EMBARGOED UNTIL 11.30 AM WEDNESDAY 14 NOVEMBER 2018

THE FORWARD VIEW: AUSTRALIA NOVEMBER 2018

A healthy growth outlook but some concerns about the consumer

OVERVIEW

The economy grew at a strong pace over the first half of 2018 – with output expanding by over 4% in annualised terms. Looking forward, we expect growth to slow in annual terms, though still at a pace which should erode spare capacity. Public sector demand – both infrastructure spending and NDIS-related consumption will remain strong. We also expect non-mining business investment to benefit from additional spill-overs. Exports are expected to continue to grow relatively strongly - as the last of the large LNG projects reach full production capacity – and then level off. Mining is a potential upside factor to the forecasts, with that sector now clearly reporting the strongest conditions and confidence, commodity prices having remained high and the drag from the unwinding of the boom now fading.

Despite the above special factors adding to growth, our main concern remains weak consumption growth - which is likely to weigh on broader economic growth (accounting as it does for over half of all economic activity). With an already low savings rate, weak wage growth, high debt levels and some anxiety from slower growth in household wealth - we see a very cautious household sector over the next couple of years. The construction cycle is also expected to move down but, only moderately and as such its impact on growth will be small.

On a more positive note, recent data suggest that the labour market remains healthy with trend employment growth tracking at around 25-30k per month. This should be enough to see the unemployment rate decline further after falling to a 6-year low of 5.0% in September. Despite the strong growth and tightening labour market, the September quarter CPI suggests that inflationary pressure remains weak. While a number of one off adjustments to administered prices drove the weakness in headline inflation, our overall read is that both imported and domestic inflation remain subdued.

We have left our outlook for interest rates unchanged this month but our view remains heavily data dependent. While growth has been strong and progress has been made on reducing the unemployment rate, the RBA will likely want to see further evidence of a pickup in wages growth and inflation. There has been some progress on this front but the process has been gradual and is likely to remain so, with still some spare capacity in the labour market and the economy more broadly. Readings on the WPI for Q3 and labour market data for October will provide important updates on the current pace of wage growth and momentum in the labour market.

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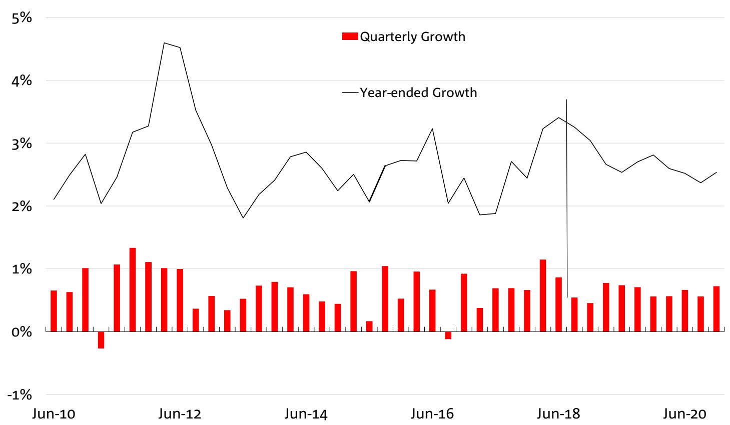
KEY ECONOMIC FORECASTS

	2017	2018-F	2019-F	2020-F
Domestic Demand (a)	3.0	3.1	2.5	3.0
Real GDP (annual average)	**2.2**	**3.2**	**2.7**	**2.5**
Real GDP (year-ended to Dec)	**2.4**	**3.0**	**2.8**	**2.5**
Terms of Trade (a)	11.6	1.0	-4.0	-0.8
Employment (a)	2.3	2.6	2.2	1.9
Unemployment Rate (b)	5.4	5.1	4.9	4.8
Headline CPI (b)	1.9	2.2	2.1	2.7
Core CPI (b)	1.9	1.9	2.0	2.5
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

Consumption growth appears to have slowed in the second half of 2018 after holding up relatively well in the first half with a decline in the household saving rate offsetting some of the weakness in income growth. Retail sales data suggest that the volume of retail sales grew by 0.2% in Q3. While the national accounts measure of consumption captures a broader spectrum of household spending this outcome suggests some downside risk to consumption in Q3.

While household spending appears to have slowed, the strength in the labour market appears to have continued into the second half. Employment (in trend terms) has growth at just under 25-30k per month over recent months, and the unemployment rate has fallen to 5.0% - after holding at around 5.5% for some time. Around two-thirds of employment growth has been on a full-time basis over the past year.

