EMBARGOED UNTIL 11.30 AM WEDNESDAY 10 OCTOBER 2018

THE FORWARD VIEW: AUSTRALIA OCTOBER 2018

A strong first half and continuing near term momentum but slowing into the medium term.

OVERVIEW

Fundamentally we have not changed our macroeconomic forecasts and have slightly lowered our near term AUD forecasts.

From a higher base (reflecting revisions to history) we see the following factors as key drivers to the outlook. Public sector demand – both infrastructure spending and consumption through the NDIS – will remain strong, and will probably flow over into quite strong non-mining investment. Mining is a potential upside factor to the forecasts, with that sector now clearly reporting the strongest conditions and confidence. At a minimum 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 of capex will be required in the future to maintain production - with the now larger capital stock in the sector. The lower currency in an environment where the domestic economy is strong will also help maintain domestic growth momentum.

The housing cycle will now probably detract a touch more from growth but not more than the usual cyclical swings and roundabouts. Today we have lowered our house price forecasts (see our Residential Property Survey, Q3-2018) but fundamentally we are still forecasting a soft landing – with house prices still around 15-20% above where they were 3 years ago. Again our main concern remains with consumer spending. We doubt the current momentum (to the extent it really happened) will be maintained in an environment of weak wages growth, high utility prices, falling house prices and concern about high debt levels. Drought while severe in NSW and Queensland is unlikely to be a significant drag nationally.

The net outcome of the above sees little change to our previously published quarterly growth profile, with GDP growth of around 3¼% in 2018, slowing to 2.7% in 2019 and 2.5% in 2020. That growth profile should see the labour market tighten – we maintain an unemployment forecast of 5% by mid-2019 with risk that this could be achieved sooner. Wages growth should also lift moderately (we expect wages growth of around 2.3% by year-end and around 2.5% by mid to late 2019) 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 lifting rates 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. We still see the first move up from mid-2019 but clearly that is very data dependent.

CONTENTS

Consumers, labour market and wages 2
Housing and construction 3
Business and trade 4
Commodities 5
Inflation, monetary policy and FX 6
Appendix A: detailed forecast tables 7

CONTACTS

Alan Oster, Group Chief Economist
+(61 0) 414 444 652

Gareth Spence, Senior Economist
+(61 0) 436 606 175

Phin Ziebell, Economist
+(61 0) 475 940 662

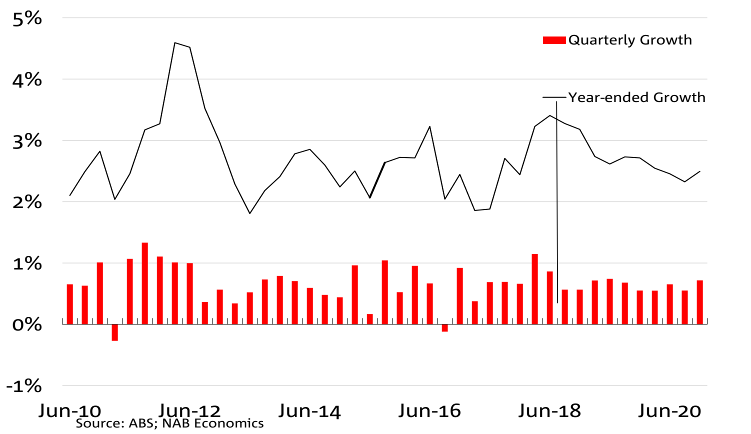
KEY ECONOMIC FORECASTS

	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	0.71	0.75	0.75

(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

While consumption grew at a stronger than expected rate in the first half of 2018 (with a decline in the savings rate offsetting continued weak income growth), data to for Q3 to date suggests a weaker outcome. Monthly retail sales rose 0.3% in August after the flat outcome in July. 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 September.

Our outlook for the consumer remains weak, with continued weak wage growth, high household indebtedness and slower growth in household wealth continuing to weigh on spending over the next few years. Overall we expect consumption to only grow at a moderate 2.5% per year in 2019 and 2020.

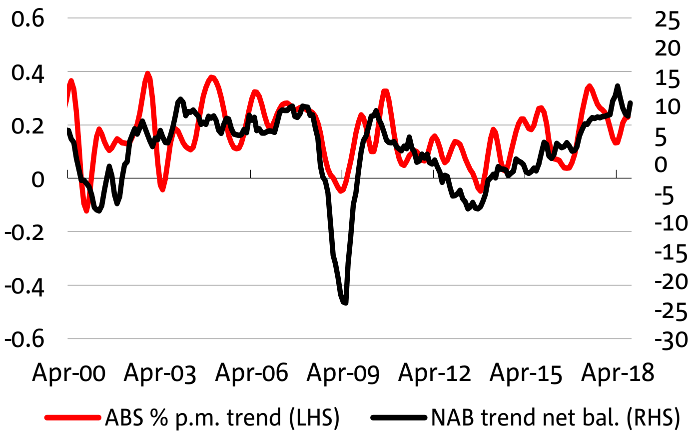
While wages growth has remained weak, conditions in the labour market remain favourable. Employment continued to grow at a trend rate of just under 30k in August, and though the participation rate increased, the trend unemployment rate remained at 5.3% - its lowest level since 2012.

