EMBARGOED UNTIL 11.30 AM AEDT, WEDNESDAY 13 NOVEMBER 2019

THE FORWARD VIEW: AUSTRALIA NOVEMBER 2019

Private Demand still stalled. Broadly unchanged forecasts but slightly lower growth in the near term. Policy help delayed.

OVERVIEW

We are becoming increasingly concerned about the near-term momentum in private demand growth. We know retail sales fell in Q3 and our internal data shows a very weak service sector consumption spend. Our internal data also continues to point to tax refunds mainly being used to repair household balance sheets by paying down debt. Meanwhile investment in dwellings continues to fall substantially and private sector investment shows worrying weakness – with no improvement in sight. As a result we have downgraded our Q3 GDP estimate to around 0.3% (or 1.5% y/y). Also yesterday's NAB business survey showed private sector demand starting Q4 at depressed levels.

Beyond that near term softness we have broadly maintained the shape of our growth forecasts That is, the key dynamics behind our assessment of the economy continue to be headwinds from a weak consumer and a significant downturn in housing construction. We have also slightly lowered business investment. Partially offsetting this is strong public sector spending and growth in exports. Our global forecasts are broadly unchanged.

In summary

- Putting that lower start point into our forecasts means GDP growth this year might be 1.6% (was 1.7%) and it marginally lowers 2020 to 2.1% (was 2.2%) and 2021 at 2.5% (was 2.4%).
- In through the year terms 2020 and 2021 are unchanged at 2.3% and 2.6% respectively
- Again that would not be enough to lower unemployment which we still see at around 5.5% by mid to late 2020 and into 2021.
- Core inflation forecasts are unchanged with core inflation not back to around 2% (bottom of the band) by end 2021. That reflects weak wage growth and ongoing margin pressures – especially in wholesale and retail.

Our forecasts are clearly lower than the RBA – who essentially are expecting growth to return to around 2¾% to 3% going forward. Also they talk of the economy as being at a gradual upward turning point. We see no evidence of this in the near term. On our forecasts both fiscal and monetary policy stimulus are needed now. However the RBA is strongly signalling their faith in a better economic performance and will sit and watch for some time. As such we have delayed the timing of the next rate cut from December to February 2020. Also we could well be closer to unconventional monetary policy than generally assumed with a material fiscal stimulus unlikely any time soon.

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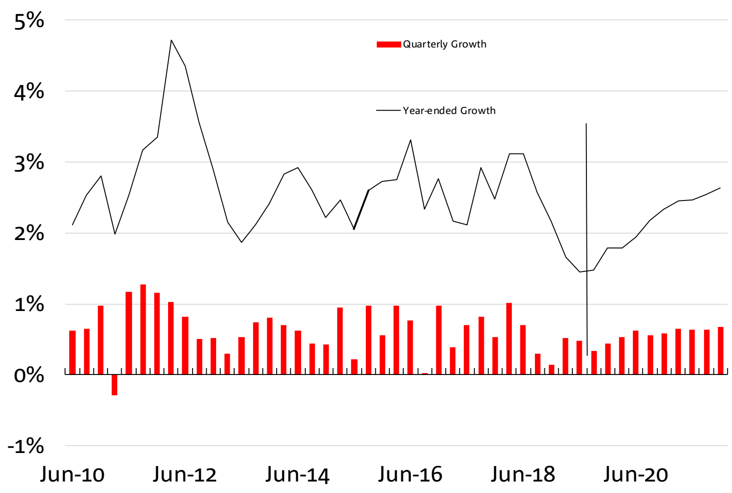
KEY ECONOMIC FORECASTS

	2018	2019-F	2020-F	2021-F
Domestic Demand (a)	2.8	0.9	1.7	2.7
Real GDP (annual average)	**2.7**	**1.6**	**2.1**	**2.5**
Real GDP (year-ended to Dec)	**2.2**	**1.8**	**2.3**	**2.6**
Terms of Trade (a)	2.0	6.1	-6.3	-1.8
Employment (a)	2.7	2.3	1.0	0.8
Unemployment Rate (b)	5.0	5.3	5.4	5.5
Headline CPI (b)	1.8	1.8	1.9	2.4
Core CPI (b)	1.8	1.4	1.6	2.1
RBA Cash Rate (b)	1.50	0.75	0.50	0.50
$A/US cents (b)	0.71	0.69	0.71	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

The unemployment rate edged lower in September, printing at 5.2% - but remains around ¼ ppt higher than its recent trough in early 2019. Employment rose by 14.7k in the month, with another solid rise in full-time employment (+26k) offset by a decline in part-time workers. The participation rate edged lower but remains elevated after increasing to record highs in 2019.

