EMBARGOED UNTIL 11.30 AM WEDNESDAY 15 MAY 2019

THE FORWARD VIEW: AUSTRALIA MAY 2019

With a weaker inflation outlook, rate cuts ahead.

OVERVIEW

Our forecasts are largely unchanged from around the time of the release of the budget with the exception of a weaker inflation outlook. We still expect growth of 2.0% in 2019 and around 2¼% in 2020 and 2021. Alongside this below trend growth we forecast the unemployment rate to see little further improvement - remaining flat over 2019 before drifting up over the forecast out period. With below trend growth and ongoing spare capacity in the labour market, inflation is likely to remain weak. We expect underlying inflation to be 1.3% over 2019, before gradually picking up, but only to the bottom of the target band by the end of 2021.

We see growth being constrained overall by still weak consumption growth over the next few years, with key drivers being the impact of slow growth in incomes (due to very moderate wages growth), high debt levels and potentially some impact from the fall in house prices. We also expect a sizeable fall in dwelling investment – of around 20% - over the next two years. Against this, we still expect a ramp up in LNG exports to provide support in the near-term, as well as ongoing spending in the public sector (infrastructure and NDIS). Also helping is an expected pick-up in business investment.

A comparison of through-the-year forecasts suggests our forecasts are broadly in line with the RBA for 2019 - with the Bank forecasting 2¾% in comparison to our expectation for 2.5%. Further out, however, we are notably weaker forecasting growth closer to 2¼% while the RBA has maintained growth at 2¾%. As a result, we see a weaker labour market with the unemployment rate drifting up slowly especially into 2020 and beyond, while the RBA sees a flat profile for the unemployment rate through to end 2020 and a small improvement in 2021.

With our outlook for below trend growth, and below target inflation combined with little further improvement in the labour market, we expect the RBA to cut rates twice in 2019, taking the cash rate to a new record low of 1%. However, with the RBA still looking for an improvement in the labour market and monthly figures often volatile, we recognise that the timing of the first cut will be especially data dependent. At this point the next three meetings are clearly live and we expect a cut by at least August. We have left our call for the first cut as July, with a follow up in November. On the one hand a marked deterioration in upcoming labour market data as well as weaker national accounts partials, could see the cut brought forward to next month. Against that a cut could be delayed to August when the Bank will have observed another quarter of likely weaker GDP growth, a further update on the CPI and a revised set of staff forecasts ahead of the next SMP.

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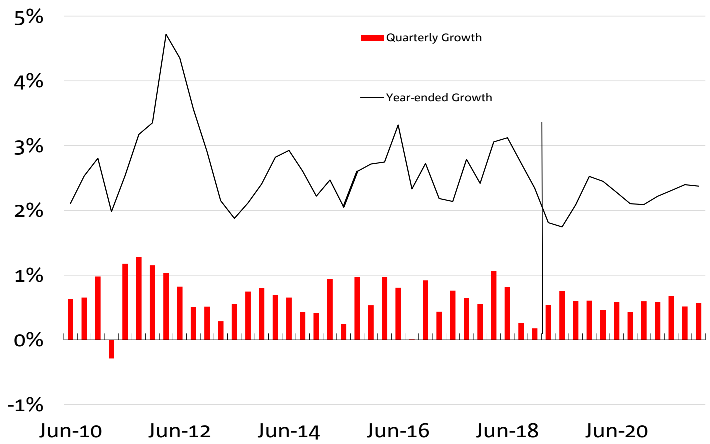
KEY ECONOMIC FORECASTS

	2018	2019-F	2020-F	2021-F
Domestic Demand (a)	3.0	2.1	2.4	2.7
Real GDP (annual average)	**2.8**	**2.0**	**2.2**	**2.3**
Real GDP (year-ended to Dec)	**2.3**	**2.5**	**2.1**	**2.4**
Terms of Trade (a)	1.8	4.9	-3.3	-1.5
Employment (a)	2.7	1.9	1.2	1.2
Unemployment Rate (b)	5.0	5.0	5.1	5.3
Headline CPI (b)	1.8	1.8	2.0	2.4
Core CPI (b)	1.8	1.3	1.8	2.1
RBA Cash Rate (b)	1.50	1.00	1.00	1.00
$A/US cents (b)	0.71	0.75	0.79	0.76

(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

Following the modest growth outcomes for household consumption over the second half of 2018, weakness in consumer spending looks to have continued into Q1 2019. Though nominal monthly retail sales growth has been volatile, the quarterly volumes measure fell by 0.1% in the March quarter. This suggests another weak quarterly outcome for consumption with retails sales accounting for around 30% of household consumption.

The NAB Cashless Retail Sales measure to be released next week will provide an early indication of how sales are tracking in early Q2. Beyond that, we expect consumption to grow only modestly over the next two years. We see ongoing household restraint, with debt remaining high, wage growth remaining low and to a lesser extent, some wealth impacts from the slowing in the housing market.

