National Australia Bank

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Global & Australian Forecasts

July 2014

Moderate global growth continues after early 2014's slowing, resulting in slightly lower growth forecasts in 2014 but nearer trend in out years. Mixed picture among advanced economies as US & Euro-zone growth disappoints expectations but UK expansion stays solid & Japan has coped with April's tax hike better than some feared. Mixed picture in emerging economies too as trend slowing in China continues, other East Asian economies & Latin America stay sluggish & India disappoints. Australian forecasts unchanged: business confidence still unaffected by Budget, conditions better but still below average, but employment down & forward indicators soft. Cash rate on hold until late 2015; unemployment to edge up.

- After rising through 2013, the main business surveys have gone sideways in 2014 and the pace of global growth has slipped slightly. World GDP growth softened from 3.3% yoy to 3% yoy between late 2013 and early 2014 and monthly data on industrial output and world trade confirm the fading in the previous upward momentum of growth. Bad weather in North America explains some of early 2014's disappointing outcome but the Euro-zone upturn also faltered and Japan's economy has to digest the April rise in indirect taxes. Despite these headwinds, we expect global growth to quicken to 3.7% in 2015 and 2016 as the US recovers and expansion picks up in long-time under-performing economies like India and the Euro-zone.
- Domestic indicators continue to point to jobless growth and no certainty that declining mining investment will be replaced quickly. Retail looks softer and property market seems near a plateau. Extent of fiscal consolidation remains uncertain and could be a slow burn on activity with concerned consumers. Forward indicators from survey still weak.
- Australian forecasts unchanged: 3.3% in 2014/15, 3.0% in 2015/16. But jobless growth still sees unemployment rate peak at 6¼% by end-2014. Cash rate unchanged until late 2015. On rates our judgement is that the risks of a further easing has risen but so far hasn't satisfied the high hurdle necessary to get the RBA to do anything about it.

Key global GDP forecasts (calendar years)

Country/region	*IMF weight*	2012	2013	2014	2015	2016
				% change		
United States	*19*	2.8	1.9	1.6	3.0	2.8
Euro-zone	*14*	-0.6	-0.4	0.9	1.3	1.6
Japan	*6*	1.4	1.6	1.6	1.4	0.9
China	*15*	7.8	7.7	7.3	7.0	6.8
Emerging Asia	*8*	3.8	3.9	4.0	4.3	4.5
Global total	*100*	3.1	2.9	3.2	3.7	3.7
Australia	*2*	3.6	2.4	3.5	3.1	3.1

Key Australian forecasts (fiscal years)

GDP components	13/14	14/15	15/16	Other indicators	13/14	14/15	15/16
		% annual average				*% through-year*	
Private consumption	2.5	2.8	3.1	Core CPI	2.7	2.1	2.8
Domestic demand	1.1	0.8	0.6			*% end of year*	
GDP	3.0	3.3	3.0	Unemployment rate	5.8	6.1	5.6

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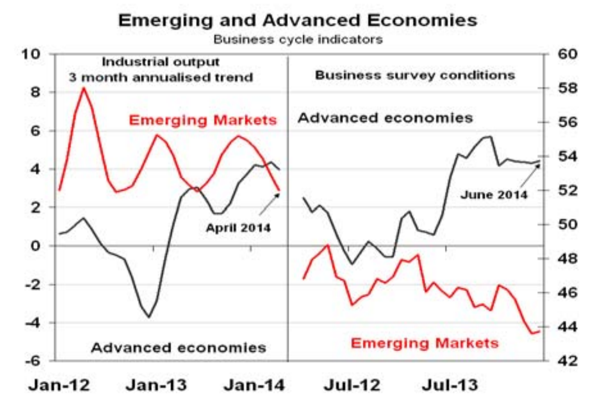
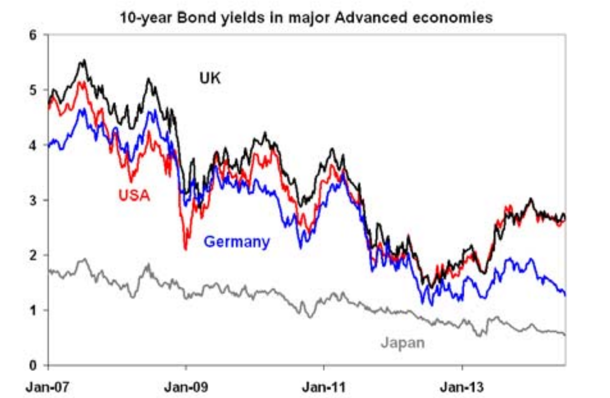
Global outlook

