

April 2015

The Bigger Picture – A Global & Australian Economic Perspective



Global: *Global growth remains stuck at a sub-trend pace. After 3.3% in 2014 we now expect only 3.4% in 2015. While the Euro-zone and Japan are experiencing upturns, recent US data has disappointed. We have delayed the Fed starting till September (or later) and reduced US GDP in 2015 to 2.7%. March quarter business surveys do not suggest any acceleration in advanced economy growth – which we require to achieve the 2015 forecast. There is no evidence of an upturn in emerging market economy growth either.*

- Divergence in economic conditions between the big advanced economies has been highlighted in recent central bank decisions on monetary policy. The Fed is still preparing the ground for a gradual rise in US policy interest rates but recent soft activity data and an absence of inflation pressures give the Fed discretion over when to start raising rates. We think the first 25 bps rise will come in September with another by year end. The Bank of Japan's policy remains focussed on promoting inflation and a recovery in output by keeping zero interest rates through boosting the money supply by buying assets (especially government bonds). They will maintain these policy settings until confident inflation has settled at the target 2%. With Euro-zone CPI inflation turning negative in late 2014, little growth in output and double-digit unemployment, the ECB stepped up its asset buying policy with the decision to purchase government bonds. Divergent underlying conditions between the big advanced economies are reflected in the fall in the Yen and Euro and the appreciation of the \$US.
- Global GDP growth continues at a sub-trend pace of just over 3%. Partial data available for February shows industrial output growing at just over 3% yoy, around the same rate as averaged over the previous 6 months. Advanced economy business survey results for March quarter show a mixed picture. Recent poor results for the US have depressed overall sentiment in the advanced economy industrial sector. Economy-wide surveys show activity growth holding up but not accelerating in the first quarter. Emerging economy conditions also vary with positive results in India (third biggest global economy), soft outcomes across much of East Asia - including China (possibly now the world's biggest economy) and recessionary conditions in Brazil (the seventh biggest global economy).
- Annualised growth in the big 7 advanced economies accelerated across the first three quarters of 2014 before slowing slightly in the final quarter. The US accounted for most of this slowing in late 2014 as Japanese and Euro-zone growth was faster. March quarter business surveys show measures of manufacturing and services activity trending down in the US, picking up in the Euro-zone and mixed signals in the UK and Japan. The surveys are, however, consistent with solid growth in the UK and US plus continued, albeit still weak, growth in Japan. Some of the recent weakness in the US reflects bad weather and port strikes but, as softer than expected data has gradually accumulated through recent weeks, there are concerns that growth could continue to weaken. The stronger \$US is now curbing activity with reports of heightened competitive pressure on exports and import competing industry. Elsewhere, the Euro zone seems to have commenced a long awaited economic upturn and there is plenty of scope for further catch-up. The jobless rate across the G7 Advanced economies has fallen to around 7%, not far off its 25 year average and the amount of idle industrial capacity has halved. However, unemployment rates in the UK, US and Japan have fallen to below their 25 year average, Euro-zone unemployment is still 10%.
- Emerging market economy growth remained around 6% yoy through 2014 and, taken overall, neither the business surveys nor the partial data on trade volumes or industrial output suggest a pickup. Business surveys give a mixed picture. Confidence levels in Indian business have picked up but Brazilian surveys are at recession levels and survey readings across East Asia are not very strong. The sluggishness in world trade and falling commodity prices have depressed income and activity in many key emerging markets. Chinese industrial output and fixed investment spending continues to slow, while retail trade has held up much better (in line with policy objectives). Indian data on trade and output is not as solid as recent buoyant business surveys might suggest.
- We are now forecasting a more muted upturn in the global economy than was the case a few months ago. Although our forecasts are below those of the IMF and Consensus, their direction of risk is probably still downwards. This reflects the notable risk that the long awaited acceleration in global growth gets postponed again. Indeed, our tracking indicators of current world economic activity are still not showing much sign of an impending upturn.

Australia: We have fine tuned but not fundamentally changed our forecasts– 2014/15 2.3% and 3.0% in 2015/16. The non mining sector is still struggling to offset the impact on domestic demand of sharply lower mining investment. Further falls in commodity prices are lowering income flows. A particular concern is the weak medium term outlook for non mining investment, while the consumer remains cautious. As a result we still see unemployment rising to 6.7% by end 2015. Another rate cut is expected – most likely May but could be delayed if the economy improves (tentative signs of this in the March NAB Business Survey). We see the probability of a cut to below 2% being around 35-40% - well below market expectation (fully priced). Rate rises to start in late 2016.

