

The Bigger Picture – A Global & Australian Economic Perspective

***Global:* Moderate sub-trend global growth continues with a diversity of economic conditions (solid expansion in US, UK, India and China, weakness in Euro-zone, Japan, Latin America). Falling oil prices should boost global activity, although the impact varies between oil exporting and importing countries. Our estimates are conservative but lower oil prices still boost our forecasts for the US, Japan, Euro-zone, India, China and non-Japan Asia while Russia and other big energy suppliers are revised down. Adding in the other (mainly negative) recent changes in the environment gives growth going from 3% last year to 3½% in 2015 and 2016.**

- Divergent economic conditions between the big advanced economies are reflected in recent central bank decisions on monetary policy. With growth looking solid, the Fed is still preparing the ground for a gradual rise in US policy rates, although low inflation means that tightening could start later than we previously expected. The Bank of Japan's policy remains focussed on promoting inflation and a recovery in output by keeping zero interest rates through boosting the money supply. Policy rates in the Euro are near zero, but negative inflation and a weak economy prompted the ECB to step up its asset buying policy to include government bonds. Currencies also reflect the divergence in conditions, with the yen and euro weakening as the \$US appreciates, which should rebalance growth toward the weaker economies. Bond yields have also fallen sharply across key economies, reflecting the drop in world inflation, safe haven effects and sluggish growth, but we expect US bond yields to rise back to 2¾% by early 2016.
- Global economic growth appears to be continuing at a sub-trend pace and business survey readings are consistent with moderate growth. Key \$US commodity prices have been falling sharply with the CRB measure down by almost 10% since late November. The biggest falls have been for industrial raw materials, whereas falls in food and agricultural raw materials have been more modest. Demand growth, while lacklustre, has held up, implying price falls are due to a supply response to previously high non-fuel commodity prices alongside the higher \$US in which many commodities are traded. Lower commodity prices will feed into already softening global inflationary pressures. Inflation pressures in big emerging market economies like Brazil, India, S Africa and Mexico are supporting overall CPI inflation but price pressures are minimal in the big advanced economies. The Euro zone is concerned by deflation, Japan is still focused on finally getting out of its deflationary trap, while US and UK CPI inflation is well below target.
- Although quarterly growth in the big advanced economies picked up through last year, the recovery remains lacklustre overall with big variations between regions. North America and the UK have been the out-performers in the G7, although the recoveries have been muted. Looking at the timely business surveys: results have been strong in the US, signs of a slowdown following a solid UK upturn, virtual stagnation in the Euro-zone and a Japanese economy that is still struggling to recover from last April's tax hike. The combination of much lower oil prices, Euro depreciation, a reduced pace of fiscal austerity, more central bank asset buying and better credit supply and demand conditions should help the Euro-zone, but the recovery will be very gradual. Similarly, lower oil prices and yen depreciation will drive a modest upturn in Japanese growth, at least until the planned April 2017 hike in indirect taxes. Despite the resumption of growth elsewhere, the US will remain the main driver of advanced economy growth.
- Emerging market growth slowed last September quarter, but monthly trade data for late 2014 showed a modest upturn commencing. As in the advanced economies, the monthly partial indicators show conditions are mixed across the emerging markets. There is weakness across much of Latin America and parts of East Asia, a trend slowing in Chinese growth while the anticipated upturn in India is still to show up in the export and industrial output data. While the fall in oil prices is a net positive for activity in most advanced economies, many emerging market economies are important oil exporters. Consequently, GDP in entire regions like North Africa and the Middle East as well as important economies like Russia, Venezuela and Indonesia will eventually be hit by a protracted period of price weakness. Other emerging market economies like China and India should derive considerable benefits from lower prices
- Forecasts have been revised only modestly, reflecting our cautious initial assessment of the impact from (largely supply driven) falls in the oil price, given the rather downbeat global environment in which this shock has occurred. Despite downside risks, we see growth accelerating from around 3% in 2014 to near 3½% this year and next, still slightly below trend. If this oil shock had a similar impact to previous episodes, there is scope for the acceleration in growth to be greater, especially given the scope to keep interest rates lower than usual.

