

# AUSTRALIAN MARKETS WEEKLY

## The RBA confronts lower potential growth



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- The highlight in Australia this week is the wage price index, where we expect unchanged quarterly growth of 0.6% (consensus: 0.6%), with annual growth picking up from 2.3% to 2.4% (consensus: 2.3%). Annual wage growth reached a low-point in 2016, but the pace of recovery has been slow and growth is low by past standards.
- The first read on the labour force survey for this year is due Thursday, where we think employment growth slowed by slightly more than the market expects (ie. an increase of 11k versus the consensus at 15k). The unemployment rate is forecast to remain unchanged at 5.0% (consensus: 5.0%), although we think there is a strong risk that it could tick up to 5.1% given the moderation in the NAB survey's employment index and SEEK job ads.
- The Reserve Bank also features heavily with the Board minutes of the February meeting due Tuesday and Governor Lowe testifying before parliament on Friday. In both cases, we expect more colour on the board's decision to drop its long-held bias to raise interest rates, as well as its latest assessment of the housing market, where prices have been falling in Sydney and Melbourne and forward indicators point to a large drop in construction. For its part, the OIS market is now pricing in a 80% risk of a 25bp rate cut by December 2019. NAB expects rates on hold for the foreseeable future, with a rising risk of a rate cut.
- Offshore this week, geopolitics remains in focus, with President Trump declaring a national emergency to secure funding for a wall between the US and Mexico. There are also media reports that the US and China could either reach a deal on trade before the 1 March deadline or extend bilateral talks. Preliminary PMIs for February are also due for the major economies.
- In this weekly, we look at the recent downgrade to the Reserve Bank's forecast profile for growth, where the Bank has regularly overstated growth and inflation over the past ten years. The Bank has reacted to this pattern of overestimation in part by marking down its estimate of potential growth to 2.5%, although the reasons for overstating inflation are less straightforward.

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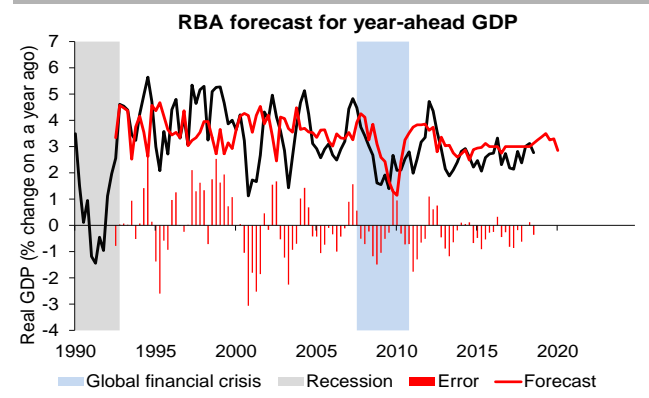
[Rate Strategists](#)

### Key markets over the past week

	Last	% chg week		Last	bp/% chg week
AUD	0.7153	1.0	RBA cash	1.50	0
AUD/CNY	4.83	0.7	3y swap	1.80	5
AUD/JPY	79.1	1.3	ASX 200	6,088	0.5
AUD/EUR	0.632	0.8	Iron ore	85.3	-3.3
AUD/NZD	1.038	-1.1	WTI oil	55.9	6.6

