EMBARGOED UNTIL 11.30 AM WEDNESDAY 11 SEPTEMBER 2019

THE FORWARD VIEW: AUSTRALIA SEPTEMBER 2019

Below-trend growth and low inflation still expected as downside risks build. We have inserted another rate cut(s) in early 2020.

OVERVIEW

Post the National Accounts – not surprisingly - we have not materially changed our forecasts. That said, we are increasingly worried about downside risks. That is consistent with our August Business Survey which shows no let up in the downward loss of momentum in private demand. Our internal data also highlights the risk that tax refunds have done little to boost spending, while business investment remains weak and the dwelling cycle could well be deeper than previously forecast. The international outlook also is not inspiring confidence.

That said, our forecasts remain for GDP growth of around 1.7% in 2019, 2¼% in 2020 and 2½% in 2021 (as more expansionary policy kicks in). As per previous forecasts 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.

These below trend forecasts see no improvement in the degree of labour market spare capacity and we see the unemployment rate rising slightly, reaching 5.5% by mid to end-2020 and broadly remaining there over the forecasting period. 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.

We continue to expect the RBA to cut rates by 25 points by November – but are very aware that any further near term data weakness will see the October RBA meeting as live. With the Government seemingly reluctant to further boost fiscal policy in the near term we are moving to insert another cut into our rate profile. At this stage we have tentatively placed it in early 2020 (February).

With tax cuts making little impact on consumer spending (and probably wont in the near term) and rate cuts taking time to impact we continue see a need for further fiscal stimulus, through new infrastructure spending or the pull-forward of tax cuts. Unless something meaningful is done on fiscal policy we would not rule out another cut (bringing the Official Cash rate to 0.25%) by mid-2020 together with non-conventional monetary policy. It should be noted that RBA growth forecasts are still at least 0.5ppt stronger than our projections.

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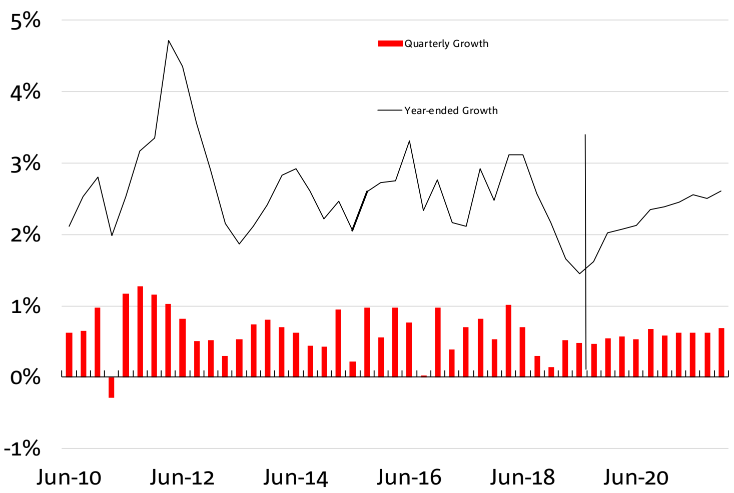
KEY ECONOMIC FORECASTS

	2018	2019-F	2020-F	2021-F
Domestic Demand (a)	2.8	0.9	1.7	2.6
Real GDP (annual average)	**2.7**	**1.7**	**2.2**	**2.5**
Real GDP (year-ended to Dec)	**2.2**	**2.0**	**2.4**	**2.6**
Terms of Trade (a)	2.0	3.2	-7.9	1.8
Employment (a)	2.7	2.0	0.8	1.2
Unemployment Rate (b)	5.0	5.3	5.5	5.4
Headline CPI (b)	1.8	1.6	2.0	2.4
Core CPI (b)	1.8	1.3	1.7	2.1
RBA Cash Rate (b)	1.50	0.75	0.50	0.50
$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 GDP FORECASTS



Source: ABS, NAB Group Economics

LABOUR MARKET, WAGES AND THE CONSUMER

Total employment rose by 41k in July, driven by a 35.5k increase in full-time employment and a 9.6k rise in the number of part-time workers. The Participation rate rose in the month, which despite the strong employment growth, saw the unemployment rate remain unchanged at 5.2%. The unemployment rate has now held steady at this level for the past four months, after having drifted 0.25ppt higher from the recent low of 4.9% in early 2019. While employment growth has continued at a high rate in annual terms, at well over 2.5%, the rise in participation has seen a degree of spare capacity remain in the labour market, with most current estimates of full employment around 4.5%. Consequently wage growth has remained modest, with wage growth printing at 0.5% q/q in Q2 – for an annual rate of 2.3%.

