EMBARGOED UNTIL 11.30 AM WEDNESDAY 13 MARCH 2019

THE FORWARD VIEW: AUSTRALIA MARCH 2019

Slowing growth with rate cuts ahead.

OVERVIEW

While we have integrated the latest national accounts data and fine tuned our growth forecasts we have not fundamentally changed our view on pattern of growth outcomes over the next two years. Thus last month, prior to the Accounts, we were expecting through the year growth to December 2019 of 2.6% now we are expecting 2.5%. We have also not changed our forecasts for 2020 at around 2¼. What has however happened – given the new history - is a much larger slowing in year average terms in 2019 – previously 2.4% now 2.1%. However we see the through the year growth numbers as providing a better gauge of growth momentum going forward.

As was heralded in yesterday's February Monthly Business Survey the slowing in the growth momentum has continued into Q1 2019. In particular, the situation in discretionary retail and consumption more generally has deteriorated even further. We now expect not much improvement in the growth rate in consumer spending in 2019 – at around 2.0% and any improvement in 2020 will need policy action. The Accounts also highlighted a turn down in the construction cycle – which appears to have continued (and indeed accelerated) into early 2019. This reinforces our view that over the next two years we are facing a pronounced residential construction cycle (a fall of around 20%).

That said supporting growth will be continued spending by the public sector, both on the NDIS and infrastructure. In addition to this, we still expect business investment to make a significant contribution to growth – though there are growing risks to this. Also exports will continue to grow, as LNG hits full production then plateaus at a high level. So it is important not to get too negative on our growth prospects.

That said our forecasts now point to below trend growth and a degree of rising spare capacity in the economy (already evident in the February Business Survey). This will mean less progress on reducing unemployment and slower than anticipated progress in wage growth (outside of policy intervention) and ultimately inflation. We now see no improvement in unemployment till mid 2020 and a slight deterioration thereafter.

This is why we now expect the RBA to cut the cash rate twice in 2019. While the exact timing of cuts is data dependent, we see the RBA cutting rates in July and then November. We believe this would be the path of "least regret" for the bank. We expect that as slower growth and less progress on reducing unemployment take hold at a time of subdued inflation and abating financial stability concerns the Bank will assess it can do more to bolster the economy. Of course a material deterioration in the labour market in the next few months (not our forecast) could see an earlier cut from the RBA.

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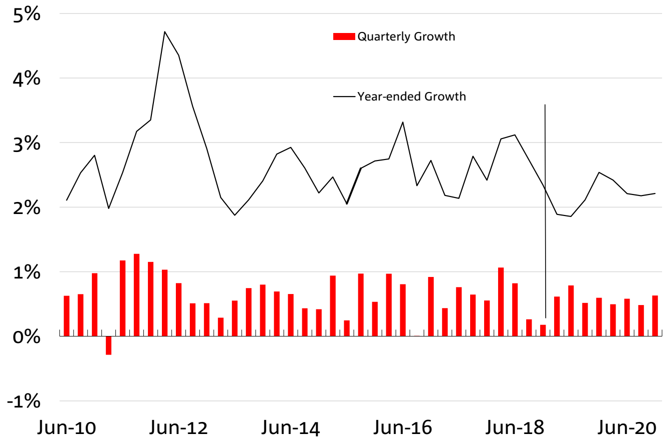
KEY ECONOMIC FORECASTS

	2017	2018-F	2019-F	2020-F
Domestic Demand (a)	2.9	3.0	2.1	2.4
Real GDP (annual average)	**2.4**	**2.8**	**2.1**	**2.3**
Real GDP (year-ended to Dec)	**2.4**	**2.3**	**2.5**	**2.2**
Terms of Trade (a)	11.5	1.8	-2.2	-0.2
Employment (a)	2.4	2.7	1.9	1.2
Unemployment Rate (b)	5.4	5.0	5.1	5.2
Headline CPI (b)	1.9	1.8	2.3	2.4
Core CPI (b)	1.9	1.7	2.2	2.2
RBA Cash Rate (b)	1.50	1.50	1.00	1.00
$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

The Q4 National Accounts saw consumption rise by 0.4% (following 0.3% in Q3) to be 2.0% higher over the year. Consumption was generally supported by stronger growth in services, while goods consumption growth was weaker. This was inline with a weak 0.1% quarterly volumes growth in the ABS retail sales release. Nominal retail sales data for January suggest little improvement in the early part of Q1 2019 with nominal retail sales printing at 0.1% in January. The NAB Cashless Retail sales index will be released next week providing an early update on how sales tracked in February.