The NAB Monthly Business Survey employment index edged higher in September and based on historical patterns continues to suggest employment growth of over 20k per month. Should employment continue to grow at this rate, the unemployment rate will fall further and wage growth will begin to lift. We forecast the unemployment rate to decline to around 5.0% by mid-2019 and wages growth to lift to around 2.5% by late next year.

Surveyed price and wage measures fell in the September NAB Monthly Business Survey, after showing some signs of a pick-up in recent months. Notably the survey suggested that retail prices declined at a quarterly rate of 0.1% in the month. Input prices and labour costs growth also eased in the month suggesting despite some evidence of a pickup, inflationary pressure is still weak.

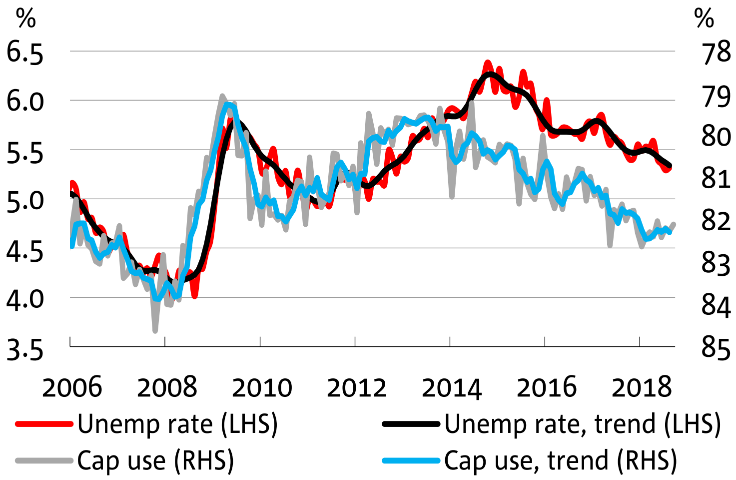
EMPLOYMENT

ABS vs NAB



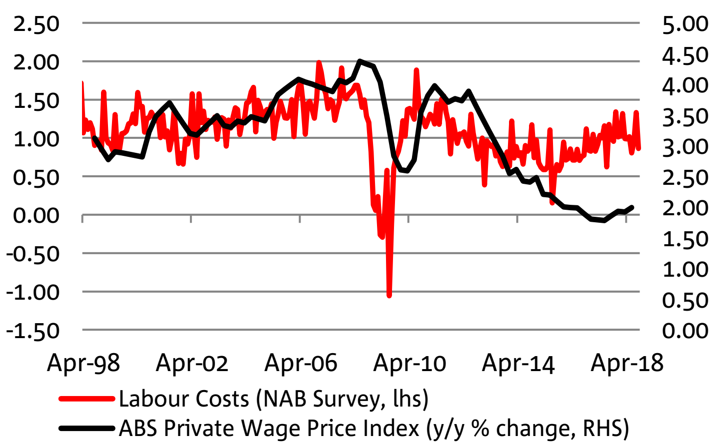
UNEMPLOYMENT AND CAPACITY UTILISATION

ABS (unemployment) and NAB monthly survey



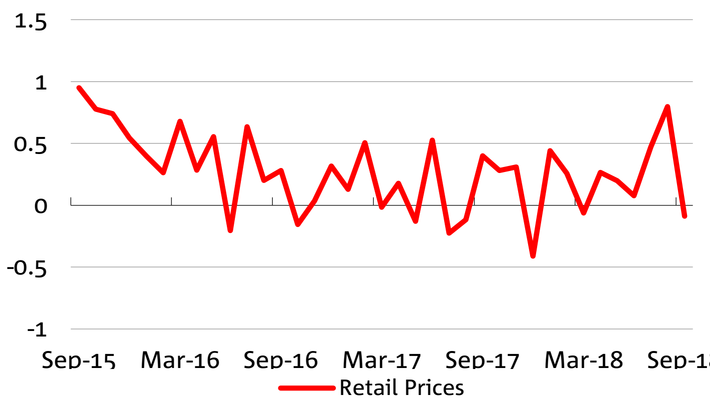
NAB WAGE GROWTH PROXY

y/y % change



NAB BUSINESS SURVEY RETAIL PRICES

% change at quarterly rate



Sources: ABS, NAB Group Economics

HOUSING AND CONSTRUCTION

The housing market has continued to cool over the past month. Prices in the established market fell further, credit growth slowed further and dwelling approvals continued to trend lower.

