more give, less take

Global & Australian Forecasts

by NAB Group Economics

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National Australia Bank

Key Points:

- **Disappointing global growth continued into mid-2014 with GDP expanding by a sub-trend 3% yoy and concern over weakness in Japan and the Euro-zone offsetting solid growth in the US and UK. Chinese forecasts unchanged. We expect global growth to improve to around 3½% yoy through 2015 and 2016, mainly reflecting faster growth in the US and India as well as a return to more normal growth in Latin America. Inflationary pressures should remain subdued, allowing central banks in the US and UK to lift rates very gradually through the next few years while rates should stay low in Japan and the Euro-zone.**
- **Weaker Q3 and terms of trade means GDP forecasts revised down modestly: 2014/15 2.8% (was 2.9%) and 2015/16 3.2% (was 3.4%). Unemployment rate still to peak at around 6½%. We continue to expect no change in cash rate until a tightening cycle begins near the end of 2015.**

Key global and Australian forecasts (*% change*)

Country/region	IMF weight	2012	2013	2014	2015	2016
United States	16	2.3	2.2	2.2	3.0	2.8
Euro-zone	12	-0.6	-0.4	0.7	0.9	1.1
Japan	5	1.5	1.5	1.0	1.0	0.8
China	16	7.8	7.7	7.3	7.0	6.8
Emerging Asia	9	3.9	3.9	3.9	4.2	4.4
New Zealand	0.2	2.5	2.8	3.8	3.4	1.8
Global total	100	3.1	3.0	3.0	3.4	3.6
Australia	2	3.6	2.3	3.0	3.0	3.2

Australia (*fiscal years*)	12/13	13/14	14/15	15/16
Private consumption	2.1	2.5	2.1	2.6
Domestic demand	2.0	1.2	1.1	1.1
GDP	2.6	2.8	2.8	3.2
Core CPI (*% through-year*)	2.4	2.8	2.0	2.5
Unemployment rate (*% end of year*)	5.7	5.9	6.5	5.9

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Global and Australian overview

Global overview

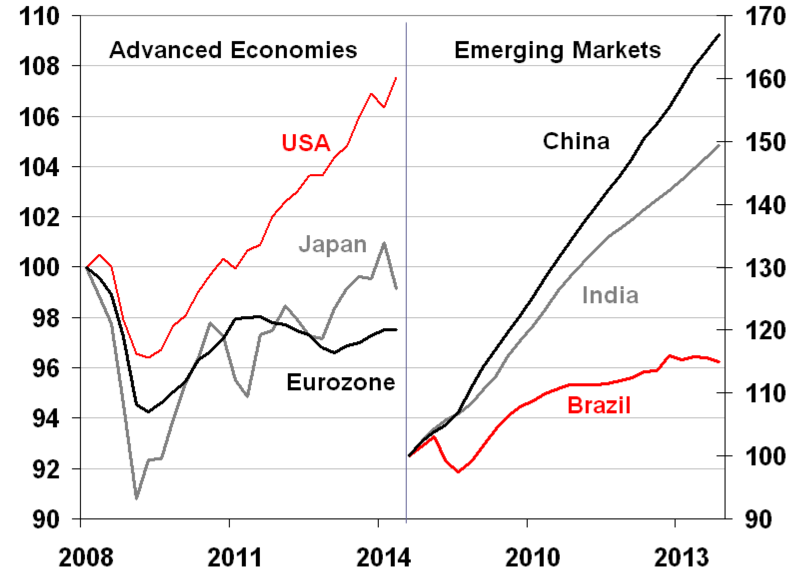
- Global growth was around 3% in the first half of 2014, below trend and with marked variations in performance between major economies. North America continues to perform strongly with solid growth in both the US and Canada. Although the UK's pace of growth could have peaked, it continues to run at a solid rate while recovery in Japan and the Euro-zone has faltered. Conditions are also mixed across the emerging market economies with an upturn in India after some disappointing years, continuing trend slowdown in China, falling output in key Latin American nations like Brazil and Argentina and sluggish growth across most of emerging market East Asia (as the weakness of growth in world trade affects export-driven Asian economies). Global growth should quicken next year to a still sub-trend 3.4%, largely driven by the US and India.

Australian overview

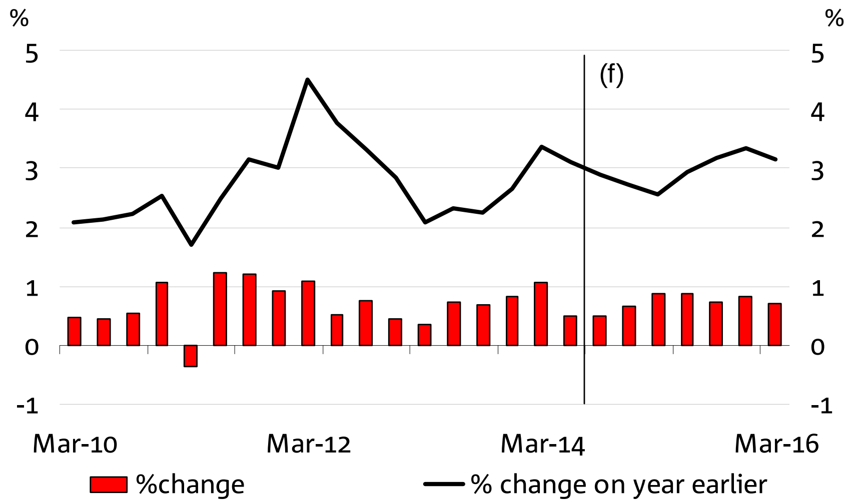
- Retreating confidence and conditions and likely sharp decline in terms of trade point to weak Q3. In September, capacity utilisation continued falling, forward orders declined and employment slumped further into negative territory. In August, retail trade growth was soft, vehicle sales fell, personal credit growth remained weak and non-residential building approvals trended down.
- Forward indicators suggest that the recent improvement in conditions has been sustained. Still few signs of a sustained increase in non-mining investment to fill the emerging mining investment cliff. However, the easing in the AUD should assist trade-exposed sectors of manufacturing and services. Business credit barely grew in August.
- Terms of trade profile weaker in response to sharp declines in commodity prices. Consequently, GDP forecasts revised down modestly: 2014/15 2.8% (was 2.9%) and 2015/16 3.2% (was 3.4%). Unemployment rate still to peak at around 6½%. No change in cash rate expected until near the end of 2015.

