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The Bigger Picture – A Global & Australian Economic Perspective

Global: While growth remains sub-trend, the global economy has also proved resilient. Output has continued to grow, despite a series of financial and political shocks this year. However, 2016's growth has been concentrated into just three countries –the US, China and India – and that looks set to persist. Monetary policy in the big advanced economies is shifting toward gradual rate rises (in the US), cutbacks in asset buying (Euro-zone) or more of the same, rather than yet more stimulus (UK, Japan). Global long bond yields are already turning up and the USD should appreciate further as markets digest the change in US economic policy. Our view is for global growth to modestly accelerate from 2016's 3% to 3¼% in the following two years. However, high debt burdens, further political uncertainty – particularly next year's Euro-zone elections – pose big risks to the outlook.

- Mr Trump's victory in the US Presidential election has contributed to an upturn in share prices and bond yields. US equity indices have climbed to record levels and US 10 year bond yields, which fell below 1½% in July, were back around 2½% by early December. Higher equity prices and bond yields have been seen in other markets as well – German 10 year bonds have shifted from mid-year's negative yields to around 20 bps. Japanese yields were close to -0.3% around mid-year but are now slightly positive and French and German equity markets are around 20% above their post-Brexit lows. Tradeweb data shows that the value of bonds trading globally at negative yields has fallen from around USD13½ trillion to USD10¾ trillion since mid-August.

- Global economic growth remains moderate with a sub-trend pace of GDP expansion set to continue. Advanced economy growth has lifted slightly to 1½% yoy in the latter half of 2016 while emerging market growth has stayed around 4½% yoy. Additionally, there has been a modest uptick in the still subdued underlying quarterly pace of growth in global industrial output, while monthly business surveys have been improving in the months leading up to November. Our measure of manufacturing activity in the big advanced economies has shown stronger growth in the four months to November 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 has also been looking better. Services industry growth has generally been faster than for manufacturing and November saw a rebound in service sector business surveys.

- 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 USD 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 started rising slightly, helping support growth in places like South Africa, South America, Australia and New Zealand.

- Increasingly central banks face criticism that they have innovated and ramped up their stimulus by enough and should now consider either gradual monetary tightening (in the US) or more of the same, rather than yet more rounds of rate cuts or additional asset buying. The Fed looks lifted rates in December, but future tightening should be very gradual with only two more 25bps rises next year. Consequently, US rates should still be very low by historical standards at the end of 2017. The Bank of England launched another round of monetary easing in the wake of the Brexit vote but is not signalling more to come. The European Central Bank will cut the scale of its monthly asset buying from next March but has extended its purchasing to end-2017. The Japanese central bank looks set to stick with asset buying and zero to negative interest rates well into next year rather than implement more easing.

- We expect global growth to pick up from around 3% this year to 3¼% in 2017 and 2018, mainly on the back of Mr Trump's expansionary economic policies in the US and an end to the recessions that have hit the Russian and Brazilian economies (respectively the 6th and 7th biggest in the world). With Japan and the Euro-zone appearing locked into low growth trajectories, the UK facing Brexit-related uncertainties and Canadian growth disappointingly soft, the US stands out as the main growth centre among the advanced economies. It along with China and India account for almost two-thirds of forecast global output expansion in 2017, highlighting the globe's reliance on demand expansion in just three big economies.

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)

***Australia**: Multiple one-off factors, including weather related disruptions, contributed to the weak Q3 GDP outcome, but are unlikely to be repeated in Q4. However, the lower base for growth has led to a downgrade of our 2016 and 2017 growth forecasts to 2.3% and 2.4% respectively. Nevertheless, near-term risks are tilted to the downside with a significant slowdown in indicators such as business conditions, employment and household spending. Further out, our forecasts continue to include a notable slowdown, which risks a rise in the unemployment rate in the absence of more policy stimulus – we still expect two more cash rate cuts by the RBA from mid next year. Our unemployment rate forecasts have been revised up to around 5¾% through to 2018.*