To date, the labour market has held up relatively well. The unemployment rate ticked up to 5.0% in March, with an increase in the participation rate offsetting the 26k lift in employment. Over the past year, employment has grown strongly, rising by around 300k (2.4%), mostly on a full-time basis. Unemployment is 0.5ppt lower than this time last year, but has seen no substantial improvement since September, despite the strength in employment growth.

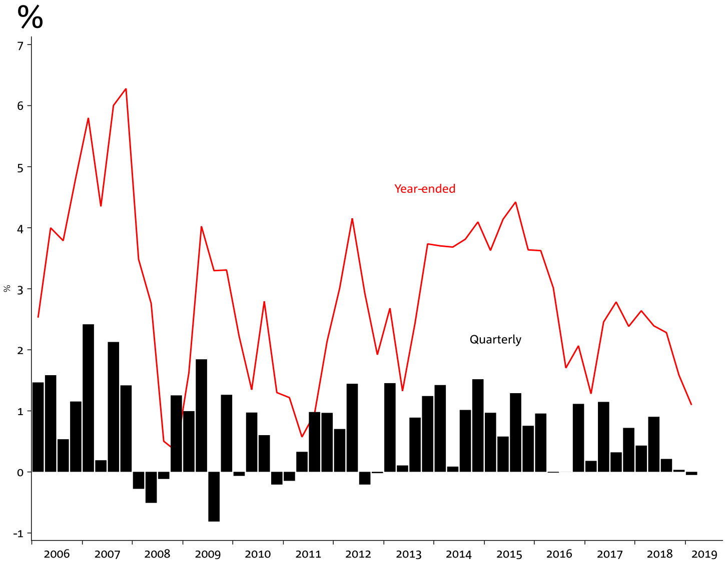
By state, the unemployment rate remains lowest in New South Wales and Victoria. In trend terms, Queensland and Western Australia have seen some improvement recently, but remain elevated at around 6%. After deteriorating recently, the unemployment rate is highest in Tasmania; South Australia has also seen some deterioration but is around 6.0%.

Going forward we expect little further improvement in the labour market, with ongoing employment growth but a broadly flat unemployment rate – before a more substantial deterioration from mid-2020. For now, unemployment remains low, but well above most estimates of the level of full-employment, as evidenced by ongoing weak wage growth.

Labour market indicators should be closely watched, as a turn in the labour market could reasonably be expected given the prior slowing in output growth. The NAB Survey measure of employment weakened in April and job ads appear to have fallen. Against this, vacancies remain high, and forward looking NAB Quarterly employment measures remain elevated – though these are now dated.

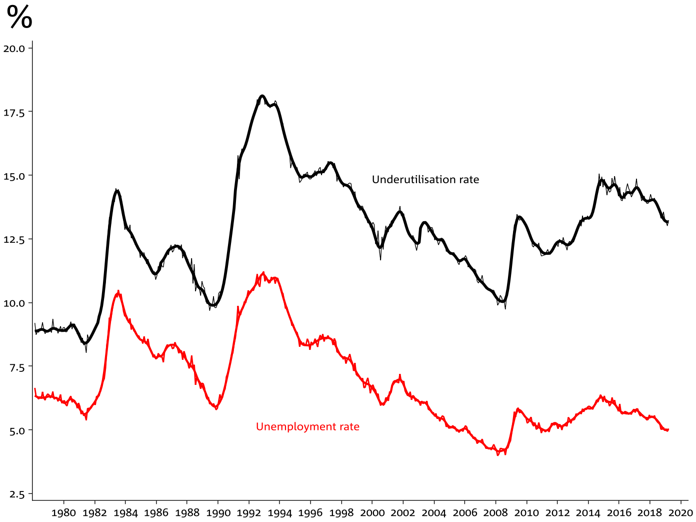
Overall, wage pressure looks to remain weak, with the Q1 WPI likely to show little pickup in wage growth and the NAB Monthly Business Survey suggesting wage costs (a wage bill measure) and input prices remain weak.

