EMBARGOED UNTIL 11.30 AM WEDNESDAY 12 SEPTEMBER 2018

THE FORWARD VIEW: AUSTRALIA SEPTEMBER 2018

A strong first half and easing downside risks

OVERVIEW

Overall there has been little change to our view on the economy over the next couple of years. Growth is expected to remain above trend which should see the labour market tighten, wages growth lift and inflation more broadly begin to rise. As spare capacity is reduced, and inflationary pressures become more evident, we expect the degree of accommodation in monetary policy to be gradually reduced, with the RBA beginning a process of rates normalisation towards a more neutral setting. The speed at which this occurs is highly dependent on the pace at which the labour market continues to tighten and how quickly this is translated into faster wage growth and broader price pressures.

While the national accounts show growth was particularly strong in the first half of 2018 with a solid outcome in Q2 following an upwardly revised Q1 – we have not changed our view on the future and pace of growth to our recent forecasts. With our quarterly profile broadly unchanged, we expect growth of around 3¼% in 2018, slowing to 2.7% in 2019 and 2.5% in 2020. Public sector investment in infrastructure, strong growth in exports and a recovery in non-mining business investment are expected to drive growth over the next few years. In addition, the drag from falling investment in the mining sector is expected to wane as the last of the LNG mega-projects enter the production phase. It is also likely that there will be some new mining investment as depleted mines are replaced and because a higher level capex will be required in the future to maintain production with the now larger capital stock in the sector. Consumption is expected to grow only modestly as wage growth – and therefore household income growth remain weak. The cooling in the housing market will also see a modest decline in dwelling investment, though the large pipeline of work to be done, suggests it will remain high.

Overall, we think the risks to our forecasts are relatively balanced. Business conditions in the NAB business survey rebounded somewhat in August, partially reversing some of the downward trend in recent months which we had previously highlighted as a risk. Significant uncertainty around the consumer remains. We expect only modest growth in consumption over the next two years, with a series of headwinds facing households. Slow wage growth, high debt levels and slowing growth in wealth are expected to weigh on households. On the positive, tax cuts to low income earners may provide some support and there are signs that wage growth is lifting from low levels but these factors are more likely to provide support near the end of the forecast horizon. The potential for an escalation in US-China trade tensions also remains a risk.

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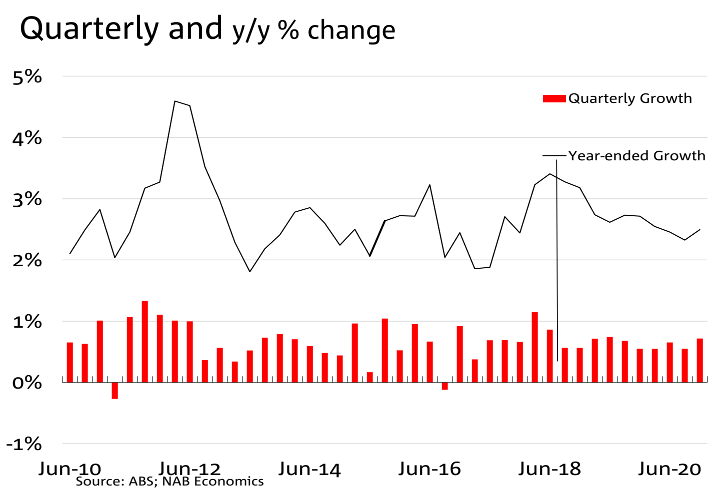
KEY ECONOMIC FORECASTS

	2017	2018-F	2019-F	2020-F
Domestic Demand (a)	3.0	3.2	2.6	3.0
Real GDP (annual average)	**2.2**	**3.3**	**2.7**	**2.5**
Real GDP (year-ended to Dec)	**2.4**	**3.2**	**2.7**	**2.5**
Terms of Trade (a)	11.6	-0.8	-5.7	-0.8
Employment (a)	2.3	2.5	2.0	1.8
Unemployment Rate (b)	5.4	5.3	5.0	4.9
Headline CPI (b)	1.9	1.9	2.1	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



Source: ABS, NAB Group Economics

CONSUMERS, LABOUR MARKET AND WAGES

Consumption recorded another reasonable outcome in the Q2 national accounts at 0.7% q/q. Overall, the accounts suggest that households spending has grown at a moderate pace over the past year. Our expectation is still for a small slowing in consumption growth from here, with our view that headwinds in the household sector will persist. Indeed, while retail sales data have been stronger than expected in recent months, July retail sales recorded a flat outcome. An update on the NAB Cashless Retail Sales Index which is derived from around 2 million transactions per day across NAB platforms will be available next week for an early read on sales in August.