The Core Logic 8 Capital City dwelling price index fell a further 0.6% in September and is now 3.7% lower than a year ago. Over the year, the declines in house prices have been driven by Sydney (which peaked first) and Melbourne (where the pace of decline has quickened recently). That said, Perth appears to have weakened again recently and growth has slowed across the other capitals. In general, the lower end of the market and regional prices have held up better, and the weakness to date has been concentrated in houses, with apartments falling by less.

Peak-to-trough, Sydney prices have now fallen by 6.2% while Melbourne is down 4.4%. Despite these moderate falls, prices remain around 60% higher in Sydney and 50% higher in Melbourne than they were in 2012. Based on recent momentum and the results of our quarterly residential property survey, we have revised down our forecasts for house prices a little further and expect this orderly correction to continue over the next 18 months.

Housing credit slowed further to 5.4% y/y in August. Investor credit has slowed to 1.5% over recent months While credit extended to owner occupiers is tracking at around 7.5%.

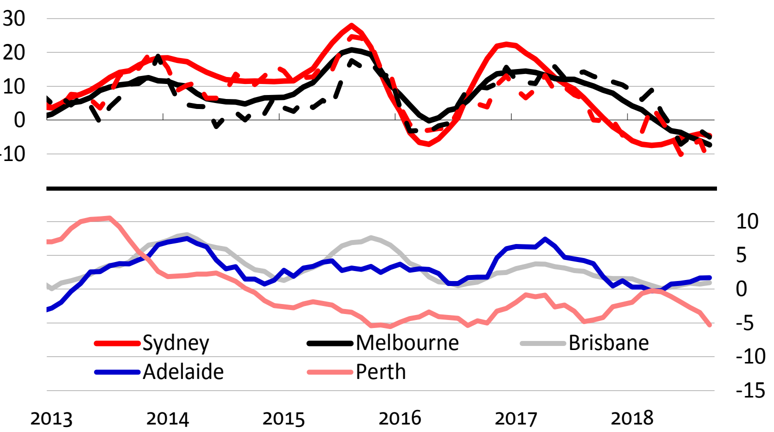
Residential building approvals continued their downward trend in August, falling 9.4% m/m (following a 5.2% decline in July). While often volatile, approvals for both apartments and houses are now clearly trending lower, though remain elevated.

We expect dwelling investment to decline over the next couple of years as the housing market continues to cool, though we do not expect a large subtraction from growth. Approvals have trended lower, but remain relatively high and the pipeline of work-yet-to-be done also remains elevated. it is possible that dwelling investment will be volatile as it peaks, then plateaus and declines over the next few years – as evidenced by the surprise increase in the Q2 national accounts.

Overall, while the recent momentum in the housing market has been slightly more negative than we anticipated, we expect the correction in prices to remain orderly and do not expect a sharp tightening in borrowing conditions in the sector. Instead, while the pipeline of construction remains large, and investor demand (both domestic and foreign) appears to have slowed on the expectation of declining prices, we expect population growth in the key centres to continue to support prices over the next few years. Indeed, policy makers would welcome this adjustment in prices and gradual slowing in construction, while the economy continues to grow at a solid pace and the unemployment rate is declining. These adjustments would serve to remove some of the build-up in risk for the household sector over recent years.

HOUSE PRICES

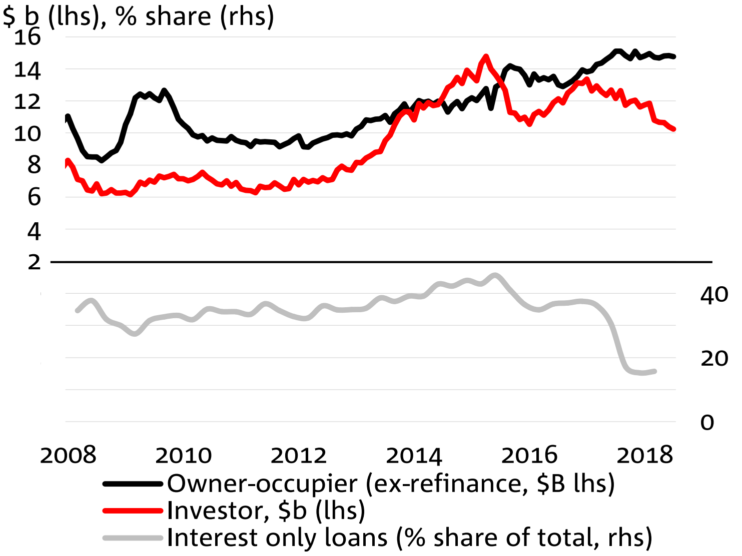
Dwelling price growth (%, 6-month annualised)