- There were some tentative signs of improvement in the NAB Monthly Business Survey for March, with the post RBA cut fall in confidence reversed in March. Surprisingly, the lift was particularly pronounced in mining, although confidence is still lowest for this industry. Elsewhere outcomes were mixed, suggesting some industry specific factors are also at play. Business conditions recorded a notable lift, with each component (trading, profit, employment) posting an improvement – although employment continues to be relatively muted. This level of conditions is pointing to a slightly above average rate of activity, although the trend is somewhat softer. If maintained it could well boost confidence further. There was a surprisingly strong improvement in conditions for the ‘bellwether’ wholesale industry, although the export index is yet to respond to the more favourable AUD, while orders are soft (and down slightly). Capacity utilisation and capex, encouragingly, both improved.
- While there is still considerable noise in the labour market indicators, recently some partials such as job ads and vacancies appear to have marginally softened. That said, many of the partials still suggest stronger labour demand than the official employment series, which has also weakened. NAB’s employment series (from the Survey), which leads official statistics by around 6 months, suggests some near term softness. For the next 6 months the index is pointing to employment growth of around 180k jobs per annum or around 15k per month – a rate of employment growth that, at the margin, might be insufficient to stabilise the unemployment rate (unless the participation rate falls). Clearly confidence will need to improve before business is prepared to significantly hire. We continue to expect unemployment to reach 6.7% by end 2015 and remain stubbornly high – still above 6% by end 2016/17.
- The pattern of retail sales has been volatile, affected by special events – such as the release of the iPhone 6 in September 2015. Thus much of the strength in Q4 real consumption reflected the iPhone base effect. Similarly, despite better nominal sales in early 2015, Q1 2015 consumption will be lowered by base effects of very weak retail sales in late 2015. To date reasonable retail sales growth in January / February is encouraging, although indications from the NAB Business Survey are not as promising. Online retail has also been somewhat volatile, but the latest reading for February was strong. Generally consumer anxiety is up and appetite for discretionary spending is still lacking. Consequently, personal credit growth is also weak.
- According to RP Data-Rismark dwelling prices in Australia rose 7.4% in the year to March – with the strongest markets very much Sydney (up 13.9%) with the next best Melbourne (up 5.6%). Outside of Sydney it appears that the heat is coming out of the housing market. In contrast it appears that the February rate cut has lifted Sydney prices in year on year terms. Clearly the investor market in Sydney is driving this momentum, and based on loan approval data, is unlikely to pull back any time soon. On credit, housing credit growth continues to run at 0.5% per month or 7.2% in the year to February. However investor credit is much stronger at 0.7% per month or 10.1% annually. The latter is still above APRA’s maximum growth rate.
- Very high levels of approvals for dwellings construction – especially apartments – means dwelling investment will be strong over the next year. While recent attempts to tighten foreign investment rules may slow demand eventually, the reality is that the existing approvals will be built – and contribute to the reallocation of resources from mining to the non mining sector. With mining work yet to be done falling, the expected declines in mining investment are well underway. The latest NAB monthly survey points to some rises in near term non mining investment and business credit is now significantly stronger. That said it is difficult to be sure if the trend will be short lived or not. Certainly the medium term expectations data is much more concerning.
- Our forecasts have not fundamentally changed: GDP growth of 2.3% in 2014/15 and 3% in 2015/16. The non mining sector is still struggling to offset the impact on domestic demand of sharply lower mining investment. Unemployment to reach 6.7% by end 2015 and remain stubbornly high – still above 6% by end 2016/17. Another rate cut is expected – most likely May but could be delayed if the economy improves. An additional cut is possible, but likelihood is less than market expectation (fully priced). Rate rises to start in late 2016.

Alan Oster/Group Chief Economist/National Australia Bank/03 8634 2927 (Mob. 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

Vacant	Head of Australian Economics & Commodities	+ (61 3) 8634 1663
James Glenn	Senior Economist – Australia	+ (61 3) 9208 8129
Vyanne Lai	Economist – Australia	+ (61 3) 8634 0198
Amy Li	Economist – Australia	+ (61 3) 8634 1563

Dean Pearson	Head of Industry Analysis	+ (61 3) 8634 2331
Robert De lure	Senior Economist – Industry Analysis	+ (61 3) 8634 4611
Brien McDonald	Senior Economist – Industry Analysis	+ (61 3) 8634 3837
Karla Bulauan	Economist	+ (61 3) 8641 4028

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
Ivan Colhoun	Chief Economist – Markets	+ (61 2) 9237 1836
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
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

DISCLAIMER: "While care has been taken in preparing this material, National Australia Bank Limited (ABN 12 004 044 937) does not warrant or represent that the information, recommendations, opinions or conclusions contained in this document ("Information") are accurate, reliable, complete or current. The Information has been prepared for dissemination to professional investors for information purposes only and any statements as to past performance do not represent future performance. The Information does not purport to contain all matters relevant to any particular investment or financial instrument and all statements as to future matters are not guaranteed to be accurate. In all cases, anyone proposing to rely on or use the Information should independently verify and check the accuracy, completeness, reliability and suitability of the Information and should obtain independent and specific advice from appropriate professionals or experts.

To the extent permissible by law, the National shall not be liable for any errors, omissions, defects or misrepresentations in the Information or for any loss or damage suffered by persons who use or rely on such Information (including by reasons of negligence, negligent misstatement or otherwise). If any law prohibits the exclusion of such liability, the National limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable. The National, its affiliates and employees may hold a position or act as a price maker in the financial instruments of any issuer discussed within this document or act as an underwriter, placement agent, adviser or lender to such issuer."

UK DISCLAIMER: If this document is distributed in the United Kingdom, such distribution is by National Australia Bank Limited, 88 Wood Street, London EC2V 7QQ. Registered in England BR1924. Head Office: 800 Bourke Street, Docklands, Victoria, 3008. Incorporated with limited liability in the State of Victoria, Australia. Authorised and regulated in the UK by the Financial Services Authority.

U.S. DISCLAIMER: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

NEW ZEALAND DISCLAIMER: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person's particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication. National Australia Bank Limited is not a registered bank in New Zealand.

JAPAN DISCLAIMER: National Australia Bank Ltd. has no license of securities-related business in Japan. Therefore, this document is only for your information purpose and is not intended as an offer or solicitation for the purchase or sale of the securities described herein or for any other action.