National Australia Bank

April 2013

The Bigger Picture – A Global & Australian Economic Perspective

<u>Global:</u> Our global forecasts remain little changed at 3.3% in 2013 (was 3.2%) and 3.9% in 2014. Renewed Euro-zone instability has taken a toll on global equity markets, which had strengthened quite markedly since late 2012, especially when compared to global economic activity and commodity markets. While latest data on world trade and industrial output is far from strong, it is a little better than the virtual stagnation shown through much of 2012. Business surveys in the advanced economies also show a lift in sentiment over future output. The pick up in 2014 reflects expectations that recession ends in Europe, Japan reflates and the big emerging market economies gather speed.

- The protracted and confusing process of dealing with Cyprus' banks eroded financial market confidence in late March and the decision to "bail-in" depositors has only added to confusion. Is this a "one off" tax on deposits or a new template for Euro-zone handling of crises? The extent of the damage done to global equity prices from this Euro-zone crisis has been quite limited. The previous upward market trend was arrested as several big equity markets levelled off but they did not fall. In addition, the aggressive monetary measures announced by the Japanese central bank have resulted in a large increase in local equity prices. Aggregate commodity prices are trending lower, suggesting that global demand is not growing particularly strongly.
- Behind the volatility in monthly data, there has been a gradual improvement in some key measures of global economic growth through late 2012 and early 2013. World trade volumes rose to 1.3% over the three months to January, up from 0.9% in Q4 2012 and 0.2% in Q3 2012. The same pattern is evident for industrial output. The sluggish performance of growth across many of the biggest economies in the world has resulted in substantial amounts of idle capacity (around 20% of G7 industrial capacity is lying idle) and still high unemployment.
- Global CPI inflation is running at around 2% yoy and producer price inflation is down to around 1% yoy. There are still big economies where inflation remains a major policy problem, notably India, Brazil and South Africa. In the big advanced economies, however, despite all the concern expressed about central bank quantitative easing, inflation remains low.
- Revised national accounts numbers show that the level of economic activity in the US and Japan in late 2012 was not as weak as initially feared. Real GDP fell in the UK and the Euro-zone but it increased very slightly in the US and Japan. The overall performance of the big advanced economies through their recovery from the 2008/09 recession has been weak by the standard of many previous upturns in the post-war period, with quarterly growth in the G7 economies slowing from around ¼% in Q2 and Q3 2012, to a quarterly rate of -0.15% by the end of last year.
- The emerging market economies experienced a slowdown in the pace of growth through 2012. India and Brazil experienced a marked softening and their situation was further complicated by high inflation. Indian CPI inflation reached double digit rates at the end of 2012 and into early 2013 while the Brazilian CPI was up by around 6½% yoy in early 2013, well above the central bank's target rate. China has fared better than the other two big emerging economies – growth has been better maintained, improving towards the end of last year, and inflation has fallen.
- The export oriented economies of East Asia and Latin America outside of Brazil also saw a sharp slowdown through much of 2012 but conditions started to improve toward the end of 2012 and into early 2013. The upturn in industrial output and exports has been most marked in East Asia.
- Overall we have not changed our core global forecasts. For the US we have slightly revised up our 2013 forecasts to 2.4% (was 2.2%) on the back of better consumer and investment outcomes in Q1 and an on going house price improvement. The reality however Europe is that Europe will be in recession till late 2013 and Japan, despite policy initiatives is still likely to only grow by around 1% in 2013. Only China is more clearly on a stronger path. For 2014 the return to global trend growth reflects our view that Europe and the UK will by then be growing – albeit moderately, with the USA and especially Japan benefiting from easier monetary policy. China on the other hand is expected to maintain its current growth path – which in turn will benefit Non Japan Asia.

<u>Australia:</u> Our GDP forecasts remain broadly unchanged; we have lifted Q1 consumption (reflecting strong retail data) and softened our outlook for investment (reflecting lower commodity prices). We see GDP of 2.4% in 2013 (was 2.3%), before lifting to 3.0% in 2014 (was 3.1%). While there are signs the Australian economy is strengthening, falling commodity prices and a high AUD are still weighing on activity. We see unemployment rising to around 5¾% by late 2013. With inflationary pressures well contained, there is scope for two more rate cuts by year-end (possibly Jun & Nov). Timing is still fluid with higher house prices a possible delay factor but the unemployment path will be key.

- Stronger official data for employment and retail trade, a stronger stock market and the resumption of house price growth appear to some to be the 'green shoots' of a strengthening domestic economy. This may be premature. A range of forward indicators continue to point to a sluggish patch over at least the first half of 2013 with the prospect of rising unemployment and several industries deeply recessed.