REAL RETAIL SALES GROWTH



Source: National Australia Bank, Macrobond

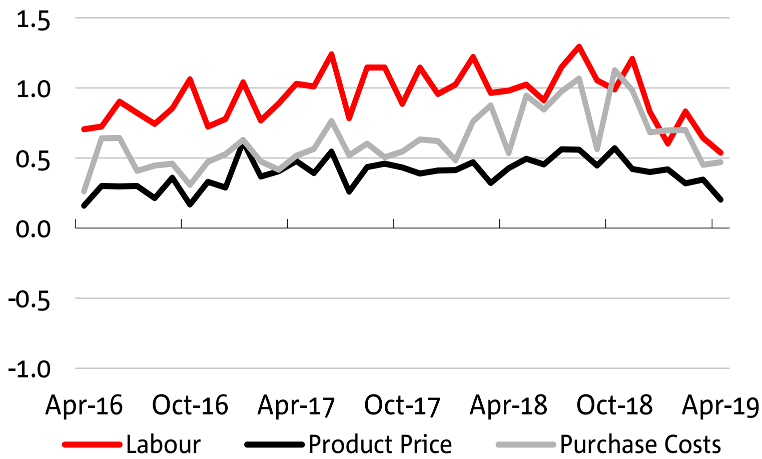
UNEMPLOYMENT AND UNDERUTILISATION



Source: National Australia Bank, Macrobond

NAB BUSINESS SURVEY PRICE PRESSURES

% change at quarterly rate



Sources: ABS, NAB Group Economics

HOUSING AND CONSTRUCTION

The impact of the downturn in the housing market appears to be affecting both output and inflation data. The cooling appears to be ongoing, with prices continuing to decline and building approvals continuing to trend down. We expect dwelling investment to record another decline in Q1 following the relatively sharp fall in the last quarter of 2018. Overall we expect dwelling investment to decline by around 20% over the next two years. Alongside this, we expect house prices to decline by another 5% nationally over 2019 and early 2020 before levelling out for a period.

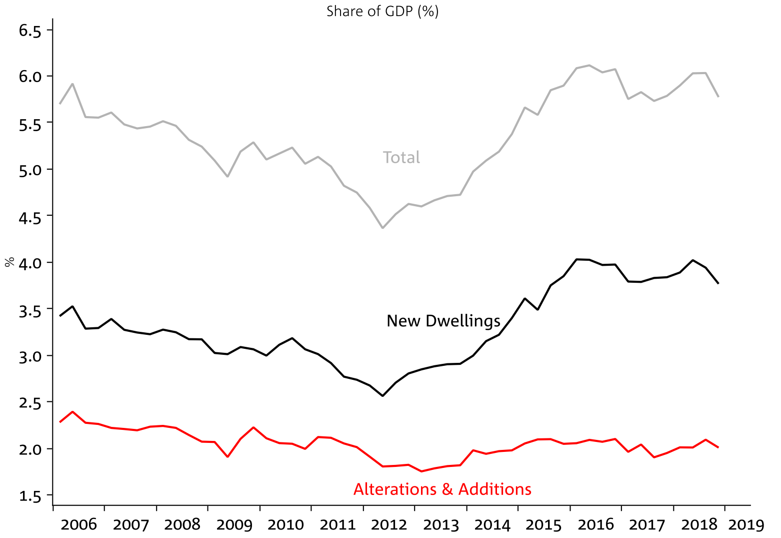
Capital city house prices have now fallen by almost 10% since peaking in late 2017. These declines have been led by Sydney (down 15%) and Melbourne (down 11%) where the role of investors is much larger and prices saw a much more significant rise. That said, recent months have seen price declines broaden to the other states, with Brisbane and Adelaide having now declined over the year in addition to the ongoing weakness in Perth. In Hobart growth has slowed, but the city remains the standout, with prices remaining well up on a year ago.

On the activity side, building approvals continued their trend decline in March, unwinding the spike a month earlier. Over the past year approvals are 27% lower and are now 37% below their peak in 2017. The decline in approvals is evident across both houses and apartments down 19% and 57% respectively from their peaks in 2017. The decline in approvals suggests that activity in the sector will weigh on growth overall as the pipeline of outstanding work is completed.

Alongside the cooling in the market, housing credit growth has continued to slow. Investor lending slowed to just 0.7% y/y in March 2019, while growth in credit extended to owner-occupiers is tracking a little higher but has slowed to 5.7%. Overall housing credit has risen by 4.0% over the past year. ABS data on the value of new loan approvals has continued to trend down suggesting that credit growth will likely weaken a little further over coming months.

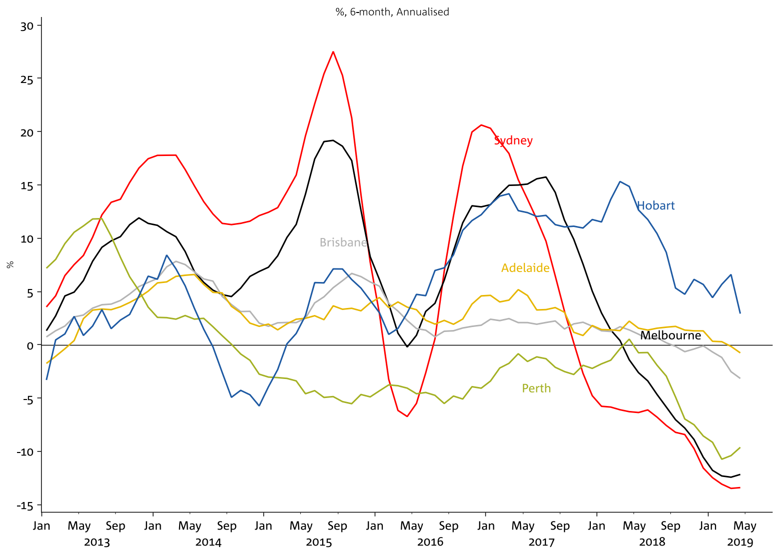
To date, the adjustment in the housing market appears to have occurred in an orderly fashion – and may have served to reduce the prior build up of risk in the sector. We see the weakness in prices as having been driven by the earlier tightening driven APRA restrictions, a waning in foreign investor demand as well as affordability constraints themselves. In addition it appears that there are some pockets of oversupply. Going further, we see the cooling in the market continuing with prices declining a little further and also a notable downturn in the construction cycle. Beyond this, we are closely watching for any additional spill overs from this sector to other sectors.