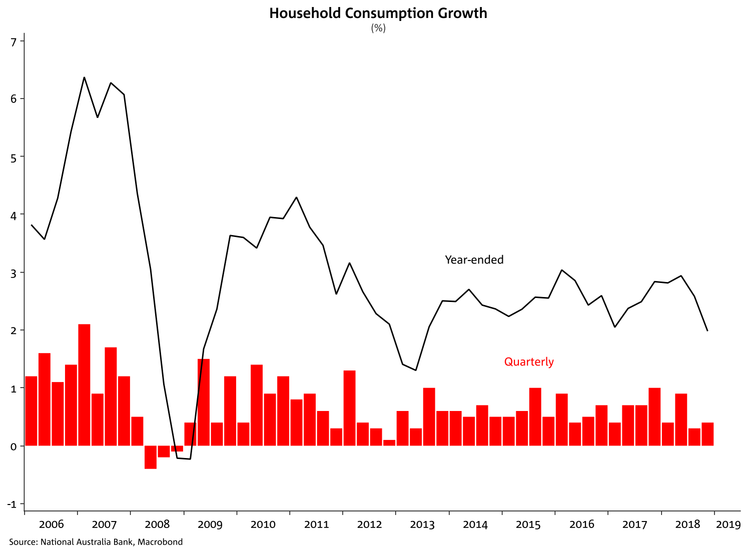
While consumption has seen only modest growth, conditions in the labour market remain healthy. Though employment growth slowed in 2018, it recorded relatively healthy growth of 270k (2.2%). The first month of January suggest the momentum in the labour market has continued into 2019 with employment rising by 39k in the month, driven by a 65k increase in full-time workers. The unemployment rate remained unchanged at 5.0%, around 0.5ppt lower than a year ago. Across the states, unemployment remains lowest in the east – with the NSW unemployment rate reaching very low levels at 3.9%.

Where labour market conditions head from here remain an important dynamic for the broader macro economy. Typically, employment growth and consequently the unemployment rate tend to lag fluctuations in output growth. Therefore, while labour market conditions have been strong, it could well be that they are yet to fully reflect the slowing in growth through the second half of 2018. To date, the tightening in the labour market has seen some rise in wage pressures and consequently boosted income growth, albeit only by a small amount, but should the labour market lose momentum this would be knocked off course. Weaker wage growth would likely see ongoing restraint on household spending as well as weaker domestic labour cost pressure. Both would put further downward pressure on interest rates.

GDP data showed a small lift in the growth of compensation of employees (per hour) in Q4. While more volatile than other measures of wages, this rise is inline with the gradual increase in the WPI over the year.

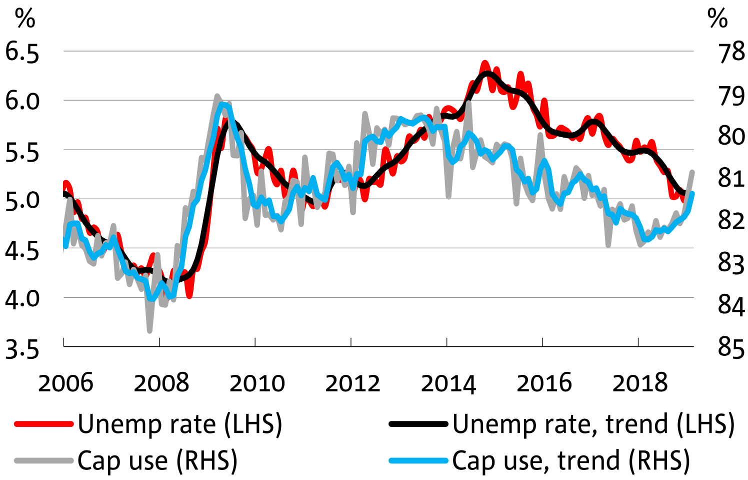
Overall, consumer price pressures appear to remain weak with surveyed measures of final products prices and retail prices growth having edged lower in February. Though input prices – labour and purchase costs – growth ticked up in February, they remain low and suggest little downstream pressure.