Source: Bloomberg

### Chart of the week: The RBA's forecast track record



Kieran Davies, Director, Economics, Markets

## The RBA confronts lower potential growth

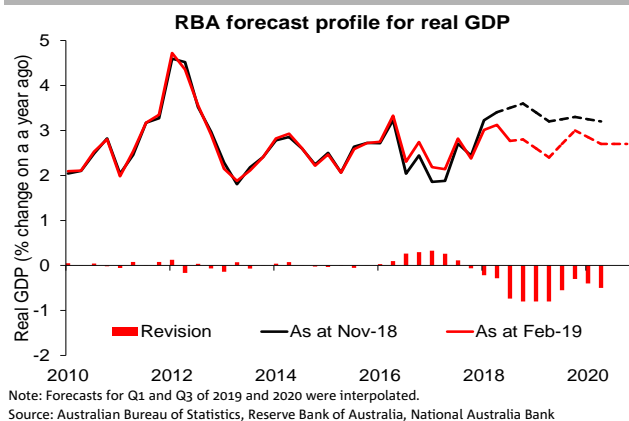
- The RBA has downgraded its outlook for growth, although history shows that the Bank has regularly overstated growth since the global financial crisis.
- The RBA has also regularly overstated inflation over the past ten years, although this could reflect a combination of factors, such as a falling natural rate of unemployment, a flatter Phillips curve and global influences.
- Importantly, the RBA has lowered its estimate of potential growth, which allows unemployment to continue to fall even with the downgrade to growth. This allows prices and wages to pick up at lower growth rates.
- Against this backdrop, the Reserve Bank’s recent shift to a neutral policy bias points to rates remaining on hold for an extended period, where we see a risk of a rate cut given financial stability risks have eased with falling house prices and lower construction.

### The RBA has downgraded its outlook for growth

One of the main changes to the Reserve Bank’s economic outlook has been the large downgrade to the forecast profile for growth in the February Statement on Monetary Policy (see Chart 1).

- The largest forecast revisions were in the near term where forecast growth in Q4 2018 was revised from 3.6% to 2.8%, while estimated growth in Q2 2019 was marked down from 3.2% to 2.4%.
- The forecast revisions to growth over the next one to two years were smaller, with forecast growth for Q4 2019 lowered from 3.3% to 3.0% and expected growth in Q4 2020 reduced from 3.0% to 2.7%.

Chart 1: The RBA has marked down its growth outlook

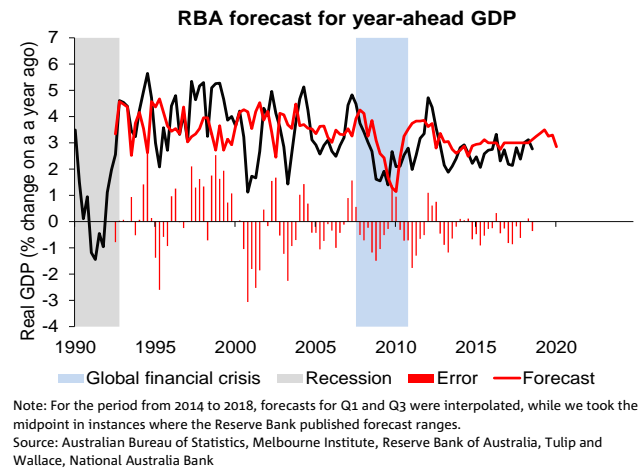


### Downward revisions to the RBA’s growth outlook have been common since the global financial crisis

The downward revision to the Reserve Bank’s outlook partly reflected a weaker starting point, with downward revisions to history. However, the Bank also took the opportunity to mark down its forecasts for annual growth over 2019 and 2020 by 0.3-0.5pp.

Such downward revisions are not surprising as the Reserve Bank has regularly overestimated growth since the global financial crisis. For example, we calculate that the Bank has overestimated year-ahead growth by an average of 0.4pp since the global financial crisis (see Chart 2).

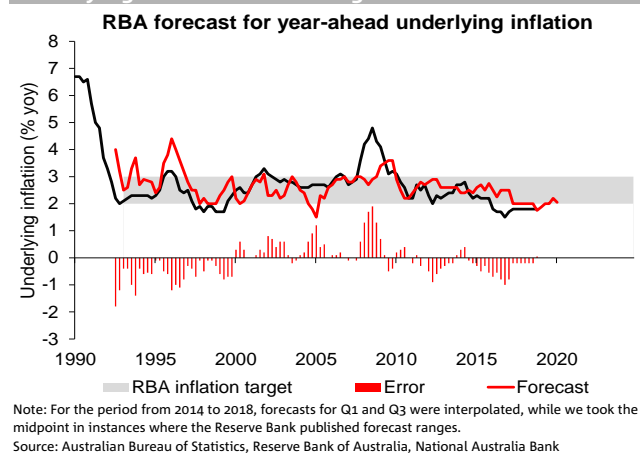
Chart 2: The RBA has regularly overestimated growth since the global financial crisis



### The RBA has also persistently overestimated underlying inflation

Consistent with the overestimation of growth, the Reserve Bank has also tended to overestimate inflation over the past ten years (see Chart 3). For example, we calculate that the Bank has overstated year-ahead underlying inflation by an average of 0.3pp since the global financial crisis, although this error has reduced in recent years.