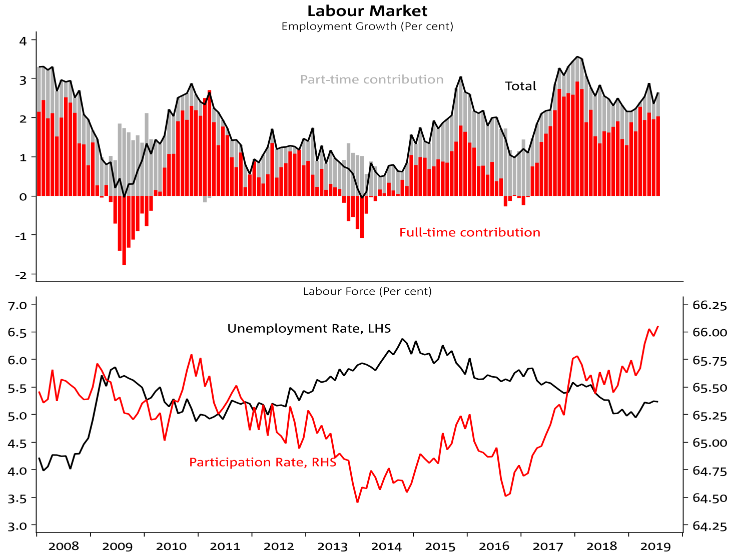
Going forward we expect the labour market to deteriorate somewhat, with employment growth to slow on the back of weaker economic activity and the unemployment rate to rise to around 5.5% over the next two years. To date, leading indicators have weakened but do not point to a sharp deterioration in the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

Household consumption growth was marginally stronger than expected in Q2, with household spending on goods and services rising by 0.4% q/q - but saw annual growth slow further to 1.4% y/y. Key contributors to the rise in the quarter was spending on hotels, cafes & restaurants, recreation and culture and financial & insurance services. Over the year however, spending growth on discretionary items has been very weak, with the bulk of consumption growth coming from growth in spending on essentials.

While the recent interest rate cuts and tax rebates occurred largely post Q2, its appears there has been little boost to households, with monthly retail sales declining by 0.1% m/m in the first month of Q3 – suggesting that to date, the stimulus provided by policy makers has had little impact or has been unable to offset the countervailing headwinds faced by the household sector. The NAB Cashless Retail sales measure released next week will provide an early indicator of how consumer spending has tracked in the middle of the quarter.

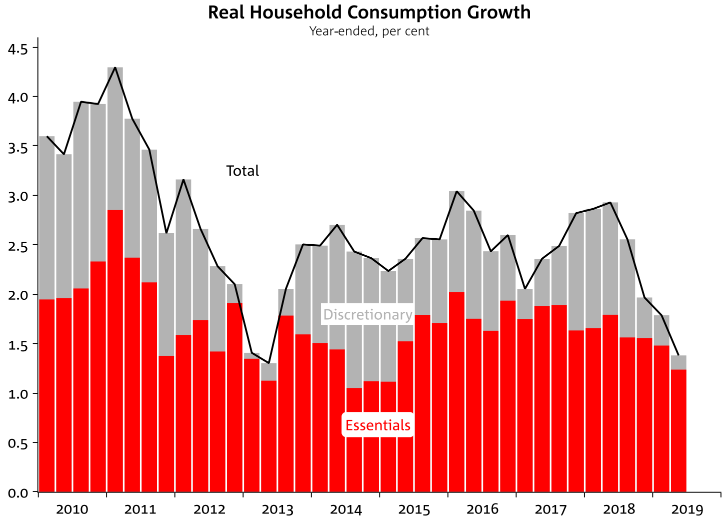
From here we expect household consumption growth to improve, but to remain modest (and well below average) rising to around 2.0% in each of the next two years. We expect the recent trend in consumption growth limited to 'essentials', largely in the form of 'services', to continue. With wage growth remaining weak, sluggish household income growth is likely to remain a headwind to consumption growth. High debt levels, low savings rates and stretched budgets on the prior run up in essentials prices are likely to also continue to weigh until such time as income growth sees a substantial lift.

SLIGHT SLOWING IN EMPLOYMENT GROWTH...



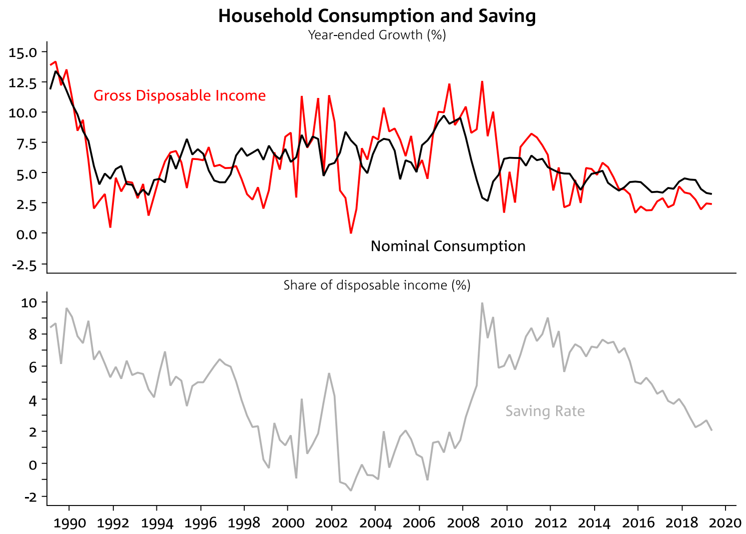
Source: National Australia Bank, Macrobond

CONSUMPTION GROWTH SLOWS FURTHER...