Employment fell in July (-3.9k) though this follows the very strong outcome in June. Nonetheless, the unemployment rate edged slightly lower, reaching 5.3%, its lowest level for some time.

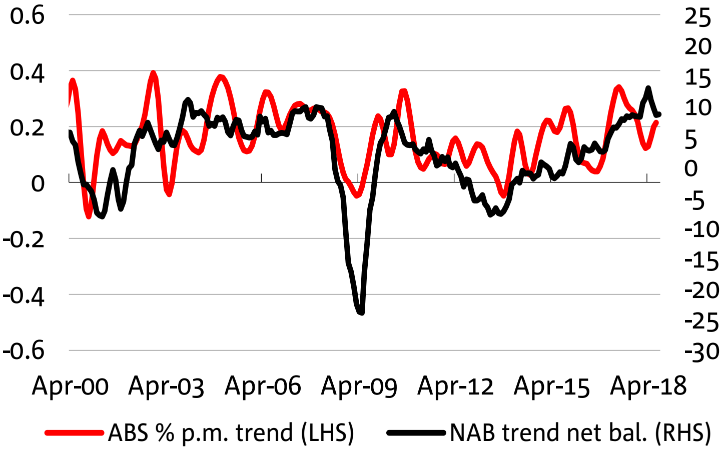
The NAB Monthly Business Survey employment index was unchanged in August after rebounding last month. Looking forward, the index – based on historical patterns – is consistent with jobs growth around 20k per month over the next 6 months, which is enough to see further declines in the unemployment rate.

Both economic growth, and forward looking indicators of labour demand, suggest employment growth will continue to outpace that of the working-age population. This will see the unemployment rate decline to around 5.0% over the next few years. While wage growth has been weak for sometime, this reduction in spare capacity should see wage growth lift, as the labour market nears full capacity.

The NAB monthly business survey suggests that price pressures may be starting to lift. In August, retail price inflation rose, while purchase costs growth also edged higher. Labour costs – a wage bill measure – also rose in the month, likely signalling some pickup in wage growth.

