Global & Australian Forecasts

by NAB Group Economics

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September 2014

National Australia Bank

Key Points:

- **Disappointing global growth continued into mid-2014 with stagnation in the Euro-zone sparking deflationary concern and ECB action while Japanese demand is still struggling to recover from April's tax rise. Solid economic upturns in the US, UK and Canada limiting the slowing in advanced economy growth while the anticipated softening in the emerging market economies is under way, pointing to another year of below-trend 3% growth. We still expect growth to accelerate to around trend through 2015 and 2016.**
- **Domestic GDP growth sub-par (0.5%) in Q2— with nominal GDP falling. Business conditions & confidence still positive but conditions give back most of August gains. Domestic forecasts revised marginally: 2014/15 2.9% (was 3.1%); 2015/16 3.4% (was 3.2%). Unemployment rate still to peak at 6½% by end-2014. Inflation at the bottom of the RBA target band. Cash rate still on hold until late 2015.**

Key global and Australian forecasts (*% change*)

Country/region	IMF weight	2012	2013	2014	2015	2016
United States	20	2.3	2.2	2.1	3.0	2.8
Euro-zone	14	-0.6	-0.4	0.7	1.1	1.6
Japan	6	1.4	1.5	1.3	1.5	0.8
China	15	7.8	7.7	7.3	7.0	6.8
Emerging Asia	8	3.9	3.9	3.9	4.2	4.4
New Zealand	0.2	2.5	2.9	4.0	3.4	1.8
Global total	100	3.1	3.0	3.0	3.5	3.7
Australia	2	3.6	2.3	3.1	3.1	3.3

Australia (*fiscal years*)	12/13	13/14	14/15	15/16
Private consumption	2.1	2.5	2.5	2.8
Domestic demand	2.0	1.2	1.4	1.1
GDP	2.6	2.8	2.9	3.4
Core CPI (*% through-year*)	2.4	2.8	2.0	2.5
Unemployment rate (*% end of year*)	5.7	5.9	6.4	6.2

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Global and Australian overview

Global overview

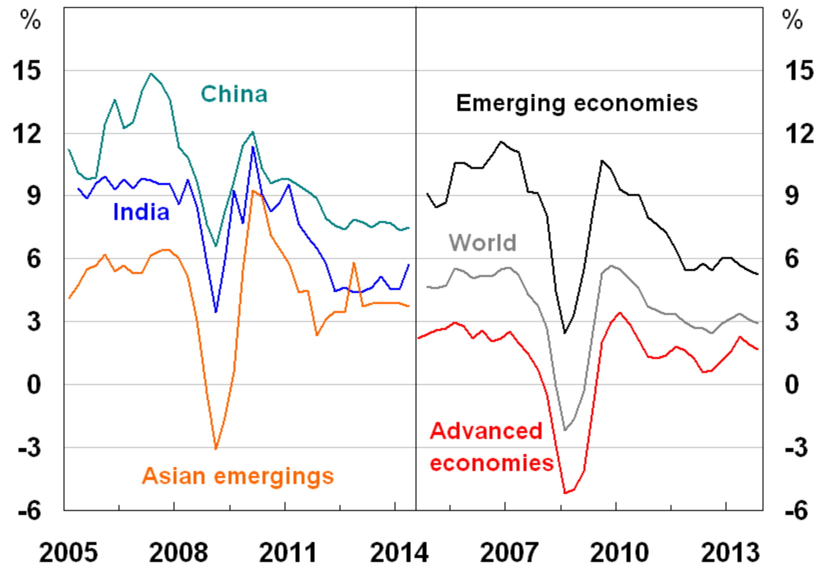
- Weakness in Japan, stagnation in the Euro-zone and a hard landing in Latin America have resulted in a slowdown in the pace of global growth through the first half of 2014. World GDP growth reached 3.4% yoy in late 2013, it slowed to 3.1% yoy in March quarter 2014 and 2.9% yoy in June quarter. We have trimmed our 2014 global forecasts to take account of weaker than expected June quarter data in the Euro-zone and Latin America (Brazil, Argentina). Economic upturns look secure in North America and the UK, Indian growth has finally picked up and we may revise our numbers higher, China's gradual slowing continues and we are counting on monetary stimulus to eventually get faster growth in the Euro-zone and Japan as the latter's tax rise effects wear off.

Australian overview

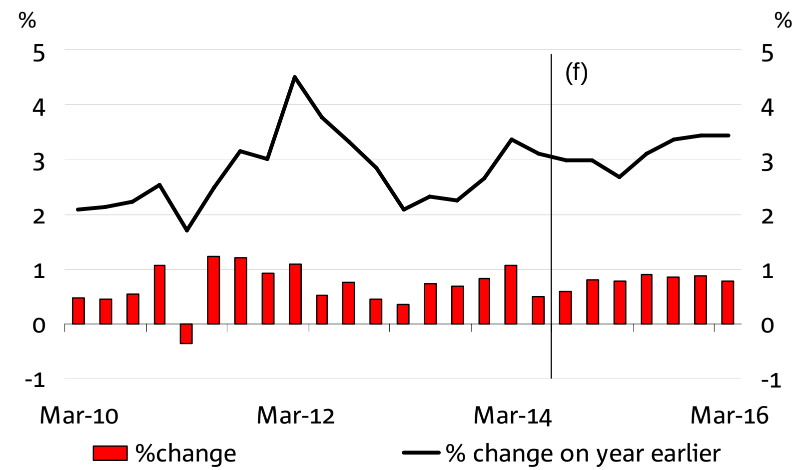
- The Australian economy grew at sub-trend pace in Q2 (GDP 0.5%, domestic demand 0.4%), constrained by sluggish household consumption, falls in underlying business investment and public demand and strong import growth. Nominal GDP actually fell in Q2. The terms of trade fell again to be 7.9% lower than a year ago. There are some signs of growth strengthening in Q3: NAB business conditions are better since June and business confidence is still solid but employment still looks soft.
- Households remain cautious about financial commitments. There are still few signs of a sustained increase in non-mining investment to fill the emerging mining investment cliff.
- Marginal adjustments to GDP forecasts: 2014/15 2.9% (was 3.1%); 2015/16 3.4% (was 3.2%). Unemployment rate still to peak at around 6½%. Inflation to move towards the bottom of the RBA's target range by year end and remain there in 2015. No change in cash rate until a tightening cycle begins in late 2015. Only a sharp deterioration in unemployment (not expected) could see rate cuts.

