EMBARGOED UNTIL: 11.30AM THURSDAY 16 MARCH 2017

THE FORWARD VIEW – GLOBAL

MARCH 2017

National Australia Bank

Global reflation continues, political risks to navigate

- The cyclical upturn in the global economy that began in late 2016 has continued into the early months of this year. Business surveys and hard data on industrial output and world trade show growth continuing to ramp up through January and February and we expect the pace of global expansion to lift back to around its trend pace by 2018 – the best performance since 2012.
- Although central banks seem to have done as much as seems likely to stimulate this upturn, they should be very cautious in tightening policy as they will not want to choke off the lift in demand. Fiscal agencies that have spent so many years emphasising the need for austerity to tackle rising public debt now seem unlikely to lift taxes or cut spending.
- There is now a much higher level of uncertainty over the political complexion of governments and the chance that incoming administrations could opt for radically different economic policies. It is still unclear what approach the Trump administration will take on a range of important tax and trade issues, the UK Government has to manage the Brexit process and a series of general elections looms in the Eurozone where some high polling populist parties advocate major changes in economic policy. Our forecast is based on these political risks not de-railing the cyclical upturn in global growth.

KEY GLOBAL FORECASTS (% change)

	IMF weights	2012	2013	2014	2015	2016	2017	2018
US	15.8	2.2	1.7	2.4	2.6	1.6	2.1	2.3
Euro-zone	12.0	-0.8	-0.3	1.1	1.9	1.7	1.9	1.8
Japan	4.2	1.5	2.0	0.2	1.2	1.0	1.0	0.7
China	17.3	7.7	7.7	7.3	6.9	6.7	6.5	6.3
Emerging East Asia	8.0	4.7	4.3	4.1	3.6	3.8	4.0	3.9
NZ	0.2	2.5	2.2	3.4	2.5	3.2	2.8	2.5
Total	100.0	3.5	3.4	3.4	3.1	3.0	3.3	3.5

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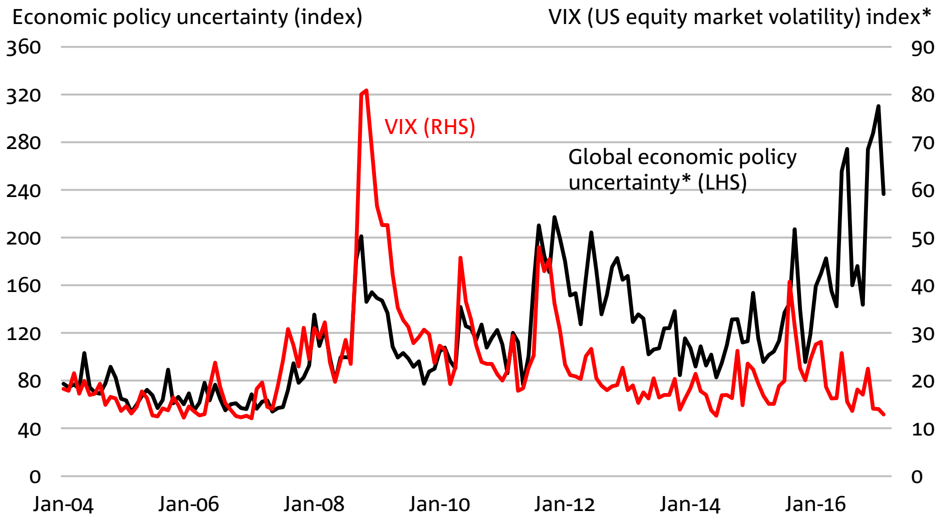
POLITICAL UNCERTAINTIES LIFT POLICY UNCERTAINTY TO HIGH LEVELS

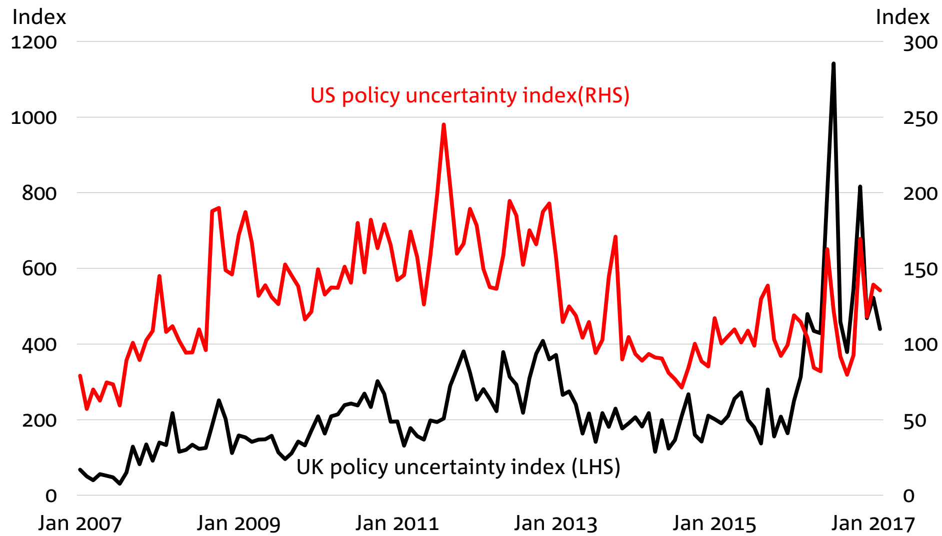
While financial markets are relatively settled, policy uncertainty is high in many countries

