EMBARGOED UNTIL 11.30 AM WEDNESDAY 9 OCTOBER 2019

THE FORWARD VIEW: AUSTRALIA OCTOBER 2019

Unchanged forecasts with low rates expected to persist.

OVERVIEW

Our forecasts for growth, inflation and the labour market are unchanged. We expect a small improvement in growth, but for growth to remain below trend. Alongside below-trend growth we expect the labour market to deteriorate slightly, with the unemployment rate edging higher and measures of labour under utilisation remaining elevated. Inflation is likely to remain weak, with little wage pressure and strong competition keeping a lid on prices domestically.

With these predictions largely a continuation of recent trends, it is likely that we will see a further reduction in interest rates by the RBA. While the RBA has now lowered rates three times this year, taking the cash rate to a record low of 0.75%, we think that further stimulus will be required to support the economy, given the private sector remains weak and heightened global uncertainty poses significant risk. We have pencilled in a further cut in the cash rate of 25bps in December taking rates to a new low of 0.5%, but see a risk that a further cut to 0.25% and unconventional policy in H1 2020 will be required should downside risk materialise and more significant fiscal stimulus fail to eventuate.

The key dynamics behind our assessment of the economy continue to be headwinds from a weak consumer and a significant downturn in housing construction. That is being partly offset by strong public sector spending and growth in exports. We continue to expect a rise in business investment, though weak domestic demand and a slowing global economy present a risk to this view.

Recent tax cuts appear to have failed to provide a significant boost to household spending, given retail sales growth remains soft. We think the recent rate cuts will have an impact, but the effects will take longer and be more variable, which will make them less apparent.

Should the economy require further support beyond our expected cut in December, it is likely that the RBA will begin to implement a range of unconventional policies. These policies will come with the intention of lowering the risk-free rate, ensuring that the community expects rates to remain low for an extended period and also to ensure the continued flow of credit in the economy. It is important to note that we are not yet in this position, with growth still positive and the labour market relatively healthy. Any actions of this nature will also depend on economic and financial circumstances at the time. But a further slowing or significant global shock could well see rates reduced even further and increasing the need for such policies. Regardless, it is likely that rates will remain at historic lows for an extended period.

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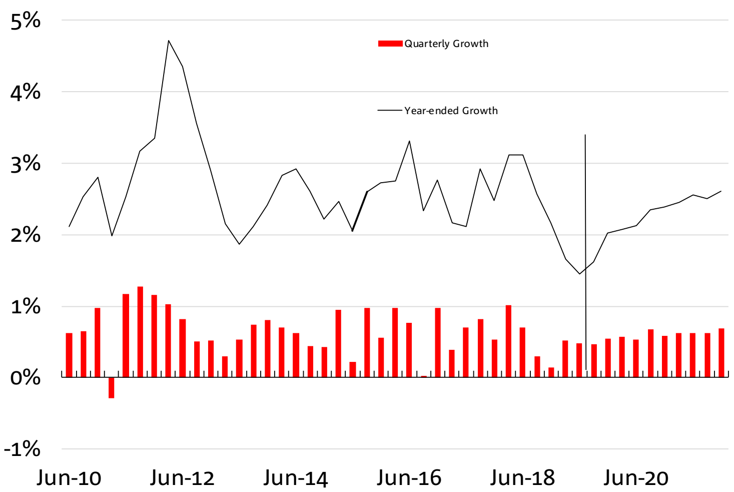
KEY ECONOMIC FORECASTS

	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	1.1
Unemployment Rate (b)	5.0	5.3	5.5	5.4
Headline CPI (b)	1.8	1.6	1.9	2.3
Core CPI (b)	1.8	1.3	1.6	2.0
RBA Cash Rate (b)	1.50	0.50	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

Despite the slowing in economic growth, labour market conditions have remained strong. Labour force participation is at a record high, and despite some deterioration this year, the unemployment rate remains relatively low compared with history, especially in NSW and Vic. In September, employment rose by 35k (full-time employment fell 15.5k while part-time rose 50.2k) to see employment 2.5% higher over the year. This is a rate well above current population growth. The participation rate increased further, which saw the unemployment rate edge up to 5.3% after hovering at 5.2% for a number of months. Overall, unemployment is now around ¼ppt higher than its trough in early 2019 and around ¾% above the RBA's most recent estimate of full employment.

