
Global Overview

&

Australia

**– where to now for the multi speed
economy**

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The global economic story

Global Overview

- Overall GDP growth still below trend - similar to 2012
- Returning to near trend growth in 2014. Developed world doing better. But emerging slowing

EUROPE

- Still very depressed – with unemployment high and rising – particularly in Spain & Greece. But recession may be bottoming out

USA

- Better fundamentals with moderate, if choppy, growth
- Timing of withdrawal of stimulus causing volatility in equity / rates / currency markets Tapering delayed till march 2014.
- Assuming fiscal shutdown & debt ceiling get solved eventually

JAPAN

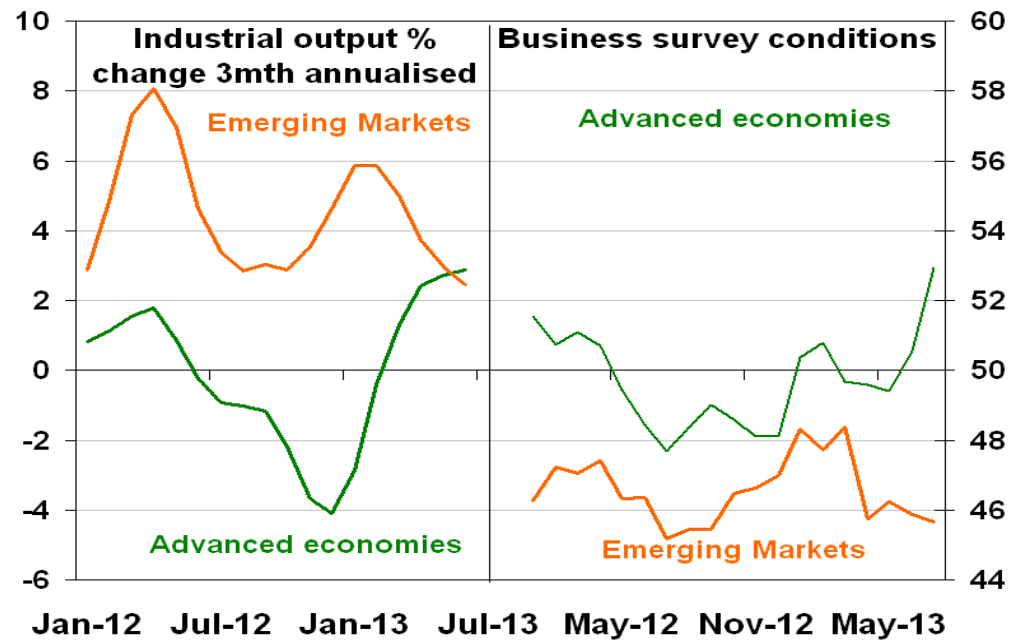
- New stimulus packages implemented – with Abe now in driving seat politically. QE weakened Yen and has driven up equities. The bright spot!!

CHINA

- Focus on quality of growth rather than quantum
- Growth still robust but rapid pace of previous years over

Are we seeing the start of a rotation in global growth drivers

Advanced and Emerging Economies Business Indicators



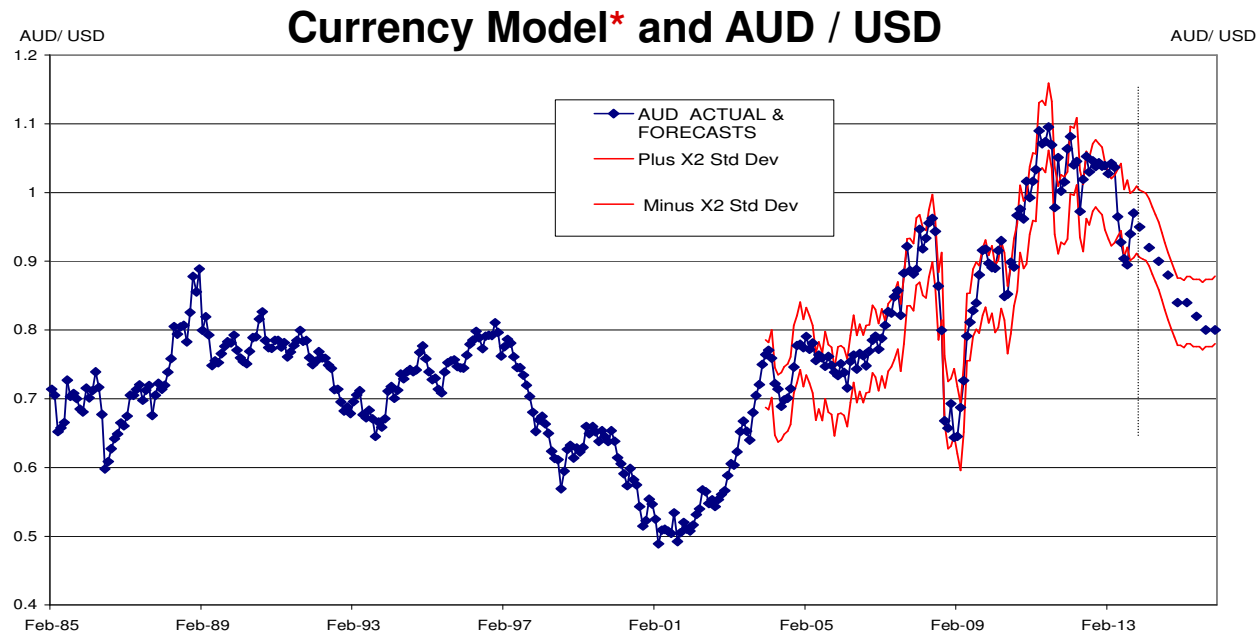
Global economic forecasts. Nearly back to trend growth in 2014.

| | 2012 | 2013 | 2014 | 2015 |
|-----------------------|------------|------------|------------|------------|
| World | 3.1 | 2.9 | 3.6 | 3.6 |
| United States | 2.8 | 1.6 | 2.7 | 2.9 |
| Euro zone | -0.6 | -0.5 | 1.3 | 1.6 |
| Japan | 1.9 | 1.9 | 2.3 | 1.7 |
| China | 7.8 | 7.5 | 7.2 | 7.0 |
| Asian Tigers | 3.8 | 3.6 | 3.7 | 4.2 |
| India | 5.1 | 4.4 | 4.6 | 4.9 |
| Aust Trading Partners | 4.2 | 4.0 | 4.2 | 4.2 |

Global developments have been key drivers of the currency

- In recent years central banks have been big drivers of the AUD as a diversity play – Australia seen as a play on China in a AAA environment
- Most of those big portfolio adjustments now done
- A recent concern is when will the Fed will start to “taper” its QE. The key focus is, if its soon, the US economy is better than you think and hence buy USD and sell yield currencies. Lots of shorts on AUD
- Fed surprised not starting tapering in September. Now expect tapering to start in March 2014
- Recent China data more reassuring but Australian data still weak. Market now more in line with model based forecasts.

Currency model still indicative. Post tapering (March) suggests moderately lower AUD (commodities & USD).



Forecasts:

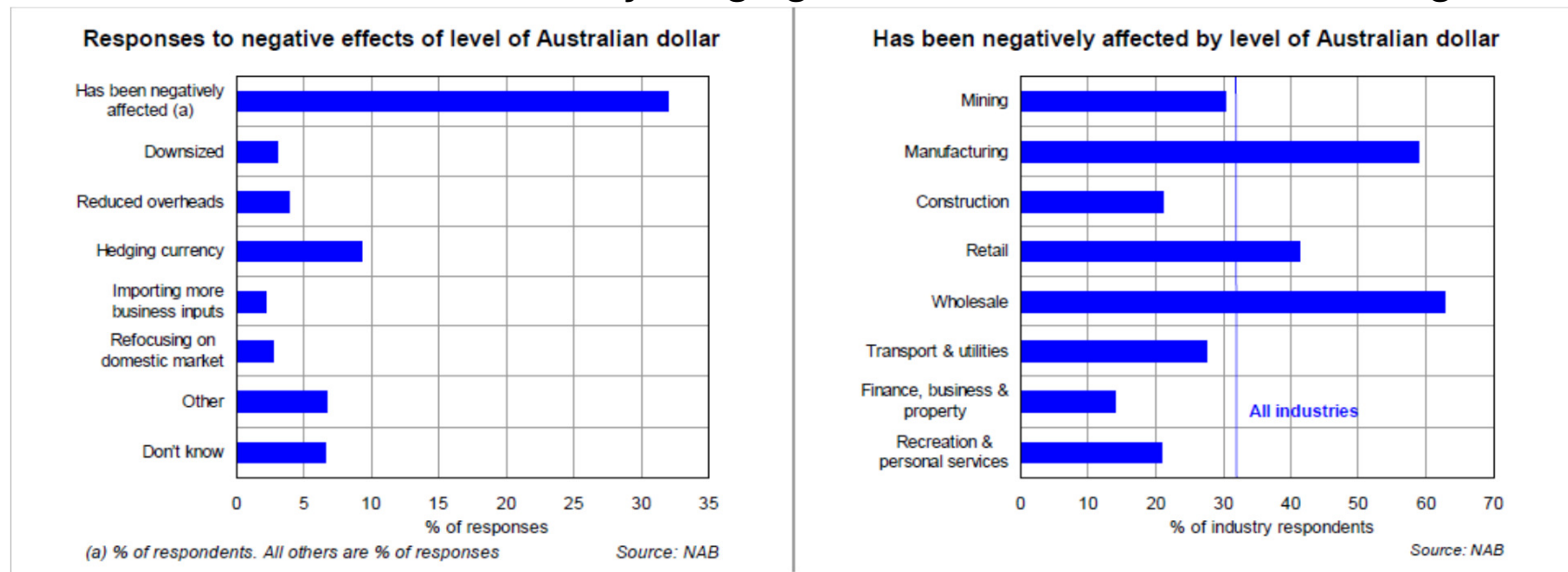
End 2013 = 95c AUD/USD

End 2014 = 86c AUD/USD

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

Currency has negatively effected around 30% of firms especially wholesale, manufacturing, retail and mining

Reactions varied but dominated by hedging – and to lesser extent downsizing & costs



* Data derived from a special question in the quarterly NAB business survey, in collaboration with the Commonwealth Department of Industry.

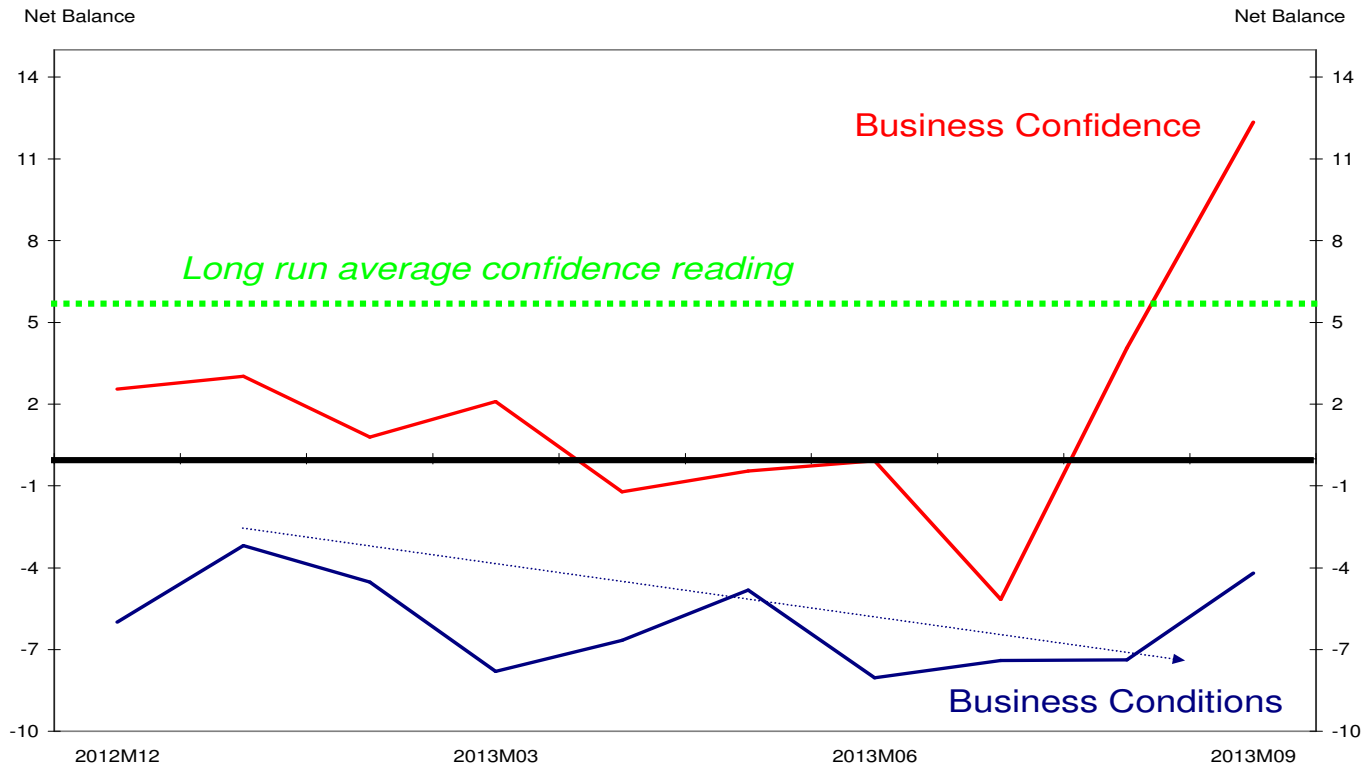
Where to now for Australia?

- **Political change & prospect of a more stable policy framework has helped confidence**
 - Key question is will it last or will weaker activity drag confidence back down
- **Domestic economy still sub par and grinding lower**
 - Business conditions still below trend
 - Labour market deteriorating
 - Forward orders restrained but confidence better
 - Lower rates are lifting house prices (esp., Sydney & Melbourne) but consumers continue to de-leverage and saving rates are near GFC levels
- **Multi-speed nature is still very apparent**
 - Weak sectors, like retail and manufacturing, at or near recessionary levels
 - Mining and mining services especially weak
 - Consumer spending on services the key (but important) bright spot.

Where to now for Australia?

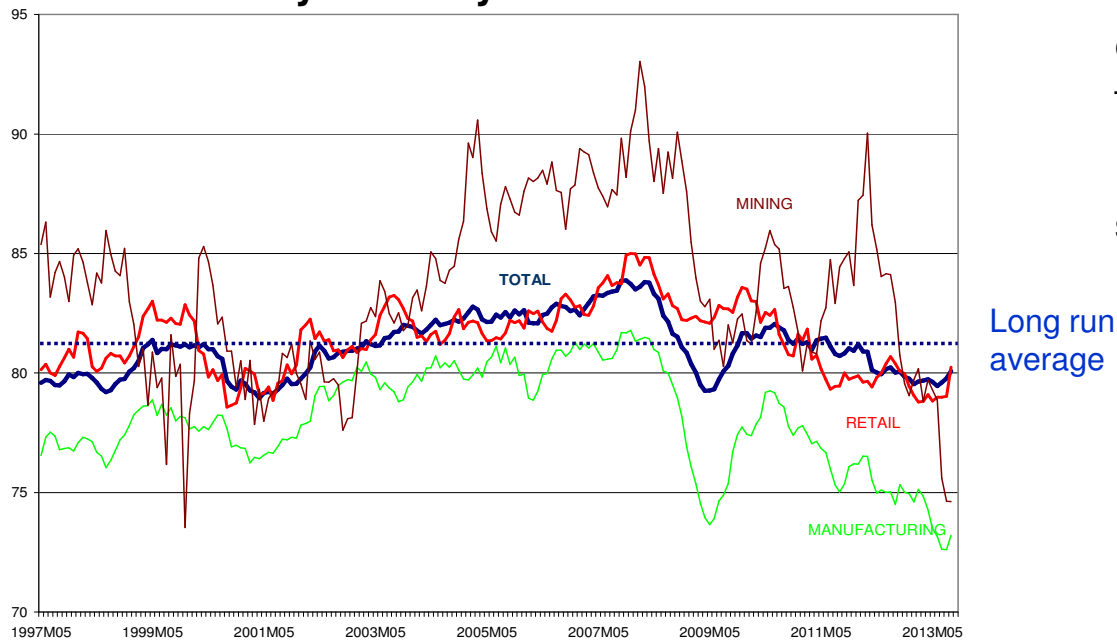
- Mining no longer the driver of domestic demand
 - Mining investment still at very high levels (8% of GDP) but now slowing
 - Mining now moving into export phase and hence will support GDP
 - But will detract from demand and will itself require less employment
- Critical question is: what will fill the mining hole in demand
 - To date nothing
 - Lower rates not really driving non-mining investment
 - Lower capacity utilisation not helping
 - Political kick in confidence v a further weakening in the labour market??
- Economy might grow at 2 to 2½% but demand growth only ¾ to 1%
 - Implies higher unemployment (6¼% by end 2013 & higher into 2014)
 - Fiscal policy to be tightened
 - RBA prefer not to cut looking at house prices, activity v confidence and unemployment. With low inflation and much higher unemployment we see another cut (Feb 2014) and then long period of stability.

