EMBARGOED UNTIL 11.30 AM WEDNESDAY 14 AUGUST 2019

THE FORWARD VIEW: AUSTRALIA AUGUST 2019

Below-trend growth and low inflation – another rate cut ahead

OVERVIEW

We have not materially changed our forecasts this month, with the exception of a near-term tuning of our Q2 GDP forecasts based on weaker than expected consumption partials and a stronger than expected trade balance. At this point we expect Q2 GDP to rise by between 0.4-0.5% which will see the year ended rate fall to around 1½% - a relatively weak outcome. Beyond that, our forecasts remain unchanged, with year-average growth of 2¼% in each of the next two years. The key dynamics continue to be a weak household sector, with only modest growth in consumption and declining dwelling investment offset by strength in public spending, business investment and exports in the near term.

Given our outlook for below trend growth, we see the unemployment rate rising slightly, reaching 5.5% by end-2020 and broadly remaining there, on the back of slowing employment growth. With unemployment well above current estimates of full employment, a key implication is that wage growth will likely remain weak – though we do expect it to rise gradually.

On the inflation front our outlook remains subdued. We expect core inflation to gradually lift from here, but for it to only reach the bottom of the RBAs target band in late-2021. While the exchange rate has deteriorated somewhat recently, the pass through to consumer prices is likely to be lagged and comes in the face of weak global inflation. Domestically, ongoing weak wage growth and strong competition will likely see market sector prices growth remain contained, while housing (a large component of the CPI) is expected to remain weak.

Consequently, we expect further policy easing, with the opportunity for the RBA to move back to the target more quickly. We see a further cash rate cut in November to a new record low of 0.75% but do not rule out the risk of further cuts or unconventional policy measures. In addition we think that there is the need for further fiscal stimulus, through new infrastructure spending or the pull-forward of tax cuts. The impact of tax cuts to date is likely to be small, while the impact of rates – which will have a larger effect – is likely to take some time to flow through to the economy.

Indeed, the RBA sees inflation remaining low for a significant period with little chance of a rise in rates before inflation sustainably rises towards the middle of the band – a gradual process. It should be noted that while the RBA currently forecasts growth around 0.5ppt stronger than our own persistently over the next two years, the outlook for inflation is not dissimilar. Our outlook for the labour market is weaker.

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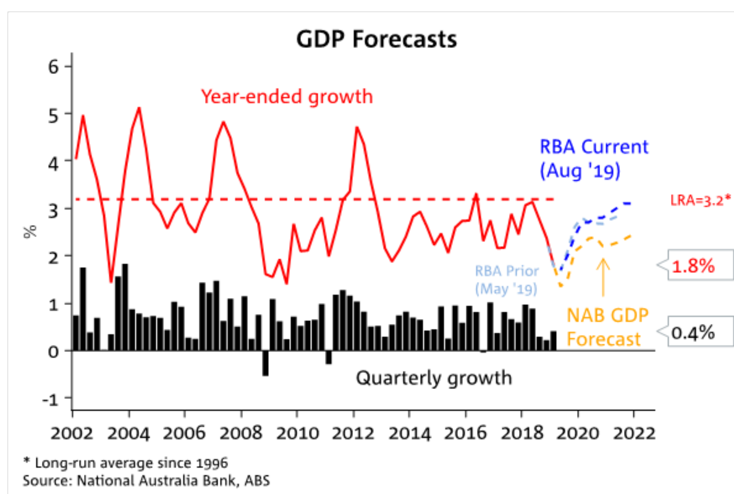
KEY ECONOMIC FORECASTS

	2018	2019-F	2020-F	2021-F
Domestic Demand (a)	2.9	1.4	2.1	2.6
Real GDP (annual average)	**2.8**	**1.6**	**2.2**	**2.3**
Real GDP (year-ended to Dec)	**2.4**	**2.0**	**2.2**	**2.5**
Terms of Trade (a)	1.8	4.1	-7.6	1.8
Employment (a)	2.7	2.0	0.8	1.1
Unemployment Rate (b)	5.0	5.3	5.5	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	0.65	0.70	0.74

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

NAB AND RBA GDP FORECASTS



Source: ABS, NAB Group Economics

LABOUR MARKET, WAGES AND THE CONSUMER

The unemployment rate was steady at 5.2% in June (around 0.25ppt higher than its local trough in January). Employment increased by 500 persons in the month, with a 21.1k rise in full-time employment offset by a 20.6k fall in part-time employment – reflecting payback from the temporary election boost to employment in May. With the participation rate unchanged at 66%, the employment-to-population ratio remained at a high level. Overall, labour market conditions remain relatively healthy though it appears employment growth has slowed over recent months. The unemployment rate has hovered above the 5% level for much of 2019, but has come alongside strength in labour force participation.

