

THE FORWARD VIEW – GLOBAL

APRIL 2017



Geo-political risks fail to dent global deflation...for now

- The global economic upturn has ridden out geo-political shocks in the UK and US. 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 through the early months of 2017 and fear of global deflation has gone as modest price pressure returns.
- So far, the advanced economy upturn has only had a modest impact on global growth. Emerging market economies are the main drivers of global expansion and their growth has stagnated. Industry has shown the strongest cyclical recovery in the advanced economies but it is less than a fifth of GDP with the much bigger service sector showing a less pronounced upturn.
- 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.
- We look at how China's growth model has delivered high but very unequal income expansion with wealth and income concentrated at the top and in certain regions. This is now changing with inequality coming off in recent years, faster growth in poorer regions and the top 10% share of income falling. A growing lack of social mobility is still a major problem.

KEY GLOBAL FORECASTS (% change)

	IMF weights	2012	2013	2014	2015	2016	2017	2018	2019
US	15.8	2.2	1.7	2.4	2.6	1.6	2.1	2.3	2.0
Euro-zone	12.0	-0.8	-0.3	1.1	1.9	1.7	1.9	1.8	1.5
Japan	4.2	1.5	2.0	0.2	1.2	1.0	1.1	0.8	0.7
China	17.3	7.7	7.7	7.3	6.9	6.7	6.5	6.3	6.0
Emerging East Asia	8.0	4.7	4.3	4.1	3.6	3.9	3.9	4.0	3.9
NZ	0.2	2.5	2.2	3.4	2.5	3.1	2.7	2.5	1.8
Total	100.0	3.5	3.4	3.4	3.1	3.0	3.3	3.5	3.3

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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

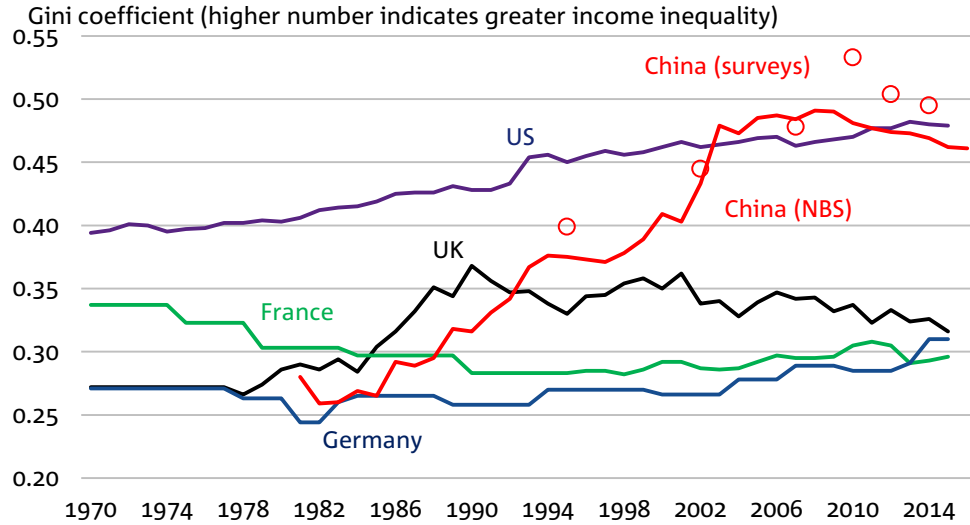
Gerard Burg, Senior Economist

John Sharma, Economist

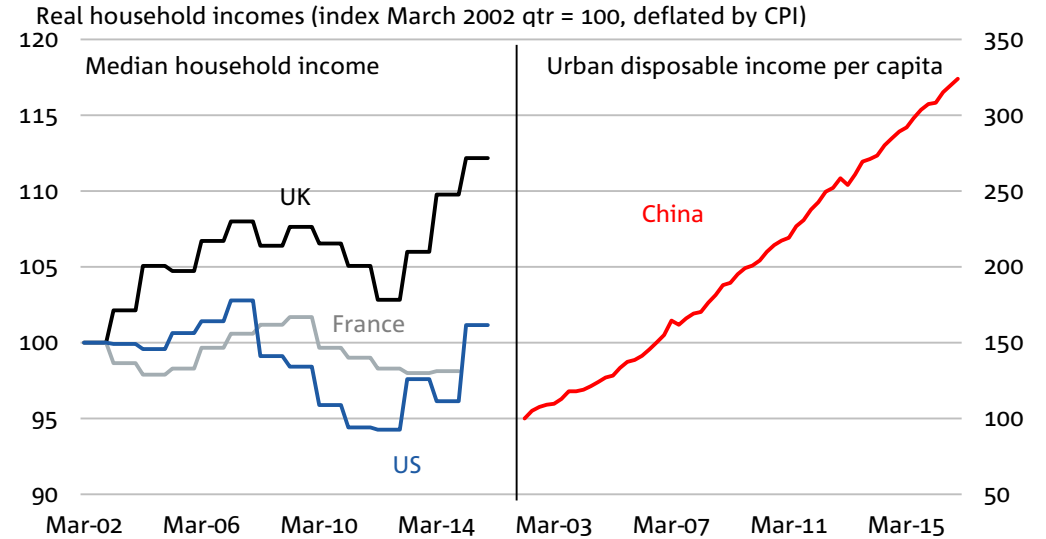
CHINA'S ECONOMIC MODEL STARTS TO DELIVER LESS UNEQUAL GROWTH

Chinese model delivers rapid income growth, a growing middle class and high inequality