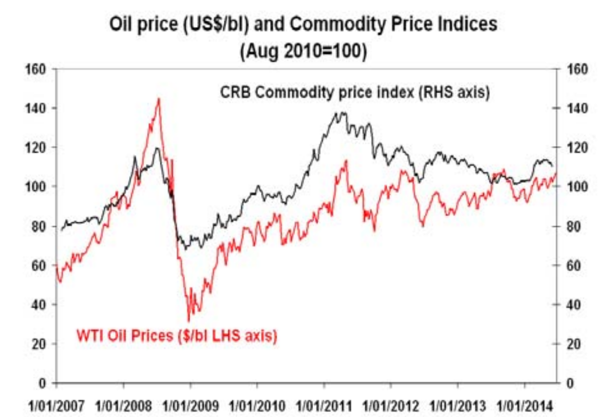
- With two notable exceptions (Japan and the UK) the early 2014 slowdown in global growth looks broadly based and increasingly sharp. Output fell in the US, Euro-zone growth was very low and the slowing trend across the main emerging market economies continued.
- Recent international business surveys as well as monthly data on trade and industrial output suggest that June quarter global GDP growth has settled around the 3% yoy pace that was seen in the March quarter (from 3¼% yoy in late 2013).
- US growth appears to have resumed, Japan could well avoid recession in the wake of April's tax rise, solid recovery continues in the UK and the clear result in the Indian elections could finally boost confidence there. Against that, China's trend growth is gradually slowing and a group of under-performing big economies (Brazil, France and Italy) are putting a drag on global growth.
- Moderate 3¼% growth is expected to continue through 2014 followed by acceleration to around trend 3¾% in 2015 and 2016. The upturn mainly reflects faster growth in the US and India alongside a return to more normal growth rates in the Euro-zone and Latin America.



Financial & commodity markets

After a long period in which the focus of most central banks in the big advanced economies has been on low interest rates and injecting liquidity to stave off deflation, boost growth and repair the consequences of the GFC, we are now entering a period of greater diversity in monetary policy. The Fed is still winding back its asset purchases at a rate that should see them end this year but it is still signalling low interest rates into 2015. The Bank of England recently surprised the markets saying that rate rises could come sooner than generally expected. By contrast, the ECB and the Bank of Japan are focussed on ending or avoiding deflation with the former recently loosening policy and the latter continuing its ultra-easy policy as inflation finally starts to rise.

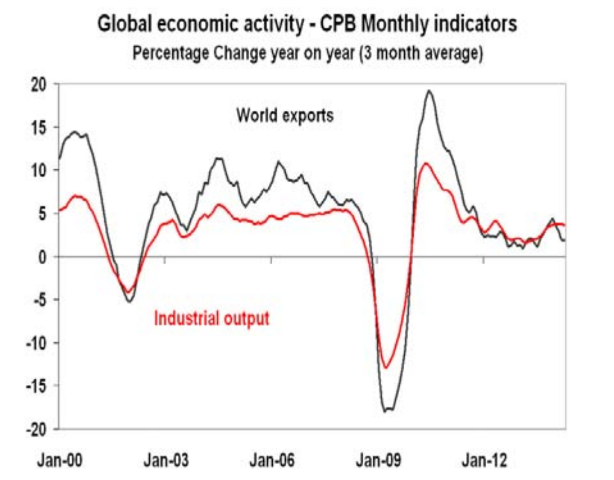




Global trends

The pace of growth in global industrial output has settled at a moderate pace of around 3¾% yoy since late 2013, a clear improvement on the sub-2% yoy growth rates seen at the start of 2013. This pick-up through 2013 reflected an improvement in conditions in the big advanced economies alongside a slowing trend in the main emerging market economies.

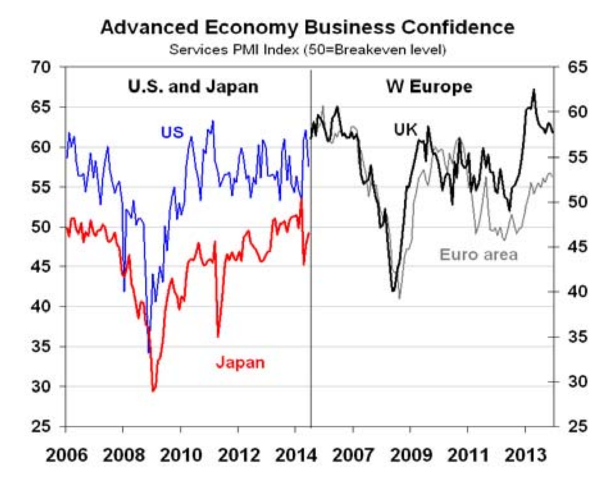
World trade, on the other hand, has been more volatile with a distinct slowdown since the end of last year. Year on year growth has slipped from 4½% yoy in December 2013 to under 2% yoy in March and April and this slowing reflects a concerning outright fall in the level of world exports since late 2013 which has been spread across both advanced and emerging market economies. International trade data does tend to fluctuate more than production so it is too early to sound the alarm bells that shrinking global trade could signal a weakening in output - but the monthly data should now be closely watched in case of ongoing weakness.



Advanced economies

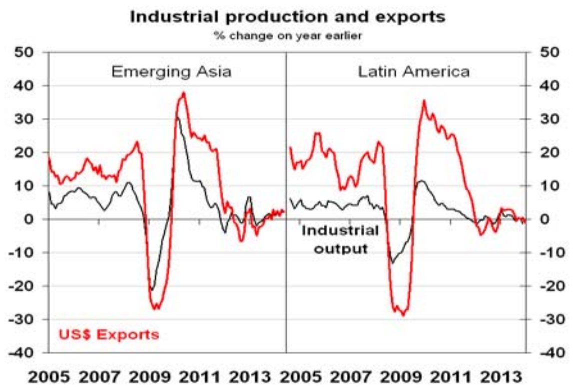
Revised US data has magnified the slowdown in G7 advanced economy growth that was recorded in early 2014. Annualised growth in those economies peaked at around 2½% last September quarter before slipping to under 2% in December and only ¼% in March quarter 2014. Some of the early 2014 weakness should be discounted as it reflected the impact of bad weather and other shocks in North America. Also business surveys have not been as weak as GDP – so business is not sensing a sudden move toward recessionary conditions.