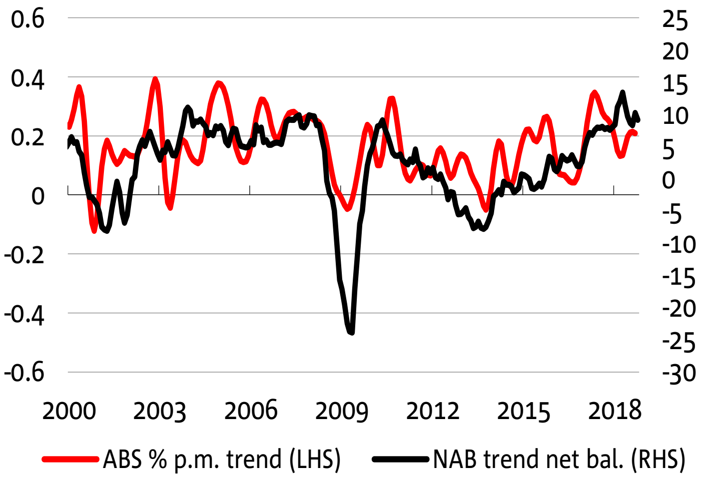
The NAB Monthly Business Survey employment index fell in October, but still implies employment growth of over 20k per month. This should be enough for the labour market to hold on to recent gains, and see further gradual declines in the unemployment rate over the next year or so.

As the labour market tightens further, and employers are forced to bid up wages to attract and retain staff we expect wages growth to lift. We still expect this to be a gradual process and overall, even after rising over the next year or so, we expect wages growth to remain low by historical standards. This will likely be an ongoing constraint on household income growth.

Surveyed wage and price variables from the NAB Monthly Business survey suggest that overall, wage and inflation pressures remained weak in October.

