EMBARGOED UNTIL 11.30 AM WEDNESDAY 10 JULY 2019

THE FORWARD VIEW: AUSTRALIA JULY 2019

Forecasts unchanged. – including key drivers of growth. Rate cuts to help but mainly in 2020. Fiscal stimulus impact small..

OVERVIEW

We have not changed our forecasts for this year and each of the next two years. We expect continuing sluggish activity in Q2 - with through-the-year growth to June, moving down to around 1.3% - before improving somewhat in H2 2019. That gives year-average growth in 2019 of 1.7% with through-the-year growth of around 2% by years-end. Further out, year-average growth remains around 2.3% in 2020 and 2021. That growth is below trend and hence unemployment deteriorates further – with unemployment reaching around 5.3% by end 2019, before moving up to around 5.5% in 2021.

The key drivers of our forecasts also 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 only moderate wage 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 of 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).

Much focus has recently been on the impact of recent rate cuts and fiscal policy. To explore these impacts we have used the AUS-M Model to try to quantify their impact on the economy (see also page 6). On rate cuts, we have included the two recent cuts and assumed a further 25bp cut in late 2019. The rate cut scenario shows a small boost to though the year growth by end-2019 (around 0.2%) before building into 2020 to peak at around 0.8%. This also sees a reduction in unemployment of around 0.2ppt relative to base line. The fiscal policy shock includes over $7.0bn in tax cuts in 2019/20. Not unexpectedly, the impact even by late 2020 is very modest at around 0.15 points to y/y growth – the impact on GDP of these tax cuts is small and tax multipliers reduce the expenditure effect even further.

Overall, these activity outcomes imply very weak underlying inflation and we do not expect to see core inflation at the bottom of the 2-3% target until mid-2021. On monetary policy, as noted above, we are factoring in another cut in late 2019 – but see a risk of further monetary policy action should the economy weaken further. 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.

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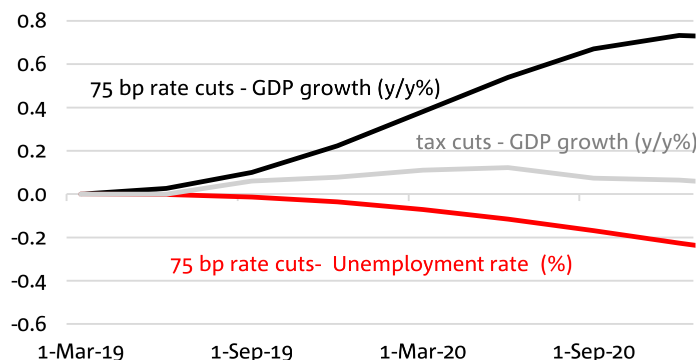
KEY ECONOMIC FORECASTS

	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	1.1
Unemployment Rate (b)	5.0	5.3	5.3	5.5
Headline CPI (b)	1.8	1.6	1.9	2.3
Core CPI (b)	1.7	1.3	1.6	2.0
RBA Cash Rate (b)	1.50	0.75	0.75	0.75
$A/US cents (b)	0.71	0.73	0.76	0.76

(a) annual average growth, (b) end-period, (c) through the year inflation

IMPACT OF RATE CUTS AND FISCAL POLICY

Deviation from y/y % baseline forecasts



*Rate cuts: 25bp cut in each of Q2, Q3, Q4 2019; annual tax cut of $7.2b starting Q3 2019. NAB estimates utilsing AUS-M model

Source: ABS, NAB Group Economics

LABOUR MARKET, WAGES AND THE CONSUMER

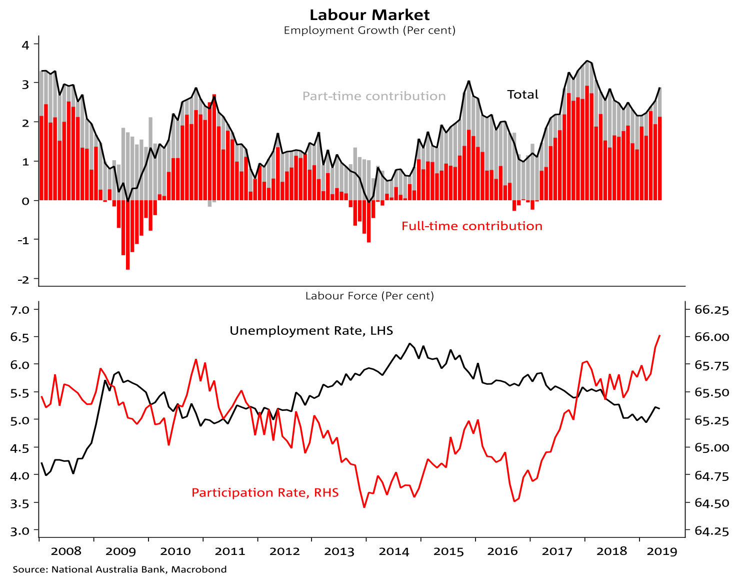
The May labour force survey saw employment rise by 42.3k to be around 3.0% higher in year-ended terms. In contrast to the trend over the past year, increase was driven by part-time employment (likely boosted by temporary election employment), while full-time employment rose by 2.4k. Alongside the rise in employment, the participation rate rose further, keeping the unemployment rate stable at 5.2%. While low by historical standards, the unemployment rate has lifted somewhat over recent months and is now around a ¼ ppt higher than the recent trough in January 2019. Further, the labour under utilisation rate (a broader measure of spare capacity) has also risen in recent months.

