

AUSTRALIAN MARKETS WEEKLY

February SoMP Preview – a less optimistic RBA



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- The RBA's Statement on Monetary Policy (SoMP) is due to be released on Friday 8 February, where the Bank will reveal its updated forecasts for key economic indicators: GDP, unemployment and inflation.
- In today's Weekly we preview what to expect for the RBA's forecasts and the narrative and risk around its outlook for the economy. We're likely to see the Bank wind back the growth outlook and trim its inflation forecasts.
- The growth outlook in particular has deteriorated since November, something the RBA will likely give a further nod to in February. We have seen: (i) some signs of softer consumer spending; (ii) more pronounced falls in building approvals and housing markets; and (iii) deterioration in the global economic and markets backdrop. There's not that much that has been moving in the other direction, although unemployment remains low, mining is recovering – as is non-mining capex – while defence and infrastructure are forecast to be strong. It's likely the RBA will downgrade its growth forecast for 2019 and 2020.
- We believe the RBA's hiking bias is largely dependent on the outlook for consumer spending – a risk the RBA also openly acknowledges – resulting in much less conviction about the next move in rates, moving toward a more neutral stance.
- Global equities ended Friday with solid gains, the S&P500 having its best start since 1987. US factory production expanded in December by the most in 10 months, by 1.1%. In contrast, US Consumer Sentiment in January was down 7.7% from December.
- China has offered to increase goods imports from the US by a combined value of more than \$1trn over the next six years to reduce the trade surplus with the US to zero by 2024. The offer has been met with scepticism by US negotiators. This could be good news for US exporters, but perhaps not for other countries exporting to the China. Elsewhere, President Trump offered a compromise to end the government shutdown that was rejected by the Democrats.
- The USD closed last week stronger, outperforming most major currency pairs, also hampering the AUD that failed to benefit from the improvement in global risk appetite. Wednesday's NZ CPI is often seen as a precursor to Australia's which is out next week, both very important releases for the RBA and RBNZ and for market pricing.
- The Forecasts page includes our downgraded US growth outlook and expectation of a steady hand from the Fed this year.
- The December Labour Force report is out on Thursday, NAB looking for a solid 25K gain in employment and steady 5.1% unemployment rate (risk of 5%). NAB's Cashless Retail Sales index for December is out Wednesday and the NAB Residential Property Survey is out Thursday.
- Offshore, after Chinese Q4 GDP and December activity data today, it's a quieter week for offshore releases, more interest perhaps in the unfolding US reporting season, the ECB and the BoJ are expected to sit on their hands, with continuing interest in Brexit.

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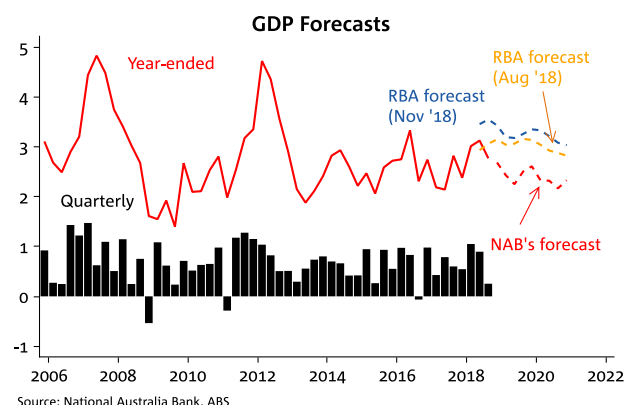
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Key markets over the past week

	Last	% chg week		Last	bp/% chg week
AUD	0.7164	-0.4	RBA cash	1.50	0
AUD/CNY	4.87	0.1	3y swap	1.97	8
AUD/JPY	78.6	1.0	ASX 200	5,903	2.2
AUD/EUR	0.630	0.4	Iron ore	74	3.4
AUD/NZD	1.063	0.7	WTI oil	53.5	5.9

Source: Bloomberg

Chart of the week: RBA forecasts appear too optimistic



SoMP Preview – a less optimistic RBA

The RBA’s Statement on Monetary Policy (SoMP) is due to be released on Friday 8 February, where the Bank will reveal its updated forecasts for key economic indicators: GDP, unemployment and inflation. The Bank was notably upbeat in its November SoMP – upgrading its forecasts – but a disappointing Q3 GDP and other recent news suggest that the domestic and global outlooks are less positive than the Bank had hoped a quarter ago.

