

AUSTRALIAN MARKETS WEEKLY

RBA expects a slow, bumpy recovery; much will depend on Victoria



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RBA expects a slow, bumpy recovery, very much virus dependant

- The RBA's latest scenarios for the economy see a slower improvement in unemployment, with the unemployment rate set to peak at around 10% at the end of this year (instead of 9% previously expected) and only fall to 7% by the end of 2022. GDP is expected to contract 6% this year and rise 5% in 2021, with the economy not getting back to pre-COVID levels until 2022.
- Ongoing labour market spare capacity has also seen forecasts for wages growth and inflation downgraded by around 0.25% points across the horizon with trimmed mean inflation not getting back to the RBA's 2-3% target range in the forecast horizon.
- Importantly, below target inflation occurs in all three RBA forecast scenarios (upside, baseline and downside), suggesting the RBA could do more to get inflation towards target, although fiscal policy is clearly best placed to address the current pandemic shock to the economy. This will be a key question markets will be focusing on when the RBA Governor gives his parliamentary testimony on Friday.
- The RBA's inflation forecasts are also in sharp contrast to the inflation fears seen amongst some in the market, where breakeven inflation rates and gold prices have risen recently. So far, the impact from COVID-19 has affected demand more than supply even with record government stimulus and very easy monetary policy.

The week ahead

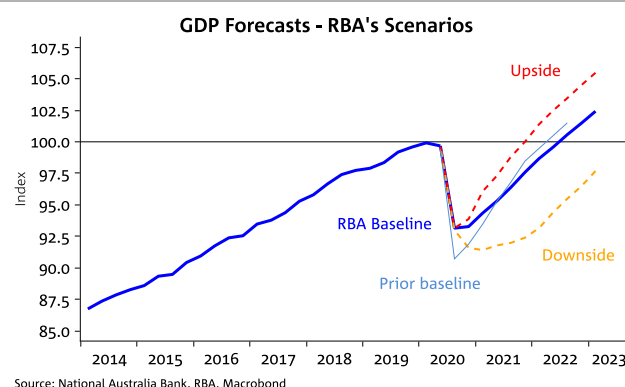
- Australia:** A busy week domestically where focus remains on Victorian virus counts which are showing signs of flattening out. Data wise, Australian payrolls are published on Tuesday for the week ended 25 July with job losses from Melbourne's earlier stage 3 lockdown needing to be weighed against continued reopening elsewhere. The NAB Business survey is also out on Tuesday. The Wage Price Index on Wednesday will be closely watched for early impact on wages, while employment on Thursday is likely to dominate with a wide range of market expectations from -120k to +150k – the key being whether the reference week was too early to pick-up the slowing seen in payrolls to date. RBA Governor Lowe rounds out the week on Friday in parliamentary testimony.
- International:** **NZ:** across the ditch the RBNZ meets on Wednesday where consensus is for no change. **CH:** activity indicators for July on Friday under focus, particularly retail sales given the recovery seen in the services PMI so far. Also out is aggregate financing figures due anytime in the week. **Europe:** quiet week with the summer holiday season firmly underway. **US:** politics to dominate with Democratic Presidential hopeful Biden set to announce his running mate, potentially influential for the odds of a Democratic clean sweep come November (currently 52% according to PredictIt). Discussion over a fiscal package will continue despite Trump's executive actions, while on the data front the CPI is on Wednesday and Retail Sales is on Friday. US-China trade negotiators are also set to meet on Saturday.

Key markets over the past week

	Last	% chg week		Last	bp/% chg week
AUD	0.7165	0.7	RBA cash	0.14	1
AUD/CNY	4.99	0.7	3y swap	0.20	-1
AUD/JPY	75.8	0.4	ASX 200	6,083	2.6
AUD/EUR	0.608	0.3	Iron ore	113	2.0
AUD/NZD	1.085	0.7	Brent oil	44.8	1.4

Source: Bloomberg

Chart of the week: GDP not back to pre-COVID until 2022



Before starting on this Weekly's main topic, it is encouraging for the Australian economic outlook that Victorian new virus cases appear to be starting to peak with the 7-day moving average levelling out and now starting to trend lower (Chart 1). The trend lower should continue given Melbourne's level 4 lockdown has been in place for a week now, while the mean incubation period for the virus is 5-14 days. If virus infections do drop away in a quick fashion, there is a real prospect that consumer and business confidence can recover more quickly than recently feared when cases appeared to be continuing to climb despite progressive lockdowns.

