THE FORWARD VIEW – GLOBAL

SEPTEMBER 2016

National Australia Bank

Global growth still not lifting off

- Sluggish global growth was the focus of the latest G20 meeting, particularly protectionist trade measures, rising support for "populist" anti-globalisation political parties and the difficulty in persuading voters to support reforms needed to lift productivity and growth.
- Despite signs of stabilisation in areas of the world where economic activity has been weak, there is little evidence of new growth engines appearing that could pull economic growth out of the doldrums. Consequently, we do not expect much improvement in global growth which should remain below trend.
- Sub-trend growth and below target inflation means that central banks are under little pressure to lift their policy interest rates off historically low levels. The Fed should continue its ultra-cautious tightening with a rate hike in December but in the UK, Japan and Euro-zone the odds are skewed more to monetary loosening than interest rate increases.
- While global growth has been disappointingly sluggish, output expansion has continued through numerous shocks – Brexit, 2015's Chinese currency and share market volatility and the early 2016 growth scare to name just three.

KEY GLOBAL FORECASTS (% change)

	IMF weights	2012	2013	2014	2015	2016	2017	2018
US	15.8	2.2	1.7	2.4	2.6	1.5	2.1	1.9
Euro-zone	11.9	-0.8	-0.3	1.1	1.9	1.6	1.5	1.6
Japan	4.3	1.7	1.4	-0.1	0.6	0.5	0.6	0.6
China	17.1	7.7	7.7	7.3	6.9	6.6	6.5	6.3
Emerging East Asia	8.0	4.8	4.2	4.2	3.8	3.6	3.6	3.5
NZ	0.2	2.4	2.4	3.7	2.5	3.2	3.0	1.9
Total	100.0	3.5	3.3	3.3	3.0	2.9	3.1	3.2

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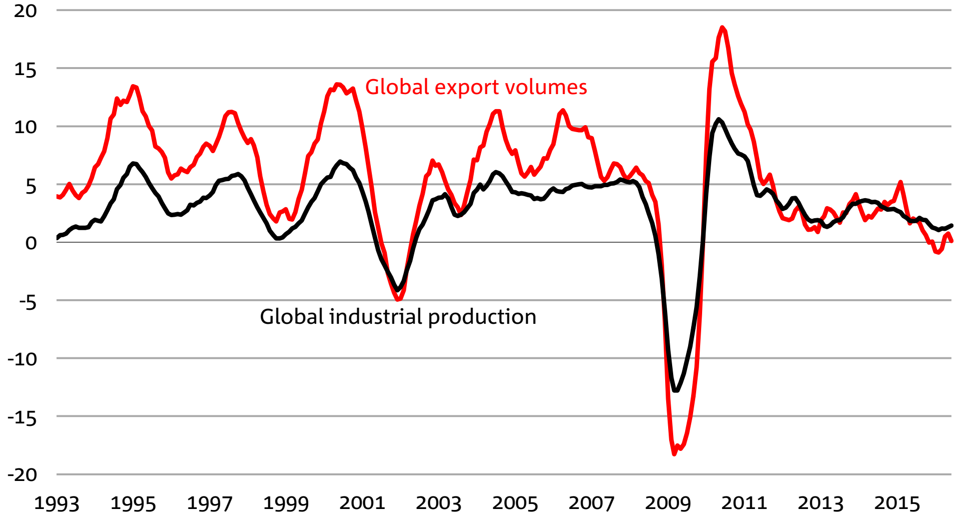
TRADE FADES AS ENGINE OF GLOBAL GROWTH

PM Turnbull highlights growing worries over trade protection at G20

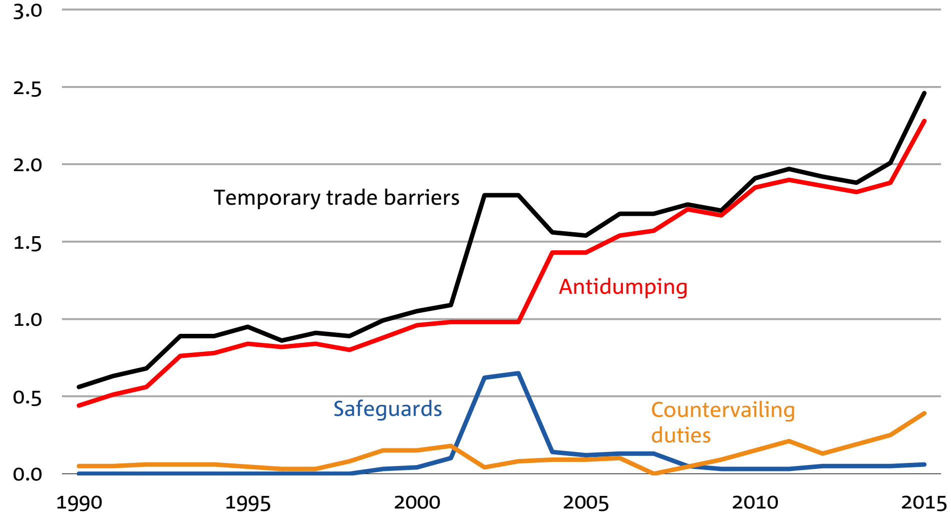
GLOBALISATION GOES INTO REVERSE AS TRADE STALLS

CPB global industrial production and export volumes (% yoy)