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 having fallen recently and the ABS job vacancies series declining in May. The NAB Monthly Business survey employment index rebounded somewhat in June, providing some optimism, though we will be watching closely to see if this signal persists.

Nominal retail sales increased by 0.1% m/m in May following a decline of a similar magnitude in April, which has seen growth over the year fall to 2.4%. A lift in turnover of household goods, other retailing and cafes & takeaway was partially offset by weakness in food, clothing & footwear, and department stores. Taken together, the first two months of Q2 suggest another weak outcome for goods retailing in volume terms. This follows a small fall in Q1 volumes and an overall weak result for consumption growth of 0.3% in the Q1 national accounts. An update on the NAB Cashless Retail Sales index, to be released next week, will provide an early indication of how retail turnover fared in June – ahead of the official estimates for quarterly volumes to be released next month.

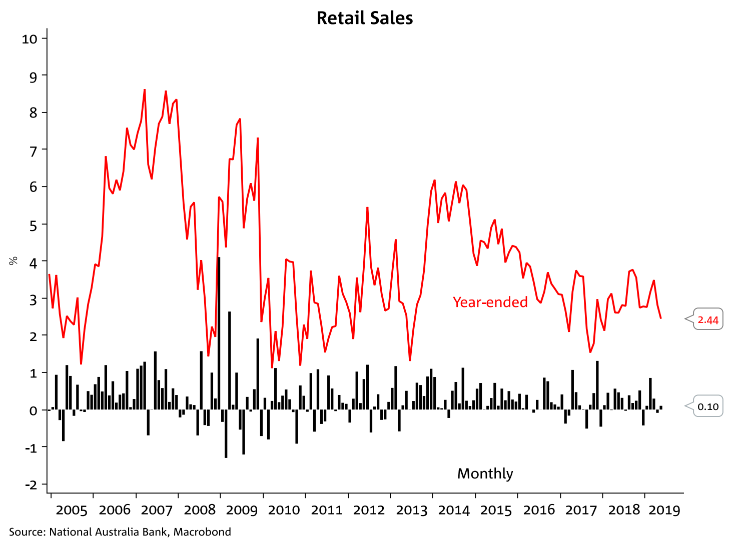
We forecast caution in the household sector will persist with slow income growth on the back of weak wage rises, high debt levels and some risk of negative 'wealth effects' with the recent decline in house prices. Overall, we see the recent tax cuts providing some support to consumption in the near term, though do not see this as a substantial form of stimulus and is unlikely to lead to sustained increases in wage growth and a recovery in household spending growth. Overall, we see a small improvement in consumption growth to around 2-2¼% over the next two years – a relatively weak outcome compared with history and one that due to the size of consumer spending in the economy, will see GDP growth continue at a below trend rate.

HEALTHY LABOUR MARKET...



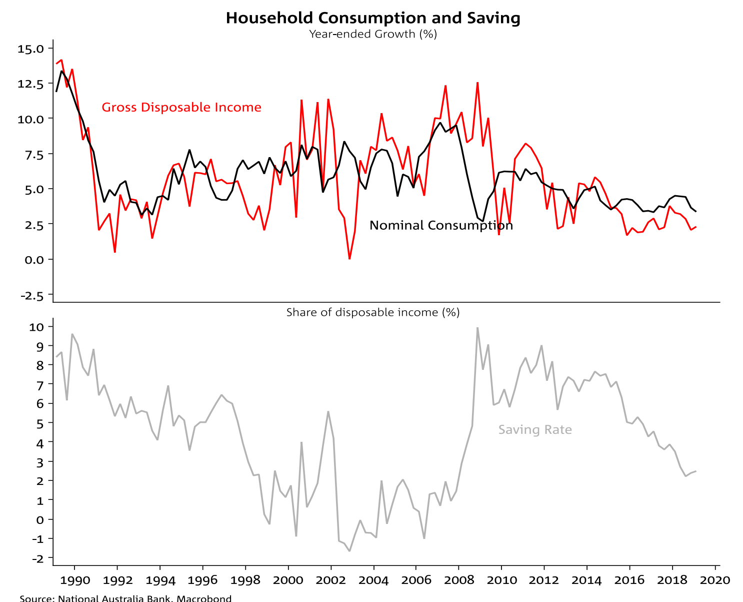
Source: National Australia Bank, Macrobond

SOFT RETAIL SALES GROWTH...



