Australia: Economic and Financial Outlook

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more give, less take

Australian economy and financial markets continue to be impacted by a large number of large and diverse forces

Positives

- Low interest rates
- Strong recovery in residential construction (especially apartments)
- Continuing relatively rapid population growth (slowing a little)
- Infrastructure spending, especially in NSW
- A lower $A
- Significant drop in oil prices (for consumers and business input costs)
- Stronger mining exports
- US economy strengthening; continuing tailwind from many aspects of Chinese growth (India?)

Negatives

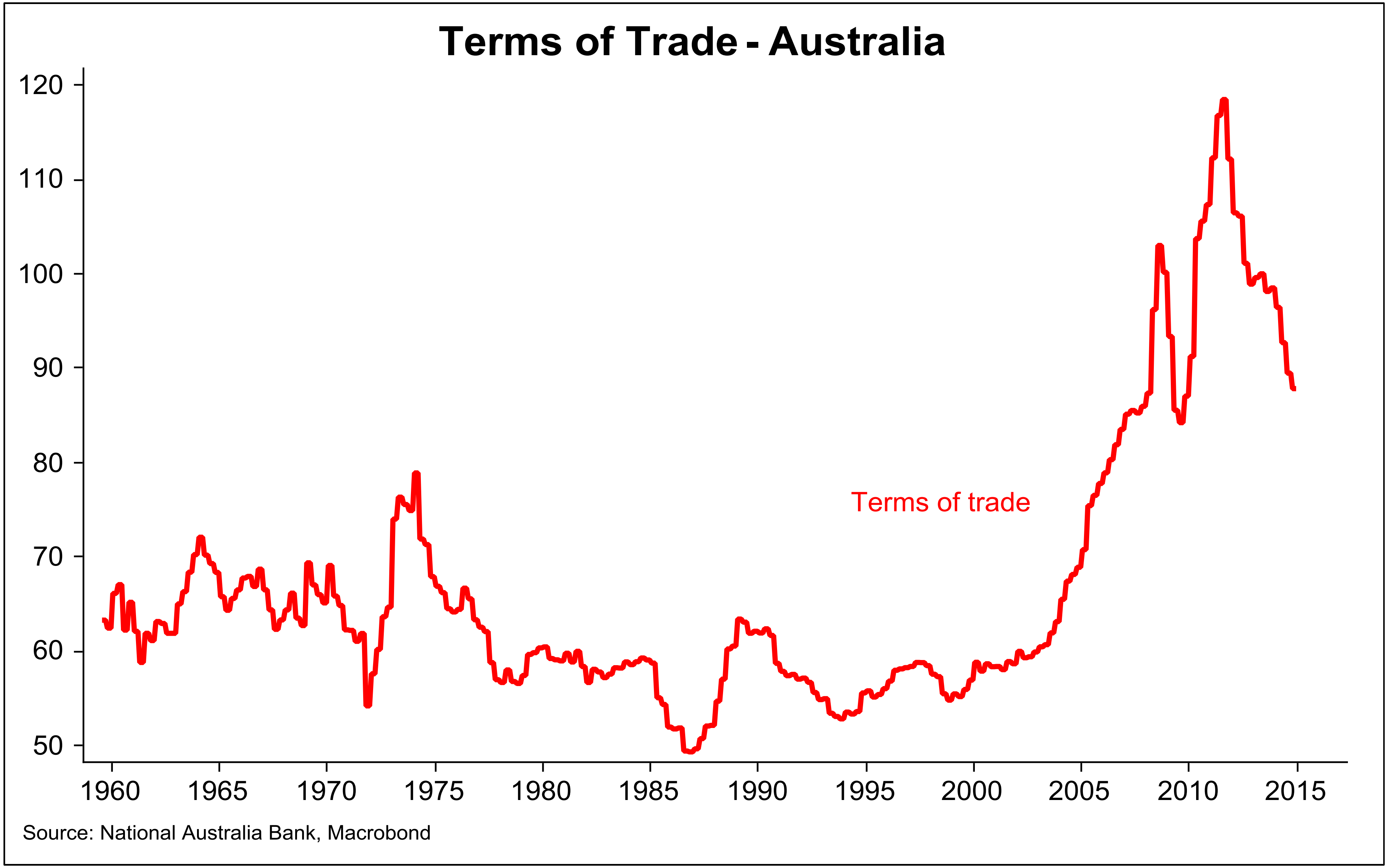
- Falling commodity prices/terms of trade = weak incomes growth and government revenues = fiscal tightening
- Large mining projects completing and lower oil prices to hit oil & gas sector spending (impact on WA/NT/parts of QLD)
- Consumer and business confidence still a little fragile – budget this year has been more helpful
- Slower growth in China affecting some sectors; still relatively slow growth in Europe and Japan

➔ Strengthening now occurring in the non-mining economy. Question is about pace and sustainability

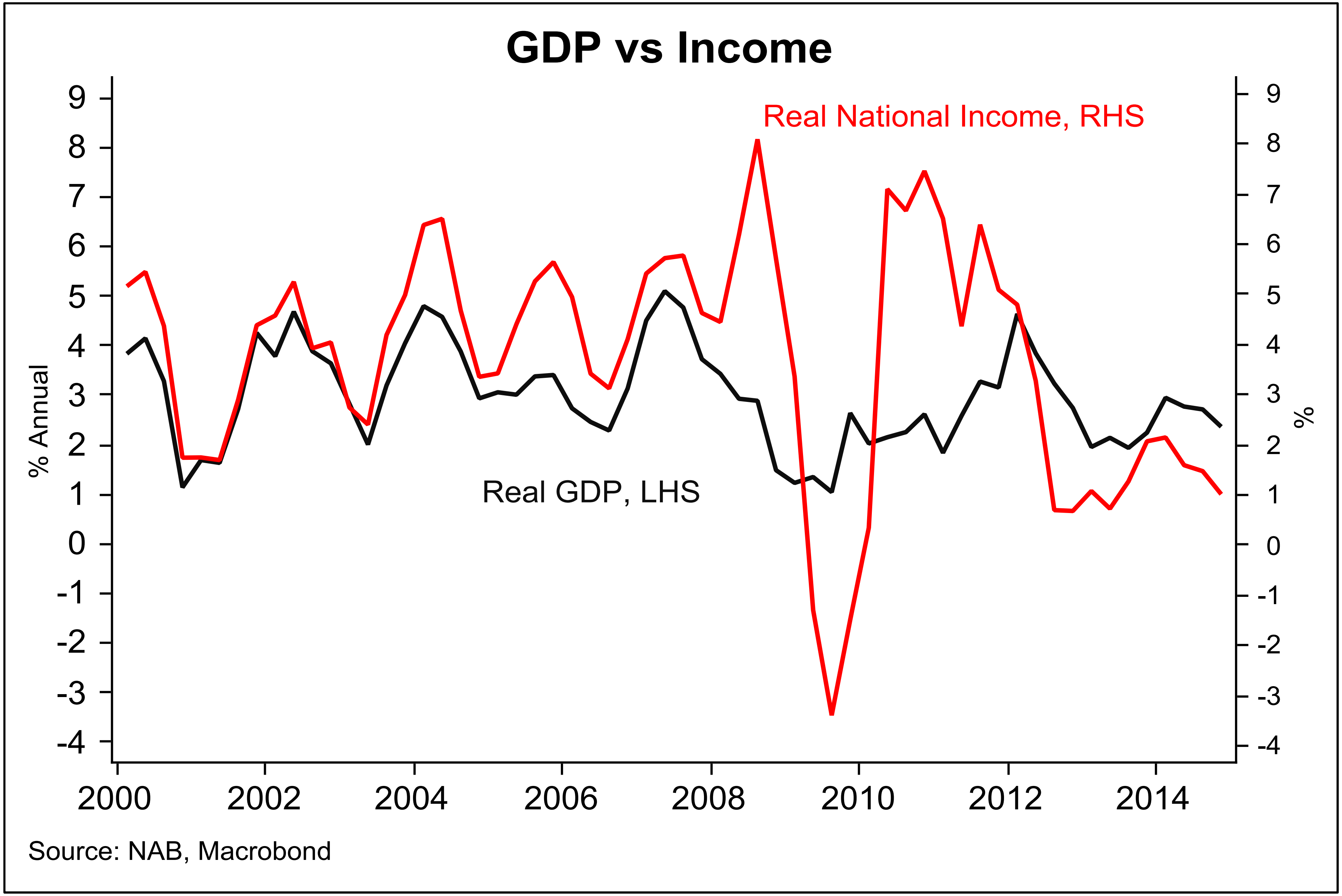
Other issues

- The ageing population
- Technology: the Internet and Digital Disruption
- Impact of QE and zero/negative interest rates in Europe and Japan – possible Greece exit from Euro?
- The first increase in US interest rates in nine years

Significant decline in the terms of trade (commodity prices) a drag on the economy, incomes and budget revenues



Income growth much softer than GDP growth when terms of trade falling – concentrated in mining and sectors exposed to mining?