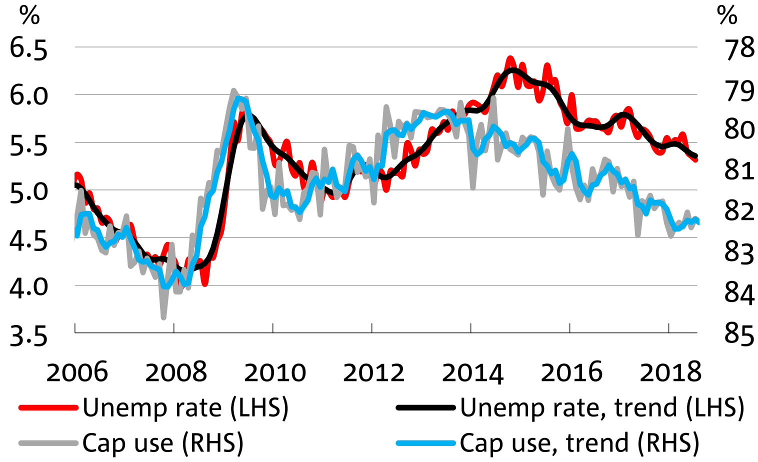
EMPLOYMENT

ABS vs NAB



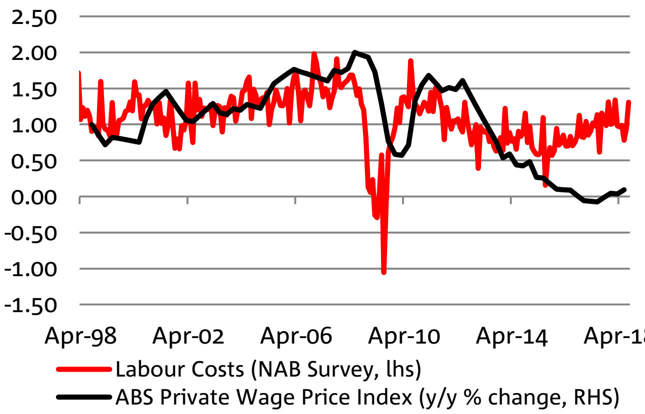
UNEMPLOYMENT AND CAPACITY UTILISATION

ABS (unemployment) and NAB monthly survey



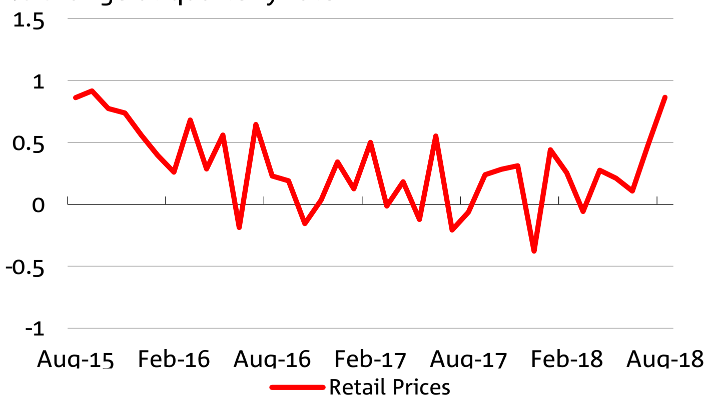
NAB WAGE GROWTH PROXY

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 continued their correction in August, with the Core Logic 8 Capital City dwelling price index falling a further 0.4% in August to be 2.9 per cent lower over the year. Prices fell in each of the state capitals, except Adelaide, in the month.

The weakness continues to be driven by Sydney (-0.3% m/m) and Melbourne (-0.6% m/m), though Perth (-0.6% m/m) has again weakened after some signs of a stabilisation in prices earlier in the year. The pace of decline in Melbourne has accelerated recently with prices now down 1.7% over the year, and Sydney – after peaking first - has declined 5.6%. While growth has generally slowed across the remaining capitals, outcomes have been a little more mixed. Hobart prices were 10.7% higher over the year to August, while Brisbane and Adelaide were marginally higher at 0.9% and 1.0% respectively.

Peak-to-trough, Sydney prices have now fallen by 7.0% while Melbourne is down 3.0%. Despite these moderate falls, prices remain 70% higher in Sydney and 56% higher in Melbourne than they were in 2012.

Housing credit rose by 0.4% in July, growing at 5.6% y/y. In the month credit to owner-occupiers rose 0.5% m/m, while investor credit rose by 0.1%, after recording its first monthly fall since 2009 last month. Over the year owner occupier housing credit continued to slow, but is well above that of investor lending. Relatedly, the value of approvals for owner-occupiers ex-refinancing fell by 0.4% m/m while new loans to investors decreased 1.3% m/m.

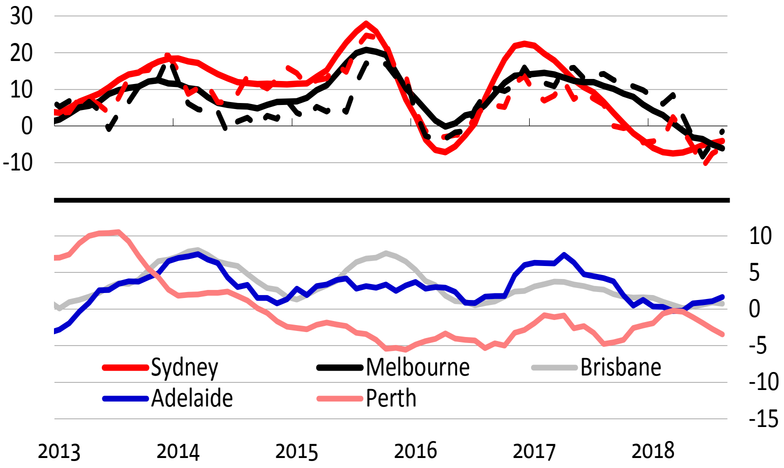
The national accounts measure of dwelling investment rose 1.7% q/q in Q2. Investment in new dwellings was up 3.6% q/q, but offset by a decline of 2.1% q/q in alterations & additions. While we think that dwelling investment will decline over the next few years, alongside the cooling in the housing market, it is likely quarterly outcomes may display some volatility as construction activity reaches its peak with a large pipeline of work yet to be completed. The Q2 outcome was also likely boosted by drier than normal conditions in NSW and Victoria in Q2.

More recent data suggest that residential building approvals fell 5.2% m/m in July. Both new approvals for apartments and houses fell in the month. Looking through the monthly volatility, approvals remain at a high level, but have trended downwards this year.

Though there is still a large increase in supply to enter the market over the next few years (owing to still high approvals and a large pipeline of work yet to be done), growth in the population remains relatively strong. This is particularly true of Sydney and Melbourne, the areas likely to see the largest increases in supply, and where population growth remains above that of the other states. While we do expect some further weakness in prices, we see this as an orderly correction (after a period of very strong growth) with prices still well up on 5 years ago, rather than a large contraction.

