Global & Australian Forecasts

by NAB Group Economics

Embargoed until:
11:30am Tuesday 9 December 2014

December 2014

National Australia Bank

Key Points:

- **Recent monthly economic indicators and business surveys show continued moderate global economic growth along with big variations between economies. Low interest rates, falling oil prices and smaller budget cutbacks in big advanced economies underpin faster growth of 3½% in 2015 and 2016. Global economic growth should remain heavily reliant on an upturn in India accompanied by continued good performance in China and the US. Headwinds to global growth should come from weakness across Japan, the Euro-zone and Latin America.**
- **Softer commodities outlook and prospect of more severe deterioration in labour market mean we have changed our rate call to two cuts of 25 bp in March and August 2015, then on hold until late 2016. GDP forecasts cut reflecting weaker history and terms of trade: 2014/15 2.5% (was 2.9%); 2015/16 3.0% (was 3.2%). Unemployment rate now to peak at around 6¾% (was 6½%).**

Key global and Australian forecasts (*% change*)

Country/region	IMF weight	2012	2013	2014	2015	2016
United States	16	2.3	2.2	2.3	3.0	2.8
Euro-zone	12	-0.6	-0.4	0.7	0.9	1.1
Japan	5	1.5	1.5	0.5	1.1	0.9
China	16	7.8	7.7	7.3	7.0	6.8
Emerging East Asia	8	4.5	4.3	4.0	4.3	4.5
New Zealand	0.2	2.5	2.8	3.8	3.4	1.8
Global total	100	3.3	3.2	3.1	3.5	3.6
Australia	2	3.6	2.1	2.8	2.6	3.1
Australia (*fiscal years*)		12/13	13/14	14/15	15/16	
Private consumption		1.9	2.2	2.4	2.5	
Domestic demand		1.6	1.0	0.6	1.3	
GDP		2.5	2.5	2.5	3.0	
Core CPI (*% through-year*)		2.5	2.7	1.9	2.4	
Unemployment rate (*% end of year*)		5.7	6.0	6.8	6.5	

Contents

Key points 1
Global and Australian overview 2
Global forecasts 7
Australian outlook 8
Australian financial markets 13

For more information contact:
Alan Oster, Chief Economist: (03) 8634 2927 or 0414 444 652
Rob Brooker, Head of Australian Economics & Commodities: (03) 8634 1663 or 0457 509 164
Tom Taylor, Head of International Economics: (03) 8634 1883

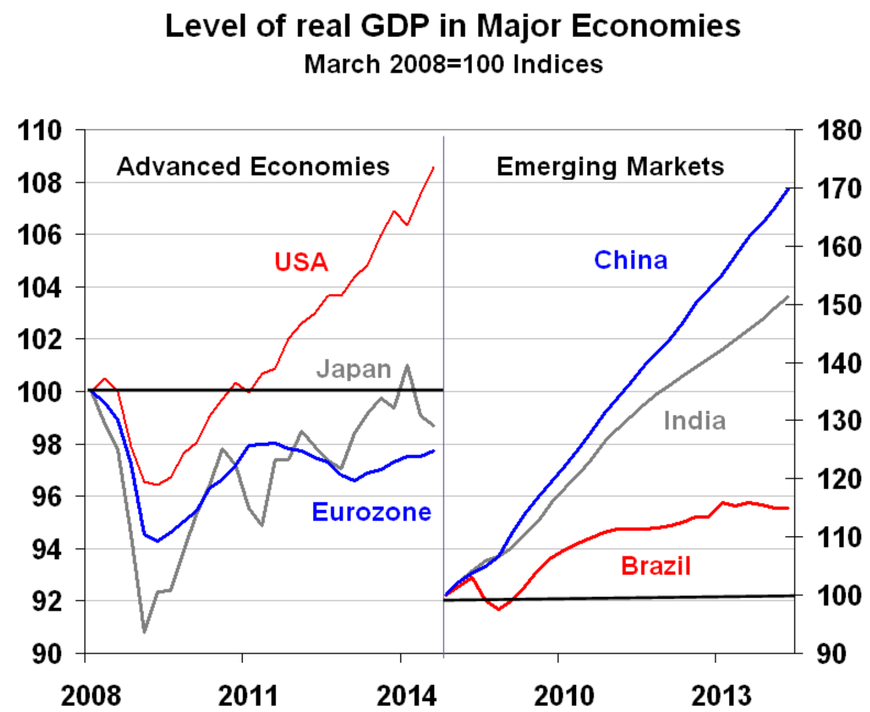
Global and Australian overview

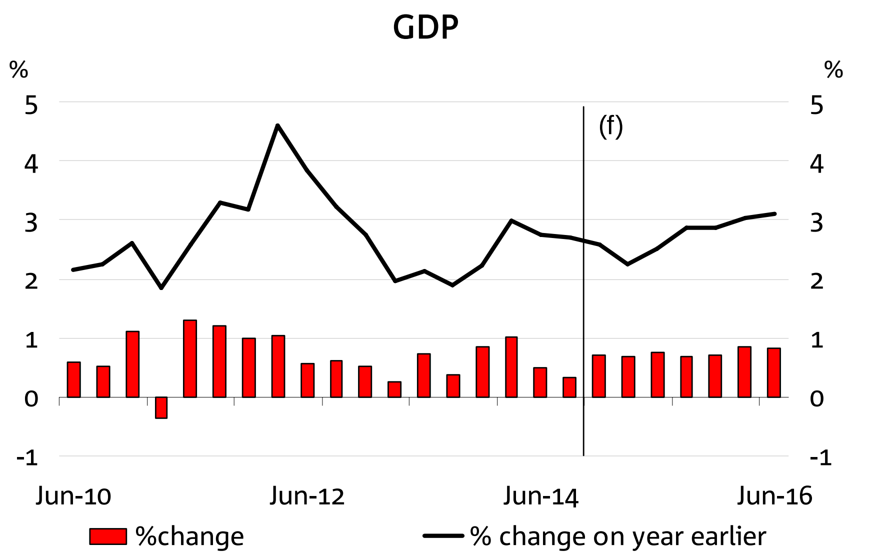
Global overview

- Global growth remained around 3% yoy in Q3, sightly below trend but it is expected to pick-up to 3½% in 2015 and 2016. Major differences in the strength of economic activity persist between regions with the US, India and China accounting for almost 2 ppts of the 3½% forecast for global growth through 2015 and 2016 and growth in the first two should accelerate. Headwinds to growth are coming from a group of other big economies representing almost a quarter of global output including the Euro-zone (3rd biggest economy) , Japan (5th) , Russia (7th) and Brazil (8th). We are revising our oil price forecast which should help boost global growth. Much depends on the sign, cause (supply vs demand) and duration of the oil shock. OECD models show a sustained $20 drop in oil prices adds 0.4 ppts to OECD growth over 2 years but temporary shocks have less impact. Lower oil prices boost activity in India but dampen growth in the many energy exporting economies.

Australian overview

- Softer resource commodity prices in October are expected to persist and subtract over $20 b from export earnings in 2014/15 compared with our previous forecasts. Business conditions softened in November but are largely in line with long-run averages. The employment outlook remains soft and business confidence retreated.
- GDP growth in Q3 of 0.3% was below expectations and slower than Q2. Although the data are preliminary, they continue to point to soft (possibly even declining) demand. There are increasing risks that the mining cliff, while deferred, may turn out steeper.
- We have changed our view on the cash rate and now expect two of 25 bp in March and August 2015 then remaining on hold until late 2016. Exchange rate to track US3 cents lower. GDP forecasts cut reflecting weaker history and terms of trade: 2014/15 2.5% (was 2.9%); 2015/16 3.0% (was 3.2%). Unemployment rate now to peak at around 6¾% (was 6½%).