Source: National Australia Bank, Macrobond

WEAK INCOME GROWTH AND LOW SAVINGS...



Source: National Australia Bank, Macrobond

HOUSING AND CONSTRUCTION

The housing market has shown tentative signs of stabilisation. The rate of decline in prices in the established market has slowed, with Sydney and Melbourne prices increasing in June and auction clearance rates lifting. Nonetheless activity indicators continue to suggest a slowing in construction with approvals having fallen and the high rate of work done seeing the remaining pipeline of work completed relatively quickly.

The CoreLogic 8-Capital city dwelling price index showed a decline of 0.1% in June, driven by declines in Brisbane, Adelaide and Perth. This is in contrast to the trends seen for much of the past 2 years, with declines having primarily been driven by weakness Sydney and Melbourne. These cities saw increases of 0.1% and 0.2% respectively in the month, their first rises since their respective peaks in 2017. Regional dwelling prices were 0.4% lower over the month suggesting some deterioration outside of the capital cities, where prices had previously held up better.

The apparent stabilisation in the two largest cities follows almost 2 years of declines, which have seen falls of 15% in Sydney and 11% in Melbourne from their peaks in mid-to-late 2017 and despite the increases in the month, prices are down 9-10% over the year.

In the other markets, Perth has declined by 9.0% over the year, after having shown some signs of stabilisation in early 2018. Brisbane and Adelaide prices have declined by a more moderate rate amount but have weakened recently. Price growth in Hobart, which had previously been the standout, has also slowed recently.

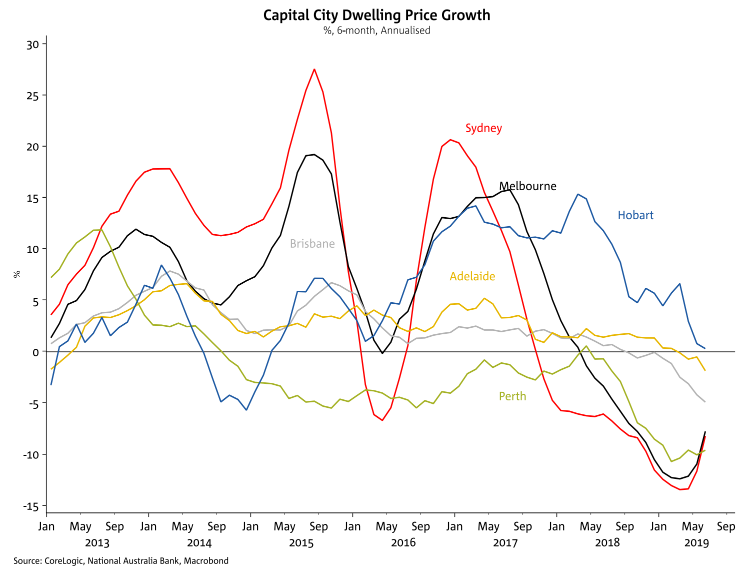
On the activity side, approvals for new building continue to trend down despite a small uptick in the month. Approvals for houses down 0.3% in May (-12.7% y/y) and while they were offset by a small rise in apartments, up 1.2% in the month, overall approvals remain 19.7% lower than a year ago.

Housing credit growth has slowed, to 3.7% y/y, driven by a marked slowdown in investor credit which has been largely flat over the past five months and has seen the year-ended rate of growth slow to just 0.5%. Credit extended to owner-occupiers has also slowed but continues to grow at a faster rate of 5.3% y/y.

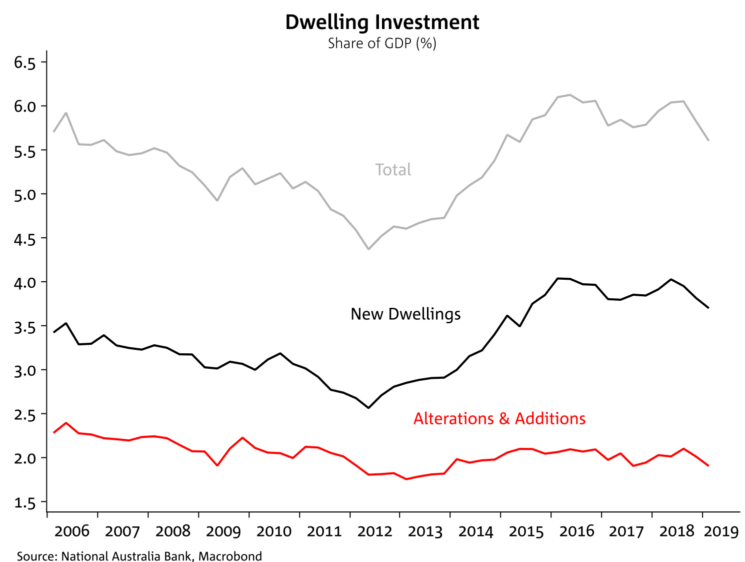
We expect further declines in the national accounts measure of dwelling investment, which has declined by around 5% to date. With approvals continuing to trend down and work done continuing at a high rate we expect further declines of around 15% over the next year and a half – albeit from high levels.