VIX 'FEAR INDEX' IS LOW BUT POLICY UNCERTAINTY HAS RISEN

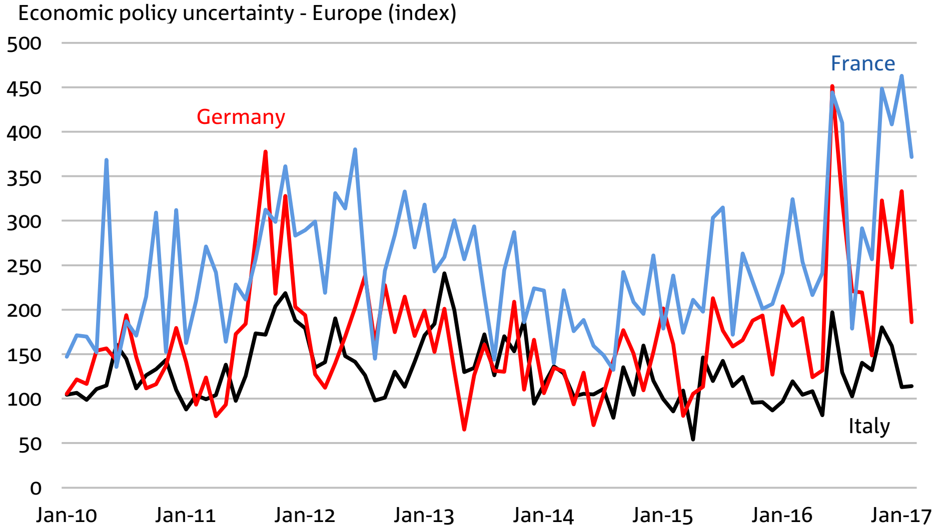


* Max value within each month

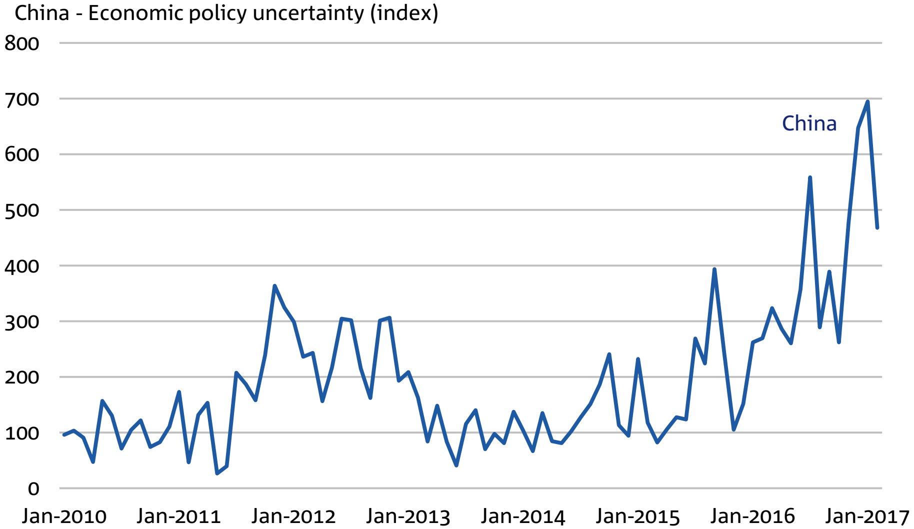
BREXIT REFERENDUM AND US ELECTION ADDED TO POLICY UNCERTAINTY



IT IS ALSO RISING IN EUROPE AHEAD OF 2017 ELECTIONS



POLICY UNCERTAINTY FOR CHINA HAS ALSO JUMPED TO HIGH LEVELS



Sources: "Measuring Economic Policy Uncertainty" by Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com, CBOE/Thomson Reuters Datastream, NAB

