

AUSTRALIAN MARKETS WEEKLY

RBA to signal rate cuts; More evidence of spare capacity



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Shock election result sees the unexpected re-election of the Coalition government

- In a shock result, the Liberal/National Coalition won Saturday's election with a roughly 0.5% swing on a 2-party preferred basis, confounding opinion polls and betting agencies that had long pointed to a change of government. The Coalition may also be able to form majority government given that it currently holds 75 seats and is leading in 2 others (77 seats are required for a majority assuming the Coalition supplies the speaker of the house). If the Coalition is unable to form a majority government, it would again rely on the support of independents.
- In terms of policy priorities, the Coalition made relatively modest election promises during the campaign and the Treasurer has said that the focus will be on legislating the budget's personal income tax cuts, so they can take effect on 1 July. The larger tax cuts are some time off and we estimate that the cuts slated for 2019-20 equate to about 0.2% of GDP, or slightly less allowing for some leakage to imports.
- The make-up of the Senate won't be known for some time, but the Coalition will still have to negotiate with the minor parties and independents to secure the passage of legislation through parliament.

RBA expected to signal rate cuts

- We recently brought forward the timing of our first rate cut from July to June and expect that the RBA will signal easier policy in Tuesday's May Board minutes and Governor Lowe's speech, which is entitled "The economic outlook and monetary policy". We think rate cuts are warranted given April labour force data provided more evidence that the economy was weaker than the RBA had expected, where the Board had emphasised that "a further improvement in the labour market was likely to be needed for inflation to be consistent with the target".

Analysis – More evidence of spare capacity

- Recent data show the unemployment rate has risen over the past couple of months. With the RBA's focus on the divergence between the strong labour market and weak GDP growth, it will be concerned that the labour market may finally be reflecting the earlier slowdown in activity.
- With unemployment picking up, we found evidence of increased spare capacity from a range of indicators, namely: (1) the prime age unemployment rate; (2) underemployed workers; (3) the prevalence of second jobs; and (4) surveyed capacity utilisation. In contrast, a smaller number of indicators pointed to capacity usage remaining tight, namely, (1) hours sought by unemployed/underemployed workers; and (2) surveyed skill shortages.
- All this heightens our concern that inflation will continue to undershoot the Reserve Bank's 2-3% target band, where we do not expect a return to the range until mid 2021.

To contact NAB's market experts, please click on one of the following links:

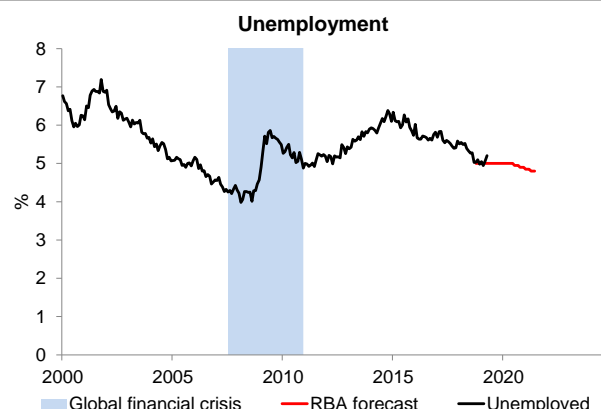
[Ask the Economists](#)
[Ask the FX Strategists](#)
[Ask the Interest Rate Strategists](#)

Key markets over the past week

	Last	% chg week		Last	bp/% chg week
AUD	0.6896	-0.6	RBA cash	1.50	0
AUD/CNY	4.75	-0.4	3y swap	1.29	-5
AUD/JPY	75.9	0.0	ASX 200	6,365	0.9
AUD/EUR	0.618	-0.1	Iron ore	98	6.4
AUD/NZD	1.057	0.0	WTI oil	63.5	3.9

Source: Bloomberg

Chart of the week: Unemployment has increased



More evidence of spare capacity

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- With unemployment picking up, we found evidence of increased spare capacity from a range of indicators, namely: (1) the prime age unemployment rate; (2) underemployed workers; (3) the prevalence of second jobs; and (4) surveyed capacity utilisation. In contrast, a smaller number of indicators pointed to capacity usage remaining tight, namely, (1) hours sought by unemployed/underemployed workers; and (2) surveyed skill shortages.
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Unemployment has risen and surveyed employment has turned negative

For some time now, the Reserve Bank has focused on the tension between the strength of the labour market and the weakness in GDP growth, where Deputy Governor Debelle had thought that the business surveys sat in between the two extremes.¹

Recently, though, both the labour force survey and the NAB business survey have deteriorated, suggesting that the labour market may finally be reflecting the earlier weakness in GDP growth.