Quarterly GDP in major economies

January 2008=100 Indices



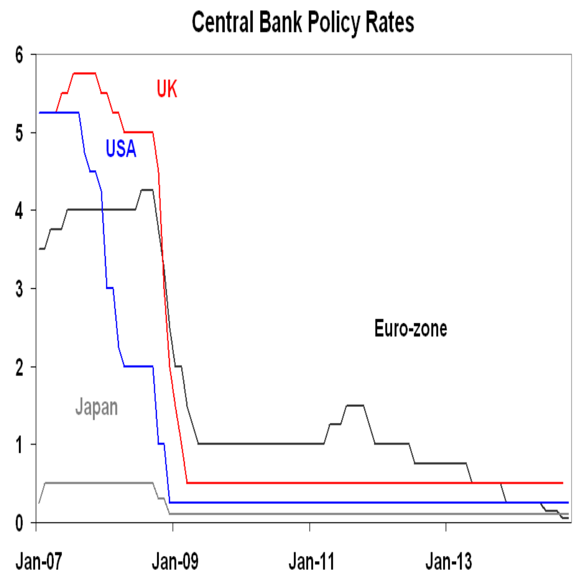
GDP

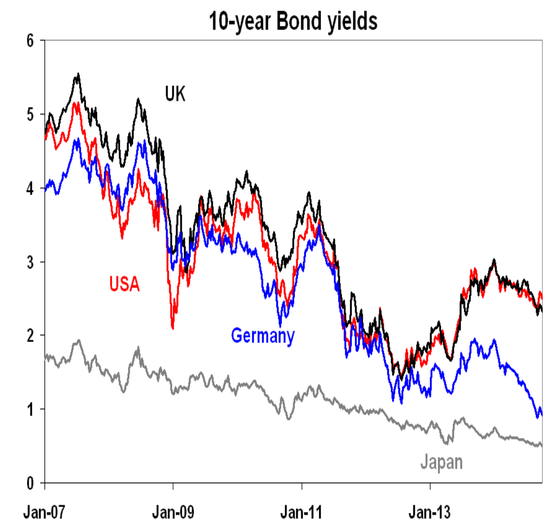


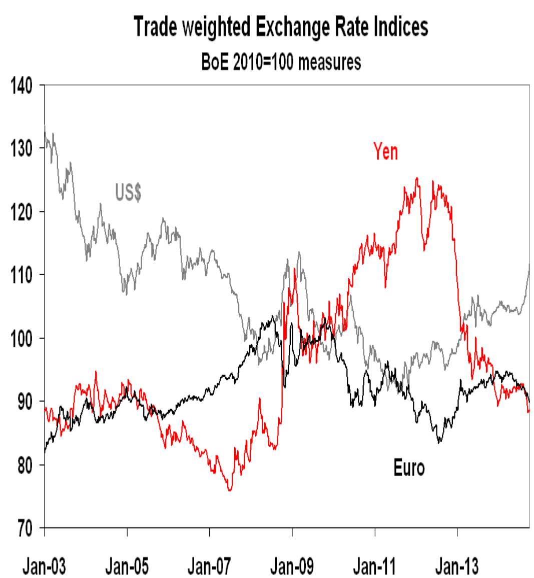
Sources: ABS, NAB estimates

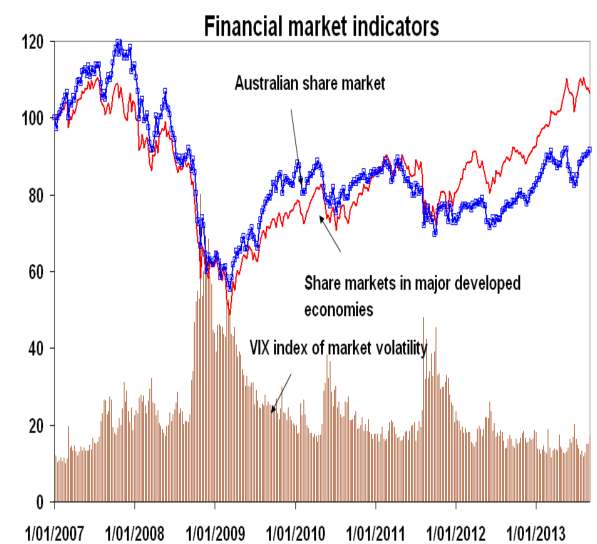
Financial markets

- Following a long period of low and falling policy interest rates across the big advanced economies, the growing divergence in their economic conditions should be increasingly reflected in a greater diversity of experience in monetary policy and in currency movements through the next couple of years.
- The US Federal Reserve seems quite confident that moderate economic growth looks set to continue and that inflation should be at or below the 2% goal by 2017, allowing it to gradually prepare the ground for a slow tightening in policy. The Fed's program of asset purchases is nearing its end but the fed funds interest rate should thereafter remain unchanged for a "considerable time". Even once the US labour market and inflation are around Fed target levels, the funds rate may well stay below its long run normal rate. We think the Fed will start lifting rates in mid-2015.
- The Euro-zone and Japan face an entirely different situation. In both cases, economic activity is turning out soft and weaker than expected, there is no pressure whatever from inflation causing upward pressure on rates and bond yields are exceptionally low. Deflation is a risk in the Euro-zone, with CPI inflation down to only 0.3% yoy and the Bank of Japan is still trying to escape deflation by getting inflation up to 2% as soon as possible (but core inflation is only 1¼% yoy). Neither the ECB nor the Bank of Japan looks set to end their asset buying programmes soon and a lift in their policy interest rates is probably still years away.
- This divergence in economic conditions and monetary policy is flowing into currency markets via the long awaited $US appreciation.