Economic growth by region

Year-ended percentage change



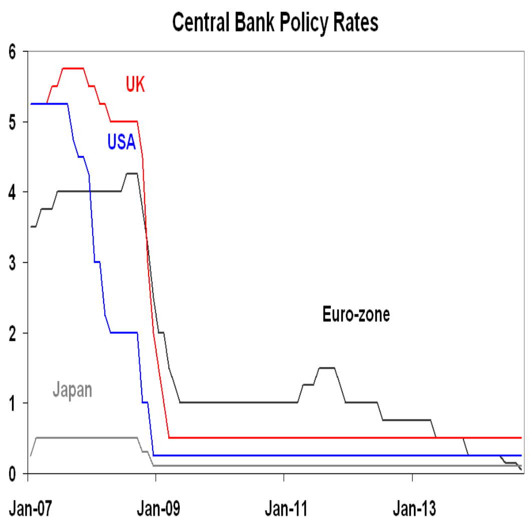
GDP

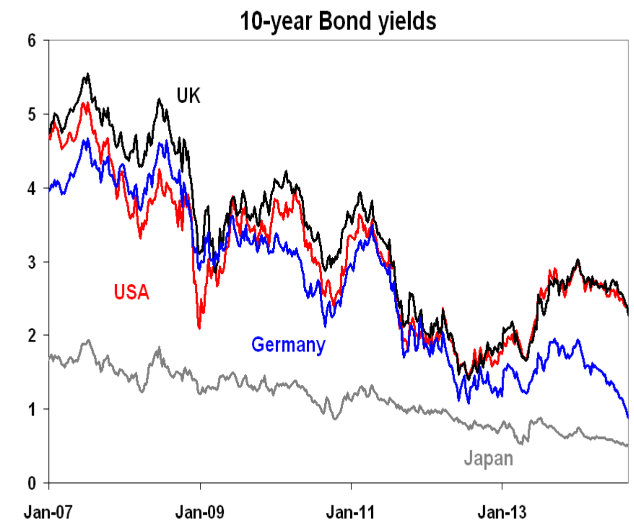


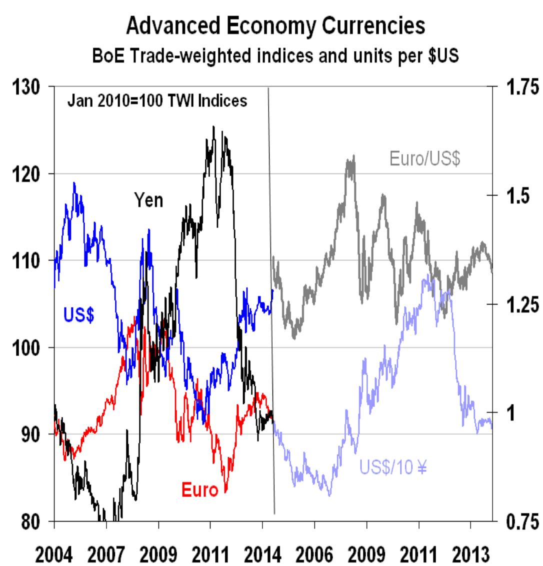
Sources: ABS, NAB estimates

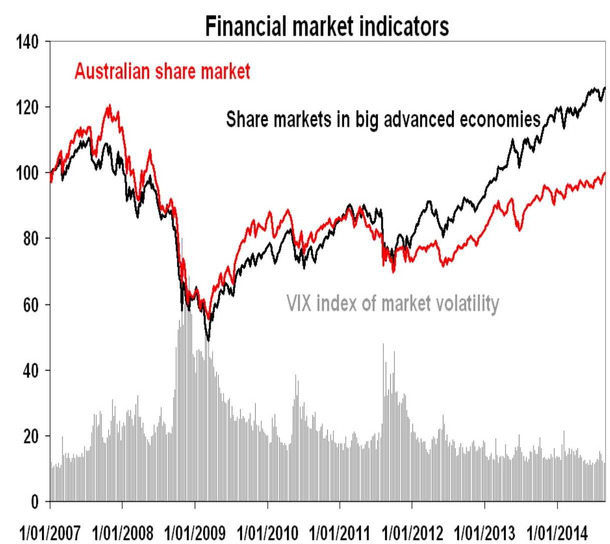
Financial markets

- After a long period of stimulatory monetary policies in all of the big advanced economies, growing divergence in their economic outlooks should lead to variations in central bank interest rate policies and that should impact on currencies (higher $US).
- The US Fed appears convinced that sustained moderately paced growth should continue, gradually taking inflation up towards the 2% target and cutting unemployment and underemployment. Hawkish Fed governors already support a faster ending to loose monetary policy and a higher track for future interest rates than is implicit in the Fed's guidance. This guidance says that rates should stay low "for a considerable time" after the Fed finishes its asset purchase programme (in October) and the Fed funds rate should stay below "normal" levels "for some time" when the Fed's inflation and labour market targets have been met. The Bank of England has also stopped loosening its policy with some MPC members now voting for rate rises.
- Elsewhere, the Bank of Japan has confirmed that it will continue its zero interest rate and big asset buying programmes for as long as necessary to get its 2% inflation target – so no sign there of even considering winding back the stimulus, let alone tightening. Facing deflationary risks and a sluggish Euro-zone economy, the ECB has announced another easing in its monetary policy with a 10 bp cut to its policy rates (taking its refi lending rate to 5 bps) and plans to buy assets to boost its balance sheet to the size it was in early 2012 (which implies a €1 Trillion rise).



