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The Bigger Picture – A Global & Australian Economic Perspective



National
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Bank

Global: Global growth remains sluggish and below trend and, unlike the IMF, our forecasts do not envisage much pick-up in the next couple of years. Emerging markets being impacted by falling commodity prices, the prospect of higher US interest rates, a build-up in debt and uncertainty over the pace of Chinese growth weigh on sentiment. By contrast, growth in the advanced economies picked up in mid-2015. We are still forecasting little to no pick up in the pace of global growth, which should remain just over 3% through the next couple of years, a disappointing sub-trend performance.

- Following a period of increased volatility, global equity markets have stabilised in the last few weeks but commodity markets remain weak. Uncertainty over the timing of Fed rate increases, the slowing in Chinese economic growth and their impacts on emerging market economies underpinned this volatile period and these concerns have not yet been resolved. Exchange rate markets have already seen big changes in key advanced economy currencies, but the previous trend appreciation in the \$US and depreciation in the yen appear to have halted (for now). We expect the Fed to start lifting its policy rate in December and continue the monetary tightening with further rate rises next year. The BoE and ECB appear unlikely to start lifting their interest rates until late 2016 and mid-2017 respectively while the BoJ could again loosen monetary policy. Some emerging market central banks have cut their rates to boost growth, most recently the 50 bps cut by the Indian Reserve Bank. We expect to see two more rate cuts next year in India and a 25 bps cut in China by end-2015 but Brazil is likely to raise rates next year.
- Growth in global GDP, the broadest measures of output, has been disappointing and the latest data for industrial output and world trade still show weak growth. Industrial output growth is well below its long run trend, but while world trade has been even weaker recently, it picked up slightly in July. Business surveys give the most up to date measure of the pulse of economic activity and they are not signalling any imminent upturn. Industrial sector readings for business conditions in the big advanced economies have been trending down for the last year and there was little growth shown by the September surveys. Emerging market business surveys are also failing to register any solid acceleration in growth. The latest Indian business survey showed fading growth, South African surveys are trending down, Brazilian surveys show continued recession, the Caixin Chinese business surveys were weak and results were mixed for the official business survey. Commodity markets remain under pressure from the slowing in China's industrial growth.
- A recovery in US and UK quarterly growth from weak first quarter outcomes has lifted the pace of annualised GDP expansion in the G7 advanced economies. By contrast, growth outcomes in the Euro-zone and Japan were disappointing. The monthly business surveys show mixed conditions continuing across the big advanced economies through to September. US services growth is solid but the high \$US is hitting industry, UK growth looks to be slowing, Euro-zone growth is modest and Japan's economy still looks weak. The differential growth performance is only partly reflected in jobless rates with the stronger US and UK upturns leading to big falls in their unemployment rates and the weak Euro-zone outcome underpinning a continued double-digit jobless rate. Japan's jobless rate, however, has trended down despite its weak output record, highlighting demographic challenges of a declining and ageing population. Canada's jobless rate has also stayed higher than expected, given the strength of output growth.
- A slowdown in emerging market growth has offset the lift in the advanced economies. The headwinds facing emerging market growth (falling commodity prices, weak world trade) remain and new problems have appeared in the last couple of months (notably the bursting of the Chinese share market bubble). Although some of the latest monthly trade and industrial data shows a modest lift, the numbers are volatile. This slightly better tone in emerging market data seen through mid-2015 is far from uniformly evident across the biggest economies. Chinese trade and industrial output continued its trend decline, Indian industrial output has picked up but trade flows remain weak. Brazilian economic conditions remain weak with inflation running above target, falling commodity prices eroding national income and political tensions over the Government's accounts. Modest growth continues across East Asia (excluding China), but well below the region's long-run trend and with falling levels of industrial output and \$US exports.
- We are still forecasting little to no pick up in the pace of global growth. Global growth should remain just over 3% through the next couple of years, a disappointing sub-trend performance. The IMF has consistently been more optimistic and predicts a pick-up to 3.6% next year but it has also just revised its 2015 numbers down again as outcomes fall short of its expectations.