HOUSE PRICES

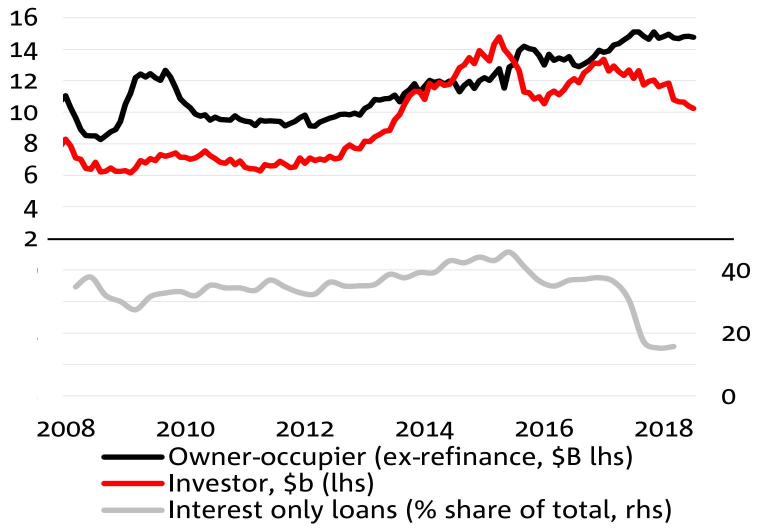
Dwelling price growth (%, 6-month annualised)



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

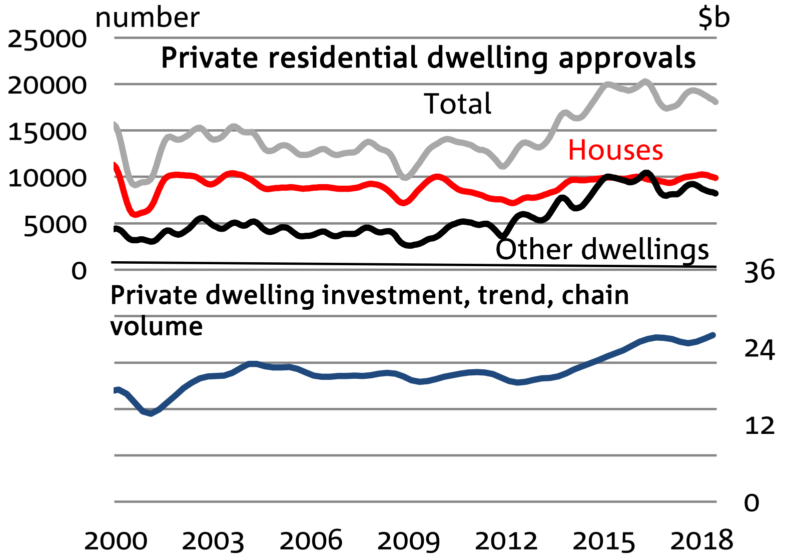
HOUSING FINANCE APPROVALS

$ b (lhs), % share (rhs)



BUILDING APPROVALS & RESIDENTIAL INVEST.

Trend basis



Source: ABS, NAB, Core Logic, APRA.

BUSINESS AND TRADE

Recent data paint a mixed picture of the business sector. Both the ABS Capex survey and the national accounts suggest there was a pull-back in non-mining investment in Q2 – somewhat at odds with our view of continued growth in the sector. The national accounts measure of new business investment fell by 0.2% in the June quarter, driven by declines in both machinery & equipment and engineering construction (down 1.7% and 0.8% respectively). Non-residential construction rose in the quarter. Interestingly, the ABS attributed the fall in investment the non-mining sector, with mining investment rising by 5.7% in the quarter.

Forward looking indicators on investment also suggest mixed outcomes. Capex survey expectations for 2018/19 imply further weakness in both mining and the selected non-mining industries, though the survey covers only a subset of industries. The expectations were revised up slightly this quarter, however, suggesting a marginally better outlook. More positively, the NAB Monthly business survey saw a rebound in actual capex in August to relatively high levels (the quarterly survey released next month will provide an update on expectations over the next 12 months). While the mining sector contributed to this, intentions remain above average in most industries. Retail remains weak, but likely reflects the ongoing structural changes in that industry. Capacity utilisation from the survey also edged higher in the month and remains high after increasing in recent years.

Indeed, profitability and business conditions more broadly also rose in the month and remain at well above average levels. The strength in conditions appears to be relatively broad-based with all states recording above average readings. Forward orders (which showed some weakness in previous months) also increased to above average levels in the month removing some of the downside risk we saw in the business sector previously.

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.