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

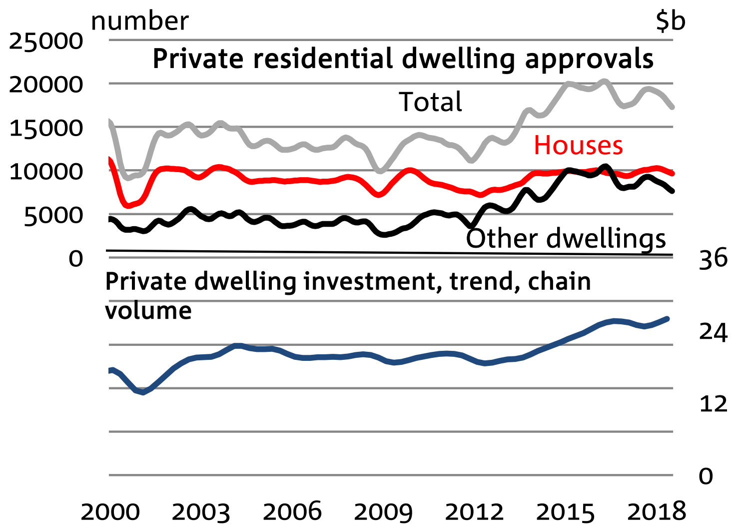
HOUSING FINANCE APPROVALS

$ b (lhs), % share (rhs)



BUILDING APPROVALS & RESIDENTIAL INVEST.

Trend basis



Source: ABS, NAB, Core Logic, APRA.

BUSINESS AND TRADE

The business sector is an important component of our outlook for the economy over the next couple of years. We expect non-mining business investment to grow at a relatively strong rate, supported by both a recovery in the sector as well as some additional spill overs from the high levels of public sector infrastructure investment. In addition, we expect the drag from the unwinding of the mining investment boom to wane, as the last of the LNG mega-projects enters production. The mining sector is likely to also require a higher level of 'sustaining capex' going forward as the capital stock in the sector is now significantly larger and there will also be some investment in new mines (as planned) when current pits are depleted. Relatedly, trade also remains key to our outlook with exports continuing to increase strongly over the next year, before levelling off as the LNG sector reaches capacity.

The Q2 national accounts suggested a pull-back in the non-mining sector while the mining sector rose relatively sharply (though remains around 10% lower over the year). Expectations for 2018/19 from the ABS capex survey suggests that both the mining and non-mining sectors (though only includes a subset of industries) will decline further.

Higher frequency indicators – such as the NAB Business Survey – suggest more positive outcomes in the sector though are also a little mixed. Business confidence edged back to average in September and business conditions continued to stabilise after some weakness in the middle of the year. Overall, conditions and confidence remain highest in mining – with commodity prices remaining higher than expected and export demand remaining strong. Conditions generally remain favourable in the non-mining industries, with actual capex (in trend terms) at high levels and capacity utilisation is also at strong levels.

The volatile measure of non-residential building approvals continued to trend lower in August – and has declined notably through 2018. Despite this easing, the value of approvals remains elevated.

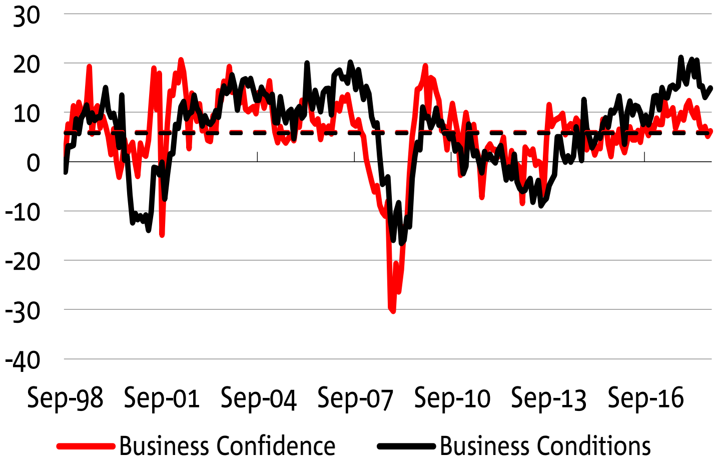
International trade continues to play out largely as expected with commodity exports continuing to rise as LNG production ramps up. To date, a rise in beef exports has offset the decrease in grain exports – the drought has seen a shift of some exports to the domestic market, while slaughter rates are also up for cattle.