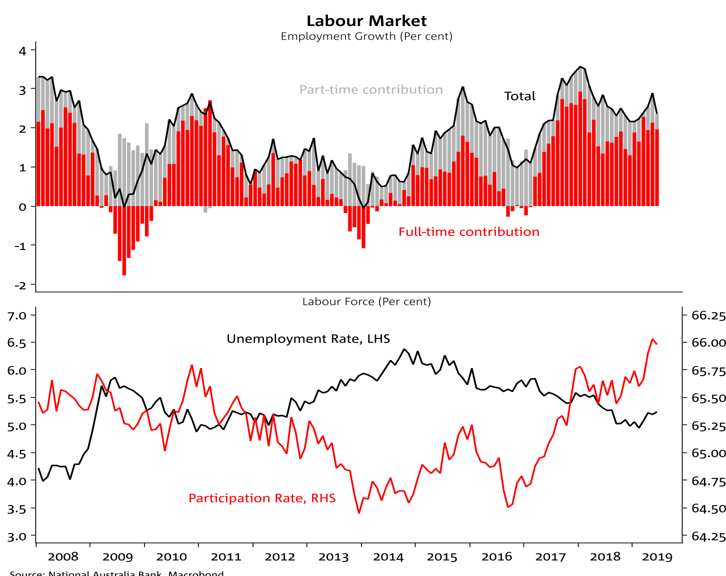
Going forward we expect the labour market to deteriorate somewhat, with employment growth to slow on the back of weaker economic activity and the unemployment rate to rise to around 5.5% over the next two years. To date, leading indicators have weakened but do not point to a sharp deterioration in the labour market. Job ads have fallen but remain high, job vacancies growth has slowed, while the NAB Monthly Business survey employment index reversed its June rebound in July, and is now back below average.

Nominal retail sales increased by 0.4% m/m in June, after rising by 0.1% in May. In the month, the value of sales rose across all categories except department stores (down 0.6% m/m). The quarterly volumes measure rose by 0.2% after a 0.1% decline in the March quarter – resulting in the lowest annual growth in retail sales since the 1990s recession. The NAB Cashless retail sales index release next week will provide an early indicator of how retail sales have tracked in the early part of Q3 – which is likely to see a boost in consumer expenditure from the tax offsets recently legislated.

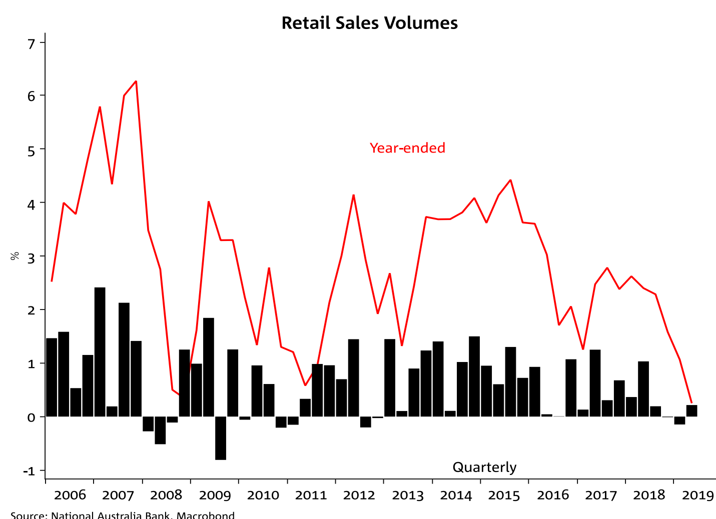
Based on the outcome for quarterly retail sales volumes and our own internal modelling using transaction data, we expect another weak outcome for consumption in Q2 (to be released in next months national accounts). We expect real household consumption to increase by 0.4%, following the 0.3% outcome in Q1. This would see year-ended growth print at 1.3% - the weakest outcome since 2013. We expect goods consumption to remain very weak, while services consumption growth is also expected to moderate.

We expect the recent tax cuts and reductions in interest rates to provide some support to the household sector – though how much and for how long remains unclear. For now we expect the heightened levels of consumer thrift to continue with wage growth remaining weak, debt levels high and confidence weak on tighter household budgets. We expect a small in improvement in consumption growth going forward, but for it to remain weak at 2¼ y/y for the next two years.

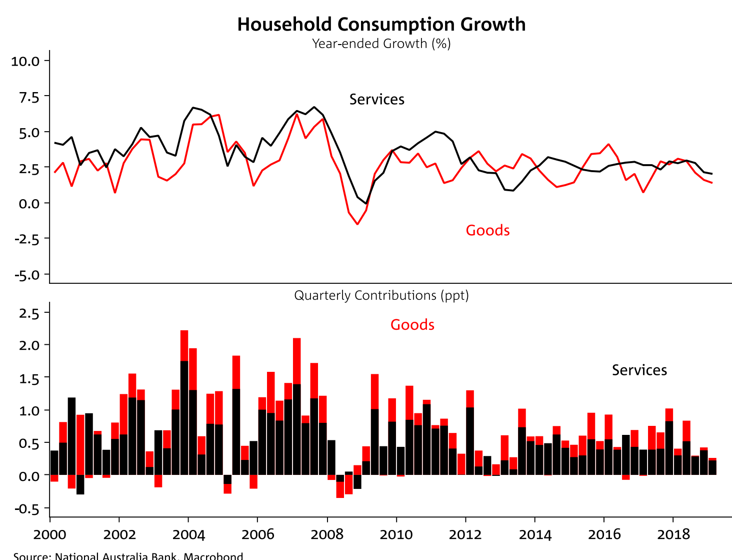
SLIGHT SLOWING IN EMPLOYMENT GROWTH...



