

AUSTRALIAN MARKETS WEEKLY

US price pressures and labour market tightness



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- US labour market data remains consistent with a 3.25% unemployment rate in around 12 months' time.
- ISM inflation indicators Prices Paid and Supplier Deliveries continue to signal inflation rising sustainably above the Fed's 2% target in 1-2 years, which should see the Fed continue to gradually increase rates (including next week). The debate is turning to whether the Fed will need to raise rates above neutral at some stage. That will depend – among other things – on the extent to which wages growth accelerates, but it's certainly looking more likely.
- Together these influences suggest continuing upward pressure on the US yield curve. Our rate strategists expect this to flow through to longer-term Australian rates, though shorter-term yields will be range bound until the market becomes more convinced the RBA is closer to lifting Australian interest rates.
- There is therefore expected to be continuing downward pressure on the AUD from interest rate differentials given higher US yields, but assuming fairly resilient commodity prices and risk sentiment, NAB's FX strategists still see AUD/USD ending 2018 around US\$ 0.75.
- This week is a busy one for Australian data and events: it starts with the final indicators of Q1 GDP, which is published on Wednesday, where NAB and the market look for a 0.8% q/q outcome, in part reflecting a bounce back from temporary weakness in net exports in Q4.
- The RBA meets tomorrow, but little new is expected, given the Bank's forecasts for continued but only gradual progress in lowering unemployment over time, which is in turn expected to see wages strengthen and inflation track back toward the middle of the target band. Market participants are likely to be interested in any discussion of further tightening in bank lending standards – auction clearance rates softened again last weekend and modest price declines are being recorded in Melbourne and Sydney, admittedly after a number of years of very strong growth.

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

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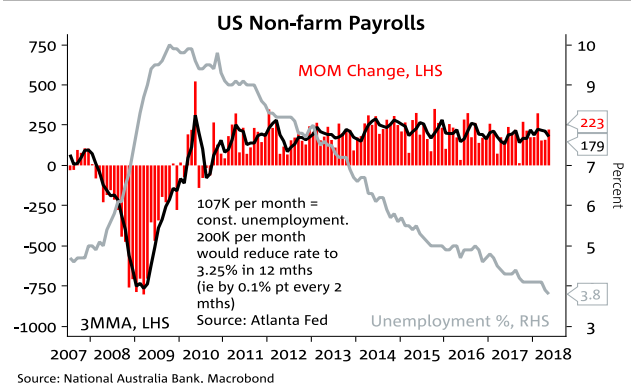
[Ask the Interest Rate Strategists](#)

Key markets over the past week

	Last	% chg week		Last	bp / % chg week
AUD	0.7576	0.1	RBA cash	1.50	0
AUD/CNY	4.86	0.5	3y swap	2.22	2
AUD/JPY	83.1	0.4	ASX 200	6,035	0.3
AUD/EUR	0.649	0.0	Iron ore	66.2	3.5
AUD/NZD	1.085	-0.3	WTI oil	65.8	-3.0

Source: Bloomberg

Chart 1: Unemployment headed to 3.25%?



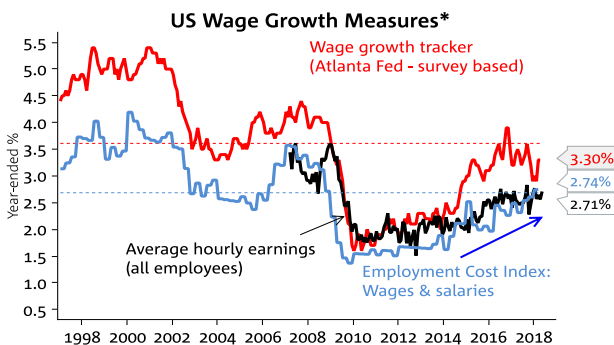
With the RBA comfortably on hold awaiting further progress lowering unemployment and lifting inflation back toward the midpoint of the target band, this week, we look at the US labour market and inflationary pressures in that economy. The bottom line is the US is not having the same problems as Australia, with the unemployment rate falling to 3.8% in May (the lowest level since one month in the 2000s' tech boom and before that the late 1960s). Inflation measures are close to the Fed's 2% target and are likely to rise further in the months ahead, as signalled by the steady rise in the Supplier Deliveries and Prices Paid components of the ISM index. Together, these developments suggest that the Fed will continue to raise US interest rates and the debate will increasingly turn to a move above neutral being likely.