The trade surplus widened in August, with growth in exports (due to a rise in LNG and soft commodities) offsetting the rise in imports. While imports has been volatile with fuel and aircraft volatile, other capital goods also increasing. This is a possible indicator of further investment in the business sector.

Going forward, we expect exports to rise over the next year or so before levelling out. Further gains in exports will likely be related to improved productivity at existing iron ore and LNG projects rather than large new mines.

NAB CONFIDENCE AND CONDITIONS

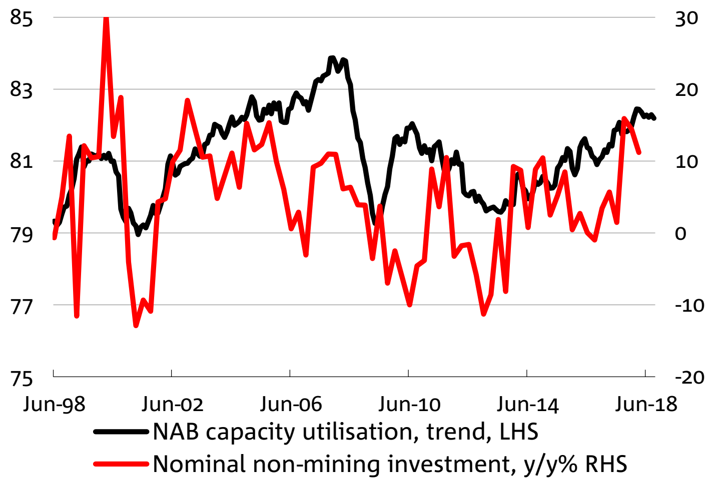
Net balance



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

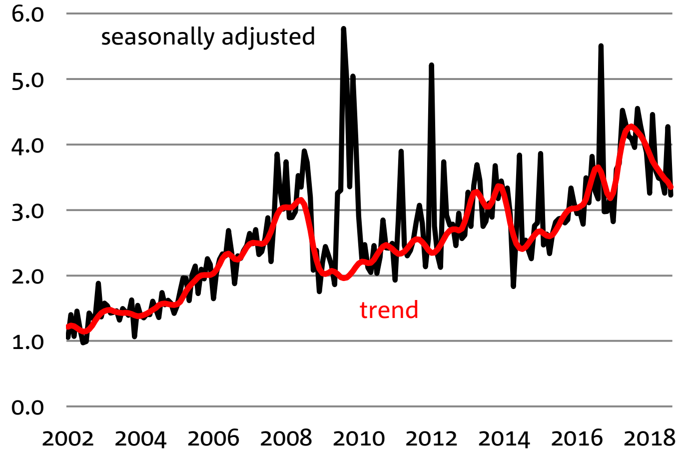
NAB SURVEY CAPACITY UTILISATION

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



NON-RESIDENTIAL APPROVALS

Value of non-residential building approved ($b)



Sources: ABS, NAB.

COMMODITIES AND TRADE

Spot prices for iron ore have remained largely range bound – between US$60 a tonne and US$70 a tonne – since the second half of March 2018. At the time of writing, 62% ore landed in China was near the upper bound of this range – at US$69.50 a tonne. The outlook for China's steel demand has become increasingly uncertain, as authorities grapple with a range of policy responses to US tariffs. One measure is a loosening in policy restrictions on infrastructure development – which could provide a boost for China's steel consumption in the short term. That said, this may only offset weaker demand from the rest of the construction sector.

Prices for hard coking coal have risen back towards US$200 a tonne in mid-September (from around US$175 a tonne), while thermal coal prices have trended above US$110 a tonne since early June. In the short term we see limited downside to these prices.

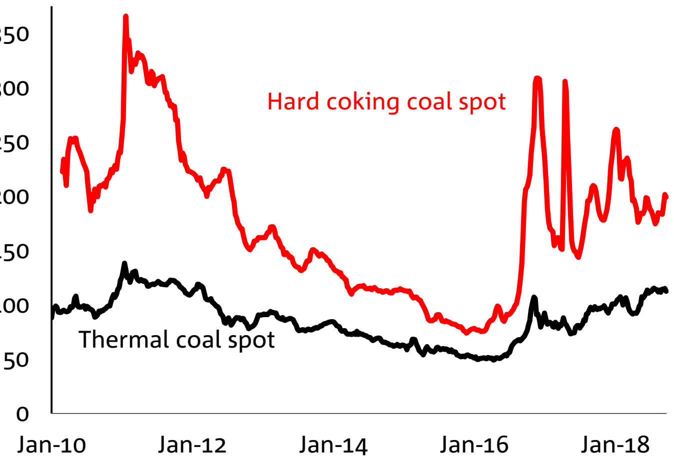
Oil prices have been much higher recently, with Brent in the mid-80s range and WTI in the mid-70s.