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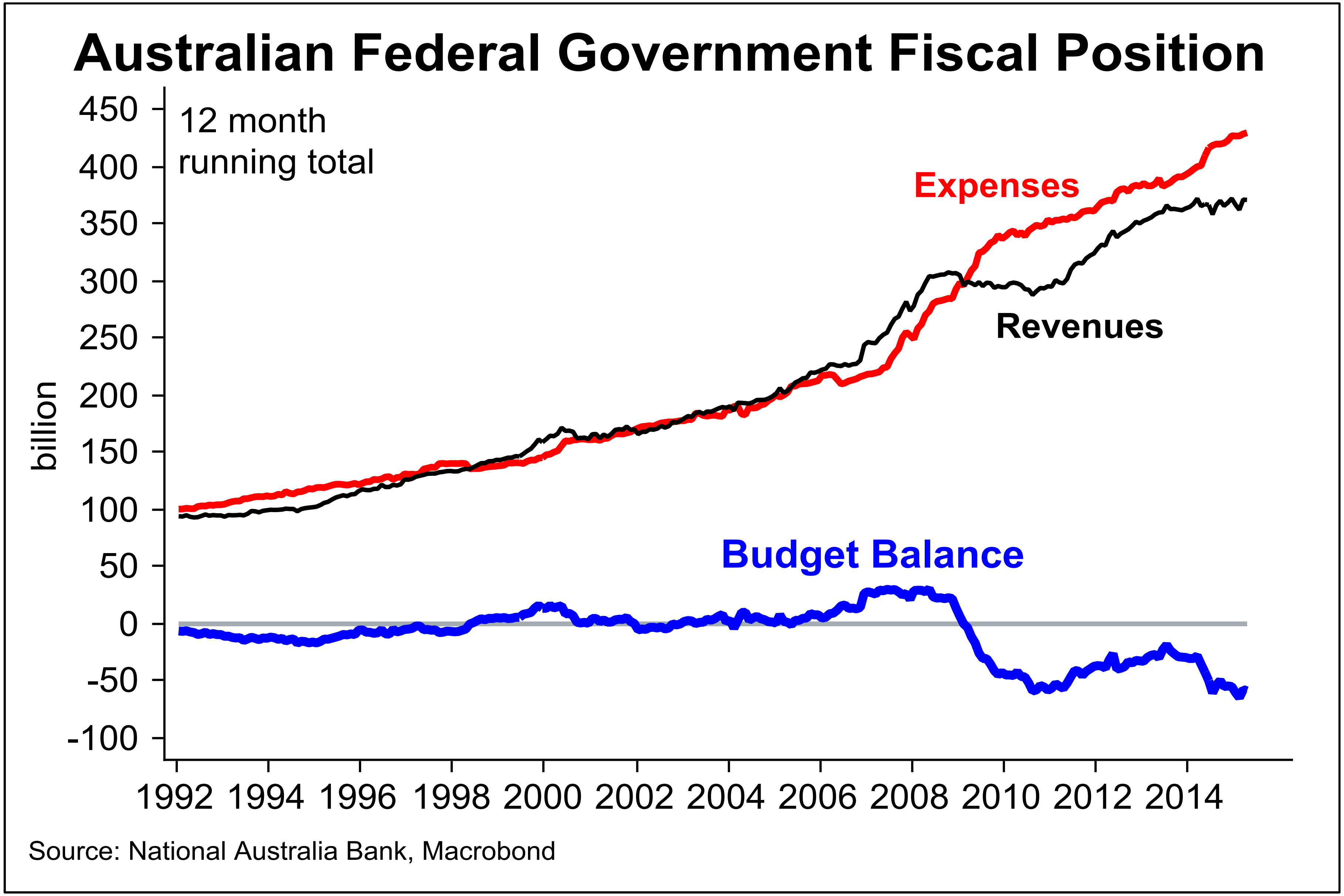
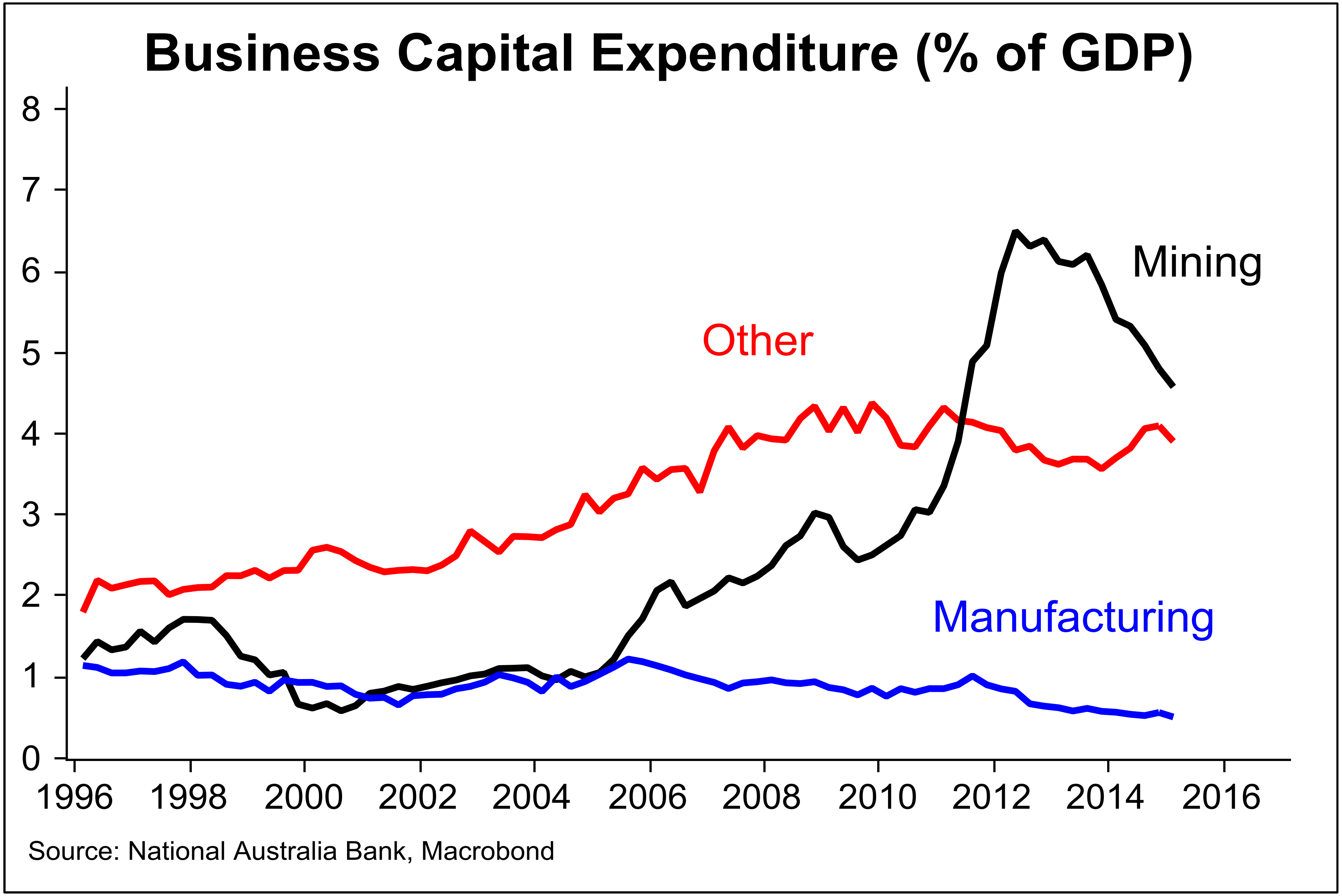
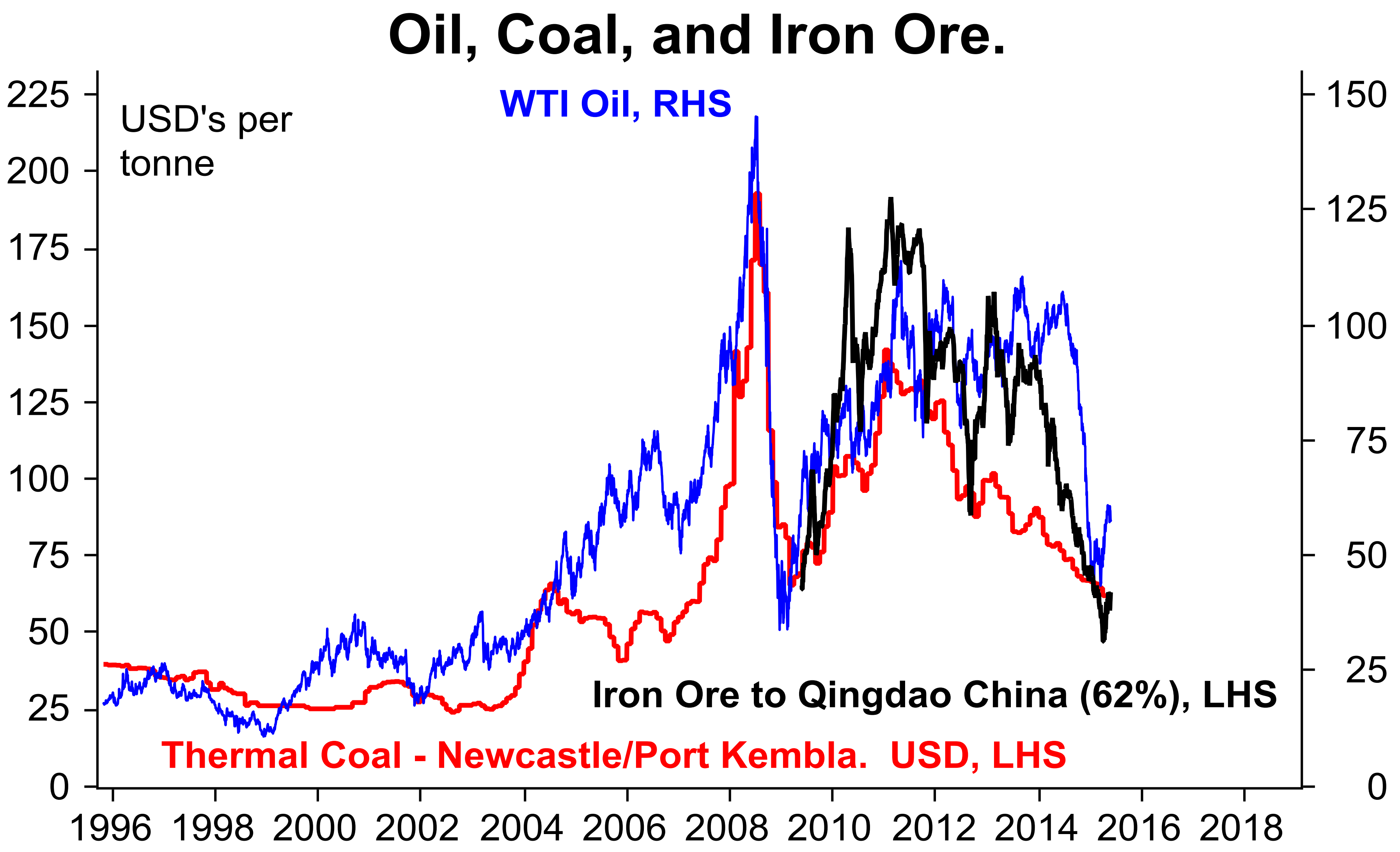
Expenses growth the main issue, but colliding with soft revenue growth due to terms of trade decline and slow wages growth



Completion of major mining projects also a headwind

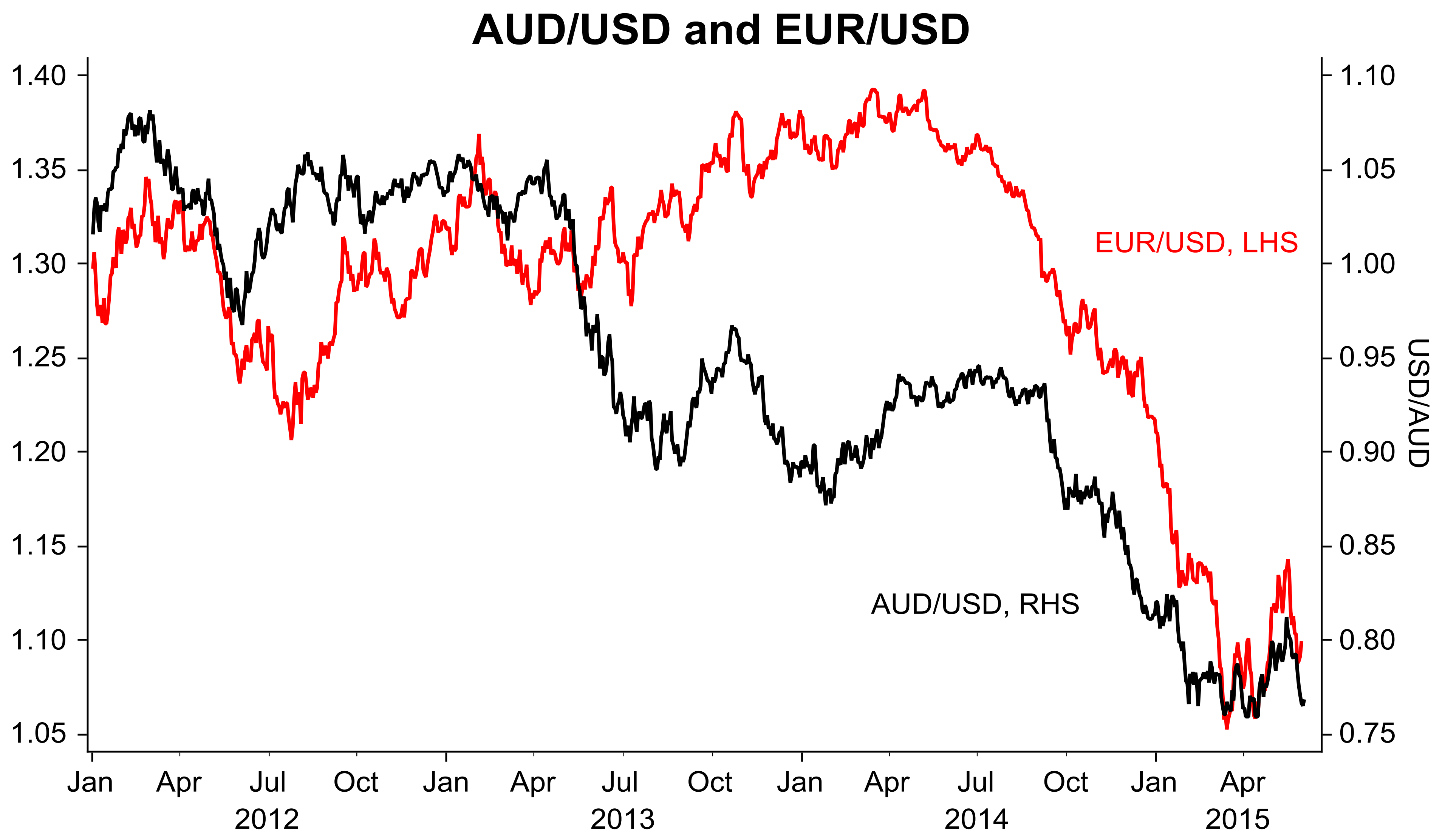


A dramatic fall in oil and iron ore prices – oil prices should boost consumer spending



Source: National Australia Bank Forecasts, Macrobond

Some major currency realignments taking place also – mainly against the US$. Positive medium term for the economy, but a challenge for retailers' pricing?



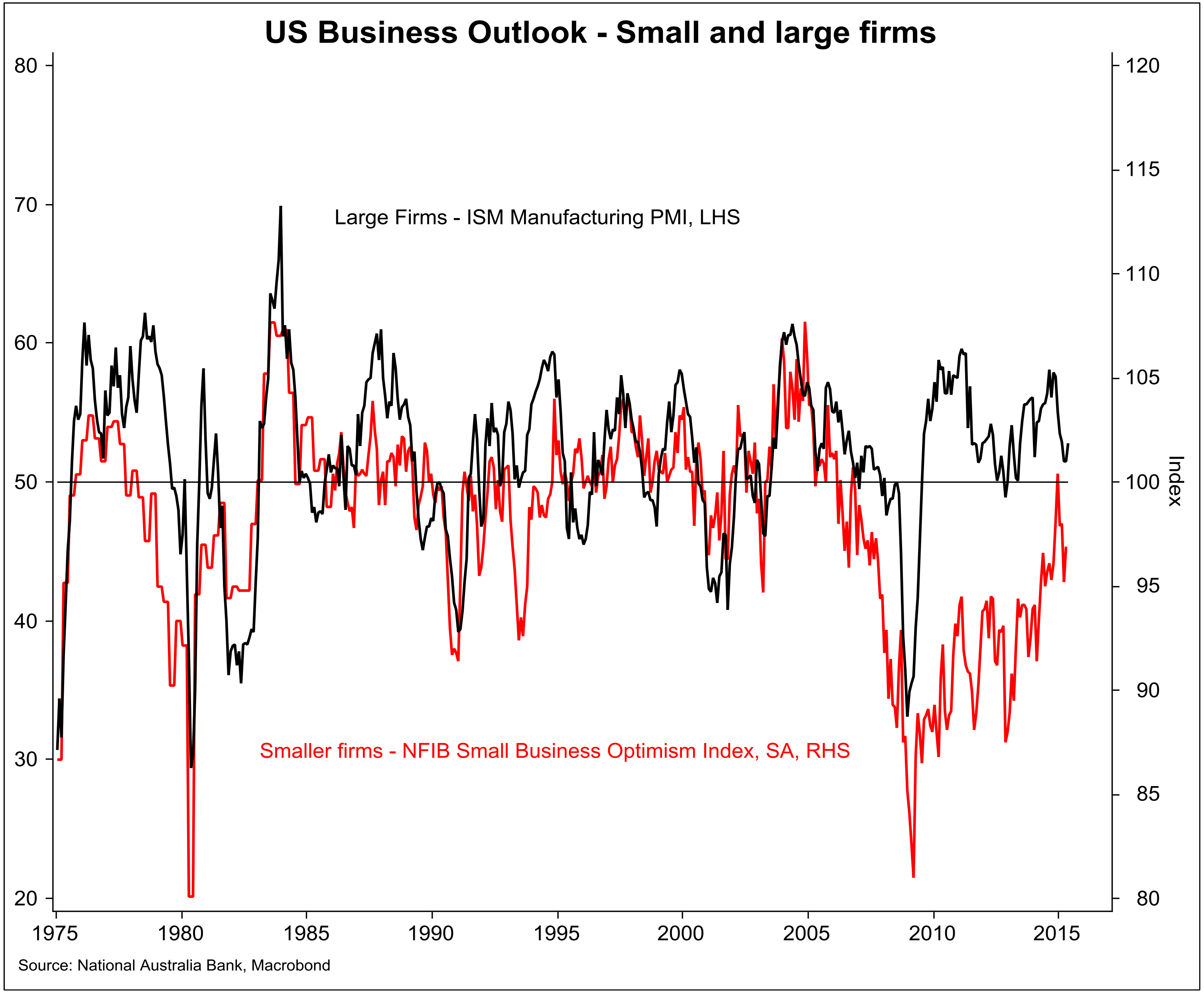
Source: National Australia Bank, Macrobond