Let's review Friday night's May data. Employment rose 223,000, bouncing back from the "softish" circa 150,000 reads in March and April. Even rises of around 150,000 are sufficient to reduce the unemployment rate in the US. In fact only 107,000 jobs per month are required to keep the unemployment rate constant (Chart 1). If employment continues to grow at around 200,000 jobs per month, the unemployment rate could be around 3.25% in twelve months' time. The US unemployment rate has not been below 3% since 1953.

So far, this tightening of the US labour market hasn't had as big an effect on US interest rate markets as arguably would usually be the case for a number of reasons: (i) the Fed seems relaxed about continuing on a path of gradual removal of monetary accommodation; (ii) wages have not accelerated especially quickly; and (iii) there have been a variety of global forces keeping downward pressure on US longer-term interest rates (including negative interest rates in Europe and Japan and various international geopolitical uncertainties).

That said, the wages picture is unlikely to remain quite so benign going forward if the unemployment rate continues to decline. As Chart 2 shows, wages have picked up slightly over the past few months. Last week's Beige book from the Fed reported that "labour market conditions remained tight across the country", with "shortages of qualified workers including truck drivers, sales personnel, carpenters, electricians, painters and information technology professionals". "Many firms responded to talent shortages by increasing wages as well as the generosity of their compensation packages".

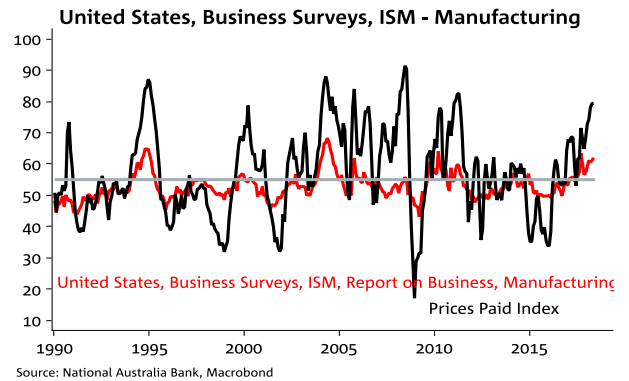
Chart 2: US wage pressures slowly lifting



* Dotted lines represents long-run averages since 1997
Source: National Australia Bank, Macrobond

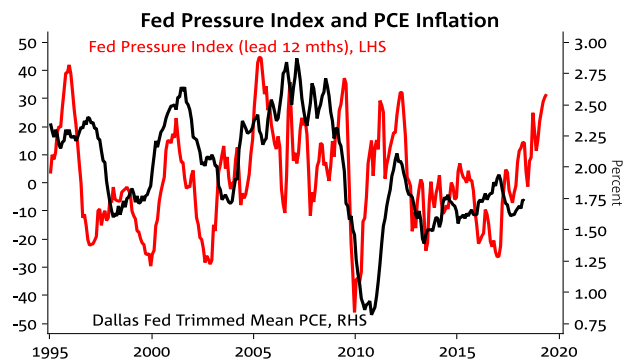
The ISM report contains two important inflationary indicators – the Prices Paid and Supplier Deliveries components. Both rose to new cycle highs in May (Chart 3). We combine these two components to form the Fed Pressure Index, which also rose to a new cycle high in May – and which leads various core inflation measures by 1-2 years (Chart 4).

