THE FORWARD VIEW – GLOBAL

OCTOBER 2016

National Australia Bank

Sluggish global growth set to continue

- Global growth remains sluggish and sub-trend. Faster rates of output expansion would help overcome many of the problems besetting the world economy – debt overhangs, insufficient investment, tepid wage growth contributing to the undershooting of inflation targets, as well as a growing anti-globalisation populist backlash in big advanced economies.
- Despite signs of stabilisation in areas of the world where economic activity has been weak, there is little evidence of new growth engines that could pull economic growth out of the doldrums. Consequently, we do not expect much improvement in global growth, which should remain below trend. The emerging markets are the key drivers of global output expansion and there is growing concern that the advanced economies could be locked into a cycle of slow growth.
- Weak growth and below target inflation allows central banks to keep rates historically low and the focus in fiscal policy is shifting away from austerity to wind back big public debts and towards how public sector investment can be increased.
- While global growth has been disappointingly sluggish it has at least proved resilient, continuing 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	12.0	-0.8	-0.3	1.1	1.9	1.6	1.5	1.6
Japan	4.2	1.7	1.3	-0.1	0.6	0.5	0.6	0.6
China	17.3	7.7	7.7	7.3	6.9	6.6	6.5	6.3
Emerging East Asia	8.0	4.6	4.2	4.1	3.5	3.7	3.6	3.5
NZ	0.2	2.4	2.4	3.8	2.5	3.4	3.1	1.9
Total	100.0	3.5	3.3	3.3	3.0	2.9	3.2	3.2

CONTENTS

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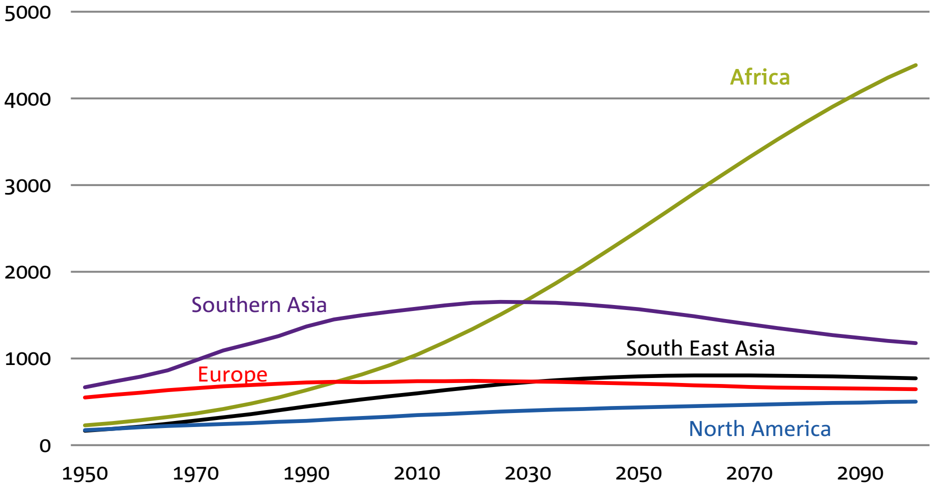
DEMOGRAPHICS TO RESTRAIN WORLD GROWTH

Population decline and ageing will increasingly drag down global growth

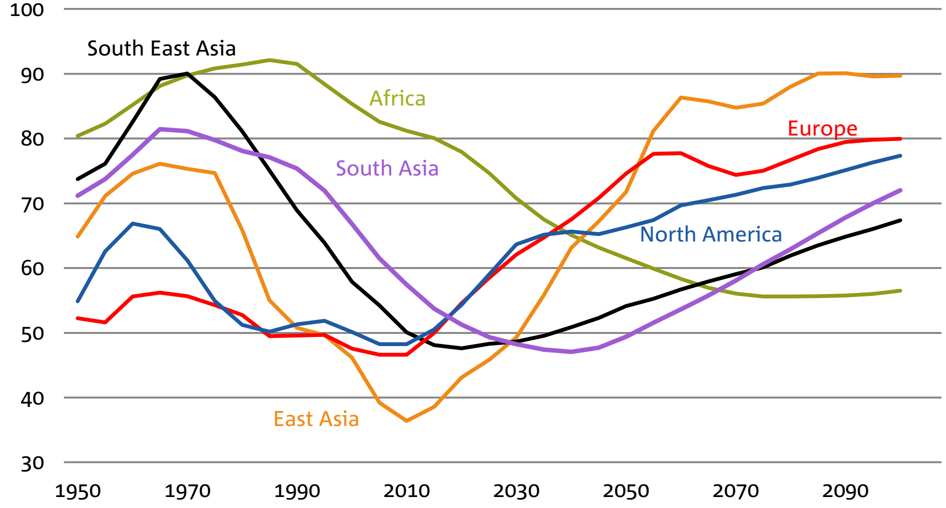
POPULATION GROWTH TO SLOW IN MANY REGIONS