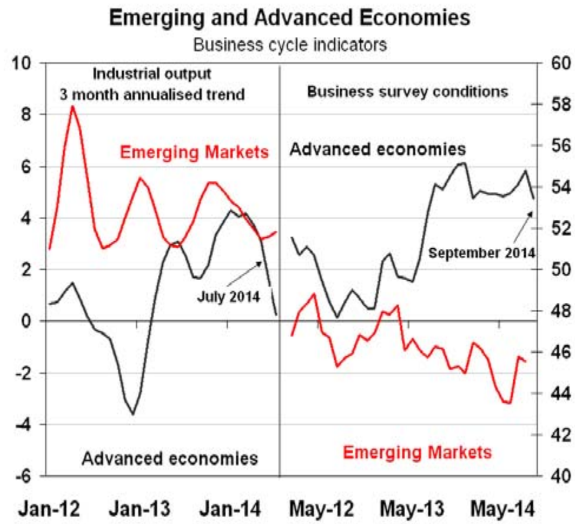


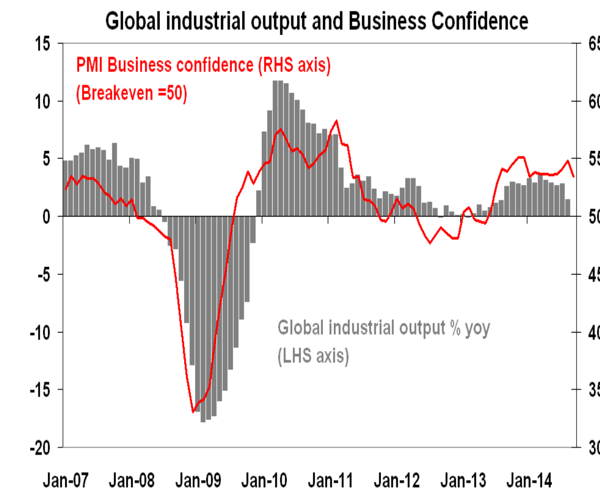


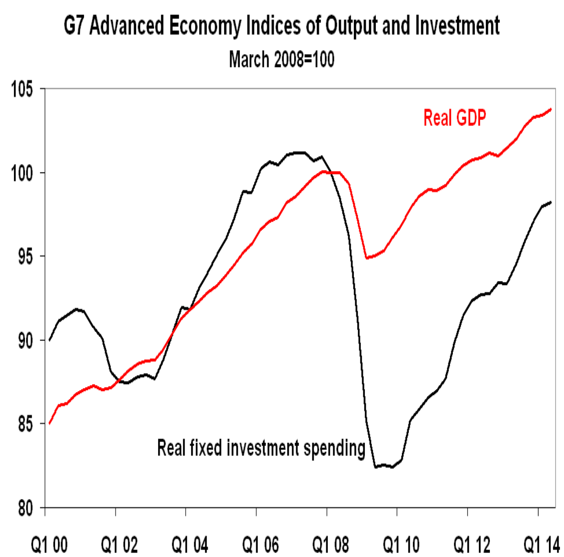


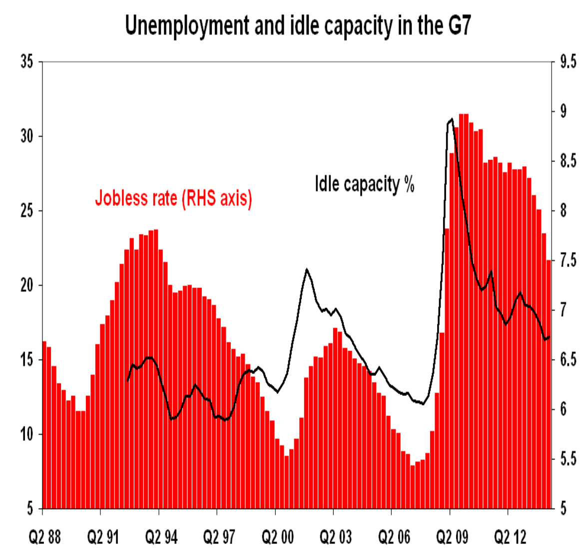
Global Economic Trends

- Softness in economic activity in the Euro-zone, Japan and Brazil alongside the trend slowdown in China has offset solid growth in North America and some recovery in India. The result has been a slowing in the pace of global industrial growth through 2014 from around 3% yoy to under 2½% yoy by August. This slowing, concentrated in post-tax rise Japan and the Euro-zone, mirrors a winding back in confidence levels seen in recent industrial sector business surveys, although the results are still consistent with ongoing moderate growth.
- Global growth in service industry output has also slowed recently, dipping from 3½% yoy to around 3% yoy between the March and June quarters. This mainly reflects a fall in Japanese spending on services in the wake of the April rise in indirect taxes and a slowdown in the Euro-zone. Service sector output continues to grow rapidly in the UK (by around 3½% yoy) and in big emerging market economies like China, India and Indonesia. Recent business surveys show a modest slowdown in global service sector growth continuing into the third quarter.
- The hesitation of businesses in the big advanced economies to invest and borrow reflects the heightened risk aversion that set in after the 2007/08 financial crisis and recession. Although output in the G7 Advanced Economies clearly exceeds its pre-crisis level, investment spending has still not fully recovered, partly reflecting the availability of idle capacity that allows firms to delay taking decisions to spend.



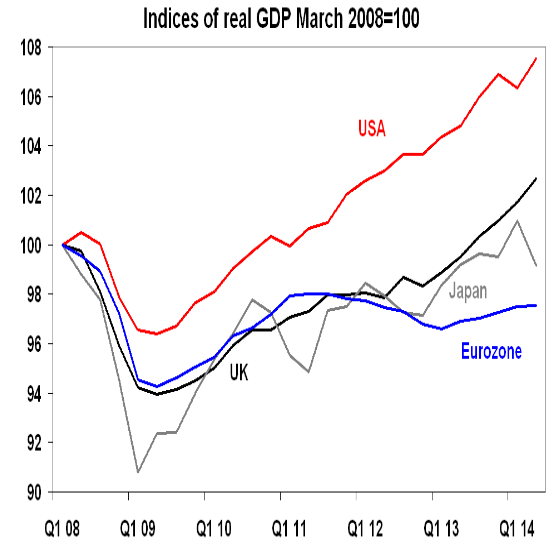


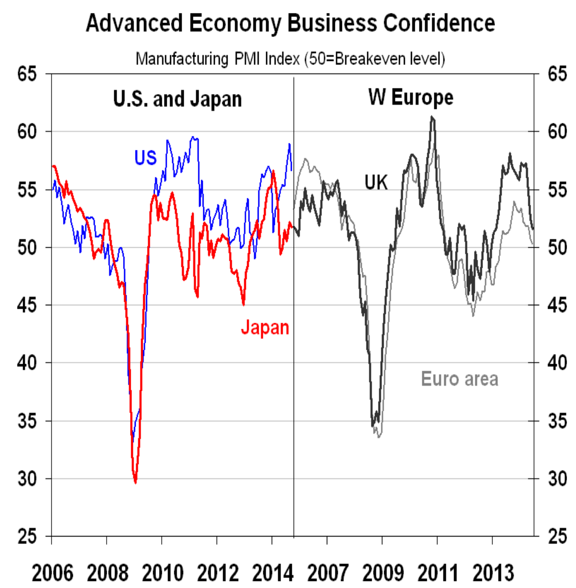


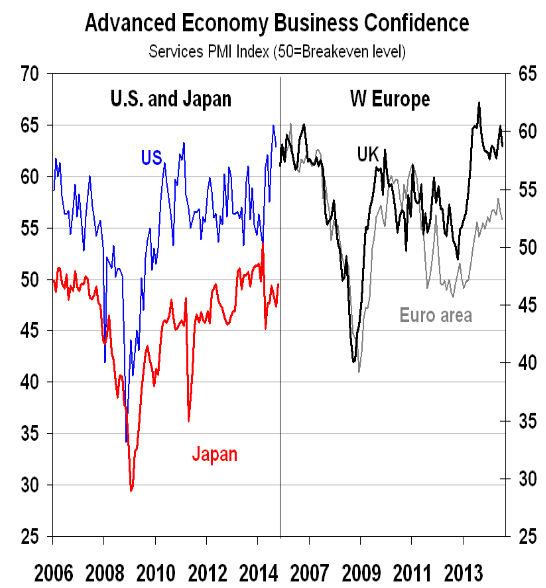


Advanced Economies

- Although G7 Advanced economy annualised growth quickened from ½% in March quarter to 1½% in June, almost all of this occurred in North America (plus a very small contribution from the UK) while Japanese output fell and Euro-zone production stagnated. Output in the US and UK has risen above its March 2008 (pre-financial crisis) level but GDP in Japan and the Euro-zone in mid-2014 was below its early 2008 level, marking 7 lost years for economic growth, unseen since the 1930s.
- Recent business surveys point to continued growth in both the industrial and services sectors of the big advanced economies. Taken overall, however, the monthly readings through September quarter point to a loss of momentum and the rate of growth is no longer accelerating.
- The surveys also show a marked difference between industrial sectors across the big advanced economies. Solid results in the US are in contrast to a clear softening in Western Europe while Japanese industry is struggling to recover from April's tax rise. Service sector surveys for the last few months also diverge, showing very strong results in the UK and US as well as modest growth in the Euro-zone alongside weak outcomes in Japan.
- The principal concern at present is the extent to which advanced economy growth is being driven by just one big economy – the US – with recent GDP releases, partial economic indicators and surveys highlighting the failure of the other two big regions (Japan and the Euro-zone) to deliver growth.

