

Global Overview & Australia

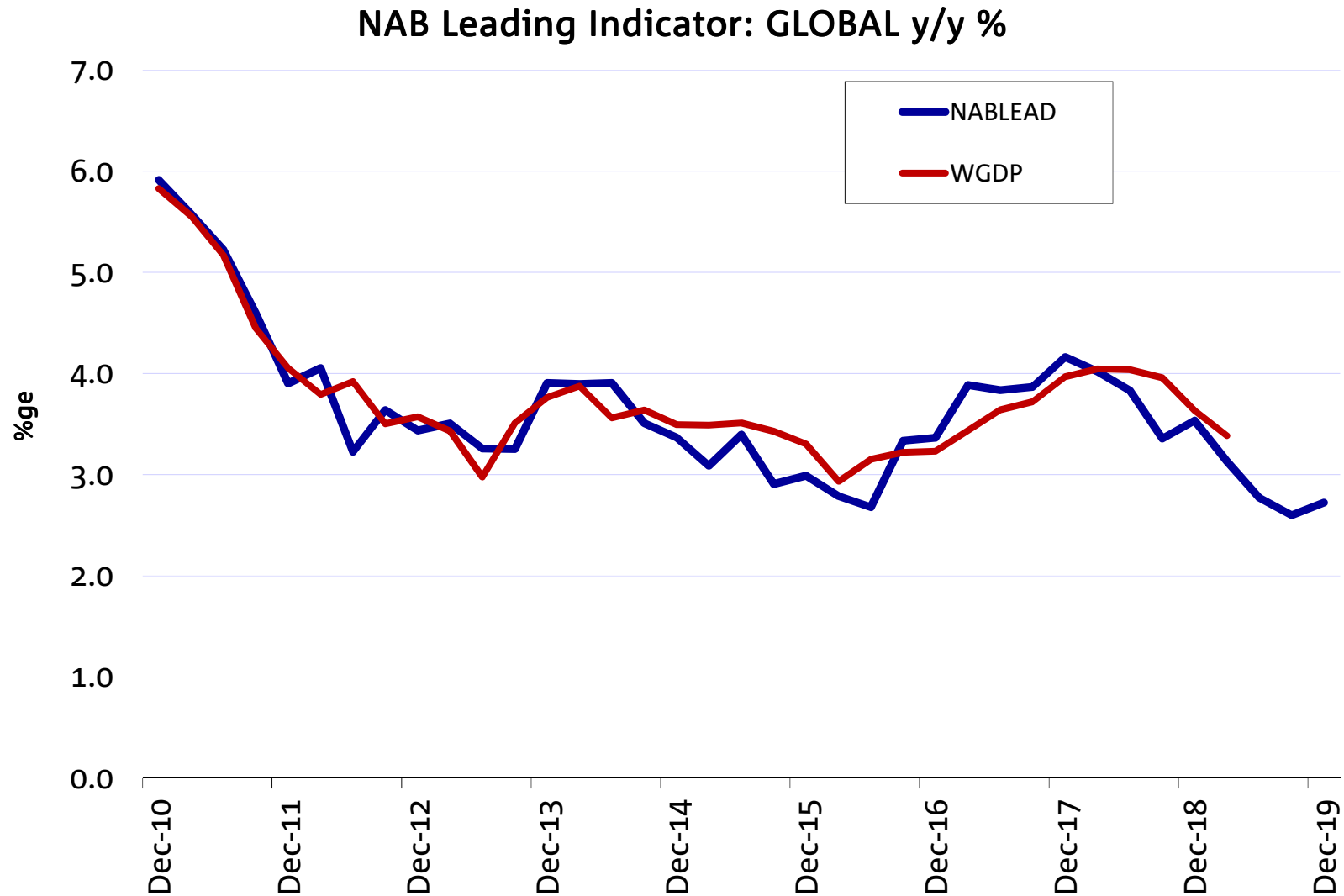
Where is our multispeed economy at - and where to from here?

Alan Oster – Group Chief Economist

Global and Local - Macroeconomic summary.

- **Global growth slowing** – especially in Emerging market economies but also advanced economies ex the US (Europe and Japan). Trade disputes one factor and risk of further escalation.
 - US also slowing but not crashing. Tariffs likely to slow growth further and see further cuts following July action (September and October). China OK with 6% growth reasonable – again with policy stimulus.
- **Domestic growth** was good through the first half of 2018, but has slowed substantially and continues into July. Confidence up on election and rate cuts – but didn't last.
 - **Critical weakness is consumers** (especially discretionary consumption as budgets remain tight) and construction related to house price falls. These are core views in our forecasts. Rate cuts affect next year not now and tax cut very small impact
 - But infrastructure, public consumption, LNG exports and broader investment will maintain growth in near term (2019). Beyond that more focus on the consumer;
 - We are still weaker than RBA on GDP – in 'through the year' terms we are 2.0% in 2019 and 2 to 2¼% in the out years. RBA is still expecting growth of around 2¾% through out the forecasting period.
- **Inflation** has surprised on downside and continues to track lower. A concern for an inflation targeting central bank. **Wages** growth will still be slow and price competition in retail intense.
- **Outlook for rates** has changed a bit in the last few months with latest data flow;
 - **NAB – After cuts in June and July we expect another cut in November. And haven't ruled out non conventional policy next year.**
 - Basically with very low inflation and signs that the labour market is weakening the RBA needs to act now. We also think that **additional fiscal stimulus will be needed in late 2019.**

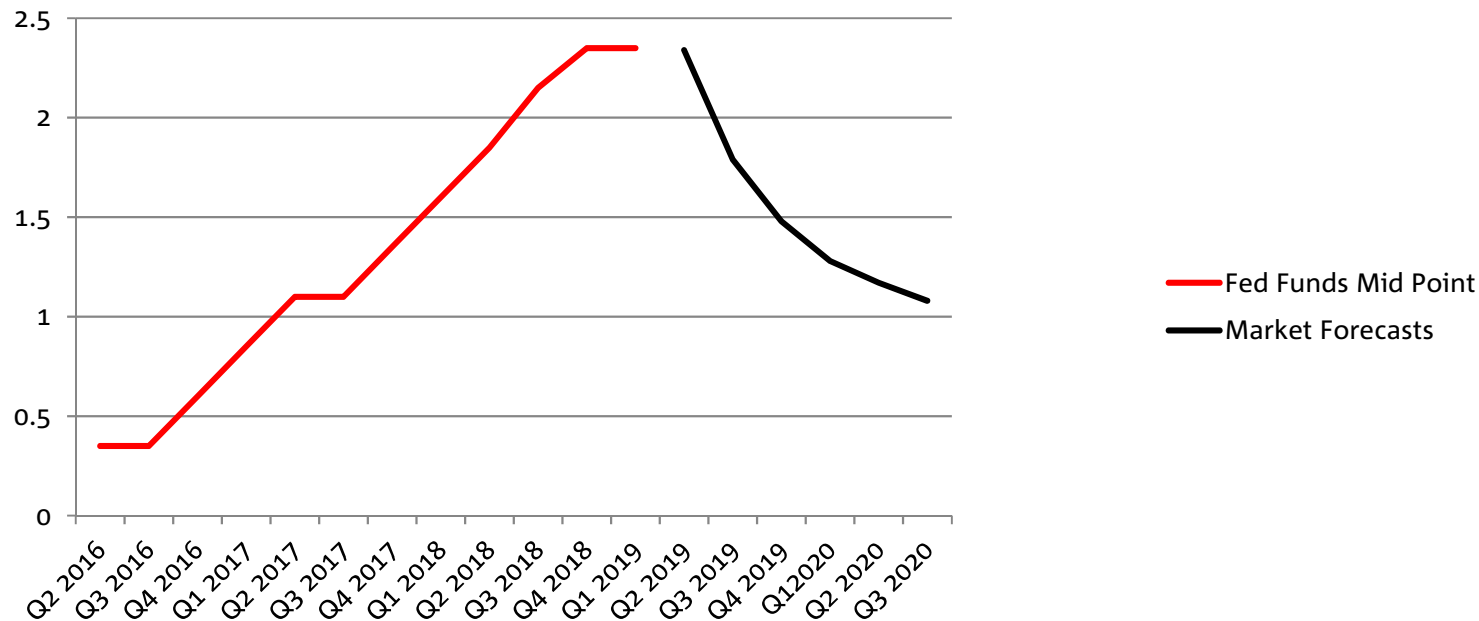
Our global leading indicator suggests that global economy has weakened.
- That trend looks likely to continue. Trade and technology important here.



Our global leading indicator – is based on Baltic shipping, global airfreight, metal prices, Asian leading index and yield curves in major economies.

US economy weakening forward path has seen Fed doing insurance cuts. But fear of global weakness and tariff chaos has seen markets getting very bearish on rates – up to 4 more cuts.

- We now expect growth of around 2.3% in 2019 - with a weak patch in H2 2019 and into 2020;
- While labour market is strong we are looking at below potential growth from late 2019 which will probably see unemployment bottom around 3.6%;
- And inflation less a risk. Tariffs likely to lower growth further (now around 1.6% in 2020);
- Hence we think the Fed will be cutting twice more in H2 2019 (September and October);
- Market has two cuts in late 2019 and approaching 1% by late 2020 (another 4 cuts).