Meanwhile, outside of NSW, virus counts remain close to zero, while in NSW they remain at very low levels (below 15 per day over much of the past week). The course of the NSW counts of positive cases of unknown origin are the key figures to follow in determining whether NSW might follow Victoria into tighter restrictions, but so far thankfully these cases remain very low.

New Daily Cases of COVID 19

Date	Australia excl. Victoria	Victoria* (7day ma)
2020 Mar 8	~10	~0
2020 Apr 1	~350	~50
2020 May 1	~10	~10
2020 Jun 1	~10	~10
2020 Jul 1	~10	~100
2020 Aug 1	~10	~500
2020 Aug 15	~10	~450

* Dark blue line represents Victoria's 7-day moving average
Source: National Australia Bank. government sources gathered by covid19data.com

This week, we thought it would be interesting to discuss the RBA's scenarios for the economy given the uncertainty stemming from Victoria's virus resurgence. The Bank's latest "forecasts" were unveiled in Friday's August Statement on Monetary Policy and were also elaborated on by the RBA's chief economist and Assistant Governor Luci Ellis in a webinar to the Australian Business Economists ([for a recording please see this link](#)).

Under the RBA's baseline scenario, GDP is set to contract 6% over 2020 and only partly bounce back in 2021 by +5%. It takes until 2022 for the economy to return to pre-COVID levels of activity (see Table 1 and Chart 2). The baseline scenario assumes the Victorian lockdown controls the virus within the six-week lockdown timeframe (encouraging signs as noted above) with no significant outbreaks in other states. International border restrictions are assumed to remain in place until mid-2021, while a vaccine is assumed not to be widely available until 2022. Unemployment under this scenario peaks at 10% and takes a long time to edge back down only falling to 7% by the end of 2022.

Given the significant spare capacity in the labour market, wages growth is expected to remain subdued and as a consequence, inflation is set to undershoot the RBA's 2-3% inflation target for the entirety of the forecast horizon.

Table 1: RBA Baseline Forecasts Compared to Prior

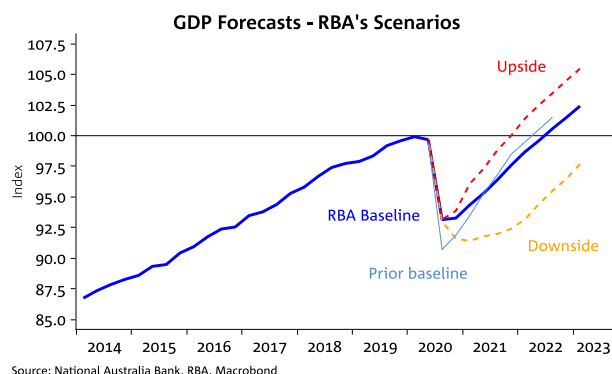
	Dec-20		
	May SoMP	Aug SoMP	Change
GDP in detail			
Household consumption	-9	-7	2
Dwelling investment	-13	-14	-1
Business investment	-13	-17	-4
Public demand	2	3	1
Imports	-11	-12	-1
Exports	-7	-9	-2
GDP	-6	-6	0
Unemployment	9	10	1
Wage price index	1.5	1.25	-0.25
Trimmed mean inflation	1.25	1	-0.25
Consumer price index	0.25	1.25	1

	Dec-21		
	May SoMP	Aug SoMP	Change
GDP in detail			
Household consumption	9	6	-3
Dwelling investment	6	8	2
Business investment	4	6	2
Public demand	2	2	0
Imports	13	9	-4
Exports	12	8	-4
GDP	6	5	-1
Unemployment	7.5	8.5	1
Wage price index	1.75	1.25	-0.5
Trimmed mean inflation	1.25	1	-0.25
Consumer price index	1.25	1	-0.25

	Dec-22		
	May SoMP	Aug SoMP	Change
GDP in detail			
Household consumption	--	4	--
Dwelling investment	--	5	--
Business investment	--	9	--
Public demand	--	3	--
Imports	--	7	--
Exports	--	5	--
GDP	--	4	--
Unemployment	--	7	--
Wage price index	--	1.75	--
Trimmed mean inflation	--	1.5	--
Consumer price index	--	1.5	--