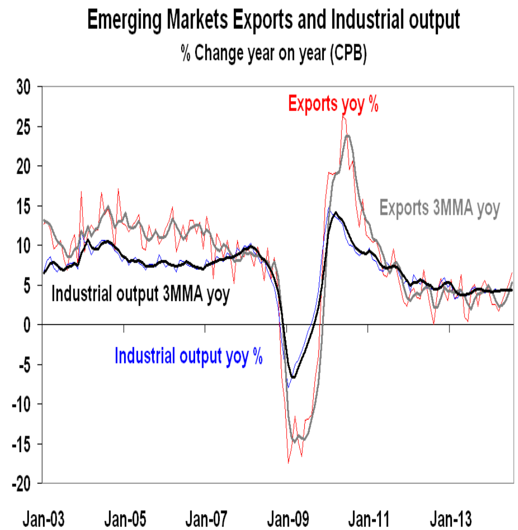


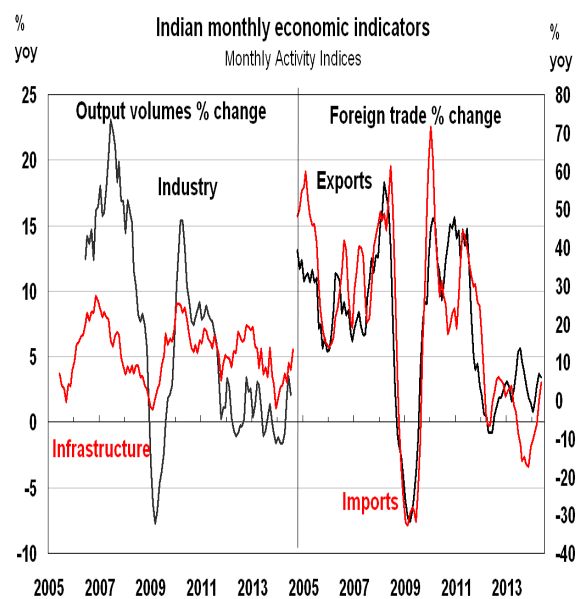




Emerging Market Economies

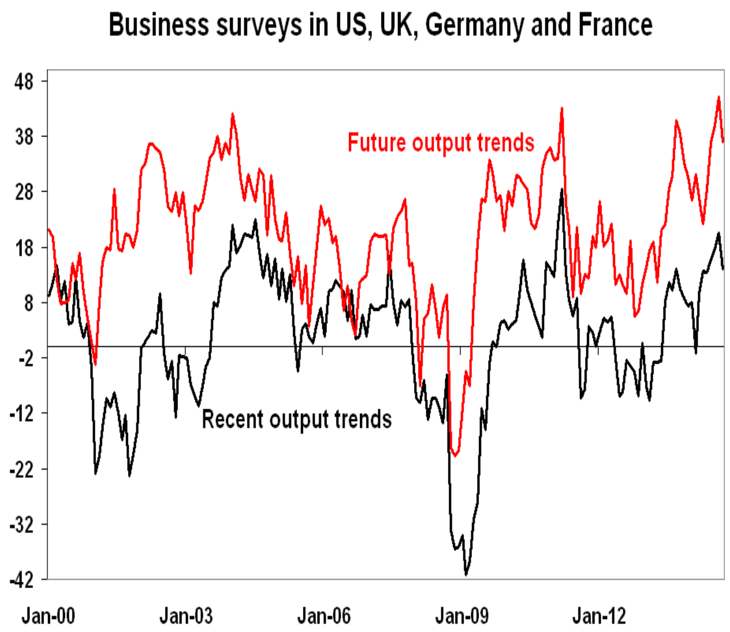
- Having delivered the bulk of global economic growth through the last 5 years, the emerging market economies now account for 56% of the global economy and China is coming close to displacing the US as the biggest single economy.
- Although the emerging market economies are growing much faster than the advanced economies, the pace of expansion in the former has steadily eased. Emerging economy growth reached 6% yoy in mid-2013 but it had slowed to 5.7% by the end of last year and 5.3% by mid-2014. Latin America has seen the sharpest slowing with growth only reaching 0.3% yoy. GDP fell in both Brazil and Argentina in Q2 with the latter's default on its external debt hitting confidence. India has picked up through mid-2014. In contrast, Chinese growth is gradually slowing and growth across the rest of emerging East Asia has gradually eased to around 3¾% yoy in mid-2014, well below 5% long-run average growth.
- The monthly economic indicators show emerging economy industrial growth running around 4½% yoy, around the trend pace seen through the last few years but well below the growth rates recorded prior to the financial crisis.
- Although world trade growth remains sluggish, there has been an acceleration in the growth of exports from emerging market economies, largely reflecting faster growth in Chinese export earnings through mid-2014 after a weak start to the year





Global forecasts

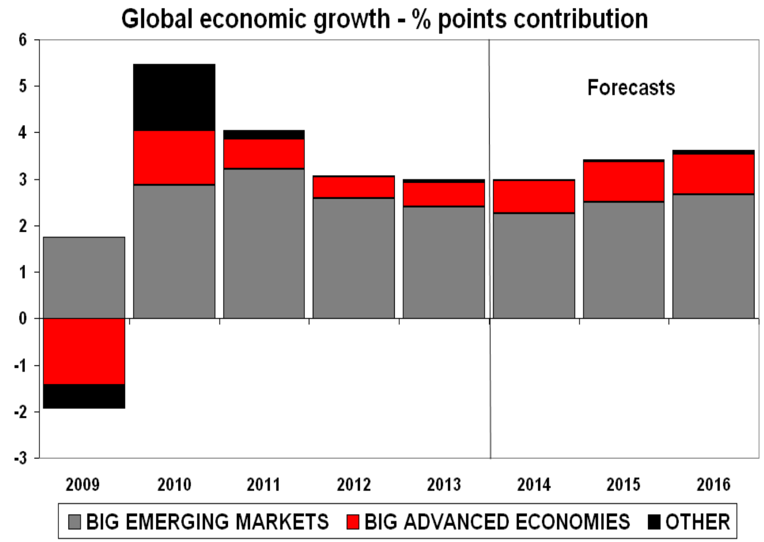
- Although continuation of the economic upturns in North America and the UK looks reasonably assured, there are real question marks over the Euro-zone and Japan and they comprise one-sixth of the world economy. We are expecting only modest economic growth in both of the latter economies; April's tax hike has hit Japanese growth harder than expected and another rise is planned for next October. Moreover, recent economic indicators in the core countries of the Euro-zone look disturbingly soft. Emerging market growth is expected to pick-up, reflecting stronger Indian growth and a recovery in Latin America
- Global growth should accelerate from 3% in 2014 to just under 3½% next year and slightly over 3½% in 2016 – leaving it still slightly below its long-run trend. That pace of growth is probably not enough to either rapidly erode output gaps in many of the Advanced economies or put demand-side stresses on commodity prices, putting a lid on inflation and allowing central banks to keep policy interest rates low.