Chart 3: The RBA has persistently overestimated underlying inflation since the global financial crisis



### The RBA has recently reduced its estimate of potential growth to about 2½%

In our view, some of the overestimation of growth points to the overestimation of potential growth.

Lower potential growth has been a common feature of advanced economies since the global financial crisis, although the debate over lower potential in Australia has lagged the international debate by several years. That said, the Reserve Bank marked down its estimate of potential growth from 3-3¼% in 2015 to 2¾% and looks to have recently marked it down again to about 2½%.

### The reason for overestimating inflation is less clear

The reason for the general overstatement of inflation over recent years is less straightforward as it could reflect:

- A falling natural rate of unemployment, which the Reserve Bank estimated at around 5% in 2017;
- Inflation and wages becoming less sensitive to spare capacity in the economy (ie, a flattening of the Phillips Curve); and/or
- A stronger influence from low global inflation.

The Reserve Bank is well aware of these risks, canvassing them in its commentary and speeches. For example, Bank staff noted that estimates of the natural rate of unemployment can be significantly revised as more data become available, while Governor Lowe noted the trade-off with financial stability involved in cutting rates by more to offset a flatter Phillips Curve.<sup>1</sup>

**Wage growth has troughed and is slowly picking up**

At least, though, with respect to core inflation, wage growth has troughed on a variety of measures and has slowly picked up. This can be seen in annual growth in the wage price index, which has picked up from 1.9% at the end of 2016 to 2.3% in Q3 2018 and where we expect this week’s figures to show a further tick up to 2.4%.

NAB’s internal data suggest that wage growth will print at an annualised 2.4% in Q4 2018 and Q1 2019. In addition, our modelling shows that unemployment is now beginning to boost wage growth a little, while RBA monitoring reports that more people are now receiving wages increases, which will be important for income growth.

The broader policy outlook – on hold with the risk of a rate cut.

More generally for the Reserve Bank, the board’s recent shift to a neutral policy bias points to rates remaining on hold for an extended period. With the Reserve Bank now factoring in slow growth in actual and potential growth, we think unemployment will remain a key short-term guide to the board’s deliberations.

As for the risks around the outlook for policy, we see a rising risk of a rate cut, with the Reserve Bank’s concern over financial stability easing given falling house prices and leading indicators pointing to a sharp fall in residential construction.

**Chart 4: Wage growth has turned the corner, but the pick-up to date has been modest**



Source: Australian Bureau of Statistics, National Australia Bank

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<sup>1</sup> See Tom Cusbert, *Estimating the NAIRU and the unemployment gap*, Reserve Bank Bulletin, Q2 2017, and Reserve Bank Governor Lowe, *The labour market and monetary policy*, 26 July 2017.

# CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEDT
<b>Monday, 18 February 2019</b>								
US	<b>Public Holiday - Presidents' Day</b>						<b>18 Feb</b>	
NZ	Performance Services Index	Jan				53	21.30	8.30
NZ	Population Estimates	Q4				1.9	21.45	8.45
JN	Core Machine Orders MoM / YoY	Dec		-1/3.4		0/0.8	23.50	10.50
<b>Tuesday, 19 February 2019</b>								
AU	<b>RBA Minutes of Feb. Policy Meeting</b>						<b>0.30</b>	<b>11.30</b>
NZ	Non Resident Bond Holdings	Jan				54.6	2.00	13.00
UK	Claimant Count Rate / Jobless Claims Change	Jan		/		2.8/20.8	9.30	20.30
UK	ILO Unemployment Rate 3Mths	Dec		4		4	9.30	20.30
GE	<b>ZEW Survey Current Situation / Expectations</b>	<b>Feb</b>		<b>21/-13.7</b>		<b>27.6/-15</b>	<b>10.00</b>	<b>21.00</b>
EC	ZEW Survey Expectations	Feb				-20.9	10.00	21.00
US	Fed's Mester Speaks on Economic Outlook and Monetary Policy						13.50	0.50
EC	ECB's Praet Participates in Panel Discussion in Berlin						15.00	2.00
<b>Wednesday, 20 February 2019</b>								
NZ	Dairy Auction Avg. Winning Price MT	19 Feb				3265	early am	
NZ	Business Price Indexes	Q4	1.5		3.6		21.45	8.45
AU	Westpac Leading Index MoM	Jan				-0.21	23.30	10.30
JN	Trade Balance	Jan		-1028.7		-55.286	23.50	10.50
AU	<b>Wage Price Index QoQ / YoY</b>	<b>4Q</b>	<b>0.6 / 2.4</b>	<b>0.6/2.3</b>		<b>0.6/2.3</b>	<b>0.30</b>	<b>11.30</b>
US	MBA Mortgage Applications	15 Feb				-3.7	12.00	23.00
EC	Consumer Confidence	Feb A		-7.7		-7.9	15.00	2.00
US	Fed's Bullard Takes Part Monetary Policy Forum in New York						18.30	5.30
US	FOMC Meeting Minutes	30 Jan					19.00	6.00
<b>Thursday, 21 February 2019</b>								
NZ	Tax working group publishes final results							
JN	Nikkei Japan PMI Mfg	Feb P				50.3	0.30	11.30
AU	<b>Employment Change / Unemployment Rate</b>	<b>Jan</b>	<b>10 / 5</b>	<b>15/5</b>		<b>21.6/5</b>	<b>0.30</b>	<b>11.30</b>
AU	Participation Rate	Jan	65.6	65.6		65.6	0.30	11.30
JN	All Industry Activity Index MoM	Dec		-0.2		-0.3	4.30	15.30
JN	Machine Tool Orders YoY	Jan F				-18.8	6.00	17.00
GE	CPI MoM / YoY	Jan F		-0.8/1.4		-0.8/1.4	7.00	18.00
EC	ECB's Praet Speaks in Luxembourg						8.00	19.00
GE	Markit/BME Germany Manufacturing PMI	Feb P		49.9		49.7	8.30	19.30
GE	Markit Germany Services PMI	Feb P		52.9		53	8.30	19.30
EC	Markit Eurozone Manufacturing PMI	Feb P		50.3		50.5	9.00	20.00
EC	Markit Eurozone Composite PMI	Feb P		51.1		51	9.00	20.00
UK	Public Sector Net Borrowing ex Banking Groups	Jan		-10		3	9.30	20.30
US	Fed's Bostic Speaks on Economy and Monetary Policy						12.50	23.50
CA	Wholesale Trade Sales MoM	Dec		-0.2		-1	13.30	0.30
US	Philadelphia Fed Business Outlook	Feb		14.7		17	13.30	0.30
US	Initial Jobless Claims	16 Feb		230		239	13.30	0.30
US	<b>Durable Goods Orders / Cap Goods Nondef Ex Air</b>	<b>Dec P</b>		<b>1.8/0.1</b>		<b>0.7/-0.6</b>	<b>13.30</b>	<b>0.30</b>
US	Markit US Manufacturing PMI	Feb P		55		54.9	14.45	1.45
US	Markit US Services PMI	Feb P		54.3		54.2	14.45	1.45
US	Leading Index	Jan		0.2		-0.1	15.00	2.00
CA	Bank of Canada Governor Stephen Poloz Speech						17.35	4.35
<b>Friday, 22 February 2019</b>								
AU	RBA's Lowe Parliamentary Testimony						22.30	9.30
JN	Natl CPI YoY / Ex Fresh Food YoY	Jan		0.2/0.8		0.3/0.7	23.30	10.30
NZ	Credit Card Spending YoY	Jan				4.5	2.00	13.00
GE	GDP SA QoQ / YoY	4Q F		0/0.6		0/0.6	7.00	18.00
GE	IFO Business Climate	Feb		98.9		99.1	9.00	20.00
EC	CPI Core YoY	Jan F		1.1		1.1	10.00	21.00
EC	CPI MoM / YoY	Jan		-1.1/1.4		0/1.6	10.00	21.00
CA	Retail Sales MoM / Ex Auto MoM	Dec		-0.3/-0.3		-0.9/-0.6	13.30	0.30
US	Fed's Williams Discusses Inflation at Policy Forum in New York						15.15	2.15
US	New York Fed's Potter Discusses Quantitative Tools						17.30	4.30
US	Fed's Bullard to Speak on Balance Sheet in New York						18.30	5.30
US	Fed's Harker Takes Part in Panel Discussion on Balance Sheet						18.30	5.30
US	New York Fed's Williams Gives Closing Remarks at Fed Event						22.30	9.30
<b>Upcoming Central Bank Interest Rate Announcements</b>								
Australia, RBA		5-Mar	1.5%	1.5%		1.5%		
Canada, BoC		6-Mar	1.75%	1.75%		1.75%		
Europe, ECB		7-Mar	-0.4%	-0.4%		-0.4%		
Japan, BoJ		15-Mar	-0.1%	-0.1%		-0.1%		
US, Federal Reserve		20-Mar	2.25-2.5%	2.25-2.5%		2.25-2.5%		
UK, BOE		21-Mar	0.75%	0.75%		0.75%		
New Zealand, RBNZ		27-Mar	1.75%	1.75%		1.75%		