- The decline in bulk commodity prices in the second half of 2012 has made heavy inroads into confidence and conditions in the mining sector. While several mega LNG projects are now under way and construction on these projects will continue for some time, the feasibility of many prospective coal, iron ore and base metals projects will be under review. There are now indications that the lengthy pipeline of mining engineering work is beginning to be run down. At the same time, there is little prospect that sectors outside the mining industry are in any position to seize the reins of growth.

- The NAB survey highlighted the challenging environment faced by business in March. Business conditions deteriorated to -7 points, the lowest level since May 2009, reflecting a weakening in trading and employment conditions, while profitability was unchanged at a subdued level. While forward orders improved, they remained weak, with the outlook for near-term demand not helped by still low levels of capacity utilisation and capital expenditure. Heavy falls in manufacturing and retail conditions indicate we are yet to see the upswing in consumer demand that policy makers are searching for. Business confidence was resilient in March (at +2 points), despite reignited worries about a European crisis and political uncertainty at home.

- Forward indicators for the labour market have weakened appreciably over recent months. In February, ABS job vacancies fell by 10% and DEEWR internet vacancies were down 4.5% relative to November. In March, ANZ job ads fell by 1.5%. Also in March, NAB employment conditions drifted down to a net balance of -5 points – the eleventh consecutive month of negative readings for this indicator. The decline in commodity prices has meant that real wages faced by producers have been growing relatively rapidly in recent quarters. All this suggests that the recent surge in the official employment data in February, showing employment up 71,500 jobs, may be thrown sharply into reverse in coming months. The unemployment rate, at 5.4%, is probably a more realistic reading of the state of the labour market at present.

- Household balance sheets have been aided by the improvement in equity and house prices but there are few signs of a willingness to increase discretionary spending. Housing and personal credit growth remained subdued into February. While there has been an improvement in retail turnover, it may mostly represent a catch up following the stagnant period in late 2012.

- The RBA left the cash rate unchanged at 3.0% at its April meeting, with its view of the global and domestic outlook little changed from its assessment at its previous meeting in March. While the RBA Board seems very content with its accommodative stance on monetary policy, it has not ruled out the possibility of making further adjustments to policy if needed to "foster sustainable growth in demand". We see the need for a 25 bp rate reduction by the middle of this year, which we have pencilled in for June. Thereafter, we believe the RBA will wait and see how the non-resource sector performs as mining investment begins to retreat. In our view, an additional 25 bp rate cut will be needed (in November) to help support weakening labour market conditions. However, timing is likely to be quite fluid, with higher house price inflation a potential delayer/stopper of rate cuts. Ultimately, however, the key swing variable will be the rate of deterioration in unemployment.

Alan Oster
Group Chief Economist
National Australia Bank
03 8634 2927   (Mobile 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	Head of Australian Economics & Commodities	+(61 3) 8634 1663
Alexandra Knight	Economist – Australia	+(61 3) 9208 8035
Vyanne Lai	Economist – Agribusiness	+(61 3) 8634 0198
Dean Pearson	Head of Industry Analysis	+(61 3) 8634 2331
Gerard Burg	Economist – Industry Analysis	+(61 3) 8634 2788
Robert De Iure	Economist – Property	+(61 3) 8634 4611
Brien McDonald	Economist – Industry Analysis & Risk Metrics	+(61 3) 8634 3837
Tom Taylor	Head of International Economics	+(61 3) 8634 1883
John Sharma	Economist – Sovereign Risk	+(61 3) 8634 4514
Tony Kelly	Economist – International	+(61 3) 9208 5049
James Glenn	Economist – Asia	+(61 3) 9208 8129

Global Markets Research - Wholesale Banking

Peter Jolly	Global Head of Research	+(61 2) 9237 1406
Robert Henderson	Chief Economist Markets - Australia	+(61 2) 9237 1836
Spiros Papadopoulos	Senior Economist – Markets	+(61 3) 8641 0978
David de Garis	Senior Economist – Markets	+(61 3) 8641 3045

New Zealand

Tony Alexander	Chief Economist – BNZ	+(64 4)474 6744
Stephen Toplis	Head of Research, NZ	+(64 4) 474 6905
Craig Ebert	Senior Economist, NZ	+(64 4) 474 6799
Doug Steel	Markets Economist, NZ	+(64 4) 474 6923

London

Nick Parsons	Head of Research, UK/Europe & Global Head of FX Strategy	+(44 20) 7710 2993
Tom Vosa	Head of Market Economics – UK/Europe	+(44 20) 7710 1573
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