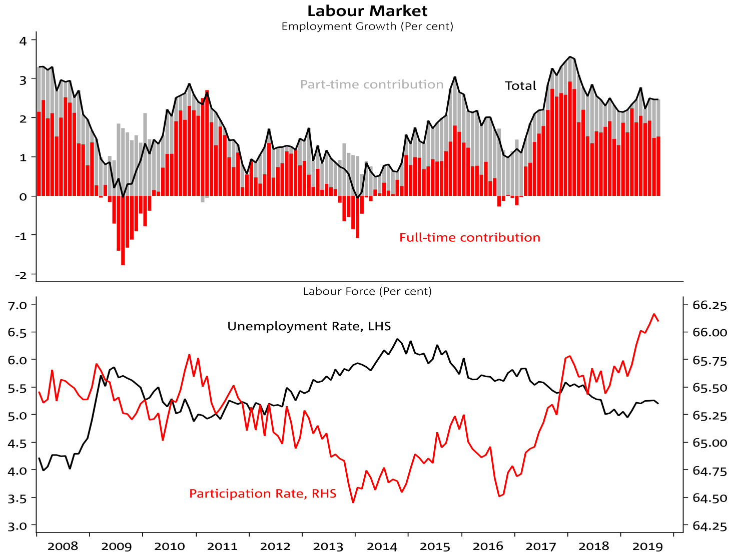
Overall, labour market conditions remain healthy despite the slowing in private sector growth over the last year. Employment has risen by 2.5% over the past year, with the bulk of this on a full-time basis. This compares with population growth around 1 ppt slower and has seen work force participation rise to a record high. In addition, the unemployment rate is relatively low compared with history despite increasing slightly in H1 2019. Unemployment is relatively low in NSW and Vic, with the rates in these states similar to a year ago. QLD and SA have deteriorated over the past year and currently see the highest unemployment rates on the mainland, with WA having seen an improvement over the past year.

We expect employment growth to slow from here, with private sector demand remaining weak and leading indicators of the labour market having softened. Consequently we expect the unemployment rate to move higher, reaching around 5.5% by the end of 2020 (and staying there in 2021). With unemployment rising further above the level of 'full-employment' it is also likely that wage growth will remain weak – implying ongoing weakness in household income growth. This implies only a modest outlook for consumption going forward.

Indeed, retail sales growth looks to have remained weak in Q3. Monthly values rose by 0.2% in September, supported by growth in other retailing, cafes & takeaway and food, offset by declines in department stores, household goods and clothing & footwear. More significantly, the quarterly volumes figures suggest that real retail sales declined by 0.1% in the quarter, reversing the increase in Q2 and seeing sales around 0.2% lower over the year. This is the weakest result since the early 1990s, and we will likely see another soft print for consumption (which includes household spending on services) in Q3.

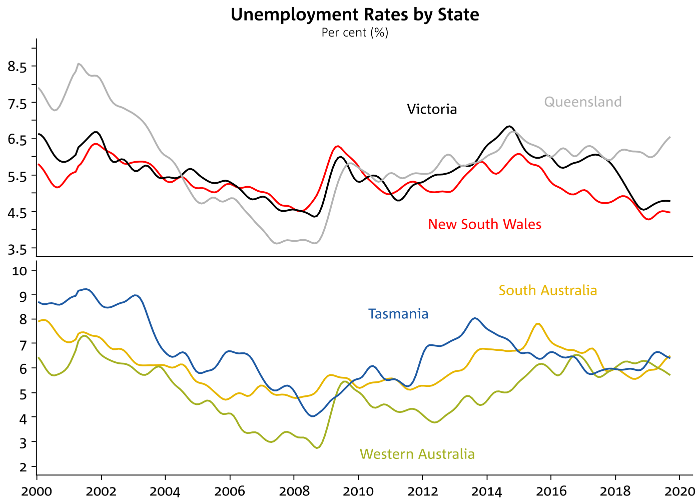
It appears that the recent tax cuts and rate cuts in June and July have done little to offset the weakness in household spending. While, these cuts provide a boost to income in the short-run, they are unlikely to address the impact of slow wage growth, high debt levels and stretched budgets which have all served to constrain household spending. The NAB Cashless Retail sales index will provide an early indicator of how sales have tracked in the first month of Q4. Beyond that, we expect consumption growth to remain modest, with low income growth to persist.

HEALTHY LABOUR MARKET...



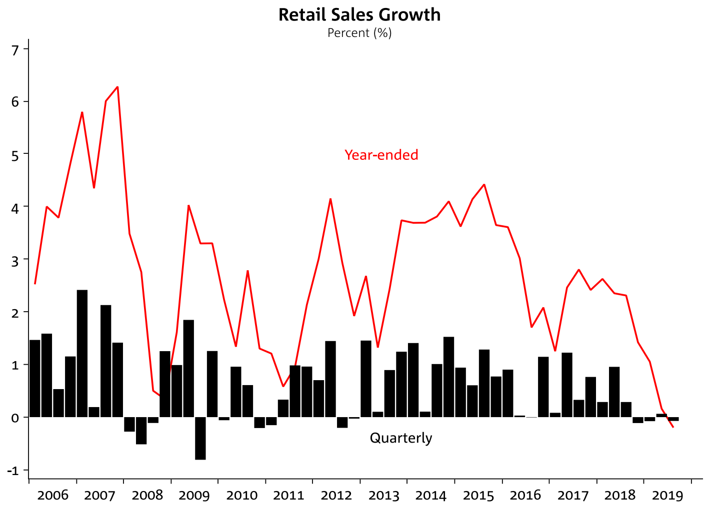
Source: National Australia Bank, Macrobond

UNEMPLOYMENT IS LOWEST IN THE EAST...



