A better H2 ahead

Commonwealth Bank of Australia

CEDA Economic & Political Overview - 2019

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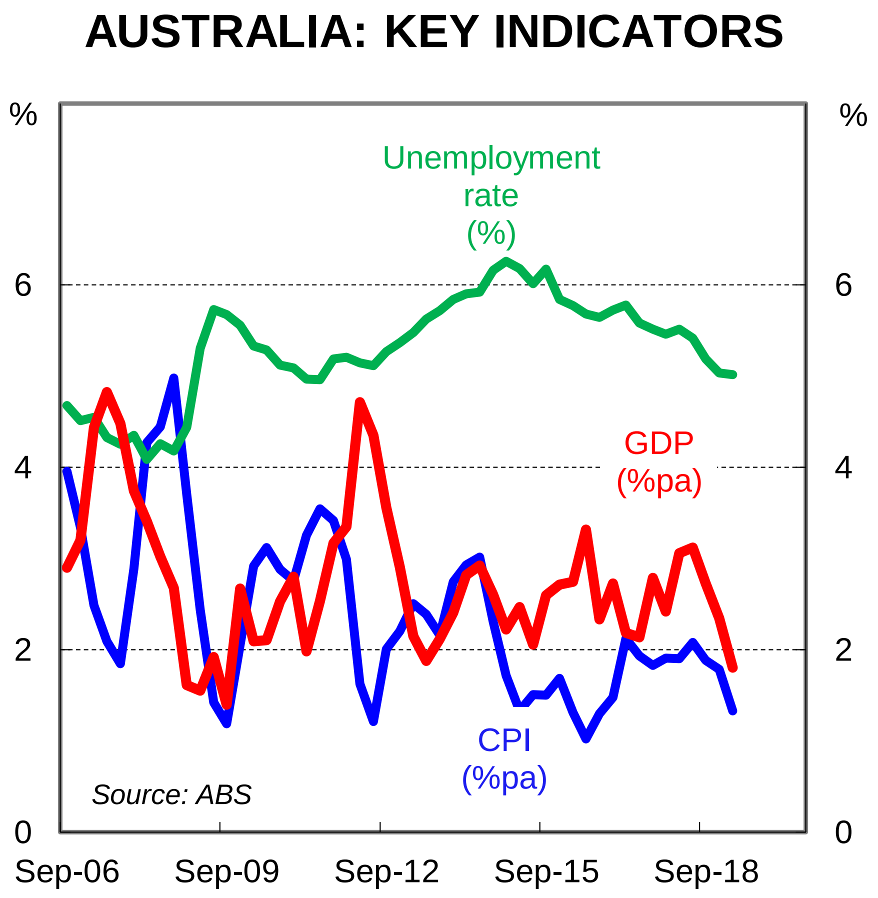
June 2019

Australia



- **The expansion is in its 28th year – the last real recession was in 1990/91.**
- **Unemployment is low. Wages growth is lifting.**
- **Inflation rates are low.**
- **Public finances and the financial system remain in respectable shape:**
  - the AAA rating remains;
  - the financial system is well capitalised, well regulated and profitable.
- **Policy makers retain some firepower:**
  - policy interest rates are well above zero;
  - the OECD estimates that Australia has considerable “fiscal space”.
- **The generational benefits of the resources boom and the Asian emergence continue.**

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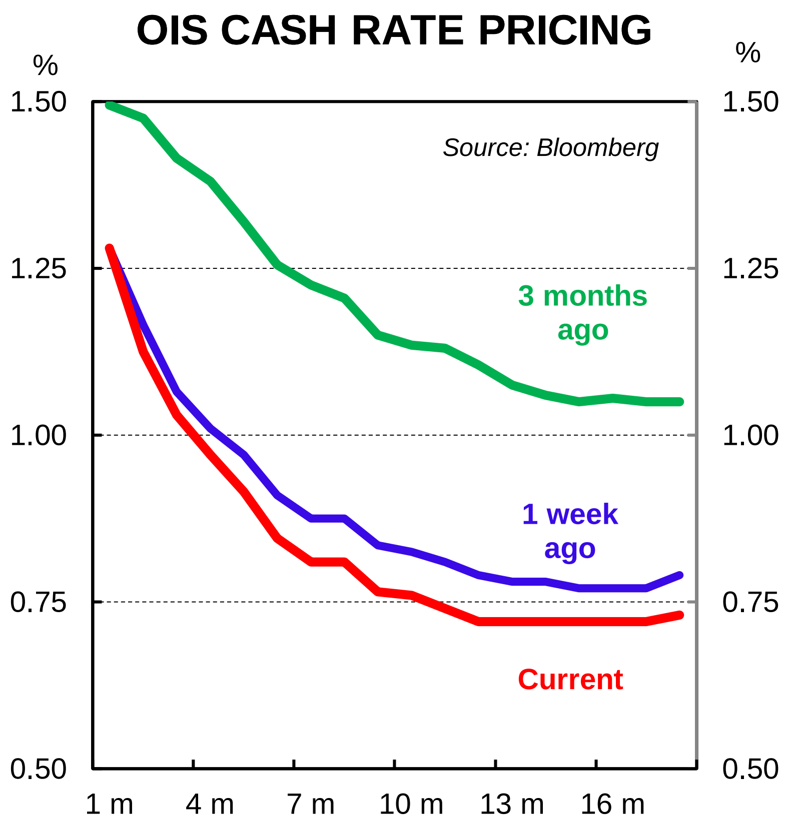
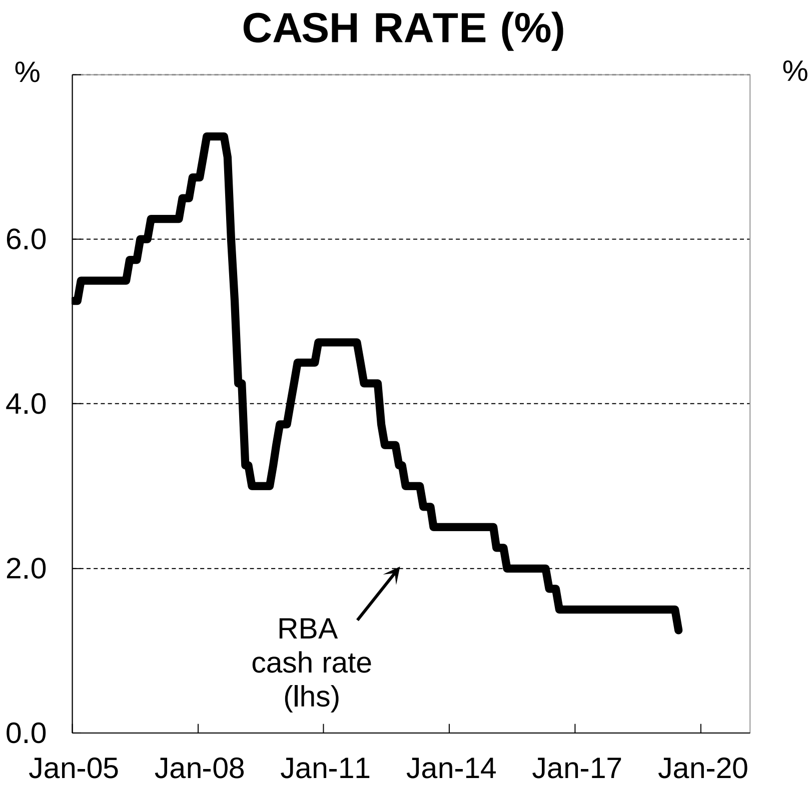
The RBA

