EMBARGOED UNTIL 11.30 AM WEDNESDAY 15 AUGUST 2018

THE FORWARD VIEW: AUSTRALIA AUGUST 2018

An unchanged economic outlook, but downside risks building

OVERVIEW

Overall there has been little change to our growth, labour market and inflation forecasts for the Australian economy over the next two years – though we believe risks continue to build to the downside. While we have not altered our forecasts yet, a continuation of these trends would probably require a reassessment of our outlook, including interest rates.

GDP is expected to increase by just under 3.0% in 2018 and 2019. Growth will be driven by mining exports, public infrastructure investment and a continued recovery in non-mining business investment (which will receive some support from spill overs from public infrastructure investment). We think consumption will grow at a relatively weak pace over the next couple of years, constrained by household headwinds including high debt levels, relatively weak wage growth and, to a lesser extent, slower growth in household wealth. Both our Business Survey and Cashless Retail Sales continue to point to subdued activity and poor confidence in the retail sector.

We think the balance of risks has shifted a little to the downside in July. The NAB Monthly Business Survey showed that business conditions continued their downward trend in the month and confirmed that across industries, this trend has been relatively broad-based. Confidence has remained around average. Employment rebounded this month, but trading and profitability continued their downward trend. Forward orders, a forward looking indicator has also declined over recent months to be around average levels.

The key upside risks still revolve around new investment in the mining sector and greater spill overs to non-mining business investment from public infrastructure spending.

At this stage we see the impact of recently implemented tariffs between the US and China as relatively contained and manageable. However, should threatened tariffs be put in place, there would likely be an impact on global growth.

Despite the decline in business conditions, the index remains well above average, suggesting continued robust outcomes for the business sector in 2018. We think this should still see unemployment edge down to near 5% by mid-2019 and core inflation remain above the bottom of the RBA 2-3% target range in late-2019 – consistent with wages growth around 2½% in 2019. At this stage we also still see the RBA starting to increase rates from mid 2019 – but should the tightening in the labour market occur more gradually or inflation rise more slowly, it is likely that any rate rises could be delayed beyond our current expectations.

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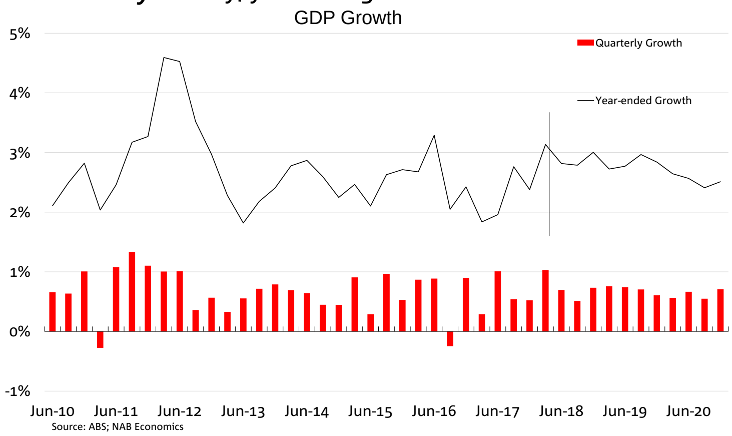
KEY ECONOMIC FORECASTS

	2017	2018-F	2019-F	2020-F
Domestic Demand (a)	3.0	2.8	2.9	3.2
Real GDP (annual average)	**2.2**	**2.9**	**2.8**	**2.5**
Real GDP (year-ended to Dec)	**2.4**	**3.0**	**2.8**	**2.5**
Terms of Trade (a)	11.7	-1.2	-5.4	-1.0
Employment (a)	2.3	2.5	2.0	1.7
Unemployment Rate (b)	5.4	5.4	5.0	5.1
Headline CPI (b)	1.9	1.9	2.2	2.9
Core CPI (b)	1.9	1.9	2.1	2.7
RBA Cash Rate (b)	1.50	1.50	2.00	2.50
$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 GDP GROWTH PROFILE

Quarterly and y/y % change



Source: ABS, NAB Group Economics

CONSUMERS, LABOUR MARKET AND WAGES

Official retail sales data suggest a relatively strong outcome for consumption in the June quarter, with retail volumes rising by 1.2% over the quarter. Monthly turnover data has generally been stronger than implied by our NAB Cashless Retail Sales Index which is derived from around 2 million transactions per day across NAB platforms. An update will be available next week for July. This will give an advance read on last month's retail sales.

Despite a strong rise in employment in June (+51k), employment growth has slowed in 2018 to date after the rapid pace of 2017. However, with the flattening of the participation rate, this growth has been enough to see the unemployment rate edge slightly lower. Both the seasonally adjusted and trend unemployment rates were 5.4% in June.

The NAB Monthly Business Survey employment index rebounded in July after declining in recent months.