CONSUMPTION GROWTH



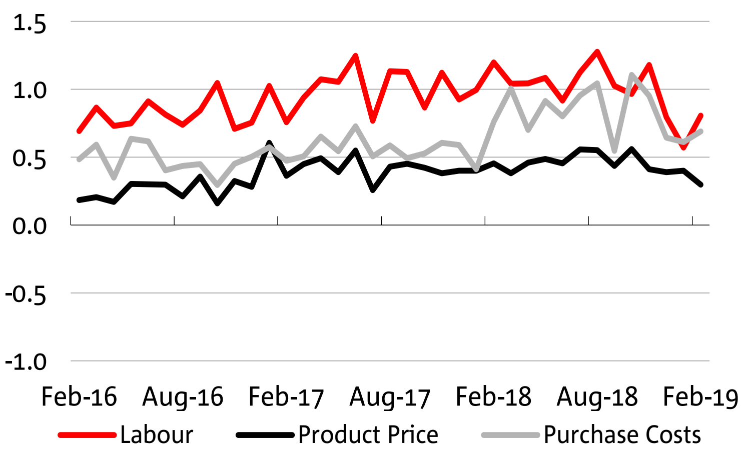
UNEMPLOYMENT AND CAPACITY UTILISATION

ABS (unemployment) and NAB monthly survey



NAB BUSINESS SURVEY PRICE PRESSURES

% change at quarterly rate



Sources: ABS, NAB Group Economics

HOUSING AND CONSTRUCTION

The downturn in the construction cycle appears to have taken hold following with the ongoing cooling in the housing market continuing. National Accounts data showed a 3.4% decline in overall dwelling investment driven by a fall of 3.6% in investment in new dwellings, and a 3.1% decline in alterations & additions. This is a relatively large fall – and comes after a surprise increase in the previous quarter – but is inline with our expectations for a decline of around 20% over the next two years. Interestingly, this is a larger fall than expected by the RBA and will pose further pressure for the Bank to confront its relatively optimistic growth forecast.

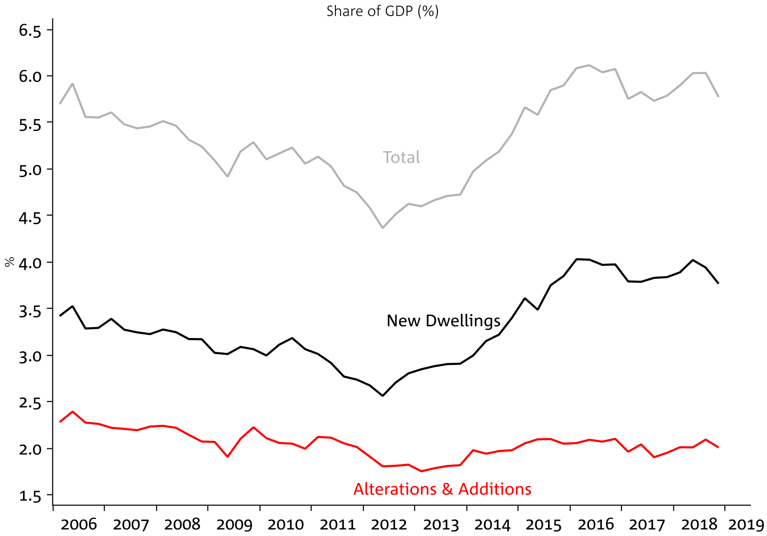
Forward indicators of construction activity are in line with our forecast over the next two years. Building approvals edged higher in January with detached dwelling approvals increasing by 2.5%. Approvals for houses rose 2.1% while approvals for the more volatile apartments rose 2.7%. Despite this increase, approvals continue to trend down. Approvals for non-detached dwellings are 51% lower than a year ago while houses have declined by a more moderate 6.6%.

Nationally, house prices have continued to decline, still led by declines in Melbourne and Sydney. Though Perth has also weakened significantly over recent months and declines appear to have become a little more broad-based. The Core Logic 8-Capital City Dwelling price index declined by 0.7% in January. Both Melbourne and Sydney saw 1.0% declines in the month and are down 10.4% and 9.1% over the year, respectively. Peak to trough Sydney prices have now declined 13.1% and Melbourne has declined 9.6%. Perth declined 1.5% in the month and is now down 6.9% over the year. The other capitals have held up better. We think there are a number of factors driving the weakness in house prices including weaker foreign demand, earlier prudential tightening, affordability issues as well as weaker price expectations by investors. Even after the relatively sharp declines to date prices remain well up on 5 years ago. While there are likely pockets of oversupply (and large pipeline of work outstanding) it is likely any impact will be contained with population growth still strong.

Alongside the cooling in the market, housing credit growth has continued to slow. Investor lending slowed to 1.0% y/y in January 2018 and while credit extended to owner-occupiers has also slowed, it is tracking at a higher pace of around 6.2% y/y. Overall, housing credit growth has risen by 4.4% over the past year. A relatively slow rate when compared with history, but one likely driven by both demand and supply factors.

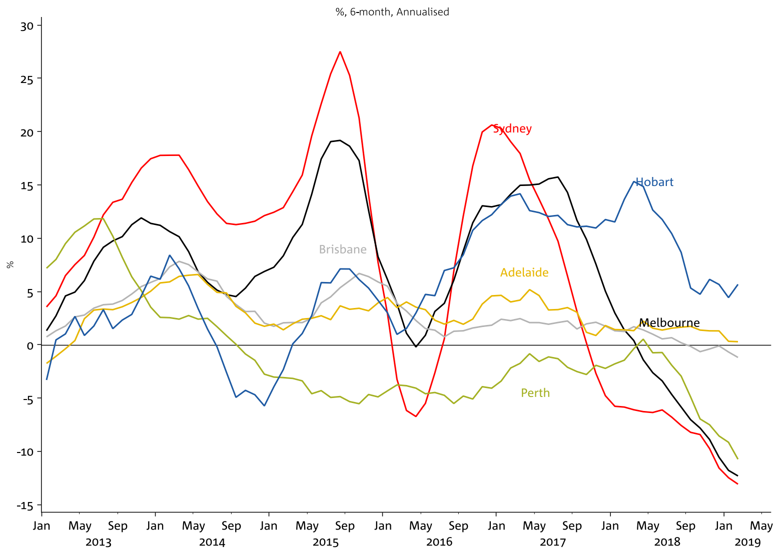
We expect house prices to decline further, in an orderly fashion, and housing activity indicators to show further weakness as the market continues to adjust. Our forecasts embody a relatively sharp slowdown in dwelling investment with a fall approaching 20% over the next two years. This is consistent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