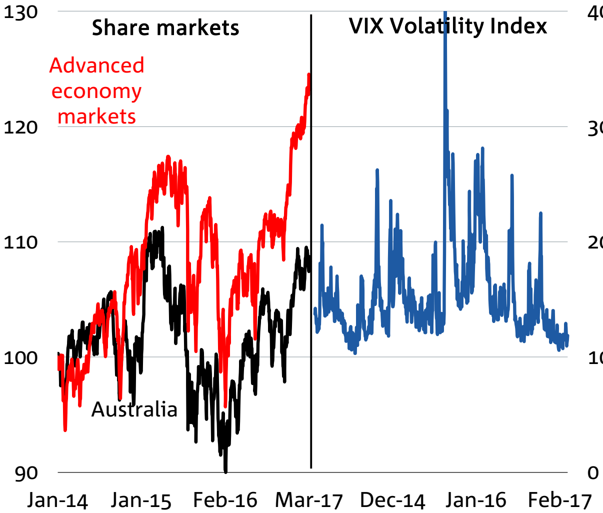
National Australia Bank

FINANCIAL AND COMMODITY MARKETS

US reflation hopes lift shares, bond yields and $US

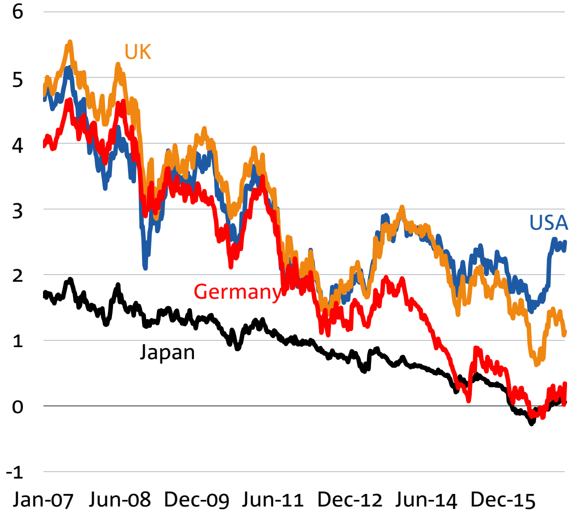
SHARES RISING, VOLATILITY LOW

Share markets and volatility indices



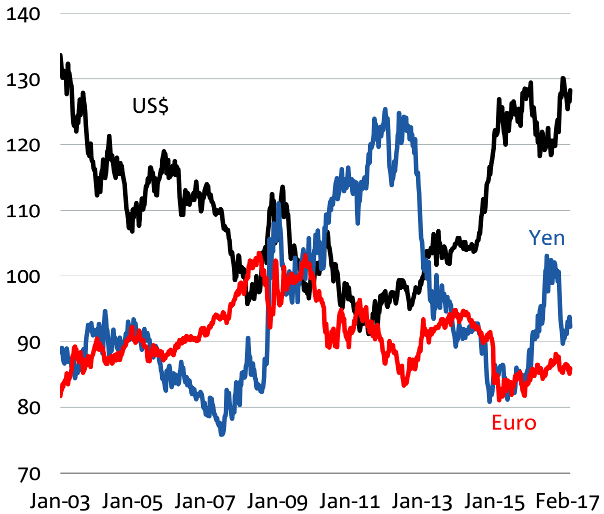
GLOBAL BOND YIELDS MOVE UP

10 yr Government Bond yields (%)



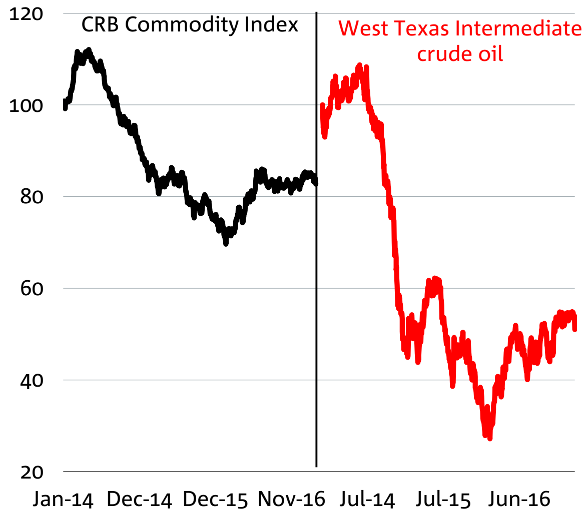
TRUMP POLICY EFFECT LIFTS $US

Trade weighted exchange rate indices (1 Jan 2010 = 100)



OIL RISES, BROAD INDICES FLAT

Commodity price indices (1 Jan 2014 = 100)



- With the outlook for economic growth looking brighter, reflected in increases in major equity markets, bond yields and commodity prices, central banks in the big advanced economies have gone about as far as they plan to in easing monetary policy. The Fed is already raising rates, the Bank of England appears unlikely to further expand its announced asset purchase program, the European Central Bank will cut its monthly asset buying from €80 billion to €60 billion from April, and the Bank of Japan has kept the same target rate of asset buying since mid-2016.

- The Fed lifted its funds rate target range by 25 bps in its meeting this month, taking it to 0.75% to 1.00%, signalling that the previously glacial pace of policy tightening is picking up. However, the Fed still says rate hikes will be 'gradual'. We are expecting two further rate hikes this year and for rates to remain well below pre-GFC averages in coming years. There is also renewed focus on when and how the Fed will start to shrink its balance sheet but so far all it is saying is that this won't occur until the process of interest rate rises is "well under way".

- Barring unexpected weakness in the economy as Brexit unfolds, the Bank of England looks to have reached its limits in cutting interest rates and increasing its balance sheet. Inflation is set to outstrip the Bank's target rate and while the Bank has indicated its willingness to be patient in bringing it back down to target, it has also said there is a limit to how long it can tolerate above target inflation. Euro-zone interest rates appear to have bottomed and there is market speculation over potential rate rises down the track and further reductions in central bank asset buying. The ECB certainly no longer shows much "sense of urgency" for further action, reflecting improved Euro-zone economic conditions, higher headline inflation and reduced risks for the outlook.

