Global & Australian Forecasts

by NAB Group Economics

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National Australia Bank

Key Points:

- **Recent monthly economic indicators and business surveys show continued moderate global economic growth along with big variations between the major economies. Low interest rates, falling oil prices and smaller budget cutbacks in big advanced economies should underpin a gradual acceleration in growth to 3½% in 2015. Global economic growth remains heavily reliant on the continued good performance of China and the US with weakness across Japan, the Euro-zone and Latin America and a sluggish performance in Emerging East Asian economies.**
- **Jump in Australian business conditions points to strong start to Q4 but growth still constrained by weak terms of trade, soft labour market and signs of a softening in building cycle. GDP forecasts up slightly: 2014/15 2.9% (was 2.8%) and 2015/16 3.2% (unchanged). Unemployment still to peak at around 6½% and no change in cash rate expected until tightening begins near the end of 2015.**

Key global and Australian forecasts (*% change*)

Country/region	IMF weight	2012	2013	2014	2015	2016
United States	16	2.3	2.2	2.2	3.0	2.8
Euro-zone	12	-0.6	-0.4	0.7	0.9	1.1
Japan	5	1.5	1.5	1.0	1.1	0.9
China	16	7.8	7.7	7.3	7.0	6.8
Emerging Asia	9	3.9	3.9	3.8	4.0	4.2
New Zealand	0.2	2.5	2.8	3.8	3.4	1.8
Global total	100	3.1	3.0	3.0	3.4	3.5
Australia	2	3.6	2.3	3.1	3.0	3.3
Australia (*fiscal years*)		12/13	13/14	14/15	15/16	
Private consumption		2.1	2.5	2.4	2.8	
Domestic demand		2.0	1.2	1.1	1.0	
GDP		2.6	2.8	2.9	3.2	
Core CPI (*% through-year*)		2.5	2.7	2.0	2.6	
Unemployment rate (*% end of year*)		5.7	6.0	6.4	5.9	

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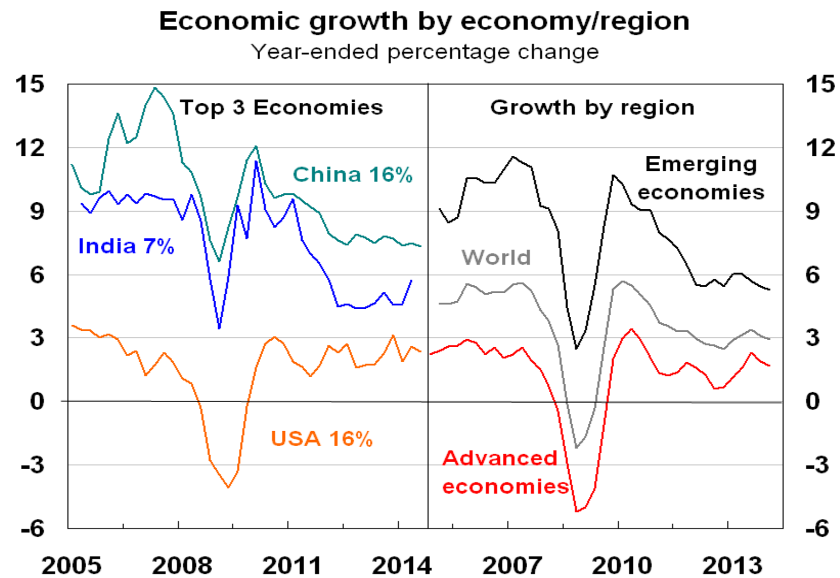
Global and Australian overview

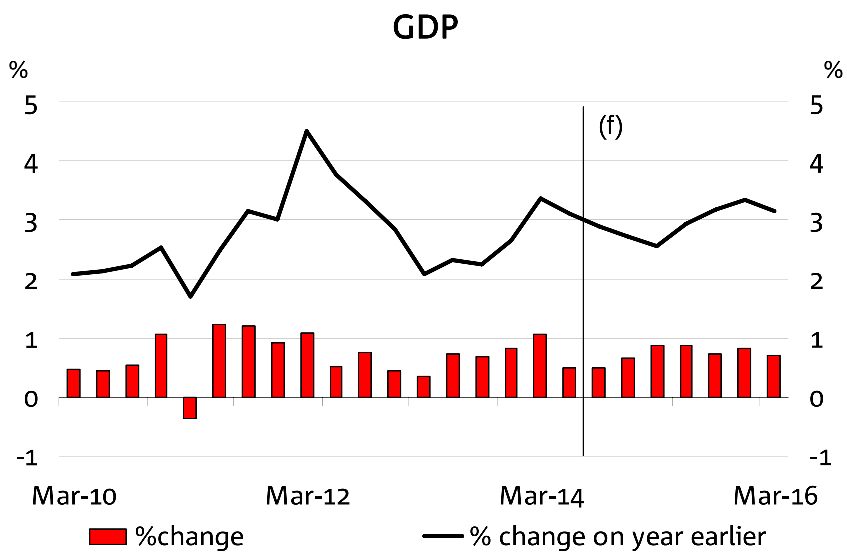
Global overview

- Global growth remains moderate and sub-trend with big variations between key economies. China and North America represent around one-third of global GDP but they currently account for around half of global growth. By contrast, Japan and the Euro-zone are the main drags on the global economy, accounting for one-sixth of world output but contributing very little to global growth. Low interest rates, less fiscal retrenchment, lower oil prices and a gradual recovery in investment in India should produce an acceleration in global growth from this year's 3% to 3.4% in 2015. Although the US and UK upturns look solid, the emerging markets economies continue to drive around three-quarters of the increase in global output in 2014 with China and India contributing around half, but that share should trend down.

Australian overview

- Business conditions improved sharply in October except in transport and wholesale. Sales and profitability were much better but employment still lags. Forward orders ticked up and capacity utilisation improved. While this may point to a strong start to Q4, there are reasons to be cautious: business confidence is moderate, income remains under pressure and job security still an issue.
- Retail trade grew more strongly in September (abstracting from iPhone6) and car sales were better, but personal credit demand still weak. While engineering construction in mining increased and business credit demand may be improving, there are signs that the building construction cycle has begun to turn down.
- GDP forecasts up slightly: 2014/15 2.9% (was 2.8%) and 2015/16 3.2% (unchanged). Unemployment still to peak at around 6½% and no change in cash rate expected until tightening begins near the end of 2015. Inflation to slow further in near term.