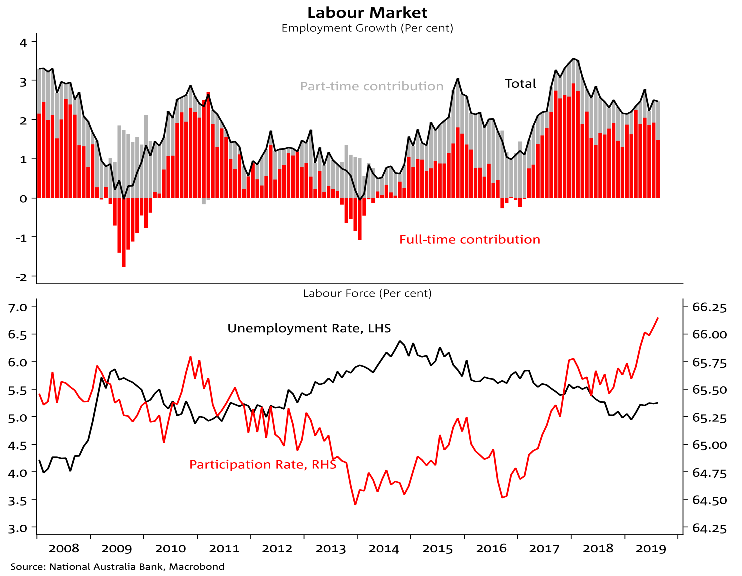
Given private sector growth has stalled, we expect employment growth to slow which will see a small deterioration in the unemployment rate going forward. There has been some pullback in leading indicators, but both the high level of job vacancies and NAB business survey continue to point to reasonable employment growth. We expect the unemployment rate to drift up to 5.5% over the next year or so. With the unemployment rate 1ppt above the NAIRU, we expect wage growth to remain weak – albeit with a small improvement.

Retail sales rose 0.4% in August to be 2.6% higher over the year. Sales were driven by an increase in food retailing, though most other categories including clothing & footwear, department stores, other retailing and household goods saw rises. Cafes & restaurants offset some of these gains.

The NAB Cashless Retail sales index released next week will provide an early read on retail sales for September ahead of the official release that will include the quarterly estimate of real growth in sales. However, taken together with the flat outcome in July, this outcome suggests that consumer spending likely remained weak in Q3. With the consumer accounting for around 60% of GDP (including services spending) it is likely we could see another soft quarter of growth.

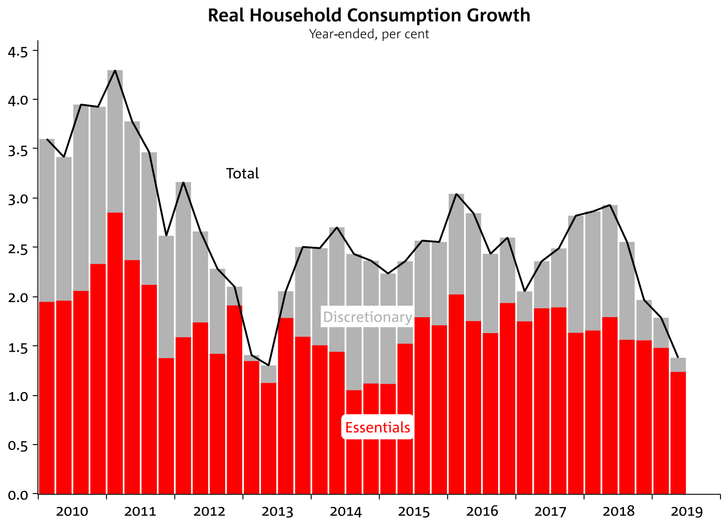
While tax rebates and three rate cuts this year are likely to provide some support to household spending, it appears that more stimulus will be required to provide a material turnaround in consumption and it is likely that the impact of rate cuts will take some time to flow through. NAB Economics view is that consumption growth will improve but remain modest overall. We expect a similar pattern of growth to continue, with services and essential spending contributing the most to growth. Slow wage growth, high debt levels and stretched budgets are likely to continue to weigh on the household sector for some time.

HEALTHY LABOUR MARKET...