Global growth forecasts (a)

	2011	2012	2013	2014	2015	2016
US	1.6	2.3	2.2	2.2	3.0	2.8
Euro-zone	1.6	-0.6	-0.4	0.7	0.9	1.1
Japan	-0.4	1.5	1.5	1.0	1.0	0.8
UK	1.6	0.7	1.7	3.0	2.5	2.4
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	5.3	6.1	6.2
Latin America	4.7	2.2	2.2	0.7	1.9	3.2
Emerging Asia	4.3	3.9	3.9	3.9	4.2	4.4
New Zealand	1.9	2.5	2.8	3.8	3.4	1.8
World	4.1	3.1	3.0	3.0	3.4	3.6
memo						
Advanced Economies	1.6	1.2	1.4	1.8	2.2	2.1
Emerging Economies	6.9	5.2	5.1	4.7	5.1	5.4
Major trading partners	4.6	4.2	4.5	4.6	4.6	4.5

(a) Percentage changes represent average annual growth



Australian outlook

- In our September survey, both conditions and confidence have retreated from the modestly higher ground they occupied mid-year, suggesting that Q3 was disappointing. Capacity utilisation continued falling in September, forward orders declined and employment slumped further into negative territory. Other indicators are consistent with this subdued outlook: in August, retail trade growth was soft, vehicle sales fell, personal credit growth remained weak and non-residential building approvals trended down.
- Recent volatility in the ABS labour market data has led to the suspension of seasonal adjustment. Forward indicators suggest that the recent improvement in conditions has been sustained, although the NAB employment index weakened. We still expect the unemployment rate to peak at around 6½% by the end of 2014 before showing signs of improvement.
- Household demand for retail goods and personal credit remains weak. There are still few signs of a sustained increase in non-mining investment to fill the emerging mining investment cliff. However, the easing in the AUD should assist trade-exposed sectors of manufacturing and services. Business credit barely grew in August.
- Weaker terms of trade and Q3 mean GDP forecasts revised down modestly: 2014/15 2.8% (was 2.9%) and 2015/16 3.2% (was 3.4%). Unemployment rate still to peak at around 6½%. We continue to expect no change in cash rate until a tightening cycle begins near the end of 2015.

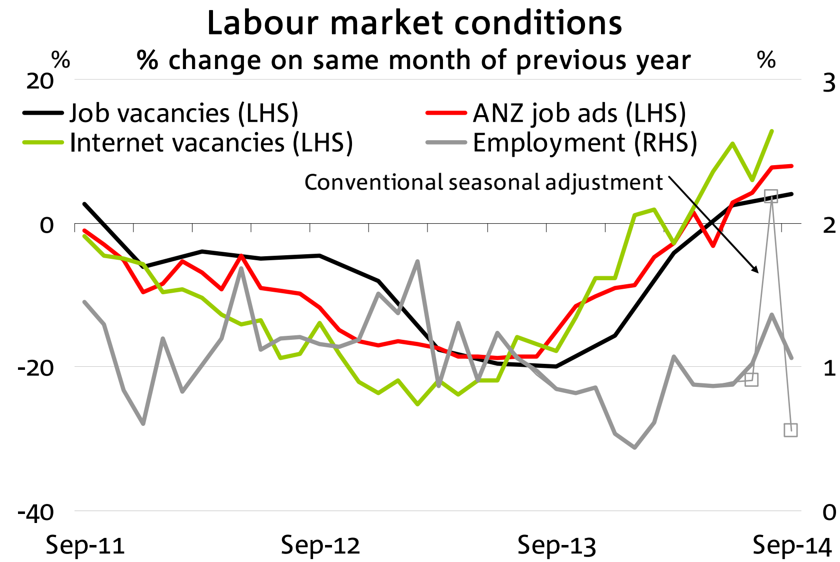
Australian economic and financial forecasts (a)

	Fiscal Year			Calendar Year		
	2013-14	2014-15 F	2015-16 F	2014-F	2015-F	2016-F
Private Consumption	2.5	2.1	2.6	2.3	2.4	2.6
Dwelling Investment	5.0	10.5	3.5	10.5	6.5	1.4
Underlying Business Fixed Investment	-6.2	-7.4	-7.4	-7.1	-6.6	-8.3
Underlying Public Final Demand	1.5	0.7	0.9	1.1	0.6	1.3
Domestic Demand	**1.2**	**1.1**	**1.1**	**1.3**	**1.1**	**1.0**
Stocks (b)	-0.4	0.1	0.0	0.0	0.1	0.0
GNE	**0.8**	**1.2**	**1.1**	**1.2**	**1.2**	**1.0**
Exports	6.8	5.9	9.3	6.6	7.8	9.3
Imports	-2.3	-0.8	0.3	-1.2	-0.2	0.0
GDP	**2.8**	**2.8**	**3.2**	**3.0**	**3.0**	**3.2**
– Non-Farm GDP	2.9	2.8	3.2	3.1	3.0	3.2
– Farm GDP	2.1	0.1	2.0	-1.9	1.8	2.0
Nominal GDP	4.1	3.2	4.9	3.4	4.4	4.9
Federal Budget Deficit: ($b)	50	30	17	NA	NA	NA
Current Account Deficit ($b)	46	45	20	48	32	6
(-%) of GDP	2.9	2.8	1.2	3.0	1.9	0.4
Employment	0.8	1.1	1.5	1.0	1.0	2.1
Terms of Trade	-4.0	-6.4	-1.4	-6.9	-2.5	-2.3
Average Earnings (Nat. Accts. Basis)	2.1	2.5	2.9	2.2	2.8	3.0
End of Period						
Total CPI	3.0	2.1	2.8	2.2	2.5	2.9
Core CPI	2.8	2.0	2.5	2.4	2.1	2.7
Unemployment Rate	5.9	6.5	5.9	6.4	6.1	5.9
RBA Cash Rate	2.50	2.50	3.50	2.50	3.00	4.00
10 Year Govt. Bonds	3.54	3.85	4.50	3.55	4.30	3.90
$A/US cents :	0.94	0.85	0.80	0.88	0.82	0.80
$A - Trade Weighted Index	72.0	69.4	67.4	69.8	68.4	67.3