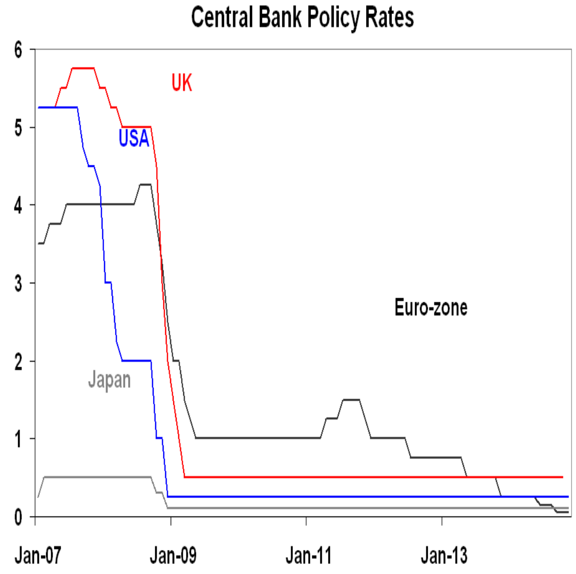


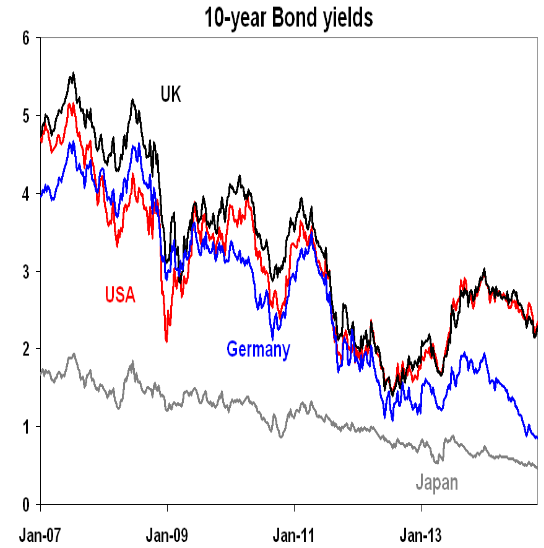


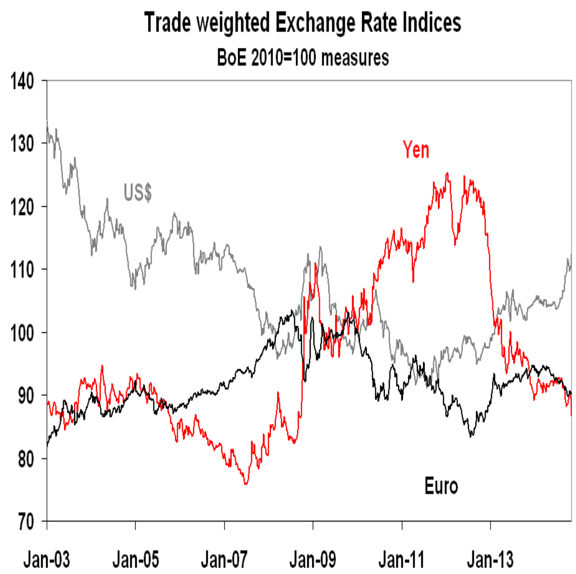
Sources: ABS, NAB estimates

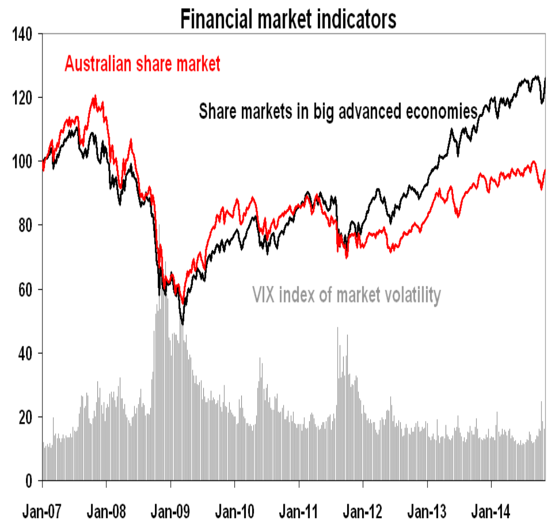
Financial markets

- Divergence in economic conditions between the big advanced economies has been highlighted in recent central bank decisions on monetary policy. The US fed is carefully and gradually moving toward less easy monetary policy while the Bank of Japan (BoJ) has eased again.
- The US Fed has decided to stop increasing its balance sheet through net purchases of Treasury and agency securities and it has outlined its plans for how US monetary policy will be "normalised". This will eventually involve interest rate increases but the Fed still says it should keep rates unchanged for "a considerable time" after it has stopped net asset purchases. Moreover, even once inflation and the US labour market are near the Fed's targets, the Fed says it may well still keep its policy interest rate below the levels that it would see as "normal in the longer run".
- By contrast, the Bank of Japan has just ratcheted up its already massive purchases of Government bonds, aiming to inject even more liquidity to produce faster growth of the monetary base and hopefully ensure that it achieves its 2% inflation target. The BoJ is focussed on ending the deflation that has plagued Japan and recent falls in oil prices plus the slump in demand since April's rise in the GST have got it worried that people might think it is not going to hit its inflation target. Several key CPI measures have stagnated in the last 5 months rather than increased and the BoJ views its latest steps as lowering the risk of yet another undershoot of inflation.
- This divergence is also seen in Europe with pressure on the ECB to do more to curb deflation while the discussion at the Bank of England is over when rates should be increased.