Source: National Australia Bank, Macrobond

INCOME GROWTH REMAINS WEAK...



Source: National Australia Bank, Macrobond

HOUSING AND CONSTRUCTION

Prices in the established housing market recorded a third consecutive rise in August, following the relatively large correction over the prior 18 months. The CoreLogic 8-Capital City dwelling price index rose by 1.0% m/m in August with increases in Sydney (1.6%) and Melbourne (1.4%) driving the increase. Prices in Brisbane and Hobart were also up 1.2% and 0.5% in the month, respectively. Outside of the capital cities, price growth remains modest.

Overall, prices remain 5.9% lower over the year across all capitals and 2.9% lower across regional areas. With the bulk of the prior adjustment having occurred in Sydney and Melbourne, these markets remain over 6.0% lower over the past year, while Perth has also continued to show weakness, down 8.8%.

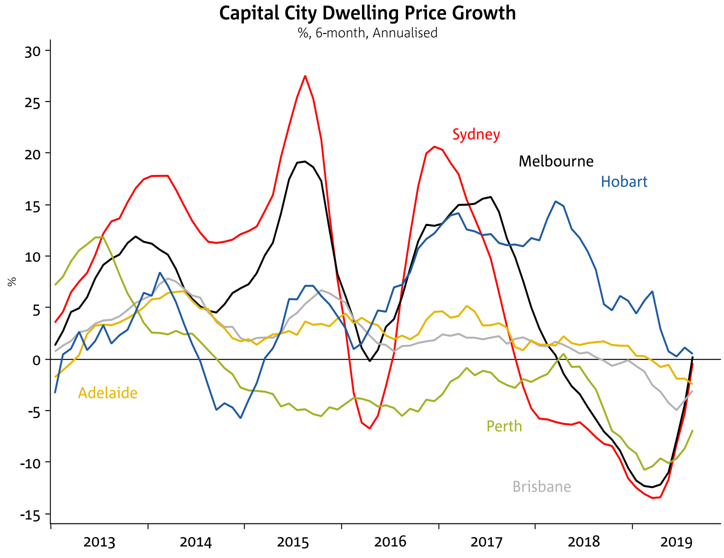
However, despite the stabilisation in prices, activity in the residential construction sector continues to weaken, with approvals continuing to trend down and construction work declining. The national accounts measure of dwelling investment saw a third sharp decline in Q2, falling by 4.4% q/q. The decline was driven by a sharp fall in new construction, down 5.9%, while alterations & additions also declining 1.4%. With approvals remaining weak, we expect dwelling investment do decline further – around another 10% over the next year or so before levelling out.

While dwelling construction has declined relatively sharply, there appears to be a large pipeline of work yet to be done, with the lagged building activity release, suggesting a large amount of outstanding work remains in NSW and VIC. However, with the large rate of work done at present, the pipeline will be relatively quickly eroded in the absence of a substantial pickup in building approvals in the near term.

Alongside the cooling in the housing market (notwithstanding the recent lift in clearance rates and stabilisation in house prices), housing credit growth has continued to slow. Growth in credit extended to owner occupiers has slowed to 4.9% y/y while investor credit, which has declined in each of the past two months, has slowed to 0.3% y/y. Overall, housing credit growth has slowed to 3.3% y/y.

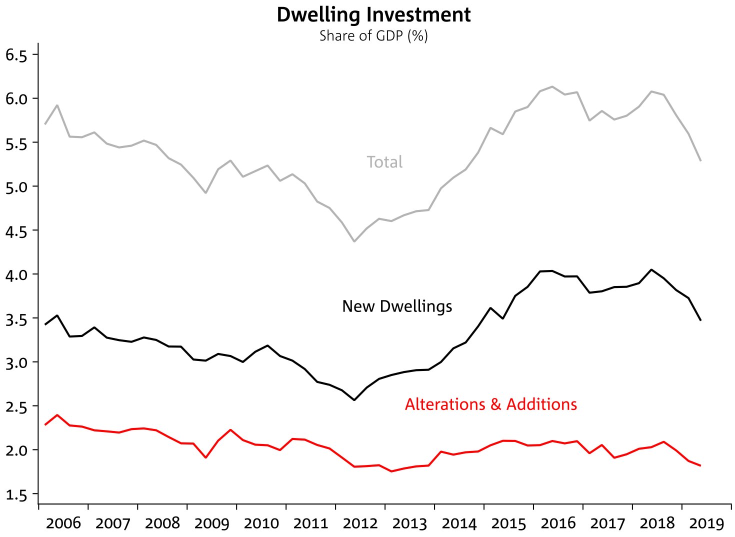
Though the recent fall in house prices was relatively large by historical standards but it occurred in an orderly fashion against a backdrop of relatively low unemployment and interest rates. The decline in investment (dwelling construction) has been sharp but has begun from a very high level. We expect house prices to remain stable over the next year or so, but for construction activity to decline further before itself levelling out. The recent interest rate cuts as well as easing in some aspects of macroprudential policy will act to support the market. However, we are unlikely to see the growth in prices which occurred between 2012 and 2017 with prices remaining elevated, debt levels in the household sector high and income growth remaining weak.

