

THE POWER OF BEING UNDERSTOOD

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Economic Update

Alan Oster, Chief Economist, nab

Hosted by RSM in Perth, 11
December 2015

Global Overview & Australia

- Commodity price falls, and mixed economic data -
- So where to now for the multispeed economy, house prices and interest rates

Alan Oster – Group Chief Economist

Date: December 2015



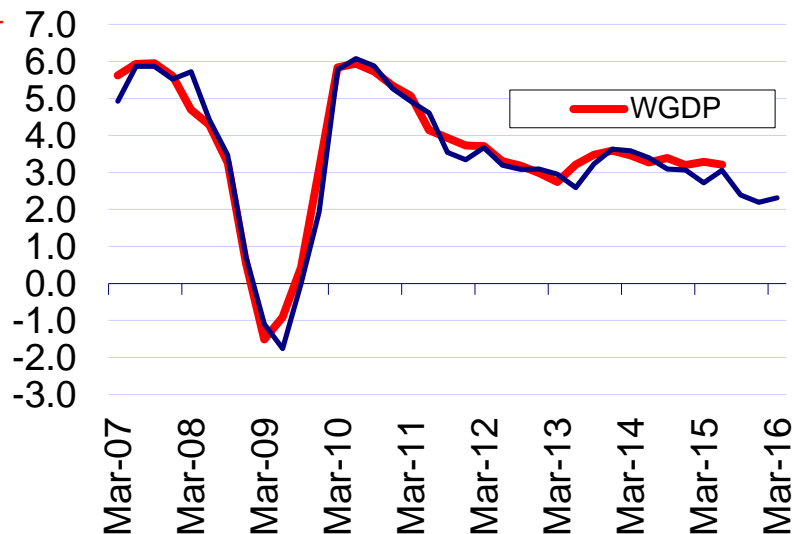
National
Australia
Bank
Bank

Global outlook very mixed.

Around 3% in 2015 . Not much better into 2016/17.

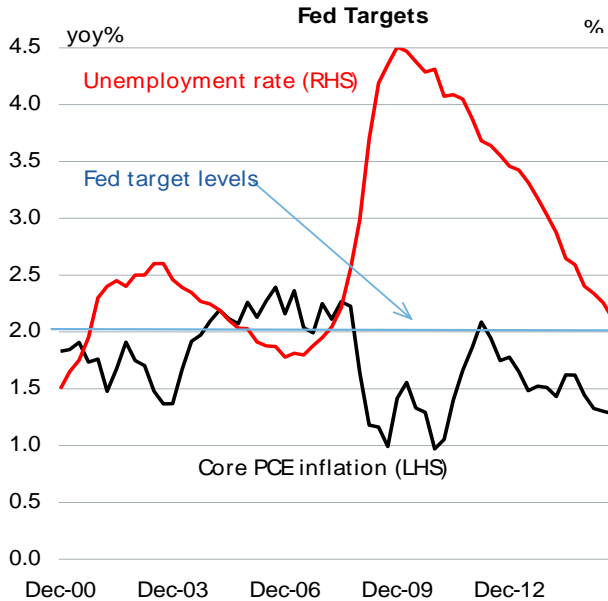
- No real sign of kick up global growth –
- indeed still weakening in late 2015

NAB Leading Indicator: GLOBAL y/y %

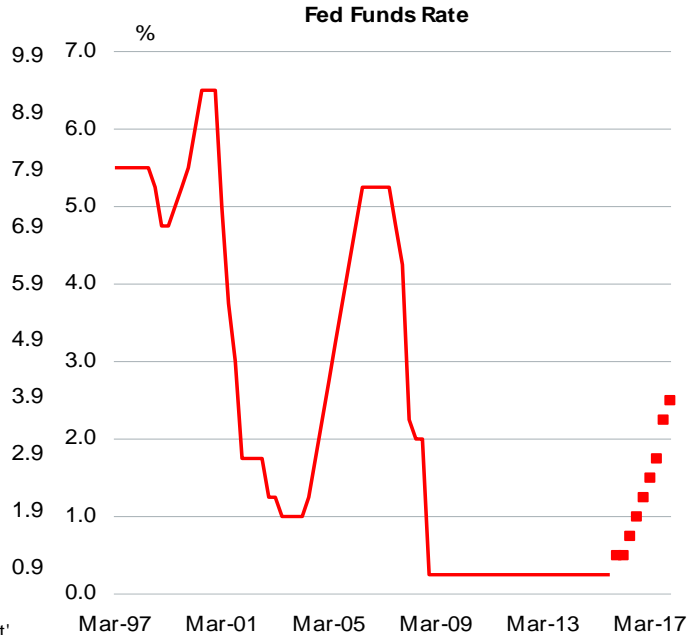


- **USA** - Doing reasonably but oil price, higher USD and equity markets creating headwinds
- GDP has slowed in Q3 but still expect around 2½% over next year or so
- Employment still good. Services sector quiet strong.

Fed set to lift rates as unemployment falls...even with low inflation

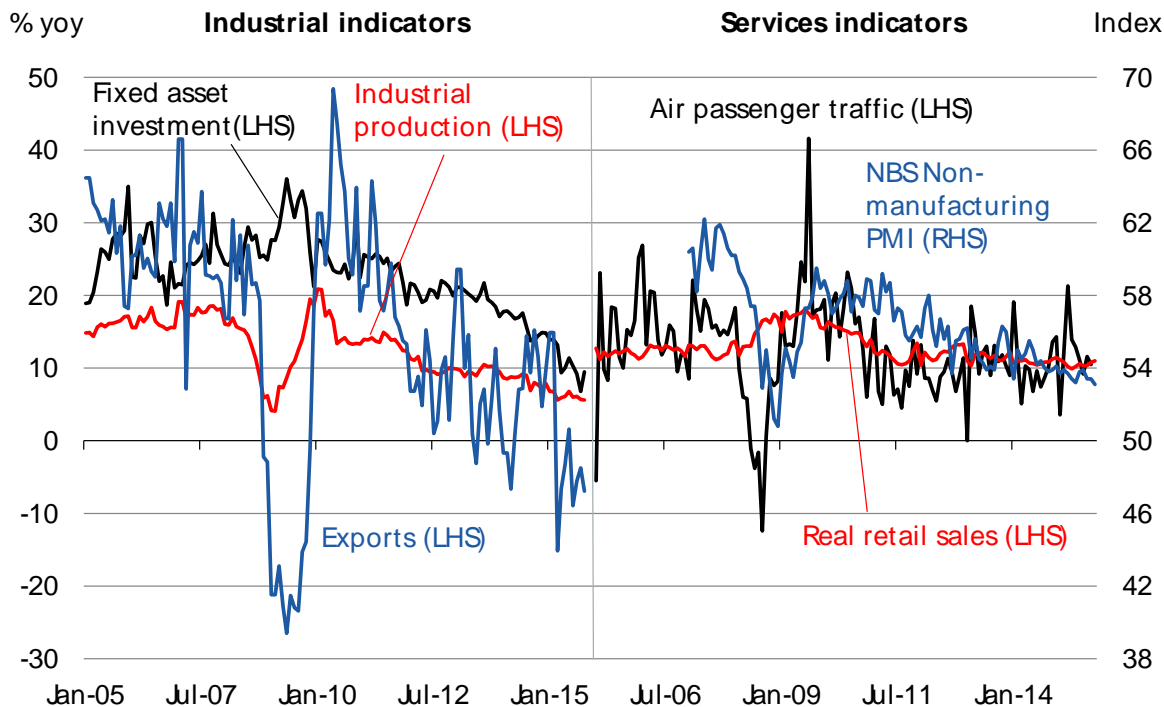


Sources: BEA, Federal Reserve, Data are qtrly. Fed unemployment 'target' set at median of Fed member long-run projection



Source: Datastream, Federal Reserve, NAB

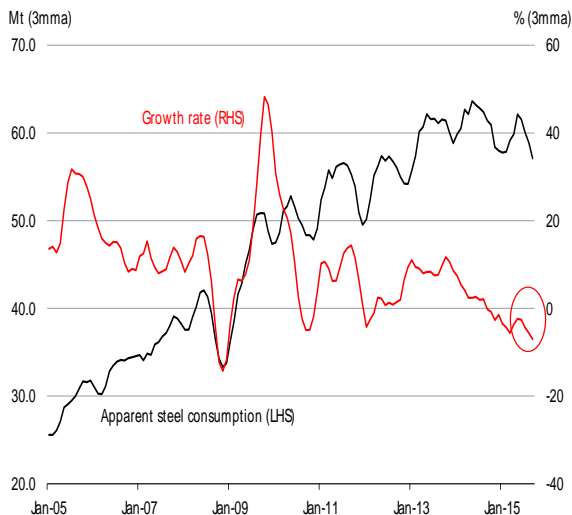
While China's 'old' industries are slowing, services continue to underpin growth



Source: CEIC, NAB Economics

So with little prospect of increased demand - and over supply - we see little scope for increased commodity prices. But don't expect large further falls