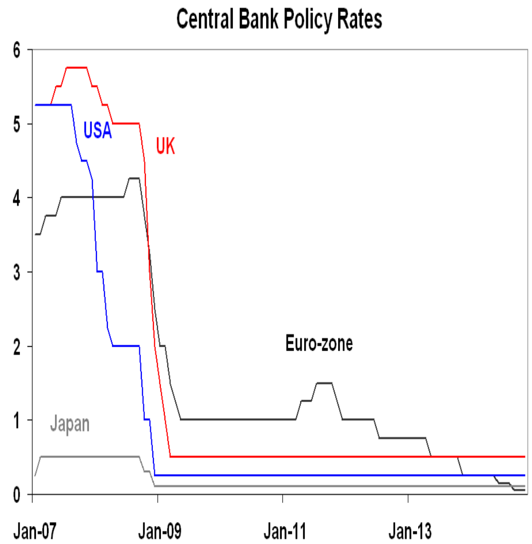


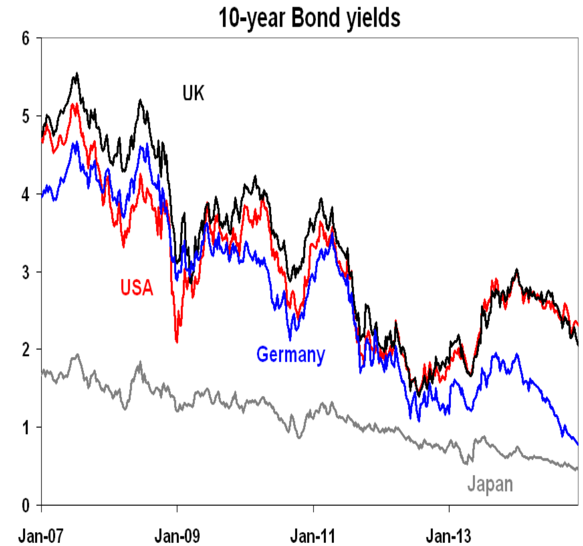


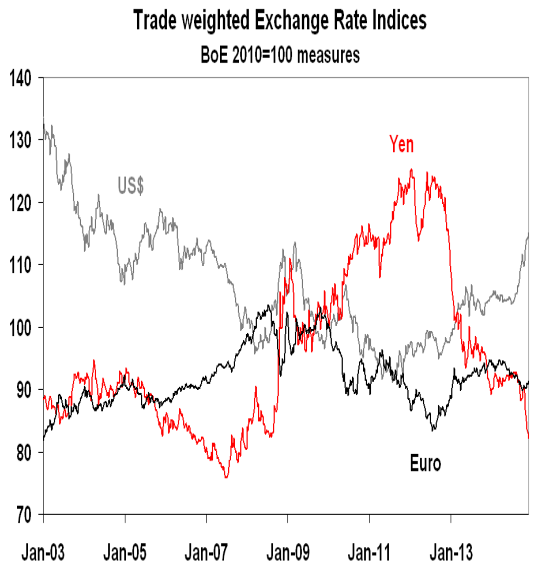
Sources: ABS, NAB estimates

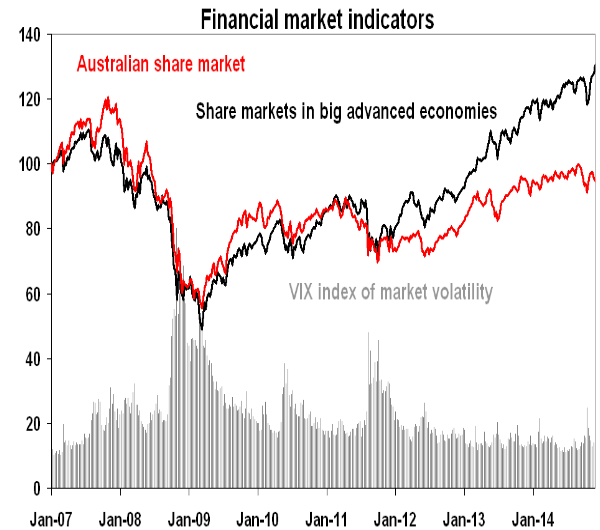
Financial markets

- Divergence in economic conditions between the big advanced economies has been highlighted in recent central bank decisions on monetary policy. The US Fed is moving toward less easy monetary policy, UK debate focuses on whether rates should be increased, the Bank of Japan (BoJ) persists with zero interest rates and injecting liquidity and the European Central Bank is set to continue with near zero policy rates and a debate on which assets it can or should buy.
- The US Fed has ended its asset purchase programme, although it continues to be active in the market as it reinvests funds released from maturing securities. The Fed is still targeting a Fed funds range of between zero and ¼% and says that such a range should remain appropriate for a “considerable time”. Even after employment and inflation rise to around its target levels, the Fed advises that it may still keep the Fed funds rate below levels that would be viewed as “normal in the longer run”.
- The Bank of Japan stepped up its asset buying program in late October, lifting purchases of both Government bonds and private sector paper in an effort to boost the monetary base and promote faster growth and inflation. The BoJ reaffirmed its intention to stick with this policy at its November meeting and the disappointing third quarter GDP outcome should keep pressure for zero rates and money printing on the central bank.
- Markets are now focussing most on the ECB as it grapples with an economy where output has stagnated and inflation subsided to very low levels. Whether the ECB is willing to expand its asset buying to include sovereign bonds has become the most contentious issue as there is considerable opposition to that step in Germany.