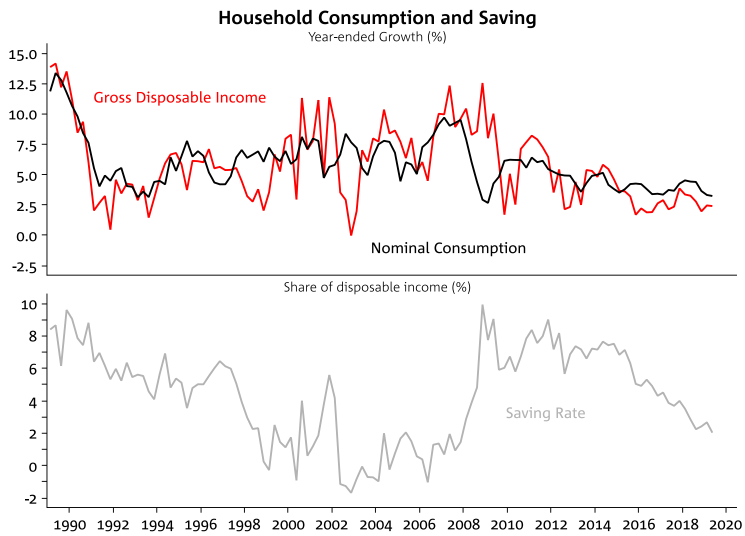
Source: National Australia Bank, Macrobond

DISCRETIONARY SPEND TO REMAIN WEAK...



Source: National Australia Bank, Macrobond

INCOME GROWTH REMAINS WEAK...



Source: National Australia Bank, Macrobond

HOUSING AND CONSTRUCTION

Conditions in the established housing market continue to brighten, with house prices continuing their recovery in Sydney and Melbourne. The activity side of the market has weakened, with dwelling investment declining and building approvals continuing to trend lower – implying that there will be further falls in construction work done as the pipeline of outstanding work shrinks.

In September the CoreLogic 8-Capital City dwelling price index rose by 1.1% m/m. Sydney and Melbourne continue to drive the recovery, each rising by 1.7%. Brisbane and Adelaide were broadly flat, while Perth and Hobart saw small declines.

Sydney prices are now 4.8% lower than a year ago, while Melbourne is 3.9% lower, following rises of around 3.5% in the last quarter. Melbourne and Sydney are now 7.9% and 11.9% below their peaks in 2017, respectively.

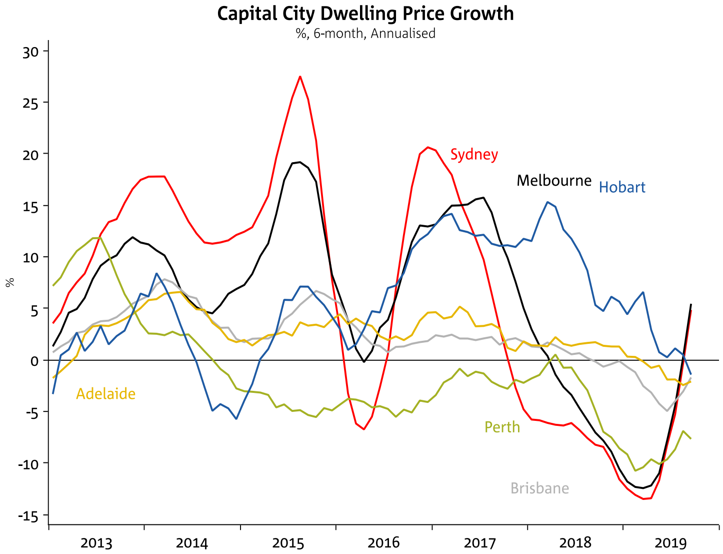
Conditions in Perth remain weak with prices now 9.0% lower over the year, and 21.3% lower than their peak in 2014. Growth remains weaker than other states, with unemployment higher and population growth slower. Overall, it appears the adjustment in the housing market post-boom is continuing. Elsewhere, Brisbane and Adelaide have seen small declines over the past year, but are around 7-10% higher over the past 5 years. Price growth in Hobart has slowed recently but remain 38.2% higher than five years ago.

It is likely that lower interest rates, low unemployment and still strong population growth, combined with a pull-back in construction, will support prices going forward, there are clearly a number of state specific factors at play.

The activity side of the market is likely to continue to weaken with building approvals continuing to trend down. Approvals for private high-density dwellings increased by 3.4% in August but are 29% lower than a year ago. Approvals for detached houses fell 2.4% in the month and around 24% lower than their peak.