RETAIL WEAKNESS PERSISTS...



GOODS CONSUMPTION TO REMAIN WEAK...



HOUSING AND CONSTRUCTION

Prices in the established housing market appear to have stabilised, with the CoreLogic 8-Capital City dwelling price index recording its second consecutive monthly increase in July. Prices in Sydney and Melbourne each rose by 0.2% in the month after declining by 14.9% and 11.1%, respectively, from peak to trough. Prices also increased by 0.2% in Brisbane and 0.3% in Hobart, while prices fell 0.3% in Adelaide. Prices in Perth fell another 0.5% in the month and are now down 8.9% over the year – suggesting that there continues to be ongoing adjustments in the west, following the tailing off of the mining boom.

Overall, prices remain 7.3% lower over the year across all capitals and 3.0% lower across regional areas. We expect house prices to stabilise in Sydney and Melbourne from here, and some small weakness in the other capitals over the next year.

While prices appear to have stabilised in the established market, activity in the new segment of the market appears to be continuing its downward adjustment. Building approvals – a leading indicator of future construction activity – recorded another small fall in June (down 1.2%) after a relatively flat outcome in May. Approvals for new detached houses increased by 0.5% while approvals for apartments fell by 7.0%. Over the year, approvals are now 25.6% lower, with approvals for apartments down 39.0%.

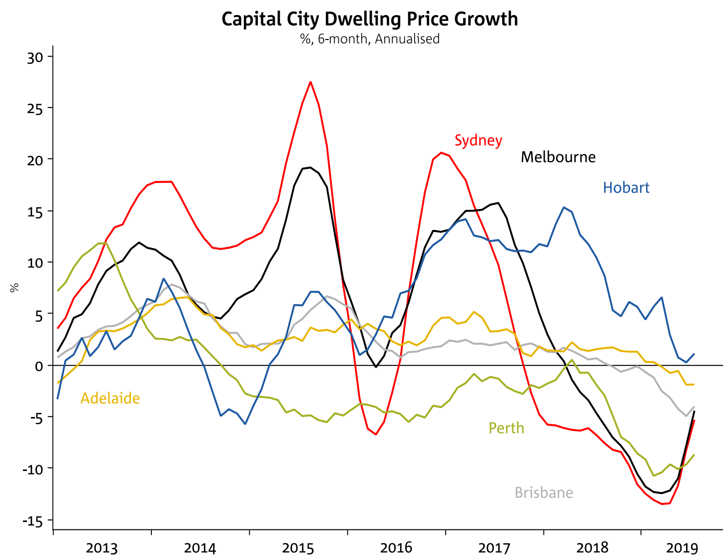
The lagged building activity release, suggests that despite the adjustments in the housing market over the past year or so, the pipeline of work yet to be done remains relatively high. However, the high level of work done also suggests that in the absence of a significant pickup in approvals, this pipeline will be eroded relatively rapidly.

With the ongoing pull-back in construction we expect the national accounts measure of dwelling investment to continue to decline. Over the past two quarters investment in dwellings has decline by around 5%, and we expect this to decline by a further 10-15% over the next 18 months. That is, we expect construction in the residential housing sector to continue to drag on GDP and likely have some labour market impacts in the sector. However, we expect this adjustment to continue in an orderly fashion, with dwelling investment having peaked at a relatively high share of GDP.

Housing credit growth has continued to slow in year ended terms, with a 6th consecutive flat outcome for investor credit in June, and a further slowing in credit extended to owner-occupiers (now 3.7% y/y). Overall, housing credit growth has slowed to 3.3% y/y.

