

AUSTRALIAN MARKETS WEEKLY

A broad range of indicators point to unemployment edging higher



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Analysis – A broad range of indicators point to unemployment edging higher

- The labour market is a key influence on monetary policy. There is a close relationship between the unemployment rate and the cash rate and Governor Lowe has emphasised the importance of achieving full employment, taken to be the RBA's 4.5% estimate of the NAIRU.
- To gauge the risks around the outlook, we constructed a leading index of unemployment based on the predictive power of a very large number of official and surveyed indicators. Unfortunately, the index provides only a near-term lead on unemployment, acting more as cross-check on the unemployment rate, which has been volatile of late.
- The index suggests unemployment is likely to edge higher in the near term, breaking out of the recent 5.1-5.3% range, with the economic shock from the coronavirus placing additional upward pressure on the jobless rate depending on the duration and severity of the outbreak.
- This contrasts with the Reserve Bank's forecast outlook of a gentle decline in the unemployment rate and is consistent with NAB's view that an underperforming economy will see the bank ease monetary policy further.

The week ahead – AUGDP partials; NZ ANZ survey; COVID-19; Chinese PMIs

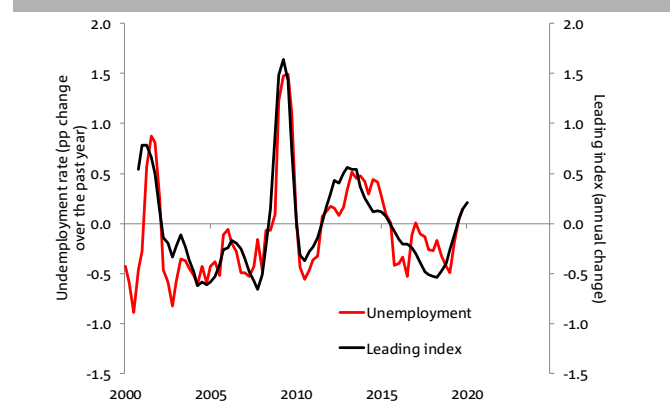
- **Australia/NZ.** Pre-GDP partials kick off with construction work done on Wednesday and the CAPEX survey on Thursday. Construction is expected to fall again in Q4, while firms' investment plans for 2019-20 are likely to be mixed, with a mining pick-up largely offset by non-mining weakness. Credit figures on Friday assume more importance given the RBA's renewed financial stability concerns, but should show continued slow growth. In NZ, Thursday's ANZ business survey, taken during February, will be the first local economic report to give a decent insight into the implications of COVID-19 and the emerging drought.
- **International.** COVID-19 is the focus with more cases outside of China, particularly in Japan and South Korea. In China, the focus is the speed at which production ramps up given the gradual lifting of internal virus-related travel bans. Progress has been slow, although there are reports that migrant workers have started to return to the eastern provinces. That said, pollution levels suggest industrial activity is tracking 20-30% below this time last year, pointing to a significant hit to Q1 GDP. The official Chinese PMIs out this week are expected to show sharp declines in February. As for US data, the focus is on consumer confidence (Tuesday) and durable/capital orders (Thursday); the latter should be affected by the woes at Boeing.

Key markets over the past week

	Last	% chg week		Last	bp/% chg week
AUD	0.6610	-1.5	RBA cash	0.75	0
AUD/CNY	4.65	-0.9	3y swap	0.66	-10
AUD/JPY	73.7	0.0	ASX 200	6,984	-2.0
AUD/EUR	0.611	-1.4	Iron ore	90	2.3
AUD/NZD	1.045	0.2	Brent oil	57.1	-1.1

Source: Bloomberg

Chart of the week: Unemployment is likely to edge higher



A broad range of indicators point to unemployment edging higher

- The labour market is a key influence on monetary policy. There is a close relationship between the unemployment rate and the cash rate and Governor Lowe has emphasised the importance of achieving full employment, taken to be the RBA's 4.5% estimate of the NAIRU.
- To gauge the risks around the outlook, we constructed a leading index of unemployment based on the predictive power of a very large number of official and surveyed indicators. Unfortunately, the index provides only a near-term lead on unemployment, acting more as cross-check on the unemployment rate, which has been volatile of late.
- The index suggests unemployment is likely to edge higher in the near term, breaking out of the recent 5.1-5.3% range, with the economic shock from the coronavirus placing additional upward pressure on the jobless rate depending on the duration and severity of the outbreak.
- This contrasts with the Reserve Bank's forecast outlook of a gentle decline in the unemployment rate and is consistent with NAB's view that an underperforming economy will see the bank ease monetary policy further.

