

THE FORWARD VIEW – GLOBAL

JULY 2017



Global upturn remains in place despite the risks

- The global economic upturn continues, despite some disappointing output data from the big advanced economies in early 2017. The business surveys and the timely monthly updates on industrial output and world trade show expansion continuing at a moderate pace. Inflation remains below central bank targets in several key advanced economies and price pressures coming through the pipeline from commodities and manufacturing are waning.
- Despite ongoing low inflation, the growing evidence that advanced economy growth is being consolidated at a reasonable rate and the passing of earlier fears of price deflation is causing a policy rethink among several central banks. They seem to be reconsidering the need for such low interest rates and such extensive asset buying. We expect global growth to pick-up from the near 3% rate reached in 2016 to 3¼% this year and 3½% in 2017.
- Our focus this month is on the brighter looking indicators coming from the Euro-zone economy – important to Australia as it is the third largest economic block in the world, representing one-eighth of the global economy. Output is growing in the single-currency block with several economic measures at multi-year highs. There also remains a marked variation between countries with some strong recoveries in some of the once hard-hit peripheral economies like Ireland and Spain and a deep-seated problem of high unemployment in France and Italy. The amount of spare capacity is narrowing but remains substantial and inflation is below target but the central bank seems to be softening the markets up for less expansionary monetary policy.

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	1.0	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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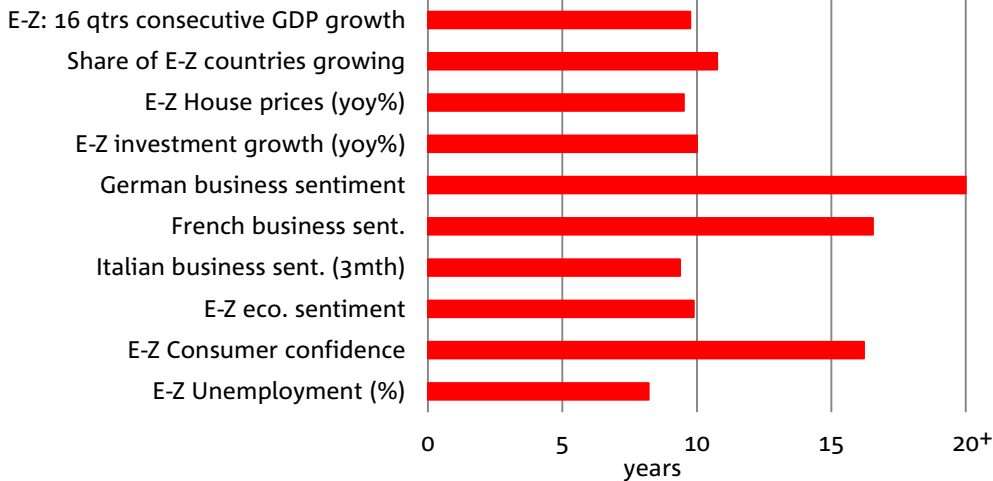
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EURO-ZONE ECONOMY