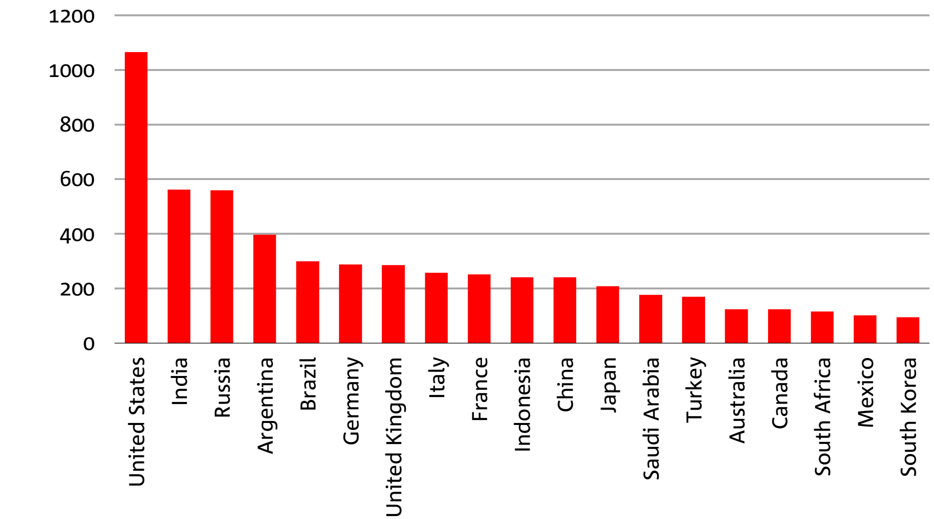
TRADE BARRIERS IN G20 ECONOMIES RISING SINCE 2012

% of imported products under trade barrier in effect



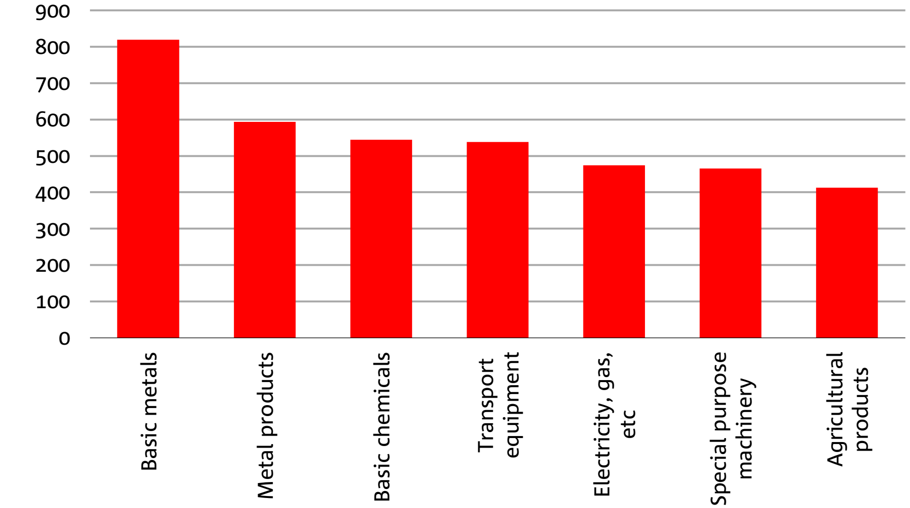
US, INDIA & RUSSIA THE MAIN OFFENDERS

Number of protectionist trade measures implemented since November 2008



BASIC METALS (STEEL) MOST AFFECTED

Number of protectionist trade measures implemented since November 2008



Sources: CPB, Datastream, World Bank, IMF, CEPR, NAB Economics

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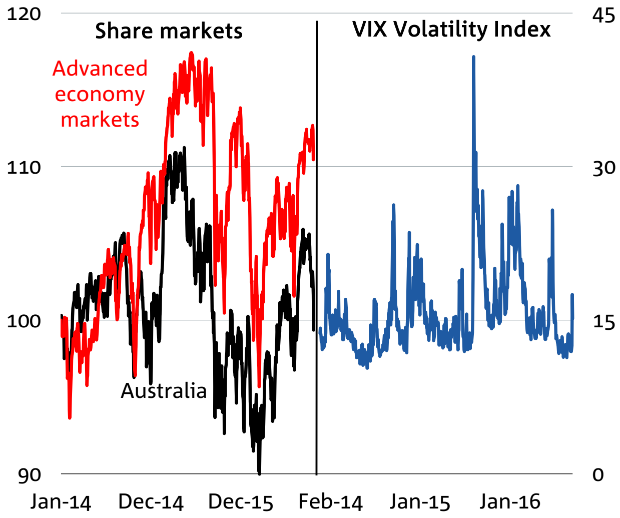
FINANCIAL AND COMMODITY MARKETS