Elsewhere conditions are mixed. Euro-zone growth in early 2014 was very disappointing and the business surveys since then have not shown much of an improvement. In fact, recent European Commission and PMI industrial surveys for the Euro-zone have been trending down as ongoing weak conditions in France and Italy weigh on sentiment. However the Belgian central bank's business survey – a useful guide to conditions across the region – is not showing any collapse in firms' demand expectations, so things should at least stabilise. Elsewhere, the UK is finally recovering strongly from its deep and protracted downturn and Japanese business is adjusting to the shock to demand caused by the April hike in sales taxes.



Emerging economies

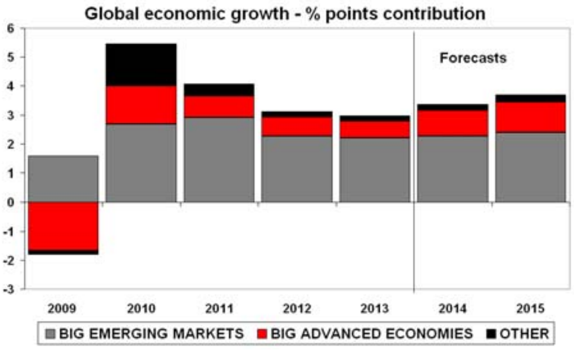
The slowing trend in the big emerging economies has continued into 2014 with March quarter growth slipping to 5.4% yoy, down from the 6% yoy recorded in mid-2013. Industrial growth has settled at around 4% yoy since mid 2013 but a couple of soft monthly numbers early this year have cut the trend annualised growth rate to below 3%. Services are the biggest single sector in the emerging market economies and growth there has been gradually trending down for years. Services growth was around 6% yoy in March quarter, well below the over 8% yoy growth rates seen a few years ago. The emerging market slowdown is also widespread with recent monthly data showing China continuing its gradual slowing trend, India still disappointing the optimists and modest outcomes in Latin America and East Asia.



Forecasts

Downward revisions to US March quarter history have flowed into a cut in our 2014 US growth forecasts to only 1.6%, but growth should recover to 3% next year as the economy recovers from its early 2014 dip. The other big downward revision is for Latin America where new data shows Argentinean GDP (the 22nd biggest global economy) fell in early 2014 as the economy faced a new debt crisis. There is also uncertainty surrounding the impact of the World Cup on the recently soft Brazilian economy.

Global growth is forecast to quicken from 3.2% this year to 3.7% in both 2014 and 2015, which is around or slightly above the long-run trend. The Emerging market economies should still account for the bulk of the increase in global output but the contribution from advanced economies should pick-up this year and next as the latter's growth accelerated from 2013's 1¾% to 2¾% this year and next. Emerging market growth should remain over 5% as India's growth finally picks up.



Australian outlook

Key Points

- Business conditions recovered some ground in June, moving into positive territory (but still below average), and business confidence remained solid. While trading and profitability improved, employment conditions worsened, consistent with jobless growth.
- Forward indicators are mixed, both in the NAB survey and in the labour market. Although house prices strengthened again in June, this may have been seasonal and leaves them broadly unchanged since April.
- Mining engineering construction fell in Q1 but remains elevated, while the pipeline of work yet to be done continued to contract.
- Our GDP forecasts are unchanged: for 2014/15 3.3% (unchanged); for 2015/16 3.0%. We still expect the unemployment rate to peak at around 6¼% by the end of this year. For the cash rate, we continue to expect no further change until a tightening cycle begins near the end of 2015.

National trends

The domestic economy continues to experience relatively jobless growth: over year to Q1, GDP grew by 3.5%, much faster than hours worked (1.3%) and employed heads (0.4%). So far, Q2 has seen a continuation of weak demand for labour, particularly in terms of hours worked.

The latest NAB business survey reveals encouraging improvements in sales and profitability in June, especially in mining and construction, but overall employment weakened again. Conditions remain challenging in wholesale and manufacturing. Forward indicators are mixed, with possible evidence of restocking offset by flat orders and weaker capacity utilisation.

Retail trade fell in May following a soft April, possibly indicating some statistical payback from the surprising strength of the data earlier this year. This is in line with the plunge in consumer confidence in the lead up to, and after, the federal budget.

Residential building approvals are showing signs of stabilising following their decline since the start of the year. Non-residential building approvals are very bouncy with the May jump helping to partly moderate the extent of the recent trend down.

The latest engineering construction data confirms a weakening trend for mining construction and a declining pipeline of work yet to be completed. While the level of mining construction remains high by historical standards, the data are only for Q1 and we expect several major projects to be commissioned during the remainder of 2014.

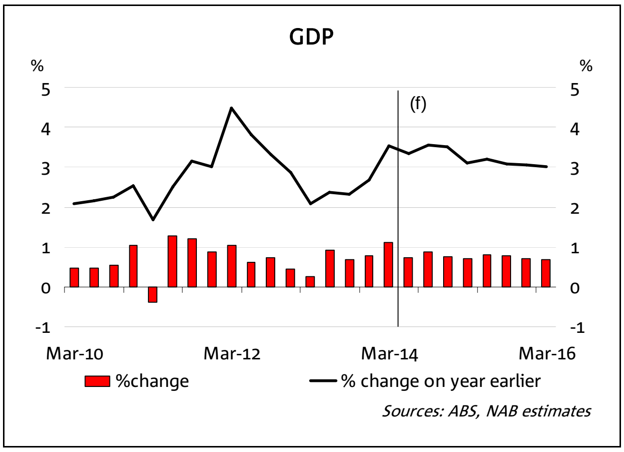
NAB survey data for Q2 imply stronger predicted GDP growth but weaker predicted demand growth compared with Q1. Our 'wholesale leading indicator' points to soft business conditions in coming months which suggests little change in predicted GDP growth in Q2.