- The November NAB Monthly Business Survey gave more hints of a moderation in the non-mining economic recovery. Business conditions slid further in the month, dropping back to long-run average levels for the first time since April 2015. However, in spite of the declining trend in business conditions, business confidence has remained relatively resilient, tracking broadly sideways in recent times and showing a modest improvement in November – although it remains at levels that are not conducive of higher levels of investment activity.
- Employment rebounded sharply by 39.1k, but a 0.2ppt rise in the participation rate saw the unemployment rate tick up by 0.1% to 5.7%. Looking through the volatility of the monthly data, the overall trend employment growth remains subdued, although the fact that full-time employment (in trend terms) has stopped declining is a welcome development. Employment growth in most states and territories continue to trend downwards, with the easing in NSW persisting. The employment index from the NAB monthly business survey was largely stable at +1, which is around the long-term average level and suggests annual job creation of around 182k (15k per month) in the next 6-months, which is barely sufficient to steady the unemployment rate. We forecast the unemployment rate to stay around 5.7% by end-16, stabilising in 2017, before rising to 5.8% by end-18.
- According to the Q3 National Accounts, household consumption growth was lacklustre (0.4% q/q; 2.5% y/y), largely reflecting the weakness in real retail activity. The subdued household consumption reading was despite a lower household saving ratio (at 6.3%) and notable pick-up in household income growth in the quarter. Meanwhile, NAB's monthly Online Retail Sales Index showed that trend growth for online spending eased further in October, while retail conditions in the NAB business survey hit their lowest level since late 2014 (in trend terms). However, the latest ABS retail trade data has improved, which signals stronger growth for Q4. Going forward, household consumption is expected to grow moderately on the back of a declining saving ratio and a low interest rate environment.
- Conditions in the major eastern housing markets were more mixed in November, suggesting that supply concerns might be starting to manifest in some segments. Hedonic property prices in Sydney showed yet another month of solid growth, but prices in Melbourne declined – although 6-month annualised growth remains in double digits for both, while auction clearance rates are still fairly elevated – although large falls in transaction volumes suggests that market fatigue may be working in favour of sellers. Brisbane prices saw modest growth in the month, while Adelaide prices bounced back to a new high, following a drop in October. Overall, market fundamentals are expected to become less favourable over the next 12-18 months, which should see price growth slow.
- Underlying private business investment fell by a further 3.2% in Q3, with engineering construction again being a major driver – although weakness was relatively broad-based. A timelier read from the value of non-residential building approvals suggests a lift in the project pipeline, although the recent spike in approvals was quickly unwound in October. Very subdued business conditions in retail suggest an unfavourable environment for additional investment, but fairly low vacancy rates and solid rental growth in some office markets (namely Sydney and Melbourne) may be supportive. Other indications of future business investment are less encouraging. The ABS Private Capital Expenditure Survey shows that the anticipated recovery in non-mining investment remains elusive. On dwelling investment, construction in Q3 was much weaker than expected (-1.4 q/q), but is still up solidly over the year. The pipeline in apartment construction remains substantial, despite some pull-back in approvals. This will fuel strong rates of dwelling investment next year, but will drag on activity in 2018.
- Net exports are expected to recover and contribute positively to GDP growth in the near term. The terms of trade are forecast to rise by another 5.8% in Q4, after two quarters of increases, to be 11.4% higher than a year ago, before retreating again in 2017. We have revised up our bulk commodity price forecasts since last month. However, as we do not expect a significant improvement in fundamental demand, the higher prices are unlikely to sustain or spur further investment, therefore limiting the growth in export volumes in the long term.
- The election of Trump as US President elect has led to an upward revision to our USD forecasts and reinforced our conviction that the AUD/USD will depreciate to 0.70 by end-2017. Our expectation for bulk commodity prices and the terms of trade to retreat through 2017 (despite some modest upgrades), is also consistent with this view. Finally, soft economic conditions are likely to more than offset the impact of higher commodity prices on government finances, adding to the difficulty of achieving surplus by 2020-21 and increasing the chances of a downgrade to Australia's AAA rating – although the implications beyond confidence effects will be minimal.

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities

Riki Polygenis
Head of Australian Economics
+(61 3) 8697 9534

James Glenn
Senior Economist – Australia
+(61 2) 9237 8017

Vyanne Lai
Economist – Australia
+(61 3) 8634 0198

Phin Ziebell
Economist – Australia
+61 (0) 475 940 662

Amy Li
Economist – Australia
+(61 3) 8634 1563

Industry Analysis

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

Steven Wu
Senior Analyst – Industry Analysis
+(61 3) 9208 2929

International Economics

Tom Taylor
Head of Economics, International
+(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

Australia

Economics
Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

David de Garis
Senior Economist
+61 3 8641 3045

Tapas Strickland
Economist
+61 2 9237 1980

FX Strategy
Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848

Rodrigo Catril
Currency Strategist
+61 2 9293 7109

Interest Rate Strategy
Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Alex Stanley
Senior Interest Rate Strategist
+61 2 9237 8154

Credit Research
Michael Bush
Head of Credit Research
+61 3 8641 0575

Simon Fletcher
Senior Credit Analyst – FI
+61 29237 1076

Andrew Jones
Credit Analyst
+61 3 8641 0978

Distribution
Barbara Leong
Research Production Manager
+61 2 9237 8151

New Zealand

Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Senior Economist
+64 4 474 6923

Kymberly Martin
Senior Market Strategist
+64 4 924 7654

Jason Wong
Currency Strategist
+64 4 924 7652

Yvonne Liew
Publications & Web Administrator
+64 4 474 9771

UK/Europe

Nick Parsons
Head of Research, UK/Europe, and Global Co-Head of FX Strategy
+44 207 710 2993

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

Derek Allassani
Research Production Manager
+44 207 710 1532

Asia

Christy Tan
Head of Markets Strategy/Research, Asia
+852 2822 5350

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055