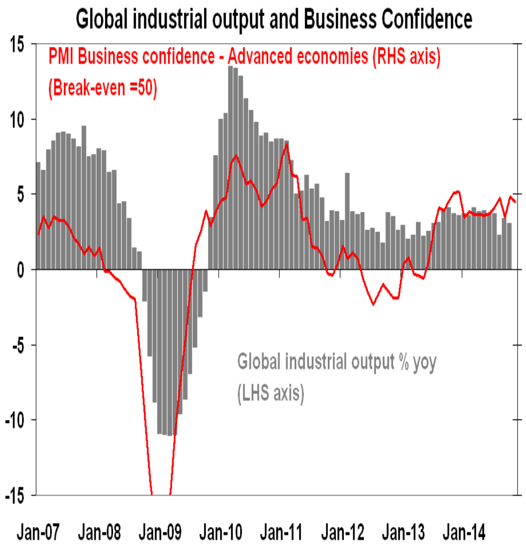


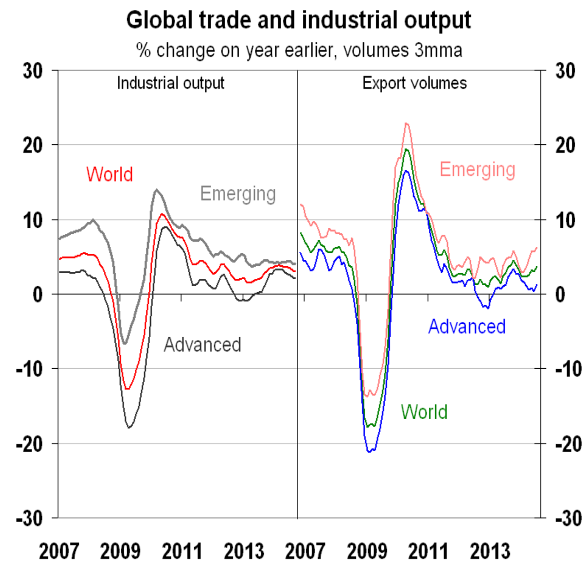


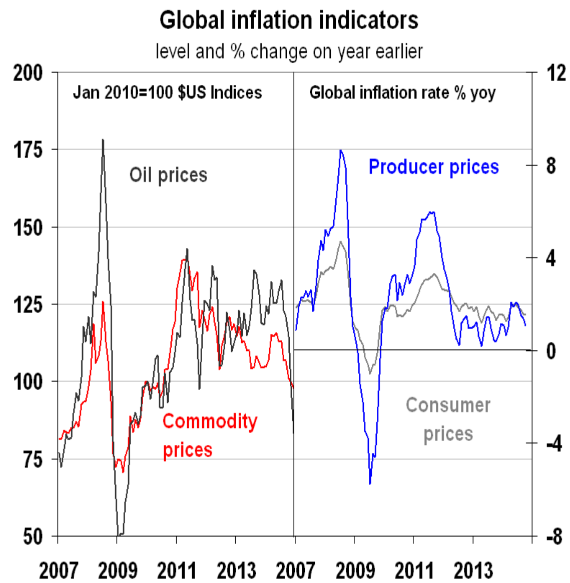


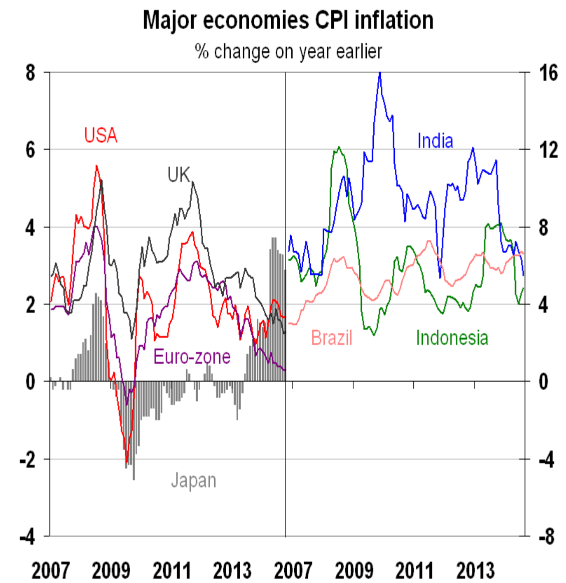
Global Economic Trends

- Global economic growth appears to be continuing at a moderate pace with industrial output expanding by around 3% yoy and business survey readings consistent with moderate growth.
- The pace of growth in both industrial output and exports in the emerging markets has been faster than among the advanced economies, although in both groupings the growth rate is generally running below its pre-GFC level. Global industrial growth has been around 3% with advanced economies growing by 2% yoy and emerging economies at twice that rate. The disparity has recently widened between the groups for trade growth with advanced economies expanding by only 1% yoy while a recent run-up in emerging economy exports has taken their growth rate to around 6% yoy.
- Inflation also differs between the major advanced and emerging economies. Globally the slide in oil and other commodity prices alongside above-trend jobless rates in the advanced economies have put downward pressure on inflation. World CPI inflation is only 1½% yoy and producer price inflation, at under 1% yoy, is even more subdued.
- With the exception of Japan, where April's rise in indirect taxes has boosted prices, inflation is either trending down or below target in most big advanced economies. In big emerging market economies, outside China, the situation is different with central banks in Brazil and Indonesia recently lifting rates to combat above target inflation. Inflation has risen to 8¼% yoy in Russia but progress toward lower inflation is being made in India.



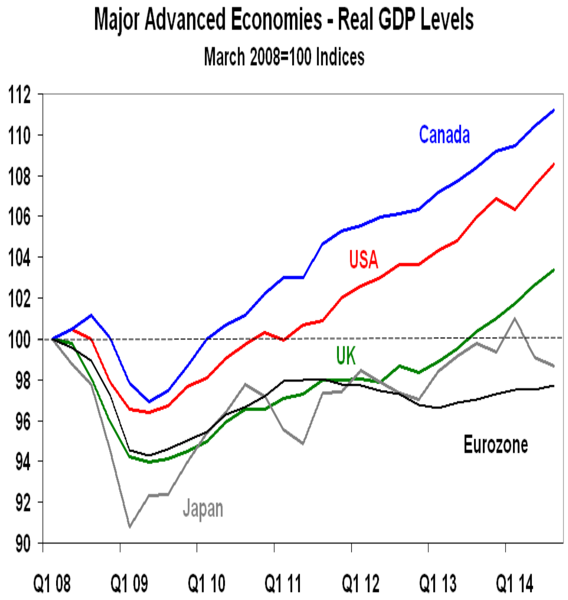


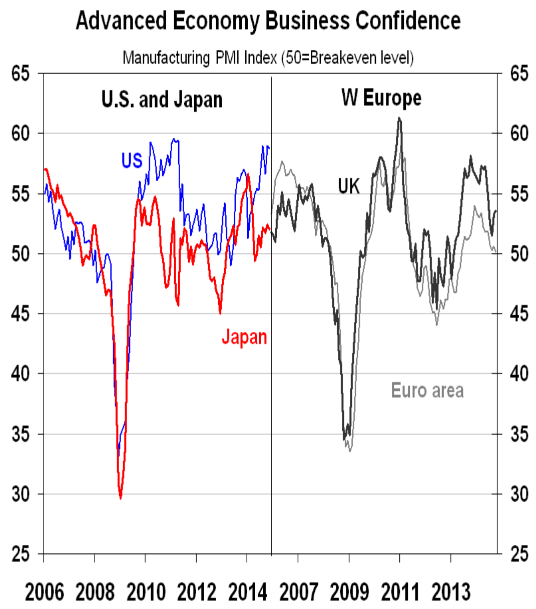


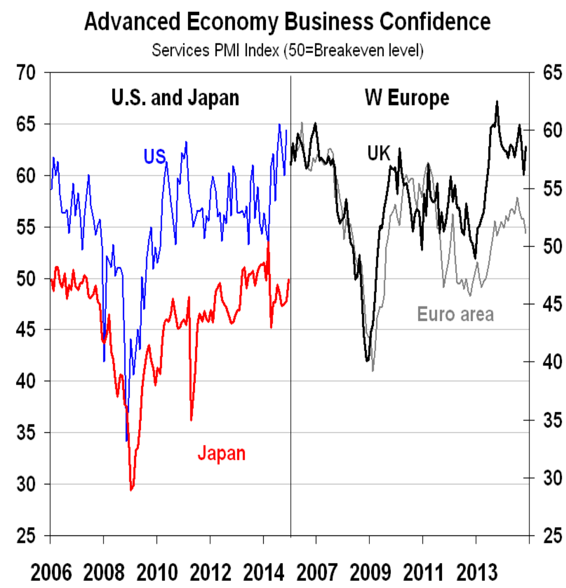


Advanced Economies

- The pace of quarterly growth in the G7 advanced economies has been quickening through 2014 – from around 0.15% in March quarter to 0.35% in June and 0.5% in September. North America still has the best performing economies with quarterly growth of around 1% in the US and 0.7% in Canada. By contrast, Euro-zone third quarter growth was only 0.2% and output in Japan declined by 0.4% as the effects of April's indirect tax rise weighed on spending.
- The recent divergence in growth between the English speaking G7 countries and Japan or the Euro-zone reflects a trend that began in early 2013. Prior to that UK output had tracked the weak conditions in the Euro-zone and Japan rather than the recovery profile seen in the US or Canada. As a result of the varying strength of these national economic upturns, September quarter 2014 Canadian GDP was around 11% above its pre-GFC levels while US and UK output were 9% and 3% higher respectively. By contrast, September quarter output in Japan and the Euro-zone remained below its pre-crisis level.
- November business surveys show the US continuing to outperform other advanced economies with solid results in its industrial sector alongside lacklustre readings in the Euro-zone and Japan. The UK purchasing manager survey shows industrial activity picking up in November after falling quite sharply in recent months. Recent business survey results for the services sector outside the Euro-zone have been strong with rising business activity in the US, UK and Japan, although conditions in the latter remain weaker than before April's tax rise.