Source: National Australia Bank, RBA

Chart 2: GDP not back to pre-COVID until 2022

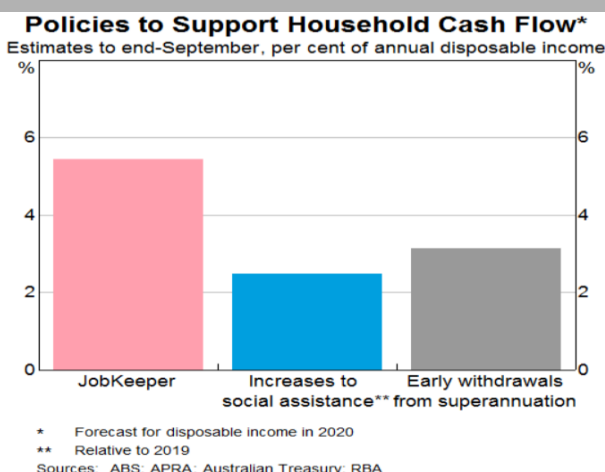


Importantly, the Bank notes the recovery has begun, though recovery is expected to be slow and bumpy, with the renewed Victorian lockdown a substantial drag on Q3 GDP, as other states continue reopening. The forecasts in the previous table show:

- The short-term impact on the economy not as negative as previously expected, but still a very big negative impact;
- Consumer spending significantly impacted by shutdowns;
- Business investment expected to be extremely weak; and
- Housing construction also to be quite weak.

The key uncertainties around the outlook focus on the resiliency of household consumption to the tapering of the JobKeeper and JobSeeker support schemes after September. To date government support has significantly bolstered household incomes despite elevated unemployment (Chart 3).

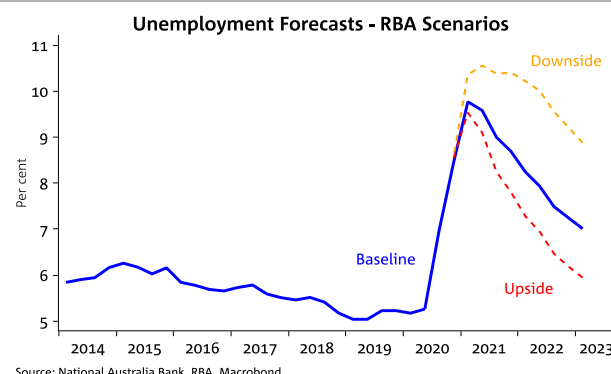
Chart 3: Household cash flow supported by government



Business investment is expected to be very weak in the near term with many businesses putting investment plans on hold. Dwelling investment is also expected to be weak. The government's HomeBuilder policy is expected to provide some support to detached home building in the near term. Interestingly even with international borders closed, the RBA has factored in the re-start of international students from early next year – a

trial of international students is being pushed by the government, though quarantine breaches in Victoria suggest this will need to be done in a measured way.

Chart 4: Unemployment falls very slowly

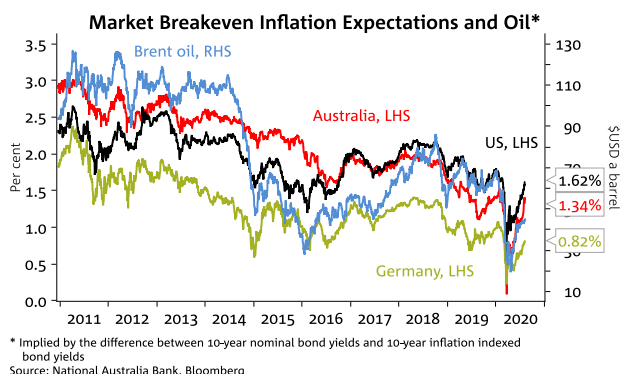


Given the uncertainty the RBA also has provided two alternative scenarios of the economy, an upside and a downside scenario. In the upside scenario, faster progress in controlling the virus domestically helps to limit the damage to consumer and business confidence. Activity restrictions, particularly domestic borders are eased, while international travel restrictions remain. The unemployment rate recovers more quickly in this scenario. The downside scenario sees Australia face further virus outbreaks with the need to re-impose restrictions to some degree. Until Victoria's virus resurgence, Australia appeared to be closer to the RBA's upside scenario. Effective control of the virus in Victoria in the near term, could see the Australian outlook back towards the upside scenario given there is currently little spread of the virus outside of Victoria. The hit to the Australian economy however remains very large even in the upside scenario with output not back to pre-COVID levels until the end of 2021 (instead of 2022).

