EMBARGOED UNTIL 11.30 AM WEDNESDAY 12 JUNE 2019

THE FORWARD VIEW: AUSTRALIA JUNE 2019

Weakness in private demand to continue. Policy stimulus needed – fiscal, structural and monetary.

OVERVIEW

We have revised down our near term economic forecasts. This reflects the inclusion of the Q1 national accounts, but more importantly continuing weak consumer demand in Q2 as well as further weakness in the construction cycle. That evidence comes both from our Business Survey for May and internal NAB transaction data. It is interesting to note that by Q2 2019 year to growth will be as low as 1.3% y/y% - with little contribution from underlying private sector demand. Against that we have increased consumer demand in Q4 reflecting the timing of tax cuts and hopefully some benefits from lower interest rates. However the net effect has lowered through the year growth in 2019 to 2.0% (previously 2.3%) and in year average terms 1.7% (previously 2.0%).

Not surprisingly that produces a weaker labour market outcome for 2019 – with unemployment rising to around 5.3% by year's end. There is some risk that should growth be this weak, unemployment could deteriorate further.

For 2020 and 2021 we have not fundamentally changed our forecasts – with through the year growth ranging between 2 and 2¼ percent. In year-average terms growth remains around 2.3% (for both years). That growth is below trend and hence unemployment deteriorates further – with unemployment reaching 5.5% in 2021. It is worth noting here that this forecast assumes two rate cuts and alternative policy action equivalent to a third cut.

The key drivers of our forecasts however have not changed. That is we see growth being constrained by still weak consumption growth over the next few years (despite scheduled tax cuts), 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 ongoing sizeable falls in dwelling investment over the next two years – a peak-to-trough fall of around 20% of which around 5% has already occurred. Offsetting some this weakness, we 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.

Clearly this scenario implies weaker inflation and we do not now expect to see core inflation at the bottom of the 2-3% target till mid-2021. On monetary policy, as noted above, we are factoring in another near term cut – still in August but we would not discount July. Also we see the need for further monetary policy action in early 2020 – if not sooner. Thus, unlike the RBA, we do see the outlook as having deteriorated recently. However we do agree with their assessment that other areas of policy need to lend a hand – especially fiscal and structural policy.

CONTENTS

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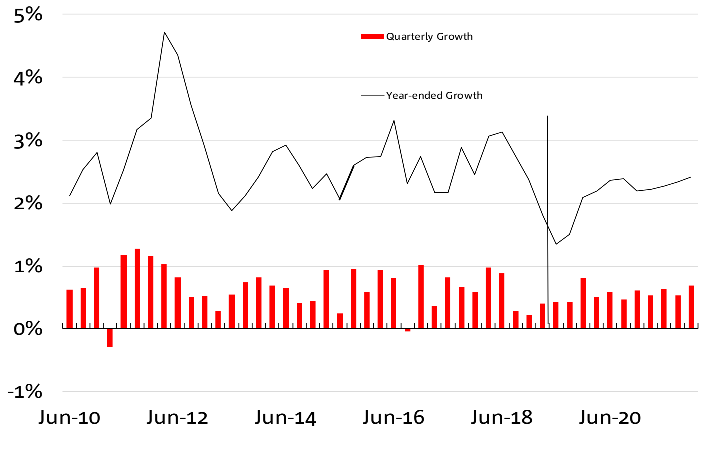
KEY ECONOMIC FORECASTS

	2018	2019-F	2020-F	2021-F
Domestic Demand (a)	2.9	1.4	2.3	2.7
Real GDP (annual average)	**2.8**	**1.7**	**2.3**	**2.3**
Real GDP (year-ended to Dec)	**2.4**	**2.1**	**2.2**	**2.4**
Terms of Trade (a)	1.8	2.9	-3.8	-1.5
Employment (a)	2.7	2.0	1.0	1.2
Unemployment Rate (b)	5.0	5.2	5.3	5.4
Headline CPI (b)	1.8	1.8	1.9	2.3
Core CPI (b)	1.7	1.3	1.6	2.0
RBA Cash Rate (b)	1.50	1.00	1.00	1.00
$A/US cents (b)	0.71	0.73	0.76	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

LABOUR MARKET, WAGES AND THE CONSUMER

Conditions in the labour market remain relatively healthy. Employment rose 26k in April to be over 300k higher than a year ago, with the bulk of employment growth over the past year having been on a full-time basis. The participation rate ticked up in the month and is now around its highest level since the lead-up to the GFC. Despite the ongoing strong employment growth, the unemployment rate also ticked up with the rise in labour force participation.

Going forward we expect the labour market to deteriorate somewhat, with employment growth to slow on the back of weaker economic activity and the unemployment rate to rise to around 5.5% over the next two years. Indeed, leading indicators of the labour market have shown some signs of a slowing in the demand for labour with job ads falling in May and the NAB Monthly Business survey employment index now back around average. Based on historical relationships the survey is now consistent with employment growth of around 18k per month.