Source: National Australia Bank, Macrobond

RETAIL SALES GROWTH IS WEAK...



Source: National Australia Bank, Macrobond

HOUSING AND CONSTRUCTION

House prices have continued to rise relatively strongly in Sydney and Melbourne since reaching a trough in May. Outside of the two largest cities, conditions have been more mixed. Despite the recovery in house prices, the activity side of the market remains weak, with construction likely to continue to decline for some time, following the sharp declines seen over recent quarters.

In October the CoreLogic 8-Capital City dwelling price index rose by 1.4% m/m. In the month, rises were led by Melbourne (2.3%) and Sydney (1.7%), while Brisbane, Adelaide and Hobart also saw increases. Perth declined by 0.4%. Prices have now risen by 5.3% in Sydney and 6.0% in Melbourne from their troughs in May – a fairly sharp recovery. After previously having fallen by 14.9% and 11.1% respectively from peak to trough, these gains have seen a significant proportion of the previous correction unwound.

While Brisbane and Adelaide prices also rose in the month, they are around 1% lower than a year ago. Prices in Hobart are 2.6% higher coming off a period of strong growth in 2018 but have slowed recently. In contrast, Perth continues to weaken with prices 8.7% lower over the year and substantially weaker than the other capitals over the past 6 months.

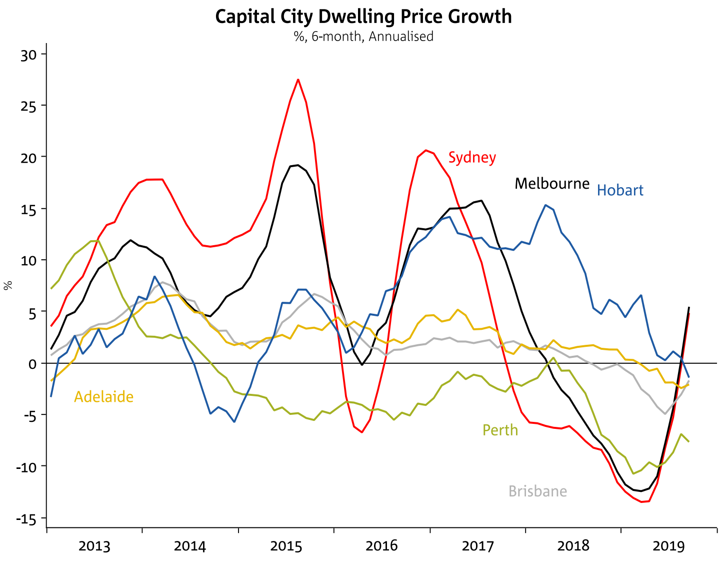
Lower interest rates and a reduction in serviceability floors are likely to have contributed in part to this recovery. While population growth remains strong and the unemployment rate is also relatively low in each of these states. The adjustment underway on the supply side (weaker construction), would also serve to support prices.

Though prices have recovered somewhat, the activity side of the market is likely to continue to weaken with building approvals continuing to trend down. While residential building approvals rose 7.6% in September, they remain 19% lower than a year ago. Approvals for houses rose 3.0% and the volatile high-density component rose 16%. Apartment approvals are now 57% below their peak in 2017, while approvals for houses are 21% below their high.

Alongside these developments, housing credit growth has slowed substantially over the past year. Investor credit growth has slowed sharply, recording a flat outcome over the year to September. Credit extended to owner occupiers has continued to track a faster pace but has slowed to 4.8% y/y.