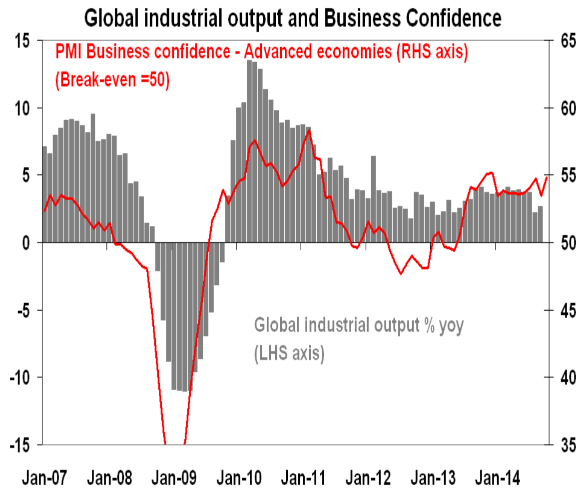


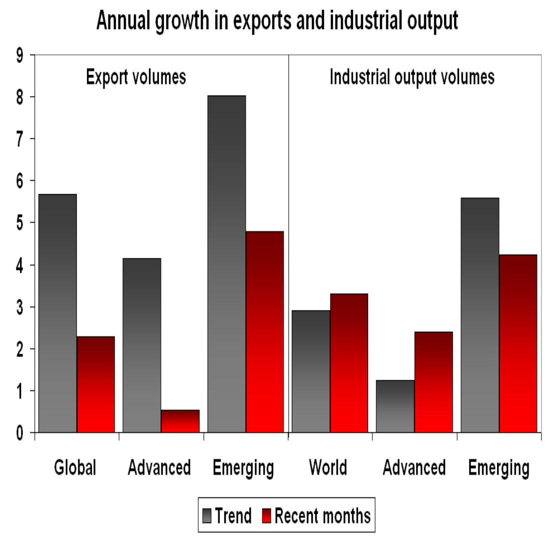


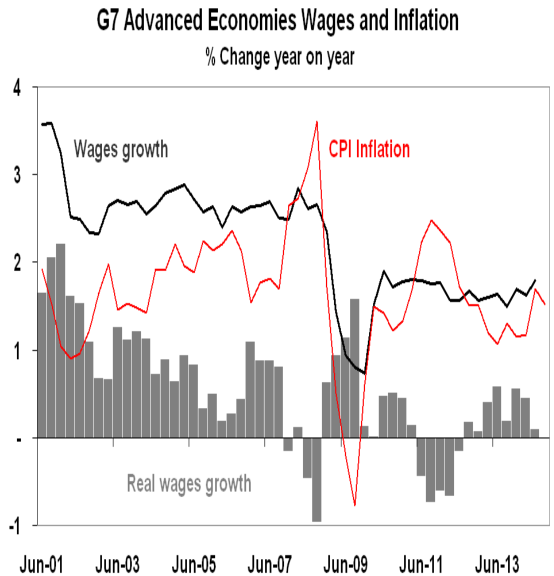


Global Economic Trends

- Global economic growth appears to be continuing at a moderate pace with industrial output expanding by between 2 and 3% yoy. World trade growth has been well below trend. This sluggishness in world trade growth is broad-based and the sub-1% growth rate in advanced economy exports shows the limited prospects facing countries hoping to rely on export-led growth to offset weak domestic demand.
- The reliance of global growth on a few key economies also stands out with industrial growth of around 4% yoy in the US and UK and double that in China contrasting with the weak growth performance seen across the Euro-zone, Japan, the rest of East Asia and Latin America. October business surveys show this divergence between the big advanced economies continuing with improving conditions in the US and UK and weakness in the Euro-zone, although a few of the surveys are showing an upturn in Japan.
- One of the main factors holding down the pace of growth in the advanced economies has been slow growth in real household incomes and that, in turn, owes much to the little or no growth seen in real wages in key economies. Across the G7, nominal pay has been rising by less than 2% and CPI inflation is not far off that, meaning little change in real salaries (but falling oil prices should help here). There are big differences between economies with signs of an upturn in wage growth in the US, Germany and Japan alongside the downward trend in wage growth in the other big European countries.

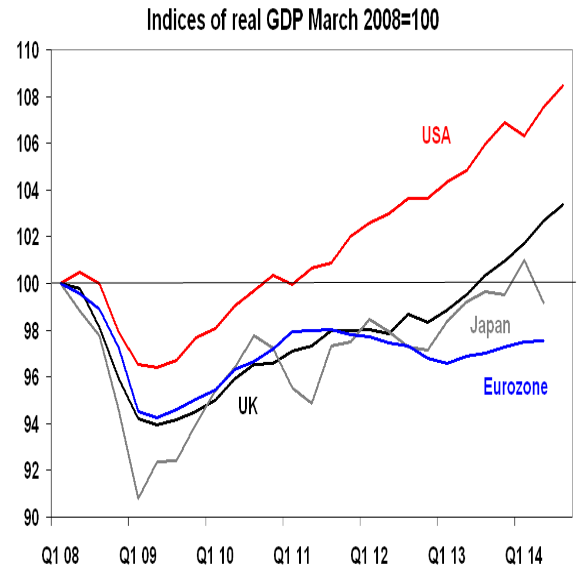


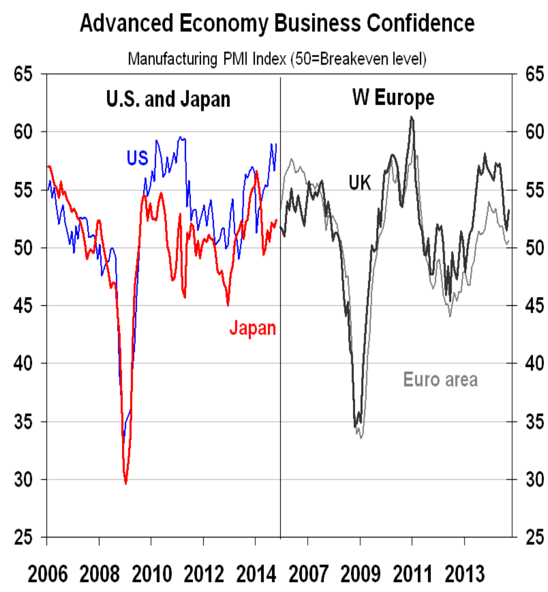


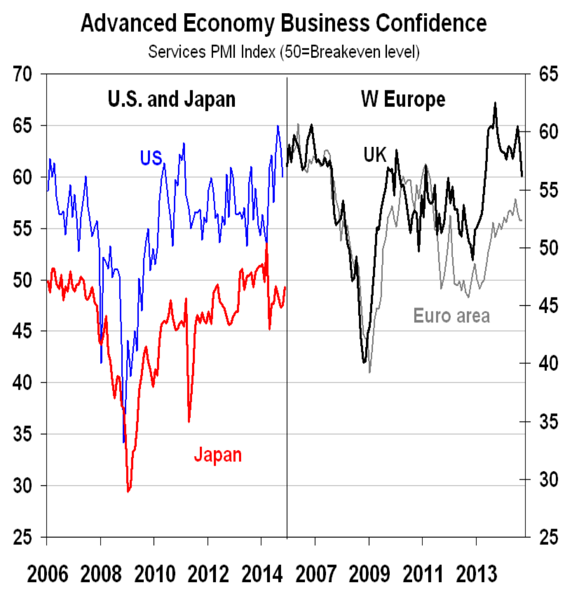


Advanced Economies

- Although G7 Advanced economy annualised growth quickened from ½% in March quarter to 1½% in June, it could well have slowed in September. Early measures of third quarter US and UK GDP growth, while still solid, were weaker. The Japanese economy is still struggling to digest the impact of the April rise in consumer taxes along with disappointing export outcomes. Business sentiment in the Euro-zone trended down through the six months to September, not a favourable sign for output.
- The extent to which recovery from deep recession in 2008/9 in the US and UK has outstripped that in Japan and the Euro-zone is shown in the top right chart opposite. The double-dip downturn in the Euro-zone that was followed by stagnation meant that its economy in mid-2014 was 2½% smaller than it was in early 2008. The setback to Japan's recovery stemming from its tax rise has also taken its mid-2014 GDP back below its early 2008. These are exceptionally bad outcomes, probably unseen in big western economies in peace-time since the 1930s.
- The October business surveys still show the strongest results in the UK and US across both manufacturing and services. Euro-zone purchasing manager survey readings have been trending down since the middle of the year and the European Commission survey showed a similar pattern until October, when it picked up slightly. The surveys also show a generally soft picture for the Japanese economy, although again some surveys are weaker than others and there is a a slow recovery from the weak post-tax rise readings.