The US decision to walk away from the Iran deal and reimpose sanctions is having a serious impact on Iranian crude exports, and combined with ongoing malaise in Venezuela, has seen spare capacity in the system shrink considerably. Saudi Arabia is moving to increase production but so far this has not settled markets. Combined with the lower AUD, this means that Australian pump prices are likely to see upside pressure (as will domestic gas prices).

Australian agriculture continues to face the challenge of drought in the east – particularly NSW and Qld. While WA had a very good winter, a dry start to spring and late frosts has taken the top off our wheat forecasts. Meanwhile conditions in Vic and SA are slipping quickly. Grain prices have risen sharply, with ASX eastern Australian wheat touching a record $450/t last month, but this huge premium to global benchmarks surely cannot last. The NAB Rural Commodities Index was up 6.5% in September.

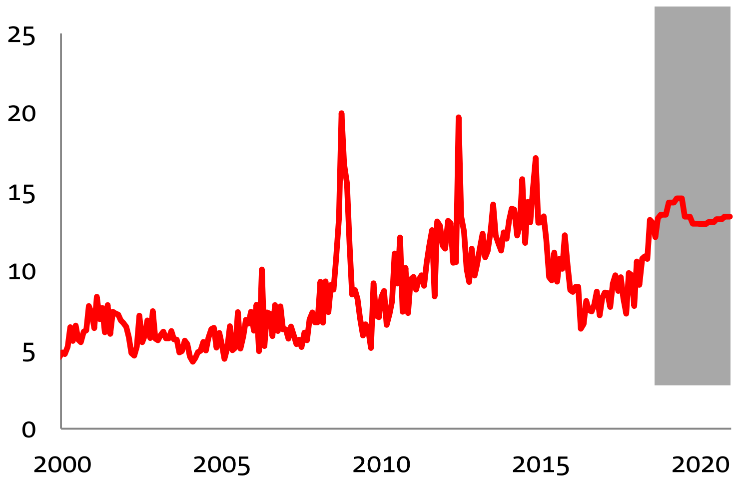
COAL SPOT PRICES

USD/t



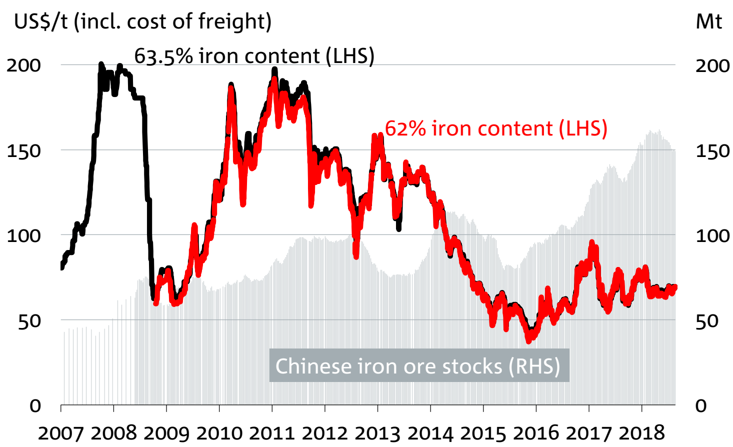
AUSTRALIAN LNG EXPORT PRICES

Monthly actuals and quarterly forecasts, AUD/GJ



IRON ORE SPOT PRICE

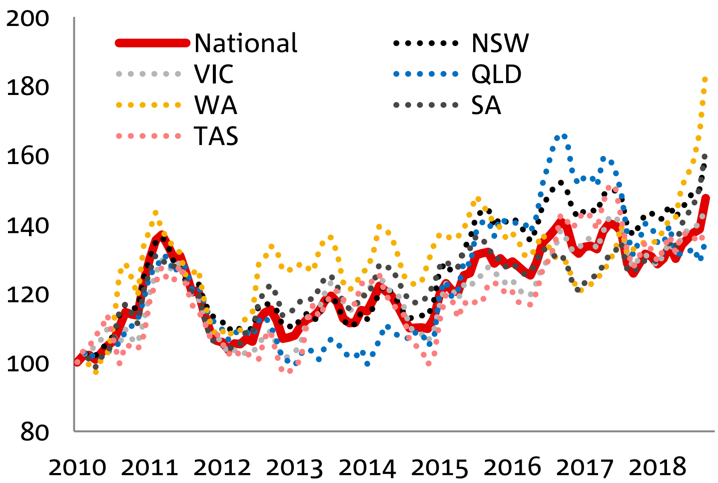
US$/t (incl. cost of freight)



