EMBARGOED UNTIL: 11.30AM THURSDAY 16 FEBRUARY 2017

THE FORWARD VIEW – GLOBAL

FEBRUARY 2017

National Australia Bank

Brighter signs suggest moderate global reflation continues

- Business surveys and measures tracking the volume of activity suggest that the global economic upturn lifted a notch toward the end of last year and that trend seems to have continued into early 2017. After years of worrying about sub-target inflation or deflation, there are finally a few signs that price pressures are returning, but only mildly.
- Having worked for years to generate this upturn, the authorities should be reluctant to nip it in the bud and avoid tough budgetary measures or premature monetary tightening. We have probably seen monetary policy about as loose as it gets this cycle but rates look set to stay low by historical standards for a long time to come.
- We expect a moderate upturn in global growth that takes it back to its long-term trend level by 2018. China and India are still big drivers of global growth but there is also an important forecast lift in the US as President Trump's fiscal agenda is pursued.
- One big risk hanging over this predicted upturn is that political events and policy U-turns see markets turn risk averse and business confidence erode. We have already seen Brexit, what trade measures the US will adopt remain unclear and the French Presidential elections loom as an important test that could upset the markets and slow the pace of global growth.

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	2.3
Euro-zone	12.0	-0.8	-0.3	1.1	1.9	1.7	1.9	1.8
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	6.7	6.5	6.3
Emerging East Asia	8.0	4.6	4.2	4.1	3.5	3.7	3.7	3.6
NZ	0.2	2.5	2.2	3.4	2.5	3.2	2.9	2.5
Total	100.0	3.5	3.4	3.4	3.1	2.9	3.2	3.4

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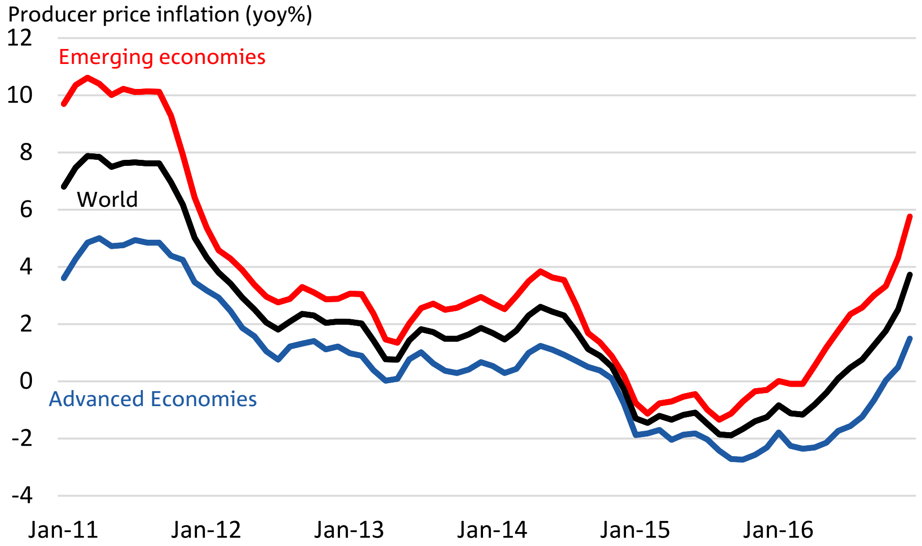
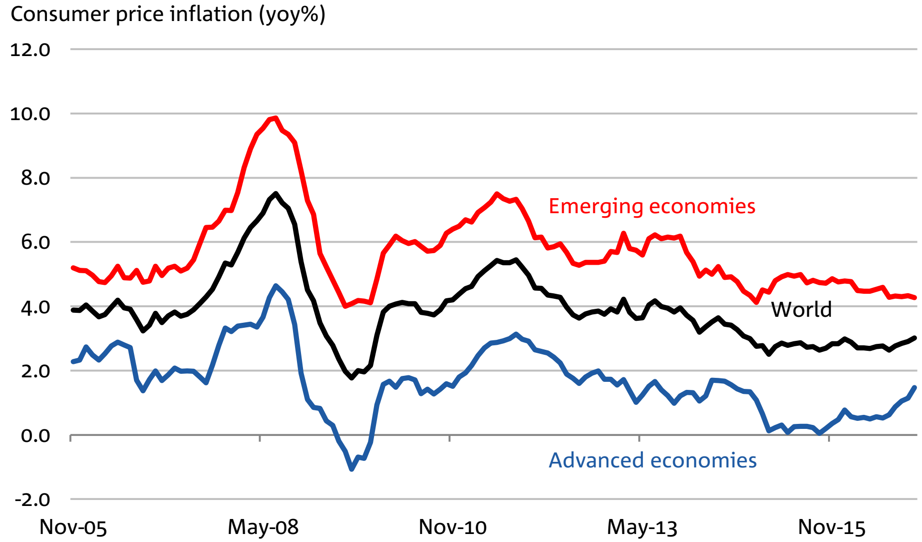
INFLATION STILL LOW BUT ITS ON THE WAY BACK UP

