

The Bigger Picture – A Global & Australian Economic Perspective

Global: Global growth remained around 3% yoy in Q3, slightly below trend but it is expected to pick-up to 3½% in 2015 and 2016. Major differences in the strength of economic activity persist between regions with the US, India and China accounting for almost 2 ppts of forecast global growth. Headwinds to growth are coming from another group of big economies including the Euro-zone, Japan, Russia and Brazil. We are revising down our oil price forecast which should help boost global growth. Much depends on the cause (supply vs demand) and duration of the oil shock. OECD models show a sustained \$20 drop in oil prices adds 0.4 ppts to OECD growth over 2 years but temporary shocks have less impact. Lower oil prices boost activity in India but dampen growth in the many energy exporting economies.

- Divergence in economic conditions between the big advanced economies has been highlighted in recent central bank decisions on monetary policy. The US Fed has ended its asset purchase programme, but continues to reinvests funds released from maturing securities. The Fed maintains that a near zero Fed funds rate should remain appropriate for a “considerable time”. The Bank of Japan stepped up its asset buying program in late October in an effort to boost growth and inflation. The BoJ reaffirmed its intention to stick with this policy at its November meeting. Markets are now focussing most on the ECB as it grapples with a stagnating economy and very low inflation. Whether the ECB is willing to expand its asset buying to include sovereign bonds has become the most contentious issue as there is considerable opposition to that step in Germany. In contrast, the UK debate focuses on when rates should be increased.
- Global economic growth has continued at a moderate pace with industrial output expanding by around 3% yoy and business survey readings consistent with moderate growth. The pace of growth in both industrial output and exports in the emerging markets has been faster than among the advanced economies, although in both groupings the growth rate is generally running below its pre-GFC level. Inflation also differs between the major advanced and emerging economies. Globally the slide in oil and other commodity prices alongside above-trend jobless rates in the advanced economies have put downward pressure on inflation. With the exception of Japan, where April’s rise in indirect taxes has boosted prices, inflation is either trending down or below target in most big advanced economies. In big emerging market economies, outside China, the situation is different with central banks in Brazil and Indonesia recently lifting rates to combat above target inflation.
- The pace of quarterly growth in the G7 advanced economies has been quickening through 2014. November business surveys show the US continuing to outperform other advanced economies with solid results in its industrial sector alongside lacklustre readings in the Euro-zone and Japan. The UK purchasing manager survey shows industrial activity picking up in November after falling quite sharply in recent months. Recent business survey results for the services sector outside the Euro-zone have been strong with rising business activity in the US, UK and Japan, although conditions in the latter remain weaker than before April’s tax rise.
- The pace of economic expansion in the main emerging market economies has gradually slowed through 2014. The slowdown reflects the big downturn in South America and a modest slowing across East Asia, partially offset by faster growth in India. Industrial growth in the emerging market economies has held up around 4% yoy since late 2013 and export volumes have been rising recently (although volatile). 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.
- Although neither quarterly GDP nor the monthly trade and industry data show evidence of any acceleration in global growth, the combination of lower oil prices, monetary policy aimed at boosting activity and a slower pace of fiscal tightening in the big advanced economies should lead to growth picking up to 3½% next year.
- The outlook for continued low inflation and only a gradual erosion of advanced economy margins of spare capacity should allow central banks to keep their policy interest rates very low by historical standards. The Fed should start gradually lifting its rates from mid-2015 and the Bank of England in the third quarter but neither the ECB nor the Bank of Japan are expected to increase their policy rates next year.

Australia: Softer commodity prices in October are expected to persist and subtract over \$25b from export earnings in 2014/15 compared with our previous forecasts. Business conditions softened in November but are largely in line with long-run averages. The employment outlook remains soft and business confidence retreated – indeed the latter is increasingly concerning. GDP growth in Q3 of 0.3% was below expectations and probably overstates the real position, but continues to point to soft (possibly even declining) demand. There are increasing risks that the mining cliff, while deferred, may turn out steeper. We have changed our view on the cash rate and now expect two of 25 bp cuts in March and August 2015 then remaining on hold until late 2016. Exchange rate forecasts to track US3 cents lower than previously expected. GDP forecasts cut reflecting weaker history and terms of trade: 2014/15 2.5% (was 2.9%); 2015/16 3.0% (was 3.2%). Unemployment rate now to peak at around 6¾% (was 6½%).

- Labour market forward indicators have been moving broadly sideways. The NAB employment index retreated to zero in November. Department of Employment internet vacancies were practically unchanged in October while ANZ job ads increased by 0.7% in November. Overall, we still expect the unemployment rate to rise above its current level (6.2%) over coming months and to track a higher path than before, peaking at around 6¾%.
- Last month's spike in business conditions was again short-lived, pulling back towards long run average levels in November. Despite the drop, the overall trend is still looking much better than 12-18 months prior and levels of capacity utilisation have continued to improve. Orders held up reasonably well, which reflects well on near-term demand. The fall in conditions was driven by all three components (sales, profits and employment), although the last remains the weakest, pointing to only very modest growth in employment – insufficient to prevent a further rise in the unemployment rate. Firm's uncertainty over the outlook for their industries was reflected in a further erosion of business confidence. Confidence levels vary greatly across industries, although the spread narrowed considerably in the month. Services have been replaced with construction as the most optimistic. Other leading indicators are mixed. Forward orders maintained last month's rise, but the 'bellwether' wholesale industry remains weak.
- The upward trend in the growth rate of retail trade continued into October. While growth of 0.4% was down sharply on September's 1.3%, the decline was more modest when account is taken of the release of iPhone 6 in September. In the NAB survey November retail trading conditions gave back some of the strong gains from the previous month but at -1 remain better than we have seen for most of the past five years. Orders remain in negative territory. Following tepid growth over the past three months, personal credit contracted marginally in October. Overall, the improvement in consumer appetite for spending appears limited at best. There are signs that some steam escaped from the residential property market in November.
- According to RP Data-Rismark dwelling prices fell 0.3% across the capital cities and, although Sydney prices rose 1.0%, Melbourne prices declined by 2.6%. Housing credit growth is still moderate at 0.6% in October and continues to be tilted towards investors, although owner-occupier credit growth has started to pick up. While historically low interest rates have driven down interest payments on housing and personal debt relative to income, housing credit growth has contributed to a rise in household debt relative to income – now approaching its peak levels of 2010. This suggests some vulnerability when interest rates are eventually tightened.
- Dwelling investment declined by 0.9% in Q3, reflecting the easing in apartment approvals mid-year. Apartment approvals seem to have resumed their upward trend, abstracting from monthly volatility, but housing approvals continue to drift. New private non-dwelling construction fell 3.6% in Q3 as the slowdown in mining investment contributed to the fourth consecutive quarterly fall in engineering construction. Nevertheless, mining construction has held up for longer than we expected; consequently, the mining pipeline has fallen faster than we foresaw. Hence, there is an emerging risk that the bulk of the decline in mining construction may be deferred into 2015 but will be steeper than anticipated.
- Softer commodities outlook and prospect of more severe deterioration in labour market mean we have changed our rate call to two cuts of 25 bp in March and August 2015, then on hold until late 2016. GDP forecasts cut reflecting weaker history and terms of trade: 2014/15 2.5% (was 2.9%); 2015/16 3.0% (was 3.2%). Unemployment rate now to peak at around 6¾% (was 6½%).

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