11 June 2019

AUSTRALIAN MARKETS WEEKLY

RBA calls for government support to help reduce unemployment

In this issue

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Analysis – RBA calls for government support to help reduce unemployment

- With the RBA embarking on a new easing cycle, Governor Lowe has said that reducing unemployment to the bank's 4.5% estimate of the NAIRU should return inflation to the 2-3% target band. At the same time, Lowe repeated his call for government support in achieving this goal, via fiscal stimulus (including spending on infrastructure) and structural policies.
- Given interest rates are already at very low levels, government intervention would be helpful, particularly measures aimed at boosting Australia's dismal labour productivity, which is growing at the slowest trend rate in decades. Labour productivity has been restrained by: (1) recession-like growth in the capital stock, which is the product of years of underinvestment by companies; (2) slow growth in the world technological frontier; and (3) an absence of lasting reforms over the past two decades.
- Weighing up these options, we think any government rethink on fiscal policy will feature infrastructure spending given the appetite for reform seems low. The downside to infrastructure spending is the lags involved, where the experience of spending on schools during the global financial crisis shows that even the most "shovel-ready" projects can take time to have an effect, such that the burden of delivering timely stimulus is still likely to be borne by the Reserve Bank cutting interest rates.

The week ahead – Temporary election workers boost May employment

- Thursday's labour market data are key for financial markets given the RBA's repeated emphasis on the importance of the unemployment rate for near-term policy. NAB is forecasting a strong report given the employment boost from temporary workers hired to run the federal election. We expect employment grew by 40k in May and the unemployment rate ticked down to 5.1%. If we are wrong and unemployment increases again, then the market would price in more risk of a July rate cut. RBA Assistant Governor (Economic) Ellis is speaking on "Watching the Invisibles" and we expect she'll discuss the theoretical policy concepts of the NAIRU and the neutral interest rate, suggesting that both have fallen over recent years.

Updated FX forecasts – Revising our AUD forecasts

- Our FX Strategy team has made some modest adjustments to our AUD forecasts given that an early resolution of the US-China trade dispute looks unlikely. The AUD/USD is now forecast to be 0.73 at end-2019, down from 0.75 previously. Support for a firmer AUD is still seen coming from both a weaker USD trend that now looks to be under way, and key Australian export prices, assuming China pulls policy levers (other than the currency) to keep growth on an even keel in the absence of an early de-escalation in trade tensions. There are also some modest adjustments to our AUD cross-rate forecasts, as detailed on page 6.

Key markets over the past week

	Last	% chg week		Last	bp/% chg week
AUD	0.6950	-0.6	RBA cash	1.25	-25
AUD/CNY	4.80	-0.5	3y swap	1.14	-9
AUD/JPY	75.5	-0.2	ASX 200	6,542	3.5
AUD/EUR	0.614	-1.2	Iron ore	100	6.0
AUD/NZD	1.054	-0.4	WTI oil	53.6	0.2

Source: Bloomberg

Chart of the week: Productivity growth has been dismal

Kieran Davies

RBA calls for government support to help reduce unemployment

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The RBA Governor wants unemployment to fall towards 4.5%, again calling for government support

With the Reserve Bank embarking on a new easing cycle, Governor Lowe stated he now believes that the economy can "sustain an unemployment rate of 4 point something", with Lowe confident that inflation will return to the 2-3% target band if unemployment can reach the bank's downwardly-revised NAIRU of 4.5%.[1]

At the same time, the governor again acknowledged that current policy settings might not be sufficiently stimulatory to reduce unemployment, which would add to the case for another rate cut ("monetary policy … [would] have an important role to play [in this situation and the] capacity to play that role if needed").

Lowe cautioned, though, that there were downsides to relying only on interest rates with "limitations on what, realistically, can be achieved", even as he suggested that the Reserve Bank might have more room to move on rates than previously thought (he indicated that the effective lower bound for the cash rate could be a "reasonable amount lower" than the current rate of 1.25%, citing that policy rates had reached 0.25-0.5% in the UK, the USA and Canada).

