

AUSTRALIAN MARKETS WEEKLY



Boring, boring, boring as the central forecast plays out

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| Boring boring boring | 2 | • This week's article highlights that despite an awful lot of noise in markets (think North Korea, the US-China trade dispute, Oil and the Middle East and Italian political uncertainties), the boringly positive development has been that the central forecast for a slow improvement in Australian and global growth, continues to play out. |
| Calendar of economic releases | 4 | |
| Forecasts | 5 | • While we should not become complacent about this fact – unknown developments frequently knock us off the central forecast path – the past six to twelve months have been somewhat unusual to the extent that forecast revisions have been relatively minor. |
| | | • The inference remains that while the RBA is currently in no hurry to move interest rates, if the forecast continues to play out as expected, at some stage the RBA will begin to lift its official cash rate. |
| | | • In markets, the week begins with news that Russia and OPEC are discussing increasing oil output, which has seen oil prices sharply lower. Interest rate markets have broadly been rallying over the past week or so mostly as a result of Italian political uncertainty, with lower oil prices likely further supporting the moves on Friday night. Currency markets have been mixed – the EUR mostly weaker on Italian developments. Higher oil prices also likely have been part of the story of softer European PMIs (along with cold weather), so lower oil prices may well help growth sentiment improve. |
| | | • This week, while Australian capex expectations will be closely watched to assess the progress of non-mining investment, together with any signs of an early lift in mining capex (it's likely too early for the latter just yet given the larger new projects being talked about have long lead times), market participants' focus will largely be on offshore developments. Next week is more important for Australia with the RBA June Board meeting and Q1 GDP, where NAB looks for a strong 0.8/0.9% q/q print. |
| | | • Offshore, the US PCE measure of inflation (Thursday), Non-farm Payrolls (and hourly earnings) (Friday) and ISM (Friday) will each be closely followed for clues as to how many further interest rate rises will be seen in the US this year. Fed officials seem to be trying to assess whether a prospective rise in inflation above 2% will prove temporary (a contention not supported by Prices Paid and Supplier Deliveries data in the ISM). The track of the unemployment rate below NAIRU should also influence market expectations about US wages growth. Europe also publishes CPI data on Thursday (oil likely to be an influence), while China releases its official PMI data on Thursday, which will be closely watched given some indications of manufacturing softening in Europe in recent months. |

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[Ask the Economists](#)

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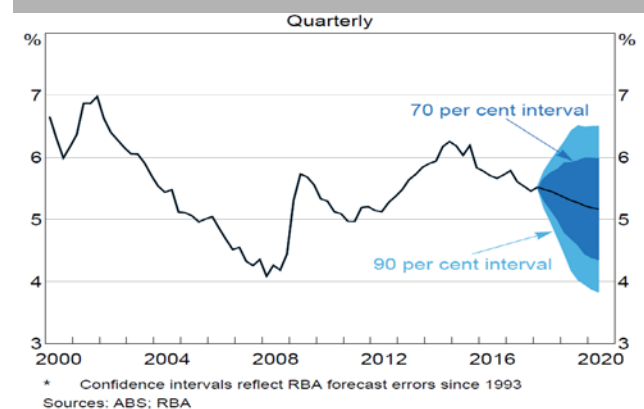
[Ask the Interest Rate Strategists](#)

Key markets over the past week

	Last	% chg week		Last	bp / % chg week
AUD	0.7557	-0.3	RBA cash	1.50	0
AUD/CNY	4.83	0.8	3y swap	2.21	-5
AUD/JPY	82.8	-1.6	ASX 200	6,033	-0.9
AUD/EUR	0.647	0.6	Iron ore	63.9	-4.5
AUD/NZD	1.092	0.1	WTI oil	67.3	-7.0

Source: Bloomberg

Chart 1: RBA Unemployment Forecast Performance



Peter Jolly, Global Head of Research

Boring, boring, boring as the central forecast plays out.

All forecasts are subject to risk. One of the best illustrations of the risks to any forecast is the fan charts that are regularly shown in the RBA’s Quarterly Statement on Monetary Policy – see Chart 1 on the front page.

The fans around the central forecast are the historic forecasting errors of the RBA’s economics team and they are clearly quite large. Thinking about the latest “central” forecast made in early May for the unemployment rate to decline from 5½% now to 5¼% by mid-2020, if the Bank’s historic forecasting performance is a guide, they can only be 70% confident the unemployment rate will lie between 4¼% and 6% two years from now and only 90% confident it will be between 4% and 6.5%.

These wide confidence bands do not reflect the RBA’s forecasting ability – the RBA has high quality researchers, more resources than most, and are very probably one of the best macroeconomic forecasting units in the country.

