EMBARGOED UNTIL: 11.30AM THURSDAY 15 JUNE 2017

THE FORWARD VIEW – GLOBAL

JUNE 2017

Global upturn remains in place although momentum stalled in early 2017

- Although the pace of global economic growth stabilised in early 2017, the reflation of the global economy continues. Business survey results remain overwhelmingly positive in the big advanced economies, the most timely "hard" economic data on new orders, industrial output and trade flows point to continued growth and a lift in global prices has eased fears of deflation.
- With a cyclical upturn in prices rather than volumes driving much of the lift in nominal (dollar) activity, the course of both commodity prices and wages become crucial. Commodity markets have been softening recently, which should feed into lower rates of industrial cost inflation. Wage growth has remained surprisingly subdued, despite sizeable falls in unemployment in several economies. This emphasises the importance of volume growth picking up to lift global growth momentum.
- Our forecasts point to a further modest lift in global output growth, despite disappointing first quarter outcomes in some big economies. We expect growth to lift from 2016's near 3% rate to 3¼% this year, before accelerating further to an around-trend rate of 3½% in 2018 and 2019's growth pace should be fairly similar.
- Given the focus in Australia on sluggish pay growth, we look in more detail at wages across key advanced economies. Recent falls in unemployment have frequently failed to deliver the anticipated degree of pick-up in wages with at best modest gains in real wages and some outright declines. The extent to which subdued wage growth reflects a fundamental change in the bargaining environment or there is just a delay before tighter labour markets lift pay remains to be seen.

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	-0.9	-0.2	1.3	1.9	1.7	2.0	1.9	1.6
Japan	4.2	1.5	2.0	0.2	1.1	1.0	1.2	0.9	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	4.2	4.0	3.9
NZ	0.2	2.5	2.2	3.4	2.5	3.1	2.5	3.1	2.4
Total	100.0	3.5	3.4	3.5	3.2	3.1	3.3	3.5	3.4

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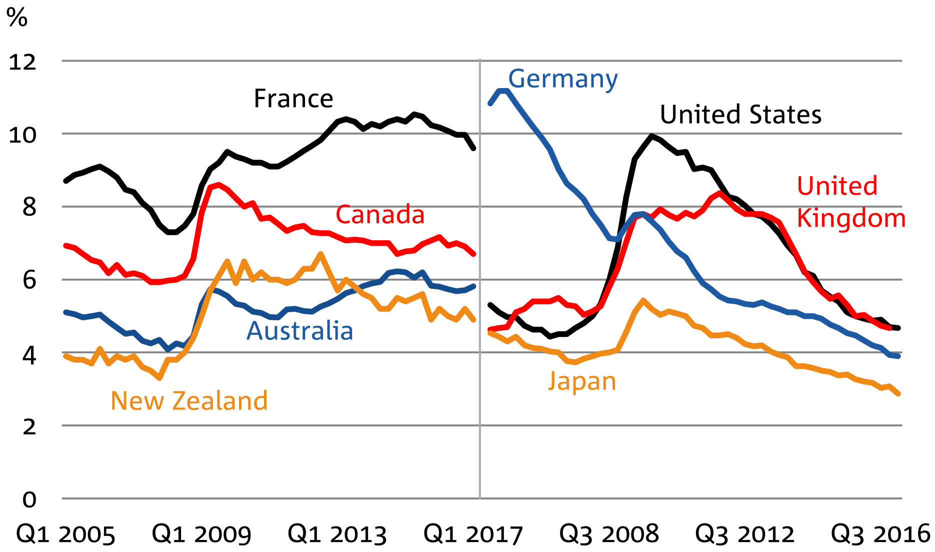
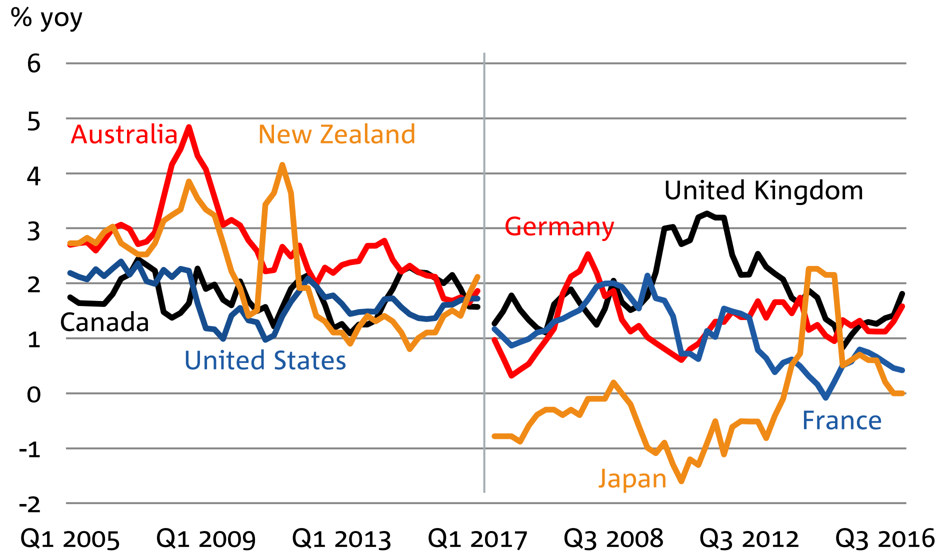
WAGES GROWTH STILL SUBDUED IN MAJOR ECONOMIES