While conditions still weak, political change has given a temporary kick to confidence. Sustainable???



Capacity utilisation is low providing little incentive for new investment

**Capacity Utilisation Total Economy
And by industry**



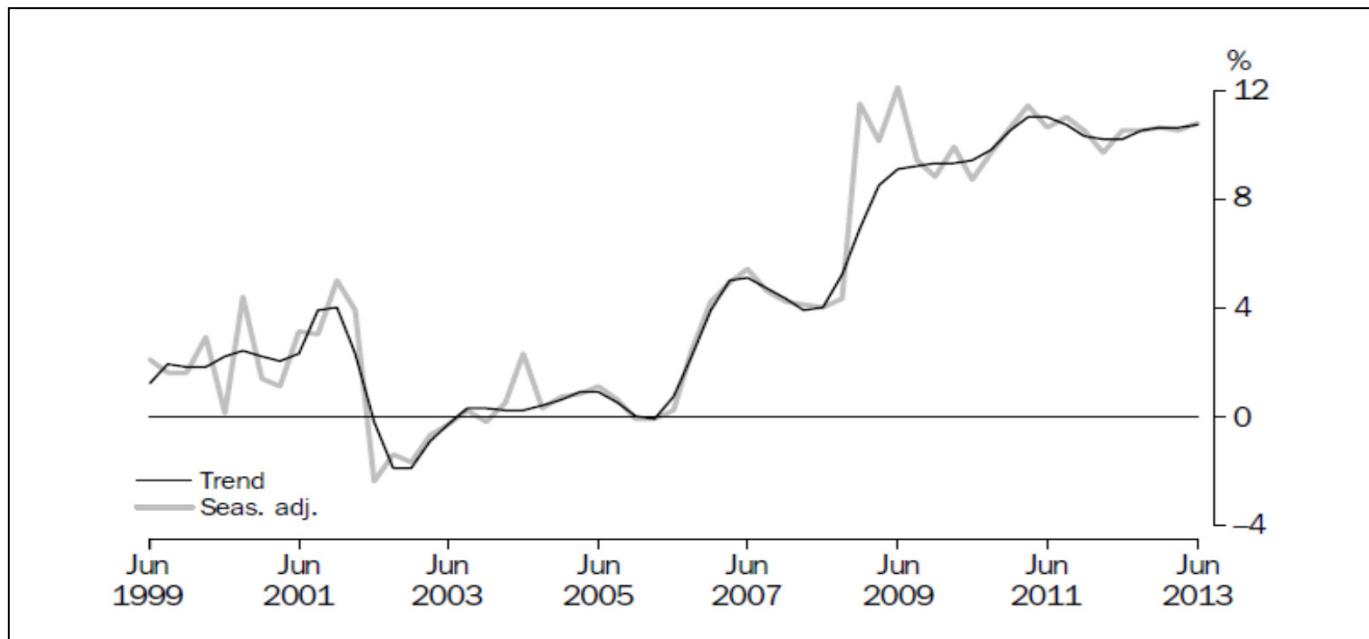
➤ Capacity utilisation across the economy still at relatively low levels – but off most recent lows

➤ Capacity utilisation by industry shows

- shows the fall back in mining...
- and the scary state of manufacturing...
- with retail tracking general trends

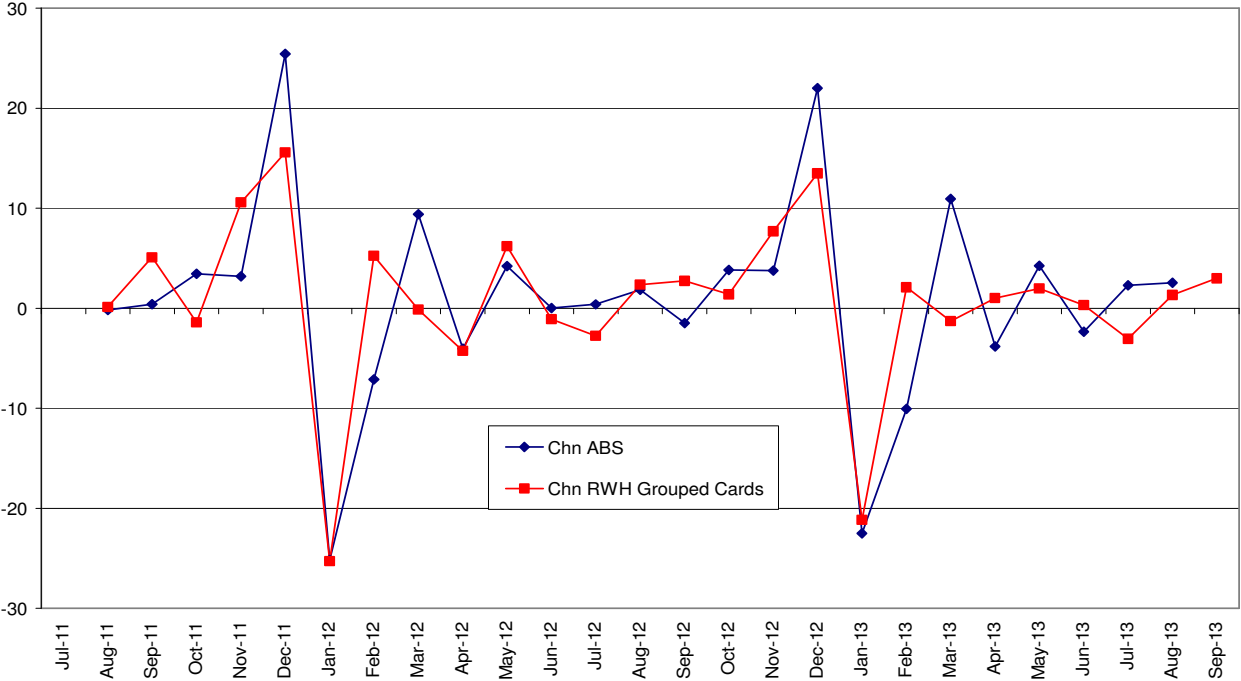
Consumers are very cautious with savings ratios very high

Household Saving Rate (Income less Consumption) %



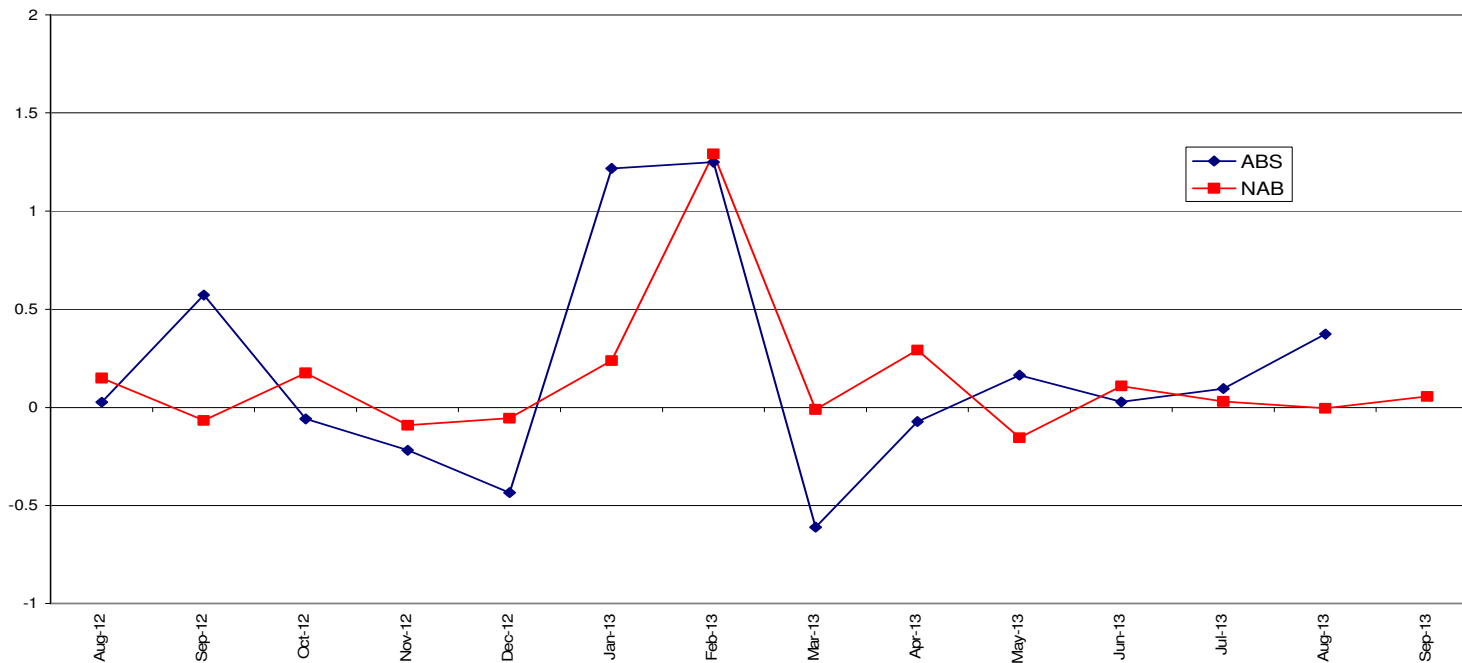
Our cards data tracks retail sales well through time