Rather, the wide confidence bands illustrate that all forecasts are subject to risk. Heading into Rumsfeldian territory: 1) a known risk to the forecast may escalate; or 2) something unforeseen may appear to knock the forecast off track. As well as external factors knocking the forecast off track, our understanding of the intricate economic/financial linkages is limited – so even if our assumptions are correct, the economy and markets may evolve in a different manner than we expect.

In recent years something unusual has occurred against this backdrop of ever-present forecasting difficulties. It is that the central forecast path is largely playing out as expected!

The changes we’ve made to NAB’s macroeconomic forecasts over the past year for GDP, employment, the unemployment rate and inflation have been fairly modest. The direction of the tweaks is relevant though, as they have generally been towards better activity (more employment and GDP) and a delayed pick-up in wages and inflation.

The changes to the RBA’s forecast have been similarly modest and positive. The charts below show how the RBA’s forecasts for the unemployment rate and underlying inflation have evolved in their quarterly updates since August 2017:

- The unemployment rate has generally been consistently forecast to decline by the RBA in recent years. Despite an interruption to its decline over the past year (as the participation rate rose broadly in line with very strong employment gains) the RBA’s forecast for the unemployment rate to decline towards 5¼% over the next few years didn’t change between their February and May forecasts. At NAB we are a little more optimistic expecting a slightly steeper decline in the unemployment rate ahead.
- For underlying inflation, the RBA has consistently forecast a gradual lift in inflation and a return to their 2 to 3% band in the years ahead. The largest revision to this forecast was between August and November 2017, where the forecast was revised down after a

fairly low Q3 2017 print. Since then the underlying inflation forecast has been stable to higher – the one and two year ahead forecasts made in February and May this year are basically identical.

So macroeconomic conditions in Australia are evolving: 1) fairly slowly along the forecast path; and 2) generally in a positive direction. **Also, it’s worth knowing that if we continue to move along this path, the RBA will eventually lift the cash rate.** That’s what the Minutes from the 1 May Board meeting stated, saying “members agreed that it was more likely that the next move in the cash rate would be up, rather than down.”

No hurry for now, but the RBA’s current thinking implicitly assumes a higher cash rate at some point. How the forecast evolves will influence the timing.

Chart 2: Slow decline forecast (NAB more optimistic)

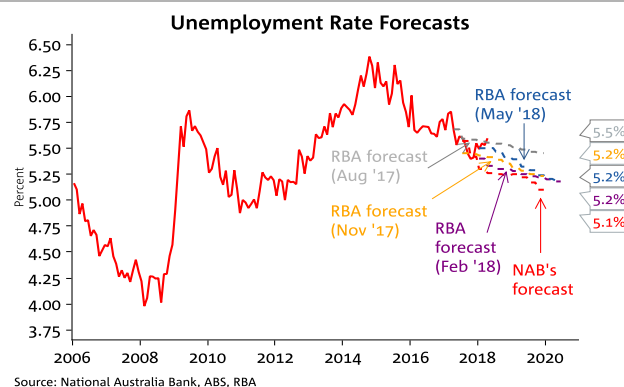
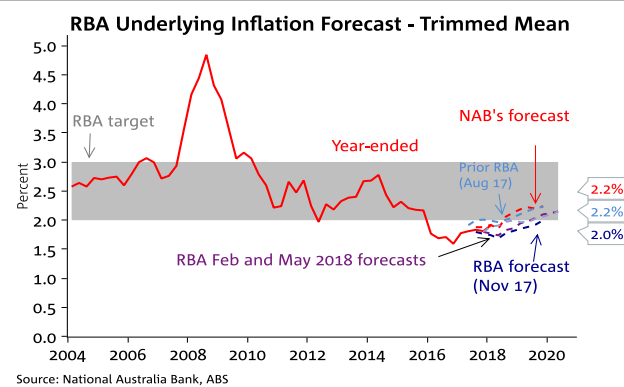


Chart 3: Slow increase expected (little change recently)



The global backdrop is also boringly positive

Global macroeconomic developments are also evolving slowly, but also in a positive fashion. We illustrate this in Chart 4 with the evolution of the IMF’s forecasts for global growth in their World Economic Outlook. A year ago the IMF was forecasting global GDP would grow at a slightly above-trend rate of 3.6% and their latest forecast made in April now sees 2018 growth at 3.9% – this upward revision is largely due to the fiscal stimulus stemming from the Trump Administration’s tax reform package. Absent this tax reform and it’s likely that the global GDP forecast would be little different to that made a year ago.