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

# FORECASTS

Economic Forecasts					Annual % change															
					2017				2018				2019				2020			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>Australia Forecasts</b>	2017	2018	2019	2020																
Household Consumption	2.4	2.5	2.1	2.4	0.4	0.8	0.6	1.1	0.3	0.9	0.3	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Underlying Business Investment	3.7	1.6	3.8	5.7	3.3	0.3	3.7	0.4	0.8	-0.8	-2.5	1.6	1.3	1.7	2.2	1.2	1.2	1.3	1.0	1.7
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	-3.0	-2.3	-2.2	-1.9	-2.1	-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
Exports	3.5	5.1	3.7	2.5	-1.9	2.8	0.8	-1.5	4.3	1.2	0.1	-0.4	1.8	1.5	1.0	0.6	0.5	0.5	0.4	0.6
Imports	7.7	3.8	1.6	3.7	3.0	0.2	3.3	0.6	1.9	0.5	-1.5	0.5	0.5	0.8	1.0	0.9	0.9	0.9	0.8	1.1
Net Exports (a)	-0.8	0.3	0.5	-0.2	-1.0	0.5	-0.5	-0.5	0.5	0.2	0.3	-0.2	0.3	0.2	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
Domestic Demand - qtr%					0.7	0.9	0.8	0.8	0.8	0.7	0.3	0.4	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.7
Dom Demand - ann %	2.9	2.9	2.0	2.5	2.2	2.5	3.5	3.2	3.4	3.2	2.7	2.2	1.8	1.7	2.1	2.3	2.4	2.5	2.4	2.6
Real GDP - qtr %					0.4	0.8	0.6	0.5	1.0	0.9	0.3	0.4	0.8	0.7	0.6	0.5	0.5	0.6	0.5	0.7
Real GDP - ann %	2.4	2.9	2.4	2.2	2.2	2.1	2.8	2.4	3.0	3.1	2.8	2.6	2.3	2.2	2.6	2.7	2.4	2.2	2.1	2.2
CPI headline - qtr %					0.5	0.2	0.6	0.6	0.4	0.4	0.4	0.5	0.2	0.6	0.6	0.8	0.5	0.6	0.6	0.7
CPI headline - ann %	1.9	1.9	1.9	2.6	2.1	1.9	1.8	1.9	1.9	2.1	1.9	1.8	1.5	1.8	2.0	2.2	2.6	2.6	2.6	2.5
CPI underlying - qtr %					0.5	0.6	0.3	0.5	0.5	0.4	0.3	0.4	0.5	0.6	0.5	0.6	0.6	0.6	0.5	0.5
CPI underlying - ann %	1.9	1.8	1.9	2.3	1.7	1.9	1.9	1.9	2.0	1.8	1.7	1.7	1.6	1.8	2.0	2.2	2.3	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
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
Unemployment Rate (%)	5.6	5.3	4.9	4.9	5.9	5.6	5.5	5.4	5.5	5.6	5.1	5.1	5.0	4.9	4.9	4.9	4.9	4.8	4.9	4.9
Terms of trade	12.1	1.3	-1.1	-0.1	5.3	-5.9	-0.1	-0.1	3.1	-1.1	0.9	2.4	-3.8	0.3	-1.9	0.9	0.6	-0.3	-0.9	0.1
G&S trade balance, \$Abn	9.6	23.1	22.1	16.6	6.7	3.3	0.9	-1.2	4.2	3.9	6.6	8.4	5.5	6.7	4.6	5.3	5.5	4.8	3.3	3.0
% of GDP	0.5	1.2	1.1	0.8	1.5	0.7	0.2	-0.3	0.9	0.8	1.4	1.7	1.1	1.4	0.9	1.1	1.1	0.9	0.6	0.6
Current Account (% GDP)	-2.6	-2.2	-2.4	-2.7	-1.6	-2.4	-2.9	-3.4	-2.3	-2.6	-2.2	-1.8	-2.4	-2.2	-2.6	-2.5	-2.4	-2.6	-2.8	-2.9