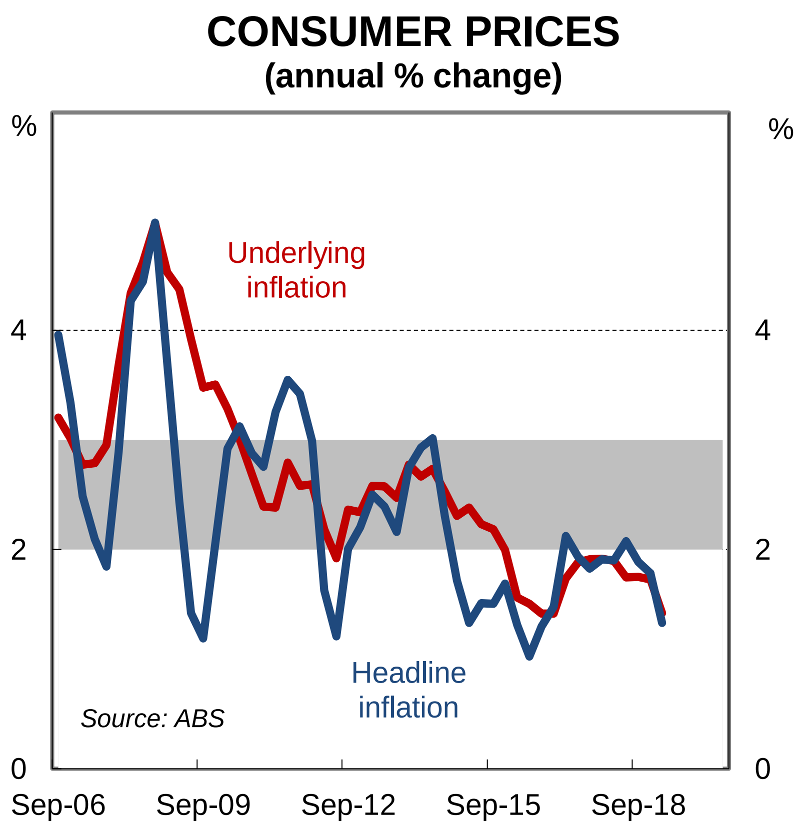


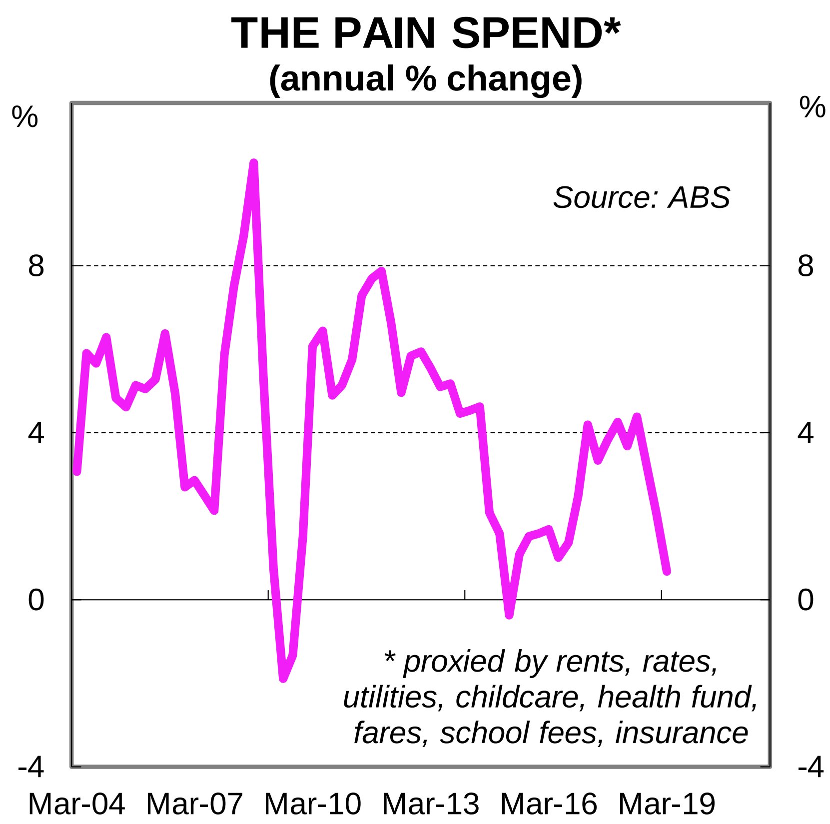


- **Financial markets are pricing in close to two more rate cuts after the RBA cut rates in June.**
- **We expect another cut in August.**
- **Governor Lowe has said he doesn't expect rates to get as low as other countries of between 0.25% - 0.5%.**

Why is the RBA cutting the cash rate?

Inflation has moved further away from target





- **Inflation has moved further away from the RBA 2-3% target.**
- **Part of the decline in inflation relates to spare capacity in the economy.**
- **But politicians have been working on reducing cost of living pressures. These measures are also weighing on inflation outcomes.**