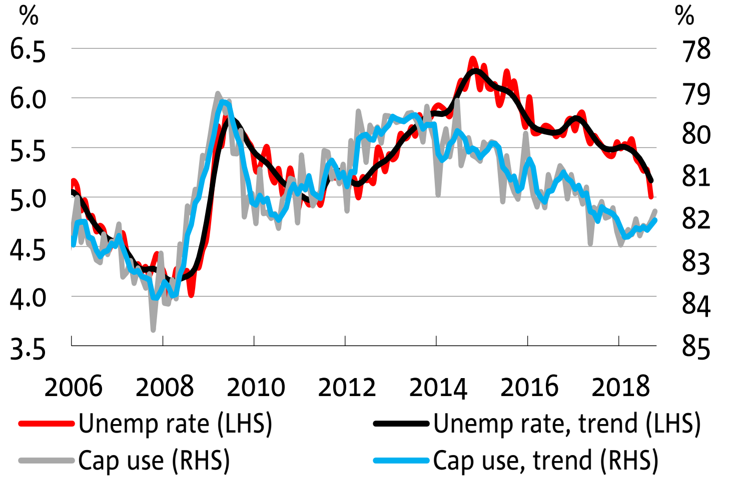
EMPLOYMENT

ABS vs NAB



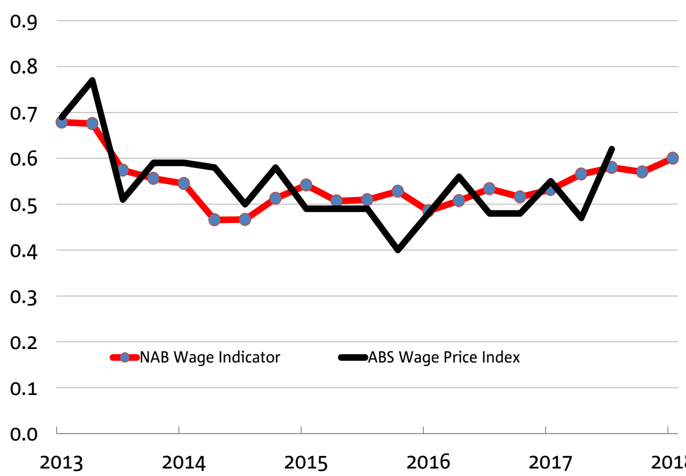
UNEMPLOYMENT AND CAPACITY UTILISATION

ABS (unemployment) and NAB monthly survey



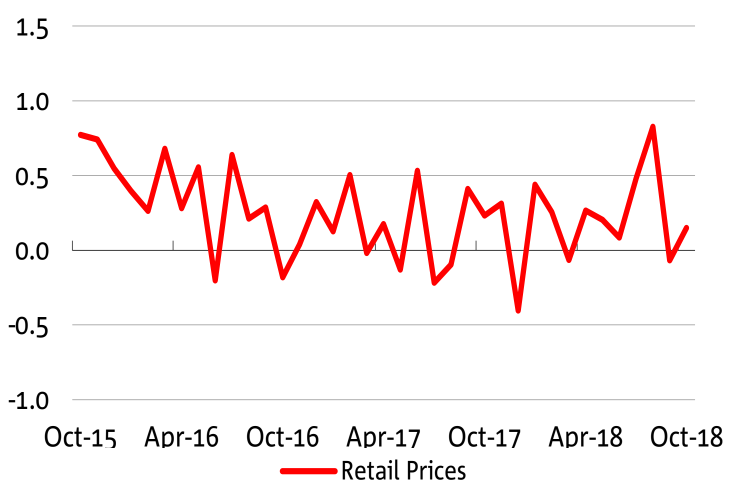
NAB WAGE GROWTH PROXY

Q/Q%



NAB BUSINESS SURVEY RETAIL PRICES

% change at quarterly rate



Sources: ABS, NAB Group Economics

HOUSING AND CONSTRUCTION

The recent run of housing related data has confirmed that the housing market continues to cool. House prices weakened further in October, clearance rates hovered at a low level and credit growth slowed further. On the construction side, the data also suggest a slowing with approvals now clearly trending downwards, though the pipeline of work yet to be done remains elevated.

The Core Logic 8 Capital City dwelling price index fell 0.6% in October – a similar pace of decline to last month - and is now 4.3% lower over the year. Perth fell most this month, down 0.8% to be 3.3% lower than a year ago. Sydney and Melbourne which have led the declines to date, each fell another 0.7% in the month to be down 7.4% and 4.7% over the year. Prices in Brisbane and Adelaide have held up – with prices in these cities slightly higher over the year. Hobart remains the stand out, with prices up 10% over the year.

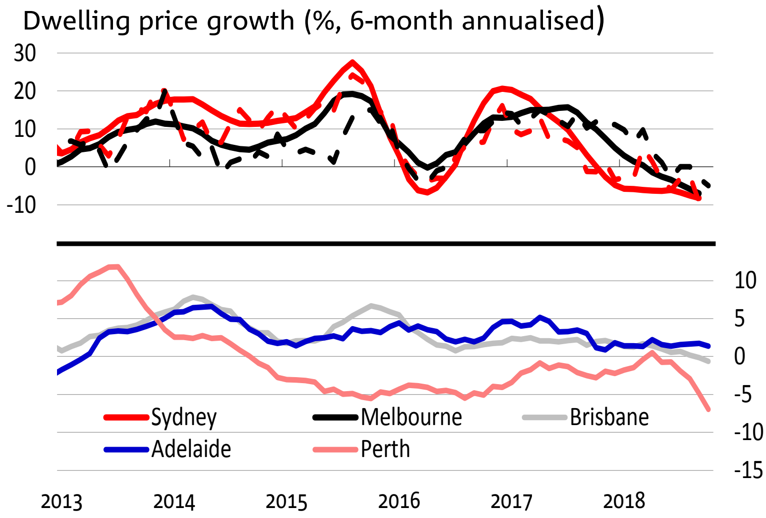
Peak-to-trough, Sydney prices have now fallen by 8.4% while Melbourne is down 4.7%. Overall, we see some further weakness in house prices, with an orderly correction serving to remove some of the prior build-up of risk in the housing sector. Despite the declines that have occurred over the past year, dwelling prices remain well up on 5 years ago.

Alongside the decline in house prices, housing credit has slowed this year. Growth in outstanding credit slowed further in September, with the year-ended growth rate falling to 5.2%. Investor credit has slowed markedly, falling to a year-ended rate of 1.4%. While credit extended to owner-occupiers has also slowed, it continues to track at a more robust rate – 7.3% over the year to September. Loan approvals (new loans) declined further in September with approvals to owner-occupiers down 1% while investor loan approvals fell a further 2.5%. Taken at face value, these data suggest a further slowing in credit growth.

On the activity side, residential building approvals rebounded slightly in September, coming off two months of consecutive declines. However, the rise in the month was driven almost entirely by the volatile apartment segment (in Victoria). The downward trend in approvals across both detached houses and apartment approvals is now clearly evident. In aggregate, approvals for houses are now 7.5% lower than a year ago, while approvals for apartments have fallen 22%. While approvals have declined, work done is likely to remain high with a large pipeline of work yet to be completed.

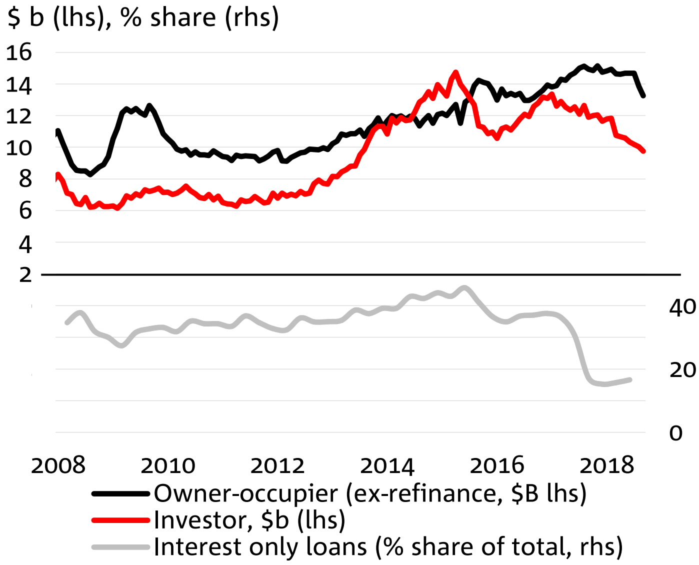
Overall, we expect dwelling investment to decline over the next couple of years, though it is likely to be volatile as it plateaus. To date, new building approvals have declined somewhat, indicating that activity may slow – though the pipeline of work remains elevated. While the housing market is clearly cooling, Sydney and Melbourne, which have seen the most significant price declines, are likely to be supported somewhat by still strong population growth.

