EMBARGOED UNTIL 11.30 AM WEDNESDAY 13 FEBRUARY 2019

THE FORWARD VIEW: AUSTRALIA FEBRUARY 2019

Growth still reasonable but to move below trend – with rates now unlikely to rise. Indeed a significant & growing risk of a cut.

OVERVIEW

While we have fine tuned some of our near term forecasts – to include weaker than expected private consumption and net exports in Q4 2018 – we have fundamentally not changed our GDP forecasts. In brief we continue to worry about the consumer. Indeed both our Business survey and internal NAB data point to continued consumer weakness in the early part of 2019. Also construction looks likely to be hit. Overall our key forecasts remain unchanged with GDP growth of 2.4% in 2019 and 2.2% in 2020 – with a more marked slowdown in the through the year numbers (2.7% and 2.2% respectively).

A key change to our forecasts this month relates to our interest rate forecasts. We no longer see the next move in rates as up – with an unchanged forecast over the next few years. That said, we are now seriously contemplating the possibility of a cut. In short our forecasts raise the question as to why the RBA would not move to give the economy a pre-emptive boost. Certainly any sign of deteriorating labour market conditions would be enough to see the RBA act more quickly than is currently expected (See our Rate Change Note out yesterday).

On the forecasts themselves, it is important to emphasise that we still see a reasonable outcome for the economy – albeit significantly weaker than the RBA expects. Areas of strength include public sector demand – both infrastructure spending and NDIS-related public consumption. We also expect non-mining business investment to benefit from additional infrastructure spill-overs. Exports are expected to continue to grow relatively strongly - as the last of the large LNG projects reach full production capacity. And we see the weakness in Q4 net exports as likely to be reversed in early 2019.

Against that, private sector consumption will continue to weigh on growth, with consumers facing significant further headwinds. In particular, we see ongoing slow wage growth, a falling savings rate, high debt levels and falling house prices. While there is limited evidence, as yet, of a significant wealth effect of house prices it clearly will not help. Beyond a turnover related slowdown in retailing of household goods we do expect a pronounced downturn in the construction cycle. We expect dwelling investment to fall by 18% peak-to-trough.

Not surprisingly we haven't changed our forecasts for the labour market which still sees unemployment dropping a touch below 5% in the near term but making little improvement thereafter (at around 4.9%). With our estimate of the NAIRU well below 5%, we also continue to only modest growth in wages to between 2.5 to 2.7% by end 2019 and core inflation not back above 2% until end-2019 before moving moderately higher into 2020.

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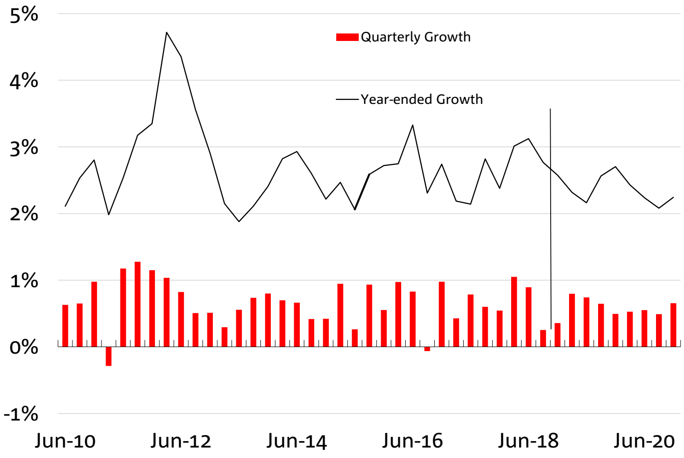
KEY ECONOMIC FORECASTS

	2017	2018-F	2019-F	2020-F
Domestic Demand (a)	2.9	2.9	2.0	2.5
Real GDP (annual average)	**2.4**	**2.9**	**2.4**	**2.2**
Real GDP (year-ended to Dec)	**2.4**	**2.6**	**2.7**	**2.2**
Terms of Trade (a)	11.5	1.6	-2.5	-0.2
Employment (a)	2.3	2.7	1.9	1.5
Unemployment Rate (b)	5.4	5.1	4.9	4.9
Headline CPI (b)	1.9	1.8	2.2	2.5
Core CPI (b)	1.9	1.7	2.2	2.3
RBA Cash Rate (b)	1.50	1.50	1.50	1.50
$A/US cents (b)	0.78	0.71	0.75	0.79

(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 looks to have recorded a back to back weak print in the December quarter. Quarterly retail sales volumes rose by 0.1% in the quarter and we expect services consumption will also weigh. While there was likely some payback in Q3 for the upward surprise in consumption growth earlier in the year, a second quarter of weak growth will likely confirm the risk around the consumer has materialised somewhat. We expect the headwinds of slow income growth, high debt levels and weaker growth in household wealth to weigh on consumption over coming years.