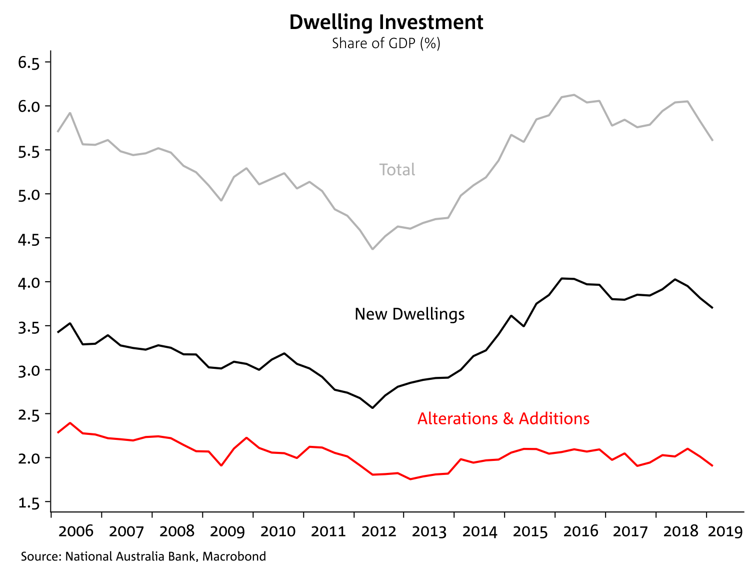
The reduction of the cash rate to a record low, fiscal stimulus as well as the easing of some macroprudential measures in the housing market will likely see the market bottom out at a higher level than previously anticipated but we do not yet see a return to the high rates of growth in prices and activity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

PACE OF DWELLING PRICE DECLINES EASES..



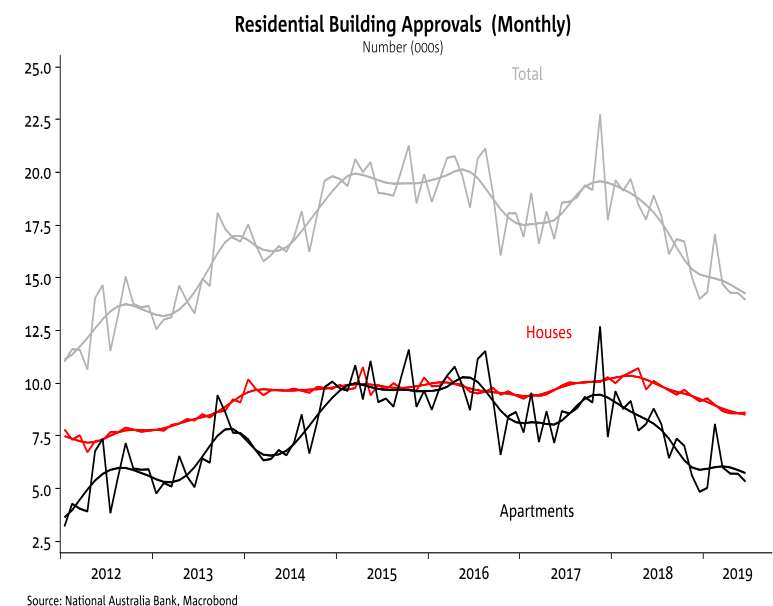
Source: CoreLogic, National Australia Bank, Macrobond

DWELLING INVESTMENT TO FALL FURTHER..



Source: National Australia Bank, Macrobond

APPROVALS SUGGEST MORE WEAKNESS..



Source: National Australia Bank, Macrobond

BUSINESS AND TRADE

Ahead of the ABS measures of business investment to be released later this month and in the national accounts, the NAB Monthly Business survey – a higher frequency indicator - suggests that there may be some downside risk to both actual and expected investment.

Both business conditions and confidence remain below average (conditions fell 2pts in July to +2, confidence ticked up 2 pts to +4). Forward orders and capacity utilisation, now both below average, in addition to weak confidence, suggest that business conditions are unlikely to pick-up in the near term. Mirroring the decline in conditions and capacity utilisation over the past year, business capex has also declined to around average. Alongside the decline in the employment index, this suggests that the loss in momentum in the business sector since early 2018 (coinciding with the recent peak in GDP growth) has fed through to hiring and investment decisions.

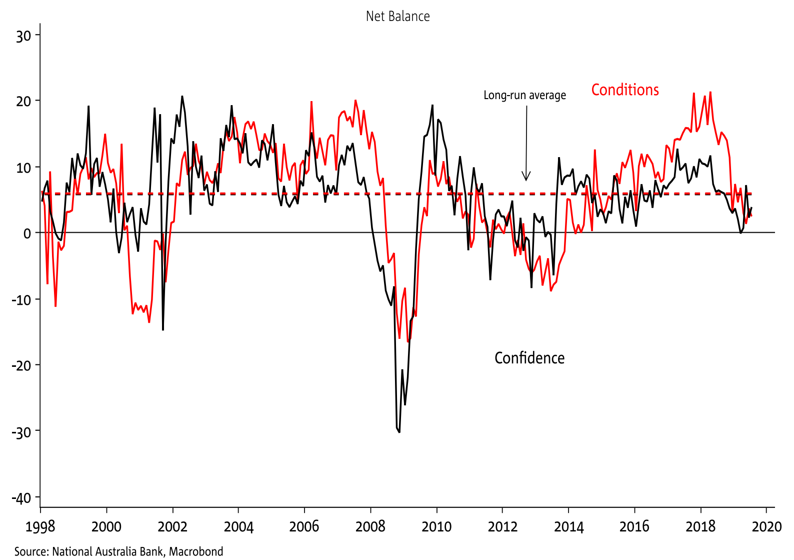
The survey suggests that outside of mining, the weakening in conditions has been broad-based across states in the past year. The decline has also been broad-based across industries. The retail sector remains particularly weak, with conditions at recessionary levels. Manufacturing and wholesale are also weak.