With slower employment growth and unemployment someway above the NAIRU we only expect a small rise in the pace of wage growth from is current rate of 2.4% y/y in Q1.

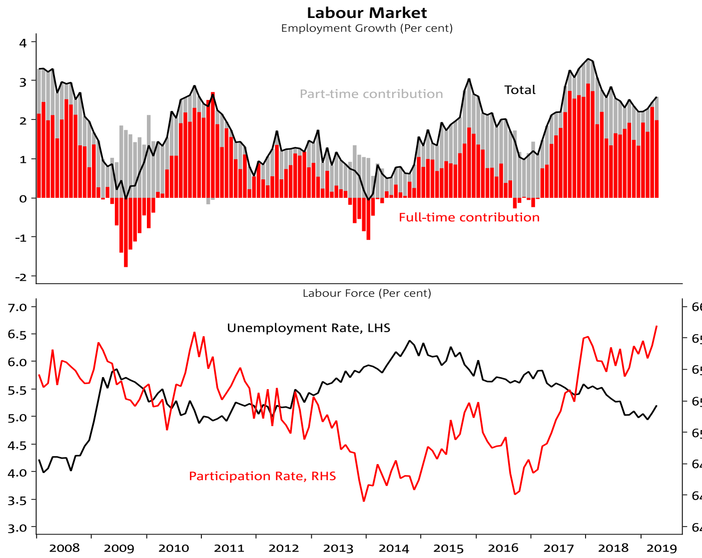
Despite the relative strength of employment growth, household consumption growth remains modest. Consumption growth rose by 0.3% q/q in Q1 to be 1.8% higher over the year. In the quarter, consumption growth was driven by an increase in spending on finance & insurance services, health, utilities and food (largely essential items). Spending on recreation & culture, clothing & footwear and cafes & restaurants was lower - all discretionary spending.

Indeed, almost all of the growth in spending over the last year has been on 'essentials' with around 1.5ppt of the 1.8% growth in consumption accounted for by this category. Consumption growth in discretionary categories has slowed sharply over the past year. Consistent with the quarterly outcome, the bulk of spending growth in the last year has been on household services.

A key driver of this weakness in consumption, household income growth, ticked up in the quarter but continues to track a very low pace. Nonetheless, this tick-up saw a small rise in the savings rate, with consumption growth having slowed further. Overall, the savings rate appears to have stabilised after declining in recent years, but remains relatively low.

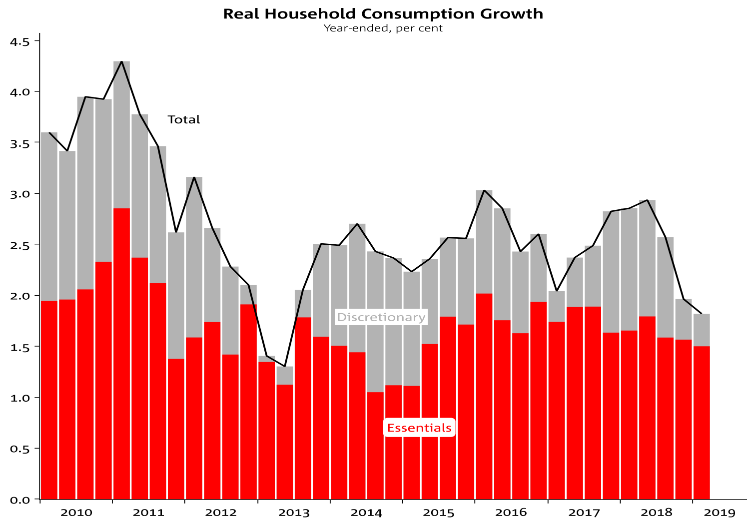
We forecast caution in the household sector will persist with slow income growth on the back of weak wage rises, high debt levels and some risk of negative 'wealth effects' with the recent decline in house prices. We see consumption growth improving, but only slightly over the next few years with growth tracking around 2.0% y/y.

HEALTHY LABOUR MARKET...



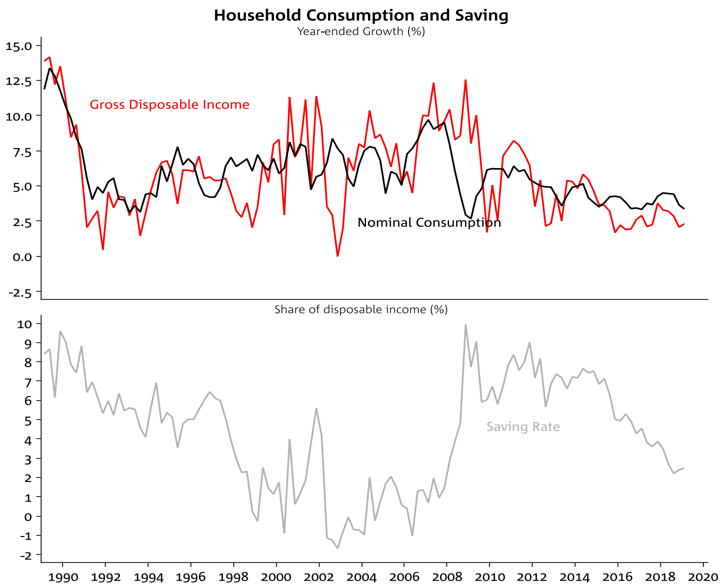
Source: National Australia Bank, Macrobond

SOFT CONSUMPTION GROWTH...