Higher commodity prices start to lift global inflation

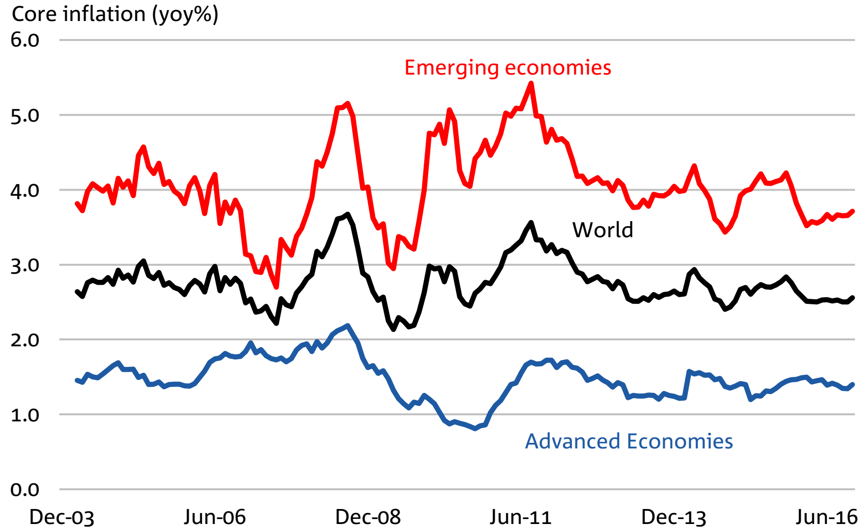
RECOVERY IN COMMODITY PRICES DRIVES PRODUCER PRICES UP



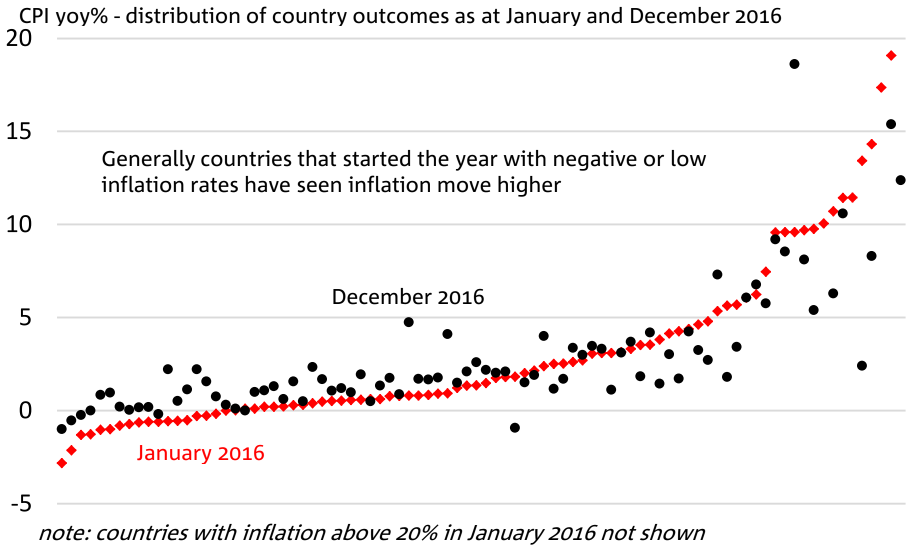
ADVANCED ECONOMY INFLATION MOVING HIGHER