The reduction of the cash rate to a record low, fiscal stimulus as well as the easing of some macroprudential measures in the housing market will likely see the market bottom out at a higher level than previously anticipated but we do not yet see a return to the high rates of growth in prices and activity seen in the lead-up to 2017.

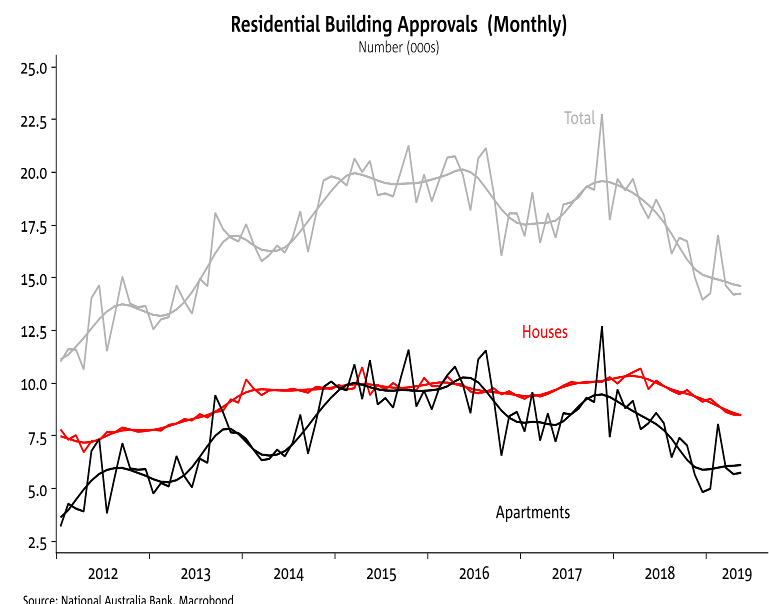
PACE OF DWELLING PRICE DECLINES EASES..



DWELLING INVESTMENT TO FALL FURTHER..



APPROVALS SUGGEST MORE WEAKNESS..



BUSINESS AND TRADE

Despite a small pick-up in business conditions in June, the NAB Monthly Business survey suggests that that the business sector has lost significant momentum over the past year. It also shows that the weakening in the sector has been broad-based across industries and states.

In more detail, business conditions rose 2 pts to +3 index points in June, but remain well below the long-run average levels. The pickup in conditions was driven by increases in finance, business & property services and construction which rose sharply; transport and utilities and retail also contributed to the increase, though by a smaller amount.

Overall, mining continues to see the best conditions across all industries – by some way. Commodity prices have generally remained high, cost pressures have abated somewhat and production has ramped up following the completion of major resource projects. Outside of mining, the services industries and construction currently see the best conditions. On the other hand, retail continues to lag, with conditions at levels last seen in the GFC. The weakness appears broad-based across retail, with food, car, household and other goods all continuing to record negative readings.

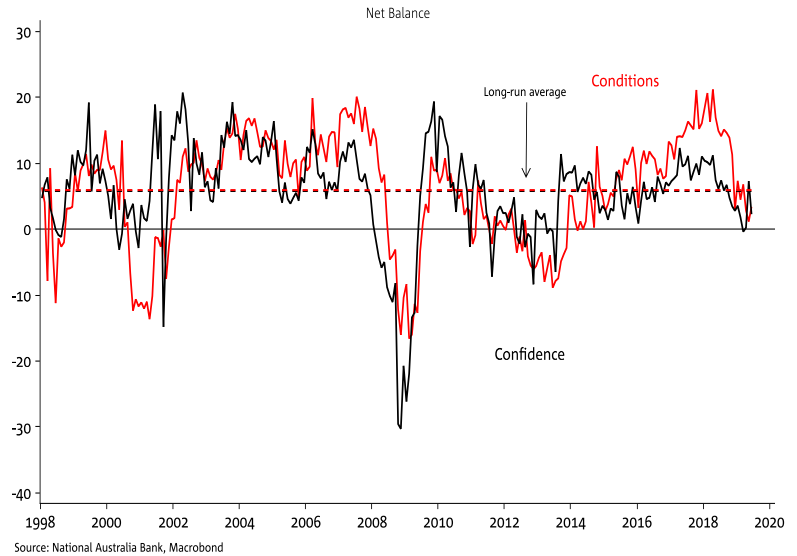
Forward looking indicators in the survey suggest that there is unlikely to be a substantial improvement in conditions going forward. The spike in business confidence in May was short-lived and forward orders remain negative and well below average. Capacity utilisation rose sharply in the month, which is a positive, but remains lower than the level seen through much of 2018. The NAB Quarterly business survey, released next week will provide an updated set of surveyed expectations for each of the key survey variables.