In the case of the labour force survey, employment posted another strong increase in April, but this failed to keep pace with the number of people joining the workforce. As a result, unemployment rose again, increasing from an eight-year low of 4.9% in February to 5.2% in April.

At the same time, the NAB business survey reported weaker business conditions in April, with the employment index turning negative for the first time since 2016. Experience suggests that weak survey readings point to a risk of rising unemployment.

Chart 1: Unemployment has risen over the past couple of months

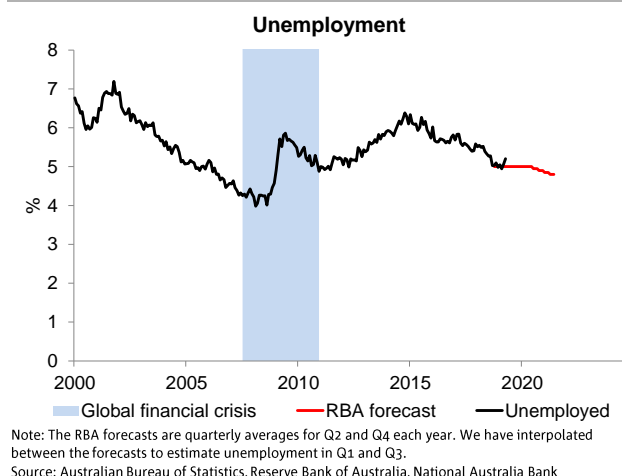
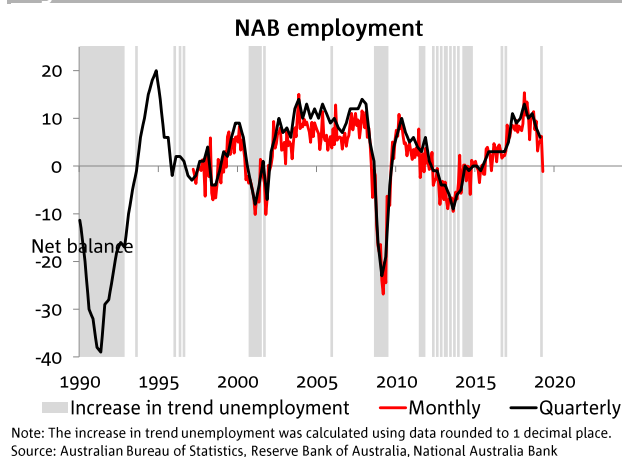


Chart 2: The NAB measure of employment has turned negative



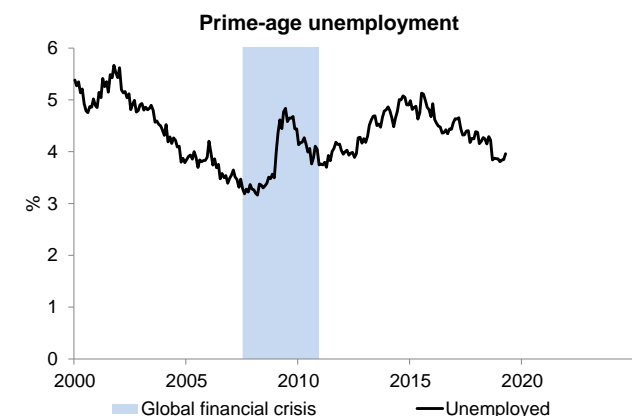
Most indicators point to increased spare capacity

With unemployment picking up, we have examined other measure of spare capacity to see if they are providing the same signal.