Despite lower unemployment trends, low inflation and productivity constraining wages

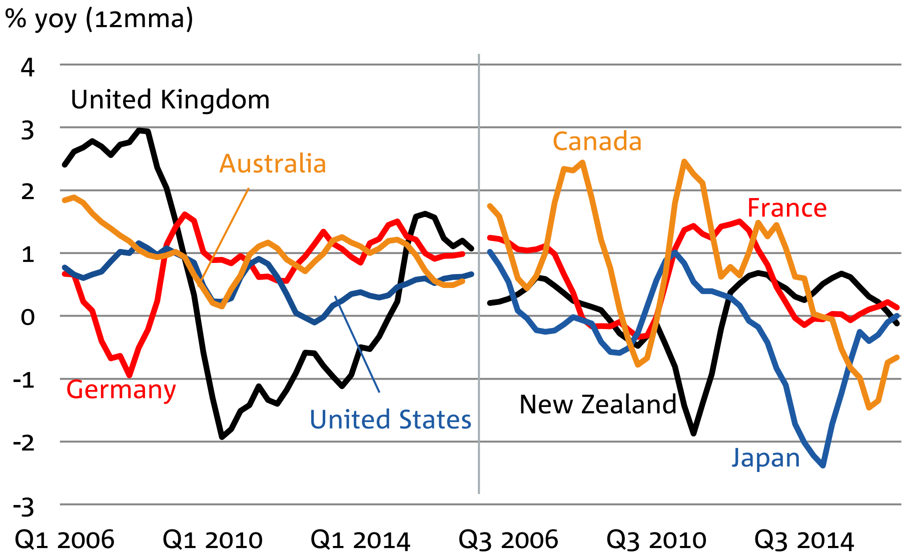
UNEMPLOYMENT BACK AT PRE-CRISIS LEVELS IN KEY ECONOMIES



WHILE CORE INFLATION HAS REMAINED AT OR NEAR HISTORIC LOWS

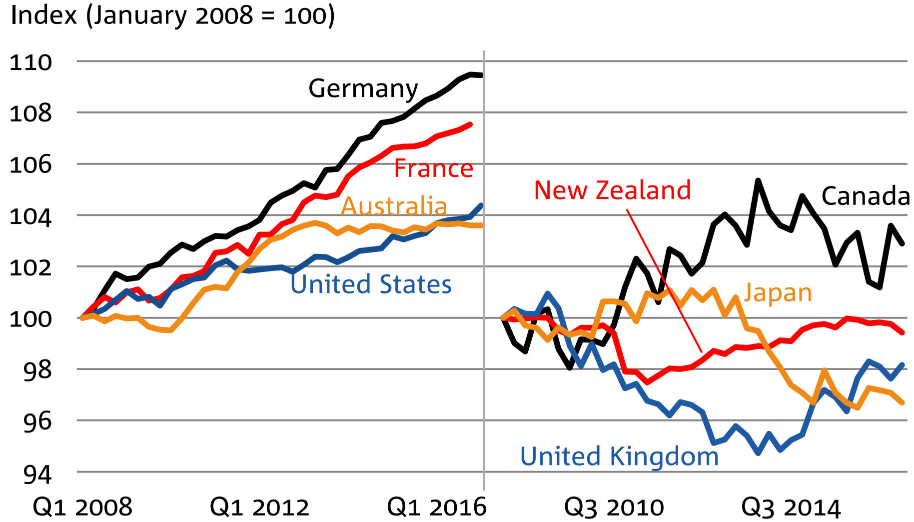


REAL WAGE GAINS GENERALLY MODEST



Sources: OECD, Thomson Reuters Datastream, NAB Economics

REAL WAGES BELOW 2008 CRISIS LEVELS IN SOME ECONOMIES



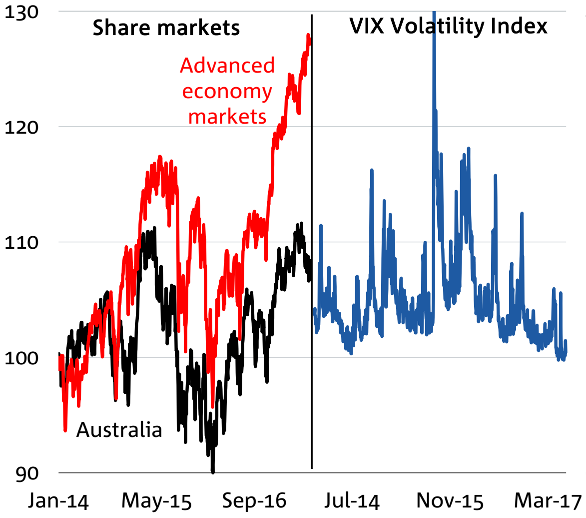
Source: Datastream, NAB Economics