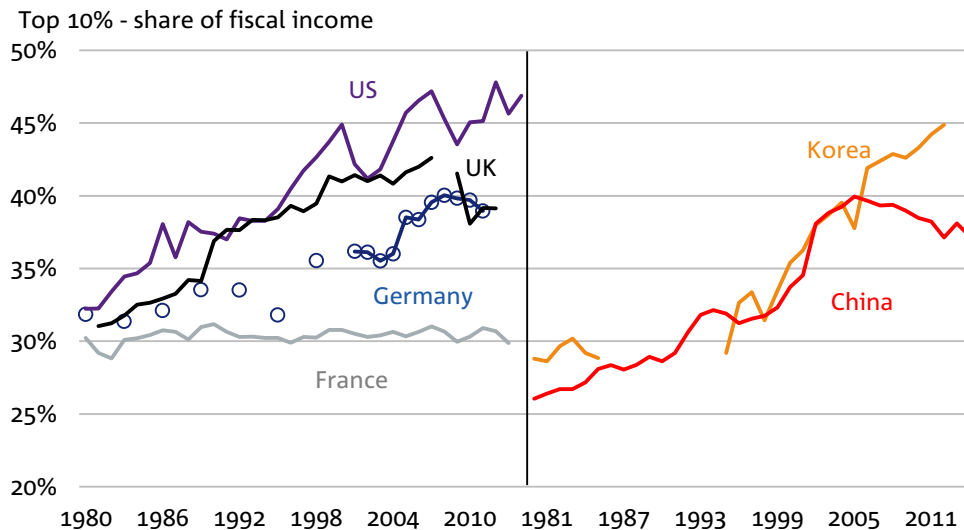
CHINESE INEQUALITY STILL HIGH BUT SEEMS TO HAVE PEAKED



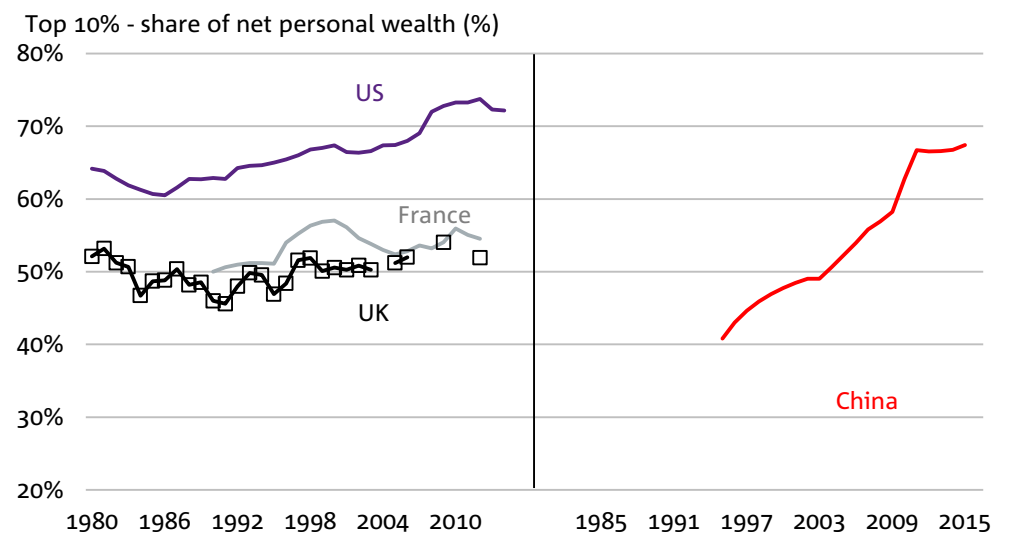
CONTRAST CHINESE INCOME TAKEOFF WITH POOR OUTCOMES IN WEST



SHARE OF TOP INCOME GROUP TAPERS OFF IN CHINA



CHINESE WEALTH CONCENTRATION RISES TO NEAR US LEVEL

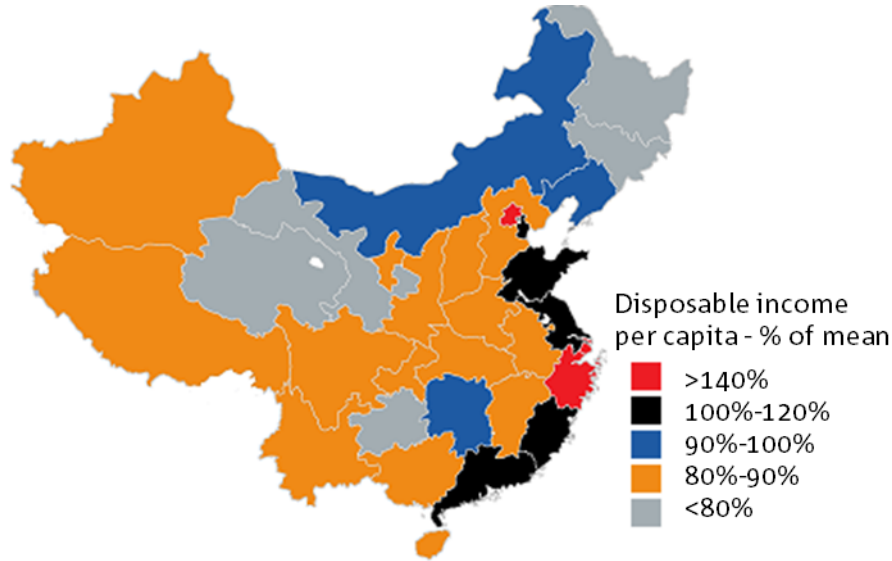


Sources: US Census Bureau, Thomson Reuters Datastream, WID.world

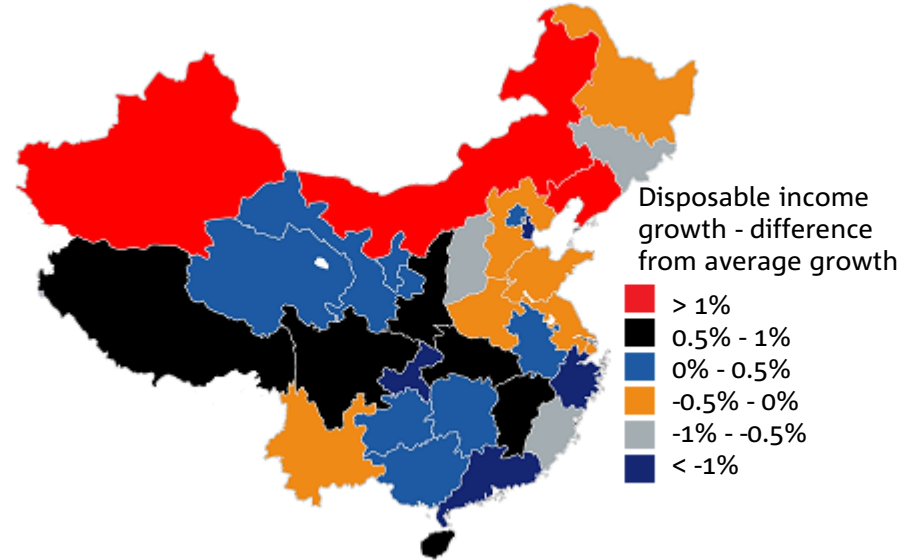
PATTERN OF REGIONAL GROWTH EASES DIFFERENCES BUT LOW SOCIAL MOBILITY