Population by selected region (million)



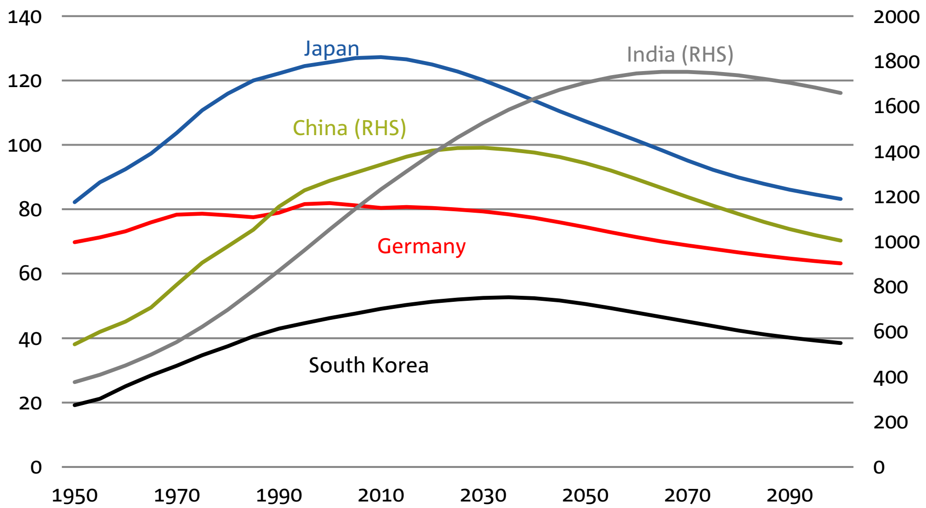
AGEING REFLECTED IN RISING DEPENDENCY RATIOS

Dependency ratio (popn <15 and >64 as % of 15-64 popn)



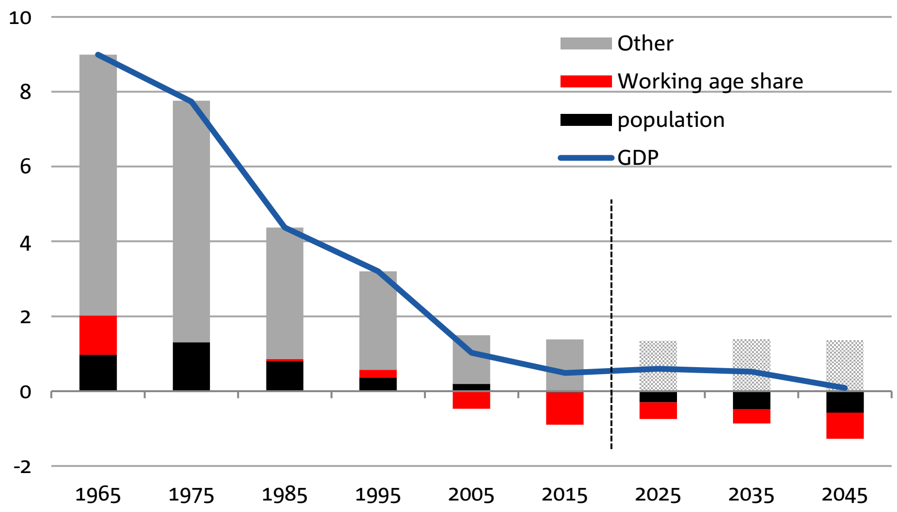
INCLUDING SEVERAL KEY AUSTRALIAN TRADING PARTNERS

Population by country (million)



JAPAN ALREADY SHOWS THE IMPACT ON ECONOMIC GROWTH

Contributions to annual %GDP growth ('other' from 2025 = average of 1996-2015 period)



Sources: United Nations (World Population Prospects, medium fertility variant), Datastream, NAB Economics