Australia: The ongoing high level of business conditions and trend improvement in key leading indicators supports our view of a gradual recovery in the non-mining economy – buoyed by low interest rates and the lower AUD. Our domestic forecasts are unchanged this month, with real GDP expected to expand by 2.4% in 2015/16 and 3.1% in 2016/17. The unemployment rate remains elevated for an extended period, but does ease to 6% by end 2015/16 and to 5¾ by end 2016/17, given the structural shift back towards more labour-intensive sectors. There remain clear downside risks from offshore, and weak commodity prices and falling mining investment will remain a drag. However, the case for further policy easing on purely domestic grounds is limited and we view market pricing for another 25bp cut over the coming 6 months as overly pessimistic.

- Overall, the NAB Business Survey suggests resilience in what appears to be a building non-mining sector recovery. This is particularly apparent in industries thought to be highly responsive to currency changes in the near-term, including personal and business services. Business conditions held up at above average levels, while the positive trend in capital utilisation augurs well for non-mining business investment and the labour market. There was also a partial recovery in business confidence as the Government's leadership uncertainties were resolved, while financial market volatility and emerging market concerns have moderated from the heights of the previous month – although market concerns remain elevated.
- The unemployment rate is forecast to stabilise in coming months, and then drift slightly downwards to around 5¾% by end-2016. This partly reflects the fact that slower population growth requires a slightly lower rate of job creation to stabilise the unemployment rate. Looking at the near term, forward-looking measures of the labour market have become more consistently positive, although there is a notable divergence between mining and non-mining states. Measures of job advertisements and capacity utilisation having been rising for some time, while the monthly NAB Business Survey employment index also turned positive in September, the first time since late 2014. 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. Nevertheless, ongoing spare capacity in the labour market is evidenced by the slowdown in wages growth.
- A general improvement in the trading environment for retailers, including the lower AUD and strength in the housing market in some states, is helping to sustain national retail spending at a resilient level. ABS data on retail turnover showed growth somewhat rebounded in August, with retail spending growth (in trend terms) strongest in the largest non-mining states of NSW and Victoria – moderate in WA and NT, and neutral in Qld and SA. Relatively strong housing activity in NSW and Vic has led to a surge in the spending on household goods nationally, which is evident in the superior performance by the household goods retail category relative to other categories since late 2014. The August NAB Online Retail Index also partly reversed its 1.4% fall in July, to be up 0.6% m/m in the month. Amidst subdued household income growth, we expect a modest pick-up in consumer spending growth through to 2017, driven by a gradual decline in the household savings rate. Subdued consumer sentiment could be a risk near-term. In contrast, business conditions of retailers as indicated by the monthly NAB Business Survey remain above their long-run average, although retail confidence has moderated in recent months. A lower AUD should also re-direct spending onshore.
- The outlook for non-mining business investment is a key uncertainty. While the resilience in employment can be explained by the tilt towards labour-intensive industries, these industries are also less capital-intensive. Moreover, firms continue to demand high hurdle rates on investment, despite much lower borrowing rates. Dwelling investment meanwhile is already at a high level, and will add less to economic growth in 2016/17 than in 2015/16. Nevertheless, residential markets remain strong, with dwelling prices continuing to grow more than 10% over the year to September. Investor housing credit growth has dropped below the regulators 10%, although this partly reflects a reclassification of loans by banks.
- Aside from the well-known headwinds to commodity exports and markets, there are signs that the lower AUD is supporting exports, particularly in services – tourism exports are improving in net terms and we expect this process to continue going forward.
- Our domestic forecasts are unchanged this month, with real GDP expected to expand by 2.4% in 2015/16 and 3.1% in 2016/17. 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. There remain clear downside risks from offshore, and weak commodity prices and falling mining investment will remain a drag. Nevertheless, a more resilient non-mining economy suggests the RBA can afford to keep rates on hold to monitor how these risks play out.

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