EMBARGOED UNTIL: 11.30AM WEDNESDAY 14 DECEMBER 2016

THE FORWARD VIEW – GLOBAL

DECEMBER 2016

National Australia Bank

Brighter signs reinforce forecasts for continued moderate growth

- 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 due to solid expansion in domestic spending in all three economies.
- Central banks appear increasingly convinced that they should be nearing their maximum dose of monetary stimulus to get inflation back towards trend. 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 $US should appreciate further as markets digest the change in US economic policy.
- The main risks around our view that global growth should modestly accelerate from 2016's 3% to 3¼% in the following two years come from the high debt burdens hanging over key economies alongside further political uncertainty, particularly next year's Euro-zone elections, where electoral upsets could see sharp policy reversals that would unsettle markets.

KEY GLOBAL FORECASTS (% change)

	IMF weights	2012	2013	2014	2015	2016	2017	2018
US	15.8	2.2	1.7	2.4	2.6	1.6	2.1	2.4
Euro-zone	12.0	-0.8	-0.3	1.1	1.9	1.6	1.5	1.6
Japan	4.2	1.5	2.0	0.3	1.2	1.0	0.8	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	3.6	3.8	3.8	3.7
NZ	0.2	2.4	2.4	3.8	2.5	3.4	3.2	2.4
Total	100.0	3.5	3.4	3.4	3.1	2.9	3.2	3.3