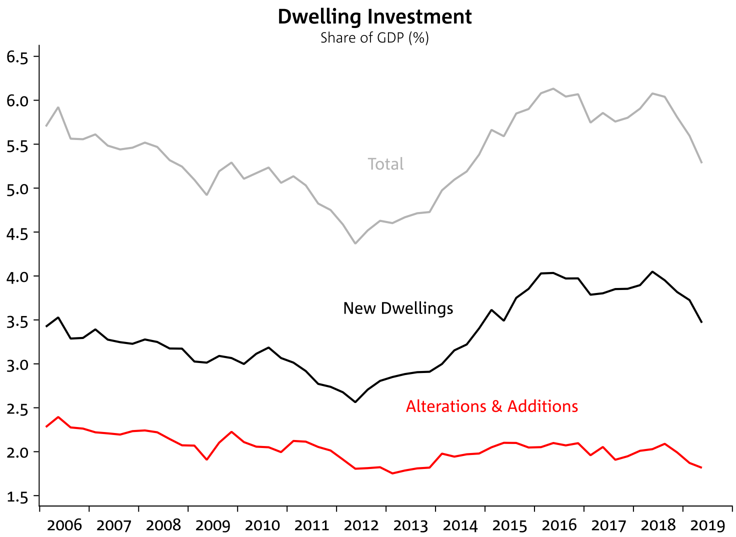
Overall, we expect the recovery in prices to continue with Sydney and Melbourne prices increasing by around 7.5% over 2020. The other cities are likely to see flatter outcomes. Overall we expect prices nationwide to increase by around 5.0% over the year. While we expect prices to continue to rise, we expect dwelling construction to continue to decline relatively sharply. We expect dwelling investment to decline by a further 9% in 2020 before levelling off in 2021. While the pipeline of work remains elevated the high rate of work done will see this rapidly eroded with approvals (new work) continuing to trend lower.

PRICES ARE STABILISING...



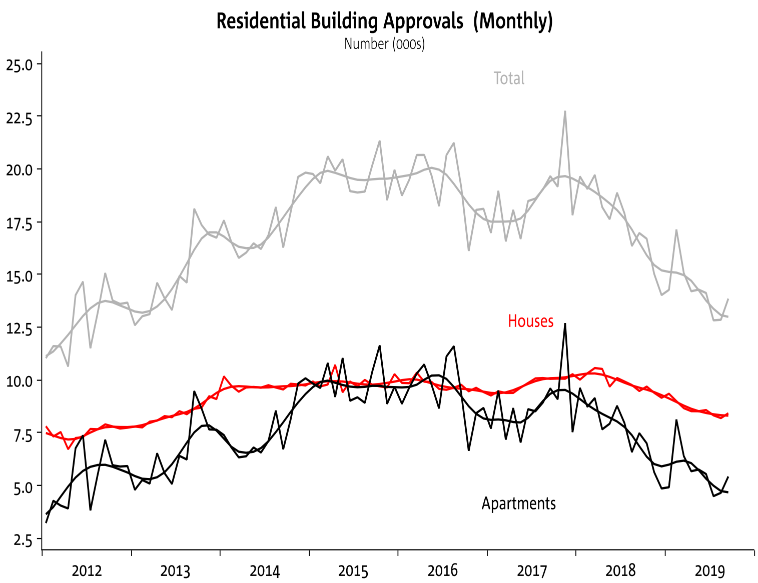
Source: CoreLogic, National Australia Bank, Macrobond

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. Business investment is expected to rise moderately over the next two years despite showing weakness recently. It appears that mining investment has now troughed and will likely require an ongoing higher level of sustaining capex. We also expect non-mining business investment to rise, with spill-overs from the large pipeline of public infrastructure work. Though there are some risks around this outlook.

The NAB Monthly Business survey broadly continued to track sideways in the month, suggesting ongoing weakness in the private sector. While confidence rose in October and conditions edged higher, both remain below average after deteriorating through 2018 and early 2019. The improvement in conditions was driven by an uptick in the profitability and trading sub-components, while the employment index was flat. Conditions in the services sectors are now most favourable, while goods-related sectors including retail and wholesale are weakest. By state, NSW, WA and SA see the most favourable conditions, while Vic (after deteriorating this year) and QLD are weakest.

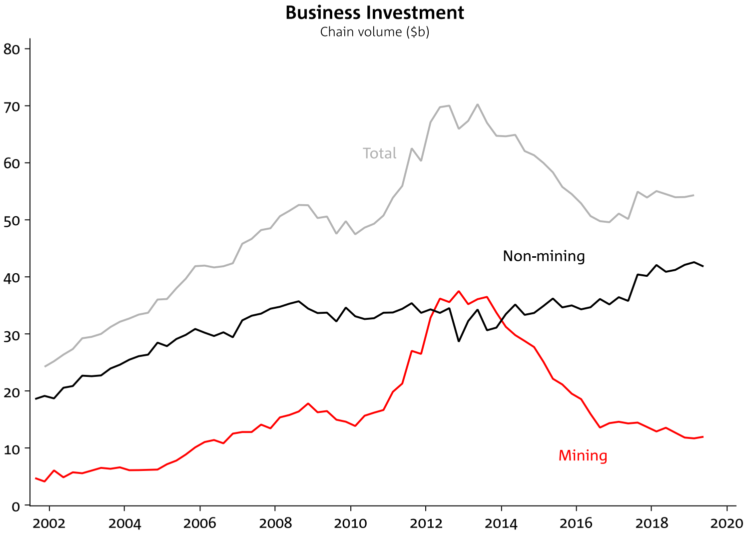
Overall, our assessment is that forward-looking indicators continue to point to more of the same but possibly indicate a bottoming in conditions. Forward orders have increased to above average levels recently, but in trend terms remain negative. Capacity utilisation edged lower in the month but remains above average – though after declining earlier in the year, capacity utilisation remains well below its recent highs. The capex and employment measures suggest some ongoing intention to expand.