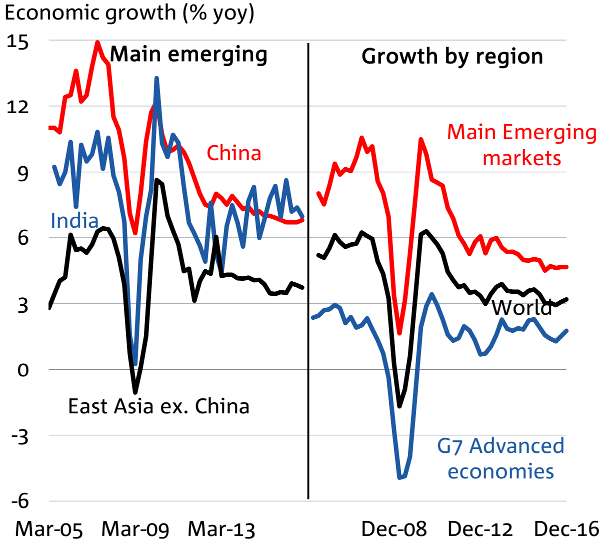
- The Bank of Japan seems content with its very loose monetary policy of negative short term rates, around zero 10-year bonds and big asset buying, possibly hoping for a growing divergence with the Fed to do its work for it through the currency. It appears likely to stay in "wait and see" mode rather than ease policy again, although achievement of its 2% inflation target, on a sustainable basis, still appears a stretch under the current outlook and policy settings.

Sources: Datastream, NAB Economics

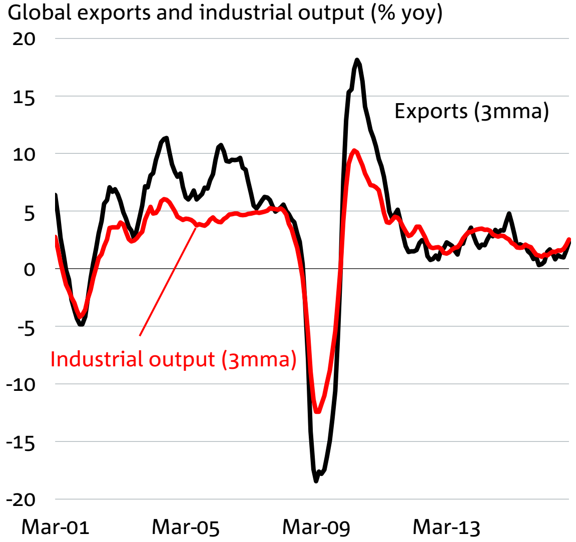
GLOBAL ECONOMIC TRENDS

Signs of economic growth picking up as global demand reflates

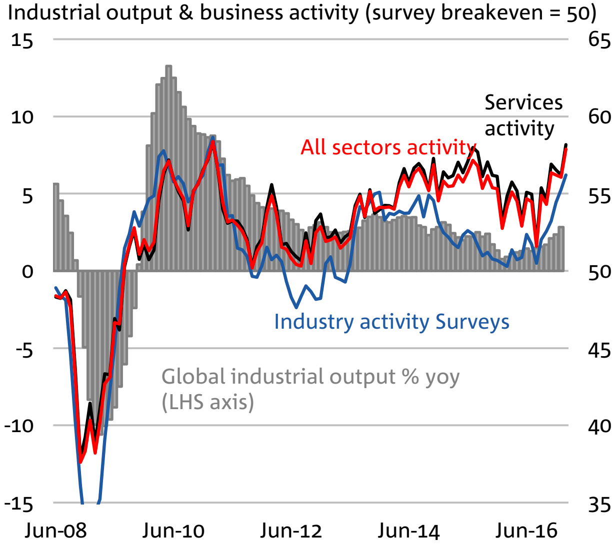
UPTICK IN GLOBAL GROWTH



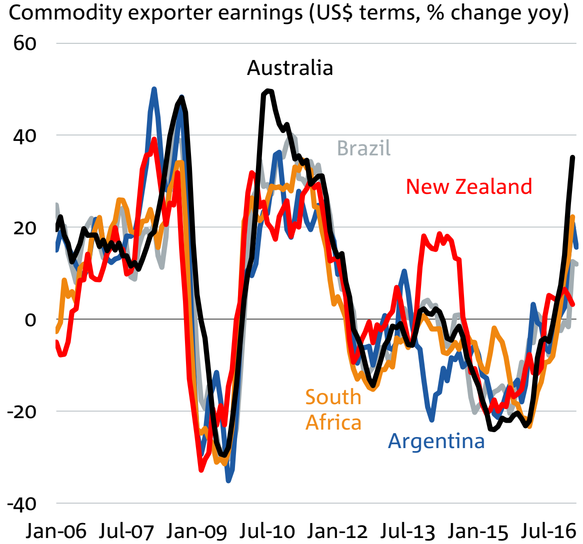
OUTPUT AND EXPORTS PICKING UP



GROWTH PICKS UP FROM LATE 2016



COMMODITY EARNINGS TAKE OFF



- After settling around 3% yoy through the first three quarters of 2016, global growth picked up to 3.2% yoy in December, mainly because of an upturn in growth in the big advanced economies - where the pace of growth lifted sequentially from 1¼% yoy in June to 1½% yoy in September and then to 1¾% yoy in December. Growth has not picked up in the emerging market economies, staying just below 4¾% yoy all through 2016, mainly because of the flat-lining of an already solid pace of expansion in India and China.