Business credit growth edged down to 0.2% in May, indicating that business has little appetite for debt at present.

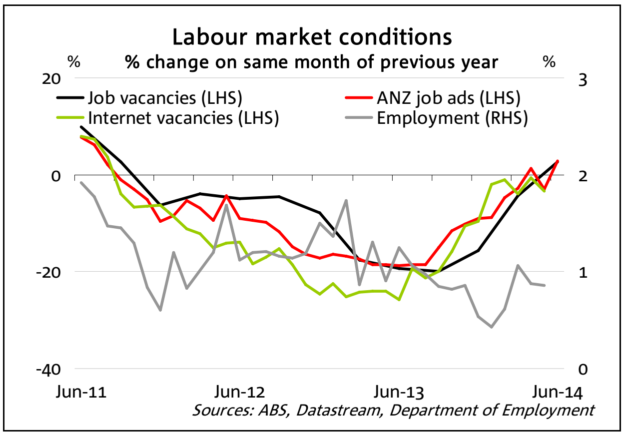
Housing prices rose again in June, although there may have been a seasonal element in this. Housing credit grew at just 0.4% in May. Share prices weakened in June.

The change in the composition of the Senate on 1 July will lead to further negotiations over the fate of several major federal budget measures (thus far the high income tax surcharge is the only major measure with immediate effect agreed to be passed). We are unlikely to have a firm view on the macroeconomic impact of the budget until these negotiations have been concluded. Nevertheless, it seems likely that fiscal restraint will provide a headwind to growth in coming quarters. Equally it is hard to judge the impact on growth from unsettled consumers – and the "Budget" may prove to be a slow downside burn.

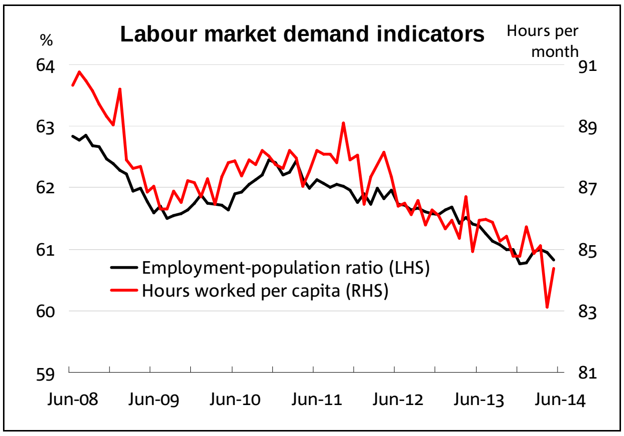
Our cash rate call is unchanged. We expect no change in the cash rate until the second half of next year. At present, the RBA is caught between the fear of weakening the economy by prematurely tightening and the risk that further relaxation of policy may further stimulate asset price growth. Nevertheless, the AUD remains at levels that the RBA regards as uncomfortable for many businesses. On balance our judgement is that the risks of a further easing has risen but so far hasn't satisfied the high hurdles necessary to get the RBA to do anything about it.



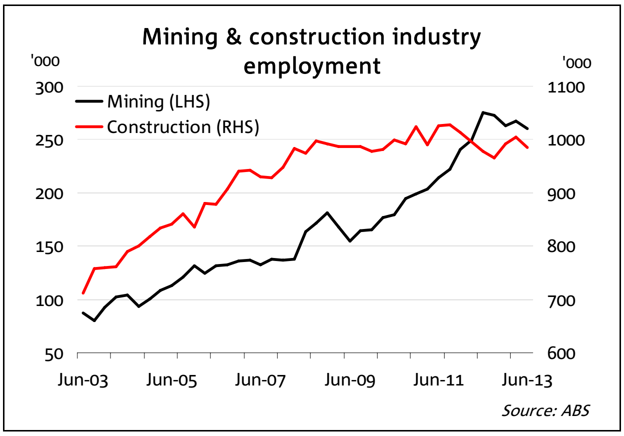
Labour market



Labour market forward indicators, while generally much better than a year ago, remain mixed. Department of Industry internet ads rose sharply at the start of the year but have since declined to levels last seen in the mid-year trough of 2013, although ABS job vacancies have risen 5% since the end of last year. ANZ job ads in June recovered some of the ground lost in May.



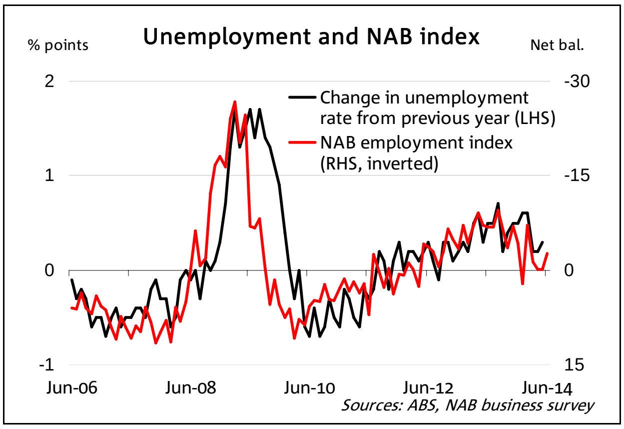
The NAB employment index from the business survey declined to -3 points in June, to be consistent with further upward drift in the unemployment rate.