Central Banks ponder their policy options

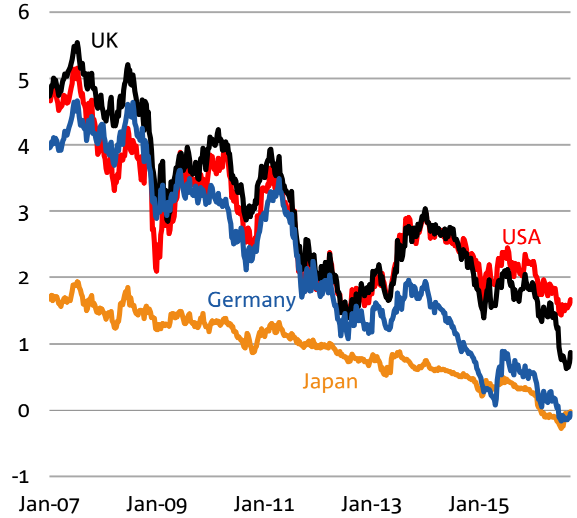
MARKETS FOCUS ON CENTRAL BANKS

Share markets and volatility indices



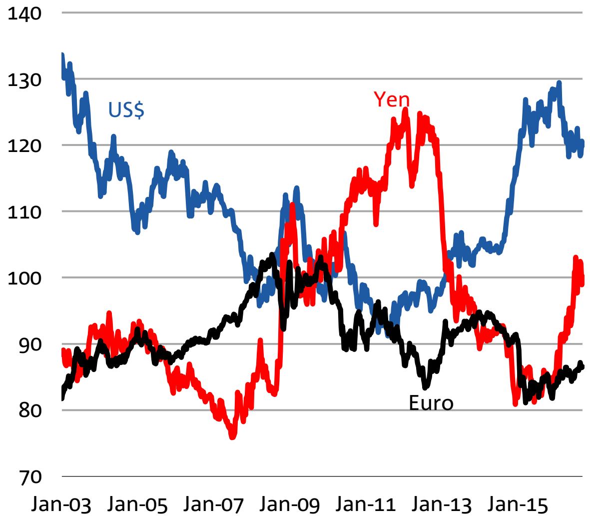
BOND YIELDS TRACKING LOWER

10 year government bond yields (%)



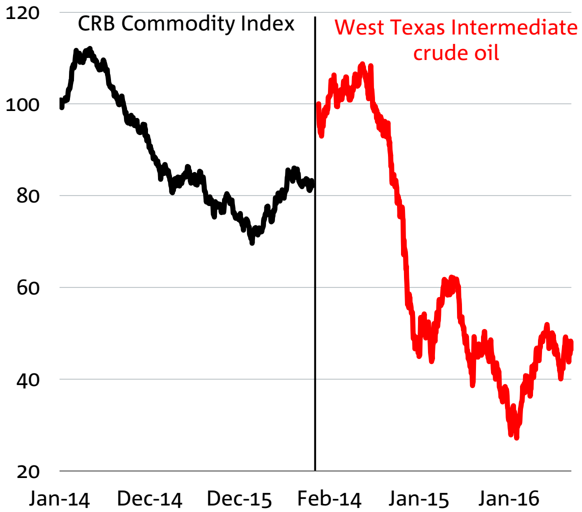
YEN SURGE UNWELCOME TO BOJ

Trade weighted exchange rate indices (Jan-10 = 100)



COMMODITIES OFF EARLIER PEAKS

Commodity price indices (1 Jan 2014 = 100)



Sources: Datastream, NAB Economics

- Global financial markets recovered well from the shock of Brexit but the prospects that the US Fed could lift interest rates and other central banks could be running out of ammunition has prompted another round of volatility. Given that any Fed rate hike reflects its confidence in the US economy and that central banks in Europe and Japan still have ways to ease their monetary policy, the latest market concerns appear overdone. Abundant central bank liquidity has supported financial markets but the Fed is likely to be very cautious in winding back its monetary stimulus.

- Although some bond yields have risen slightly recently, government bond yields remain very low by historical standards – 10 year government bonds in Japan and Germany have recently had negative yields, UK bond yields have been at record lows and some corporate bond yields have turned negative. This unprecedented situation reflects sub-target inflation and sub-trend economic growth, keeping short term central bank policy rates anchored at historically low levels (negative in some places). With investors looking for safe assets to place their funds, government bonds have seemed one of the safest bets on offer.

- With the exception of the US Fed – who we expect to lift rates in December and follow up with two more hikes next year – central banks seem in no hurry to increase their policy rates. Indeed, the Bank of England adopted a raft of monetary easing measures in August after the Brexit vote and more easing could still be to come, the European Central Bank is still assessing if its March package of rate cuts and stepped-up asset buying will finally get growth and inflation higher and the Bank of Japan looks more likely to continue easing its already ultra-easy monetary policy than lift rates or cut its asset buying.