Monthly Movement in card sales v ABS Retail sales – Original data



After seasonality etc cards shows weaker August than ABS and no fundamental improvement in Sept

Retail Sales v Nab cards (for retail) – Seasonally adjusted

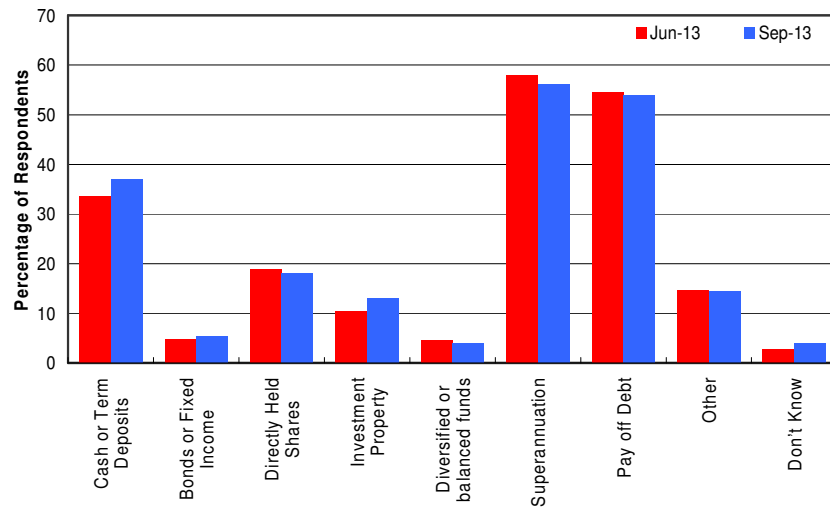


Consumers still very conservative in investment choice as well

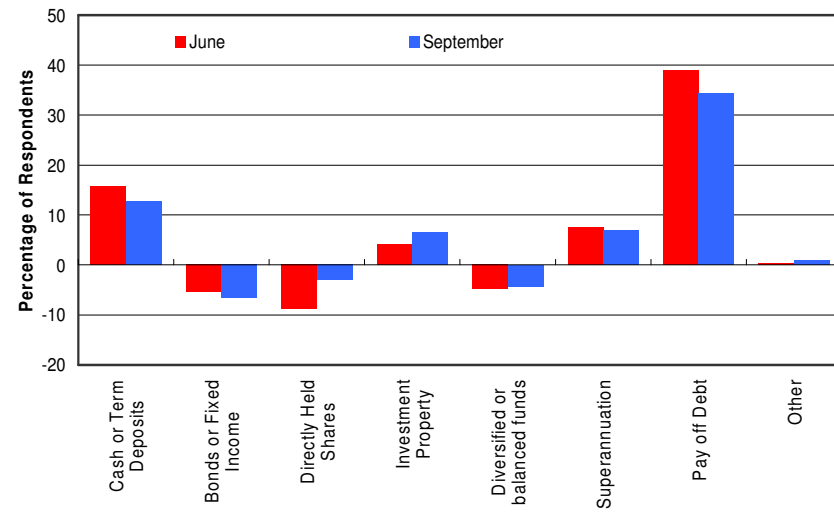
Focus still on deposits and debt repayment

But recently more open to property
and less negative to shares.
But...

Current Financial Situation

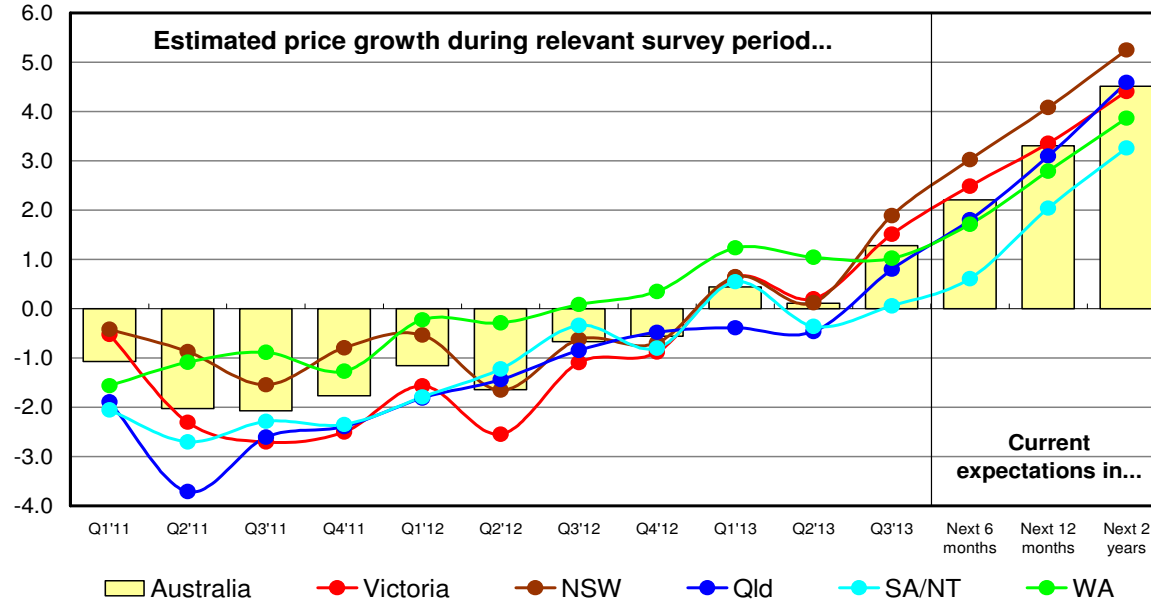


Next Three Months - Investment Choice - Net



Lower rates have seen expectations (and actual) house prices increase.

House Price Expectations for the Coming Period %



Source: NAB Residential Housing Survey Q3 2013

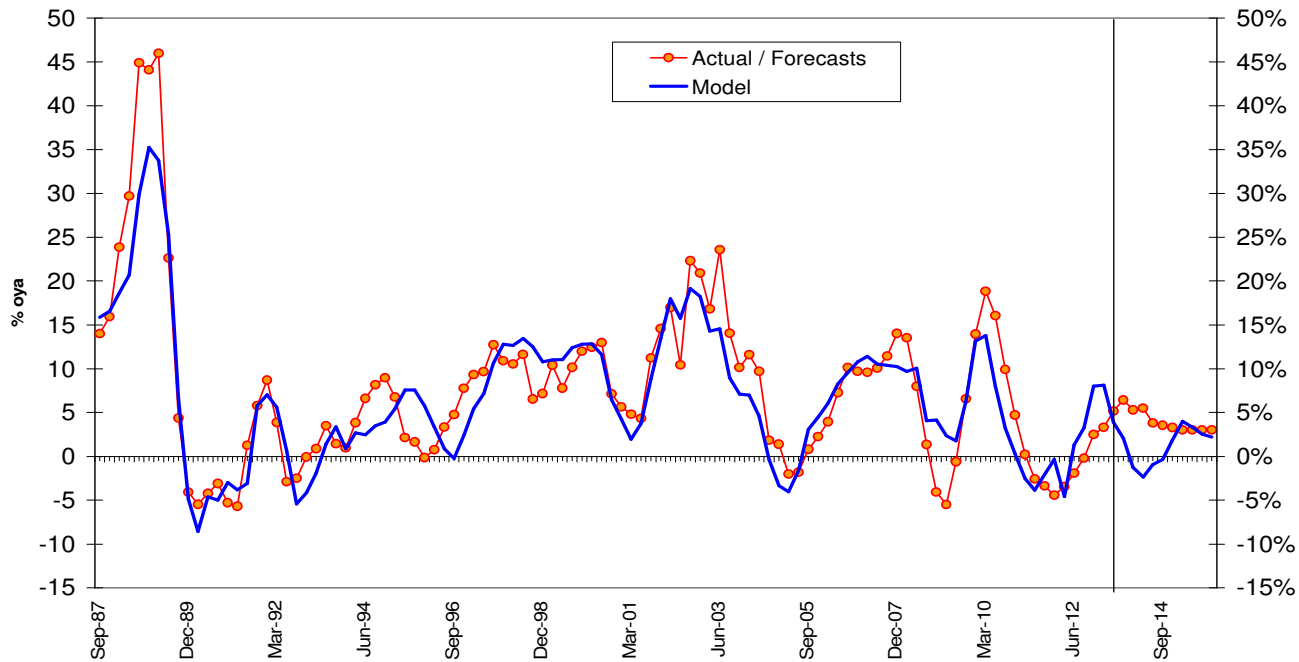
➤ House price expectations have turned up as rate cuts take effect – esp. in NSW

