-1.7	3.0	1.2	-1.8	2.1	1.9	1.8	1.6	0.5	0.8	0.8	0.9	0.9
Imports	0.2	7.6	4.2	4.5	-0.8	2.5	0.8	2.3	2.9	0.8	2.2	0.5	1.1	0.9	0.9	1.1	1.0	1.2	1.4	1.3	1.3
Net Exports (a)	1.2	-0.9	0.0	-0.2	1.0	-0.3	0.0	0.1	-1.0	0.4	-0.2	-0.5	0.2	0.2	0.2	0.1	-0.1	-0.1	-0.2	-0.1	-0.1
Inventories (a)	0.1	-0.1	0.0	0.0	0.0	0.4	0.2	-0.4	0.4	-0.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic Demand - qtr %					0.1	0.6	-0.1	1.0	0.7	0.9	0.9	0.6	0.7	0.6	0.6	0.7	0.6	0.7	0.8	0.8	0.8
Dom Demand - ann %	1.9	2.9	2.7	2.7	1.5	1.8	1.7	2.5	2.3	2.6	3.6	3.1	3.1	2.7	2.4	2.5	2.5	2.6	2.9	3.0	3.0
Real GDP - qtr %					1.0	0.8	-0.2	1.1	0.5	0.8	0.7	0.4	0.9	0.8	0.7	0.8	0.5	0.7	0.6	0.7	0.7
Real GDP - ann %	2.6	2.3	2.8	2.7	2.7	3.3	2.1	2.4	1.9	2.0	2.9	2.4	2.8	2.7	2.7	3.1	2.8	2.7	2.6	2.5	2.5
CPI headline - qtr %					-0.2	0.4	0.7	0.5	0.5	0.2	0.6	0.6	0.4	0.5	0.6	0.7	0.5	0.5	0.6	0.8	0.8
CPI headline - ann %	1.3	1.9	2.2	2.3	1.3	1.0	1.3	1.5	2.1	1.9	1.8	1.9	1.9	2.2	2.2	2.3	2.4	2.3	2.3	2.4	2.4
CPI underlying - qtr %					0.2	0.5	0.3	0.5	0.5	0.6	0.4	0.4	0.5	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	2.1	1.6	1.6	1.5	1.5	1.8	1.8	1.9	1.9	1.8	1.8	1.9	2.0	2.1	2.1	2.1	2.2	2.2
Wages (Pvte WPI - qtr %)					0.5	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7
Wages (Pvte WPI - ann %)	1.9	1.8	2.1	2.5	2.0	2.0	1.9	1.8	1.8	1.8	1.9	1.9	2.0	2.1	2.2	2.3	2.4	2.5	2.5	2.6	2.6
Unemployment Rate (%)	5.7	5.6	5.4	5.1	5.8	5.7	5.7	5.7	5.9	5.6	5.5	5.4	5.5	5.5	5.4	5.2	5.2	5.1	5.1	5.1	5.1
Terms of trade	0.5	12.2	-1.1	-0.9	-1.9	2.5	4.1	11.2	5.4	-6.0	-0.1	0.2	2.7	-3.0	-3.2	-1.0	-1.9	-2.2	0.3	0.4	0.4
G&S trade balance, \$Abn	-14.2	11.8	2.7	-25.1	-8.4	-7.5	-4.3	6.0	6.9	3.0	2.0	-0.1	3.5	1.5	-0.9	-1.4	-4.0	-6.8	-7.2	-7.2	-7.2
% of GDP	-0.8	0.7	0.1	-1.3	-2.0	-1.8	-1.0	1.4	1.5	0.7	0.4	0.0	0.8	0.3	-0.2	-0.3	-0.8	-1.4	-1.5	-1.5	-1.5
Current Account (% GDP)	-3.1	-2.3	-3.0	-4.4	-3.7	-3.9	-3.3	-1.4	-1.4	-2.4	-2.4	-3.1	-2.4	-2.8	-3.3	-3.4	-4.0	-4.5	-4.6	-4.6	-4.6

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

Exchange Rate Forecasts

	21-May	Jun-18	Sep-18	Dec-18	Jun-19	Dec-19
Majors						
AUD/USD	0.7516	0.77	0.75	0.75	0.75	0.75
NZD/USD	0.6903	0.71	0.70	0.70	0.71	0.70
USD/JPY	111.00	110	108	106	102	99
EUR/USD	1.1757	1.23	1.25	1.26	1.28	1.32
GBP/USD	1.3463	1.42	1.45	1.50	1.53	1.55
USD/CNY	6.3800	6.28	6.20	6.20	6.23	6.25
USD/CAD	1.2886	1.24	1.24	1.22	1.23	1.25
USD/CHF	0.9988	0.98	0.97	0.96	0.95	0.93

Australian Cross Rates						
	21-May	Jun-18	Sep-18	Dec-18	Jun-19	Dec-19
AUD/NZD	1.0888	1.08	1.07	1.07	1.06	1.07
AUD/JPY	83.4	85	81	80	77	74
AUD/EUR	0.6393	0.63	0.60	0.60	0.59	0.57
AUD/GBP	0.5583	0.54	0.52	0.50	0.49	0.48
AUD/CNY	4.7952	4.84	4.65	4.65	4.67	4.69
AUD/CAD	0.9685	0.95	0.93	0.92	0.92	0.94
AUD/CHF	0.7507	0.75	0.73	0.72	0.71	0.70

Interest Rate Forecasts

	21-May	Jun-18	Sep-18	Dec-18	Jun-19	Dec-19
Australia Rates						
RBA Cash rate	1.50	1.50	1.50	1.50	1.75	2.00
3 month bill rate	1.94	1.95	1.95	1.95	2.15	2.40
3 Year Swap Rate	2.27	2.1	2.3	2.3	2.8	3.2
10 Year Swap Rate	3.04	3.0	3.2	3.2	3.6	3.8
Offshore Policy Rates						
US Fed funds	1.75	2.00	2.25	2.25	2.75	3.00
ECB deposit rate	-0.40	-0.40	-0.40	-0.40	-0.20	0.00
BoE repo rate	0.50	0.50	0.50	0.75	1.00	1.25
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	2.00	2.50
China 1yr lending rate	4.35	4.35	4.35	4.35	4.35	4.35
China Reserve Ratio	16.0	16.0	16.0	16.0	16.0	16.0
10-year Benchmark Bond Yields						
Australia	2.87	2.80	3.05	3.05	3.30	3.50
United States	3.08	3.00	3.25	3.25	3.50	3.50
New Zealand	2.84	2.90	3.20	3.25	3.60	3.85

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP

Dec year	2014	2015	2016	2017	2018	2019	20 Yr Avg
Australia	2.6	2.5	2.6	2.3	2.8	2.7	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	2.7	2.5	1.5
UK	3.1	2.3	1.9	1.8	1.8	1.7	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	7.6	7.9	6.4	6.8	7.2	6.6
New Zealand	3.6	3.5	4.0	2.9	3.0	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	4.1	3.8	5.0

Commodity prices (\$US)

	21-May	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Brent oil	71.7	67	67	66	65	66	67	68
Gold	1290	1320	1330	1360	1380	1370	1380	1390
Iron ore	66.7	67	63	61	60	58	60	62
Hard coking coal	184	175	130	110	101	99	100	100
Thermal coal	104	90	90	90	90	65	65	65
Copper	6837	6690	6630	6630	6630	6630	6630	6630
Aust LNG (*)	12.5	11.2	11.5	11.8	11.7	11.3	11.7	11.8

(*) Implied Australian LNG export prices.

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