- ***Australia: Fully factoring in lower oil and other commodity forecasts have created a larger “v” in the shape of our activity forecasts – softer in the near term (2014/15) as iron ore/coal effects dominate but stronger in the medium term (2015/16) reflecting oil prices, rate cuts and marginally stronger MTP growth and exports. Cuts to national incomes and lower inflation are key short term outcomes. Core CPI 1¾% by Q1 2015. Unemployment to continue to deteriorate but peak lower (6.6%) and later (Q4 2015). Still expect two rate cuts in 2015 but timing very dependent on data flow and could start a touch later.***
- The Survey again shows a patchwork economy with little-to-no momentum building. In December, conditions eased for the second successive month after October’s surprisingly strong result, to be a touch below the long run average. Additionally, forward orders fell back significantly (broad based) suggesting soft demand conditions will continue in the near term. On the other hand, levels of capacity utilisation edged up a touch. By industry, the deterioration was particularly pronounced in construction and mining. Business confidence improved a touch, but was flat to one decimal point. More importantly confidence remains well below long run averages. Falls in commodity prices underlie substantial declines in mining confidence. Lower oil prices appear have contributed to a kick in optimism in transport/utilities firms (now the most confident). The ‘bellwether’ wholesale industry remains very weak. Consistent with this, the recent strength in business credit eased back to 0.2% in November (but around 4.6% y/y).
- The employment numbers at the end of 2014 surprised on the upside, but could reflect statistical catch with traditional partial labour market indicators (such as job ads). That said, not all the labour market indicators are strong – especially hours worked and employment to population ratios. Going forward, the activity outlook is what matters for employment. On this, the December Monthly Business Survey suggested that, slowing business conditions, flat/weak confidence and falling new orders are weighing on employment (which fell back below its longer term trend). Overall, we expect the unemployment rate to gradually rise to around 6.6% by end 2015 (previously expected 6.8%) and coming later in the year. Unemployment is then expected to improve somewhat faster than previously expected on the back of rate cuts, falls in oil prices and better export volumes from improved major trading partner growth prospects.
- After a period of strength, both retail and online sales weakened in November. Generally consumer sentiment remains relatively weak (including into January) as does retail confidence. While consumer anxiety eased back a touch in Q4, consumers are still very much focussed on what might be called non discretionary purchases (such as utility costs, transport, medical expenses and paying off debt). It is early days re retail spend over the Christmas period, but NAB credit/debit card data suggest spending was not as strong as last year. Anecdotal evidence is that the lead into Christmas was particularly weak but was boosted by pre Christmas sales. Consistent with a weak lead into Christmas consumer lending in November was flat.
- According to RP Data-Rismark dwelling prices in Sydney and Melbourne started to flatten towards the end of 2014. Evidence of heat coming out of the housing market can be seen in the NAB Quarterly Australian Residential Property Survey, where expectations for house prices increases over the next year eased back considerable with fears of falls in Perth. On credit, housing credit growth maintained recent growth rates with owner occupied still around 0.5% (y/y 5.7%) in November and investor a touch lower at 0.8% (but still around 10% y/y).
- Dwelling investment recorded a surprise decline in Q3, partly due to softer apartment approvals mid-year. That trend has now reversed sharply, especially in the four storeys and above apartments. That is increasingly likely to show up in new starts and activity – albeit housing approvals and starts remain subdued. Further rate cuts are likely to help boost housing approvals and investment into 2016. Regarding non-residential construction, there is an emerging risk that the decline in mining construction this year will be steeper than anticipated. Against that, expectations in the non resources sector are being boosted by the lower AUD, expected rate cuts and continued aggressive apartment building construction. Overall, however, we see the scope for even faster falls in private investment. Low confidence and falls in new orders (across all sectors) are also not helping. Nor are concerns over the global outlook.
- Given our expectation for softer near term activity, we still expect two rate cuts in 2015 – although the timing is very dependent on data flow and could start a touch later than expected (March and August). Unemployment to continue to deteriorate but peak lower (6.6%) and later (Q4 2015). GDP forecasts cut in near term, but recovers faster: 2014/15 2.3% (was 2.5%); 2015/16 3.2% (was 3.0%).