The unemployment rate was unchanged at 5.8% for the third consecutive month in May and hours worked per capita regained most of the ground lost in April. Aggregate employment continued to move broadly sideways with unemployment kept in check by declining labour force participation.

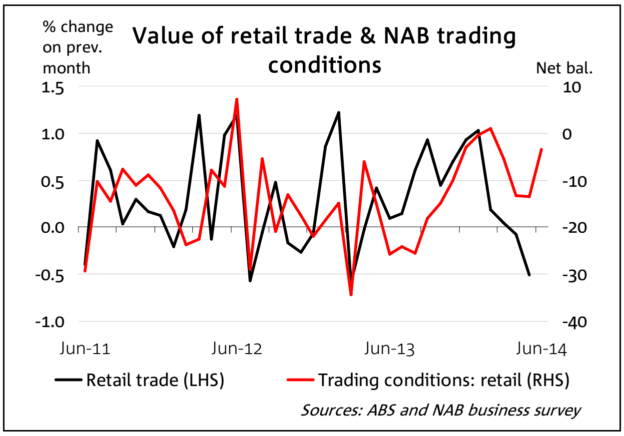
Employment in mining and construction has begun to show signs of a sustained decline. A sharp downward correction still appears likely because commissioned projects should need less labour than during their construction phase.

We still expect the unemployment rate to peak at around 6¼% by the end of 2014 before progressively declining during 2015 as displaced mining construction and services labour is absorbed into new infrastructure projects, dwelling construction and associated activities. The NAB employment index suggests that there is more upside to the unemployment rate in the near term.



Consumer demand & housing market

Retail trade declined by 0.5% in May following a (revised) declined of 0.1% in April. This may involve some statistical payback from the surprising strength of the data earlier this year, but is broadly consistent with the weakness in the NAB retail trading conditions index. It is also in line with the plunge in consumer confidence in the lead up to, and after, the federal budget. The softest areas were department stores and clothing, footwear & personal accessories. NAB retail trading conditions improved in June but remain in negative territory.



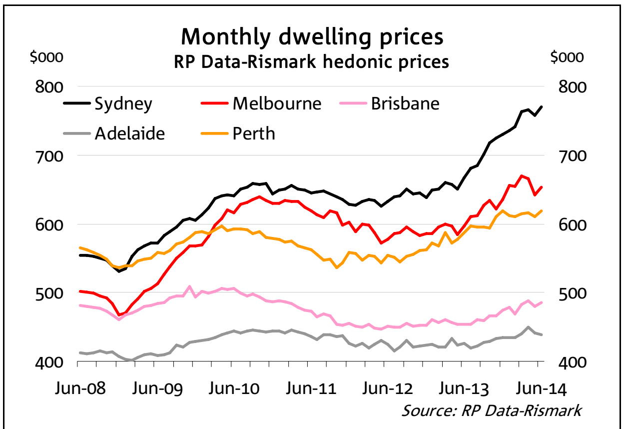
Consumer confidence has remained depressed, in contrast to business confidence. Business confidence among retailers is still a surprisingly positive +8 points. However, personal credit declined by 0.3% in May, further pointing to weakness in the demand for discretionary items.

The NAB online retail sales index rose modestly in trend terms in May, but still remains low compared with the very strong growth rates of recent years. Annual growth in online retail sales has fallen from double-digit rates to just 5.1% (for more detail, including in-depth results, see NAB online retail sales).

Total passenger and SUV vehicle sales continued to drift in May, at about 73,500 units, compared with an average of just over 75,000 in 2013.

According to RP Data-Rismark, capital city dwelling prices rose 1.4% nationally in June, partly reversing their sharp fall in May, although media reports suggested this may have been partly seasonal. The gains were strongest in Melbourne, Sydney and Brisbane. Total housing credit grew by 0.5% in May, at the same rate that has applied in six of the past nine months. Investors continue to outpace owner-occupiers (0.8% compared with 0.4%).

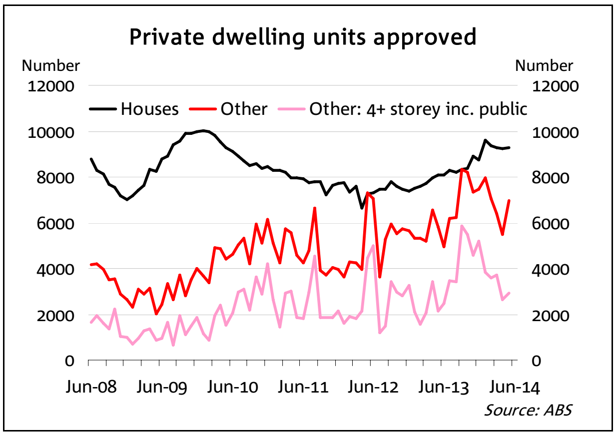
Share prices lost a little ground during June, with broad-based losses across bank, industrial and resources stocks.