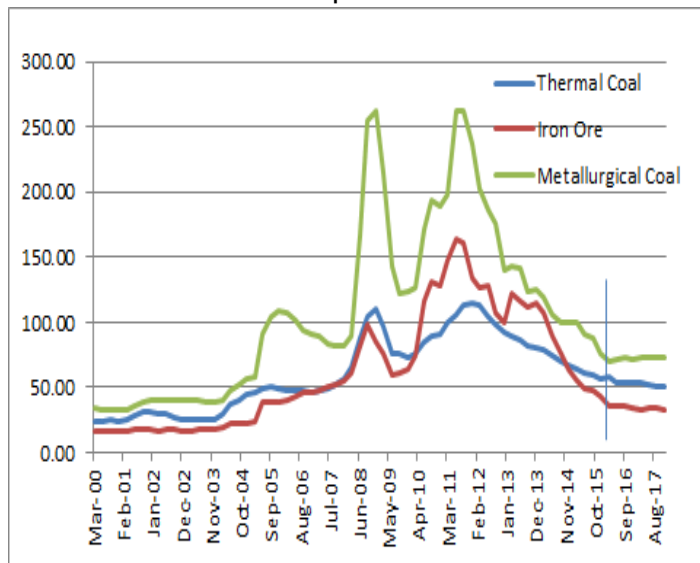
Consumption of steel is already falling in China



Sources: CEIC, Bloomberg, NAB Economics

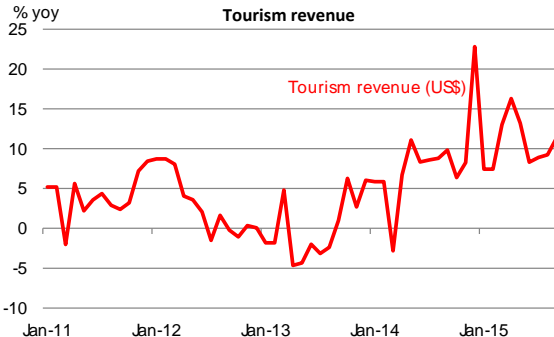
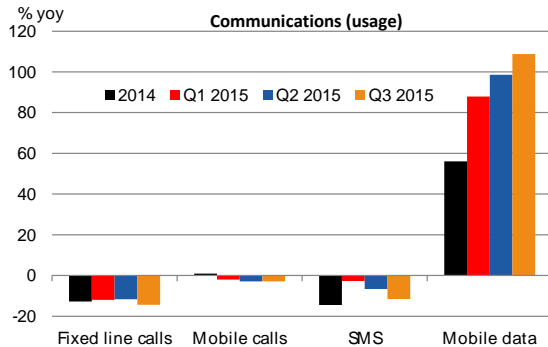
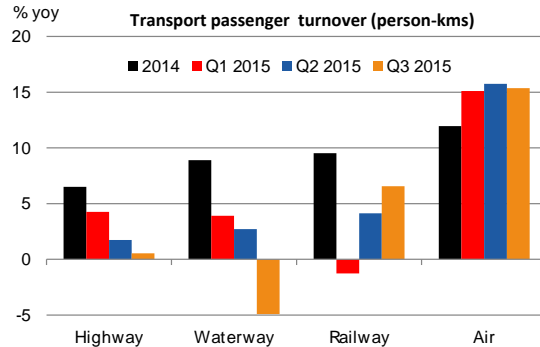
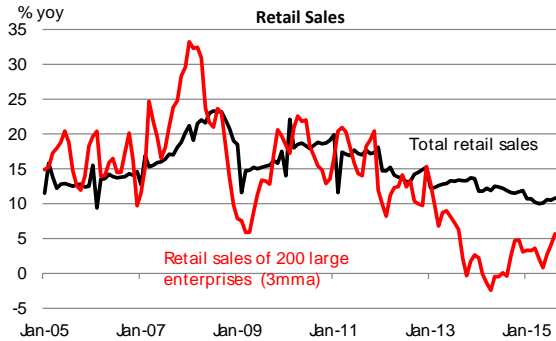
Bulk Commodity Prices USD / Tonne

Export Value *



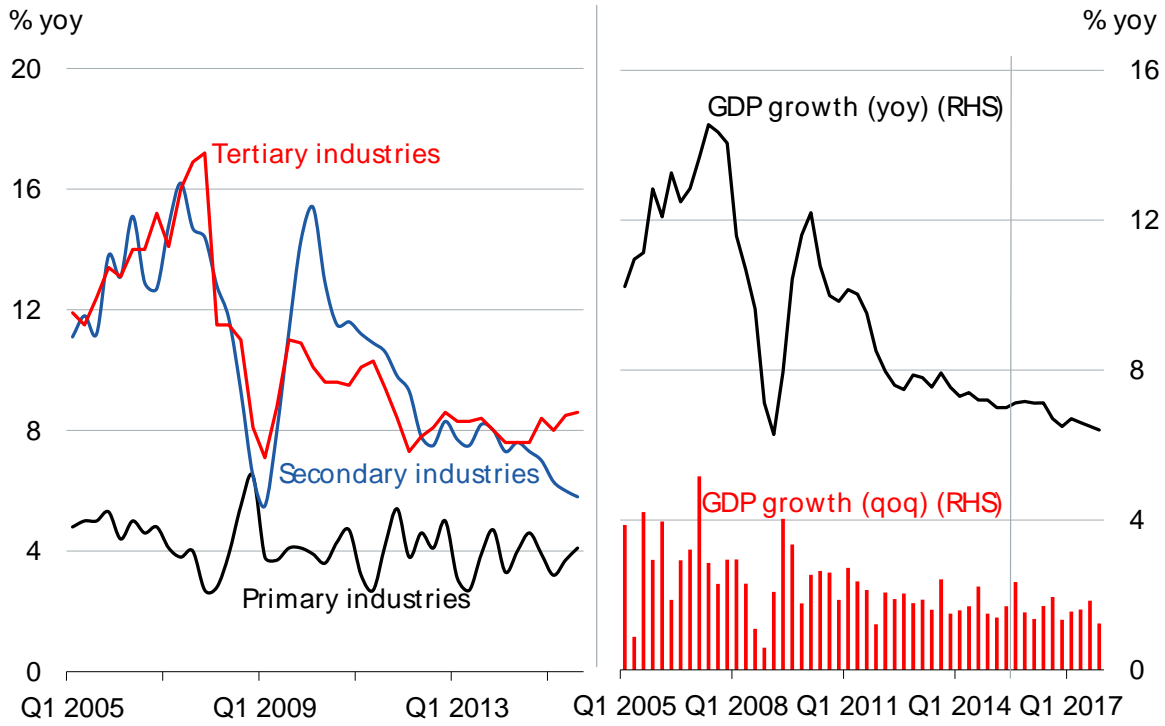
* Prices at Dec 17: Iron Ore \$33.1 ; Thermal Coal \$52.8 and Met Coal \$72.9

Service sector indicators point to differing conditions by sector – but mobile data and air travel still very strong. Real retail sales around 11%.



Source: CEIC, NAB Economics

Overall we still see China as likely to experience a soft landing



Source: CEIC, NAB Economics

Elsewhere very mixed – and disappointing (ex India)

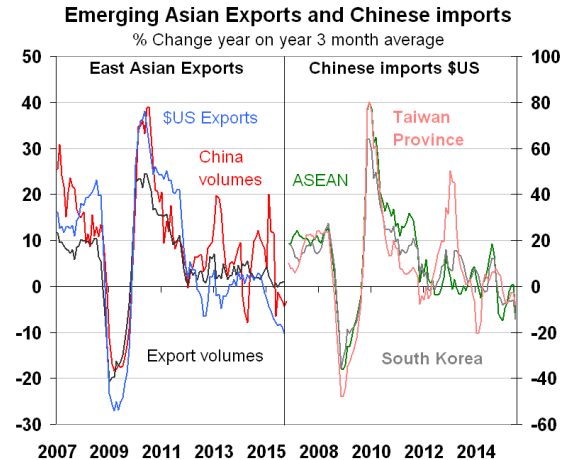
- **India** - Ok at around 7½% - growth levelling out
 - Rate cut in September to maintain momentum

- **Japan** - Still misfiring. Back into recession in Q3.
 - GDP around 1¼% in 2016.
 - Little structural reform – demographic negatives

- **Global trade** Very weak meaning Asian tigers struggling

- **Europe** - Partials better - Germany. But very mixed.
 - GDP around 1¾% in 2016.
 - Further stimulus (negative rates) in Dec 2015
 - Greece not a contagion threat – but depression

- **Latin America**
 - In Recession. Very disappointing



Global growth forecasts % change year on year

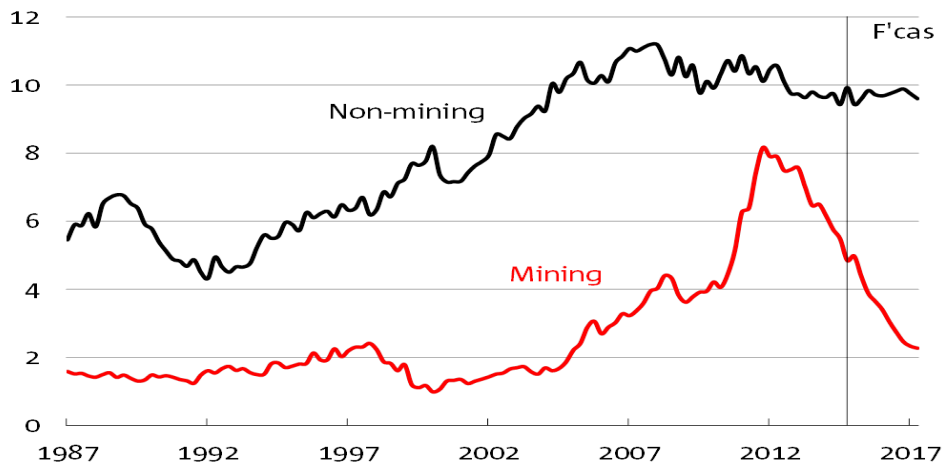
	NAB Forecasts						
	2011	2012	2013	2014	2015	2016	2017
US	1.6	2.2	1.5	2.4	2.5	2.4	2.3
Euro-zone	1.7	-0.8	-0.2	0.9	1.4	1.7	1.9
Japan	-0.4	1.7	1.6	-0.1	0.6	1.1	0.9
UK	2.0	1.2	2.2	2.9	2.4	2.3	2.2
Canada	3.0	1.9	2.0	2.4	1.0	1.7	1.8
China	9.3	7.8	7.7	7.3	6.9	6.7	6.5
India	7.9	4.9	6.4	7.1	7.5	7.6	7.4
Latin America	4.9	2.5	2.6	0.9	-0.2	1.1	1.6
Emerging East Asia	4.4	4.6	4.2	4.0	3.7	3.8	4.1
New Zealand	1.8	2.4	2.3	3.3	2.2	1.8	2.0
World	4.4	3.4	3.3	3.3	3.0	3.2	3.3
memo							
Advanced Economies	1.7	1.2	1.2	1.8	1.9	2.0	2.1
Big Emerging Economies	7.0	5.3	5.6	5.1	4.6	4.9	4.9
Major trading partners	4.6	4.3	4.6	4.5	4.4	4.5	4.4