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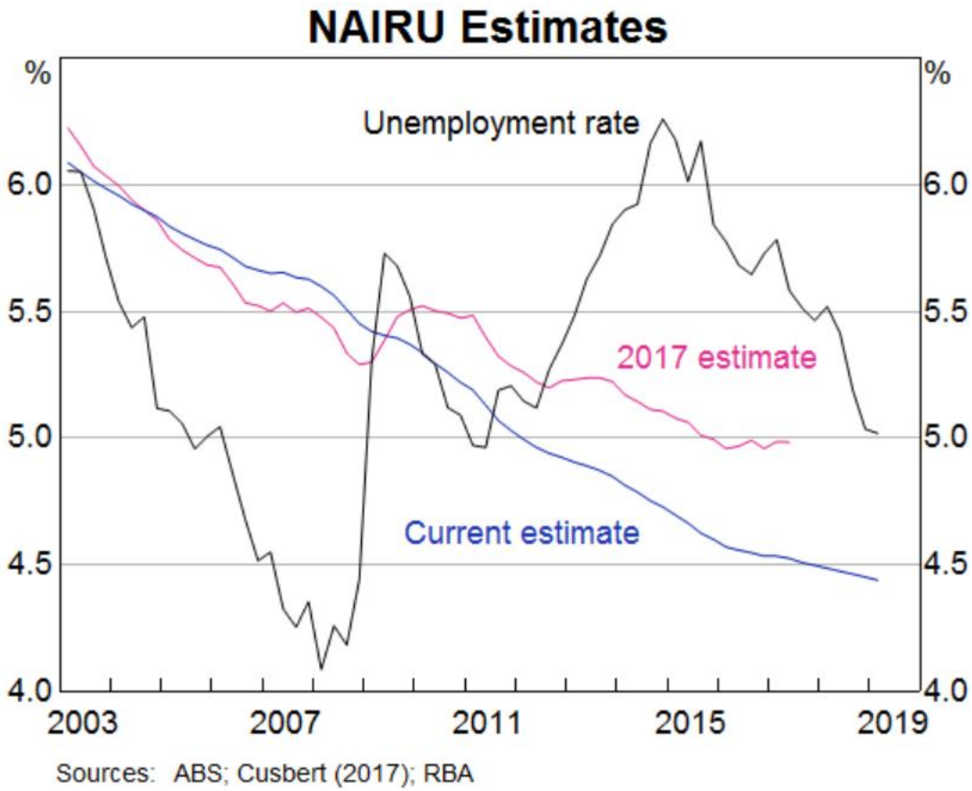
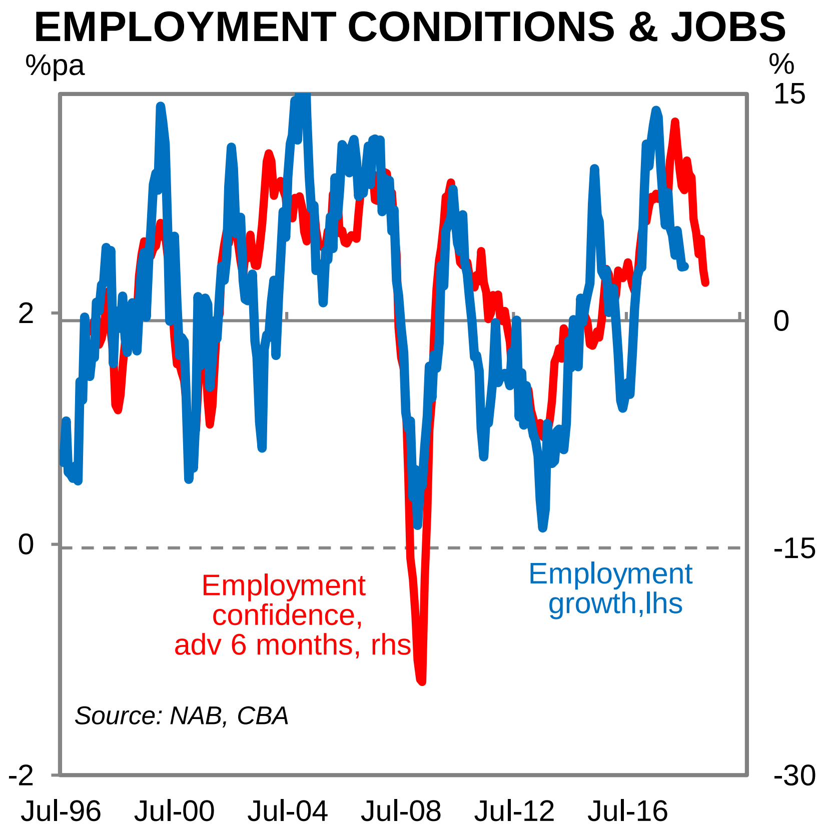
Why is the RBA cutting the cash rate?

There is still spare capacity in the labour market





- This year the RBA has emphasised the importance of the labour market in their decision making.
- There is still spare capacity in the labour market and leading indicators have pulled back.

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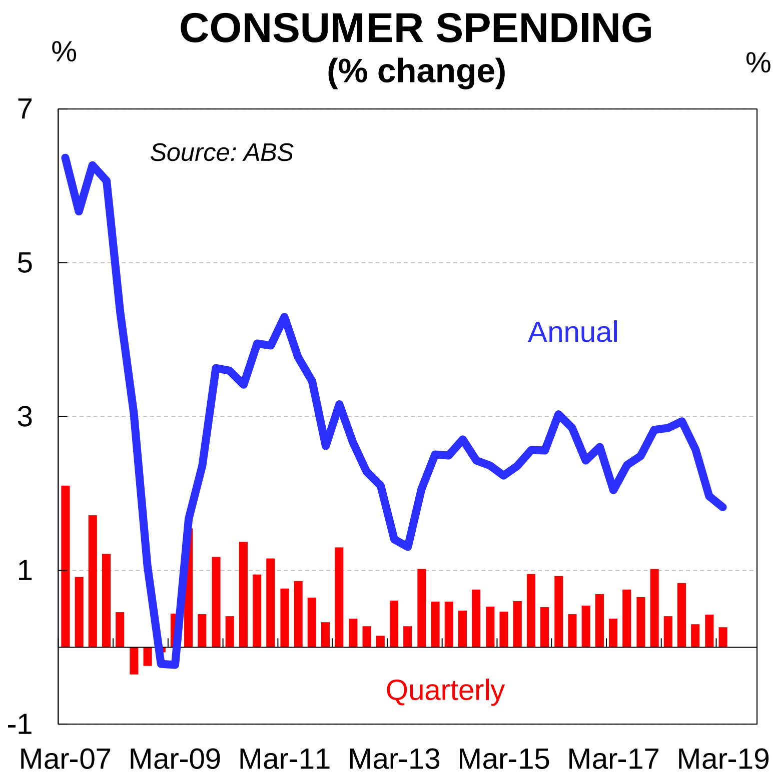
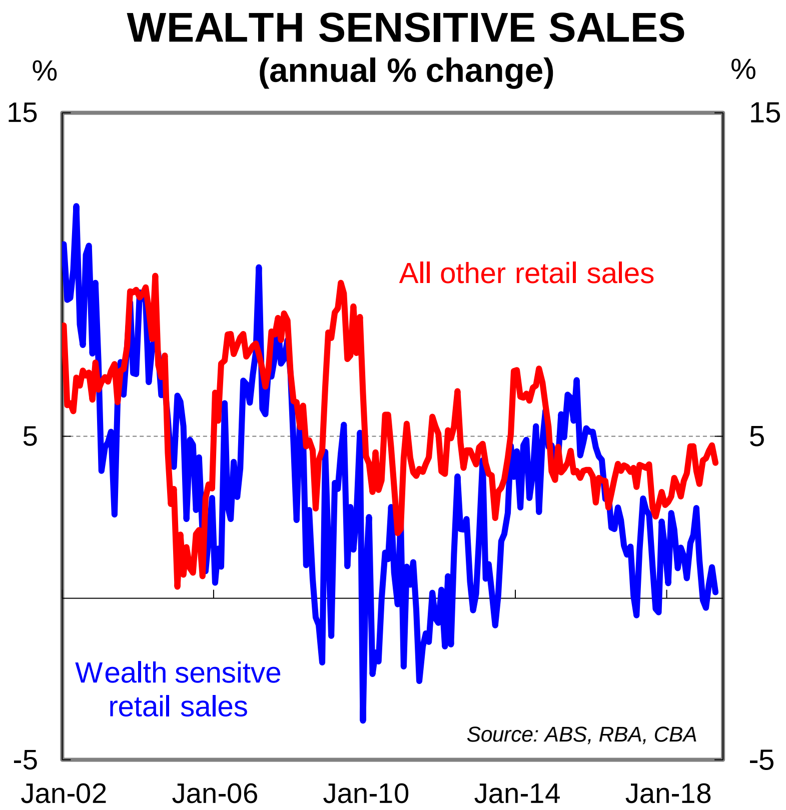
Why is the RBA cutting the cash rate?