- The acceleration in growth across the big advanced economies has also been evident in the monthly measures of trade and industry. Global industrial output grew at an annualised rate of around 2% in the June and September quarters of 2016 before growth ramped up again in the final quarter of last year. The pick-up has been more marked in world trade, which has been sluggish in recent years. After falling at an annualised rate of 1½% last June quarter, growth resumed at an annualised pace of 2½% last September before accelerating further to around 4½% in the December quarter.

- The upturn has continued into 2017 with global industrial output growing by almost 3% yoy in the 3 months ended January 2017, the fastest growth since the start of 2015. This industrial acceleration has been quite broadly based with an uptrend in big advanced economies like the US and Japan, much faster growth across the arc of East Asian export-driven economies stretching from South Korea to Singapore and signs of a levelling out in activity in big South American economies like Brazil and Argentina which have been hit by deep recessions.

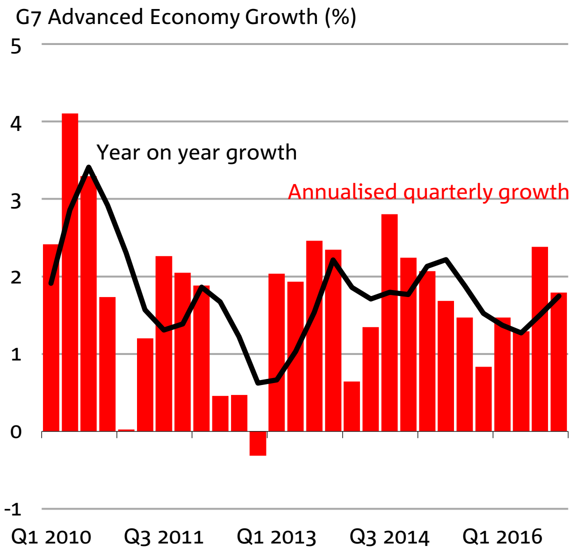
- Business surveys, the most up to date measure of the pulse of the global economic cycle, confirm that the reflation in economic activity across the big advanced economies has picked up speed further in February to deliver the strongest result since early 2011. The upturn in global industrial demand accompanied by China-related supply cutbacks has lifted global commodity markets, underpinning a strong upturn in export earnings by the big primary product exporting nations of the Southern Hemisphere.