Inflation to be well below target

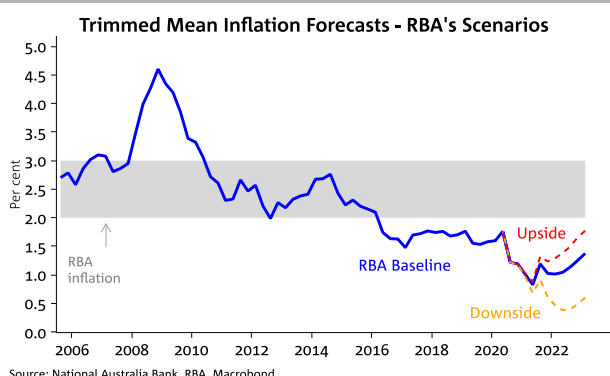
A debate in markets at the moment is whether all the monetary and fiscal stimulus being seen in Australia and offshore will be inflationary. Implied break-even inflation rates have risen, while the gold price has risen strongly – perhaps partly due to its traditional role as an inflation hedge (Chart 4). Nevertheless, outside of food, there appears to be very little inflationary pressure in the global economy with the demand shock from COVID-19 overwhelmingly outweighing the initial supply shock. The RBA makes the point, however, that the longer-term supply impacts of the Covid-19 shock are unknown.

Chart 5: Breakeven inflation rates lifts



The RBA's view according to their forecasts is similar with the Bank not seeing core inflation pick up much across its entire forecast horizon. Indeed, even under the optimistic upside scenario, inflation remains well below the RBA's 2-3% inflation target, possibly until 2023.

Chart 6: Inflation forecast to be well below target

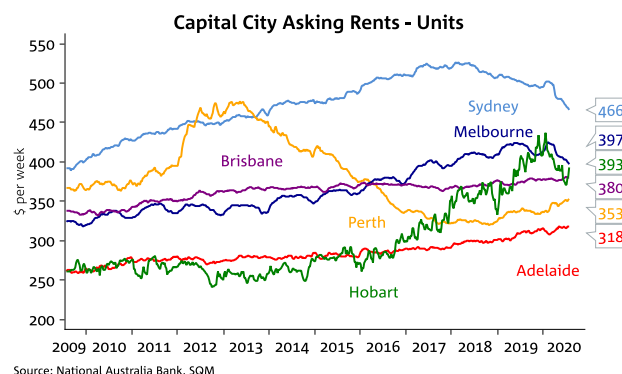


Key to the subdued inflation outlook in Australia is the forecast of elevated unemployment putting downward pressure on wages. According to the RBA's business liaison program, more than 10% of contacts have reported COVID-related wage cuts to date. And while the majority of those are expected to be unwound as business conditions recover, around 35% of businesses expect wage freezes in the year ahead. The recent minimum wage decision of 1.75% will also see more subdued minimum wages growth relative to history – recent increases in the minimum wage have averaged around 3% pa. The Q2 WPI on Wednesday will provide the first insight into impacts on wages from the shock..

The other driver of a subdued inflation outlook is Australia's net migration flows coming to a virtual halt given international border closures and the impact this is having on the rental market and demand for new dwellings – combined these two make up around 15% of the headline CPI basket and more for the core measures.

Net migration used to contribute around 2/3rds of Australia's 400k a year population growth. The RBA's baseline assumption sees Australia's borders remaining closed until mid-2021. NAB's prior analysis suggested should that occur, then Australia's population would be 500k less than forecast under the ABS central scenario back in 2018 – those forecasts used as a baseline for many businesses (see prior [AMW: residential construction outlook](#)).

Chart 7: Rent declines drag down the CPI



What more could the RBA do?

Governor Lowe is talking in Parliamentary Testimony on Friday where markets will be trying to assess what more the RBA could do given the forecast trajectory of the baseline scenario and risks to the outlook.