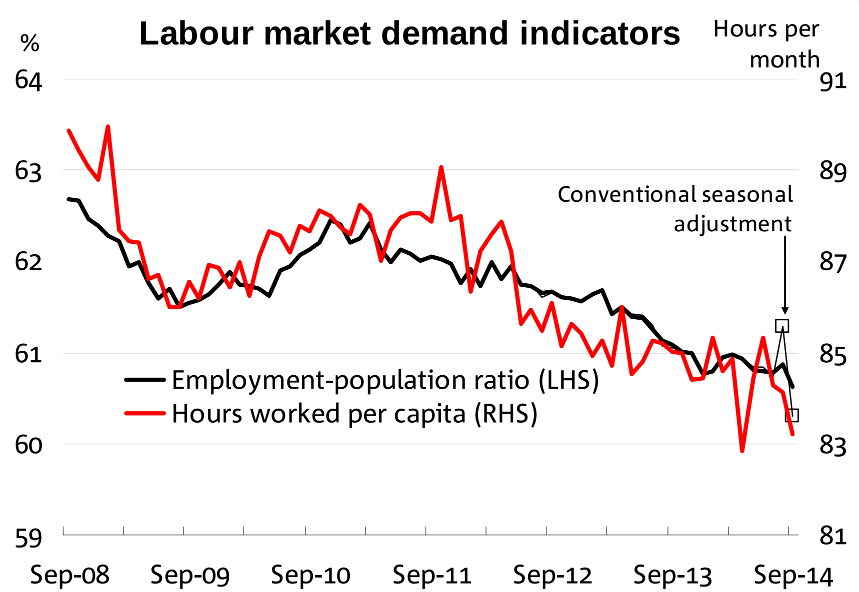
(a) Percentage changes represent average annual growth, except for cash and unemployment rates. The latter are end June. Percentage changes for CPI represent through the year inflation.
(b) Contribution to GDP growth

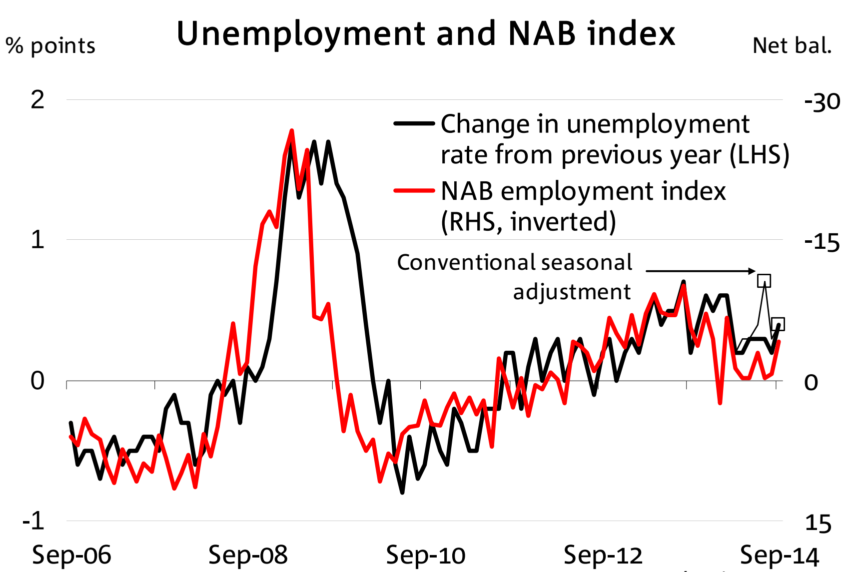
Australian labour market

- The ABS has effectively suspended the seasonal adjustment of most components of the labour force survey from August on the grounds that there has been a shift away from "normal seasonal patterns." The charts include estimates by the ABS of the major series under conventional seasonal adjustment in addition to the published series. The unemployment rate in September was 6.1% (official and if seasonally adjusted). Looking through the data, the official employment data still appear weaker than might be expected from the forward indicators.
- Forward indicators remain modestly supportive. While ABS job vacancies slipped back 0.7% in the 3 months to August, ANZ job ads rose 3.1% over the same period. In August, internet vacancies picked up to their highest level since October 2012 (the series has been extensively revised following the removal of one service provider).



Sources: ABS, Datastream, Department of Employment

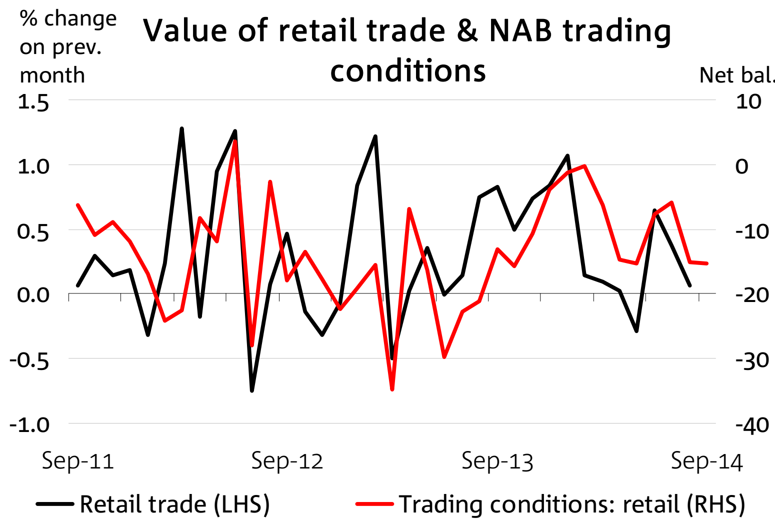




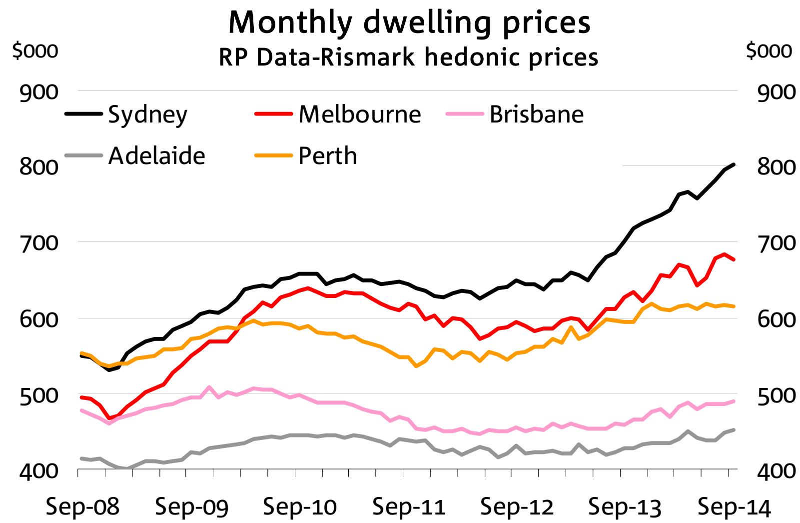
Sources: ABS, NAB business survey

Australian consumer demand and housing market

- Retail trade struggled again in August, edging up by just 0.1%. After stepping up during 2013, retail trade has grown by an insipid 1.1% since January 2014, with department stores particularly weak, and softness in clothing/ footwear/ accessories and household goods. Not surprisingly, retail business conditions remain deeply in negative territory, especially sales and profits. A surge in retail business confidence in July proved transient and business sentiment is now at its lowest level over the past year. The Westpac/MI consumer confidence index gave up its previous monthly gain in September.
- Online retail trade growth, while still higher than traditional retailing, also slowed in August to 0.7% compared with 0.9% in July. (see NAB Online Retail Sales Index). Total passenger and SUV vehicle sales fell back to around 72,700 units in August, the weakest reading since July 2012. The weakness in consumer spending is mirrored in soft demand for credit: personal credit grew just 0.2% in August to be only 1.1% higher than a year earlier.
- An improvement in the NAB measure of household wellbeing in Q3 has so far not been reflected in stronger spending (see NAB Wellbeing Index).
- According to RP Data-Rismark dwelling prices rose again at a solid rate in Sydney (0.8%) and rises were also recorded in Adelaide (0.9%) and Brisbane (0.7%). Prices dropped in Melbourne and Perth. Housing credit growth remains historically subdued and continues to be tilted towards investors. The RBA expressed concern about the composition of housing and mortgage market activity in its recent Financial Stability Review and indicated that it was discussing with APRA measures to reinforce "sound lending practices" with respect to investor finance.
- In September, the ASX200 share price index fell almost 6%, shedding most of this year's gains. Commentary suggested that weakness in the AUD was partly responsible for offshore selling.