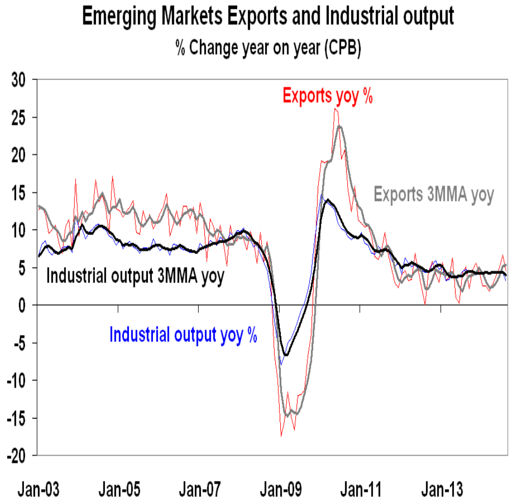


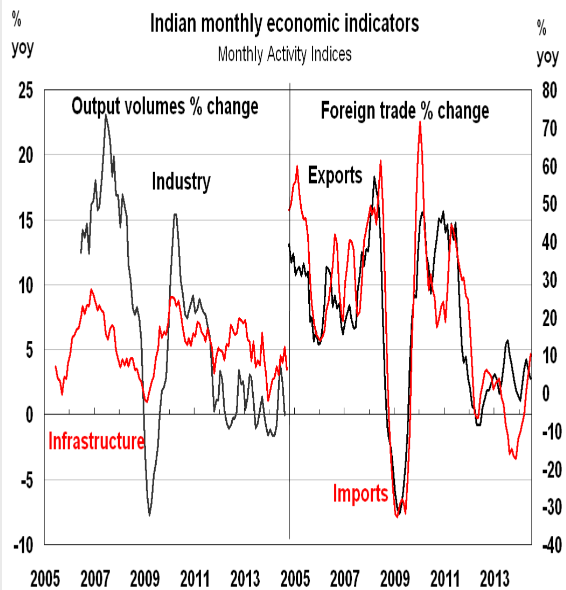




Emerging Market Economies

- Industrial growth in the emerging market economies is around 4% yoy, well below its long-term average but double the pace seen in the advanced economies. Emerging Market Economy export growth is also well below its long-run performance with emerging market growth of around 5% yoy recently.
- Growth performance also varies considerably among the emerging market economies with China continuing its gradual trend slowing, Indian growth poised for an upturn after several disappointing years, weakness in South America and sluggish growth in the trade-oriented emerging market economies of East Asia.
- With the exception of the volatile trade data, most of the Chinese monthly economic indicators line up with the quarterly national accounts in showing a gradual slowing in growth. Most of the recent Indian data shows a trend upturn after some weak years with higher imports pointing to increased domestic demand, faster growth in infrastructure spending, industrial output that is so volatile it is hard to detect any trends and some of the business surveys finally signalling better conditions.
- Latin America is the area of greatest weakness with June quarter GDP falling in both Brazil and Argentina, minimal growth in regional $US exports and falling industrial output.

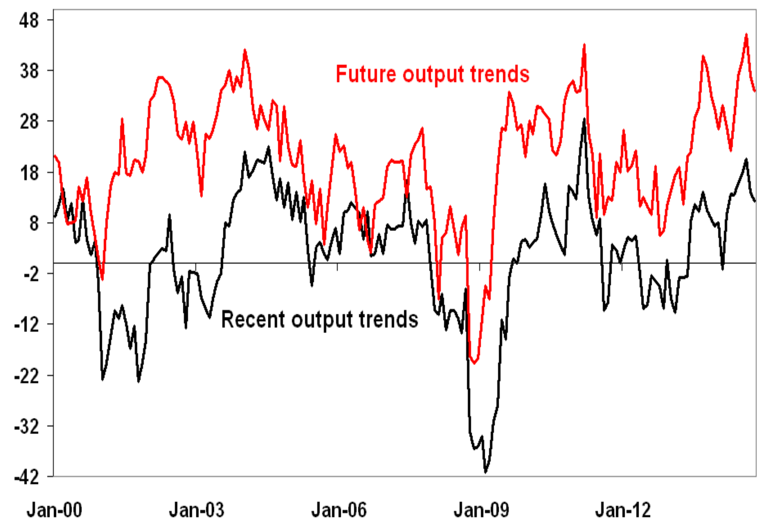




Global forecasts

- Recent business surveys and monthly partial data remain consistent with our forecast for continued moderate sub-trend expansion with global growth expected to increase from 3% in 2014 to 3.4% next year. The strength of economic activity is patchy between regions and that divergence is increasingly going to be reflected in monetary policy and currency markets. The US and UK upturns look solidly established but there are concerns over persistent weakness in Japan and the Euro-zone, reflected in the latest monetary easing by the Bank of Japan and ECB comments that it plans to increase the size of its balance sheet.
- The prolonged period of historically low interest rates in big Advanced economies, a slowdown in the pace of fiscal retrenchment (from the pace seen in the last few years) and a gradual recovery in private sector willingness to invest (as risk fears recede) provide the foundation of the expected upturn around most of the world. The recent fall in oil prices should also boost global economic activity as it adds to purchasing power in importing countries while oil exporters are unlikely to wind back their development plans and social spending in step with lower oil earnings.

Business surveys in US, UK, Germany and France

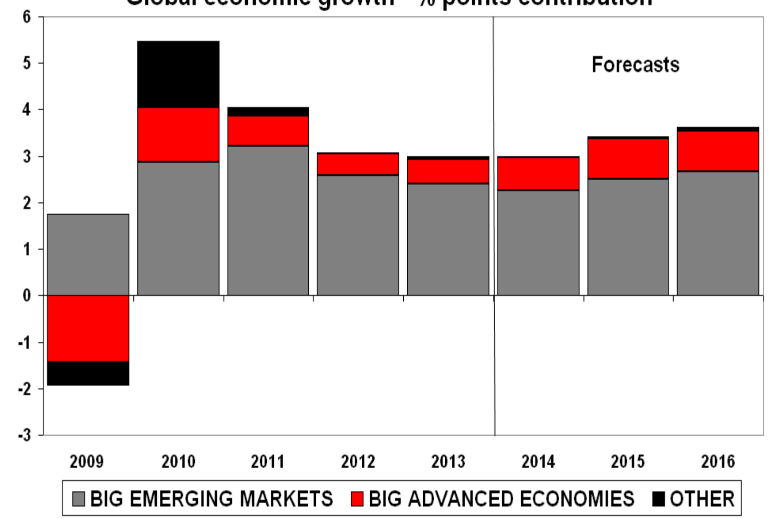


Global growth forecasts (a)