DWELLING INVESTMENT



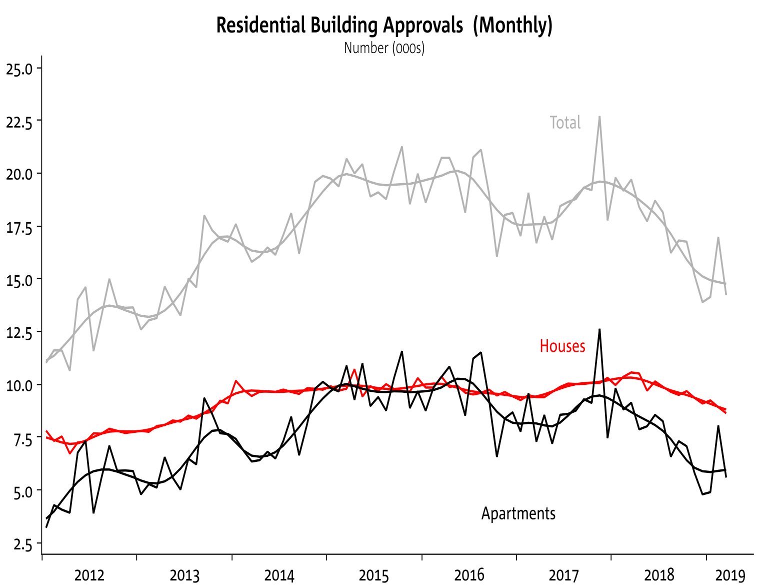
Source: National Australia Bank, Macrobond

DWELLING PRICES



Source: CoreLogic, National Australia Bank, Macrobond

RESIDENTIAL BUILDING APPROVALS



Source: National Australia Bank, Macrobond

BUSINESS AND TRADE

The outlook for the business sector is important for our overall outlook for the economy over the next few years - where we expect relatively strong growth in business investment. In the non-mining sector we expect business investment to grow relatively strongly, and see some additional support from the spill-overs from the large pipe-line of public infrastructure work currently underway. In the mining sector, we see the drag from the unwinding of the mining boom fading, as the last of large LNG projects are completed. In addition, it is possible that there is some new investment in the mining sector and greater spending on sustaining capex in order to maintain the now larger capital stock in the sector.

Most official indicators of business investment are now dated but suggest that this pattern of activity is playing out. ABS Capex data suggest an improvement in the next financial year, while the national accounts for Q4 showed an ongoing increase in the non-mining sector. While investment continued to decline in the mining sector, anecdotal evidence suggests that the end of the decline is near. An update on these indicators will be available over the next month with the release of the national accounts for Q1, along with the usual partials.

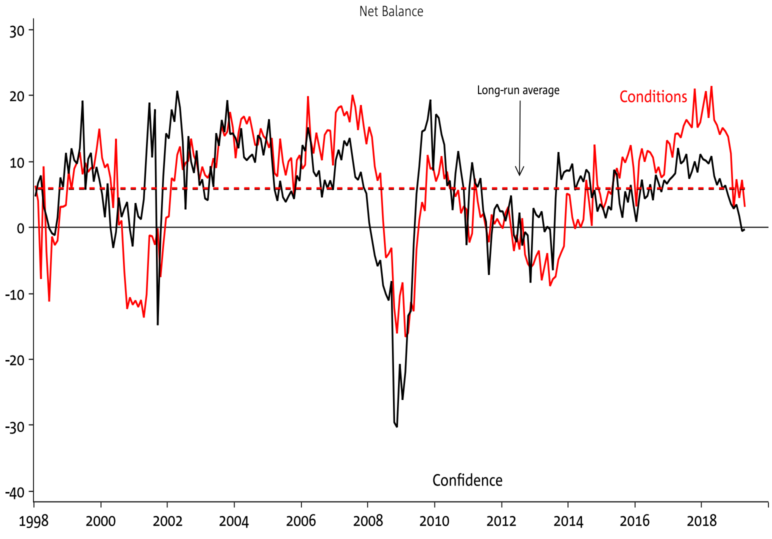
The NAB Monthly Business Survey – a higher frequency indicator – continues to suggest that there are some risks around the business outlook. The April survey saw below average prints for confidence, conditions and forward orders. Capacity utilisation has edged higher over the past two months, but remains around average levels, and well below the levels seen in 2018. As an indicator of future capex and employment intentions this suggests there is some further risk to our forecasts – indeed, for the first time, employment has showed some weakness in the survey. Lower capacity utilisation is also consistent with ongoing weak price pressures which are also evident in firms' responses to the survey.

The decline in business conditions has been broad-based across industries and states over the past 6 months and forward looking indicators suggest little improvement going forward.