Source: National Australia Bank, Macrobond

WEAK INCOME AND INCREASING SAVINGS...



Source: National Australia Bank, Macrobond

HOUSING AND CONSTRUCTION

The housing market continues to cool, with the adjustment likely to continue to play out over the next year. Prices have fallen further, approvals for both new building as well as financing have fallen, and dwelling investment recorded another substantial fall in Q1. Alongside this, housing credit growth has continued to slow. To date, the adjustment has been orderly with low interest rates and unemployment at least providing some support to the market.

In the established market, capital city house prices declined a further 0.4% in May to be 8.4% lower over the year. However, the pace of decline appears to have eased somewhat over recent months, particularly in Sydney and Melbourne which have been responsible for much of the decline in prices to date. In the month, Sydney declined by 0.5% while prices in Melbourne decreased 0.3%, to be down 14.9% and 11.1% respectively from their respective peaks in 2017. Perth prices have also fallen (-8.8%) significantly over the past year, despite showing some stabilisation earlier in 2018.

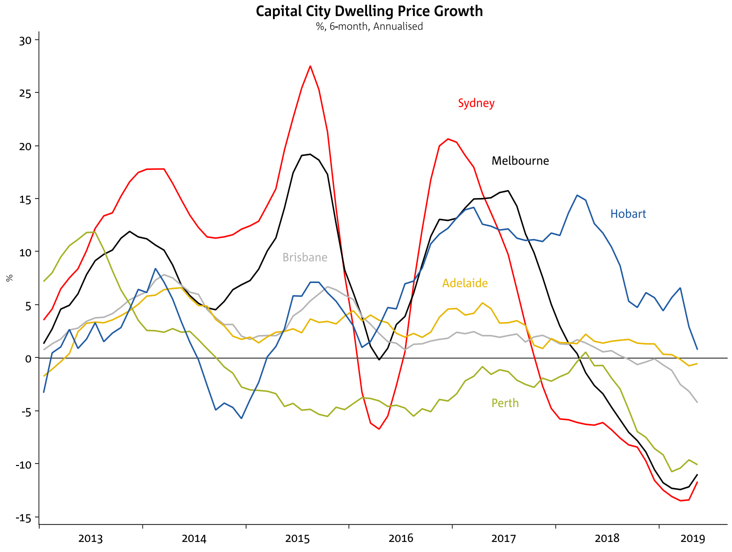
Elsewhere, prices have help up better with a small rise in Hobart, a relatively flat outcome in Adelaide and a small fall in Brisbane over the past year.

The Q1 national accounts confirmed the ongoing decline in dwelling investment. Investment in new dwellings fell 2.5% in the quarter and is now down 5.3% over the past 6 months. In the quarter, investment in new dwellings declined 1.8%, while alterations & additions declined by a sharp 3.8%. The declines were concentrated in NSW (-4.8%) and Victoria (-2.4%) – the two states which saw the largest run-up in both prices and activity in the upswing. Dwelling investment also declined in WA, SA and Tas; Qld saw a rise in the quarter. Overall we expect dwelling investment to decline a further 10-15% over the next 2 years.

While the pipeline of housing construction work remains large, it is likely that the high rate of work done will see this completed relatively quickly. Building approvals fell further in April, declining by 4.7% to be 24.2% lower over the year. The bulk of the decline has been driven by decreases in the apartment segment which has fallen 28.8% over the past year. Detached house approvals have also declined (down 20.5% y/y) and are now back to levels last seen in 2013.

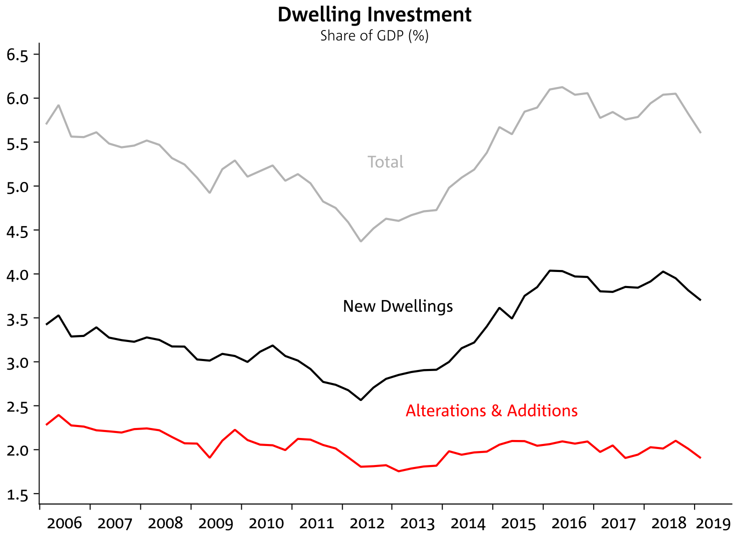
Alongside the cooling in the market, housing credit growth has continued to slow. Investor lending slowed to just 0.6% y/y in April and 5.5% to owner-occupiers. Overall, housing credit has risen 4.9% over the past year. ABS data on the value of new loan approvals stabilised in April with the value of loan approvals excluding refinancing up 0.2%. In the month, investor loan approvals fell further (-2.2%) while loans for owner-occupiers rose (1.0%). Overall, approvals are down 17.5% on a year ago.