Global Growth Forecasts

Global GDP

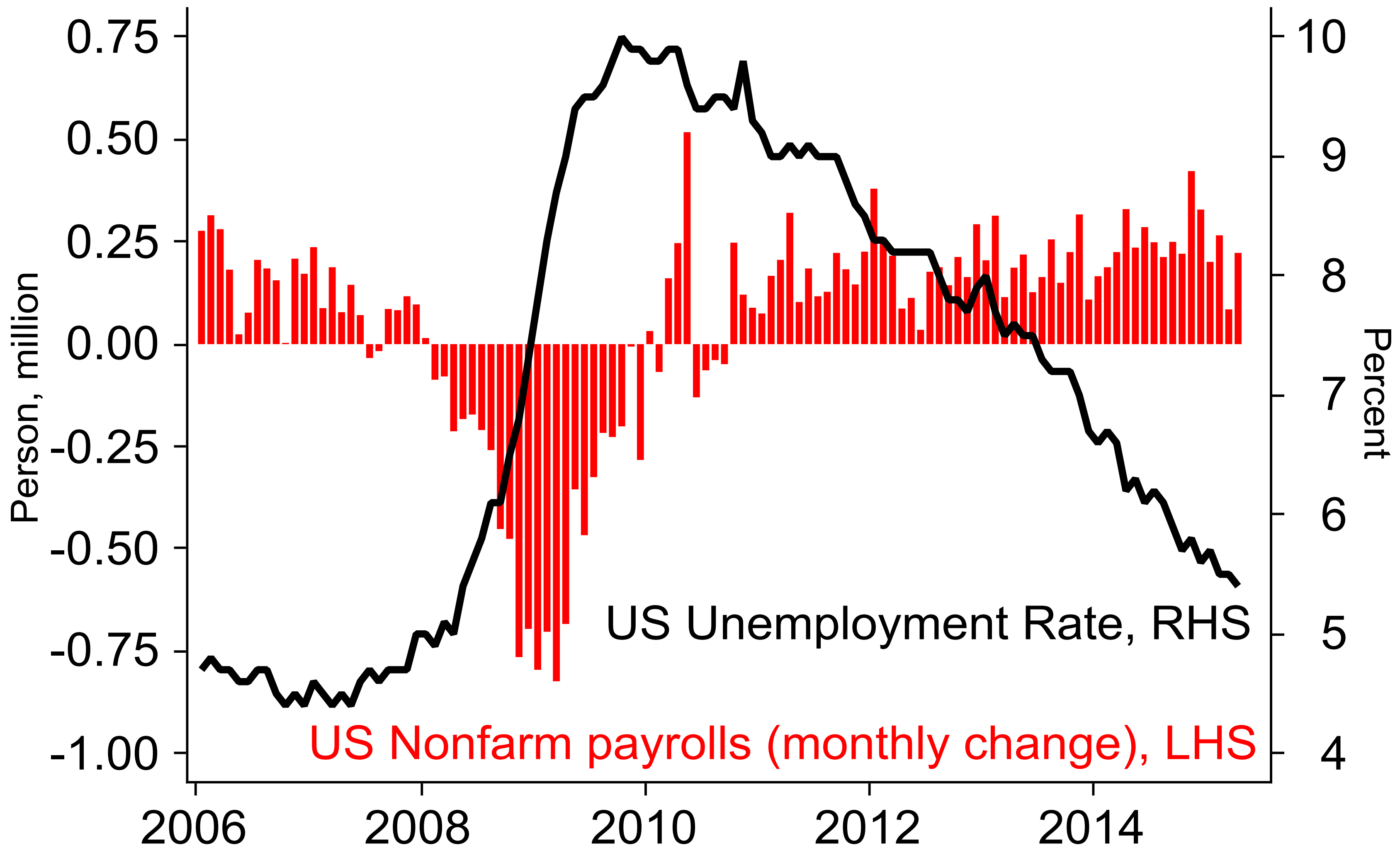
Dec year	2013	2014	2015	2016	20 Yr Avge
Australia	2.1	2.7	2.4	3.2	3.4
US	2.2	2.4	2.5	2.7	2.6
Eurozone	-0.4	0.9	1.4	1.8	1.5
UK	1.7	2.8	2.2	2.4	2.4
Japan	1.6	-0.1	0.8	1.3	0.8
China	7.7	7.4	7.1	6.9	9.2
India	6.3	7.2	7.7	7.9	6.6
New Zealand	2.2	3.3	2.8	2.0	3.0
World	3.3	3.3	3.2	3.4	3.5

US economy improving – small businesses more positive. Complicated by weather, port disruptions and oil spending weakness in recent months



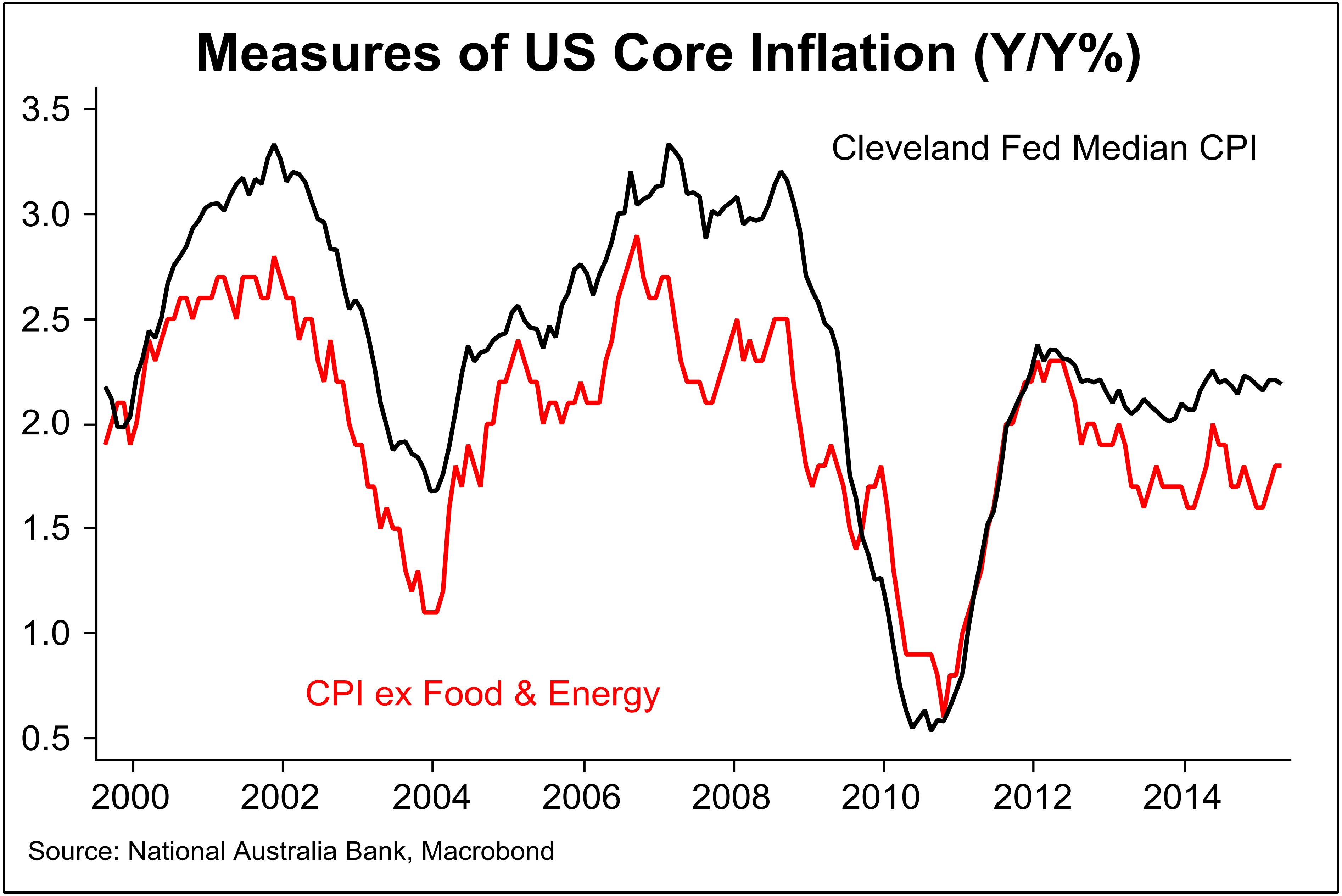
Small firms do 60-70% of the employing in the United States.

Forecast trend for US unemployment a key factor in timing of Fed rate rises: 5-5.5% considered full employment



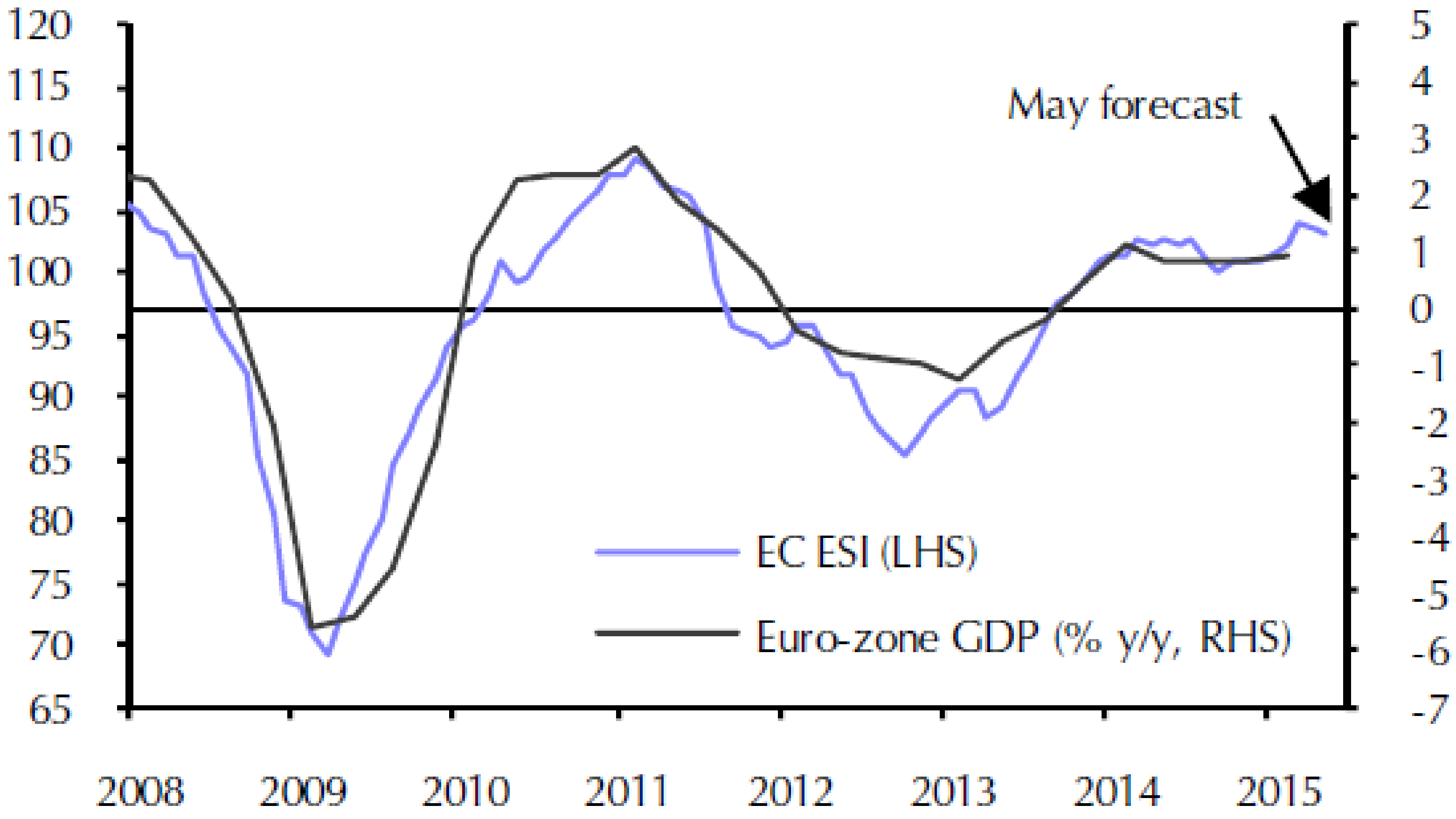
Source: National Australia Bank, Macrobond

Fed also needs to be convinced inflation heading back to 2%



Europe – mildly better data and a lower EUR, but Greek uncertainty still remains

CHART 1: EC ECONOMIC SENTIMENT & EURO-ZONE GDP



Sources – EC, Thomson Datastream

And Greece (and the EU/IMF) have some important deadlines to meet over July-August