Monthly trade data suggest the trade surplus widened early 2019, driven by increases in resource exports. Using these data in combination with the quarterly trade prices release suggest that net exports made a contribution of 0.2-0.3ppt to GDP growth in the March quarter.

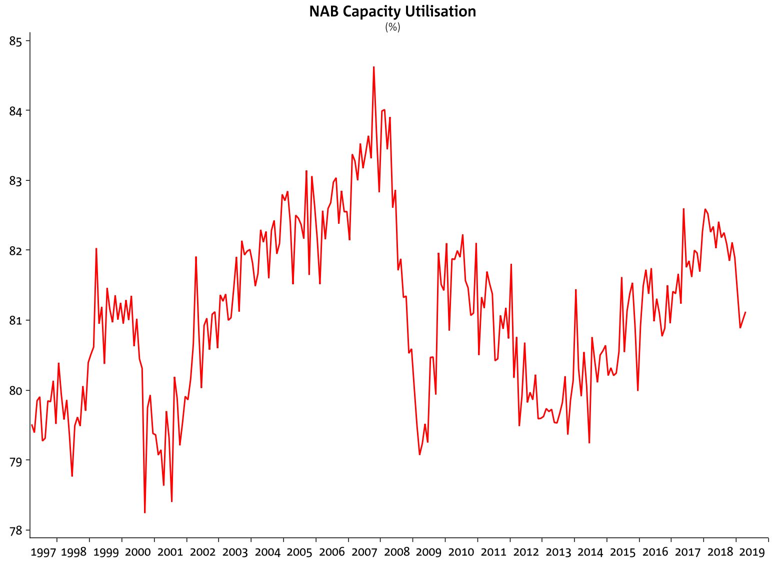
Going forward, the external sector continues to form an important part of our outlook. We expect the ramp up of the remaining LNG projects to contribute to ongoing growth in resource exports in the near term, before exports as a whole level off. There may well be some new investment in the sector over coming years, but any increase in production is likely to remain modest compared to the rise seen over recent years.

NAB SURVEY CONDITIONS AND CONFIDENCE



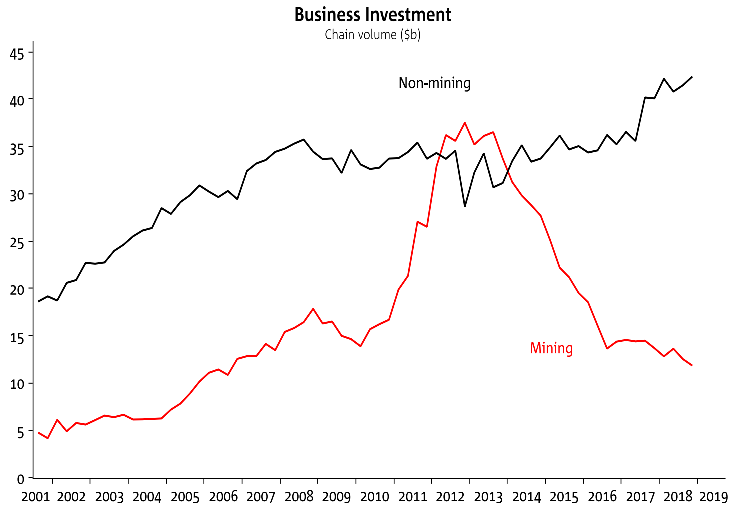
Source: National Australia Bank, Macrobond

CAPACITY UTILISATION



Source: National Australia Bank, Macrobond

BUSINESS INVESTMENT BY SECTOR



Source: National Australia Bank, Macrobond

COMMODITIES

Iron ore prices have remained at their elevated levels, reflecting the supply constraints in the market – both the medium term issues in Brazil (with first quarter sales falling by 30% yoy) and shorter term disruptions in Western Australia (due to cyclone activity). There remains some uncertainty around the resumption of Brazilian supply – with Vale suggesting that around half of the shuttered capacity could resume within a year, while some would be offline for two to three years. Our forecast is for 62% ore to average US$86 a tonne in 2019, before easing to US$72 a tonne in 2020.

Trends in coal markets remain divergent, with prices for thermal coal prices having trended down since the middle of 2018, while hard coking coal prices trended higher. That said, thermal coal prices have edged higher since mid-April, with rumours that China's customs restrictions on Australian coal are set to end this month. This was evidenced by range of Chinese private sector power generators starting to purchase Australian volumes. We forecast thermal coal prices to average US$88 a tonne in 2019 and US$90 a tonne in 2020. Hard coking coal prices are forecast to average US$185 a tonne in 2019 and US$158 a tonne in 2020.