Back in November, following surprisingly strong GDP growth in Q2 2018, an optimistic RBA stated ‘GDP growth is expected to be around 3½ per cent on average over 2018 and 2019’.

However, since then, we have seen: (i) another bout of soft consumer spending; (ii) more pronounced falls in building approvals and housing markets; and (iii) a softening in the global economic and markets back-drop. There’s not that much that has been moving in the other direction, although unemployment remains low, mining is recovering – as is non-mining capex – while defence and infrastructure are forecast to be strong.

GDP outlook – slower growth

Recent Q3 data revealed GDP growth (plus revisions) was a lot weaker than embodied in the November SoMP forecast. GDP growth is currently at 2.8% y/y, around ¾ ppt lower than what the RBA had pencilled in.

As such, the RBA will almost certainly revise down its forecasts in the near term. In order to achieve the currently slated 3½% y/y growth (to the nearest ¼ ppt) in Q4 2018, the Bank would need a stellar 1.2% growth in the quarter. Instead, a more likely growth outcome of 0.5 to 0.6% q/q would see annual growth hold steady.

Table 1: Growth will be revised down

	RBA SoMP forecasts											
	Sep-18		Dec-18		Jun-19		Dec-19		Jun-20		Dec-20	
	RBA	NAB	RBA	NAB	RBA	NAB	RBA	NAB	RBA	NAB	RBA	NAB
GDP growth (y/y %)	2.8	3½	2.7	3½	2.2	2.6	3½	2.3	3	2.3		
Unemployment rate (%)	5.2	5	5.1	5	4.8	5	4.7	4%	4.7	4%	4.8	
CPI inflation (y/y %)	1.9	2	1.6	2	1.7	2½	2.2	2½	2.3	2½	2.5	
Core inflation (y/y %)	1.8	1½	1.7	2	1.9	2½	2.1	2½	2.2	2½	2.3	

(a) Nov '18 technical assumptions: SA at US\$0.73, TWI at 63; Brent crude oil price at US\$72 per barrel. Highlighted figures differ to NAB's latest Forward View due to updated forecasts for Q4 2018. Sources: NAB, RBA Statement on Monetary Policy

Key for the medium-term outlook is what happens to household spending. The RBA has repeatedly flagged downside risks around its consumption profile – and in Q3 that risk partially materialised. For the second time in a year, household spending grew at a rate of only 0.3% q/q.

These data challenge the RBA’s view that household consumption growth is expected to continue at around 3% y/y. Household spending is currently growing at 2.5% y/y and, unless Q4 2018 is as strong as Q4 2017 (a very strong +1.1% q/q), spending growth is likely to soften further in year-ended terms. (The December retail sales report on 5 February will be an important signpost.)

The less assured tempo of household spending growth makes it difficult, in our view, to justify GDP growth of around 3% y/y. To do so, the Bank would need very good reason to believe the soft spending data is not representative of the underlying pace of growth. The past few months have provided little reassurance on this front – retail sales data and company reports suggest that the Christmas sales period broadly disappointed.