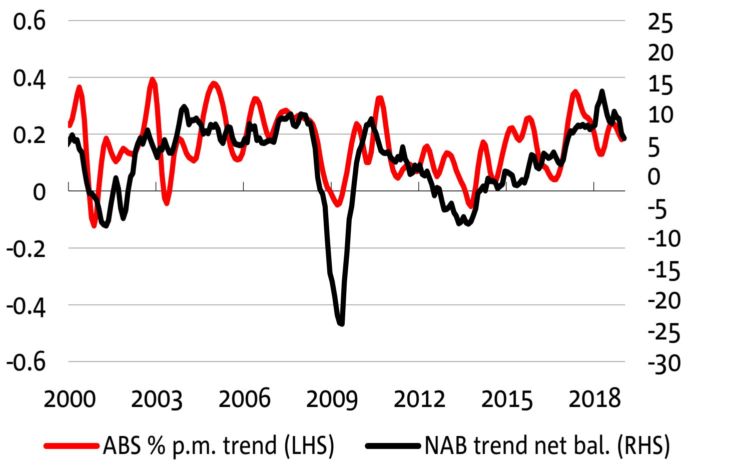
While household consumption and dwelling activity indicators have weakened over recent months, conditions in the labour market have remained robust. The unemployment rate fell to 5.0% in December with employment rising by 22k (FT: -3k and PT: +25k).

The NAB Monthly Business Survey employment index has eased in recent months, but remains well above average. Based on historical relationships, the NAB survey suggests ongoing employment growth of around 19k per month. This is slightly lower than previous readings but is likely enough to see the labour market hold onto recent gains.

We expect the unemployment rate will decline to around 4¾ from here before levelling out. While this is around the levels of previous estimates of full employment, it appears that the true level of full employment could be some way below this. Consequently we expect wage growth to continue to show a gradual rise over the next two years, but remain well below the 3%+ prints seen in the lead up to the GFC. Indeed, the NAB Quarterly and Monthly business surveys point to ongoing weakness in labour costs growth, as well as firms' expectations of wage pressures over the next 6 months remaining weak.