Globe's third biggest economic block looking better

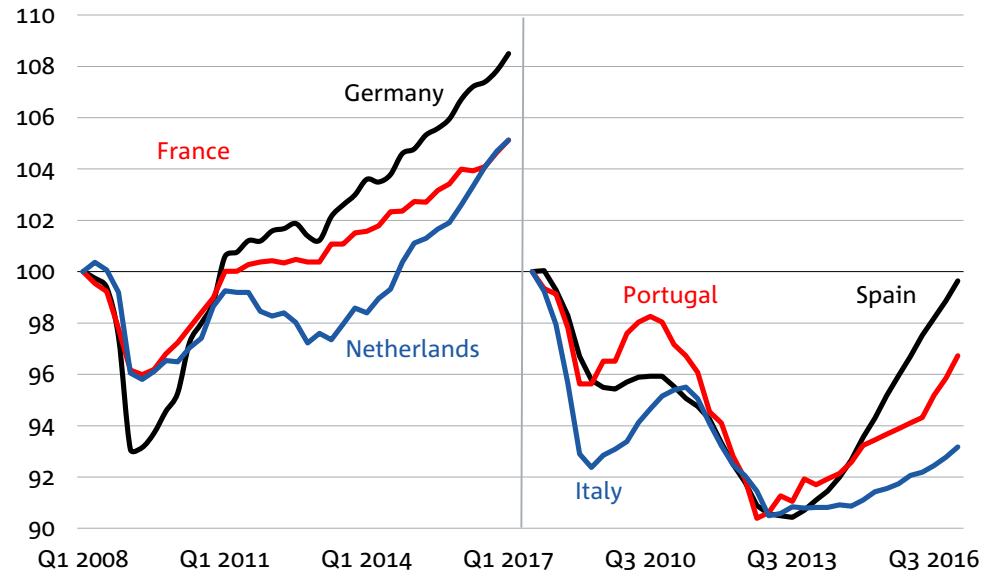
MANY INDICATORS AT MULTI-YEAR HIGHS

Number of years since indicator was better than current reading

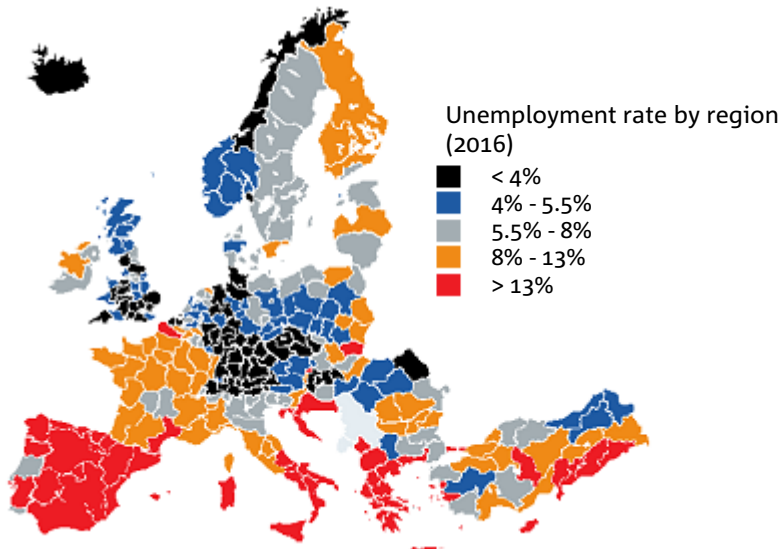


BIG VARIATION IN ECONOMIC PERFORMANCE BETWEEN COUNTRIES

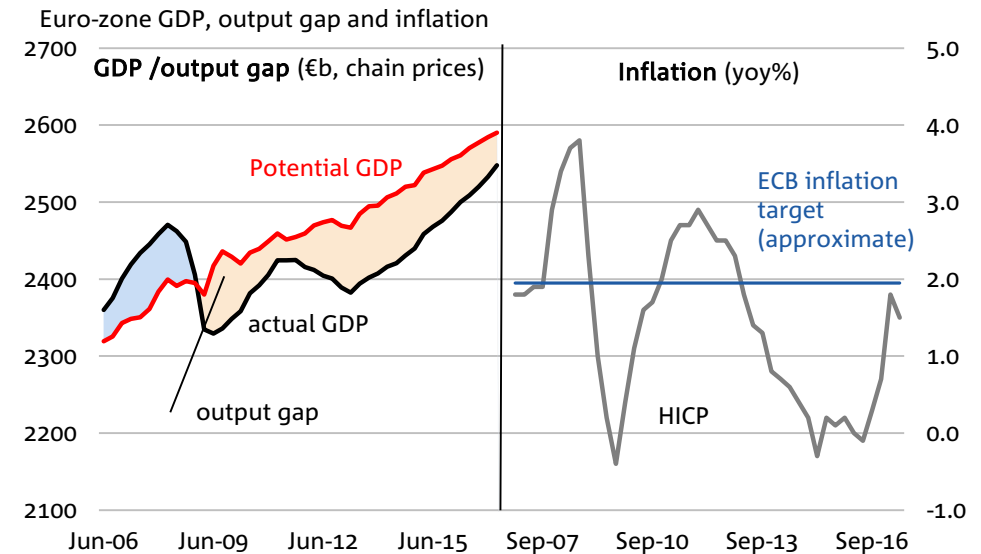
GDP Index (Q1 2008 = 100)