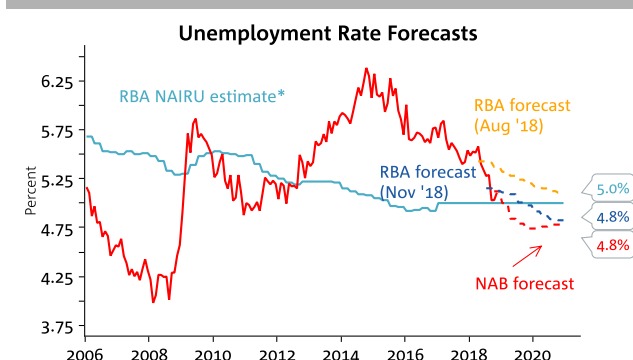
NAB’s forecasts for year-ended Dec 2019 GDP were already quite a lot weaker than the RBA’s at 2.7% (incorporating a weaker outlook for consumer spending already). It’s likely the RBA will have to move in that direction – at least to 3%, quite possibly to 2.75%. While this remains above the Bank’s estimate of trend growth, the weakness in consumption presents a risk to its overtightening bias.

Unemployment outlook – still on track

On unemployment, the RBA looks broadly on track. NAB expects the unemployment rate remained at 5.1% in December, although we see some risk of a 5% result. Regardless, the average rate over Q4 is likely to be 5.1%, in line with the RBA’s expectation of around 5%.

There’s little sign that the pace of progress in the labour market will pick up, particularly with economic growth slowing (although still above trend). It’s likely that the unemployment rate will continue to only slowly trend lower. In November, the Bank upgraded its outlook for the unemployment rate – to be closer to NAB’s view of around 4¾ % at the end of 2020 – we see little reason to shift its outlook.

Chart 2: On track – progress is still gradual



* Q2 2017 Bulletin. Source: National Australia Bank, ABS, RBA. NAIRU is the Non-Accelerating Inflationary Rate of Unemployment, below which inflation accelerates.

Of course, should Thursday’s Labour Force data reveal a further tick higher in the unemployment rate, say to 5.2%, optically this would only add to the Bank’s and market concerns that labour market progress has stalled for now lifting the risk further that it could be more even handed on the medium term outlook for rates. In contrast, a tick down to 4.9% or lower would be welcome, but even then might be viewed as somewhat temporary if the growth outlook has softened.

Inflation outlook – more drags on inflation?

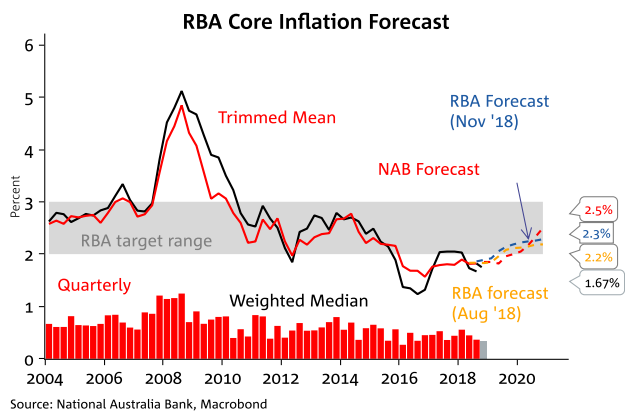
With oil prices having fallen over 20% (in US\$ terms) since the recent peak, a softer outlook for activity and weak price growth for rents and new dwellings (large components of core inflation), it seems likely that the RBA will need to pare back its inflation outlook.

In November, the Bank revised up its trimmed mean inflation forecast for Q4 2019 to 2¼%, from 2%. Given recent developments – and our expectation for a soft Q4 2018 (data next week) – we expect this forecast will have to be reduced back to at least the 2% the RBA was previously forecasting.

Any larger downgrade would be surprisingly dovish and, to us, signal the Bank is even more uncertain than we

anticipated. If the RBA revises their trimmed mean inflation forecast to 2% or less at the end of the 18-24 month forecast horizon, that would signal little conviction from the Bank the next move is up – if anything markets are likely to expect a cut in the near term. On balance they are still likely to hold to a forecast of 2-2¼% for 2020, ascribing some of the softness for now possibly temporary.