PRICES ARE STABILISING..



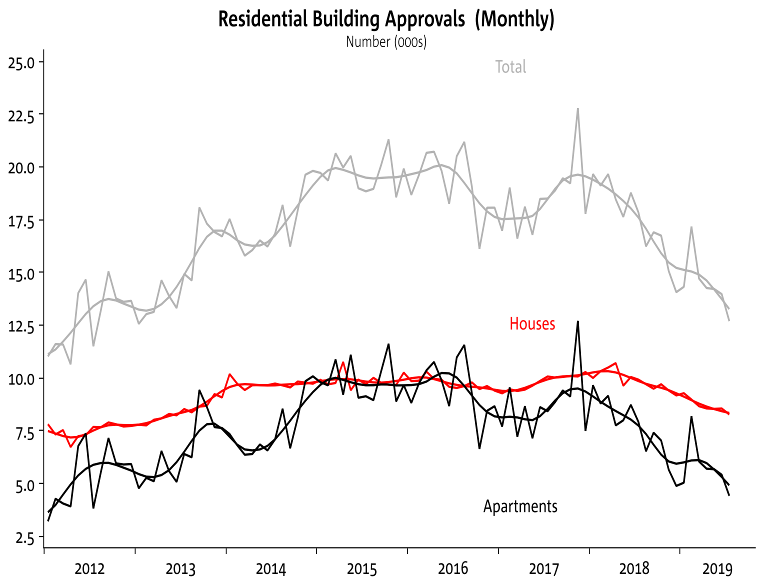
Source: CoreLogic, National Australia Bank, Macrobond

DWELLING INVESTMENT TO FALL FURTHER..



Source: National Australia Bank, Macrobond

APPROVALS SUGGEST MORE WEAKNESS..



Source: National Australia Bank, Macrobond

BUSINESS AND TRADE

The recent run of official ABS data on business investment as well as the latest NAB Business Survey suggest that the business sector has made little contribution to growth outside of mining.

New private business investment fell by 0.4% q/q, with falls in both engineering investment and non-residential building offsetting the increase in spending on machinery & equipment in the quarter. By sector, mining investment saw a rise in the quarter – in line with our view that the unwind of the mining boom has troughed, or is close. Non-mining investment declined however, suggesting some risk around our view that the sector will see reasonable growth over the next few years.

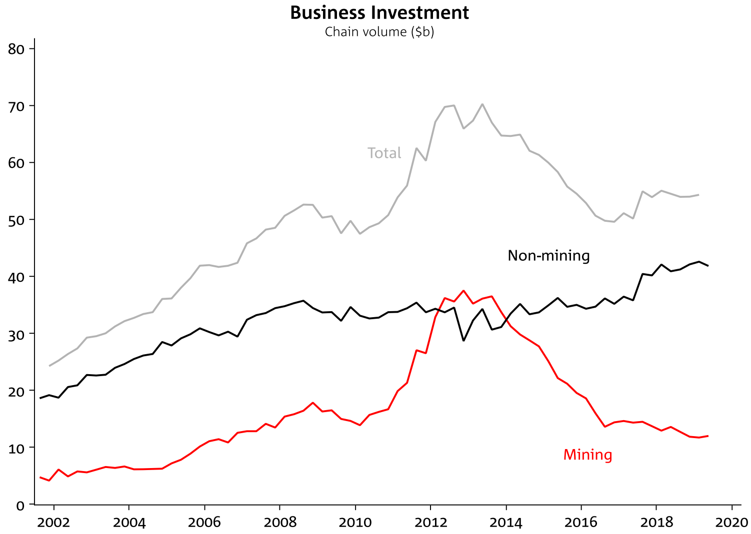
More recent data from the NAB Monthly business survey show that both business confidence and conditions remain weak with both edging lower in August. Both remain well below their long-run average, but for now remain positive. The decline in business conditions has been broad-based across industries since mid-2018, with the exception of mining which has continued to see a resurgence as the tail end of the mining boom fades. Retail remains weak, but wholesale, manufacturing and construction have also seen a deterioration.