DWELLING INVESTMENT



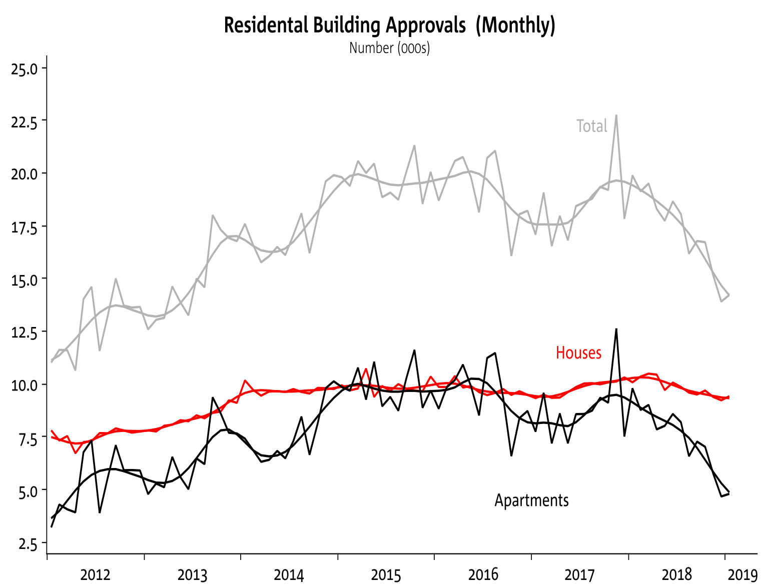
Source: National Australia Bank, Macrobond

DWELLING PRICES



Source: CoreLogic, National Australia Bank, Macrobond

RESIDENTIAL BUILDING APPROVALS



Source: National Australia Bank, Macrobond

BUSINESS

The outlook for the business sector is important for our overall outlook for the economy over the next few years. We expect relatively strong business investment growth. However, the full range of recently released indicators on the business sector paints a mixed picture. With official, but lagged, data pointing to some strength in the non-mining sector but the NAB Business Survey pointing to some risks in the sector.

Q4 National accounts data suggest investment the non-mining sector rose 2.2% while the mining sector continued its decline, falling 5.5%. By component the increase in investment overall was driven by a rise in spending on machinery & equipment as well as non-residential construction. Engineering investment declined – likely reflecting the ongoing wind-down of LNG construction.

ABS Capex data also paint a positive picture for investment with the first intention for 2019/20 around 11% higher than the first estimate for the current financial year. This is due to rise in the initial estimate for both the mining and non-mining subsectors.

The NAB Monthly Business Survey – a higher frequency indicator – suggests that there are some risks around the business outlook. Both conditions and confidence declined in February and are both below average. While there has been some volatility in business conditions over the past few months, the downward trend through 2018 has continued into 2019.

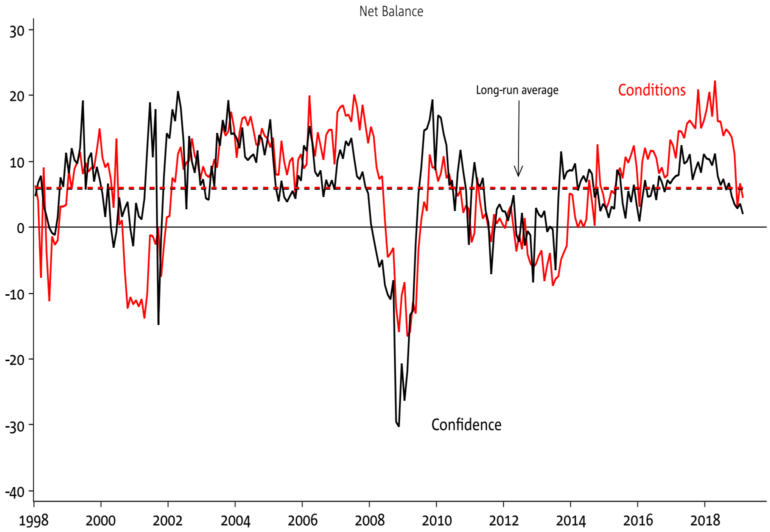
The decline in business conditions has been broad-based across industries and states over the past 6 months. Conditions in the retail sector remain particularly weak, with the sector being the only one to report negative conditions. Within the sector, the weakness is evident across all sub industries, though car retailing and personal & household goods continue to show significant weakness.