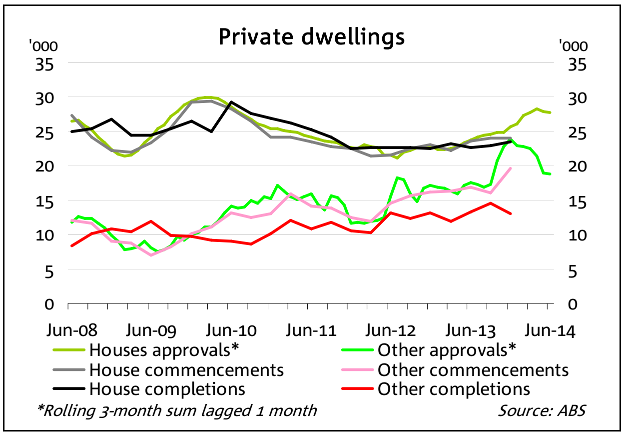
Investment

New home sales fell in May for the first time in five months, with particularly heavily declines for apartments and other multi-units, according to the HIA.

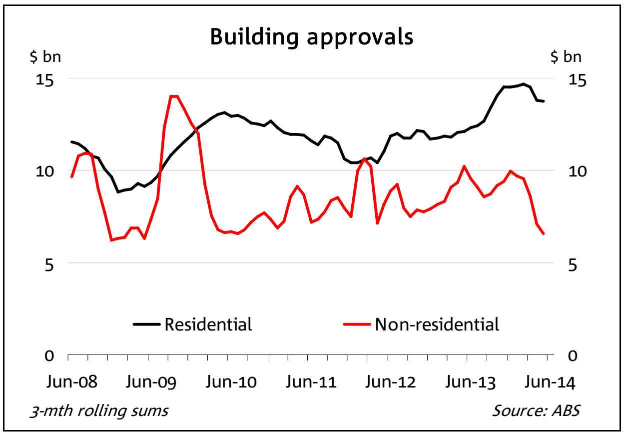
The downward trend in residential building approvals since the start of the year is showing signs of stabilising. House approvals edged up in May and there was a strong rise in unit approvals (although less so in multi-storey apartments). Nevertheless, the trend in residential building approvals remains moderate.



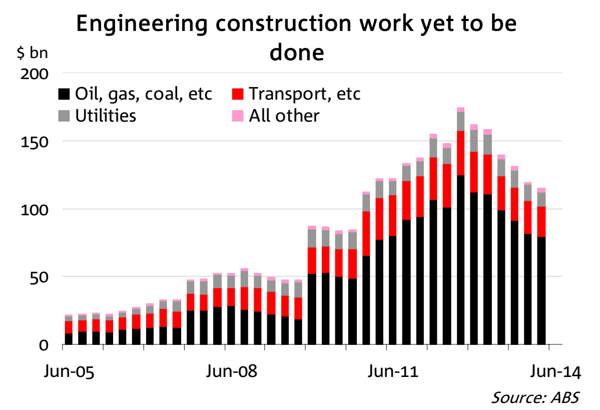
The prior increase in dwelling approvals can be expected to contribute to growth in building activity in Q2, given the lags involved. However, subsequent growth should moderate given the recent softness in building approvals.

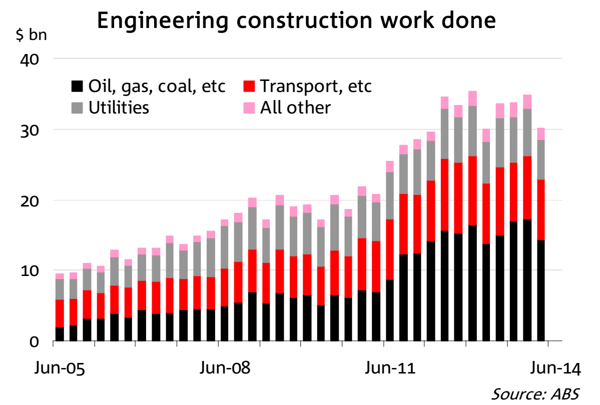


The value of non-residential building approvals continued to trend down in May (3-month rolling sum). There has been a pronounced downward trend in approvals for private commercial and industrial projects.



Although engineering construction in the mining sector declined by 17.4% in Q1, it remained historically high. However, the pipeline of minerals and energy work yet to be done declined for the sixth consecutive quarter.





Commodity prices and net exports

Oil price stability has been disturbed by unexpectedly severe sectarian turmoil in Iraq but, with Iraqi exports largely unaffected, prices have now eased somewhat. European gas prices continued to fall despite continuing tensions in Ukraine as inventories remain buoyant after a mild European winter. US gas prices have remained largely stable as inventories rebuild after a harsh US winter.

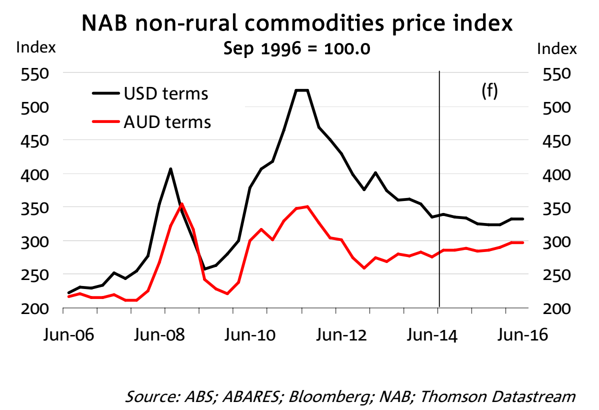
Prices for bulk commodities were far less volatile in June, iron ore recovering some ground (from a 21 month low), metallurgical coal tracking sideways and thermal coal easing. Bulk commodity markets remain well supplied, with little prospect for strong price recoveries.