Consumer spending growth has slowed

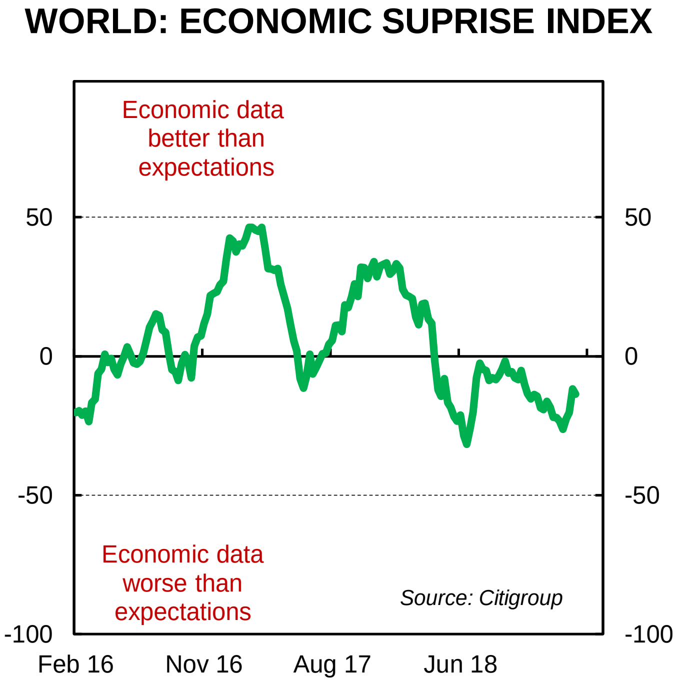


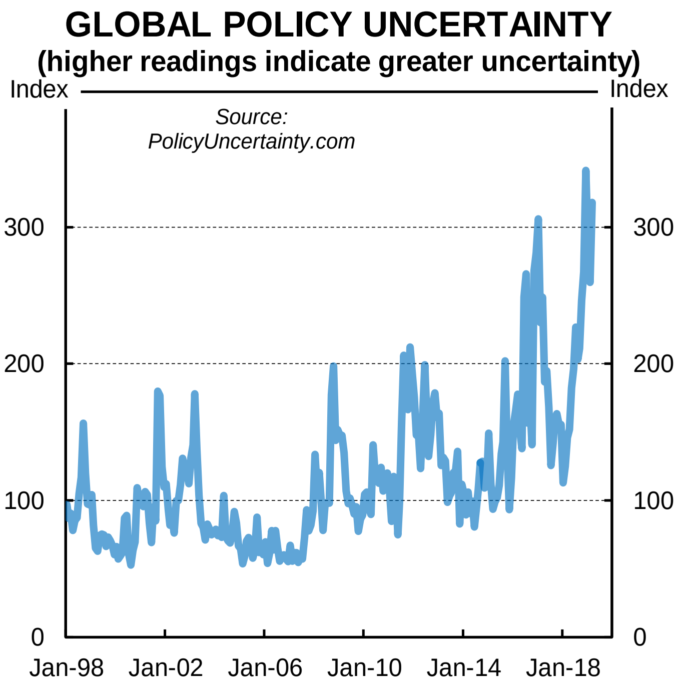


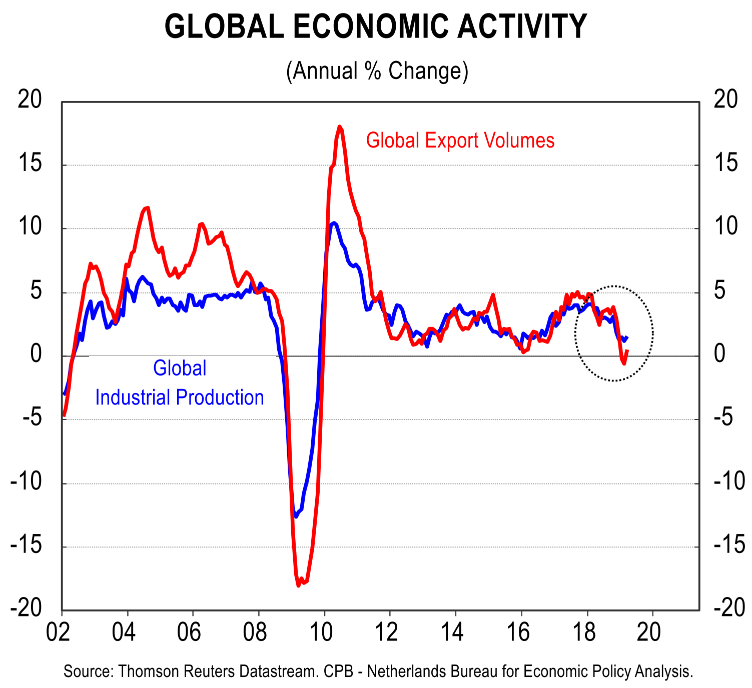
- **Consumer spending has been soft for the last three quarters.**
- **High household debt levels, weak income growth, falling house prices and rising tax share all weighing.**

Why is the RBA cutting the cash rate?

