

The Bigger Picture – A Global & Australian Economic Perspective

Global: Global growth remains sluggish and below trend and we have slightly lowered our forecasts to take account of weaker than expected outcomes in India, Canada and Brazil. The bursting of the Chinese share market bubble and the authorities' confusing response adds further unwelcome volatility and uncertainty to an already uninspiring outlook and we expect growth to remain soft and below trend through the next two years with no sign of any imminent upturn in activity and sizeable downside risks.

- The bursting of the Chinese share market bubble, the timing of US interest rate rises by the Fed and the continued slide in global commodity markets remain key areas of concern to the markets. Around 30 trillion RMB (\$US4½ billion) has been wiped off Chinese share market capitalisation, equal to almost half of GDP in 2014. While the impact of this seemingly huge fall on household wealth and business funding should not be exaggerated, the failed efforts of the Chinese authorities to stabilise the market has raised deeper concerns about their appetite for economic reform and the true strength of growth in the economy. Volatility in the Chinese market has spilled over into other equity markets, depressing prices. While recent market volatility may cause the Fed to delay lifting its policy interest rates, we still expect this process to start by the end of the year. This process of rate increases should prove to be gradual and the peak rate lower than in the past.
- Growth in global GDP has disappointed by staying around 3¼% yoy since mid-2014 rather than picking up. Partial data for industrial activity has not shown any pick-up in global activity since June and the August industrial purchasing manager surveys across the largest advanced and emerging market economies pointed to slower rather than faster growth. At the same time, falling commodity prices are eroding export earnings in key primary producers. Brazil and Canada are in recession, South Africa's economy shrank in the second quarter, and Australian GDP proved weaker than expected. The limited data available on the service sector shows growth easily outpacing industry. Advanced economy business surveys for services are consistent with solid growth and services expansion remains buoyant in many Asian emerging market economies.
- Growth in the G7 advanced economies accelerated in the June quarter primarily reflecting a rebound in US growth, which was dragged down by temporary factors in the first quarter. The UK was the only other bright spot with growth accelerating in the June quarter after a weak first quarter outcome. Elsewhere advanced economy growth was generally disappointing with falls in output in Japan and Canada and a modest drop in Euro-zone growth. The recovery in advanced economy investment has been particularly lacklustre – it took almost 7 years to regain its early 2008 level, despite an upturn in business profits and a drop in the extent of idle capacity. This reflects the risks and volatility in the global economic environment as well as a lack of confidence in business that is partly an overhang of previous financial crises and deep recessions. The business surveys show solid growth continuing in services (albeit clearly slowing in the UK) alongside generally disappointing results for manufacturing that are consistent with modest growth at best.
- A slowdown in emerging market economy growth in the June quarter has offset the lift in the advanced economies, leaving world growth flat. The headwinds facing emerging market growth (falling commodity prices, weak world trade) remain and new problems have appeared in recent months (notably the bursting of the Chinese share market bubble). As the emerging market economies of East Asia are generally export-driven, the weakness of world trade has weighed on output while falling commodity prices have hit exports and incomes in big Latin American primary producers like Brazil. Uncertainty surrounding the pace of Chinese growth hangs over financial markets. Most partial indicators point to slowing growth with a clear softening trend in industrial output, export deliveries, fixed investment and (until recently) the real estate sector. Indicators all point to quite soft growth in China's industrial sector, helping explain the fall in global commodity prices. The extent to which service activity is picking up is far from clear with business surveys trending down.
- We have shaved our 2015 and 2016 forecasts down by 10 bps to take account of weaker than expected outcomes in Canada and Brazil with global growth set to remain sub-trend through the entire forecast horizon. Growth is expected to fall from 3.3% in 2014 to 3.1% this year and remain much the same in 2016 with our global tracking indicator showing no sign yet of any upturn in growth.