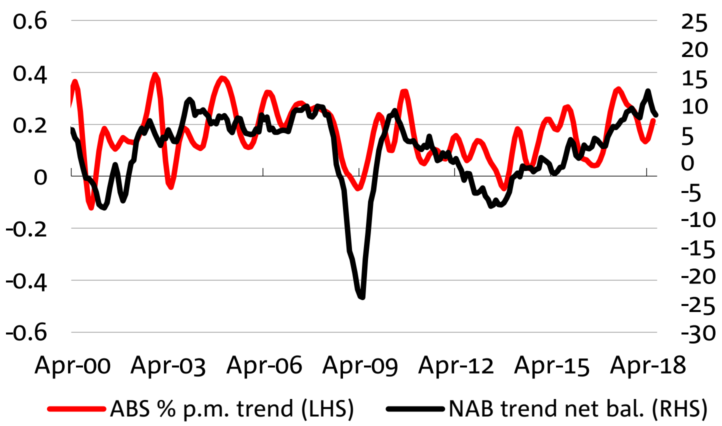
Looking forward, the index – based on historical patterns – is consistent with jobs growth around 23k per month over the next 6 months, which is enough to see further declines in the unemployment rate.

Indeed, with output growth expected to pickup, we expect continued growth in employment and this will see a gradual decline of the unemployment rate to 5.0%. As spare capacity is reduced in the labour market, we expect wages growth to lift although we expect wage pressures to rise only gradually. Surveyed labour cost growth picked up in the month, but this likely reflects the effect of the minimum wage increase. In line with this, we expect an unchanged pace of growth for the WPI in the June quarter.

Purchase cost and final product price growth edged higher in July – but continue to suggest weak price pressure more generally. Retail prices inflation rose in July, after the weak outcome in June.

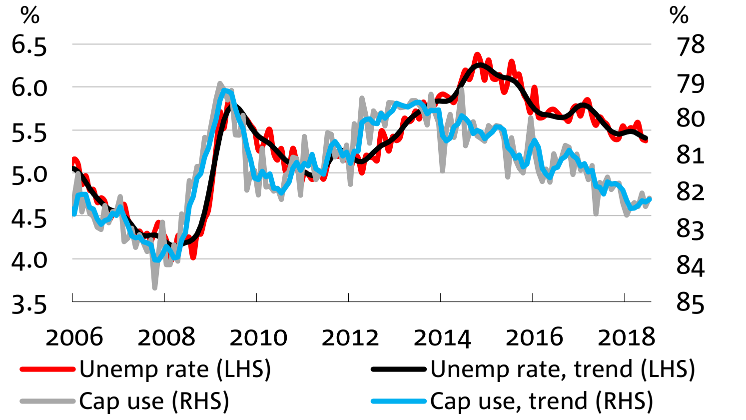
EMPLOYMENT

ABS vs NAB



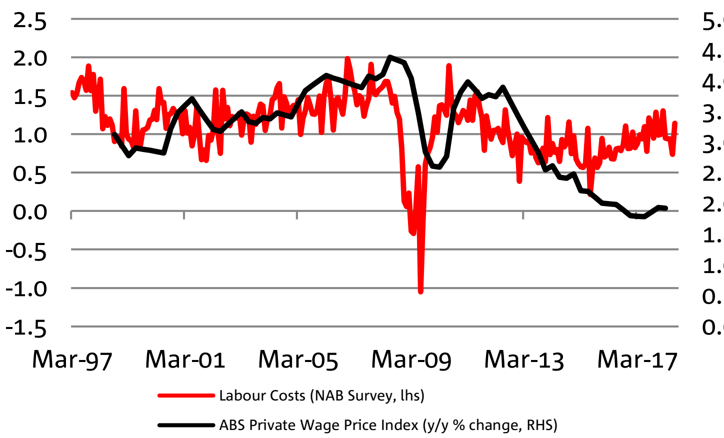
UNEMPLOYMENT AND CAPACITY UTILISATION

ABS (unemployment) and NAB monthly survey



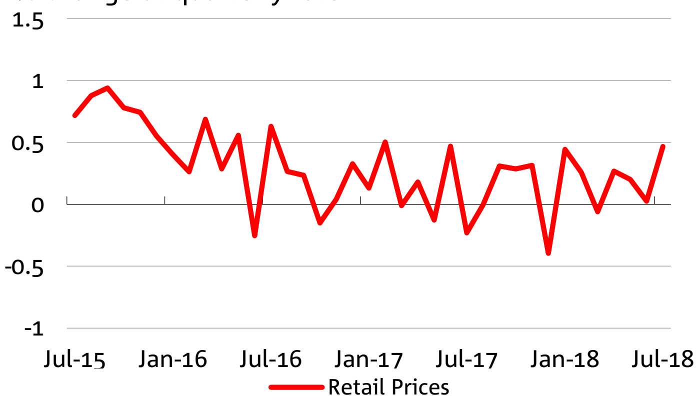
NAB WAGE GROWTH PROXY

y/y % change



NAB BUSINESS SURVEY RETAIL PRICES

% change at quarterly rate



Sources: ABS, NAB Group Economics

HOUSING AND CONSTRUCTION

Prices in the established housing market weakened further over the past month despite a slight pickup in auction clearance rates. The Core Logic 8 Capital City dwelling price index fell 0.6% in July and is 2.4% lower over the year.