REFLECTED IN BIG DISPARITIES IN UNEMPLOYMENT RATES



EURO-ZONE OUTPUT GAP NARROWS BUT INFLATION REMAINS LOW



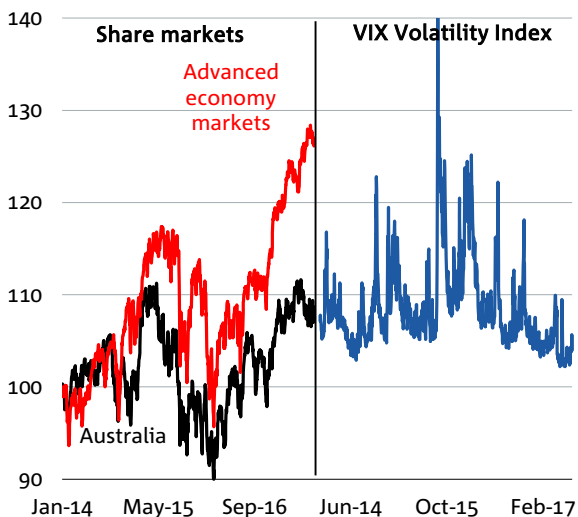
Sources: OECD, Eurostat, Thomson Reuters Datastream, NAB Economics

FINANCIAL AND COMMODITY MARKETS

Advanced economy central banks looking to remove the 'punch bowl'