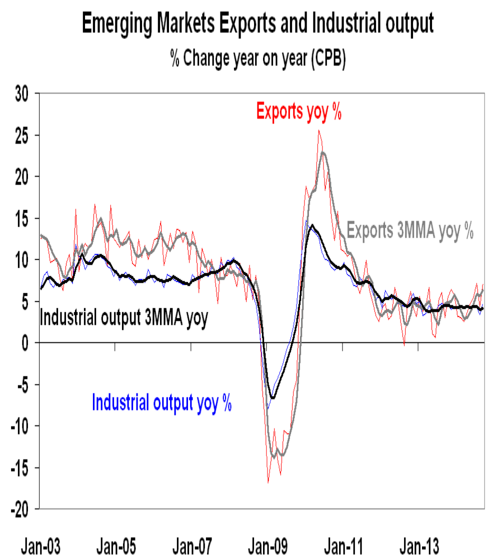


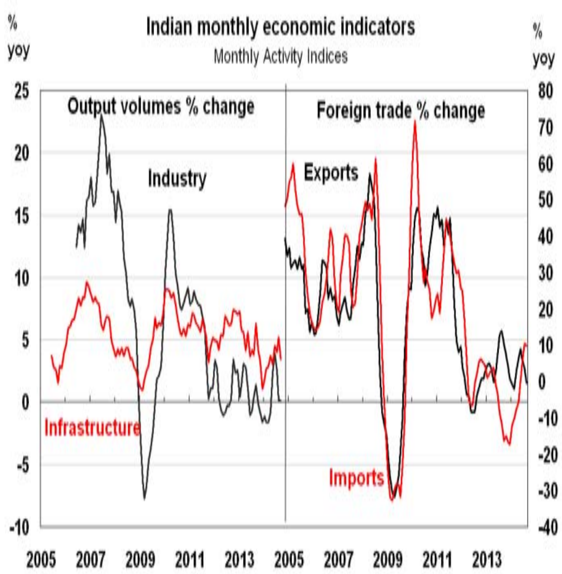




Emerging Market Economies

- The pace of economic expansion in the main emerging market economies has gradually slowed through 2014 with year on year growth rates of 5.5%, 5.3% and 5.1% respectively in the first three quarters. This slowdown reflects the big downturn in South America along with modest slowing across East Asia, partially offset by faster growth in India.
- Industrial growth in the emerging market economies has held up at around 4% yoy since late 2013 and export volumes have been rising recently (although the monthly data is volatile).
- Growth performance also varies considerably among the emerging market economies with China continuing its gradual trend slowing, Indian growth poised for an upturn after several disappointing years, weakness in South America and sluggish growth in the trade-oriented emerging market economies of East Asia.
- With the exception of the volatile trade data, most of the Chinese monthly economic indicators line up with the quarterly national accounts in showing a gradual slowing in growth. Some of the recent Indian data shows a trend upturn after some weak years especially the turnaround to import growth, which could well point to increased domestic demand. The central bank and purchasing manager surveys show an expected improvement in India's industrial sector, although recent monthly output shows no clear sign of an upturn yet. Infrastructure output had been trending up but that levelled out recently and export growth has stopped ramping up.





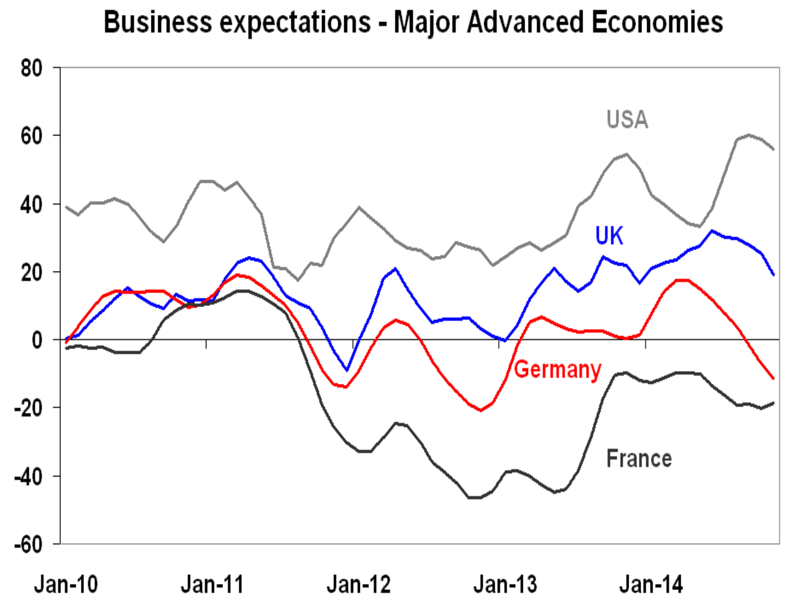
Global forecasts

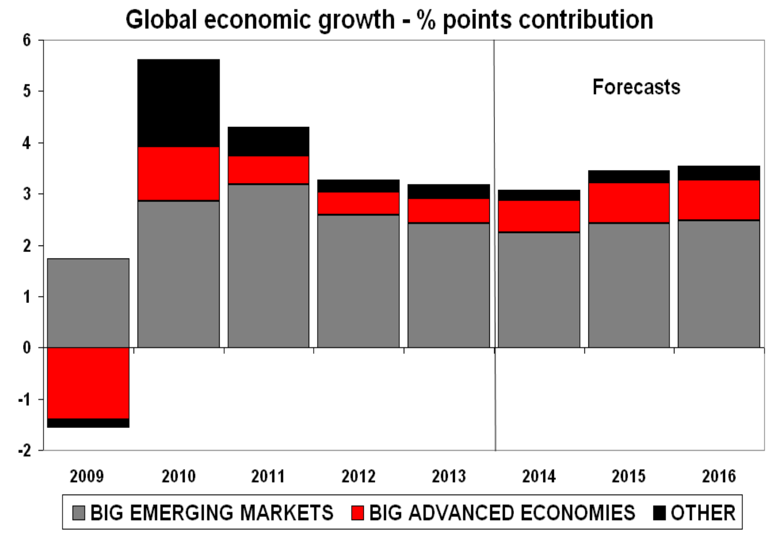
- Although neither quarterly GDP nor the monthly trade and industry data show evidence of any acceleration in global growth, the combination of lower oil prices, monetary policy aimed at boosting activity and a slower pace of fiscal tightening in the big advanced economies should lead to growth picking up to 3½% next year.
- The pattern of world economic growth remains very unbalanced with China, the US and India accounting for two-thirds of global growth this year and slightly less in 2015, well above their 40% share of global output. Recent advanced economy business survey readings show the extent to which expectations in the US are more optimistic than in other major economies.
- The outlook for continued low inflation and only a gradual erosion of advanced economy margins of spare capacity should allow central banks to keep their policy interest rates very low by historical standards. The Fed should start gradually lifting its rates from mid-2015 and the Bank of England in the third quarter but neither the ECB nor the Bank of Japan are expected to increase their policy rates next year.