The monthly pattern across states was in line with the trends over the past year, with Melbourne and Sydney leading the falls. However, in 6-month annualised terms, it appears that the rate of decline in Sydney has eased a little, while falls in Melbourne have gathered pace.

Sydney dwelling prices have now declined 6.0% from their peak in mid-2017. Sydney house prices have fallen 7.0% and apartment prices have declined by a more moderate 2.0% over the year – despite the increase in supply.

The fall in Melbourne dwelling prices has accelerated recently. Like Sydney, the declines have been led be weakness in houses (down 3.7%) with apartments having fallen a little less to date (around 1.0%). Conditions in Perth prices have weakened again recently, after a period of stabilisation, falling 2.3% over the year. Prices have held up better in the other capitals and regional areas to date.

Housing credit growth continued to slow in June, driven by the first monthly fall in outstanding investor credit since 2009. Owner occupier housing credit also slowed, but continues to grow at a higher rate than investor credit.

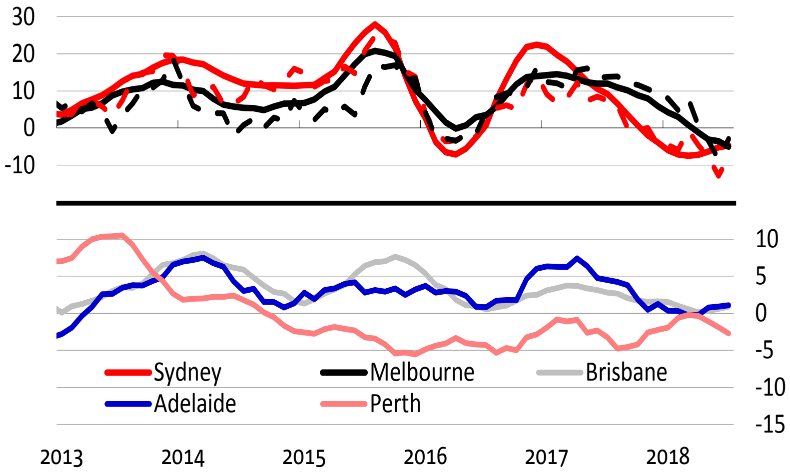
Related, housing finance approvals (i.e. new loans) declined in June. Approvals for new loans to both owner occupiers and investors declined in the month. The weakness was broad-based with falls for both owner-occupier (down 0.5%) and investor lending (down 2.7%).

Building approvals rose 6.4% in June, with an increase in both approvals for houses and apartments. Looking through the recent volatility suggests that building approvals have continued to trend down. Nonetheless they remain elevated, suggesting that the pipeline of work remain to come will remain elevated for some time.

National accounts data (to be released in early September) will provide an update on the national accounts measure of dwelling investment. Dwelling investment fell by around 1.0% over the year to March. Going forward we expect dwelling investment to ease modestly over the next two years, with continued population growth supporting the outlook for investment, even with the large supply of apartments entering the market and continued weakness in household income growth.

HOUSE PRICES

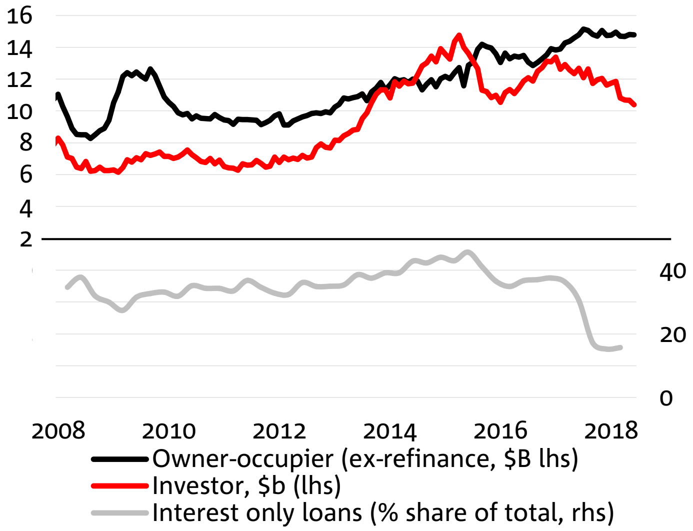
Dwelling price growth (%, 6-month annualised)