CONTENTS

CONTACT

Alan Oster, Group Chief Economist
+61 3 8634 2927

Tom Taylor, HO International Economics, +61 (0)477 723 767

AUTHORS

Tom Taylor

Tony Kelly, Senior Economist

Gerard Burg, Senior Economist

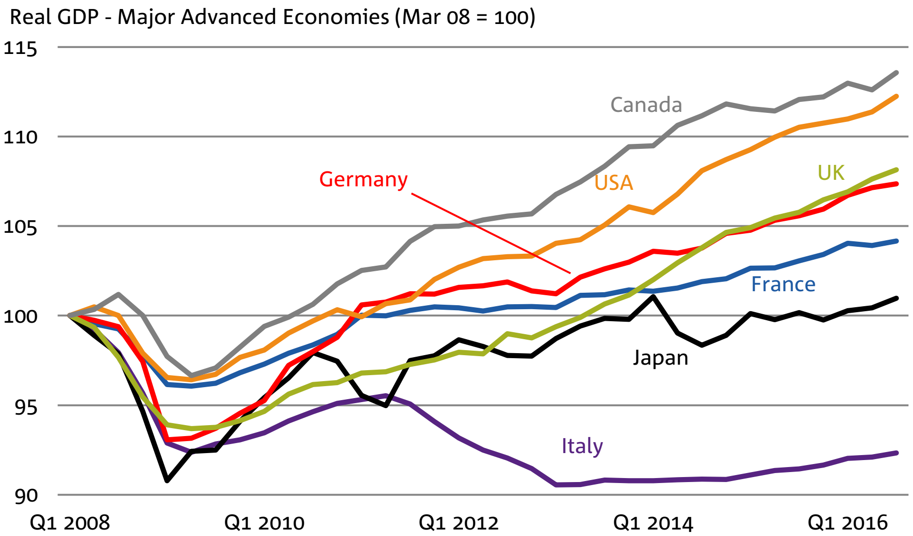
John Sharma, Economist

NAB Group Economics

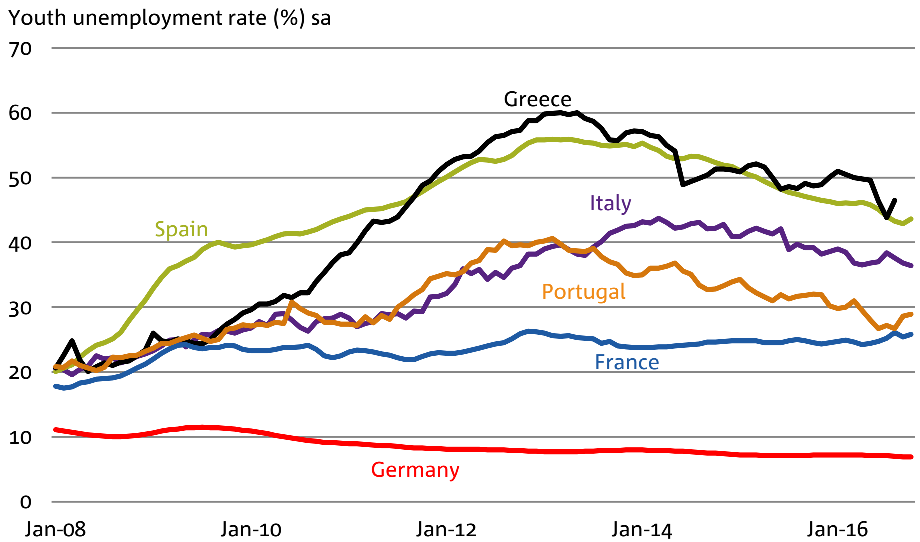
ITALIAN REFERENDUM JUST ONE OF EURO-ZONE'S MANY POLITICAL HURDLES

Italian referendum outcome reflects deep economic and social problems

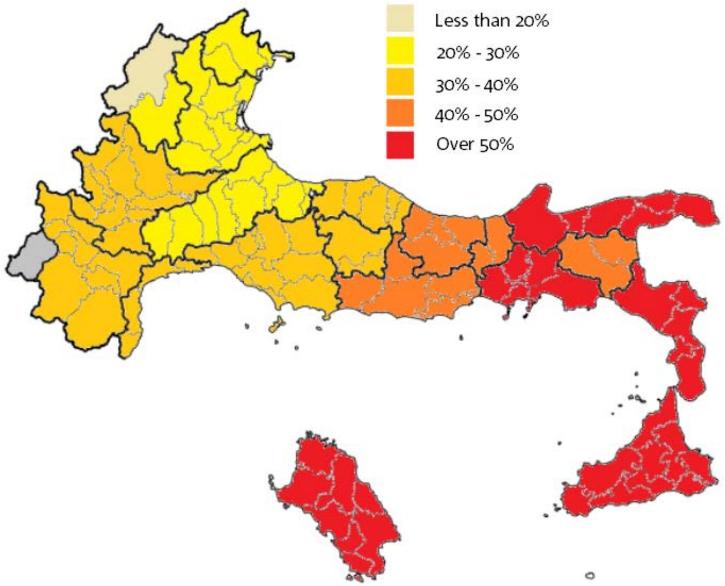
ITALIAN ECONOMY SHRUNK SINCE 2008 – A "LOST DECADE" LOOMS



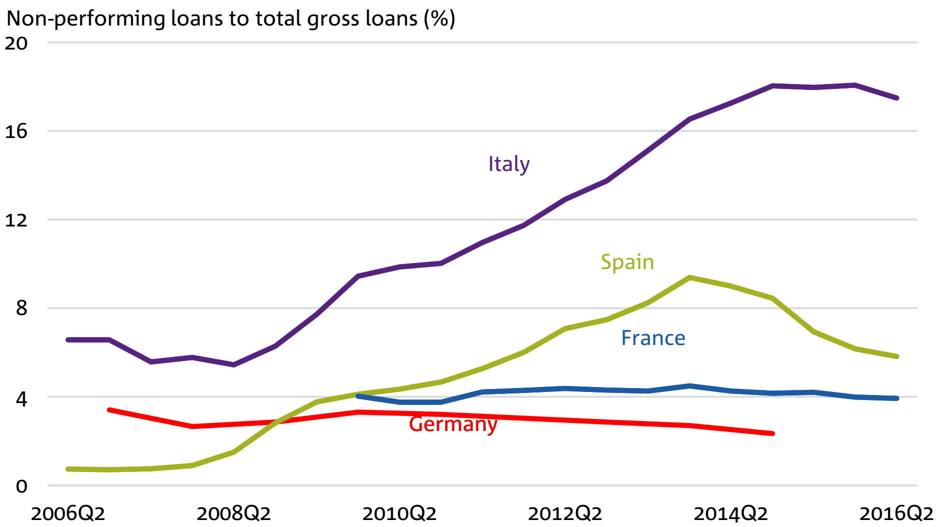
YOUTH JOBLESS RATE UNDERPINS CONCERN FOR "LOST GENERATION"