FINANCIAL AND COMMODITY MARKETS

Equities continue to climb as commodity prices and yields come-off

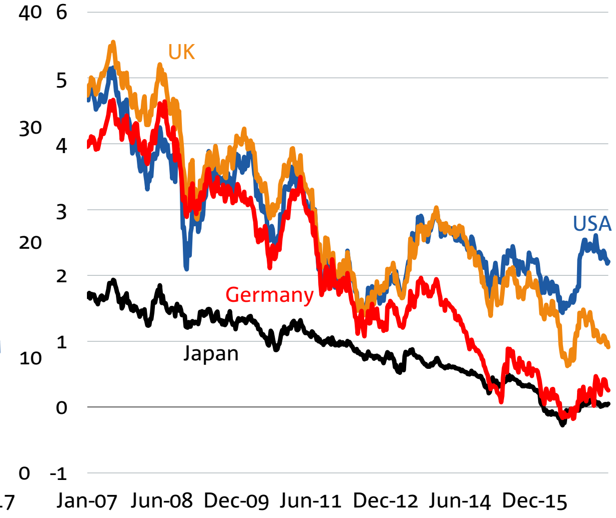
SHARE MARKETS ON THE UP

Share markets and volatility indices



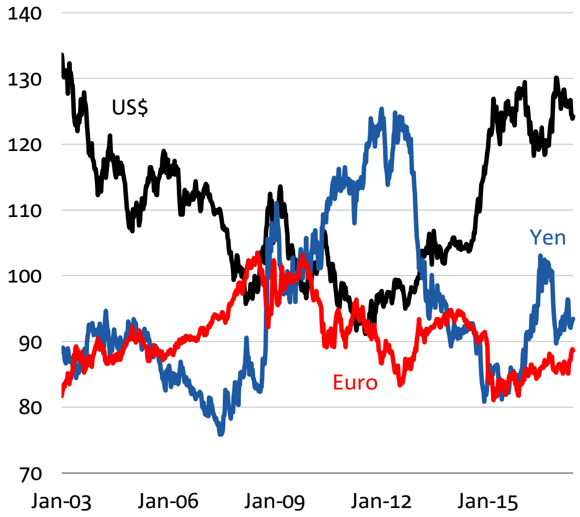
RISE IN YIELDS PARTIALLY UNWOUND

10 yr Government Bond yields (%)



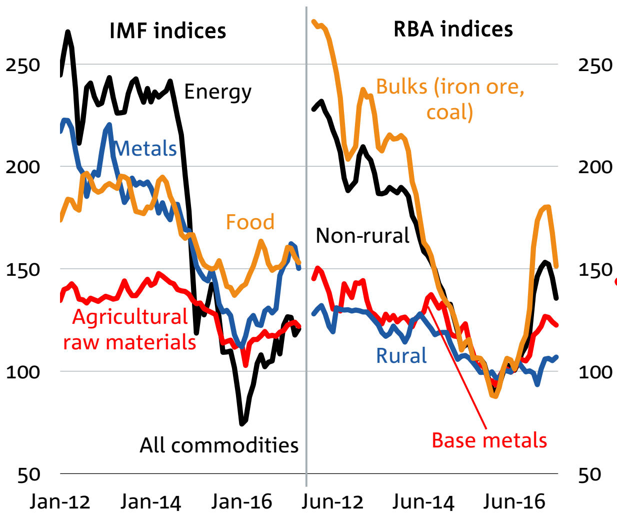
US$ GIVES UP ELECTION GAINS

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



COMMODITY PRICES HAVE EASED

Commodity Price Indices (US$ terms)