Our outlook for international trade is important to our overall forecasts – with the external sector being a key offset to weakness in private domestic demand. We expect recent trends to continue with exports continuing to support growth in the near-term, primarily driven by an increase in LNG exports. However, eventually it is likely that production in the sector will reach full capacity and with only incremental investment across the rest of the mining industry, that exports will plateau.

Indeed the trade surplus widened in September driven by an increase in LNG exports, non-rural exports and non-monetary gold. Taking the monthly trade data in combination with the trade prices release, we expect that next exports will contribute another 0.1-0.2ppt to growth in Q3.

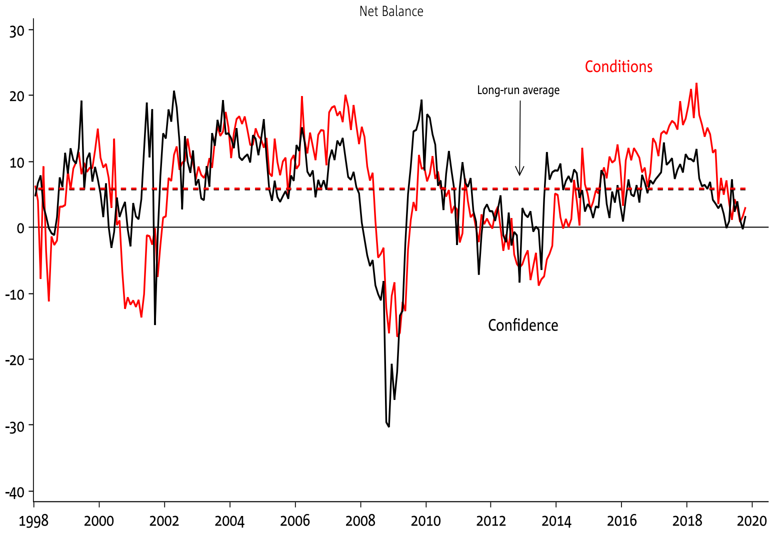
With only marginal additions to the mining capital stock from here, an increase in exports will have to occur in other sectors. The exchange rate will be an important dynamic in this sense. A lower exchange rate would serve to support non-resource exports, particularly in the services sector such as education and tourism – though demand for these services will also depend on global economic conditions.

NON-MINING INVESTMENT IS WEAK..



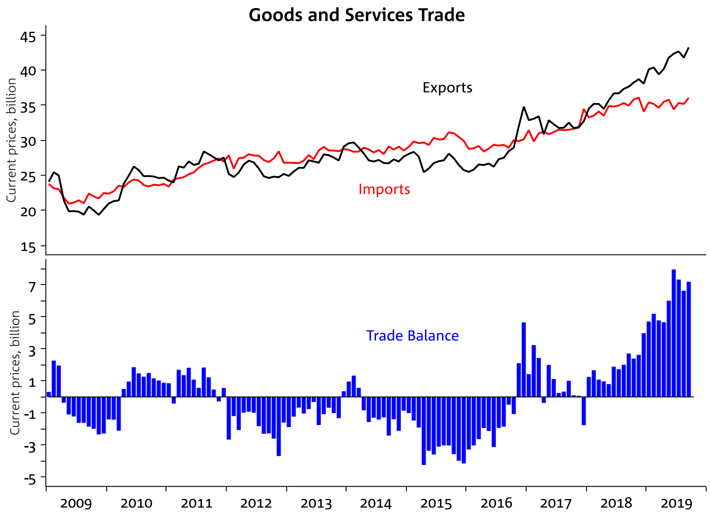
Source: National Australia Bank, Macrobond

CONFIDENCE AND CONDITIONS WEAK...



Source: National Australia Bank, Macrobond

EXPORTS CONTINUE TO RISE...



Source: National Australia Bank, ABS

COMMODITIES

Spot prices for iron ore trended lower in October – from around US$94 a tonne (for 62% ore landed in China) at the start of the month, to around US$84 a tonne in early November. Supply side pressures – which saw prices at elevated levels in early 2019 – are easing, with the market likely to be considerably weaker in 2020. This reflects the recovery in Brazilian supply and weaker Chinese steel production as the country's construction sector weakens. Our iron ore forecasts are unchanged – with Chinese landed spot prices averaging US$93 a tonne in 2019, before easing to around US$74 a tonne in 2020.