50%+ YOUTH JOBLESS IN SOUTHERN ITALY – 65% IN CALABRIA



ITALIAN BANKS FACE SERIOUS BACKLOG OF BAD LOANS



Sources: Datastream, Eurostat, IMF, NAB Economics

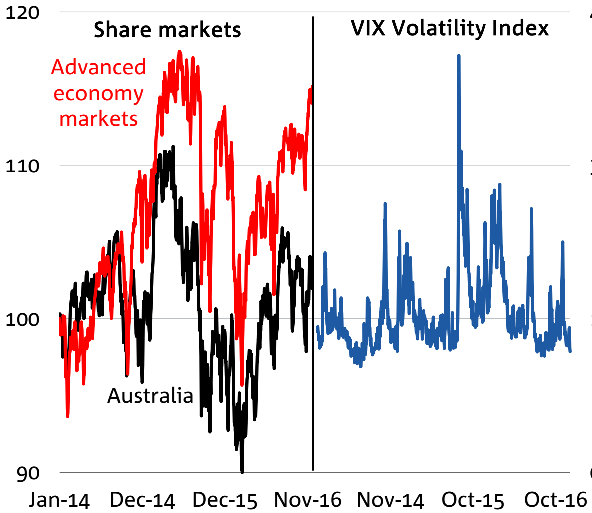
National Australia Bank

FINANCIAL AND COMMODITY MARKETS

Trump's policies boost long term bond rates, share markets and the $US

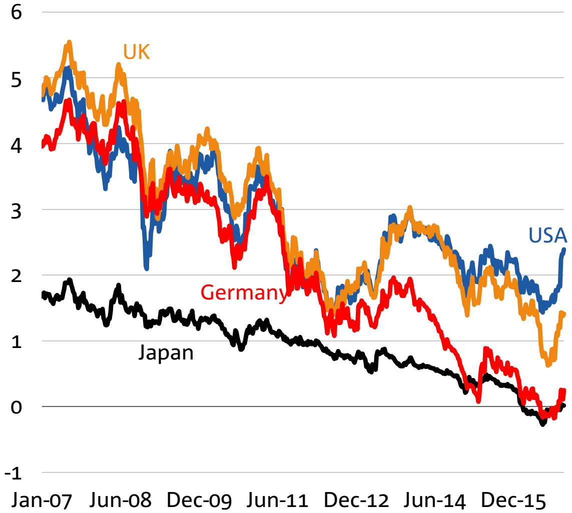
SHARES RISE, VOLATILITY LOW

Share markets and volatility indices



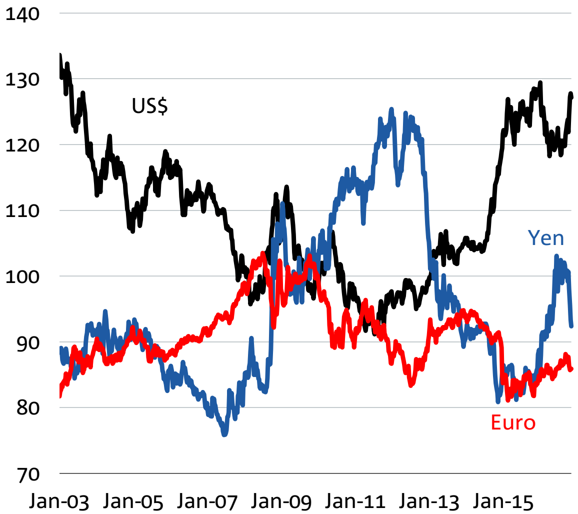
TRUMP WIN LIFTS BOND YIELDS

10 yr Government Bond yields (%)



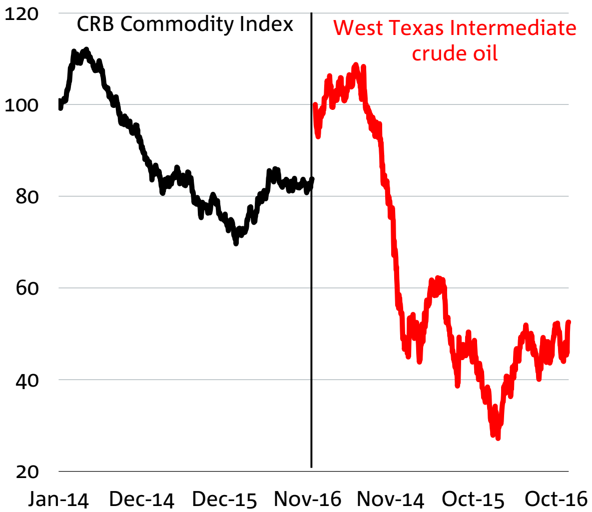
$US RISES, EURO AND YEN WEAKEN

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



OIL RISES, BROAD INDICES FLAT

Commodity price indices (1 Jan 2014 = 100)



- 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 $US13½ trillion to $US10¾ trillion since mid-August.

- 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 set to lift rates in December but the 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.

- The same factors pushing up yields have also fuelled a rise in the US dollar. This looks a good outcome for the advanced economies as it helps shift some of the growth in US demand toward slower growing regions like Japan and the Euro-zone whose currencies have been depreciating. Although the US$ has already undergone quite a sizeable rise in value, we expect it to appreciate further against the Euro, RMB and Yen. The forecast $US appreciation against the Chinese currency is more problematic as it is occurring at a time of growing trade protectionist sentiment in the US. The incoming President has said he supports declaring the Chinese Government to be "currency manipulators" which could spark US trade measures.