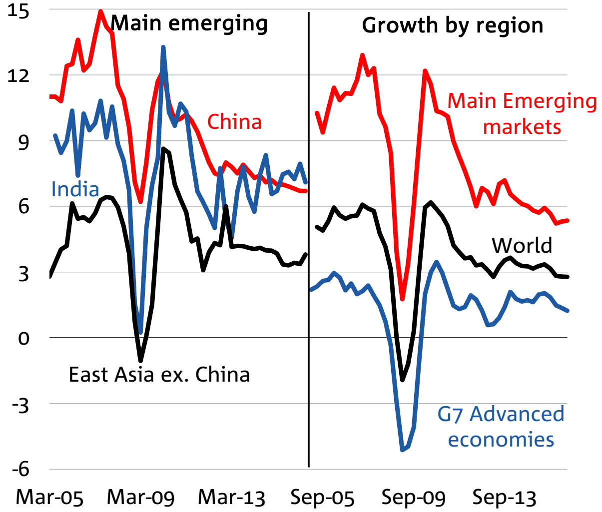
- Despite its move to negative policy rates and more asset buying, currency movements have not favoured the Bank of Japan with the Yen rising until recently – the exact opposite of what policy makers hoped for. Attention is focussing on what else policy makers in countries like Japan and the Euro-zone can do to lift demand – print money and giving it to the government to spend is one radical option. Central bankers worry what ammunition they still have if there was another economic downturn as rates are already so low and balance sheets inflated. We still think there is scope for central banks to ease further.

GLOBAL ECONOMIC TRENDS

Still no definitive sign of long awaited acceleration in growth

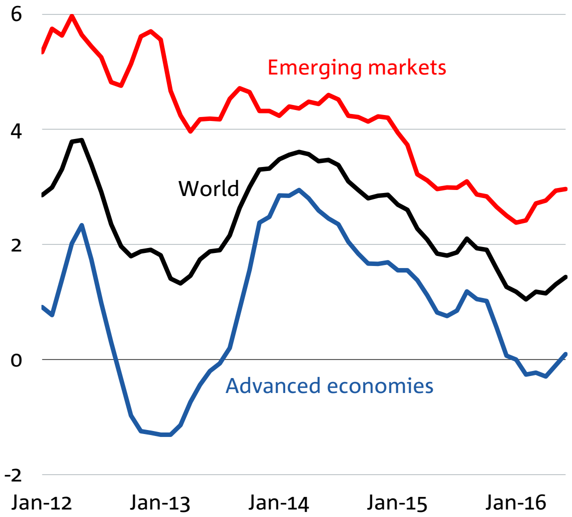
GLOBAL GROWTH STILL SUBDUED

Economic growth (% yoy)



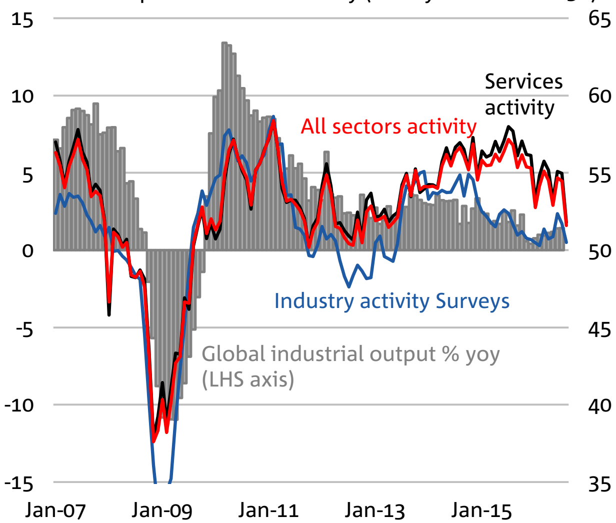
OUTPUT HAD BEEN EDGING UP

Global changes in industrial output (% yoy (3mma))



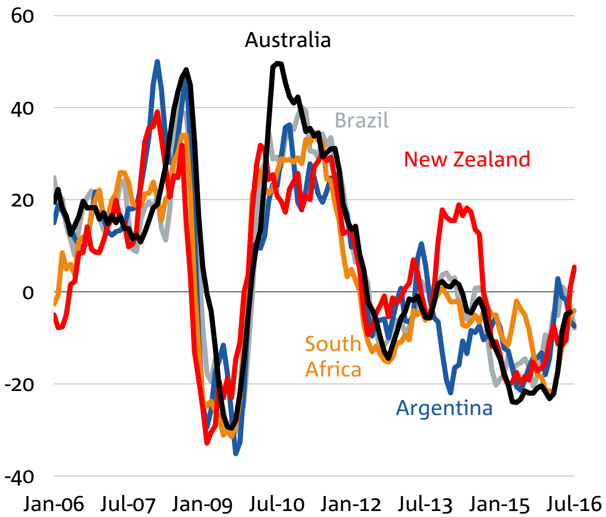
BUT LATEST SURVEYS MUCH WEAKER

Industrial output & business activity (survey breakeven = 50)



COMMODITY EARNINGS STABILISING

Commodity exporter earnings (US$ terms, % change yoy)



- Global growth remains sub-trend with no sign of an upturn yet. Global growth settled around 2¾% yoy at the end of 2015 and has remained at that rate through the first half of 2016. Emerging economy growth has stabilised at around 5¼% yoy but expansion in the big advanced economies has disappointed, slowing from almost 2% yoy in mid-2015 to only 1.2% yoy in mid-2016.