A less helpful global backdrop







- **Global economic data has disappointed.**
- **And global policy uncertainty has lifted.**
- **Trade tensions are impacting on global trade. Uncertainty has weighed on business investment.**

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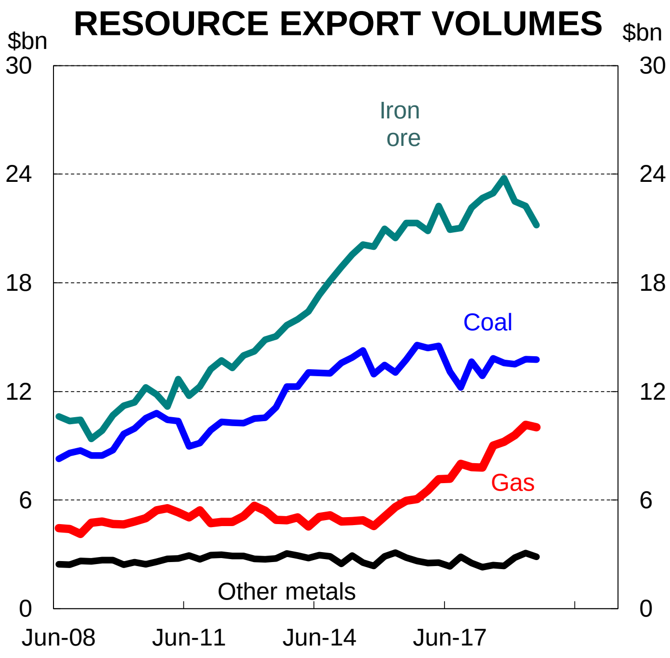
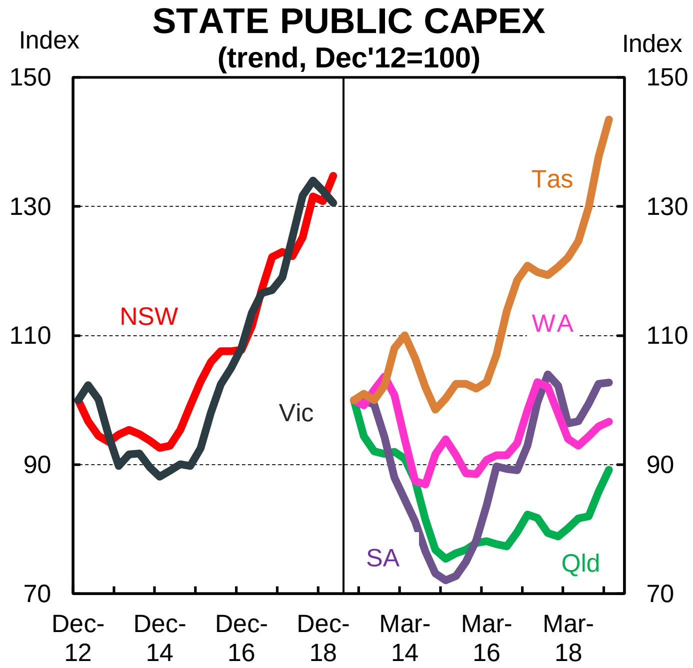
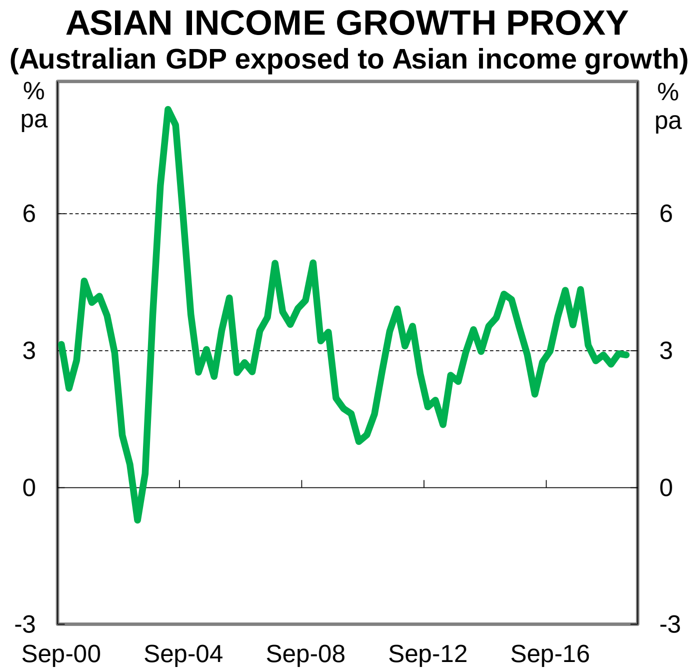
Domestic drivers still in place