In terms of the series that show either unchanged or an increase in capacity:

- The prime age unemployment rate has picked up.** The prime age unemployment rate covers workers aged 25-54 years of age and is published with a slight lag. Based on the current available demographic split of unemployment, we estimate that it has picked up from 3.8% in March to 4.0% in April.

¹ See Reserve Bank Deputy Governor Debelle, *The state of the economy*, 10 April 2019.

Chart 3: The prime age unemployment rate has picked up


Note: The April 2019 observation was estimate using the unemployment rate for people aged 25-64 years old.

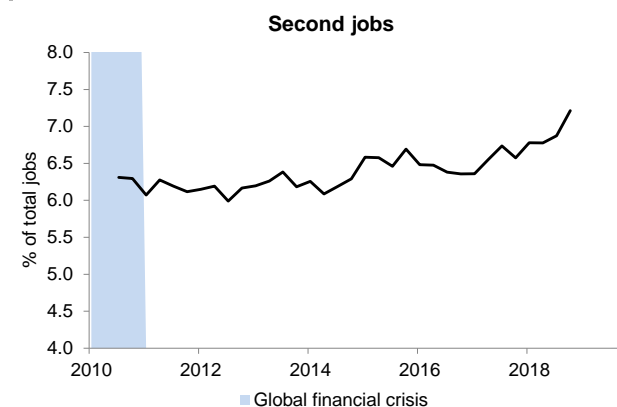
Source: Australian Bureau of Statistics, Reserve Bank of Australia, National Australia Bank

- **Underemployment has also picked up.** Underemployment, as measured using the number of workers who would like to work more hours, has risen from 8.1% of the labour force in February to 8.5% in April.

Chart 4: The number of underemployed workers has risen over recent months


Source: Australian Bureau of Statistics, National Australia Bank

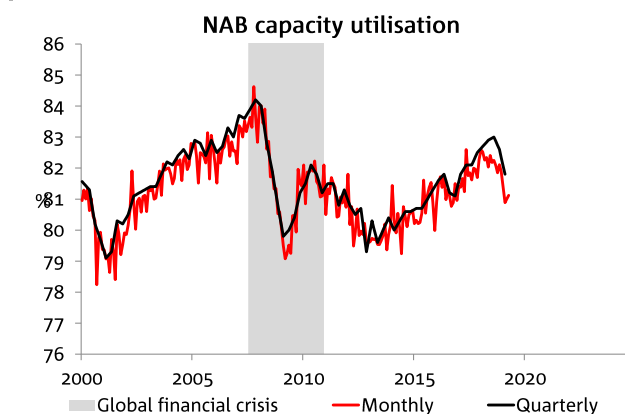
- **More people are working a second job.** The number of second jobs increased to 7.2% of all jobs at the end of 2018, which includes jobs worked by non-residents. This is the highest share since quarterly data became available in 2010.

Chart 5: More people are working a second job


Note: Total jobs= main jobs + secondary jobs

Source: Australian Bureau of Statistics, National Australia Bank

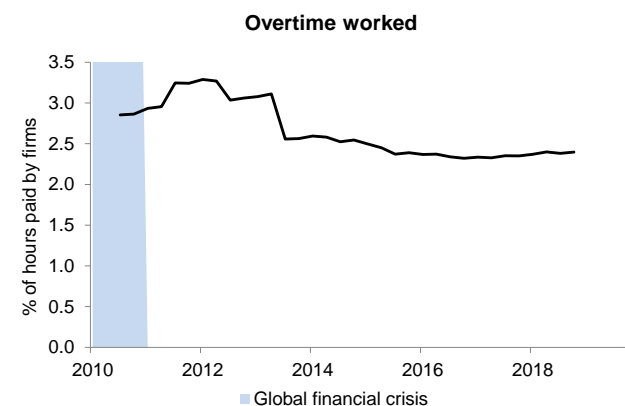
- **Capacity utilisation has declined.** The NAB business survey measure of capacity utilisation has fallen from its recent peak of 82.6% in early 2008 to 81.1% in April. This is the lowest level of capacity utilisation since 2016.

Chart 6: Surveyed capacity utilisation has fallen


Source: National Australia Bank

One indicator points to unchanged capacity.