EXCLUDING COMMODITY SECTORS, INFLATION IS STILL SUBDUED



INFLATION CONVERGES NEARER TARGETS ACROSS COUNTRIES



Sources: Datastream, Econdata DX (CEIC), NAB Economics

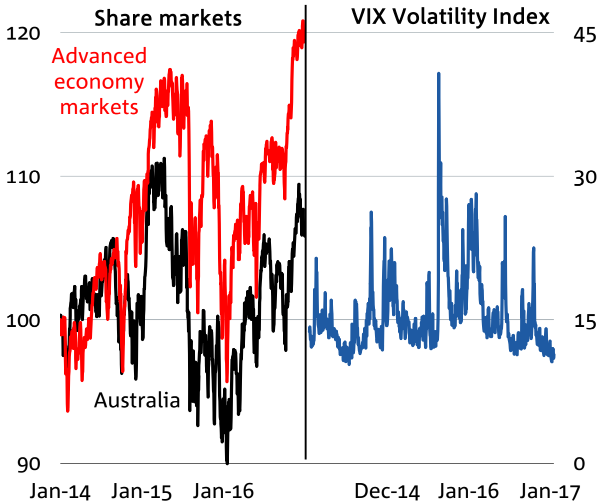
National Australia Bank

FINANCIAL AND COMMODITY MARKETS

Signs of global reflation mark end to additional central bank policy easing

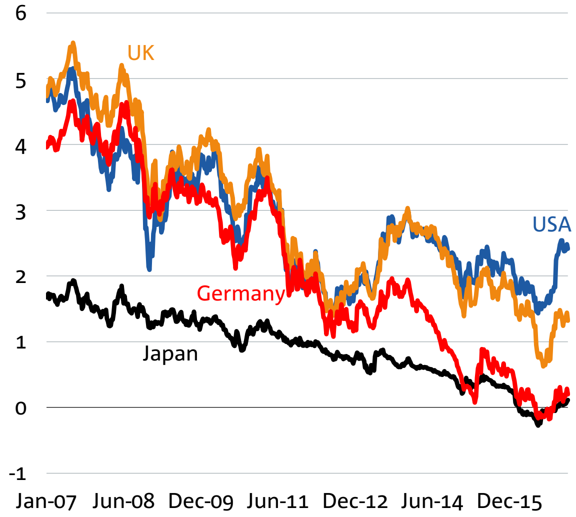
SHARES RISING, VOLATILITY LOW

Share markets and volatility indices



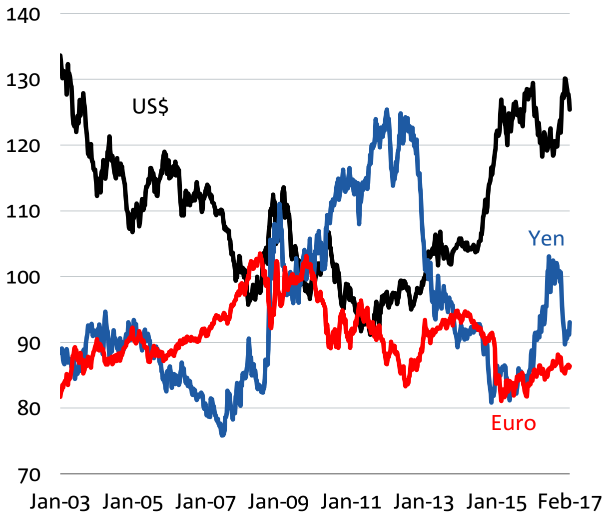
GLOBAL BOND YIELDS MOVE UP

10 yr Government Bond yields (%)



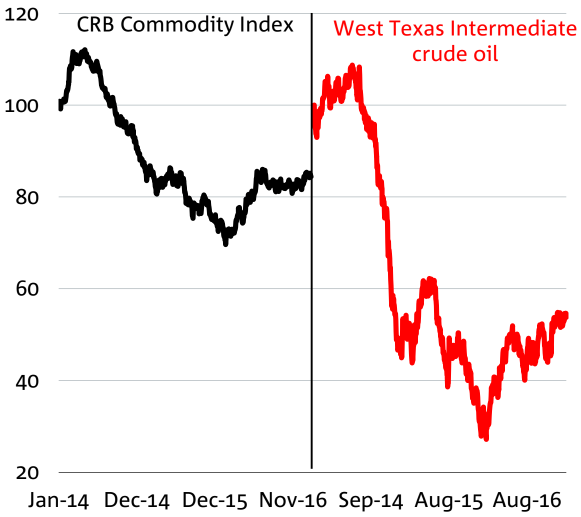
TRUMP POLICY EFFECT LIFTS $US

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



OIL RISES, BROAD INDICES FLAT

Commodity price indices (1 Jan 2014 = 100)



- After spending years worrying about how to lift sluggish economic growth and ward off deflation, central banks in the big advanced economies seem to have gone about as far as they plan to in easing their monetary policy. Equity markets, bond yields and some commodity prices have moved higher, symptoms of better economic times, and market volatility is very low. Policy interest rates are near zero or negative, central banks have bought huge stocks of bonds and we seem well past the peak in monetary easing. The US Federal Reserve and the Bank of England appear unlikely to further increase existing targets for asset stocks, the European Central Bank plans to cut its monthly asset buying from €80 billion to €60 billion from April and the Bank of Japan has kept the same rate of asset buying since mid-2016.

- While the pace of central bank asset buying has peaked, this does not mean that we can expect to see significant increases in policy interest rates in the near term. The Fed lifted its funds rate by 25 bps to a range between 0.5% to 0.75% last December, the first hike for a year, and foreshadowed further increases. Even though Fed officials signalled that rates could rise by another 75 bps through 2017 (we expect 50 bps in the latter half of the year), they also stressed that they would be very cautious in tightening monetary policy. US rates should stay well below pre-GFC averages for years to come and the Fed will only start to shrink its balance sheet once its process of interest rate rises is well under way.