	2011	2012	2013	2014	2015	2016
US	1.6	2.3	2.2	2.2	3.0	2.8
Euro-zone	1.6	-0.6	-0.4	0.7	0.9	1.1
Japan	-0.4	1.5	1.5	1.0	1.1	0.9
UK	1.6	0.7	1.7	3.0	2.5	2.4
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	5.3	6.3	6.3
Latin America	4.7	2.2	2.2	0.7	1.9	3.2
Emerging Asia	4.3	3.9	3.9	3.8	4.0	4.2
New Zealand	1.9	2.5	2.8	3.8	3.4	1.8
World	4.1	3.1	3.0	3.0	3.4	3.5
memo						
Advanced Economies	1.6	1.2	1.4	1.8	2.2	2.1
Emerging Economies	6.9	5.2	5.1	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

Global economic growth - % points contribution



Australian outlook

- Sharp improvement in conditions in October NAB survey suggests possibly strong start to demand in Q4, although employment (while better) still lags. Orders and capex picked up strongly, capacity utilisation less so. However, it is unclear whether these better conditions will be sustained: conditions weakened in transport and wholesale, business confidence is moderate, income remains under pressure and job security still an issue.
- The ABS believes that it has now rectified the problems in its labour force survey and has revised recent history. Weak employment growth in October left the unemployment rate unchanged at 6.2%. In November, the NAB survey employment index and ANZ job ads showed some improvement from weak levels. Overall, forward indicators for the labour market are at best mixed.
- Household retail demand growth picked up moderately in October (after allowing for iPhone6) and online sales were better but personal credit growth was still weak. Mining engineering work rose in Q2 but this is unlikely to be sustained as the pipeline continues to shrink. Forward indicators suggest that the building construction cycle may be softening. Business credit showed signs of improvement in September.
- GDP forecast revised up slightly: 2014/15 2.9% (was 2.8%) but 2015/16 3.2% (unchanged). 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.

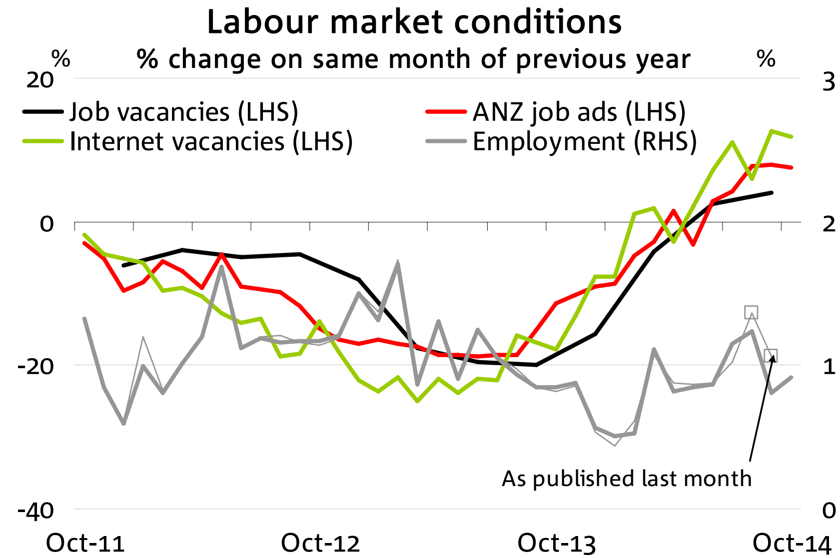
Australian economic and financial forecasts (a)

	Fiscal Year			Calendar Year		
	2013-14	2014-15 F	2015-16 F	2014-F	2015-F	2016-F
Private Consumption	2.5	2.4	2.8	2.4	2.6	2.7
Dwelling Investment	5.0	10.5	3.5	10.5	6.5	1.4
Underlying Business Fixed Investment	-6.2	-8.5	-8.7	-7.2	-8.8	-8.7
Underlying Public Final Demand	1.5	0.7	0.9	1.1	0.6	1.3
Domestic Demand	**1.2**	**1.1**	**1.0**	**1.3**	**1.0**	**1.0**
Stocks (b)	-0.4	0.1	0.0	0.0	0.0	0.0
GNE	**0.8**	**1.2**	**1.1**	**1.3**	**1.0**	**1.1**
Exports	6.8	8.6	9.3	8.0	9.1	9.3
Imports	-2.3	1.6	0.2	0.1	0.7	0.3
GDP	**2.8**	**2.9**	**3.2**	**3.1**	**3.0**	**3.3**
– Non-Farm GDP	2.9	3.0	3.2	3.2	3.0	3.3
– Farm GDP	2.1	0.1	2.0	-1.9	1.8	2.0
Nominal GDP	4.1	3.5	4.8	3.5	4.3	5.1
Federal Budget Deficit: ($b)	50	30	17	NA	NA	NA
Current Account Deficit ($b)	46	42	18	47	29	2
(-%) of GDP	2.9	2.5	1.1	2.9	1.7	0.1
Employment	0.8	1.1	1.6	0.9	1.2	2.2
Terms of Trade	-4.0	-5.7	-2.0	-6.6	-2.6	-1.9
Average Earnings (Nat. Accts. Basis)	2.1	2.5	2.9	2.2	2.8	3.0
End of Period						
Total CPI	3.0	2.2	2.9	2.3	2.5	3.0
Core CPI	2.7	2.0	2.6	2.2	2.2	2.7
Unemployment Rate	6.0	6.4	5.9	6.3	6.0	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	4.45	3.30	4.25	4.00
$A/US cents :	0.94	0.83	0.79	0.86	0.81	0.78
$A - Trade Weighted Index	72.0	68.8	66.9	68.8	68.3	66.0

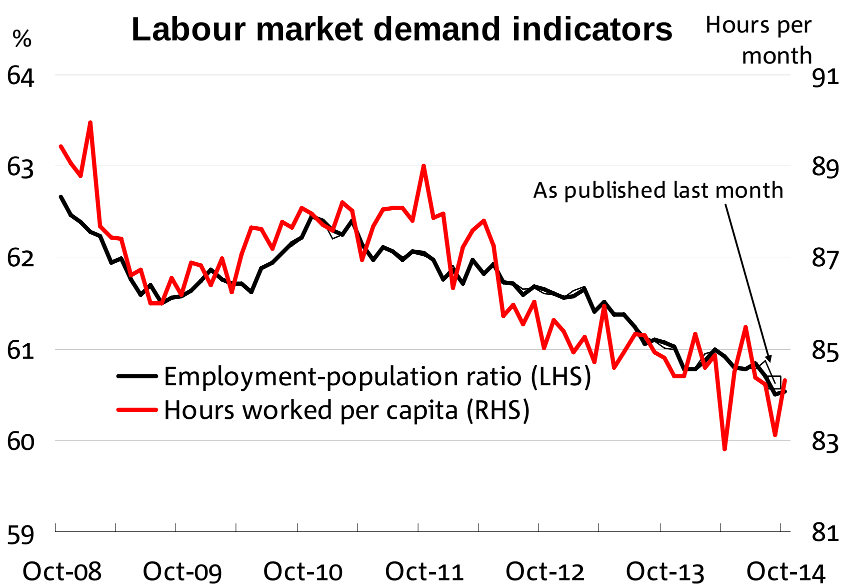
(a) Percentage changes represent average annual growth, except for cash and unemployment rates. The latter are end June. Percentage changes for CPI represent through the year inflation.
(b) Contribution to GDP growth