- **Use of overtime hours remains low.** As at the end of 2018, overtime hadn't budged from 2.4% of total hours paid by companies since mid 2017.

Chart 7: The use of overtime remains low


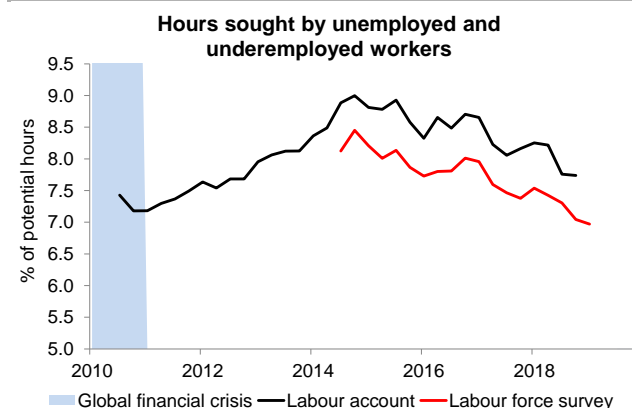
Note: Hours paid = ordinary time hours + overtime.

Source: Australian Bureau of Statistics, National Australia Bank

In terms of indicators showing capacity usage remains tight:

- **Hours sought by unemployed and underemployed workers are low relative to potential hours.** Volume measures of spare capacity are low, with hours sought by unemployed and underemployed workers unchanged at 7.0% in Q1 using household estimates. Based on a longer history that uses data from companies, this is likely the lowest level since 2012.

Chart 8: Hours sought by unemployed/underemployed workers remain low

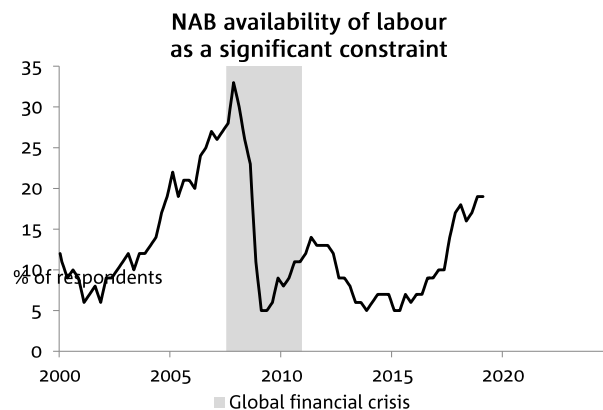


Note: Potential hours = hours worked + hours sought. The labour account measures hours worked as actual hours worked, while the labour force survey measures hours usually worked.
Source: Australian Bureau of Statistics, Reserve Bank of Australia, National Australia Bank

- **Surveyed skilled shortages are still significant.** The NAB business survey still points to skill shortages with almost 20% of firms in Q1 reporting that the availability of labour was a significant constraint. This is the highest share since the global financial

crisis and the fourth-highest share in the past fifty years.

Chart 9: The NAB business survey still points to skill shortages



Source: National Australia Bank

Broad evidence of spare capacity points to reduced pressure on inflation

With the majority of indicators pointing to increased spare capacity, this reinforces the signal from the unemployment rate. It also heightens our concern that inflation will continue to undershoot the Reserve Bank's 2-3% inflation target (we think that inflation will take until mid 2021 to return to the bottom of the band, such that the bank will have to mark down its inflation profile again when it updates its forecasts in August).