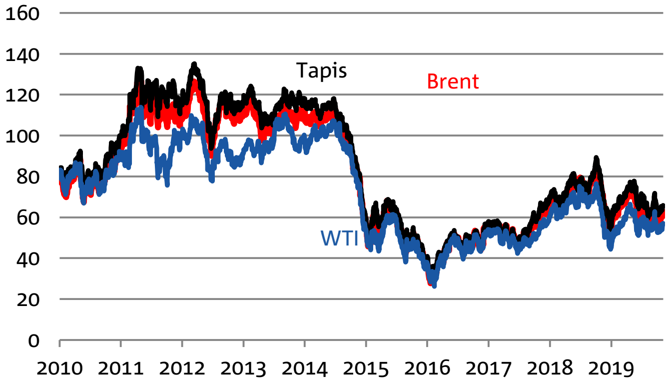
Spot prices for hard coking coal rallied briefly in mid-October, pushing back above US$150 a tonne, before correcting sharply as expiring futures contracts rolled over. Spot prices in early November dropped into the mid-US$130s range – the lowest levels since mid-2016. In contrast, thermal coal prices have been stable at relatively low levels – in the mid-US$60s a tonne. In the near term, restocking ahead of the northern winter could put some upward pressure on thermal coal prices, however beyond this we see coal markets generally being weaker. Hard coking coal is forecast to average US$150 a tonne in 2020, while thermal coal is forecast to average US$70 a tonne – with the current weakness highlighting downside risk to this view.

Oil has broadly trended sideways on mixed cues. Increasing prospects of a "Phase One" deal between the US and China have generally been favourable. Further, a weaker USD, the October rate cut by the US Federal Reserve and the positive US labour market reading have also been supportive. Conversely, higher than expected US crude inventories have put the brakes on further increases. Separately, OPEC indicated it expects to account for a lower share of global supply over the next 5 years, highlighting growth from other supply sources, namely US shale producers. We have maintained our 2019 oil price forecasts, with Brent at US$65/bbl in Q4.

With major gas projects having come on stream, gas export volumes are expected to largely flatten out at the current level. In terms of prices, they are anticipated to peak around September quarter this year (driven largely by a weaker AUD), and thereafter hover around the AUD11-12/GJ range going forward. Chinese LNG demand growth is anticipated to ease compared to 2018, according to analysts Wood Mckenzie. This is likely driven by the uncertain climate for growth and industrial activity. In the near term, there is likely to be some weakness in Asian LNG prices, as offshore vessels storing LNG commence discharging their cargoes into a generally oversupplied market.

GLOBAL OIL PRICES

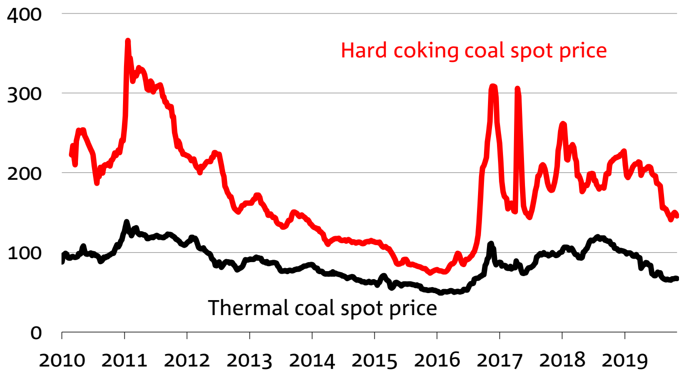
USD/bbl, daily



Source: Refinitiv, NAB Economics

COAL SPOT PRICES

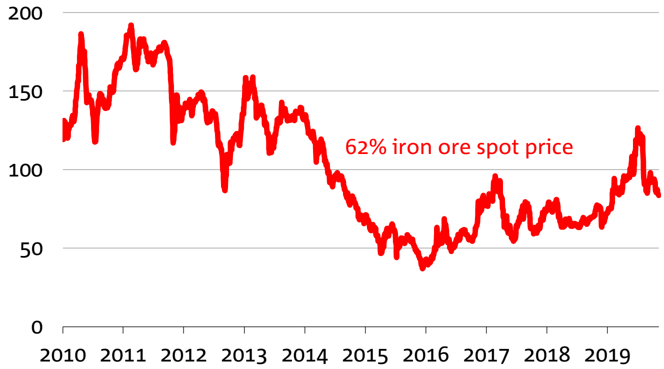
USD/T



Sources: Bloomberg, NAB Economics

IRON ORE SPOT PRICE

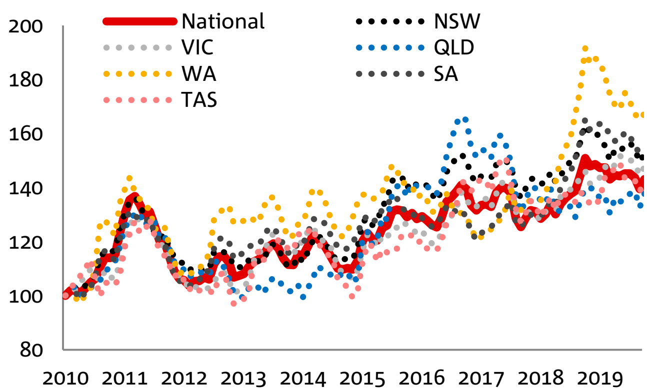
US$/t (incl. cost of freight)



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 noted above the RBA has a positive view on the outlook for the economy. Indeed the first paragraph of last week's Statement on Monetary Policy (SOMP) reads "The Australian economy is gradually coming out of a soft patch. GDP growth has been recovering since its low point last year; it picked up a little in the first half of 2019 and moderate growth is expected over the remainder of the year. Growth is expected to reach 2¾ per cent over 2020 and around 3 per cent by the end of 2021." That said the RBA is still aware of consumer downside risks.