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

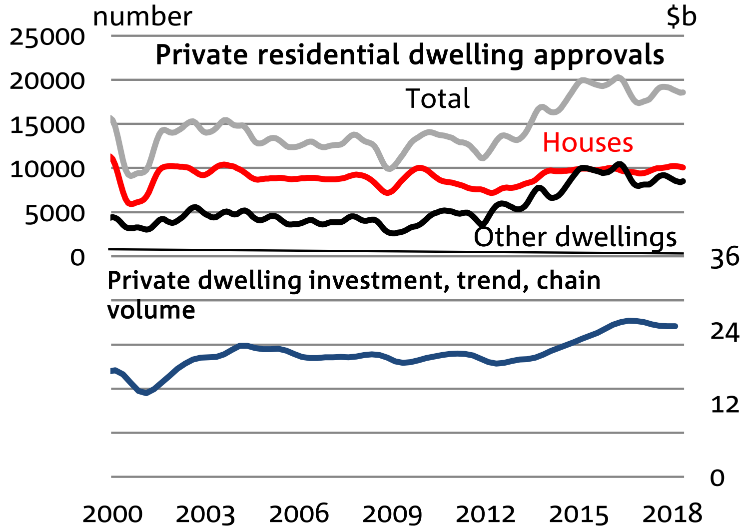
HOUSING FINANCE APPROVALS

$ b (lhs), % share (rhs)



BUILDING APPROVALS & RESIDENTIAL INVEST.

Trend basis



Source: ABS, NAB, Core Logic, APRA.

BUSINESS AND TRADE

The NAB Monthly Business Survey suggests that conditions in the sector continued to ease in July. After declining in recent months, conditions are now well below the highs observed earlier in the year. A continuation in this trend could suggest a pull-back in activity in the business sector. While this trend is somewhat concerning, we believe a slowdown in the business sector remains a downside risk to our forecasts at this point, rather than a central scenario.

Forward looking survey indicators were again mixed in July. Forward orders declined again in the month (to be around average levels), as did capacity utilisation – which remains elevated after trending higher in recent years. Business confidence remains around average, though of some concern is the weakness in New South Wales and Victoria.

Despite signs of a possible slowdown, we believe conditions generally remain favourable in the business sector. We continue to expect a recovery in non-mining business investment to contribute to GDP growth over the next two years. We expect underlying business investment to rise by close to 3% in 2018 before accelerating to around 6% in 2019 and 2020. Further, it is likely that spill overs from the large pipeline of infrastructure work will see further business investment.

Alongside the completion of the remaining LNG projects, we expect the effect of the unwinding mining boom on mining investment to wane over the next couple of years. In addition there is likely to be some new investment – with higher than expected commodity prices and strong confidence and conditions in the sector. With a now larger capital stock, and renewed confidence in the sector it is also likely that sustaining capex will see higher levels of investment going forward.

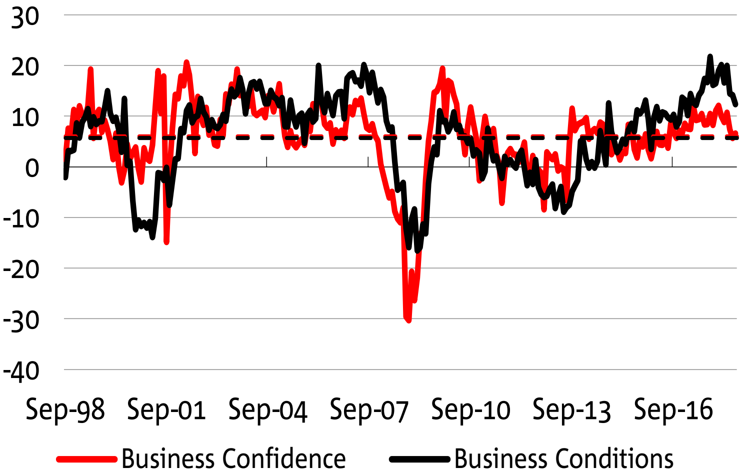
The volatile measure of non-residential building approvals continued to trend lower in June. Despite this easing, the value of approvals remains elevated, suggesting continued growth in the non-mining sector.

On the trade front, outcomes have evolved broadly as expected. The trade surplus widened in June, with stronger than expected growth in exports. In the month, growth was driven by a lift in iron ore, LNG and metals exports. We expect this trend will continue, with a further ramp up in LNG exports as the last of the new major LNG projects reach fullcapacity. On the imports side, a rise in capital imports was offset by the other import components.

As a whole, the monthly trade data for the past three months in combination with the quarterly trade prices release implies that net exports are likely to make only a marginal contribution to growth in the June quarter – if at all.

