

# THE FORWARD VIEW – GLOBAL

NOVEMBER 2016



## *US election hanging over global markets*

- The US Presidential election campaign ends today and the outcome may finally lift some of the uncertainty that has hung over global markets in recent months. Much depends on the victor winning a clear mandate and not facing a continuation of policy gridlock because they are unable to get their legislation through a hostile Congress.
- The upturn in global output has continued at a moderate pace through numerous shocks and growth scares – the Euro-zone’s worries, Brexit, Chinese market volatility to name just three – highlighting the underlying resilience of demand in the big emerging market economies of China and India and the ability of advanced economy central banks to keep the show on the road by means of historically low policy interest rates and asset buying aimed at cutting longer term bond yields.
- Central banks in the big advanced economies may well have now eased their policy by as much as they want to with US attention focussed on the profile of Fed rate rises, the Bank of England moving away from its rate cutting bias, the ECB about to consider if it will cut back its asset purchases next year. Partly as a result global bond yields are off their lows. We expect global interest rates to remain very low through the next few years as central banks seek to get inflation up to target rates.

## 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	3.0	1.9
Total	100.0	3.5	3.3	3.3	3.0	2.9	3.2	3.2

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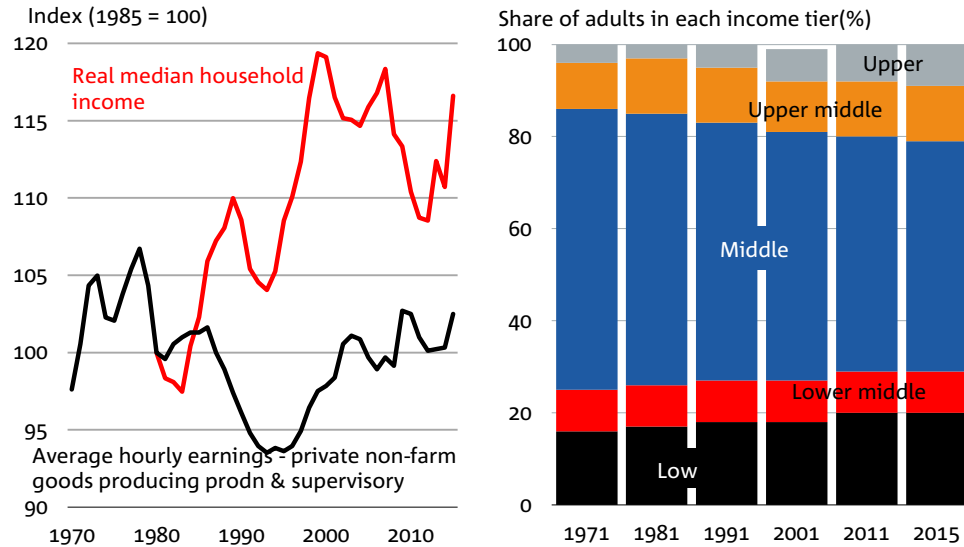
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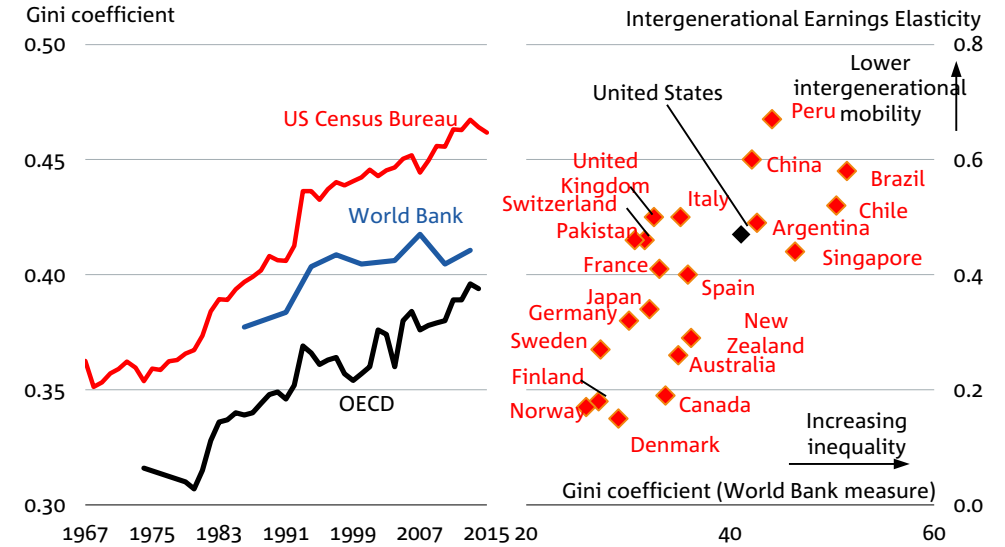
# US ELECTION HIGHLIGHTS SOCIAL AND ECONOMIC TENSIONS