Australia: Key themes

- ❑ Number one challenge is to deal with effects of massive fall in mining investment
- ❑ Not a risk to GDP (mining exports add 2% per annum) but to domestic demand
- ❑ Policy – especially rates- aimed at stimulating non mining demand
- ❑ AUD falls also help a lot – bigger fall than during great recession
- ❑ Australia rebalancing better than many think – NAB Survey
- ❑ Growth gradually shifting up towards 3%. Domestic demand more around 1½%
- ❑ Slower growth potential means – together with better non mining activity (the big employer)- that unemployment has peaked. But will remain elevated (but lower than RBA expects).
- ❑ Housing prices to flatten but not crash. Apartments?
- ❑ RBA has finished – on our and their forecasts

Key challenge facing the economy significant shock from mining investment

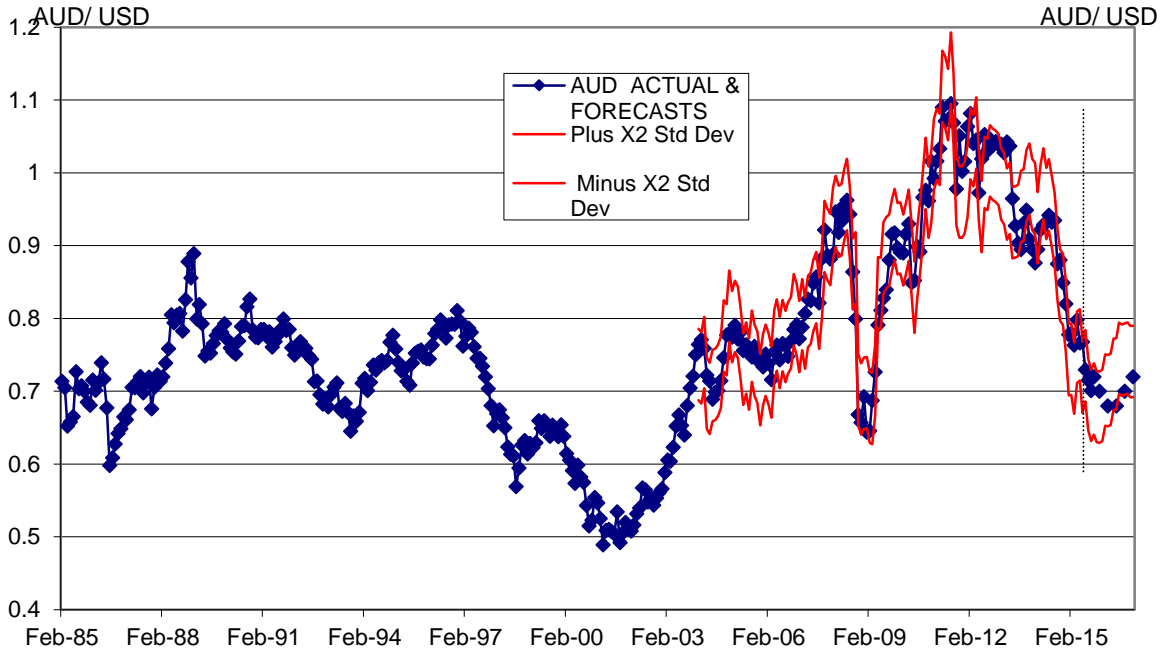
- Moving from the investment phase of an export phase will see a significant drag on domestic demand as mining investment falls sharply



- RBA's challenge is to stimulate the rest of the economy to fill in the hole. Lower AUD helps. Fiscal policy doesn't. Monetary policy ??

Currency model. USD .68 +/- 5c. Recent volatility driven by fear re China and timing of US rate rise. Model suggest near term downside risk. Then to flatten out at around 68c in early 2016 – and a touch higher in late 2016.

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.

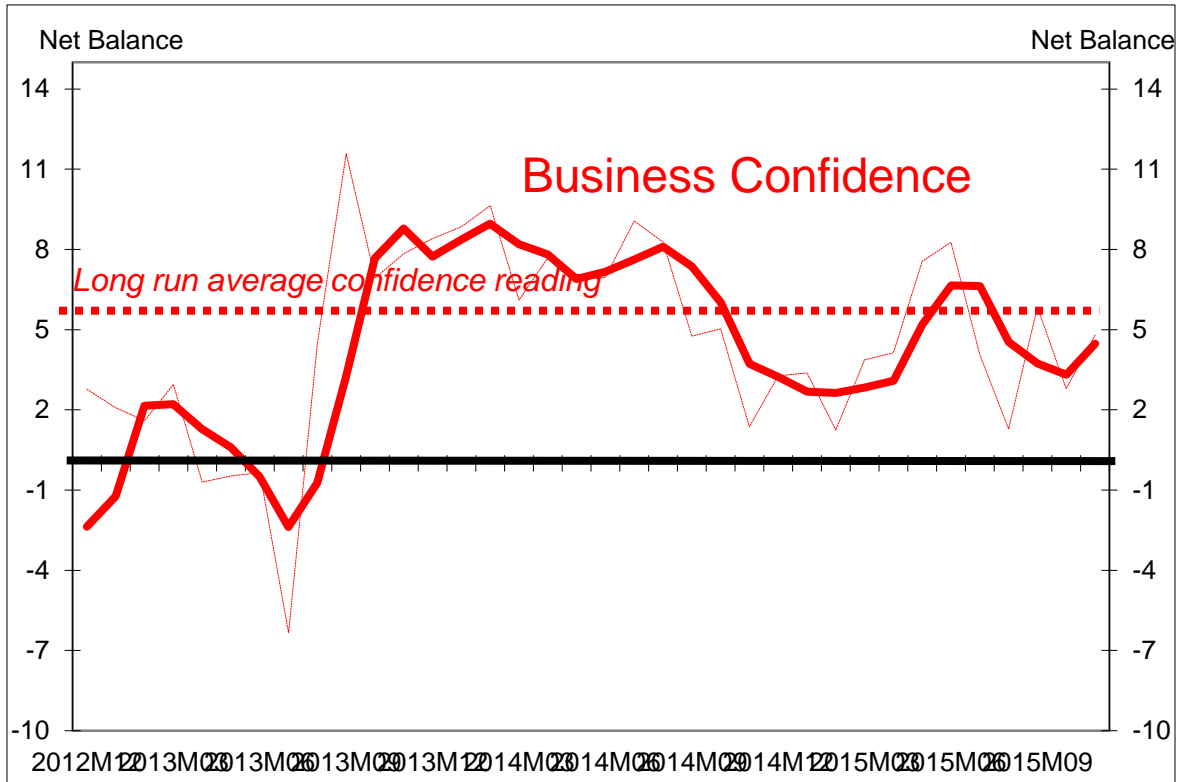
Forecasts:

End 2015 = 70c AUD/USD

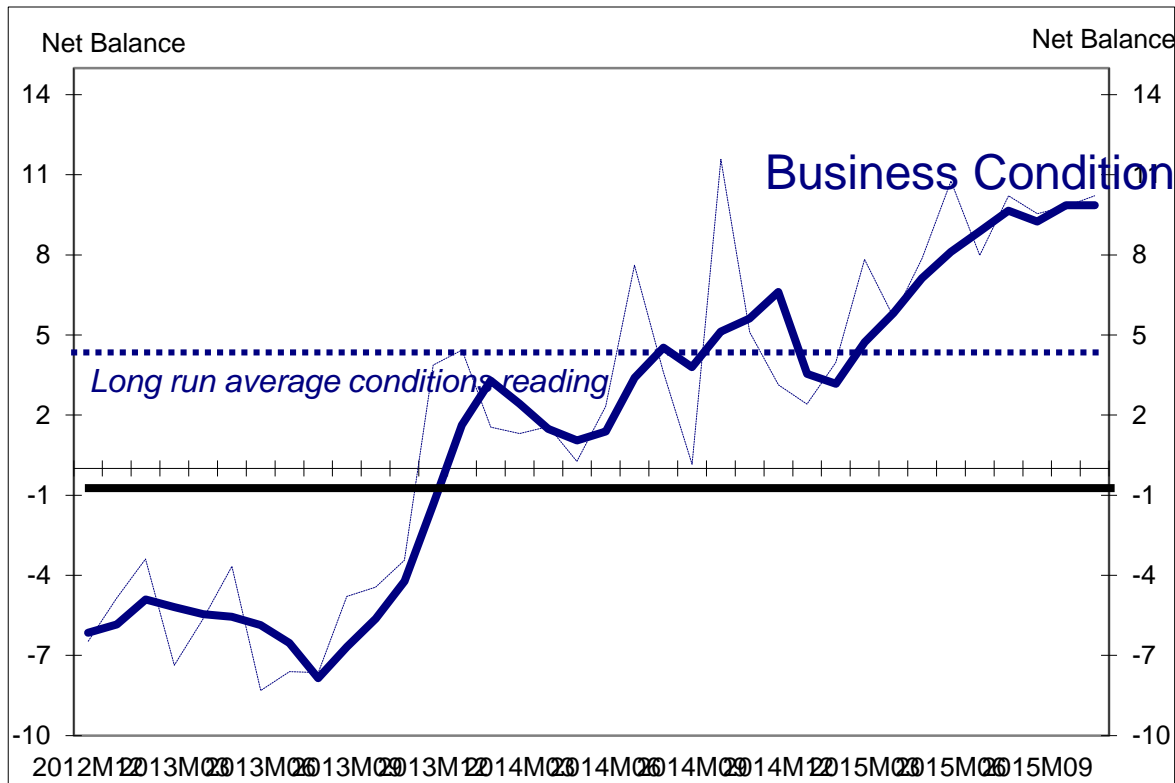
End 2016 = 72c AUD/USD



So where are we at re Business confidence.
Not bad but still a bit wary.

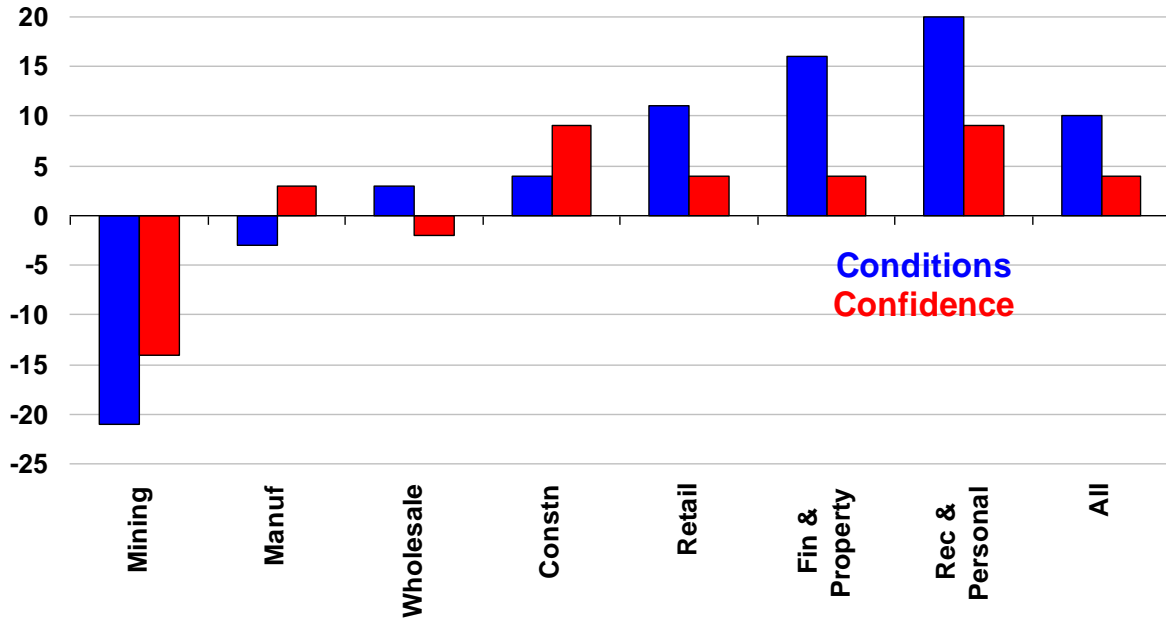


Business outcomes (conditions) continues to perform strongly. Green shoots starting to multiply – and no signs of wilting.



November: Strength very much driven by services –Personal & Rec services (consumer services) and Property. Construction mixed. Retail improving (but not discretionary). Wholesale & manufacturing better than it was. Miners & mining services terrible.

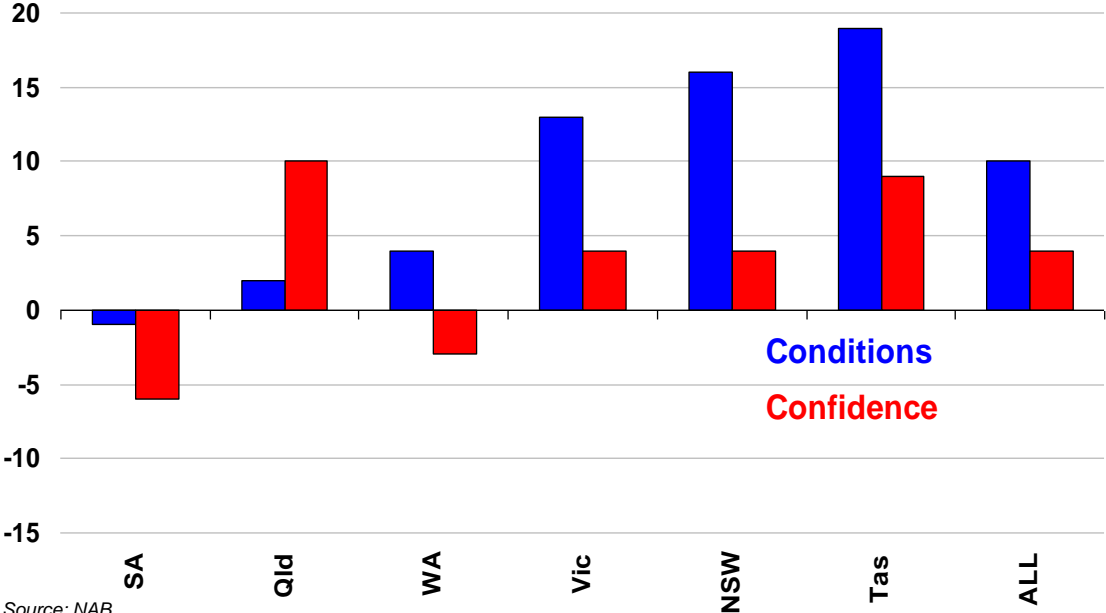
**Business Conditions and Confidence
November 2015; (Trend)**



Source: NAB

Industry conditions also impacting on activity by geography.
WA and Qld interesting contrast re outcomes and confidence.

Business Conditions and Confidence
November 2015; (Trend)