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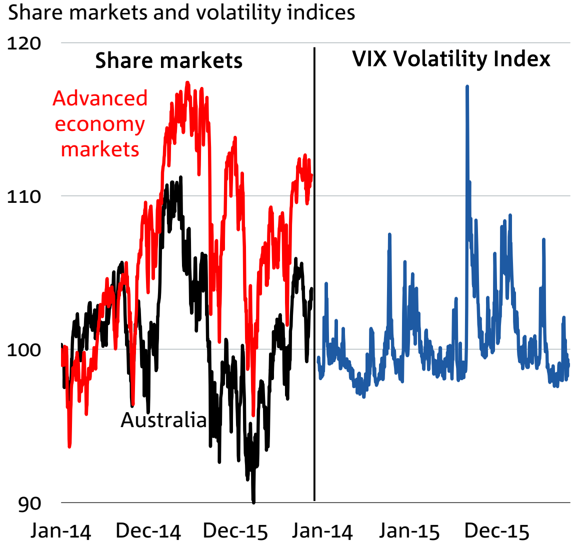
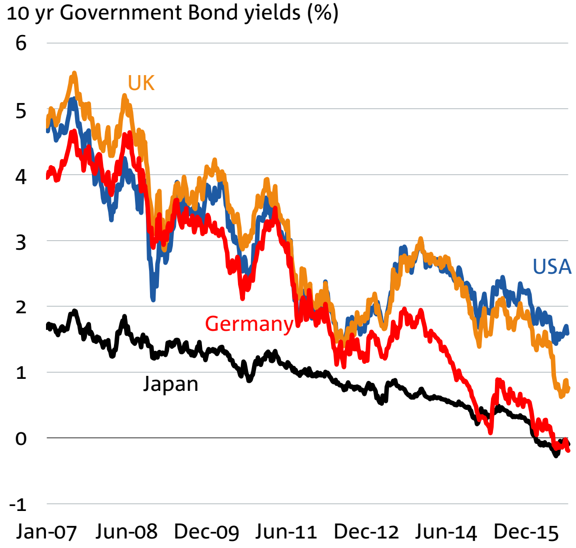
FINANCIAL AND COMMODITY MARKETS