HOUSE PRICES

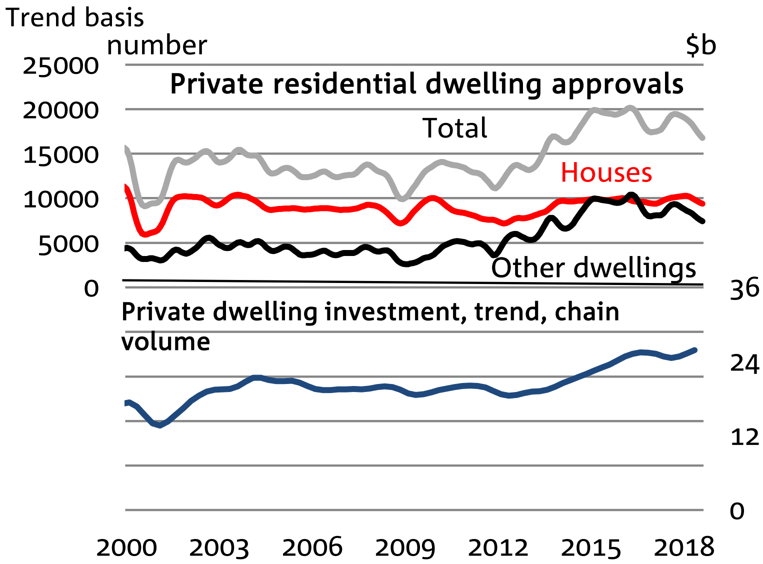


* Solid lines are hedonic prices. Dotted lines represent simple median prices.

HOUSING FINANCE APPROVALS



BUILDING APPROVALS & RESIDENTIAL INVEST.



Source: ABS, NAB, Core Logic, APRA.

BUSINESS AND TRADE

Business and trade remain important components of our overall forecast – we expect non-mining business investment to grow relatively strongly and mining investment to stabilise at a new higher level. Further, we expect spill-overs from strong public sector infrastructure investment to provide some additional support to the non-mining sector. On the trade front, we expect exports to continue to rise over the next year, with the tail end of the construction phase of the LNG mega-projects wrapping up and production reaching full capacity.

Most official ABS data for the business sector - capex, profits and national accounts measures of investment are now a little dated. The next release of these data in late November and early December will provide an important update on how activity is tracking in the sector. Of particular interest will be whether capex intentions for the mining sector level out and whether there are signs of ongoing improvement in the non-mining sector.

Higher frequency indicators – such as the NAB Business Survey – suggest that the business sector has lost some momentum through the middle of 2018, with business conditions easing back from the highs seen earlier in the year. Nonetheless, despite this weaker trend, business conditions remain well above average suggesting that conditions are generally favourable. Confidence has now been at or below average for sometime, suggesting that business outlook may be less positive than previously.

The survey measure of forward orders, which we believe best lines up with official data, has also eased but remains just above average. Capacity utilisation eased slightly in October but remains high after trending upwards over recent years. Capex rebounded a little in the month after also easing previously. Overall, this suggests activity in the sector is likely to remain robust for the remainder of 2018 and into the new year.

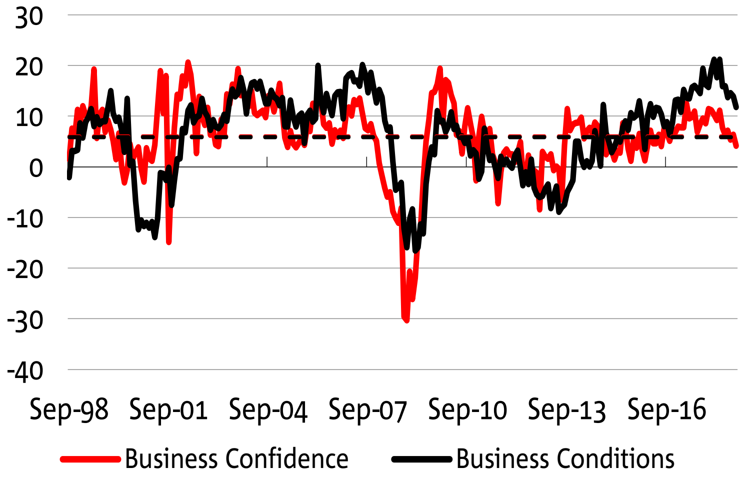
The volatile measure of non-residential building edged lower in September – continuing its trend decline through 2018. Despite this easing, the value of approvals remains elevated.