Outside of the survey ABS data on non-residential building approvals though volatile, increased in June. In trend terms, approvals have tracked sideways at a high level for the past year or so, suggesting a healthy pipeline of non-residential construction work.

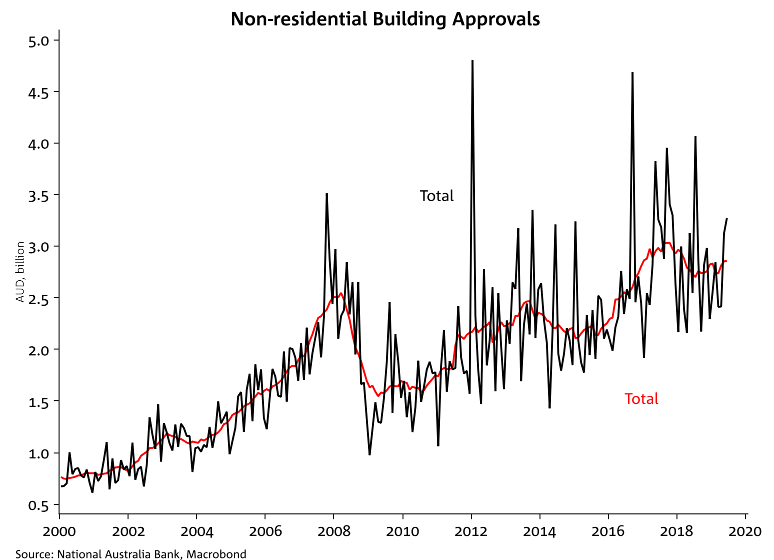
The trade surplus continues to set records, with a strong lift in iron ore exports seeing the surplus widen to record levels. Based on monthly trade data and information on prices for imports and exports in Q2, we estimate that net exports will make a positive contribution (of 0.3-0.4 ppt) in Q2.

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- 5% y/y over the next few years. The ongoing large pipeline of public sector investment is likely to see some spill-overs to the non-mining part of the private sector, while the mining sector is expected to stabilise at a new higher level. With commodity prices generally remaining higher than expected, it is possible that there is some new investment in the sector, though it is unlikely to reach the levels seen during the height of the mining boom. In the near term, we expect resource exports to continue to rise before reaching a plateau in later 2019. While resource exports may continue to grow on the back of new investment, it is unlikely that they will see the magnitude of increases seen over the past few years with the last of the LNG mega projects coming online.

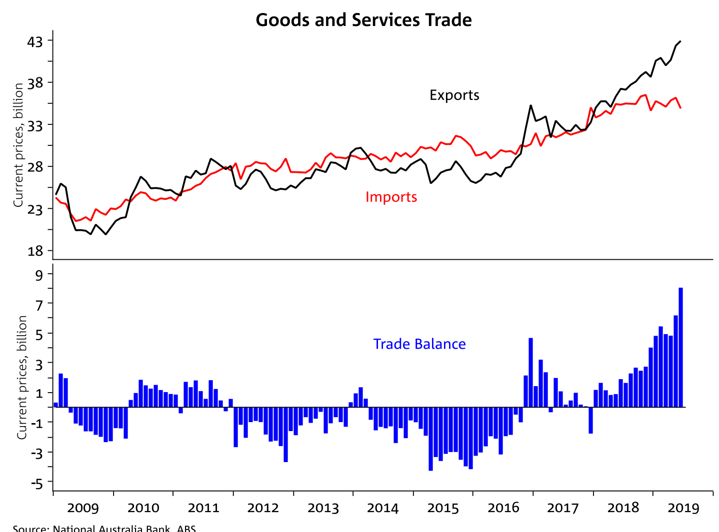
CONDITIONS BELOW AVERAGE..



NON-RES HOLDING UP...



EXPORTS CONTINUE TO RISE...



COMMODITIES

Spot prices for iron ore corrected sharply in early August – from in excess of US$120 a tonne at the end of July to the low-to-mid US$90s a tonne at the time of writing. Supply side pressures – led by disruptions to Brazilian output – are beginning to fade, as Brazil's exports continue to recover (up 17% mom in July). China's port stockpiles – which fell between mid-April and mid-July – have started to increase again, indicative of an easing in the underlying market balance. The recent ratcheting up of US-China trade tensions adds some concerns on the demand side, with signs that speculators may be exiting the market. We forecast 62% ore landed in China to average US$93 a tonne in 2019, before easing to US$74 a tonne in 2020.