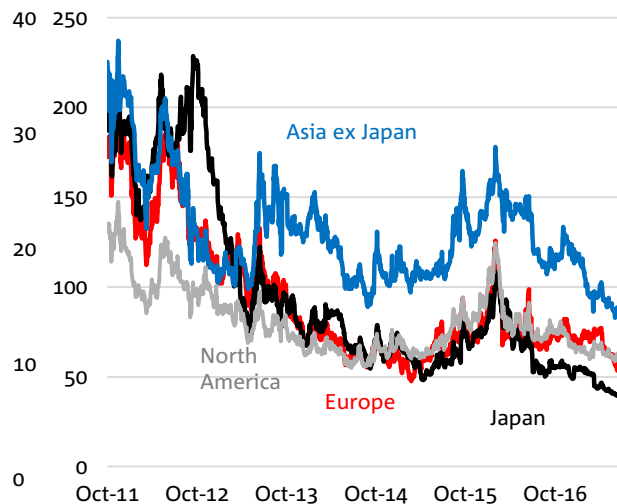
MAJOR SHARE MARKETS UP

Share markets and volatility indices



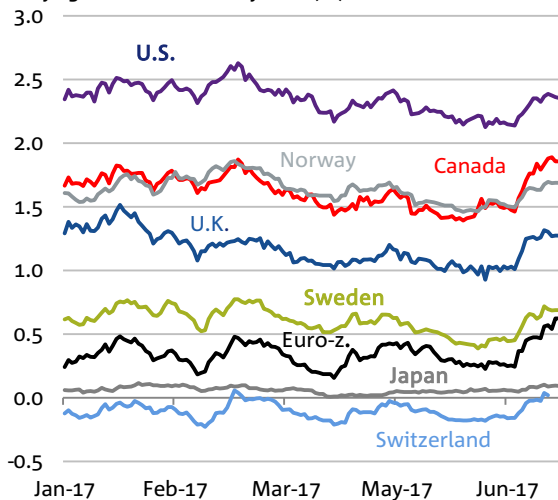
FINANCIAL CONDITIONS EASING

ITRAXX Credit Default Swap indices



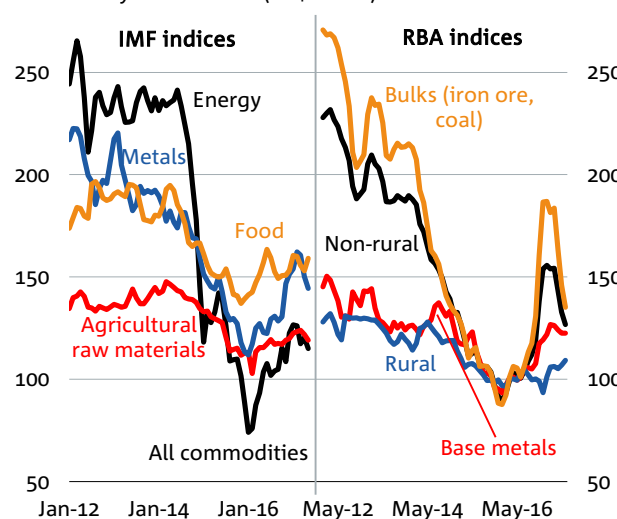
YIELDS REACT TO BANK TALK

10yr government bond yields (%)



COMMODITY PRICES HAVE EASED

Commodity Price Indices (US\$ terms)



- Reflecting the improvement in the global economy, major equity markets have moved higher this year, although the same gains have not been seen in emerging markets. With some risks receding – particularly Euro political risk and fears of a China/US trade war, measures of volatility (such as the VIX) have moved to low levels. Credit spreads have also been falling, contributing to an underlying easing in financial conditions. However, commodity prices have come off recent peaks, as supply constraints have eased and Chinese demand is expected to soften.
- Rising asset prices, easing financial conditions and a sounder global outlook have not gone unnoticed by advanced economy central banks. A former head of the Federal Reserve once said that its job was to “to take away the punch bowl just as the party gets going”. The US Federal Reserve has been tightening policy for a while (with more expected) and this month the Bank of Canada raised its policy rate for the first time since 2010. However, for some other central banks it is more a case that they are planning to stop pouring more punch in rather than removing it any time soon.
- The ECB recently removed its interest rate easing bias and markets are focussed on when the ECB will start winding down its QE asset purchase program, although this probably won't occur until early 2018. Norway's Norges Bank and the Swedish Riksbank have also recently removed their easing bias. There has also been a change in sentiment at the Bank of England, which is now indicating a tightening in policy might be required. While this might occur in late 2017, an early 2018 move looks more likely. For the moment, near term rate hikes by these central bank are not in prospect, and in the case of the ECB and Riksbank QE programs are continuing for now, but the change in direction has had an effect on markets, reflected in a marked rise in 10 year government bond yields – across many countries – starting around late June.
- The Bank of Japan (BoJ) is somewhat of an exception as, with inflation still well below target, it is expected to persist with its very loose monetary policy for an extended time. That said, it appears to have little appetite for further easing measures. While its current pace of asset purchases is below that required to meet its stated expectation of the annual increase in its government bond holdings (80 trillion), this has become secondary to its other policy tool of maintaining around zero 10-year bond yields. While the 10 year yield has been pulled higher recently, this has been by less than that experienced by other advanced economies.

GLOBAL ECONOMIC TRENDS

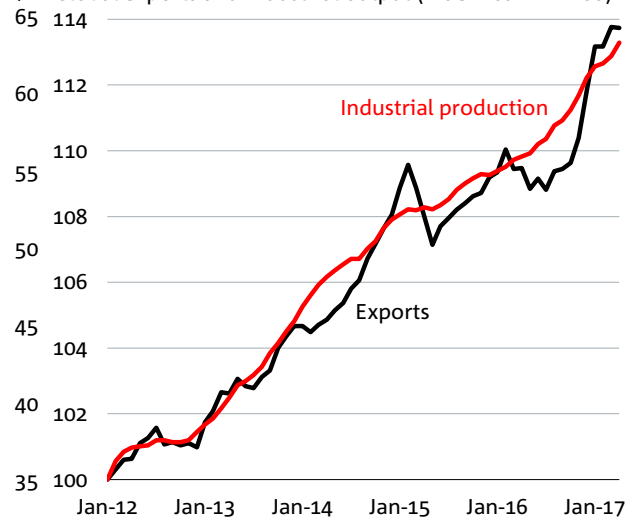
Upturn still under way as price pressures ease