Global growth forecasts (a)

	2011	2012	2013	2014	2015	2016
US	1.6	2.3	2.2	2.3	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	0.5	1.1	0.9
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	6.3	6.5
Latin America	4.3	2.1	2.3	0.6	1.5	2.6
Emerging East Asia	4.5	4.5	4.3	4.0	4.3	4.5
New Zealand	1.9	2.5	2.8	3.8	3.4	1.8
World	4.3	3.3	3.2	3.1	3.5	3.6
memo						
Advanced Economies	1.6	1.2	1.4	1.8	2.2	2.1
Emerging Economies	6.9	5.2	5.2	4.7	5.1	5.3
Major trading partners	4.6	4.2	4.5	4.6	4.6	4.5

(a) Percentage changes represent average annual growth





Australian outlook

- GDP grew 0.3% in Q3, below expectations. This estimate should be treated with caution: underlying public investment, a notoriously difficult item for initial estimation, detracted 0.5% points from growth (with more than half of this from Victoria). But even without this decline, domestic demand would have grown by only 0.2% (it fell 0.3%). Underlying private investment drifted down but net exports contributed solidly, supported by increased volumes of bulk commodities.
- The signal event of October has been the sharp decline in bulk commodity prices. Despite a depreciating AUD, lower bulk export prices have forced a downward revision to our forecast track taking over $20 b off our previous estimate of export income for 2014/15 and $30 b off 2015/16.
- Household retail demand growth continues to trend up but consumers remain tight-fisted and demand for personal credit weakened. Housing credit growth continues to gather pace from low levels and there are signs of a rise in household debt, although the household saving rate remains elevated.
- There is a risk that the expected decline in mining investment may occur later but be larger than so far expected. Strengthening business credit growth offers some prospect that the non-mining investment climate is improving.
- Cash rate cut of 25 bp now expected in March and another in August then remaining on hold until late 2016. Exchange rate to track US3 cents lower. GDP forecasts cut reflecting weaker history and terms of trade: 2014/15 2.5% (was 2.9%); 2015/16 3.0% (was 3.2%). Unemployment rate now to peak at around 6¾% (was 6½%).

Australian economic and financial forecasts (a)

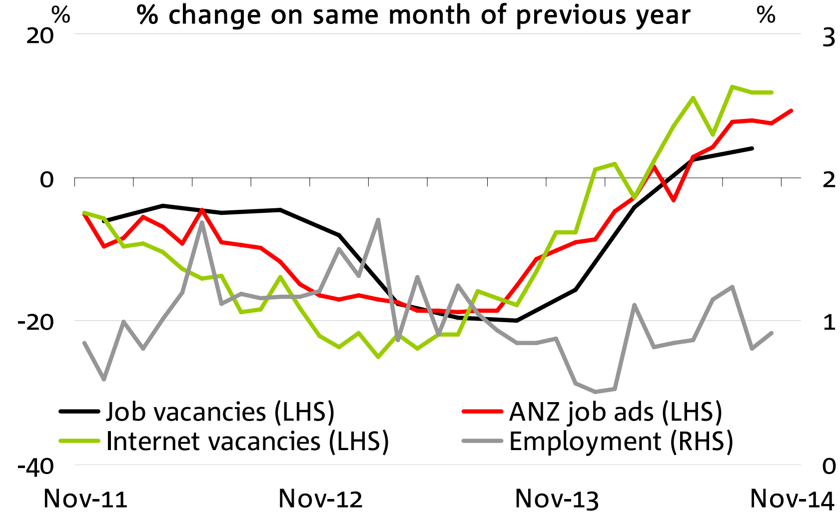
	Fiscal Year			Calendar Year		
	2013-14	2014-15 F	2015-16 F	2014-F	2015-F	2016-F
Private Consumption	2.2	2.4	2.5	2.5	2.4	2.4
Dwelling Investment	5.1	6.9	7.2	8.4	6.8	4.7
Underlying Business Fixed Investment	-5.8	-7.1	-6.2	-6.0	-7.5	-4.7
Underlying Public Final Demand	1.5	-0.4	0.9	0.7	-0.1	1.3
Domestic Demand	**1.0**	**0.6**	**1.3**	**1.1**	**0.7**	**1.4**
Stocks (b)	-0.3	0.3	-0.1	0.1	0.1	-0.1
GNE	**0.7**	**0.9**	**1.1**	**1.2**	**0.8**	**1.3**
Exports	5.8	8.1	9.2	6.9	9.0	9.1
Imports	-2.1	-0.4	0.7	-1.1	-0.1	1.0
GDP	**2.5**	**2.5**	**3.0**	**2.8**	**2.6**	**3.1**
– Non-Farm GDP	2.4	2.6	3.0	2.9	2.7	3.1
– Farm GDP	5.1	-2.4	2.0	-2.7	0.9	2.0
Nominal GDP	4.1	1.5	4.1	3.0	2.2	5.2
Federal Budget Deficit: ($b)	49	40	30	NA	NA	NA
Current Account Deficit ($b)	47	62	53	52	63	38
(-%) of GDP	3.0	3.9	3.2	3.2	3.9	2.2
Employment	0.8	0.8	0.6	0.9	0.5	1.2
Terms of Trade	-3.4	-12.6	-4.2	-8.4	-10.5	-0.1
Average Earnings (Nat. Accts. Basis)	2.1	2.3	2.9	2.1	2.7	3.0
End of Period						
Total CPI	3.0	2.1	2.7	2.2	2.4	2.7
Core CPI	2.7	1.9	2.4	2.2	2.1	2.4
Unemployment Rate	6.0	6.8	6.5	6.3	6.7	6.2
RBA Cash Rate	2.50	2.25	2.00	2.50	2.00	2.75
10 Year Govt. Bonds	3.54	3.00	3.35	3.05	3.30	3.50
$A/US cents :	0.94	0.80	0.76	0.83	0.78	0.75
$A - Trade Weighted Index	72.0	66.6	63.7	67.7	65.2	62.4

(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

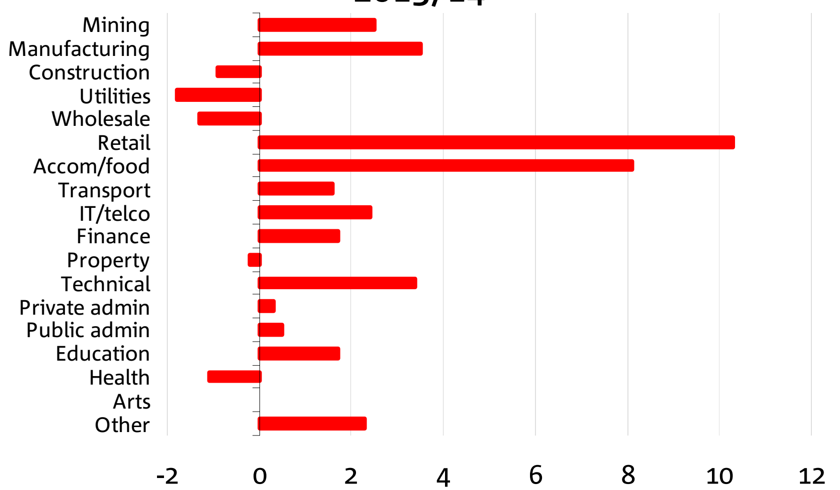
- Labour market forward indicators have been moving broadly sideways. The NAB employment index retreated to zero in November. Department of Employment internet vacancies were practically unchanged in October while ANZ job ads increased by 0.7% in November. Overall, we still expect the unemployment rate to rise above its current level (6.2%) over coming months and to track a higher path than before, peaking at around 6¾%.
- Much of the increased unemployment during 2014/15 has comprised former retail and hospitality industry workers. However, there was also some contribution from mining and the related technical & professional services sector. Manufacturing also contributed to higher unemployment during the period. On balance, public sector cuts do not appear to have been an important source of higher unemployment. As major energy construction projects are commissioned, we can expect further rises in unemployment to be source from mining and technical services.