 Sources: Datastream, NAB Economics

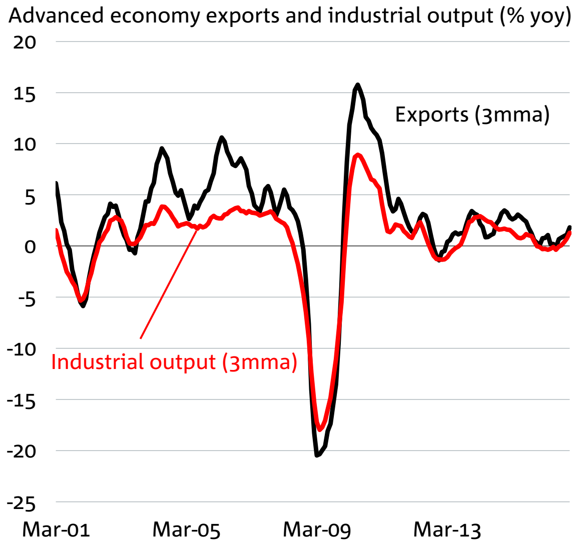
ADVANCED ECONOMIES

A broad-based lift in conditions

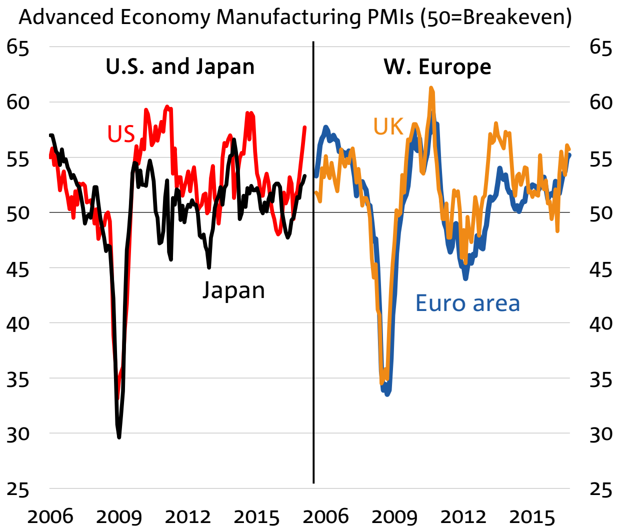
G7 GROWTH TRENDING HIGHER



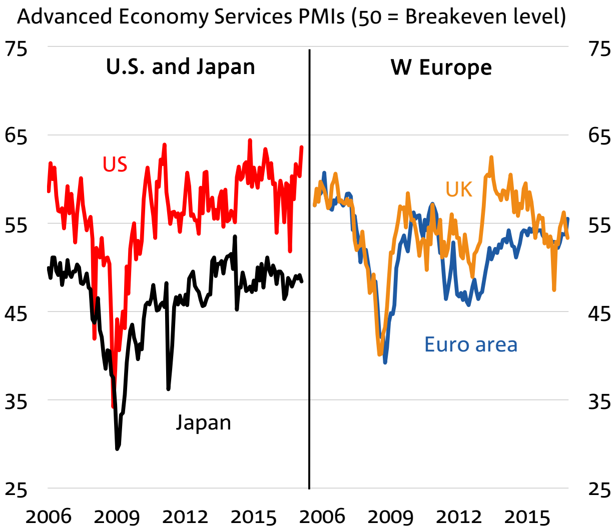
ADVANCED ECONOMIES STRONGER



SOLID INDUSTRIAL GROWTH



SERVICES SECTOR GROWING TOO



- Growth looks to be on an upward trend across the big advanced economies. While broad measures of economic activity like quarterly GDP did not show a particularly strong pace of expansion at the end of 2016, these measures tend to be lumpy and volatile and we need to look at a range of measures to work out the underlying trend in these economies.

- The annualised rate of growth in G7 GDP was around 1¾% in the December quarter, well below September's 2½% annualised pace but much higher than the in the first half of last year. The late 2016 slowing in G7 GDP growth reflected trends in North America where the pace of expansion in both US and Canadian GDP slowed between September and December. Japanese and Euro-zone growth remained much the same while the rate of expansion in the UK picked up, despite concern over the impact of the Brexit vote. While the quarterly pace of G7 growth slipped toward the end of 2016, the low 2015 base ensured that the year on year picture looks better with a sustained and solid ramping up in GDP – and we think that measure gives the most accurate picture of the underlying trend of growth in these economies.

- Monthly industrial and trade data as well as the business surveys show the extent of the acceleration in growth through late 2016 and early 2017. Industrial growth picked up from an annualised 1½% in the September quarter to 3½% in December while export growth picked up from 2½% to 5½% between the same two quarters. Year on year growth shows the upturn clearly with industrial output shifting from being flat at mid-year to almost 2% yoy in December while the lift in exports has been from flat to 3%.

- February business surveys show solid growth across both the manufacturing and services sectors. The upturn in growth looks quite broad based as well with very strong looking US surveys, an upturn in Japanese industry, much better readings from the Euro-zone and a mixed picture for the UK (with buoyant sentiment among manufacturers but less resilience in the service sector). Private sector output growth is picking up in these big economies but we need to see how that is reflected in measures of GDP that include imports and government as well.

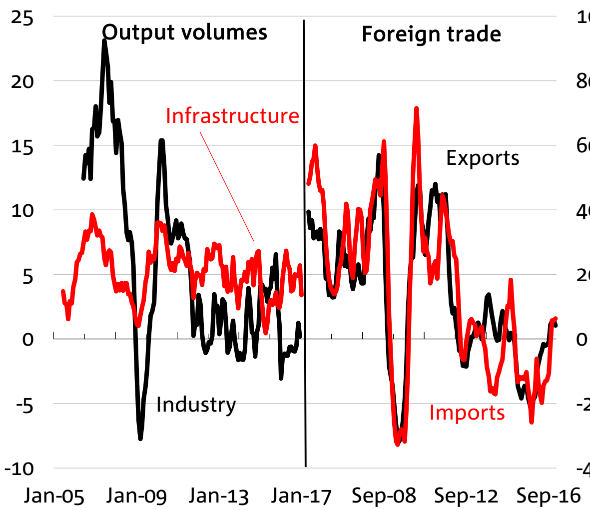
Sources: Datastream, NAB Economics

EMERGING MARKET ECONOMIES

GDP growth flat-lines but there are positive signs in trade and industry

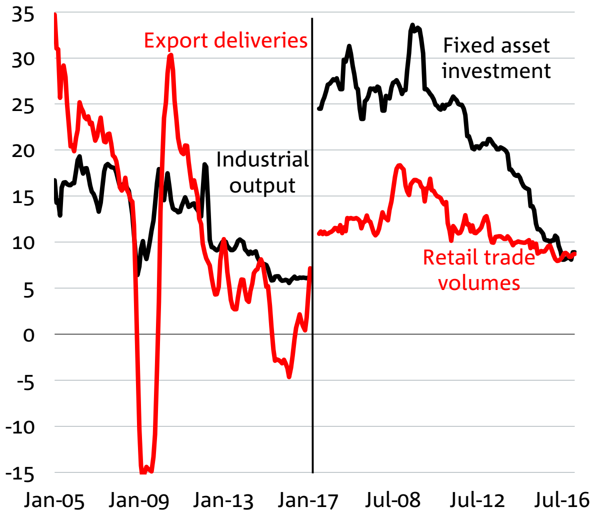
INDIA BETTER THAN EXPECTED

Indian monthly economic indicators (% yoy)