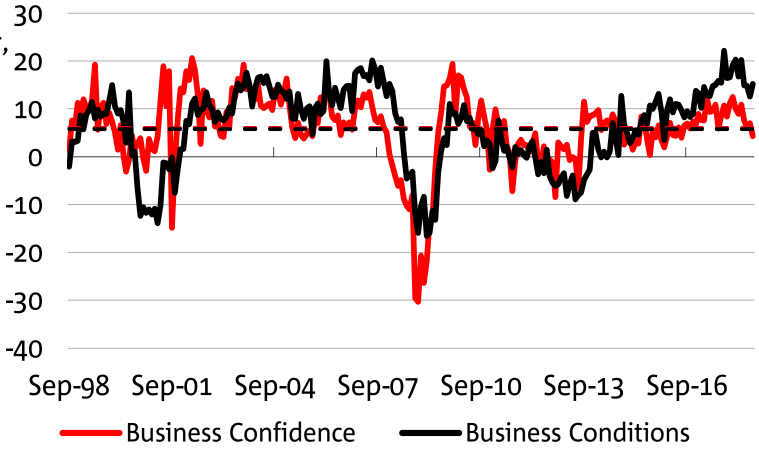
On the trade front, outcomes have evolved broadly as expected – with net exports making a small contribution to growth in Q2. Export volume growth moderated but was still solid at 1.1% q/q in Q2, and was broad-based across each of the main categories (rural, manufacturing, resources and services). Over the last year, resource export growth has been the standout – up over 10% y/y,

More recent data show the trade surplus narrowed in July, with a slight pull-back in exports of iron ore after the strong outcome in June. Imports were driven by intermediate goods (likely fuels) in the month.

We expect further export gains as the last of the new major LNG projects reaches full capacity before exports level out at a high level. Farm exports however will be a substantial, though temporary, drag over 2018-19, given the significant drought in NSW and parts of Queensland.

NAB CONFIDENCE AND CONDITIONS

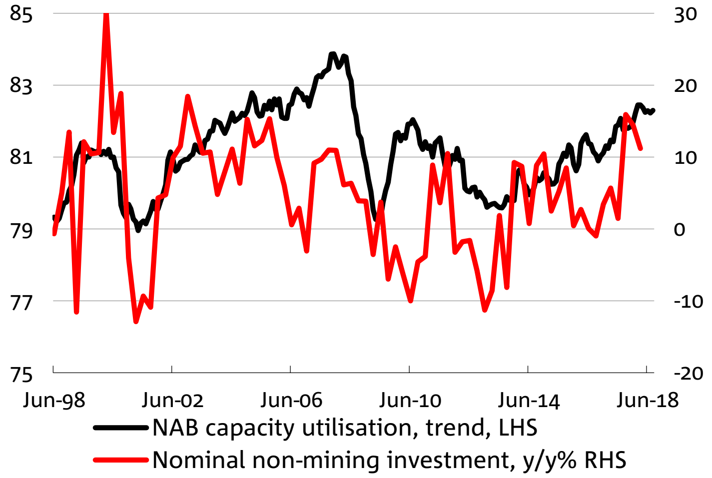
Net balance



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

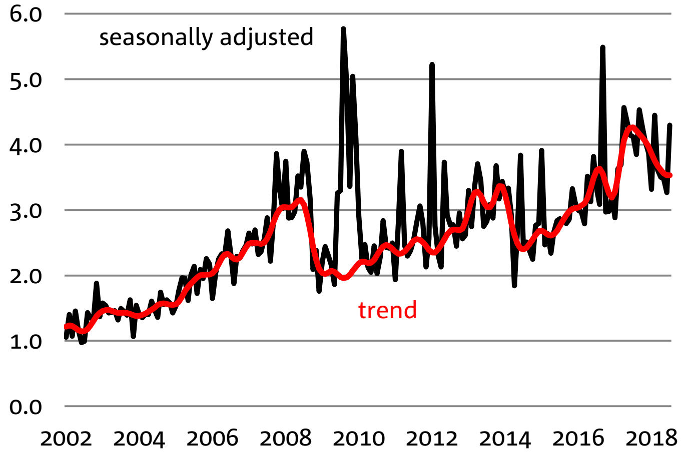
NAB SURVEY CAPACITY UTILISATION

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



NON-RESIDENTIAL APPROVALS

Value of non-residential building approved ($b)



Sources: ABS, NAB.

COMMODITIES

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

Prices for iron ore have remained range bound – in the mid-to-high US$60s a tonne – indicative of a balanced market at present. In contrast, infrastructure constraints in Queensland have contributed to the still elevated prices for hard coking coal. While off its mid-year peaks (in excess of US$200 a tonne), prices moved back above US$180 in mid August, and are likely to remain high for some time.

