December 2015

The Bigger Picture – A Global & Australian Economic Perspective

National Australia Bank

<u>Global</u>: Although some of the risks hanging over global markets have abated, recent global economic growth and the outlook remains lacklustre. Global growth remains stuck around the 3¼% seen since mid-2012 as lower commodity prices, capital flow reversals and central banks focused on getting inflation back toward target take a toll on the pace of expansion in the big emerging market economies that have underpinned most global growth.

- Divergent economic conditions across the big advanced economies are reflected in their monetary policies. Despite having inflation below target, the Fed is preparing to lift its policy interest rate after keeping them close to their floor for 7 years. This tightening reflects confidence that less drag from energy and import prices plus further improvement in the job market will bring inflation back to 2%. Fed leaders also want to avoid the need for a more abrupt and disruptive series of rate rises later on. However, rate hikes are expected to be gradual (we expect three more 25 bps hikes). Euro-zone inflation is also below target and the European Central Bank (ECB) has announced another round of policy easing. The ECB has again cut its inflation projections, with it not hitting the target until 2017. The Bank of Japan also faces inflation well below target but has not announced another round of policy easing as it still seems convinced that it has done enough for now, a view which looks doubtful.
- Growth in global GDP, the broadest measures of output, has disappointed by staying around 3¼% yoy since mid-2014 rather than picking up. The latest data for industrial output and trade still shows only modest growth. The weakest trade outcomes have been recorded in the emerging market economies where export volumes have been flat to down in year on year terms – normally only seen in a global recession. This weakness in emerging economy exports is mirrored in their imports, while demand for foreign goods has been far better maintained in the advanced economies. East Asian exporters have fared the worst through this soft patch for global trade as they have suffered sizeable falls in their export volumes. Latin American exporters, by contrast, have lifted their trade volumes – reflecting a ramping up of commodity export tonnages at a time of falling prices, similar to what has been seen in Australia. A downturn in intra-Asian regional trade, largely centred on China, has driven weakness across East Asia with falling export volumes across in China and the rest of the region and falling Chinese import volumes. While commodity producers have been lifting their export volumes as new capacity comes on stream, weak commodity prices have eroded their earnings with large falls in the $US value of exports across Southern Hemisphere producers.
- Quarterly growth in the big advanced economies has remained volatile but a moderate trend upturn has continued. Quarterly growth slowed in the US and UK but picked up in Canada. Euro-zone growth stayed lacklustre and Japanese output shrank for the second consecutive quarter. The marked disparity between the pace of the upturn in North America and the UK, on one hand, and Japan and the Euro-zone, on the other, has continued. The monthly purchasing manager surveys give the most up to date measure of the pulse of activity across the big 7 advanced economies and it showed modest growth in manufacturing continuing into November. The strength of the US$ is hitting US industry increasingly hard with the surveys showing a clear loss of momentum since late 2014. The business survey readings for November across Western Europe and Japan are consistent with moderate growth in industrial output. Business survey results for services have shown faster growth than for manufacturing, especially in the US and UK. Nevertheless, US and UK services growth dipped in November while growth in the Euro-zone and Japan has been picking up. Overall, combining the manufacturing and services surveys shows continued moderate growth in late 2015.
- Growth in the main emerging economies continued to slow into the second half of the year. The monthly data on trade volume and industrial output trends show a few signs of less weakness in output, exports and imports in some regions in the September quarter but it is too early to get overly optimistic. The slowdown in emerging market economy growth is broad based, with India the only big emerging economy to buck the trend. The monthly partial data on foreign trade, output and domestic spending confirms that the September quarter has seen a continuation of trends evident throughout the year. Industrial output, fixed investment and export deliveries of industrial goods have all continued to either drop or show slowing growth in China while retail trade has held up, in accordance with the government's aim to re-balance the economy. After disappointing for much of the last few years, output in the Indian industrial and infrastructure sectors seemed to be trending higher since mid-year but the November PMI survey was disappointing and trade flows still look weak. Elsewhere, the trade-driven economies of East Asia and the commodity economies of South America remain weak.
- While we have slightly lowered our growth forecasts for Japan, Brazil and a few East Asian economies to take account of worse than expected September quarter outcomes, the changes are not big enough to alter our global forecasts; 3% in 2015 (well below trend), 3.2% in 2016, and 3.3% in 2017.