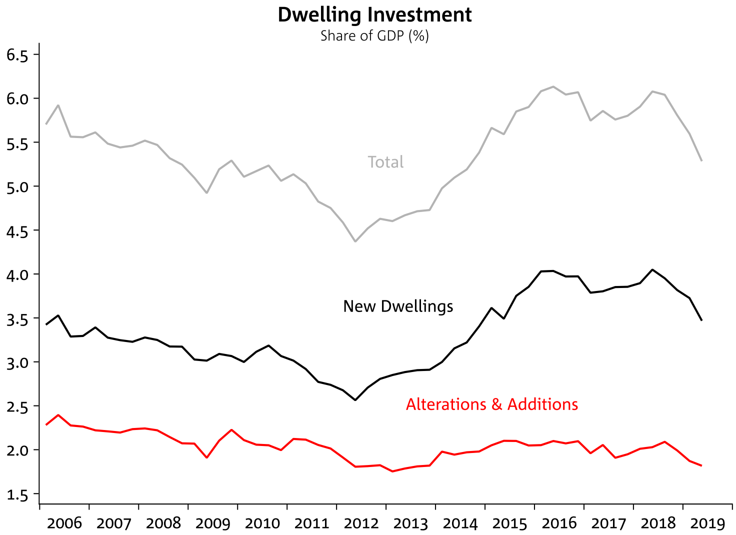
Overall, we expect the downturn in the housing construction cycle to continue. We expect further falls in dwelling investment with approvals continuing to trend lower and the large pipeline of work outstanding to be rapidly depleted. The increase in prices to date is a positive, but will need to be sustained, with activity returning to more normal levels in the market before residential construction sees a recovery. We continue to expect a modest increase in process over the next year or so.

PRICES ARE STABILISING...



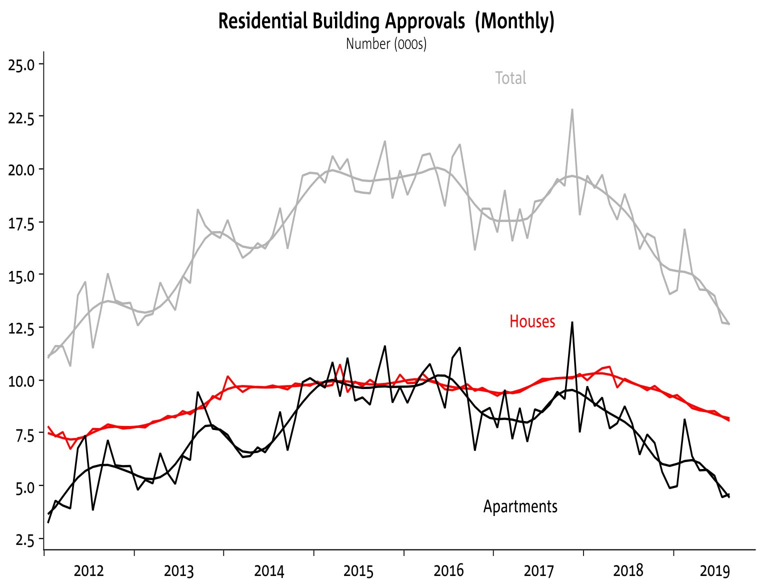
Source: CoreLogic, National Australia Bank, Macrobond

DWELLING INVESTMENT TO FALL FURTHER...



Source: National Australia Bank, Macrobond

APPROVALS SUGGEST MORE WEAKNESS...



Source: National Australia Bank, Macrobond

BUSINESS AND TRADE

We remain optimistic on business and trade. We expect mining investment to stabilise after significant declines, and for a higher level of ongoing investment in the sector. The non-mining sector is expected to be supported by spill-overs from the large pipeline of public sector infrastructure investment. However, there are some risks around this view with the NAB Monthly Business Survey suggesting that activity has pulled back significantly from the levels seen in early 2018.

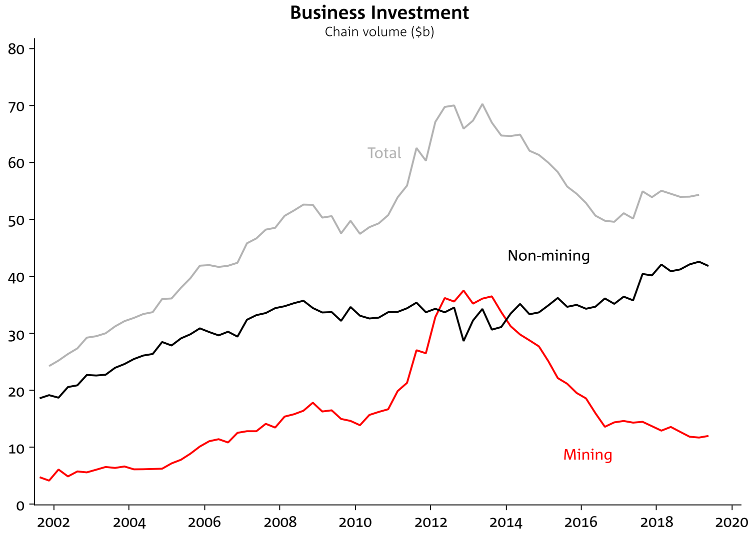
The NAB Monthly Business survey tracked side-ways in September – that is conditions and confidence have remained largely around the same levels as recent months. Conditions ticked up in the month but remain well below average. Generally, the goods production/distribution industries have remained weak and construction appears to have been significantly affected by the downturn in housing market. Further, manufacturing is weak, likely affected by both weaker housing and consumption domestically, as well as raised uncertainty globally. The services sectors and mining continue to see the best conditions.