- The Bank of England could also have reached its limits in cutting policy interest rates and increasing its balance sheet. With inflation looking set to outstrip its target rate and Brexit having less initial impact on UK growth rate than expected, there seems little need for further easing in the UK. Euro-zone interest rates should remain at their current low levels for “an extended period of time” but better economic conditions and fading deflation worries have lessened pressure on the ECB to cut again (a move the Bundesbank would oppose).

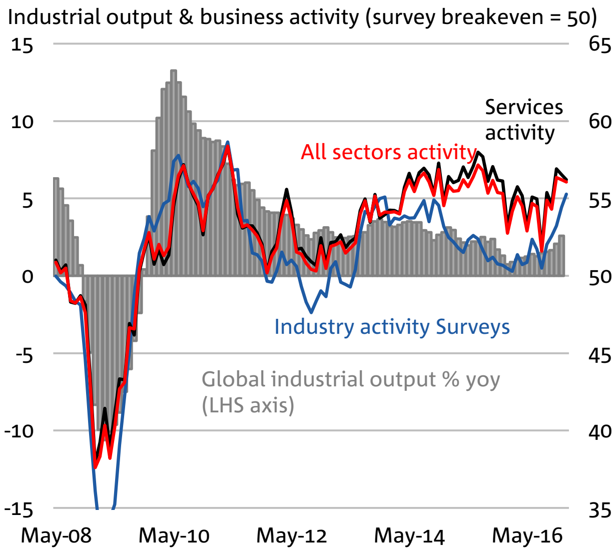
- The Bank of Japan seems content with its very loose monetary policy of negative short term rates, zero 10-year bonds and big asset buying. It appears likely to spend the next while in “wait and see” mode rather than easing policy again. The central bank thinks that economic growth and higher energy prices should be sufficient to move inflation back toward target by late 2018 but we have heard this before.

Sources: Datastream, NAB Economics

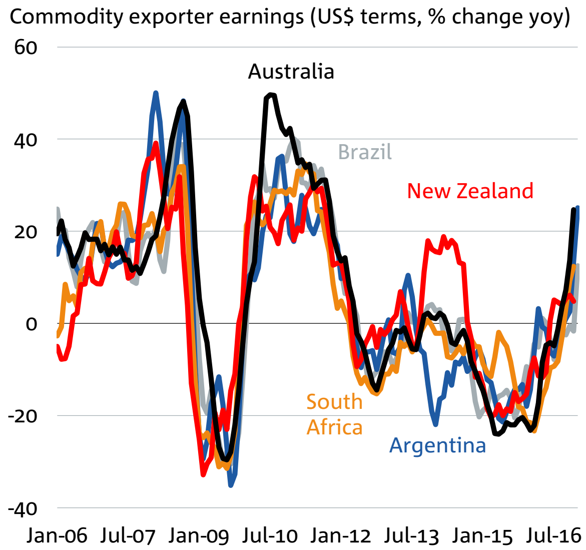
GLOBAL ECONOMIC TRENDS

Signs of economic growth picking up as global demand reflates

GROWTH PICKS UP FROM LATE 2016



COMMODITY EARNINGS TAKE OFF



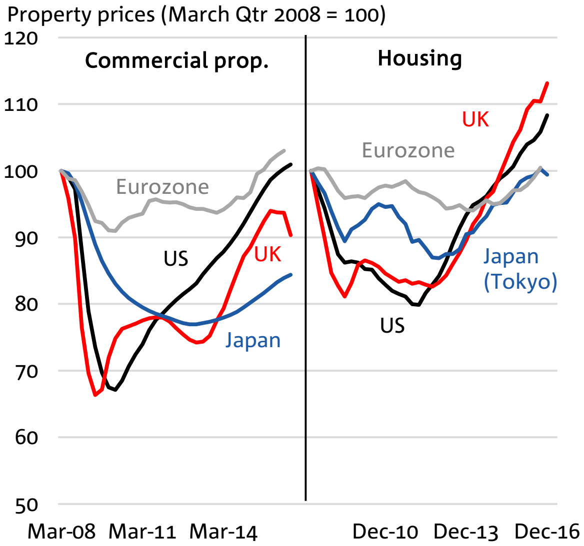
- While the pace of world economic growth remains moderate, after several false dawns the evidence is accumulating that conditions are finally improving. Global industrial output growth picked up toward the end of last year – after growing by a modest 1.8% in 2015 and an annualised rate of around 1.5% in the first half of last year, growth began ramping up through the latter half of the year. The CPB measure of global output grew by an annualised 2½% last September quarter and December quarter annualised growth could prove to be around 3%.