Central banks ponder their policy options

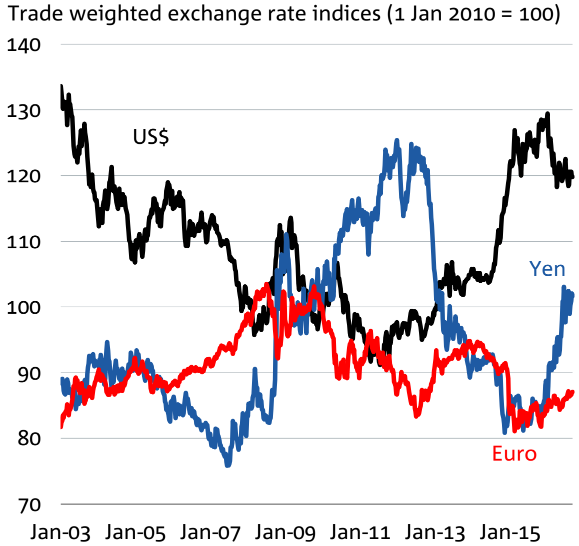
MARKETS FOCUS ON CENTRAL BANKS



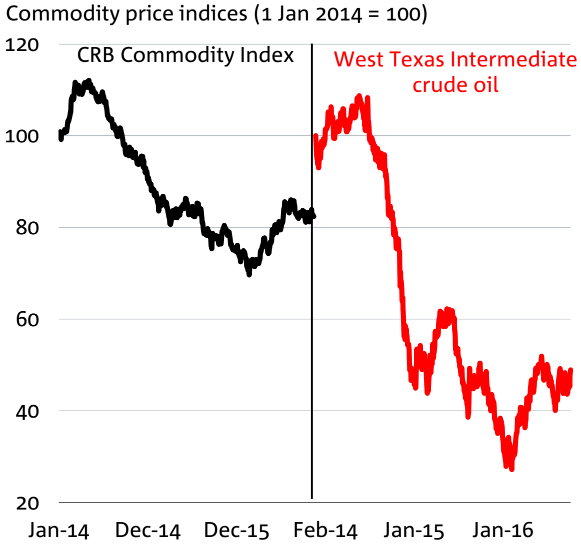
BOND YIELDS TRACKING LOWER



YEN SURGE UNWELCOME TO BOJ



COMMODITIES OFF EARLIER PEAKS



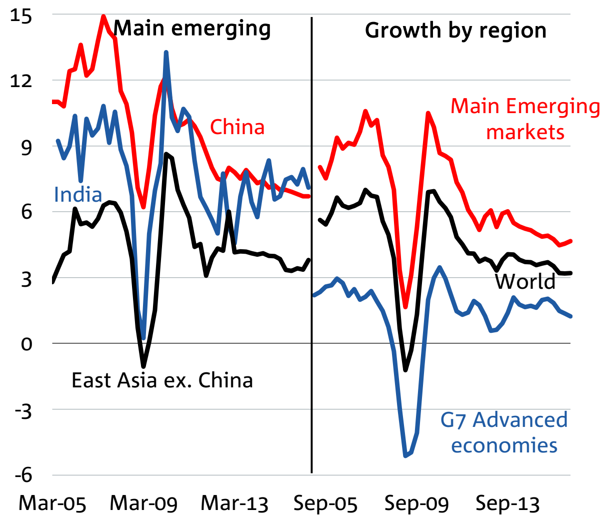
- Facing sub-target inflation and (at best) modest rates of economic growth, central banks in the big advanced economies have kept their policy interest rates at very low levels and been wary of moving to "normalise" them at higher levels. Central banks in Japan, the Euro-zone, Sweden, Denmark and Switzerland have even been running negative interest rates – in which commercial banks pay to deposit their reserve funds at the central bank rather than receiving interest to do so.
- Central banks in the UK, Japan and the Euro-zone are also undertaking massive asset buying operations to keep long term interest rates down and boost liquidity. These purchases have contributed to historically low long term bond yields, with investors paying borrowers (usually governments, but also some corporates) to hold their assets.
- While all central banks have been wary of lifting rates to more "normal" levels, there are important differences in the health of their economies. Among the big economies, the US economy has gone furthest toward achieving success in getting sustained economic growth and the unemployment rate down. While inflation is still well below the Fed's 2% target, it is expected to hit it over the medium term. Several Fed Governors want an immediate hike in interest rates, 3 voted for a rise at the September rate setting meeting and other non-voting officials want a small rate rise now to pre-empt problems down the track. We expect the Fed to lift rates by 25 bps in December, followed up by 2 more rises next year but for rates to stay very low by historical standards considering the reasonable state of the economy.
- Other advanced economy central banks seem nowhere near as ready as the Fed to consider lifting rates. In the wake of the UK's Brexit vote, the Bank of England eased policy and at its September meeting the central bank said that another small interest rate cut looked likely if the UK economy behaved as expected. In the event, the UK has fared better than initially feared and the markets seem unconvinced that another rate cut is coming but we still consider one likely. Both the European Central Bank and the Bank of Japan have big asset buying programmes. Recent media reports that the former could wind back its buying look premature and the latter has recently re-emphasised its plans to keep its policy aimed at getting inflation up to its target.