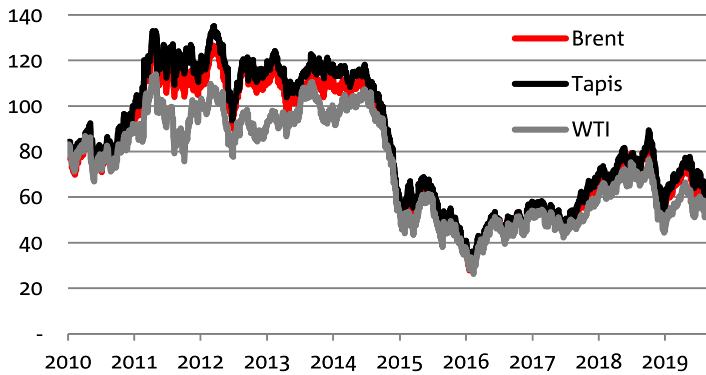
Downward pressure on coal prices has continued, with spot prices for thermal coal dropping below US$70 a tonne in early August, while hard coking coal prices have fallen below US$160 a tonne. It is unclear how strict is a proposed quota on Chinese coal imports (limiting the full year total to 281.5 million tonnes, the same quantity as 2018) as this would result in a significant slowdown for the remainder of this year. India plans to cut coal imports by at least one-third over the next five years – which would significantly reduce global demand over this period. Prices for hard coking coal are forecast to fall to US$156/t in 2020 (from US$185/t in 2019), while thermal coal prices are forecast to ease to US$76 a tonne in 2020 (from US$79/t).

Oil prices have been generally lower over the past month, with Brent back in the $50s range for this first time since January. The market continues to face competing forces, with ongoing output cuts and simmering geopolitical tensions, but weak demand so far this year and a weakening global growth outlook. IEA data shows that the first five months of 2019 saw the weakest consumption growth in a decade.

In response to these factors, we have cut out oil price forecasts, with Brent at US$68/bbl in Q4. We forecast an increase in AUD LNG export prices, although this largely reflects our lower expectations for the AUD itself. We still see Australian LNG volumes topping out this year.

GLOBAL OIL PRICES

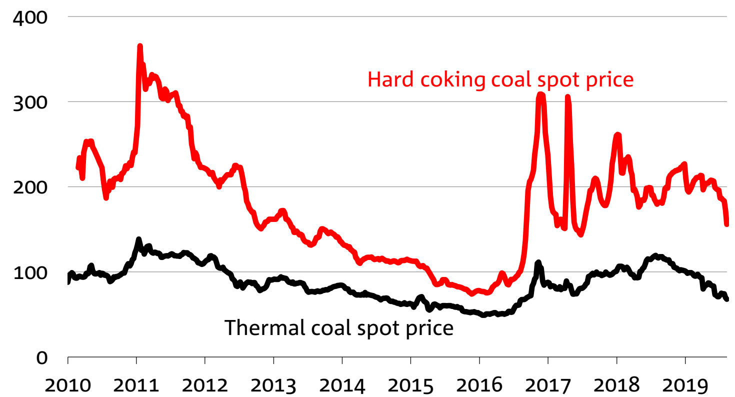
USD/bbl, daily



Sources: Refinitiv, NAB Economics

COAL SPOT PRICES

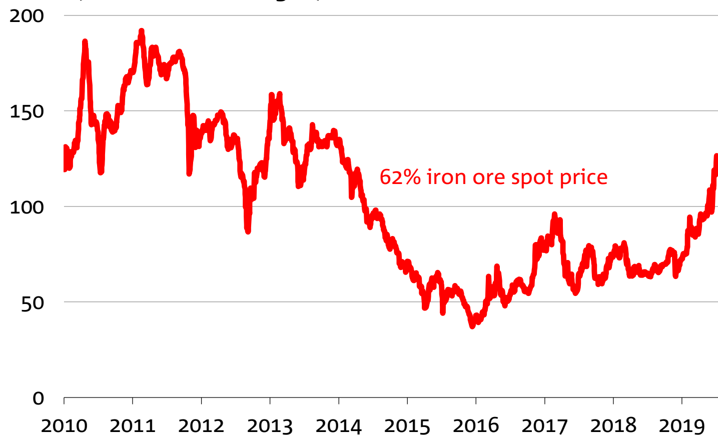
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