Forward looking indicators in the survey suggest that there is unlikely to be an imminent turnaround in conditions with forward orders negative and well below average, and capacity utilisation (though recently volatile) now well below the levels seen 12 months ago. Reported capex has mirrored these trends and is now around average, as is firms hiring activity.

For now, we continue to forecast a solid contribution from business investment growth going forward with a stabilisation in the mining sector (and higher sustaining capex) and spill overs from the large pipeline of public infrastructure work to boost business investment. However, this there appears to be increasing risk that this outlook is too optimistic, with the private sector remaining weak and business conditions showing a loss of momentum. Next months NAB Quarterly business survey will provide an update on business capex intentions.

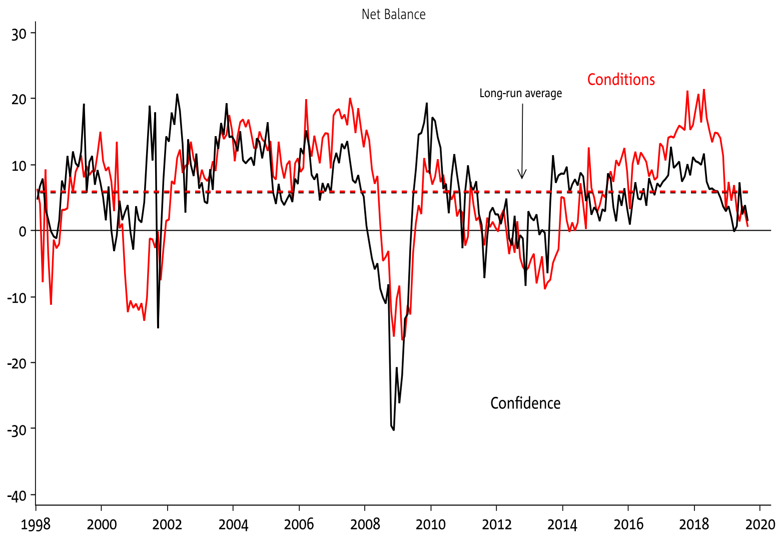
Net exports made a solid contribution to growth in Q2 (0.6ppt) on the back of a surge in LNG exports. The strong rise in commodity exports following the huge expansion to extraction capacity in LNG and iron ore during the boom saw the first current account surplus in 44 years in Q2. Over the past year, exports have been a significant support to growth, but we expect this to tail off as LNG production reaches full capacity and exports level out. This should occur in the near-term which will see the significant boost from trade which has provided a key support to growth fade. While there is the change of some new investment in the sector over the next few years, it is unlikely to result in the large increases in exports seen in recent times. It is likely that projects smaller in nature and often replacing existing mines.

NON-MINING INVESTMENT IS WEAK..



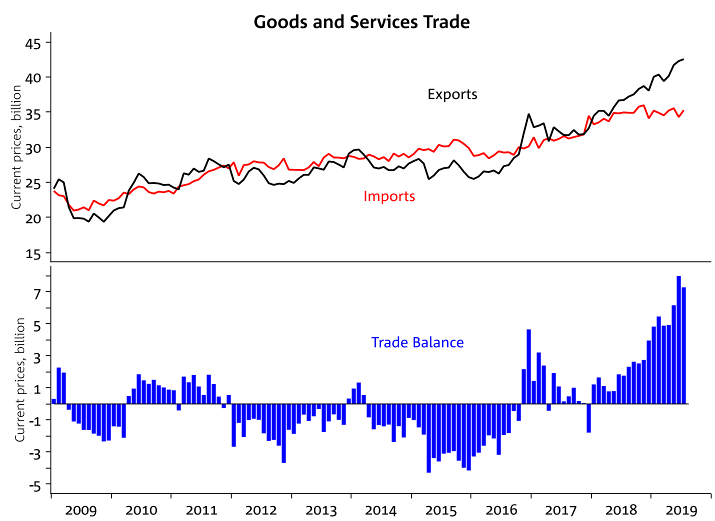
Source: National Australia Bank, Macrobond

CONFIDENCE AND CONDITIONS WEAK...



Source: National Australia Bank, Macrobond

EXPORTS CONTINUE TO RISE...



Source: National Australia Bank, ABS

COMMODITIES

Spot prices for iron ore plunged in August 2019 – averaging US$93 a tonne during the month (compared with US$120 a tonne in July). Supply side pressures (particularly from Brazilian mine closures) have started to ease (with Brazils exports rising by 15% mom in August), while Chinese demand is expected to ease – with steel mill profit margins falling. The latter (in early August at its lowest levels since November 2016) has been largely driven by falling prices for key steel products in the Chinese market. Our forecasts for 62% ore landed in China are unchanged – averaging US$93 a tonne in 2019, before easing back to around US$74 a tonne in 2020.