PACE OF DWELLING PRICE DECLINES EASES..



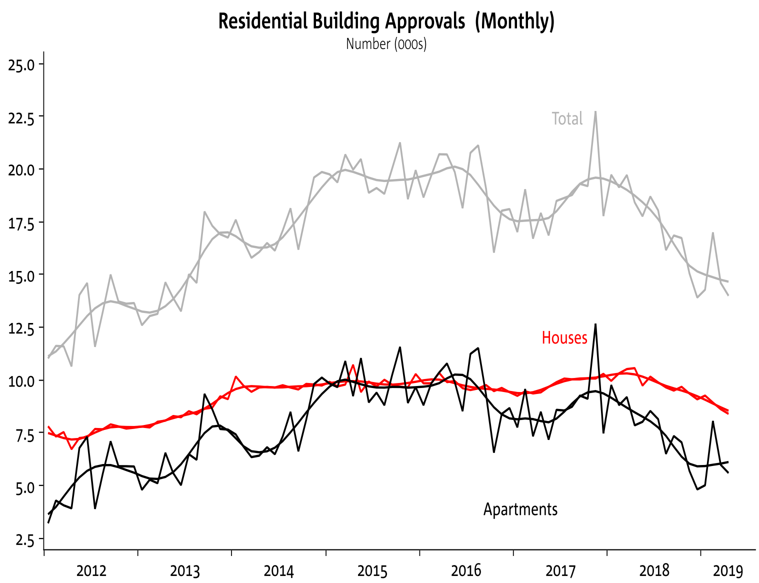
Source: CoreLogic, National Australia Bank, Macrobond

DWELLING INVESTMENT FALLS FURTHER..



Source: National Australia Bank, Macrobond

APPROVALS SUGGEST MORE WEAKNESS..



Source: National Australia Bank, Macrobond

BUSINESS AND TRADE

The national accounts largely confirmed that the dynamics in the business sector are playing out as we expect. New business investment increased by 0.6% in the quarter, but remains 1.3% lower than a year ago. By sector, non-mining investment saw an increase of 2.0%, while mining sector investment continued to decline (-1.8%) as the tail end of the mining boom is still winding down. New building investment increased by 4.5%, while investment in machinery & equipment (-0.3%) and engineering construction (-1.5%) were lower in the quarter.

Next months NAB Quarterly survey will provide an important update on expected capex over the next 3 and 12 months. However, with capacity utilisation having declined and business conditions now well below average it is likely that investment intentions have pulled-back (Indeed, ABS Capex survey suggests that nominal investment will fall by 1.8% in the next financial year).

Overall, the NAB Monthly Business Survey suggests that the moderation in activity in the business sector has continued into Q2. Business conditions declined further in May and are now well below average (and only just positive). The decline was driven by a further deterioration in trading conditions and profitability. The employment index rebounded to be around average, but is well below the level of three months ago.

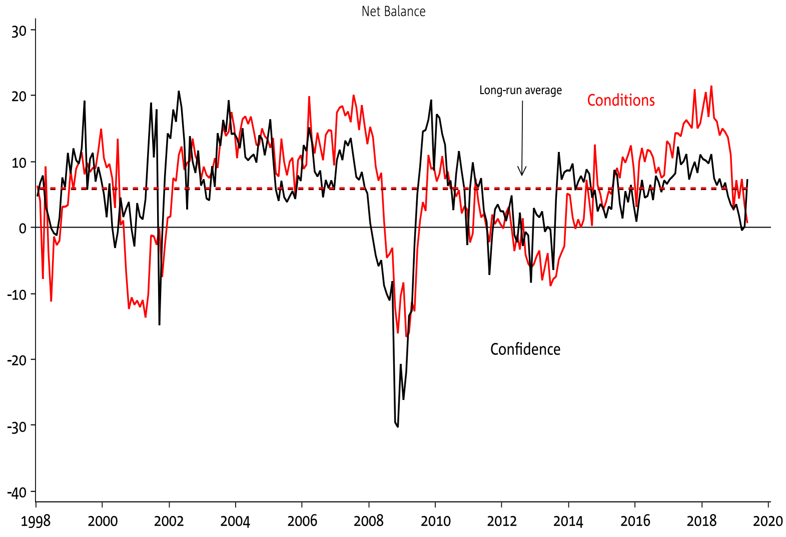
Going forward, the survey suggests that conditions are unlikely to rebound. Forward orders fell further in the month, and capacity utilisation is now a touch below average. While the increase in confidence in the month is positive, it could be short lived – and will rely on conditions improving.