Outside of the survey ABS data on non-residential building approvals though volatile, rose sharply in May. Approvals have trended higher over the past quarter and reman elevated relative to history though have come off their peaks in mid-to-late 2017.

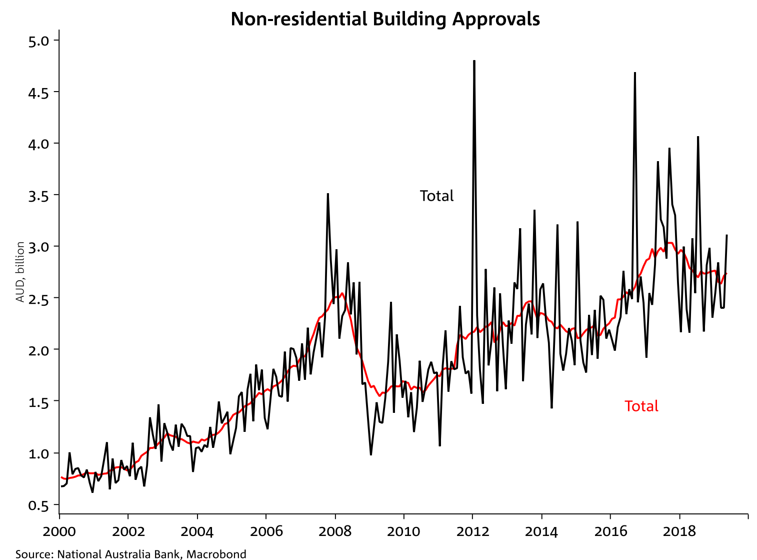
The trade surplus widened further in May driven by a large increase in the value of iron ore exports which more than offset the increase in imports. While some of this increase is due to the recent spike in iron ore prices, it appears that net exports will again likely support growth in Q2 following the 0.2ppt contribution in the March quarter.

Going forward, both the business sector and exports play an important role in our forecasts, providing some offset to the weakness in the household sector. Business investment is still expected to grow relatively strongly with further rises in non-mining on the back of spill overs from the large pipeline of public sector investment as well as a stabilisation in mining investment. Further it is likely that the sector will see some new investment with commodity prices still high. Exports are expected to increase in the near-term with the final ramp-up of LNG production underway before levelling off.

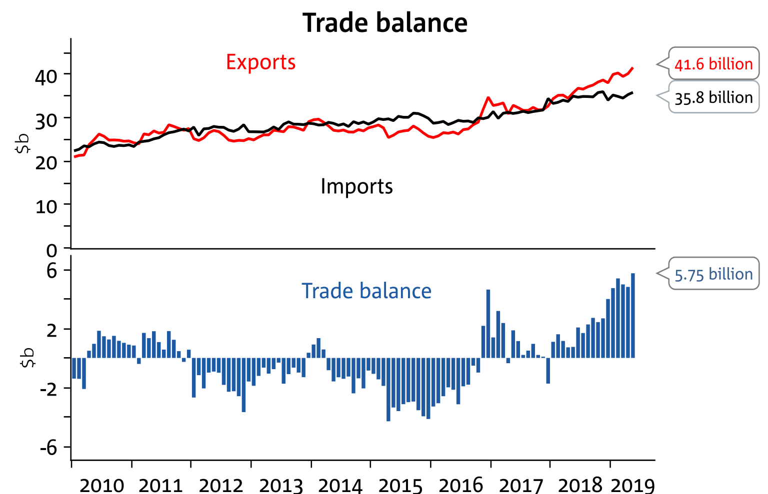
NAB SURVEY CONDITIONS AND CONFIDENCE



NON-RES APPROVALS STILL HIGH...



EXPORTS CONTINUE TO RISE...



COMMODITIES

The iron ore price rally continued into early July – rising above US$120 a tonne (the highest prices since February 2014) – as global markets remain constrained by supply disruptions in Brazil and Australia (the latter largely due to short term weather related issues). That said, Brazilian exports are gradually recovering, which combined with an easing in China's demand, should put downward pressure on spot iron ore prices. We forecast 62% ore landed in China to average US$92 a tonne in 2019, before easing to US$74 a tonne in 2020.