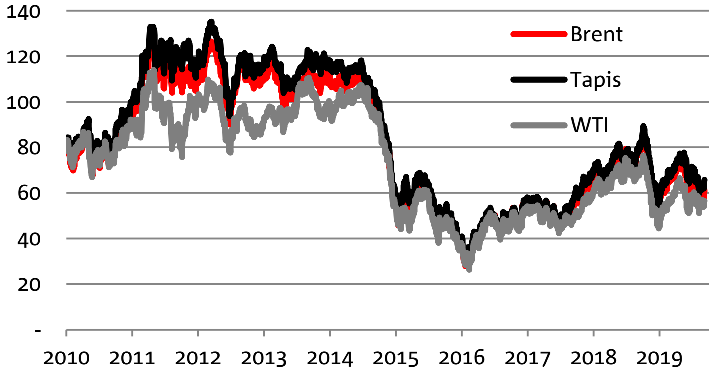
Coal spot prices continued to ease across much of August. Prices for thermal coal have fallen into the mid-US$60s range, while hard coking coal prices fell below US$150 a tonne in early September (from over US$200 a tonne in early June). Weaker prospects in key import markets such as China and India – both in terms of short term slowing in growth and longer term structural changes – could constrain demand going forward (particularly Indian government plans to cut coal imports by one-third over the next five years). Hard coking coal prices are forecast to average US$156/t in 2020, while thermal coal prices are forecast to average US$76/t .

Oil prices have been mixed recently, with Brent in the high $50s to low $60s range. The market continues to face competing forces, with ongoing output cuts and simmering geopolitical tensions, against soft demand and ongoing concerns around the global economic outlook. The Saudi energy minister and head of Saudi Aramco were replaced this week, leading to somewhat higher prices. We have again cut our oil price forecasts, with Brent now forecast to be US$65/bbl in Q4 (was US$68).

Strong Australian LNG export volumes have been a major support to GDP but are now nearing their peak. We expect that volumes will top out this year, as remaining projects come up to full operational capacity. Our model forecasts the LNG export price to increase to AUD13.33/GJ in Q3 although it largely reflects AUD depreciation. We see prices largely in the AUD11-12/GJ range for the forecast

GLOBAL OIL PRICES

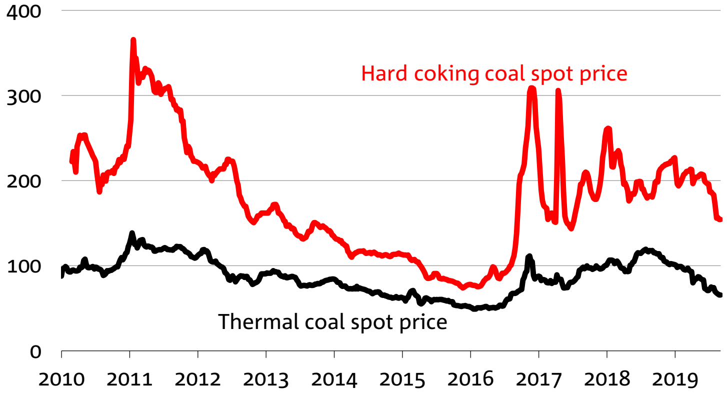
USD/bbl, daily



Sources: Refinitiv, NAB Economics

COAL SPOT PRICES

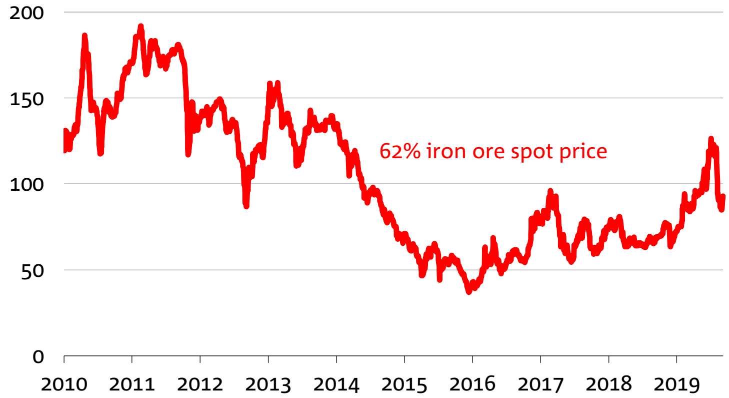
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

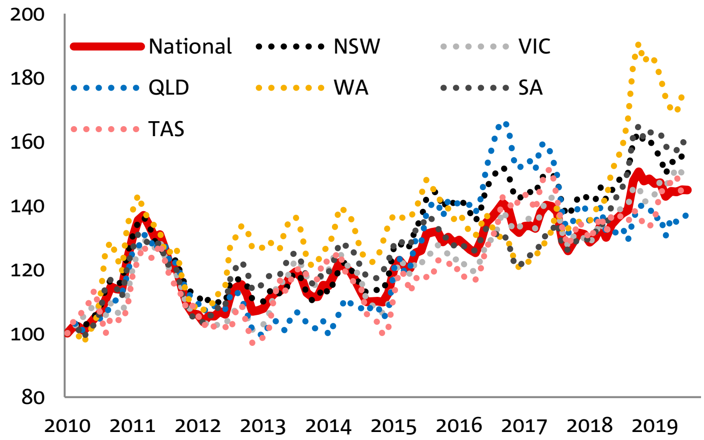
US$/t (incl. cost of freight)