Sources: Datastream, NAB Economics

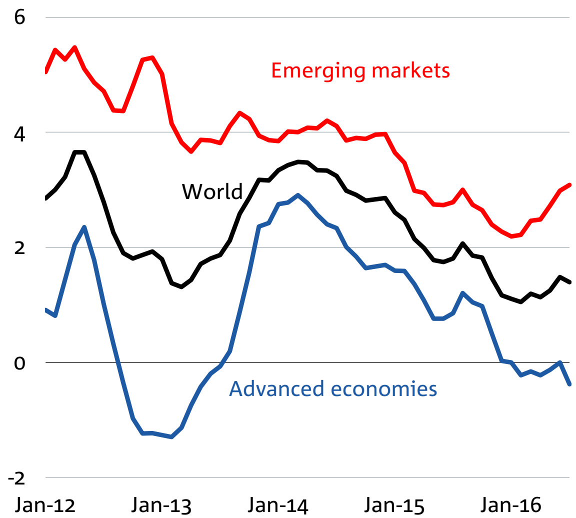
GLOBAL ECONOMIC TRENDS

Still no sign of acceleration in growth

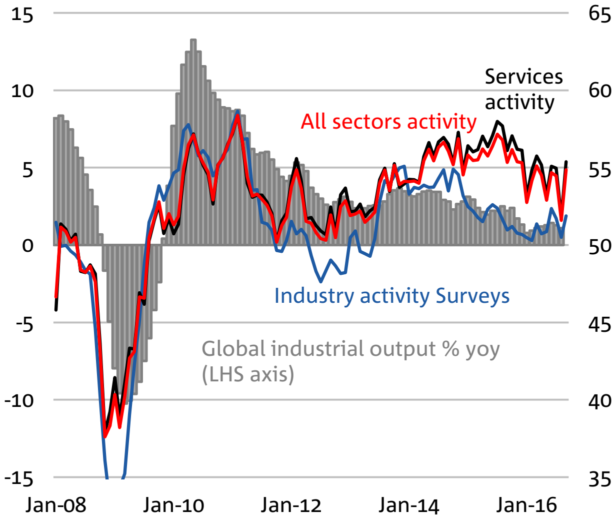
GLOBAL GROWTH STILL SUBDUED



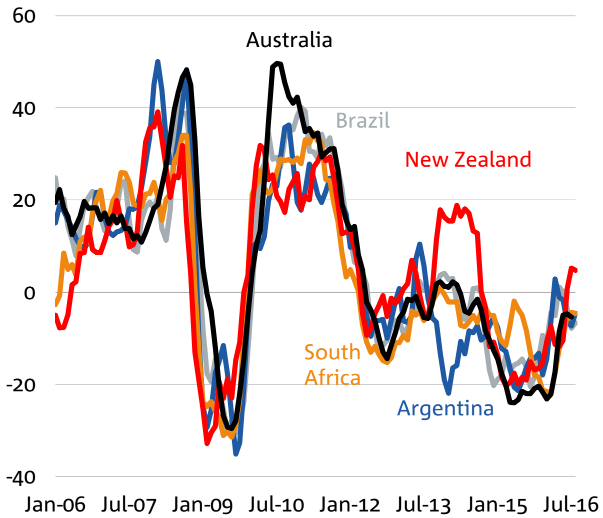
OUTPUT HAD BEEN EDGING UP



LATEST SURVEYS SHOW UPTICK



COMMODITY EARNINGS STABILISING



- Global economic growth remains soft with a sub-trend pace of expansion set to continue and few signs of an upturn. The pace of economic growth remained stuck at around 3¼% yoy between late 2015 and mid-2016. Advanced economy growth was running at less than 1½% yoy while emerging market economies have been growing by 4½% yoy. As the advanced and emerging market economies each account for around half of the world economy, their combined outcome is a global growth rate of about 3%.

- The CPB measure of global industrial output has been published to July and growth was still running between the 1% and 1½% yoy seen since late 2015. An upturn in emerging market economy industrial output has been offset by renewed weakness in the manufacturing sectors of the big advanced economies. We calculate a measure of industrial growth for a smaller array of countries that is available to August and it shows growth stuck around 1% yoy with falling output across many of the advanced economies. Finally, business survey readings are now available for September in the big advanced economies and they showed a modest uptick in activity from August's weak outcome but business sentiment has only got back to its July level which was not strong.

- While industrial output has been growing, albeit slowly, world trade continues to fare surprisingly poorly. Normally trade grows much faster than output, lifting the globalisation of economic activity. However, in recent years global trade growth has only been under 3%, less than the annual growth in GDP. The latest CPB measures of world trade shows flat trade in the first three months of 2016 and a fall of 0.8% in the June quarter and the weakness looks to have continued into the second half of the year. Lower commodity prices added an extra headwind to key Southern Hemisphere primary exporters but prices have been rising recently, reinjecting income back into those economies.

- While manufacturing growth has been sluggish, services drive most economic activity and growth here has been stronger. The US service sector, in particular, has kept growing strongly.

Sources: Datastream, NAB Economics

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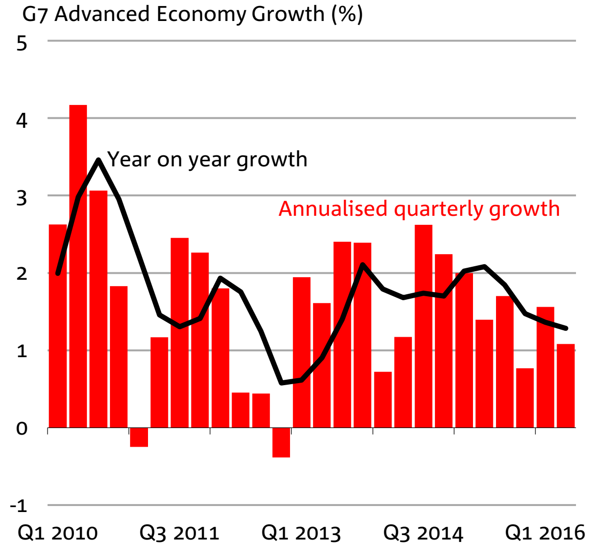
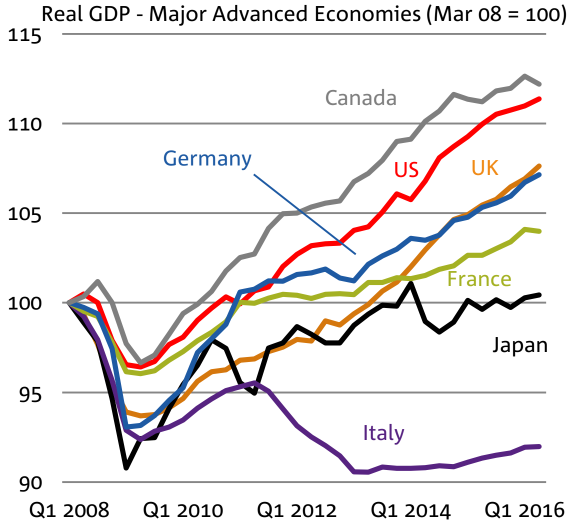
ADVANCED ECONOMIES