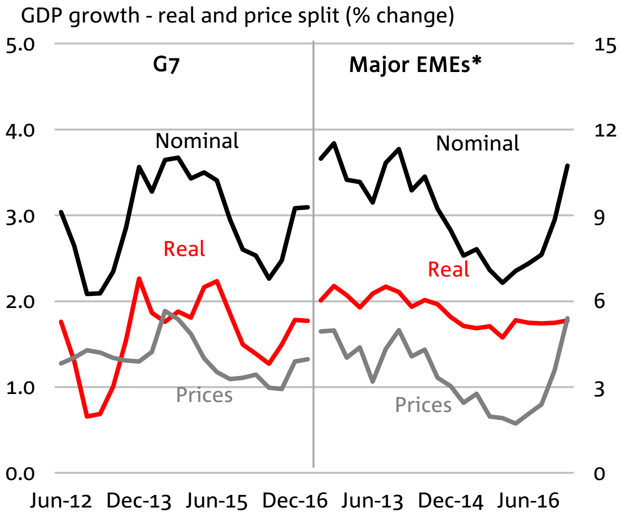
Sources: Datastream, NAB Economics

- In line with improved global economic conditions, major equity markets have continued to move higher. Moreover, as reflected in the VIX, some risks around the outlook have receded – particularly Euro political risk and fears of a China/US trade war. However, bond yields and commodity prices have come off from their recent peaks. In part, this reflects uncertainty about the prospect for fiscal stimulus in the US – a factor also behind the US dollar returning back around pre-election levels. The passing of some temporary supply disruptions and expectations of softer Chinese demand have contributed to the fall in commodity prices, while increased shale production has weighed on oil prices.
- The focus of central banks in the big advanced economies continues to shift away from whether to ease policy to whether to tighten it. The Fed is set to raise rates further, the Bank of England is flagging future monetary tightening, the European Central Bank (ECB) has removed its easing bias, and the Bank of Japan is in wait and see mode.
- The Fed increased the fed funds rate at its June meeting. Continuing falls in the unemployment rate are offsetting, for now, any concerns about the recent slowdown in inflation which the Fed is viewing as temporary. The Fed is indicating that, if the economy evolves as expected, that there will be a further rate hike, as well as the start of balance sheet 'normalisation' – which involves reducing the size of the Fed's balance sheet – in the second half of 2017.
- With inflation moving above target due to the large fall in sterling following Brexit, and unemployment low and falling, the Bank of England has flagged the prospect of future monetary tightening. However, the rate outlook is subject to a smooth exit from the EU – no certain thing – and no change in rates in the immediate future is most likely. While indicating at its June meeting that rates are on hold for an extended time, the ECB removed its easing bias and markets are speculating when it will announce a further scaling back of its asset purchase program.
- The Bank of Japan (BoJ) is expected to persist with its very loose monetary policy of negative short term rates, around zero 10-year bonds and big asset buying. While the BoJ continues to struggle to meet its inflation target, there appears to be no desire to further loosen policy and, with the economy generally performing well, it appears content with its current policy settings.

GLOBAL ECONOMIC TRENDS

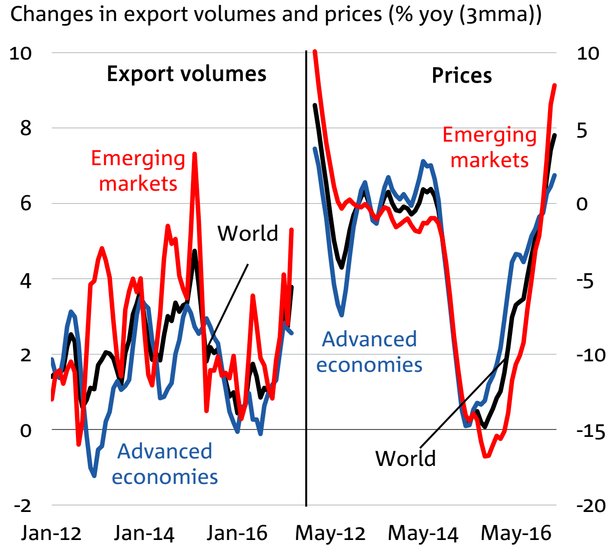
Reflation still under way as prices and output lift