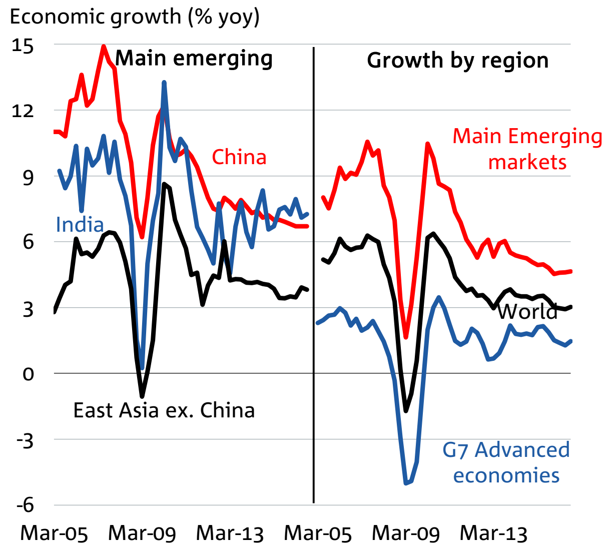
Sources: Datastream, NAB Economics

National Australia Bank

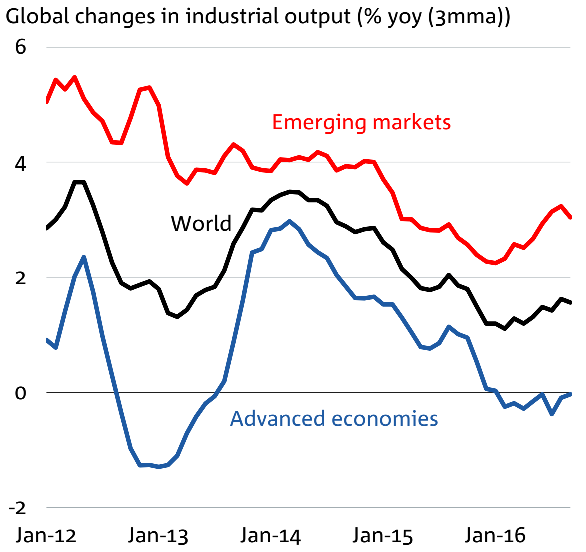
GLOBAL ECONOMIC TRENDS

Modest acceleration in advanced economies helps global growth

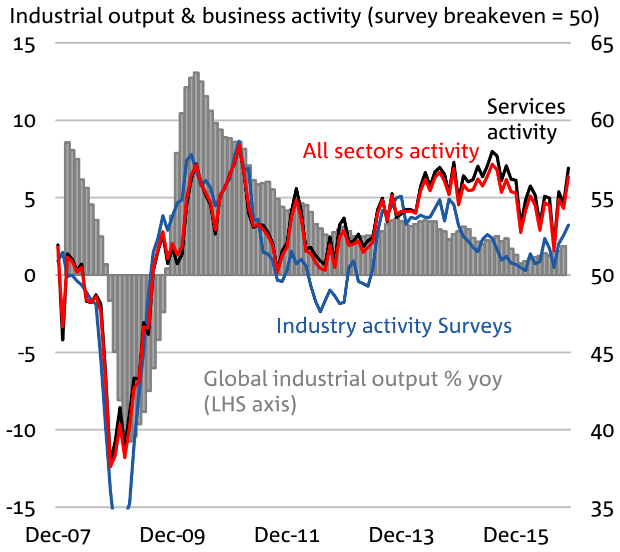
SLIGHT PICKUP IN GROWTH



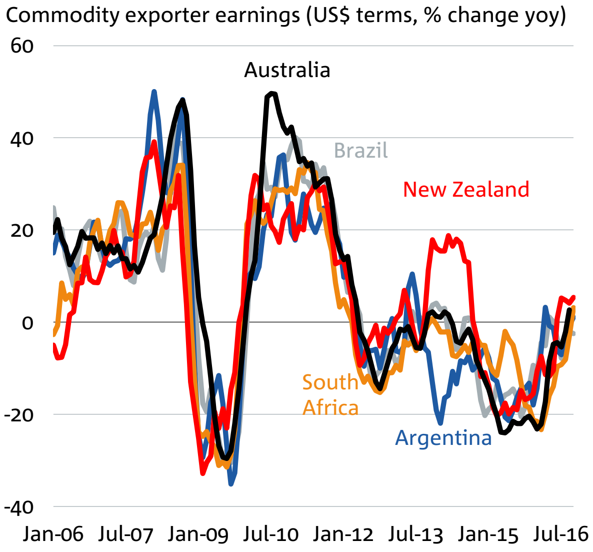
ADVANCED ECONOMIES LESS BAD



BUSINESS SURVEYS LOOK STRONGER



COMMODITY EARNINGS NOW RISING



- Global economic growth remains moderate with a sub-trend pace of GDP expansion set to continue. The pace of economic growth has remained stuck at around 3% yoy between late 2015 and September 2016. Advanced economy growth has lifted slightly to 1½% yoy in the latter half of 2016 while emerging market growth has stayed around 