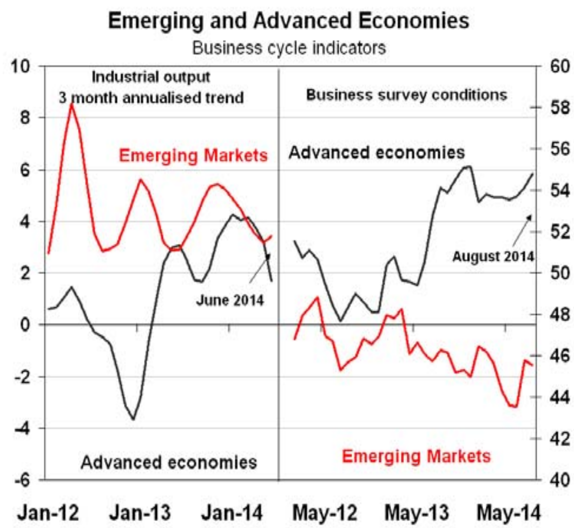


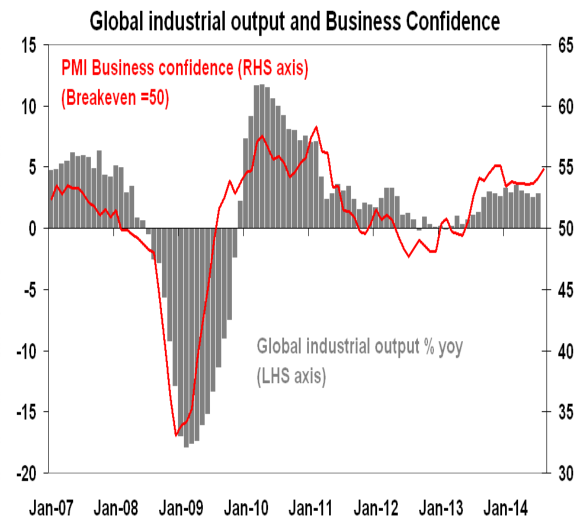


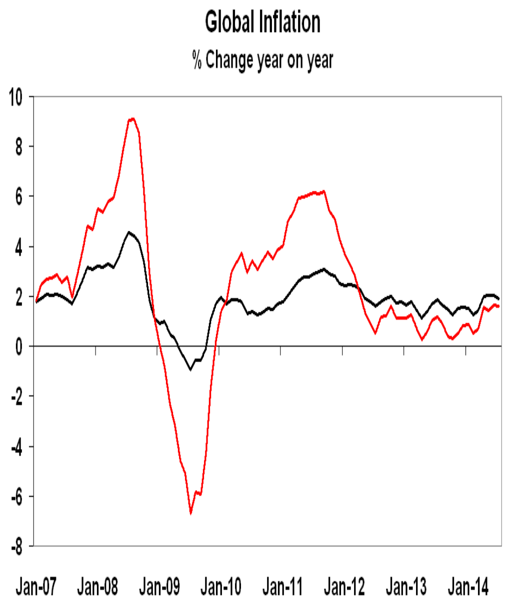


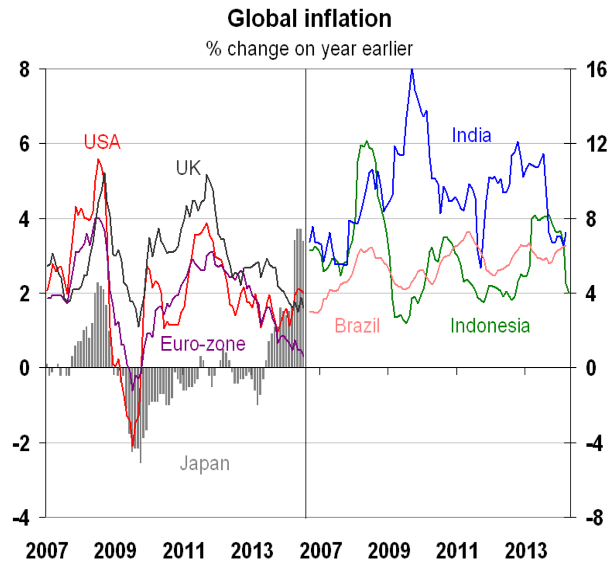
Global Economic Trends

- Global economic growth has proved weaker than expected through 2014 with April's indirect tax rise in Japan having a bigger than expected impact on activity and structural problems in the Euro-zone stalling its upturn in mid-2014. By contrast, after a weather-related soft first quarter, the US economy has looked strong with 4% annualised growth in the second quarter and around 3% expected in the second half of the year.
- Weakness in Japan and the Euro-zone explains mid-2014s sharp downturn in industrial growth in the advanced economies – previously their rate of expansion had matched that of the emerging market economies. However, overall, business surveys in the advanced economies have continued to trend up. This reflects solid outcomes in the US and a partial recovery from a post-tax-rise slump in Japan. Readings across Western Europe are still weakening.
- Global industrial growth has remained in the 2¾ to 3% yoy range since late 2013 as robust Chinese manufacturing expansion and the start of cyclical upturns in India and across the emerging market economies of East Asia offset weakness in Japan, the Euro-zone and Latin America – helping to support global commodity demand.
- With the exception of Japan, where April's indirect tax rise boosted prices, inflation remains flat and subdued (global CPI inflation is around 2%, producer price inflation is around 1½% yoy) – underpinning low interest rates and other monetary stimulus measures.