PRICE UPTURN BOOSTS GLOBAL GDP

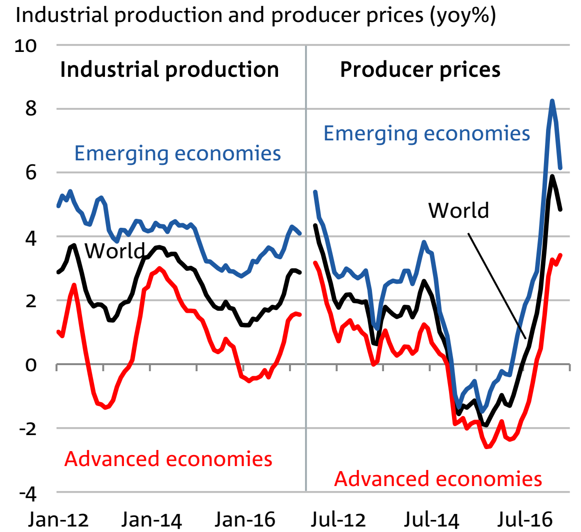


* China, India, Brazil, Indonesia, Russia

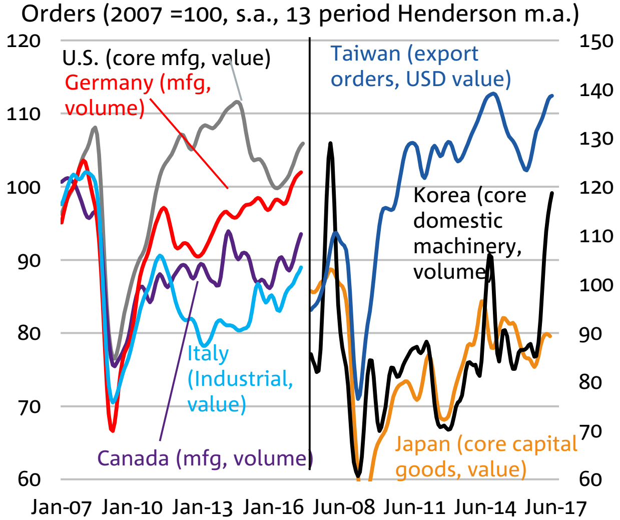
TRADE VOLUMES AND PRICES LIFT



INDUSTRY BENEFITS FROM REFLATION



NEW ORDERS MOVING UP



Sources: Datastream, Markit, IMF, Bloomberg, NAB Economics

- After a long 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 3¼% yoy last December quarter, mainly because of an upturn in the big advanced economies. A recent flat-lining in advanced economy growth saw the rate of global economic expansion stabilise in March quarter 2017 rather than continue to ramp up.

- While the broadest measure of economic activity (global GDP) showed growth momentum failed to pick up in early 2017, other key economic indicators show the process of global reflation continuing. Concerns over sub-target inflation or even outright deflation have eased as price rises have picked up. Inflation (GDP deflators) in the big advanced economies lifted from less than 1% yoy in mid-2017 to 1.3% yoy in early 2017. This price pick-up has been more marked in the emerging market economies – from less than 2% yoy in early 2016 to around 5½% yoy in early 2017.

- Measures of manufacturing sector activity and world trade provide timely and cyclically sensitive indicators of the pulse of the global economic cycle. Early 2017 saw a levelling out in the rate of growth in global industrial output and a modest dip in output price inflation but export volume growth and inflation continued to accelerate. Taken overall, these partial measures of economic activity are consistent with the upbeat message of "softer" data from the business surveys – economic growth remains solid.

- Manufacturing new orders are a useful gauge of shifts in business conditions and a round-up of global orders measures shows a geographically widespread upturn in order inflows. The industrial sectors across selected North American, West European and East Asian economies are sharing in a synchronised upturn in demand.

- Most timely data on economic activity focuses on manufacturing, services generally provide the bulk of economic activity and they are generally much less cyclical than industry. Consequently the acceleration in broader measures of global activity (like GDP) would be expected to show less of a pick-up than trade or industry based measures.

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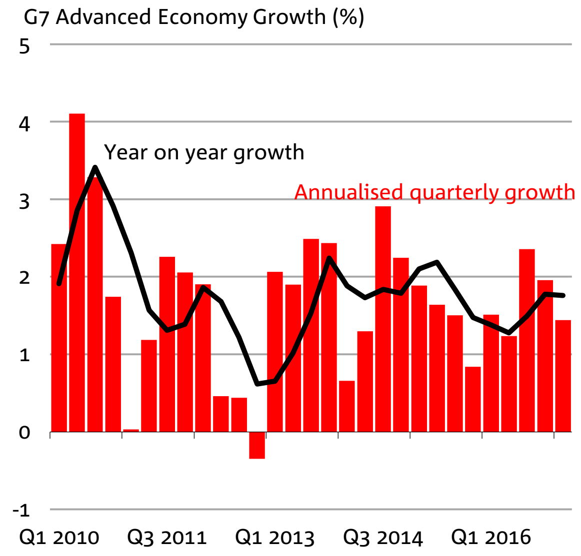
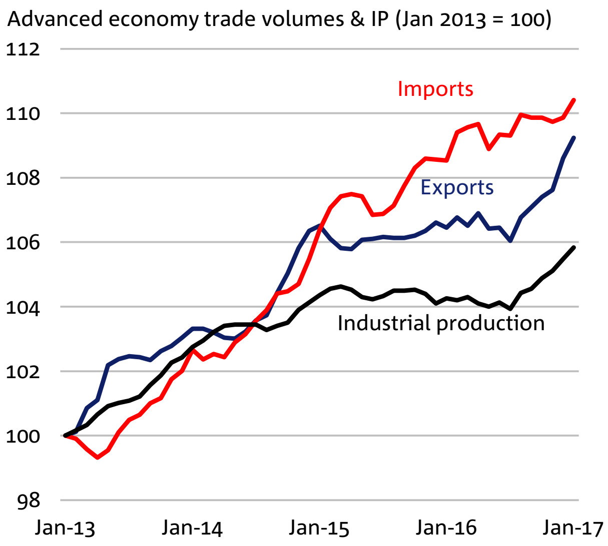
ADVANCED ECONOMIES