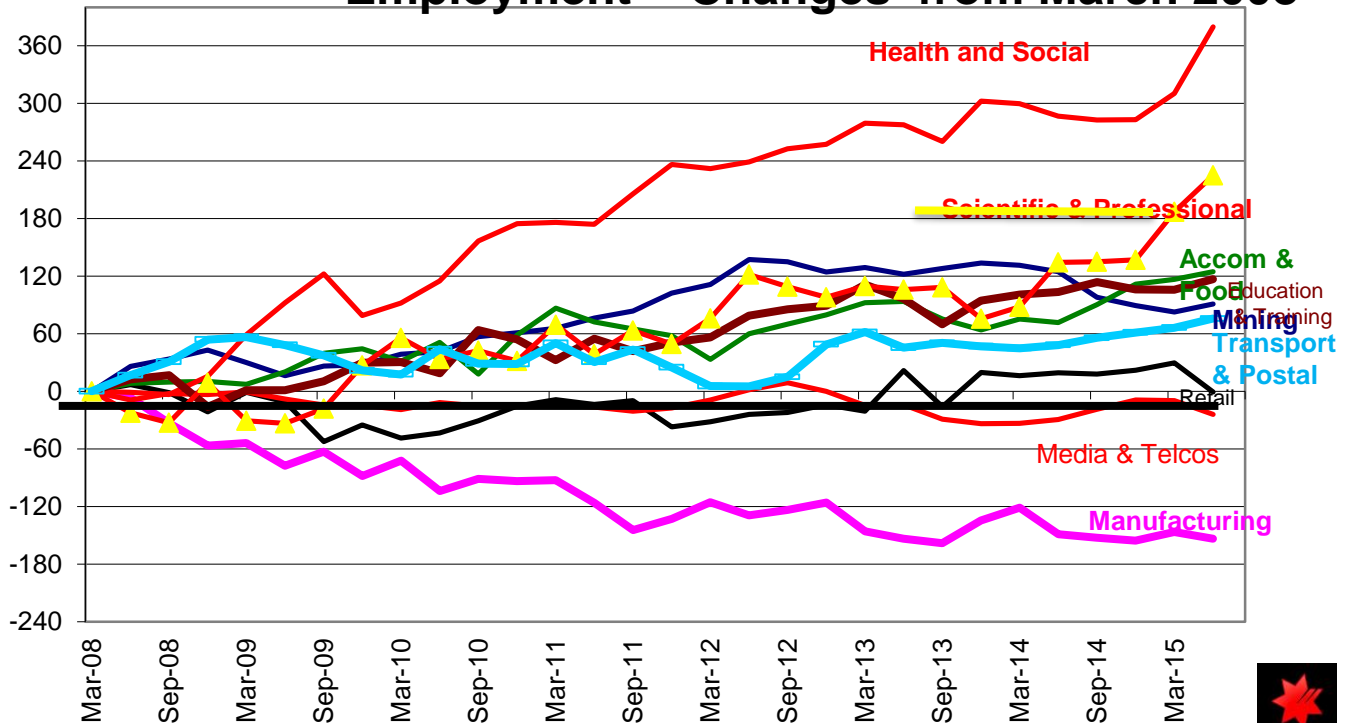


Source: NAB



Labour market trends also showing industry differences

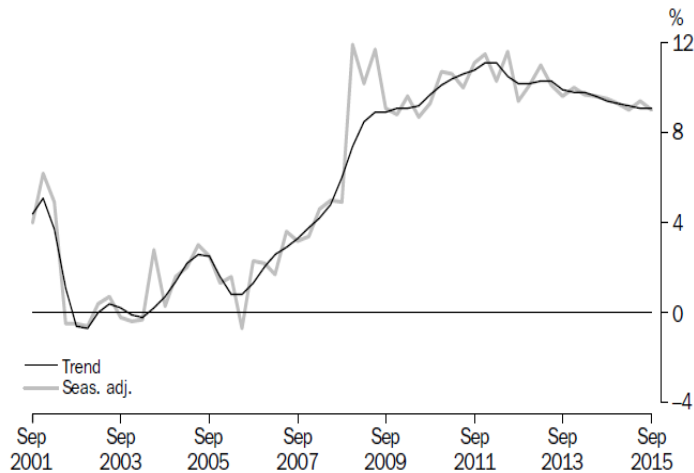
Employment - Changes from March 2008



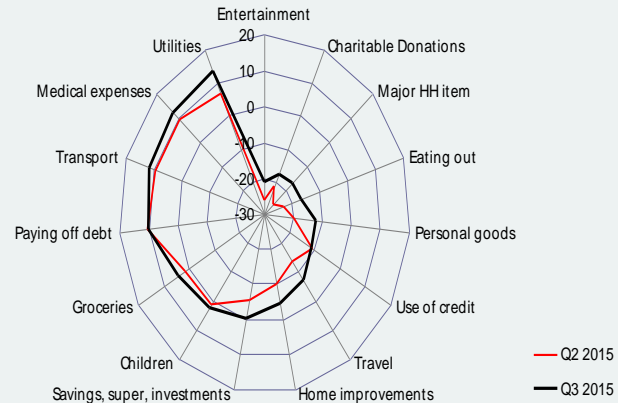
Underpinning our forecasts is a view that **consumers are still very conservative**. Have started to spend a bit more but necessities the key area of spend – and paying off debt

Consumers expect to focus spending on essentials

HOUSEHOLD SAVING RATIO, Current prices



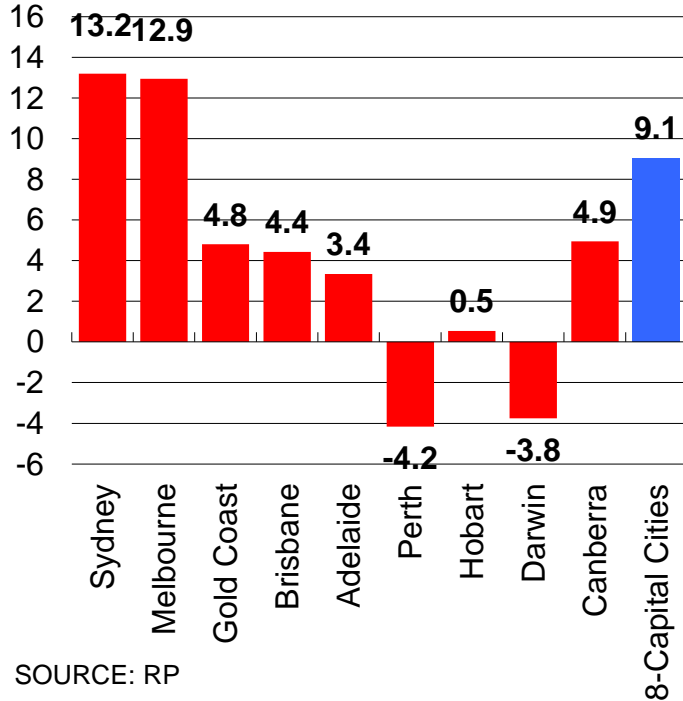
Changes in Spending Behaviour (net balance)



Source: NAB Consumer Anxiety Survey Q3 2015

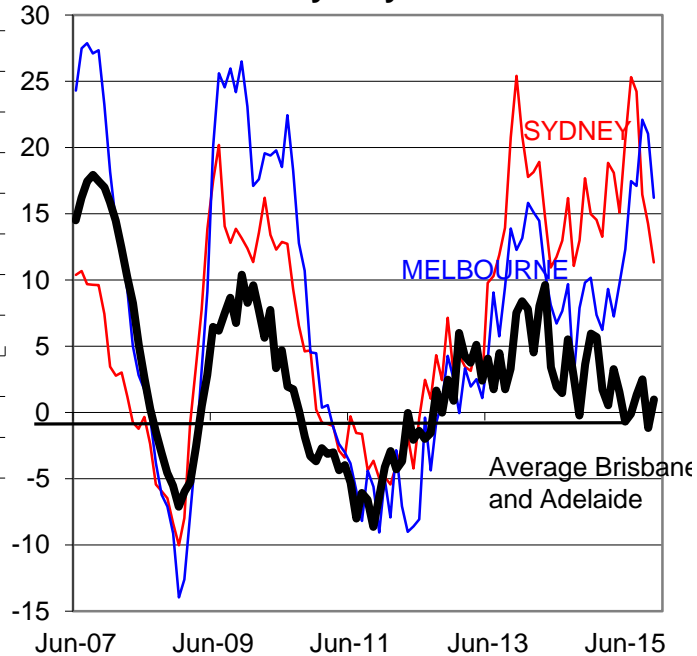
Very different house price story across cities. Key driver of house prices is Sydney – where undersupply and investors dominate – and Melbourne – again investors but also foreigners. Elsewhere very mixed to poor. Recent easing in Sydney (especially) and Melbourne

Annual % Change in Capital City House Values to November 2015



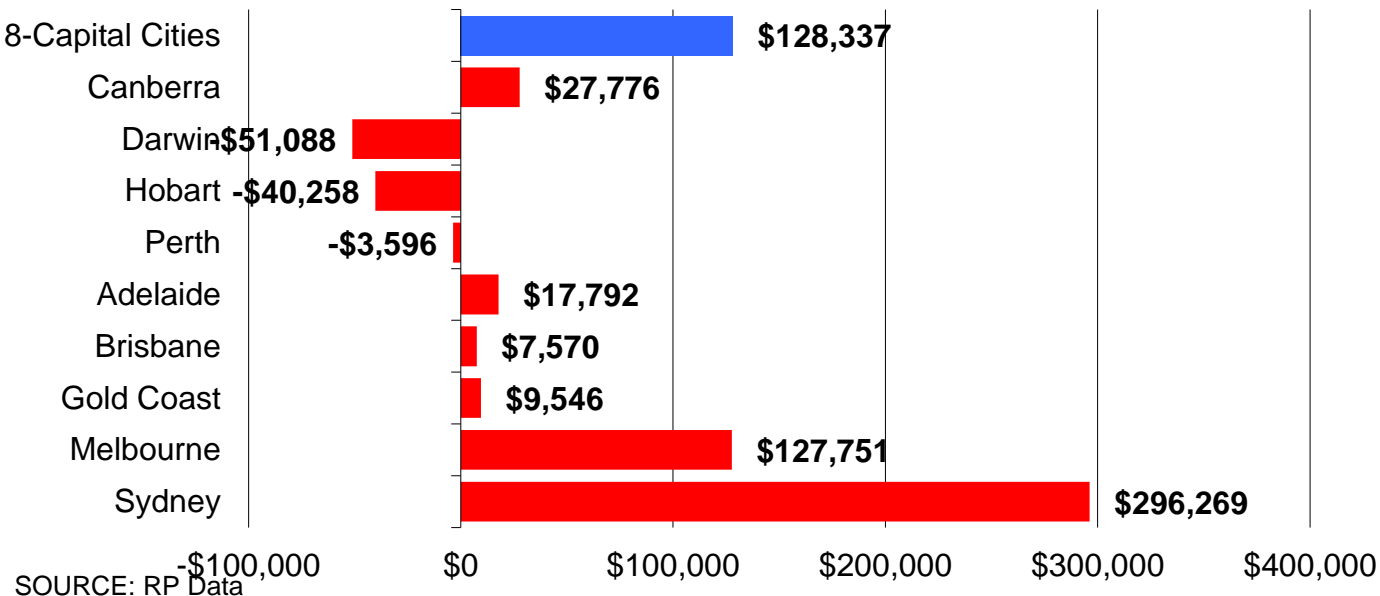
SOURCE: RP

House Prices - 6 mth annualised % Melbourne Sydney and the Rest



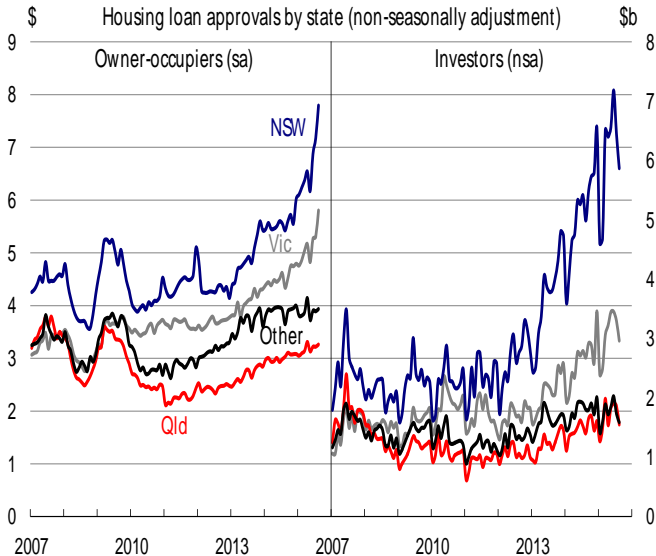
Cyclically many markets are below previous peak. Sydney the stand out exception and then Melbourne.