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 three months to August – clearly faster but still marking a pace of output expansion that falls well below trend. We track monthly industrial growth across the biggest economies, providing some insight into how things were faring up to September and recent months have seen a modest pick-up in growth.

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

 Sources: Datastream, NAB Economics

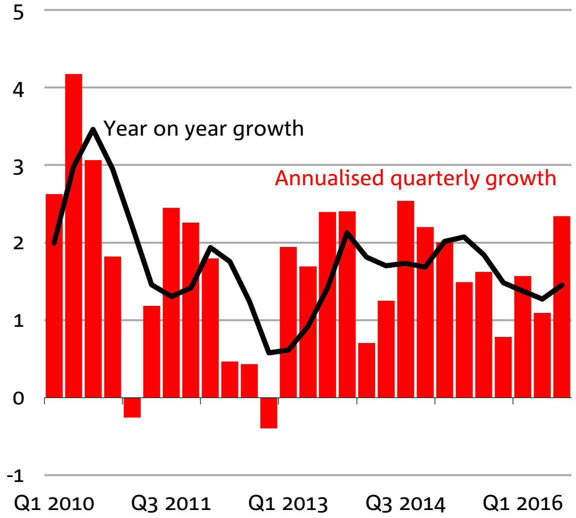
National Australia Bank

ADVANCED ECONOMIES

Modest pick up in growth and inflation – but both still too low

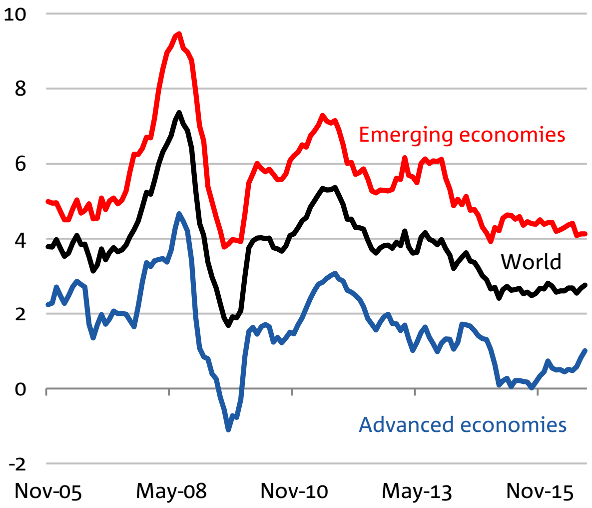
G7 GROWTH PICKS UP

G7 Advanced Economy Growth (%)



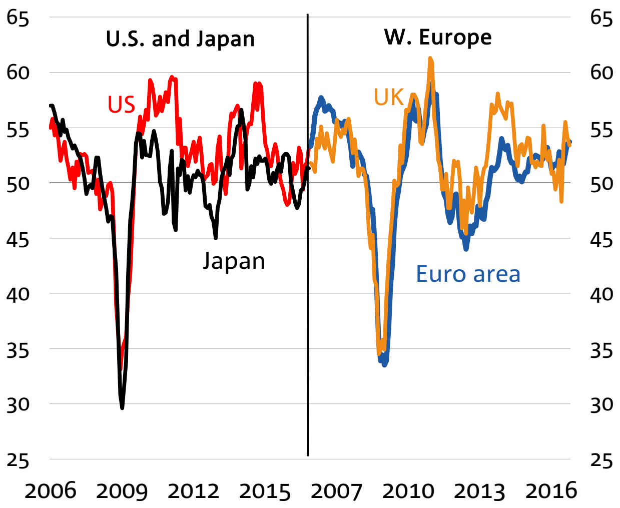
INFLATION PICKS UP TOO

Consumer price inflation (yoy%)