Persistently sluggish growth raises concern about economic stagnation

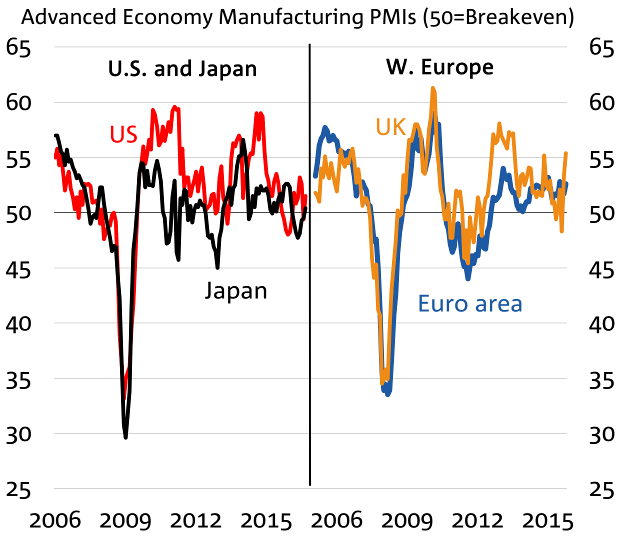
G7 GROWTH SLOWS



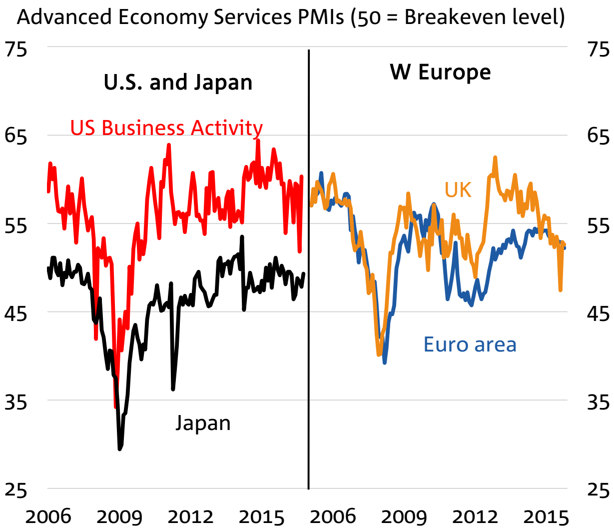
UPTURN PERFORMANCE MIXED



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 fell to only 1% in the June quarter, down from March quarter's 1.6%. By mid-2016 the volume of output in the G7 economies was only 1.3% higher than in mid-2015, well below trend growth.

- Conditions vary between the big economies with the US and Germany the stand-out performers while Japan and Italy have lagged. Canada and the UK, which had shown solid growth performances earlier in this upturn, have lagged. Canadian growth was hit by falling commodity prices, the winding back of investment in energy sector and production shutdowns caused by forest fires. UK growth was hit by uncertainty delaying business investment in the lead up to the Brexit vote and, while the business surveys show a much less adverse impact from the Brexit vote than initially feared, we still do not have a clear picture of what the impact will be on business investment.

- With the exception of a post Brexit bounce in the UK, possibly reflecting an influx of export orders as Sterling fell, the latest business surveys are not pointing to much growth in the manufacturing sector. However, things are considerably better in the services sector with a sizeable rebound in new orders for US service firms in September and consolidation of UK service sector activity at levels well above those experienced straight after the Brexit vote. Service sector expansion has been slowing in the Euro-zone and remains subdued in Japan.

- As soft economic growth continues, there is growing concern that a combination of unfavourable demographic trends, disappointing productivity growth and the impact of a prolonged period of sub-trend investment on the capital stock could have lowered the rate of growth that big advanced economies can sustain. Alongside this is the fear that economic policy has been too harsh and compressed demand, further hitting growth. The IMF is clearly now worried that "secular stagnation" is possible.