➤ But we still expect relatively moderate gains (by historical norms) in the next 12 months

- around 5%
- with differences across cities

Our models also suggest moderate house price gains.
Lower rates help initially but higher unemployment hurts

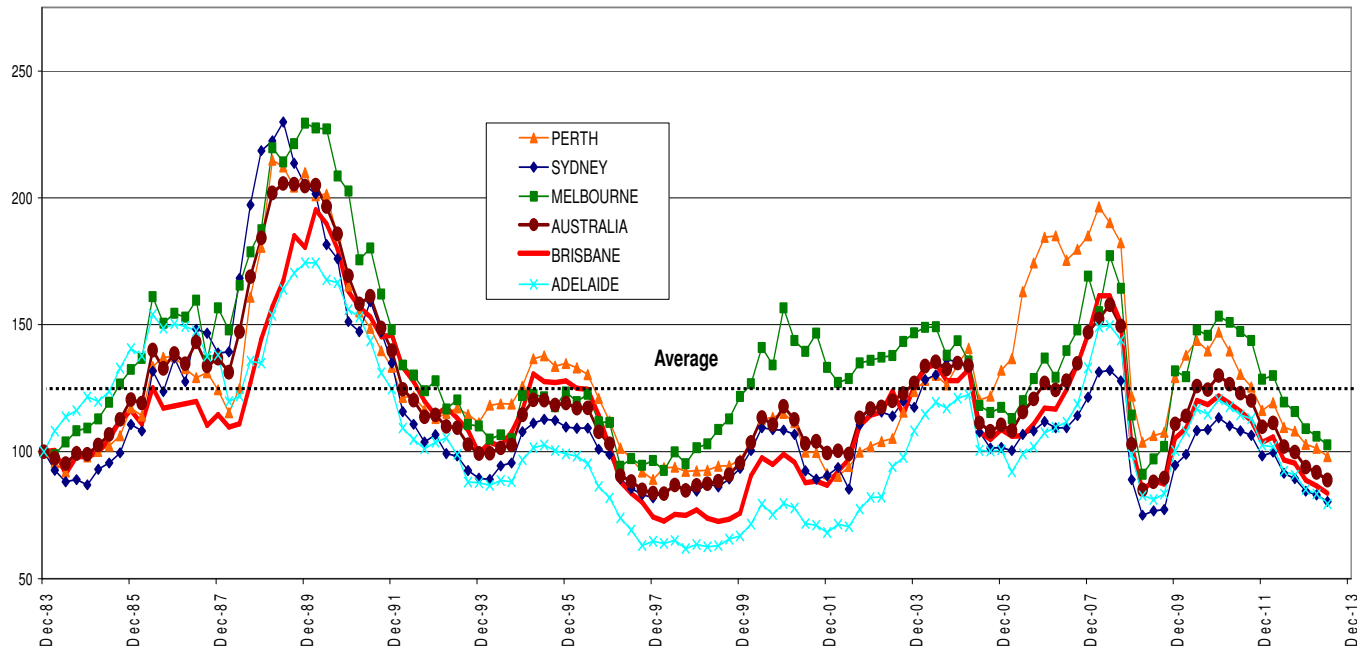
Australian House Prices – Y/Y %



Source: NAB Economics Housing price model.

House prices relatively low relative to Borrowing Ability

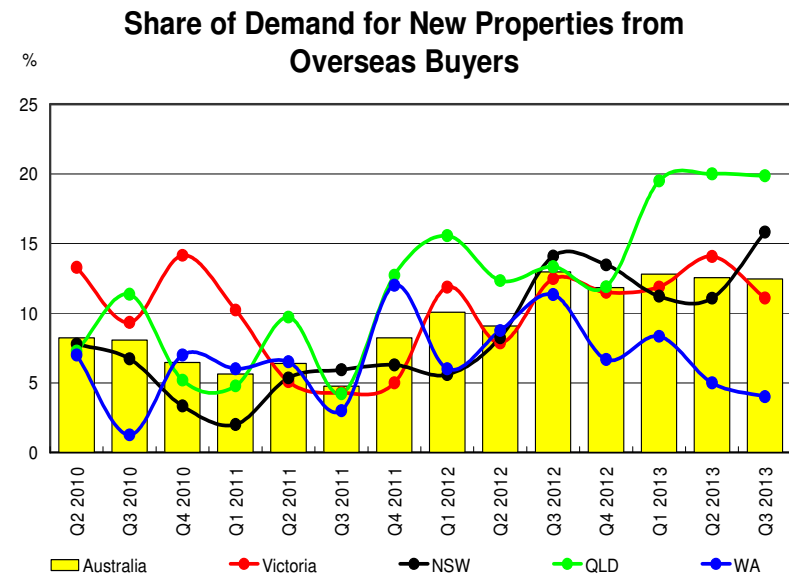
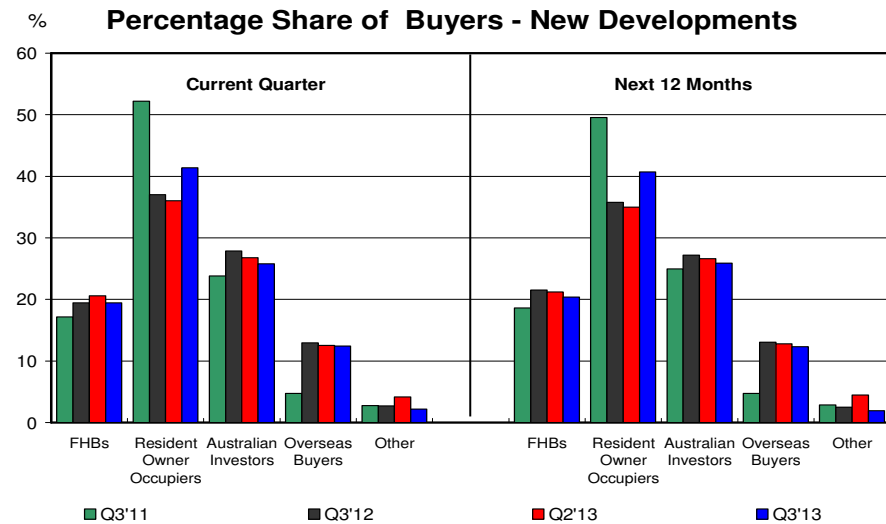
HOUSE PRICES TO HYPOTHETICAL BORROWING ABILITY



