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THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

***Global**: The global economic upturn has ridden out geo-political shocks coming from Brexit and the risk of US policy U-turns in the wake of President Trump's election victory. The latest business surveys show very positive sentiment across the big advanced economies, recent data on global industrial output and trade shows the upturn continuing into 2017 and fear of global deflation has gone as modest price pressure returns. The main disappointment has been the big emerging economies which are key drivers of commodity demand. Central banks appear more relaxed about the outlook, with the period of maximum policy stimulus probably now behind us as the US Fed focuses on gradually lifting interest rates and the others see little need to take any new measures to boost demand. Politics still presents the main risk to our forecast acceleration in global growth from 2016's 3% rate to around 3½% by 2018 with the focus shifting to the series of elections due in Western Europe through the next year, especially those in France and Italy where anti-Euro populist parties have been polling strongly.*

- The improved outlook for the global economy has been reflected in increases in major equity markets, bond yields and commodity prices. This is not withstanding a recent pause, in part due to renewed uncertainty around the scale and timing of any US fiscal stimulus, and the prospect for increased oil production. Central banks in the big advanced economies have gone about as far as they plan to in easing monetary policy. The Fed is already raising rates, the Bank of England appears unlikely to further expand its asset purchase program, the ECB's monthly asset buying will slow from €80 billion to €60 billion starting this month, and the Bank of Japan is in wait and see mode.
- After settling around 3% yoy through the first three quarters of 2016, global growth picked up to 3.2% yoy in December, mainly because of an upturn in big advanced economies. Reflation in the big advanced economies goes beyond the acceleration in output growth, with price pressures also lifting modestly. Meanwhile, the pick-up in inflation in the big emerging market economies has been more marked, driven by higher energy and raw material prices. The global upturn has continued into 2017 with the rate of expansion in the volumes of both world trade and industrial output ramping up through to January 2017 according to the CPB measure. Business survey results are available up to March and they show the lift in activity through late 2016 continuing into this year.
- The big advanced economies that have seen the clearest evidence of faster growth. The trend in most of that data continued to be positive into early 2017. Quarterly industrial growth has lifted and the upturn in export volume growth is even stronger. The monthly business surveys have been positive for the first three months of 2017, with industrial measures showing a particularly marked lift that appears highly synchronised across the big advanced economies. Services industries make up the bulk of output in all advanced economies and they tend to be much less cyclical. Consequently, it is only to be expected that the current upturn in service sector business surveys looks less pronounced than for manufacturing. At the same time, recent survey readings are higher than for manufacturing, pointing to the former's faster rate of growth.
- Economic growth in the emerging markets stagnated through last year, largely reflecting the absence of additional growth momentum in the biggest economies. That does not mean that the cyclical upturn being experienced in advanced economy output and the lift in global inflation has not been helping activity in some emerging market economies. The rate of growth in both industrial output and export volumes in the emerging market economies picked up through late last year and the upturn has carried over into 2017. The arc of export-driven East Asian economies stretching from South Korea to Singapore has seen a sharp upturn in industrial output and exports, a rebound connected to the parallel improvement in world trade. Higher global commodity prices have also boosted export revenues and national income in the many big primary producing emerging market economies.
- The business surveys suggest that global reflation is set to continue. By contrast, our global leading indicator of economic activity shows acceleration in growth to mid- year, but conditions dip a little after that – although it appears too early to call a pause in the growing pace of reflation. We expect the pace of global growth to quicken from 3% in 2016 to 3.3% in 2017 and then rise further to 3.5% in 2018. Our first estimate of growth for 2019 sees it coming back to around 3.3% as the US gets nearer to full capacity and Fed rate hikes bear down on growth, the Euro-zones cyclical upturn fades a little and Chinese growth continues its trend slowing. The most obvious risk hanging over this fairly positive global outlook comes from an array of geo-political risks, although so far the world economy has navigated these risks with surprisingly little impact.
- For more detail on the global outlook, please see the Forward View – Global, released earlier today.

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Australia: Economic growth is expected to oscillate through 2017, with partial indicators suggesting very modest growth in Q1, Q2 heavily affected by Cyclone Debbie and then Q3 and Q4 forecast to surge on LNG exports, a rebound in cyclone-affected coal exports and reduced drag from mining investment (GDP growth forecast at 2.3% in annual average terms). Momentum will slow through 2018 as dwelling construction and LNG exports both peak (growth at 2.8% in annual average terms but slowing to 2.3% in through the year terms by Dec-18). Household spending will remain subdued amidst low household income growth, while business investment improves and solid government spending provides an offset. A moderate recovery in domestic demand is then expected in 2019. Against a backdrop of below-target inflation and elevated unemployment, policy makers are unlikely to address their concern about household balance sheets via interest rates, with further macro-prudential measures possible. We expect the RBA to remain on hold for an extended period, before some small hikes in late 2019 as domestic demand improves.