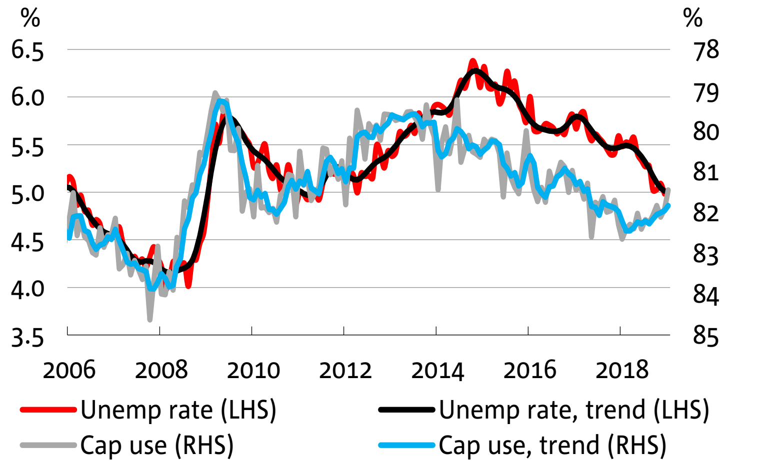
EMPLOYMENT

ABS vs NAB



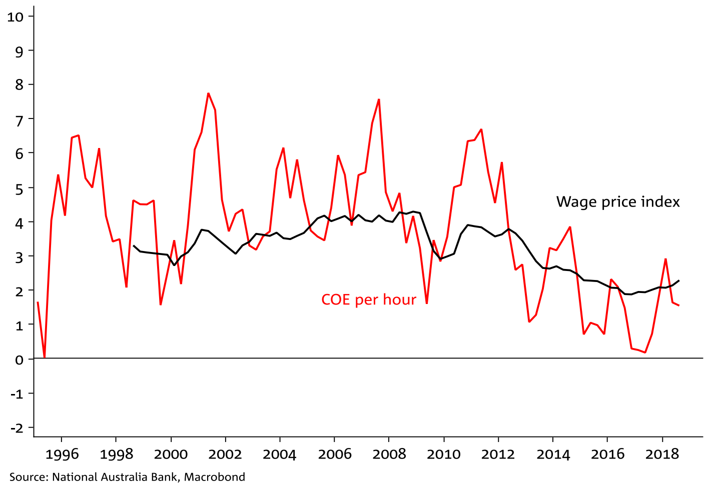
UNEMPLOYMENT AND CAPACITY UTILISATION

ABS (unemployment) and NAB monthly survey



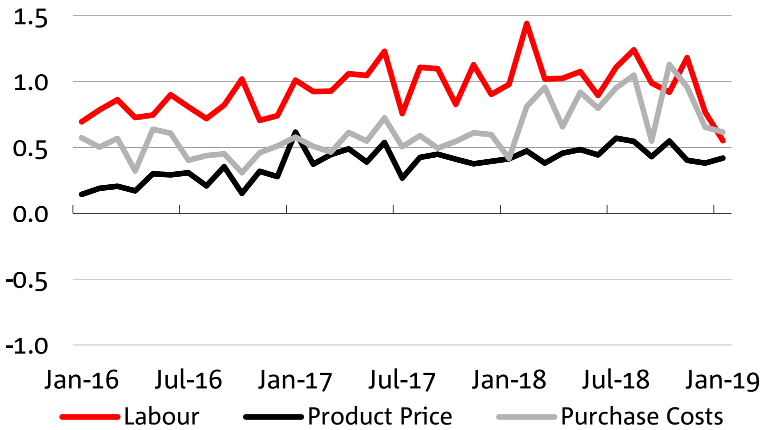
WAGE AND INCOME GROWTH

Y/Y%



NAB BUSINESS SURVEY PRICE PRESSURES

% change at quarterly rate



Sources: ABS, NAB Group Economics

HOUSING AND CONSTRUCTION

The cooling in the housing market continued in late-2018 and into early 2019. The fall in prices across Sydney and Melbourne has now been ongoing for 18 months, but the decline in prices appears to have accelerated in the back end of 2018. The fall in prices has also been reflected in the activity side of the housing market with turnover falling and clearance rates remaining low. Investment in dwellings held up in the Q3 national accounts but was supported by alterations and additions. We expect the downturn in the construction cycle to continue over the next two years.

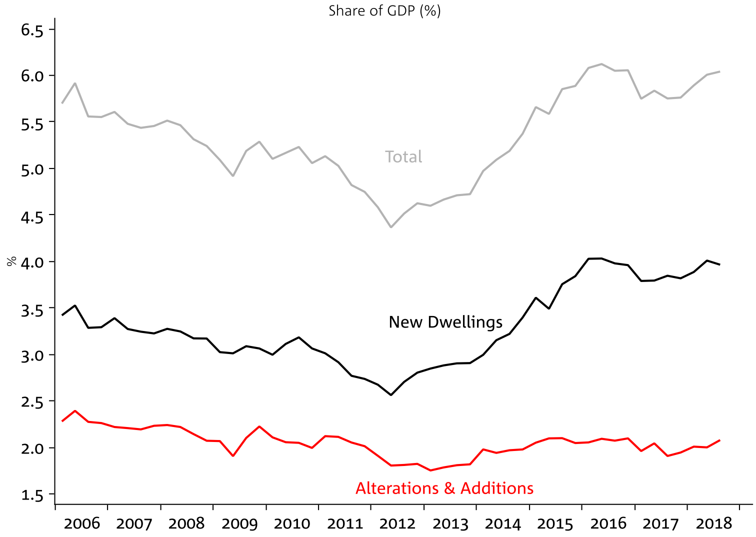
Further declines in Sydney and Melbourne saw the Core Logic 8 Capital City dwelling price index fall 1.3% in December and 1.2% in January. Sydney prices are now 12% below their July 2017 peak and Melbourne has declined by 9% since November 2017. Prices in Perth have weakened again recently after showing some signs of stabilisation in mid-2018. The other capitals have held up better (likely less effected by developments in the investor segment of the market). We expect house prices to decline further over 2019 before levelling out in 2020. We see peak-to-trough declines of around 15% in both Sydney and Melbourne but acknowledge that based on current momentum the declines may be larger, particularly in Sydney. Though this would be a historically large decline, prices would still be well above levels of 5 years ago, and the adjustment has continued to play out in an orderly fashion.

Alongside the cooling in the market, housing credit growth has continued to slow. Investor lending slowed to 1.1% y/y in December 2018 and while credit extended to owner-occupiers has also slowed, it is tracking at a higher pace of around 6.5% y/y.

The weakening in prices has begun to flow through to construction activity. Approvals for new building have declined sharply in recent months and are now around levels last seen in 2012. The decline has been sharpest in approvals for apartments, though approvals for detached dwellings have also trended down. Activity is likely to be provided some support from the large pipeline of work yet to be done, based on the previous high levels of approvals.

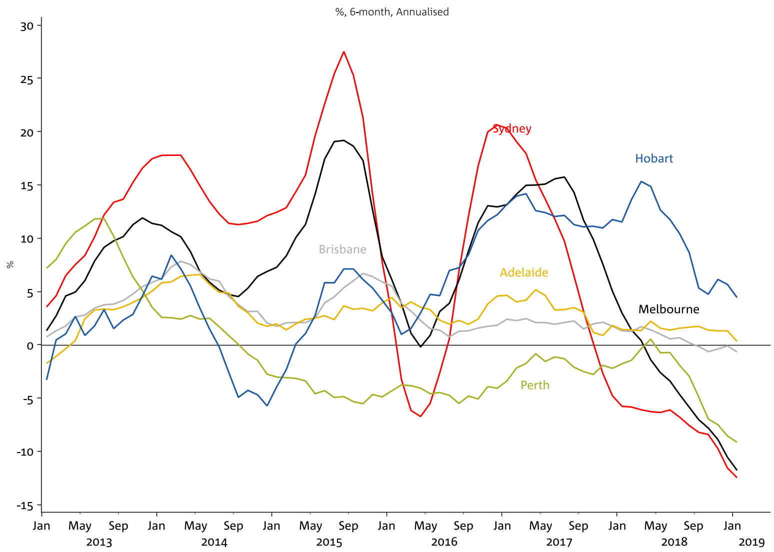
We expect house prices to decline further, in an orderly fashion, and housing activity indicators to show further weakness as the market continues to adjust. Our forecasts embody a relatively sharp slowdown in dwelling investment with a fall approaching 20% over the next two years. This is consistent with further weakness in building approvals and a relatively sharp downturn in the construction cycle.