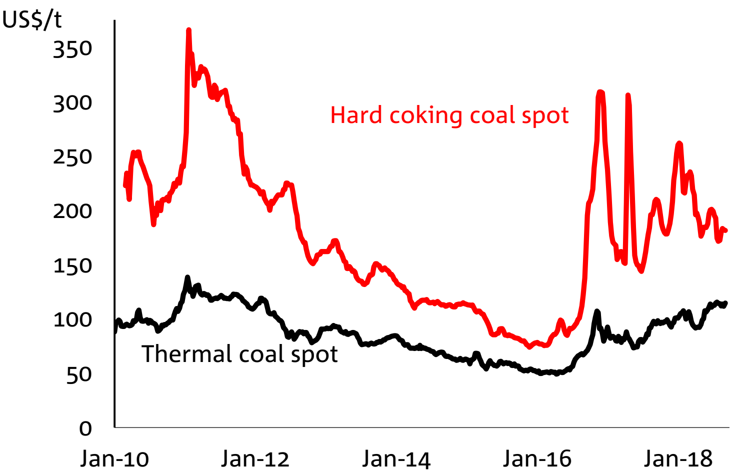
Oil prices trended higher in August but have been a little lower this month. Brent has been generally in the $76-78/bbl range this month. With oil prices at this level, combined with a lower Australian dollar, Australian LNG export prices are likely to see some upside and will remain in double digits in AUD terms for the foreseeable future. This suggests that domestic gas prices will remain high, with summer electricity demand a coming test.

Agricultural prices and production continues to be very region and commodity specific. While most of New South Wales and parts of Queensland are in severe drought, the wheat belt of Western Australia looks on track for an above average season. Conditions in Victoria and South Australia are varied, although a dry spring will be a challenge. The Bureau of Meteorology remains on El Nino watch – pointing to a 50% chance of El Nino developing in 2018. The three month outlook is generally drier than average.

The NAB Rural Commodities Index was up 0.8% in August, with grain, lamb and wool prices on the rise, but cattle and dairy lower. Continued drought conditions in the east is likely to see elevated grain prices but lower cattle prices.