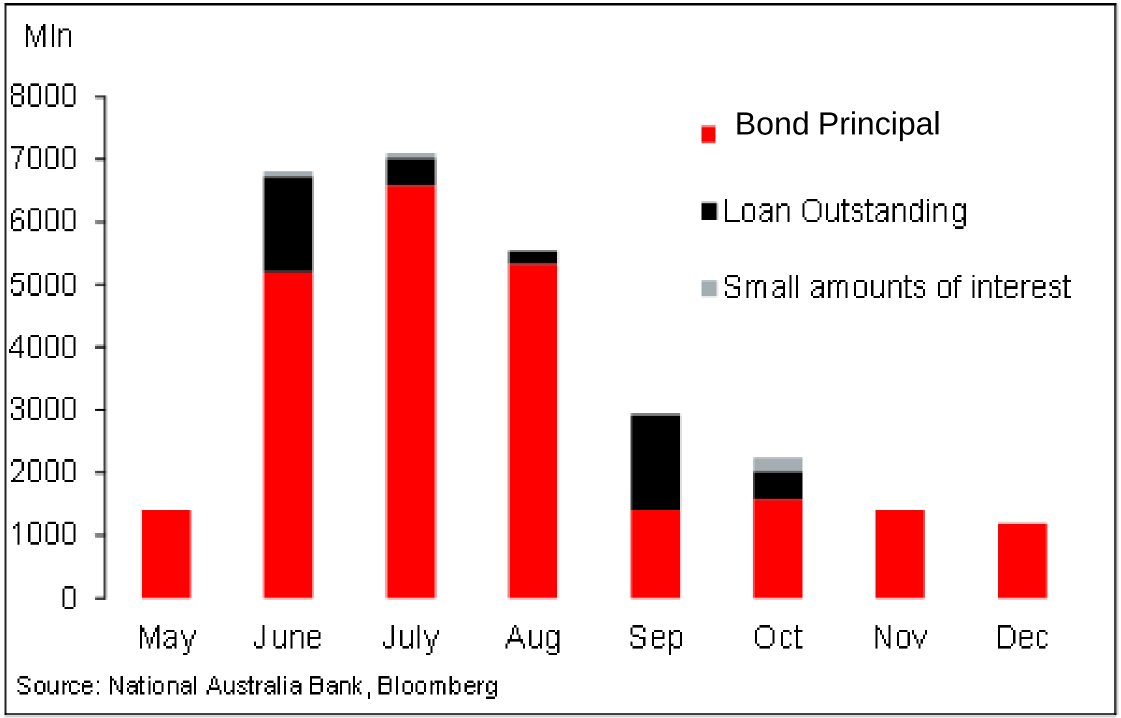
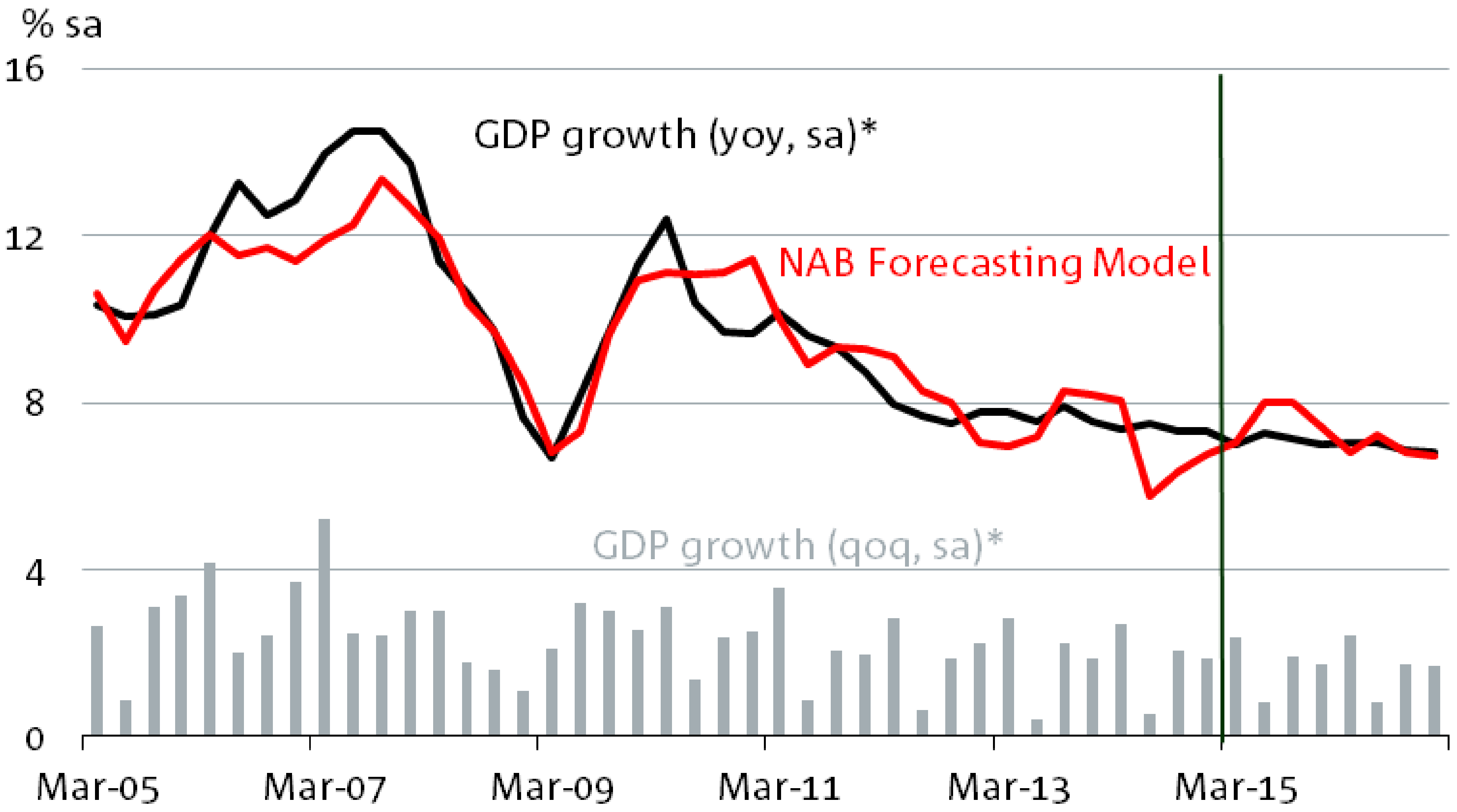


TABLE 1: FORTHCOMING GREEK DEBT PAYMENTS

5th Jun.	IMF repayment €300m
12th Jun.	IMF repayment €350m
16th Jun.	IMF repayment €580m
19th Jun.	IMF repayment €350m
13th Jul.	IMF repayment €460m
20th Jul	ECB redemption €3.6bn
1st Aug	IMF repayment €140m
20th Aug	ECB redemption €3.2bn

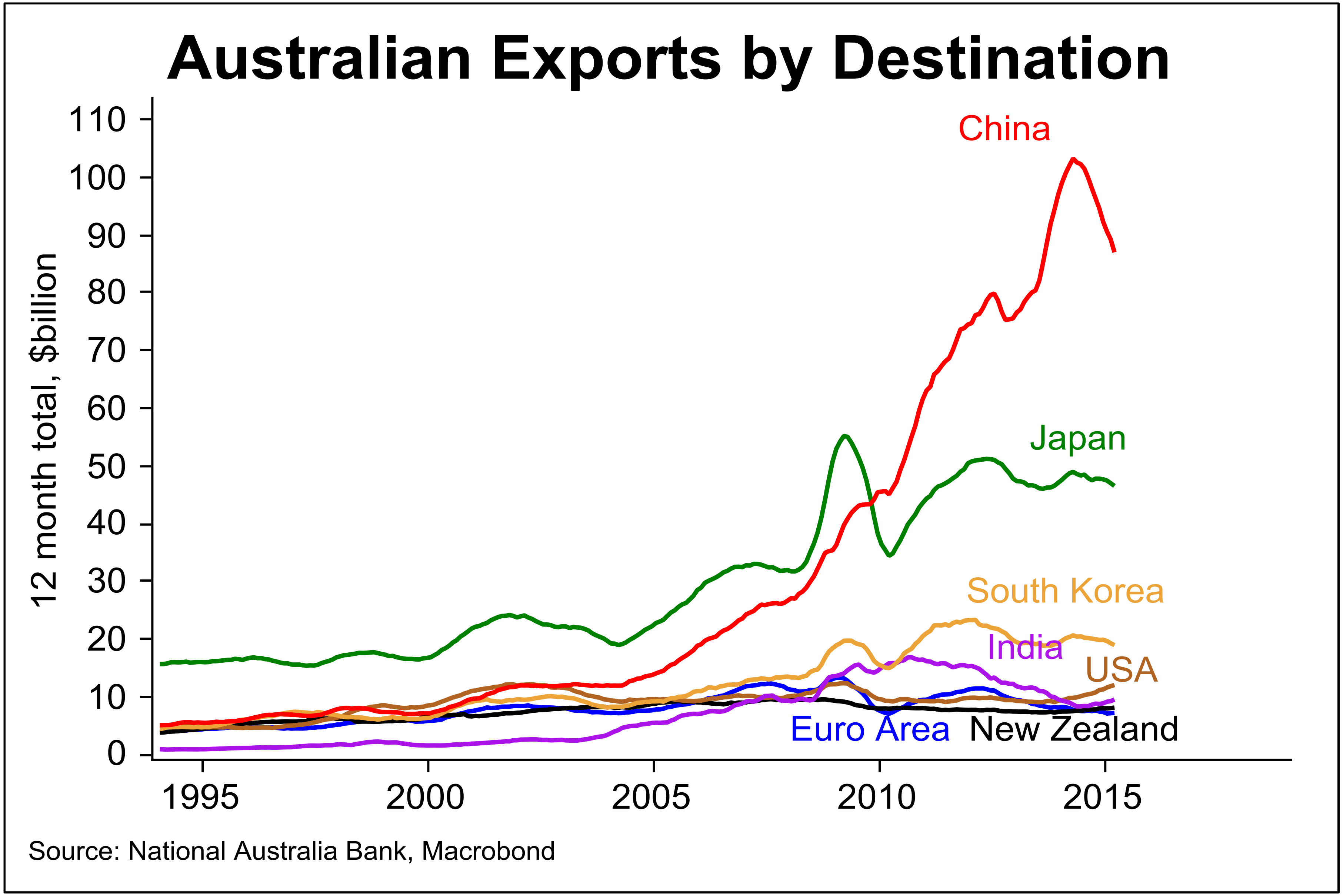
China – GDP slowing trend clearly evident, but 6-7% growth still very quick.



* Seasonally adjusted growth series are estimated by NAB.
Source: CEIC, NAB Economics

Industrial side of China's economy slowing relatively quickly

China and Japan are Australia's biggest export markets…by a large margin



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Major markets for Australia's major exports (2013-14)

Export Destinations by Commodity					
1 Iron ores & concentrates	**$m**	**%**	**6 Gold**	**$m**	**%**
1 China	57,043	76.4	1 China	8,110	61
2 Japan	9,664	12.9	2 Singapore	2,273	17
3 Republic of Korea	6,096	8.2	3 United Kingdom	640	5
4 Taiwan	1,710	2.3	4 Turkey	537	4
5 Indonesia	110	0.1	5 Thailand	445	3
2 Coal	**$m**	**%**	**7 Crude Petroleum**	**$m**	**%**
1 Japan	13,170	33.0	1 No Country Details (mainly China & Japan)	5,254	50.4
2 China	9,311	23.3	2 Thailand	1,632	15.7
3 Republic of Korea	5,216	13.1	3 Singapore	1,609	15.4
4 India	4,955	12.4	4 Republic of Korea	627	6.0
5 Taiwan	2,816	7.0	5 Papua New Guinea	544	5.2
3 Natural Gas*	**$m**	**%**	**8 Beef**	**$m**	**%**
1 Japan	13,174	80.8	1 Japan	1,439	22.4
2 China	2,592	15.9	2 United States	1,360	21.2
3 Republic of Korea	424	2.6	3 Republic of Korea	892	13.9
4 Taiwan	49	0.3	4 China	787	12.3
5 Middle East	49	0.3	5 Indonesia	258	4.0
4 Education Services	**$m**	**%**	**9 Wheat**	**$m**	**%**
1 China	4,142	26.3	1 Indonesia	1,194	19.6
2 India	1,464	9.3	2 Vietnam	496	8.1
3 Vietnam	939	6.0	3 China	484	8.0
4 Republic of Korea	743	4.7	4 Yemen	349	5.7
5 Malaysia	698	4.4	5 Japan	319	5.2
5 Personal Travel Services	**$m**	**%**	**10 Aluminium ores & concentrates**	**$m**	**%**
1 China	1,909	13.8	1 No Country Details (mainly Japan)	5,532	91.0
2 United Kingdom	1,867	13.5	2 China	528	8.7
3 New Zealand	1,334	9.6	3 Republic of Korea	12	0.2
4 United States	1,018	7.3	4 United States	6	0.1
5 Japan	744	5.4	5 Philippines	0	0.0

Source: DFAT, ABS.