NAB CONFIDENCE AND CONDITIONS

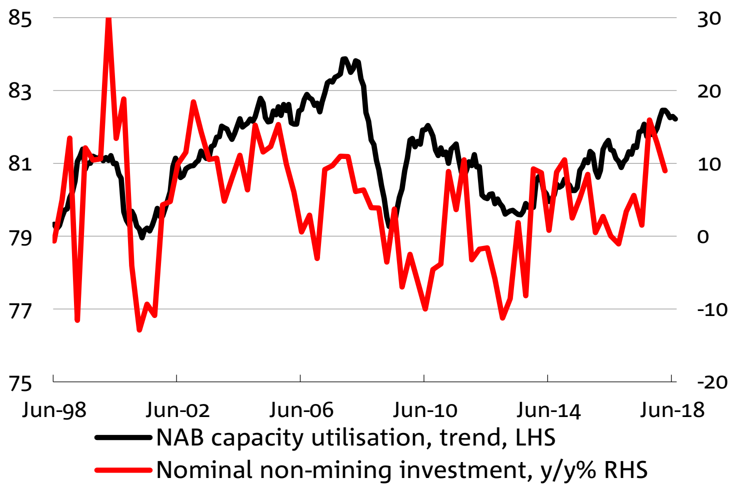
Net balance



* Dotted lines are long-run averages since Mar-97.

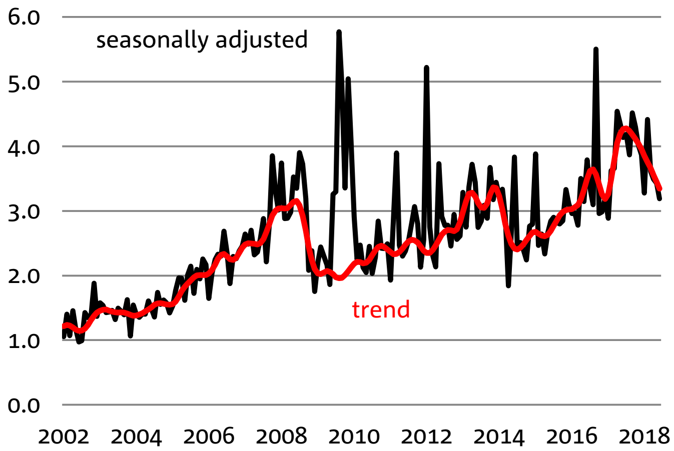
NAB SURVEY CAPACITY UTILISATION

Non-mining investment (y/y%) & survey capacity utilisation (%)



NON-RESIDENTIAL APPROVALS

Value of non-residential building approved ($b)



Sources: ABS, NAB.

COMMODITIES

NAB's USD non-rural commodity price index declined by over 3% q/q in Q2 2018. Commodities in Q3 have been mixed so far. Iron ore prices have tracked a little higher over the past month – pushing closer to US$70 a tonne – however they have remained range bound between US$60 and US$70 since the middle of March 2018. In contrast, prices for hard coking coal have been trending lower (from over US$200 a tonne in late June to around US$170 at the start of August), as supply constraints in Queensland unwind.

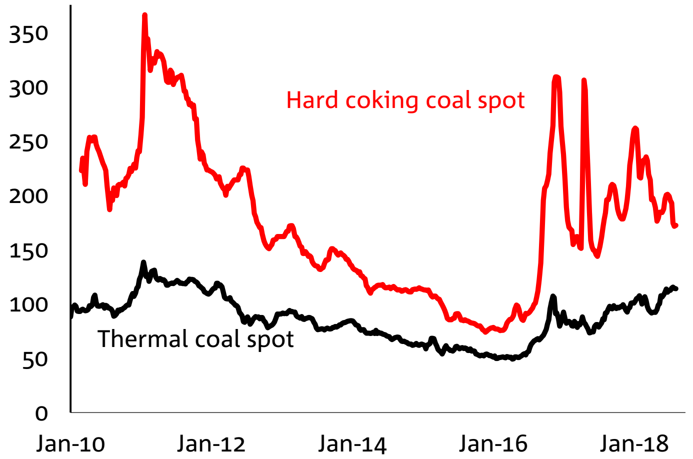
Oil prices have trended somewhat lower, with Brent having fallen below $72/bbl, its lowest level since April. Geopolitical pressures (in both directions) continue to abound, most recently in the form of a further escalation in the US-China trade dispute. Still, oil prices at this level should be enough to keep Australian LNG export prices in double digits in AUD terms for the foreseeable future. This suggests that domestic gas prices will remain high.

We continue to expect that economic fundamentals will lead to further falls in overall USD commodity prices through to end-2019. The acceleration seen in global growth in 2017 is no longer occurring (although it remains above average) and overall global growth appears to have peaked.

Overall, the NAB Rural Commodities Index was up 1.3% in July, led largely by higher grain and lamb prices. Drought conditions continue unabated in New South Wales and parts of Queensland, with the Bureau of Meteorology reporting that July 2018 was the driest nationally since 2002. Conditions in Victoria and South Australia are better, although mostly drier than average and would be challenged by a dry spring. Meanwhile, the Western Australian wheat-belt is enjoying broadly favourable conditions and looks set for a strong season, with average to above average yields.