*"... [The Board recognises that] the balance between the benefits of lower interest rates and the risks can change over time and that balance is very much dependent upon the state of the economy. If the **unemployment rate** were to be moving materially in the wrong direction and there was no further progress [on] the inflation target, the balance of the arguments would tilt towards a further easing of monetary policy (emphasis added). So we're continuing to watch the labour market carefully, as we seek to strike the right balance in the interests of the community as a whole."*

Reserve Bank Governor Lowe
7 February 2020¹

The unemployment rate has a key bearing on monetary policy

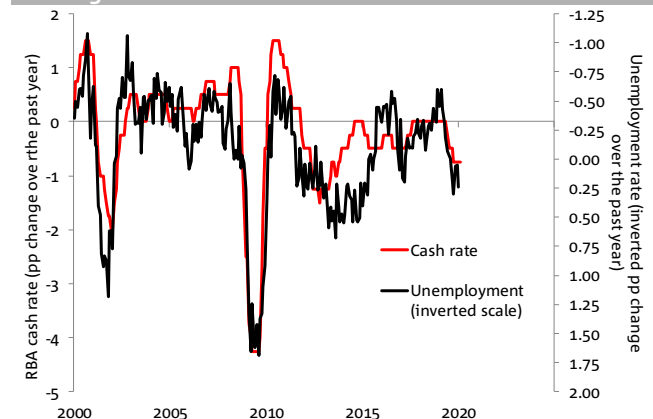
Unemployment is a key economic indicator for the Reserve Bank. Historically, there has been a close relationship between the cash rate and the unemployment rate and last year Governor Lowe emphasised the importance of achieving full employment, represented by the bank's 4.5% estimate of the NAIRU.

The labour market is sometimes downplayed as a lagging indicator, but the unemployment rate has the key advantages of being more timely than most official and indicators and covering all sectors in the economy.

Moreover, the Reserve Bank places more weight on the *actual* unemployment rate than the forecast rate. This is not surprising considering that the bank finds it very

hard to reliably forecast unemployment, something borne out by the review of its forecast performance.²

Chart 1: The unemployment rate has an important bearing on the cash rate



Source: Australian Bureau of Statistics, Reserve Bank of Australia, National Australia Bank

A very large number of partial indicators suggest unemployment is likely to edge higher

Given the importance of the unemployment rate to policy, we have assessed the usefulness of a mix of official and private-sector indicators, combining the series that have proved to be statistically significant in forecasting unemployment into a leading index. As such, this analysis was an atheoretical horse-race, where the inclusion of an indicator in the index hinged on its ability to help forecast unemployment over the past twenty years.

The findings on the forecast performance of the individual indicators are detailed in the appendix, where we found that:

- **GDP.** GDP was statistically significant, but with very few other components of output (only consumer spending, private demand and imports);
- **Housing activity.** Only private-sector house approvals proved useful;
- **Job vacancies.** All measures of job vacancies – i.e. the official, ANZ Bank and SEEK series – were significant;
- **NAB business survey.** Almost every index proved significant, covering confidence, actual and expected business conditions, forward orders, capacity utilisation, and most constraints on production;
- **ACCI/Westpac manufacturing survey.** Like the NAB business survey, almost every series was useful, covering confidence, actual and expected business conditions, new orders, capacity utilisation, and some constraints on production; and
- **Westpac-Melbourne Institute consumer confidence.** Overall consumer confidence was statistically significant, including two components (family finances and the year-ahead expectations on the economy), as well as expected unemployment.

¹ See House of Representatives Standing Committee on Economics, *Reserve Bank of Australia annual report 2019*, Commonwealth of Australia Proof Committee Hansard, Canberra, 7 February 2020.

² See Peter Tulip and Stephanie Wallace, *Estimates of uncertainty around the RBA's forecasts*, Reserve Bank of Australia Research Discussion Paper RDP 2012-07, November 2012.