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

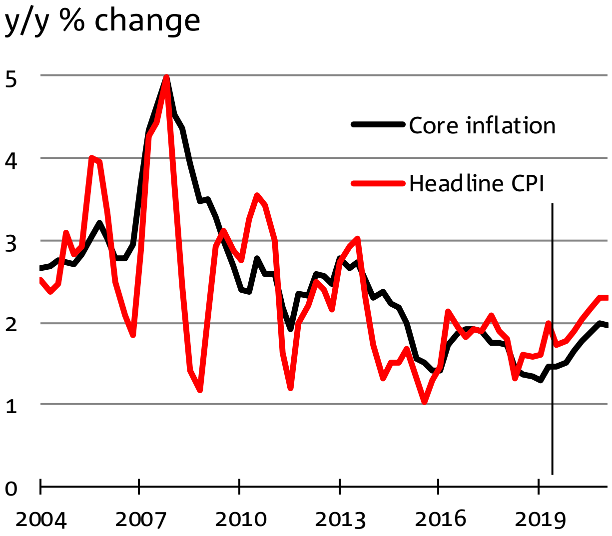
We have left our forecasts for inflation unchanged this month – expecting inflation to remain modest but slowly rise towards the mid point of the RBAs target band. With a degree of spare capacity remaining in the labour market, wage growth is expected to remain modest, and in combination with strong competition, prices growth is expected to remain weak. Further, global inflation remains low and while the exchange rate has depreciated the pass through to consumer prices typically occurs with a long lag contributing further to an overall low inflation environment.

Against the backdrop of weak private sector growth and meek inflation, the RBA left the cash rate unchanged at 1.0% in September – though slightly broadened the easing bias in the post meeting statement while seemingly remaining cautious on the next move looking for an "accumulation of evidence". Indeed, the national accounts released the day after the last board meeting suggested that private demand remains very weak, and is likely to force the RBA to confront its optimistic forecasts for consumption and the business sector, while also suggesting the downturn in the housing cycle could be deeper than previously anticipated. Overall, these outcomes put at risk their view that the unemployment rate will fall – albeit gradually – over the next couple of years.

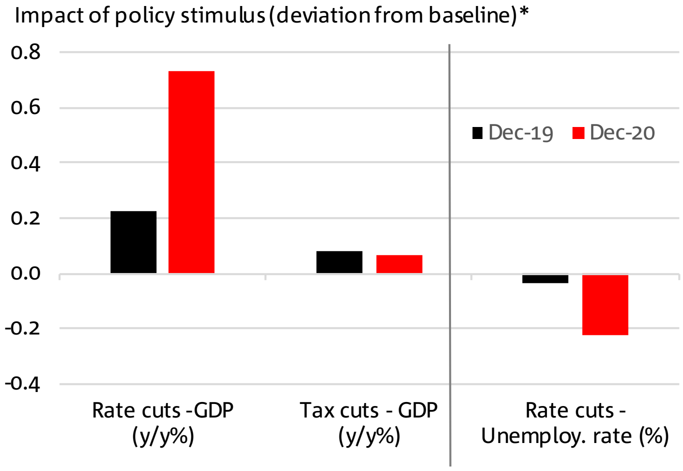
With the recent run of domestic data, against a backdrop of weakening global conditions, we have revised our rates outlook. With the NAB business survey as well as internal data suggesting that that the tax cuts have done little to boost consumption we now expect an additional reduction in the cast rate to 0.5% in February 2020 following our predicted 25bp cut in November. At this point we would expect the RBA to begin to outline its path for unconventional policy, and that the government will need to provide additional support through fiscal policy. Should a more significant boost from fiscal policy fail to materialise we expect the RBA to take further action, cutting the cash rate to 0.25% by mid next year, while beginning to implement unconventional policy – most likely in the form of government bond purchases, though the exact mix of unconventional policy would likely reflect economic and financial conditions at the time.

The exchange rate is an important mechanism by which global developments will impact the local economy as well as an important channel of monetary policy. The exchange rate has recovered somewhat after reaching decade lows last month, to trade near US68.5c. Further resolution of US-China trade tensions could see the Aussie reach US69.0c in the short-term. Our forecasts for the Aussie are unchanged, expecting a bout of near-term weakness, falling to US65.0c by year's end before a gradual appreciation towards US70c over the next year. In the out year we expect the AUD to appreciated further, reaching around US75.0c by end 2021.