So far the RBA has been at pains to emphasise the limits of monetary policy and the RBA Board has ruled out several possible policy measures from the monetary toolbox: (1) there is "not a case" for FX intervention given the AUD is "broadly in line with its fundamentals"; (2) negative rates are still "extraordinary unlikely" with the main potential benefit being on the AUD, but with a number of significant costs; (3) monetary financing of budget deficits "is not an option", especially with government being able to fund at historically low interest rates ([SoMP p.5](#)).

Instead further stimulus if it is required will likely first come from fiscal policy and second from tweaking existing measures. Governor Lowe in his recent Anika Foundation speech hinted that such tweaks could include: "For example, the various interest rates currently at 25 basis points could have been set lower, at say 10 basis points. It would also have been possible to introduce a program of government bond purchases beyond that required to achieve the 3-year yield target. Different parameters could have also been chosen for the Term Funding Facility" ([see Lowe 2020](#)).

That view was reinforced by Assistant Governor (Economic) Ellis who said the RBA "haven't completely ruled out doing more" and have merely "ruled out things that it thinks will be counter-productive". Dr Ellis also reinforced the RBA "haven't walked away from the inflation target" and that the medium term isn't necessarily the same as the forecast horizon.

Tweaks are unlikely to add much more stimulus than already available with fiscal policy having to do the heavy lifting should the outlook worsen or remain weak for an extended period. It is encouraging that Prime Minister Morrison and Finance Minister Cormann are showing a pragmatic willingness to extend support measures where necessary to support recovery.

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CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEST
Monday 10 August 2020								
NZ	REINZ House Sales YoY	Jul		--		7.1		10 August
CH	Money Supply M2 YoY	Jul		11.1		11.1		10 August
CH	New Yuan Loans CNY	Jul		1215		1810		10 August
NZ	ANZ Business Confidence	Aug P		--		-31.8	0.00	11.00
AU	ABS household survey			--		--	0.30	11.30
CH	PPI YoY	Jul		-2.5		-3	0.30	11.30
CH	CPI YoY	Jul		2.6		2.5	0.30	11.30
CA	Housing Starts	Jul		200.58		211.681	11.15	22.15
Tuesday 11 August 2020								
NZ	ANZ Truckometer Heavy MoM	Jul		--		14.5	21.00	8.00
JN	BoP Current Account Balance	Jun		132.6		1176.8	22.50	9.50
AU	NAB Business Conditions	Jul		--		-7	0.30	11.30
AU	ABS payrolls			--		--	0.30	11.30
UK	ILO Unemployment Rate 3Mths	Jun		--		3.9	5.00	16.00
UK	Jobless Claims Change	Jul		--		-28.1	5.00	16.00
GE	ZEW Survey Expectations	Aug		60		59.3	8.00	19.00
US	NFIB Small Business Optimism	Jul		98.5		100.6	9.00	20.00
US	PPI Final Demand YoY	Jul		-0.7		-0.8	11.30	22.30
Wednesday 12 August 2020								
NZ	Net Migration SA	Jun		--		590	21.45	8.45
AU	Westpac Consumer Conf Index	Aug		--		87.9	23.30	10.30
AU	Wage Price Index QoQ	2Q		0.35		0.5	0.30	11.30
AU	Wage Price Index YoY	2Q		2		2.1	0.30	11.30
NZ	RBNZ Official Cash Rate	Aug 12		0.25		0.25	1.00	12.00
UK	Industrial Production YoY	Jun		--		-20	5.00	16.00
UK	Monthly GDP (MoM)	Jun		--		1.8	5.00	16.00
UK	GDP QoQ / YoY	2Q P		--		-2.2 / -1.7	5.00	16.00
EC	Industrial Production WDA YoY	Jun		-11.4		-20.9	8.00	19.00
US	CPI YoY	Jul		0.7		0.6	11.30	22.30
Thursday 13 August 2020								
NZ	Food Prices MoM	Jul		--		0.5	21.45	8.45
JN	PPI YoY	Jul		-1.1		-1.6	22.50	9.50
AU	Consumer Inflation Expectation	Aug		--		3.2	0.00	11.00
AU	Employment Change	Jul	-90	85		210.8	0.30	11.30
AU	Unemployment Rate	Jul	8.2	7.7		7.4	0.30	11.30
AU	Participation Rate	Jul		64.5		64	0.30	11.30
GE	CPI YoY	Jul F		--		-0.1	5.00	16.00
US	Initial Jobless Claims	Aug 1		1400		1186	11.30	22.30
Friday 14 August 2020								
NZ	BusinessNZ Manufacturing PMI	Jul		--		56.3	21.30	8.30
CH	Fixed Assets Ex Rural YTD YoY	Jul		-1.6		-3.1	1.00	12.00
CH	Retail Sales YoY	Jul		0.1		-1.8	1.00	12.00
CH	Industrial Production YoY	Jul		5.1		4.8	1.00	12.00
EC	GDP SA QoQ	2Q P		-12.1		-12.1	8.00	19.00
EC	GDP SA YoY	2Q P		-15		-15	8.00	19.00
US	Retail Sales Advance MoM	Jul		1.7		7.5	11.30	22.30
US	Industrial Production MoM	Jul		2.7		5.4	12.15	23.15
US	U. of Mich. Expectations	Aug P		--		65.9	13.00	0.00
US	U. of Mich. Sentiment	Aug P		71		72.5	13.00	0.00
Upcoming Central Bank Interest Rate Announcements								
New Zealand, RBNZ		Aug 12	0.25	0.25		0.25		
Australia, RBA		Sep 1	0.25	0.25		0.25		
Canada, BoC		Sep 9	0.25	0.25		0.25		
Europe, ECB		Sep 10	-0.50	-0.50		-0.50		
Japan, BoJ		Sep 17	-0.10	-0.10		-0.10		
US, Federal Reserve		Sep 16	0/0.25	0/0.25		0/0.25		
UK, BOE		Sep 17	0.10	0.10		0.10		