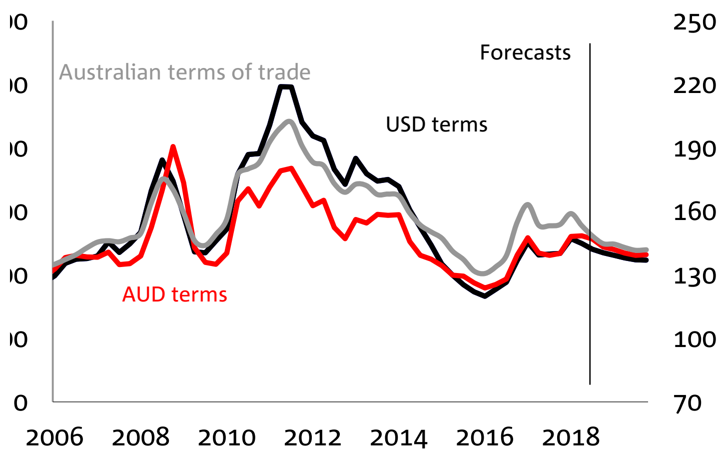
COAL SPOT PRICES

USD/t



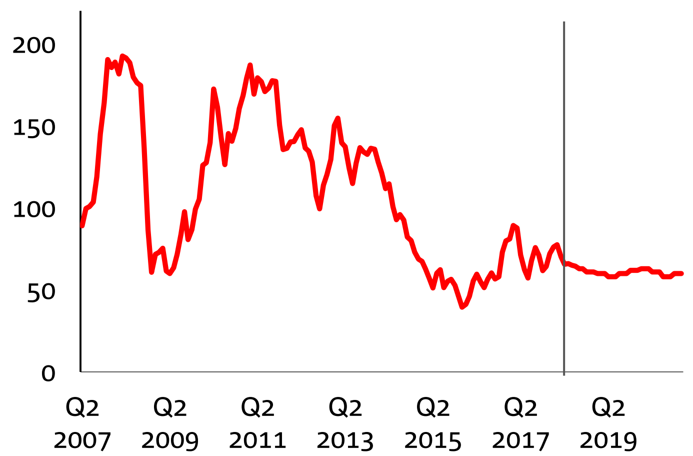
NAB NON-RURAL COMMODITIES PRICE INDEX

Sep 1996 = 100



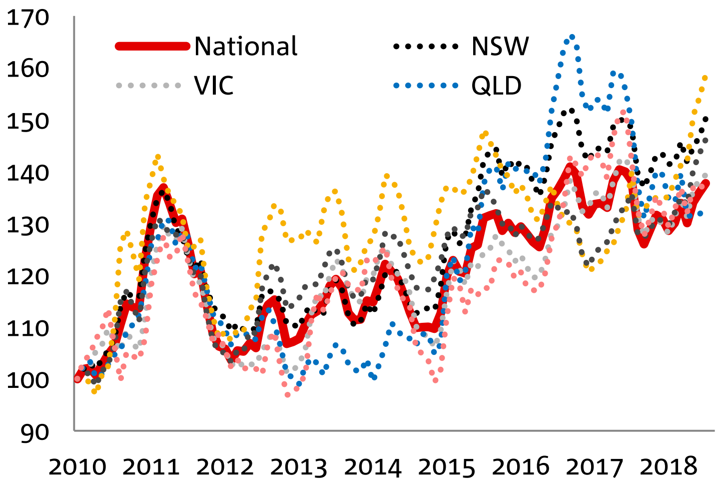
IRON ORE SPOT PRICE FORECASTS

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

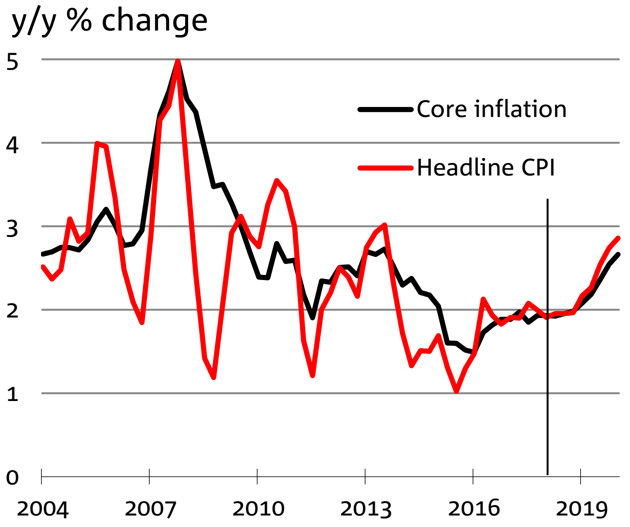
The latest statement of monetary policy was released last week by the RBA . In general staff forecasts for growth and inflation were broadly unchanged (albeit with a slight lowering in the near term outlook for headline CPI). Growth is forecast to be a little above 3% in 2018 and 2019 and the unemployment rate is expected to decline to 5% (around the 'consensus' rate of full employment) by late 2020. Inflation is forecast to remain around the bottom of the target band over 2019 before edging further toward the middle of the target band – though not quite reaching it – by the end of 2020. Conditions in the household sector are the largest source of uncertainty for these forecasts. Like us, the RBA sees high debt levels, slow income growth and weaker growth in household wealth continuing to weigh on the outlook for consumption. We are generally a little weaker than RBA forecasts for growth but stronger on the labour market and inflation.