By sector, the goods distribution industries have weakened further. Retail in particular now reports conditions are at GFC levels. Services sectors have held up better, but all industries have declined over the past year. The weakening in conditions has also been evident across all states.

International trade continues to be an important driver of the economy. Net exports contributed 0.2ppt in the March quarter with import volumes falling (weaker services imports) and exports rising in the quarter. Trade data for April suggest the trade surplus stayed near record levels, with further strong growth in resource exports (on the back of higher iron ore prices) enough to offset broad-based growth in imports.

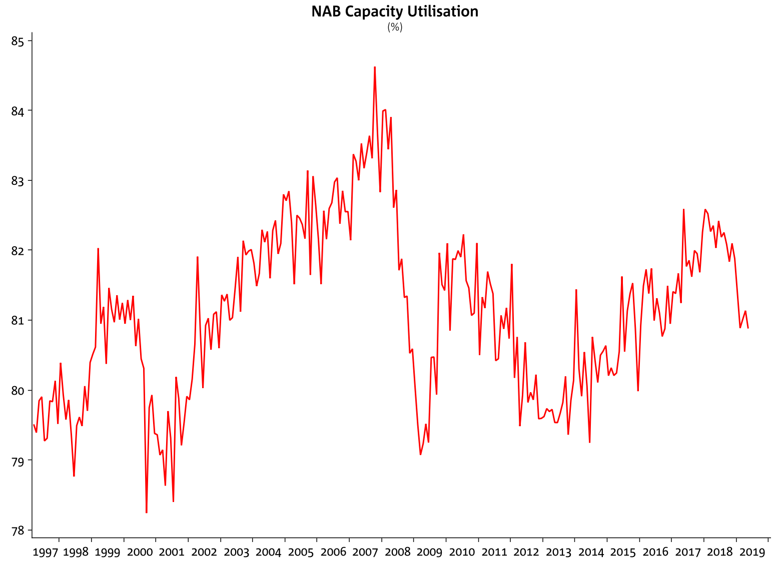
Going forward, both the business sector and exports play an important role in our forecasts. Exports are expected to increase in the near-term with the final ramp-up of LNG production underway before levelling off. We also expect business investment will grow relatively strongly with the drag from the end of mining-related construction fading and the non-mining sector continuing to grow strongly – in part supported by spill-overs from the large pipeline of public infrastructure investment.

NAB SURVEY CONDITIONS AND CONFIDENCE



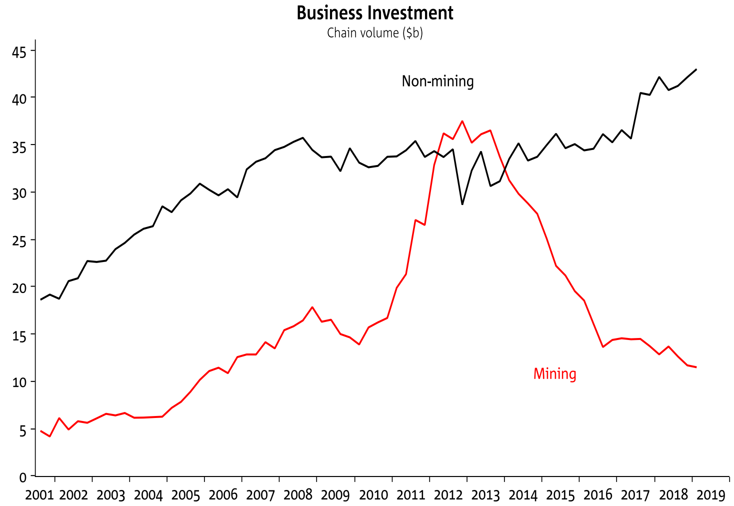
Source: National Australia Bank, Macrobond

CAPACITY UTILISATION



Source: National Australia Bank, Macrobond

BUSINESS INVESTMENT BY SECTOR



Source: National Australia Bank, Macrobond

COMMODITIES

Supply side constraints have continued to support iron ore prices near US$100 a tonne – with prices for 62% iron ore in China peaking in late May at their highest level since April 2014. That said, Brazilian exports are gradually recovering (following safety related closures which could still leave some capacity offline for two to three years). Exports in May were around 16% lower year-on-year, but up almost 60% month-on-month. Increased supply should place downward pressure in the second half, with 62% ore forecast to average US$87 a tonne in 2019 before declining to around US$72 a tonne in 2020.