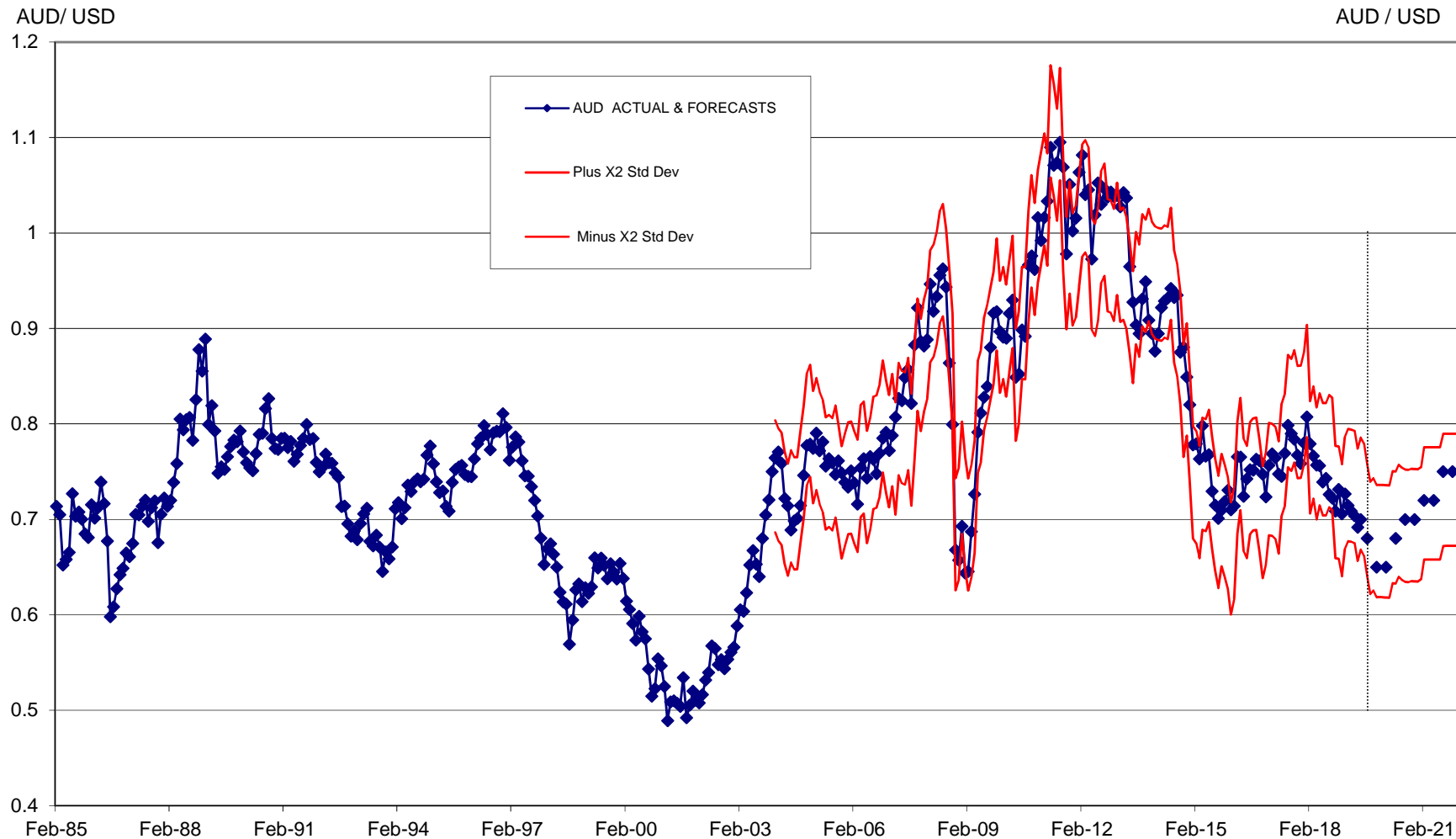


Global economic forecasts. - After above trend growth in 2018, 2019 looks slower – includes tariff effects. But a touch higher in 2020 and 2021 – mainly due to India and emerging markets.

	2018	2019	2020	2021
US	2.9	2.2	1.7	1.8
Euro-zone	1.9	1.1	1.2	1.4
Japan	0.8	1.2	0.3	0.9
UK	1.4	1.2	1.2	1.5
Canada	1.9	1.4	1.5	1.7
China	6.6	6.3	6.0	5.8
India	6.8	6.3	7.0	7.1
Latin America	1.0	0.6	1.7	2.4
Other East Asia	4.1	3.5	3.7	3.8
Australia	2.8	1.7	2.3	2.3
NZ	2.9	2.4	2.6	2.5
Global	3.6	3.1	3.3	3.5

Currency model. USD .68+/- 5c. - Roughly now where model expects and global uncertainty (trade wars) likely to push AUD down to mid 60s before moving back to around 70c by end 2020 and a touch higher into 2021. USD safety play important.

Currency Model* and AUD / USD



- Model driven by: commodity prices; US TWI – as measure of USD strength; long and short run rates; relative unemployment; relative equity markets and VIX.

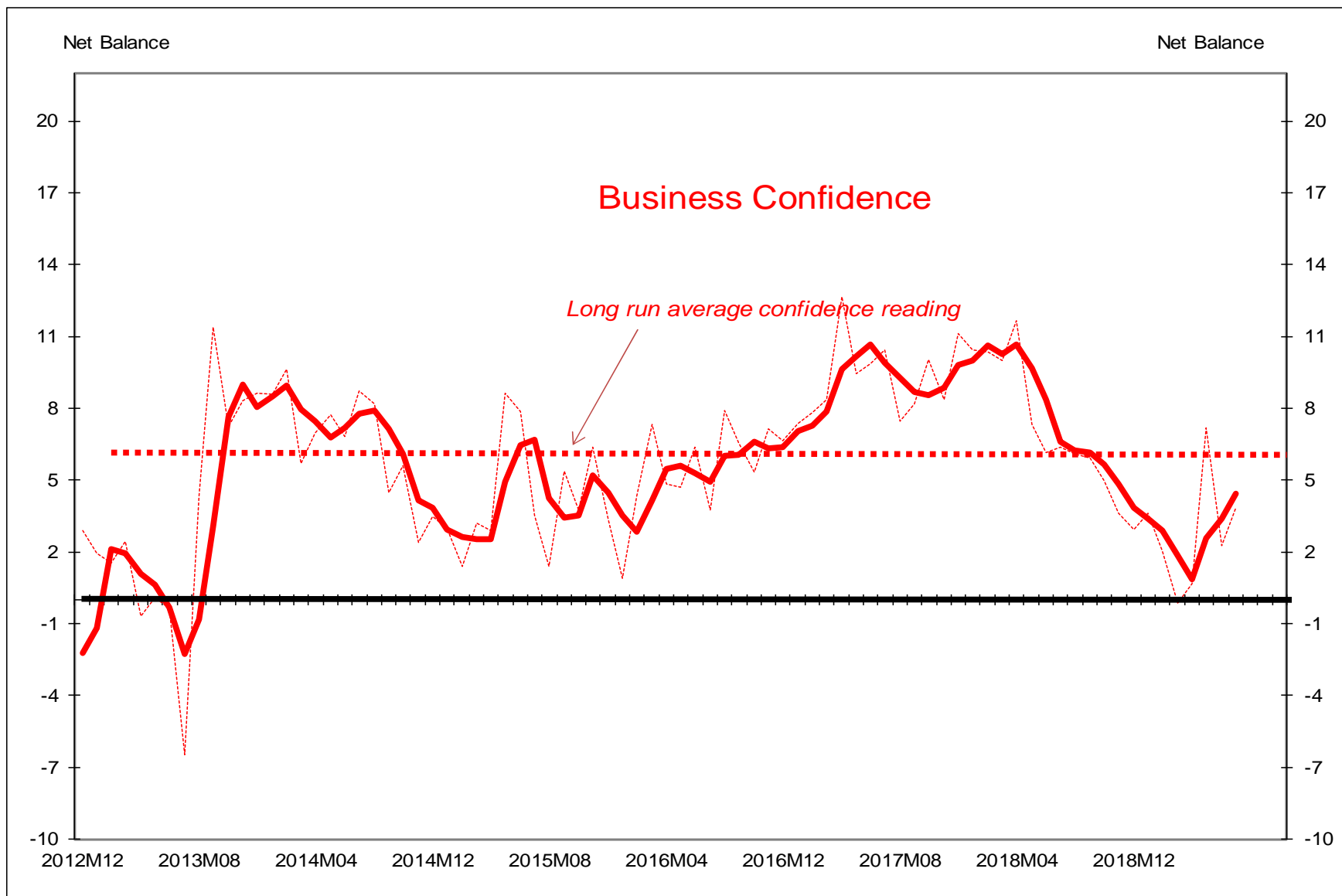
Forecasts:

End 2019 = 65c AUD/USD

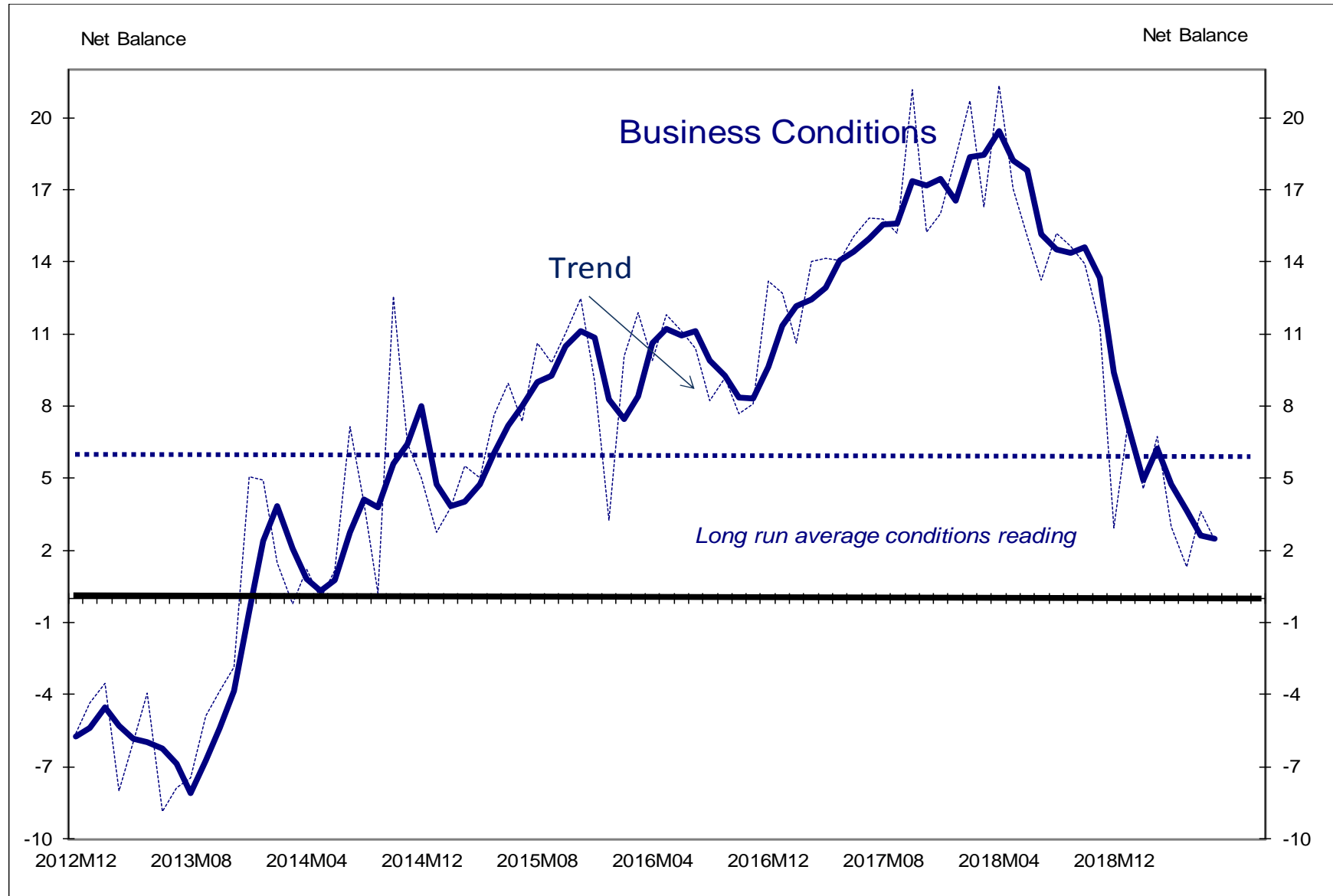
End 2020 = 70c AUD/USD

End 2021 = 72c AUD/USD

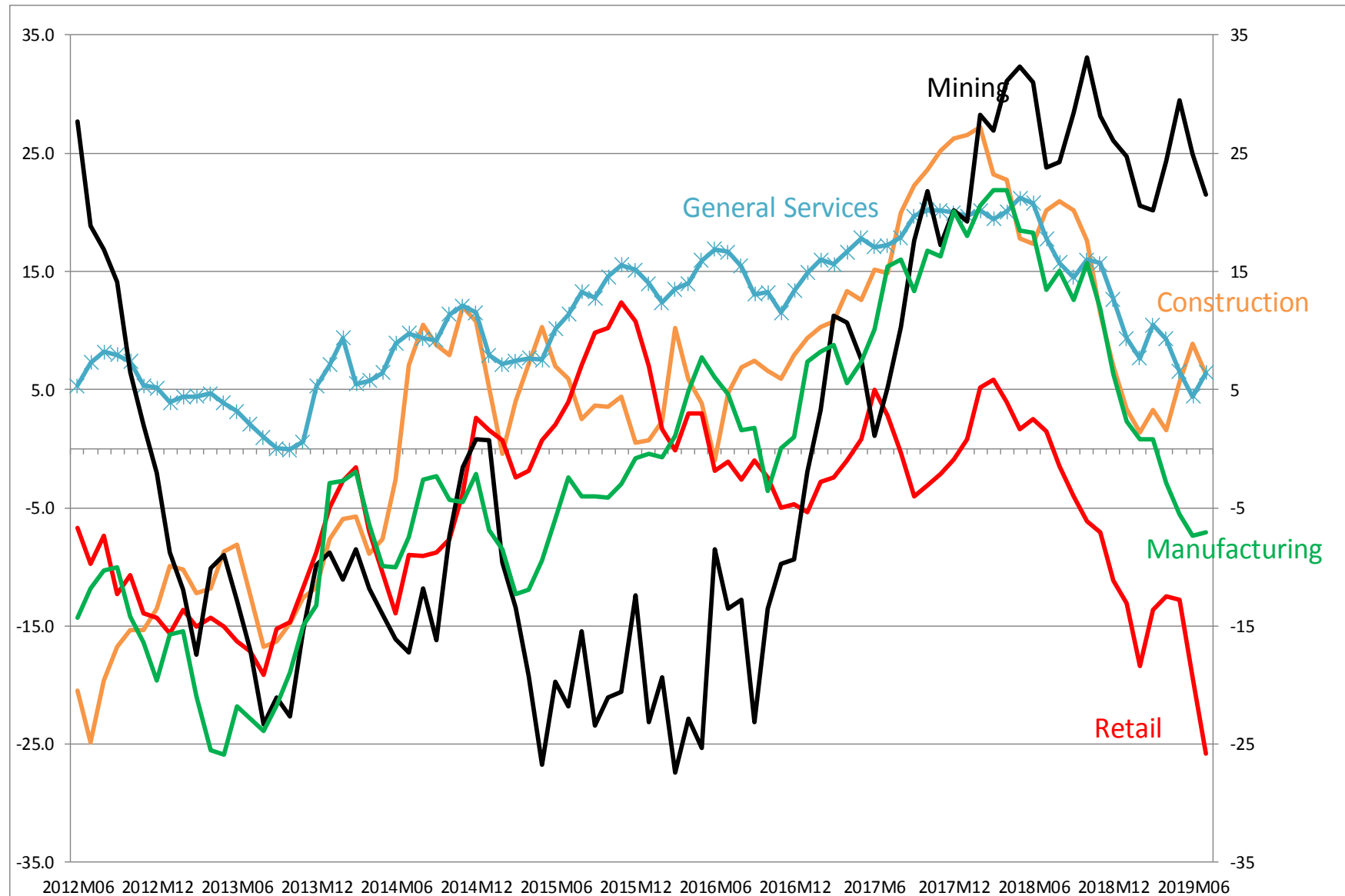
Business Confidence – has tracked down but then enjoyed a post election bounce and talk of rate cuts. - *But hasn't been maintained in the face of below average conditions...*



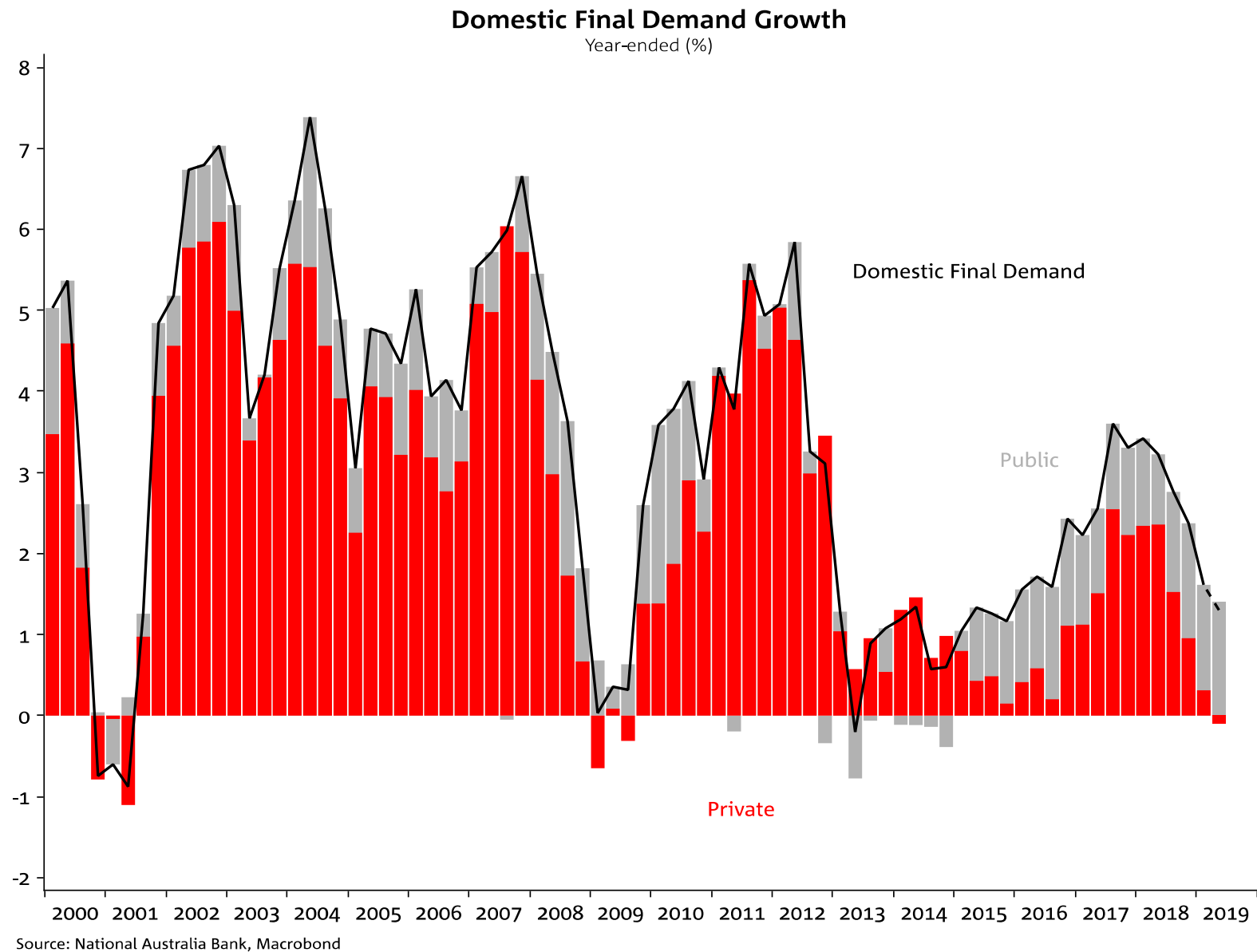
On business outcomes, have seen large falls recently – over last 6 months.
The trend is telling. - Fundamentally private sector momentum has come off a lot and **it is still moving lower in trend terms in July.**