Accordingly, he again laid the case for a rethink on fiscal policy as a way of lowering unemployment, highlighting the options of:

- Fiscal stimulus, including through spending on infrastructure, which can add to demand and increase the economy's productive capacity.
- Structural policies that support firms expanding, investing, innovating and employing people.

[1] See Reserve Bank Governor Lowe, *Today's reduction in the cash rate* and *Transcript of Q& A session, 4* June 2019.

Policies to boost demand and supply in the economy would be helpful given dismal productivity growth

Given interest rates are already at a low level, we think government intervention would be helpful, particularly measures that boost demand and supply in the economy. The downside to such policies is that they typically take time both to be implemented and boost growth.

The case for such policies is clear from analysing Australia's productivity performance, where productivity is a key driver of both economic growth and household incomes.

On our calculation, labour productivity is currently growing at a trend rate of only 0.7% per annum. Trend estimates can be revised as more data become available, but this is the slowest growth in the past fifty years, matching the low reached in the late 1980s just before the economy tipped into recession.

The story is much the same if we exclude the resources boom from the calculation. Non-mining labour productivity is growing at a trend rate of 0.5% per annum, slightly above the multi-decade low of 0.4% reached in the late 1980s.

Chart 1: Labour productivity growth has been dismal

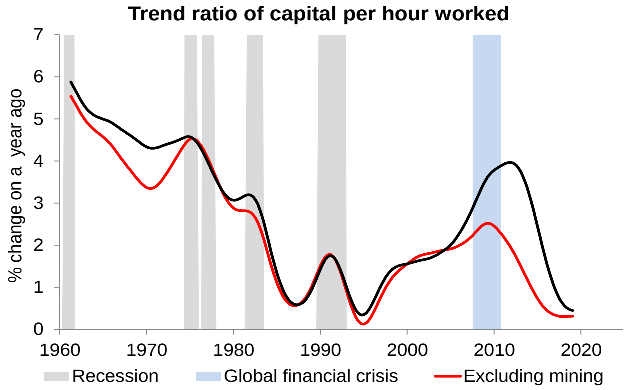
Note: Labour productivity = output / total hours worked. Trends were calculated using a HP filter.
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

Dismal productivity reflects very weak investment over recent years

Labour productivity can be boosted by either increasing capital per worker (ie. "capital deepening") or using the existing capital stock and workforce more efficiently (ie. technological progress).

The ratio of capital per worker – or rather per hour worked – is barely growing in trend terms, up 0.4% over the past year for both the whole economy and excluding the mining sector. This is the weakest growth in decades, almost matching the low reached after the early 1990s recession, when companies prioritised repairing their heavily-indebted balance sheets over undertaking investment.

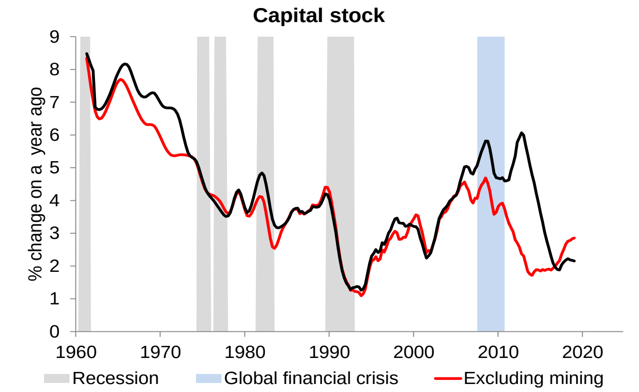
Chart 2: Labour productivity has been held back by very weak capital per worker



Note: Ratio of capital per hour worked = real capital stock / total hours worked. Trends were calculated using a HP filter.
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

The weakness in capital per worker has reflected recession-like growth in the capital stock as companies underinvested over the 2010s. Growth in the total capital stock – covering both the non-defence public and private sectors – continues to languish at 2%, although growth in the non-mining capital stock has picked up to 3% after holding at 2% for most of this decade. The long-awaited recovery in non-mining investment is a very positive development, although to date it has been outpaced by strong growth in hours worked.

