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The Bigger Picture – A Global & Australian Economic Perspective

***Global**: Financial markets had not priced-in a Trump victory in the US Presidential election and are now working through what it means for likely US fiscal, tax, monetary and trade policy. We are still assessing the quantum and timing of such aspects of Mr Trump's pre-election policy as business and personal tax cuts as well as increased infrastructure spending. We are reviewing how suggested trade measures such as moves against "unfair" Chinese trade and the re-negotiation of existing free trade deals will proceed. The next few weeks should hopefully deliver more clarity on these measures, enabling us to include their effects in our forecasts of output and inflation.*

- Global economic growth remains soft with a sub-trend pace of expansion set to continue and few signs of an upturn. That said, behind the monthly volatility, there has been a modest uptick in the still subdued underlying quarterly pace of growth in global industrial output. Quarterly growth picked up from 0.2% in late 2015 and early 2016 to 0.5% in June, before accelerating again to 0.7% in the 3 months to August – clearly faster but still marking a pace of output expansion that falls well below trend. We track industrial growth across a sample of important economies that enables us to get some impression of how things were faring up to September and again recent months have seen a modest pick-up in growth compared to the experience at the start of the year.
- Monthly business survey readings provide the most up to date measure of the pulse of global economic growth – and they have been improving in the months leading up to October. Our measure of manufacturing activity in the big advanced economies has shown stronger growth in the 4 months to October than it did in the first half of the year. A broader business-survey derived measure of activity that covers both the advanced and emerging market economies hit a two year high in October. Services industry growth has been faster than for manufacturing and even a softer US outcome in October barely dampened the solid pace of expansion.
- Growth in the big Southern Hemisphere primary product exporting economies was hit by the steep and broad-based decline in commodity prices seen through 2014 and 2015 – with $US non-fuel commodity prices falling by 26% between the starts of 2014 and 2016. This took a toll on exports and incomes in the commodity producers but prices have stopped falling, helping support growth in places like South Africa, South America, Australia and New Zealand.
- As the long period of cuts in interest rates and increases in asset purchases by big advanced economy central banks seems to be drawing to an end, markets have increasingly wondered what comes next. At the same time, long term interest rates on government bonds have been rising from historically low levels. Barring an upsurge in post-election financial market volatility, we expect the US Fed to lift its policy interest rate in December, the first since the end of 2015, taking rates to only 0.75%. At its November meeting the central bank said that the case for interest rate increases was strengthening with Fed committee hawks already voting for an immediate rate hike.
- Elsewhere, the big advanced economy central banks seem to be shifting towards stable policy with the prospect next year of less asset buying by the European Central Bank (ECB). The Bank of England, which looked set to cut UK interest rates at its September meeting, appears to have changed its mind as the post-Brexit vote depreciation in Sterling looks set to lift UK inflation through the target rate. Nevertheless, the central bank is not signalling rate increases or winding back its very big programme of government bond purchases.
- Our expectations for global growth remain largely unchanged, with growth of 3.2% expected in both 2017 & 2018 (following 2.9% in 2016). Our forecast of a modest lift in global growth is based more on the passing of temporary weakness in some big economies than the emergence of new engines of economic expansion. Recessions gradually fade in Brazil and Russia and the recovery in commodity prices helps primary product exporters, reducing their drag on global growth. Ongoing low inflation and modest growth in the big advanced economies should mean a very gradual movement by their central banks away from exceptionally low interest rates and significant asset buying.

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<u>Australia</u>*: There has been a loss of momentum in some key high frequency indicators, but at this stage, the deterioration is not yet enough to warrant a significant change in the outlook. Our real GDP forecasts have been revised slightly, mainly due to lower starting point for Q3 2016 with partial data suggesting a large subtraction from net exports. We now expect real GDP growth of 2.8% in 2016, 2.7% in 2017 and 2.6% in 2018. The unemployment rate is expected to hover between 5.5% and 5¾% through the forecast horizon. These forecasts are somewhat more cautious than the RBA, especially in 2018. Further growth in coking coal prices has raised our 2016-17 forecasts for the terms of trade and nominal income in recent months. These forecasts were finalised prior to the US election, and do not incorporate the impact on financial markets, the global economy or Australian economy from the result.