DWELLING INVESTMENT



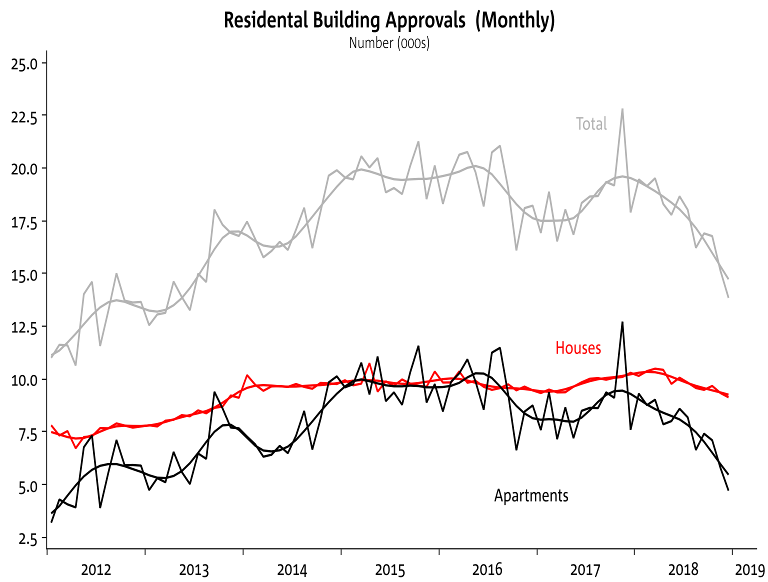
Source: National Australia Bank, Macrobond

DWELLING PRICES



Source: CoreLogic, National Australia Bank, Macrobond

RESIDENTIAL BUILDING APPROVALS



Source: National Australia Bank, Macrobond

BUSINESS

The outlook for the business sector is a key driver to the upside in our growth forecasts with consumption and dwelling investment to weigh on growth. With official data on these sectors now dated, recent readings from the business survey are obviously important pending more updated measures from the national accounts and capex data – to be released in late February and early March.

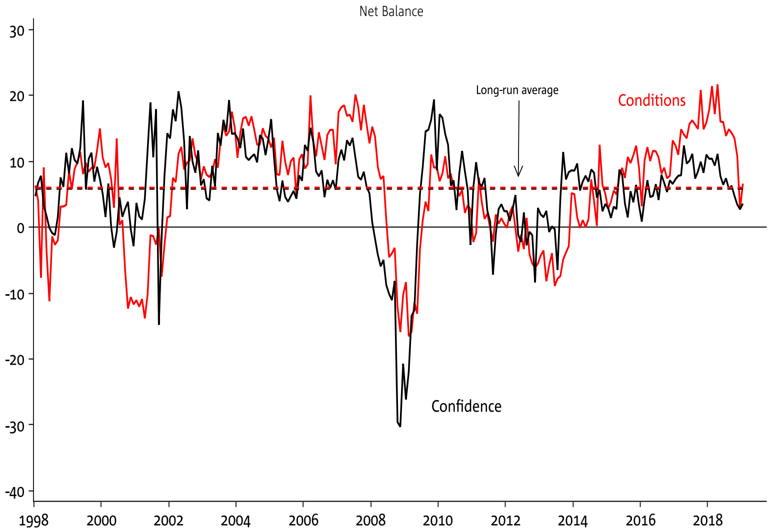
We expect underlying non-mining business investment to grow relatively strongly over the next couple of years, with capacity utilisation relatively high and balance sheets relatively healthy. Further, it is likely there will be some additional spill-overs to the private sector from the strong growth in public infrastructure spending. The decline in mining investment is also likely to wane as the last of the large LNG projects reach full production. Further, with commodity prices having remained elevated, it is also likely there will be some new investment in the mining sector in addition to the new higher level of sustaining capex following the large expansion in productive capacity over recent years.

While we forecast strong business investment over the next few years, the NAB Business Survey suggests that the business sector has lost some momentum through the second half of 2018. Despite partially reversing the sharp fall in in business conditions in December, conditions have eased notably from the high levels seen earlier in 2018. The decline in business conditions has been broad-based across industries and states. Our assessment is that the retail industry remain close to recession levels while the construction industry is slowing sharply.

Overall, while the non-mining business sector has lost some momentum (in the second half of 2018) activity levels still remain reasonable. That said readings from the survey over coming months will be important in assessing whether there has been further loss in momentum in early 2019.