Labour market conditions



Sources: ABS, Datastream, Department of Employment

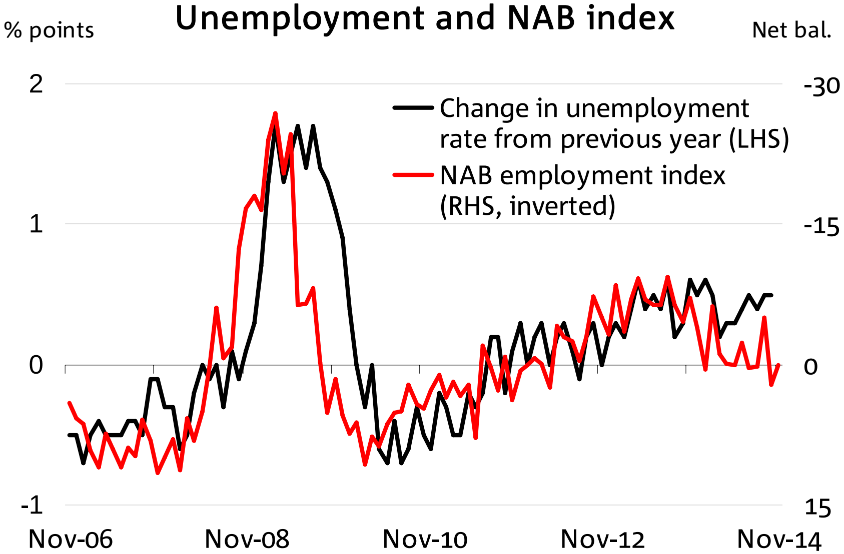
Sources of unemployment growth 2013/14



'000 persons, 4-quarter moving averages

Source: ABS

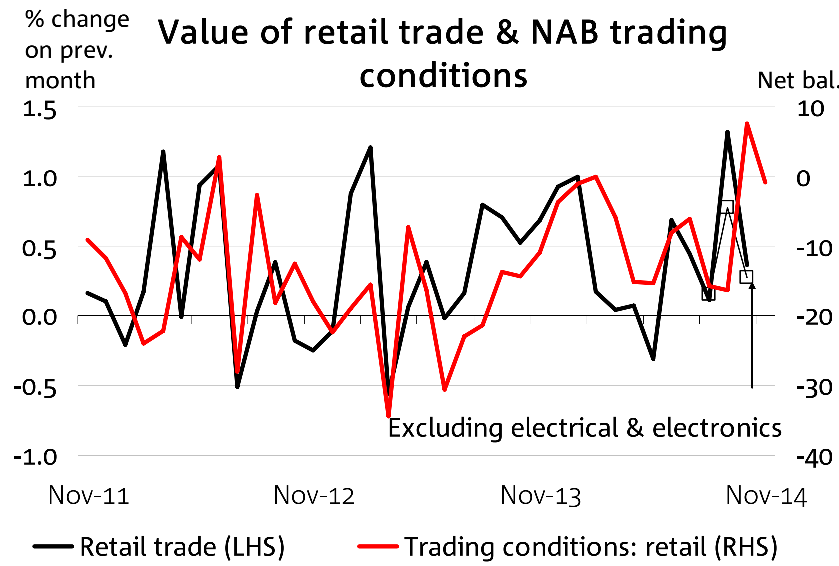
Unemployment and NAB index



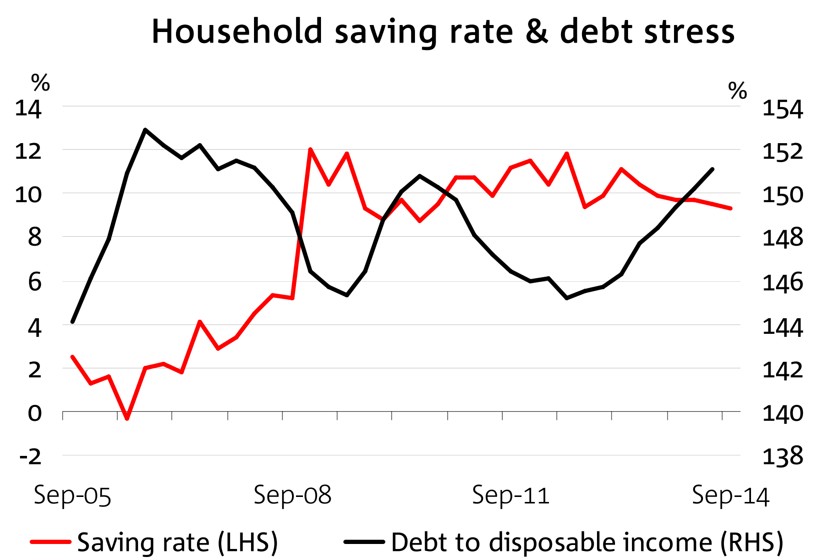
Sources: ABS, NAB business survey

Australian consumer demand and housing market

- The upward trend in the growth rate of retail trade continued into October. While growth of 0.4% was down sharply on September's 1.3%, the decline was more modest when account is taken of the release of iPhone 6 in September. The trend monthly growth rate of 0.4% compares with a trough ot 0.1% in April. In the NAB survey November retail trading conditions gave back some of the strong gains from the previous month but at -1 remain better than we have seen for most of the past five years. Orders remain in negative territory.
- Trend growth in online retail eased down a little in October to 1.0%, compared with 1.3% in the previous month, but still ahead of the traditional retail sector (see NAB Online Retail Sales Index). Total passenger and SUV vehicle sales slipped back to around 73,600 units in October, broadly in line with levels seen for most of this year. Following tepid growth over the past three months, personal credit contracted marginally in October. Overall, the improvement in consumer appetite for spending appears limited at best.
- There are signs that some steam escaped from the residential property market in November. According to RP Data-Rismark dwelling prices fell 0.3% across the capital cities and, although Sydney prices rose 1.0%, Melbourne prices declined by 2.6%. Annual capital city price growth has eased back to 8.5%. Housing credit growth is still moderate at 0.6% in October and continues to be tilted towards investors, although owner-occupier credit growth has started to pick up.
- The household saving rate has remained elevated throughout the post-GFC period, declining only modestly in recent quarters. While historically low interest rates have driven down interest payments on housing and personal debt relative to income, housing credit growth has contributed to a rise in household debt relative to income. This latter metric is now approaching its peak levels of 2010. This suggests some vulnerability when interest rates are eventually tightened.
- Share prices retreated in November, with the ASX200 index declining almost 4%, led by a 9% fall in the resources index, reflecting the sharp decline in hard commodity prices.