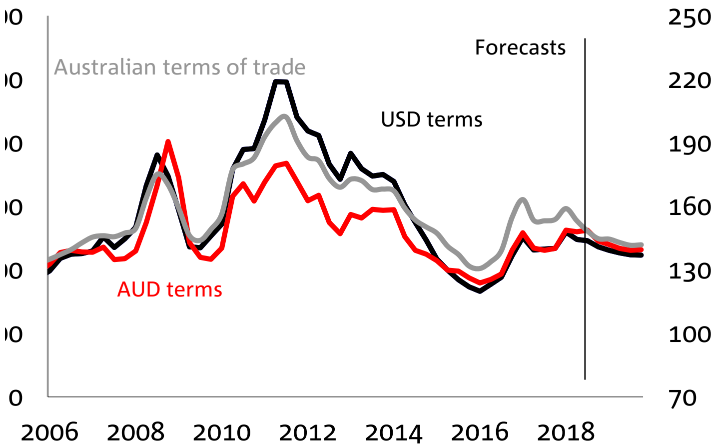
COAL SPOT PRICES

USD/t



NAB NON-RURAL COMMODITIES PRICE INDEX

Sep 1996 = 100

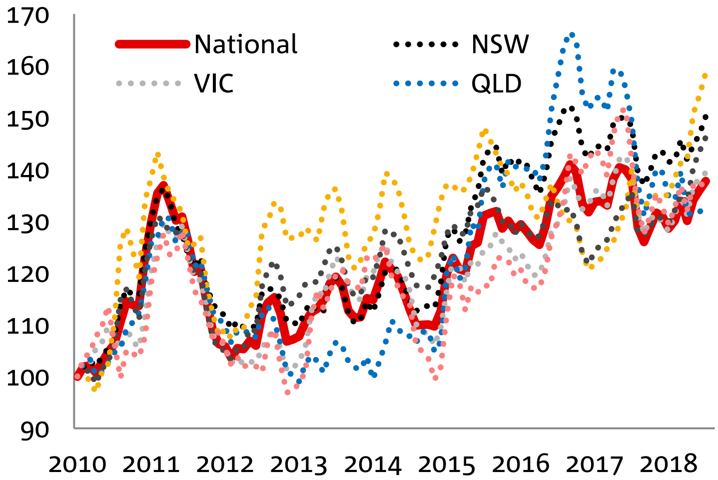


IRON ORE SPOT PRICE FORECASTS

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

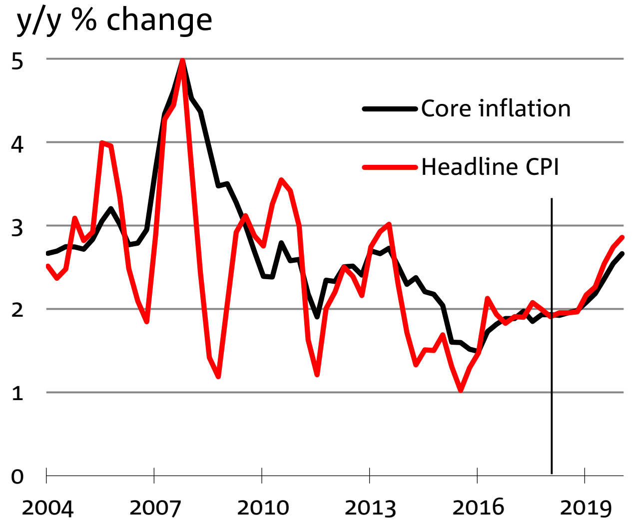
MONETARY POLICY, INFLATION AND FX

The official cash rate was left unchanged at 1.5% for the 25th consecutive month in September – as was expected. While above trend growth (as recorded in the Q2 national accounts) suggests that capacity may be eroded at a faster pace than previously anticipated, the outcomes for growth in the economy are broadly inline with RBA forecasts as at the August statement on monetary policy. While this result will provide comfort to policy makers that the economy continues to expand and spare capacity is being reduced, further evidence that a tightening of the labour market and pick-up in wages growth will be needed to provide enough confidence that inflation is rising towards the middle of the target band on an ongoing basis. Recent labour market data suggest that the unemployment rate has edged lower over recent months, reducing the degree of spare capacity in the labour market and there are some tentative signs wage growth has begun to accelerate. More recent indicators, such as capacity utilisation and surveyed price and labour cost growth have provided some further evidence of the supply/demand balance shifting. This shift is occurring slowly but is in line with recent commentary from the RBA that has sought to emphasise progress is likely to be gradual, that the next move in rates will be up and that they will seek to remain a source of stability and confidence.

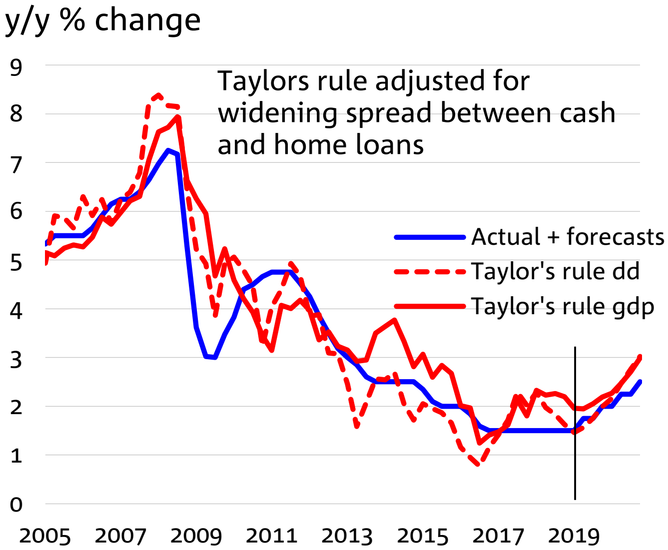
We have left out expectation for the path of monetary policy unchanged, though as in previous months, we recognise the risk that this could well be delayed. While growth has been quite strong and the labour market generally healthy, the unemployment rate until recently has remained at around 5.5% - around 0.5% above most current estimates of full employment. This has seen only a slight pick-up in wage growth and inflation to date, with the former well below the 3.5% seen as necessary for inflation in the middle of the band and the latter at the bottom of the band itself. Further, the release of Q2 national accounts confirmed that inflation pressures according to the broader national accounts measures of price inflations – the domestic final demand and consumption deflators – suggest continued meek outcomes. National accounts measures of earnings - while conceptually different to the WPI – suggests earnings growth remains weak.

The exchange rate has traded a lower over the past month, trading in the low US0.70s range. Risk sentiment around EM debt and exchange rate crisis have weighed further, as has ongoing uncertainty over US-China trade policy, with speculation of impending implementation of previously mooted tariffs on $200bn of Chinese imports to the US. Our models suggest a slightly higher fair value of the exchange rate, closer to the mid-70s mark. We see a general weakness in the currency over the next couple of years with widening interest rate differentials and an easing in commodity prices staring to weigh. The recent depreciation would be viewed as helpful with regard to monetary policy, as the additional support provided by the lower exchange rate would somewhat offset the tightening in financial conditions elsewhere.