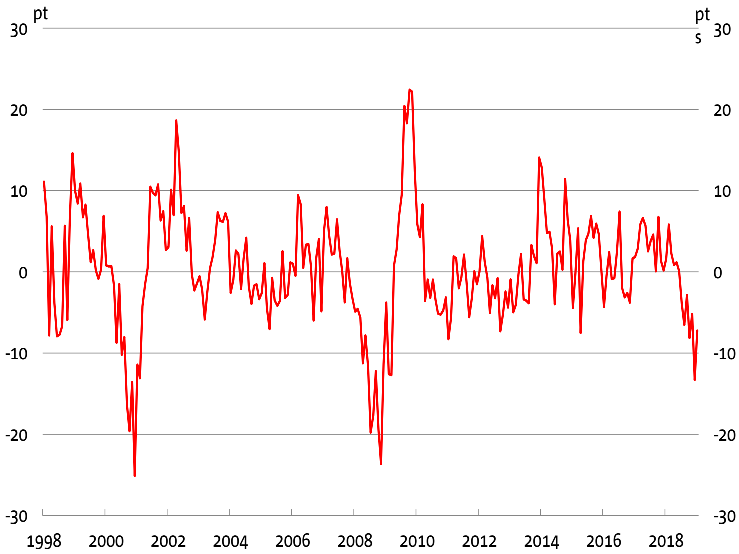
Business confidence rose slightly in January but has been below average for some time. Other forward looking indicators (including from the quarterly survey) generally eased in recent months but remain at or above average. Our judgement overall is that business demand will remain reasonable and will be further supported by infrastructure spill-overs.

NAB SURVEY CONDITIONS AND CONFIDENCE

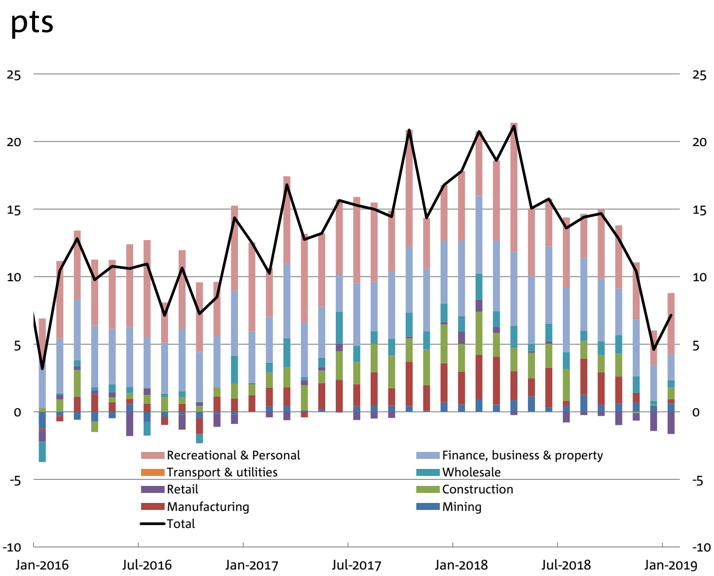


Source: National Australia Bank, Macrobond

ROLLING 6-MONTH CHANGE IN CONDITIONS



CONTRIBUTIONS TO CONDITIONS



TRADE AND COMMODITIES

The monthly outcomes for the trade surplus , taken together with quarterly trade prices, suggest that in real terms exports were relatively weak while imports increased moderately. That is a good deal of the Q4 trade surplus reflected price effects. Indeed it appears net exports will subtract around 0.3ppt from growth in the December quarter.

That said we expect much stronger export volumes going into 2019 – not least from the last of the major LNG projects reaching full production. Beyond (in 2020) we expect LNG exports to stop growing but remain at a high level.

As for LNG prices – we have moderated our expectations somewhat, reflecting relatively low oil prices which have had a knock-on effect for Australian LNG export prices, many of which are tied through long term contracts. This means that LNG prices are likely lower this year – around AUD11-12/GJ from Q2. That said, natural gas for domestic users in eastern Australia will likely remain high by historic standards.

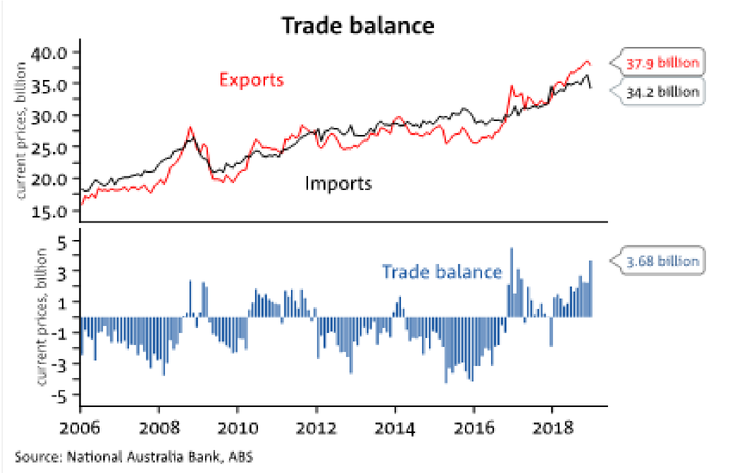
Iron ore mine closures in Brazil – in response to safety concerns around unsafe tailing dam infrastructure – are likely to limit the growth of global ore supply in 2019 (and beyond). As a result, we have revised our price forecasts higher – to US$80 a tonne in 2019 (from US$62 previously) and US$70 a tonne in 2020 (from US$60).