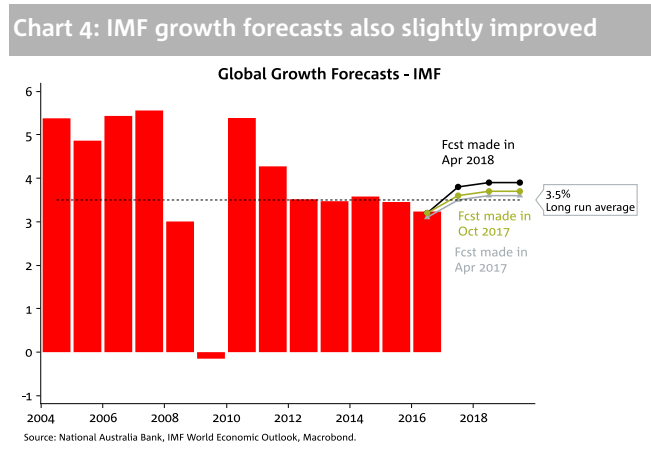
Known risks

History warns against complacency and in the years ahead the Australian and global economies will surely

be knocked off these forecast paths. Some of the known risks to the outlook include: 1) the US Fed moving along the previously unwalked path of Quantitative Tightening; 2) ongoing geopolitical risks; 3) risks emanating from the sharp rise in debt in China’s economy in recent years that RBA Governor Phil Lowe pointed to in a speech last week; 4) the rise in Australian household leverage which has made the broader economy more vulnerable to an economic downturn; and related to this 5) a now evident slowdown in Australian house price growth – and even some falls in cities like Sydney.

Boring but good

These and other risks will always capture the headlines. But for now the more obvious and rather boring story is that both the Australian and global economies are progressing gradually along the forecast path, which continues to see growth being modestly above trend. Good news and completely unworthy of headlines.



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CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEST
Monday, 28 May 2018								
Memorial Day Public Holiday - US								
UK	Nationwide House PX MoM/ NSA YoY	May		0.2/3		0.2/2.6	28 May to 3 June	
Tuesday, 29 May 2018								
JN	Jobless Rate	Apr				2.5	22.30	9.30
EC	ECB's Villeroy to Speak in Paris						6.45	17.45
EC	M3 Money Supply YoY	Apr		3.9		3.7	7.00	18.00
US	Conf. Board Consumer Confidence	May		128		128.7	13.00	0.00
US	Dallas Fed Manf. Activity	May		23		21.8	13.30	0.30
Wednesday, 30 May 2018								
NZ	RBNZ Publishes Financial Stability Report						20.00	7.00
NZ	Building Permits MoM	Apr				14.7	21.45	8.45
JN	Retail Sales MoM/YoY	Apr P		0.5/1		-0.7/1	22.50	9.50
JN	BoJ Governor Kuroda Speaks at Conference						23.00	10.00
AU	Building Approvals MoM/ YoY	Apr	-2.1/5	-3/4.1		2.6/14.5	0.30	11.30
GE	CPI Saxony MoM/YoY	May		/		0/1.6	6.00	17.00
GE	Unemployment Claims Rate SA	May		5.3		5.3	6.55	17.55
EC	Economic Confidence	May		112		112.7	8.00	19.00
EC	Consumer Confidence	May F		0.2		0.2	8.00	19.00
US	MBA Mortgage Applications	25 May				-2.6	10.00	21.00
GE	CPI EU Harmonized MoM/YoY	May P		0.3/1.8		-0.1/1.4	11.00	22.00
US	ADP Employment Change	May		190		204	11.15	22.15
CA	Industrial Product Price MoM	Apr		0.6		0.8	11.30	22.30
US	Wholesale Inventories MoM	Apr P		0.5		0.3	11.30	22.30
US	GDP Annualized QoQ	1Q S		2.3		2.3	11.30	22.30
US	Core PCE QoQ	1Q S		2.5		2.5	11.30	22.30
CA	Bank of Canada Rate Decision	30 May		1.25		1.25	13.00	0.00
US	U.S. Federal Reserve Releases Beige Book						17.00	4.00
Thursday, 31 May 2018								
JN	Industrial Production MoM / YoY	Apr P		1.4/3.6		1.4/2.4	22.50	9.50
NZ	ANZ Business Confidence	May				-23.4	0.00	11.00
CH	Manufacturing PMI	May		51.4		51.4	0.00	11.00
CH	Non-manufacturing PMI/Composite PMI	May		54.8/		54.8/54.1	0.00	11.00
AU	Private Capital Expenditure	1Q	0.5	1		-0.2	0.30	11.30
AU	Private Sector Credit MoM/YoY	Apr	0.3/5	0.4/5		0.5/5.1	0.30	11.30
NZ	Credit Aggregates	Apr				5.9	2.00	13.00
JN	Vehicle Production YoY	Apr				0.2	3.00	14.00
UK	Mortgage Approvals	Apr		63.35		62.9	7.30	18.30
EC	Unemployment Rate	Apr		8.4		8.5	8.00	19.00
EC	CPI Core YoY	May A		1		0.7	8.00	19.00
EC	CPI Estimate YoY	May		1.6		1.2	8.00	19.00
CA	Quarterly GDP Annualized	1Q		1.9		1.7	11.30	22.30
US	Initial Jobless Claims	46143		229.5		234	11.30	22.30
CA	GDP MoM/YoY	Mar		0.3/3		0.4/3	11.30	22.30
US	PCE Core MoM	Apr		0.1		0.2	11.30	22.30
US	Chicago Purchasing Manager	May		58		57.6	12.45	23.45
US	Fed's Bostic Speaks in Moderated Q&A in Orlando						15.30	2.30
Friday, 1 June 2018								
NZ	ANZ Consumer Confidence Index	May				120.5	21.00	8.00
AU	AiG Perf of Mfg Index	May				58.3	21.30	8.30
NZ	Merchandise Terms of Trade	1Q	-2.2	-1.5		0.8	21.45	8.45
JN	Capital Spending YoY	1Q		3.1		4.3	22.50	9.50
AU	CoreLogic House Px MoM	May				-0.3	23.00	10.00
JN	Nikkei Japan PMI Mfg	May F				52.5	23.30	10.30
CH	Caixin China PMI Mfg	May		51.2		51.1	0.45	11.45
JN	Vehicle Sales YoY	May				0.5	4.00	15.00
AU	Commodity Index SDR YoY	May				-1.4	5.30	16.30
GE	Markit/BME Germany Manufacturing PMI	May F		56.8		56.8	6.55	17.55
EC	Markit Eurozone Manufacturing PMI	May F		55.5		55.5	7.00	18.00
UK	Markit UK PMI Manufacturing SA	May		53.5		53.9	7.30	18.30
US	Change in Nonfarm Payrolls/Unemployment Rate	May		190/3.9		164/3.9	11.30	22.30
US	Average Hourly Earnings MoM/YoY	May		0.2/2.6		0.1/2.6	11.30	22.30
CA	Markit Canada Manufacturing PMI	May				55.5	12.30	23.30
US	Markit US Manufacturing PMI	May F		56.7		56.6	12.45	23.45
US	Construction Spending MoM	Apr		0.8		-1.7	13.00	0.00
US	ISM Manufacturing	May		58		57.3	13.00	0.00
Upcoming Central Bank Interest Rate Announcements								
Canada, BoC		30-May	1.25%	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%		
UK, BOE		21-Jun	0.5%	0.5%		0.5%		
New Zealand, RBNZ		28-Jun	1.75%	1.75%		1.75%		