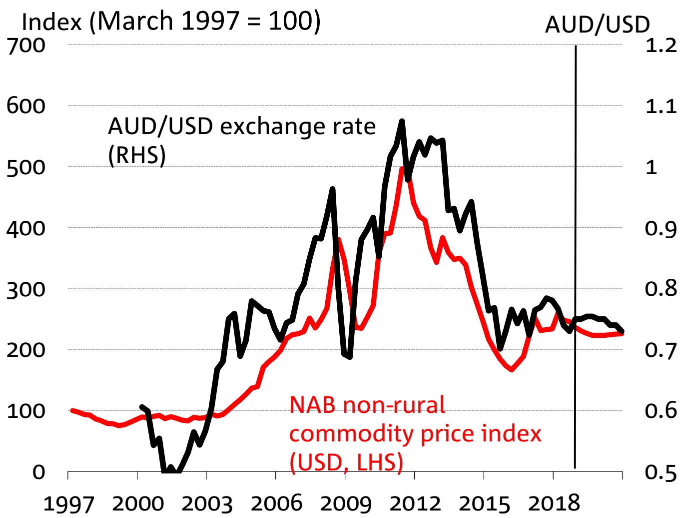
HEADLINE AND CORE INFLATION



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	3.0	2.5	2.5	2.9	2.7	2.8	2.5	2.5
Dwelling Investment	3.1	-0.5	-1.3	-4.5	8.7	-2.2	2.7	-5.3	-1.9
Underlying Business Investment	-6.6	6.4	2.6	6.2	-11.9	3.1	3.0	5.1	5.8
Underlying Public Final Demand	5.0	4.9	4.0	4.5	5.1	4.5	4.6	4.2	4.5
Domestic Demand	**2.3**	**3.5**	**2.6**	**2.9**	**1.9**	**3.0**	**3.2**	**2.6**	**3.0**
Stocks (b)	0.1	0.0	-0.1	0.0	0.1	-0.1	0.1	-0.1	0.0
GNE	**2.4**	**3.5**	**2.5**	**2.9**	**1.9**	**2.9**	**3.3**	**2.5**	**3.0**
Exports	5.4	3.4	5.5	3.5	6.8	3.5	5.0	4.8	2.5
Imports	4.8	6.9	3.4	4.6	0.2	7.8	5.0	3.6	4.9
GDP	**2.1**	**2.9**	**2.9**	**2.6**	**2.6**	**2.2**	**3.3**	**2.7**	**2.5**
Nominal GDP	5.9	4.7	4.0	4.2	3.8	5.8	4.8	3.5	4.7
Current Account Deficit ($b)	38	54	69	89	56	47	57	80	97
(-%) of GDP	2.2	2.9	3.6	4.5	3.3	2.6	3.0	4.1	4.8
Employment	1.4	3.0	2.1	1.9	1.6	2.3	2.5	2.0	1.8
Terms of Trade	14.4	1.9	-4.1	-2.9	0.1	11.6	-0.8	-5.7	-0.8
Average Earnings (Nat. Accts. Basis)	0.2	1.4	1.9	2.6	0.9	0.6	1.7	2.3	2.7
End of Period									
Total CPI	1.9	2.1	1.9	2.5	1.5	1.9	1.9	2.1	2.9
Core CPI	1.8	1.9	1.9	2.3	1.5	1.9	1.9	2.1	2.7
Unemployment Rate	5.6	5.5	5.0	4.8	5.7	5.4	5.3	5.0	4.9
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	7/09/2018	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	77	75	76	74	72	70	68	67	68	69	70	70
Tapis oil	US$/bbl	78	78	77	75	73	71	69	68	69	70	71	71
Gold	US$/ounce	1198	1310	1230	1280	1310	1330	1330	1340	1370	1380	1390	1400
Iron ore (spot)	US$/tonne	n.a.	66	66	63	60	58	60	62	63	61	58	60
Hard coking coal*	US$/tonne	n.a.	190	180	155	150	155	145	140	130	125	120	125
Thermal coal (spot)	US$/tonne	117	102	114	100	95	85	80	75	77	73	70	68
Aluminium	US$/tonne	2031	2261	2050	2075	2080	2055	2025	2000	1985	1962	1958	1955
Copper	US$/tonne	5915	6877	6100	6000	6250	6500	6600	6700	6750	6800	6800	6650
Lead	US$/tonne	2058	2383	2125	2275	2265	2280	2300	2300	2280	2260	2240	2220
Nickel	US$/tonne	12271	14456	13500	13750	14000	13750	13525	13025	13250	13500	13250	13000
Zinc	US$/tonne	2423	3112	2550	2650	2750	2725	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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