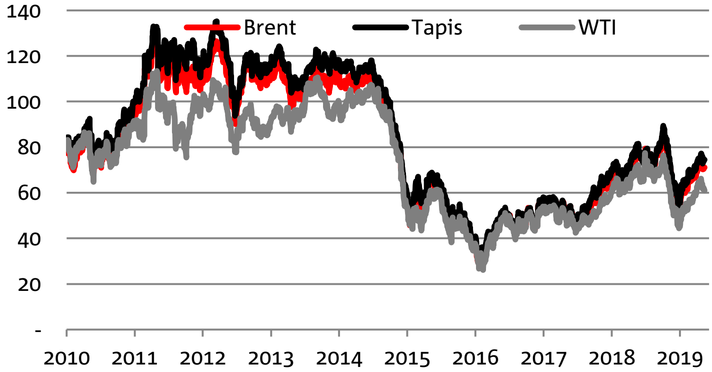
Oil prices have been generally flat to lower since a peak in late April, when Brent reached the mid 70s range. Brent has generally been in the low 70s range this month, although, the escalation in the US-China trade tensions looks to have taken a bite out of prices. Geopolitical tensions in the Strait of Hormuz have the potential to flare, providing a counterbalance to a market otherwise focussed on US-China tensions.

Our outlook for the oil market is for fairly limited further upside for prices this year, with Brent in the mid 70s range in the second half of the year. However, US-China tensions present something of a downside to this forecast.

Overall, the NAB Rural Commodities Index rose 1.1% in April, largely reflecting higher cattle, lamb, dairy and cotton prices, offsetting further declines in grain.

GLOBAL OIL PRICES

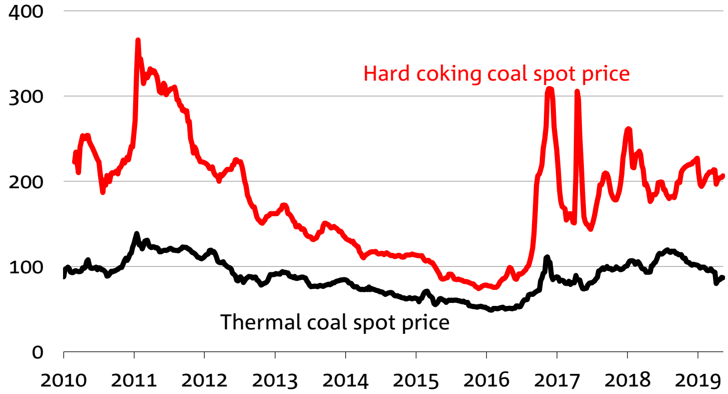
USD/bbl, daily



Sources: Refinitiv, NAB Economics

COAL SPOT PRICES

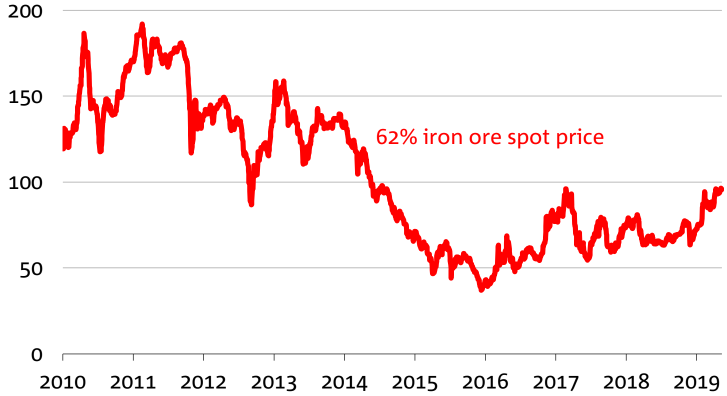
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

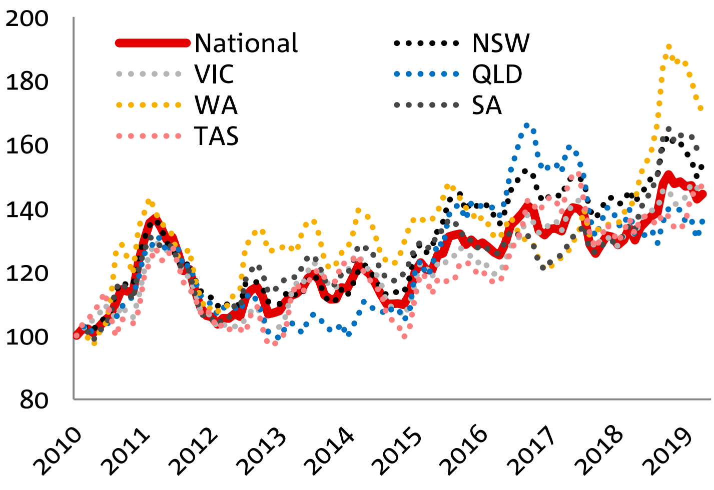
US$/t (incl. cost of freight)



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

Economy-wide inflation pressures remain muted. The headline CPI was flat in Q1 which saw the year-ended rate fall to 1.3% - well below the RBA's target of 2-3%. Underlying inflation (averaging the trimmed-mean and weighted median measures) was 0.2% in the quarter and 1.4% over the year suggesting that inflation is unlikely to sustainably reach the target band any time soon. A series of one-offs have weighed on headline inflation over the past year, including petrol prices in Q1. Nonetheless, the underlying pace of wage costs, housing costs and global inflation suggest the weakness is likely to be persistent and it is now clear, that there is some level of spare capacity in the economy.