More interest in investor market – especially foreign

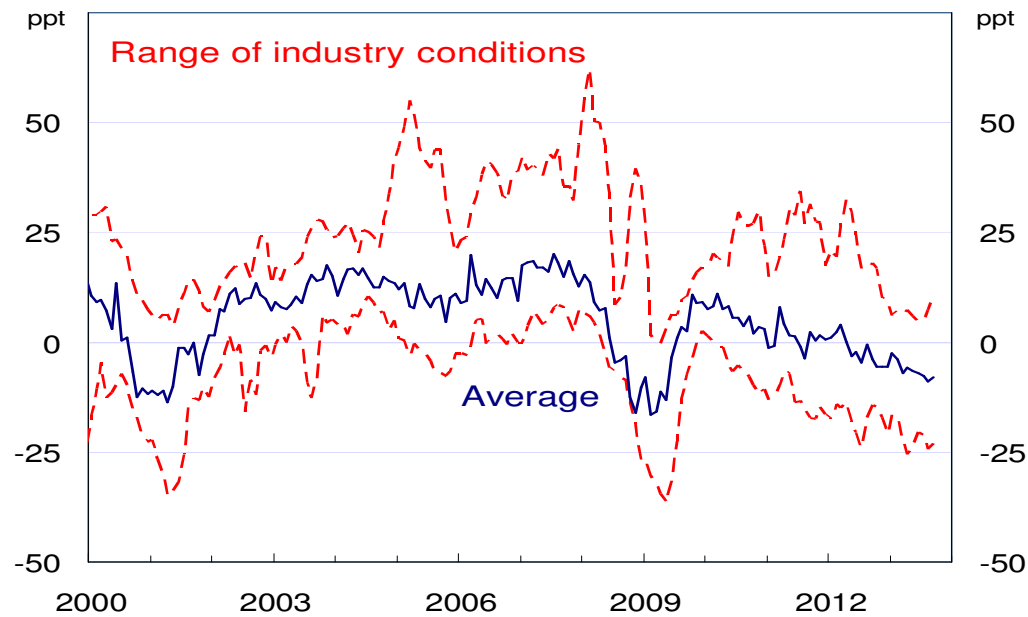
Owner occupier the largest share
 And appears to be increasing again
 But overseas investor (Asian) around 12.5%.

Main focus is Qld & recently NSW



Overall business conditions have weakened across all sectors – weak and strong alike

Monthly Business Conditions by Industry
Net balance Deviation from Industry Averages



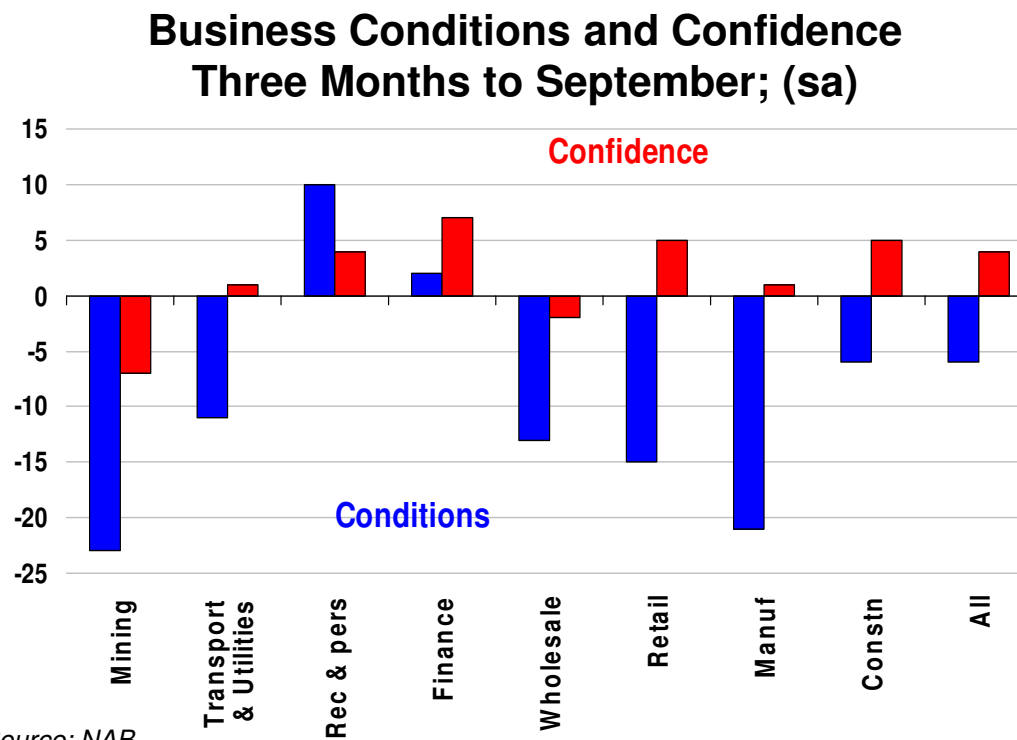
Source: NAB

And conditions are broadly consistent with an economy in the 2 – 2½% range

Business conditions (change & level) as an indicator of GDP (6-monthly annualised)



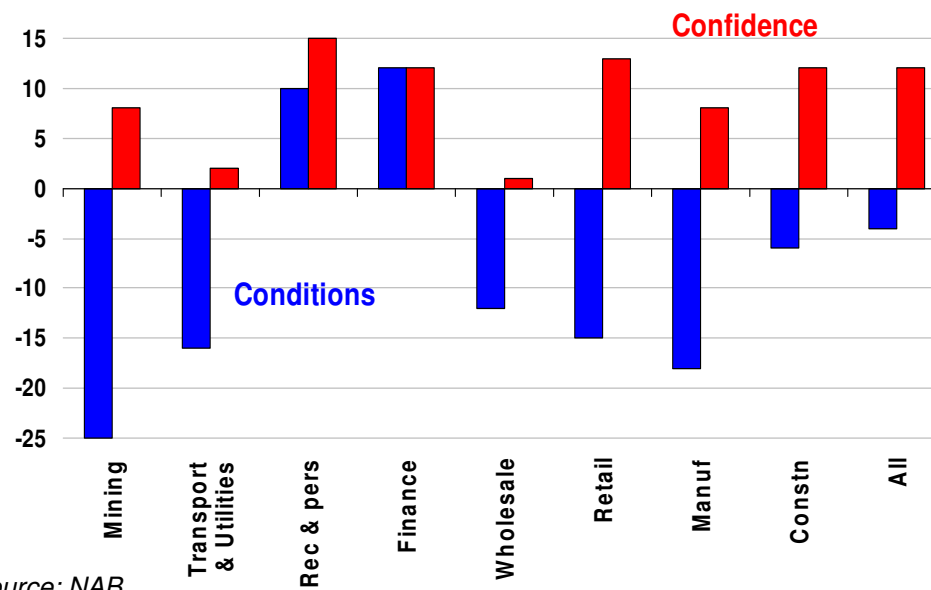
Still big divergence of conditions and confidence across industries. But mining deteriorating rapidly



Source: NAB

Still big divergence of conditions and confidence across industries. But mining deteriorating rapidly

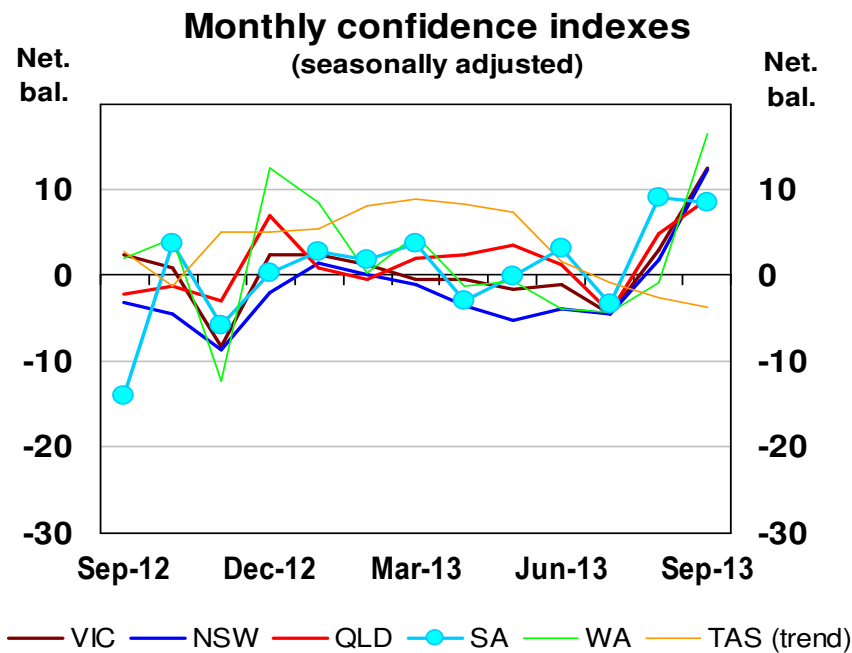
**Business Conditions and Confidence
September; (sa)**