Chart 3: The capital stock has been growing at a recession-like rate



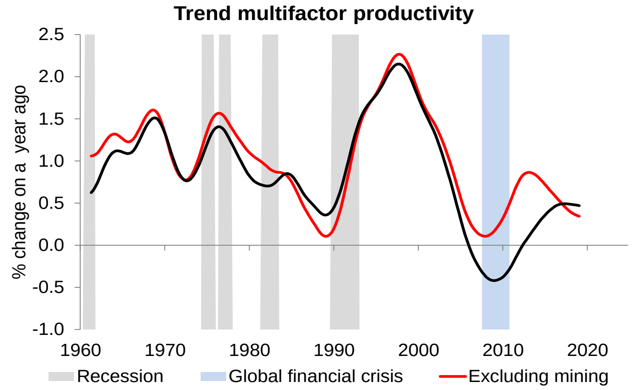
Note: The capital stock excludes livestock and art.
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

Technological progress has been subpar given weak growth in the world frontier and a lack of domestic reform

The efficiency with which capital and labour are used by firms and government is measured by multifactor productivity. Like capital per worker, multifactor productivity has also held back labour productivity over recent years.

Economy-wide multifactor productivity actually fell in trend terms during the global financial crisis and almost stalled excluding the mining sector. Trend growth has since recovered to 0.5%, or 0.3% excluding mining, which is only slightly above the multi-decade lows reached in the late 1980s.

Chart 4: Growth in multifactor productivity is extremely weak

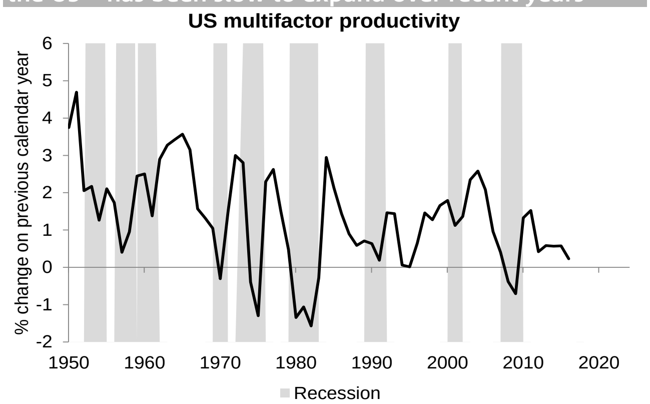


Note: Multifactor productivity is derived as a residual from a Cobb-Douglas production function. Trends were calculated using a HP filter.
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

We suspect that this weakness reflects global and domestic factors.

- Globally, the technological frontier – as proxied by US multifactor productivity – has grown at a modest rate since the global financial crisis, well short of the increases seen in the 2000s during the tech boom.
- Domestically, the last major reform was the introduction of the goods and services tax in 2000. There have been more recent attempts at tax reform, such as the mining super profits tax and the carbon tax, but none have lasted.

Chart 5: The world technological frontier – as proxied by the US – has been slow to expand over recent years



Source: Bureau of Labor Statistics, National Bureau of Economic Research, National Australia Bank

Infrastructure spending will take time to boost growth

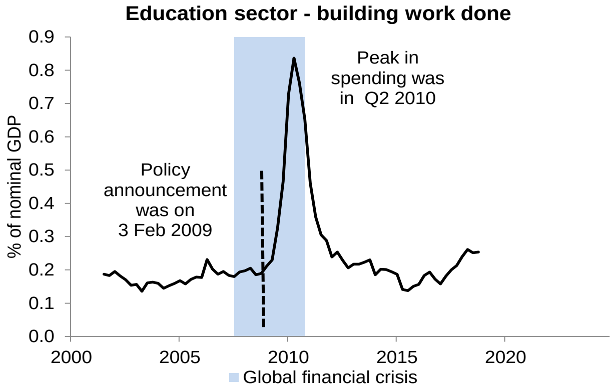
Considering the drivers of productivity and hence growth and incomes, we think any government support from fiscal policy will feature infrastructure spending given the appetite for reform seems low.