*The end of an acrimonious campaign*

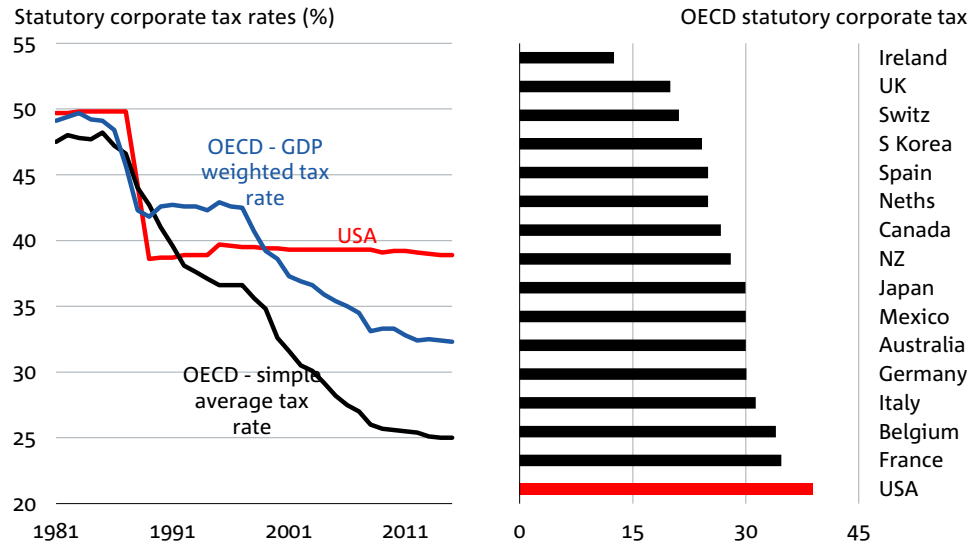
## MIDDLE CLASS INCOMES STAGNATE AND SHARE FALLS



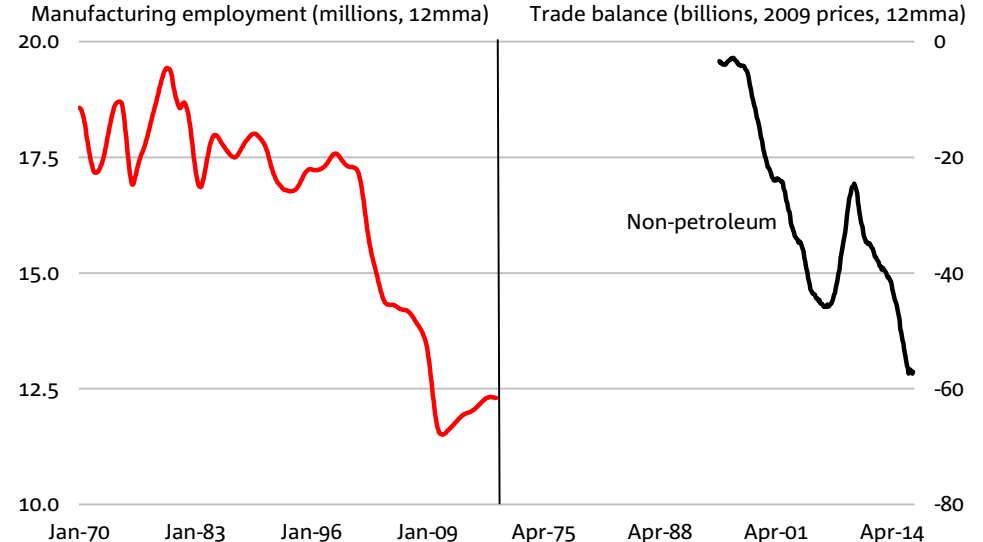
## INCOME INEQUALITY RISES, LOW SOCIAL MOBILITY BY OECD STANDARDS



## US A HIGH CORPORATE TAX OUTLIER, DEBATE OVER CUTS



## JOB LOSSES AND TRADE DEFICIT FUELS ANTI-FREE TRADE SENTIMENT



Sources: US Census Bureau, BLS, Pew Research Center, World Bank, Institute for the Study of Labor, OECD, NAB Economics