Holding rates at present also "allows time to assess the effects of the recent easing of monetary policy as well as global developments. Given the outlook, the Board is prepared to ease monetary policy further if needed to support sustainable growth in the economy, full employment and the achievement of the medium-term inflation target over time" .

Clearly we are much more wary on the near term and longer run growth outlook. That also applies to our unemployment expectations – which also feeds into weak wages growth. Like the RBA, however, we see few signs that inflation will do any better than reaching the bottom of the target (i.e. 2%) before December 2021 – indeed they forecast 1.9%. Our forecasts based around relatively weak wages growth (not helped by rising unemployment), low productivity growth and strong downward margin pressure in the retail sector.

The differences in NAB and RBA forecasts can then flow through into the timing of further policy action. While we suggest the economy (and especially private sector demand) points to need for near term policy action, the RBA view would be more consistent with taking more time to judge developments.

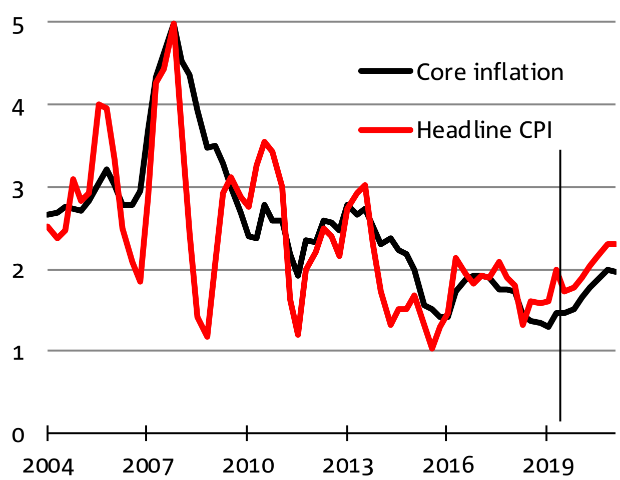
Hence we have reluctantly moved the timing of the next cut to February 2020 (previously December 2019). The RBA has stated that " the possibility that further easing could unintentionally convey an overly negative view of the economic outlook, or that the usual channels of policy transmission might be less effective at low interest rates". On the latter it is our view that transmission mechanisms have probably weakened – especially in household cashflow terms (as households opt not to pay less on mortgages and fixed incomes become harder to live on). Despite very low interest rates, the use of sticky hurdle rates (around 14%) also constrains business investment.

We also have less confidence that we will see a meaningful fiscal stimulus. Implying a move to unconventional policy sooner than otherwise (as noted in the SOMP).

The exchange rate is however still an important channel of monetary policy and a mechanism by which global developments will impact the domestic market. The exchange rate recently - post the increased confidence of a global trade deal and less action priced for the Fed - is trading around 0.685c with the TWI around 59.5. The latter is interesting in that it remains around the same level as when the RBA started cutting in June 2019. Clearly as other central banks also cut, the currency has remained broadly unchanged rather than depreciating. During the month we changed our currency forecast to 0.69c by end 2019 (was 0.65) and around 0.70c by end 2020 and 0.74c by end 2021 (both unchanged). Clearly a rising currency is not helpful in current circumstances.