CPI data, released prior to the RBA's update, was largely as expected – confirming that inflationary pressures remain relatively weak. Headline inflation rose by 2.1% over the year, while measures of underlying inflation continued to track just below the band. It remains our view that as the labour market tightens and wage growth lifts, domestic unit labour cost growth should see inflation return to the middle of the target band (albeit relatively slowly). Indeed, the NAB Survey suggests some pockets of tightness in the labour market leading to a pickup in the labour market. At this point, it appears these pressures have been relatively isolated, but as the unemployment rate trends down, these pressures should become more broad-based.

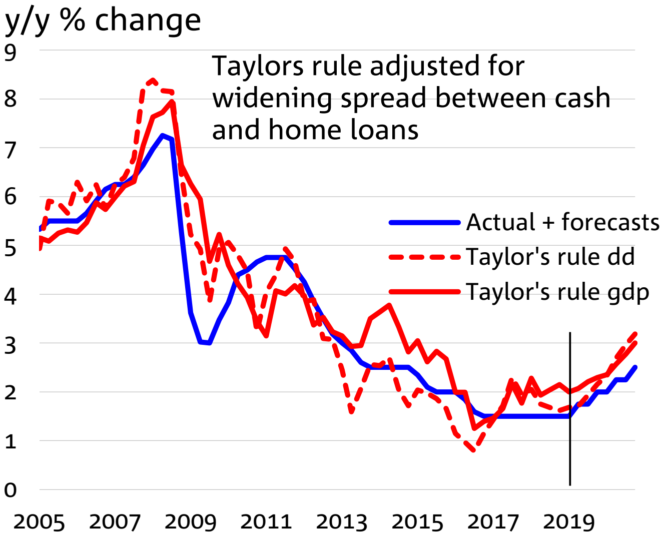
For most of the month, the exchange rate remained around the US74c mark – a little lower than earlier in the year. Albeit the recent Turkey crisis has seen the AUD trade lower. We see the exchange rate tracking broadly around the low to mid 70c range over the next couple of years. That is, we see the exchange rate depreciating a little over the forecast period with easing commodity prices and a widening in interest rate differentials. In the short-term, there are likely to be bouts of volatility related to risk sentiment in global markets and ongoing uncertainty over global trade policies (though impacts on global growth to date of the escalating war between the US and China appear to be manageable).

Our outlook for monetary policy is unchanged, though we think there are some growing risks to our forecast for the first increase in the cash rate to occur in mid next year. That is, the risk is growing that the first increase in the cash rate will be delayed to late-2019 or even early 2020. While we have the labour market tightening a little quicker, and wages growth lifting a little faster than RBA staff forecasts, we see little signs of a broad-based pickup in wages growth and inflationary pressures at present. Indeed, the RBA forecasts are for only a very gradual pickup in inflation, reaching the middle of the target band in mid-to-late 2020. With both wages and inflation growth only slowly approaching the middle of the target band, even accounting for the forward looking nature of monetary policy, it is likely that an increase in rates will be some time away. We will reassess our view for rates based on the upcoming labour market, wages and GDP data which will provide an update on underlying growth and inflation pressures in the economy.