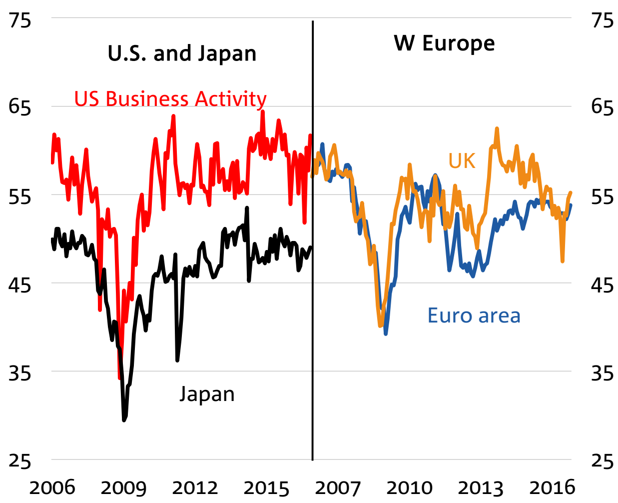
MODERATE INDUSTRIAL GROWTH

Advanced Economy Manufacturing PMIs (50=Breakeven)



SOLID US/UK SERVICES GROWTH

Advanced Economy Services PMIs (50 = Breakeven level)



- Growth in the big advanced economies has picked up in the latter half of the year. The pace of quarterly output growth almost doubled from 0.3% in the June quarter to 0.6% in September, pulling year on year growth up from 1¼% yoy in June to 1½% yoy in September. Behind the quarterly volatility, each of the big 7 economies has been growing moderately, although to differing degrees. Even with Brexit uncertainty hanging over the business sector, the UK was still the fastest growing G7 economy in the September quarter (up by 2¼% yoy) while Italy was the weakest (with year on year growth seldom getting above 1% yoy, not enough to offset the drop in output caused by the two deep recessions Italy has experienced in the last decade).

- The monthly business surveys as well as the data on industrial output and trade confirm this modest pick-up in second half growth across the big advanced economies. Quarterly industrial output growth was 0.3% in September quarter, a far from impressive pace of expansion but much better than the 0.2% drop in output reported in the June quarter. Imports into the advanced economies also recovered – rising by 0.5% in the September quarter after a fall of 0.7% in June. The picture was the same for exports from the advanced economies with growth of 0.6% in the September quarter, offsetting a 0.6% decline in the June quarter.

- November business survey results show improved trading conditions across the US, UK and Euro-zone, consistent with continued moderate growth. Japanese industry is also still expanding but at a slower pace. Service sector trading conditions in the US and UK are also consistent with moderate growth, the Euro-zone outcomes show a slightly slower rate of expansion.

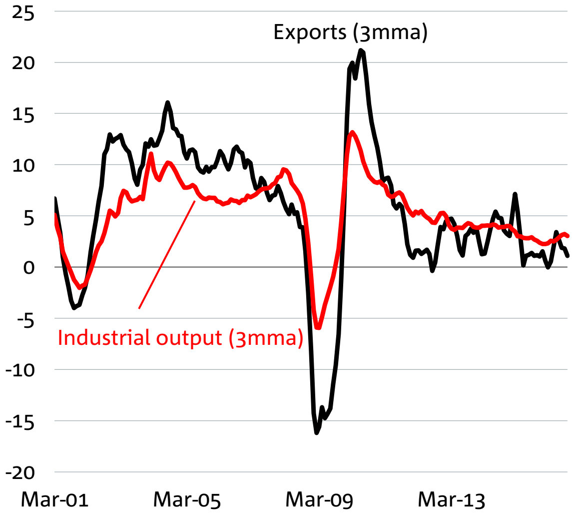
- Sub-target inflation has been an issue for central banks across the US, Euro-zone and Japan as weak wages growth and previous falls in commodity prices undermined inflationary pressures. The gradual tightening in labour markets in countries like the US and Japan plus the recovery in commodity prices is being reflected in higher CPI inflation in the advanced economies – it exceeded 1% yoy in October for the first time since late 2014.

EMERGING MARKET ECONOMIES

China and India the big drivers in a world of sluggish trade growth

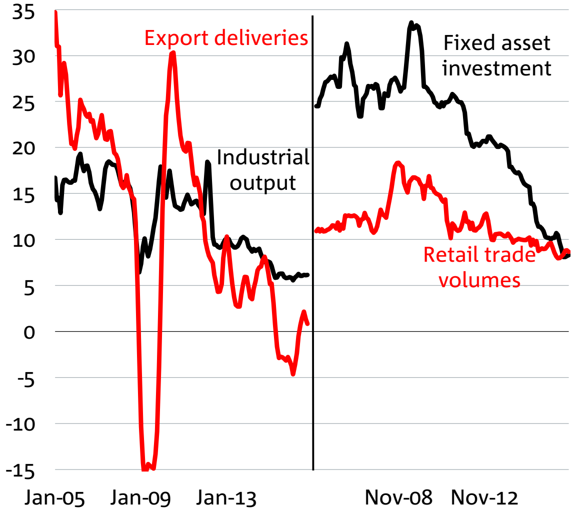
EXPORTS REMAIN WEAK

Emerging market exports and industrial output (% yoy)



