

The Bigger Picture – A Global & Australian Economic Perspective

Global: Weak GDP results in the US, UK and Canada have outweighed a pick-up in Japan and the Euro-zone and similarly mixed trends among the big emerging economies saw China slowing, India picking up and Brazil still very weak. The monthly manufacturing output and world trade numbers were soft, particularly the latter, and the business surveys do not show any clear evidence yet of an imminent lift in growth momentum. Our forecast is for more of the same this year with global growth staying around 3¼% in 2015, followed by a modest upturn in 2016 (largely driven by the US).

- 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 and we expect the first rise in September. 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 this setting until confident inflation has settled at its target 2%. Although Euro-zone headline CPI inflation turned positive in May, the European Central Bank remains committed to its policy of very low interest rates and monthly asset purchases of €60 billion which should continue until September 2016 at the earliest. The Euro-zone recovery is proving weaker than the ECB hoped, adding to the case for it to keep policy stimulatory. Divergent underlying conditions between the big advanced economies have been reflected in the fall in the Yen and Euro and the appreciation of the \$US. Foreign exchange markets marked the \$US down through April and early May but it has since regained ground.
- Global growth has not ramped up to around its long run trend as was expected. Monthly data on world production and trade flows suggests that growth in manufacturing output has lost momentum, while the volume of trade actually shrank in early 2015. Preliminary data for April shows global manufacturing output growing by around 2% yoy, less than half its long-run trend rate. There was a modest rise in business confidence in advanced economy manufacturing but it is too early (and the data sufficiently volatile) to read much into it. The limited information available on service sector activity does not point to an upturn either (with the possible exception of Japan, where the economy is gradually recovering from last year's tax rise).
- The March quarter saw falling output in the US and Canada, which along with a halving in the UK growth rate, was sufficient to almost offset solid growth in the Euro-area and Japan. The outcome was a near stagnation in output across the G7 advanced economies in the opening months of 2015. As the US and UK have been the standout performers in the G7 upturn, the softer early 2015 output figures show a marked shift in the regional composition of global growth. The extent to which this setback in the US recovery is only temporary and due to "special factors" has been much debated. Our forecast lines up with public guidance from the US Federal Reserve that the US upturn has not been de-railed and it will continue through the remainder of the year – making the case for the Fed to lift policy interest rates. Timely surveys of purchasing managers show growth continuing across the manufacturing and services sectors across W Europe, the US and Japan – but at widely varying rates. Most of these survey readings are consistent with at most moderate rates of economic expansion but there are a couple of stand-out sectors – especially in the services sector where results across the UK, US and Euro-zone appear more buoyant than for manufacturing. Japan has been the weak link in service sector activity but it appears to be finally picking up.
- There is no evidence that growth in the main emerging market economies accelerated in early 2015. The monthly trends in trade and manufacturing output volumes do not show evidence of any pick-up either. Export volumes fell quite heavily in the quarter and export receipts were even more depressed as commodity prices softened, hitting incomes in the big commodity producing countries across Latin America, Africa and SE Asia. Chinese growth is gradually slowing, while the monthly partial economic indicators show a mixed picture – most are consistent with a softening in growth. The weakness shown in world trade is reflected in exports from big emerging economies in Latin America and East Asia. Lower commodity prices have eroded receipts in major economies like Brazil, Argentina and Indonesia.
- We have revised our forecasts downwards to take account of the weak first quarter US results and the longer than expected downturn in Brazil. Although our forecasts are below those of the IMF and Consensus, their direction of risk is probably still downwards. This reflects the risk that the long awaited acceleration in global growth gets postponed again.

Australia: We have fine tuned but not fundamentally changed our forecasts– 2014/15 2.4% (was 2.3%), 2015/16 2.6% (was 2.9%) and 3.0% (unchanged) in 2016/17. The domestic economy is struggling to offset the impact of sharply lower mining investment – as again highlighted in the Q1 National accounts. Subsequently some recent data- such as the Nab Survey - has improved, but capex expectations in the non mining sector have weakened, business are reluctant to employ and consumers remain cautious. With future domestic demand still weak, unemployment is expected to rise a touch to around 6.4% by end 2015 and remain relatively for some time. Given our forecasts, we see the RBA keeping interest rates on hold, with the next move to up – but not till late 2016.

- The recent Federal Budget and interest rate cut appears to have had a positive impact on business confidence, which moved up significantly in May to its highest level since August 2014. Confidence was significantly higher in retail / wholesale (possibly associated with expectations from the Small Business Package) and finance, business and property services. Mining confidence, on the other hand, fell significantly. The pick-up in confidence could also reflect improved business conditions, which further cementing the upward trend seen over recent months. All components of the conditions index (trading, profitability and employment) improved in the month. The 'bellwether' wholesale industry improved, but remains weak (transport was weak also). Encouragingly, leading indicators such as forward orders improved, as did capacity utilisation and capex spending. Business credit eased back a touch – flat in April but is still up 5% over the year.
- It appears that moderate growth in employment has continued and there has been some flattening out of labour market partials. Looking at the employment series in the Nab survey – which provides a strong 6 month lead on annual employment growth – the current reading would be consistent with growth in employment of around 15k jobs per month over the next 6 months – a rate of employment growth insufficient to stabilise unemployment (unless participation rates fall). More encouragingly, there has in recent months been a significant increase in hours worked per employee, albeit with no real change in the employment to population ratio. With employment expected to rise around 15k per month for the rest of 2015, the unemployment rate is forecast to edge up marginally to around 6.4% by years end. Thereafter employment growth edges higher and the unemployment rate starts to move down but at a very moderate rate – remaining above 6% till mid 2017.
- The pattern of retail sales continues to be volatile. That said, real consumption growth in the Q1 National Accounts continued to disappoint – indicative of a still wary consumer, who at present is also facing falls in average earnings per employee (according to the National accounts). More recently retail sales have slowed, although the Nab survey does suggest retail improved in May. Online retail has also been volatile. In trend terms, on line retail has been running around 0.6% per month - but April sales were much stronger. Consumer anxiety has increased in Q1 2015 and remains relatively high, although monthly measures have improved. Personal credit remains flat – up just 0.6% in the year.
- According to RP Data-Rismark dwelling prices in Australia have risen 9.6% in the year to May - but with radically different outcomes across Australia. Thus Sydney was up 16.4% in the year to May, Melbourne 9.8%, Brisbane 3.1%, Adelaide 3.4%, Perth 1.0% and Hobart a fall of 1%. The Sydney market in particular is facing severe undersupply issues as well as low interest rates – with similar issues evident in Melbourne. These markets have been driven by investor activity which is difficult to restrain in the face of low interest rates and high tax rates. On credit, housing credit growth continues to run around 0.5% per month or 7.2% in the year to April. However investor credit is much stronger at 0.8% per month or 9.9% annually – just below APRA's maximum growth rate.
- Dwelling investment was solid in Q1 2015 and with very high building approvals – especially apartments – we expect to see similar or stronger growth in dwelling investment over the forecasting horizon. A significant driver of new apartment demand has come from foreign investors. Indeed property developers estimate around 15% of new sales are to foreigners with much concentrations in both Melbourne and Sydney (around 20% – anecdotal reports are even higher). Recent attempts to tighten foreign investment rules may slow demand eventually, but existing dwelling approvals will still contribute to a 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.
- Our forecasts have been fine tuned: GDP growth of 2.4% in 2014/15 (was 2.3%) and 2.6% in 2015/16 (was 2.9%). Our activity and labour market forecasts suggest that the rate cutting phase is finished with rates on hold for a considerable period and then rise from late 2016.

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 Iure	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.