

The Bigger Picture – A Global & Australian Economic Perspective

Global: *The generally upward trend in advanced economy purchasing manager surveys began to fade through late 2013 and 2014 and that has been followed by a levelling out in the rate of growth in world trade and industrial output. Growth in North America should pick up following the disruption caused by the harsh winter. Policy is becoming more positive for growth in the Euro-zone and the UK economy looks set to continue a solid recovery. While Japanese demand has to adjust to the imposition of a higher indirect tax rate, the underlying economic situation looks far better than it did after previous tax hikes. Among the emerging economies, China is slowing and while an upturn is expected across the rest of East Asia and Latin America, there is little sign of it yet. Overall, global growth should be around trend this year and above trend in 2015.*

- The Fed is still cutting its asset purchases (“tapering”) at a rate that should see the programme finish late this year. Interest rates look set to stay between zero and 0.25% for “a considerable time” and we expect the first rise in mid-2015. Central banks in Japan and the Euro-zone are focussed on combating deflationary risks which points to loose monetary policy for a long time to come. Facing well below-target inflation and a risk of deflation, the European Central Bank has announced lower policy lending interest rates, negative rates for banks depositing money with it, an assurance of low cost funding to the banking system, a scheme to encourage commercial bank lending to business borrowers by providing low cost funds to banks and further preparatory work on central bank asset purchasing. The aim is to prevent the Euro-zone falling into a Japan-style deflation.
- The levelling out in business sentiment shown in the purchasing manager surveys for the industrial sectors of the big advanced economies has been reflected in their output. The trend 3-month annualised growth rate of industrial output in the advanced economies stabilised at around 4% through the first few months of 2014, a change from the ramping up in growth seen through 2013. The comparable measure of industrial growth in the emerging market economies has continued to slow. Taken overall, there has been a significant slowing in the pace of growth of the biggest advanced economies since mid-2013. Annualised growth in the G7 peaked at around 2½% in June and September 2013, falling to just under 2% in December and around 1% in March 2014. Part of this slowdown reflected the harsh winter conditions in North America (which contributed to a fall in US output) but there was also a disappointingly weak GDP outcome in the Euro-zone. The pull-forward of spending in Japan to beat the April tax rise offset some of the weakness in other big advanced economies.
- The monthly purchasing manager indices (PMIs) confirm this mixed picture across the big advanced economies. The level of Japanese economic activity has fallen since the indirect tax change but the manufacturing and services PMIs have recovered some of their April losses, suggesting that the economy is holding up better than it did in the wake of the 1990s tax hikes and supporting the Government’s view that the recent tax rise should not de-rail growth. In the US, the PMIs point to ongoing moderate growth, smoothing out the bad weather related volatility seen in the national accounts and monthly “hard” economic data. UK PMIs show strong growth but Euro-zone indices are less buoyant.
- The slowing trend in the big emerging economies continued into the early months of 2014 with a virtual stagnation in the level of their industrial output after a long period of solid growth. This lines up with the levelling off in import and export volumes and the weakness in their recent business surveys. Emerging Asian industrial growth was down to around 1½% yoy, in Latin America it was near zero (Brazil was negative) while Indian growth was negative. China is the exception to this picture of modest industrial expansion, its growth is slowing but (at almost 9% yoy) it remains far stronger than any other big global economy.
- Forward looking questions in the business surveys of big advanced economies show growth is expected to continue at a moderate pace but they no longer point to growth accelerating. Our forecast is for advanced economy growth to pick up from 1.3% in 2013 to 1.9% this year and around 2.3% through 2015 and 2016. Turning to the emerging economies, growth is expected to stagnate at around 5½% between 2014 and 2016 - slightly slower than the late 2013/early 2014 rate. Trends are mixed across these economies with China expected to slow, India to pick up (after a long disappointing period) and a modest acceleration in Latin America and emerging Asia. Global growth is expected to reach 3.4% this year, close to its 35 year trend rate, and rise to an above-trend 3.7% in 2015.