- Business surveys confirm the pick-up in industrial activity in the big advanced economies continued into the new year with January delivering the highest reading on activity since the middle of 2011. This strength is quite broad-based with January showing the strongest reading for US and UK manufacturing since late 2014 and mid-2014 respectively, the biggest improvement in Japanese industrial operating conditions for three years and the best outcomes for Euro-zone industry for almost six years.

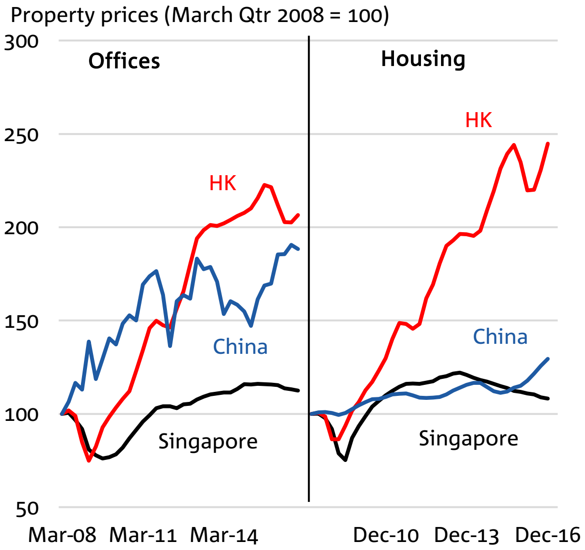
- World trade has also turned up, after a number of very weak years. Global export volumes were falling in June quarter 2015 but that shifted to annualised growth of around 0.8% last September and December quarter growth looks to be over 2%. Alongside this growth in volumes is an upturn in trade prices, linked to the resurgence in producer price inflation which, in turn, reflects the upturn in global commodity prices. Commodity exporting economies have seen growth resume in their export earnings as weakness fades for primary product prices.

- Reflation is not confined to faster growth in the volume of economic activity and an upturn in goods and services prices, it is also evident in the upturn in property prices in big advanced economies, although some Asian markets look less buoyant.

ADVANCED ECONOMY PROPERTY LIFTS



ASIAN PROPERTY TRENDS MIXED



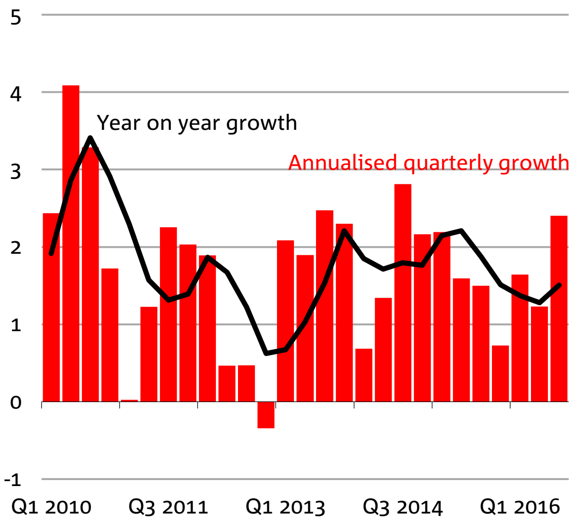
Sources: Datastream, NAB Economics

ADVANCED ECONOMIES

Surveys show broad-based lift in conditions

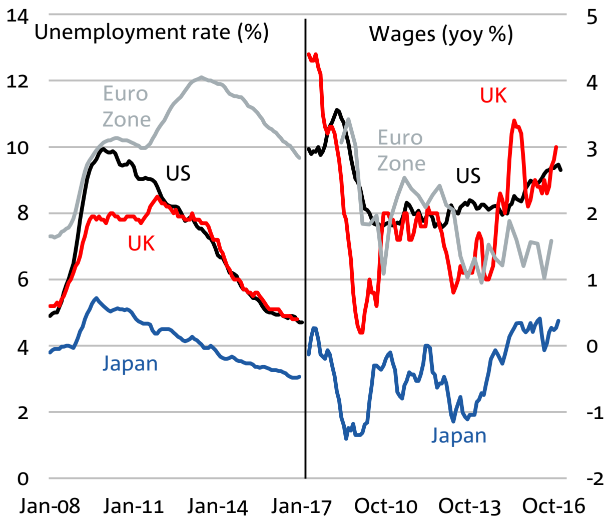
G7 GROWTH PICKS UP

G7 Advanced Economy Growth (%)



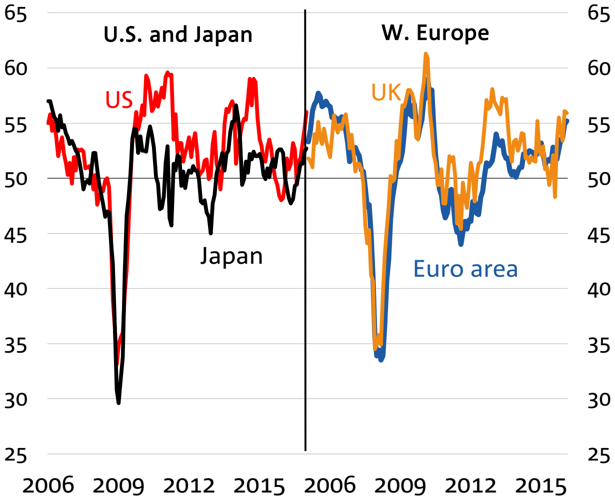
WAGES LIFT AS JOBLESS RATE FALLS

Labour market indicators (3mth m.a.)