Average prices across the base metals complex were mixed in June. Tight physical supplies are supporting metals prices, while some recent positive economic data is fuelling slightly better optimism about the demand outlook. Aluminium and zinc posted the largest gains for the month.

Gold prices rallied strongly in June, supported by escalating political tensions in Iraq, ECB easing and comments from the US Fed which weighed on the USD.

NAB's non-rural commodity price index is expected to fall by around 1.9% in September quarter (in US dollar terms) – following on from a 5.8% decline in June. Weaker prices for iron ore and metallurgical coal – Australia's largest commodity exports – are the main drivers (with the forecast for metallurgical coal lowered this month to reflect the impact of recent weak trends on Q3 contract levels).

In Australian dollar terms, commodity prices are forecast to track sideways across the remainder of 2014, before edging higher in 2015 (up by around 2%) – largely reflecting the continued softening in the Australian dollar.



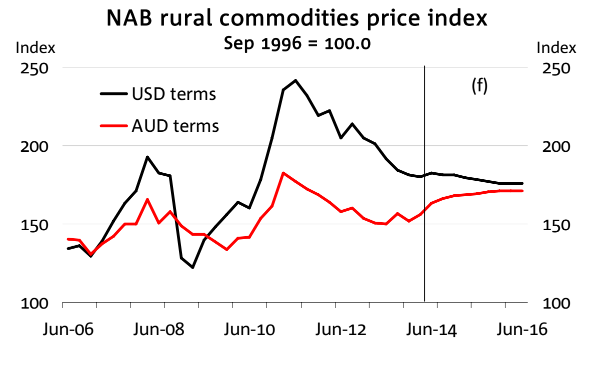
In domestic agriculture, while the past winter crop harvest was unaffected by drought, the summer crop this year is estimated to have fallen by 33% to 3.7 million tonnes. So far winter crop planting has progressed well foreshadowing a reasonable outcome for 2014/15, but unlikely to repeat the strong volumes of 2013/14. ABARES expects that winter crop production will fall by 12% in 2014/15 with some downside risks from a likely El Niño event.

Domestic wheat prices continue to maintain a premium to international prices on the back of supportive domestic fundamentals. Australian exports of beef and veal reached an unprecedented 108,000 tonnes in May, after only breaching the 100,000 tonnes mark for the first time in history just a year ago.

The Australian wool market has been gripped by soft demand conditions, partly reflecting the lack of credit for Chinese manufacturers. The quality of wool offerings has deteriorated as drought conditions in NSW and Queensland wear on, serving to cap the upward momentum of prices.

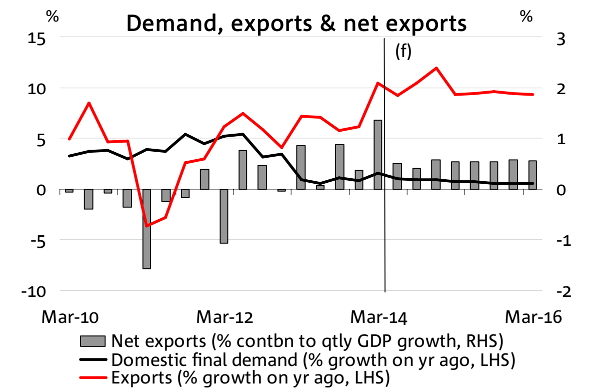
Global dairy commodity prices fell for the third consecutive month in May according to BNZ's global weighted index, but remain at historically elevated levels. Above-average rainfall in the southern parts of the country during the autumn months bolstered milk production during the period. Tighter Oceanian supplies as the production season draws to a close should lend a floor to prices, while Chinese imports maintain a strong pace given a persistent production deficit.

The Rural Commodities Index eased slightly in May largely in response to moderate declines in the prices of livestock and dairy. Overall, the Index declined 1.2% in AUD terms and 1.3% in USD terms. Beef and lamb both fell 4% in May in AUD terms, having risen substantially in the two months prior, reflecting a slightly disappointing end to otherwise decent autumn rainfalls. Dairy and cotton both suffered their third straight month of decline, whereas wheat, barley and sugar posted moderate gains.



Sources: ABS; ABARES; Bloomberg; NAB; Thomson Datastream

In AUD terms, we project a moderate increase of 3.6% in the rural commodity price index over the coming year before stabilising, largely reflecting a declining AUD, which is forecast to dampen the impact of falling dairy prices and low growth in wheat prices in USD terms. AUD prices for individual commodities are forecast to generally increase over the coming year, except dairy, which is projected to decline before stabilising in June 2015. In USD terms, we forecast the index to decline 2.3% to June 2015.



Sources: ABS, NAB forecasts

For more detail, see our [Minerals & Energy Commodities Research] and [Rural Commodities Wrap]. Based on our outlook for commodity prices, we see the terms of trade continuing to edge down, losing 5% through the course of 2014 and another 2% through 2015. As major energy projects are completed, we expect the volume and value of energy exports to grow, particularly from the LNG mega-projects.