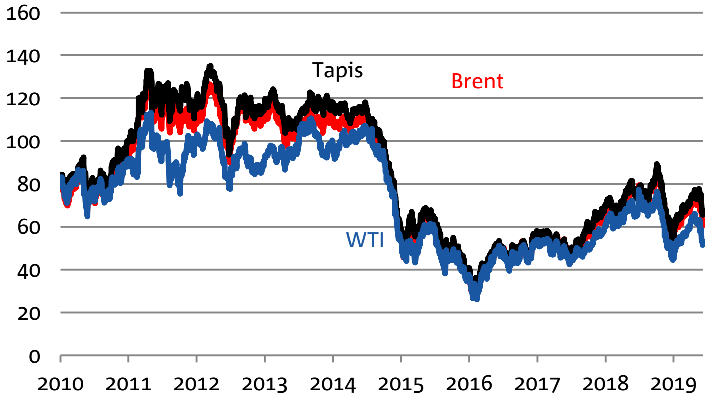
Price trends in coal markets remain divergent. Thermal coal prices have tracked lower since the middle of 2018, down into the mid-US$70s range for the first time since May 2017. A rumoured easing in Chinese port restrictions – which have delayed customs clearances and reduced demand for Australian volumes in recent months – appears not to have eventuated, keeping Australian coal prices suppressed. Our expectation of stronger prices in 2020 – an average of US$90 a tonne – is predicated on an easing in these restrictions. In contrast, hard coking coal remains supported in the short term by strong steel output (primarily in China). Softer steel demand in 2020 (in line with weaker global economic growth) is expected to ease prices – down to US$158 a tonne (from just under US$200 a tonne at the time of writing).

Oil prices have plunged in response to the deteriorating global trade environment. Brent crude fell from around US$70 a barrel in late May to just over US$60 a barrel in the first week of June – likely a response to concerns that weaker global economic growth (due to wider tariff measures) could impact oil demand. Given the ongoing uncertainty – our forecast, with Brent in the mid-US$70s range in the second half of 2019, is currently under review.

Base metal prices have generally declined since late May – again in line with a more negative trade outlook – continuing a downward trend from mid April onwards.

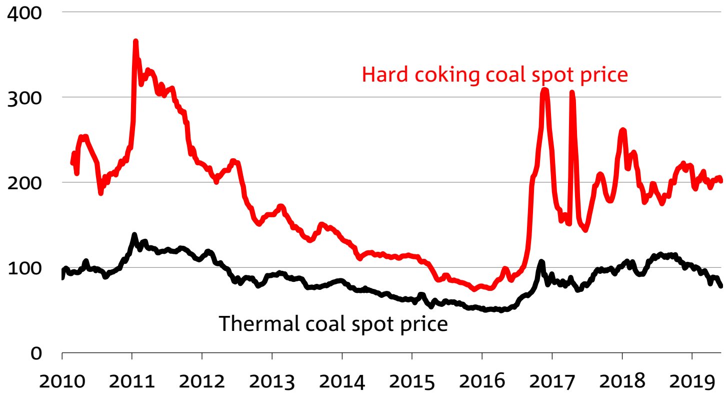
GLOBAL OIL PRICES

USD/bbl, daily



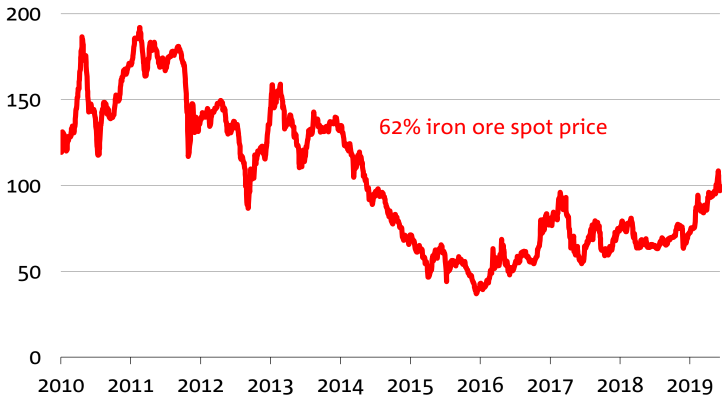
COAL SPOT PRICES

US$/t



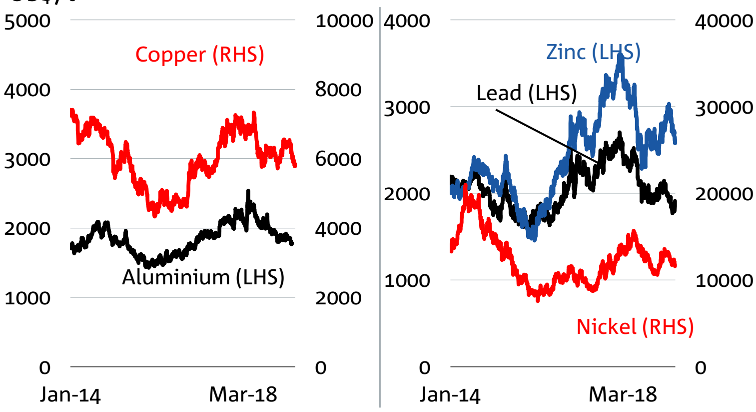
IRON ORE SPOT PRICE

US$/t (incl. cost of freight)



BASE METAL PRICES

US$/t



Source: Bloomberg, Refinitiv, NAB Economics

MONETARY POLICY, INFLATION AND FX

The RBA lowered the cash rate by 25bps to an historic low of 1.25% at the June board meeting – as we expected. This marks the first reduction in interest rates since August 2016 and comes after a sustained period of below-target inflation. The statement released following the announcement highlighted the opportunity to see a faster decline in the unemployment rate, by supporting employment growth. With current levels of spare capacity in the economy, this would see little risk of overshooting inflation, and in fact would foster a more sustained approach back to the inflation target.