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

## Exchange Rate Forecasts

	18-Feb	Mar-19	Jun-19	Sep-19	Dec-19
<b>Majors</b>					
AUD/USD	0.7153	0.71	0.70	0.73	0.75
NZD/USD	0.6884	0.68	0.67	0.69	0.70
USD/JPY	110.53	113	113	110	108
EUR/USD	1.1309	1.17	1.18	1.20	1.23
GBP/USD	1.2910	1.35	1.40	1.43	1.45
USD/CHF	1.0036	0.98	0.98	0.99	0.97
USD/CAD	1.3229	1.31	1.31	1.27	1.27
USD/CNY	6.7731	6.88	6.82	6.68	6.60

Australian Cross Rates					
	18-Feb	Mar-19	Jun-19	Sep-19	Dec-19
AUD/NZD	1.0391	1.04	1.04	1.06	1.07
AUD/JPY	79.1	80	79	80	81
AUD/EUR	0.6325	0.61	0.59	0.61	0.61
AUD/GBP	0.5541	0.53	0.50	0.51	0.52
AUD/CNY	4.8448	4.88	4.77	4.88	4.95
AUD/CAD	0.9463	0.93	0.92	0.93	0.95
AUD/CHF	0.7179	0.70	0.69	0.72	0.73

## Interest Rate Forecasts

	18-Feb	Mar-19	Jun-19	Sep-19	Dec-19
<b>Australia Rates</b>					
RBA Cash rate	1.50	1.50	1.50	1.50	1.50
3 month bill rate	1.95	1.95	1.90	1.90	1.90
3 Year Swap Rate	1.80	1.85	1.85	1.95	2.05
10 Year Swap Rate	2.38	2.60	2.60	2.70	2.80
<b>Offshore Policy Rates</b>					
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	13.5	13.0	12.5	12.0	12.0
<b>10-year Benchmark Bond Yields</b>					
Australia	2.13	2.40	2.40	2.50	2.60
United States	2.66	2.80	2.80	3.00	3.00
New Zealand	2.22	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	2.2	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)

	18-Feb	Mar-19	Jun-19	Sep-19	Dec-19
Brent oil	66.5	60	65	65	70
Gold	1321	1300	1320	1330	1350
Iron ore	86.1	84	82	78	76
Hard coking coal	208	200	193	178	170
Thermal coal	95	95	93	98	95
Copper	6193	6100	6250	6400	6300
Aust LNG (*)	16.1	14.0	11.3	11.6	11.4

(\*) Implied Australian LNG export prices.

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