Forward looking indicators suggest there is unlikely to be any improvement in conditions. Business confidence remains below average (and is weakest in the eastern states) and forward orders are currently negative and below average. Next months NAB Quarterly Business Survey will provide an update on a full range of business's expectations for key survey variables.

Capacity utilisation which has also gradually trended lower over 2018 declined to below average levels in February. As an indicator of future capex and employment intentions this suggests there is some further risk to our forecasts.

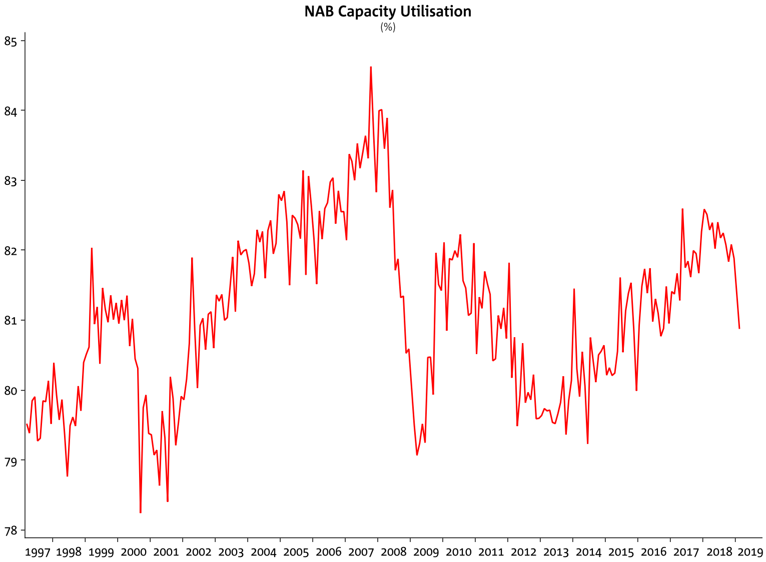
Non-residential building approvals point to ongoing growth in investment in buildings with approvals having held at a relatively high level for some time.

NAB SURVEY CONDITIONS AND CONFIDENCE



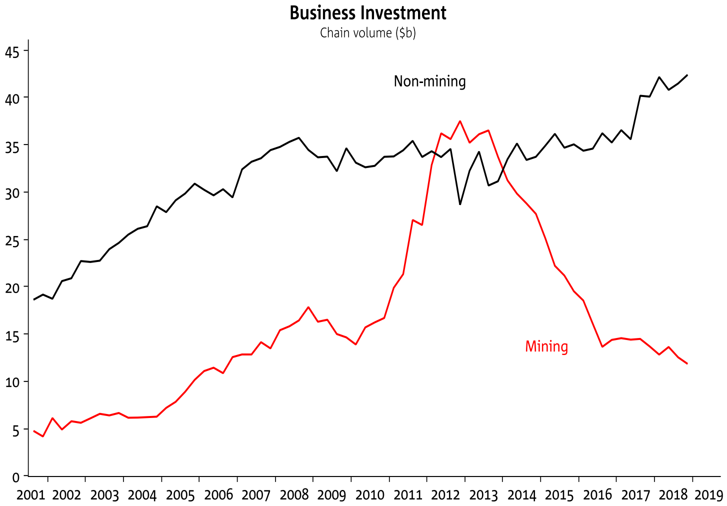
Source: National Australia Bank, Macrobond

CAPACITY UTILISATION



Source: National Australia Bank, Macrobond

BUSINESS INVESTMENT BY SECTOR



Source: National Australia Bank, Macrobond

TRADE AND COMMODITIES

January saw a near record trade surplus of $4.5b, driven by a relatively sharp increase in exports. While a sharp rise in non-monetary gold was partly responsible for this, other resource exports such as metal ores, coal and other mineral fuels all rose. We expect resources exports to continue to support growth over the next year, as the last of the LNG mega-projects reaches full-production.

Iron ore spot prices have eased from recent peaks (albeit still high by recent standards), as the market continues to digest the impact of Brazilian mine closures on global supply. Resolving tailing dam safety concerns at Vale's Southern System mines could take as long as three years to complete. We expect a relatively balanced market in the short term – with demand in China expected to ease in coming years – until output can be boosted from other sources (including Brazil).

Chinese trade policy is the key uncertainty around coal markets at present, following reports (that were later denied) that Australian coal imports were banned from a number of northern ports.

Our broad view of demand remains unchanged – with weaker steel output in China going forward – meaning that hard coking coal prices should decline from around US$185 a tonne in 2019 to US$158 a tonne in 2020. Thermal coal prices are tipped to ease more gradually.