When compared with the rapid downturn in thermal coal spot prices, declines in hard coking coal have been more modest. This could change in coming months, should a reported Chinese import quota be implemented in September, which could place downward pressure on benchmark Asian market prices. It is worth noting that details around this proposal remain scarce. Informal Chinese import restrictions have contributed to the decline in Newcastle spot prices for thermal coal. Prices are forecast to fall from US$190/t in 2019 to US$158 in 2020.

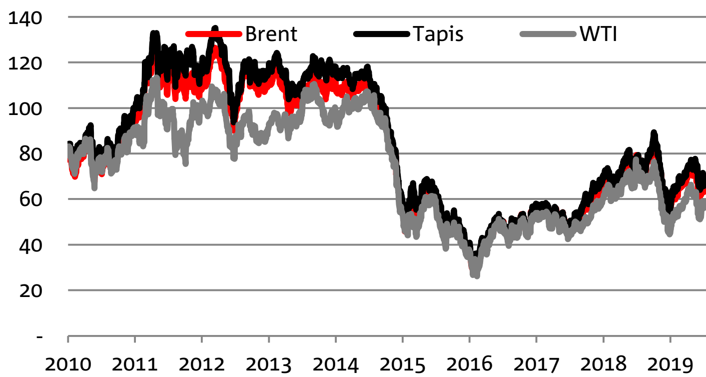
Oil prices continue to face competing forces. On one hand, OPEC has elected to continue output cuts and geopolitical tensions remain elevated, putting upward pressure on prices. On the other, demand expectations remain fairly subdued, reflecting the impact of the trade war and broader concerns around global economic growth. The net impact of these forces has seen Brent trading in the mid-60s range, up from a month ago, but below the mid-70s prices seen as recently as April. Overall, we see a moderate increase in prices from here, reaching US$70/bbl by the end of the year.

Australian LNG exports are nearing their peak. Volumes were close to flat on a q/q basis in Q1 and monthly data in April and May was a little weaker again. This is consistent with our expectation that Australian export volumes will top out this year.

Agricultural prices have been mixed, but overall the NAB Rural Commodities Index has been quite stable recently. Seasonal conditions are looking fairly good in WA, SA and VIC, but poor in parts of NSW and Qld.

GLOBAL OIL PRICES

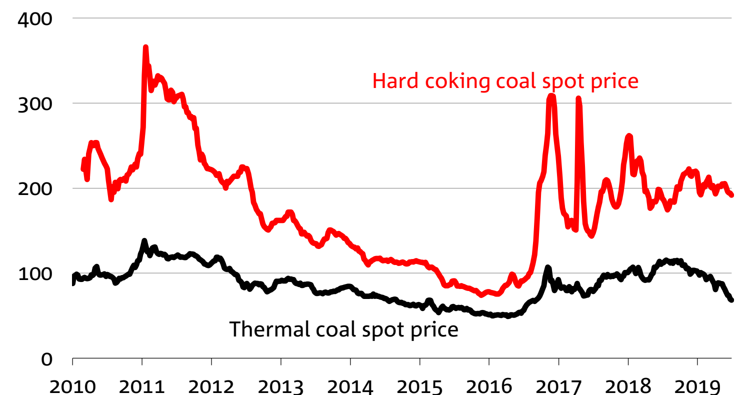
USD/bbl, daily



Sources: Refinitiv, NAB Economics

COAL SPOT PRICES

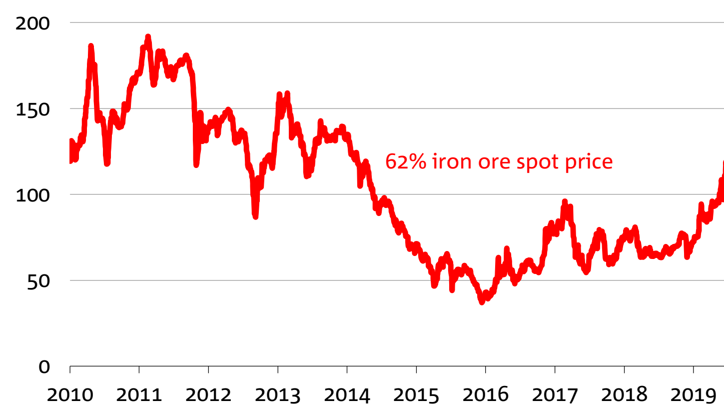
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