Incomes grow rapidly but increasingly difficult to change social rank

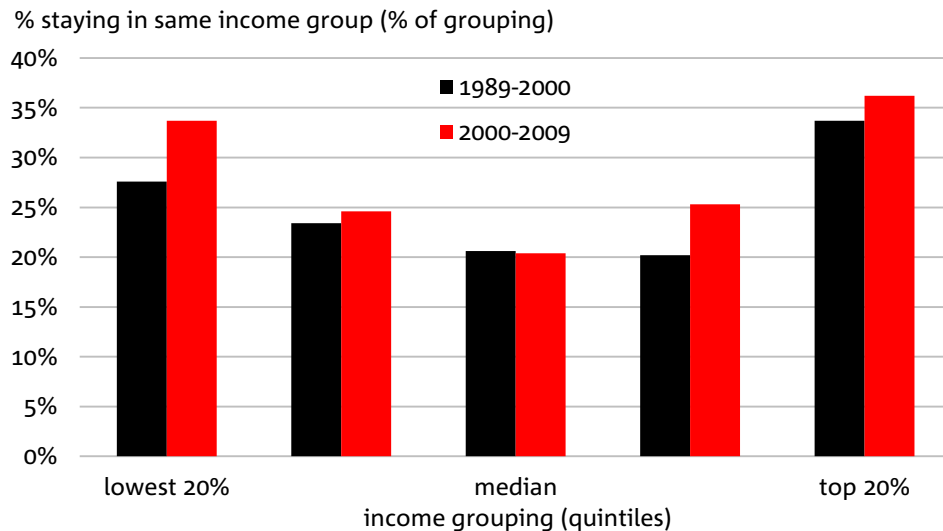
STILL ARE BIG REGIONAL DIFFERENCES IN AVERAGE INCOMES



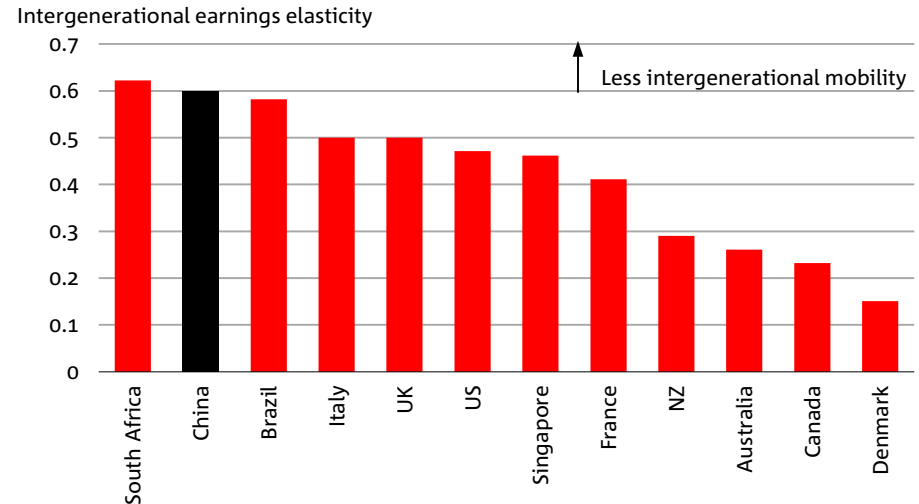
BUT FASTER GROWTH IN POORER AREAS WILL ERODE INEQUALITY



FAST INCOME GROWTH BUT MOBILITY LOW – MANY STUCK AT THE BOTTOM



AND CHINESE INTER-GENERATIONAL MOBILITY LOW AND FALLING



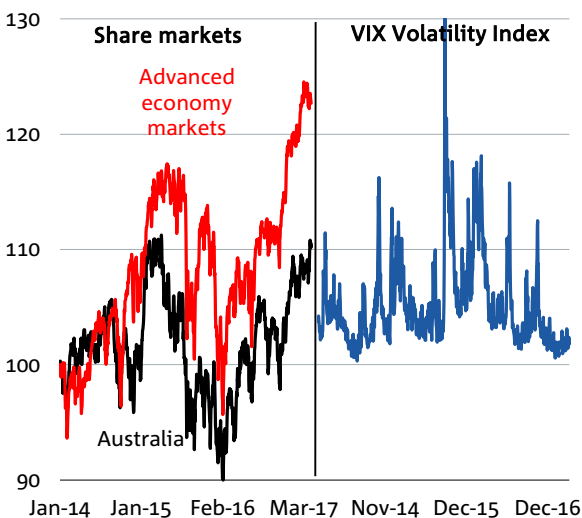
Sources: CEIC, Mobility in China, Yi Chen and Frank Cowell (2013), Economic Mobility Miles Corak (2016)