Change in House Values from Previous Peak to November 2015



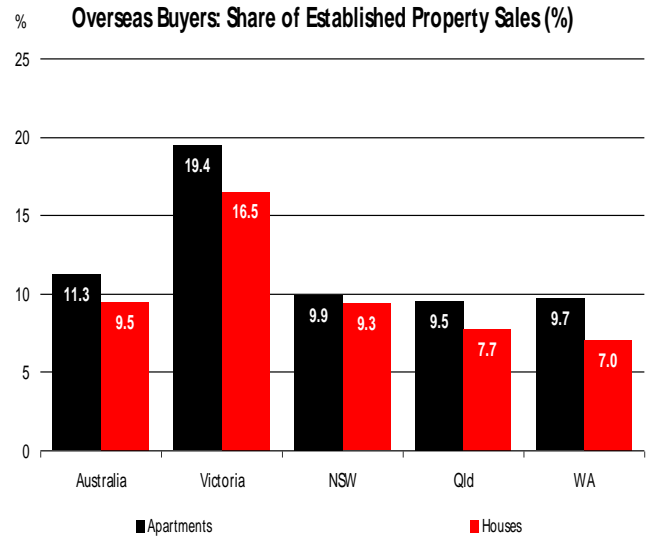
Investors are very important in the Sydney market. Foreigners are also important especially in Melbourne

Mortgage Approvals by State and Type

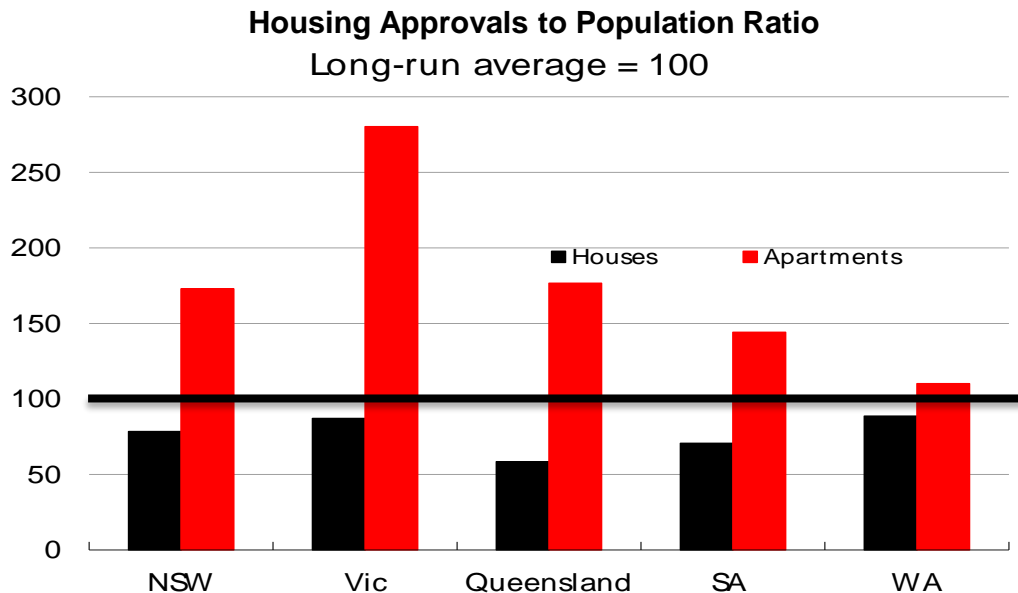


*Owner-occupied includes refinancing

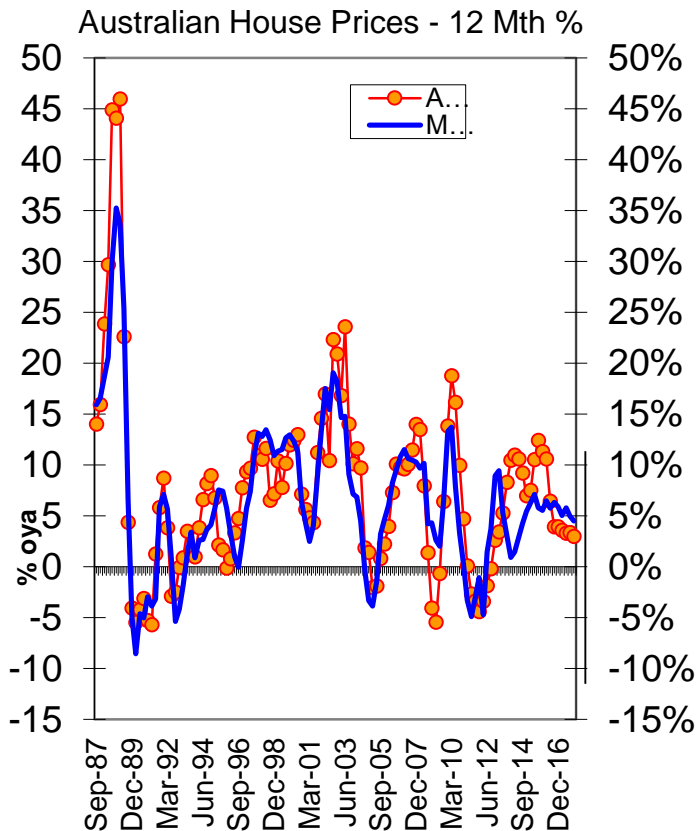
Overseas Buyers: Share of Established Property Sales (%)



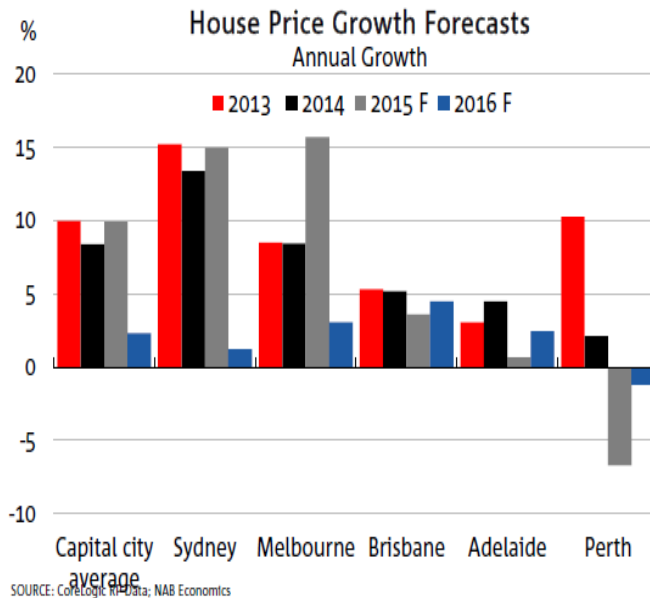
That said the house market still looks undersupplied
But not the apartment market which is oversupplied – especially in Melbourne – and
hence very dependent on foreign demand.



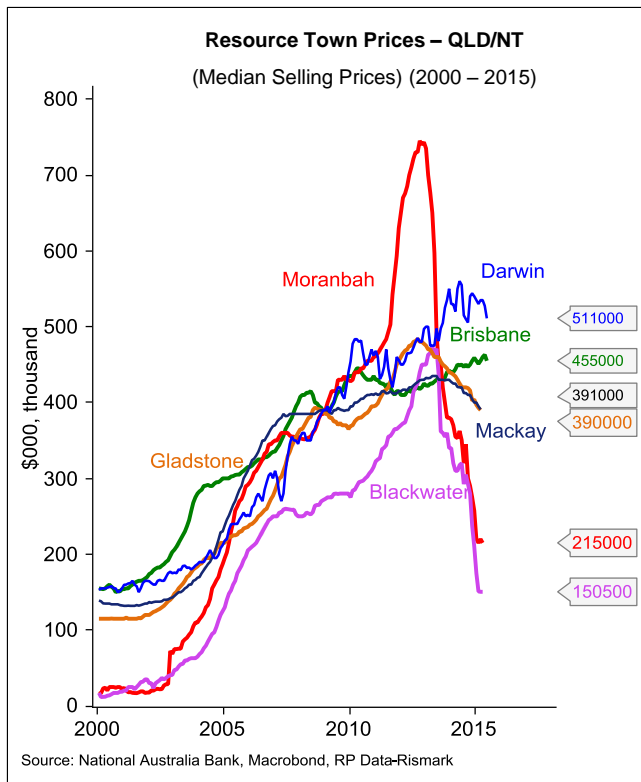
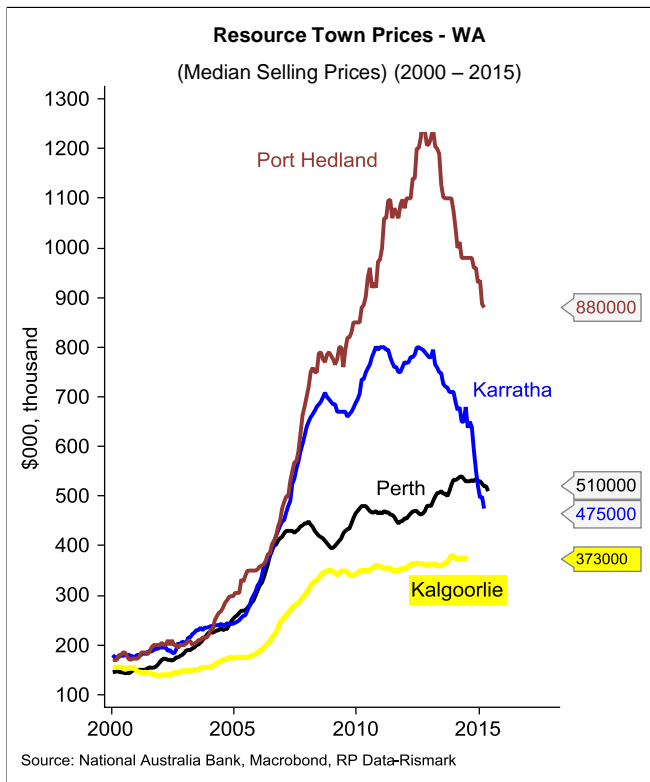
Going forward we expect house price growth to moderate. Recent reacceleration hard to explain by fundamentals. Expect a marked slowing but not a crash. APRA limits on investor housing growth (less than 10% growth) has started to impact.