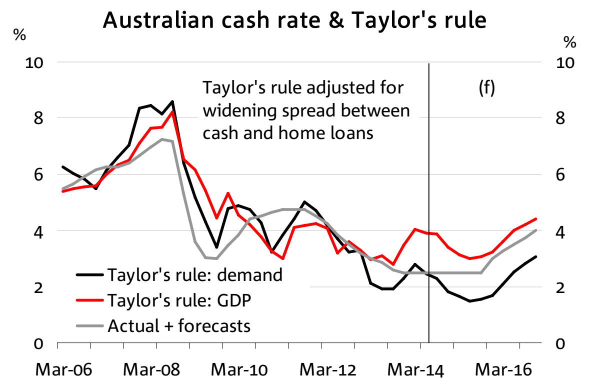
Exchange rate

In May, the AUD continued its momentum, ending the month at USD 0.93. Nonetheless, with market volatility at historic lows, the AUD remains in very tight ranges. The AUD is being driven by the low volatility environment, although with iron ore and yields declining, the upside pressure is lower. The sharp drop in the iron ore price in May (since partly recovered) points to strategic downside pressure on the AUD. However, NAB does not expect rapid adjustment in the near term unless the global environment starts to re-price risk and volatility rises.

Interest rates

The RBA kept the cash rate at 2.50% in July as expected. The Governor's statement acknowledged that recent better domestic growth has resulted from strong increases in mining exports but that resource sector investment is starting to decline significantly. Overall, the RBA continues to expect growth to be a little below trend for the year ahead. The RBA noted that inflation is likely to remain "consistent" with the target for the next two years, provided costs remain contained and despite a depreciating dollar.

The RBA is reluctant to raise the cash rate so long as growth is likely to remain below trend and uncertainties persist about the impact of the restructuring associated with the end of the mining investment boom. A higher cash rate would also likely place more upward pressure on the AUD, which is currently at a level the RBA describes as "offering less assistance than it might in achieving balanced growth." However, it is also reluctant to cut a cash rate that is already historically low, particularly given the recent re-ignition of house price growth. These cross-currents are likely to see the cash rate on hold for the remainder of the year and well into next.



Sources: RBA, NAB estimates

Global growth forecasts % change year on year

	2011	2012	2013	2014 (NAB Forecasts)	2015 (NAB Forecasts)	2016 (NAB Forecasts)
US	1.8	2.8	1.9	1.6	3.0	2.8
Euro-zone	1.6	-0.6	-0.4	0.9	1.3	1.6
Japan	-0.4	1.4	1.6	1.6	1.4	0.9
UK	1.1	0.3	1.7	2.9	2.4	2.5
Canada	2.5	1.7	2.0	2.3	2.5	2.4
China	9.3	7.8	7.7	7.3	7.0	6.8
India	7.7	4.8	4.7	5.2	5.8	6.2
Latin America	4.7	2.2	2.2	2.1	3.3	3.5
Emerging Asia	4.2	3.8	3.9	4.0	4.3	4.5
New Zealand	1.9	2.6	2.7	4.1	3.4	1.8
World	*4.1*	*3.1*	*2.9*	*3.2*	*3.7*	*3.7*
memo						
Advanced Economies	1.7	1.4	1.3	1.7	2.3	2.3
Emerging Economies	6.9	5.2	5.1	5.1	5.4	5.5
Major trading partners	4.6	4.2	4.5	4.6	4.6	4.5

Australian Economic and Financial Forecasts (a)

	Fiscal Year			Calendar Year		
	2013-14 F	2014-15 F	2015-16 F	2014-F	2015-F	2016-F
Private Consumption	2.5	2.8	3.1	2.6	3.0	3.1
Dwelling Investment	5.1	9.0	0.5	10.2	3.8	-0.2
Underlying Business Fixed Investment	-6.3	-9.8	-11.7	-7.9	-10.8	-12.1
Underlying Public Final Demand	1.2	-0.3	0.5	0.2	-0.1	1.2
Domestic Demand	**1.1**	**0.8**	**0.6**	**1.1**	**0.6**	**0.7**
Stocks (b)	-0.6	0.1	0.3	-0.4	0.4	0.2
GNE	**0.5**	**0.9**	**0.8**	**0.7**	**1.0**	**0.9**
Exports	7.9	10.2	9.4	10.5	9.4	9.3
Imports	-3.5	-0.4	0.4	-2.5	0.5	0.8
GDP	**3.0**	**3.3**	**3.0**	**3.5**	**3.1**	**3.1**
– Non-Farm GDP	2.9	3.4	3.0	3.6	3.1	3.1
– Farm GDP	5.5	0.7	2.0	0.0	2.0	2.0
Nominal GDP	4.5	4.7	4.3	4.9	4.1	4.9
Federal Budget Deficit: ($b)	50	30	17	NA	NA	NA
Current Account Deficit ($b)	35	6	-13	15	-1	-26
(-%) of GDP	2.2	0.4	-0.7	0.9	-0.1	-1.4
Employment	0.8	1.6	2.1	1.1	1.9	2.3
Terms of Trade	-3.1	-2.6	-4.5	-2.7	-4.5	-2.9
Average Earnings (Nat. Accts. basis)	2.3	2.9	3.0	2.7	3.0	3.0
End of Period						
Total CPI	3.2	2.2	3.1	2.3	2.6	3.2
Core CPI	2.7	2.1	2.8	2.3	2.3	3.0
Unemployment Rate	5.8	6.1	5.6	6.2	6.0	5.4
RBA Cash Rate	2.50	2.50	3.50	2.50	3.00	4.00
10 Year Govt. Bonds	3.75	4.60	4.85	4.10	4.90	4.75
$A/US cents :	0.90	0.83	0.80	0.85	0.81	0.80
$A - Trade Weighted Index	72.1	67.0	66.2	67.5	66.4	66.1

(a) Percentage changes represent average annual growth, except for cash and unemployment rates. The latter are end June. Percentage changes for CPI represent through the year inflation.

(b) Contribution to GDP growth

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