FINANCIAL AND COMMODITY MARKETS

Despite recent pause, markets have been lifted by better global outlook

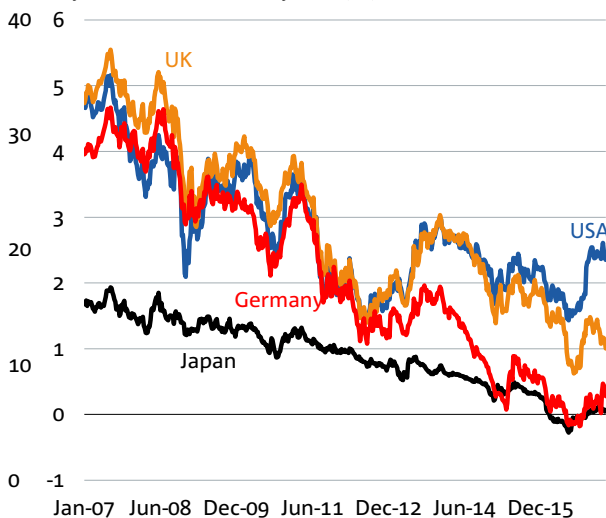
SHARES STABILISE AT HIGH LEVELS

Share markets and volatility indices



RISE IN YIELDS PARTIALLY UNWOUND

10 yr Government Bond yields (%)

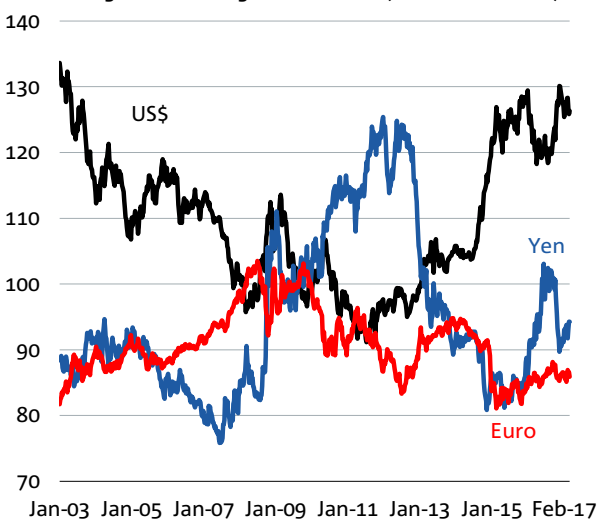


The improved outlook for the global economy has been reflected in increases in major equity markets, bond yields and commodity prices. This is notwithstanding a recent pause, in part due to renewed uncertainty around the scale and timing of any US fiscal stimulus, and the prospect for increased oil production.

- 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 announced asset purchase program, the European Central Bank's (ECB) 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.
- Having basically achieved its unemployment goal, and closing in on its inflation target, the Fed lifted its funds rate target range by 25 bps in its last meeting and is flagging a further two rate rises this year as part of a 'gradual' monetary tightening. The Fed is starting to focus on how it will start to unwind its large balance sheet – the result of QE asset purchases – with most Fed members thinking this should process start later this year. As a result, we think that the Fed will hike rates in June and September, and start unwinding QE late in 2017.

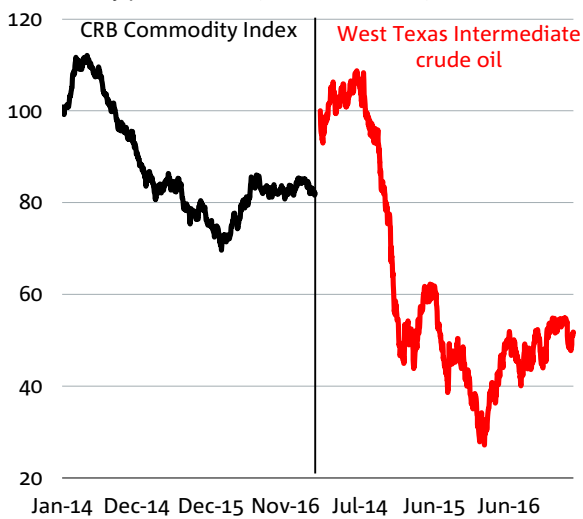
SOME UNWINDING OF TRUMP \$US GAIN

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



COMMODITY PRICES TAKE A PAUSE

Commodity price indices (1 Jan 2014 = 100)



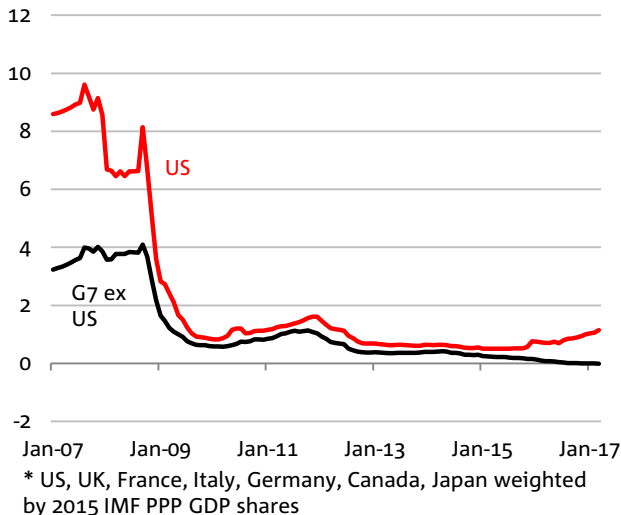
- The Bank of England looks to have reached its limits in cutting interest rates and increasing its balance sheet. Inflation is set to outstrip the Bank's target rate due to the large fall in sterling, and while the Bank has indicated it will be patient in bringing inflation back to target, it has also said there is a limit to how long it can tolerate above target inflation. Similarly in the Euro-zone, with the economy showing positive signs and inflation well above last year's levels, the focus is on when the ECB might start increasing the official deposit rate – currently negative – and announce further reductions in central bank asset buying.
- The Bank of Japan (BoJ) is in no rush to make any changes to its very loose monetary policy of negative short term rates, around zero 10-year bonds and big asset buying. With core inflation measures having softened over the last year, and risks seen to be skewed to the downside, the BoJ appears comfortable with a widening divergence between Japanese and US long-term rates.