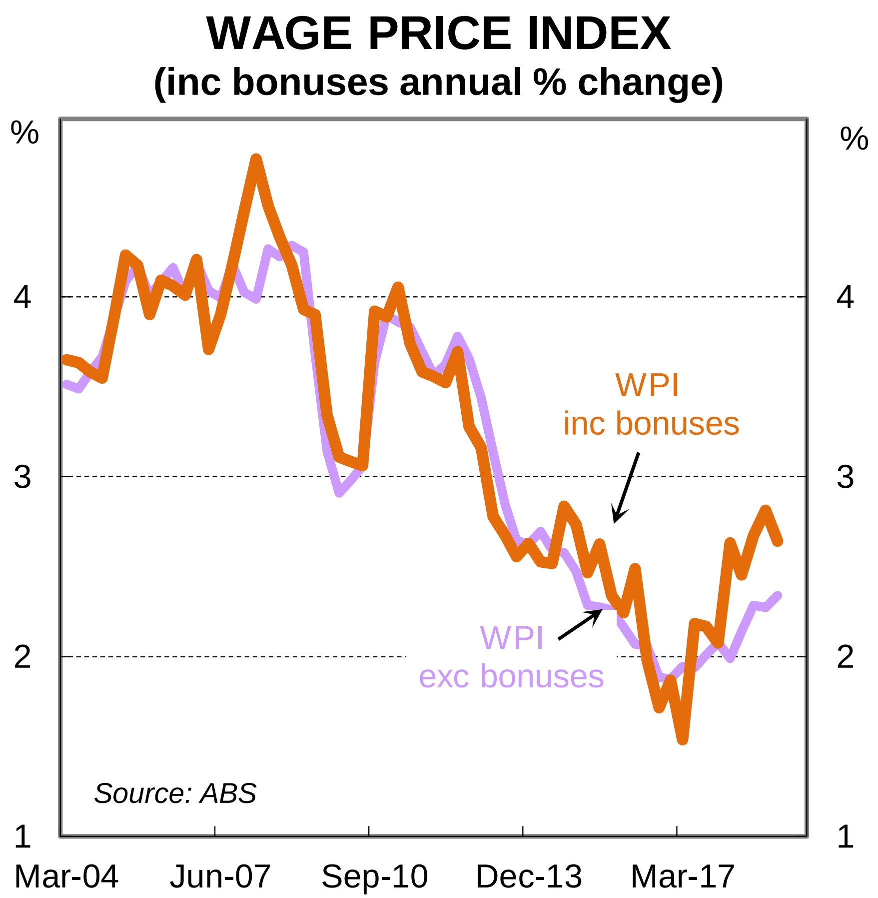


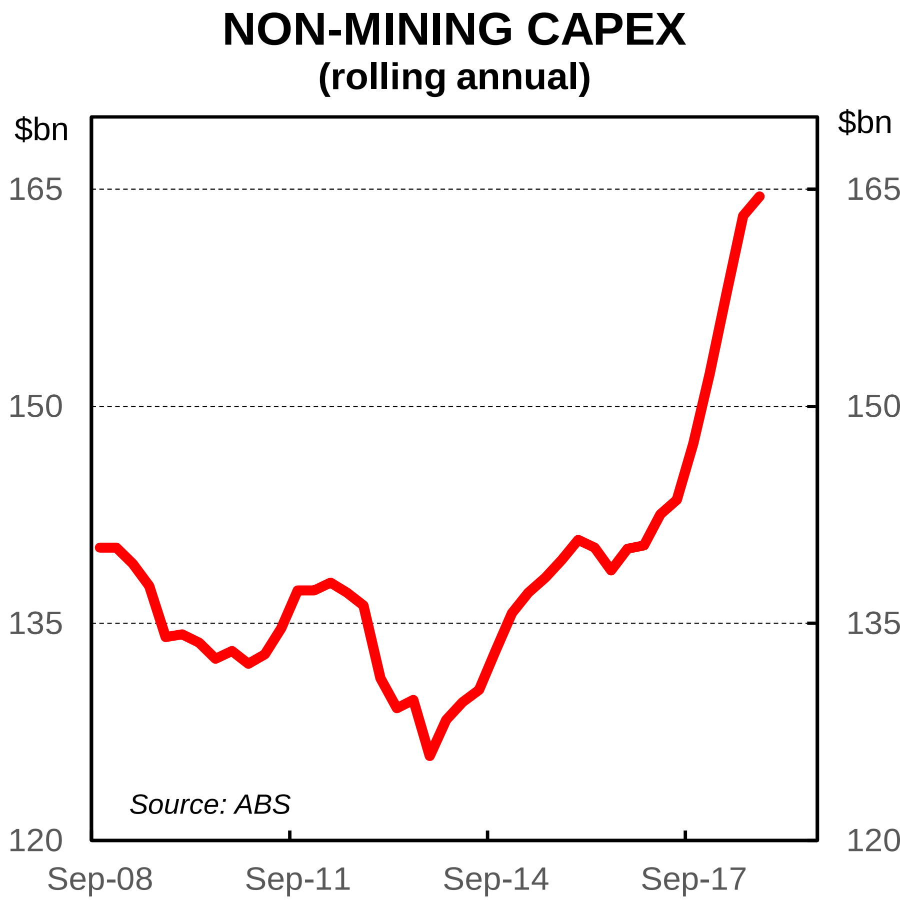




- **Key growth drivers for the year ahead include LNG exports, infrastructure spending and Asian income growth.**
- **Chinese tourists and student dominate – they spend more than any other tourist or student.**