- Monthly data is sending mixed signals on global economic conditions. Global industrial output rose by 0.4% in the second quarter, faster than the 0.2% in the first quarter. The annual rate of growth has risen from around 1% yoy at the turn of the year to around 1¾% in June, driven by an acceleration in the emerging market economies and less negative trends in the advanced economies. World trade remains weak with export volumes down by 0.7% in the June quarter, about the same as in March.

- Industrial output trends are available for some key economies to July. Aggregating this data confirms that there has been a modest acceleration in the pace of output growth to what is still a pretty lacklustre pace by historical standards – factory output was growing by 1.3% yoy in the 3 months ended July, well below its long-run trend. Business survey data is available to August and it shows the pace of industrial growth in the big advanced economies, which had picked up modestly through the first half of the year, has subsided to quite modest levels.

- The pace of growth in services has been running well ahead of that in manufacturing – and services are by far the bigger sector. This picture has recently been clouded by a surprisingly weak survey reading for US services in August. Taken overall it is too early to say that the data points to an acceleration in growth, negative data surprises offsetting what had looked like more positive trends.

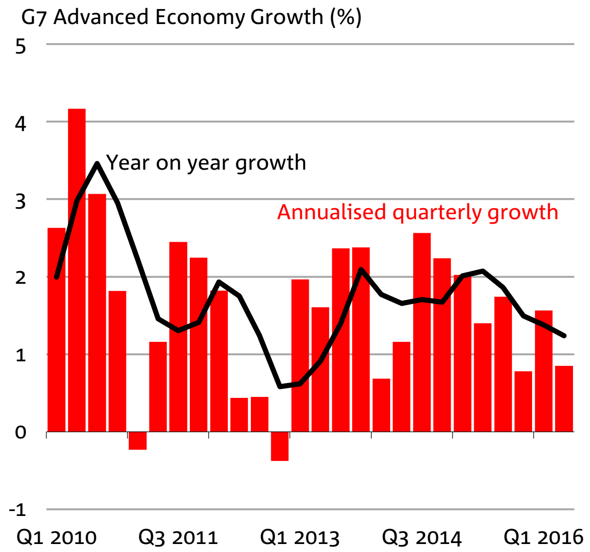
- Commodity producer export revenues are looking less weak and recent GDP outcomes in Australia, New Zealand and South Africa show solid economic growth.