GMT: Greenwich Mean Time; AEST: Australian Eastern Standard Time

FORECASTS

Economic Forecasts																
	Annual % change				Quarterly % change											
					2019				2020				2021			
	2019	2020	2021	2022	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Australia Forecasts																
Household Consumption	1.4	-3.5	3.1	3.0	0.4	0.3	0.1	0.5	-1.1	-6.5	3.7	1.0	0.7	0.9	1.2	0.7
Underlying Business Investment	-1.7	-20.2	-17.8	5.1	0.8	-0.2	-1.7	-1.5	-1.0	-16.0	-10.1	-7.6	-4.0	1.2	-0.4	1.3
Residential Construction	-6.9	-16.0	-6.9	17.2	-1.7	-3.5	-0.7	-4.1	-1.7	-10.5	-4.5	-3.8	-2.8	0.9	4.1	4.4
Underlying Public Spending	4.9	4.7	3.8	3.1	1.1	1.7	1.8	0.4	1.5	1.1	1.0	1.0	0.9	0.9	0.8	0.8
Net Exports (a)	0.9	1.9	-0.8	-0.9	0.2	0.6	0.1	-0.1	0.5	2.4	-0.9	-0.2	0.0	-0.3	-0.3	-0.2
Inventories (a)	-0.2	-0.3	0.6	0.1	0.0	-0.4	0.1	0.2	-0.2	-1.4	1.8	-0.1	0.1	0.2	0.0	0.0
Domestic Demand (q/q %)	-	-	-	-	0.3	0.4	0.4	0.2	-0.5	-5.6	1.2	0.1	0.3	0.9	1.1	0.9
Dom Demand (y/y %)	1.3	-3.6	0.9	3.9	1.2	1.3	1.2	1.3	0.5	-5.5	-4.7	-4.8	-4.1	2.5	2.4	3.2
Real GDP (q/q %)	-	-	-	-	0.5	0.6	0.6	0.5	-0.3	-4.9	2.7	0.2	0.3	0.8	0.7	0.7
Real GDP (y/y %)	1.8	-1.8	1.6	2.8	1.7	1.6	1.8	2.2	1.4	-4.1	-2.1	-2.4	-1.9	4.0	2.0	2.5
CPI headline (q/q %)	-	-	-	-	0.0	0.6	0.5	0.7	0.3	-2.0	1.6	0.7	0.4	0.4	0.3	0.3
CPI headline (y/y %)	1.6	0.7	1.7	1.3	1.3	1.6	1.7	1.8	2.2	-0.4	0.6	0.5	0.6	3.0	1.7	1.5
CPI underlying (q/q %)	-	-	-	-	0.2	0.4	0.4	0.4	0.5	0.2	0.4	0.3	0.4	0.4	0.2	0.1
CPI underlying (y/y %)	1.4	1.5	1.3	0.9	1.4	1.4	1.5	1.4	1.7	1.5	1.5	1.4	1.3	1.5	1.4	1.1
Private wages (q/q %)	-	-	-	-	0.5	0.5	0.5	0.5	0.5	0.3	0.3	0.3	0.3	0.3	0.5	0.5
Private wages (y/y %)	2.3	1.8	1.2	2.0	2.4	2.3	2.2	2.2	2.1	1.9	1.6	1.3	1.1	1.0	1.3	1.5
Unemployment Rate (%)	5.1	7.1	7.4	6.1	5.1	5.1	5.2	5.2	5.2	7.1	8.0	8.1	7.8	7.2	7.5	6.9
Terms of trade	5.1	-2.9	-1.0	0.9	3.3	1.4	0.2	-5.2	2.9	-2.9	0.3	-0.5	-1.3	0.6	1.3	0.6
Current Account (% GDP)	0.6	2.6	1.9	1.1	-0.6	1.0	1.4	0.3	1.7	3.7	2.7	2.4	2.1	2.0	1.9	1.7