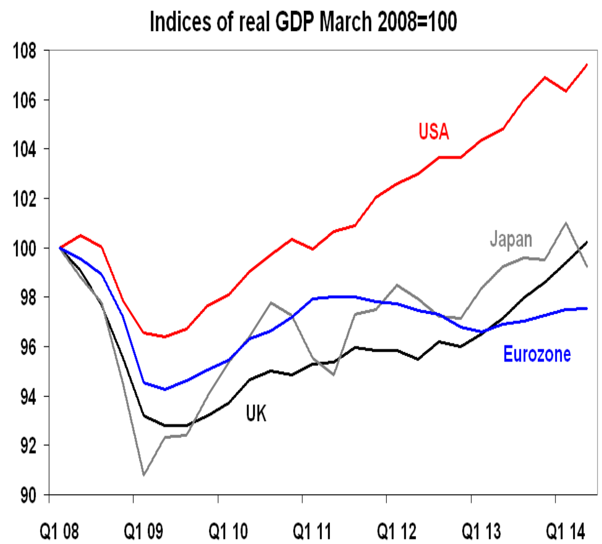






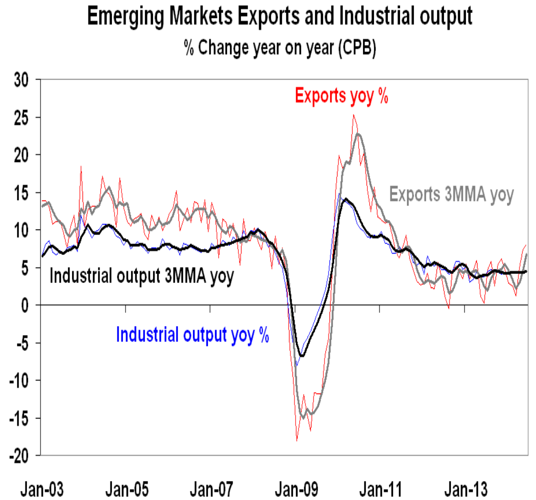
Advanced Economies

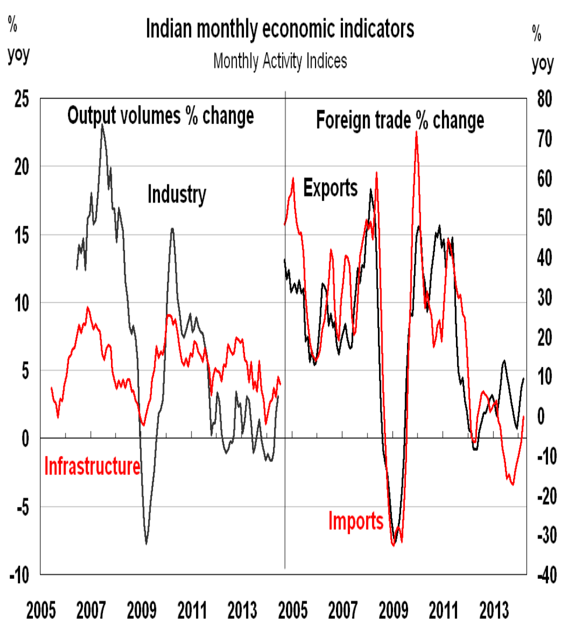
- Although G7 Advanced economy annualised growth quickened from ½% in March quarter to 1¼% in June, almost all of this occurred in North America (plus a very small contribution from the UK) while Japanese output fell and Euro-zone production stagnated.
- June quarter's divergence in output growth between the US/UK and Euro-zone/Japan continued a divergence in performance dating back to early 2013 – since then the former have grown much stronger, although the US and Canada are the only G7 economies where output has risen to well above its early 2008 pre-GFC level, the others have had 6 lost years of economic growth.
- The monthly purchasing manager surveys provide one of the most timely measures of growth momentum and the August results show the solid US performance continuing into the third quarter. Elsewhere, results are mixed. Industry is still growing in the UK and Euro-zone, but more slowly - UK services look even stronger while the Euro-zone services sector lost some of its previous growth momentum in August. That points to continuing solid UK GDP growth but another modest outcome for the Euro-zone in the September quarter. National business surveys across the Euro-zone also point to weakness.
- The August purchasing manager surveys for Japan show output struggling to regain its pre-tax rise level in both services and industry. The Shoko Chukin bank's SME survey suggests that output finally rising again through early September.



Emerging Market Economies

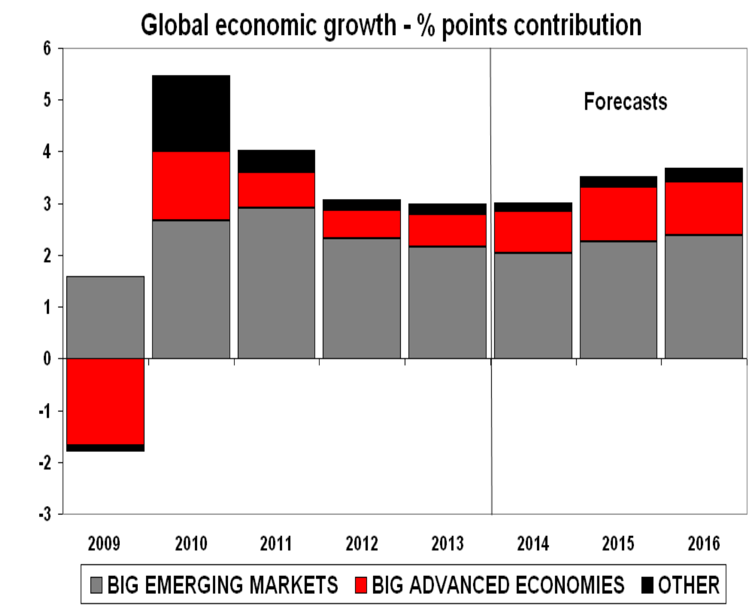
- The forecast script for 2014 called for a rotation in the composition of global economic growth away from the previously fast growing Emerging Market Economies and toward the big Advanced economies. The anticipated pick-up in advanced economy growth has proved weaker than expected but we have now seen the winding back of expansion in the Emerging Markets. There, growth in industrial output and, in particular, in exports is running well below pre-GFC rates.
- Emerging market growth has slowed from 6% yoy in mid-2013 to 5.3% in June 2014 and the slowdown has been broadly-based with softer growth in China, the rest of East Asia and a particularly hard landing for Latin America. India is the only big Emerging Market economy that has gone against the trend, its monthly indicators of trade and output have turned upwards, business surveys look more positive and leading indicators suggest faster growth.
- Unlike its quarterly national accounts, Chinese monthly activity indicators are consistent with a very gradual trend slowing in growth and a “soft landing” for the economy. Conditions are mixed across this enormous economy with problems in housing and construction while retailing remains solid and exports have been strong, given the sluggish growth in world trade.
- Other East Asian economies show a moderate lift in industrial growth and exports since early 2014 but Latin America is very weak with Argentina’s default and falling output in Brazil.





Global forecasts

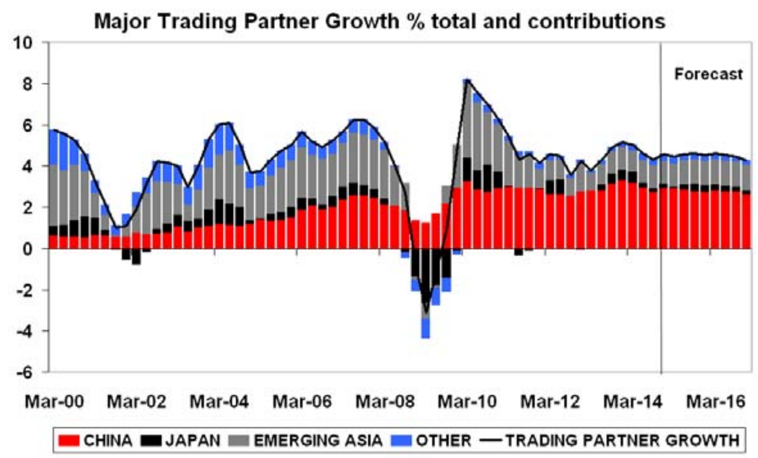
- With the upturns in the US, UK and Canada looking securely established and monetary stimulus in Japan and the Euro-zone finally helping their economies, we expect Advanced economy growth to pick up from 1.8% in 2014 to 2.3% in 2015 and 2016. The lacklustre responses to forward looking questions in Euro-zone national business surveys suggest that its upturn will be muted. Emerging market growth should also pick-up as faster expansion in India, Latin America and East Asian Emerging Market Economies outweighs China's slowing trend growth.
- Global growth should accelerate from 3% in 2014 to 3½% next year and 3¾% in 2015 – taking it back to around its long-run trend. That pace of growth is probably not enough to either rapidly erode output gaps in the Advanced economies or put demand-side stresses on commodity prices, putting a lid on inflationary pressures and allowing central banks to either continue their expansive monetary policies (ECB, BoJ) or take their time over moving rates to more "normal" levels (BoE, Fed).