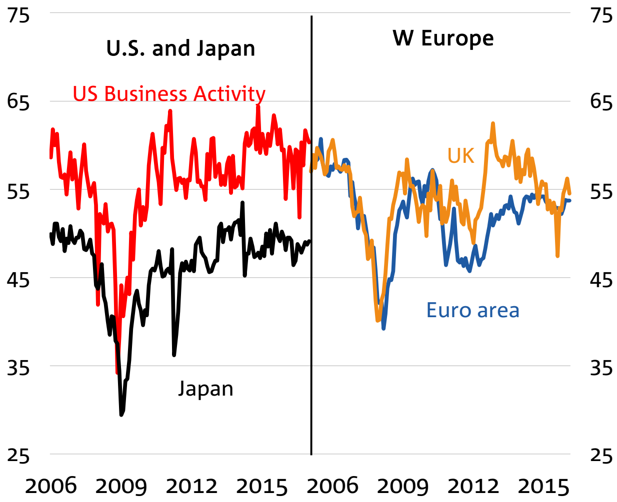
SOLID INDUSTRIAL GROWTH

Advanced Economy Manufacturing PMIs (50=Breakeven)



SERVICES SECTOR GROWING TOO

Advanced Economy Services PMIs (50 = Breakeven level)



- While recent trends in industrial output and trade confirm that the upturn in the business surveys is flowing into increased manufacturing activity, the overall pace of growth remains only moderate across the big advanced economies – it is still uphill work to boost sales, lift margins or get income increases. The pace of US economic growth virtually halved from 0.9% to 0.5% between the September and December quarters but this was partly because "one-off" factors boosted output in the former quarter – the underlying pace of annual growth remains around 2%. Euro-zone growth picked up slightly from 0.4% in September to 0.5% in December and the UK has fared much better than expected post the Brexit vote with growth staying around an annualised rate of 2½% through the latter half of 2016. In contrast, Canadian growth does not appear to have lifted much through the latter half of 2016.

- While output growth remains modest, it has been sufficient to lower unemployment rates across the big economies and that tightening in labour market conditions seems to be producing an increase, albeit modest, in wage growth. Wages stopped falling in Japan as the jobless rate fell below 4% and pay outcomes in the US and UK have climbed into the 2½ to 3% yoy range. The Euro-zone unemployment rate remains a high 9.6% and although this is well down on the 12% peak seen a few years ago, that fall does not seem enough to produce much pressure for higher wage outcomes. Tighter labour markets have generally delivered smaller wage gains than historical experience suggested likely and, as a result, central banks have revised down their views of the jobless rates consistent with running acceptable rates of inflation.

- While the big advanced economies are finally experiencing the long-awaited acceleration in growth that was expected to follow years of historically stimulatory monetary policy, there are growing risks to the upturn. These focus on the way that marked political changes can prompt U-turns in economic policy, unsettling business confidence and curbing growth. Markets are already digesting the uncertainty caused by the Brexit and President Trump's trade and tax policies and there are a series of important elections this year. The stakes are high here with French elections scheduled for March/April with one well supported party calling for exit from the Euro-zone.