SURVEYS SHOW UPTURN CONTINUES TRADE LEVELS OUT AFTER SURGE

Industrial output & business activity (survey breakeven = 50)



Global exports and industrial output (Index - Jan-12=100)



- After picking up through 2016, global growth levelled off at around 3¼% yoy through the first half of 2017 – better than the 3% seen through late 2015 and early 2016 but below the long-term pace of 3½% and a disappointment for those who hoped to see the acceleration in the rate of global expansion continue unabated.

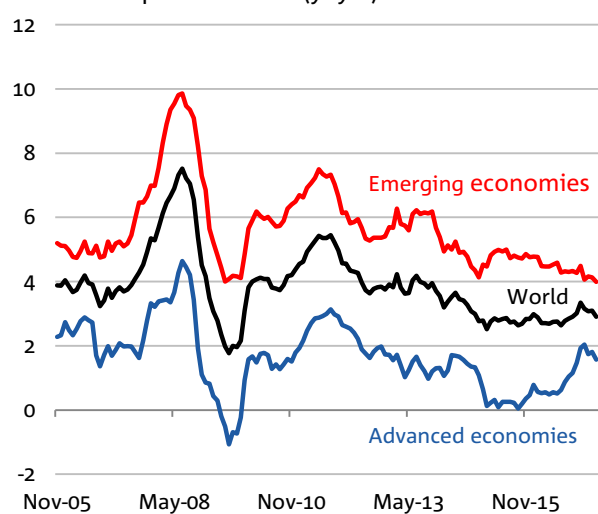
- The most timely partial measures of economic activity – which focus on industrial output and international trade – also point to a levelling out in the pace of growth. According to the CPB measure, growth in global industrial production stabilised at an annualised rate of around 2½% between January and April with a modest uptick in advanced economy growth offsetting an easing in the emerging market economies. May industrial output numbers for a range of key global economies confirm that there has not been much change in the pulse of expansion – it remains just over 3% yoy.

- Early last year there was concern that the process of globalisation which had underpinned a lot of economic growth in previous decades was losing momentum. The triggers for this concern were a levelling out in the volume of world trade alongside concerns that populist protectionist sentiment was gathering steam in key advanced economies. These concerns should now have eased – a run-up in export volumes through the end of 2016 and early 2017 brought their growth more into line with industrial output and there has not been the feared outbreak of global “trade wars”.

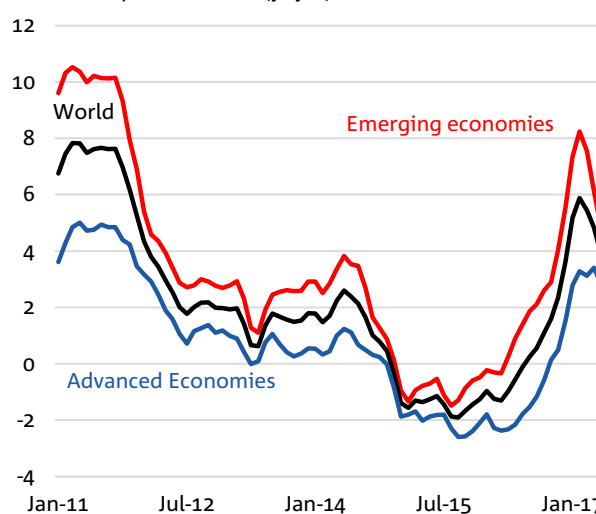
- Cause for concern has eased on the trade front, but some of the news on inflation has been less positive. While deflation fears have largely gone, the promising upturn in advanced economy CPI inflation toward the 2% or so targeted by most central banks has faded as well. Inflationary pressure coming through the pipeline from the lift in producer prices appears to have peaked, wage growth remains weak even as jobless rates fall and market watchers are puzzling over the softness of some recent inflation outcomes. As getting inflation in the big advanced economies back up to target is an important step in reflating the global economy and returning interest rates to more “normal” levels, financial markets are following recent trends with some concern.