Detrending the statistically significant indicators, we constructed a simple leading index of the unemployment rate by averaging across the series.³

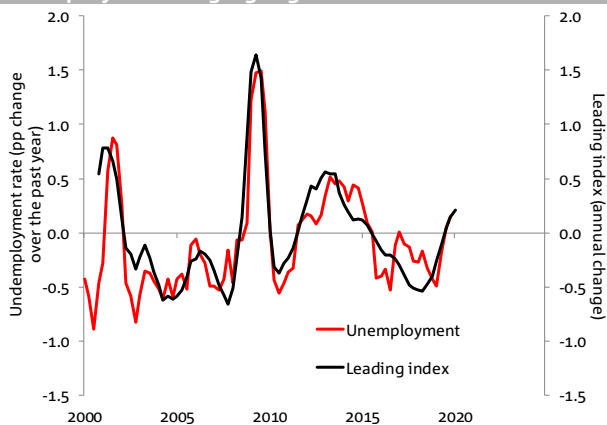
The relationship between the summary index and unemployment is shown in Chart 2. Unfortunately, the index provides only a near-term lead on the labour market of a quarter at most, acting more as a smoother cross-check on the current trend in the unemployment rate.

That said, the Reserve Bank is currently forecasting unemployment will edge lower over this year, whereas the broad sweep of available partial indicators for Q4 and Q1 to date captured in this index suggest that unemployment is more likely to edge higher from the 5.1-5.3% range of recent months.

Moreover, nearly all the indicators predate the economic shock of the coronavirus, which will likely place additional upward pressure on unemployment depending on the duration and severity of the outbreak.

This supports NAB’s view on monetary policy, which is that an underperforming economy will see the Reserve Bank cut rates further, where we have pencilled in the next rate cut for April.

Chart 2: A broad range of partial indicators point to unemployment edging higher



Source: Australian Bureau of Statistics, ACCI and Westpac, ANZ Bank, Reserve Bank of Australia, SEEK, Westpac and Melbourne Institute, National Australia Bank

Further work

As a next step, we plan to construct a leading index based on a subset of the monthly indicators. This will likely be more volatile than the quarterly index we have constructed, but should prove a more timely read on the near-term risks to the unemployment rate.

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³ We experimented with a principal components analysis, but the results were not materially different from a simple average of the detrended indicators.

Appendix – Test results for predictive power

We tested for predictive power by seeing whether past values of each indicator could help forecast the unemployment rate.

This involved estimating a simple VAR model for each series, comprising the series and the unemployment rate, using quarterly data over the period from 2000 to 2019. We then tested for Granger causality at the 10% level of significance.

We also examined whether there was feedback from the unemployment rate to each series, testing whether past values of unemployment could help forecast each indicator.

Table 1: Tests for Granger causality

(Series)	(A) Series helps predict unemployment (p-value)	(B) Unemployment helps predict the series (p-value)	(A) Statistically significant	(b) Statistically significant
(1) Real GDP				
Consumer spending	0.01	0.92	YES	
New residential construction	0.11	0.15		
Renovations to existing homes	0.23	0.28		
Total residential investment	0.11	0.17		
Business investment	0.83	0.96		
- new non-residential building	0.36	0.56		
- new engineering construction	0.73	0.74		
- new equipment	0.43	0.76		
- software	0.85	0.05		YES
- total mining	0.66	0.12		
- total non-mining	0.38	0.23		
New public demand	0.35	0.50		
- public consumption	0.48	0.28		
- public investment	0.63	0.04		YES
New private demand	0.02	0.53	YES	
Exports	0.57	0.69		
Imports	0.00	0.82	YES	
GDP	0.07	0.98	YES	
(2) Residential building approvals				
Private sector	0.15	0.02		YES
- houses	0.06	0.02	YES	YES
- units	0.67	0.10		
Public sector	0.82	0.10		
Total	0.17	0.01		YES
(3) Measures of job vacancies				
ABS	0.00	0.09	YES	YES
ANZ Bank	0.00	0.40	YES	
SEEK	0.00	0.06	YES	YES
(4) NAB business survey				
Business confidence	0.00	0.04	YES	YES
Business conditions	0.00	0.01	YES	YES
- expected	0.00	0.03	YES	YES
Trading	0.00	0.02	YES	YES
- expected	0.00	0.10	YES	YES
Profits	0.00	0.01	YES	YES
- expected	0.00	0.01	YES	YES
Employment	0.00	0.18	YES	
- expected	0.00	0.25	YES	
Forward orders	0.00	0.00	YES	YES
- expected	0.00	0.08	YES	YES
Capacity utilisation	0.00	0.13	YES	
Significant constraints on production				
- suitable labour	0.00	0.90	YES	
- sales & orders	0.00	0.06	YES	YES
- premises and plant	0.03	0.21	YES	
- suitable materials	0.51	0.35		
Expectations next twelve months				
- business conditions	0.00	0.11	YES	
- employees	0.00	0.38	YES	
- capital expenditure	0.00	0.23	YES	
- profits	0.00	0.02	YES	YES
(5) ACCI/Westpac survey of industrial trends				
General business situation	0.07	0.03	YES	YES
Capacity utilisation	0.04	0.06	YES	YES
New orders	0.01	0.00	YES	YES
- expected	0.00	0.06	YES	YES
Output	0.02	0.09	YES	YES
- expected	0.00	0.06	YES	YES
Factors limiting production				
- orders	0.05	0.94	YES	
- capacity	0.60	0.39		
- labour	0.00	0.22	YES	
- finance	0.98	0.81		
Expected profit	0.00	0.09	YES	YES
Expected equipment investment	0.01	0.13	YES	
Expected non-residential constr.	0.00	0.52	YES	
Employment	0.04	0.03	YES	YES
- expected	0.00	0.44	YES	
Overtime	0.49	0.00		YES
- expected	0.04	0.02	YES	YES
(6) Westpac-Melbourne Institute consumer confidence				
Consumer confidence	0.04	0.46	YES	
- family finances	0.02	0.71	YES	
- expected family finances	0.36	0.57		
- year-ahead economy	0.03	0.78	YES	
- 5 years-ahead economy	0.83	0.03		YES
- time to buy h'hold items	0.16	0.14		
Expected unemployment	0.00	0.39	YES	