Chart 3: Increased downside risks to the outlook



Policy outlook – less conviction the next move is up

Over the past quarter, it’s become harder for the RBA to maintain its confidence in the next move being up. We

suspect the Bank will sound more dovish than two months ago and are likely to signal it is watching/monitoring the outlook closely. Markets have already priced in around a 50% chance of a rate cut by the end of 2019.

What would cause the Bank to remove its hiking bias?

We believe the RBA’s policy stance will be primarily dependent on retail sales and consumer spending data over the next few months (barring any major global risk event occurring). The Bank’s current policy stance – waiting for gradual improvement – has been reliant on resilient household consumption. The RBA needs to have confidence that consumption remains supported if it is to continue to hold and wait.

Any signs that the households are beginning to weaken in the face of growing headwinds will make it very difficult to preach patience. This is particularly the case with little signs that the pace of progress in the labour market or on the inflation front is gaining momentum that will persist.

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CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEDT
Monday, 21 January 2019								
NZ	Holiday (partial) - Wellington Anniversary							
CH	Retail Sales YoY	Dec		8.1		8.1	2.00	13.00
CH	Industrial Production YoY	Dec		5.3		5.4	2.00	13.00
CH	Fixed Assets Ex Rural YTD YoY	Dec		6		5.9	2.00	13.00
CH	GDP YoY	4Q		6.4		6.5	2.00	13.00
UK	BOE's Place, Fried Speak in London						16.00	3.00
Tuesday, 22 January 2019								
NZ	Performance Services Index	Dec				53.5	21.30	8.30
UK	Claimant Count Rate / Jobless Claims Change	Dec		/		2.8/21.9	9.30	20.30
UK	ILO Unemployment Rate 3Mths	Nov		4.1		4.1	9.30	20.30
UK	Public Sector Net Borrowing ex Banking Groups	Dec		1.9		7.2	9.30	20.30
GE	ZEW Survey Current Situation / Expectations	Jan		43.3/-18.5		45.3/-17.5	10.00	21.00
CA	Wholesale Trade Sales MoM	Nov		-0.3		1	13.30	0.30
CA	Manufacturing Sales MoM	Nov		-0.75		-0.1	13.30	0.30
Wednesday, 23 January 2019								
NZ	CPI QoQ / YoY	4Q	0/1.8	0/1.8		0.9/1.9	21.45	8.45
AU	Westpac Leading Index MoM	Dec				-0.09	23.30	10.30
JN	Trade Balance	Dec		-41.165		-737.3	23.50	10.50
NZ	RBNZ Sectoral Factor Inflation Gauge						2.00	13.00
JN	BOJ Policy Balance Rate	23 Jan	-0.1	-0.1		-0.1	around 2pm	