ADVANCED ECONOMY INFLATION STALLS LESS PRICE PRESSURE IN PIPELINE

Consumer price inflation (yoy%)



Producer price inflation (yoy%)

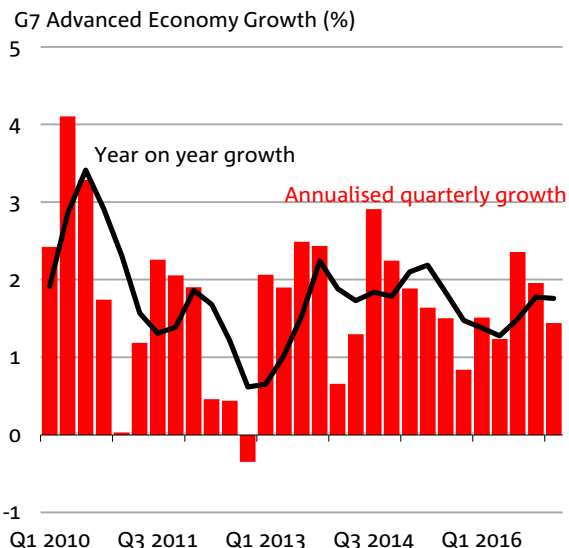


Sources: Datastream, Markit, ISM, Bloomberg, NAB Economics

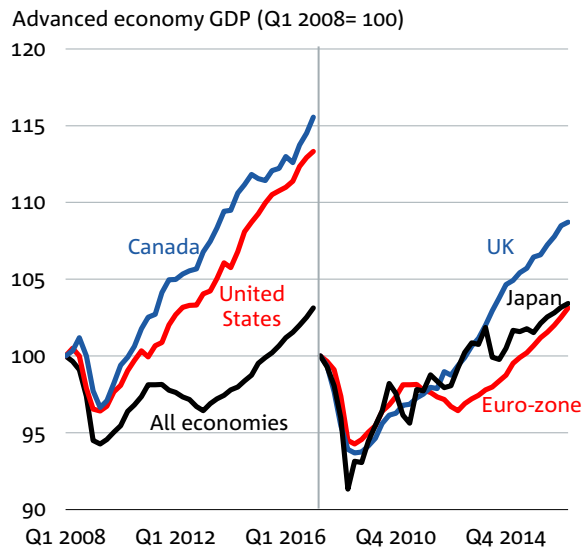
ADVANCED ECONOMIES

Growth momentum stabilised in early 2017

GROWTH SURGE FADES ACROSS G7

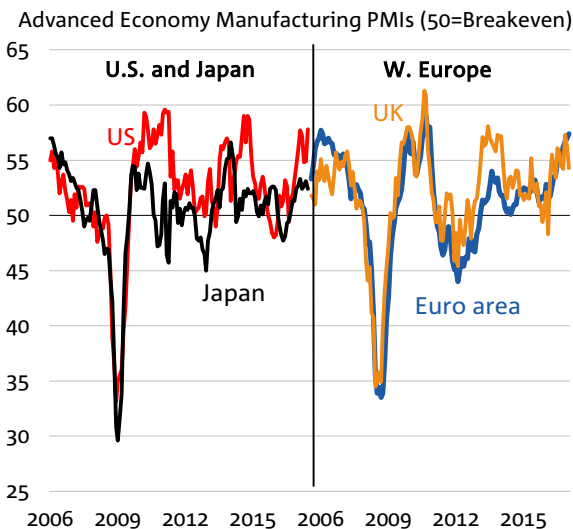


DIVERSITY IN PERFORMANCE

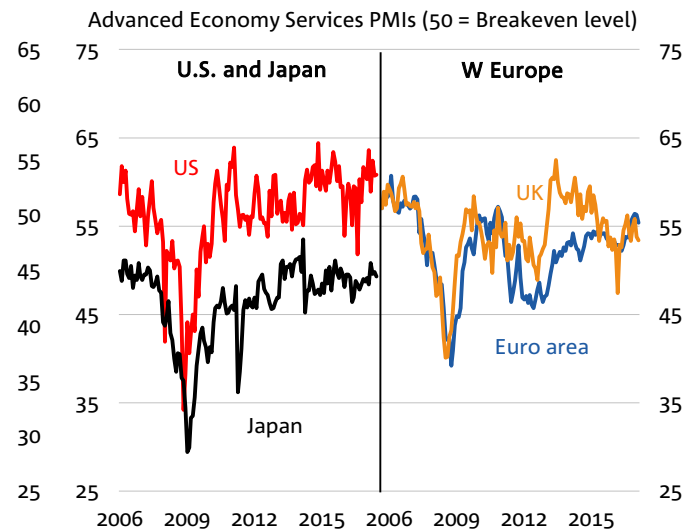


- Growth in the big advanced economies through late 2016 and early 2017 has disappointed those who expected a smooth ramping-up in the pace of economic expansion. After hitting a peak of 0.6% in September quarter 2016, quarterly growth in the G7 advanced economies slowed to 0.5% in December and 0.4% in March. As a result of this slowing in quarterly growth, the rate at which output was growing from year-earlier levels gradually stopped rising and stabilised in early 2017 at around 1.8% yoy.
- Overall, advanced economy growth has stayed positive and moderate through the last few years. However, there have been big differences between individual economies over the longer run. Canada and the US have been the strongest performers since the onset of the GFC with early 2017 output that was 15% and 13% respectively above early 2008 levels.