Global growth forecasts (a)

	2011	2012	2013	2014	2015	2016
US	1.6	2.3	2.2	2.1	3.0	2.8
Euro-zone	1.6	-0.6	-0.4	0.7	1.1	1.6
Japan	-0.4	1.4	1.5	1.3	1.5	0.8
UK	1.6	0.7	1.7	2.9	2.4	2.5
Canada	2.5	1.7	2.0	2.3	2.5	2.4
China	9.3	7.8	7.7	7.3	7.0	6.8
India	7.7	4.8	4.7	5.2	5.8	6.2
Latin America	4.7	2.2	2.2	0.7	1.9	3.2
Emerging Asia	4.3	3.9	3.9	3.9	4.2	4.4
New Zealand	1.9	2.5	2.9	4.0	3.4	1.8
World	4.1	3.1	3.0	3.0	3.5	3.7
memo						
Advanced Economies	1.6	1.2	1.4	1.8	2.3	2.3
Emerging Economies	6.9	5.2	5.2	4.7	5.1	5.4
Major trading partners	4.6	4.2	4.5	4.6	4.6	4.5

(a) Percentage changes represent average annual growth



Australian outlook

- The national accounts confirmed that the Australian economy grew at sub-trend pace in Q2 (GDP 0.5%, domestic demand 0.4%). Growth was constrained by sluggish household consumption as well as falls in underlying business investment and public demand and strong import growth. The main area of support was from dwelling investment. Reflecting the weakness in commodities, the terms of trade fell again to be 7.9% lower than a year ago. Nominal GDP actually fell marginally in Q2
- There are signs that growth may be strengthening in Q3. NAB business conditions have been well into positive territory since June. In August, the business conditions retraced much of their recent sharp gain, although the environment remains better than earlier in the year and business confidence is still solid. However, employment still looks like a soft spot.
- Households remain cautious about financial commitments. The household saving ratio remained historically high (9.4%) in Q2 and credit growth is subdued (in July, 0.5% for housing and 0.2% for personal credit). There are still few signs of a sustained increase in non-mining investment to fill the emerging mining investment cliff. Business credit growth of 0.3% in July remains modest, assuming that the large bridging loan that affected the June data has not been fully repaid..
- Marginal adjustments to GDP forecasts: 2014/15 2.9% (was 3.1%); 2015/16 3.4% (was 3.2%). Unemployment rate still to peak at around 6½%. We continue to expect no change in cash rate until a tightening cycle begins near the end of 2015.

Australian economic and financial forecasts (a)

	Fiscal Year			Calendar Year		
	2013-14 F	2014-15 F	2015-16 F	2014-F	2015-F	2016-F
Private Consumption	2.5	2.5	2.8	2.5	2.8	2.6
Dwelling Investment	5.0	10.5	3.5	10.5	6.5	1.4
Underlying Business Fixed Investment	-6.2	-6.8	-7.9	-6.5	-7.3	-8.2
Underlying Public Final Demand	1.5	0.7	0.9	1.1	0.6	1.3
Domestic Demand	**1.2**	**1.4**	**1.1**	**1.5**	**1.3**	**1.0**
Stocks (b)	-0.4	0.1	0.1	-0.1	0.1	0.1
GNE	**0.8**	**1.5**	**1.3**	**1.4**	**1.4**	**1.1**
Exports	6.8	8.4	9.5	7.9	9.0	9.6
Imports	-2.3	2.6	0.6	0.5	1.5	0.3
GDP	**2.8**	**2.9**	**3.4**	**3.1**	**3.1**	**3.3**
– Non-Farm GDP	2.9	3.0	3.4	3.2	3.2	3.4
– Farm GDP	2.1	0.1	2.0	-1.9	1.8	2.0
Nominal GDP	4.1	4.7	4.8	4.3	4.8	5.0
($b)	50	30	17	NA	NA	NA
($b)	46	27	4	37	16	-11
(-%) of GDP	2.9	1.6	0.2	2.3	0.9	-0.6
Employment	0.8	1.3	1.7	1.0	1.3	2.3
Terms of Trade	-4.0	-0.1	-2.9	-3.4	-1.1	-2.8
Average Earnings (Nat. Accts. Basis)	2.1	2.5	3.0	2.2	2.9	3.0
End of Period						
Total CPI	3.0	2.1	2.8	2.2	2.5	3.0
Core CPI	2.8	2.0	2.5	2.3	2.1	2.8
Unemployment Rate	5.9	6.4	6.2	6.5	6.2	5.8
RBA Cash Rate	2.50	2.50	3.50	2.50	3.00	4.00
10 Year Govt. Bonds	3.54	3.85	4.50	3.55	4.30	3.90
$A/US cents :	0.94	0.85	0.80	0.88	0.82	0.80
Index	72.0	69.4	67.4	69.8	68.4	67.3

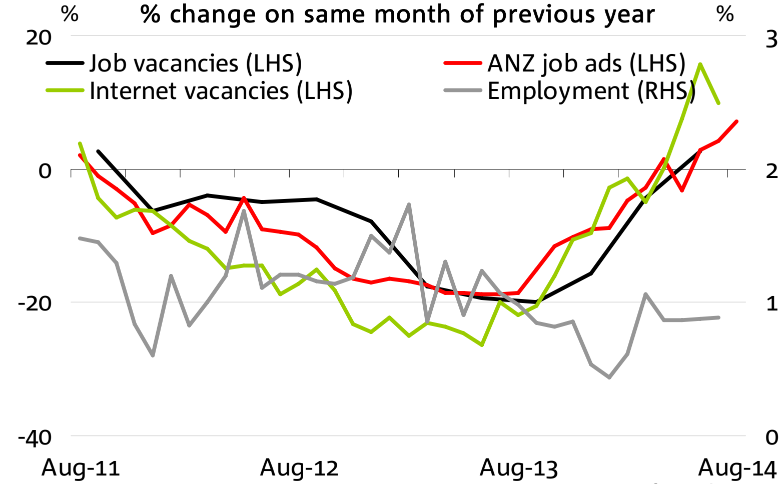
(a) Percentage changes represent average annual growth, except for cash and unemployment rates. The latter are end June. Percentage changes for CPI represent through the year inflation.
(b) Contribution to GDP growth

Australian labour market

- Since July, partial indicators for the labour market have improved modestly. While the NAB employment index was unchanged at a weak zero balance in August, internet vacancies rose by 0.6% in July and ANZ job ads by 1.5% in August. We still expect the unemployment rate to peak at around 6½% by the end of 2014 before showing signs of improvement.
- There has been no growth in mining employment fort two years (even longer for construction employment). We expect a sharp weakening in employment in mining and related construction activity over the next two years as major resource projects are commissioned.