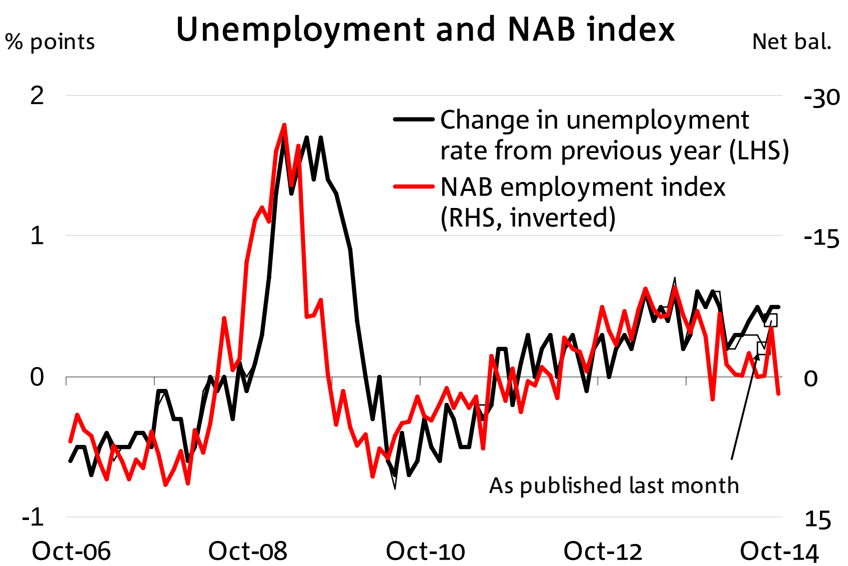
Australian labour market

- The ABS has now advised that the recent breakdown in seasonality in the labour force series was caused by changes in the timing and content of the associated supplementary surveys. These surveys were previously conducted at the same time each year so that their effects were reflected in the seasonality of the data. Having finally conducted the analysis it failed to do when it made these changes, the ABS has now pre-filtered the data to try to remove their impacts prior to seasonal adjustment. It now appears that seasonally adjusted employment fell in both August and September and that the unemployment rate rose to 6.2% in September.
- Employment rose 0.2% in October but a compensating rise in the participation rate left the unemployment rate unchanged at 6.2%. The new ABS method continues to point to quite tepid demand for labour. Some forward indicators, such as ANZ job ads and the NAB employment index, have gained momentum, although the overall outlook for the labour market remains quite soft.



Sources: ABS, Datastream, Department of Employment

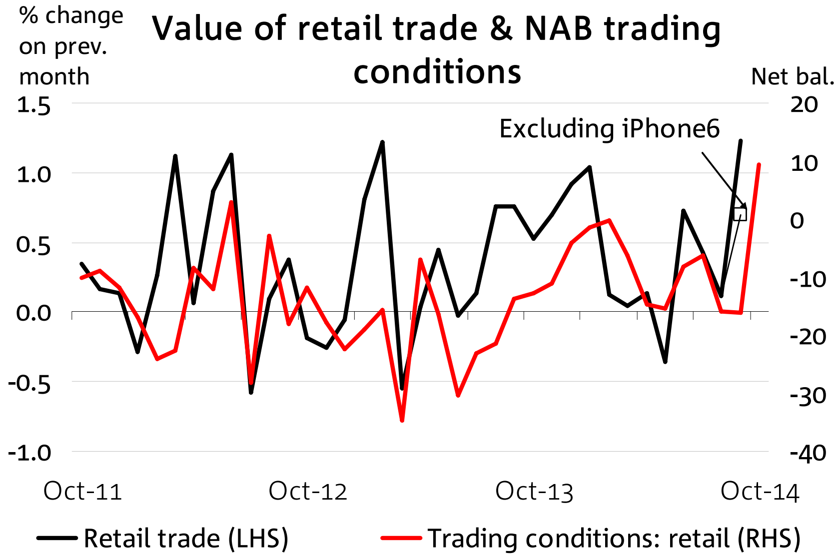




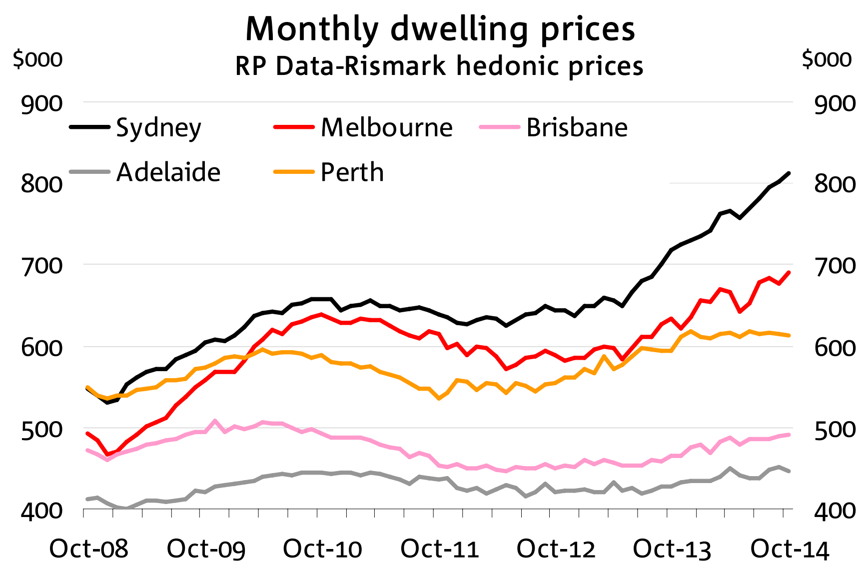
Sources: ABS, NAB business survey

Australian consumer demand and housing market

- While there are signs of an improvement in retail trade, they need to be put into perspective. The official measure rose by a strong 1.2% in September on the back of a surge in household goods and stronger cafe & takeaway food sales. However, household goods were affected by the release of the iPhone6: excluding electrical & electronic goods, retail trade rose 0.6% in the month. In October retail conditions in the NAB survey (especially sales) lifted strongly to be in positive territory for the first time in more than 4½ years. However, it is too early to be confident that stronger growth in consumer spending is about to become entrenched.
- The improving climate was supported by higher online retail trade growth and vehicle purchases. Online retail grew by 1.1% in September compared with 0.9% in July and August (see [NAB Online Retail Sales Index]). Total passenger and SUV vehicle sales jumped to over 75,000 units in September, the highest level this year following a weak reading in August. However, personal credit growth remained modest at just 0.2% in September, up 1.0% on a year ago.
- RP Data-Rismark dwelling price data indicated solid rises again in Melbourne (1.9%) and Sydney (1.3%) with more subdued rises or falls elsewhere. Housing credit growth remains historically subdued and continues to be tilted towards investors. Housing finance continued to grow at a moderate pace, rising by 0.6% in September to be 6.8% higher than a year ago. Investor interest is still strong, with investor housing finance up 9.5% over the year, but the data are not consistent with a debt-fuelled housing bubble. However, with the cost of finance low, household gearing has begun rising relative to income and has stabilised relative to asset values.
- In October, the ASX200 share price index rose 4.4%, regaining most of the ground lost in September.