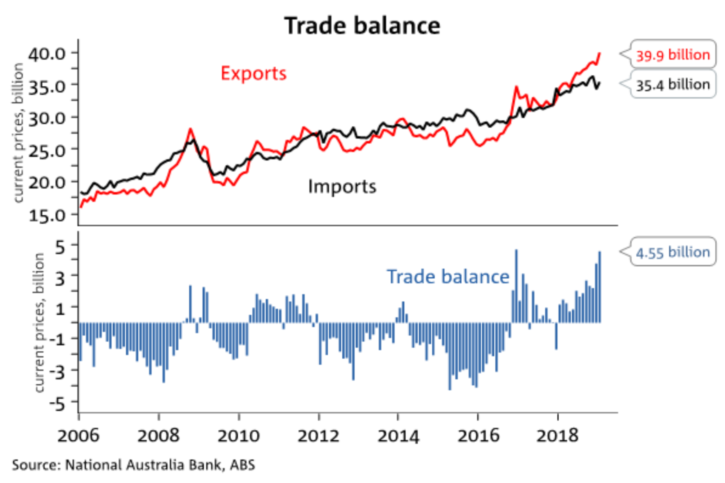
On balance, we see a gradual uptrend for oil this year, with Brent forecast to reach US$70/bbl by the end of the year. Australian LNG export volume growth has been very strong but will moderate in line with the completion of the final terminals this year.

For more detail please see the attached: Minerals and Energy Outlook – February 2019.

The Australian agricultural sector desperately needs rain – and soon. The drought continues in much of eastern Australia and the traditional start of winter planting is now only six weeks away. The benchmark eastern young cattle indicator has fallen below 400c/kg for the first time since late 2014. Progress of the season will be closely watched.

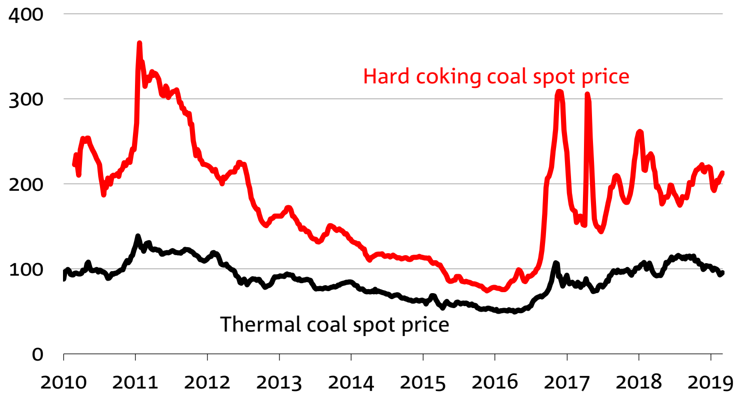
TRADE BALANCE

$B



COAL SPOT PRICES

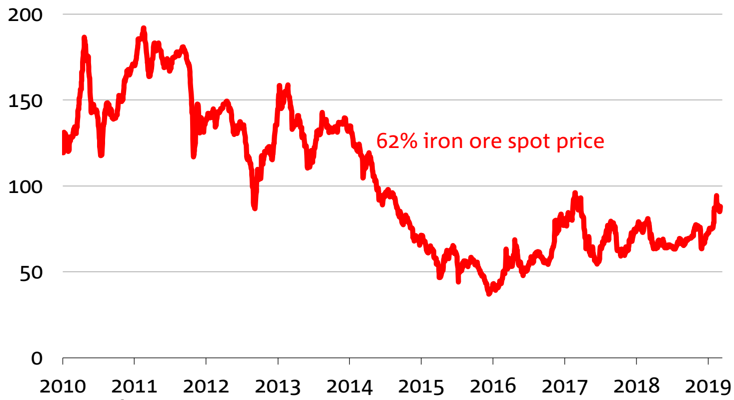
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

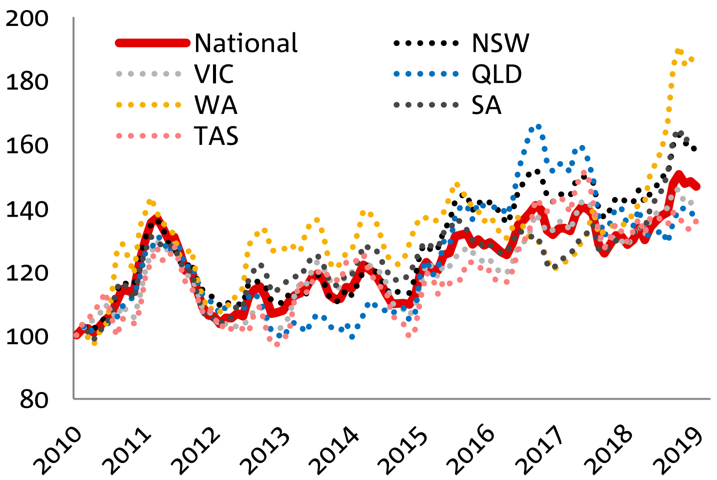
US$/t (incl. cost of freight)



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 March at 1.5% - with the record run of unchanged rates now at 31 months. This outcome was largely as expected with recent RBA communication largely emphasising the Bank's current balanced outlook for rates.