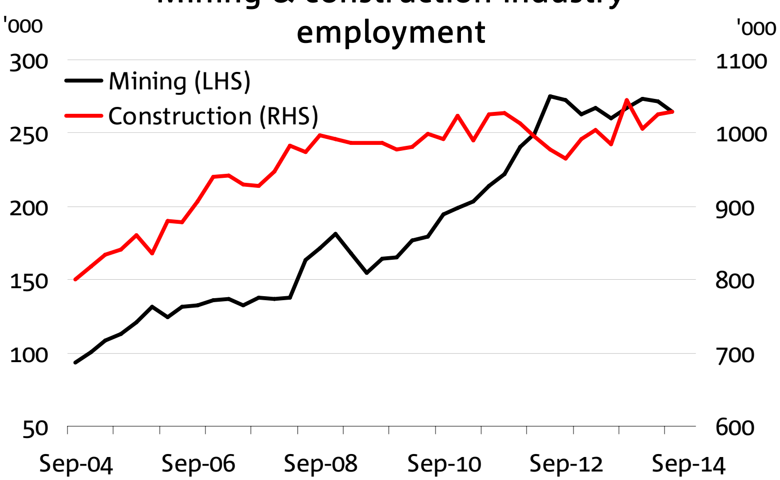
Labour market conditions

% change on same month of previous year



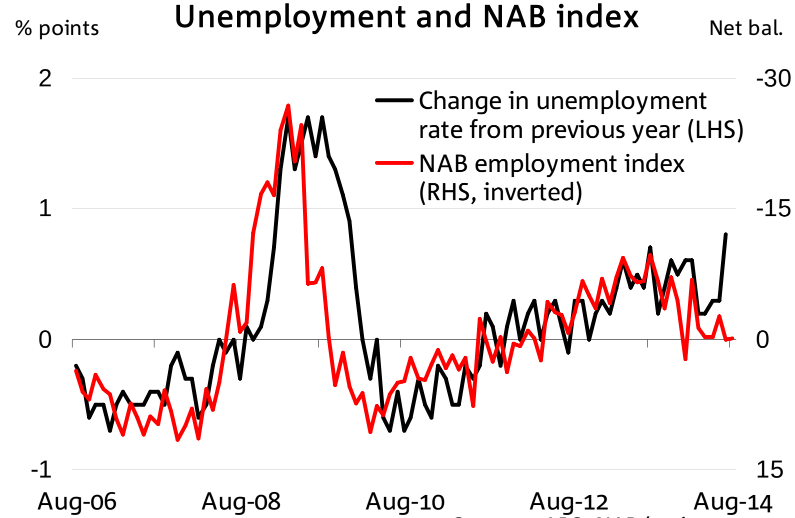
Sources: ABS, Datastream, Department of Employment

Mining & construction industry employment



Source: ABS

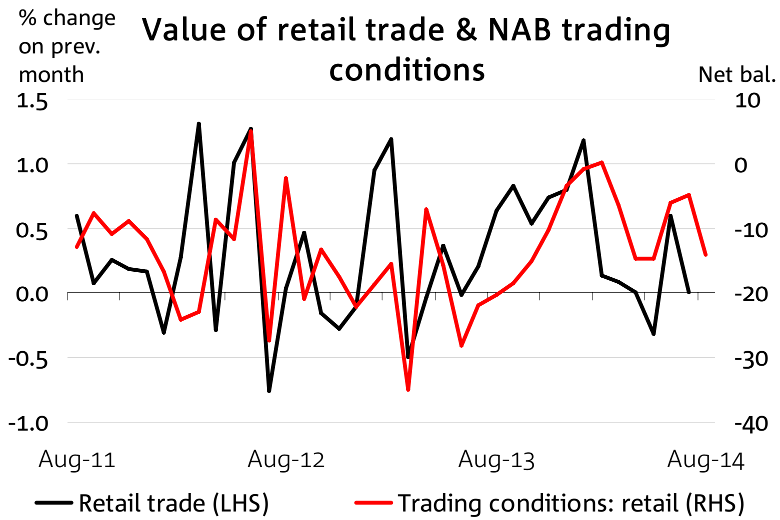
Unemployment and NAB index



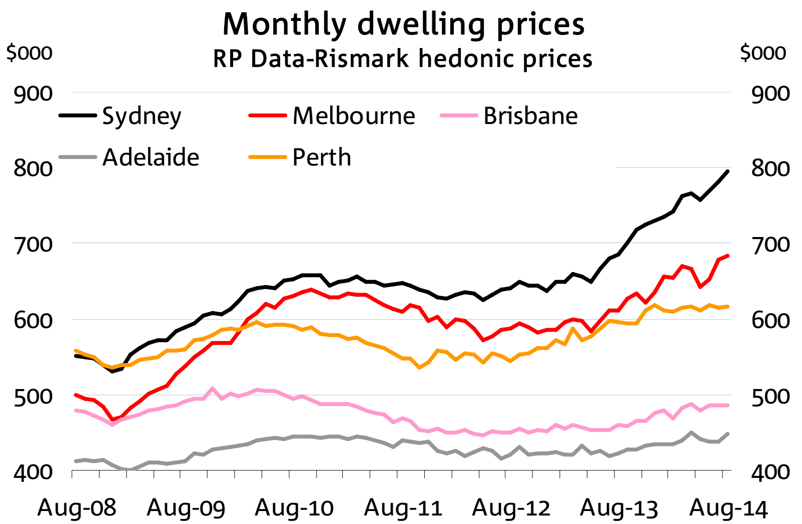
Sources: ABS, NAB business survey

Australian consumer demand and housing market

- Consumers remain cautious, with consumer anxiety rising again in Q2 (see NAB Quarterly Australian Consumer Anxiety Index). Real consumer spending grew at a relatively modest 0.5% in Q2, compared with a decline of 0.2% in retail trade volumes. The decline in retail is difficult to align with the national accounts, where the only goods components to record declines were clothing & footwear and other goods & services. The household saving ratio edged up to 9.4% but remains broadly in line with its recent, historically high, trend.
- In July, retail trade grew 0.4% to be 5.9% higher than a year ago, still representing a modest rate of growth. For August, retail business conditions in the NAB survey fell back sharply because of weaker sales and profitability, giving up all the gains in July and suggest that growth may be softer in coming months. Online retail trade grew by 0.9% in July to be 8.6% higher than a year earlier (see NAB Online Retail Sales Index).
- Measures of consumer confidence returned to their post-GFC trend level during August, making up most of the decline sustained before and during the Budget. The jump in confidence on the part of retail business recorded by NAB in July was largely unwound in August.
- Total passenger and SUV vehicle sales edged up again in July to around 75,000 units, broadly in line with the 2013 average.
- Major capitals dwelling price growth continued largely unabated in August, up 1.8% in Sydney and 0.8% in Melbourne. Elsewhere, price growth was muted, although Adelaide prices sprang back. While prices remain inside the range that can be justified by borrowing fundamentals, their recent comments make it is clear that asset price inflation is being closely watched by the RBA. The ASX200 share price index edged down marginally during August.