GLOBAL ECONOMIC TRENDS

Policy stimulus paying off as global economy reflates – output and inflation up

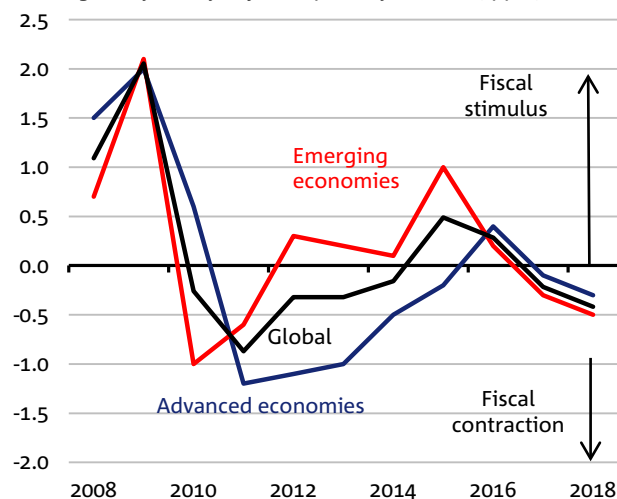
VERY LOW INTEREST RATES

G7 - 3mth interbank interest rate (%)



BUDGETS TURN EXPANSIONARY

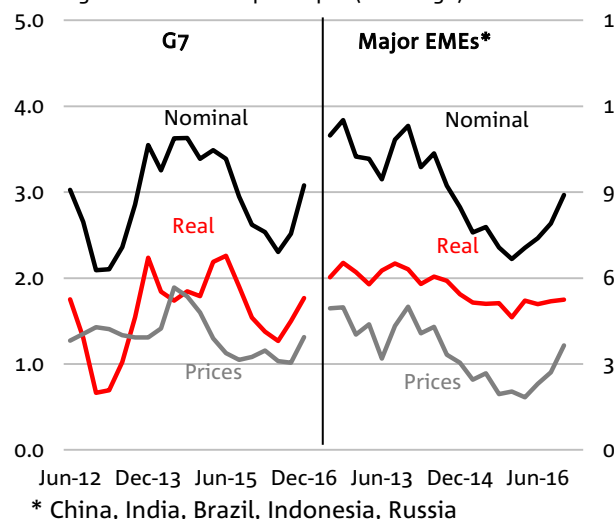
Change in cyclically adjusted primary balance (-ppts)



- After a long flat period of sluggish growth, global growth began accelerating toward the end of last year. 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. The latter's pace of growth lifted from 1¼% yoy in mid-2016 to 1¾% yoy at the end of the year. Growth has not picked up in the emerging market economies, staying just below 4¾% yoy all through 2016, mainly because of the flat-lining of an already solid pace of expansion in India and China.
- Reflation in the big advanced economies goes beyond the acceleration in output growth, with price pressures also lifting modestly – from around 1% yoy through most of last year to 1¼% yoy in December. The pick-up in inflation in the big emerging market economies has been more marked with output prices rising by over 3½% yoy at the end of 2016, about double the pace at the start of the year. Higher energy and raw material prices account for much of this increase in price pressures.

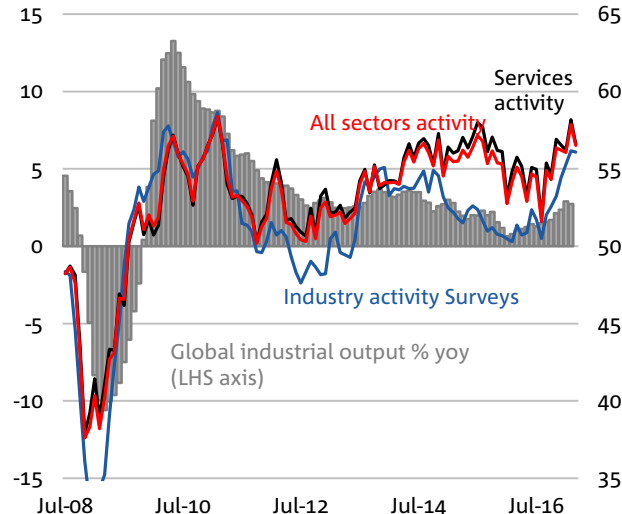
MODEST REFLATION BEGAN IN 2016

GDP growth - real and price split (% change)



UPTURN CONTINUES INTO 2017

Industrial output & business activity (survey breakeven = 50)