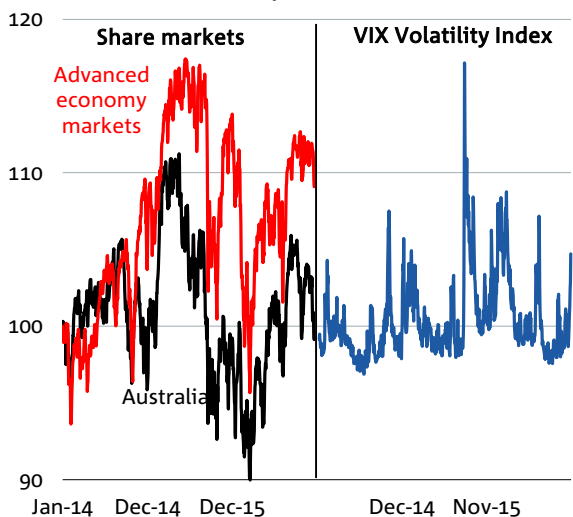


# FINANCIAL AND COMMODITY MARKETS

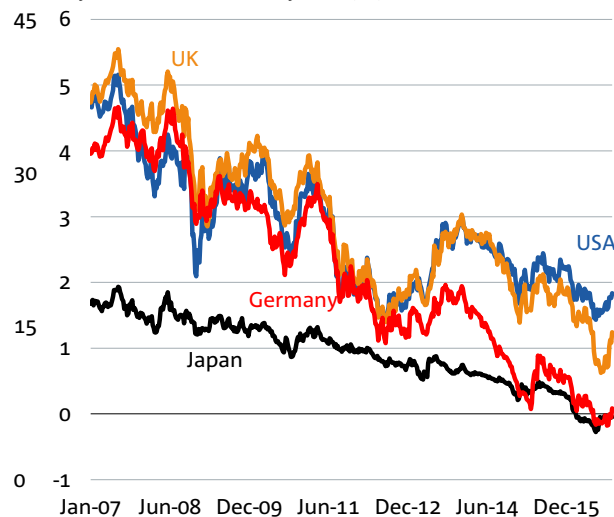
## The end of the monetary easing

### SHARES FALL AND VOLATILITY RISES BOND YIELDS TURN UP

Share markets and volatility indices



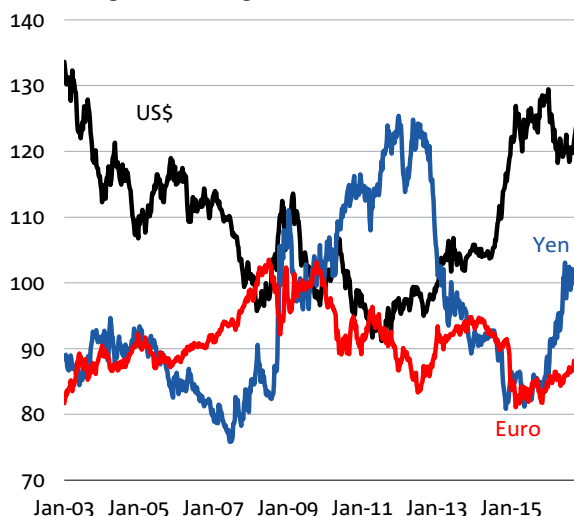
10 yr Government Bond yields (%)



- Political uncertainty around the outcome of the US Presidential election has been the focus of market interest in recent weeks, replacing the previous focus on central bank policy. As the long period of cuts in interest rates and increases in asset purchases by big advanced economy central banks seems to be drawing to an end, markets have increasingly wondered what comes next. At the same time, long term interest rates on government bonds have been rising from historically low levels.
- Barring an upsurge in post-election financial market volatility, we expect the US Fed to lift its policy interest rate in December, the first since the end of 2015, taking rates to only 0.75%. At its November meeting the central bank said that the case for interest rate increases was strengthening with Fed committee hawks already voting for an immediate rate hike.
- Elsewhere, the big advanced economy central banks seem to be shifting towards stable policy with the prospect next year of less asset buying by the European Central Bank (ECB). The Bank of England, which looked set to cut UK interest rates at its September meeting, appears to have changed its mind as the post-Brexit vote depreciation in Sterling looks set to lift UK inflation through the target rate. Nevertheless, the central bank is not signalling rate increases or winding back its very big programme of government bond purchases.