JN	BOJ Outlook Report						around 2pm	
JN	All Industry Activity Index MoM	Nov		-0.4		1.9	4.30	15.30
US	MBA Mortgage Applications	18 Jan				13.5	12.00	23.00
CA	Retail Sales MoM	Nov		-0.6		0.3	13.30	0.30
US	FHFA House Price Index MoM	Nov		0.3		0.3	14.00	1.00
US	Richmond Fed Manufact. Index	Jan		-2		-8	15.00	2.00
EC	Consumer Confidence	Jan A		-6.5		-6.2	15.00	2.00
US	Wholesale Inventories MoM	Nov P		0.5		0.8	delayed by shutdown	
US	New Home Sales	Nov		562.5		544	delayed by shutdown	
US	Construction Spending MoM	Nov		0.2		-0.1	delayed by shutdown	
US	Factory Orders	Nov		0.3		-2.1	delayed by shutdown	
US	Trade Balance	Nov		-54		-55.5	delayed by shutdown	
US	Retail Sales Advance MoM	Dec		0.1		0.2	delayed by shutdown	
US	Total Net TIC Flows	Nov				42	delayed by shutdown	
US	Housing Starts / Building Permits	Dec		1253/1290		1256/1328	delayed by shutdown	
Thursday, 24 January 2019								
AU	Employment Change	Dec	25	18		37	0.30	11.30
AU	Unemployment Rate	Dec	5.1	5.1		5.1	0.30	11.30
AU	Participation Rate	Dec	65.7	65.7		65.7	0.30	11.30
JN	Nikkei Japan PMI Mfg	Jan P				52.6	0.30	11.30
NZ	Credit Card Spending YoY	Dec				6.1	2.00	13.00
GE	Markit/BME Germany Manufacturing PMI / Services PMI	Jan P		51.5/52.2		51.5/51.8	8.30	19.30
EC	Markit Eurozone Manufacturing PMI	Jan P		51.3		51.4	9.00	20.00
EC	ECB Main Refinancing Rate	24 Jan		0		0	12.45	23.45
EC	ECB Marginal Lending Facility	24 Jan		0.25		0.25	12.45	23.45
EC	ECB Deposit Facility Rate	24 Jan	-0.4	-0.4		-0.4	12.45	23.45
US	Wholesale Inventories MoM	Nov F		0.5		0.8	13.30	0.30
US	Initial Jobless Claims	19 Jan		219		213	13.30	0.30
US	Markit US Manufacturing PMI / Services PMI	Jan P		53.5/53.9		53.8/54.4	14.45	1.45
US	Leading Index	Dec		-0.1		0.2	15.00	2.00
Friday, 25 January 2019								
NZ	Net Migration SA NB: New data methods	Nov				4660	21.45	8.45
JN	Tokyo CPI YoY / Ex Fresh Food YoY	Jan		0.2/0.9		0.3/0.9	23.30	10.30
GE	Ifo Business Climate	Jan		100.6		101	9.00	20.00
GE	Ifo Current Assessment	Jan		104.2		104.7	9.00	20.00
US	Durable Goods Orders	Dec P		1.5		0.8	13.30	0.30
US	New Home Sales	Dec		562.5		544	15.00	2.00
Upcoming Central Bank Interest Rate Announcements								
Japan, BoJ		23-Jan	-0.1%	-0.1%		-0.1%		
Europe, ECB		24-Jan	-0.4%	-0.4%		-0.4%		
US, Federal Reserve		30-Jan	2.25-2.5%	2.25-2.5%		2.25-2.5%		
Australia, RBA		5-Feb	1.5%	1.5%		1.5%		
UK, BOE		7-Feb	0.75%	0.75%		0.75%		
New Zealand, RBNZ		13-Feb	1.75%	1.75%		1.75%		
Canada, BoC		6-Mar	2%	2%		1.75%		