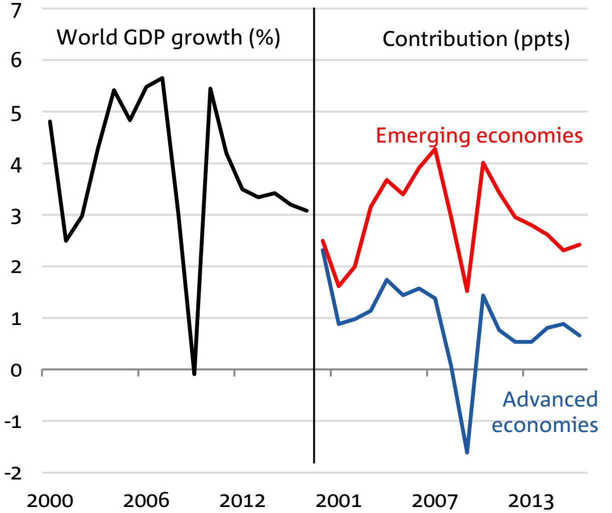
Sources: Datastream, NAB Economics

EMERGING MARKET ECONOMIES

Growth still solid but little sign of an acceleration

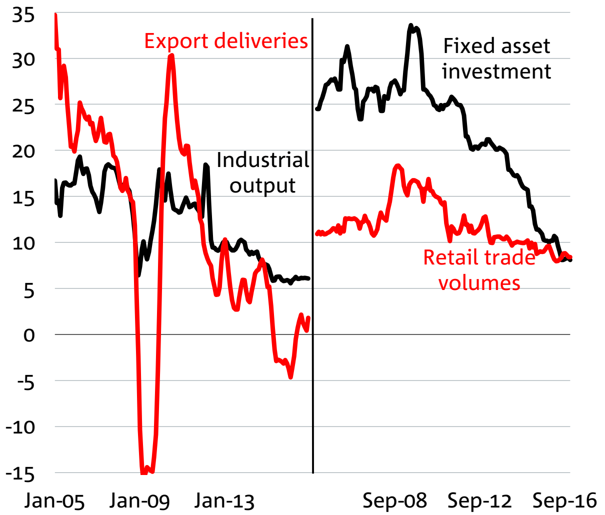
EMERGING ECONOMIES THE DRIVERS

World growth & Advanced/Emerging economy contributions



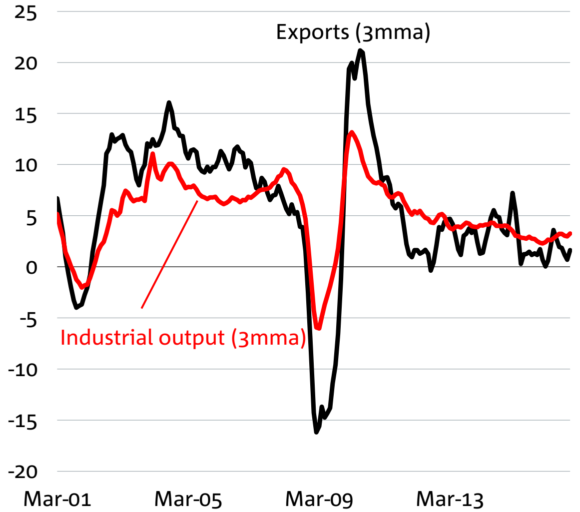
CHINESE GROWTH MIX SHIFTING

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



GROWTH NOT PICKING UP MUCH

Emerging market exports and industrial output (% yoy)



TRADE FOCUSED REGIONS WEAK

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

- The emerging market economies – particularly China (the world's biggest economy) and India (3rd biggest) – have long been the main drivers of global growth and last year was no exception. However, the late-2016 upturn in trade and industry in the big advanced economies was much less evident for the emerging market economies. Their annualised rate of industrial growth slowed from around 5% last June quarter to just over 3% in September and preliminary estimates for December quarter do not suggest any acceleration. Export volumes fell by an annualised 2¾% last June, but the decline slowed to -1.6% in September and December quarter might be flat to slightly down. There seems less weakness rather than resumed growth in emerging market export volumes.

- Emerging market growth has been held back by the sluggish performance of world trade and the income losses that earlier falls in primary product prices imposed on commodity exporting countries. World trade growth averaged only 3% annually in the last five years, well below the 5½% long term annual average and this was reflected in a marked deceleration in the growth rate of emerging economy export volumes. This export shock hit the open trade-driven economies of East Asia very hard. Furthermore, the 40% fall in non-fuel commodity prices between early 2011 and the start of 2016 added pressure on big primary producers across Latin America, SE Asia and South Africa.

- The situation has improved for these trade and commodity reliant economies more recently. World trade volumes are growing again, albeit modestly, and commodity prices have risen off their early 2016 lows. The outcome has been a reinjection of income into commodity exporters like Brazil and South Africa – but at the cost of big commodity importers like India and China – and a better trading environment for places like Taiwan or Malaysia.

- The sheer size of their economies mean that China and India are still the big drivers of emerging market growth. Both are still growing at a solid pace of around 7%, underpinned by rapid growth in domestic spending. With neither country facing the sort of economic imbalances that would require major policy changes to suddenly curb growth, the outlook remains positive.