Forward indicators are mixed, with orders edging slightly higher recently, but remaining below average (and negative). Capacity utilisation has been volatile, but remains above average. The business survey continues to point to ongoing employment growth, but at a slower pace than observed in recent official data. Capex has pulled back with this measure now below average and declining.

The trade balance narrowed in August, with a pull-back in the value of iron ore exports. The decline is likely to largely be a result of the recent falls in iron ore prices. The trade balance remains close to record levels following the substantial increase in exports of commodities over recent years. LNG exports have provided a significant boost recently as the last of the mega-projects ramp up to full capacity. Indeed, net exports made a 0.4ppt contribution in Q2 on the back of higher LNG exports. We expect this trend to continue in the near term, before exports level off further out.

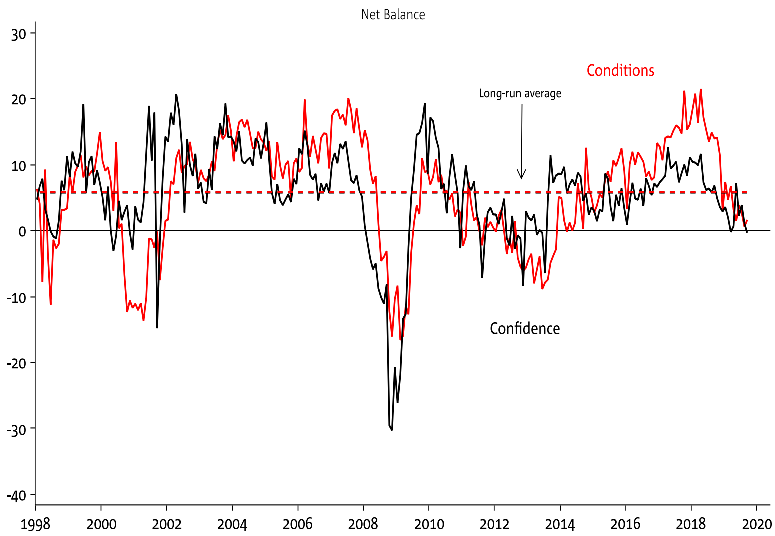
While there is the chance of some new investment in the sector over the next few years and the potential for other minerals to contribute to growth, it is unlikely to result in the large increases in exports that have occurred in the last decade. For now the focus of investment in the sector is likely to be around sustaining capex which should settle a higher level following the large increase in the capital stock during the mining boom. That is, most new investment will likely focus on replacing existing capacity or maintaining equipment rather than large wholesale expansions.

NON-MINING INVESTMENT IS WEAK..



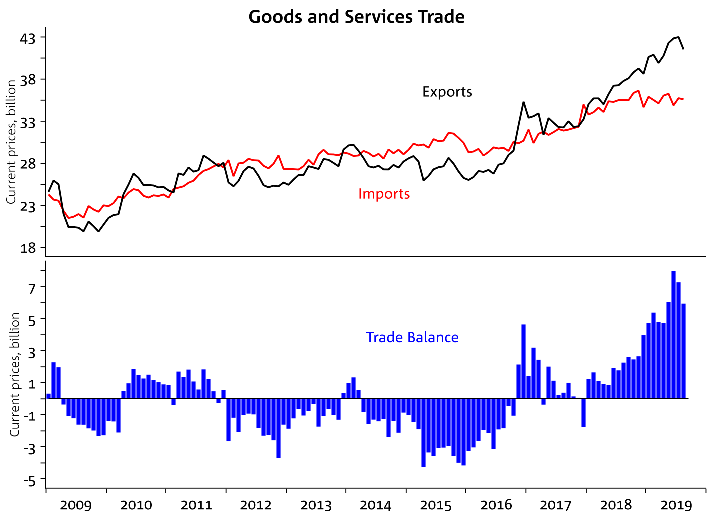
Source: National Australia Bank, Macrobond

CONFIDENCE AND CONDITIONS WEAK...



Source: National Australia Bank, Macrobond

EXPORTS CONTINUE TO RISE...