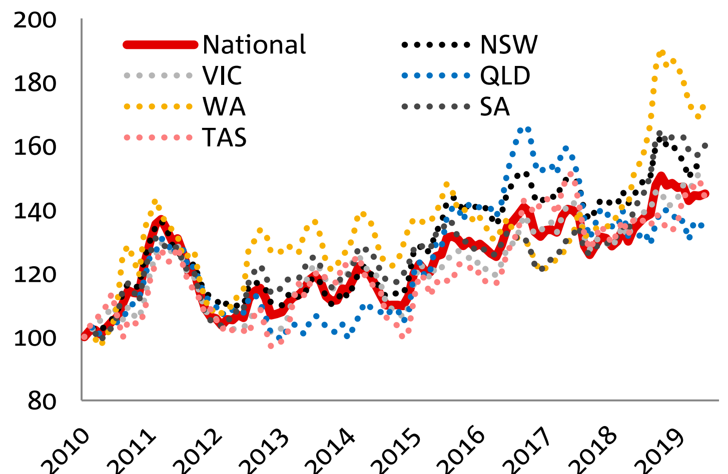
US$/t (incl. cost of freight)



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

As expected the RBA lowered the cash rate by 25bps to an historic low of 1.0% at the July board meeting. The RBA continues to argue that there has not been a deterioration in the economic outlook (we disagree) but that additional stimulus will help reduce spare capacity in the labour market and the general economy. While we agree, as noted in our modelling on page one these impacts are likely to be more apparent in 2020 and the fiscal adjustments are likely to have only a marginal effect on the economy. This environment will, however, help private sector demand – albeit at present private domestic demand growth to Q2 2019 is likely to be around zero (the first time since the GFC and the 2000 global recession). Our forecasts see private demand increasing to around 1¾% by late-2020 and around 2½% by late 2021. Current levels of spare capacity in the economy suggest there is little risk of overshooting inflation.

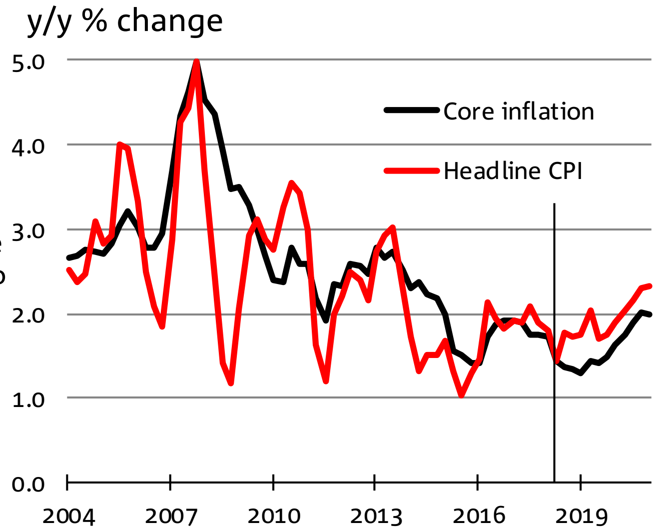
It is unlikely that the picture on inflation will change significantly in the rest of 2019 from the Q1 print of 1.4% in average across the core measures. While some transitory factors such as petrol prices are likely to unwind somewhat in Q2, there is little reason to think that underlying inflationary pressures have risen. Domestically, the unemployment rate, while historically low, remains well above the NAIRU and wage growth has remained weak. Global inflationary pressure remains low and there has been little depreciation in the Australian dollar.

On monetary policy, we are factoring in another rate cut in late 2019 – though continuing poor data could prompt an earlier reaction. The current timing of a November cut would allow time for the RBA to assess pass-through of the recent rate moves (albeit like our models their models will be mainly suggesting a 2020 impact) as well as any impact via income tax cuts (again we remain sceptical of their size). 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 (almost certainly involving a further downgrade) in the August SMP.

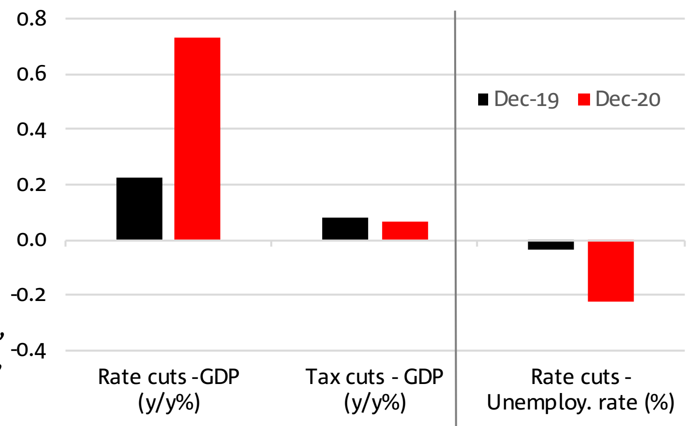
As noted previously, unlike the RBA, we do see the outlook as having deteriorated recently. However we do agree with their assessment that other areas of policy need to lend a hand – especially fiscal and structural policy.