Source: Australian Bureau of Statistics, ACCI and Westpac, ANZ Bank, Reserve Bank of Australia, SEEK, Westpac and Melbourne Institute, National Australia Bank

CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEDT
Monday 24 February								
GE	IFO Business Climate	Feb		95.3		95.9	9.00	20.00
GE	IFO Current Assessment	Feb		98.6		99.1	9.00	20.00
Tuesday 25 February								
GE	GDP SA QoQ	4Q F		0		0	7.00	18.00
GE	GDP WDA YoY	4Q F		0.4		0.4	7.00	18.00
Wednesday 26 February								
US	Conf. Board Consumer Confidence	Feb		132.1		131.6	15.00	2.00
AU	Construction Work Done	4Q	-0.5	-1		-0.4	0.30	11.30
Thursday 27 February								
US	New Home Sales	Jan		715		694	15.00	2.00
NZ	Trade Balance NZD	Jan		-532.5		547	21.45	8.45
NZ	ANZ Business Confidence	Feb		-		-13.2	0.00	11.00
AU	Private Capital Expenditure	4Q	0.2	0.5		-0.2	0.30	11.30
EC	M3 Money Supply YoY	Jan		5.3		5	9.00	20.00
EC	Consumer Confidence	Feb F		-		-6.6	10.00	21.00
Friday 28 February								
US	Durable Goods Orders	Jan P		-1.5		2.4	13.30	0.30
US	Core PCE QoQ	4Q S		1.3		1.3	13.30	0.30
US	GDP Annualized QoQ	4Q S		2.1		2.1	13.30	0.30
US	GDP Price Index	4Q S		1.4		1.4	13.30	0.30
CA	Current Account Balance	4Q		-8.955		-9.86	13.30	0.30
NZ	ANZ Consumer Confidence Index	Feb		-		122.7	21.00	8.00
JN	Jobless Rate	Jan		2.2		2.2	23.30	10.30
JN	Tokyo CPI YoY	Feb		0.5		0.6	23.30	10.30
JN	Tokyo CPI Ex-Fresh Food YoY	Feb		0.6		0.7	23.30	10.30
JN	Industrial Production MoM	Jan P		0.2		1.2	23.50	10.50
JN	Industrial Production YoY	Jan P		-3.1		-3.1	23.50	10.50
AU	Private Sector Credit MoM	Jan		0.2		0.2	0.30	11.30
GE	Unemployment Change (000's)	Feb		4.5		-2	8.55	19.55
GE	Unemployment Claims Rate SA	Feb		5		5	8.55	19.55
Saturday 29 February								
GE	CPI MoM	Feb P		0.3		-0.6	13.00	0.00
GE	CPI YoY	Feb P		1.7		1.7	13.00	0.00
US	Wholesale Inventories MoM	Jan P		0.1		-0.2	13.30	0.30
US	PCE Core Deflator MoM	Jan		0.2		0.2	13.30	0.30
US	PCE Core Deflator YoY	Jan		1.7		1.6	13.30	0.30
CA	Quarterly GDP Annualized	4Q		0.3		1.3	13.30	0.30
US	U. of Mich. Expectations	Feb F		-		92.6	15.00	2.00
US	U. of Mich. Sentiment	Feb F		100.7		100.9	15.00	2.00
CH	Manufacturing PMI	Feb		47.4		50	1.00	12.00
CH	Non-manufacturing PMI	Feb		50		54.1	1.00	12.00
Upcoming Central Bank Interest Rate Announcements								
Australia, RBA		Mar 3		0.75	0.75	0.75		
New Zealand, RBNZ		Mar 25		1	1	1		
GMT: Greenwich Mean Time; AEDT: Australian Eastern Daylight Time								