The trade balance widened in September with strong growth in exports of bulk commodities including LNG and iron ore. Taken together with trade prices for Q3, net exports appears to have made a moderate contribution to growth in Q3 of around 0.2ppt.

Overall, trade continues to play out as expected with ongoing strong demand for our key bulk commodity exports from Asia continuing and commodity prices holding their ground. We expect this strong demand to continue and LNG exports to rise over the next year or so as the last of the LNG projects reach full production capacity.

NAB CONFIDENCE AND CONDITIONS

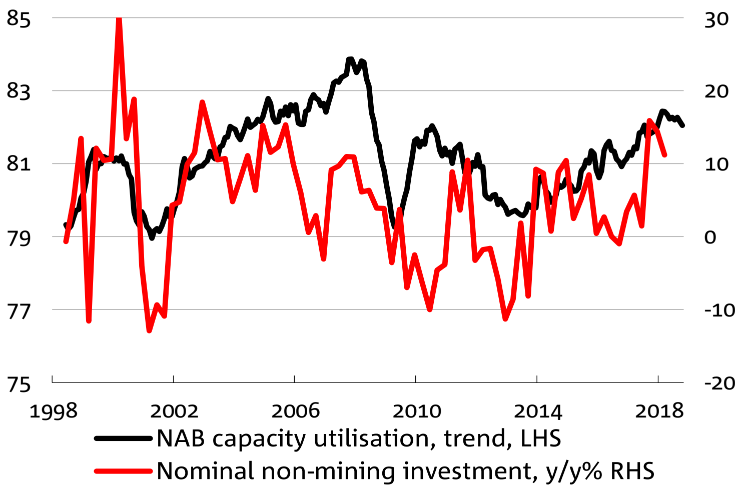
Net balance



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

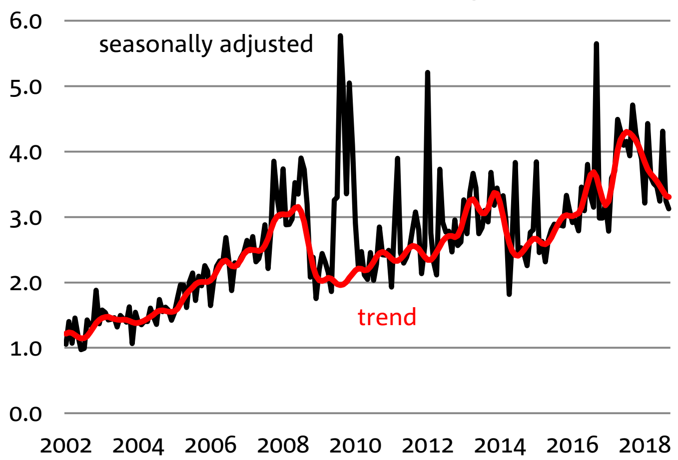
NAB SURVEY CAPACITY UTILISATION

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



NON-RESIDENTIAL APPROVALS

Value of non-residential building approved ($b)



Sources: ABS, NAB.

COMMODITIES

The spot price for iron ore broke out of its six month long range (US$60 to US$70 a tonne) in mid-October – pushing up to around US$75 a tonne, the highest levels since early March. Strong Chinese steel production (ahead of winter capacity closures) has supported demand, which could also be supported by greater Chinese infrastructure investment going forward (providing domestic stimulus in the wake of US-China trade tensions). Rail problems in WA could impact supply, keeping prices elevated in the short term.

Prices for hard coking coal have remained relatively high – at around US$215 a tonne – with supply growth constrained by infrastructure issues in Queensland, while thermal coal prices remain above US$100 a tonne – having tracked broadly sideways over the past month.

Australian fuel prices have risen considerably recently, reflecting a combination of high oil prices and a lower AUD. That said, global oil prices have fallen significantly over the past month. Brent, for example, has fallen from a peak above USD86/bbl in early October to the mid 60s range at present.