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CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEST
Monday, 20 May 2019								
NZ	Performance Services Index	Apr				52.9	22.30	8.30
JN	GDP SA QoQ	1Q P		-0.1		0.5	23.50	9.50
JN	Industrial Production MoM / YoY	Mar F		/		-0.9/-4.6	4.30	14.30
US	Chicago Fed Nat Activity Index	Apr		-0.2		-0.15	12.30	22.30
US	Fed's Harker Speaks About Management Science in Boston						13.30	23.30
US	Powell Speaks at Atlanta Fed Financial Markets Conference						23.00	9.00
Tuesday, 21 May 2019								
AU	RBA Minutes of May Policy Meeting						1.30	11.30
AU	RBA Governor Lowe Gives Speech in Brisbane						2.15	12.15
NZ	Credit Card Spending YoY	Apr				5.1	3.00	13.00
UK	BOE's Carney, Broadbent, Tenreyro, Saunders Speak in London						8.30	18.30
EC	OECD Publishes Economic Outlook						9.00	19.00
EC	Consumer Confidence	May A		-7.7		-7.9	14.00	0.00
US	Fed's Evans Discusses Economy and Monetary Policy						14.45	0.45
Wednesday, 22 May 2019								
NZ	Dairy Auction Avg. Winning Price MT	22 May	slightly lower			3490		early am
NZ	Retail Sales Ex Inflation QoQ	1Q	0.5	0.6		1.7	22.45	8.45
JN	Trade Balance	Apr		229.5		528.501	23.50	9.50
JN	Core Machine Orders MoM / YoY	Mar		0/-3.5		1.8/-5.5	23.50	9.50
AU	Westpac Leading Index MoM	Apr				0.19	0.30	10.30
AU	Construction Work Done	1Q	-2.2	0		-3.1	1.30	11.30
JN	BOJ Harada speaks in Nagasaki						1.30	11.30
US	Fed's Bullard Speaks in Hong Kong on U.S. Economic Outlook						5.00	15.00
EC	ECB President Draghi Speaks in Frankfurt						7.00	17.00
UK	CPI MoM / YoY	Apr		0.7/2.2		0.2/1.9	8.30	18.30
UK	PSNB ex Banking Groups	Apr		5.9		1.7	8.30	18.30
EC	ECB Chief Economist Praet Speaks in Frankfurt						9.30	19.30
CA	Retail Sales MoM / Ex Auto MoM	Mar		1/0.8		0.8/0.6	12.30	22.30
US	Fed's Williams Hosts Economic Press Briefing						14.00	0.00
US	Fed's Bostic Makes Opening Remarks at Dallas Fed Conference						14.10	0.10
US	FOMC Meeting Minutes	1 May					18.00	4.00
Thursday, 23 May 2019								
JN	Nikkei Japan PMI Mfg	May P				50.2	0.30	10.30
GE	GDP WDA YoY	1Q F		0.7		0.7	6.00	16.00
JN	Machine Tool Orders YoY	Apr F				-33.4	6.00	16.00
GE	Markit/BME Germany Manufacturing PMI / Services PMI	May P		44.8/55.4		44.4/55.7	7.30	17.30
EC	Markit Eurozone Manufacturing PMI	May P		48.1		47.9	8.00	18.00
GE	IFO Business Climate	May		99.2		99.2	8.00	18.00
EC	ECB Releases Minutes of its April Monetary Policy Meeting						11.30	21.30
CA	Wholesale Trade Sales MoM	Mar		0.8		0.3	12.30	22.30
US	Initial Jobless Claims	18 May		215		212	12.30	22.30
US	Markit US Manufacturing PMI / Services PMI	May P		52.7/53.5		52.6/53	13.45	23.45
US	New Home Sales	Apr		670		692	14.00	0.00
US	Fed's Kaplan, Daly, Bostic and Barkin Speak on Panel						17.00	3.00
Friday, 24 May 2019								
NZ	Trade Balance NZD	Apr	300	400		922	22.45	8.45
JN	Natl CPI YoY	Apr		0.9		0.5	23.30	9.30
JN	All Industry Activity Index MoM	Mar		-0.2		-0.2	5.30	15.30
UK	Retail Sales Inc Auto Fuel MoM / YoY	Apr		-0.3/4.5		1.1/6.7	8.30	18.30
US	Durable Goods Orders	Apr P		-2		2.6	12.30	22.30
Upcoming Central Bank Interest Rate Announcements								
Canada, BoC		29-May	1.75%	1.75%		1.75%		
Australia, RBA		4-Jun	1.25%	1.5%		1.5%		
Europe, ECB		6-Jun	-0.4%	-0.4%		-0.4%		
US, Federal Reserve		19-Jun	2.25-2.5%	2.25-2.5%		2.25-2.5%		
UK, BOE		20-Jun	0.75%	0.75%		0.75%		
Japan, BoJ		20-Jun	-0.1%	-0.1%		-0.1%		
New Zealand, RBNZ		26-Jun	1.50%	1.5%		1.5%		