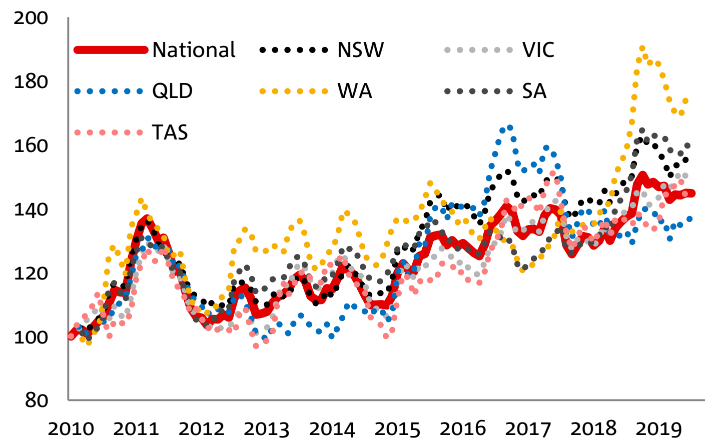
US$/t (incl. cost of freight)



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

CPI data for Q2 continues to suggest weak inflationary pressure in the economy. While headline inflation picked up on a quarterly basis (driven by a sharp rise in petrol prices) it continues to track below 2%, rising by 1.6% over the past year. Both underlying measures of inflation – the trimmed-mean and weighted-median CPI measures - rose by 0.4% in the quarter to be to be 1.6% and 1.4% higher over the year, respectively. Both international and domestic factors have driven the weak outcome for inflation. Globally, inflation has remained low, and while the exchange rate has deteriorated somewhat in 2019, the pass-through to consumer prices is long and variable. Domestically, weak wage growth and strong competition has seen prices growth remained contained, while the large housing component of the CPI (rents and new dwelling costs) have eased. All three of these factors are likely to persist for some time.

Following the release of the CPI, the RBA left the cash rate unchanged at 1.0% in August, after back-to-back 25bp cuts in June and July. Recent communication from the RBA in the SoMP, the Governor's appearance before the House economics committee and the post meeting statement emphasise inflation is likely to remain weak for some time – and that consequently rates are also likely to stay low until such time as there is evidence that inflation has sustainably returned to the middle of the target band. In fact, this communication has an easing bias with the post meeting statement noting "The Board will continue to monitor developments in the labour market closely and ease monetary policy further if needed to support sustainable growth in the economy and the achievement of the inflation target over time".

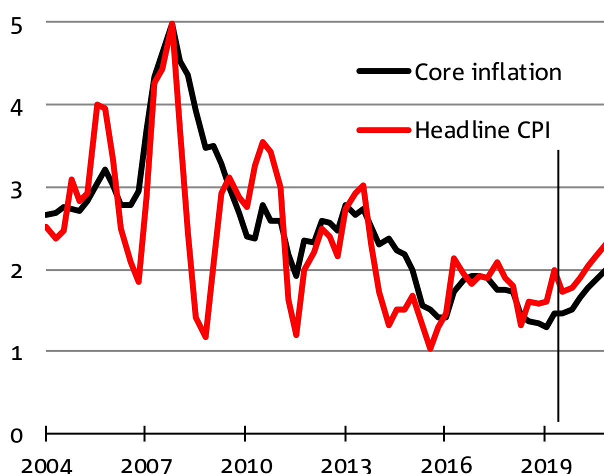
Alongside these communications the RBA has downgraded its forecasts slightly for growth, inflation and unemployment – while incorporating a further two rate cuts based on the market path at the time of Staff forecast update. Growth is expected to pick-up to around trend (2.5%), and the unemployment rate is expected to edge lower (though later than previously expected; 4.75% by end-2021). Inflation is expect to rise gradually reaching the bottom of the band by end-2021.

Base on recent data flow, our forecasts and the updated outlook of the RBA itself we expect a further reduction in the cash rate in November but acknowledge the risk that more may need to be done, including more support from fiscal policy and the possibility of unconventional monetary policies. Our modelling of the impact of the tax cuts this year suggests the boost to spending is likely to be small and while interest rates will help, their impact occurs later.

The exchange rate channel is likely to provide some support with the AUD/USD has trading lower over the past month, falling to a post 2009 low of below US67c. The escalation of trade tensions, with the threat of further tariffs saw a weakening of the Aussie alongside a move down in the Yuan. We have lowered our forecasts for the AUD over the next two years, expecting a near term dip to around US65c before rising to US70c by the end of 2020 (previously US75c).