Source: Bloomberg, Thomson Datastream, NAB Economics

NAB RURAL COMMODITIES INDEX

Jan 2010 = 100



Source: ABARES, Meat and Livestock Australia, Australian Pork, Ausmarket, ABS, Bloomberg, Thomson Reuters, BREE and Profarmer

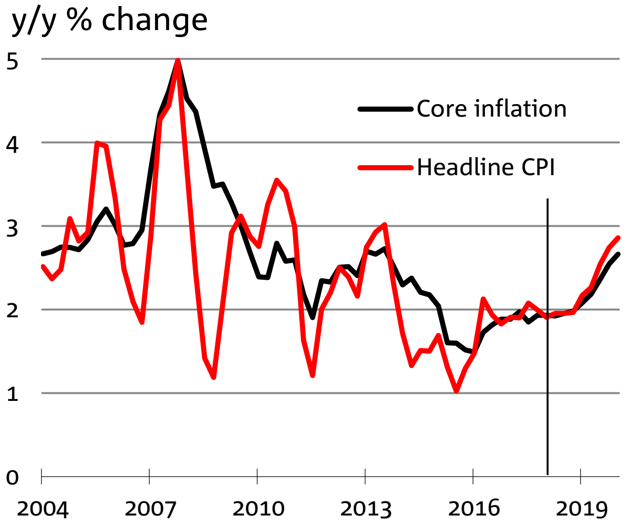
MONETARY POLICY, INFLATION AND FX

As was widely expected, the RBA left rates on hold at 1.5% in October. Market pricing implies the cash rate will be on hold until late 2019. Despite the Q2 national accounts confirming that growth has been strong over the past year, and the RBA expecting growth of above 3% for each of the next two years the outlook for inflation remains relatively weak. Global inflation is low and domestic labour cost pressures are also weak. The exchange rate has depreciated recently – a likely supporter of growth – though it appears to have done little to boost inflation (though this would be seen as a transitory factor at face value). The more important dynamic is domestic wage growth – a key determinant of labour cost pressure. While labour market conditions have been good with employment continuing to grow relatively strongly, the participation rate has also risen. While the increase in the participation rate is also a positive – more people engaged and in work, employers able to source labour – it has meant the unemployment rate has hovered near 5.5% for the most part over the last year. This degree of spare capacity and consequently weaker wage growth in combination with strong competition on price in some sectors has seen price pressures remain weak. However, the labour market has shown signs of tightening and with growth and employment expected to continue it is expected that wages and inflation will lift gradually. Therefore the RBA has signalled it does not expect to lift rates for sometime,

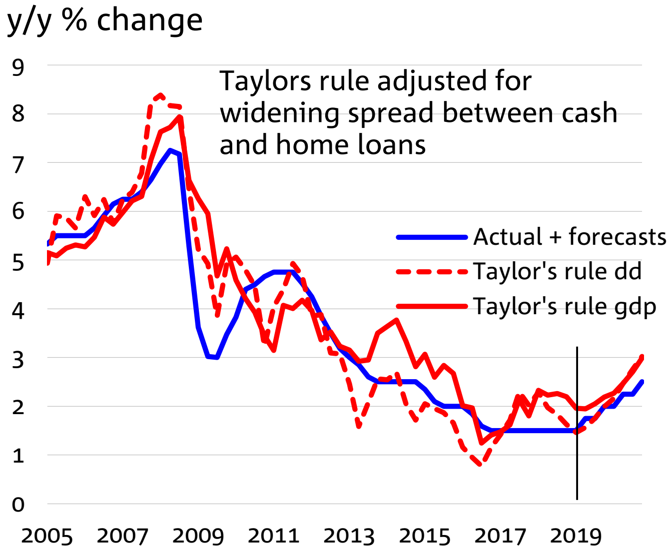
Our expectations for the path of monetary policy remain unchanged. We still expect the first rate increase to occur around mid-2019 with the economy continuing to grow at an above trend pace, employment growing stronger than the working-age population and the unemployment rate declining further. While wages growth remains low and indicators of inflationary pressure remain weak, there is some evidence that the labour market is beginning to tighten and that wage growth may be gradually starting to lift. We expect the labour market to tighten a little faster than the RBA, though also forecast inflation only rising to the middle of the target band in 2020. With the economy tracking in the right direction, and the effects of waning spare capacity beginning to bind, the RBA will begin a very gradual process of lifting rates from historical lows. There remains the risk this timing is delayed, should the labour market dynamic turn out weaker than forecast or global risks such as US-China trade tensions escalate significantly.