Along side weaker growth and spare capacity in the labour market, we expect inflation to remain weak over the next few years. We expect inflation to be tracking at 1.3% by end 2019, around 1.8% in 2020 and around 2¼% in 2021. This suggests the extended run of below-the-band inflation is likely to persist for some time.

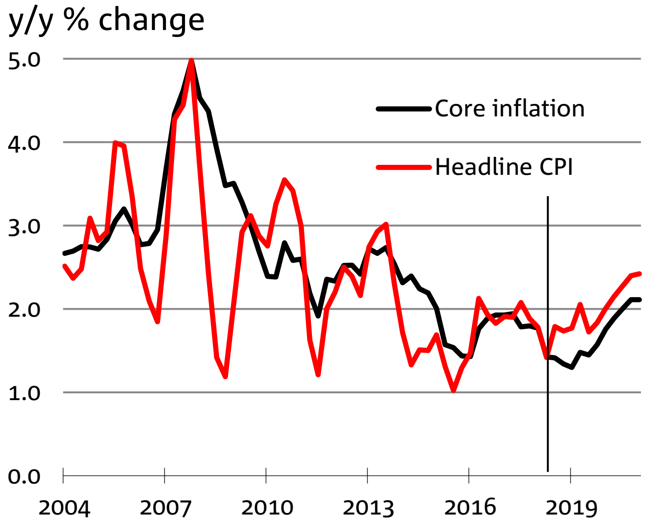
Against this back drop, the RBA left rates unchanged in April at 1.5% with market expectations of a cut at 50%. The release of the May Statement on Monetary policy saw RBA staff forecasts for both growth and inflation revised down, as well as the unemployment rate stable for a longer period, before declining slightly in 2021. Implicit in these forecasts are two rate cuts, which would see the cash rate reach 1% by sometime this year (and even then only modest improvements in output and the labour market).

In early March, we changed our cash rate call from an unchanged rate expectation, to an expected cut in July with a follow-up in November. Our view was based on our relatively weak outlook for GDP, a forecast profile for inflation that saw only a modest approach back to the RBA's target band and little further improvement in the labour market (including only a small improvement in wage growth). For now, we have left our call for July cut in place, but recognise there are some risks either side of this – given we see the timing of the call as still data dependent. A marked deterioration in upcoming labour market data as well as weaker national accounts partials, could see the cut brought forward to next month. On the other hand, the RBA could wait for an update on the CPI and a new set of staff forecasts in addition to a series of labour market updates and leading indicators (such as those contained in the Nab Survey), seeing the cut occur in August.

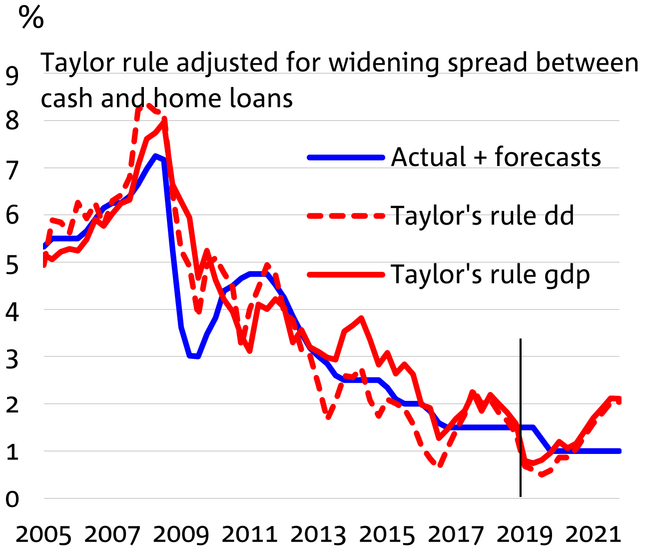
With the next three meetings from now live, we have marginally opted to keep our call for the first cut in July. We continue to see another cut by year end – with November still the most likely. At this stage we have resisted putting in another cut in 2020 but eventuation of downside risks to our forecasts – especially in the labour market and hence wages growth – could quickly change that dynamic. There are also obvious global tensions which may play out more negatively than we are currently estimating.

The AUD/USD has continued to track in the low-70c range over the past month before dipping below the 70c mark more recently on the back of escalating trade tensions. We expect the pair to gradually rise over the next few years to around the mid-70c range or higher, but it could well be the case we see a period below 70c on the back of ongoing trade ructions.

