National Australia Bank

August 2013

The Bigger Picture – A Global & Australian Economic Perspective

Global: ***Central bank statements reinforcing their guidance that interest rates should stay low for a long time yet across the big advanced economies have supported financial markets. Recent business surveys and industrial data point to an upturn in growth in these advanced economies, possibly heralding the start of the shift in the composition of global growth away from the emerging markets and toward advanced economies. While USA growth is lower, an accelerating trend is expected to see "tapering" begin in coming months. Against that, business surveys, trade and industry data and GDP releases show a softening trend in the emerging markets. We also expect slower Chinese growth to continue into 2014.***

- The consensus view has long been that annual global economic growth should increase from 3% to around trend (which is between 3½% and 3¾%) over the next year or two. Set against this forecast, the performance of the global economy through the last couple of years has been disappointing with few signs until recently that the anticipated ramping up of world economic growth was about to start. The last few months have finally brought some early evidence that things could be getting better. Some of this rotation reflects the passing of prolonged periods of economic weakness in Western Europe, some is due to the stimulus coming from Abenomics to Japanese demand while, in the background, a moderate US recovery continues.
- As there is still plenty of spare capacity in the big advanced economies, supply should not be much of a constraint on their predicted economic upturn. This idle capacity limits pricing power in labour and product markets, ensuring inflation stays down, thus allowing central banks to keep their policy interest rates at historically low levels.
- Second quarter trends in GDP for the US and UK have been reasonably positive, partial data for Japan suggests continued growth and some of the recent economic indicators in the recession-hit Euro-zone are looking less negative. The most marked evidence of improving economic conditions comes in the business surveys where the latest monthly purchasing manager surveys show a solid improvement across the US, UK and Euro-zone (but the Japanese upturn faltered in July). The combination of fiscal stimulus, central bank asset purchases and a lower yen appears to have triggered an upturn in Japanese economic growth, with exports, consumer spending and business conditions all moving up. However, there have been a few recent setbacks and markets are watching to see if growth momentum can be maintained.
- While economic conditions across the big advanced economies are looking more promising, the growth performance of the large emerging market economies has been disappointing. Chinese growth slipped from double-digit levels in 2010 to 7.5% yoy in June 2013 and quarterly growth in the second quarter was running at 1.7%. India has also slowed markedly with growth halving from around 10% in the first half of 2010 to around 5% yoy in early 2013. The emerging market slowdown extends beyond China and India, stretching from the export oriented economies of East Asia to even a big closed Latin American economy like Brazil where growth of only around 2% is expected this year. This weakness reflects subdued world trade and the exhaustion of previous credit-led growth models in places like Brazil and S Korea.
- Recent signs that growth is picking up in the big advanced economies fit in with the re-balancing of global growth toward those nations that we have been predicting for some time and which business seems to be expecting. Eventually the still weak economic conditions in Western Europe have to improve, Abenomics should boost demand in Japan while the gradual US economic upturn trundles on. The upshot is that growth in the big advanced economies should rise from just over 1% this year to 2¼% in 2014.
- While recent indicators look brighter for the advanced economies – and we have modestly revised up our 2013 forecasts for the UK and Japan – they look less rosy for some of the big emerging markets and we have slightly lowered our forecasts for China and India. Emerging economy growth is only expected to accelerate modestly through the next few years – from 5¼% in 2013 to 5½% by 2015, mainly because of an upturn in world trade that drives emerging Asian exports, monetary easing in India lifting its demand and faster expansion in Latin America. Taken overall, world economic growth is expected to rise from 3% this year to 3.6% in 2014 and 3.7% in 2015, which is back around its long-term pace.

Australia: ***There are further signs of growth grinding lower. We see GDP growth softening to 2.2% in 2013, before rising to 2.6% in 2014, and a significant deterioration in the labour market is expected this year (unemployment above 6%) and next. Our forecasts have been revised a touch lower – with downside risks building. When combined with still low inflation, we expect another RBA cut – probably in November – and more cuts may follow. We remain a touch more bearish than recently revised (down) forecasts from the Government and the RBA.***

- The Australian economic outlook remains soft. The latest NAB survey showed that business conditions in July remained at a four-year low and confidence fell to the lowest level in eight months. Conditions were especially weak in manufacturing – despite the lower Australian dollar – construction, mining and retail. Labour market forward indicators have deteriorated further, suggesting more weakness in domestic demand to follow.

- Optimism in the official family about the outlook for the Australian economy also appears to have dissipated over recent weeks. In broad terms, Treasury and RBA forecasts, while similar in tone, remain a touch more upbeat – especially when including our worries about downside risks building in our forecasts. Turning to the numbers we are forecasting GDP growth of 2.2% in 2013/14 (Treasury: 2½%, RBA: 2½%) and 2.7% in 2014/15 (Treasury: 3%, RBA: 2½-3½%).

- We think the most prominent issues are how quickly the labour market can absorb the frictions associated with the winding down of mining investment and whether the non-mining sector will have the capacity to assume the reins of growth as mining investment declines. We are already seeing signs that domestic demand is slowing and labour market conditions are weakening, suggesting that these issues are already having an impact on growth.

- While a lower Australian dollar and accommodative monetary policy settings should provide some relief for trade-exposed sectors and assist a rebalancing of growth towards greater sustainability over time, the exchange rate is still historically elevated, and is expected to remain so over the near to medium term. There are early signs that a lack of demand has seen profits take a hit rather than prices increase.

- Official ABS data are finally beginning to paint a weaker picture of labour market conditions after being at variance with partial indicators for much of this year. In July, the number of people employed fell by 10,200, more than unwinding the previous month's rise. When combined with a fall in the participation rate, the unemployment rate was unchanged at a four year high of 5.7%. Partial indicators of labour market conditions have also weakened appreciably into the middle of this year.

- Retail trade did not grow in values terms in June, nor did June quarter volumes, while personal credit growth remained weak. While there are signs of a resurgence in house price growth, the benefit of lower interest rates is likely to continue to struggle against a deteriorating labour market and worries about job security.

- Still soft ABS CPI data for the June quarter 2013 kept the door open for further monetary policy easing. Headline inflation was a fairly modest 0.4% in the quarter, while the average of RBA preferred 'core' inflation measures (trimmed mean and weighted median) lifted marginally to 0.5% (revised down by the ABS on 1 August). Through the year inflation (both headline and core) was 2.4% in the quarter – still well within the RBA's 2-3% target range.

- The RBA lowered the cash rate by 25 bps to 2.50% at its meeting on 6 August. The reduction in the cash rate confirmed the RBA Governor Glenn Stevens' sober outlook for the Australian economy provided during his recent address to the Anika Foundation. It is our view that a modest inflation read in October will pave the way for another 25 bp cut in November, taking the cash rate to 2.25%. Beyond 2013, the risk will be for further rate cuts, provided the currency remains relatively elevated and assuming the economy responds slowly to the RBA's stimulus. 2014 will be a drawn out year for the economy and a cash rate even lower than our current projection of 2.25% remains a distinct possibility.

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