Loss of momentum broadly based. But driven by retail/wholesale, manufacturing and general services. - Construction has fallen a lot but better trend starting to reverse.



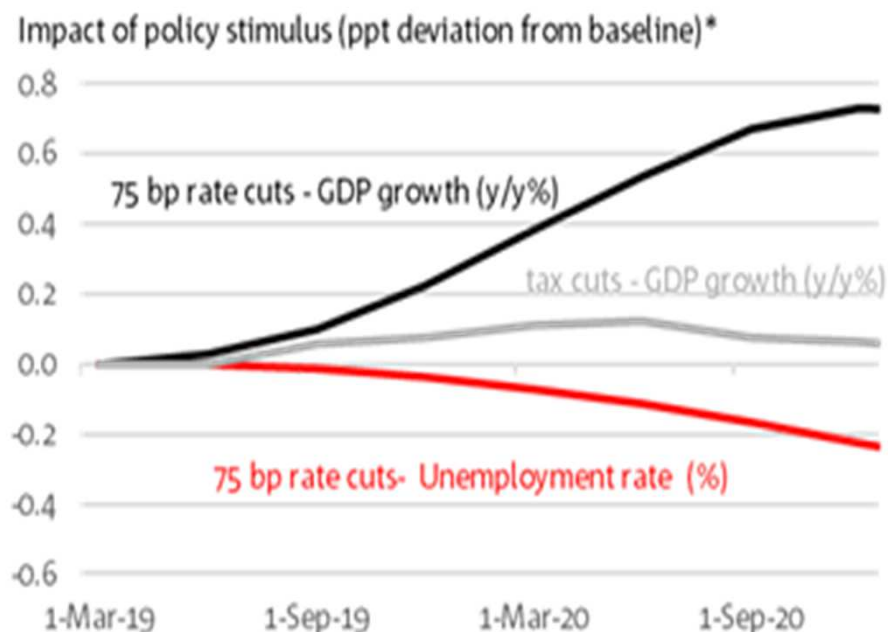
Another way to show the loss of momentum in the private sector and the offset in public demand - is from the National Accounts.



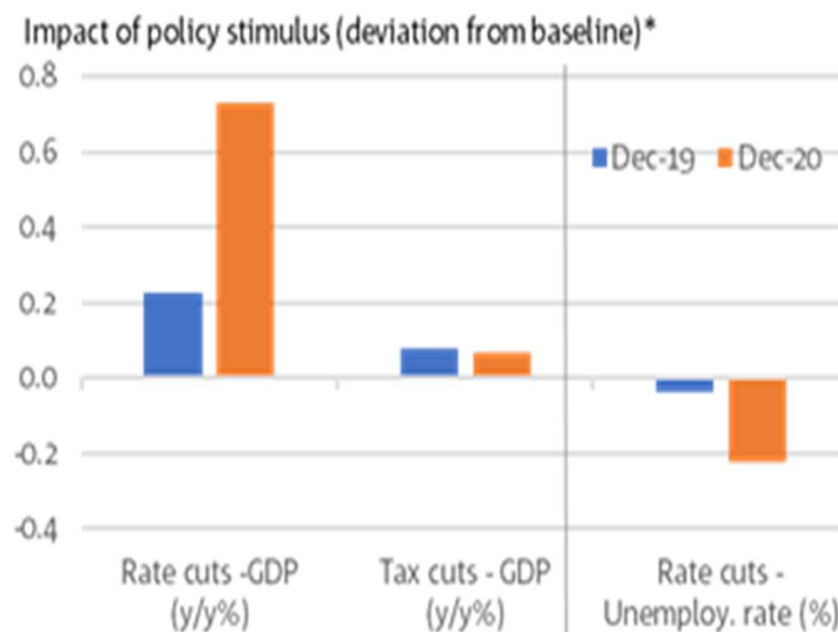
There has been much talk about the impact of recent rate cuts (and another in prospect by late 2019). Plus tax cuts etc.

- However macro impact of rate cuts mainly 2020 and fiscal impact is small.

- **On rate cuts** we included the recent cuts and assumed another cut in late 2019.
- **The fiscal policy shock** (allowing around \$7.5bn in tax cuts in 2019/20. Not unexpectedly the impact even by late 2020 is very modest at around 0.15 points to y/y growth – the tax cuts to GDP are small and tax multipliers reduce the expenditure effect even further.
- **These scenarios do however point to a positive impact on house prices** – and we now expect house prices in Sydney and Melbourne to bottom (rather than fall further).



*Rate cuts: 25bp cut in each of Q2, Q3, Q4 2019; annual tax cut of \$7.2b starting Q3 2019. NAB estimates utilising AUS-M model



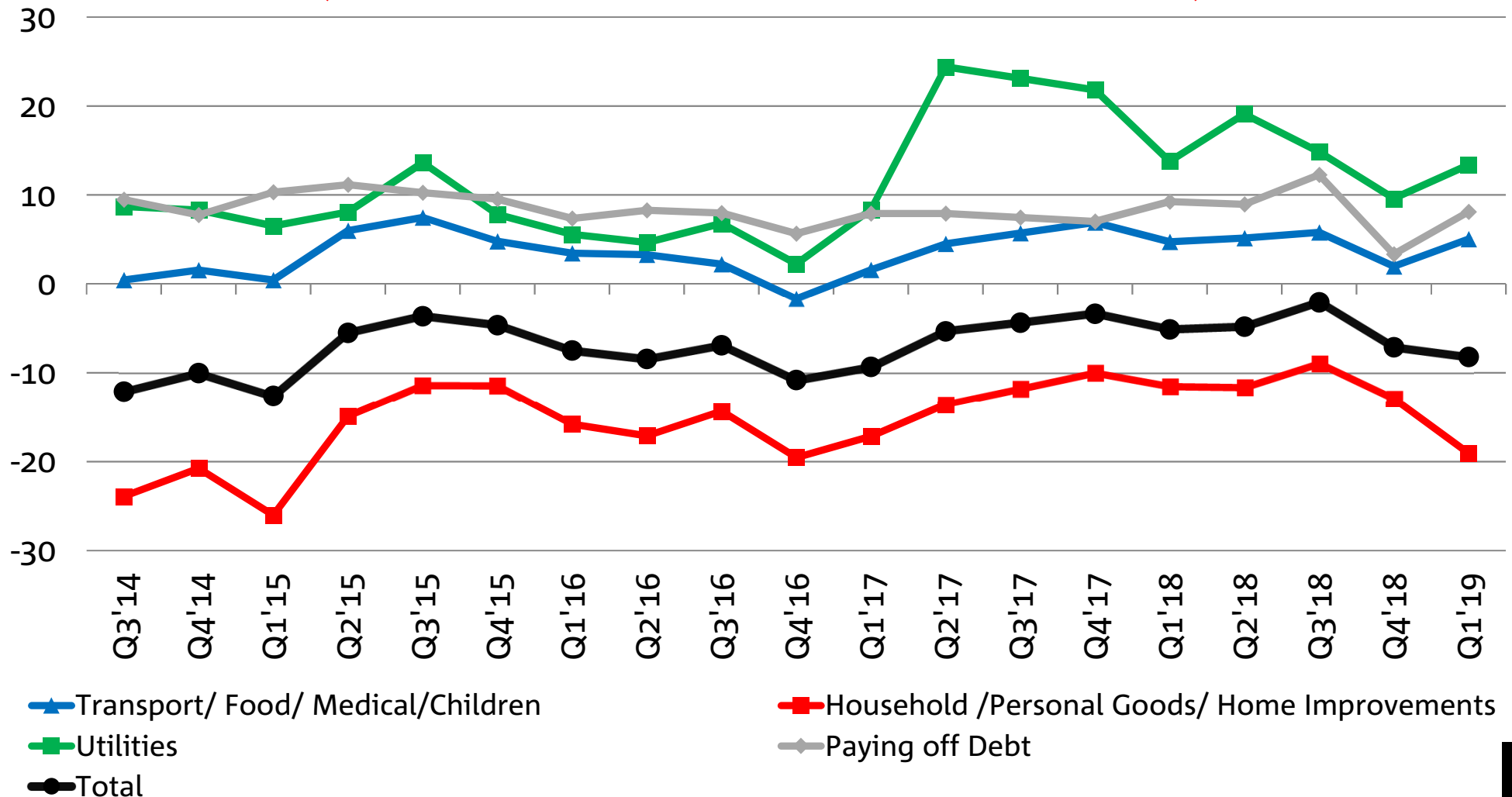
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Consumers are under the pump.