Growth momentum stabilised in early 2017

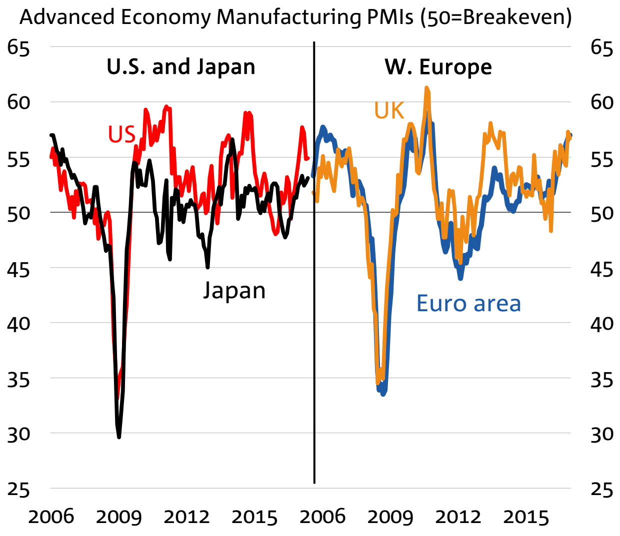
G7 GROWTH TRENDING HIGHER



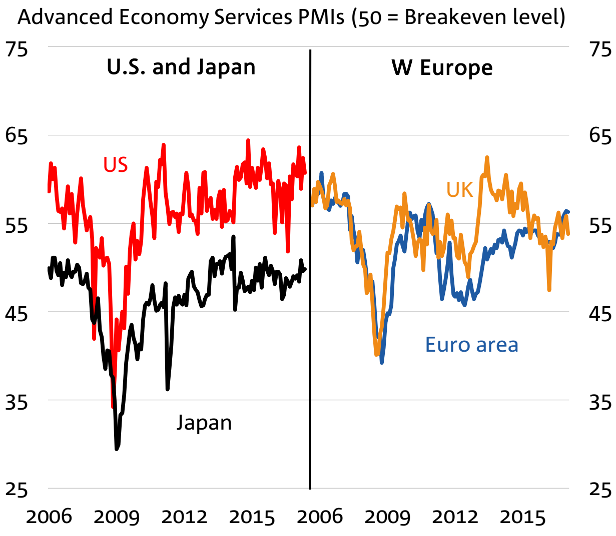
ADVANCED ECONOMIES STRONGER



INDUSTRIAL UPTURN PERSISTS



SOLID SERVICES SECTOR GROWTH



Sources: Datastream, NAB Economics

- Although the bulk of the increase in global output generally comes from the emerging economies, it was the big advanced economies that showed the clearest evidence of faster growth in this cyclical upturn. Behind the volatility in the quarterly GDP numbers, there was some loss in momentum in advanced economy growth around the turn of the year. Quarterly growth in the G7 advanced economies slipped from 0.6% last September quarter to 0.5% in December and 0.4% in March 2017. Year on year growth has flat-lined at around 1¾% through late 2016-early 2017 after running at only 1¼% in mid-2016.

- This rather disappointing outcome for recent growth in the G7 advanced economies reflects varying trends across its member nations. The US and UK economies got off to weak starts in 2017, but the former has a history of weak GDP early in the year followed by a catch-up later on which we expect to be repeated in 2017 while Brexit and election uncertainties hang over business in the UK. Annualised quarterly growth in the Euro-zone stayed at a solid 0.5% in March quarter but Japanese growth has been revised down – more in line with its falling and ageing population. Canada continued its run of strong growth outcomes in early 2017, a marked lift on its 2015-early 2016 record.

- Monthly trade flows and industrial output trends confirm that the advanced economy upturn has kept going right through the first few months of the year. The flat period for advanced economy exports and industrial output seen through 2015 and much of last year has been followed by resumed growth, especially for exports. The latest data does show evidence of a softening in the pace of quarterly industrial and export growth in March but the numbers are volatile and prone to revision so it is too early to worry.

- Business surveys provide the most timely measure of economic conditions with the May results pointing to continued solid expansion across both the industrial and services sectors. The industrial upturn has been especially robust with the strongest survey results since 2011. The lift in service sector readings has been less emphatic but they are in general higher than for manufacturing.

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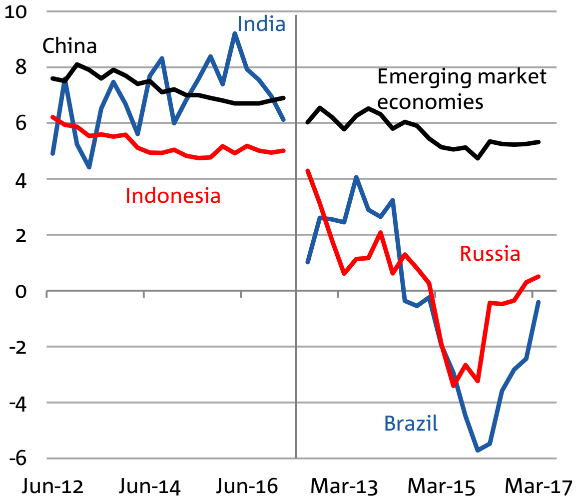
EMERGING MARKET ECONOMIES