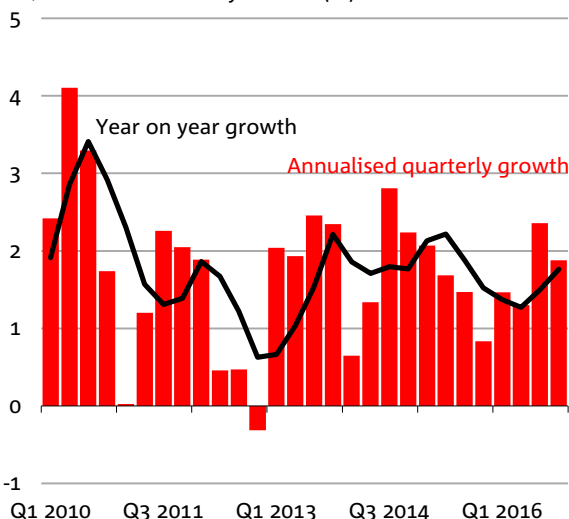
- The global upturn has continued into 2017 with the rate of expansion in the volumes of both world trade and industrial output ramping up through to January 2017 according to the CPB measure. Our estimates of global industrial growth show it running at almost 3% yoy in the first two months of the year, more than double its growth rate in mid-2016. Business survey results are available up to March and they show the lift in activity through late 2016 continuing into this year.
- This reflation in advanced economy growth and global inflation is the payoff from years of policy aimed at stimulating just such an upturn. Interest rates in the big advanced economies were held down at historically low levels for years, fiscal policy has turned from being a headwind to global growth to injecting demand in 2016 and credit is flowing more freely. The support from monetary policy to demand growth across the big advanced economies appears to have peaked but the stimulus of low interest rates and central bank asset buying will be wound back very gradually to avoid damaging the long awaited economic upturn.

ADVANCED ECONOMIES

A broad-based lift in conditions

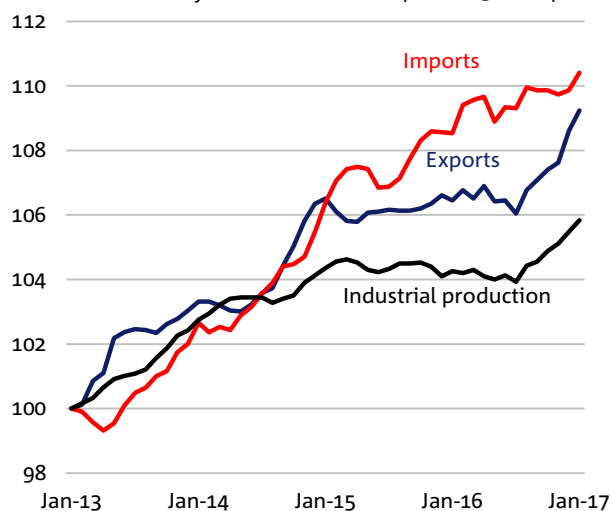
G7 GROWTH TRENDING HIGHER

G7 Advanced Economy Growth (%)



ADVANCED ECONOMIES STRONGER

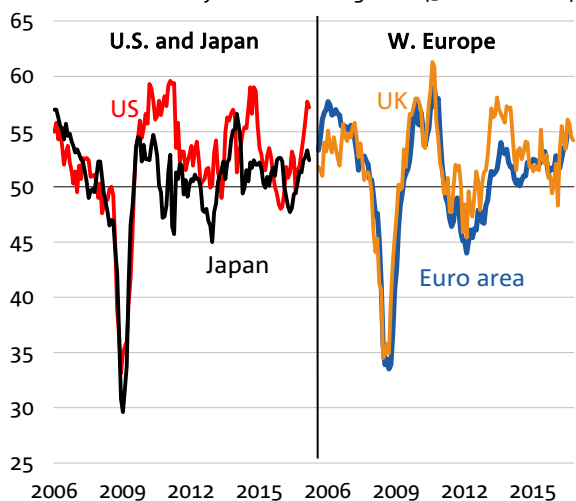
Advanced economy trade volumes & IP (Jan 2013 = 100)



- Although the bulk of the increase in global output still comes from the emerging economies, it is the big advanced economies that have seen the clearest evidence of faster growth. Behind the usual volatility in the profile of quarterly growth, the trend does seem to be one of better GDP outcomes. Using 6 monthly output numbers gives the clearest picture of the lift in the underlying pace of annualised growth – from around 1% in late 2015 and early 2016 to over 2% by the end of last year. We can expect the volatility to continue in the quarterly GDP numbers, which are affected by special factors like the weather or strikes and it is the underlying trend across a range of data that should be the focus.
- The trend in most of that data continued to be positive into early 2017. Quarterly industrial growth lifted from -0.2% last June to 0.4% in September and 0.9% in December and it looks to have continued around that pace in early 2017. The upturn in export volume growth is even stronger – after falling by 0.1% last June, the quarterly growth rate climbed to 0.6% in September and 1.5% in December and early 2017 looks to have done even better. This follows a long period of weakness in world trade.

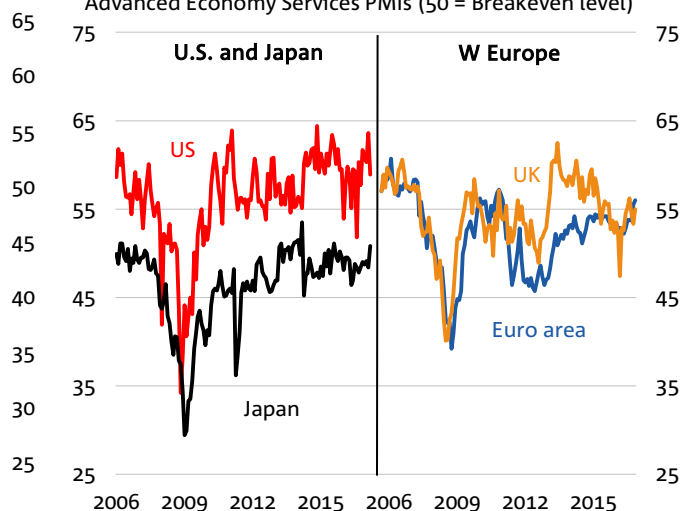
SOLID INDUSTRIAL GROWTH IN 2017

Advanced Economy Manufacturing PMIs (50=Breakeven)



SERVICES SECTOR GROWING TOO

Advanced Economy Services PMIs (50 = Breakeven level)