Australia: The Australian economy is still struggling to transition to non-mining sources of growth amidst lower national income. Against that, there is increasing evidence that growth momentum is broadening across the non-mining economy – not limited to the dwelling sector – in response to the lower AUD and interest rates, with improvement particularly evident in services sectors. Our 2015/16 GDP forecast has been revised down to 2.4%, reflecting a weaker than expected Q2 result, while the 2016/17 forecast is unchanged at 3.1%. The unemployment rate is expected to ease to 6% through 2015/16 and to 5¾ in 2016/17. While risks to the outlook stemming from financial market volatility and a slower China are front of mind, stronger local momentum in the non mining sector is expected to keep the RBA from cutting rates further.

- Business conditions in the NAB Business Survey point to a further improvement in the non-mining economy, even as jitters in financial markets weigh on confidence; the trend index lifted to its highest level since late 2009. This outcome adds to the mounting evidence that AUD depreciation and record low interest rates are having the desired effect and helping to offset the weakness in mining. Even so, outcomes vary significantly by industry, while confidence pared back further in August, unwinding the post budget gains. While confidence tends to track conditions quite closely, recent financial market ructions and China growth concerns appear to have had an unnerving effect on business.
- Australian real GDP is struggling to regain momentum, against a weak income backdrop and significant structural change at the industry and geographic level. The economy expanded by just 0.2% in the June quarter and 2.0% over the year. Australian income growth is weak as the terms of trade declines further. This is flowing through to weak corporate profits, government revenue and expenditure, as well as labour earnings. Real gross domestic income fell 0.2% over the year, while real net national disposable income has declined by 1.1% y/y (and -2.3% y/y on a per capita basis). That said, there have been a number of one-offs causing volatility in recent quarterly figures, and we are hesitant to extrapolate all of the weakness in Q2 out further. In addition, there is some evidence that momentum in the non-mining sector (beyond dwelling construction) is taking place and responding to lower rates and the weaker AUD. Gross value added in services industries such as ITC, finance & insurance and hospitality was solid in Q2. Net tourism exports continue to expand and business conditions and capacity utilisation are trending up, despite the understandable dip in confidence amidst global volatility.
- The unemployment rate is forecast to stabilise in coming months, and then drift slightly downwards to around 5¾% by end-2016. Slower population growth suggests a slightly lower rate of job creation will be necessary to keep up with population growth. Looking at the near term, forward-looking measures of the labour market are mixed, with the NAB survey employment index subdued, but measures of job advertisements and capacity utilisation painting a more positive picture. (Note the official labour market data for August will contain revisions due to population re-benchmarking, although this should be broadly neutral for historical labour market prints). The shifting composition of growth at an industry level appears to be supporting the Australian labour market, with growth more concentrated in labour-intensive sectors. Indeed the NAB employment index is strongest in services sectors such as finance, business & property services and recreation & personal services. Nevertheless, ongoing spare capacity in the labour market is evidenced by the slowdown in wages growth. Average compensation per employee grew just 0.2% in the June quarter and 0.5% over the year.
- The outlook for consumer spending and non-mining investment are the biggest swing variables. While household consumption growth is expected to remain below trend, it continues to rely on a further modest decline in the household savings ratio which is vulnerable at present to weak consumer confidence. Meanwhile, recent readings of expected non-mining capital expenditure remain weak, although we do expect some gradual improvement over time if the improvement in business conditions is sustained. In contrast residential markets remain strong, with dwelling prices continuing to grow more than 10% over the year to August. Surprisingly, dwelling investment surprisingly fell by 1.9% in Q2 despite strength in building approvals and a very elevated stock of residential projects in the construction pipeline. While this did follow growth of over 6% in each of the two preceding quarters, this weakness is likely only temporary given record levels of work to be done.
- Due to the lower base, our 2015/16 GDP forecast is now 2.4% while the 2016/17 forecast is unchanged at 3.1%. The unemployment rate eases to 6% through 2015/16 and to 5¾ in 2016/17. These forecasts are based on the AUD depreciating to USD68c by mid-2016. The risks to the economy, the RBA cash rate and the currency have tilted to the downside again as China slows and volatility on global markets remains elevated.

Macroeconomic, Industry & Markets Research

Australia

Alan Oster	Group Chief Economist	+ (61 3) 8634 2927
Jacqui Brand	Personal Assistant	+ (61 3) 8634 2181

Riki Polygenis	Head of Australian Economics & Commodities	+ (61 3) 8697 9534
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.