Reflecting current strength in prices, our near term forecast for hard coking coal has been raised, leading to a full year price of US$185 a tonne in 2019 (from US$170 previously) and US$158 a tonne in 2020. Our thermal coal forecast is marginally weaker – at US$95 a tonne in 2019 and US$90 a tonne in 2020 (from US$102 and US$100 previously). For more detail please see: Minerals and Energy Outlook – February 2019.

2019 has seen a fairly tough start for agriculture amid the hottest January (nationally) on record and a lack of rain across much of the country. Intense rainfall in northern Queensland this month has brought devastation to Townsville and other areas, as well as the deaths of potentially hundreds of thousands of cattle.

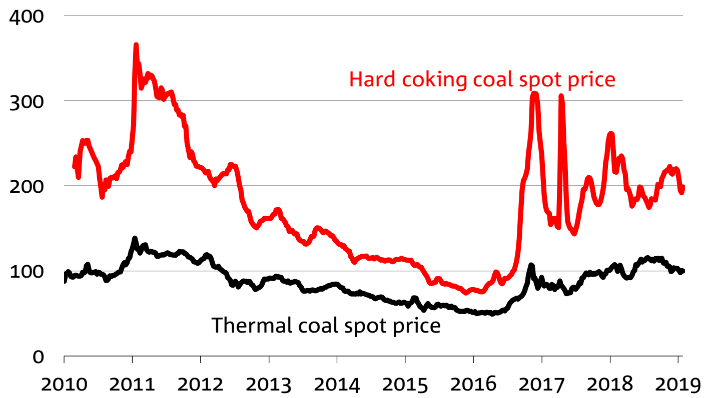
TRADE BALANCE

$B



COAL SPOT PRICES

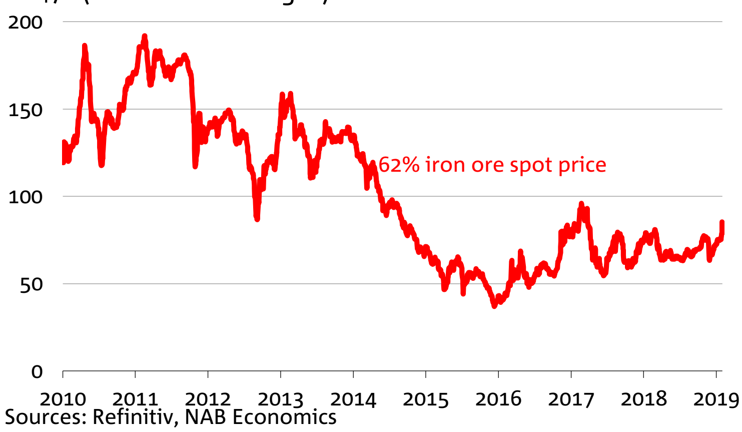
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

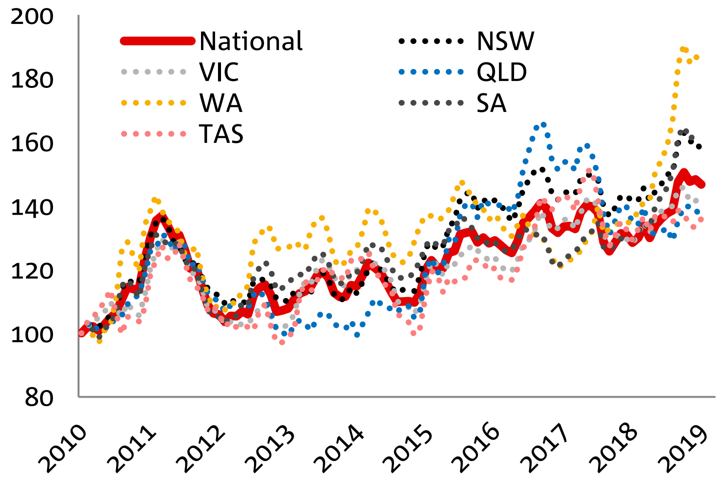
US$/t (incl. cost of freight)



Sources: Refinitiv, 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

The RBA left rates unchanged in February at 1.5% - continuing the record run of unchanged rates. This outcome was largely as expected with the RBA having remained very patient over the last few years despite inflation at or below the target band.

The most significant development following the board meeting and the release of the February SMP was the removal of the upward bias in the outlook for rates. With forecast downgrades to consumption and heightened global uncertainty as well as some weakening in domestic data the RBA moved to a more even bias based on the range of possible economic scenarios.