Sources: ABS and NAB business survey

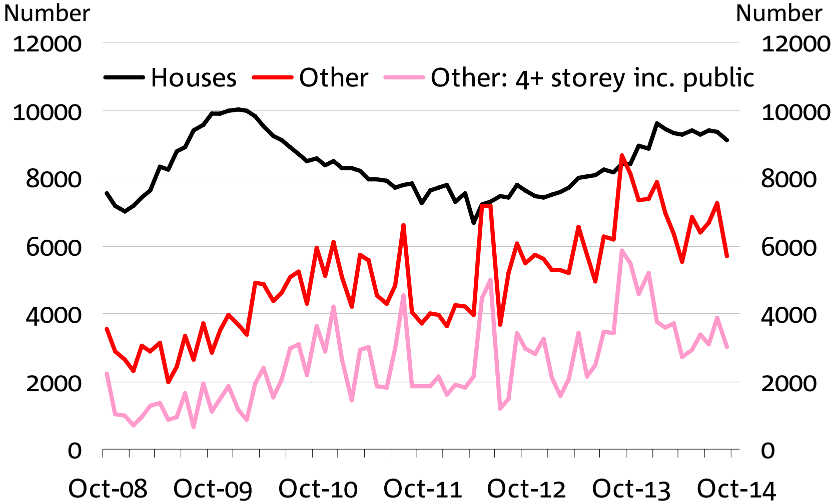


Source: RP Data-Rismark

Australian investment

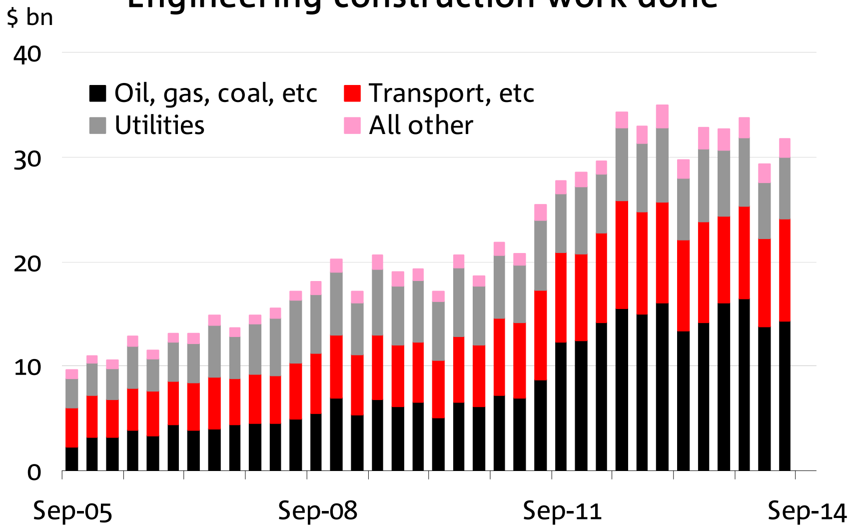
- Forward indicators for building activity weakened in September and the recent strength now looks to have been something of a local peak. Private house approvals declined for the second consecutive month in September and the bumpy other dwelling sector gave up its gains from the previous month (about half of them from large apartment projects). HIA house sales declined in September, although new multi-unit sales recorded a strong rise. Despite a pickup in private commercial approvals, the value of total non-residential approvals also fell in September. Business credit grew by 0.5% in September but has averaged just 0.2% per month since the end of June.
- Mining engineering construction is enjoying something of an Indian summer having picked up in Q2. However, the pipeline of incomplete mining engineering work continued to decline. We expect engineering construction to keep weakening as more major resources projects are commissioned.

Private dwelling units approved



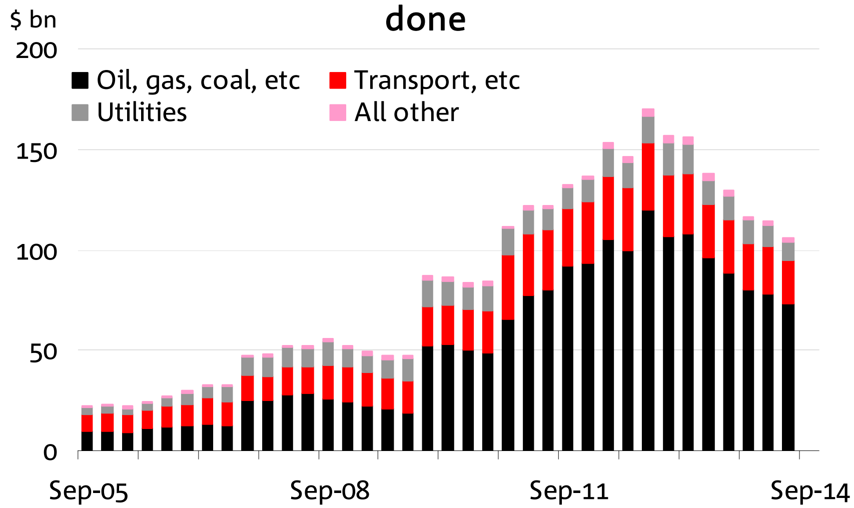
Source: ABS

Engineering construction work done



Source: ABS

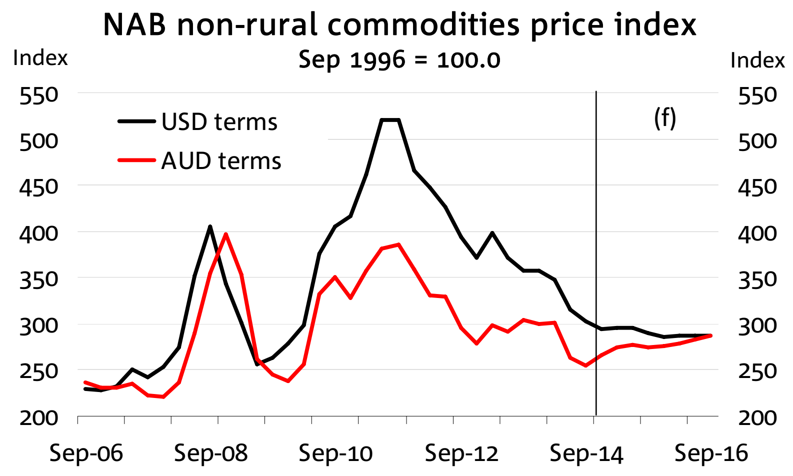
Engineering construction work yet to be done