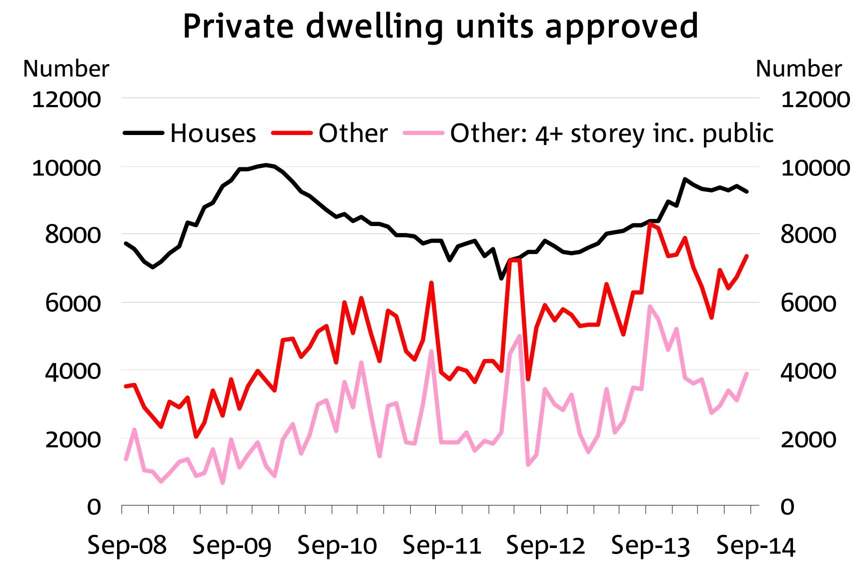
Sources: ABS and NAB business survey



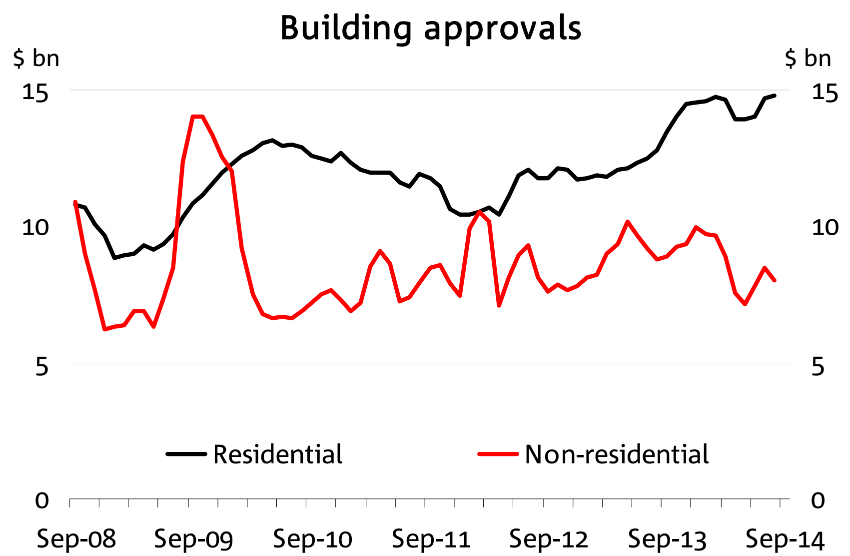
Source: RP Data-Rismark

Australian investment

- Building approvals for apartments, especially large projects, have picked up recently but permits for detached houses remain subdued. HIA new home sales recovered some lost ground in August, predominantly through a strong lift in multi-unit dwellings, in line with trends in approvals.
- Forward indicators for the buildings component of business investment have improved modestly in recent months, and this is predominantly in the non-mining sector. We expect engineering construction to continue to weaken as more major resources projects are commissioned.