While targeted infrastructure spending provides both a direct and indirect boost to growth, we are mindful that even the most "shovel-ready" projects can take longer than expected to have an impact.

For example, the increased spending on schools during the global financial crisis, where planning approvals were already in place, took about four months from the announcement date to start flowing through to GDP and the peak boost to growth was over a year later.

This leads us to believe that in the near term the Reserve Bank is more likely to bear the brunt of delivering more timely stimulus by lowering interest rates.

Chart 6: Experience shows that infrasructure spending takes time to implement



Note: Seasonally adjusted by NAB.
Source: Australian Bureau of Statistics, Treasury, National Australia Bank

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CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEST
Tuesday, 11 June 2019								
UK	ILO Unemployment Rate 3Mths	Apr		3.8		3.8	8.30	18.30
EC	Bank of England's Tenreyro Speaks at Conference in Lisbon						9.00	19.00
US	NFIB Small Business Optimism	May		102		103.5	10.00	20.00
US	PPI Final Demand MoM / YoY	May		0.1/2		0.2/2.2	12.30	22.30
Wednesday, 12 June 2019								
NZ	Net Migration SA	Apr				5020	22.45	8.45
AU	RBA's Kent Speaks in Melbourne						23.25	9.25
JN	PPI MoM / YoY	May		0/0.7		0.3/1.2	23.50	9.50
JN	Core Machine Orders MoM / YoY	Apr		-0.8/-5.3		3.8/-0.7	23.50	9.50
AU	Westpac Consumer Conf Index	Jun				101.3	0.30	10.30
CH	CPI YoY / PPI YoY	May		2.7/0.6		2.5/0.9	1.30	11.30
EC	ECB President Draghi Speaks in Frankfurt						8.15	18.15
AU	RBA's Ellis Speaks in Melbourne						9.00	19.00
EC	ECB Vice President Guindos Speaks in Frankfurt						9.00	19.00
US	MBA Mortgage Applications	7 Jun				1.5	11.00	21.00
US	CPI MoM / YoY	May		0.1/1.9		0.3/2	12.30	22.30
US	CPI Ex Food and Energy MoM / YoY	May		0.2/2.1		0.1/2.1	12.30	22.30
Thursday, 13 June 2019								
AU	Consumer Inflation Expectation	Jun				3.3	1.00	11.00
AU	Employment Change / Unemployment Rate	May	40/5.1	16/5.1		28.4/5.2	1.30	11.30
AU	Participation Rate	May	65.9	65.8		65.8	1.30	11.30
GE	CPI MoM / YoY	May F		0.2/1.4		0.2/1.4	6.00	16.00
EC	Industrial Production SA MoM / YoY	Apr		-0.5/-0.6		-0.3/-0.6	9.00	19.00
US	Initial Jobless Claims	8 Jun		215		218	12.30	22.30
Friday, 14 June 2019								
NZ	BusinessNZ Manufacturing PMI	May				53	22.30	8.30
NZ	Food Prices MoM	May				-0.1	22.45	8.45
CH	Fixed Assets Ex Rural YTD YoY	May		6.1		6.1	2.00	12.00
CH	Industrial Production YoY	May		5.4		5.4	2.00	12.00
CH	Retail Sales YoY	May		8.1		7.2	2.00	12.00
CH	Property Investment YTD YoY	May				11.9	2.00	12.00
JN	Industrial Production MoM / YoY	Apr F		/		0.6/-1.1	4.30	14.30
US	Retail Sales Advance MoM / Ex Auto and Gas	May		0.6/0.4		-0.2/-0.2	12.30	22.30
US	Industrial Production MoM	May		0.2		-0.5	13.15	23.15
US	Capacity Utilization	May		78		77.9	13.15	23.15
US	U. of Mich. Sentiment / Expectations	Jun P		98/92		100/93.5	14.00	0.00
Upcoming Central Bank Interest Rate Announcements								
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%		
Australia, RBA		2-Jul	1.25%	1.5%		1.25%		
Canada, BoC		10-Jul	1.75%	1.75%		1.75%		
Europe, ECB		25-Jul	-0.4%	-0.4%		-0.4%		