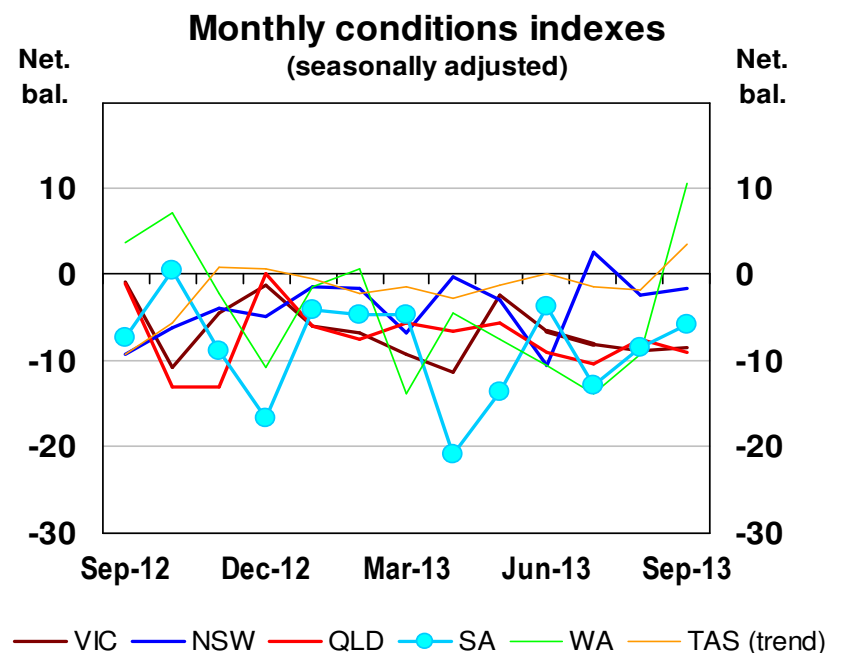
Source: NAB

Interstate variations less pronounced

Confidence up but conditions generally average



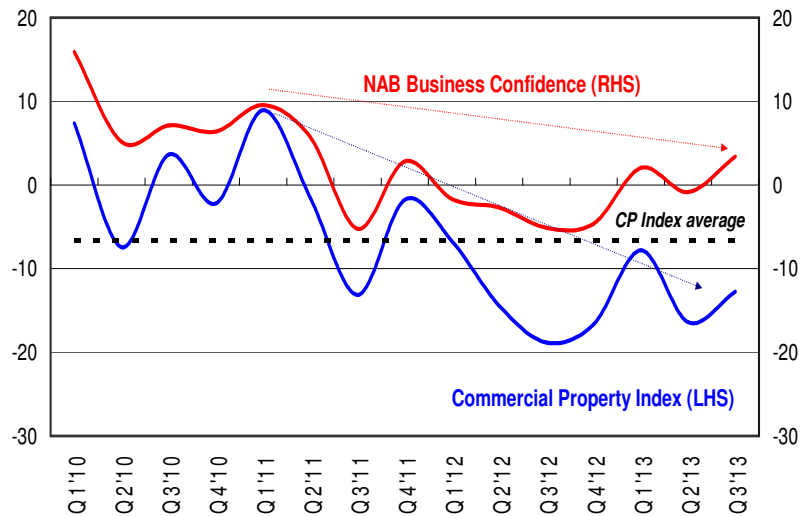
Source: NAB



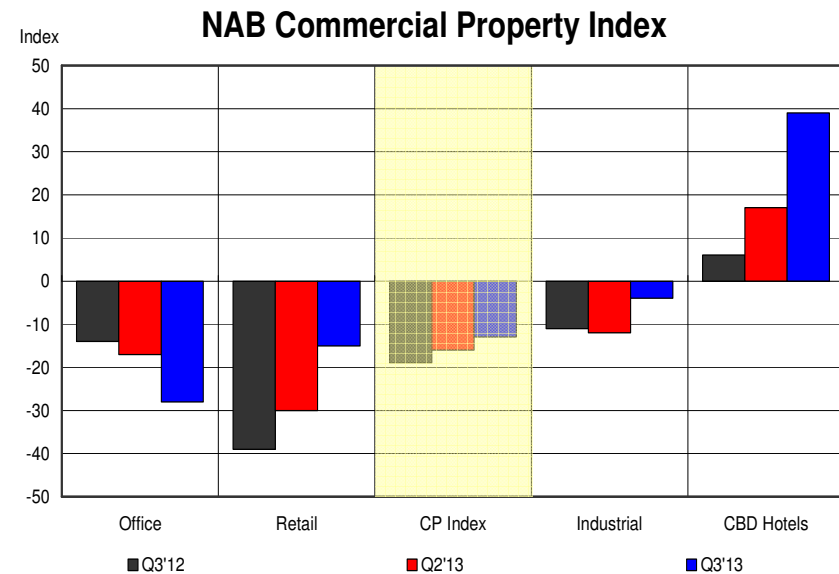
Source: NAB

Outside residential, commercial property in Australia not great

Commercial Property following business confidence down - albeit more negative

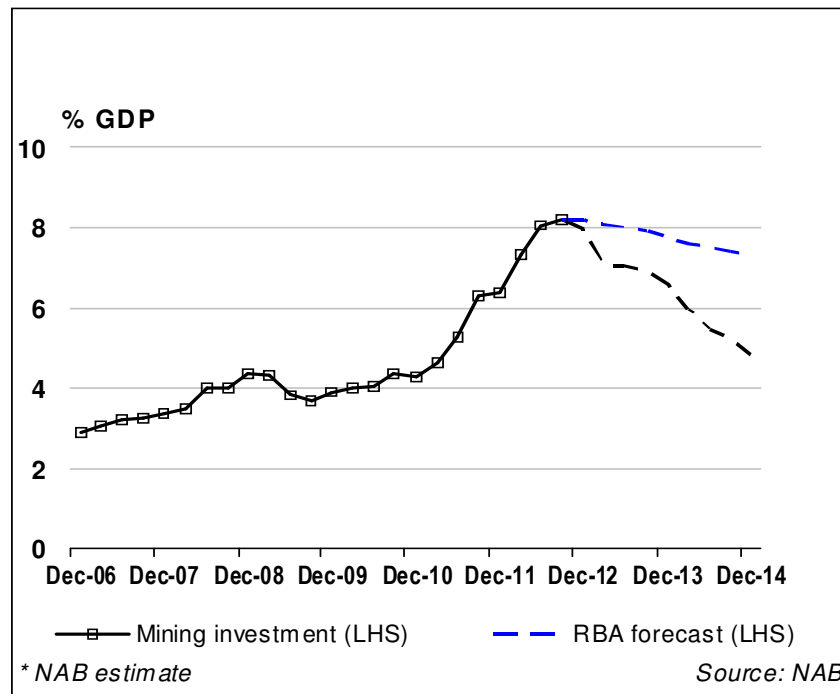


Office deteriorating, but retail still a concern. CBD hotels strong



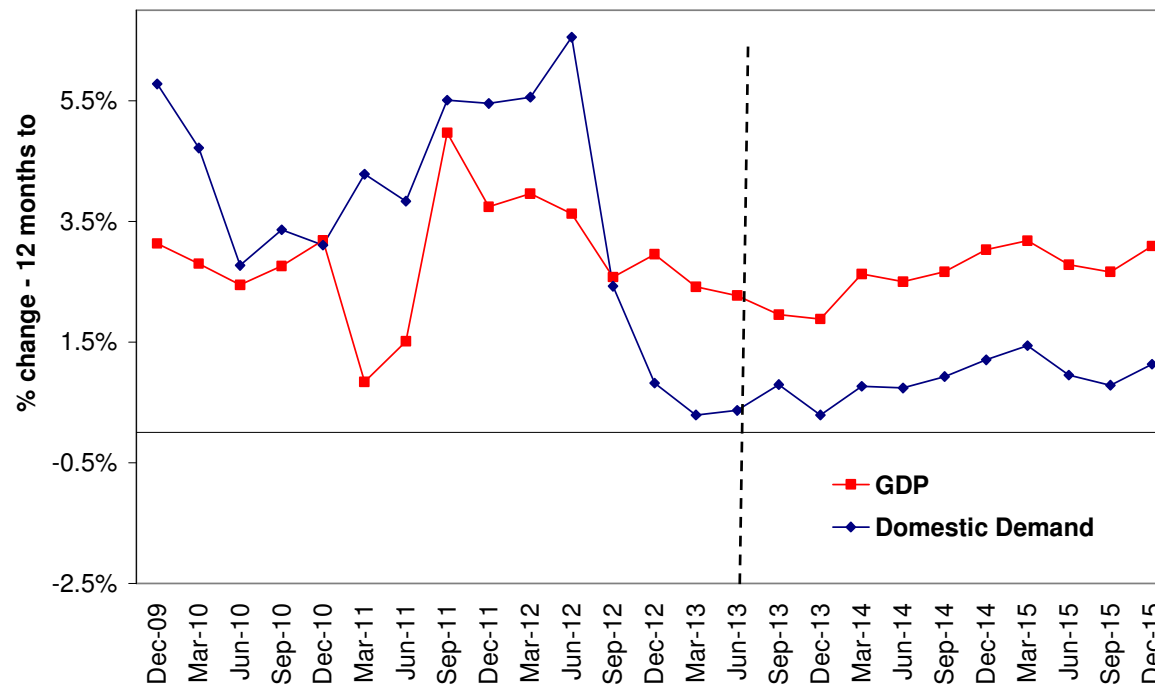
Mining investment still high in level terms but negative in terms of growth rates