Chart 3: Increasing US inflationary pressures



Source: National Australia Bank, Macrobond

Chart 4: Pointing to rising inflation ahead



Source: National Australia Bank, Macrobond

These are important developments for US interest rate markets and global markets more generally. They suggest that the US Fed will eventually come to the conclusion that the prospective rise in US inflation above its 2% target may not be temporary, which all other things being equal, means that the Fed will have to consider taking interest rates above a neutral setting. A number of Fed Governors have begun considering these possibilities, with San Francisco Fed President John Williams suggesting that the Fed is around three hikes away from neutral, but that the Fed may not pause once it reaches neutral, if the economy remains strong and inflation is at or above the 2% target. Governor Brainard has also considered the potential for the Fed to need to become restrictive.

Implications for Australia

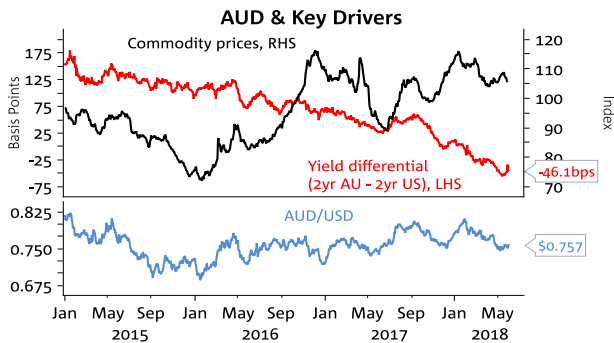
The US bond market has imparted an upward bias to Australian longer-dated borrowing rates. NAB's interest strategists look for 3-year swap rates around 3.25-3.5% next year and 10-year swap rates of 3.5-4%. With the RBA on hold until mid-2019 on NAB forecasts, continued Fed tightening will widen the Australia's negative short-term interest rate spread with the US. This is one of the components of NAB's Australian dollar fair value model and part of the reason why NAB's FX strategists are

looking for the \$A to end the year close to US\$0.75. The negative spread is currently not doing more damage to the \$A because commodity prices and volatility – the other two important drivers of the \$A – remain well supported and low, respectively (Chart 5).

In summary, US labour market and inflation developments remain consistent with NAB’s views of gradual upward pressure on Australian term interest rates and keeping the \$A contained at around US\$0.75.

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Chart 5: AUD being pulled and pushed



* Commodity price index is a daily version of the RBA Commodity Price Index
 Source: National Australia Bank, Bloomberg

CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEDT
Monday, 4 June 2018								
AU	Melbourne Institute Inflation MoM	May				0.5	1.00	11.00
AU	Melbourne Institute Inflation YoY	May				2.0	1.00	11.00
AU	Inventories SA QoQ	1Q		0		0.2	1.30	11.30
AU	Company Operating Profit QoQ	1Q	2.5	3		2.2	1.30	11.30
AU	ANZ Job Advertisements MoM	May				-0.2	1.30	11.30
AU	Retail Sales MoM	Apr	-0.1	0.3		0.0	1.30	11.30
UK	Markit/CIPS UK Construction PMI	May		52		52.5	8.30	18.30
EC	Sentix Investor Confidence	Jun		18.5		19.2	8.30	18.30
EC	ECB's Nowotny Speaks at Conference in Vienna						11.30	21.30
US	Factory Orders	0		0		0.00%	14.00	0.00
Tuesday 5 June								
AU	CBA Australia PMI Services	May				55.2	23.00	9.00
UK	BRC Sales Like-For-Like YoY	May				-4.2	23.10	9.10
JN	Household Spending YoY	Apr		0.8		-0.7	23.30	9.30
JN	Nikkei Japan PMI Services	May				52.5	0.30	10.30
AU	BoP Current Account Balance/Net exports	1Q	-8.0/+0.2	-10/+0.5		-14/-0.5	1.30	11.30
AU	Government spending	1Q				1.2	1.30	11.30
AU	Net Exports of GDP	1Q		0.5		-0.5	1.30	11.30
CH	Caixin China PMI Composite	May				52.3	1.45	11.45
CH	Caixin China PMI Services	May		52.9		52.9	1.45	11.45
AU	RBA Cash Rate Target	Jun 5	1.5	1.5		1.5	4.30	14.30
GE	Markit/BME Germany Composite PMI	May F		53.1		53.1	7.55	17.55
EC	Markit Eurozone Services PMI	May F		53.9		53.9	8.00	18.00
EC	Markit Eurozone Composite PMI	May F		54.1		54.1	8.00	18.00
UK	Markit/CIPS UK Services PMI	May		52.5		52.8	14.00	0.00
UK	Markit/CIPS UK Composite PMI	May				53.2	14.00	0.00
EC	Retail Sales MoM	Apr		0.5		0.1	9.00	19.00
EC	Retail Sales YoY	Apr		1.7		0.8	9.00	19.00
EC	ECB's Nowotny Chairs Panel at Slovak Central Bank Conference						9.30	19.30
US	Markit US Services PMI	May F		55.7		55.7	13.45	23.45
US	Markit US Composite PMI	May F				55.7	13.45	23.45
US	JOLTS Job Openings	Apr		6300		6550.0	14.00	0.00
US	ISM Non-Manf. Composite	May		57.6		56.8	14.00	0.00
Wednesday 6 June								
NZ	ANZ Commodity Price	May				1.0	1.00	11.00
AU	GDP SA QoQ	1Q	0.8	0.8		0.4	1.30	11.30
AU	GDP YoY	1Q	2.7	2.7		2.4	1.30	11.30
GE	Markit Germany Construction PMI	May				50.9	7.30	17.30
EC	EBA's Enria, ECB's Hakkaraian Speak on Supervision in Lisbon						8.15	18.15
US	MBA Mortgage Applications	Jun 1				-2.9	11.00	21.00
CA	Int'l Merchandise Trade	Apr		-3.3		-4.1	12.30	22.30
US	Nonfarm Productivity	1Q F		0.6		0.7	12.30	22.30
US	Unit Labor Costs	1Q F		2.8		2.7	12.30	22.30
CA	Building Permits MoM	Apr		-1.3		3.1	12.30	22.30
US	Trade Balance	Apr		-49.05		-49.0	12.30	22.30
CA	Ivey Purchasing Managers Index SA	May				71.5	14.00	0.00
Thursday 7 June								
NZ	QV House Prices YoY	May				7.6	17.00	3.00
AU	AIG Perf of Construction Index	May				55.4	22.30	8.30
JN	Official Reserve Assets	May				1256.0	23.50	9.50
JN	Leading Index CI	Apr				104.4	5.00	15.00
GE	Factory Orders WDA YoY	Apr		3.6		3.1	6.00	16.00
UK	Halifax House Price 3Mths/Year	May		1.9		2.2	7.33	17.33
EC	GDP SA YoY	1Q F		2.5		2.5	9.00	19.00
US	Consumer Credit	Apr		14		11.6	19.00	5.00
Friday 8 June								
JN	BoP Current Account Adjusted	Apr		2094.5		1772.3	23.50	9.50
JN	Trade Balance BoP Basis	Apr		746.4		1190.7	23.50	9.50
JN	GDP SA QoQ	1Q F		-0.1		-0.2	23.50	9.50
GE	Trade Balance	Apr		20.2		25.2	6.00	16.00
GE	Current Account Balance	Apr		20		29.1	6.00	16.00
GE	Industrial Production SA MoM	Apr		1.0		1.0	6.00	16.00
GE	Industrial Production WDA YoY	Apr		2.8		3.2	6.00	16.00
GE	Labor Costs SA QoQ	1Q				0.4	6.00	16.00
GE	Labor Costs WDA YoY	1Q				1.5	6.00	16.00
UK	BoE/TNS Inflation Next 12 Mths	May				2.9	8.30	18.30
CA	Housing Starts	May		220		214.4	12.15	22.15
CA	Capacity Utilization Rate	1Q		86.3		86.0	12.30	22.30
CA	Net Change in Employment	May		22		-1.1	12.30	22.30
CA	Unemployment Rate	May		5.8		5.8	12.30	22.30
CA	Hourly Earnings Permanent Empl YoY	May				3.3	12.30	22.30
US	Wholesale Trade Sales MoM	Apr				0.3	14.00	0.00
US	Wholesale Inventories MoM	Apr F		0		0.0	14.00	0.00
Saturday 9 June								
CH	PPI YoY	May		3.9		3.4	1.30	11.30
CH	CPI YoY	May		1.9		1.8	1.30	11.30
CH	Trade Balance	May		32.45		28.8	3.00	13.00
CH	Exports YoY	May		11.1		12.9	3.00	13.00
CH	Trade Balance CNY	May				182.8	3.00	13.00
CH	Exports YoY CNY	May		1.6		3.7	3.00	13.00
CH	Imports YoY CNY	May				11.6	3.00	13.00
CH	Imports YoY	May		19.6		21.5	3.00	13.00
Upcoming Central Bank Interest Rate Announcements								
Australia, RBA		5-Jun	1.50%	1.50%		1.50%		
Europe ECB		14-Jun		-0.4%		-0.4%		
Japan, BoJ		15-Jun		-0.1%		-0.1%		
UK BOE		21-Jun	0.5%	0.5%		0.50%		
New Zealand, RBNZ		28-Jun	1.75%	1.75%		1.75%		
Canada, BoC		12-Jul				1.25%		
US Federal Reserve		14-Jun	1.75-2.00%	1.75-2.00%		1.50-1.75%		