Communication via speeches and the semi-annual parliamentary testimony since the February SMP have stood by this view, despite the weaker than expected outcome for GDP growth. For now the bank remains focused on developments in the labour market, which despite the sharp slowing in growth since around mid last year, has remained resilient. For now, questions remain around how much of a lag there is between activity and the labour market and whether we are yet to see the effects of the prior slowing in activity.

To date, the tightening in the labour market has been moderate, wage and inflation pressure are not really accelerating much and financial stability risks are much lower. In the current environment it is thus very hard to see any rate rise in 2019. Against that, near term risks of both a slowing in the global and – especially - the domestic economy have heightened. In that case the strength in the labour market could well weaken – with the implications being that less progress could be made on wages and also inflation. We suspect that will mean that the bank will likely soon move to an easing bias.

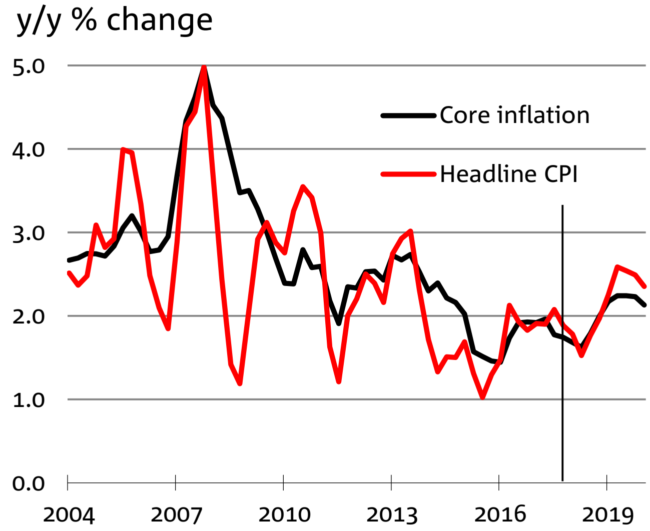
Accordingly we now expect the RBA will cut the cash rate twice in 2019, with the timing of any action highly depending on the data flow. Should the labour market materially deteriorate in the near term (not our forecast), the first move could occur relatively soon. Without a near-term reversal in labour market conditions, and based on our forecasts for growth, prices and the labour market, we expect the RBA to cut rates by 25bp in July before following up with a similar sized reduction in November.

A forward looking central bank should be expected to take action to bolster the economy at a time where there are few constraints from inflation and financial stability risks have abated. This would serve to do better on both growth and unemployment and possibly see a faster return to the target band for inflation.

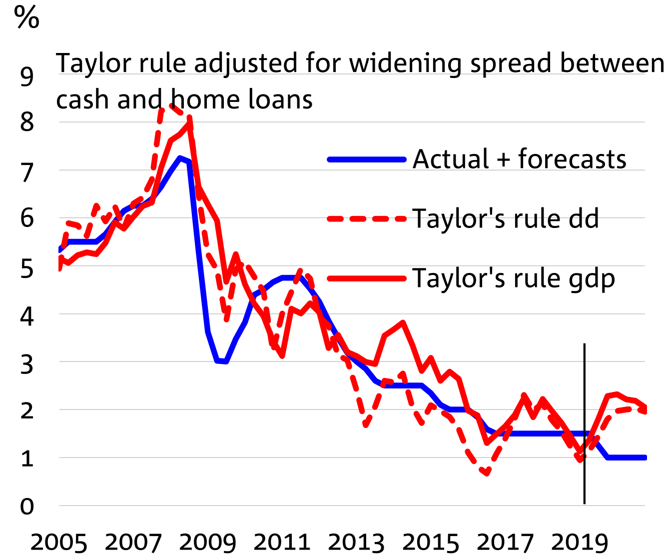
Indeed, we expect inflation to remain relatively muted in the near term, and only returning to the bottom of the band by the end of our forecast horizon. We see a gradual pickup in wage growth eventually feeding through to higher inflationary pressure but this is increasingly at risk given likely developments in the labour market. Here our forecasts are for unemployment to start rising from mid 2020.

The AUD/USD has continued to track in the low-70c range over the past month. More positive signs on a US-China trade deal have seen the pair hold ground for now. We expect the pair to gradually rise over the next few years but could well see a short-term dip below the 70c mark on ructions around trade, Brexit and a range of other idiosyncratic risk events. For now, out expectation is that the Aussie will end the year around US75c, before rising to near US80c over 2020.