It is unlikely that the picture on inflation will change significantly from the Q1 prints of 1.3% in headline inflation and 1.6% average across the core measures. While some transitory factors such as petrol prices are likely to unwind somewhat in Q2, there is little reason to think that underlying inflationary pressures have risen. Domestically, the unemployment rate, while historically low, remains well above the NAIRU and wage growth has remained weak. The adjustment in the housing market is ongoing and new dwelling prices and rents could be expected to drag on inflation for some time. Global inflationary pressure remains low and there has been little depreciation in the Australian dollar.

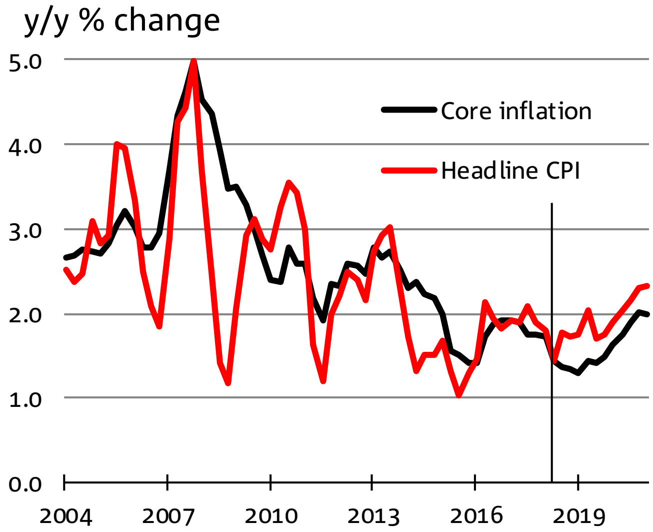
With our central scenario now implying greater spare capacity in the economy and hence weaker inflation, we now do not expect to see core inflation at the bottom of the 2-3% target until till mid-2021.

On monetary policy, we are factoring in another near-term cut – still in August but we would not discount July. This would allow time for the RBA to assess pass-through of the first move. In addition further updates on the labour market and its leading indicators, inflation and the NAB Business Survey will be available. Further, the Bank would have an updated set of staff forecasts to be released in the August SMP.

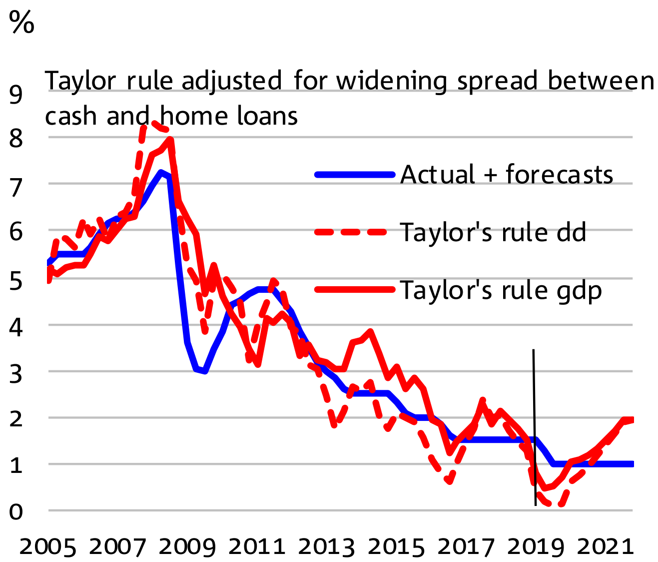
Also we see the need for further monetary policy action in early 2020 – if not sooner. Thus, unlike the RBA, we do see the outlook as having deteriorated recently. However we do agree with their assessment that other areas of policy need to lend a hand – especially fiscal and structural policy.

The AUD/USD dipped below the 70c mark over the past month with heightened expectations of RBA rate cuts and ongoing trade tensions. We have lowered our forecasts for the Aussie over the next two years with a slowing in near-term global growth, no near-term resolution to US-China trade tensions and the risk of RBA cash rate cuts below the 1% mark. We still see some downward pressure on the $US over the next two years and any weakening in the Chinese economy due to ongoing trade tensions is likely to be offset by government stimulus, providing support to commodity prices. Overall we see the AUD/USD tracking in the mid-70c range over the next year, before drifting slightly higher in the out year of our forecasts.