Australia: Australian business confidence emerged unscathed from Budget but conditions drifted down for third consecutive month and now negative. Stronger GDP growth was supported by net exports and dwelling investment, but consumption growth was weak and business investment fell again (non-mining yet to fill gap). Forward indicators from survey remain weak. Dwelling market surge subsiding and construction to soften. Australian forecasts marginally higher (reflects history): 3.3% (was 3.1%) 2014/15, 3.0% (was 2.7%) in 2015/16. However domestic demand growth likely to remain at 1% or less going forward. Hence jobless growth still sees unemployment rate peak at 6¼% by end-2014. Cash rate unchanged until late 2015.

- The national accounts point to a domestic economy on the cusp of a demand recession: domestic final demand growth has averaged just 0.3% per quarter since the middle of last year and GNE is even weaker. Quarterly growth in GDP of 1.1% (3.5% through the year) has been sustained by stronger exports (mainly minerals and energy) and weaker imports (especially capital equipment). The composition of growth is increasingly being tilted away from labour-intensive engineering and mining construction, increasing the structural adjustment task for the labour market as the mining investment boom recedes. Underlying business investment declined by 1.7% and expectations from the latest capex survey suggest that growth in non-mining investment is unlikely to compensate for the prospective fall in mining construction as major projects are commissioned over the next two years. Consumer spending grew by a soft 0.5% in Q1 to be only 2.5% higher than a year earlier.
- While business confidence appears to have emerged from the Budget intact, conditions continued to slip in May, according to the NAB business survey. Manufacturing and wholesale bore the brunt of the renewed weakness, particularly through a sharp decline in trading conditions. The precise impact of the federal budget on macroeconomic activity remains somewhat uncertain as various measures are negotiated through the Senate. Nevertheless, it seems likely that fiscal restraint will provide a headwind to growth in coming quarters.
- Forward indicators remain weak: orders rose to be barely out of negative territory and capacity utilisation was unchanged and below long-run averages for most industries. Nevertheless, confidence has held up reasonably well around long-run averages, despite headwinds from weak business conditions and a negative reaction from consumers to the recent Federal 'tough budget'. Trend forward orders for Q2 so far imply a decline in predicted annualised demand growth compared with Q1. Our 'wholesale leading indicator' points to soft business conditions in coming months which, in turn, suggests little change in predicted GDP growth in Q2.
- The labour market has improved from last year but remains soft. While the unemployment rate has been confined below 6%, the demand for labour (especially on an hours worked basis) has been quite soft. While ANZ job ads recovered lost ground in previous months, they fell back in May. Department of Industry internet ads have also lost much of the ground gained at the start of the year. The NAB employment index from the business survey, which had been deeply negative throughout 2013, also improved strongly at the start of the year but has mostly remained close to zero since then. We expect that the structural transition from mining investment to mining exports will create an element of frictional unemployment that will take time to absorb. We still expect the unemployment rate to peak at around 6¼% by the end of 2014 before progressively declining during 2015 as displaced mining construction and services labour is absorbed into new infrastructure projects, dwelling construction and associated activities.
- Our GDP forecasts are marginally higher because of history: growth to be a little stronger at 3.1% through 2014/15 (was 2.8%) and 3.0% (was 2.8%) through 2015/16. In financial year terms, GDP growth forecasts are higher: 3.3% in 2014/15 (was 3.1%), and 3.0% in 2015/16 (was 2.7%). However, with GDP increasingly driven by the capital-intensive minerals energy sector, we still see modest employment growth in the near term before it begins to recover: 0.9% (was 0.8%) to mid-2014, and 1.7% (was 1.6%) to mid-2015.
- The RBA appears decidedly unwilling to move on the cash rate in the near term, expecting better news in the second half of 2014. This leaves little scope for a tightening cycle to commence any time soon. Consequently, we still expect no further change until a tightening cycle begins near the end of 2015.

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
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	Economist – Industry Analysis & Risk Metrics	+ (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
Spiros Papadopoulos	Senior Economist – Markets	+ (61 3) 8641 0978
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
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

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