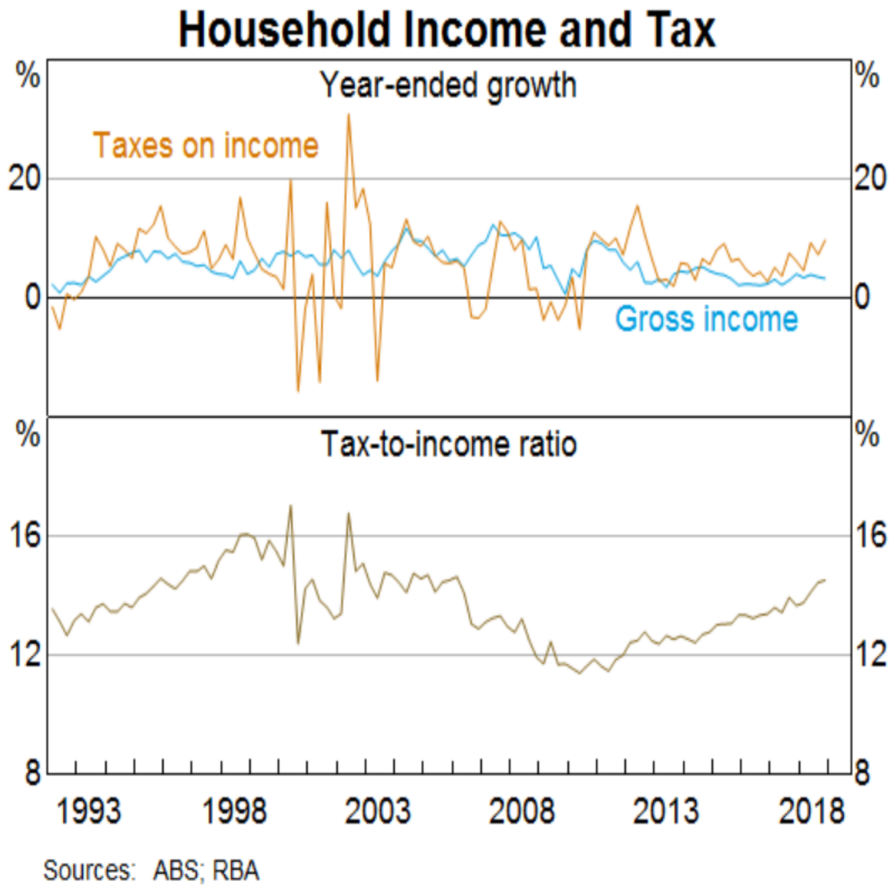
Domestic drivers still in place

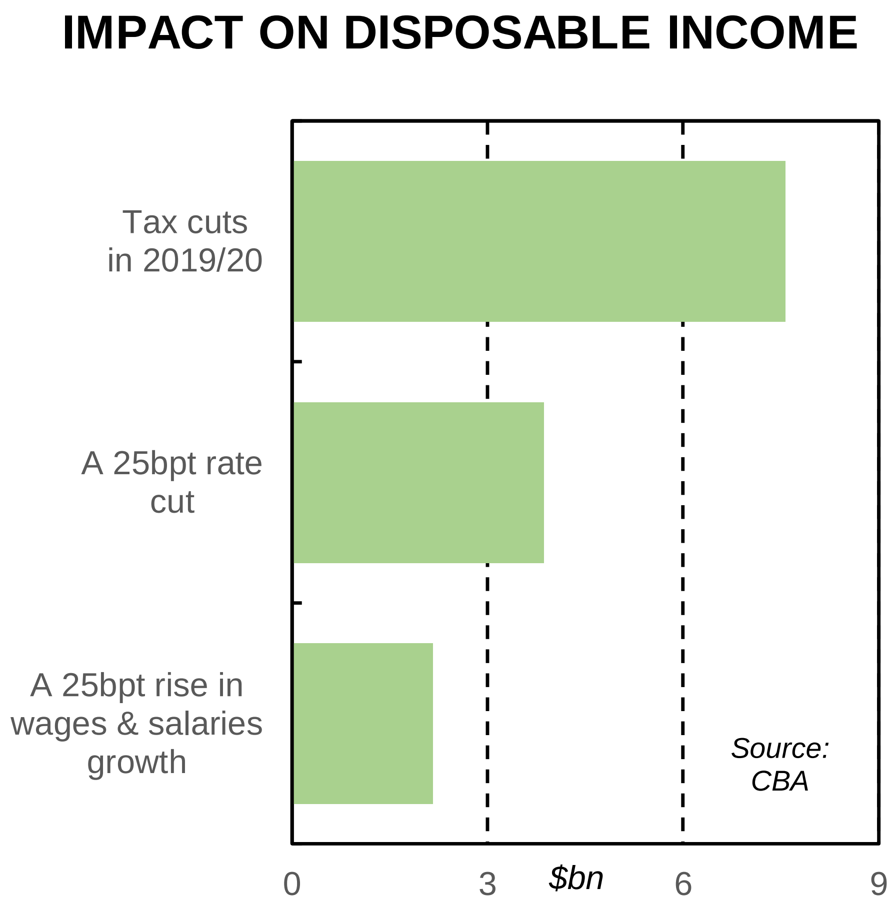




- **The fall in mining capex is ending. A (modest) lift in wages growth is underway.**
- **Strong population growth limits the downside to residential construction.**
- **Non-mining capex is rising at last. But lack of business risk appetite is a threat.**

Tax cuts will help the consumer





- We estimate that the tax cuts will have around the same impact as two 25bpt rate cuts in 2019. And again in 2020.

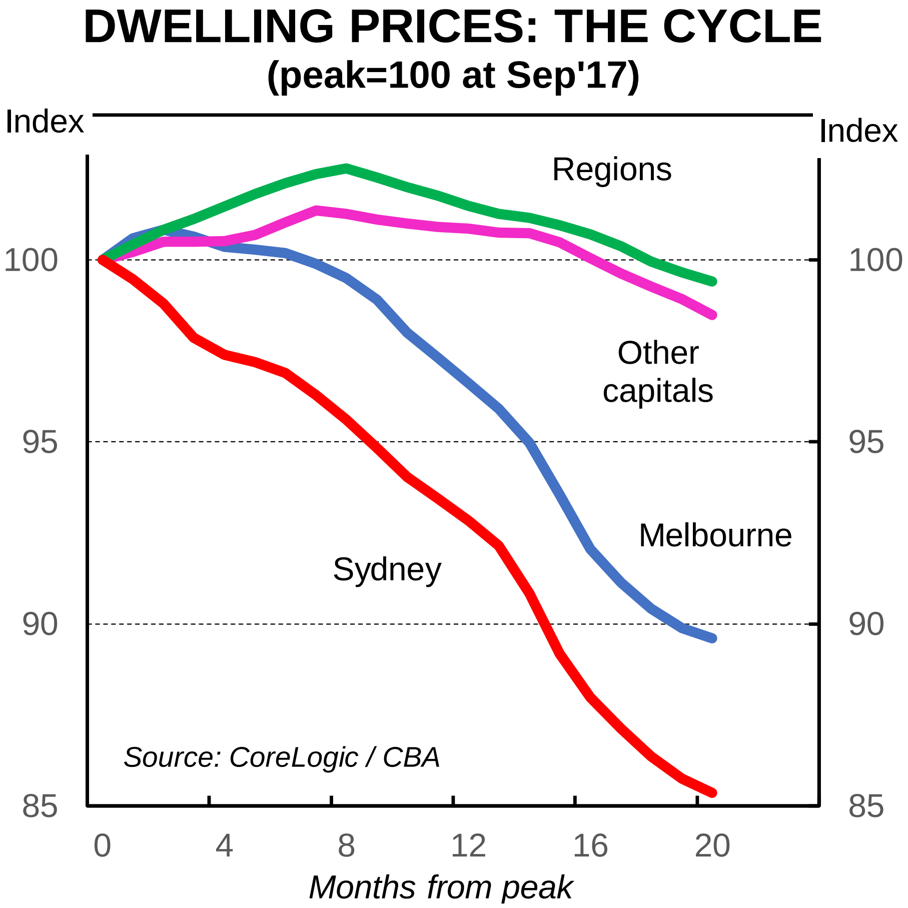
RBA cash rate cut to provide some benefits

Home Loan Repayments Behavioural Segmentation (% accounts)

	Month Ending 2019-03-31
Fixed rate	18%
Paying minimum or less	32%
Paying ahead (up to 5%)	4%
Paying ahead (>5%)	46%
Grand Total	**100%**

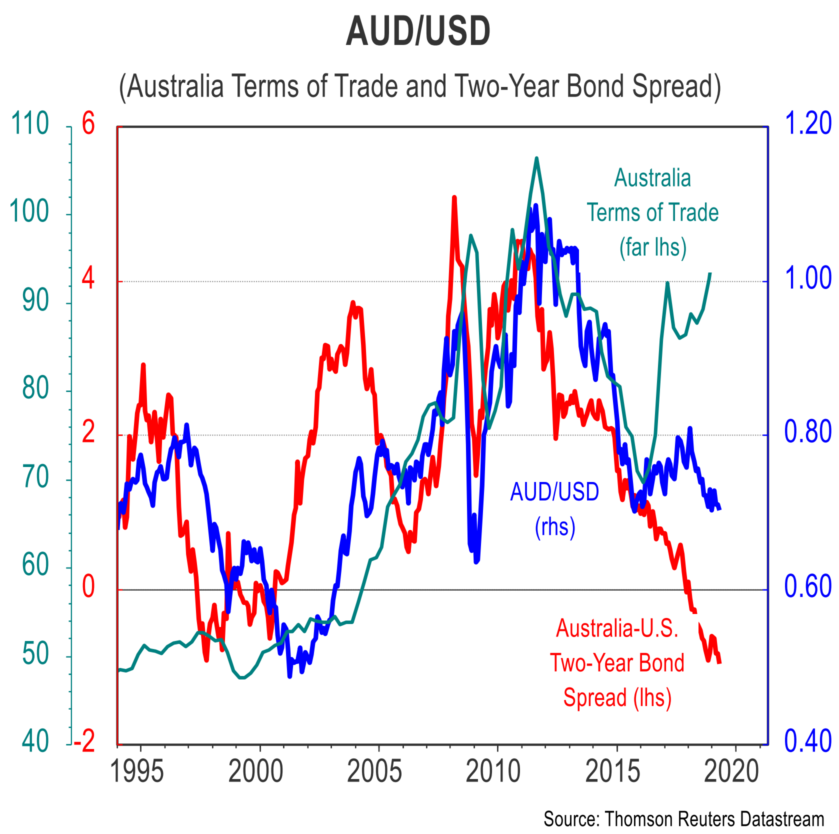
- **The RBA acknowledged in the Minutes to the April 2019 Board meeting that high household debt and falling house prices probably limited the effectiveness of interest rate cuts.**
- **They remain believers that the transmission channel via a lower AUD will work.**
- **But this time could be different:**
  - some 64% of home loan borrowers are on fixed rates or paying well above the minimum required so unlikely to cut repayments to free up some spending power; and
  - a solid commodity price backdrop has neutered much of the impact on the AUD of low rates, negative spreads and rate cut expectations.