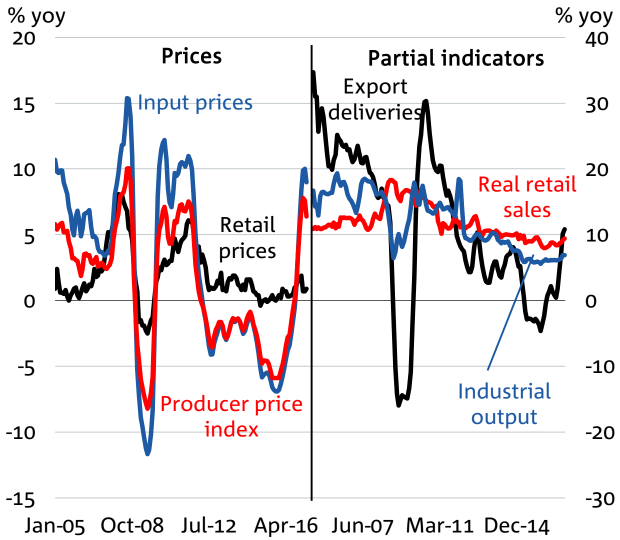
Positive signs in trade and industry but GDP growth flat-lines

VARIATION BETWEEN BIG ECONOMIES

Emerging market GDP growth (yoy%)

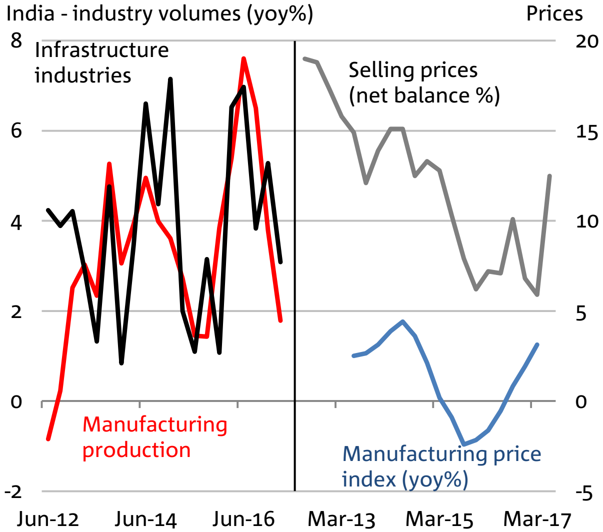


CHINESE ACTIVITY & PRICES GROWING



PRICES LIFT BUT VOLUMES SOFT

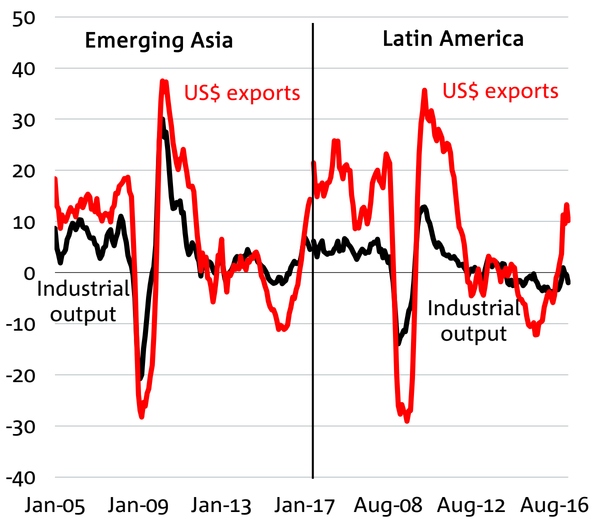
India - industry volumes (yoy%)



Sources: Datastream, CEIC, NAB Economics

EXPORTS LIFT SIGNIFICANTLY

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, Indonesia seventh and Brazil eighth. Together they account for around half of total output in the emerging economies and one third of the global economy.

- Economic performance varies between the big emerging markets. China, India and Indonesia generally show rapid rates of economic expansion whereas Brazil and Russia were hit by deep and prolonged recessions. Both of these economies are starting to climb out of these recessions with Brazil's GDP rising by 1% qoq in the March quarter while Russian GDP grew by 0.5% yoy - but there is a lot of lost ground still to make up before pre-recession trends are regained.

- Trends in emerging market industrial output and trade do not suggest that there has been any pick-up in the pace of growth in early 2017. Quarterly import volume growth stayed around 3½% in both the December 2016 and March 2017 quarters, export volume growth slowed from 2½% to around 2% while the quarterly pace of emerging market economy industrial growth almost halved between December and March from 1½% to ¾%. However, this easing in industrial growth has not been seen in Asia where the quarterly rate increased between December and March quarters at a time when trade growth has slowed.

- Reflation in demand, driven by an upturn in inflation, is evident across most of the big emerging market economies. Part of this lift in global prices reflects the increase in commodity prices that has fed through into higher manufacturing input costs and output prices. Chinese and Indian industrial prices have been moving higher as have $US export receipts from both the big commodity exporters of Latin America and the more diverse economies of East Asia.