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**	**2021**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
Household Consumption	2.6	1.7	2.4	2.3	0.4	0.9	0.3	0.4	0.4	0.3	0.5	0.6	0.7	0.6	0.6	0.5	0.6	0.7	0.6	0.5
Underlying Business Investment	1.4	1.1	4.4	3.5	0.9	-1.1	-1.8	0.4	0.3	1.0	1.3	1.4	0.6	1.6	0.5	1.5	0.6	1.1	0.4	0.6
Residential Construction	4.4	-8.4	-7.7	-1.4	3.4	2.2	0.5	-3.4	-2.7	-2.9	-2.9	-2.0	-1.9	-1.6	-1.8	-0.8	-0.2	0.5	0.2	0.8
Underlying Public Spending	5.1	5.1	4.4	4.4	1.6	0.6	2.5	1.4	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.0	1.0	1.1
Net Exports (a)	0.7	0.4	-0.3	-0.4	0.5	0.1	0.2	-0.2	0.2	0.2	0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Inventories (a)	0.1	0.0	0.1	0.0	0.0	0.1	-0.3	0.2	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic Demand (q/q %)	--	--	--	--	0.9	0.7	0.5	0.3	0.3	0.3	0.5	0.7	0.6	0.6	0.6	0.7	0.7	0.8	0.6	0.7
Dom Demand (y/y %)	3.0	1.6	2.4	2.7	3.4	3.3	2.9	2.5	1.9	1.5	1.4	1.8	2.1	2.4	2.5	2.5	2.6	2.7	2.8	2.8
Real GDP (q/q %)	--	--	--	--	1.1	0.8	0.3	0.2	0.4	0.6	0.6	0.6	0.5	0.6	0.4	0.6	0.6	0.7	0.5	0.6
Real GDP (y/y %)	2.8	1.7	2.3	2.3	3.1	3.1	2.7	2.3	1.6	1.4	1.7	2.2	2.4	2.3	2.2	2.2	2.2	2.4	2.4	2.4
CPI headline (q/q %)	--	--	--	--	0.4	0.4	0.4	0.5	0.1	0.7	0.4	0.6	0.4	0.4	0.5	0.7	0.5	0.5	0.6	0.7
CPI headline (y/y %)	1.9	1.7	1.9	2.2	1.9	2.1	1.9	1.8	1.4	1.8	1.8	1.8	2.1	1.7	1.8	2.0	2.1	2.2	2.3	2.3
CPI underlying (q/q %)	--	--	--	--	0.5	0.5	0.4	0.4	0.2	0.5	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5
CPI underlying (y/y %)	1.8	1.4	1.6	1.9	1.9	1.8	1.8	1.8	1.4	1.4	1.4	1.3	1.5	1.5	1.6	1.7	1.9	1.9	2.0	2.0
Private wages (q/q %)	--	--	--	--	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
Private wages (y/y %)	2.1	2.5	2.7	2.8	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	5.4	5.5	5.6	5.1	5.0	4.8	5.0	5.1	5.1	5.2	5.2	5.3	5.3	5.3	5.4	5.4	5.4
Terms of trade	1.8	4.9	-3.3	-1.5	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
Current Account (% GDP)	-2.1	-0.5	-1.5	-2.1	-2.3	-2.5	-2.3	-1.5	-0.2	-0.2	-0.7	-1.1	-1.3	-1.6	-1.5	-1.7	-1.8	-2.1	-2.3	-2.4