* Country shares of LNG from 2014 BP Statistical Review of World Energy

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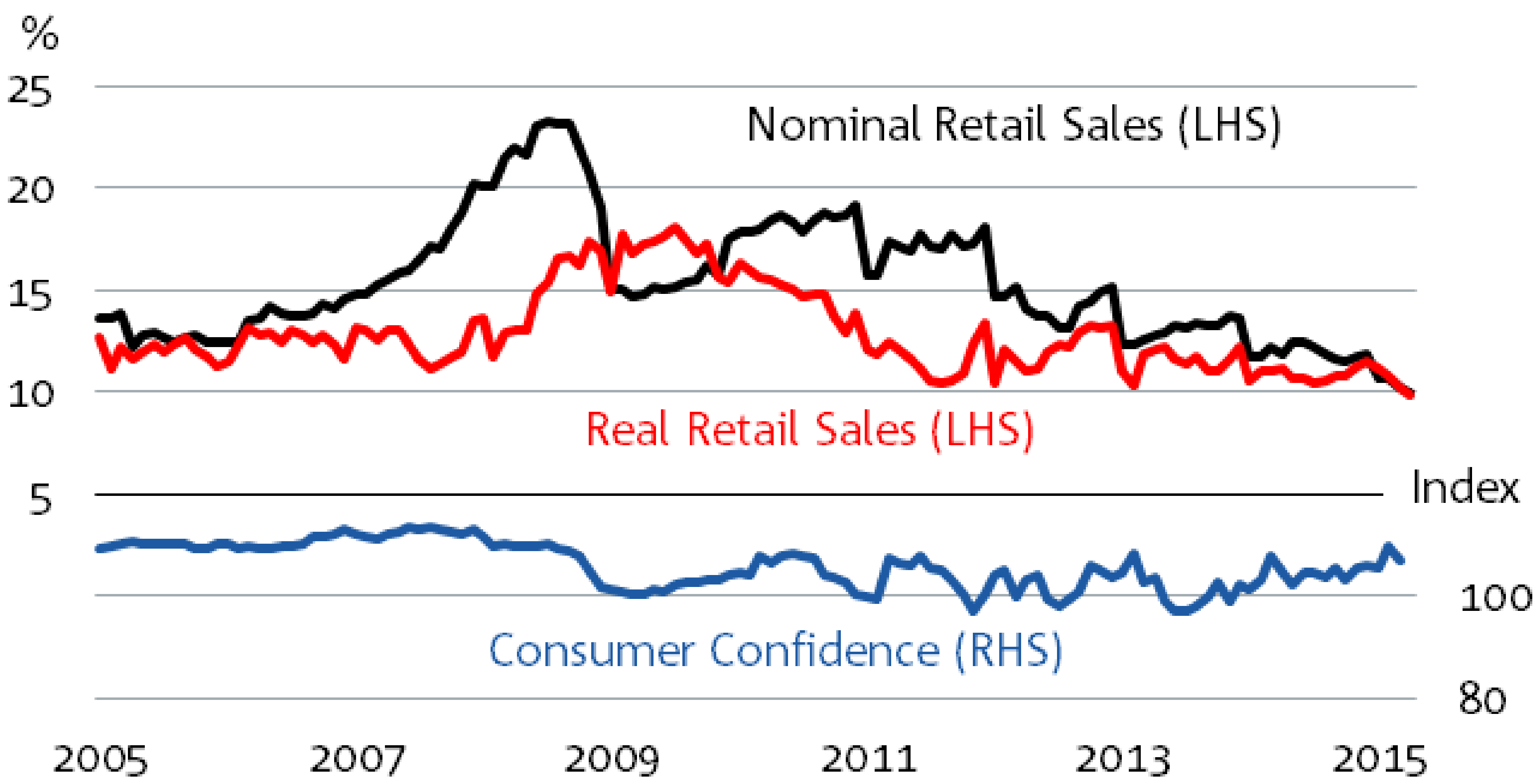
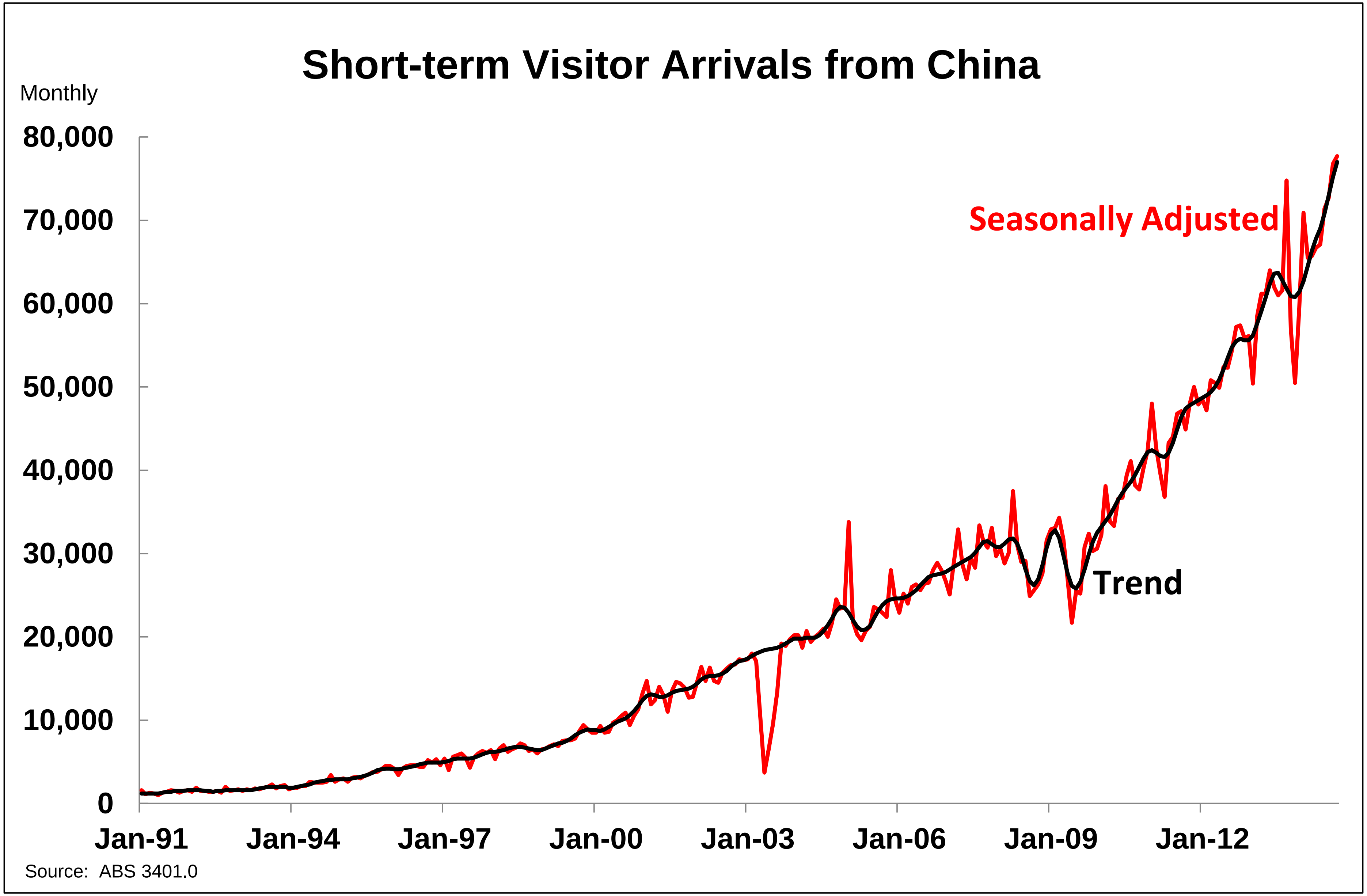
Chinese consumer indicators holding up better, though some question mark over sustainability/influence of recent stock market gains

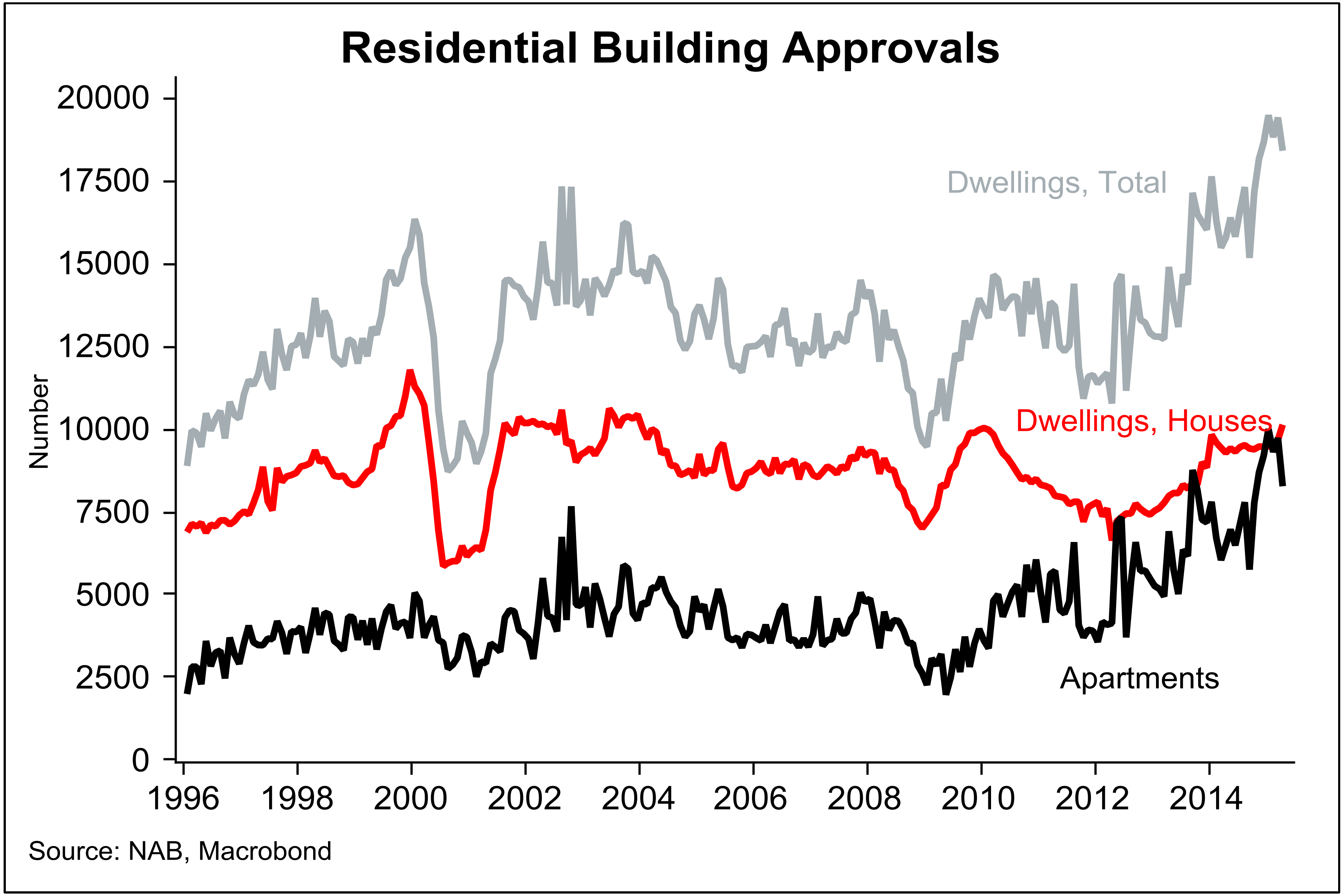


* Adjusted for Chinese New Year effects
Source: CEIC, NAB Economics

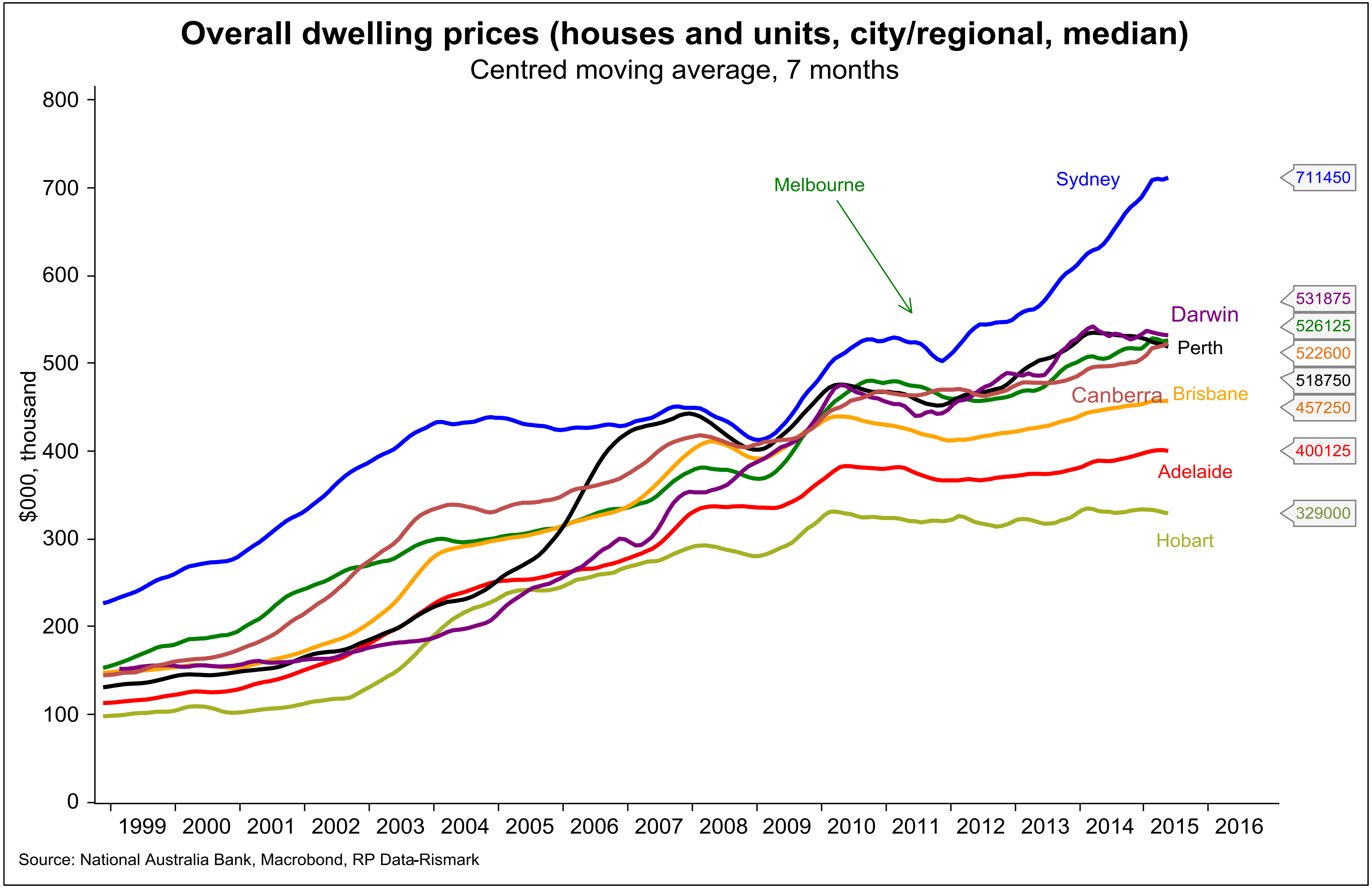
Most Chinese influences on Australia still very positive: e.g. Chinese tourist arrivals to Australia, (housing, education, dairy, wine).