FORECASTS

Economic Forecasts																				
	Annual % change				Quarterly % change															
	2018	2019	2020	2021	2018				2019				2020				2021			
Australia Forecasts	2018	2019	2020	2021	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Household Consumption	2.7	1.4	1.1	1.9	0.5	0.8	0.3	0.4	0.3	0.3	0.1	0.4	-0.1	0.3	0.6	0.5	0.4	0.5	0.5	0.6
Underlying Business Investment	1.3	-3.1	-3.5	3.9	1.0	-1.0	-1.4	-0.4	0.9	-1.2	-2.9	-1.9	-1.0	0.2	0.6	1.1	1.0	1.2	1.0	1.2
Residential Construction	4.7	-7.1	-7.0	4.1	3.4	2.5	0.4	-3.0	-1.6	-3.7	-1.7	-2.4	-2.2	-2.0	0.0	0.5	1.3	1.9	1.9	1.9
Underlying Public Spending	4.4	4.8	4.6	3.8	1.4	-0.5	2.0	0.7	1.0	1.7	1.7	0.8	1.1	1.1	1.0	1.0	1.0	0.9	0.8	0.8
Net Exports (a)	0.9	1.5	-0.2	-0.3	0.6	0.0	0.4	-0.1	0.4	0.5	0.2	0.3	0.1	0.0	-0.1	-0.1	0.0	-0.1	-0.1	-0.1
Inventories (a)	0.1	-0.3	0.0	0.1	-0.1	0.3	-0.3	0.1	-0.1	-0.4	0.1	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Domestic Demand (q/q %)	-	-	-	-	0.9	0.3	0.5	0.1	0.3	0.3	0.2	0.2	0.0	0.4	0.7	0.7	0.7	0.7	0.8	0.8
Dom Demand (y/y %)	2.9	1.1	1.1	2.8	3.7	3.3	2.6	1.8	1.2	1.2	0.9	1.0	0.7	0.8	1.3	1.8	2.5	2.9	3.0	3.0
Real GDP (q/q %)	-	-	-	-	0.9	0.7	0.3	0.2	0.5	0.6	0.4	0.4	0.0	0.4	0.7	0.7	0.6	0.7	0.7	0.7
Real GDP (y/y %)	2.7	1.8	1.5	2.6	3.1	3.2	2.5	2.1	1.7	1.6	1.7	2.0	1.5	1.2	1.5	1.8	2.4	2.7	2.7	2.7
CPI headline (q/q %)	-	-	-	-	0.4	0.4	0.4	0.5	0.0	0.6	0.5	0.7	0.4	0.4	0.5	0.6	0.5	0.5	0.6	0.7
CPI headline (y/y %)	1.9	1.6	2.1	2.3	1.9	2.1	1.9	1.8	1.3	1.6	1.7	1.8	2.3	2.1	2.1	2.0	2.1	2.2	2.3	2.4
CPI underlying (q/q %)	-	-	-	-	0.5	0.5	0.4	0.4	0.2	0.4	0.4	0.4	0.4	0.4	0.5	0.4	0.5	0.5	0.5	0.5
CPI underlying (y/y %)	1.8	1.4	1.7	2.0	1.9	1.8	1.8	1.8	1.5	1.4	1.4	1.5	1.6	1.6	1.7	1.7	1.8	1.9	2.0	2.1
Private wages (q/q %)	-	-	-	-	0.5	0.6	0.5	0.6	0.5	0.5	0.5	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Private wages (y/y %)	2.1	2.3	2.5	2.8	1.9	2.1	2.1	2.3	2.4	2.3	2.2	2.2	2.3	2.5	2.6	2.6	2.7	2.7	2.8	2.8
Unemployment Rate (%)	5.3	5.2	5.4	5.5	5.5	5.6	5.1	5.0	5.1	5.2	5.4	5.2	5.2	5.2	5.5	5.6	5.5	5.5	5.5	5.5
Terms of trade	1.8	5.1	-7.3	-1.8	3.3	-1.2	0.7	2.6	3.3	1.4	0.3	-5.5	-1.9	-1.9	0.0	-1.9	-0.3	0.2	0.2	0.6
Current Account (% GDP)	-2.1	0.7	-0.4	-1.1	-2.1	-2.6	-2.1	-1.3	-0.4	0.9	1.6	0.6	0.2	-0.3	-0.4	-1.0	-1.1	-1.1	-1.1	-1.1