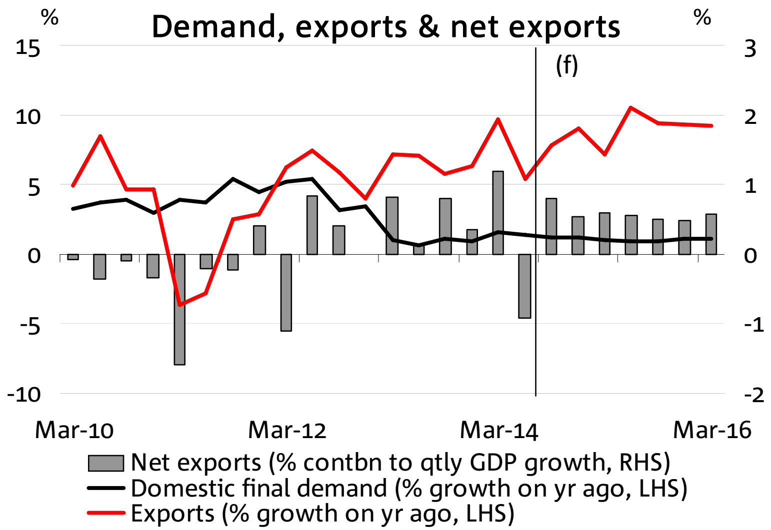
Source: ABS

Australian commodities, net exports and terms of trade

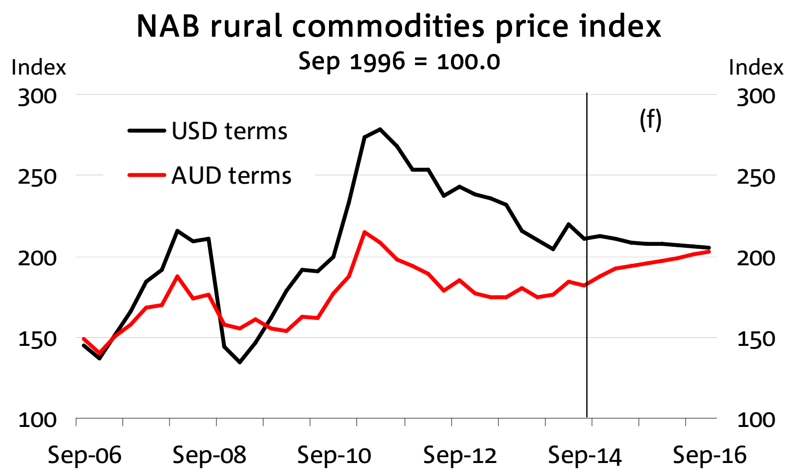
- In annual average terms, US dollar denominated non-rural commodity prices are expected to fall 15% in 2014, before easing a further 7¼% in 2015, with iron ore and gold the main contributors. We have revised down our forecast profile for some USD base metals (especially nickel). In AUD terms, commodity prices are forecast to rise a little over the forecast horizon. For more detail, see our Minerals & Energy Commodities Research. The NAB Rural Commodities Index fell for the sixth straight month in October, albeit by only 0.6% in AUD terms as the currency trended lower. In USD terms, the index was down 3.7%. In annual average terms, USD rural commodity prices are expected to fall 5.1% in 2014 and 1.6% in 2015. In AUD terms, it is expected to rise 3.7% in 2014 and 6.7% in 2015. For more detail, see our Rural Commodities Wrap..
- The terms of trade are expected to lose 7½% through the course of 2014 and be around 2% lower through 2015. The trade deficit is expected to improve during the remainder of 2014 and will move into surplus as rising resources and energy commodity exports begin to make inroads.



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



Sources: ABS, NAB forecasts



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

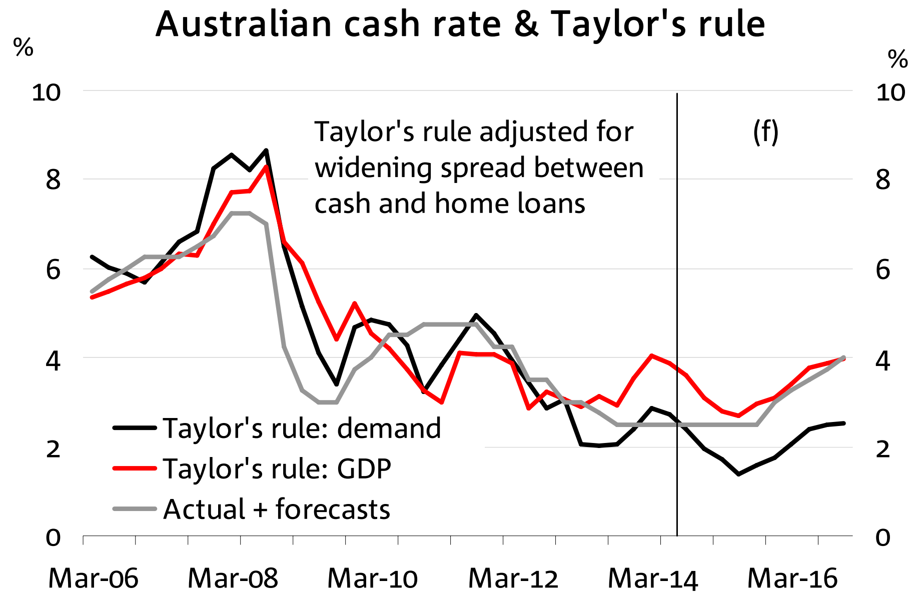
Australian financial markets

Exchange rate

- The AUD moved broadly sideways relative to the USD during October, trading mainly in the range USD 0.87 to 0.89. The bigger moves in October came from USD volatility, including USD gains on a very strong September employment report, losses after the minutes of the September FOMC meeting revealed concern that USD fluctuations may affect US growth and inflation, a mid-month bond yield 'flash crash' (unusually the AUD rose despite a spike in equity, bond and FX volatility) and USD gains after the end-October FOMC meeting announced an end to QE with hawkish commentary. At month's end the AUD/USD fell on a surge in USD/JPY on the BoJ's unexpected additional easing. There were few other sources of AUD volatility because the RBA is expected to be on hold at 2.50% for a long time to come.
- Our forecast profile implies that the AUD should remain close to current levels by the end of 2014 before resuming a gradual depreciation to 80 US cents by mid-2016.

Interest rates

- The RBA kept the cash rate at 2.50% in November, as expected. It has been unchanged for 15 months. Despite its decline the AUD was still regarded as "above most estimates of its fundamental value, particularly given the further declines in key commodity prices in recent months." The RBA still believes that a period of stability in interest rates is the most prudent policy for the time being.
- We still expect no change in the cash rate until the end of 2015. While there are tentative signs of an improvement in household spending, they do not yet signal a sustained change in household and business conditions. In the absence of any major surprises, the cash rate is unlikely to rise until late next year as monetary policy commences its return journey to normality.



Sources: RBA, NAB estimates

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