*June 2017*

# THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

***Global**: Although the pace of global economic growth stabilised in early 2017, the reflation of the global economy continues. Business surveys remain overwhelmingly positive in the big advanced economies and the timeliest "hard" economic data on new orders, industrial output and trade flows point to continued growth. Meanwhile, a lift in global prices has eased fears of deflation, although 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. 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.*

- In line with improved global economic conditions, major equity markets continued to move higher. 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 around prospects 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 lower commodity prices, while increased shale production has weighed on oil prices.
- The Fed increased the fed funds rate at its June meeting. 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. The Bank of England has flagged the prospect of future monetary tightening, with inflation moving above target and unemployment low and falling. 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 0% 10-year bond yields and asset buying.
- 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. 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.
- There was some loss in momentum in advanced economy growth around the turn of the year, but that reflects varying trends across countries. 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. Meanwhile, 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, while business surveys also point to solid expansion – albeit less emphatic for services as it is for the industrial sector.
- 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 – but are now starting to climb out of these recessions. 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.
- 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. By contrast, our global leading indicator of economic activity shows an acceleration in growth to mid-year, but then dips a little – although it is too early to call a pause in reflation. We expect the pace of global growth to quicken from 3% in 2016 to 3.3% in 2017 and then 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, 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 yesterday.

**Alan Oster (Group Chief Economist), Ph: +(61 3) 8634 2927 or M: 0414 444 652**
**Alt: Tom Taylor (Head of International Economics), Riki Polygenis (Head of Australian Economics)**

***Australia**: While Q1 2017 marked 26 years of growth in Australia without a technical recession, the pace slowed to 1.7% y/y, the lowest rate since 2009 and a continuation of the subpar growth trend since 2009. Our forecasts suggest this will continue. For now, we envisage lacklustre growth in household consumption, and a moderate cyclical upturn in non-mining investment, while government investment will help to fill some of the void left by mining investment. Real GDP growth will be supported in H2 2017 as LNG exports ramp up (with delays now suggesting the most strength in Q4), before softening to 2¼% y/y by second half of 2018 - as LNG peaks and dwelling construction turns negative. For 2019 growth improves moderately to nearer 2.7% y/y - as non-mining investment and public spending strengthen. While there is tentative evidence that macroprudential and policy changes are leading to a softening in dwelling price growth, which may help mitigate economic risks associated with rising household debt levels, the RBA is expected to keep rates on hold for a long period, with our forecasts only suggesting a hike by mid-2019.*