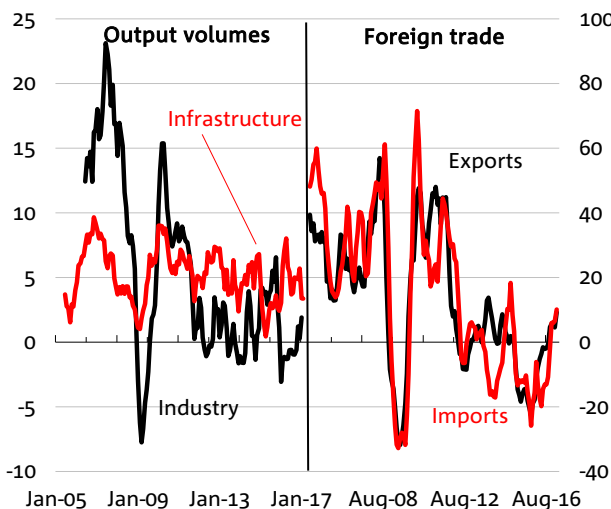
- The monthly business surveys provide the most timely indicator of the pulse of global economic activity and results from the first three months of 2017 have been positive. Industrial growth has seen a particularly marked lift, which is hardly surprising as it is usually very cyclical and so should recover strongly in an upturn. The industrial cycle also looks to be highly synchronised across the big advanced economies, in some past business cycles different countries have seen diverging output performance but this time there is strengthening in all the big 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.

EMERGING MARKET ECONOMIES

GDP growth flat-lines but there are positive signs in trade and industry

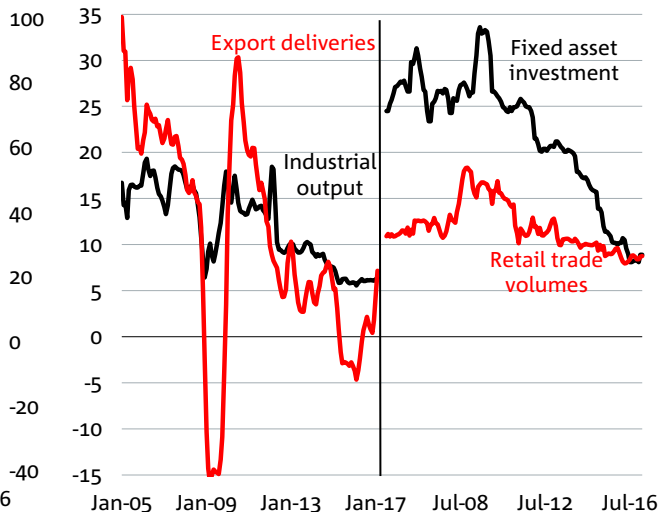
INDIA BETTER THAN EXPECTED

Indian monthly economic indicators (% yoy)



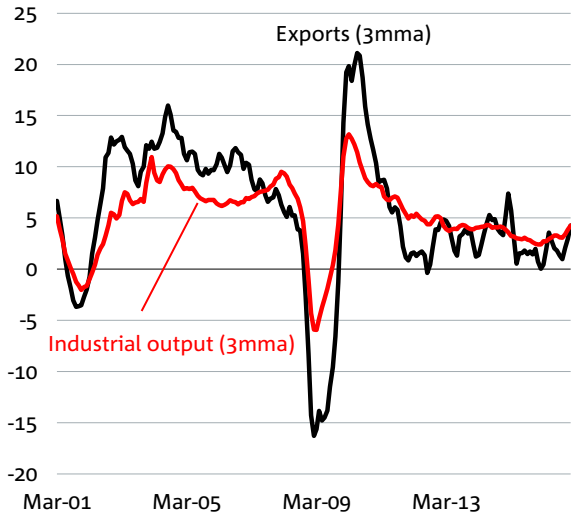
CHINESE GROWTH MIX SHIFTING

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



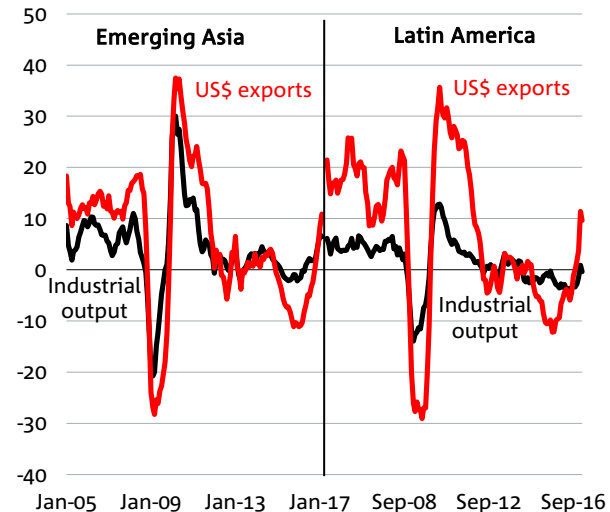
GROWTH BEGINNING TO PICK UP

Emerging market exports and industrial output (% yoy)