House prices should stabilise



- **Policy changes will support house prices:**
  - lower cash rate (lower mortgage rates).
  - APRA changes to serviceability assessment metrics will boost loan sizes.
  - Reduced uncertainty around housing tax following Coalition election win.
- **Economic forces are coming in to play:**
  - lower prices have allowed first home buyers to return;
  - population growth in Sydney and Melbourne remains robust.
  - competition for “high quality” borrowers means the rate for new loans has fallen; and
  - new dwelling supply (ie construction) is slowing.

Australian dollar



- The two main influences on AUD are commodity prices and the Australia-US two year bond spread.
- Both of these key drivers are moving in opposite directions.
- Our forecasts have the AUD/USD moving lower to 0.68 in the near.
- But lifting towards the end of the year to 0.72 because we expect the US Fed to cut rates.

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What we expect over the next year

- **Global backdrop less favourable. But policy stimulus will provide support.**
- **Commodity prices to remain well supported.**
- **Australian economic growth to be soft 2.2%pa in 2019.**
- **But economic growth to pick up over H2 2019 in response to tax cuts and RBA cash rate cuts.**
- **Unemployment rate to move a little lower.**
- **Income and wages growth to lift only gradually.**
- **The RBA to cut the cash rate again in August.**
- **Dwelling prices should bottom out soon.**
- **AUD/USD to move a little lower in the near term before lifting at the end of the year.**

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CBA Australian Economic Forecasts

	2016/17 (a)	2017/18 (a)	2018/19 (f)	2019/20 (f)	2020/21 (f)	2016 (a)	2017 (a)	2018 (a)	2019 (f)	2020 (f)
Economic Activity										
Private final demand	**0.9**	**3.4**	**1.2**	**1.8**	**2.8**	**0.5**	**2.2**	**2.7**	**0.9**	**2.5**
Of which: H/hold spending	2.4	2.8	2.0	2.0	2.6	2.7	2.4	2.6	1.8	2.4
Dwelling investment	2.5	0.2	-0.1	-5.4	-2.4	7.9	-2.4	4.4	-5.8	-3.6
Business investment	-7.1	9.2	0.1	4.9	6.5	-11.8	3.1	4.3	2.1	6.1
Public final demand	**6.5**	**3.3**	**5.4**	**3.2**	**3.0**	**6.4**	**5.0**	**4.0**	**4.3**	**3.0**
Domestic final demand	**2.2**	**3.4**	**2.2**	**2.1**	**2.9**	**1.8**	**2.9**	**3.0**	**1.7**	**2.6**
Inventories (contrib to GDP)	0.0	0.0	0.0	0.1	0.0	0.1	-0.1	0.1	0.0	0.0
GNE	**2.2**	**3.4**	**2.2**	**2.2**	**2.9**	**1.9**	**2.7**	**3.2**	**1.7**	**2.6**
Exports	5.5	4.1	2.9	5.1	4.1	6.8	3.4	5.0	2.8	5.3
Imports	4.7	7.1	0.4	2.9	5.3	0.1	7.7	4.1	0.1	4.9
Net exports (contrib to GDP)	*0.2*	*-0.6*	*0.5*	*0.5*	*-0.2*	*1.3*	*-0.8*	*0.2*	*0.6*	*0.0*
GDP	**2.3**	**2.8**	**2.2**	**2.7**	**2.7**	**2.8**	**2.4**	**2.8**	**2.2**	**2.8**
Prices & Wages										
CPI	**1.7**	**1.9**	**1.7**	**2.2**	**2.0**	**1.3**	**1.9**	**1.9**	**1.8**	**2.1**
Underlying CPI	1.7	1.8	1.7	2.0	2.3	1.6	1.8	1.8	1.7	2.2
Wage Price Index	**1.9**	**2.1**	**2.3**	**2.7**	**2.8**	**2.0**	**2.0**	**2.2**	**2.4**	**2.8**
Nominal GDP	6.2	4.7	5.3	5.3	5.1	3.9	6.1	4.9	5.6	4.9
Real h/hold disposable income	1.2	1.6	0.7	2.4	2.6	1.0	1.3	1.1	1.5	2.6
Labour Market										
Employment	1.5	3.0	2.4	2.0	2.0	1.8	2.3	2.7	2.2	1.9
Unemployment rate	5.7	5.5	5.1	4.9	4.7	5.7	5.6	5.3	5.0	4.8
External Accounts										
Current Account: $bn	**-38.3**	**-51.0**	**-22.4**	**-8.4**	**-13.6**	**-53.3**	**-46.2**	**-40.7**	**-9.2**	**-8.8**
% of GDP	*-2.2*	*-2.8*	*-1.1*	*-0.4*	*-0.6*	*-3.1*	*-2.6*	*-2.1*	*-0.5*	*-0.4*

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The Bank is a swap dealer provisionally registered with the U.S. Commodity Futures Trading Commission and is a member of the National Futures Association in such capacity (NFA ID 0249150). In the United States, swaps, and products and strategies involving swaps are not suitable for investment by counterparties that are not "eligible contract participants" as defined in the U.S. Commodity Exchange Act ("CEA") and the regulations adopted thereunder; or (ii) entities that have any investors who are not "eligible contract participants." Each hedge fund or other investment vehicle that purchases the products must be operated by a registered commodity pool operator as defined under the CEA and the regulations adopted thereunder or a person who has qualified as being exempt from such registration requirement.