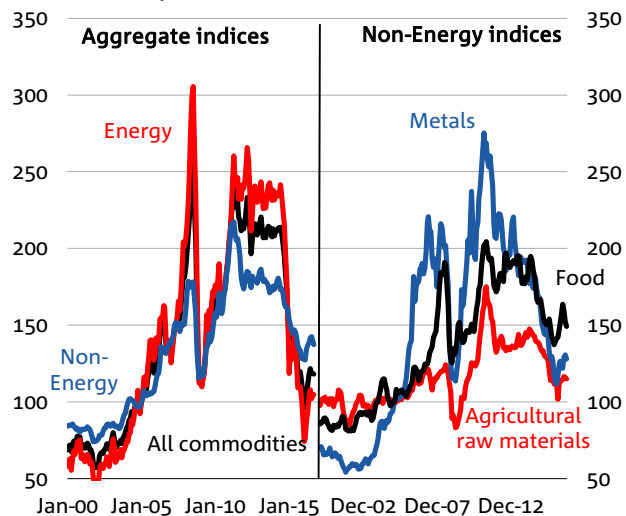
### YEN APPRECIATION LOSES GROUND

Trade weighted exchange rate indices (1 Jan 2010 = 100)



### COMMODITIES OFF EARLIER PEAKS

IMF Commodity Price Indices (US\$ terms, Jan 2005 = 100)

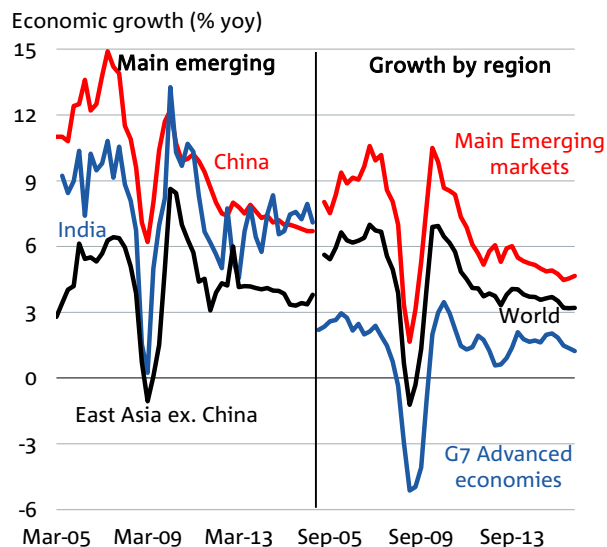


- The ECB's main policy interest rate is in negative territory and it is buying €80 billion in assets monthly at least until next March to help keep long term interest rates low. Although markets are already focusing on when the ECB will start to wind back the volume of assets it is buying, the central bank has said that it has not yet discussed such a move, it plans to keep interest rates low well past next March and it is unlikely to move abruptly to stop buying assets. We may get a clearer idea of timing after the ECB releases new economic forecasts in December.
- The Bank of Japan still thinks it can get inflation up to around its 2% target but it has postponed the timing again and is sticking to its policy of asset buying and very low interest rates (-1% for short term deposits and zero for 10 year government bonds) to boost activity and inflation.