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

FORECASTS

		Annual % change				Quarterly % change															
		2017	2018	2019	2020	2017			2018			2019			2020						
Australia Forecasts						Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Household Consumption	2.4	2.5	2.3	2.5	0.4	0.8	0.6	1.1	0.3	0.9	0.3	0.5	0.7	0.6	0.7	0.6	0.6	0.6	0.6	0.7	0.7
Underlying Business Investment	3.7	1.9	3.2	5.1	3.3	0.3	3.7	0.4	0.8	-0.8	-1.1	0.2	1.7	1.1	1.8	1.3	1.1	1.5	0.8	1.0	1.0
Residential Construction	-2.4	4.7	-7.7	-8.6	-3.8	0.2	-1.3	0.3	3.8	1.9	1.0	-2.5	-2.6	-3.1	-2.9	-2.3	-2.2	-1.9	-2.0	-0.9	-0.9
Underlying Public Spending	4.5	4.3	4.1	4.5	1.1	1.4	1.0	1.1	1.4	0.5	1.5	0.6	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Exports	3.5	5.4	4.0	2.8	-1.9	2.8	0.8	-1.5	4.3	1.2	0.1	0.7	1.5	1.4	0.8	0.7	0.6	0.7	0.5	0.8	0.8
Imports	7.7	3.8	1.7	3.7	3.0	0.2	3.3	0.6	1.9	0.5	-1.5	0.3	0.8	0.7	1.0	0.8	0.8	1.0	0.9	1.1	1.1
Net Exports (a)	-0.8	0.4	0.5	-0.2	-1.0	0.5	-0.5	-0.5	0.5	0.2	0.3	0.1	0.2	0.2	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Inventories (a)	-0.1	0.1	-0.1	0.0	0.4	-0.7	0.3	0.1	0.1	0.1	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic Demand - qtr%					0.7	0.9	0.8	0.8	0.8	0.7	0.3	0.4	0.6	0.5	0.7	0.6	0.6	0.7	0.6	0.7	0.7
Dom Demand - ann %	2.9	2.9	2.1	2.5	2.2	2.5	3.5	3.2	3.4	3.2	2.7	2.2	2.0	1.8	2.2	2.4	2.3	2.5	2.5	2.6	2.6
Real GDP - qtr %					0.4	0.8	0.6	0.5	1.0	0.9	0.3	0.5	0.8	0.6	0.6	0.5	0.5	0.6	0.5	0.7	0.7
Real GDP - ann %	2.4	2.9	2.4	2.3	2.2	2.1	2.8	2.4	3.0	3.1	2.8	2.7	2.4	2.2	2.6	2.6	2.3	2.3	2.2	2.3	2.3
CPI headline - qtr %					0.5	0.2	0.6	0.6	0.4	0.4	0.4	0.3	0.6	0.4	0.4	0.8	0.5	0.6	0.6	0.7	0.7
CPI headline - ann %	1.9	1.9	1.9	2.4	2.1	1.9	1.8	1.9	1.9	2.1	1.9	1.6	1.8	1.7	1.8	2.2	2.1	2.3	2.5	2.5	2.5
CPI underlying - qtr %					0.5	0.6	0.3	0.5	0.5	0.4	0.3	0.4	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.6
CPI underlying - ann %	1.9	1.8	2.0	2.3	1.7	1.9	1.9	1.9	2.0	1.8	1.7	1.7	1.8	1.9	2.1	2.1	2.1	2.2	2.3	2.3	2.3
Wages (Pvte WPI - qtr %)					0.5	0.5	0.5	0.5	0.6	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Wages (Pvte WPI - ann %)	1.9	2.1	2.5	2.7	1.8	1.8	1.9	1.9	2.0	2.1	2.1	2.3	2.3	2.4	2.5	2.6	2.6	2.7	2.7	2.8	2.8
Unemployment Rate (%)	5.6	5.3	4.8	4.8	5.9	5.6	5.5	5.4	5.5	5.6	5.1	5.1	4.9	4.8	4.8	4.7	4.8	4.7	4.8	4.8	4.8
Terms of trade	12.1	-0.1	-0.7	0.0	5.3	-5.9	-0.1	-0.1	3.1	-1.1	0.9	-3.4	-0.8	-1.2	-0.9	0.3	-0.4	0.3	-0.4	0.2	0.2
G&S trade balance, \$Abn	9.6	18.0	8.7	1.8	6.7	3.3	0.9	-1.2	4.2	3.9	6.6	3.3	3.2	2.6	1.4	1.5	0.9	0.9	0.1	0.0	0.0
% of GDP	0.5	1.0	0.4	0.1	1.5	0.7	0.2	-0.3	0.9	0.8	1.4	0.7	0.7	0.5	0.3	0.3	0.2	0.2	0.0	0.0	0.0
Current Account (% GDP)	-2.6	-2.5	-3.1	-3.5	-1.6	-2.4	-2.9	-3.4	-2.3	-2.6	-2.2	-2.9	-2.9	-3.1	-3.3	-3.3	-3.4	-3.4	-3.5	-3.5	-3.5