Alan Oster
Group Chief Economist
National Australia Bank
03 8634 2927 (Mob. 0414 444 652)

Macroeconomic, Industry & Markets Research

Australia

Alan Oster	Group Chief Economist	+ (61 3) 8634 2927
Jacqui Brand	Personal Assistant	+ (61 3) 8634 2181

Rob Brooker	Economic modelling	+ (61 3) 8634 1663
James Glenn	Senior Economist – Australia & Commodities	+ (61 3) 9208 8129
Vyanne Lai	Economist – Agribusiness	+ (61 3) 8634 0198
Karla Bulauan	Economist – Australia & Commodities	+ (61 3) 8641 4028

Dean Pearson	Head of Industry Analysis	+ (61 3) 8634 2331
Robert De Iure	Senior Economist – Property	+ (61 3) 8634 4611
Brien McDonald	Senior Economist – Industry Analysis	+ (61 3) 8634 3837
Amy Li	Economist – Industry Analysis	+ (61 3) 8634 1563

Tom Taylor	Head of International Economics	+ (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
Ivan Colhoun	Chief Economist – Markets	+ (61 2) 9237 1836
David de Garis	Senior Economist – Markets	+ (61 3) 8641 3045

New Zealand

Stephen Toplis	Head of Research, NZ	+ (64 4) 474 6905
Craig Ebert	Senior Economist, NZ	+ (64 4) 474 6799
Doug Steel	Senior Economist, NZ	+ (64 4) 474 6923

London

Nick Parsons	Head of Research, UK/Europe & Global Head of FX Strategy	+ (44 20) 7710 2993
Gavin Friend	Markets Strategist – UK/Europe	+ (44 20) 7710 2155

	Foreign Exchange	Fixed Interest/Derivatives
Sydney	+800 9295 1100	+ (61 2) 9295 1166
Melbourne	+800 842 3301	+ (61 3) 9277 3321
Wellington	+800 64 642 222	+800 64 644 464
London	+800 747 4615	+ (44 20) 7796 4761
New York	+1 800 125 602	+1877 377 5480
Singapore	+ (65) 338 0019	+ (65) 338 1789

DISCLAIMER: [While care has been taken in preparing this material,] National Australia Bank Limited (ABN 12 004 044 937) does not warrant or represent that the information, recommendations, opinions or conclusions contained in this document ("Information") are accurate, reliable, complete or current. The Information has been prepared for dissemination to professional investors for information purposes only and any statements as to past performance do not represent future performance. The Information does not purport to contain all matters relevant to any particular investment or financial instrument and all statements as to future matters are not guaranteed to be accurate. In all cases, anyone proposing to rely on or use the Information should independently verify and check the accuracy, completeness, reliability and suitability of the Information and should obtain independent and specific advice from appropriate professionals or experts.

To the extent permissible by law, the National shall not be liable for any errors, omissions, defects or misrepresentations in the Information or for any loss or damage suffered by persons who use or rely on such Information (including by reasons of negligence, negligent misstatement or otherwise). If any law prohibits the exclusion of such liability, the National limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable. The National, its affiliates and employees may hold a position or act as a price maker in the financial instruments of any issuer discussed within this document or act as an underwriter, placement agent, adviser or lender to such issuer.*

UK DISCLAIMER: If this document is distributed in the United Kingdom, such distribution is by National Australia Bank Limited, 88 Wood Street, London EC2V 7QQ. Registered in England BR1924. Head Office: 800 Bourke Street, Docklands, Victoria, 3008. Incorporated with limited liability in the State of Victoria, Australia. Authorised and regulated in the UK by the Financial Services Authority.

U.S. DISCLAIMER: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

NEW ZEALAND DISCLAIMER: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person's particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication. National Australia Bank Limited is not a registered bank in New Zealand.

JAPAN DISCLAIMER: National Australia Bank Ltd. has no license of securities-related business in Japan. Therefore, this document is only for your information purpose and is not intended as an offer or solicitation for the purchase or sale of the securities described herein or for any other action.