Sources: ABS and NAB business survey

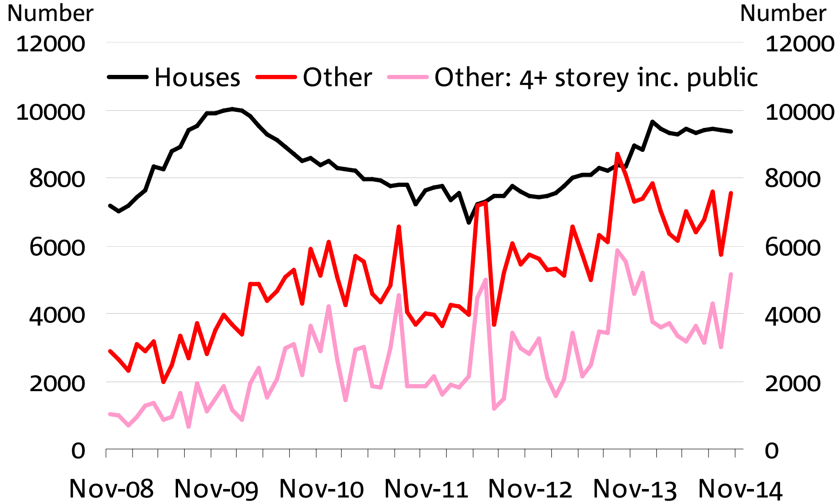


Source: ABS

Australian investment

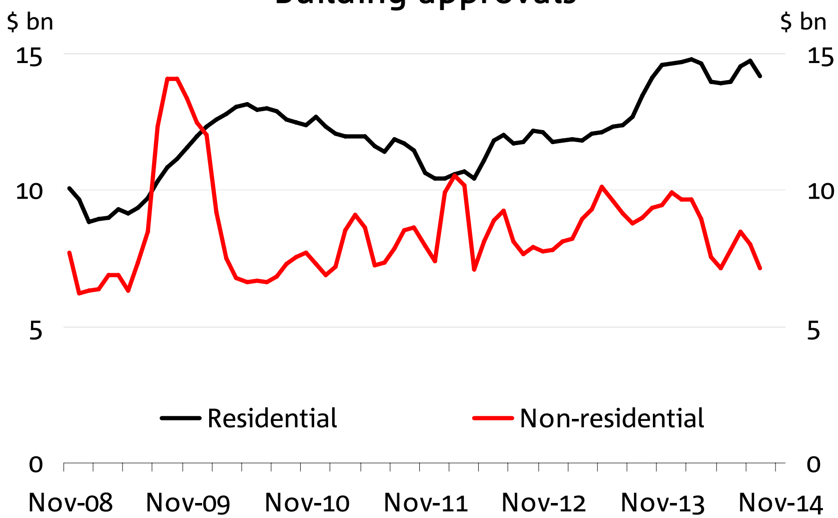
- Dwelling investment declined by 0.9% in Q3, reflecting the easing in apartment approvals mid-year. Apartment approvals seem to have resumed their upward trend, abstracting from monthly volatility, but housing approvals continue to drift.
- New private non-dwelling construction fell 3.6% in Q3 as the slowdown in mining investment contributed to the fourth consecutive quarterly fall in engineering construction (now 16.3% lower than a year ago). The weak outlook for resources also saw a large (26.7%) decline in mineral and petroleum exploration expenditure in Q3. New machinery and equipment investment was broadly unchanged. Overall new private business investment (national accounts basis) fell by 0.7%.
- Nevertheless, mining construction has held up for longer than we expected; consequently, the mining pipeline has fallen faster than we foresaw. Hence, there is an emerging risk that the bulk of the decline in mining construction may be deferred into 2015 but will be steeper than anticipated.