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

Exchange Rate Forecasts

	11-Jun	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Majors						
AUD/USD	**0.6953**	0.71	0.73	0.74	0.75	0.75
NZD/USD	**0.6595**	0.67	0.68	0.69	0.70	0.70
USD/JPY	**108.61**	107	108	107	106	105
EUR/USD	**1.1317**	1.12	1.13	1.13	1.13	1.14
GBP/USD	**1.2680**	1.22	1.24	1.24	1.25	1.27
USD/CNY	**6.9173**	6.96	6.95	6.92	6.90	6.85
USD/CAD	**1.3262**	1.33	1.30	1.29	1.27	1.28
USD/CHF	**0.9900**	0.98	0.98	1.02	1.02	1.00
Australian Cross Rates						
AUD/NZD	**1.0543**	1.06	1.07	1.07	1.07	1.07
AUD/JPY	**75.5**	76	79	79	80	79
AUD/EUR	**0.6144**	0.63	0.65	0.65	0.66	0.66
AUD/GBP	**0.5483**	0.58	0.59	0.60	0.60	0.59
AUD/CNY	**4.8096**	4.94	5.07	5.12	5.18	5.14
AUD/CAD	**0.9221**	0.94	0.95	0.95	0.95	0.96
AUD/CHF	**0.6883**	0.70	0.72	0.75	0.77	0.75

Interest Rate Forecasts

	11-Jun	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Australian Rates						
RBA cash rate	**1.25**	1.00	1.00	1.00	1.00	1.00
3 month bill rate	**1.37**	1.10	1.20	1.20	1.20	1.20
3 Year Swap Rate	**1.14**	1.25	1.20	1.30	1.40	1.50
10 Year Swap Rate	**1.72**	2.03	2.03	2.20	2.25	2.40
Offshore Policy Rates						
US Fed funds	**2.50**	2.25	2.00	2.00	2.00	2.00
ECB deposit rate	**-0.40**	-0.40	-0.40	-0.20	0.00	0.15
BoE repo rate	**0.75**	0.75	1.00	1.00	1.25	1.25
BoJ excess reserves rate	**-0.10**	-0.10	-0.10	-0.10	-0.10	-0.10
RBNZ OCR	**1.50**	1.50	1.25	1.25	1.25	1.25
China 1yr lending rate	**4.35**	4.35	4.35	4.35	4.35	4.35
China Reserve Ratio	**13.5**	12.00	12.00	12.00	12.00	12.00
10-year Bond Yields						
Australia	**1.47**	1.85	1.85	2.00	2.00	2.10
United States	**2.15**	2.65	2.70	2.80	2.80	2.90
New Zealand	**1.73**	3.30	3.45	3.55	3.65	3.70

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP

	2018	2019	2020	2021
Australia	2.8	1.7	2.3	2.3
United States	2.9	2.5	1.8	1.8
Eurozone	1.8	1.2	1.4	1.5
United Kingdom	1.4	1.5	1.5	1.6
Japan	0.8	0.2	0.5	1.0
China	6.6	6.3	6.0	5.8
India	7.1	7.1	7.2	7.1
New Zealand	2.8	2.4	2.6	2.5
World	3.6	3.3	3.4	3.5

Commodity prices ($US)

	11-Jun	Sep-19	Dec-19	Mar-20	Jun-20
Brent oil	62.5	68	70	70	75
Gold	1329	1300	1310	1350	1370
Iron ore	100	79	76	72	68
Hard coking coal*	198	178	170	165	160
Thermal coal	72	85	90	93	90
Copper	5860	6400	6300	6225	6150
Aus LNG**	10	12	12	12	12

** FOB quarterly contract prices (thermal coal is JFY contract)*

*** Implied Australian LNG export prices*

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