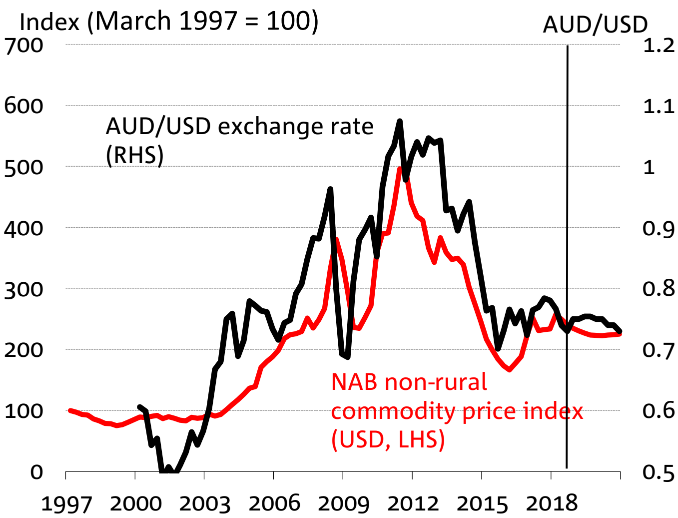
HEADLINE AND CORE INFLATION



TAYLORS RULE AND RATE FORECASTS



AUD AND COMMODITY PRICES



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	2.4	2.5	2.9	2.7	2.6	2.5	2.4
Dwelling Investment	3.1	-2.8	-2.1	-1.2	8.7	-2.2	-1.4	-2.6	0.4
Underlying Business Investment	-6.6	5.9	3.8	6.4	-11.9	2.8	3.2	5.8	6.0
Underlying Public Final Demand	5.0	5.0	4.2	4.6	5.2	4.5	4.8	4.3	4.5
Domestic Demand	**2.3**	**3.3**	**2.6**	**3.1**	**1.9**	**3.0**	**2.8**	**2.9**	**3.2**
Stocks (b)	0.1	-0.1	-0.1	0.0	0.1	-0.1	0.1	-0.1	0.0
GNE	**2.4**	**3.2**	**2.6**	**3.1**	**2.0**	**2.9**	**2.9**	**2.8**	**3.1**
Exports	5.4	3.1	5.0	3.5	6.8	3.5	4.2	4.7	2.5
Imports	4.8	6.4	3.4	5.2	0.2	7.8	4.0	4.3	5.3
GDP	**2.1**	**2.7**	**2.8**	**2.7**	**2.6**	**2.2**	**2.9**	**2.8**	**2.5**
Nominal GDP	5.9	4.5	3.8	4.3	3.8	5.8	4.3	3.7	4.7
Current Account Deficit ($b)	39	48	64	85	53	44	52	75	95
(-%) of GDP	2.2	2.6	3.4	4.3	3.1	2.5	2.8	3.9	4.7
Employment	1.4	3.0	2.0	2.0	1.6	2.3	2.5	2.0	1.7
Terms of Trade	14.5	2.0	-4.7	-2.6	0.2	11.7	-1.2	-5.4	-1.0
Average Earnings (Nat. Accts. Basis)	0.3	1.4	2.1	2.6	0.9	0.6	1.8	2.4	2.7
End of Period									
Total CPI	1.9	2.1	1.9	2.5	1.5	1.9	1.9	2.2	2.9
Core CPI	1.8	1.9	1.9	2.4	1.5	1.9	1.9	2.1	2.7
Unemployment Rate	5.6	5.5	5.1	4.9	5.7	5.4	5.4	5.0	5.1
RBA Cash Rate	1.50	1.50	1.75	2.25	1.50	1.50	1.50	2.00	2.50
10 Year Govt. Bonds	2.60	2.63	3.30	3.65	2.77	2.63	3.00	3.50	3.80
$A/US cents :	0.77	0.74	0.75	0.74	0.72	0.78	0.75	0.75	0.73
$A - Trade Weighted Index	65.5	62.6	61.3	59.1	63.9	64.9	62.7	60.2	58.2

(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	10/08/2018	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$/bbl	68	69	70	68	66	64	62	61	62	63	64	64
Brent oil	US$/bbl	73	75	76	74	72	70	68	67	68	69	70	70
Tapis oil	US$/bbl	73	78	77	75	73	71	69	68	69	70	71	71
Gold	US$/ounce	1215	1310	1250	1280	1310	1330	1330	1340	1370	1380	1390	1400
Iron ore (spot)	US$/tonne	n.a.	66	64	61	60	58	60	62	63	61	58	60
Hard coking coal*	US$/tonne	n.a.	190	170	155	150	155	145	140	130	125	120	125
Thermal coal (spot)	US$/tonne	118	102	105	98	93	85	80	75	77	73	70	68
Aluminium	US$/tonne	2087	2261	2050	2100	2080	2055	2025	2000	1985	1962	1958	1955
Copper	US$/tonne	6160	6877	6250	6600	6825	6875	6950	7050	6900	6825	6725	6650
Lead	US$/tonne	2083	2383	2175	2300	2380	2340	2300	2300	2280	2260	2240	2220
Nickel	US$/tonne	13737	14456	13725	14000	14000	13750	13525	13025	13250	13500	13250	13000
Zinc	US$/tonne	2550	3112	2640	2900	3145	2895	2700	2600	2550	2500	2485	2465
Aus LNG**	AU$/GJ	n.a.	11.6	13.3	12.8	12.5	12.1	11.8	11.6	11.4	11.8	11.9	12.2

* Data reflect NAB estimates of US$/ tonne FOB quarterly contract prices. Actual data represent most recent final quarterly contract price.

** Implied Australian LNG export prices

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