The AUD/USD has recently traded around 70c – with rate cuts in Australia and (prospectively) in the US over the past month together with continuing uncertainty on trade tensions. We have maintained 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

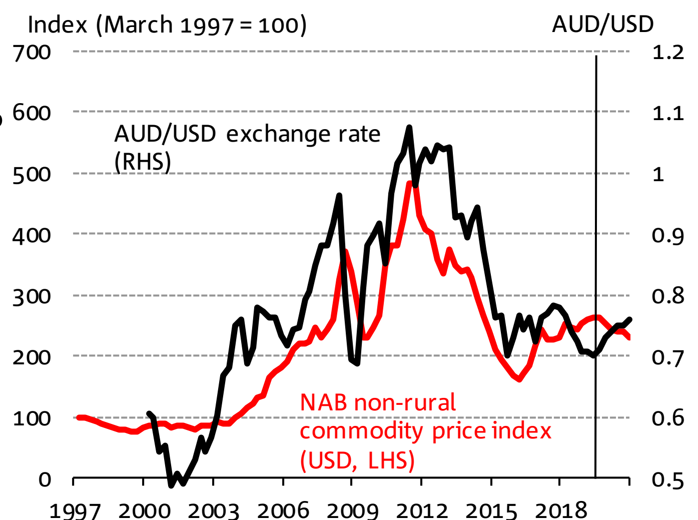


IMPACT OF FISCAL STIMULUS AND RATE CUTS ON ACTIVITY FORECASTS



*Rate cuts: 25bp cut in each of Q2, Q3, Q4 2019; annual tax cut of $7.2b starting Q3 2019. NAB estimates utilsing AUS-M model

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	2.3	2.4	2.6	1.5	2.2	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	-2.1	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**	**2.5**	**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**	**2.5**	**2.8**	**3.1**	**1.2**	**2.3**	**2.7**
Exports	4.1	3.1	4.0	2.2	3.4	5.0	2.9	3.3	2.0
Imports	7.1	0.4	2.4	3.6	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	3.7	6.1	4.9	3.9	3.1	3.9
Current Account Deficit ($b)	51	22	29	42	46	39	17	36	51
(-%) of GDP	2.7	1.1	1.4	2.0	2.6	2.0	0.9	1.8	2.4
Employment	3.0	2.4	1.4	1.0	2.4	2.7	2.0	1.0	1.1
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	2.7	0.8	1.6	2.0	2.6	2.8
End of Period									
Total CPI	2.1	1.7	1.7	2.2	1.9	1.8	1.6	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	5.3	5.3	5.5
RBA Cash Rate	1.50	1.25	0.75	0.75	1.50	1.50	0.75	0.75	0.75
10 Year Govt. Bonds	2.63	1.32	1.50	1.80	2.63	2.32	1.20	1.70	1.90
$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	60.1	63.2	63.0	64.9	60.7	62.1	63.1	61.1

(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	8/07/2019	Jun-19	*Sep-19*	*Dec-19*	*Mar-20*	*Jun-20*	*Sep-20*	*Dec-20*	*Mar-21*	*Jun-21*	*Sep-21*	*Dec-21*
WTI oil	US$/bbl	57	64	62	64	64	69	69	69	69	69	69	69
Brent oil	US$/bbl	65	73	70	70	70	75	75	75	75	75	75	75
Tapis oil	US$/bbl	67	76	72	72	72	77	77	77	77	77	77	77
Gold	US$/ounce	1398	1310	1360	1400	1410	1430	1340	1200	1250	1410	1480	1500
Iron ore (spot)	US$/tonne	n.a.	100	97	88	79	76	72	68	71	69	71	69
Hard coking coal*	US$/tonne	n.a.	199	185	170	165	160	155	152	155	153	151	150
Thermal coal (spot)	US$/tonne	72	78	68	72	74	76	78	76	74	72	71	70
Aluminium	US$/tonne	1790	1795	1775	1825	1875	1925	1950	1975	2000	2025	2000	1975
Copper	US$/tonne	5873	6121	6000	6150	6225	6150	6125	6100	6080	6060	6040	6020
Lead	US$/tonne	1873	1884	1900	1850	1825	1800	1750	1725	1700	1725	1700	1675
Nickel	US$/tonne	12676	12251	12000	12500	12600	12500	12400	12500	12250	12100	11900	11750
Zinc	US$/tonne	2370	2763	2600	2650	2625	2575	2500	2400	2300	2200	2150	2150
Aus LNG**	AU$/GJ	n.a.	11.3	12.9	12.0	11.8	11.6	12.4	12.2	11.9	12.0	12.2	12.2

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

** Implied Australian LNG export prices

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