But outlook very different by City

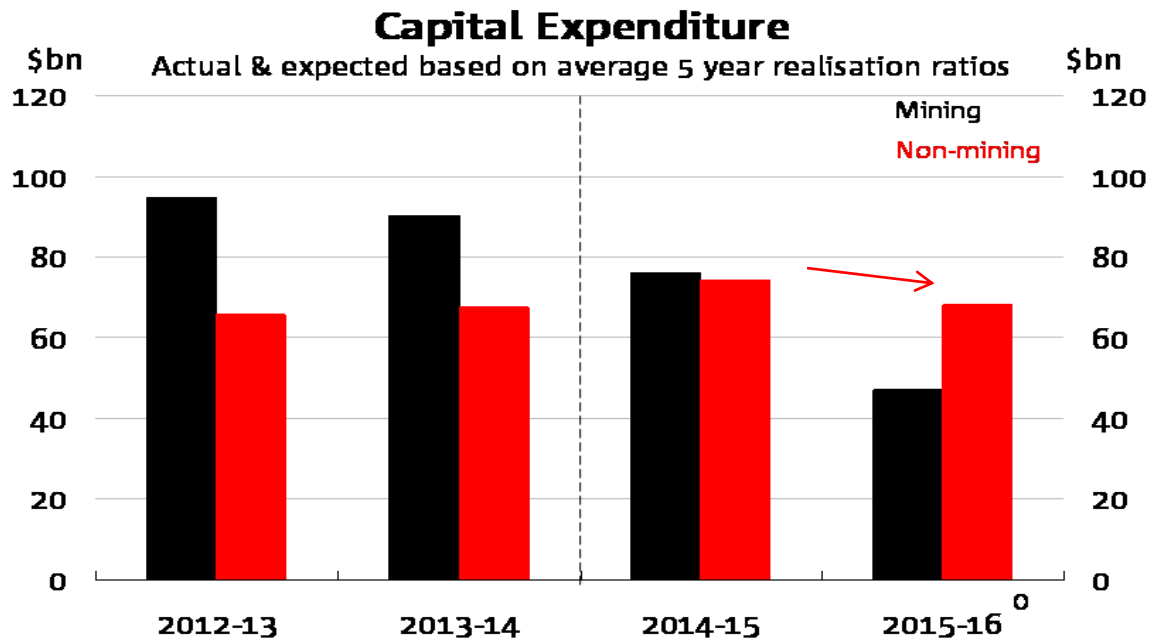


Even in housing market . Need a much more focussed regional approach, by post code.
 Also seeing it in work we are doing re mining towns



Despite better near term momentum Non Mining Business investment intentions quite poor. Especially ABS. Nab slightly better but...still not great

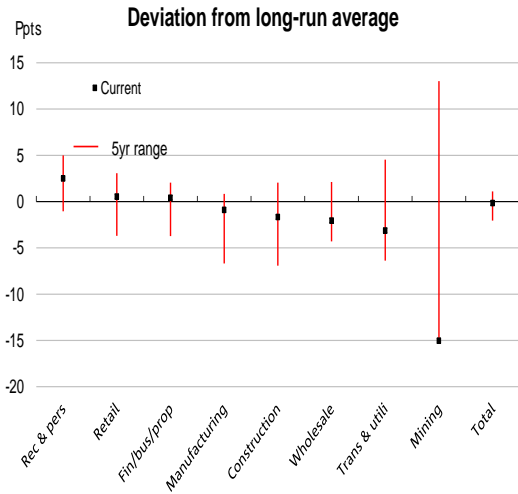
ABS Capex intentions to fall in non mining??



Source: ABS & NAB calculations

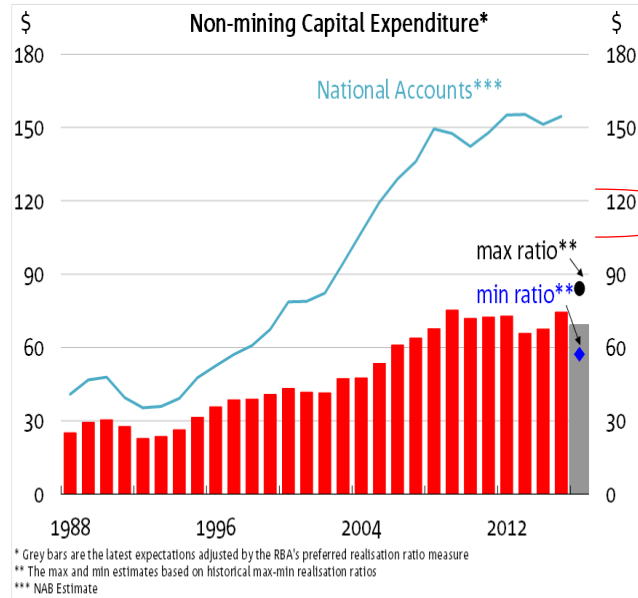
Part of the story is capacity utilisation - which is still only average but much stronger in services. Composition important as capex survey doesn't fully cover key services investment intentions especially education and health & community services..

Capacity utilisation by industry



Source: NAB Economics

Capex survey in **non mining** increasingly affected by coverage issues

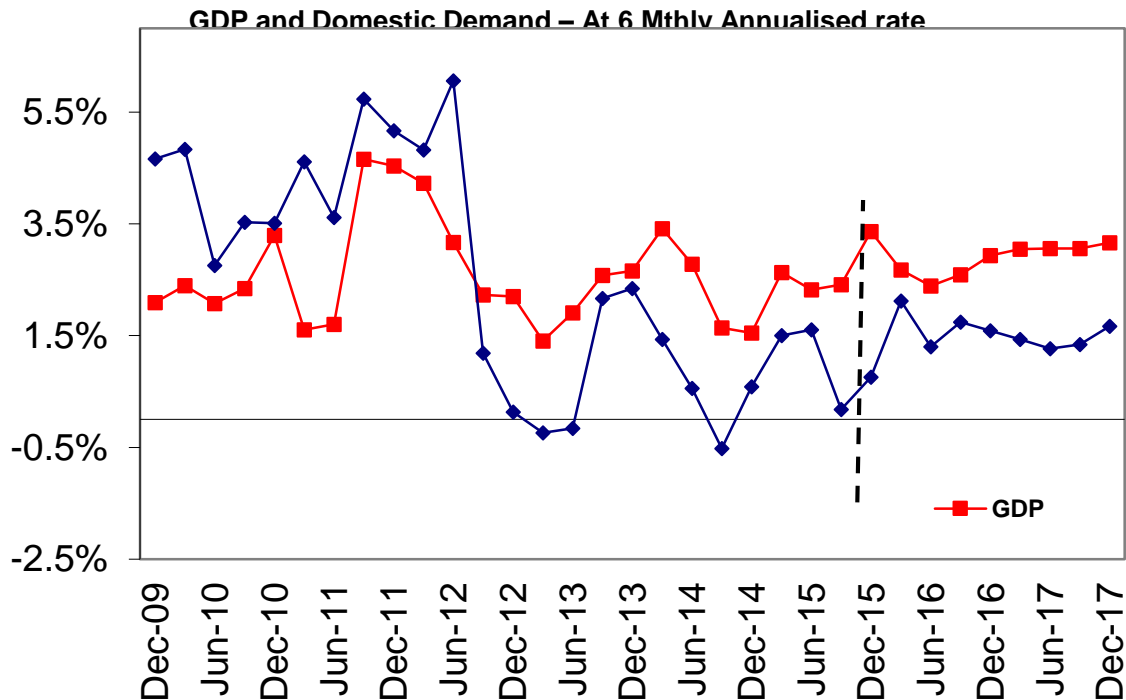


* Grey bars are the latest expectations adjusted by the RBA's preferred realisation ratio measure
 ** The max and min estimates based on historical max-min realisation ratios
 *** NAB Estimate