Should above trend growth continue and the strength in the labour market continue, wages could be expected to rise and would point to the next move in rates being up. Against that the RBA sees the key downside risks centred on the consumer and the impact of falling house prices (including the effects on the economy through channels other than wealth effects).

Based on the recent run of data, we see significant risks to the downside with rates. We have removed our expectation for the beginning of a hiking cycle in late-2020. While wages growth and inflation could be expected to continue at a gradual pace with the ongoing tightening in the labour market the risks around growth could see progress slow. We expect a second weak quarter of GDP growth in Q4 2018, only gradually rising wages and inflation (albeit slightly faster than the RBA) adding to those concerns.

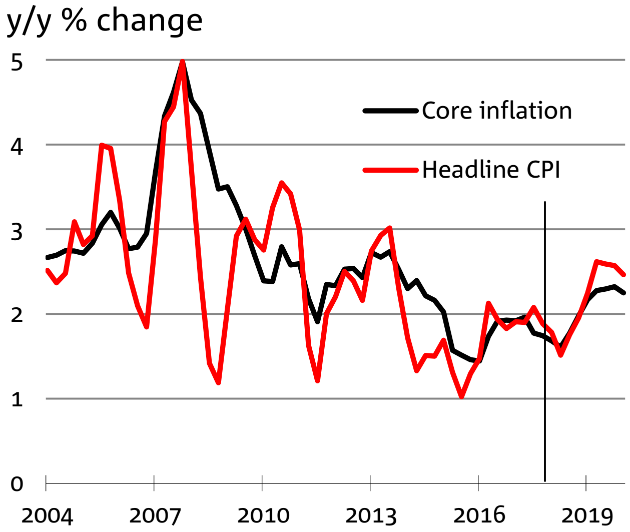
Indeed, inflationary pressure remains fundamentally weak. The trimmed-mean and weighted-median measure of underlying inflation both printed at 0.4% in the December quarter to be 1.7% and 1.8% higher over the year, respectively. Headline inflation – which printed at 1.8% y/y - was suppressed by a sizeable fall in petrol prices. That said, the core measures continue to track around ¼ppt below the band. Weaker rents and dwelling costs growth will likely continue to weigh, as will a number of one off impacts to administered prices.

In the medium term our forecasts still see tentative signs of building inflation from lower unemployment and increased difficulty of attracting suitable labour. Hopefully that will see gradually rising wage growth which should feed through to prices more generally. Albeit our numbers see core inflation only around 2.2% by end 2019 and broadly similar outcomes in 2020.

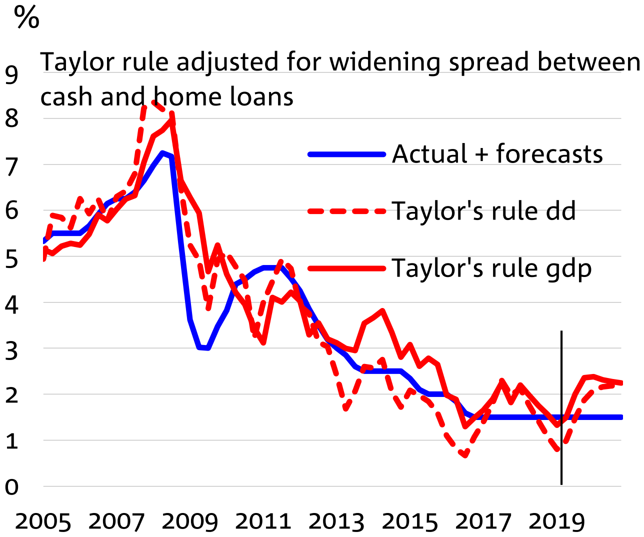
The AUD has traded down to below 0.71 cents at present from around 0.74 cents at the start of December, within which time frame it suffered a flash crash' on January 3rd that saw it quickly lose – then regain - around 3% against the USD and 6% versus the Japanese Yen. The move lower has come against the backdrop of a generally firmer US dollar and latterly, the shift in RBA rhetoric that has heightened expectations the next move in the RBA's Cash Rate could be a cut.

Unless or until rate cut expectations reverse and/or the US dollar weakens, the AUD/USD is seen vulnerable to a revisit of the 0.70 level or below in coming weeks and months, though an early trade deal of sorts between China and the US would be supportive. NAB FX Strategy team's end-Q1 forecast is 0.71 and end-H1 0.70. Further out, we continued to expect the AUD/USD to recover to the 0.75 area in H2 2019 in conjunction with an expected weakening in the US dollar.