HEADLINE AND CORE INFLATION

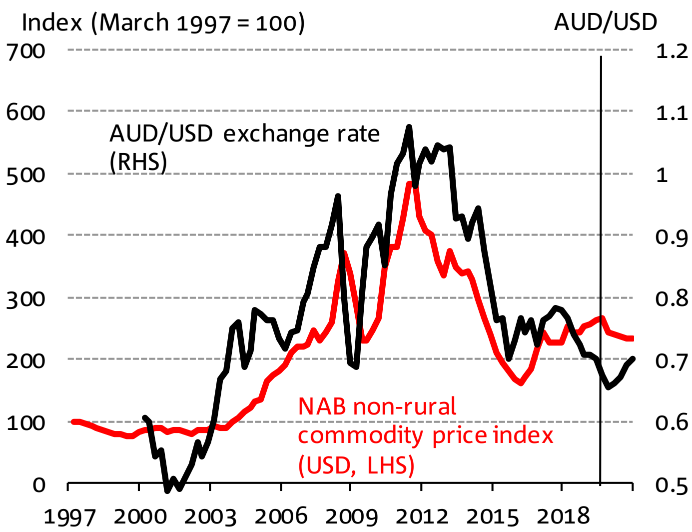


IMPACT OF FISCAL STIMULUS AND RATE CUTS ON ACTIVITY FORECASTS



*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	1.4	2.0	2.4	2.6	1.4	1.7	2.2
Dwelling Investment	0.6	-0.4	-10.6	-4.6	-2.2	4.8	-8.6	-8.1	-0.9
Underlying Business Investment	6.9	-2.5	-1.1	2.0	3.8	1.2	-2.1	0.4	2.0
Underlying Public Final Demand	4.7	4.4	3.7	3.8	4.7	4.3	4.2	3.8	3.6
Domestic Demand	**3.5**	**1.7**	**1.1**	**2.3**	**3.0**	**2.8**	**0.9**	**1.7**	**2.6**
Stocks (b)	0.0	-0.1	-0.3	0.2	-0.2	0.1	-0.4	0.1	0.1
GNE	**3.5**	**1.5**	**0.8**	**2.5**	**2.8**	**3.0**	**0.5**	**1.8**	**2.7**
Exports	4.1	3.5	5.0	2.1	3.4	5.0	4.0	3.4	2.0
Imports	7.1	-0.1	-1.2	2.5	7.7	4.0	-1.9	0.8	3.0
GDP	**2.9**	**2.0**	**2.0**	**2.4**	**2.4**	**2.7**	**1.7**	**2.2**	**2.5**
Nominal GDP	4.8	5.3	2.3	4.0	6.1	4.9	4.3	2.2	4.9
Current Account Deficit ($b)	51	12	5	14	46	40	-7	16	13
(-%) of GDP	2.8	0.6	0.3	0.7	2.6	2.1	-0.4	0.8	0.6
Employment	3.0	2.4	1.3	0.7	2.4	2.7	2.0	0.8	1.2
Terms of Trade	1.8	6.0	-6.0	-1.5	11.5	2.0	3.2	-7.9	1.8
Average Earnings (Nat. Accts. Basis)	1.4	1.8	2.6	2.7	0.8	1.5	2.3	2.6	2.8
End of Period									
Total CPI	2.1	1.6	1.7	2.2	1.9	1.8	1.6	2.0	2.4
Core CPI	1.9	1.4	1.5	2.0	1.9	1.8	1.3	1.7	2.1
Unemployment Rate	5.6	5.2	5.4	5.4	5.4	5.0	5.3	5.5	5.4
RBA Cash Rate	1.50	1.25	0.50	0.50	1.50	1.50	0.75	0.50	0.50
10 Year Govt. Bonds	2.63	1.32	1.00	1.40	2.63	2.32	0.90	1.20	1.70
$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	9/09/2019	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$/bbl	58	64	56	60	62	63	64	65	65	65	70	70
Brent oil	US$/bbl	63	73	63	65	67	68	69	70	70	70	75	75
Tapis oil	US$/bbl	66	76	65	67	69	70	71	72	72	72	77	77
Gold	US$/ounce	1502	1310	1460	1470	1490	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$/tonne	67	80	68	72	74	76	78	76	74	72	71	70
Aluminium	US$/tonne	1774	1795	1775	1750	1740	1750	1800	1850	1900	1950	2000	1975
Copper	US$/tonne	5790	6121	5875	5750	5700	5725	5750	6000	6080	6060	6040	6020
Lead	US$/tonne	2109	1884	2000	1900	1850	1800	1750	1725	1700	1725	1700	1675
Nickel	US$/tonne	18102	12251	14000	12500	12600	12500	12400	12500	12250	12100	11900	11750
Zinc	US$/tonne	2314	2763	2400	2350	2375	2400	2425	2450	2300	2200	2150	2150
Aus LNG**	AU$/GJ	n.a.	11.1	13.3	11.9	12.1	12.3	12.1	12.1	11.9	11.7	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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