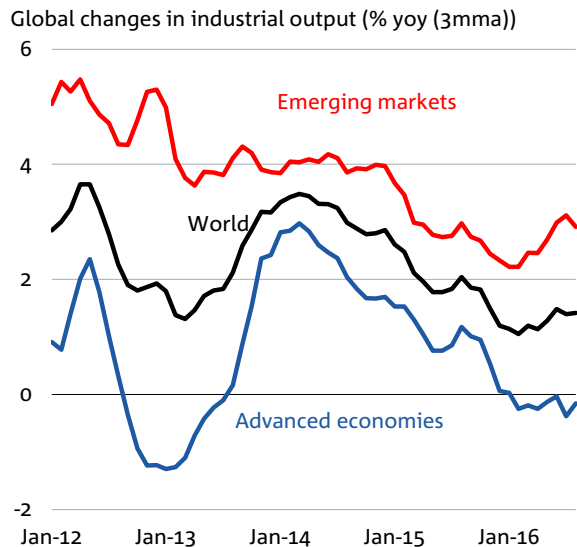
# GLOBAL ECONOMIC TRENDS

## Modest acceleration in growth

### GLOBAL GROWTH STILL SUBDUED

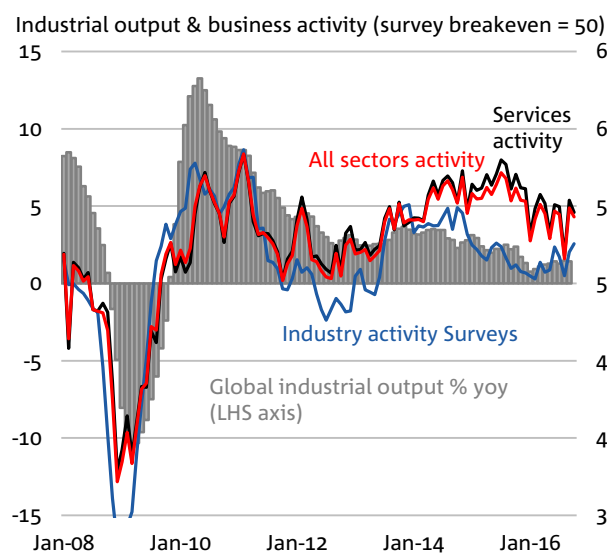


### OUTPUT HAD BEEN EDGING UP

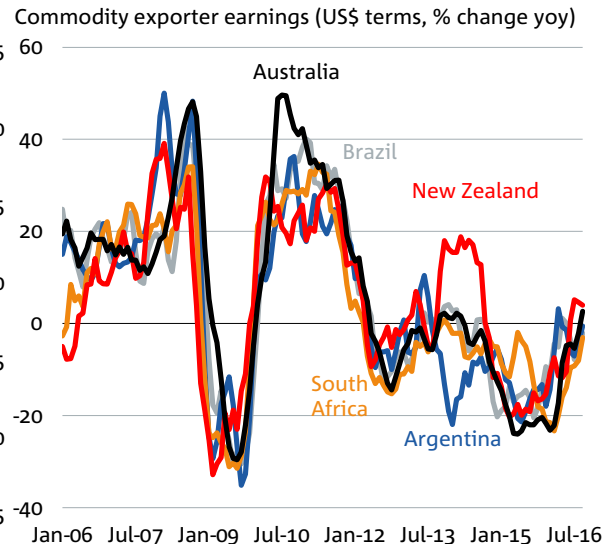


- Global economic growth remains soft with a sub-trend pace of expansion set to continue and few signs of an upturn. The pace of economic growth remained stuck at around 3¼% yoy between late 2015 and mid-2016. Advanced economy growth was running at less than 1½% yoy while emerging market economies have 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%.
- Behind the monthly volatility, there has been a modest uptick in the still subdued underlying quarterly pace of growth in global industrial output. Quarterly growth picked up from 0.2% in late 2015 and early 2016 to 0.5% in June, before accelerating again to 0.7% in the 3 months to August – clearly faster but still marking a pace of output expansion that falls well below trend. We track industrial growth across a sample of important economies that enables us to get some impression of how things were faring up to September and again recent months have seen a modest pick-up in growth compared to the experience at the start of the year.

### LATEST SURVEYS SHOW UPTICK



### COMMODITY EARNINGS STABILISING



- Monthly business survey readings provide the most up to date measure of the pulse of global economic growth – and they have been improving in the months leading up to October. Our measure of manufacturing activity in the big advanced economies has shown stronger growth in the 4 months to October than it did in the first half of the year. A broader business-survey derived measure of activity that covers both the advanced and emerging market economies hit a two year high in October. Services industry growth has been faster than for manufacturing and even a softer US outcome in October barely dampened the solid pace of expansion.
- Growth in the big Southern Hemisphere primary product exporting economies was hit by the steep and broad-based decline in commodity prices seen through 2014 and 2015 – with \$US non-fuel commodity prices falling by 26% between the starts of 2014 and 2016. This took a toll on exports and incomes in the commodity producers but prices have stopped falling, helping support growth in places like South Africa, South America, Australia and New Zealand.