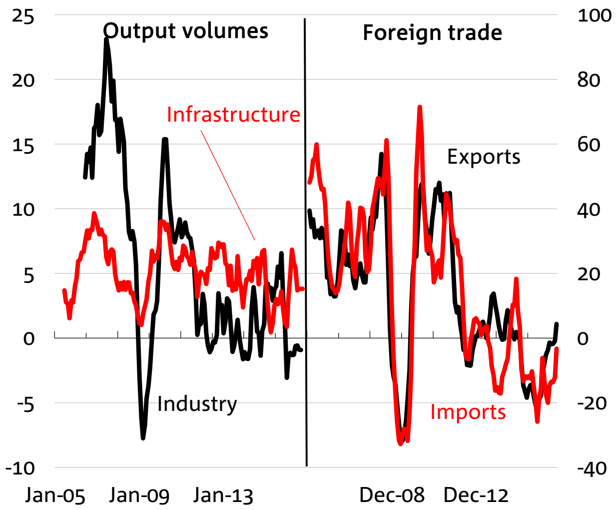
CHINESE GROWTH MIX SHIFTING

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



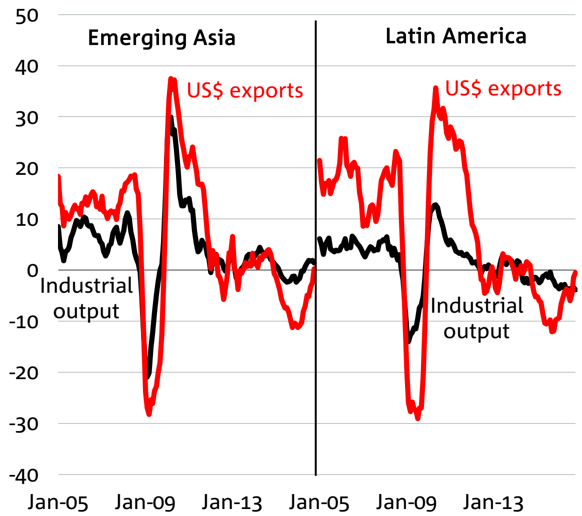
INDIAN GROWTH A PUZZLE

Indian monthly economic indicators (% yoy)



TRADE FOCUSED REGIONS WEAK

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



- Emerging market growth remains around 4½% 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 the emerging economies is vital for Australia – they account for well over half of the global economy and buy around two-thirds of our exports.

- Trend export volume growth has been running below 2% yoy and industrial growth around 3% yoy with little clear evidence of any picking up in the momentum of growth. The quarterly pace of industrial growth has also remained moderate at around 1% in both the June and September quarters. Trade volumes present a more mixed picture with exports falling in the September quarter, albeit at a slower rate than in June, while imports bounced back from a 1% fall in the June quarter to a 1% rise in the September quarter. Behind this quarterly volatility, the underlying pace of emerging economy industrial and trade growth remains modest and well below trend.

- China, now the biggest global economy, is easily the biggest driver of global growth. GDP growth has leveled out at around 6¾% yoy since late 2015, industrial output growth has stabilised at just over 6% yoy but industrial deliveries for exports are still quite flat and fixed investment has settled at around 8% yoy growth between July and October. The Government have been trying to rebalance the composition of economic growth away from fixed investment and toward more consumer spending – with only mixed success. Retail sales growth has stayed around 10% yoy in value terms and retail inflation has picked up to around 1% yoy, suggesting volume growth of around 9% yoy. This is clearly a very solid pace of growth in consumer spending but it is not ramping up in the way that might have been hoped for, given gains in household income and wealth.

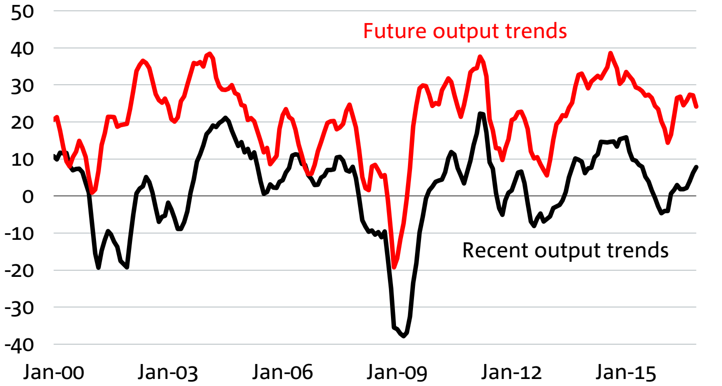
- Indian growth remains a puzzle – September 2016 GDP saw growth continue at a rapid 7% plus clip but that does not line up very well with the other economic data or the surveys. Industrial output has not been growing rapidly, infrastructure output is growing at a pace that falls well short of GDP's 7% and the business surveys do not appear consistent with an economy growing that fast. Questions have been asked over the accuracy of the GDP numbers and the impact of "demonetisation" (withdrawing certain bank notes).