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

Exchange Rate Forecasts						
	10-Aug	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Majors						
AUD/USD	0.716	0.72	0.74	0.76	0.77	0.77
NZD/USD	0.66	0.66	0.68	0.69	0.70	0.71
USD/JPY	105.8	105	103	103	100	100
EUR/USD	1.18	1.18	1.22	1.23	1.25	1.26
GBP/USD	1.31	1.31	1.36	1.40	1.40	1.43
USD/CNY	6.97	7.00	6.90	6.85	6.70	6.70
USD/CAD	1.34	1.36	1.34	1.33	1.30	1.23
USD/CHF	0.91	0.91	0.91	0.91	0.91	0.91

Australian Cross Rates						
AUD/NZD	1.08	1.09	1.09	1.10	1.10	1.08
AUD/JPY	75.8	76	76	78	77	77
AUD/EUR	0.61	0.61	0.61	0.62	0.62	0.61
AUD/GBP	0.55	0.55	0.54	0.54	0.55	0.54
AUD/CNY	4.99	5.04	5.11	5.21	5.16	5.16
AUD/CAD	0.96	0.98	0.99	1.01	1.00	0.95
AUD/CHF	0.65	0.66	0.67	0.69	0.70	0.70

Interest Rate Forecasts						
	10-Aug	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Australian Rates						
RBA cash rate	0.25	0.25	0.25	0.25	0.25	0.25
3 month bill rate	0.10	0.10	0.15	0.20	0.20	0.25
3 Year Swap Rate	0.20	0.15	0.15	0.20	0.20	0.25
10 Year Swap Rate	0.78	0.85	0.95	1.10	1.20	1.35
Offshore Policy Rates						
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25
ECB deposit rate	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60
BoE repo rate	0.10	0.25	0.25	0.25	0.25	0.25
BoJ excess reserves rate	-0.10	-0.20	-0.20	-0.20	-0.20	-0.20
RBNZ OCR	0.25	0.25	0.25	0.25	0.25	0.25
10-year Bond Yields						
Australia	0.86	0.95	1.05	1.15	1.25	1.35
United States	0.56	0.70	0.80	0.90	1.00	1.10
New Zealand	0.78	0.88	1.03	1.28	1.38	1.63

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP			
	2019	2020	2021
Australia	1.8	-1.8	1.6
United States	2.3	-5.9	4.2
Eurozone	1.2	-7.4	5.7
United Kingdom	1.4	-8.2	6.5
Japan	0.7	-6.2	3.0
China	6.1	1.5	9.5
India	4.9	-1.5	8.0
New Zealand	2.3	-7.8	3.0
World	3.0	-3.5	6.0

Commodity prices (\$US)						
	10-Aug	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Brent oil	44.8	45	49	53	55	55
Gold	2028	1725	1725	1750	1775	1800
Iron ore	na	93	87	85	90	80
Hard coking coal*	110	115	120	125	140	135
Thermal coal	55	55	59	59	61	62
Copper	6308	5750	6000	6250	6500	6750
Aus LNG**	10	7	7	7	8	8

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

** Implied Australian LNG export prices

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