US-China trade policy developments continue to be the key factor in the outlook for the exchange rate. Initially the AUD/USD traded lower in the lead up to the announcement by the Trump administration that 10% tariffs on an additional $200bn of Chinese imports would be implemented in September (rising to 25% in January). Since then the Aussie has traded in the low US70c range. It is likely we will see continued bouts of volatility with further uncertainty over trade and further bouts of EM stresses over the next year or so. Our models suggest a fair value in the mid-70c range but we have lowered our near term forecast for the AUD/USD as trade tensions play out.

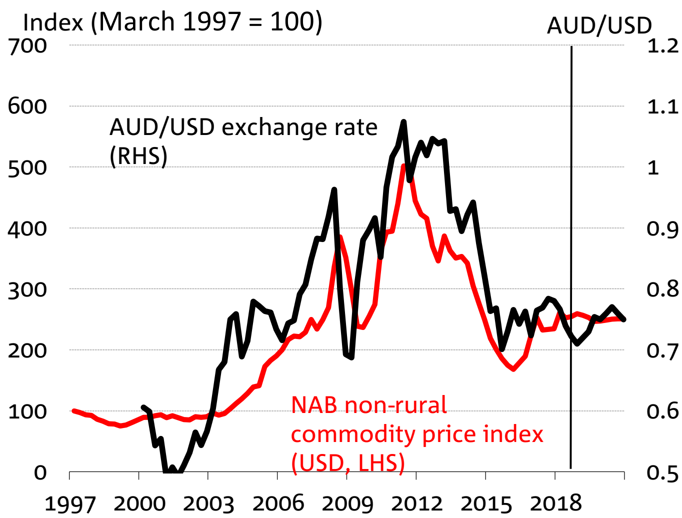
HEADLINE AND CORE INFLATION



TAYLOR 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	0.73	0.77	0.72	0.78	0.71	0.75	0.75
$A - Trade Weighted Index	65.5	62.6	64.5	65.5	63.9	64.9	61.5	65.2	62.4

(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	8/10/2018	Sep-18	*Dec-18*	*Mar-19*	*Jun-19*	*Sep-19*	*Dec-19*	*Mar-20*	*Jun-20*	*Sep-20*	*Dec-20*
WTI oil	US$/bbl	74	71	76	79	74	71	72	74	74	74	74
Brent oil	US$/bbl	84	75	82	85	80	77	78	80	80	80	80
Tapis oil	US$/bbl	87	77	83	86	81	78	79	81	81	81	81
Gold	US$/ounce	1186	1210	1240	1270	1300	1300	1320	1340	1360	1380	1410
Iron ore (spot)	US$/tonne	n.a.	67	68	63	60	61	62	63	61	58	60
Hard coking coal*	US$/tonne	n.a.	187	195	180	175	160	165	160	156	153	150
Thermal coal (spot)	US$/tonne	115	114	110	105	103	101	100	103	100	98	100
Aluminium	US$/tonne	2063	2055	2075	2080	2055	2025	2000	1985	1962	1958	1955
Copper	US$/tonne	6174	6119	6250	6350	6500	6600	6700	6750	6800	6800	6650
Lead	US$/tonne	1948	2096	2150	2200	2175	2160	2155	2150	2125	2100	2100
Nickel	US$/tonne	12496	13262	13750	14000	13750	13525	13025	13250	13500	13250	13000
Zinc	US$/tonne	2655	2537	2650	2750	2725	2700	2600	2550	2500	2485	2465
Aus LNG**	AU$/GJ	n.a.	13.3	13.5	14.3	14.6	13.4	13.0	12.9	13.1	13.2	13.4

S* 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

Group Economics
Alan Oster
Group Chief Economist
+(61 3) 8634 2927

Jacqui Brand
Personal Assistant
+(61 3) 8634 2181

Australian Economics and Commodities

Tony Kelly
Senior Economist
+(61 3) 9208 5049

Gareth Spence
Senior Economist
+(61 0) 436 606 175

Phin Ziebell
Economist – Agribusiness
+(61 0) 475 940 662

Behavioural & Industry Economics
Dean Pearson
Head of Economics
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(61 3) 9208 2929

International Economics
Gerard Burg
Senior Economist – Asia
+(61 3) 8634 2788

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

Global Markets Research
Peter Jolly
Global Head of Research
+(61 2) 9237 1406

Ivan Colhoun
Chief Economist, Markets
+(61 2) 9237 1836