Residential building approvals at record highs



House prices recently have been rising strongly in Sydney



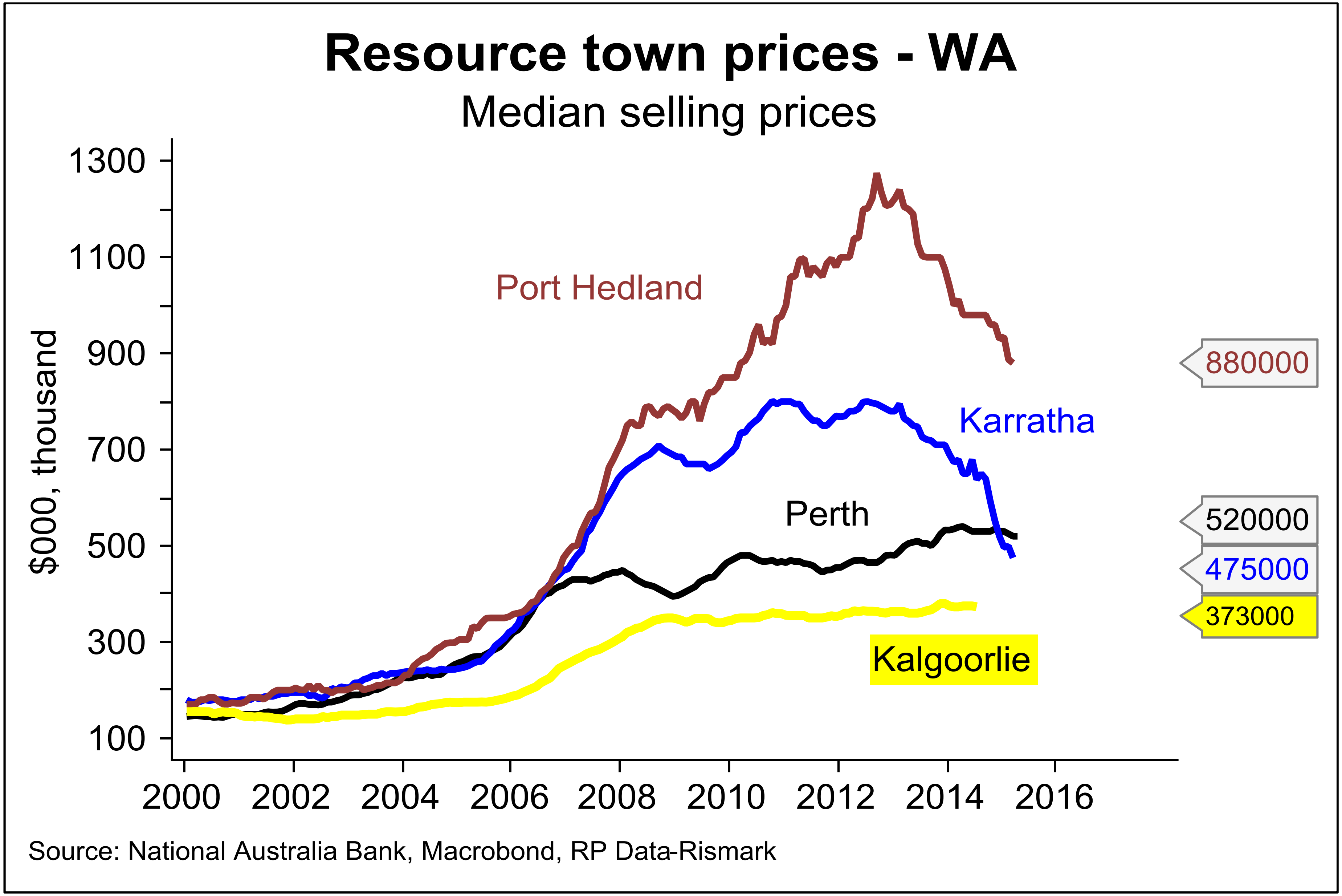
ABC News: Port Hedland house passed in at auction in million-dollar dive, sign mining boom over

PHOTO: The Port Hedland house was bought for $1.3 million in 2011. (Jan Ford Real Estate)

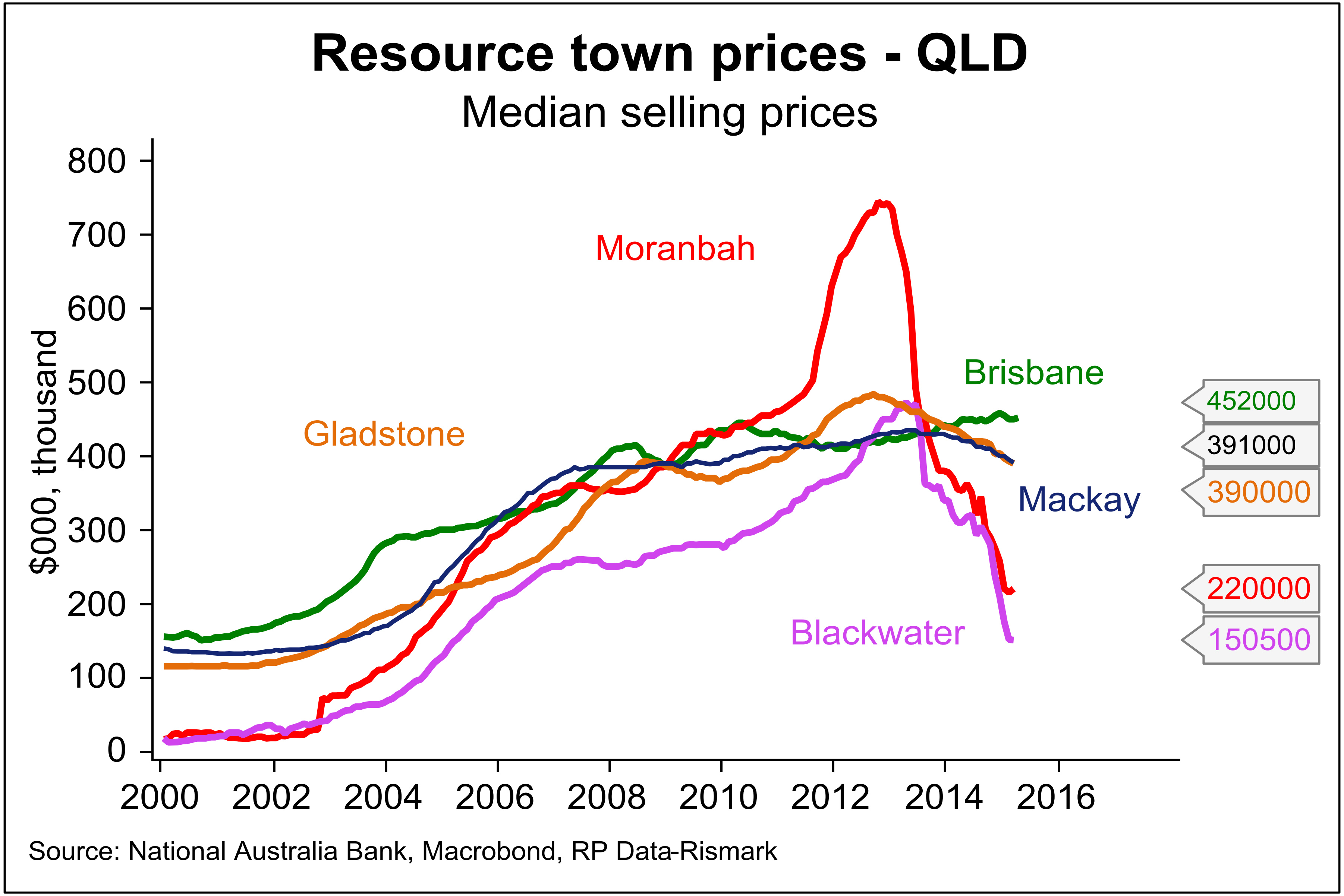
A house in the mining town of Port Hedland has been passed in at auction for $360,000 after it was bought four years ago for $1.3 million.

MAP: Port Hedland 6721

Definitely some overvaluation in mining towns, now unwinding

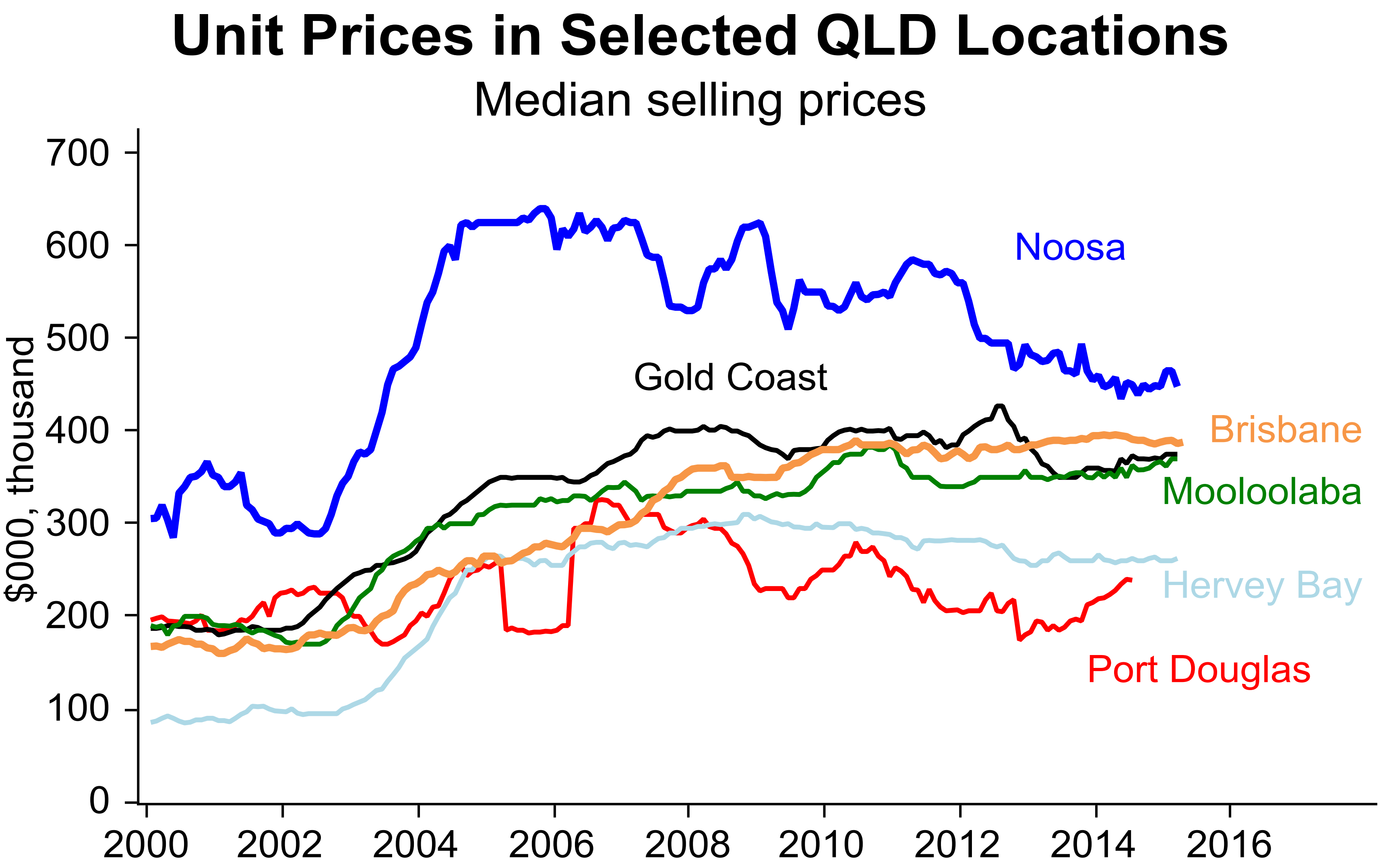


Ditto



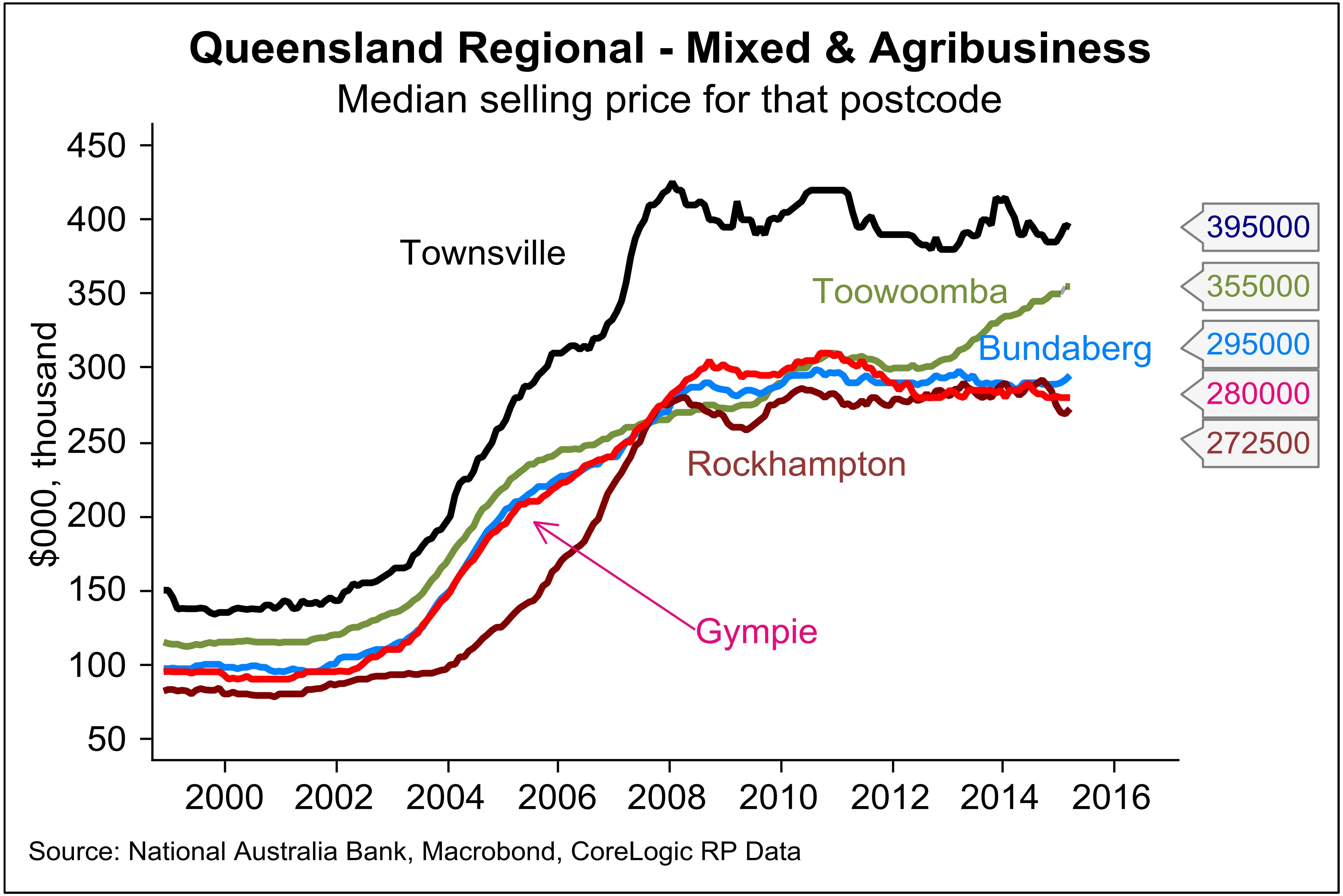
Resource town prices - QLD
Median selling prices
$000, thousand
800
700
600
500
400
300
200
100
0
2000
2002
2004
2006
2008
2010
2012
2014
2016
Moranbah
Brisbane
Gladstone
Mackay
Blackwater
452000
391000
390000
220000
150500
Source: National Australia Bank, Macrobond, RP Data-Rismark