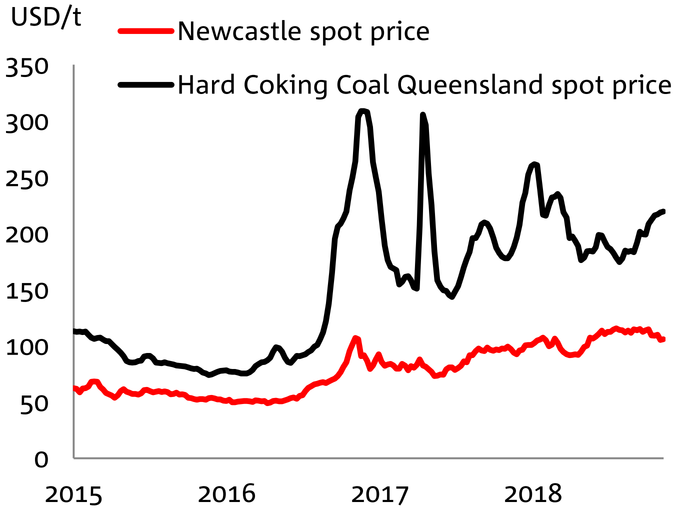
This change in sentiment has been driven by easing supply concerns amid higher US supply and most recently an easing of US policy on Iran sanctions, allowing temporary waivers for eight major Iran oil customers.

This is already providing relief at the pump, although prices are likely to remain higher than motorists would like.

The LNG production ramp-up is nearing completion, although prices are looking better. Still it is hard to see major new investment decisions being made on the east coast given constraints in sourcing feed gas.

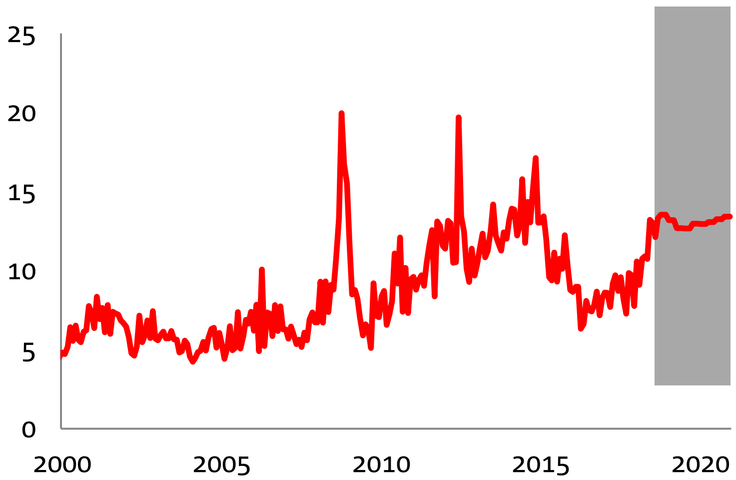
The NAB Rural Commodities Index rose 1.8% in October, following a 6.5% jump in September. October and the start of November brought good rain to some areas, although others missed out. Looking ahead, the Bureau of Meteorology's outlook for a 70% chance of El Nino this year, combined with a dry three month outlook, is concerning, especially given how little eastern Australia has in the tank.

COAL SPOT PRICES



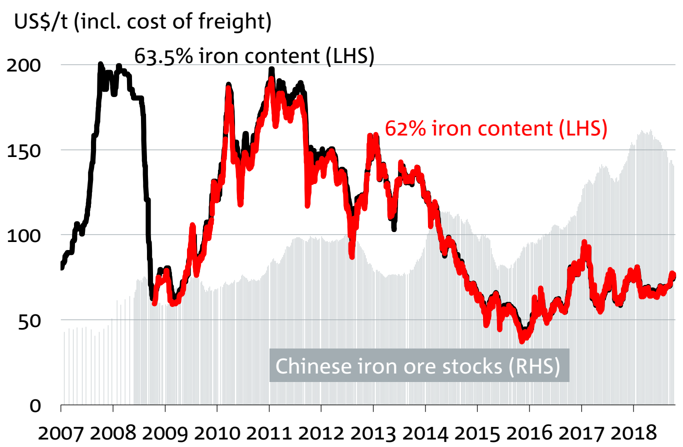
AUSTRALIAN LNG EXPORT PRICES

Monthly actuals and quarterly forecasts, AUD/GJ



IRON ORE SPOT PRICE

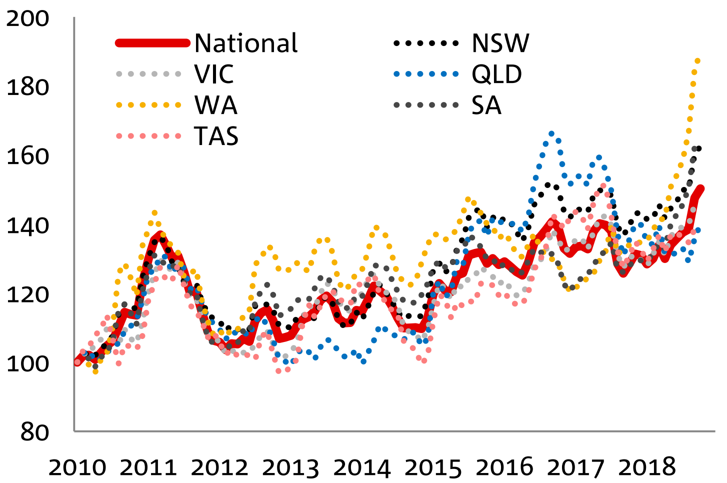
US$/t (incl. cost of freight)