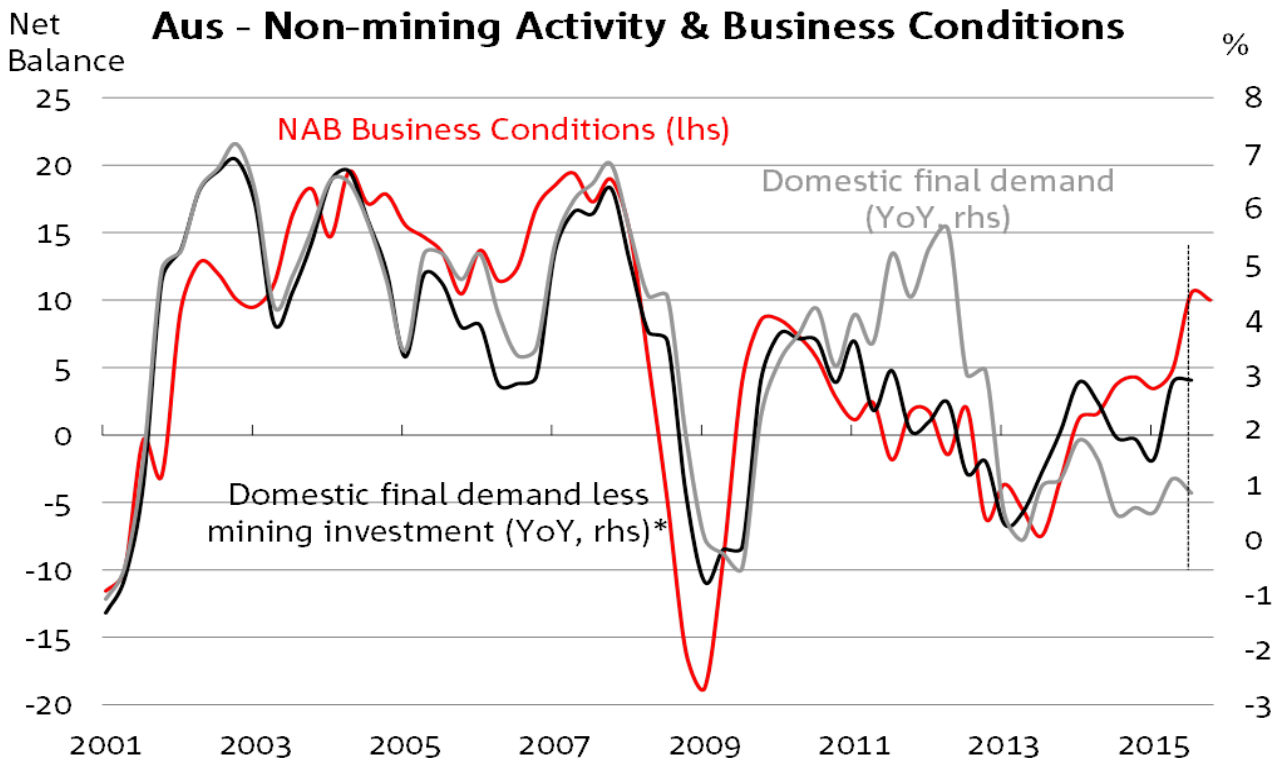
Gap from services investment growing



So we still moderate growth in domestic demand - with recent volatility in demand magnified by falls in mining investment & public sector fringes. But overall GDP moderately up.



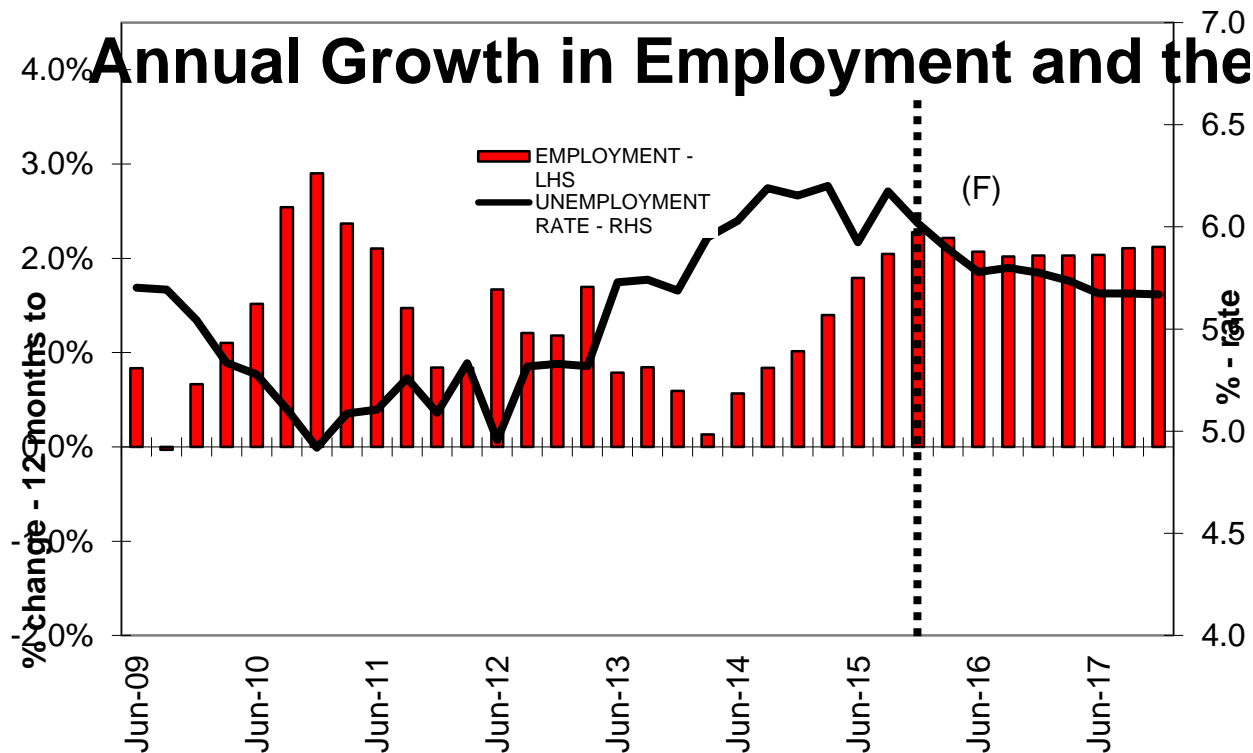
But NAB Survey suggests demand (ex mining) has started to improve significantly - Q4 2015 is strong. Composition is important in explaining strength in employment strength (& investment intentions)



* NAB estimate. Q3 2015 is a forecast

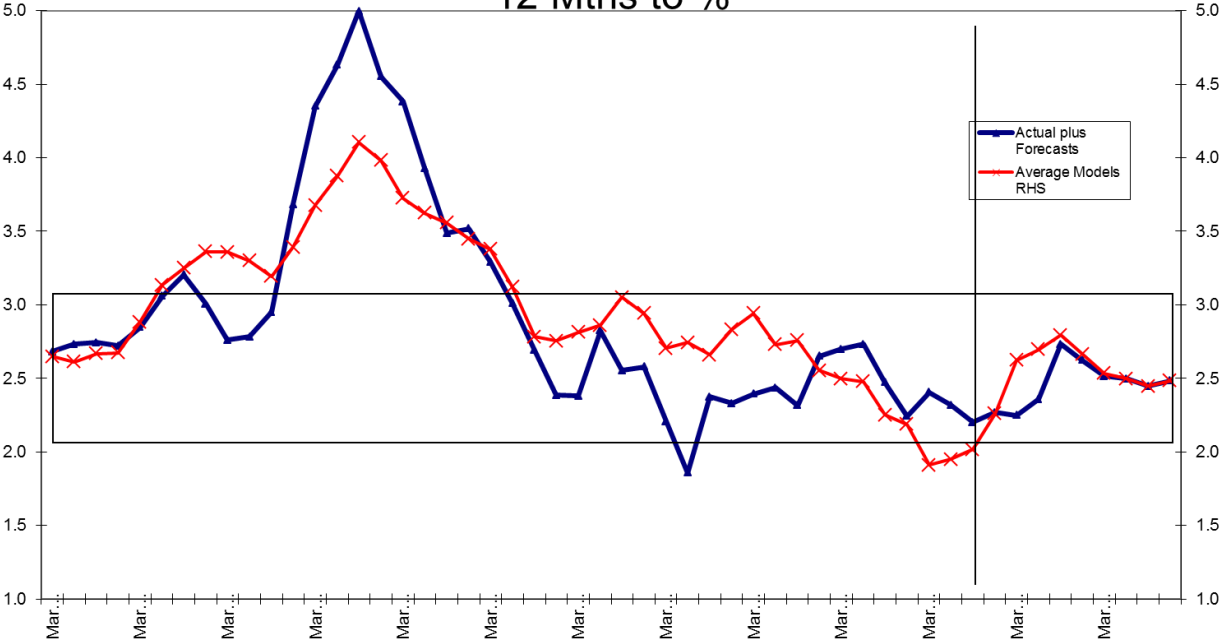


Our models from activity to employment and unemployment suggest jobs growth now is around the level you need to prevent a rise in unemployment. Especially as population growth slows. But unemployment stays high for long time.



Core inflation low but not as low as expected. But not a concern.

CORE CPI V Nab CPI MODELS 12 Mths to %



RBA unlikely to cut again given growth inflation and unemployment outlook. Rate rises from late 2016 – but at very moderate pace to lower peak of 3.5%.

- ❑ Recent economic data more encouraging – especially services
 - ❑ **Composition story very important**
 - ❑ Impacting on business conditions; credit demand; and the labour market
 - ❑ Housing a concern but RBA are relying on APRA (but to cut???)

- ❑ **Inflation low so that if anything goes wrong RBA can cut.....but**

- ❑ Not consistent with our forecasts – nor the RBA's
 - ❑ Market perceptions of cuts fast diminishing
 - ❑ We **still see the rate cut cycle as being finished.**

- ❑ **Rate rises by late 2016 or early 2017**
 - ❑ But relative modest track - a new peak of 3.5% by late 2017/early 2018.

Thank you
for joining us