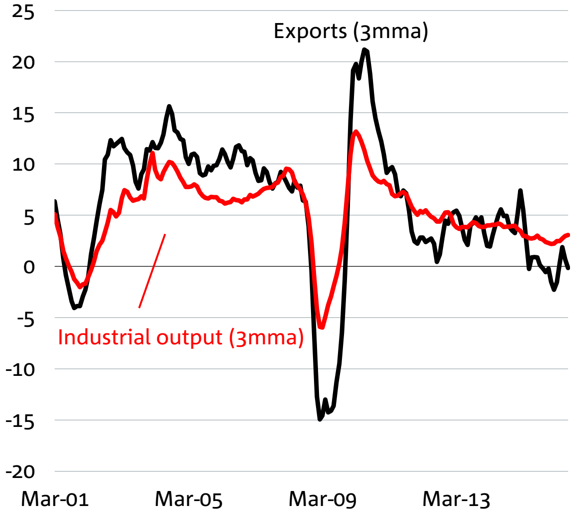
Sources: Datastream, NAB Economics

EMERGING MARKET ECONOMIES

A mixed picture but still the main drivers of global growth

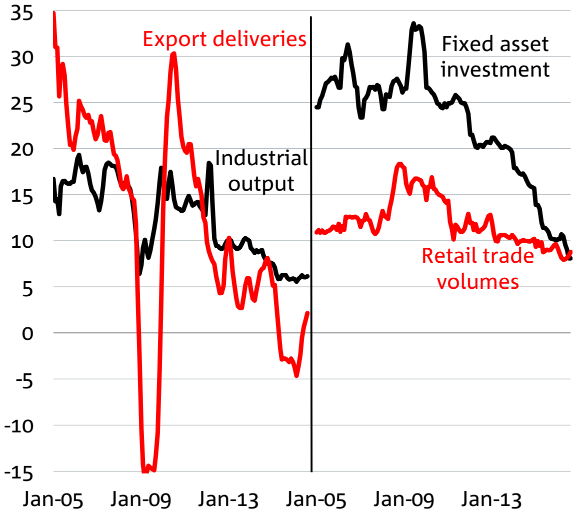
EXPORTS UNUSUALLY WEAK

Emerging market exports and industrial output (% yoy)



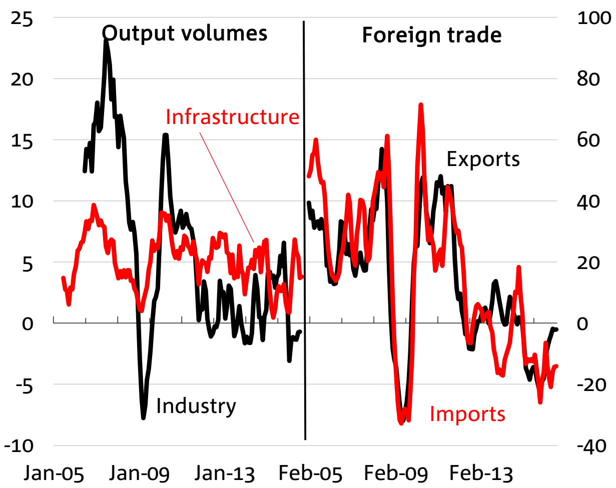
SOFTER CHINA INDICATORS

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



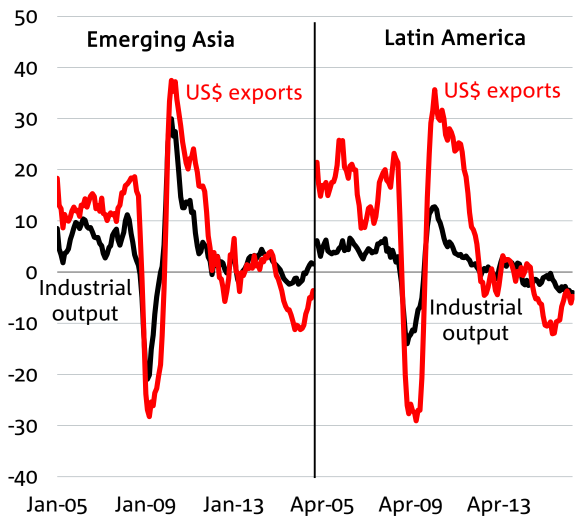
INDIAN GROWTH SOLID; TRADE WEAK

Indian monthly economic indicators (% yoy)



TRADE FOCUSED REGIONS WEAK

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



- Emerging market growth has remained stalled at around 4½% yoy since late 2015 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.

- Industrial growth has begun to pick up slightly in the emerging economies with output in the 3 months to July growing by around 3% yoy, better than the 2¼% yoy seen around the turn of the year but still well below the long-run trend pace of manufacturing expansion. Trade growth has been even weaker with emerging economy export volumes falling in the June quarter and imports declining through the entire first half of the year. The weakness looks to have extended into the second half of the year with both export and import volumes falling in July.

- The big falls experienced in commodity prices prior to their partial recovery this year added to the pressure on many emerging market economies. US$ commodity prices more than halved between mid-2014 and early 2016, non-fuel prices fell by around a quarter over the same period. Since their early 2016 trough aggregate commodity prices have recovered by around 25% and non-fuel prices by around 10% respectively. The outcome has been some reduction in the pressure on $US export earnings in the emerging economies of East Asia and Latin America, both major commodity producing regions.

- Not all emerging economies lose from lower commodity prices, however. China and India import food and/or raw materials and benefit from weaker global commodity markets. Chinese economic growth has been on a slowing trend but a series of measures taken by the authorities to boost economic growth seem to have worked. Industrial growth has stabilised at 6%+ this year, export deliveries have picked up after a long period of weakness and the property market in big cities has picked up. Overall, however, fixed asset investment has continued its downward trend as the economy continues its "re-balancing" toward a greater reliance on consumer spending in economic growth.