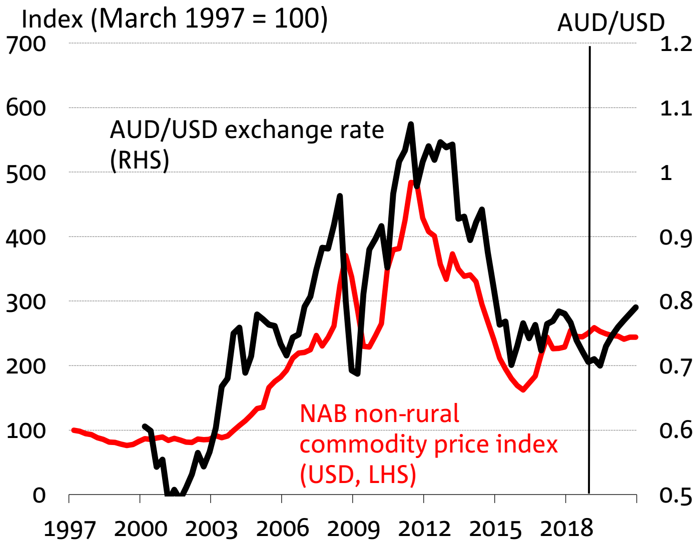
HEADLINE AND CORE INFLATION



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				
	2017-18	2018-19 F	2019-20 F	2020-21 F	2017	2018	2019-F	2020-F	2021-F
Private Consumption	2.8	2.1	2.4	2.3	2.4	2.6	2.1	2.4	2.3
Dwelling Investment	0.2	-0.4	-9.8	-5.4	-2.4	4.4	-7.8	-8.2	-1.7
Underlying Business Investment	6.7	-0.8	4.5	3.9	3.6	1.4	2.3	4.3	3.5
Underlying Public Final Demand	4.5	6.0	4.7	4.4	4.6	5.1	5.6	4.5	4.4
Domestic Demand	**3.4**	**2.4**	**2.3**	**2.5**	**2.9**	**3.0**	**2.1**	**2.4**	**2.7**
Stocks (b)	0.0	0.0	0.1	0.0	-0.1	0.1	0.0	0.0	0.0
GNE	**3.4**	**2.4**	**2.4**	**2.5**	**2.7**	**3.1**	**2.2**	**2.4**	**2.7**
Exports	4.1	2.1	2.2	1.9	3.4	5.0	0.7	2.3	2.0
Imports	7.1	0.4	2.4	3.4	7.7	4.1	0.1	3.4	3.7
GDP	**2.8**	**2.2**	**2.3**	**2.2**	**2.4**	**2.8**	**2.0**	**2.2**	**2.3**
Nominal GDP	4.7	5.2	3.7	4.0	6.1	4.9	4.8	3.4	4.2
Current Account Deficit ($b)	51	22	28	42	46	41	15	36	50
(-%) of GDP	2.8	1.1	1.4	2.0	2.6	2.1	0.8	1.7	2.4
Employment	3.0	2.3	1.4	1.1	2.4	2.7	1.9	1.2	1.2
Terms of Trade	1.6	6.1	-1.4	-1.3	11.5	1.8	4.9	-3.2	-1.5
Average Earnings (Nat. Accts. Basis)	1.4	1.8	2.6	2.8	0.8	1.6	2.2	2.7	2.8
End of Period									
Total CPI	2.1	1.8	1.7	2.3	1.9	1.8	1.8	2.0	2.4
Core CPI	1.8	1.4	1.5	2.0	1.9	1.8	1.3	1.8	2.1
Unemployment Rate	5.6	5.0	5.1	5.3	5.4	5.0	5.0	5.1	5.3
RBA Cash Rate	1.50	1.50	1.00	1.00	1.50	1.50	1.00	1.00	1.00
10 Year Govt. Bonds	2.63	1.90	2.00	2.10	2.63	2.32	1.90	2.10	2.10
$A/US cents :	0.74	0.70	0.77	0.77	0.78	0.71	0.75	0.79	0.76
$A - Trade Weighted Index	62.6	59.6	62.7	61.9	64.9	60.7	62.0	63.2	60.8

(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	13/05/2019	Mar-19	*Jun-19*	*Sep-19*	*Dec-19*	*Mar-20*	*Jun-20*	*Sep-20*	*Dec-20*
WTI oil	US$/bbl	61	54	63	64	64	64	69	69	69
Brent oil	US$/bbl	71	62	69	70	70	70	75	75	75
Tapis oil	US$/bbl	75	65	70	71	71	71	76	76	76
Gold	US$/ounce	1297	1300	1300	1310	1350	1370	1370	1380	1390
Iron ore (spot)	US$/tonne	n.a.	83	95	88	79	76	72	68	71
Hard coking coal*	US$/tonne	n.a.	202	193	178	170	165	160	155	152
Thermal coal (spot)	US$/tonne	95	95	82	85	90	93	90	88	90
Aluminium	US$/tonne	1778	1862	1850	1875	1900	1925	1935	1945	1950
Copper	US$/tonne	5987	6216	6250	6400	6300	6225	6150	6125	6100
Lead	US$/tonne	1769	2034	1950	1900	1850	1825	1800	1750	1725
Nickel	US$/tonne	11759	12365	12250	12500	12750	12600	12500	12400	12500
Zinc	US$/tonne	2708	2704	2850	2900	2850	2725	2600	2500	2400
Aus LNG**	AU$/GJ	n.a.	13.1	11.2	11.5	11.4	11.2	11.0	11.6	11.4

* Data reflect NAB estimates of US$/tonne FOB quarterly contract prices, based on quarterly average spot prices.

** Implied Australian LNG export prices

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

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