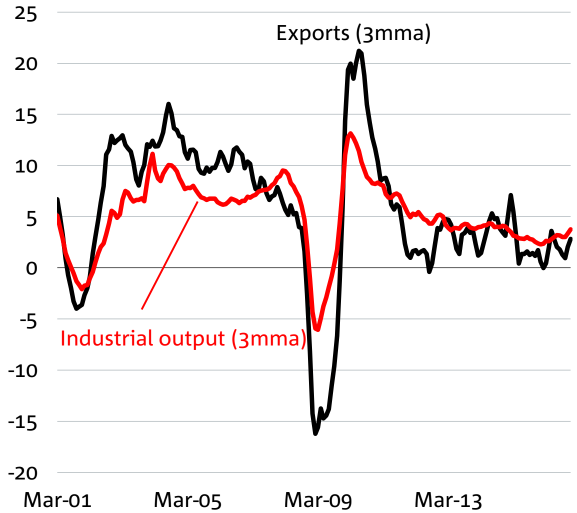
CHINESE GROWTH MIX SHIFTING

Chinese monthly economic indicators (% yoy (3mma))



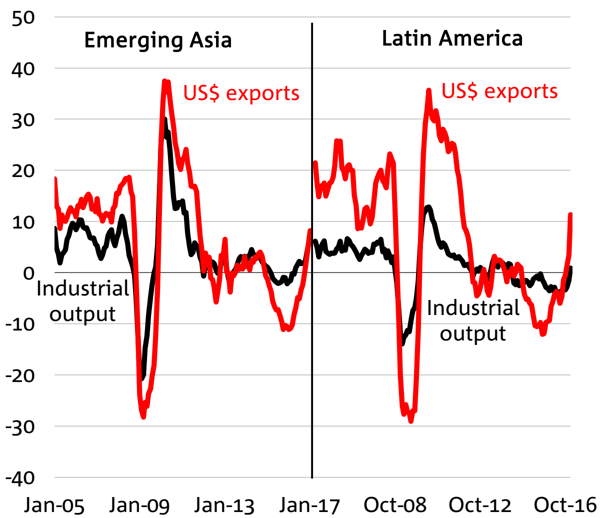
GROWTH BEGINNING TO PICK UP

Emerging market exports and industrial output (% yoy)



POSITIVE SIGNS IN KEY REGIONS

Industrial production and exports (% yoy (3mma))



- The pace of output growth in the emerging market economies did not accelerate through 2016, it stayed around 4¾% yoy right through the year. Chinese growth consolidated around 6¾% yoy and Indian growth stayed in the range between 7% and 7¾% yoy and these two countries account for almost half of total emerging market output. This means faster growth in this economic grouping would require very rapid growth across the rest of its constituent economies.

- While GDP growth remained unchanged through the latter half of last year, there was a recovery in both industrial output and export expansion. Annualised growth in emerging market industrial output was running around 3¼% last September quarter, a low rate of growth for these economies, but it picked up to over 5% in December. Export volumes, which had been falling in June quarter and were flat in September, rose by an annualised 8% in the December quarter.

- There has been a particularly sharp turnaround in the Asian emerging market economies with solid year-end export growth following very weak outcomes through the rest of the year. The latest trade data for East Asia bears out that regional incomes should now be being boosted by the global economic cycle – higher export volumes and the lift in commodity prices has seen the profile of ex-China regional $US export revenues swing from big declines through the first half of the year to growth of almost 10% yoy in the closing months of last year and into January 2017. There has also been a big cyclical shift toward growth in Latin America, probably reflecting the commodity price lift.

- The timing of Chinese new year complicates interpreting the latest crop of Chinese statistics, which present a mixed picture. Industrial growth was faster, retail sales growth was weaker, fixed investment a little stronger with a switch toward private investment, solid residential investment but house prices levelled off, imports picked up and it was unclear what exports were doing. The Chinese have set their 2017 economic targets with the growth aim being "around 6.5%, or higher if possible" and we expect growth of 6.5% this year.