- The NAB Monthly Business Survey was a little softer in May, but still points to a healthy business sector. Business conditions are elevated and confidence is holding up above long-run average levels. Capacity utilisation rates rose in the month to their highest level since mid-2008, although the Survey's indicator of capital expenditure eased back (but is still positive).
- Official employment data has strengthened considerably in recent months, rising 42K in May, with 141k jobs created since February (seasonally adjusted) – driven mostly by full-time employment. Trends in unemployment have been more variable, although the unemployment rate did drop back to 5.5% in May – having spiked to 5.9% earlier in the year – despite the participation rate holding up at 64.9%. Even with the strength in full-time employment, the underemployment rate – a measure of spare capacity in the labour market – eased by a modest 0.1ppts to 8.8%, while the underutilisation rate (a combination of unemployment and underemployment) remains elevated (but fell 0.4ppts to 14.4%). Stronger employment growth is more consistent with other survey measures – the NAB Business Survey employment index is pointing to annual an job creation rate of around 230k (around 19k per month). These trends suggest some downside risk to our current forecast for the unemployment rate to stay around 5¾% this year. Hours worked have been relatively flat in recent months, but rose 1.9% in May, while measures of wages in last week's national accounts data suggested very limited wages pressure.
- Both the latest National Accounts and NAB proprietary data again highlight the consumer focus on essentials at the expense of discretionary spending. Additionally, while consumption growth remained in positive territory in Q1 2017, up 0.5% q/q (2.3% y/y), it was driven by yet another drop in the household savings ratio to a post-GFC low 4.7% - savings driven consumption growth is likely approaching its limit given elevated levels of household debt. Nominal retail sales were stronger than expected in April, rising 1.0% according to the ABS, although that followed anaemic growth in previous months – although it is unclear what impact weather and calendar effects have been having on the numbers. However, retail continues to lag well behind other industries in the NAB Monthly Business Survey, despite a gradual improvement in trend business conditions over recent months.
- Underlying private business investment rose by 0.7% q/q in Q1. Outcomes suggest that the worst of the drag from the mining investment "cliff" is behind us, while NAB estimates indicate that non-mining investment also rose in the quarter. Meanwhile, the NAB Survey is suggesting good profitability, which is consistent with ABS data on corporate profits, and may have supported decisions to ramp-up capital spending. The value of non-residential building approvals has been volatile but rose 5.5% in April, and has trended broadly higher since early 2015, and the value of capital goods imports has improved since early 2014 (and rose 2.3% in April, but is still below earlier peaks). Leads on the longer-term outlook for business are mixed as NAB Quarterly Business Survey expectations for capex in the next 12-months have held up, while reads on non-mining investment from the ABS Private Capital Expenditure Survey remain stubbornly subdued.
- It is yet too soon to gauge the true impact of recent macro-prudential measures on the housing market, but recent reads on prices suggest the market could already be close to its peak. Looming headwinds from prudential tightening, combined with rising housing supply, affordability constraints and modest wages growth (which looks set to continue), validate our expectation for the housing market to cool from here. Meanwhile, dwelling investment dropped by a greater than expected 4.4% in Q1, occurring despite a pipeline of construction projects that is close to record levels – although weather related disruptions may have contributed to the result. New building approvals have come off from their highs, but have held steady at higher than expected levels in recent months. That might suggest the housing construction boom has a little further to run (despite recent declines in dwelling investment), although our economic modelling still points to significant downside risks to the outlook.
- Net exports are expected to detract from GDP growth again in Q2, by 0.5 ppts, after a 0.7 ppts subtraction in Q1. Weather disruptions explain the significant loss in resources production and exports. While iron ore exports are expected to recover in Q2, the brunt of the impact of Cyclone Debbie on coal exports will be felt in Q2. Net exports are expected to bounce back in Q3, as coal production returns to normal and LNG exports ramp up. Bulk commodities prices have retreated from recent peaks, which will see the terms of trade resume its gradual descent in the second half of this year (see NAB's Minerals & Energy Outlook).
- Our relatively soft outlook for growth and inflation will likely prevent any rate hikes by the RBA for some time. However, despite tentative evidence that macroprudential and policy changes are leading to a softening in dwelling price growth, helping to mitigate economic risks associated with rising household debt levels, rate cuts appear to be off the cards as well. Our forecast is for rates to remain on hold until a hike by mid-2019. The recovery in the AUD/USD since last month is not expected to last, and we have maintained our forecast for the currency to bottom at 0.70 by end 2017.
- For more detail on the Australian outlook, please see the Forward View – Australia, released yesterday.

# 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 2) 9237 8017

Phin Ziebell
Economist – Australia
+61 (0) 475 940 662

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

## 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
+(61 3) 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
Director, Economics
+61 3 8641 3045

Tapas Strickland
Economist
+61 2 9237 1980

**FX Strategy**

Ray Attrill
Global 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
Senior Economist
+64 4 474 6923

Jason Wong
Currency Strategist
+64 4 924 7652

Caro Down
Publications & Web Administrator
+64 4 474 9771

## UK/Europe

Nick Parsons
Head of Research, UK/Europe, and Global Co-Head of FX Strategy
+44 207 710 2993

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

## Asia

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

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055

## Important Notice

This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances.

NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it.

Please click here to view our disclaimer and terms of use.