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

FORECASTS

Economic Forecasts

	Annual % change				Quarterly % 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

	28-May	Jun-18	Sep-18	Dec-18	Jun-19	Dec-19
Majors						
AUD/USD	0.7559	0.77	0.75	0.75	0.75	0.75
NZD/USD	0.6922	0.71	0.70	0.70	0.71	0.70
USD/JPY	109.63	110	108	106	102	99
EUR/USD	1.1689	1.23	1.25	1.26	1.28	1.32
GBP/USD	1.3309	1.42	1.45	1.50	1.53	1.55
USD/CNY	6.3917	6.28	6.20	6.20	6.23	6.25
USD/CAD	1.2975	1.24	1.24	1.22	1.23	1.25
USD/CHF	0.9925	0.98	0.97	0.96	0.95	0.93

	28-May	Jun-18	Sep-18	Dec-18	Jun-19	Dec-19
Australian Cross Rates						
AUD/NZD	1.0920	1.08	1.07	1.07	1.06	1.07
AUD/JPY	82.9	85	81	80	77	74
AUD/EUR	0.6467	0.63	0.60	0.60	0.59	0.57
AUD/GBP	0.5680	0.54	0.52	0.50	0.49	0.48
AUD/CNY	4.8315	4.84	4.65	4.65	4.67	4.69
AUD/CAD	0.9808	0.95	0.93	0.92	0.92	0.94
AUD/CHF	0.7502	0.75	0.73	0.72	0.71	0.70

Interest Rate Forecasts

	28-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	2.15	2.15	2.40	2.65
3 Year Swap Rate	2.22	2.4	2.5	2.6	3.2	3.4
10 Year Swap Rate	2.94	3.3	3.4	3.5	3.9	4.0
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	2.75	2.80	3.10	3.10	3.40	3.65
United States	2.93	3.00	3.25	3.25	3.50	3.50
New Zealand	2.73	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)

	28-May	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Brent oil	67.2	67	67	66	65	66	67	68
Gold	1297	1320	1330	1360	1380	1370	1380	1390
Iron ore	63.9	67	63	61	60	58	60	62
Hard coking coal	183	175	130	110	101	99	100	100
Thermal coal	107	90	90	90	90	65	65	65
Copper	6872	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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