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

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	2.9	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	0.6	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	
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	
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	
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	
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	
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	
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	
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	
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	
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	
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	
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	
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	
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	
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	
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	
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	
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	
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	
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	
% 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	
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	

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

Exchange Rate Forecasts

	4-Jun	Jun-18	Sep-18	Dec-18	Jun-19	Dec-19
Majors						
AUD/USD	0.7576	0.77	0.75	0.75	0.75	0.75
NZD/USD	0.6987	0.71	0.70	0.70	0.71	0.70
USD/JPY	109.63	110	108	106	102	99
EUR/USD	1.1677	1.23	1.25	1.26	1.28	1.32
GBP/USD	1.3365	1.42	1.45	1.50	1.53	1.55
USD/CNY	6.4204	6.28	6.20	6.20	6.23	6.25
USD/CAD	1.2947	1.24	1.24	1.22	1.23	1.25
USD/CHF	0.9888	0.98	0.97	0.96	0.95	0.93

Australian Cross Rates	4-Jun	Jun-18	Sep-18	Dec-18	Jun-19	Dec-19
AUD/NZD	1.0843	1.08	1.07	1.07	1.06	1.07
AUD/JPY	83.1	85	81	80	77	74
AUD/EUR	0.6488	0.63	0.60	0.60	0.59	0.57
AUD/GBP	0.5669	0.54	0.52	0.50	0.49	0.48
AUD/CNY	4.8641	4.84	4.65	4.65	4.67	4.69
AUD/CAD	0.9809	0.95	0.93	0.92	0.92	0.94
AUD/CHF	0.7491	0.75	0.73	0.72	0.71	0.70

Interest Rate Forecasts

	4-Jun	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	1.99	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	2.91	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	2.72	2.80	3.10	3.10	3.40	3.65
United States	2.91	3.00	3.25	3.25	3.50	3.50
New Zealand	2.75	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 Avge
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)

	4-Jun	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Brent oil	65.8	67	67	66	65	66	67	68
Gold	1292	1320	1330	1360	1380	1370	1380	1390
Iron ore	66.2	67	63	61	60	58	60	62
Hard coking coal	191	175	130	110	101	99	100	100
Thermal coal	111	90	90	90	90	65	65	65
Copper	6889	6690	6630	6630	6630	6630	6630	6630
Aust LNG (*)	12.4	11.2	11.5	11.8	11.7	11.3	11.7	11.8

(*) Implied Australian LNG export prices.

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