Mining Investment as % of GDP

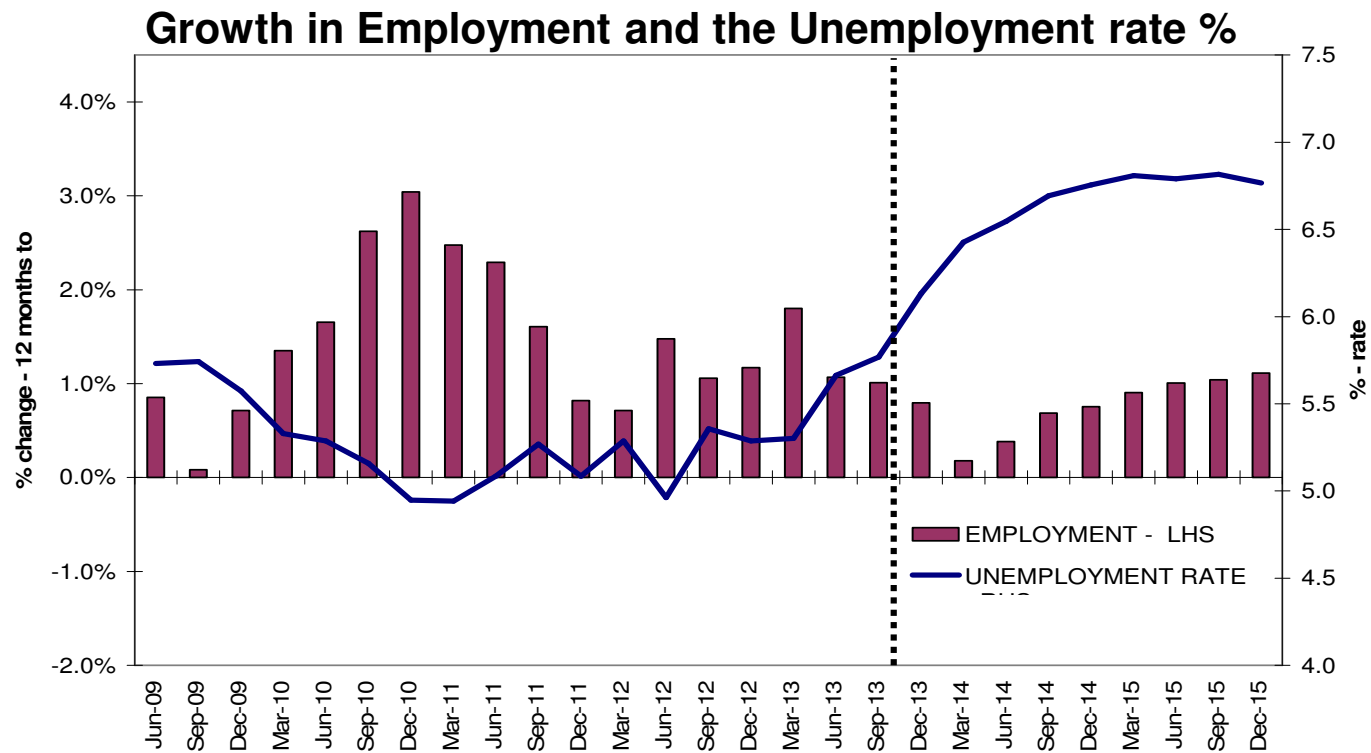


- Mining is moving from investment to exports phase
- Good for productivity and hopefully neutral for growth
- But will lower demand for employment
 - 8 people to build an LNG platform 1 to run it
 - 4 to build a mine 1 to run it
- Hence critical for non-mining investment to help offset the slack

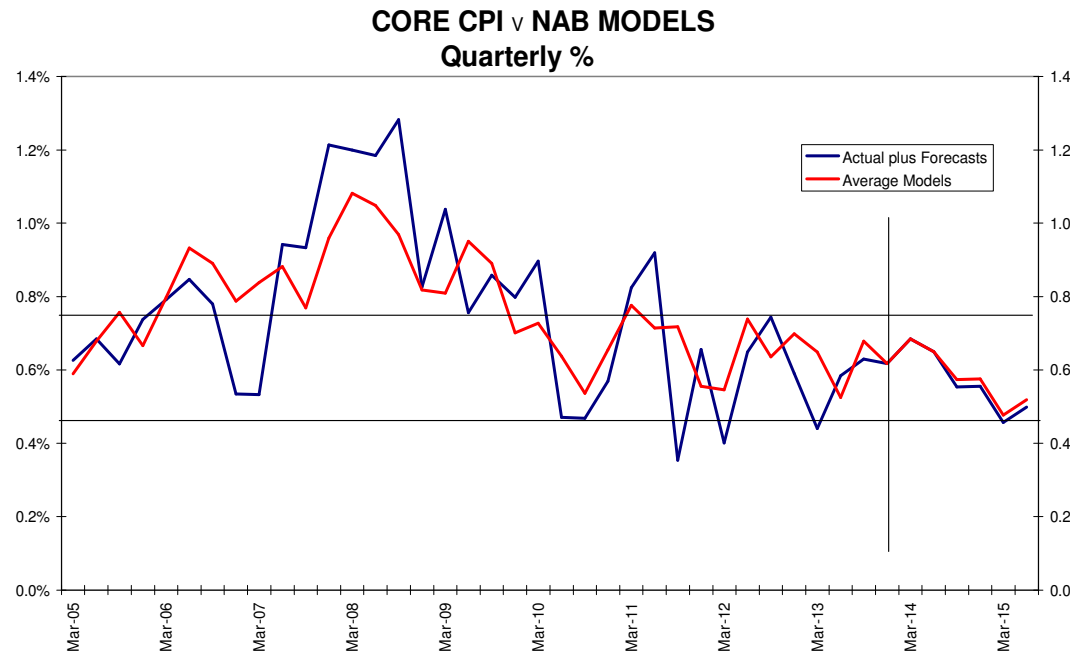
GDP will slow moderately - 2 to 2½% per annum But domestic demand will crunch – around 1% per annum



Lower demand /employment growth leads to higher unemployment. Mining boom phasing important here.



Inflation to remain very low



- **Even on a quarterly basis** models suggest inflation within target range (at the low end on a twelve months to basis)
- **Currency effects** and **retail discounting** important in near term – as is **Phillips curve impact on lower wages**
- **Carbon pricing** (either abolition or move to European price) drives down 2015 results

NAB models based on: output gap, wages, productivity, import prices, and lags. Also uses a separate Phillips curve model.

For rates another cut - but not till early 2014

- RBA now quite comfortable watching to see signs of past action working. Doesn't really want to cut further
- Are signs that low rates have started to impact on confidence (business and consumer) and house prices picking up. Albeit not yet construction or non mining investment
- These factors favour a wait and see mode
- Key factor arguing for another cut is the deterioration of the labour market – 6% by end 2013 and 6 ¾% by end 2014. But will need time to fully see this.
- Also question remains as to whether political kick in confidence gets weighed down by still tough business outcomes. And currency remains high.
- Tentatively we have **another cut but not till February 2014**. Thereafter a long period of no change. We have rate rises in 2015.

Australian economic forecasts

| | 2013 | 2014 | 2015 |
|-------------------|------|------|------|
| | NAB | NAB | NAB |
| Real GDP | 2.3 | 2.5 | 3.0 |
| Domestic Demand | 0.7 | 0.8 | 1.1 |
| Employment | 1.2 | 0.5 | 1.2 |
| Unemployment rate | 6.2 | 6.8 | 6.8 |
| CPI underlying | 2.3 | 2.6 | 2.2 |
| RBA cash rate | 2.5 | 2.25 | 3.0 |
| \$US/\$A | 0.94 | 0.86 | 0.8 |
| Nominal GDP | 3.7 | 3.9 | 4.1 |

■ At end of period

▲ Through the year growth