Source: National Australia Bank, ABS

COMMODITIES

Iron ore spot prices stabilised in September, settling in the low-to-mid US$90s range in the second half of the month, having fallen below US$90 a tonne in August. A likely speculative sell-off in August may have been overdone, however the fundamentals of the market have eased, with Brazilian supply continuing to recover – despite a month-on-month drop in exports in September. China's steel production is expected to ease, reflecting the weaker economic growth profile going forward. Our forecasts for 62% ore landed in China are unchanged – averaging US$93 a tonne in 2019, before declining to around US$74 a tonne in 2020.

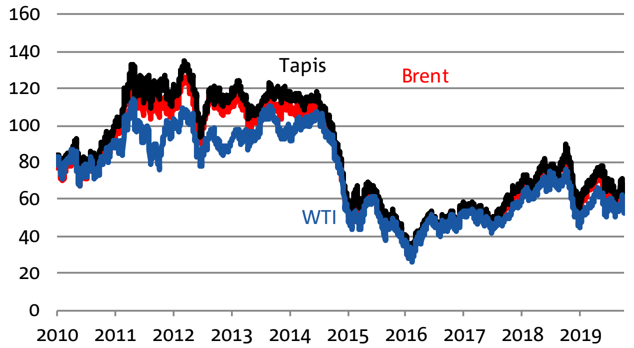
Spot prices for hard coking coal continued to ease in September – falling below US$150 a tonne – while thermal coal prices stabilised in the mid-US$60s range. In the near term there is some upside potential for thermal coal demand – reflecting heating demand in the northern hemisphere winter – however longer term demand prospects appear weaker (including in key import markets such as China and India). We've trimmed our forecast for thermal coal to US$70 a tonne in 2020 (from US$76 previously), and hard coking coal to US$150 a tonne (from US$156). Current softness in spot prices highlights the downside risk to these forecasts.

Oil prices have eased markedly since the attack on Saudi oil facilities inmid- September, when oil rose above US$71/bbl. Since then, oil production facilities have largely been restored, according to Saudi authorities, with the Kingdom producing close to 10 million barrels per day. Additionally, there remains concerns about global demand, with the US ISM factory index falling to 47.8, the lowest since June 2009. We have maintained our 2019 oil price forecasts, with Brent at US$65/bbl in Q4, although there remains downside risks. Further out, we have slightly trimmed our year-end 2021 forecasts to US$72/bbl (previously US$75).

Australia had the second highest volume of LNG exports in 2018-19, according to Energy Quest. In fact, Australian exports overtook Qatari LNG exports in November 2018 and April 2019, according to the US EIA. The growth has emerged largely from INPEX's Icthys project and Chevron's Wheatstone project. We expect export volumes to largely flatten out this year. On prices, our model forecasts the LNG export price to increase to AUD13.33/GJ in Q3, largely reflecting AUD depreciation. Moreover, we see prices mainly in the AUD11-12/GJ range going forward. It is hard to see much downside for domestic prices in Eastern Australia, particularly if we see a hot summer.

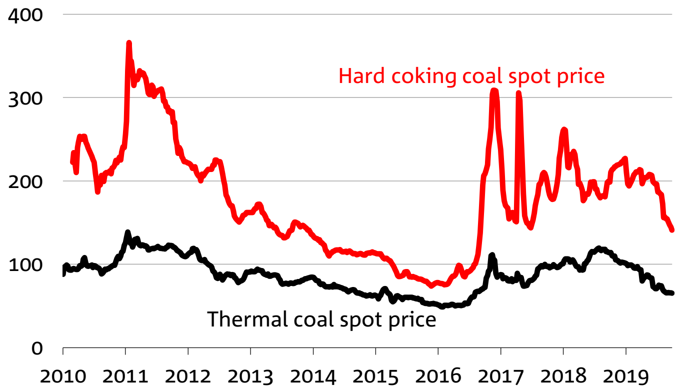
GLOBAL OIL PRICES

USD/bbl, daily



COAL SPOT PRICES

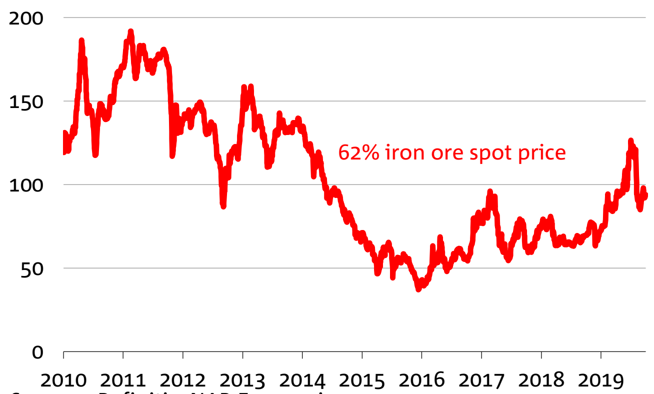
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