Sources: Datastream, NAB Economics

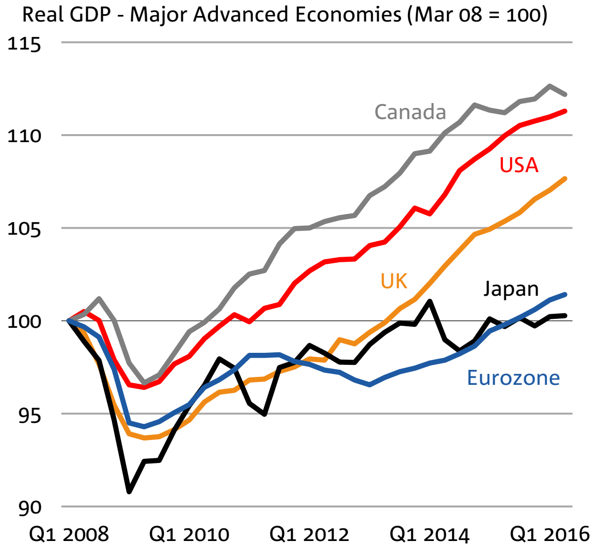
ADVANCED ECONOMIES

Sluggish growth continues

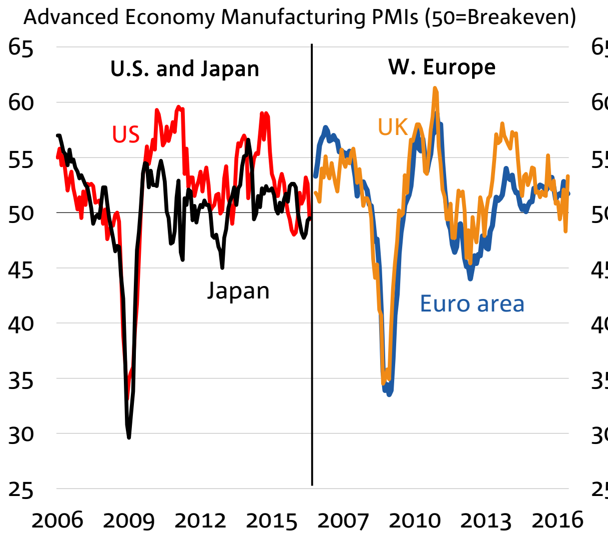
G7 GROWTH SLOWS



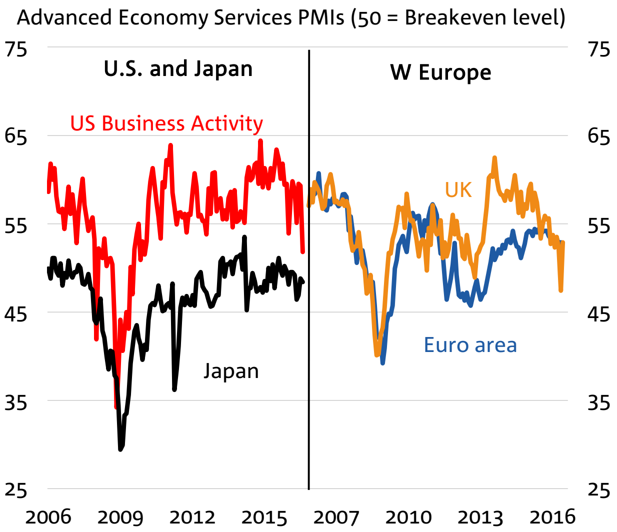
UPTURN PERFORMANCE MIXED



INDUSTRIAL SECTOR STAGNATES



MODERATE SERVICES GROWTH



- Despite stimulus from historically low interest rates, central bank asset buying and the fading headwinds from fiscal austerity, growth remains disappointing in the big advanced economies. Annualised growth in the G7 advanced economies halved to only 0.8% in the June quarter, down from March quarter's 1.6%. By mid-2016 the volume of output in the G7 economies was only 1.2% higher than in mid-2015, well below trend growth.

- US growth has been particularly soft. Annualised US growth averaged around 1% between December quarter 2015 and June quarter 2016, well short of the 2% plus annualised rate seen in the first three quarters of 2015. Japan's economy slowed in the June quarter after a solid first quarter outcome. Euro-zone growth also disappointed in the second quarter of 2016, slipping to a quarterly rate of only 0.3% as opposed to the 0.5% seen in the first quarter. Canadian growth slid from 0.6% in March to only 0.1% in June, after taking account of the impact of bush fires on energy output.

- Brexit is expected to hit UK growth, with investment spending likely to fade as firms plan what to do in the new trade and regulatory environment. Unlike several other big advanced economies, UK quarterly growth actually accelerated between the first and second quarters of 2016 – from 0.4% to 0.6% – but a marked slowing is predicted for the second half of the year. The NIESR's monthly GDP estimates show growth slowing sharply in the 3 months to July with a 50/50 chance of a UK recession by the end of the year. We no longer expect a UK recession in H2 2016.

- Monthly business surveys provide the most up to date reading of growth in the advanced economies – and there were a few surprises in the August results. After experiencing their expected post-Brexit decline in July, the UK surveys rebounded in August – suggesting that the referendum result may not have as bad an impact on the short-term UK outlook as feared. Accordingly, we have revised UK 2016 growth up slightly. The weakness in the US services sector was also surprising, but US manufacturing has been weak for some time.

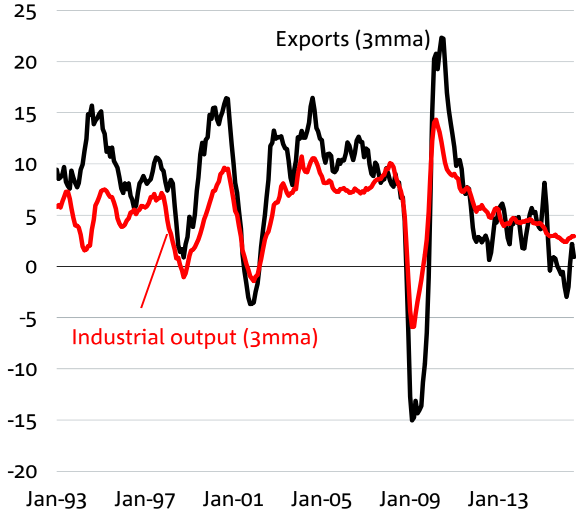
Sources: Datastream, NAB Economics

EMERGING MARKET ECONOMIES

A few brighter signs but still early days

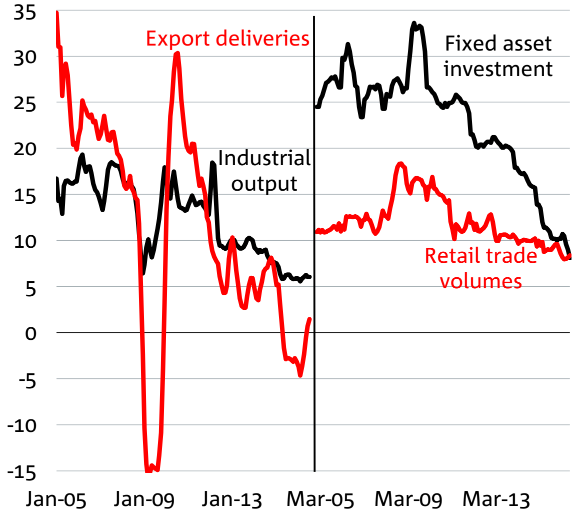
EXPORTS UNUSUALLY WEAK

Emerging market exports and industrial output (% yoy)