Tourism/lifestyle locations flat or weaker in price post GFC

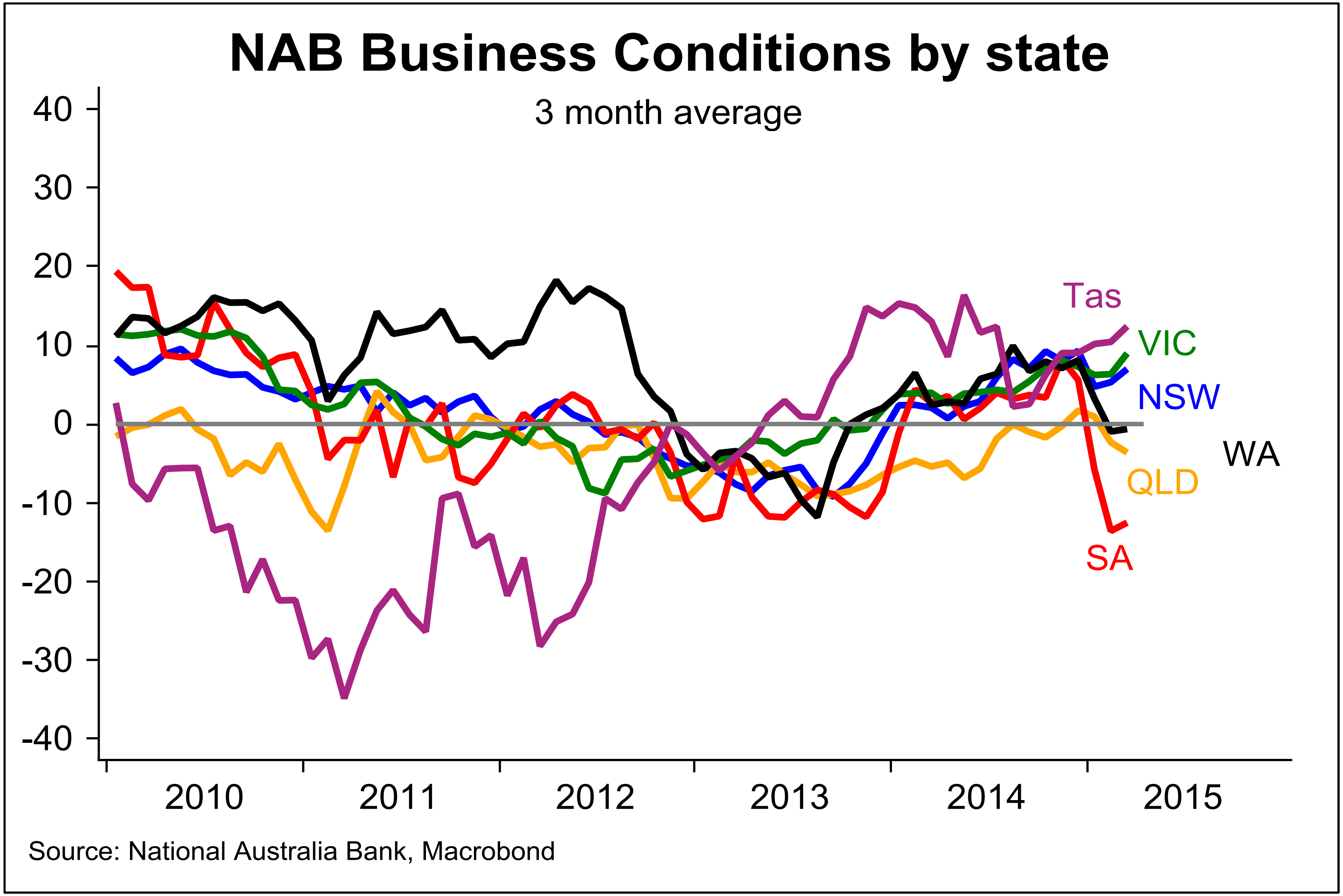


Source: National Australia Bank, Macrobond, RP Data-Rismark

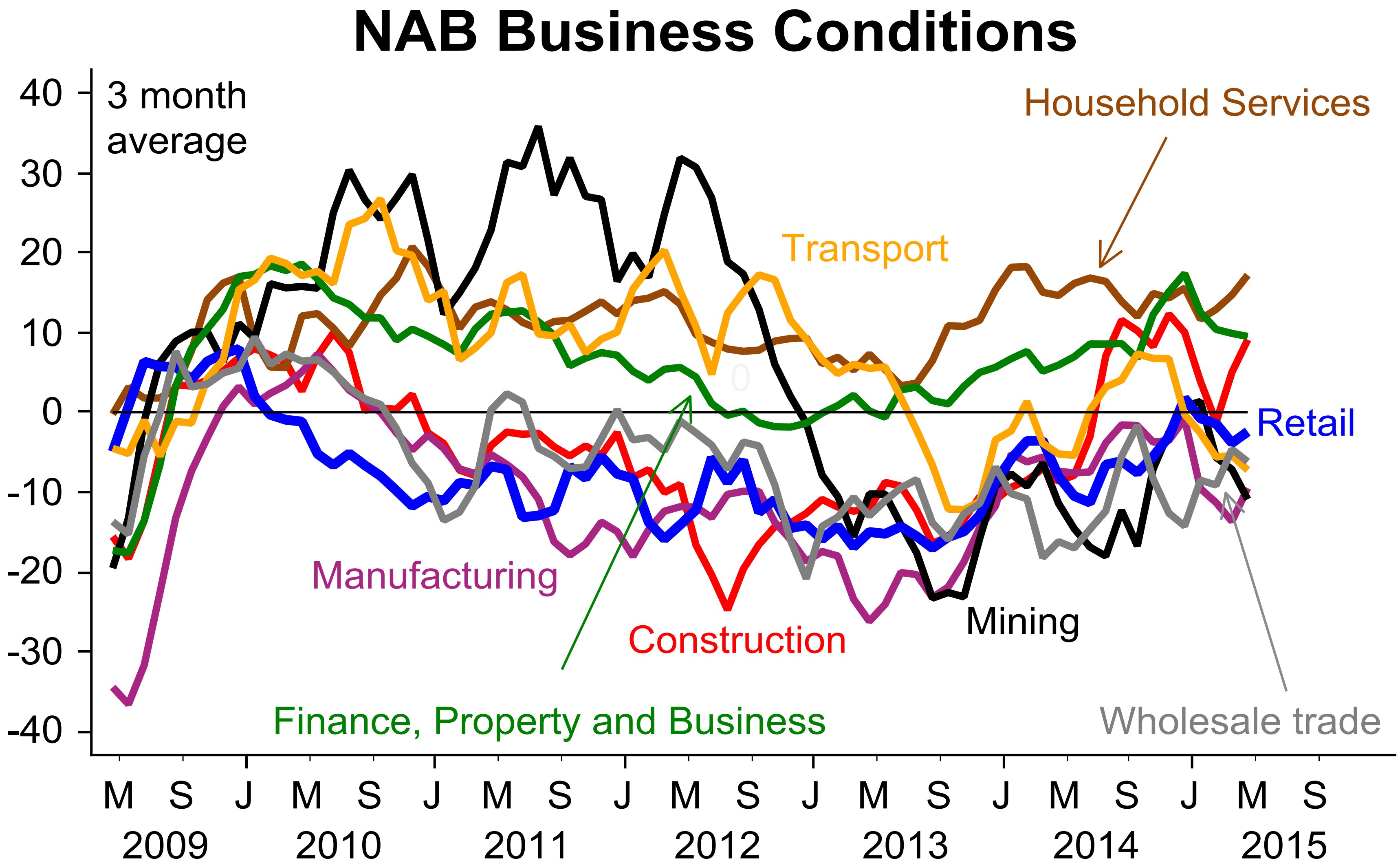
Mixed and Agribusiness areas generally flat since the GFC



Non-mining states recovering – mining underperforming. QLD has improved in recent months. WA and SA weak (SA not quite as weak as suggested by below)

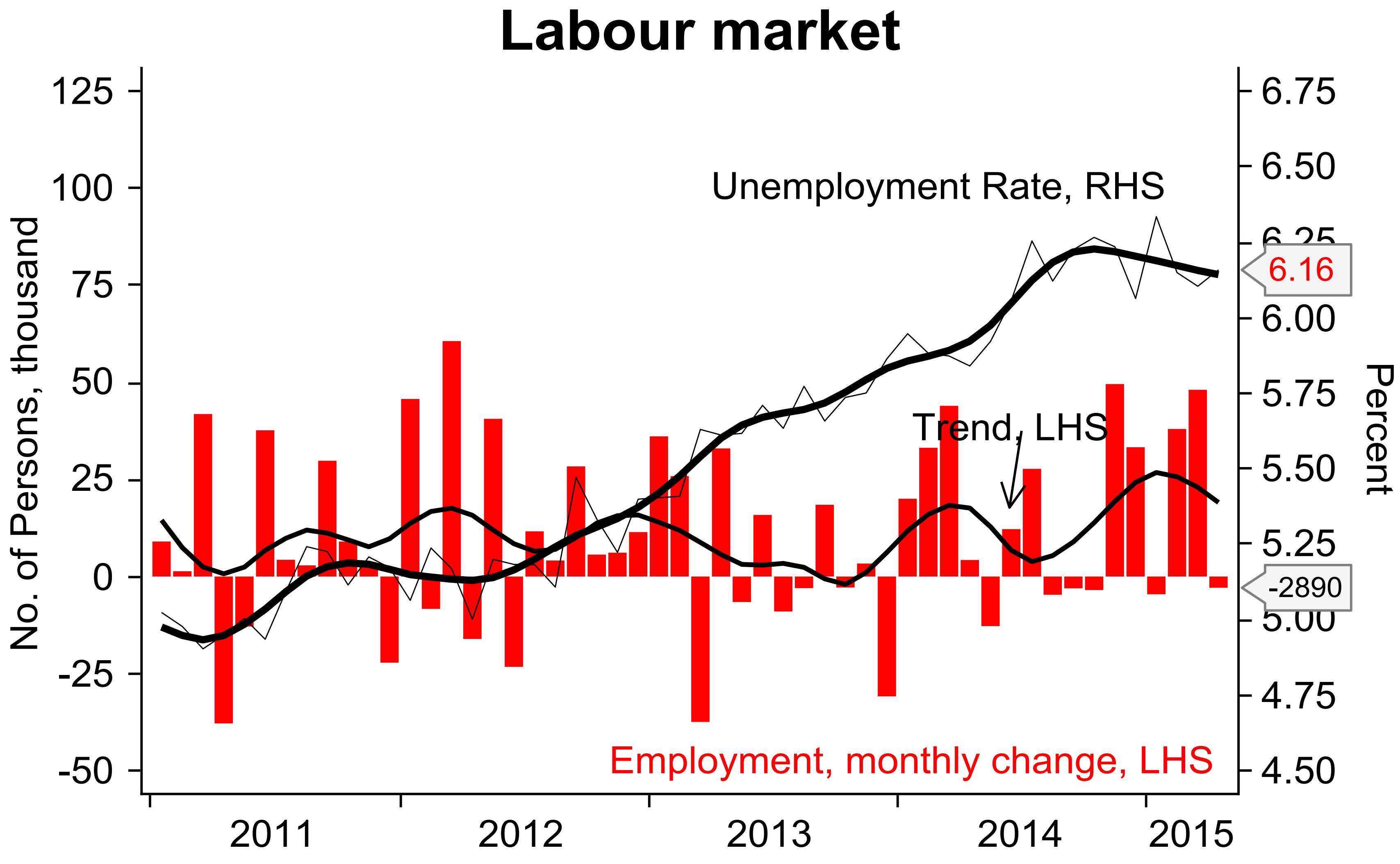


Construction (apartments) better, services strong; retail has improved a little



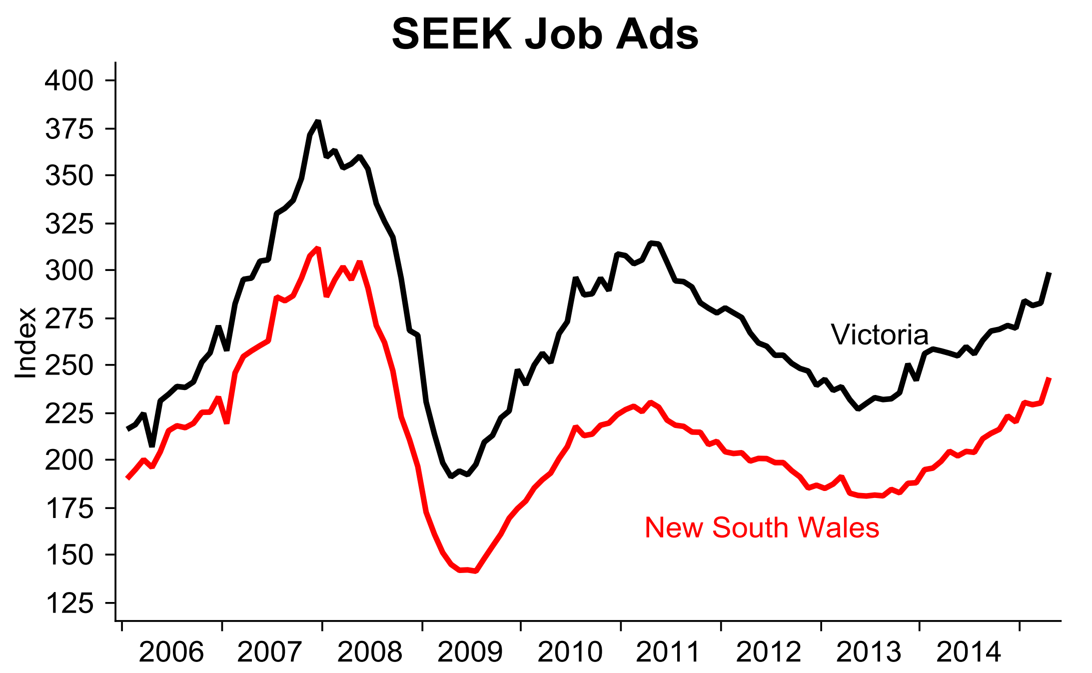
Source: National Australia Bank, Macrobond

Employment +19K trend; unemployment -0.6K trend. Encouraging. NAB forecasting a 6.4% unemployment peak.