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 expected, the RBA left the cash rate on hold at 1.5% in November and market pricing continues to indicate the first increase is likely to occur in late 2019. Following the November board meeting, the latest Statement on Monetary Policy containing the RBA's latest forecasts and assessment of risks both internationally and domestically to these forecasts was released. The Bank's growth forecasts were revised up in 2018 and 2019, largely driven by base effects of stronger than expected GDP in the near term but also a slightly stronger outlook further out. In addition, recent outcomes in the labour market saw expectations for the unemployment rate fall to 4.75% by end 2020 (previously 5%). The RBA's outlook for inflation remains broadly unchanged, with a gradual rise in wage growth eventually leading to higher labour cost growth and pass-through to consumer prices seeing inflation rise to towards the middle of the target band only by the end of the forecast horizon.

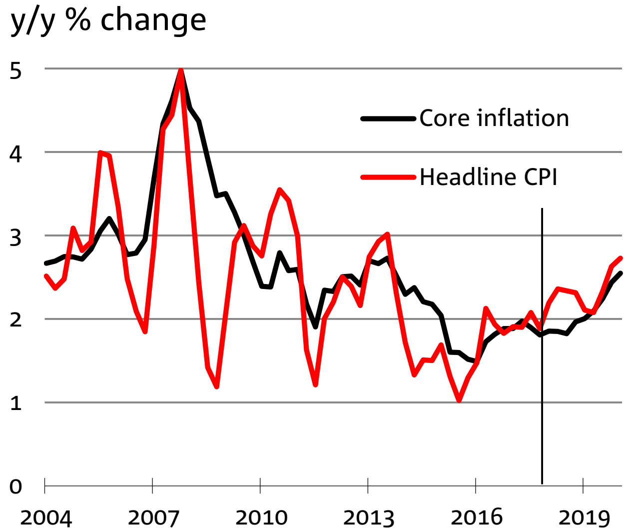
The RBA's statement focused on the risks to growth from a weaker-than-expected outcome for consumption. It is noted that significant uncertainty remains around the consumer, with slow income growth, high levels of indebtedness and stalling growth in household wealth. We forecast a weaker outcome for consumption growth over the next couple of years and therefore feel our risks are more balanced.

Q3 CPI data was released prior to the November board meeting, suggesting that inflationary pressure remains weak with the headline printing at 1.9% and the core measures averaging 1.8%. The weak headline outcome was due to a number of one-off falls in administered prices (as expected) while the full effect of rising petrol prices is yet to flow through. Nonetheless, an average of the underlying measures tracking at 1.8% remains below the RBA's target of 2-3%. Non-tradables inflation remains weak and the narrative around weaker wages growth suppressing domestic unit labour cost growth continues to play out, while tradables inflation also remains relatively weak. Also, capital city rents growth continues to weigh on inflation, having slowed substantially over recent years. With the outlooks for weaker house prices and large increases in housing supply to come online this trend is likely to continue.

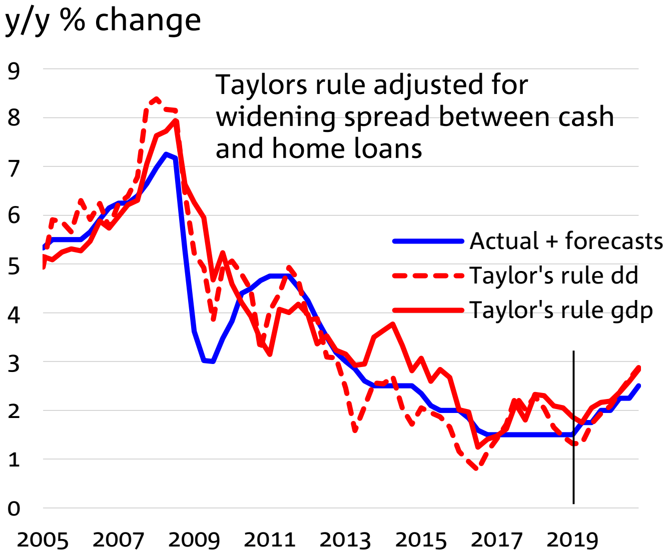
With inflation remaining weak and signs of further spare capacity in both the labour market and the economy more broadly, we continue to expect weak inflation outcomes for some time, with core inflation only reaching the bottom of the target band by end-2019 before rising to around 2.5% by the end of 2020. For now we have left our expectations for the first rate increase unchanged – around mid next year, but there is continues to be a risk that this is delayed given the very gradual process of building wage and inflation pressures.