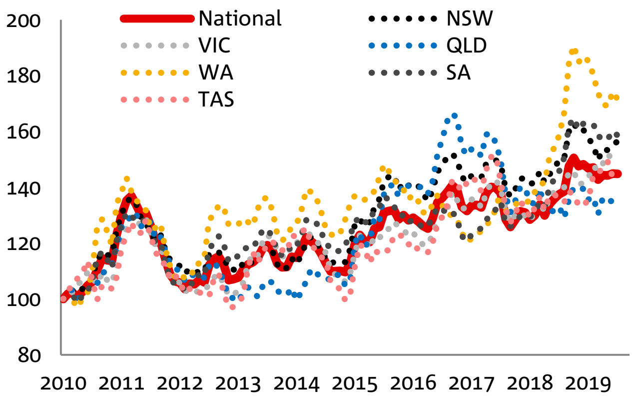
US$/t (incl. cost of freight)



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 cut the cash rate by 25bps at the October meeting, taking the overnight rate to a new low of 0.75%. A primary focus of the bank was that against a backdrop of spare capacity in the domestic economy, the failure to cut rates in a renewed global easing cycle would see a rise in the exchange rate. Any increase in the exchange rate would likely see a further dampening in the domestic economy.

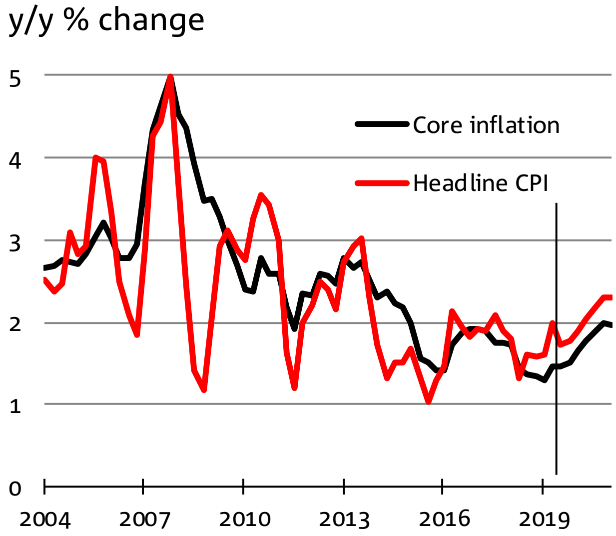
Despite the cut to interest rates, Governor Lowe has continued to present optimism – noting that "fundamentals are strong" domestically, with the recent slowing having reached a "gentle turning point" and that the global economy continues to track at a reasonable pace, despite the significant building downside risks. In addition the Bank's recent calls for greater infrastructure spending have been tempered, with a shift in the focus to structural and productivity enhancing policies with the intent of supporting future growth. That is, the bank acknowledges that monetary policy is not a boundless support for growth – and that any further cyclical downturn could well push the cash rate to near its effective lower bound.

Domestically, we expect inflation to remain weak, though for a small amount of pressure to build – seeing only a gradual lift in CPI growth back towards the bottom of the RBA's target band. Weaker global inflation, as well as soft wage growth and spare capacity in the economy more broadly are the key drivers of this outlook. Further, continued strength in competition in the retail sector, amid weaker demand will see a constraint on prices there.

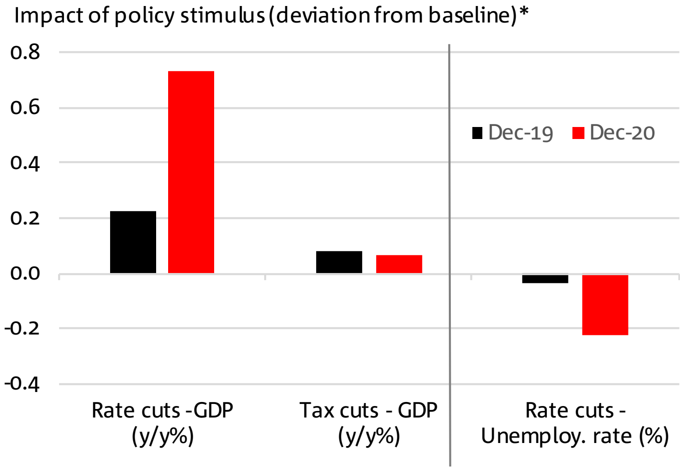
NAB Economics' view is that with below trend growth continuing (and the private sector remaining weak), that employment growth will slow and the unemployment rate is likely to drift higher over the next year. An increase in the unemployment rate would see further spare capacity in the labour market and continued weak wage growth. We think that current conditions and the risk of deterioration in the labour market has warranted further cuts for some time. Indeed, while the RBA appears to have shifted to a more dovish stance recently, the October cut (with uncertain timing) had largely been factored into the RBA's own forecasts prior to the greater build up of global risk and weaker than expected growth outcome in Q2. Therefore we continue to expect a further cut in the cash rate to 0.5% by December. Further out, we still see the risk of another cut and the introduction of unconventional policy should conditions worsen further, or a more significant fiscal boost fail to materialise.