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

Exchange Rate Forecasts

	21-Jan	Mar-19	Jun-19	Sep-19	Dec-19
Majors					
AUD/USD	0.7166	0.71	0.70	0.73	0.75
NZD/USD	0.6718	0.68	0.67	0.69	0.70
USD/JPY	109.60	113	113	110	108
EUR/USD	1.1374	1.17	1.18	1.20	1.23
GBP/USD	1.2866	1.35	1.40	1.43	1.45
USD/CHF	0.9951	0.98	0.98	0.99	0.97
USD/CAD	1.3270	1.31	1.31	1.27	1.27
USD/CNY	6.7889	7.10	7.20	7.20	7.15

Australian Cross Rates

AUD/NZD	1.0667	1.04	1.04	1.06	1.07
AUD/JPY	78.5	80	79	80	81
AUD/EUR	0.6300	0.61	0.59	0.61	0.61
AUD/GBP	0.5570	0.53	0.50	0.51	0.52
AUD/CNY	4.8649	5.04	5.04	5.26	5.36
AUD/CAD	0.9509	0.93	0.92	0.93	0.95
AUD/CHF	0.7131	0.70	0.69	0.72	0.73

Interest Rate Forecasts

	21-Jan	Mar-19	Jun-19	Sep-19	Dec-19
Australia Rates					
RBA Cash rate	1.50	1.50	1.50	1.50	1.50
3 month bill rate	2.07	1.95	1.90	1.90	1.90
3 Year Swap Rate	1.96	1.85	1.85	1.95	2.05
10 Year Swap Rate	2.57	2.60	2.60	2.70	2.80
Offshore Policy Rates					
US Fed funds	2.50	2.50	2.50	2.50	2.50
ECB deposit rate	-0.40	-0.40	-0.40	-0.20	0.00
BoE repo rate	0.75	0.75	1.00	1.00	1.25
BoJ excess reserves rate	-0.10	-0.10	-0.10	-0.10	-0.10
RBNZ OCR	1.75	1.75	1.75	1.75	2.00
China 1yr lending rate	4.35	4.35	4.35	4.35	4.35
China Reserve Ratio	14.0	13.0	12.5	12.0	12.0
10-year Benchmark Bond Yields					
Australia	2.32	2.40	2.40	2.50	2.60
United States	2.78	2.80	2.80	3.00	3.00
New Zealand	2.32	2.85	3.10	3.20	3.30

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP

Dec year	2015	2016	2017	2018	2019	2020	20 Yr Avg
Australia	2.5	2.6	2.4	2.9	2.4	2.3	3.4
US	2.9	1.6	2.2	2.9	2.1	1.8	2.6
Eurozone	2.0	1.9	2.5	1.9	1.7	1.6	1.5
UK	2.3	1.8	1.7	1.3	1.6	1.5	2.4
Japan	1.4	1.0	1.7	0.8	1.2	0.9	0.8
China	6.9	6.7	6.9	6.6	6.3	6.0	9.2
India	8.2	7.1	6.7	7.4	7.1	7.2	6.6
New Zealand	3.5	4.0	2.8	2.9	2.6	2.6	3.0
World	3.5	3.3	3.7	3.7	3.5	3.5	3.5
MTP Top 5	4.1	3.8	4.2	4.0	3.7	3.5	5.0

Commodity prices (\$US)

	21-Jan	Mar-19	Jun-19	Sep-19	Dec-19
Brent oil	63.0	85	80	77	78
Gold	1281	1276	1297	1305	1318
Iron ore	74.1	63	60	61	62
Hard coking coal	195	180	175	160	165
Thermal coal	100	105	103	101	100
Copper	6046	6350	6500	6600	6700
Aust LNG (*)	15.8	14.3	14.6	13.4	13.0

(*) Implied Australian LNG export prices.

Under review

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