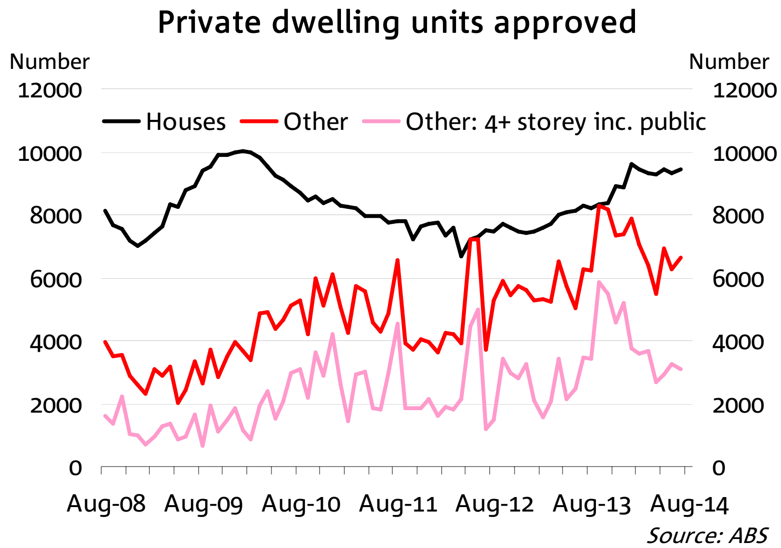
Sources: ABS and NAB business survey

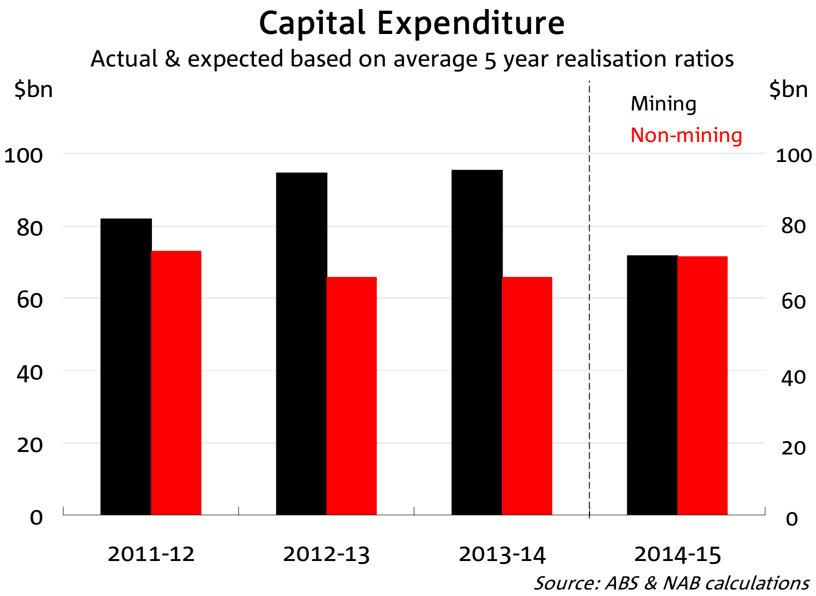


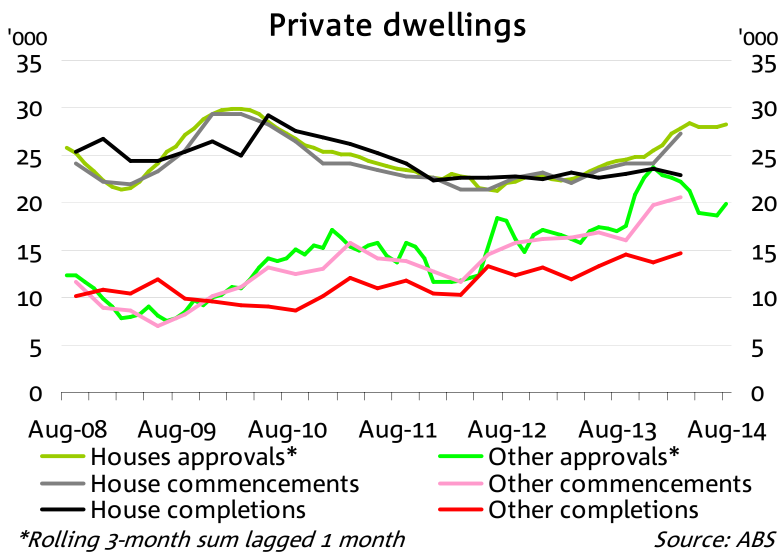
Source: RP Data-Rismark

Australian investment

- New property demand improved in Q2 according to the NAB Residential Property Survey, but the peak in the current construction cycle may be approaching. Building approvals for detached houses have flat-lined and multi-unit approvals remained off their recent peaks in July, especially for large apartment projects. HIA new home sales fell back sharply in July.
- The latest capital expenditure survey expectations confirm the looming decline in mining investment. Based on average 5-year realisation ratios, mining capex is expected to decline by almost 25% in 2014/15, compared with a projected 9% rise in other surveyed industries.