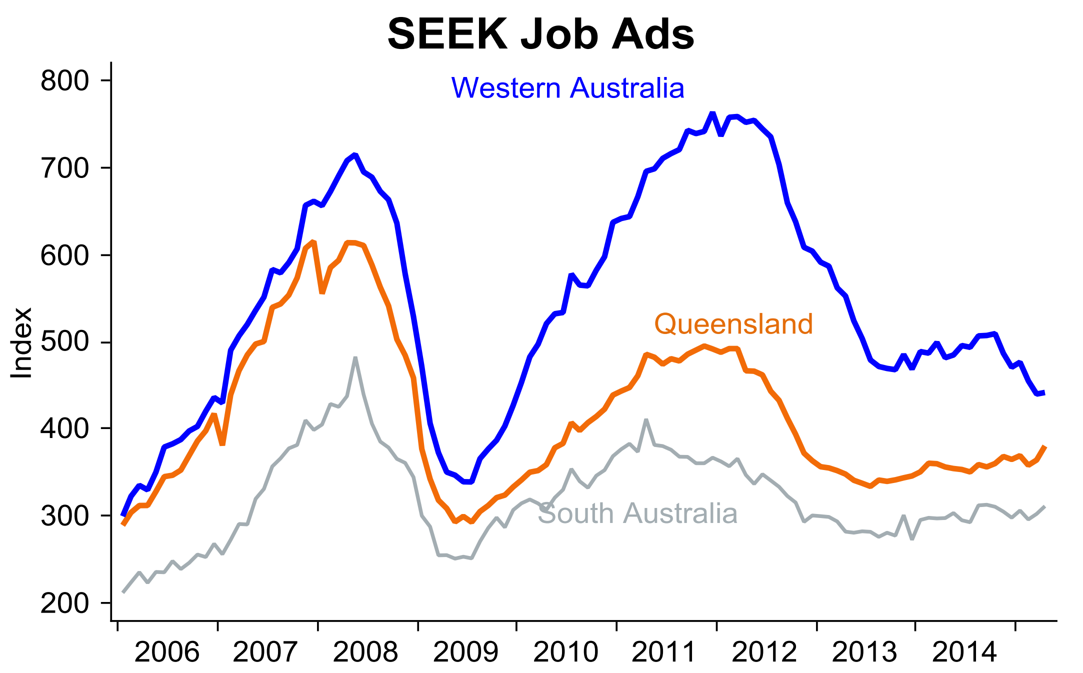


Source: National Australia Bank, Macrobond

SEEK jobs ads by state – NSW/Vic solid improvement; QLD very modest; WA weak

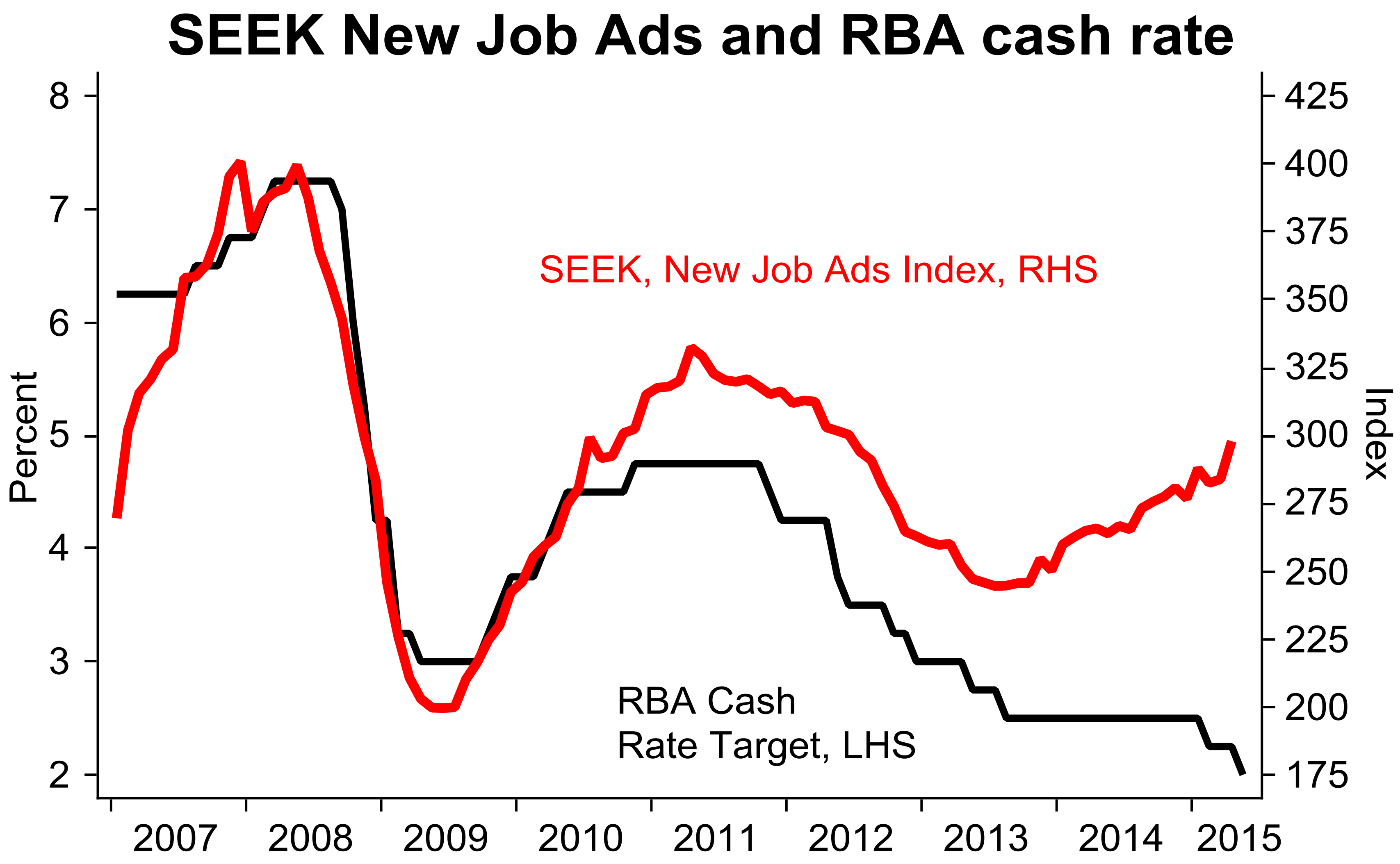


Source: National Australia Bank, Macrobond



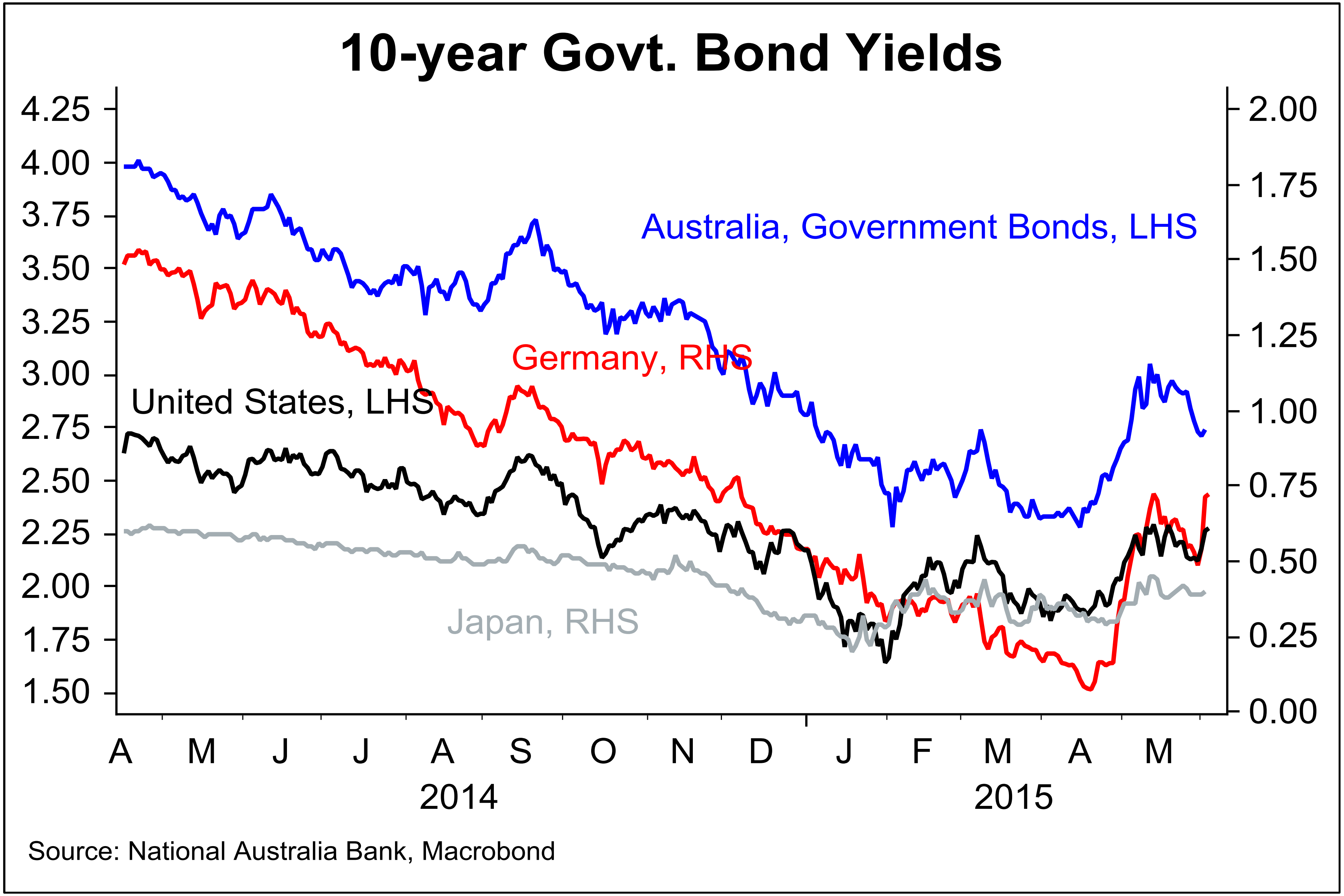
Source: National Australia Bank, Macrobond

Seek jobs ads trending higher – again pace is relatively slow, but trend is usually more consistent with rate rises



Source: National Australia Bank, Macrobond

Australian longer-term interest rates are determined globally. QE and low/negative interest rates in Europe, US and Japan have been important



Key views

- Many diverse forces continuing to impact on Australian economy and businesses.
- Non-mining growth to strengthen in H2 2015 and 2016 due to lower rates, lower $A, lower oil prices, and stronger US economy (despite much weaker mining investment and lower terms of trade).
- $A to continue to fall: US$0.74 end 2015 (risk lower if US$ continues to strengthen).
- RBA to now remain on hold for an extended period
- 3-year swap rate to rise to 2.5% at end-2015 as US Fed begins to tighten
- Increased volatility a risk in markets (especially currencies) as Fed tightens

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Key Forecasts

Forecasts

Economics - yoy%	2013	2014	2015	2016
Household Consumption	1.7	2.5	2.7	2.9
Business Investment	-4.5	-6.1	-8.5	-9.9
Domestic demand	0.4	1.2	0.9	1.2
Net Exports (a)	1.6	1.7	2.0	1.9
Real GDP	2.1	2.7	2.4	3.2
CPI	2.4	2.5	1.8	3.1
Underlying CPI	2.4	2.6	2.4	2.7
Wages	2.9	2.5	2.4	2.4
Terms of Trade	-3.9	-7.5	-8.4	-1.2
Unemployment rate (%)	5.7	6.0	6.3	6.3
Current Account - % GDP	-3.3	-2.8	-2.9	-1.3
Fiscal Balance* - % GDP	-1.3	-3.2	-1.8	-0.8

Markets /Rates	28 Apr	Jun 15	Sep 15	Dec 15	Mar 16	Jun 16
RBA Cash	2.25	2.3	2.0	2.0	2.0	2.0
3 Year Swap	2.2	2.2	2.4	2.4	2.6	2.7
10 Year Swap	2.9	3.0	3.2	3.1	3.4	3.4
10 year ACGB	2.5	2.6	2.8	2.8	3.0	3.0
Aus-US 10yr bond	58	35	30	25	20	20
Fed Funds Rate	0.3	0.25	0.50	0.75	0.75	1.25
US 10 Year Bond	1.9	2.25	2.50	2.50	2.75	2.75
AUD	0.785	0.78	0.76	0.74	0.73	0.73
AUD/NZD	1.03	1.08	1.07	1.06	1.06	1.07
AUD/JPY	93.5	96	94	93	92	92
AUD/EUR	0.72	0.76	0.75	0.74	0.73	0.72
AUD/GBP	0.52	0.55	0.55	0.56	0.55	0.54
AUD/CNY	4.9	4.9	4.8	4.6	4.5	4.5

Source: Bloomberg; NAB. * June fiscal year
a. contribution to annual GDP. Inventories and statistical discrepancy not shown

Currency forecasts

	28/04/2015	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Majors								
AUD/USD	0.7854	0.78	0.76	0.74	0.73	0.73	0.75	0.75
NZD/USD	0.7639	0.72	0.71	0.70	0.69	0.68	0.67	0.66
USD/JPY	119.10	123	124	125	126	126	127	127
EUR/USD	1.09	1.03	1.02	1.00	1.00	1.01	1.02	1.03
GBP/USD	1.5226	1.41	1.38	1.33	1.33	1.35	1.36	1.37
USD/CHF	0.9555	1.01	1.02	1.05	1.06	1.05	1.05	1.04
USD/CAD	1.2095	1.25	1.24	1.22	1.21	1.20	1.19	1.18
USD/CNY	6.2200	6.28	6.25	6.20	6.20	6.18	6.15	6.15
AUD Crosses								
AUD/NZD	1.0281	1.08	1.07	1.06	1.06	1.07	1.12	1.14
AUD/JPY	93.54	96	94	93	92	92	95	95
AUD/EUR	0.7221	0.76	0.75	0.74	0.73	0.72	0.74	0.73
AUD/GBP	0.5158	0.55	0.55	0.56	0.55	0.54	0.55	0.55
AUD/CHF	0.7504	0.79	0.78	0.78	0.77	0.77	0.79	0.78
AUD/CAD	0.9499	0.98	0.94	0.90	0.88	0.88	0.89	0.89
AUD/SGD	1.0431	1.08	1.05	1.01	0.99	0.99	1.01	1.01
AUD/KRW	842.74	905	897	888	876	869	885	885
AUD/CNY	4.8852	4.90	4.75	4.59	4.53	4.51	4.61	4.61