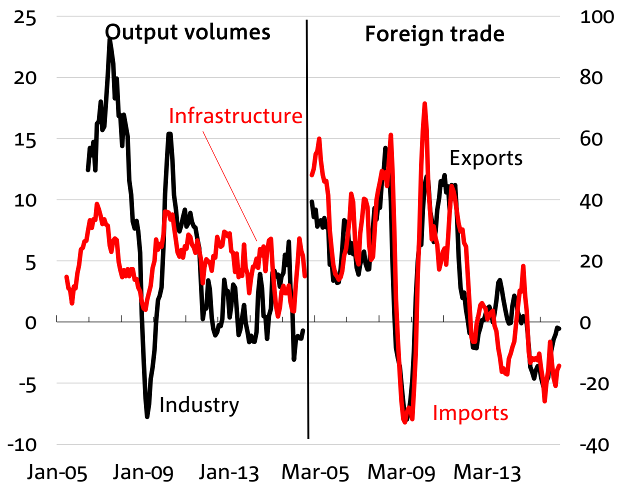
SOFTER CHINA INDICATORS

Chinese monthly economic indicators (% yoy (3mma))



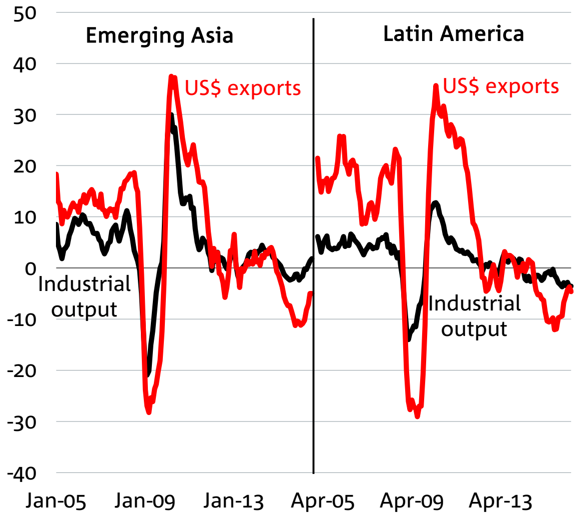
INDIAN GROWTH SOLID; TRADE WEAK

Indian monthly economic indicators (% yoy)



TRADE FOCUSED REGIONS WEAK

Industrial production and exports (% yoy (3mma))



- Emerging market growth remains stalled at around 5¼% yoy with most of the expansion driven by China and India (now the biggest and third biggest economies in the world). The economic health of these economies is vital for Australia – they account for well over half of the global economy and buy around two-thirds of our exports.

- Quarterly growth in emerging market industrial output picked up from 0.3% in March to 1% in June, mainly due to an acceleration in Asian growth. Excluding China, industrial growth has returned across the emerging market economies of East Asia – big markets for Australian exports – with export-driven economies like South Korea and Malaysia showing modest upturns. Elsewhere, Latin America remained weak where Brazil (the 7th largest economy in the world) is still in a deep recession.

- Emerging market economy exports have been unusually weak in recent years but it does look as if the situation might have improved slightly. Export volumes fell below year-earlier levels through late 2015 and early 2016 but they have tended to stabilise since then with Asian economies the best performers. Emerging economy export earnings in $US terms were hit by the earlier appreciation of the $US and the decline in commodity prices but they seem to be stabilising.

- Commodity markets have been trending up since early 2016 with the IMF's aggregate (fuel and non-fuel) price index up by over 20% and non-fuel prices around 10% higher between January and August. More recently, however, both oil and aggregate non-fuel commodity prices have dipped slightly from their mid-August peaks.

- China's economy continues to grow at a solid pace with second quarter GDP up by 6.7% yoy, much the same as in the previous 6 months. Industrial growth has stabilised at around 6% yoy since mid-2015, August imports picked up, and export deliveries have turned positive yoy after a long weak period. Retail sales growth remains around 10% and fixed investment continues to slow but year to date growth is still over 8% yoy.