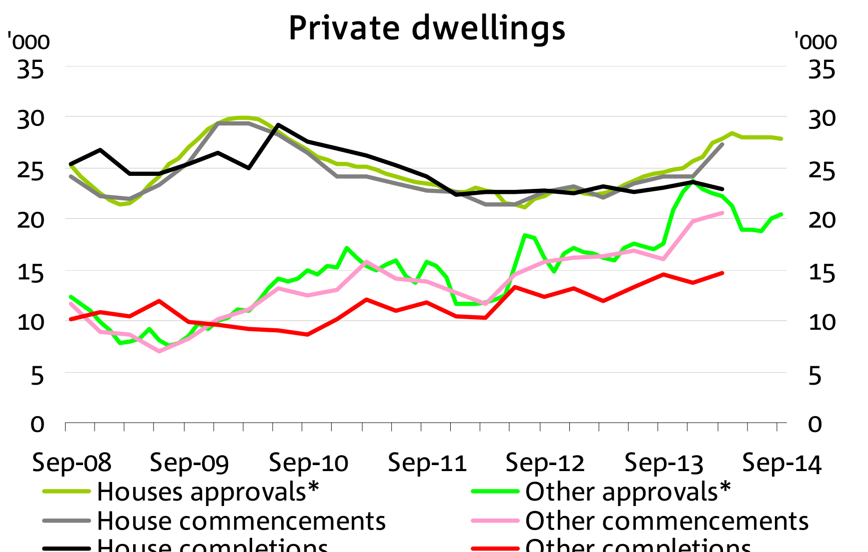


Source: ABS



3-mth rolling sums

Source: ABS

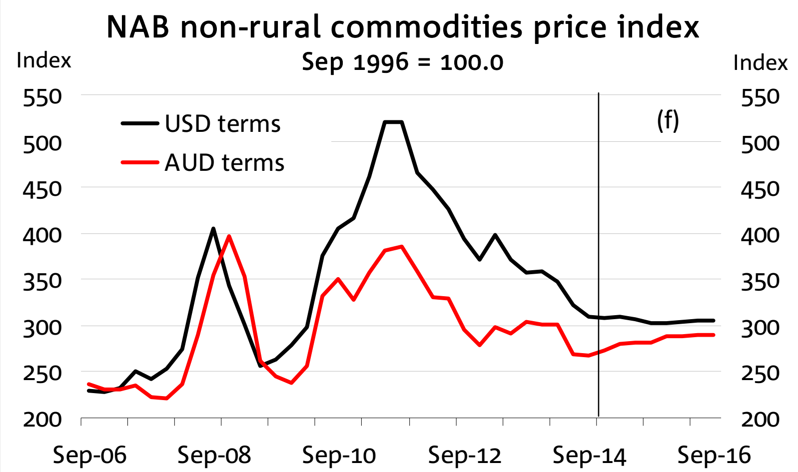


*Rolling 3-month sum lagged 1 month

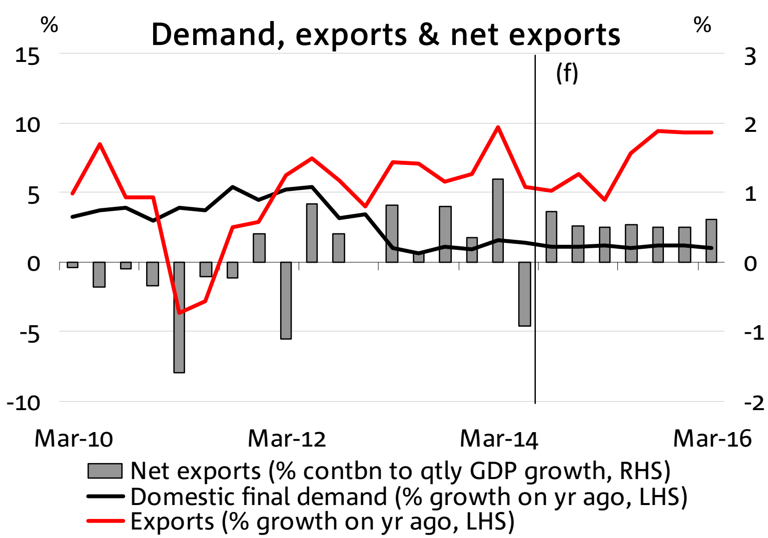
Source: ABS

Australian commodities, net exports and terms of trade

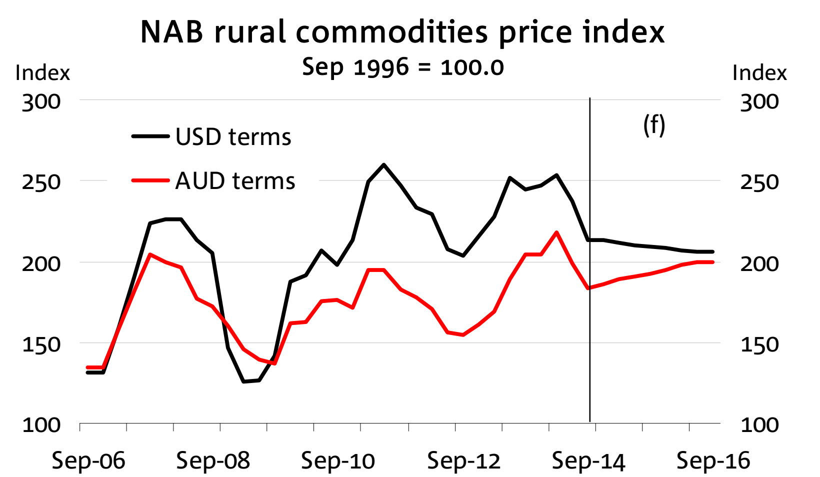
- In annual average terms, US dollar denominated non-rural commodity prices are expected to fall 15% in 2014, before easing a further 6% in 2015, with iron ore the main contributor. We have revised down our forecast profile for USD base metals (especially nickel). In AUD terms, commodity prices are forecast to rise a little over the forecast horizon. For more detail, see our Minerals & Energy Commodities Research. The NAB Rural Commodities Index fell for the fifth straight month in September, albeit by less than 1% in AUD terms as the currency trended lower. In USD terms, the index was down 2.4%. In annual average terms, USD rural commodity prices are expected to fall 5% in 2014 and 1% in 2015. In AUD terms, it is expected to rise 3% in 2014 and 5% in 2015. For more detail, see our Rural Commodities Wrap.
- The terms of trade are expected to lose 9% through the course of 2014 and be broadly unchanged through 2015. The trade deficit is expected to deteriorate during the remainder of 2014 before rising resources and energy commodity exports begin to make inroads.



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



Sources: ABS, NAB forecasts



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

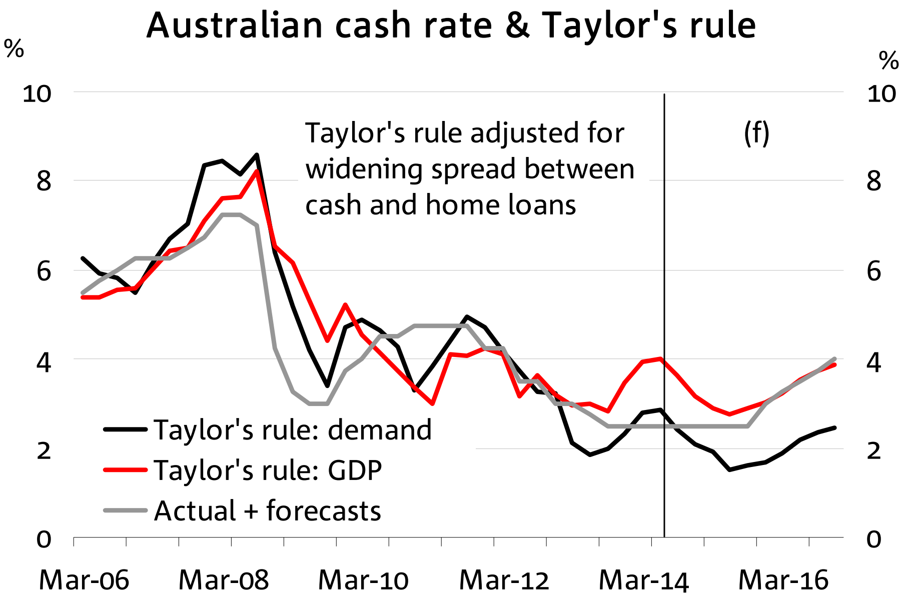
Australian financial markets

Exchange rate

- The AUD left its recent narrow trading range (93-95 US cents) in the second week of September and depreciated more or less continuously by around 7% until appearing to stabilise at the end of the month. The fall reflected an appreciation of the USD of 4% in trade-weighted terms (which has occurred more quickly than markets expected), leaving a 3% depreciation that was AUD-specific (reflecting concerns about the slowing in China and impacts on commodities).
- Our forecast profile implies that the AUD should remain close to end-September levels by the end of 2014 before resuming a gradual depreciation to 80 US cents by mid-2016.

Interest rates

- The RBA kept the cash rate at 2.50% in October, as expected, a rate at which it has remained for 14 months. Despite its decline the AUD was still regarded as “high by historical standards.”
- Like NAB, the RBA believes that a consistent decline in unemployment will be some time coming and that growth will be a tad below trend in the near term. The RBA does not see the reductions in the AUD thus far as sufficient to ensure a return to balanced growth.
- We still expect no change in the cash rate until the end of 2015. Forward indicators are soft, national income will remain under pressure from the terms of trade and spare capacity is likely to persist. In the absence of any major surprises, the cash rate is unlikely to rise until late next year as monetary policy commences its return journey to normality.



Sources: RBA, NAB estimates

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