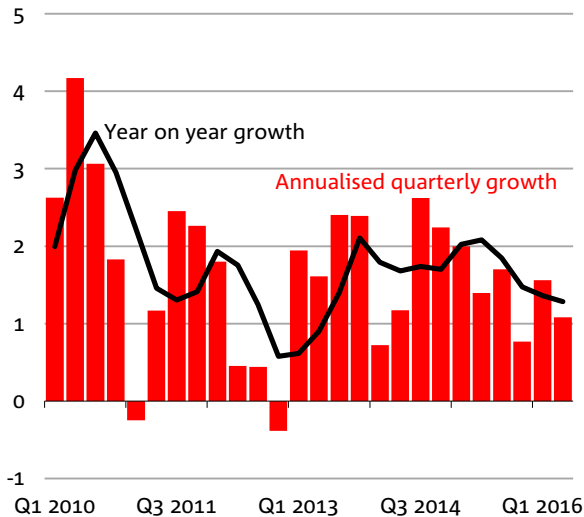


# ADVANCED ECONOMIES

*A mixed picture but neither growth nor inflation is satisfactory*

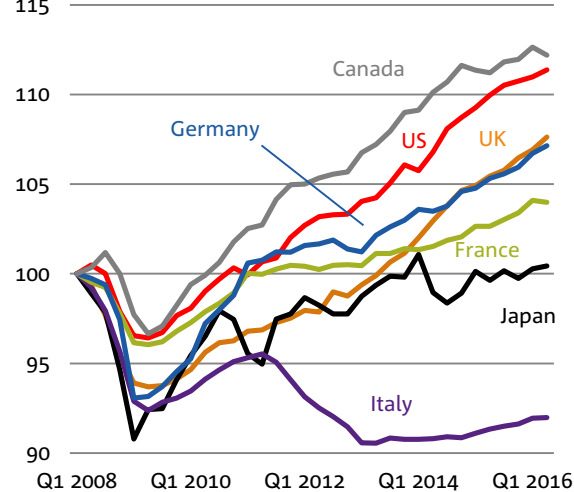
## G7 GROWTH SLOWS

G7 Advanced Economy Growth (%)



## UPTURN PERFORMANCE MIXED

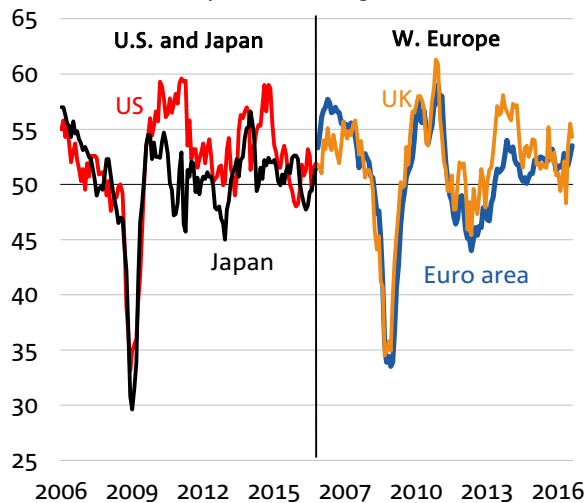
Real GDP - Major Advanced Economies (Mar 08 = 100)



- Moderate growth has continued into the second half of the year in the big advanced economies. US quarterly economic growth doubled from 0.35% in June to 0.7% in September, boosted by a temporary surge in exports. The UK economy has fared better than expected in the wake of the Brexit vote, growing by 0.5% in the third quarter – much the same pace of growth as averaged over the previous year. The first estimates of Japanese economic growth will be released in mid-November. After taking out the effect of natural disasters, the Canadian economy is growing at a moderate pace with quarterly expansion of 0.6% in March and 0.1% in June. Growth since then has been boosted by recovery from the impact of forest fires on the important energy sector.
- Euro-zone quarterly growth has been more disappointing, after running at 0.5% through late 2015 and early 2016 it slowed to 0.3% in the June quarter and stayed around that pace in the September quarter. There has been quite a difference in growth between the various Euro-zone member countries with Italy's economy being considerably smaller than it was in early 2008 and the country faces a referendum in December that has been portrayed as a measure of support for the Government.

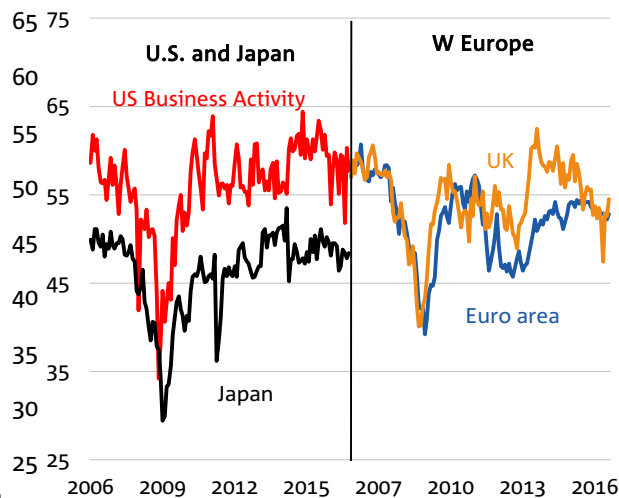
## INDUSTRIAL SECTOR PICKS UP

Advanced Economy Manufacturing PMIs (50=Breakeven)



## SOLID SERVICES GROWTH

Advanced Economy Services PMIs (50 = Breakeven level)