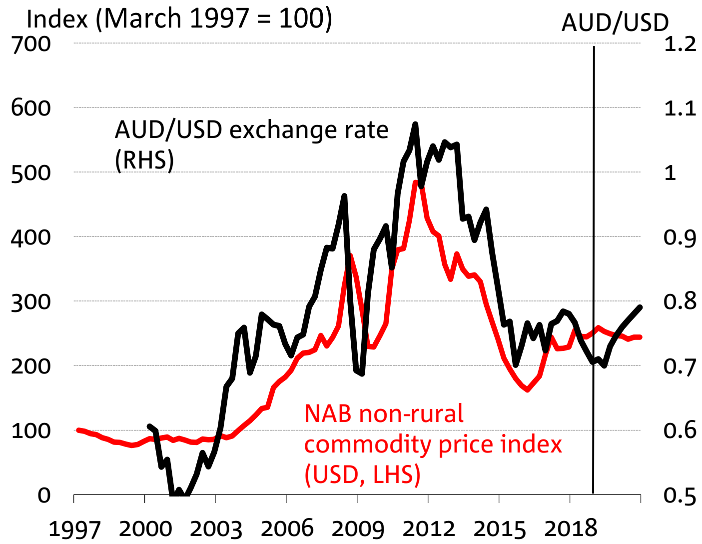
HEADLINE AND CORE INFLATION



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	2018-19 F	2019-20 F	2016	2017	2018	2019-F	2020-F
Private Consumption	2.4	2.8	2.1	2.2	2.7	2.4	2.6	2.0	2.3
Dwelling Investment	2.5	0.2	-0.4	-9.8	7.9	-2.4	4.4	-7.8	-8.1
Underlying Business Investment	-6.3	6.7	-1.1	4.6	-11.8	3.6	1.4	1.8	4.9
Underlying Public Final Demand	5.3	4.5	6.0	4.7	5.7	4.6	5.1	5.6	4.5
Domestic Demand	**2.2**	**3.4**	**2.4**	**2.2**	**1.8**	**2.9**	**3.0**	**2.0**	**2.4**
Stocks (b)	0.0	0.0	0.0	0.1	0.1	-0.1	0.1	0.1	0.0
GNE	**2.2**	**3.4**	**2.4**	**2.2**	**1.9**	**2.7**	**3.1**	**2.1**	**2.4**
Exports	5.5	4.1	3.0	3.3	6.8	3.4	5.0	2.6	2.5
Imports	4.7	7.1	1.2	3.1	0.1	7.7	4.1	1.5	3.5
GDP	**2.3**	**2.8**	**2.2**	**2.3**	**2.8**	**2.4**	**2.8**	**2.1**	**2.3**
Nominal GDP	6.2	4.7	4.4	3.8	3.9	6.1	4.9	3.5	4.3
Current Account Deficit ($b)	38	51	41	55	56	46	41	50	61
(-%) of GDP	2.2	2.8	2.1	2.8	3.3	2.6	2.1	2.6	3.0
Employment	1.5	3.0	2.3	1.3	1.7	2.4	2.7	1.8	1.1
Terms of Trade	14.3	1.6	1.4	-3.3	0.0	11.5	1.8	-3.3	-1.1
Average Earnings (Nat. Accts. Basis)	0.4	1.4	1.8	2.6	0.9	0.8	1.6	2.2	2.7
End of Period									
Total CPI	1.9	2.1	1.8	2.5	1.5	1.9	1.8	2.3	2.4
Core CPI	1.9	1.8	1.8	2.2	1.4	1.9	1.7	2.2	2.1
Unemployment Rate	5.6	5.6	5.1	5.1	5.7	5.4	5.0	5.1	5.3
RBA Cash Rate	1.50	1.50	1.50	1.00	1.50	1.50	1.50	1.00	1.00
10 Year Govt. Bonds	2.60	2.63	1.90	2.00	2.77	2.63	2.32	1.90	2.10
$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 11/03/2019	Actual *Dec-18*	Forecasts *Mar-19*	*Jun-19*	*Sep-19*	*Dec-19*	*Mar-20*	*Jun-20*	*Sep-20*	*Dec-20*
WTI oil	US$/bbl	57	66	54	59	59	64	64	69	69	69
Brent oil	US$/bbl	66	76	63	65	65	70	70	75	75	75
Tapis oil	US$/bbl	69	79	64	66	66	71	71	76	76	76
Gold	US$/ounce	1293	1230	1290	1300	1310	1350	1370	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$/tonne	96	105	95	93	98	95	93	90	88	90
Aluminium	US$/tonne	1817	1964	1865	1850	1875	1900	1925	1935	1945	1950
Copper	US$/tonne	6435	6161	6100	6250	6400	6300	6225	6150	6125	6100
Lead	US$/tonne	2057	1966	2050	1950	1900	1850	1825	1800	1750	1725
Nickel	US$/tonne	12808	11485	12000	12250	12500	12750	12600	12500	12400	12500
Zinc	US$/tonne	2779	2627	2625	2575	2500	2470	2450	2475	2450	2425
Aus LNG**	AU$/GJ	n.a.	13.6	14.0	11.8	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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