- Perhaps the biggest threat to the Australian economy in the wake of the US election is the implication for trade policy. In particular, Mr Trump's criticisms of China and his warning that a 45% tariff could be imposed on imports of Chinese goods raises the risk of a US-China trade war if the latter retaliated. China is easily Australia's biggest export market but the US is the biggest foreign investor here and the third biggest export market. Australia would face an unenviable position if trade tensions arose between such important economic partners as China and the US.
- The NAB Monthly Business Survey was a little less encouraging in October. Business conditions remain at above-average levels, but have steadily eased from their recent peak. At the same time, despite showing relatively good resilience to external shocks, business confidence has fallen to below long-run average levels. The moderation in Survey indicators is a concerning trend that warrants monitoring, but our assessment is that the deterioration to date is not (yet) enough to warrant a significant change in the outlook. However, if these trends were to continue, it would be unsettling and imply that the non-mining recovery has started to run out of steam earlier than expected.
- In September, employment fell by a further 9.8k, but another drop in the participation rate saw the unemployment rate ease by 0.1% to 5.6%. The overall easing pace in trend employment growth, characterised by consecutive falls in full-time jobs, appears symptomatic of some re-weakening of the labour market. Employment growth in most states and territories continue to trend downwards, with the easing in NSW particularly notable. Underemployment and underutilisation rates remain elevated, largely reflecting weakness in labour demand. The employment index from the NAB monthly business survey eased in October and hints at an annual job creation rate of around 181k (around 15k per month) in coming months, which is barely sufficient to steady the unemployment rate. As such, we expect the unemployment rate to remain relatively steady in coming quarters.
- Looking through some short-term volatility, recent partial indicators of consumer spending continue to paint a picture of lacklustre consumer spending activity. The latest ABS retail trade data showed that retail volumes contracted slightly in the September quarter, although nominal growth improved in the month of September. Other high frequency data such as our own NAB Online Retail Index and NAB Business Survey also paint a lacklustre picture of consumer spending in general. That said, overall consumption growth in coming quarters is expected to be partly supported by a sustained low interest environment and positive wealth impetus from higher dwelling house prices in major capital cities.
- Headline prices suggest that the east coast housing market remains heated, although conditions vary across regions. Solid price gains since the RBA interest rate cut back in August has been largely confined to the Sydney and Melbourne markets, while Brisbane and Adelaide have been showing signs of slowing. While part of the strength reflects a fall in transaction volumes, better than expected prices gains to date have prompted us to revise our near-term price forecasts higher. Lending finance and credit numbers are pointing to greater investor activity as well. That said, market fundamentals are expected to become less favourable over the next 12-18 months, which should see price growth slow.
- Partial indicators relevant to business investment were quite mixed this month. The NAB Business Survey has softened, which included some moderation in capacity utilisation rates, but non-residential building approvals spiked in September. The NAB Commercial Property Survey also showed an improvement in sentiment, although development intentions were quite mixed. We remain optimistic that non-mining investment will improve, albeit gradually. On dwelling investment, the pipeline in apartment construction remains substantial and the number of new approvals is holding up better than expected. This will fuel strong rates of dwelling investment next year, but will drag on activity in 2018.
- Recent exponential growth in coking coal prices has raised our 2016-17 forecasts for the terms of trade and nominal income in recent months. While this may lure back some idle mine capacity in Queensland, it is unlikely to stimulate additional investment amidst low exploration rates and our expectation that such high prices are unsustainable.
- Our forecasts were finalised prior to the US election, and are predicated on two further 25bp cuts to the cash rate in mid-2017to 1%. These will be in response to ongoing low inflation and a desire to prevent the unemployment rate from rising into 2018 as economic activity slows as support from LNG exports and dwelling construction taper off. As for the AUD, our forecasts remain for it to slowly depreciate against the USD to 70 cents by end-2017 and a low of 68 cents in mid-2018. However, the potential for a much looser fiscal/tighter Fed policy mix later in 2017 has implications for the degree to which the USD might strengthen next year and therefore the AUD.

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