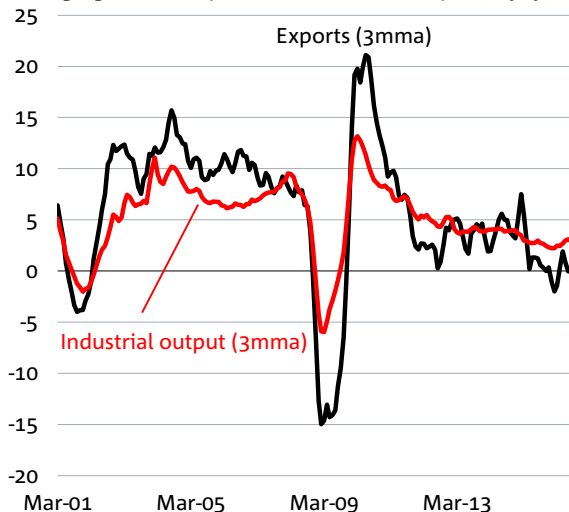
- Recent trends in the monthly business surveys, trade volumes and industrial output suggest that conditions have started to improve in the big advanced economies. Industrial output fell by 0.2% in the second quarter but it has improved since then with production up by 0.3% in the 3 months ended August. Better industrial conditions in Japan and the Euro-zone account for most of that improvement. Following a long weak period, international trade volumes have also improved in the advanced economies with modest growth in both exports and imports in the 3 months to August.
- The business surveys are consistent with moderate growth continuing through to October with an upturn in the industrial sector and ongoing solid growth in the services sector – which represents the bulk of these economies.

# EMERGING MARKET ECONOMIES

*A mixed picture but still the main drivers of global growth*

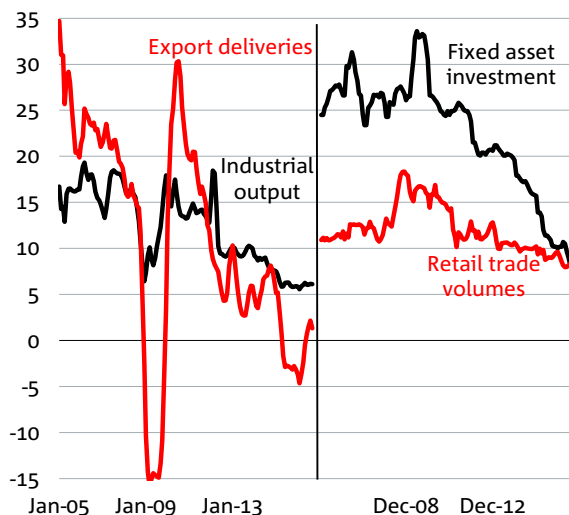
## EXPORTS REMAIN WEAK

Emerging market exports and industrial output (% yoy)



## CHINESE GROWTH MIX SHIFTING

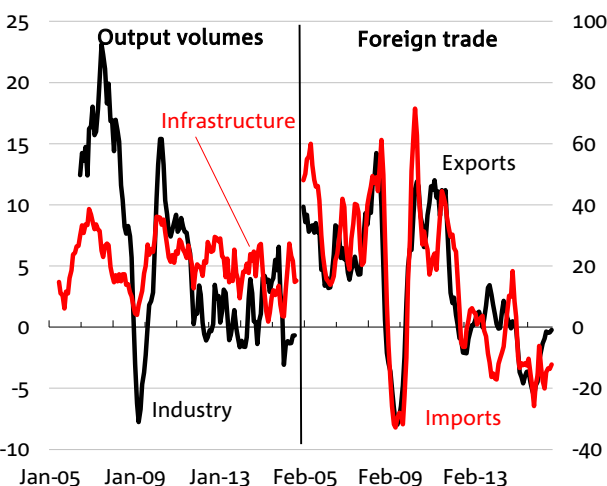
Chinese monthly economic indicators (% yoy (3mma))



- 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 August 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 remained exceptionally weak with emerging economy export volumes falling in the June quarter and imports declining through the entire first half of the year. Both export and import volumes were slightly less weak in the 3 months to August but the overall picture for trade is still far removed from the normal post-war one where rapid trade expansion was a major driver of growth in emerging market economies.

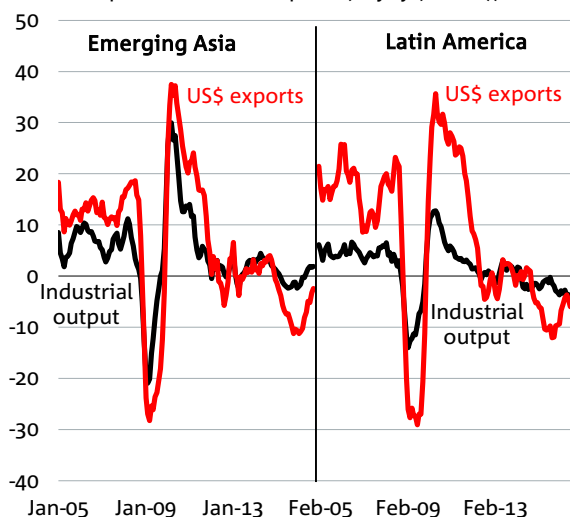
## INDIAN GROWTH SOLID; TRADE WEAK

Indian monthly economic indicators (% yoy)