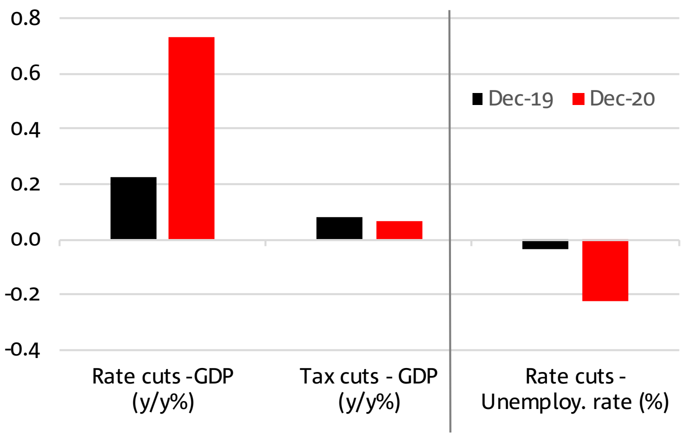
HEADLINE AND CORE INFLATION…

y/y % change



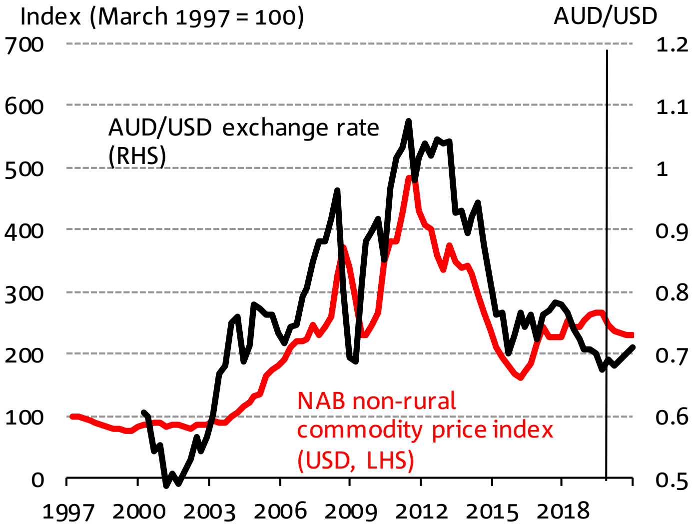
IMPACT OF FISCAL STIMULUS AND RATE CUTS ON ACTIVITY FORECASTS…

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	1.6	2.0	2.4	2.6	1.5	1.9	2.1
Dwelling Investment	0.6	-0.4	-11.9	-4.6	-2.2	4.8	-8.9	-9.6	0.6
Underlying Business Investment	6.9	-2.5	-1.8	2.1	3.8	1.2	-2.4	-0.2	3.3
Underlying Public Final Demand	4.7	4.4	3.7	3.8	4.7	4.3	4.2	3.8	3.5
Domestic Demand	**3.5**	**1.7**	**1.0**	**2.3**	**3.0**	**2.8**	**0.9**	**1.6**	**2.7**
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**	**1.7**	**2.8**
Exports	4.1	3.5	3.9	2.1	3.4	5.0	3.4	3.0	2.0
Imports	7.1	-0.1	0.6	2.8	7.7	4.0	-1.0	2.0	3.2
GDP	**2.9**	**2.0**	**1.8**	**2.4**	**2.4**	**2.7**	**1.6**	**2.1**	**2.5**
Nominal GDP	4.8	5.3	3.3	3.1	6.1	4.9	4.8	2.4	4.1
Current Account Deficit ($b)	51	12	-8	19	46	40	-14	9	23
(-%) of GDP	2.8	0.6	-0.4	0.9	2.6	2.1	-0.7	0.4	1.1
Employment	3.0	2.5	1.7	0.7	2.4	2.7	2.3	1.0	0.8
Terms of Trade	1.8	6.0	-0.6	-5.0	11.5	2.0	6.1	-6.3	-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	1.9	2.2	1.9	1.8	1.8	1.9	2.4
Core CPI	1.8	1.4	1.6	1.9	1.9	1.8	1.4	1.6	2.1
Unemployment Rate	5.6	5.2	5.4	5.5	5.4	5.0	5.3	5.4	5.5
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	0.69	0.72	0.78	0.71	0.69	0.71	0.74
$A - Trade Weighted Index	62.6	60.1	58.7	60.2	64.9	60.7	59.0	59.9	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	8/11/2019	Sep-19	*Dec-19*	*Mar-20*	*Jun-20*	*Sep-20*	*Dec-20*	*Mar-21*	*Jun-21*	*Sep-21*	*Dec-21*
WTI oil	US$/bbl	57	58	60	62	63	64	65	65	65	67	67
Brent oil	US$/bbl	63	64	65	67	68	69	70	70	70	72	72
Tapis oil	US$/bbl	66	67	67	69	70	71	72	72	72	74	74
Gold	US$/ounce	1467	1480	1480	1500	1520	1550	1570	1590	1600	1610	1630
Iron ore (spot)	US$/tonne	82	102	89	79	76	72	68	71	69	71	69
Hard coking coal*	US$/tonne	n.a.	163	150	145	150	152	150	153	151	150	150
Thermal coal (spot)	US$/tonne	67	69	72	72	70	68	70	72	68	65	65
Aluminium	US$/tonne	1817	1764	1750	1740	1750	1800	1825	1850	1870	1885	1900
Copper	US$/tonne	5911	5814	5750	5700	5725	5750	5850	5900	5950	6000	6020
Lead	US$/tonne	2112	2011	2150	2000	1900	1750	1725	1700	1725	1700	1675
Nickel	US$/tonne	16189	14891	16500	16000	15000	14000	13000	12500	12100	11900	11750
Zinc	US$/tonne	2524	2355	2450	2400	2400	2425	2450	2300	2200	2150	2150
Aus LNG**	AU$/GJ	n.a.	13.1	12.2	12.1	12.2	12.0	12.0	12.0	11.8	11.7	11.6

* 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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