GMT: Greenwich Mean Time; AEST: Australian Eastern Standard Time

FORECASTS

Economic Forecasts

		Annual % change						Quarterly % change											
		2018						2019				2020				2021			
Australia Forecasts	2018	2019	2020	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Household Consumption	2.6	2.2	2.4	0.4	0.9	0.3	0.4	0.5	0.7	0.6	0.6	0.6	0.6	0.6	0.5	0.6	0.6	0.6	0.5
Underlying Business Investment	1.4	2.2	4.3	0.9	-1.1	-1.8	0.4	1.3	1.3	0.8	1.6	0.5	1.7	0.4	1.5	0.5	1.1	0.6	0.4
Residential Construction	4.4	-7.8	-8.1	3.4	2.2	0.5	-3.4	-2.1	-3.0	-2.9	-2.1	-2.1	-1.8	-1.9	-0.9	-0.2	0.4	0.2	0.8
Underlying Public Spending	5.1	5.6	4.5	1.6	0.6	2.5	1.4	1.4	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Exports	5.0	0.7	2.3	4.1	1.3	-0.1	-0.7	-0.7	1.3	1.0	0.5	0.4	0.4	0.3	0.6	0.5	0.5	0.4	0.6
Imports	4.2	0.7	3.4	1.8	0.6	-1.0	0.1	-0.4	0.9	0.7	1.0	0.7	1.0	0.7	0.9	0.9	1.1	0.9	0.9
Net Exports (a)	0.2	0.0	-0.2	0.5	0.1	0.2	-0.2	-0.1	0.1	0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Inventories (a)	0.0	-0.1	0.0	0.1	0.1	-0.3	0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
Domestic Demand - qtr%				0.9	0.7	0.5	0.3	0.6	0.6	0.5	0.7	0.5	0.7	0.5	0.7	0.6	0.8	0.7	0.7
Dom Demand - ann %	3.0	1.9	2.4	3.4	3.3	2.9	2.5	1.7	1.6	2.0	2.4	2.3	2.4	2.4	2.4	2.5	2.6	2.8	2.8
Real GDP - % q/q				1.1	0.8	0.3	0.2	0.5	0.8	0.5	0.6	0.4	0.6	0.4	0.6	0.5	0.7	0.6	0.5
Real GDP - % y/y	2.8	2.1	2.2	3.1	3.1	2.7	2.3	1.9	1.8	2.2	2.5	2.4	2.2	2.1	2.1	2.2	2.3	2.4	2.3
CPI headline - qtr %				0.4	0.4	0.4	0.5	0.0	0.4	0.5	0.6	0.4	0.4	0.5	0.7	0.5	0.5	0.6	0.8
CPI headline - ann %	1.9	1.4	1.9	1.9	2.1	1.9	1.8	1.4	1.4	1.4	1.5	1.9	1.9	1.9	2.0	2.2	2.3	2.4	2.4
CPI underlying - qtr %				0.5	0.5	0.4	0.4	0.2	0.4	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5
CPI underlying - ann %	1.8	1.3	1.6	1.9	1.8	1.8	1.8	1.4	1.3	1.3	1.3	1.5	1.5	1.6	1.8	1.9	2.0	2.1	2.1
Wages (Pvte WPI - qtr %)				0.5	0.6	0.5	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Wages (Pvte WPI - ann %)	2.1	2.5	2.7	1.9	2.1	2.1	2.3	2.4	2.4	2.5	2.6	2.6	2.7	2.7	2.8	2.8	2.8	2.8	2.8
Unemployment Rate (%)	5.3	5.0	5.2	5.5	5.6	5.1	5.0	5.0	5.0	5.0	5.0	5.1	5.1	5.2	5.2	5.2	5.3	5.3	5.3
Terms of trade	1.5	0.0	-0.3	3.1	-1.1	0.9	3.1	4.8	-1.2	-2.2	-1.3	-0.4	-0.9	0.4	-0.2	-0.2	-0.8	-0.8	-0.5
G&S trade balance, \$Abn	22.1	45.1	25.2	4.1	3.8	5.8	8.4	13.5	12.8	10.5	8.4	7.6	6.0	6.1	5.5	4.9	3.4	2.0	1.3
% of GDP	1.2	2.3	1.2	0.9	0.8	1.2	1.7	2.7	2.6	2.1	1.7	1.5	1.2	1.2	1.1	0.9	0.6	0.4	0.2
Current Account (% GDP)	-2.1	-0.9	-1.9	-2.3	-2.5	-2.3	-1.5	-0.4	-0.6	-1.0	-1.5	-1.6	-1.9	-1.9	-2.0	-2.1	-2.4	-2.6	-2.8