Private dwelling units approved



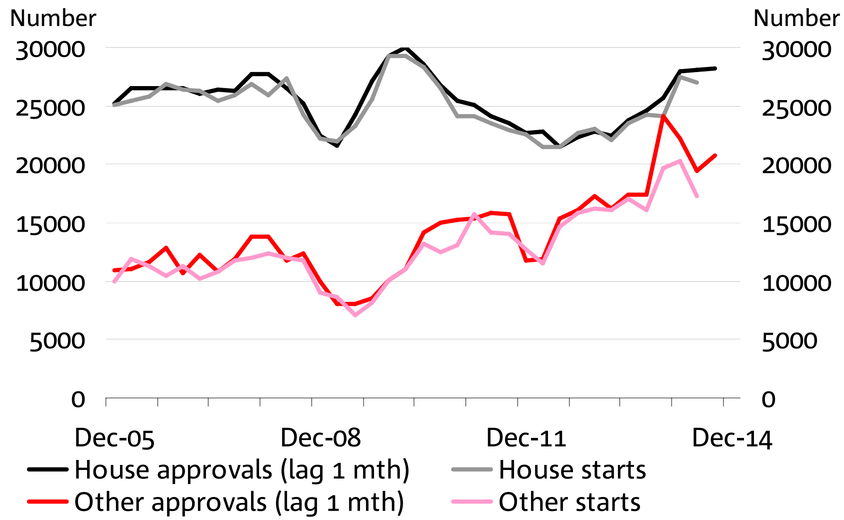
Source: ABS

Building approvals



3-mth rolling sums *Source: ABS*

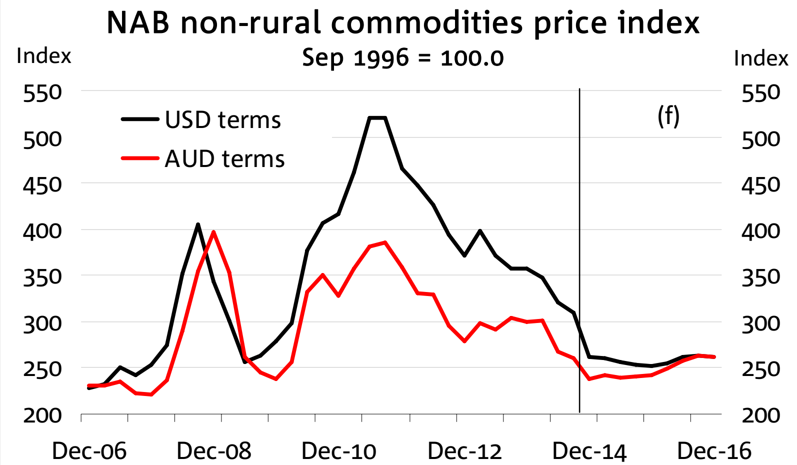
Private dwelling approvals & starts



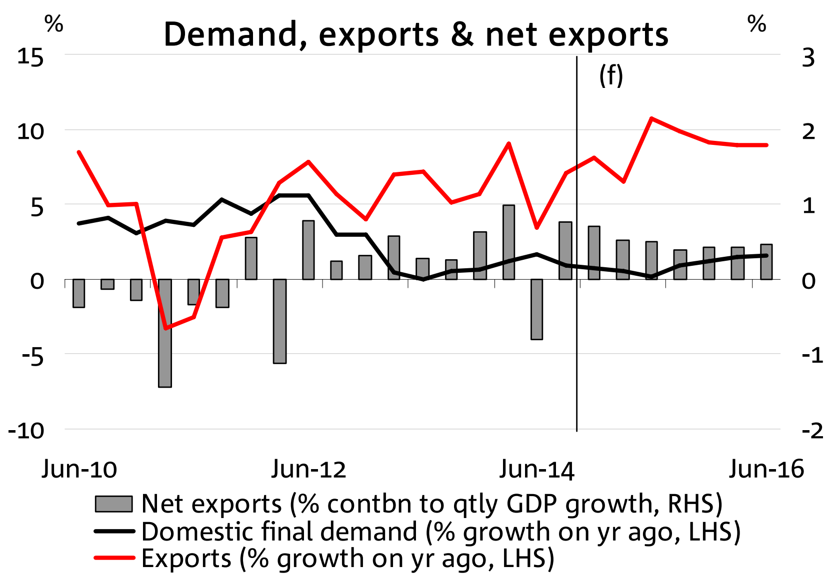
Source: ABS

Australian commodities, net exports and terms of trade

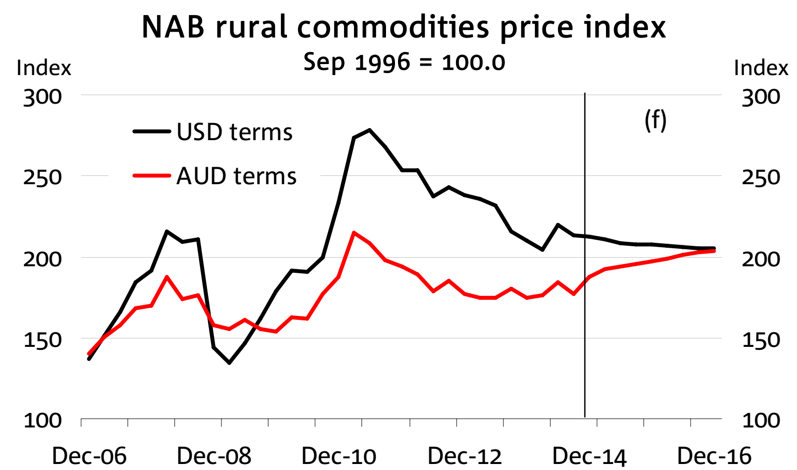
- In annual average terms, US dollar denominated non-rural commodity prices are expected to fall 21% in 2014/15 and a further 6% in 2015/16, reflecting forecast declines in the prices of iron ore, coal, gold and copper. In AUD terms, commodity prices are forecast to fall 17% in 2014/15 and to stabilise in 2015/16. For more detail, see our Minerals & Energy Commodities Research. The NAB Rural Commodities Index is expected to be broadly unchanged in annual average terms in 2014/15 and to decline modestly in 2015/16. The expected depreciation should see price gains in AUD terms of 5% in 2014/15 and 6% in 2015/16. For more detail, see our Rural Commodities Wrap..
- The terms of trade are expected to lose 15% through the course of 2014 and another 5% through 2015. The trade deficit is expected to improve during the remainder of 2014 and will move into surplus as rising resources and energy commodity export volumes outweigh the effects of declining global prices.



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



Sources: ABS, NAB forecasts



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

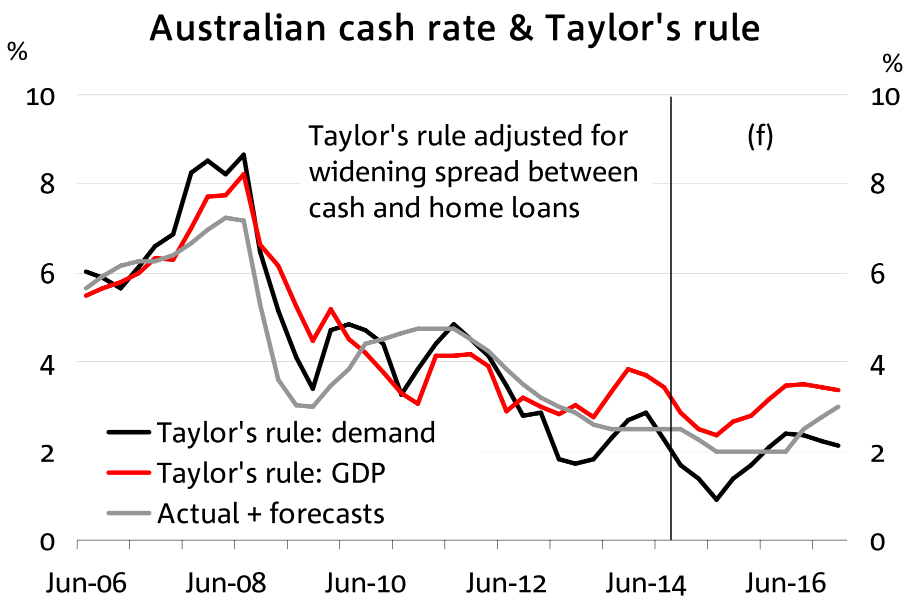
Australian financial markets

Exchange rate

- The weaker outlook for commodity prices has led us to reduce our forecast track for the AUD by US3 cents commencing Q4.

Interest rates

- The RBA kept the cash rate at 2.50% in December, as expected. In light of the weaker growth and employment outlook we have changed our RBA cash rate forecast. The modest rate increases that we previously saw from late 2015 are now unlikely to occur and we have pushed these into late 2016. Moreover, the chances of the RBA needing to lower the cash rate in the near term have risen materially over the past month.
- In their December Board Statement the RBA said they would prefer a further decline in the $A to both support and re-balance growth. If this doesn't happen in the months ahead, and if the unemployment rate continues to rise as we expect, then the benign inflation outlook and some evidence that house prices are cooling will allow the RBA to further support the economy with a lower cash rate.
- This is now the most likely scenario. We expect they will lower the cash rate a further 50bps to 2%. These interest rate cuts will further support the recovery we are already seeing in the non-mining economy and perhaps help lower the $A.
- Timing for cuts will be guided by developments in housing, employment, inflation, the $A, and commodity prices. For now we expect the first 25bps cut in either February or March, with March the more likely timing as this would allow the RBA to signal their intent/concern at their February meeting. We have put a second 25bps cut in for later in the year, in August, as we still forecast the unemployment rate to be rising through the first half of 2015. We'd add that if the $A falls sufficiently by then (to say US75 cents) a second cut may not be necessary.



Sources: RBA, NAB estimates

Group Economics
Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities
Rob Brooker
Head of Australian Economics
+61 3 8634 1663

James Glenn
Senior Economist – Australia
+(61 3) 9208 8129

Phin Ziebell
Economist – Agribusiness
+(61 3) 8634 0198

Karla Bulauan
Economist – Australia
+(61 3) 86414028

Industry Analysis
Dean Pearson
Head of Industry Analysis
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Industry Analysis
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Industry Analysis
+(61 3) 8634 3837

Amy Li
Economist – Industry Analysis
+(61 3) 8634 1563

International Economics
Tom Taylor
Head of Economics, International
+61 3 8634 1883

Tony Kelly
Senior Economist – International
+(61 3) 9208 5049

Gerard Burg
Senior Economist – Asia
+(61 3) 8634 2788

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

Global Markets Research
Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia
Economics
Spiros Papadopoulos
Senior Economist
+61 3 8641 0978

David de Garis
Senior Economist
+61 3 8641 3045

FX Strategy
Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848

Emma Lawson
Senior Currency Strategist
+61 2 9237 8154

Interest Rate Strategy
Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Rodrigo Catril
Interest Rate Strategist
+61 2 9293 7109

Credit Research
Michael Bush
Head of Credit Research
+61 3 8641 0575

Simon Fletcher
Senior Credit Analyst – FI
+61 29237 1076

Equities
Peter Cashmore
Senior Real Estate Equity Analyst
+61 2 9237 8156

Distribution
Barbara Leong
Research Production Manager
+61 2 9237 8151

New Zealand
Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Markets Economist
+64 4 474 6923

Kymberly Martin
Senior Market Strategist
+64 4 924 7654

Raiko Shareef
Currency Strategist
+64 4 924 7652

Yvonne Liew
Publications & Web Administrator
+64 4 474 9771

Asia
Christy Tan
Head of Markets Strategy/Research, Asia,
+ 852 2822 5350

UK/Europe
Nick Parsons
Head of Research, UK/Europe,
and Global Co-Head of FX Strategy
+ 44207710 2993

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

Tom Vosa
Head of Market Economics
+44 207710 1573

Simon Ballard
Senior Credit Strategist
+44 207 710 2917

Derek Allassani
Research Production Manager
+44 207 710 1532