Source: NAB Group Economics; (a) Contributions to GDP growth

Exchange Rate Forecasts						
	24-Feb	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Majors						
AUD/USD	0.661	0.68	0.69	0.70	0.71	0.71
NZD/USD	0.63	0.65	0.65	0.66	0.67	0.67
USD/JPY	111.6	109	109	108	110	108
EUR/USD	1.08	1.14	1.16	1.16	1.17	1.17
GBP/USD	1.29	1.35	1.35	1.35	1.33	1.36
USD/CNY	7.03	7.05	7.00	6.90	6.85	6.85
USD/CAD	1.33	1.31	1.30	1.30	1.31	1.32
USD/CHF	0.98	0.98	0.96	0.96	0.96	0.96

Australian Cross Rates						
	24-Feb	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
AUD/NZD	1.05	1.05	1.06	1.06	1.06	1.06
AUD/JPY	73.8	74	75	76	78	77
AUD/EUR	0.61	0.60	0.59	0.60	0.61	0.61
AUD/GBP	0.51	0.50	0.51	0.52	0.53	0.52
AUD/CNY	4.65	4.79	4.83	4.83	4.86	4.86
AUD/CAD	0.88	0.89	0.90	0.91	0.93	0.94
AUD/CHF	0.65	0.67	0.66	0.67	0.68	0.68

Interest Rate Forecasts						
	24-Feb	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Australian Rates						
RBA cash rate	0.75	0.75	0.25	0.25	0.25	0.25
3 month bill rate	0.88	0.85	0.40	0.40	0.40	0.40
3 Year Swap Rate	0.65	0.65	0.50	0.45	0.35	0.45
10 Year Swap Rate	1.05	1.15	1.02	1.02	0.92	1.02
Offshore Policy Rates						
US Fed funds	1.75	1.75	1.75	1.75	1.75	1.75
ECB deposit rate	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
BoE repo rate	0.75	0.75	0.75	0.75	0.75	0.75
BoJ excess reserves rate	-0.10	-0.20	-0.30	-0.30	-0.30	-0.30
RBNZ OCR	1.00	1.00	1.00	1.00	1.00	1.00
China 1yr lending rate	4.35	4.10	4.10	4.10	4.10	4.10
China Reserve Ratio	12.5	12.0	12.0	12.0	12.0	12.0
10-year Bond Yields						
Australia	0.92	1.00	0.90	0.90	0.80	0.90
United States	1.47	1.80	1.80	1.80	1.80	1.90
New Zealand	1.21	0.95	1.05	1.10	1.30	1.45

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP				
	2018	2019	2020	2021
Australia	2.7	1.8	1.5	2.6
United States	2.9	2.3	1.8	1.9
Eurozone	1.9	1.2	1.0	1.4
United Kingdom	1.3	1.4	1.0	1.4
Japan	0.3	1.1	0.4	1.0
China	6.6	6.1	5.5	5.8
India	7.4	5.1	6.2	7.1
New Zealand	3.2	2.2	1.7	2.3
World	3.6	3.0	3.0	3.5

Commodity prices (\$US)						
	24-Feb	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Brent oil	57.0	55	58	60	62	62
Gold	1664	1560	1540	1560	1580	1580
Iron ore	na	85	76	72	68	71
Hard coking coal*	156	135	152	150	148	151
Thermal coal	70	68	68	65	70	70
Copper	5746	5650	5725	5750	5850	5900
Aus LNG**	10	10	10	11	11	11

* FOB quarterly contract prices (thermal coal is JFY contract)

** Implied Australian LNG export prices

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