POSITIVE SIGNS IN KEY REGIONS

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



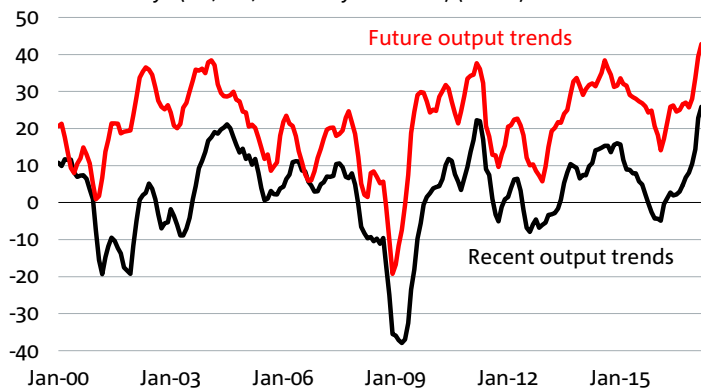
- Economic growth in the emerging markets stagnated through last year, largely reflecting the absence of additional growth momentum in the biggest economies. China is the biggest economy in the world, India ranks third, Russia sixth and Brazil eighth. Together they account for almost half of total output in the emerging economies and almost one third of the global economy.
- The pace of Chinese growth stagnated around 6% yoy throughout last year, Indian economic growth faded from around 8½% yoy at the start of 2016 to around 7% yoy in the December quarter, Brazil experienced another year of recession while the Russian economy's two year recession was followed by a return to only modest growth in the December quarter. With little impetus to faster growth coming from its biggest economies, it is hardly surprising that the pace of output expansion in the group of emerging market economies failed to accelerate.
- 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. After falling heavily since 2011, US\$ commodity markets began to recover in 2016 and by March 2017 prices were up by around a third from early 2016 levels with non-fuel prices up by almost 20%. Latin American export prices have since recovered some of their earlier heavy losses, helping to stabilise incomes in Chile, Brazil and Argentina. Big commodity producers in East Asia like Malaysia and Indonesia are similarly exposed to the commodity cycle and the upturn in world prices has helped to produce a cyclical upturn in their US\$ export earnings that parallels the profile of Latin American export earnings.

GLOBAL FORECASTS AND POLICIES

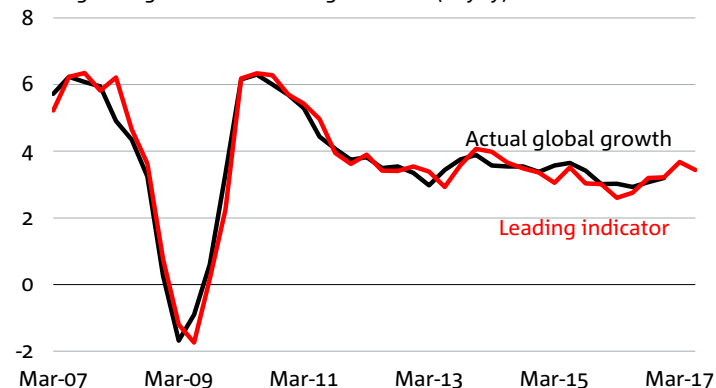
Global reflation rides out ongoing geo-political risks

GROWTH UPTURN SET TO CONTINUE

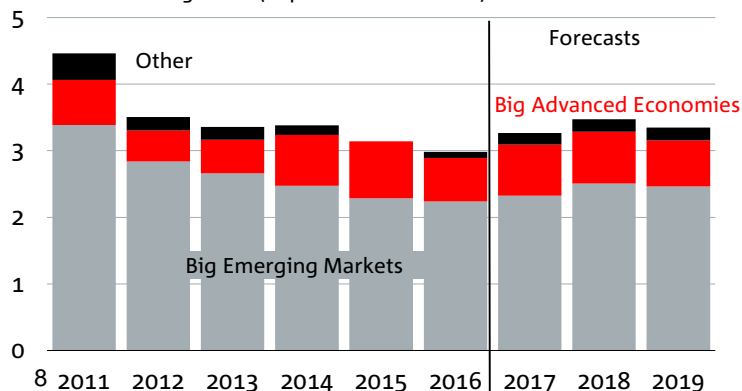
Business surveys (US, UK, Germany & France) (Index)



Actual global growth and leading indicator (% yoy)



Global economic growth (% points contribution)



- The business surveys suggest that global reflation is set to continue. Our measure of forward-looking sentiment in the business surveys of the big advanced economies is now at very high levels by historical standards, business plans should therefore be based on continued solid growth which is good for investment and hiring. This upturn in expectations has tracked the robust upturn seen in activity in recent months across the industrial sectors of the big advanced economies. By contrast, our global leading indicator of economic activity shows an acceleration in growth to mid-year. Conditions dip a little after that but 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 - and those three economic units account for around 45% of the world economy.
- The most obvious risk hanging over this fairly positive global outlook comes from an array of geo-political risks. Despite initial concerns that Brexit and the prospect of sharp policy U-turns by the Trump administration could dampen the pace of global growth, so far the world economy has navigated these risks with surprisingly little impact. The next big geo-political issue to face is the series of Euro-zone elections that have to be held over the next year with particular focus on how the big anti-Euro populist parties in France and Italy fare in the polls. Either country exiting the Euro-zone would present a sizeable shock to financial markets but current pricing across a range of markets suggests that they are counting on a continuation of the status quo.

	2012	2013	2014	2015	2016	2017	2018	2019
US	2.2	1.7	2.4	2.6	1.6	2.1	2.3	2.0
Euro-zone	-0.8	-0.3	1.1	1.9	1.7	1.9	1.8	1.5
Japan	1.5	2.0	0.2	1.2	1.0	1.1	0.8	0.7
UK	1.3	1.9	3.1	2.2	1.8	1.8	1.7	1.7
Canada	1.7	2.5	2.6	0.9	1.2	1.7	2.0	2.0
China	7.7	7.7	7.3	6.9	6.7	6.5	6.3	6.0
India	5.9	6.2	6.9	7.5	7.5	7.4	7.2	7.4
Latin America	2.7	2.5	0.9	-0.2	-1.2	0.6	2.6	2.9
Emerging East Asia	4.7	4.3	4.1	3.6	3.9	3.9	4.0	3.9
NZ	2.5	2.2	3.4	2.5	3.1	2.7	2.5	1.8
Total	3.5	3.4	3.4	3.1	3.0	3.3	3.5	3.3

Sources: Datastream, NAB Economics

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

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

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

Kymerly 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

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