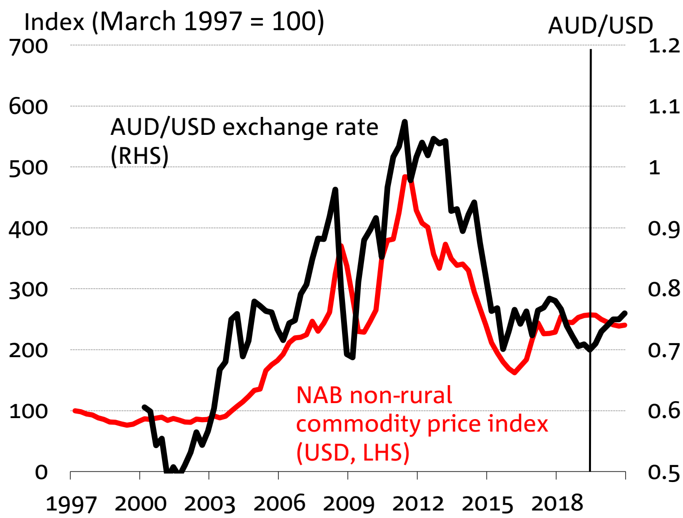
HEADLINE AND CORE INFLATION



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	1.9	1.8	2.4	2.4	2.6	1.5	2.3	2.3
Dwelling Investment	0.5	-0.2	-10.2	-5.3	-2.2	4.7	-8.2	-8.3	-1.6
Underlying Business Investment	6.8	-2.0	3.9	3.9	3.8	0.9	0.9	4.3	3.6
Underlying Public Final Demand	4.4	5.9	4.6	4.4	4.6	5.0	5.4	4.5	4.1
Domestic Demand	**3.4**	**2.0**	**1.8**	**2.6**	**2.9**	**2.9**	**1.4**	**2.3**	**2.7**
Stocks (b)	0.0	0.0	-0.2	0.0	-0.2	0.1	-0.2	-0.1	0.0
GNE	**3.4**	**2.0**	**1.6**	**2.6**	**2.8**	**3.1**	**1.2**	**2.3**	**2.7**
Exports	4.1	3.0	3.9	2.2	3.4	5.0	2.9	3.2	2.0
Imports	7.1	0.4	2.3	3.7	7.7	3.9	0.4	3.4	3.8
GDP	**2.9**	**2.1**	**2.0**	**2.3**	**2.4**	**2.8**	**1.7**	**2.3**	**2.3**
Nominal GDP	4.7	5.0	3.0	3.8	6.1	4.9	4.0	3.2	4.0
Current Account Deficit ($b)	51	22	29	43	46	39	18	36	52
(-%) of GDP	2.7	1.1	1.5	2.1	2.6	2.0	0.9	1.8	2.5
Employment	3.0	2.4	1.4	1.0	2.4	2.7	2.0	1.0	1.2
Terms of Trade	1.7	5.3	-2.8	-1.4	11.6	1.8	2.9	-3.8	-1.5
Average Earnings (Nat. Accts. Basis)	1.4	1.6	2.4	2.8	0.8	1.6	1.9	2.7	2.8
End of Period									
Total CPI	2.1	1.8	1.7	2.2	1.9	1.8	1.8	1.9	2.3
Core CPI	1.7	1.4	1.4	1.9	1.9	1.7	1.3	1.6	2.0
Unemployment Rate	5.5	5.2	5.3	5.4	5.4	5.0	5.2	5.3	5.4
RBA Cash Rate	1.50	1.25	1.00	1.00	1.50	1.50	1.00	1.00	1.00
10 Year Govt. Bonds	2.63	1.45	1.60	1.90	2.63	2.32	1.40	1.80	2.00
$A/US cents :	0.74	0.70	0.75	0.77	0.78	0.71	0.73	0.76	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	10/06/2019	Mar-19	*Jun-19*	*Sep-19*	*Dec-19*	*Mar-20*	*Jun-20*	*Sep-20*	*Dec-20*
WTI oil	US$/bbl	53	54	63	64	64	64	69	69	69
Brent oil	US$/bbl	63	62	69	70	70	70	75	75	75
Tapis oil	US$/bbl	67	65	70	71	71	71	76	76	76
Gold	US$/ounce	1329	1300	1300	1310	1350	1370	1370	1380	1390
Iron ore (spot)	US$/tonne	n.a.	83	96	88	79	76	72	68	71
Hard coking coal*	US$/tonne	n.a.	202	193	178	170	165	160	155	152
Thermal coal (spot)	US$/tonne	85	95	82	85	90	93	90	88	90
Aluminium	US$/tonne	1745	1862	1850	1875	1900	1925	1935	1945	1950
Copper	US$/tonne	5860	6216	6250	6400	6300	6225	6150	6125	6100
Lead	US$/tonne	1932	2034	1950	1900	1850	1825	1800	1750	1725
Nickel	US$/tonne	11564	12365	12250	12500	12750	12600	12500	12400	12500
Zinc	US$/tonne	2627	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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