GLOBAL FORECASTS AND POLICIES

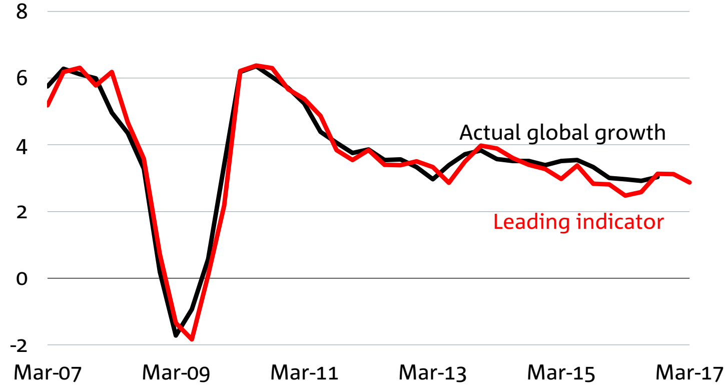
A few brighter indicators but sub-trend growth set to continue

MODERATE GROWTH SET TO CONTINUE

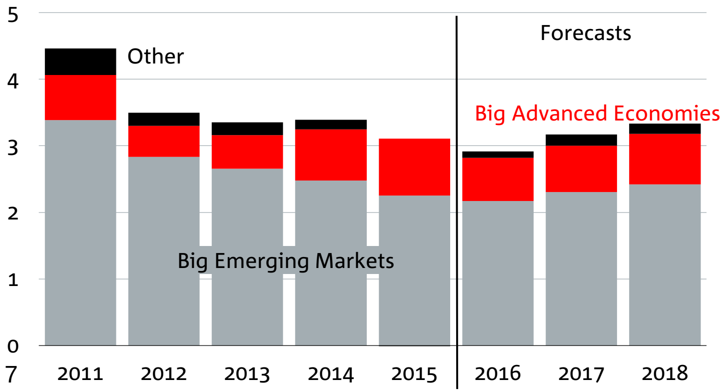
Business surveys (US, UK, Germany & France) (Index)



Actual global growth and leading indicator (% yoy)



Global economic growth (% points contribution)



- The latest business surveys as well as monthly indicators of trade and industrial output are looking slightly brighter, which is in line with our forecasts and what our leading indicator suggests. While global growth is running below its long-run average, the upturn has proved resilient through a number of financial and political shocks. The "growth scare" at the start of the year, the surprise outcomes of the Brexit vote and US Presidential election and the latest crop of Euro-zone popular votes have all failed to stall the expansion which has progressed at a 3% or so pace throughout the year.

- 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.

- The main risks facing our forecast of continued moderate global growth relate to the high burdens of debt overhanging the big advanced and emerging market economies (government and household debt in the former, corporate debt in the latter) and ongoing political uncertainty that could trigger more changes in economic policies. In particular, the Euro-zone's voting calendar is unusually full in 2017.

GLOBAL GROWTH FORECASTS (% change)

	2011	2012	2013	2014	2015	2016	2017	2018
US	1.6	2.2	1.7	2.4	2.6	1.6	2.1	2.4
Euro-zone	1.6	-0.8	-0.3	1.1	1.9	1.6	1.5	1.6
Japan	-0.1	1.5	2.0	0.3	1.2	1.0	0.8	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	4.7	2.7	2.5	0.9	-0.2	-1.2	0.2	1.9
Emerging East Asia	4.4	4.6	4.2	4.1	3.6	3.8	3.8	3.7
NZ	1.8	2.4	2.4	3.8	2.5	3.4	3.2	2.4
Total	4.5	3.5	3.4	3.4	3.1	2.9	3.2	3.3

Sources: Datastream, NAB Economics

National Australia Bank

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 4)55 052 519

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

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

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Behavioural & Industry Economics
Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 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
Markets 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

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

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055

UK/Europe
Nick Parsons
Head of Research, UK/Europe, and Global Co-Head of FX Strategy
+ 44207710 2993

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

Derek Allassani
Research Production Manager
+44 207 710 1532

National Australia Bank