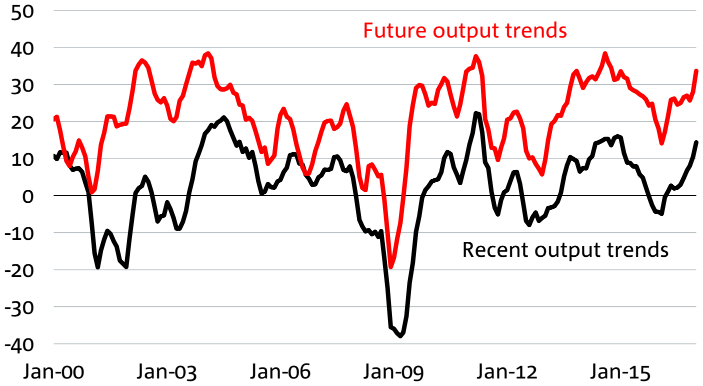
 Sources: Datastream, CEIC, NAB Economics

GLOBAL FORECASTS AND POLICIES

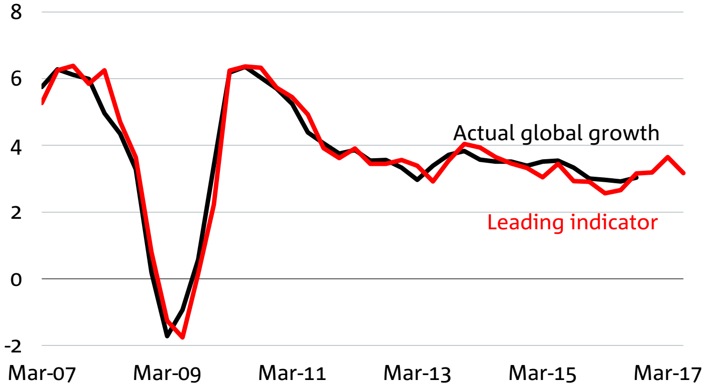
Positive signs of global reflation but political risks abound

MODERATE GROWTH SET TO CONTINUE

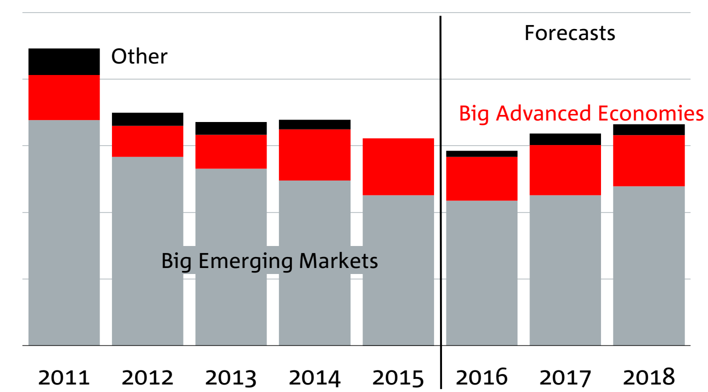
Business surveys (US, UK, Germany & France) (Index)



Actual global growth and leading indicator (% yoy)



Global economic growth (% points contribution)



- Measures tracking changes in the volume of economic activity as well as business survey trends point to a lift in the pulse of global growth toward the end of last year. Higher commodity prices, the related upsurge in producer price inflation, an easing of deflationary fears for goods and services prices and the upturn in property prices are all symptoms of that gradual moderate reflation in global demand. The rise in global equity markets and a reflation-inspired lift in bond yields suggest that the financial markets have bought into the positive view that global growth is lifting.

- Our global tracking indicator and business survey expectations are consistent with this moderate acceleration in growth persisting for a while yet. Policy makers seem very reluctant to take measures that could short-circuit this long awaited upturn with rhetoric shifting away from fiscal austerity and towards measures that would lift demand while, when it comes to monetary policy, central banks will be very cautious in tightening via rate hikes or rundowns in their assets.

- The upshot is a modest acceleration in global growth from just under 3% in 2016 to 3.2% in 2017 and 3.4% in 2018. This is still only a moderate pace of growth around the average of the last 35 years – it is certainly no economic boom – but it is better than we have seen in the last couple of years. The main risk hanging over this projected upturn is sharp changes in economic policy unsettling financial markets and eroding business confidence and this comes down to politics. The world is still digesting the impact of Brexit and President Trump's array of possible trade policy options, French Presidential elections are due in the next few months where the National Front has been polling strongly and wants to leave the Euro.

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	2.3
Euro-zone	1.6	-0.8	-0.3	1.1	1.9	1.7	1.9	1.8
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	1.8	1.7
Canada	3.1	1.7	2.5	2.6	0.9	1.2	1.7	2.0
China	9.5	7.7	7.7	7.3	6.9	6.7	6.5	6.3
India	7.9	5.9	6.3	7.0	7.2	7.1	7.2	7.2
Latin America	4.7	2.7	2.5	0.9	-0.2	-1.2	0.1	1.9
Emerging East Asia	4.4	4.6	4.2	4.1	3.5	3.7	3.7	3.6
NZ	1.8	2.5	2.2	3.4	2.5	3.2	2.9	2.5
Total	4.5	3.5	3.4	3.4	3.1	2.9	3.2	3.4

Sources: Datastream, NAB Economics

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