They are still very cautious re debt - and budgets have been crunched by utility prices.

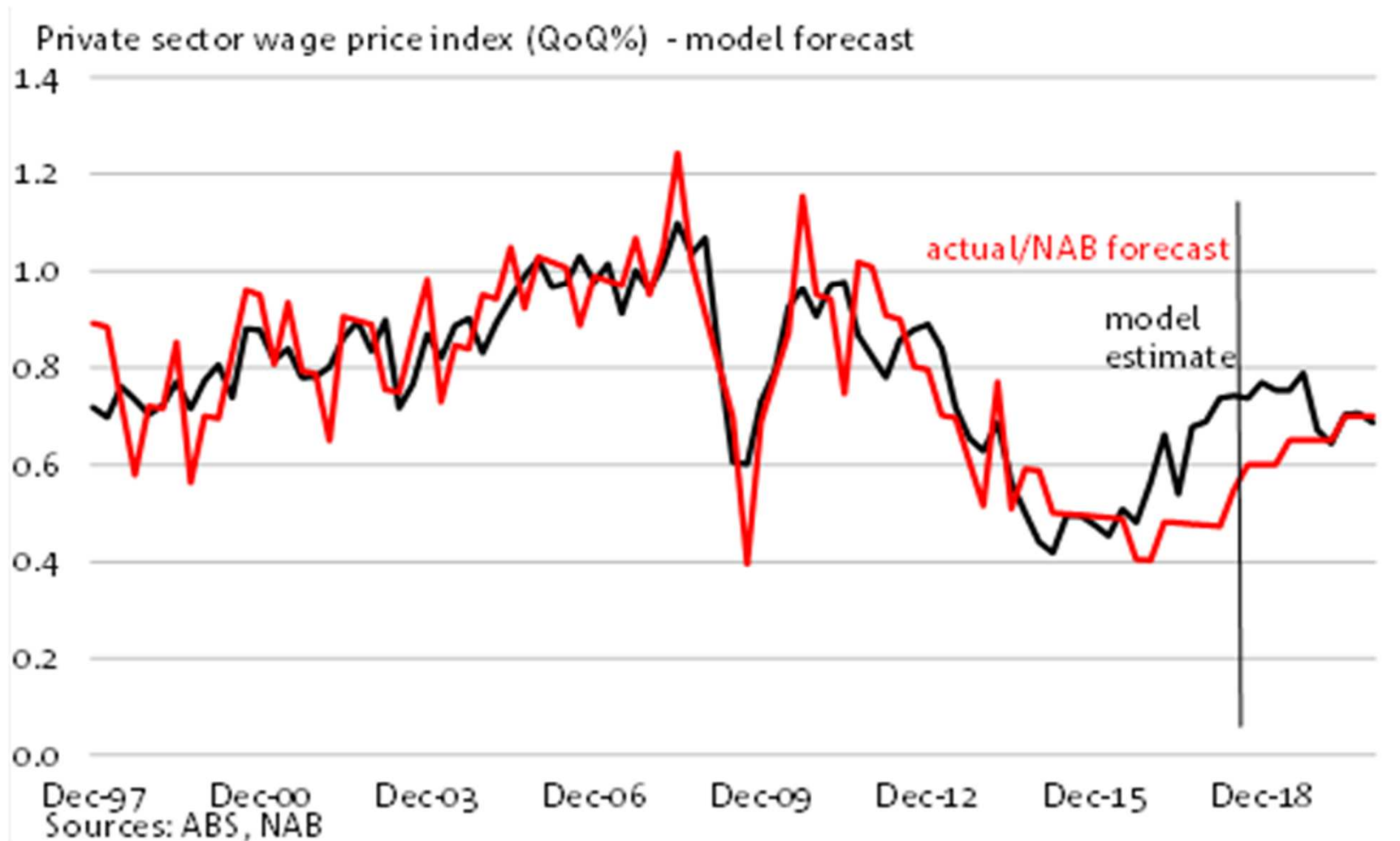
As a result discretionary retail suffers – *and getting worse in March 2019.*

CONSUMER SPENDING PATTERNS (NET BALANCES FROM NAB CONSUMER BEHAVIOUR SURVEY)

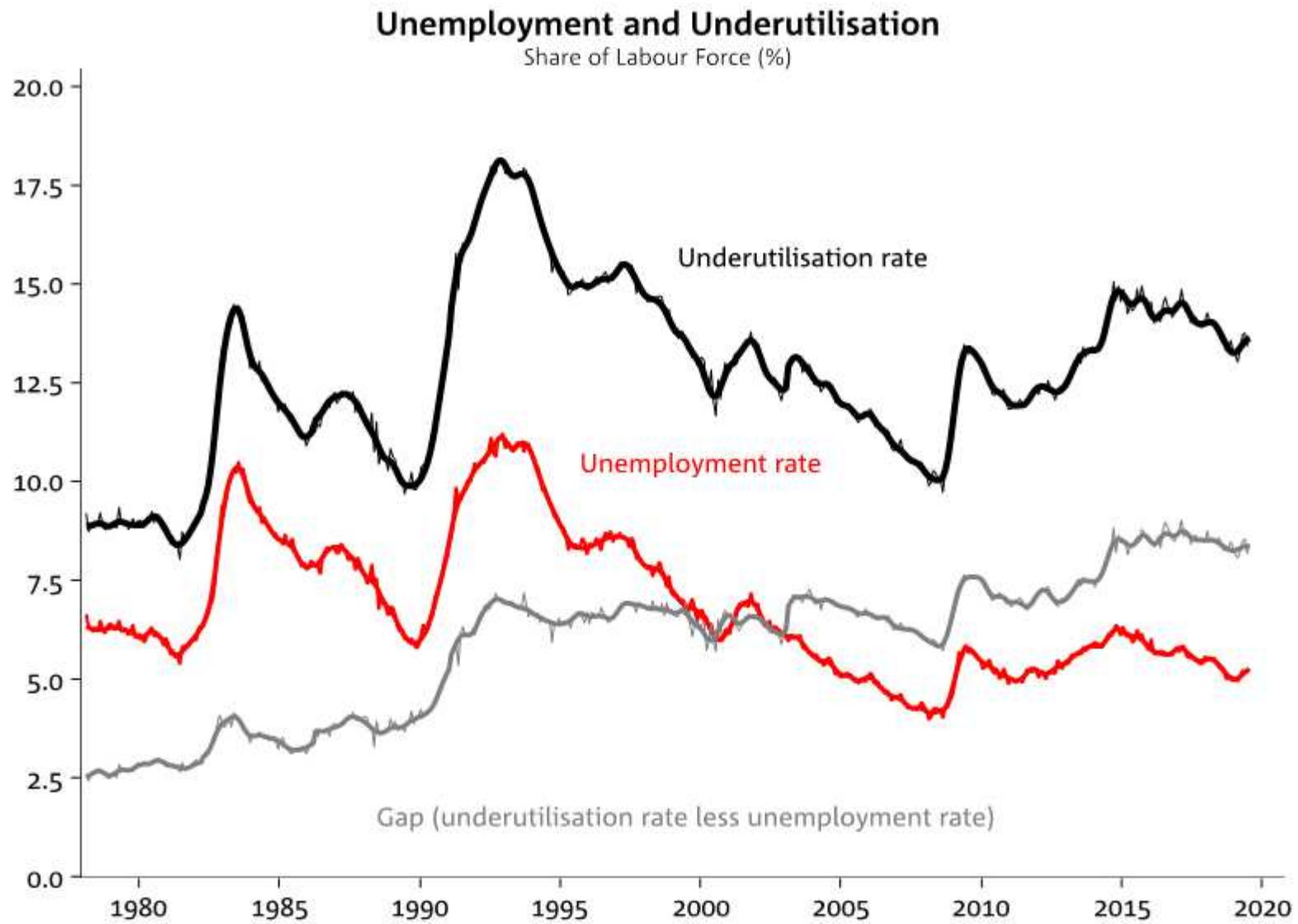


Australian wages growth stuck below pre-GFC levels – a critical problem and *why both sides of politics have tax cuts.*

Traditional relationships say wages should be going up...
But underutilisation of labour really important.