- In March, the NAB Monthly Business Survey results pointed to an overall healthy economy that is gaining momentum, at least in the near-term. Business conditions hit +14, their highest level since the GFC, although there is likely that Cyclone Debbie introduced some upward bias to the outcome (skewing the sample away from affected firms). Meanwhile, confidence was relatively muted, easing to +6, but still at solid levels. Capacity utilisation rose in the month, while the Survey's indicator of capital expenditure improved on already solid levels.
- While it is too early to accurately gauge the impact of Cyclone Debbie (which hit North Queensland on March 28), early estimates suggest a decline in coal exports of 15-20 mt, which will reduce nationwide coal exports by approximately 20% in chain volume terms in Q2, subtracting approximately 2.5ppt from total exports and 0.3ppt from Q2 GDP before rebounding in Q3. Tourism exports and revenue will also be affected in the coming months, although rebuilding may support measured GDP growth over the longer term. Damage to crops is estimated to raise headline inflation by 0.1-0.2ppt in Q2 via higher fruit and vegetable prices but will not impact core inflation.
- Notwithstanding the impact of Cyclone Debbie, the trade sector is expected to add to GDP growth in 2017, supported by LNG exports, but becoming neutral for growth in 2018 as LNG exports flatten off. Higher commodity prices have helped the trade balance move into surplus, and a current account surplus is likely in Q1, but the terms of trade are expected to peak in Q1 2017 before declining gradually through 2017 and 2018.
- Employment rebounded by a surprisingly strong 61K in March. The unemployment rate remained steady at 5.9%, as the participate rate bounced to 64.8% from 64.6%. Full time employment rose 74.5k, while part time employment fell by 13.6k. The biggest employment gains were in Queensland, up 28.8k, consistent with improving business conditions, especially in mining. Note the data pre-date cyclone Debbie, so next few months' results could show some mixed impacts. New South Wales employment also rose by a strong 23.3k, reversing losses earlier this year. We expect NSW employment to continue to improve given robust business conditions. Victoria again recorded strong jobs growth, while WA also improved on improved mining conditions. While the ABS series have been volatile, and weaker than other leading indicators, this month's results close some of the gap and are more encouraging.
- Retail turnover fell 0.1% m/m in February after rising 0.1% in January. Year on year data was slightly more encouraging, up 2.7%. Clothing and footwear as well as household goods were the worst performers in February, perhaps related to the weather or the closure of some clothing chains in the month, while department stores and food retailers grew. The NAB Online Retail Sales Index slowed in trend terms to 0.3% m/m in February, down from 0.5% in January. Meanwhile, the retail industry continues to show poor results in the NAB Monthly Business Survey, lagging well behind all other major industries – reflecting a combination of subdued demand, fierce competition and margin compression. We continue to expect a lacklustre outlook for household consumption, reflecting subdued wages growth, and elevated levels of household debt.
- Aside from the NAB Business Survey, timely indicators of capital expenditure remain fairly muted despite more favourable business conditions. Despite the jump in February, the value of non-residential building approvals has looked relatively lacklustre since spiking around mid-2016. Trend approvals were down another 3.3% in the month, to be 6.8% lower over the year. In contrast, the value of capital goods imports has risen nearly 5% in the first two months of the year, to be 17.6% higher over the year to February – suggesting solid investment in equipment. Leads on the longer-term outlook tend to be mixed with investment expectations from NAB's Business Survey holding up, while the ABS Capex Survey suggests the non-mining investment recovery may stall.
- New residential building approvals have come off their highs, but the trend has recently turned positive again. That is a surprise development given expectations for more supply constraint in light of growing settlement risk and over-supply concerns (namely for CBD apartments) – suggesting the construction cycle may extend a little longer than expected. Meanwhile, it is too soon to know how recent policy announcements from APRA (the most noteworthy relating to interest-only loans) will affect the market, although a modestly negative impact is anticipated. Even so, the market has been performing much better than expected, prompting an upward revision to our property prices forecasts for 2017 (see the Q1 Quarterly Residential Property Survey for more detail).
- Against a backdrop of below-target inflation and elevated unemployment, policy makers are unlikely to address their concerns about household balance sheets via interest rates, with further macro-prudential measures possible. We expect the RBA to remain on hold for an extended period, before some small hikes in late 2019 as domestic demand starts to improve. The AUD has gradually depreciated since late March, particularly in trade weighted terms. We maintain our projection for the AUD/USD to reach 0.70 by year-end.
- For more detail on the Australian outlook, please see the Forward View – Australia, released yesterday.

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