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

Exchange Rate Forecasts

	20-May	Jun-19	Sep-19	Dec-19	Mar-20
Majors					
AUD/USD	0.6896	0.70	0.73	0.75	0.76
NZD/USD	0.6527	0.67	0.69	0.70	0.70
USD/JPY	110.02	113	110	108	107
EUR/USD	1.1166	1.13	1.14	1.16	1.18
GBP/USD	1.2726	1.33	1.35	1.38	1.40
USD/CHF	1.0106	0.98	0.99	0.97	0.98
USD/CAD	1.3452	1.33	1.33	1.27	1.25
USD/CNY	6.9179	6.85	6.68	6.60	6.50

Australian Cross Rates

AUD/NZD	1.0565	1.04	1.06	1.07	1.09
AUD/JPY	75.9	79	80	81	81
AUD/EUR	0.6176	0.62	0.64	0.65	0.64
AUD/GBP	0.5419	0.53	0.54	0.54	0.54
AUD/CNY	4.7706	4.80	4.88	4.95	4.94
AUD/CAD	0.9276	0.93	0.97	0.95	0.95
AUD/CHF	0.6969	0.69	0.72	0.73	0.74

Interest Rate Forecasts

	20-May	Jun-19	Sep-19	Dec-19	Mar-20
Australia Rates					
RBA Cash rate	1.50	1.50	1.25	1.00	1.00
3 month bill rate	1.56	1.60	1.35	1.20	na
3 Year Swap Rate	1.28	1.45	1.35	1.35	1.40
10 Year Swap Rate	1.89	2.08	2.08	2.08	2.20

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	-0.40	-0.20
BoE repo rate	0.75	0.75	0.75	1.00	1.00
BoJ excess reserves rate	-0.10	-0.10	-0.10	-0.10	-0.10
RBNZ OCR	1.50	1.50	1.50	1.25	1.25
China 1yr lending rate	4.35	4.35	4.35	4.35	4.35
China Reserve Ratio	13.5	12.5	12.0	12.0	12.0

10-year Benchmark Bond Yields

Australia	1.64	1.90	1.90	1.90	2.00
United States	2.39	2.60	2.70	2.80	2.80
New Zealand	1.79	3.10	3.20	3.30	3.40

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP

	2015	2016	2017	2018	2019	2020	20 Yr Avg
Dec year							
Australia	2.5	2.8	2.4	2.8	2.1	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	1.8	1.2	1.6	1.5
UK	2.3	1.8	1.8	1.4	1.3	1.6	2.4
Japan	1.3	0.6	1.9	0.8	0.5	0.7	0.8
China	6.9	6.7	6.9	6.6	6.3	6.0	9.2
India	8.2	7.1	6.7	7.3	7.1	7.2	6.6
New Zealand	3.5	3.9	3.1	2.8	2.4	2.6	3.0
World	3.5	3.3	3.8	3.7	3.5	3.5	3.5
MTP Top 5	4.1	3.7	4.3	4.0	3.5	3.4	5.0

Commodity prices (\$US)

	20-May	Jun-19	Sep-19	Dec-19	Dec-20
Brent oil	73.1	68	68	70	75
Gold	1279	1300	1300	1310	1380
Iron ore	96	88	79	76	69
Met coal	n.a.	193	178	170	152
Thermal coal	n.a.	82	85	90	93
Copper	6033	6250	6400	6300	6225
Aust LNG (*)	n.a.	11.9	11.9	11.9	12.1

(*) Implied Australian LNG export prices.

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