## TRADE FOCUSED REGIONS WEAK

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



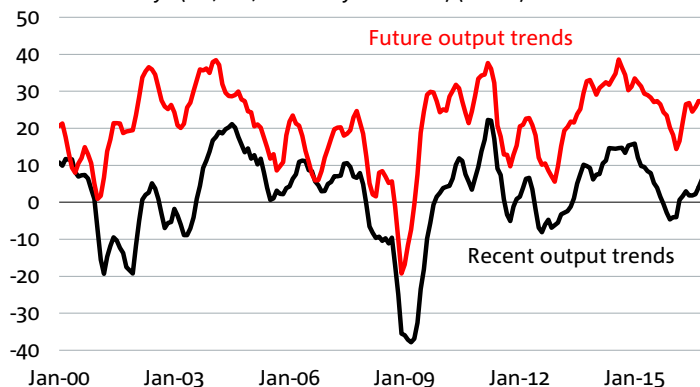
- Appreciation of the US\$ and the big falls experienced in commodity prices prior to their partial recovery this year added to the downward pressure on emerging market economy export receipts. Latin American \$US export earnings were down by 15% yoy in late 2015 but by September 2016, firmer commodity markets had led the rate of decline to slow to around 1% yoy. The emerging market economies of East Asia also include important primary product traders and here again the fall in commodity prices cut into export earnings. By the latter half of 2016 the rate of decline in \$US export earnings was less severe than it had been in late 2015 but export revenue trends were still putting downward pressure on national income.
- Turning to China, our largest trading partner, industrial growth remains around 6% yoy as progress in rebalancing the economy toward consumption rather than fixed investment continues. Growth in retail sales remains around 10% yoy while growth in fixed investment has slipped from over 15% yoy in 2014 to 9½% yoy in September 2016. This change in the mix of growth probably slows growth in the short-run but is good from the perspective of longer term sustainability.

# GLOBAL FORECASTS AND POLICIES

## A few brighter indicators but sub-trend growth set to continue

### GLOBAL OUTLOOK REMAINS SUBDUED

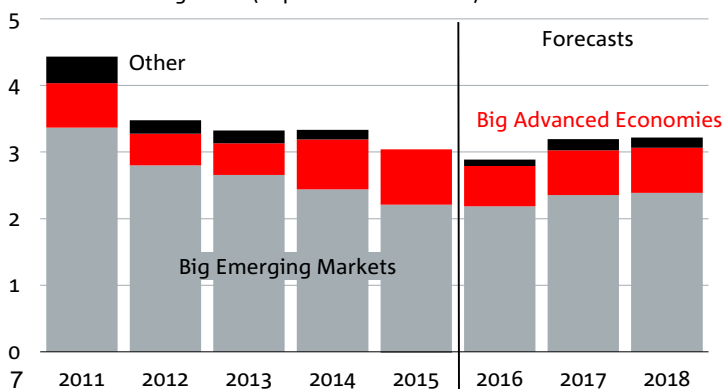
Business surveys (US, UK, Germany & France) (Index)



Actual global growth and leading indicator (% yoy)



Global economic growth (% points contribution)



- Global growth remains sub-trend and policy is still focussed on getting higher rates of output expansion and shifting inflation up towards target. The gloom should not be overdone, however. Given the number of shocks and growth scares that the global economy has had to weather in the last few years, we could easily have done worse than the outcome of ongoing moderate economic growth. Superimposed on shocks like Brexit, past volatility in the Chinese currency and share market and the ups and downs of global equities is the aftermath of the 2008/9 global financial crisis and accompanying recession. That resulted in higher public debt burdens and smaller economies than would have occurred otherwise, contributing to a debt overhang that modest rates of income growth perpetuate.
- We expect more of the same with our forecast of a modest lift in global growth based more on the passing of temporary weakness in some big economies than the emergence of new engines of economic expansion. Recessions gradually fade in Brazil and Russia and the recovery in commodity prices helps primary product exporters, reducing their drag on global growth. Ongoing low inflation and modest growth in the big advanced economies should mean a very gradual movement by their central banks away from exceptionally low interest rates and significant asset buying.
- Recent business surveys and industrial output show a slight lift in the pace of near term growth as does our leading indicator. Central bank policies designed to support demand and the shift away from budgetary austerity would be expected to eventually bear some fruit in terms of faster growth but there seems growing official acceptance that an already prolonged period of slow growth will continue.

### 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	2.0	1.3	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	3.0	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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