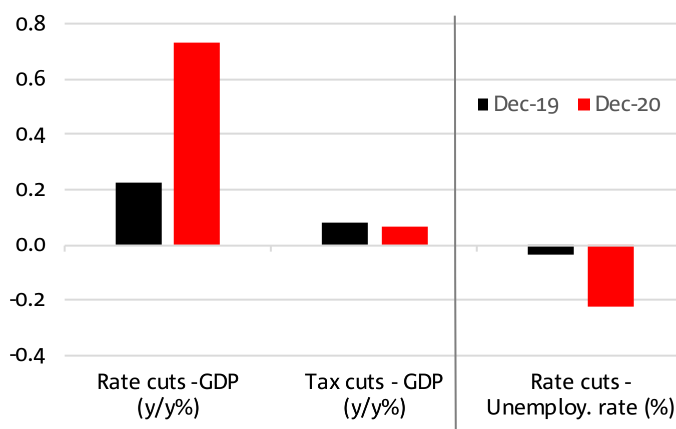
HEADLINE AND CORE INFLATION

y/y % change



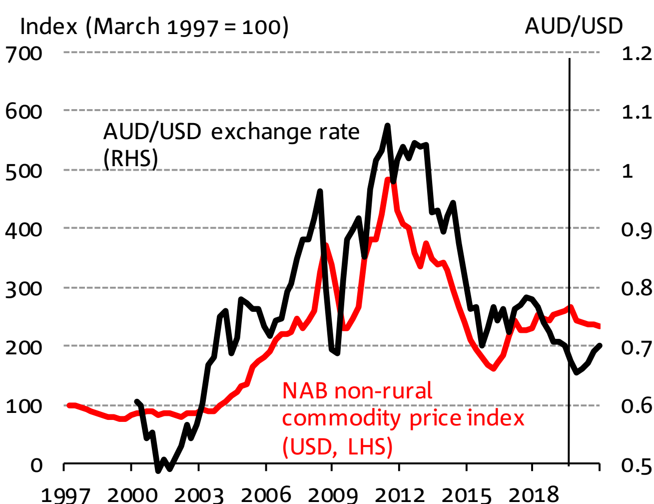
IMPACT OF FISCAL STIMULUS AND RATE CUTS ON ACTIVITY FORECASTS

Impact of policy stimulus (deviation from baseline)*



*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	1.7	2.3	2.4	2.6	1.5	2.0	2.4
Dwelling Investment	0.5	-0.2	-10.1	-5.1	-2.2	4.7	-8.2	-8.1	-1.4
Underlying Business Investment	6.8	-2.1	2.6	2.7	3.8	0.9	0.3	3.0	2.0
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**	**1.6**	**2.4**	**2.9**	**2.9**	**1.4**	**2.1**	**2.6**
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**	**1.4**	**2.4**	**2.8**	**3.1**	**1.2**	**1.9**	**2.6**
Exports	4.1	2.7	2.8	2.2	3.4	5.0	1.7	2.8	2.0
Imports	7.1	0.2	0.3	2.7	7.7	3.9	-0.7	1.6	3.0
GDP	**2.9**	**2.0**	**2.0**	**2.3**	**2.4**	**2.8**	**1.6**	**2.2**	**2.3**
Nominal GDP	4.7	5.1	2.4	3.8	6.1	4.9	4.1	2.2	4.6
Current Account Deficit ($b)	51	18	31	41	46	39	12	43	41
(-%) of GDP	2.7	0.9	1.6	2.0	2.6	2.0	0.6	2.1	1.9
Employment	3.0	2.4	1.4	0.7	2.4	2.7	2.0	0.8	1.1
Terms of Trade	1.7	6.3	-5.2	-1.5	11.6	1.8	4.1	-7.6	1.8
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	1.6	1.7	2.2	1.9	1.8	1.6	1.9	2.3
Core CPI	1.7	1.4	1.5	1.9	1.9	1.7	1.3	1.6	2.0
Unemployment Rate	5.5	5.2	5.3	5.5	5.4	5.0	5.3	5.5	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	0.67	0.72	0.78	0.71	0.65	0.70	0.74
$A - Trade Weighted Index	62.6	60.1	57.1	60.0	64.9	60.7	56.3	58.7	60.5

(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	12/08/2019	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$/bbl	55	64	56	63	65	65	65	70	70	70	70	70
Brent oil	US$/bbl	58	73	63	68	70	70	70	75	75	75	75	75
Tapis oil	US$/bbl	60	76	65	70	72	72	72	77	77	77	77	77
Gold	US$/ounce	1505	1310	1460	1450	1480	1520	1550	1570	1590	1600	1610	1630
Iron ore (spot)	US$/tonne	n.a.	99	101	88	79	76	72	68	71	69	71	69
Hard coking coal*	US$/tonne	n.a.	199	170	165	160	155	152	155	153	151	150	150
Thermal coal (spot)	US$/tonne	72	78	68	72	74	76	78	76	74	72	71	70
Aluminium	US$/tonne	1738	1795	1775	1750	1740	1750	1800	1850	1900	1950	2000	1975
Copper	US$/tonne	5716	6121	5875	5750	5700	5725	5750	6000	6080	6060	6040	6020
Lead	US$/tonne	2077	1884	2000	1900	1850	1800	1750	1725	1700	1725	1700	1675
Nickel	US$/tonne	15680	12251	14000	12500	12600	12500	12400	12500	12250	12100	11900	11750
Zinc	US$/tonne	2269	2763	2400	2350	2375	2400	2425	2450	2300	2200	2150	2150
Aus LNG**	AU$/GJ	n.a.	10.9	13.1	11.7	12.4	12.6	12.2	12.0	11.8	11.7	11.5	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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