The exchange rate is an important channel by which global developments will impact the domestic market. The exchange rate came under pressure following the outcome of the RBA's October meeting but has settled around US67.5c. It is likely that the currency will continue to be driven by bouts of global uncertainty on continuing trade ructions as well as moves on interest rates by foreign central banks. 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…

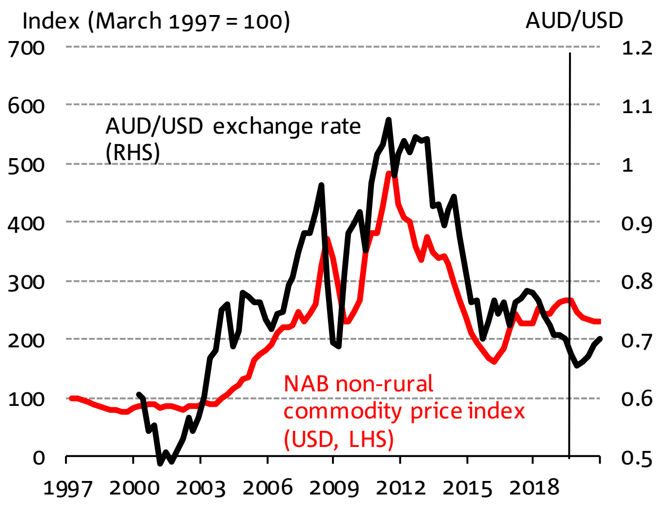


IMPACT OF FISCAL STIMULUS AND RATE CUTS ON ACTIVITY FORECASTS…



*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	2.1	2.4	2.6	1.4	1.7	2.3
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	1.8	3.8	1.2	-2.1	0.2	1.9
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**	**1.0**	**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	4.1	2.1	3.4	5.0	3.6	2.9	2.0
Imports	7.1	-0.1	-1.2	2.5	7.7	4.0	-1.9	0.8	3.1
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	2.4	3.9	6.1	4.9	4.3	2.2	4.8
Current Account Deficit ($b)	51	12	9	18	46	40	-5	20	17
(-%) of GDP	2.8	0.6	0.5	0.9	2.6	2.1	-0.3	1.0	0.8
Employment	3.0	2.4	1.3	0.7	2.4	2.7	2.0	0.8	1.1
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	2.1	1.9	1.8	1.6	1.9	2.3
Core CPI	1.9	1.4	1.5	1.9	1.9	1.8	1.3	1.6	2.0
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	0.50	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	4/10/2019	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$/bbl	53	64	58	60	62	63	64	65	65	65	67	67
Brent oil	US$/bbl	59	73	64	65	67	68	69	70	70	70	72	72
Tapis oil	US$/bbl	62	76	67	67	69	70	71	72	72	72	74	74
Gold	US$/ounce	1508	1310	1480	1480	1500	1520	1550	1570	1590	1600	1610	1630
Iron ore (spot)	US$/tonne	n.a.	99	102	88	79	76	72	68	71	69	71	69
Hard coking coal*	US$/tonne	n.a.	199	163	150	145	150	152	150	153	151	150	150
Thermal coal (spot)	US$/tonne	66	80	69	72	72	70	68	70	72	68	65	65
Aluminium	US$/tonne	1708	1795	1764	1750	1740	1750	1800	1825	1850	1870	1885	1900
Copper	US$/tonne	5608	6121	5814	5750	5700	5725	5750	5850	5900	5950	6000	6020
Lead	US$/tonne	2163	1884	2011	1950	1850	1800	1750	1725	1700	1725	1700	1675
Nickel	US$/tonne	17906	12251	14891	17500	16000	15000	14000	13000	12500	12100	11900	11750
Zinc	US$/tonne	2337	2763	2355	2350	2375	2400	2425	2450	2300	2200	2150	2150
Aus LNG**	AU$/GJ	n.a.	11.1	13.1	12.2	12.1	12.2	12.0	12.0	11.9	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

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