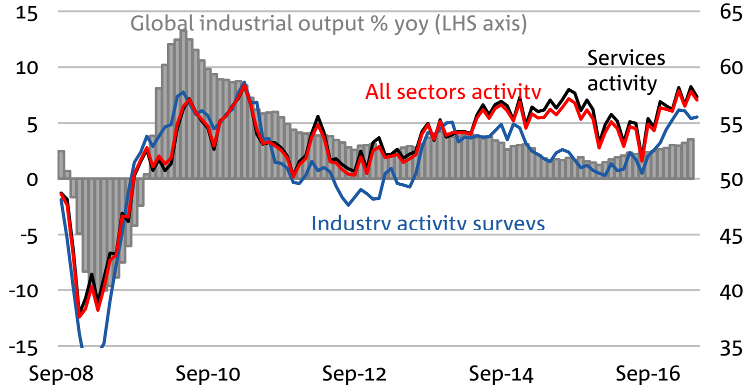
- There is less evidence of an industrial upturn in this group of important emerging market economies. Indian output growth remains surprisingly weak, given its rate of GDP growth. Chinese industrial growth remains in a narrow range and the strongest industrial upturn has been seen elsewhere in East Asia.

GLOBAL FORECASTS AND POLICIES

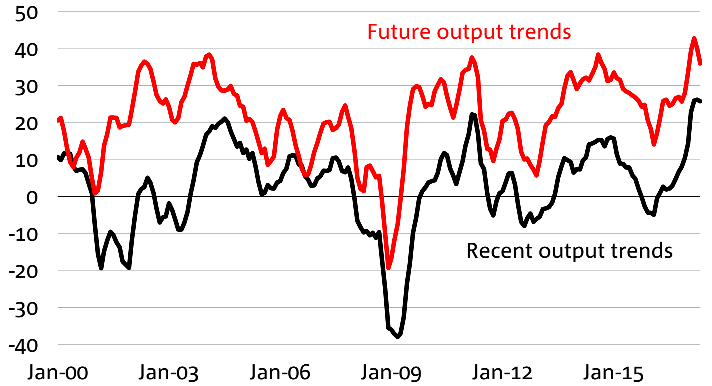
Geo-political risks fail to dent the upturn

GROWTH UPTURN SET TO CONTINUE

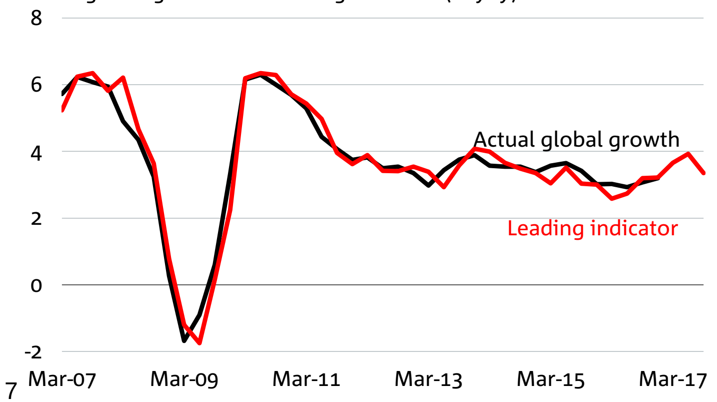
Industrial output & business activity (survey breakeven = 50)



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



Actual global growth and leading indicator (% yoy)



- 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 has come off slightly but remains high 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. Growth should then stabilise at an around trend pace in 2019 as the pace of expansion softens in the big advanced economies and China's trend slowdown continues.

- The most obvious risk hanging over this fairly positive global outlook comes from an array of geo-political risks. Despite initial concerns that Brexit, the French Presidential elections and the prospect of sharp policy U-turns by the Trump administration could dampen the pace of global growth, the world economy has navigated these risks with surprisingly little impact. This demonstrates a resilience that has underpinned the global economy in recent years, helped by the fading of austerity policies and the willingness of monetary authorities to keep short-term policy interest rates very low by historical standards and buy assets to hold down long term bond yields. Only the US Fed, among the big central banks, looks set to actually raise its interest rates in the near term and even it has adopted a very cautious approach to withdrawing monetary policy's stimulus to economic growth.

GLOBAL GROWTH FORECASTS (% change)

	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	-0.9	-0.2	1.3	1.9	1.7	2.0	1.9	1.6
Japan	1.5	2.0	0.2	1.1	1.0	1.2	0.9	0.7
UK	1.3	1.9	3.1	2.2	1.8	1.6	1.6	1.7
Canada	1.7	2.5	2.6	0.9	1.4	1.9	2.0	2.0
China	7.7	7.7	7.3	6.9	6.7	6.5	6.3	6.0
India	5.9	6.1	7.0	7.5	7.9	7.3	7.2	7.4
Latin America	2.7	2.5	0.9	-0.2	-1.2	0.8	2.6	2.9
Emerging East Asia	4.7	4.3	4.1	3.6	3.9	4.2	4.0	3.9
NZ	2.5	2.2	3.4	2.5	3.1	2.5	3.1	2.4
Total	3.5	3.4	3.5	3.2	3.1	3.3	3.5	3.4

Sources: Datastream, NAB Economics

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