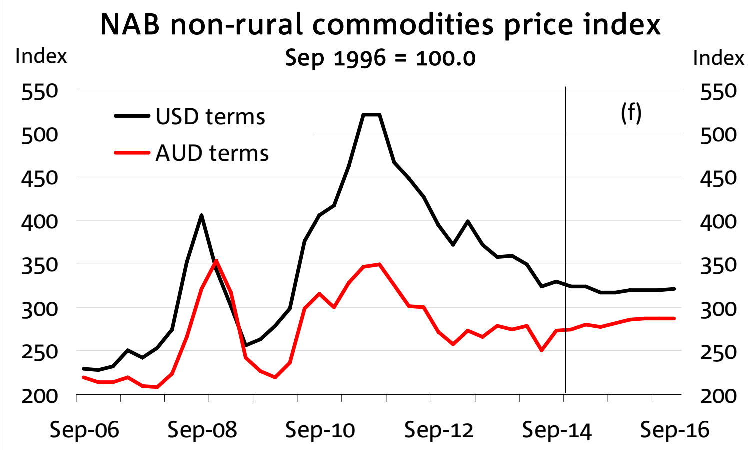




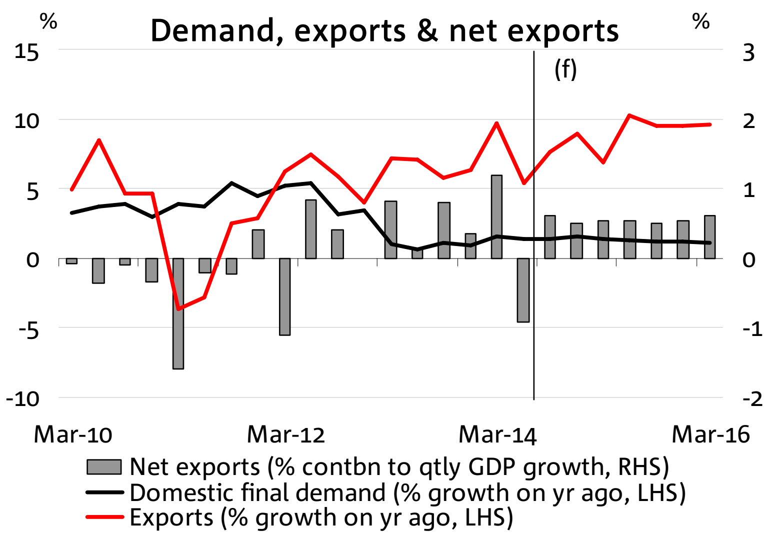


Australian commodities, net exports and terms of trade

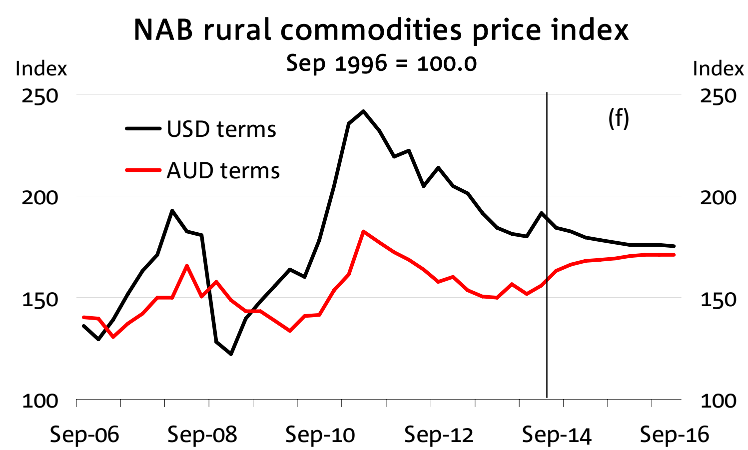
- In AUD terms, commodity prices are forecast to rise a little across the remainder of 2014, before edging higher in 2015 (up by around 4¾%) – largely reflecting depreciation of the Australian dollar as global interest rates (particularly in the US) start to normalise. For more detail, see our Minerals & Energy Commodities Research. In AUD terms, we project a moderate increase of 1.6% in the rural commodity price index in 2014-15, largely reflecting a declining AUD, which is forecast to dampen the impact of falling international wheat and dairy prices. In USD terms, we forecast the index to decline 6.8% in 2014-15. For more detail, see our Rural Commodities Wrap.
- We see the terms of trade continuing to edge down, losing 2% through the course of 2014 and another 2% through 2015. As major energy projects are completed, the volume and value of energy exports should grow, particularly from the LNG mega-projects. The trade deficit in Q2 increased to $4.8 billion from $3.0 billion.



Source: ABS; ABARES; Bloomberg; NAB; Thomson Datastream



Sources: ABS, NAB forecasts



Sources: ABS; ABARES; Bloomberg; NAB; Thomson Datastream

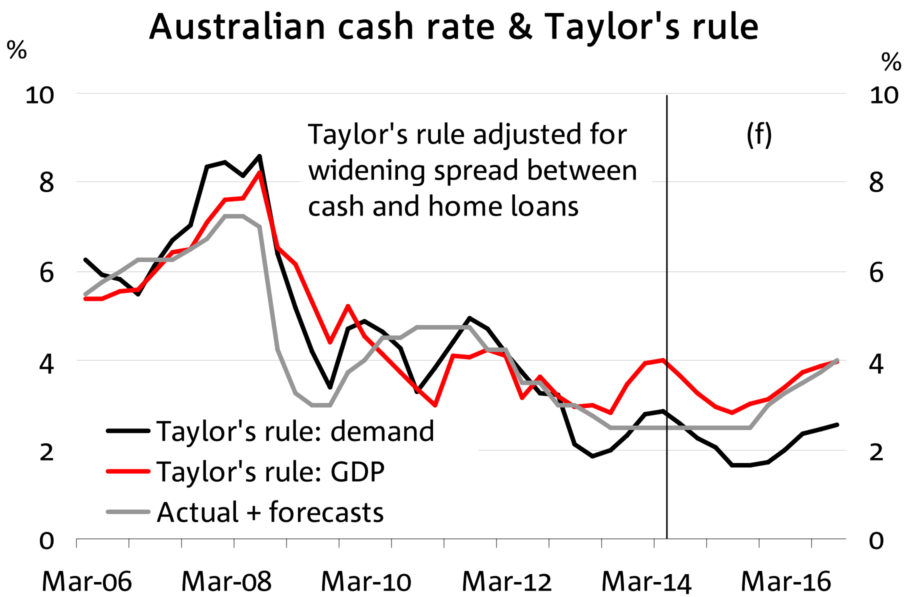
Australian financial markets

Exchange rate

- The AUD has remained in a relatively narrow range between 93 and 95 US cents for much of 2014, reflecting a relatively low volatility environment. However, the USD has made an attempted break higher across the board of late. If volatility slips lower again, the AUD is likely to move into the lower 94 to 92 US cents range; a rise in volatility would see a more sustained move toward NAB's 90 US cents end Q3 target
- With respect to the strength of the AUD, the RBA Governor recently expressed the view that "the real question is why the US dollar has remained as low as it has."

Interest rates

- The RBA kept the cash rate at 2.50% in September, as expected, a rate at which it has remained for 13 months. The accompanying statement confirmed that monetary policy is "accommodative" and that "the most prudent course is likely to be a period of stability in interest rates." In a speech to CEDA next day, the Governor indicated that although it is desirable to reduce the unemployment rate, it would be unwise to do so in a way that would involve "inflating an already elevated level of housing prices."
- We still expect no change in the cash rate until the end of 2015. The Governor's most recent remarks suggest that the next rate move will be up, even if it is a long way off. But while that may be the current mood, it might be a different matter if the labour market began to struggle with the mining adjustment task over coming months. While business confidence and conditions are much improved, it is now clear that the pace of further improvement will be slower than might have been suggested by July's survey results.



Sources: RBA, NAB estimates

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