Sources: Datastream, CEIC, NAB Economics

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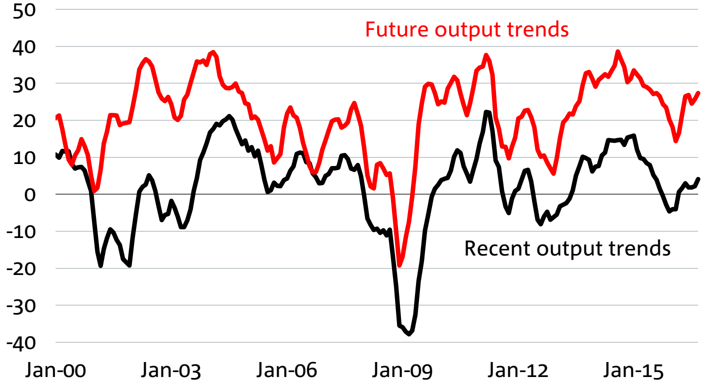
GLOBAL FORECASTS AND POLICIES

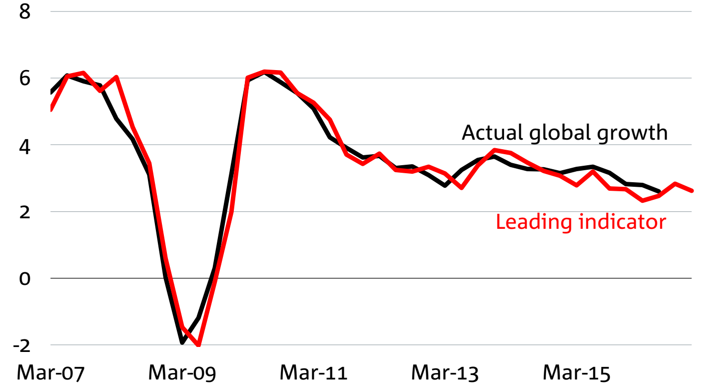
Sub-trend growth set to continue

GLOBAL OUTLOOK REMAINS SUBDUED

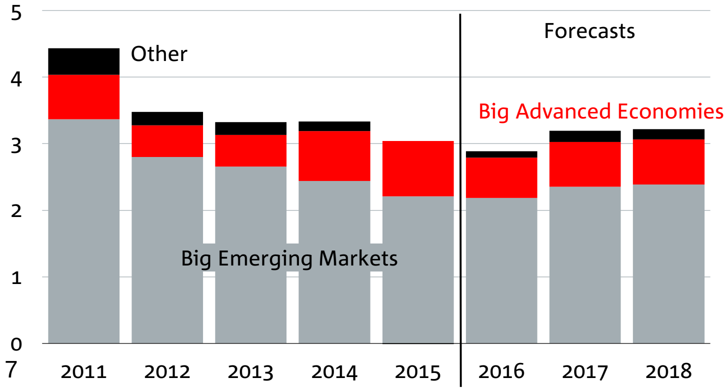
Business surveys (US, UK, Germany & France) (Index)



Actual global growth and leading indicator (% yoy)



Global economic growth (% points contribution)



- We have slightly lifted our forecasts for the UK and Emerging East Asia but the broad picture remains unchanged – sub-trend global growth of 3 to 3¼% should continue. Neither the recent business survey readings, nor our leading indicator of global growth, nor recent information on global industrial output or trade point to a lift in the pulse of global economic growth. This matters because big debt burdens hang over large parts of the global economy – government and household debt in many advanced economies and corporate debt in big emerging markets. Faster growth is a better way to wind back debt overhangs than aggressive de-leveraging, a global economic vulnerability that worries the IMF.

- We cannot see any dynamic new growth zone about to push global growth faster. Global growth remains concentrated in the emerging markets, which are driving around two-thirds of increased output. China and India are the top two engines of economic growth as Brazil and Russia (the 6th and 7th largest economies in the world) have been hit by deep recessions. The IMF thinks that global growth will reach 3.8% beyond 2017 but that reflects the fading away of recessions and the increasing shares of the fast growing Chinese and Indian economies.

- With global growth remaining stuck in the doldrums and below target inflation, Australian business still faces 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 ceiling on the growth in commodity demand at a time when supplies are still plentiful, limiting the upside for commodity prices.

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	1.3	-0.1	0.6	0.5	0.6	0.6
UK	1.5	1.3	1.9	3.1	2.2	1.8	0.8	1.6
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	4.6	4.2	4.1	3.5	3.7	3.6	3.5
NZ	1.8	2.4	2.4	3.8	2.5	3.4	3.1	1.9
Total	4.4	3.5	3.3	3.3	3.0	2.9	3.2	3.2

Sources: Datastream, NAB Economics

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