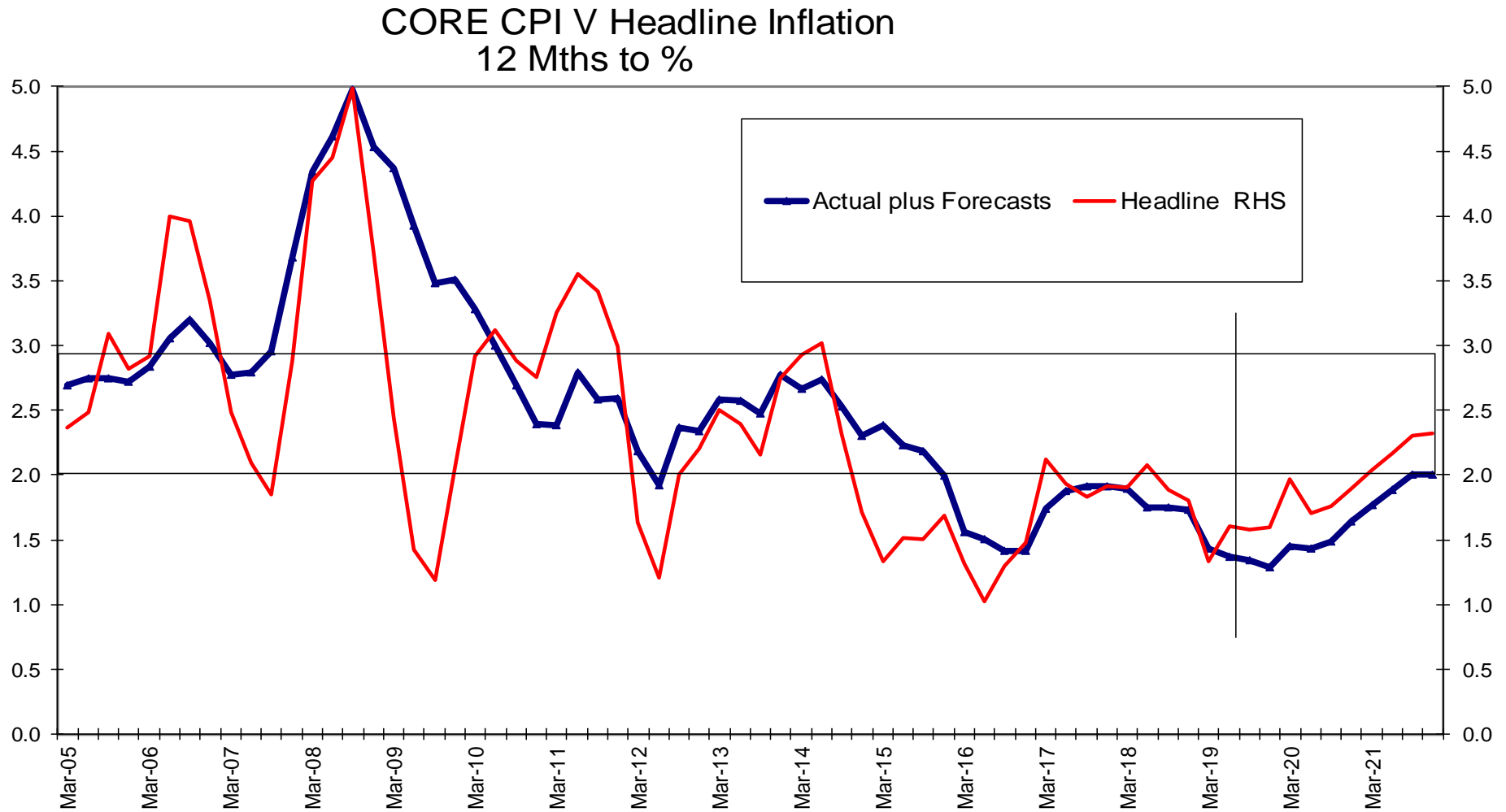


And the gap between - underutilisation of labour and unemployment remains.



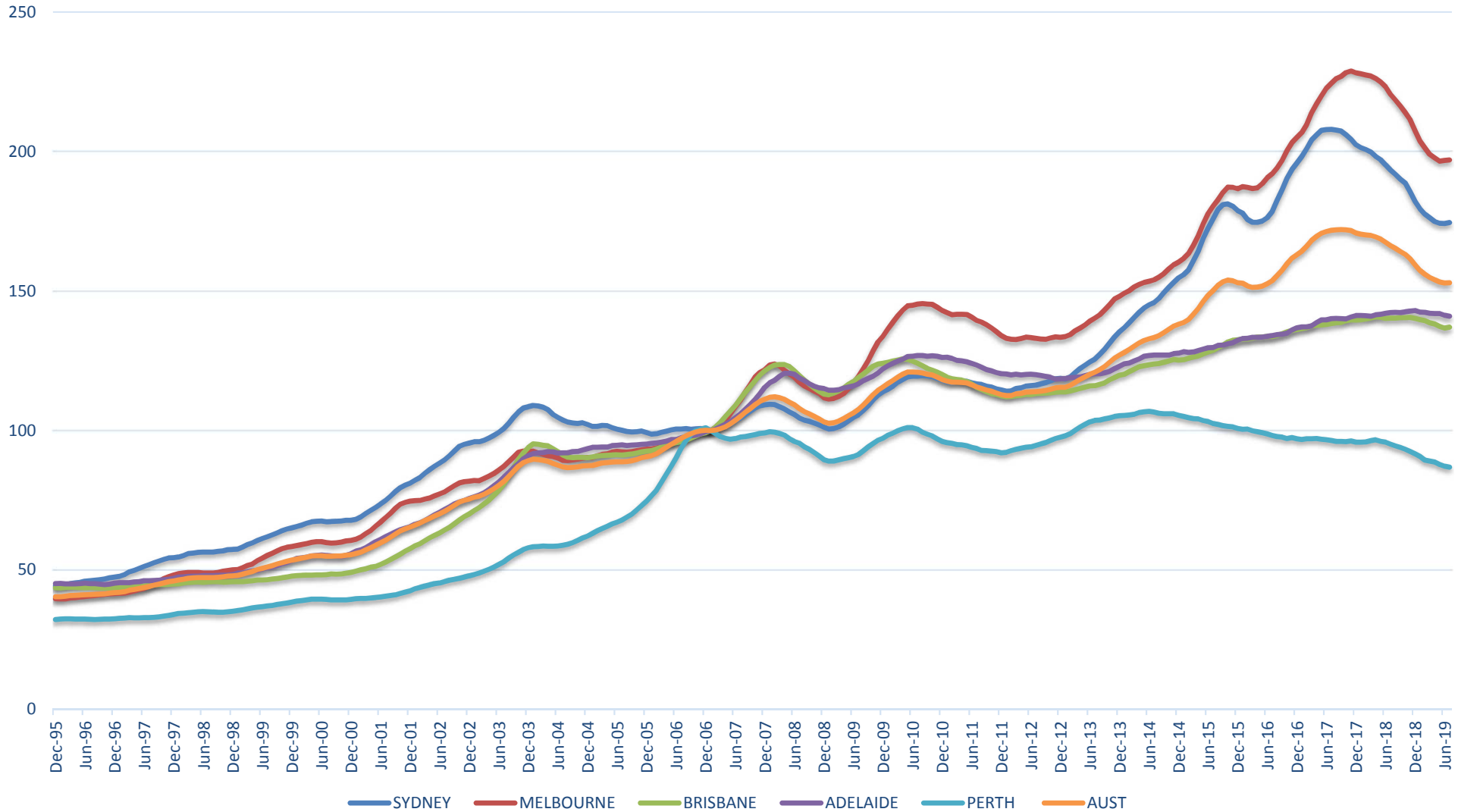
Source: National Australia Bank, Macrobond

Core inflation very low on the back of low wages growth and poor conditions in retailing (and online competition) – and likely to head lower. As an inflation targeting central bank, raises questions for RBA. Not back to bottom of target till 2021.



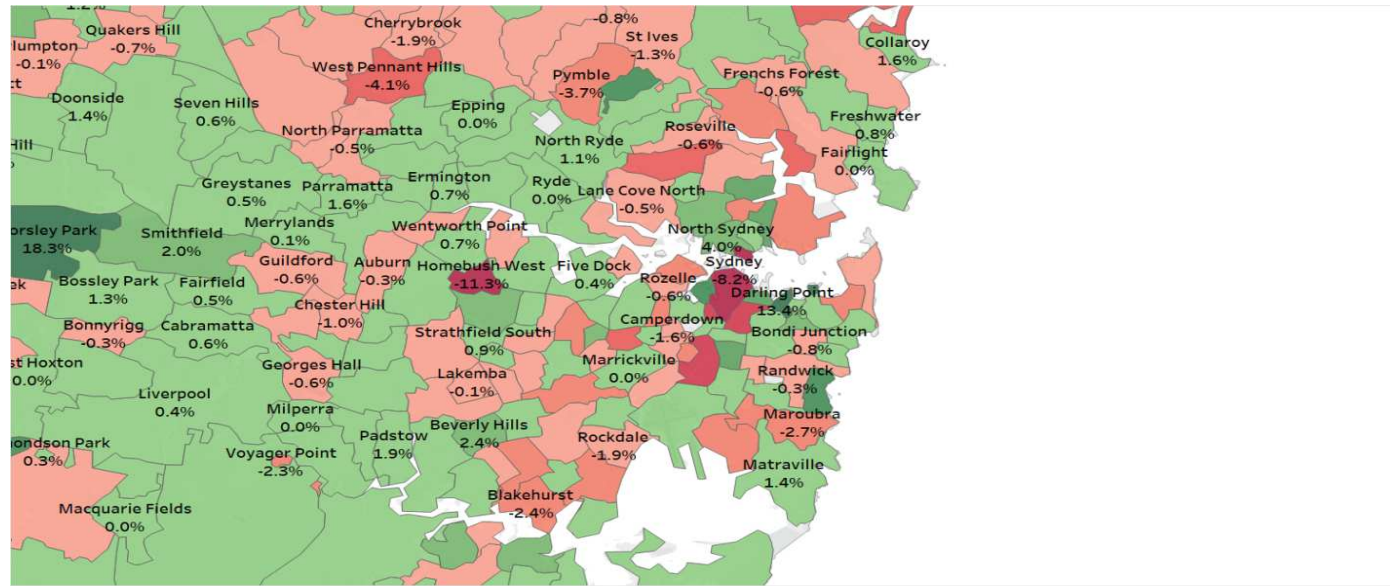
On house prices – first an historical perspective:

Australian House Prices - Jan 2007=100

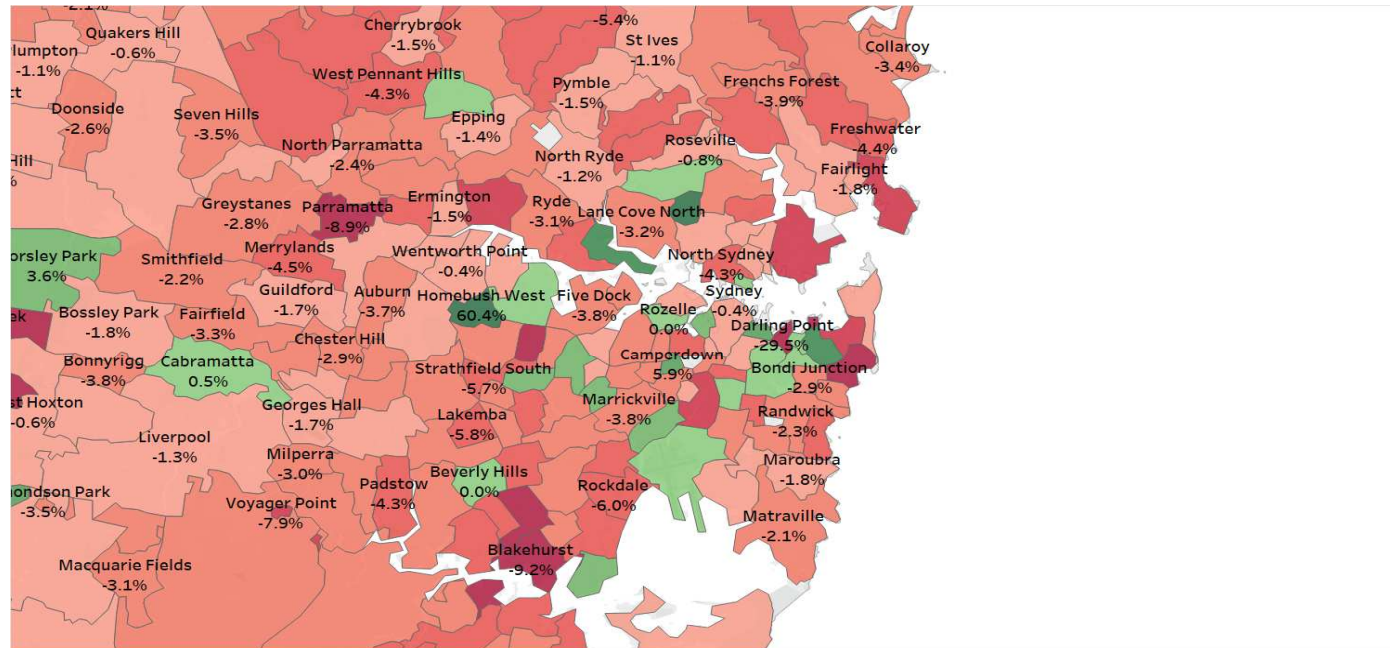


Quarterly Growth. - A story of contagion.

February 2018



November 2018



Traditional drivers of - house prices.

Typically three things matter for house prices:

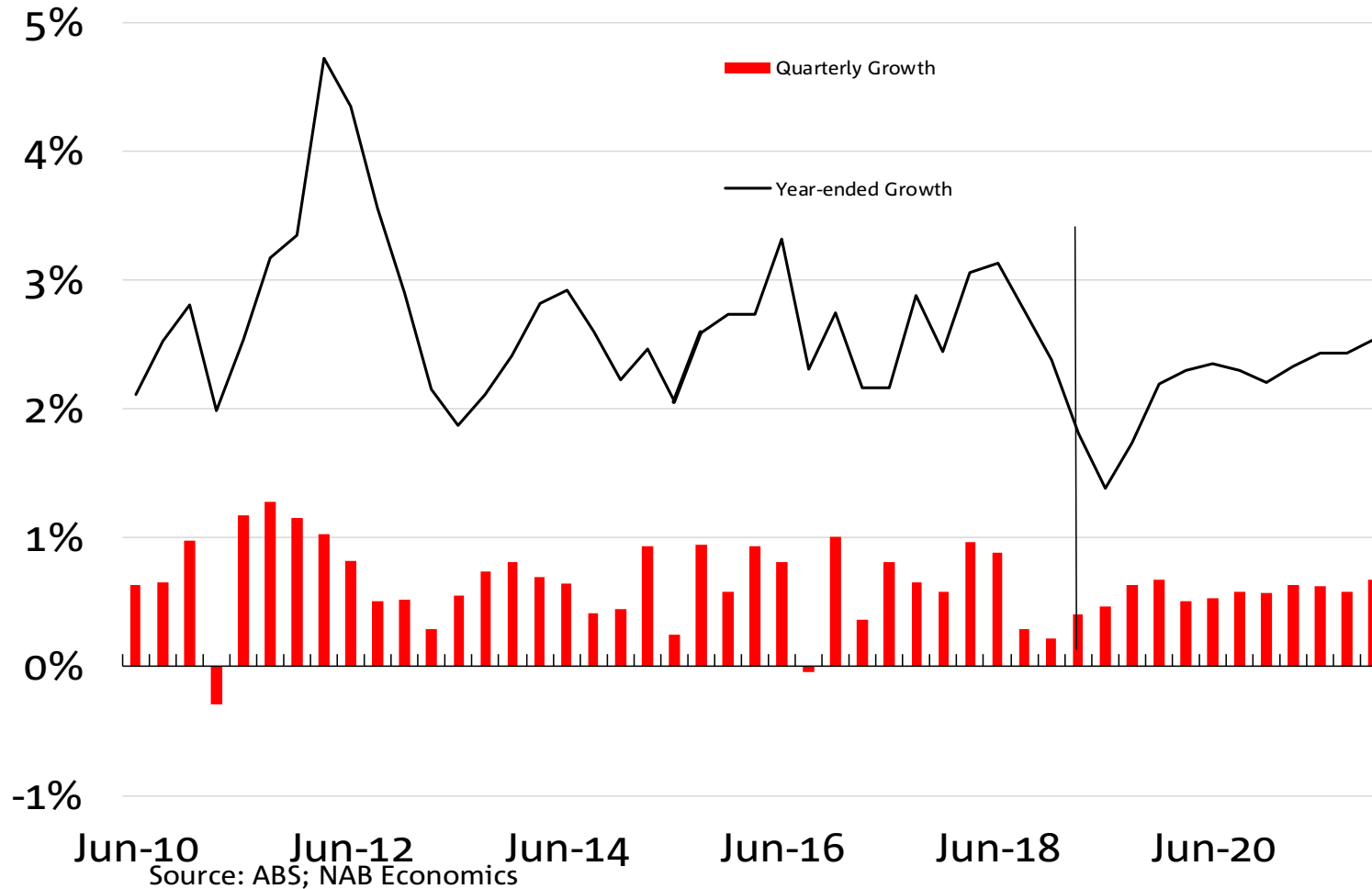
- Over/Under supply – by post code;
- Interest rate you are paying;
- Unemployment – if above 8% in post code = trouble.

But that is not what is playing out now; Rather:

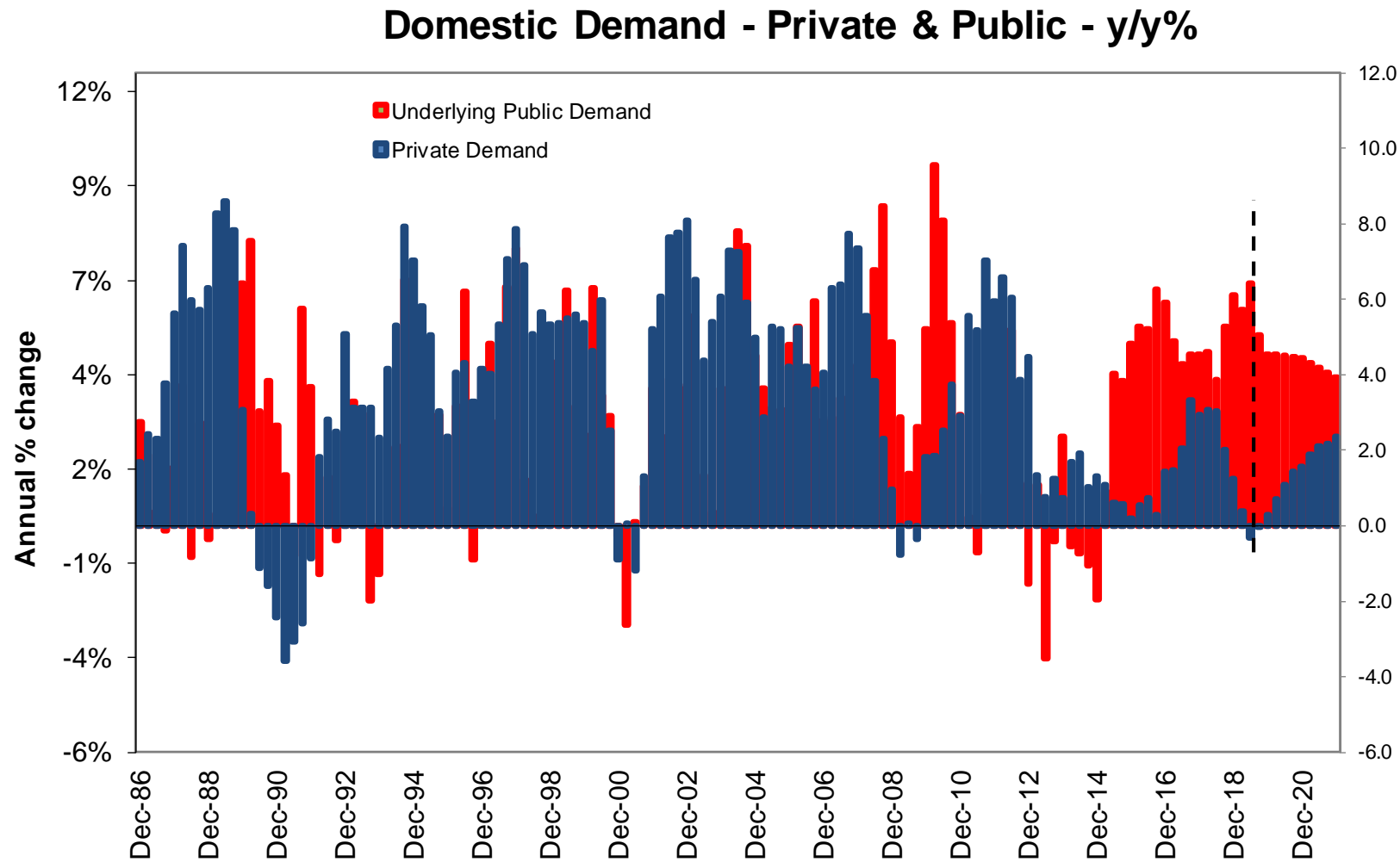
- Banks are restricting supply on investor housing – a la APRA;
- Banks are really looking carefully at expenses – actuals not just model driven;
- And its taking more time;
- And customers are more careful re expectations;
- And investors and foreigners in retreat.

That said fundamentals are good.

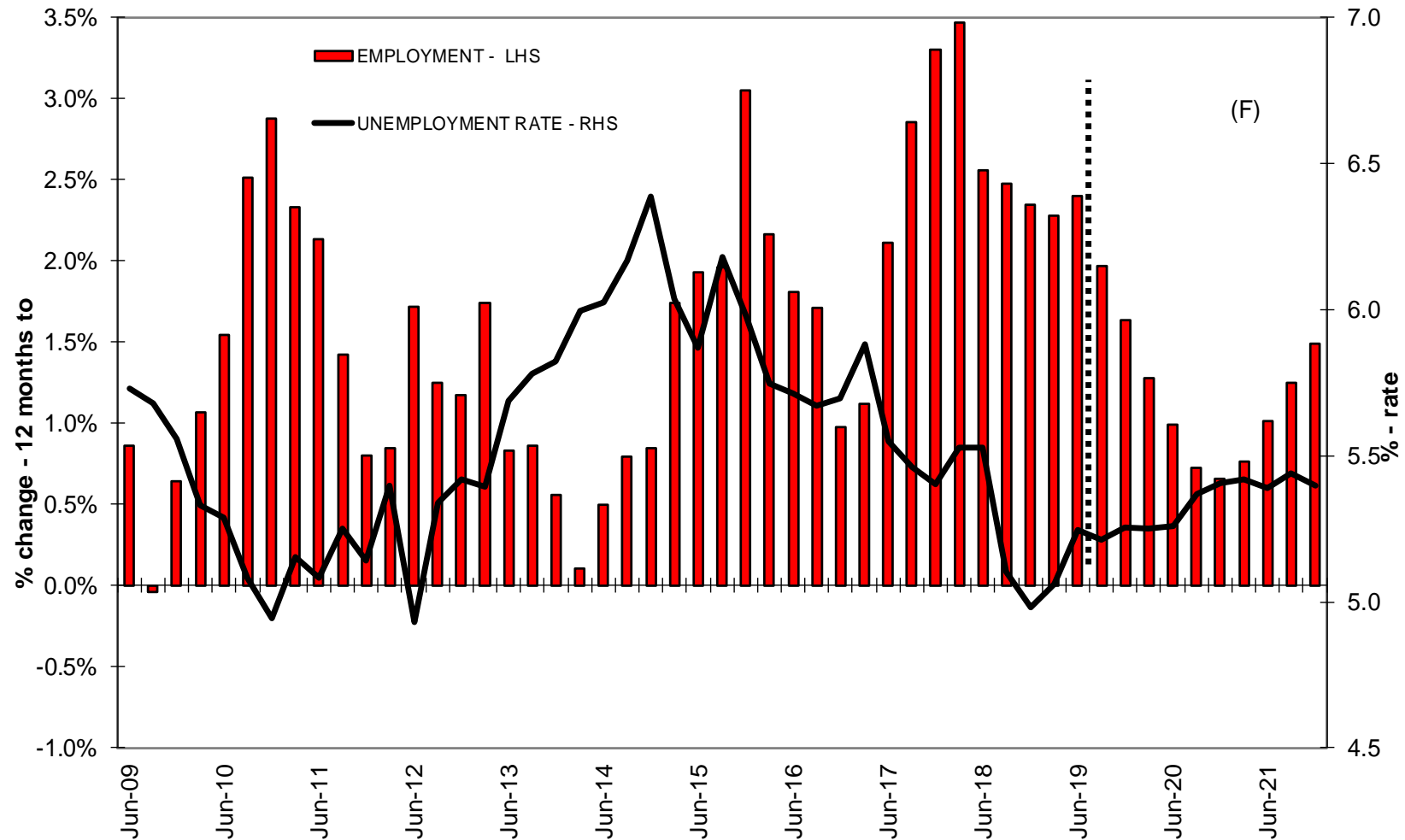
Our Growth Expectations – Strength in infrastructure & government spending (NDIS), exports (LNG). But consumer still a drag and dwelling cycle falling. GDP thru 2019 around 2.0% this year & a touch higher in 2020 and 2021. RBA still around 2.8%.



The difference between the private sector and public sector demand in the forecasts are - quite marked.

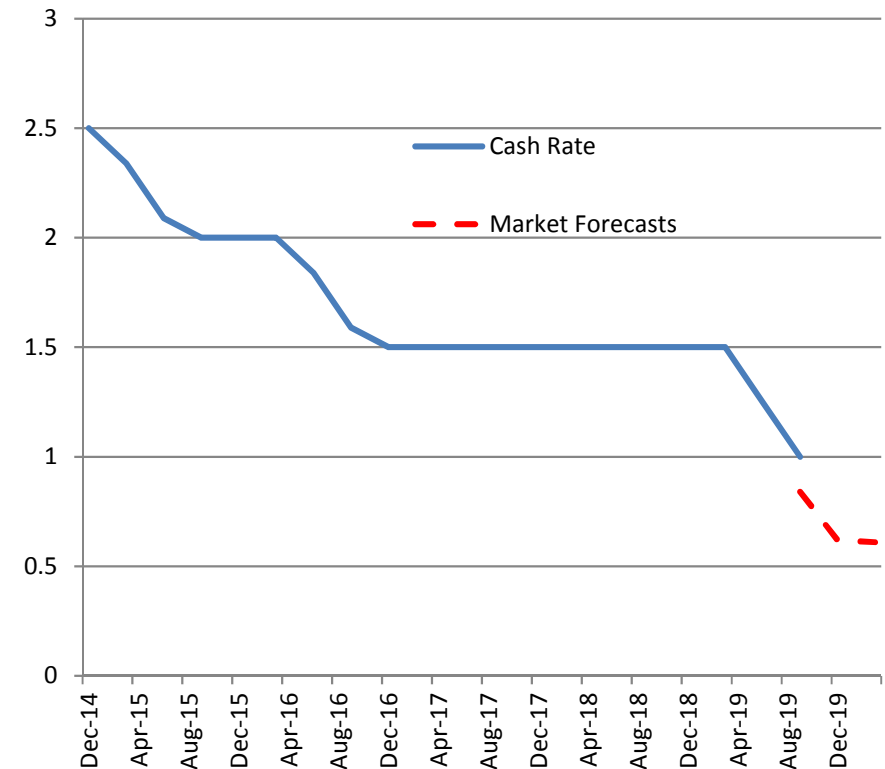


Labour market generating jobs but partly offset by changes in the participation rate.
- Unemployment unlikely to come down further from current 5¼% given our GDP forecasts and start rising from late 2019.



RBA has admitted they over-estimated growth and with the labour market weakening more policy will be required. - We have another cut in November. And fiscal policy stimulus required later this year...

- After June and July cuts we still see another cut in November. But could come sooner.
- This is all about trying to give the economy (and the private sector) a boost. **Increasingly RBA realise they are “behind the curve” and need to act ASAP.**
- We suspect that the state of the economy will see further fiscal policy stimulus in H2 2019 (from September onwards).
- And we think RBA is actively thinking about additional **non-traditional monetary stimulus in early 2020 (or earlier).**
- Markets pricing includes more cuts (late in 2019).



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