<u>Australia</u>: In Australia, Q3 GDP figures were consistent with our view that the recovery across the non-mining recovery is broadening, and recent business survey results suggest this momentum continued into Q4. Despite this, downgraded commodity price forecasts have prompted a lowering of our real GDP growth forecasts to 2.7% in 2016 and 3.0% in 2017 (previously 2.9% and 3.2% respectively). Our unemployment rate forecasts are only a fraction higher however - as the composition of growth tilts towards more labour-intensive sectors. The RBA wants to keep monetary policy 'stable', so is unlikely to ease further absent a global shock, a surprise deterioration in the non-mining economy or a sharp re-appreciation of the AUD.

- Consistently above average business conditions in the NAB Monthly Business Survey are an encouraging sign that the apparent non-mining sector recovery continues to gain traction, despite relatively muted confidence levels. Although better business conditions have not been felt uniformly across the economy, underperforming industries (outside of mining) have gradually been gaining ground in recent months – providing further evidence of a more entrenched non-mining recovery.
- Real GDP was strong in Q3 at 0.9% q/q, although this followed a weak 0.3% q/q increase in Q2. Looking through the quarterly oscillations, underlying momentum has been broadly unchanged – not a bad achievement given significant structural change as the economy adjusts to a sharply lower terms of trade, national income and mining investment trajectory. The industry detail in particular was consistent with a gradual cyclical recovery across the non-mining economy. Services industries servicing both households and business are faring well, while retail and hospitality are benefiting from a slightly less cautious consumer and net tourism inflows. This tilting composition of growth towards more labour-intensive areas will support the labour market.
- The latest October ABS labour force data was an upside surprise, resulting in a notable fall in unemployment rate (5.9% compared to 6.2% last month). While there is known volatility in the monthly data, the trend improvement is also supported by a suite of forward-looking measures, such as job ads and indicators the NAB Business Survey. Given our expectation for more labour intensive growth, we are forecasting further improvement in the unemployment rate going forward. However, the downward revisions to our GDP outlook have prompted us to revise our unemployment rate forecasts a touch lower - easing gradually to 5.8% by end-16 and 5.7% by end-17
- Household consumption growth was a little stronger in Q3, despite weak household incomes. It appears that strong employment growth is encouraging spending, while the household savings rate fell – consistent with improvements in some consumer confidence measures. While we suspect services consumption is holding up, there are signs that the strength in household goods expenditure is losing steam, possibly reflecting recent cooling of the housing market. That said, more recent data on retail spending continues to be relatively resilient, underpinned by improving trading conditions while a lower AUD has encouraged tourism spending. Meanwhile, NAB's Online Retail Sales Index showed a 0.6% contraction in October. 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.
- The Melbourne and Sydney housing markets appear to have cooled, with both prices and auction clearance rates easing. Other capital cities continue to experience only modest increases in dwelling prices. Prices growth is expected to be much more subdued in 2016, reflecting the ongoing deterioration in affordability – although housing credit growth remained robust in October. Dwelling investment rose in Q3, but only modestly given Q2's decline and the elevated pipeline of projects in the works. Nevertheless, this pipeline will support residential construction activity in the near-term, but the contribution to GDP growth is expected to diminish through 2016 and 2017.
- Mining was again a significant drag on business investment in Q3, while the read on non-mining investment was somewhat mixed. Unsurprisingly, mining firm's expectations for capital spending in 2015/16 remained extremely weak in the Q3 ABS Capex Survey. While there remains some hope that non-mining investment will eventually fill some of the gap, subdued labour costs, excess capital capacity generated from the mining boom and the apparent outperformance of less capital intensive industries (in the services sector), could mean non-mining capex remains subdued for a while yet.
- In the September quarter, net exports were the major driver of GDP growth, primarily due to higher resource volumes – although there are signs that the lower AUD is supporting other exports, particularly in services.
- Our real GDP forecasts have been revised to 2.7% in 2016 and 3.0% in 2017 (previously 2.9% and 3.2% respectively), reflecting a downward revision to the outlook for some key commodity prices. Our unemployment rate forecasts are only fractionally higher despite the downward revisions to GDP – easing gradually to 5.8% by end-16 and 5.7% by end-17. The RBA is expected to remain on hold for an extended period, with the first hike not expected until mid-17.

Alan Oster (Group Chief Economist), Ph: +(61 3) 8634 2927 or M: 0414 444 652
Alt: Tom Taylor (Head of International Economics), Riki Polygenis (Head of Aus. Economics)

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
Tapas Strickland	Economist – Markets	+(61 2) 9237 1980
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