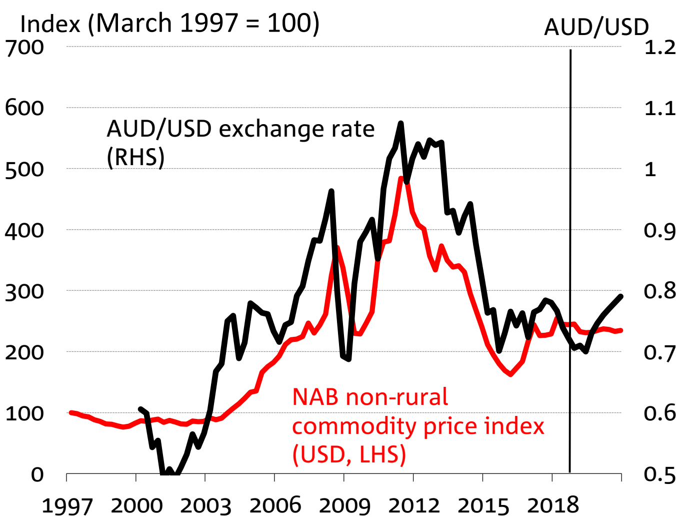
HEADLINE AND CORE INFLATION



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	2.4	2.8	2.1	2.3	2.7	2.4	2.5	2.1	2.4
Dwelling Investment	2.5	0.1	0.3	-10.2	7.9	-2.4	4.7	-7.7	-8.7
Underlying Business Investment	-6.3	6.7	-0.4	6.5	-11.8	3.5	1.5	3.7	5.7
Underlying Public Final Demand	5.3	4.4	4.2	4.4	5.7	4.5	4.3	4.1	4.5
Domestic Demand	**2.2**	**3.3**	**2.1**	**2.3**	**1.8**	**2.9**	**2.9**	**2.0**	**2.5**
Stocks (b)	0.0	0.0	-0.1	0.0	0.1	-0.1	0.1	-0.1	0.0
GNE	**2.2**	**3.3**	**2.0**	**2.3**	**1.9**	**2.7**	**2.9**	**1.9**	**2.5**
Exports	5.5	4.0	3.8	3.8	6.8	3.5	5.1	3.7	2.5
Imports	4.7	7.0	0.8	3.4	0.1	7.7	3.8	1.6	3.7
GDP	**2.3**	**2.8**	**2.5**	**2.5**	**2.8**	**2.4**	**2.9**	**2.4**	**2.2**
Nominal GDP	6.2	4.7	4.7	4.3	3.9	6.1	4.9	4.0	4.5
Current Account Deficit ($b)	38	51	42	51	56	47	42	48	55
(-%) of GDP	2.2	2.8	2.2	2.5	3.3	2.6	2.2	2.4	2.7
Employment	1.4	3.0	2.2	1.6	1.6	2.3	2.7	1.9	1.5
Terms of Trade	14.3	1.6	1.4	-2.1	0.0	11.5	1.6	-2.5	-0.2
Average Earnings (Nat. Accts. Basis)	0.5	1.4	1.5	2.6	0.9	0.8	1.5	2.2	2.7
End of Period									
Total CPI	1.9	2.1	1.8	2.6	1.5	1.9	1.8	2.2	2.5
Core CPI	1.9	1.8	1.8	2.3	1.4	1.9	1.7	2.2	2.3
Unemployment Rate	5.6	5.6	4.9	4.8	5.7	5.4	5.1	4.9	4.9
RBA Cash Rate	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
10 Year Govt. Bonds	2.60	2.63	2.40	2.60	2.77	2.63	2.32	2.60	2.70
$A/US cents :	0.77	0.74	0.70	0.77	0.72	0.78	0.71	0.75	0.79
$A - Trade Weighted Index	65.5	62.6	59.7	62.5	63.9	64.9	60.7	61.6	62.9

(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

	Unit	Spot 7/02/2019	Actual Dec-18	Forecasts Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
WTI oil	US$/bbl	53	66	53	59	59	64	64	69	69	69
Brent oil	US$/bbl	61	76	60	65	65	70	70	75	75	75
Tapis oil	US$/bbl	64	79	61	66	66	71	71	76	76	76
Gold	US$/ounce	1310	1230	1300	1320	1330	1350	1360	1370	1380	1390
Iron ore (spot)	US$/tonne	n.a.	72	84	82	78	76	72	68	71	69
Hard coking coal*	US$/tonne	n.a.	217	200	193	178	170	165	160	155	152
Thermal coal (spot)	US$/tonne	102	105	95	93	98	95	93	90	88	90
Aluminium	US$/tonne	1872	1964	1865	1850	1875	1900	1925	1935	1945	1950
Copper	US$/tonne	6228	6161	6100	6250	6400	6300	6225	6150	6125	6100
Lead	US$/tonne	2061	1966	2050	1950	1900	1850	1825	1800	1750	1725
Nickel	US$/tonne	12910	11485	12000	12250	12500	12750	12600	12500	12400	12500
Zinc	US$/tonne	2723	2627	2625	2575	2500	2470	2450	2475	2450	2425
Aus LNG**	AU$/GJ	n.a.	13.6	14.0	11.3	11.6	11.4	11.9	11.8	12.3	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

Source: Thomson Reuters Datastream, ABS, Econdata DX, RBA, NAB Economics

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