The AUD/USD is down around 10% since January, providing some support to the economy. Following the trade ructions in late September and early October which saw the Aussie trade near US70c, the AUD/USD has traded higher more recently (low-to-mid US72c range). Our models currently point to a fair value around the US74c mark and we expect the currency to drift back to this level in 2019 but is likely to remain lower in the near term.

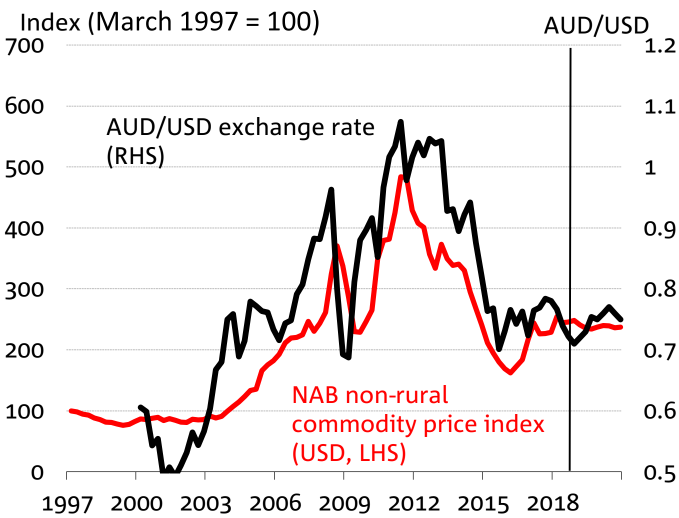
HEADLINE AND CORE INFLATION



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	2.4	2.6	2.9	2.7	2.8	2.4	2.6
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	2.0	5.8	-11.9	3.1	2.8	4.3	5.7
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**	**2.4**	**2.9**	**1.9**	**3.0**	**3.1**	**2.5**	**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**	**2.3**	**2.9**	**1.9**	**2.9**	**3.2**	**2.4**	**3.1**
Exports	5.4	3.4	3.8	3.5	6.8	3.5	4.1	3.9	2.5
Imports	4.8	6.9	1.7	4.6	0.2	7.8	4.2	2.6	5.0
GDP	**2.1**	**2.9**	**2.9**	**2.7**	**2.6**	**2.2**	**3.2**	**2.7**	**2.5**
Nominal GDP	5.9	4.7	4.6	4.2	3.8	5.8	5.1	3.8	4.7
Current Account Deficit ($b)	38	54	53	72	56	47	49	64	80
(-%) of GDP	2.2	2.9	2.8	3.6	3.3	2.6	2.6	3.2	3.9
Employment	1.4	3.0	2.2	2.0	1.6	2.3	2.6	2.2	1.9
Terms of Trade	14.4	1.9	-0.7	-2.9	0.1	11.6	1.0	-4.0	-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	2.3	2.3	1.5	1.9	2.2	2.1	2.7
Core CPI	1.8	1.9	1.8	2.2	1.5	1.9	1.9	2.0	2.5
Unemployment Rate	5.6	5.5	4.9	4.7	5.7	5.4	5.1	4.9	4.8
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	3.70	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	12/11/2018	Sep-18	*Dec-18*	*Mar-19*	*Jun-19*	*Sep-19*	*Dec-19*	*Mar-20*	*Jun-20*	*Sep-20*	*Dec-20*
WTI oil	US$/bbl	60	71	69	67	69	71	72	74	74	74	74
Brent oil	US$/bbl	71	75	75	73	75	77	78	80	80	80	80
Tapis oil	US$/bbl	71	77	76	74	76	78	79	81	81	81	81
Gold	US$/ounce	1203	1210	1250	1280	1300	1300	1320	1340	1360	1380	1410
Iron ore (spot)	US$/tonne	76	67	68	63	60	61	62	63	61	58	60
Hard coking coal*	US$/tonne	n.a.	187	195	180	175	160	165	160	156	153	150
Thermal coal (spot)	US$/tonne	110	114	110	105	103	101	100	103	100	98	100
Aluminium	US$/tonne	1930	2055	2075	2080	2055	2025	2000	1985	1962	1958	1955
Copper	US$/tonne	6074	6119	6250	6350	6500	6600	6700	6750	6800	6800	6650
Lead	US$/tonne	1908	2096	2150	2200	2175	2160	2155	2150	2125	2100	2100
Nickel	US$/tonne	11320	13262	13750	14000	13750	13525	13025	13250	13500	13250	13000
Zinc	US$/tonne	2563	2537	2650	2750	2725	2700	2600	2550	2500	2485	2465
Aus LNG**	AU$/GJ	n.a.	13.3	13.5	13.2	12.7	12.6	13.0	12.9	13.1	13.2	13.4

* 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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