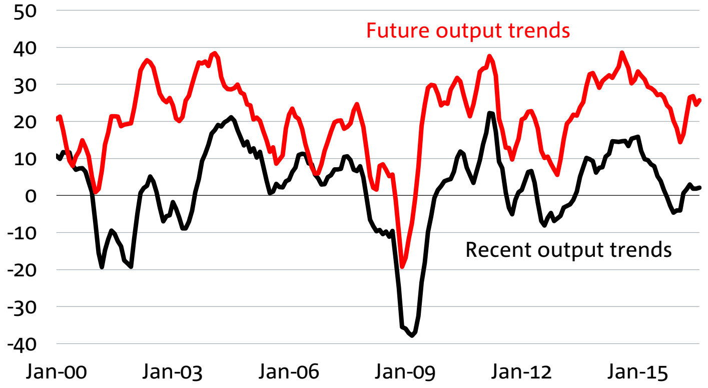
Sources: Datastream, CEIC, NAB Economics

GLOBAL FORECASTS AND POLICIES

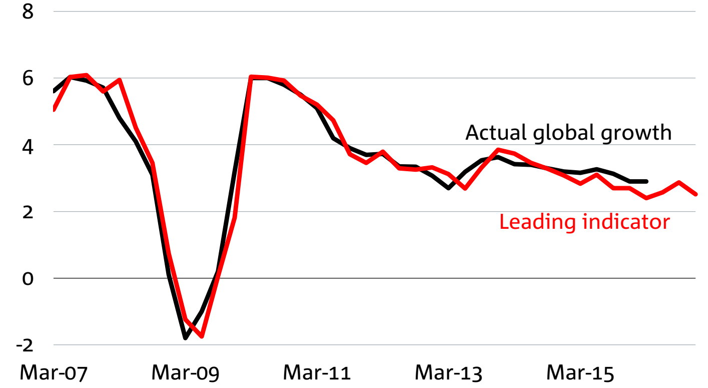
Sub-trend growth set to continue, no sign of problems easing

GLOBAL OUTLOOK REMAINS SUBDUED

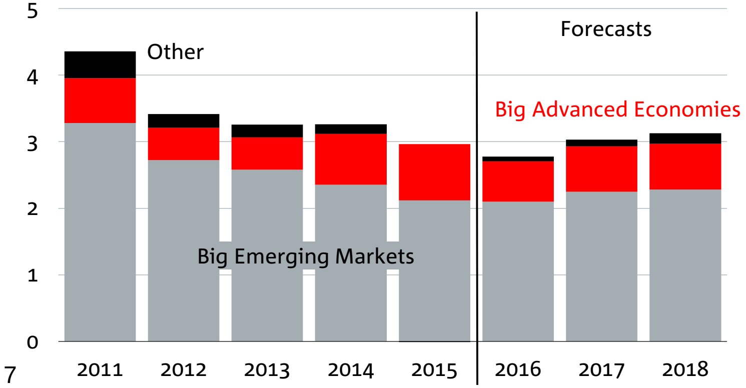
Business surveys (US, UK, Germany & France) (Index)



Actual global growth and leading indicator (% yoy)



Global economic growth (% points contribution)



- Our forecasts for global growth are little changed and we still expect to see sub-trend growth persist through the rest of the year and into 2017 and 2018. We do not expect to see the sort of marked lift in economic growth that bodies like the IMF and OECD have been hoping for in recent years. Neither the business surveys nor our tracking indicator point to any imminent change in growth momentum.

- While the bottom line is essentially unchanged, we have made a few offsetting revisions to the forecasts, notably cutting Indian growth projections and lifting those in the Euro-zone. August business survey readings pose some challenges to our numbers – the US services survey was weaker than we expected while the UK did better than post-Brexit concerns suggested was likely. As other indicators are not pointing to a marked slowing in the US, we will not revise our US growth numbers down yet and wait and see if the August survey reading was a once off. We have revised our UK forecasts up slightly and no longer see the economy falling into a recession in the second half of the year.

- With global growth remaining stuck in the doldrums and below target inflation, the environment for Australian business is still characterised by global interest rates that remain very low by historical standards, even if the US Fed does lift its policy rates. Sub-trend global growth also puts a low ceiling on the growth in commodity demand at a time when supplies are still plentiful. There have been some sizeable price increases for commodities like dairy, iron ore and coal but securing a broad-based sustained upturn probably needs the global economy to be growing faster than the 3% or so we predict.

GLOBAL GROWTH FORECASTS (% change)

	2011	2012	2013	2014	2015	2016	2017	2018
US	1.6	2.2	1.7	2.4	2.6	1.5	2.1	1.9
Euro-zone	1.6	-0.8	-0.3	1.1	1.9	1.6	1.5	1.6
Japan	-0.4	1.7	1.4	-0.1	0.6	0.5	0.6	0.6
UK	1.5	1.3	1.9	3.1	2.2	1.7	0.7	1.7
Canada	3.1	1.7	2.2	2.5	1.1	1.2	1.7	2.0
China	9.5	7.7	7.7	7.3	6.9	6.6	6.5	6.3
India	7.9	5.9	6.3	7.0	7.2	7.4	7.5	7.5
Latin America	4.5	2.3	2.5	0.4	-0.6	-0.9	0.9	1.7
Emerging East Asia	4.4	4.8	4.2	4.2	3.8	3.6	3.6	3.5
NZ	1.8	2.4	2.4	3.7	2.5	3.2	3.0	1.9
Total	4.4	3.5	3.3	3.3	3.0	2.9	3.1	3.2

Sources: Datastream, NAB Economics

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