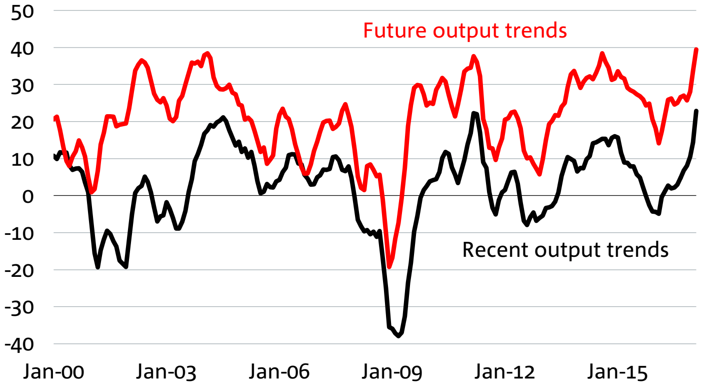
 Sources: Datastream, CEIC, NAB Economics

GLOBAL FORECASTS AND POLICIES

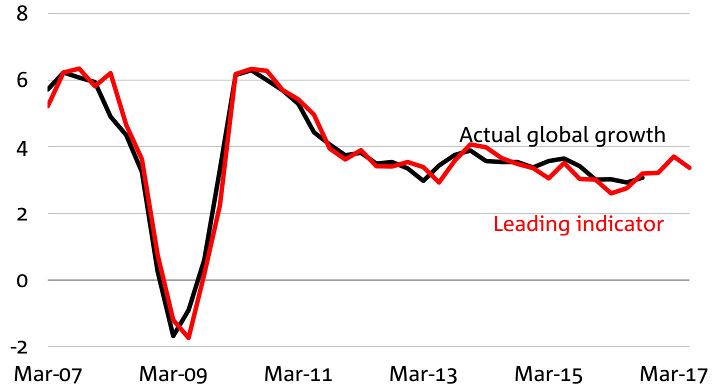
Positive signs of global reflation but political risks abound

GROWTH UPTURN SET TO CONTINUE

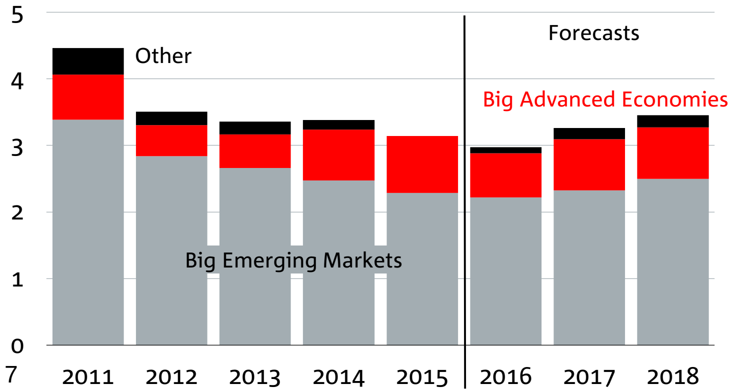
Business surveys (US, UK, Germany & France) (Index)



Actual global growth and leading indicator (% yoy)



Global economic growth (% points contribution)



- Business survey readings as well as trends in our global leading economic indicator point to another pick-up in the pace of global growth. Responses to the forward looking questions in business surveys across the big advanced economies have turned much more positive since late last year, moving in parallel with business assessments of current conditions. It looks as if many firms found themselves facing better than expected trading conditions and extrapolated that trend into the future.

- We expect the pace of global growth to quicken from 3% in 2016 to 3.3% in 2017 and then rise further to 3.5% in 2018. For the first time in many years, economic outcomes have surpassed predictions, often the sign of an upturn in the business cycle. This upturn should be welcomed by the authorities and we think central banks will be careful to avoid choking it off by premature or overly aggressive rate hikes. Similarly, fiscal authorities should avoid implementing new austerity measures that are intended to address their deficit and public debt problems but which could set back growth. The adverse short-term economic impact of badly timed hikes in interest rates and taxes plus the fall-out from rounds of pro-austerity spending cuts seen in recent years should ensure that this upturn is allowed to run far longer than many previous ones before tough restrictive policies come in to curb demand or inflation.

- Rather than either an overly early tightening in economic policy or pressures in the financial system, the most obvious risk to our forecast comes from major political and policy change. We are still awaiting the details on the trade, tax and spending policies of the Trump administration while the Euro-zone faces a series of elections this year. The Trump victory and the Brexit vote outcome warn against assuming that politics has to deliver “business as usual” policies. Opinion polls suggest “business as usual” policy outcomes in Europe but these polls have given misleading signals before.

KEY GLOBAL FORECASTS (% change)

	2011	2012	2013	2014	2015	2016	2017	2018
US	1.6	2.2	1.7	2.4	2.6	1.6	2.1	2.3
Euro-zone	1.6	-0.8	-0.3	1.1	1.9	1.7	1.9	1.8
Japan	-0.1	1.5	2.0	0.2	1.2	1.0	1.0	0.7
UK	1.5	1.3	1.9	3.1	2.2	2.0	1.8	1.7
Canada	3.1	1.7	2.5	2.6	0.9	1.2	1.7	2.0
China	9.5	7.7	7.7	7.3	6.9	6.7	6.5	6.3
India	7.9	5.9	6.2	6.9	7.5	7.5	7.4	7.5
Latin America	4.7	2.7	2.5	0.9	-0.2	-1.2	0.6	2.4
Emerging East Asia	4.4	4.7	4.3	4.1	3.6	3.8	4.0	3.9
NZ	1.8	2.5	2.2	3.4	2.5	3.2	2.8	2.5
Total	4.5	3.5	3.4	3.4	3.1	3.0	3.3	3.5

Sources: Datastream, NAB Economics

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