- Japan and the Euro-zone have had the worst output performance with years of lost growth in the wake of the 2008 recession. It took until end 2014 for Japanese output to regain its early 2008 level and the Euro-zone record was even worse with the currency block only exceeding its early 2008 level of GDP at the end of 2015. Over the nine year period between March 2008 and March 2017, output has only risen by a disappointing 3% in both Japan and the Euro-zone. The UK lies in the middle of these two groups with output rising by almost 9% over the period early from 2008 to early 2017.

INDUSTRIAL UPTURN PERSISTS



SOLID SERVICES SECTOR GROWTH

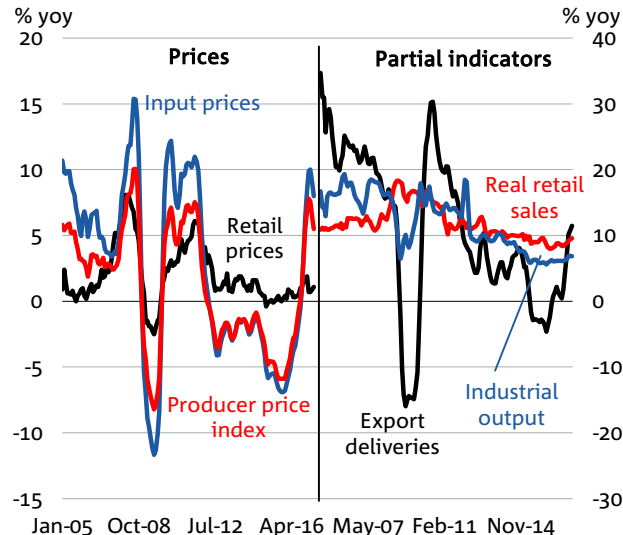


- Monthly business surveys provide the most timely measure of economic activity and they show expansion continuing at a moderate pace across the big advanced economies. Consistent with its tendency to show bigger movements through the business cycle, manufacturing activity has rebounded especially strongly in places like the US, UK and Euro-zone. The upturn in Japan has been more muted. While manufacturing has seen the biggest lift in activity, it is still services that tend to show the highest sustained readings and this is particularly the case in the US. Taken overall, economy-wide surveys show growth staying quite stable through the last few months in the big advanced economies as a group.

EMERGING MARKET ECONOMIES

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

VARIATION BETWEEN BIG ECONOMIES CHINESE ACTIVITY & PRICES GROWING

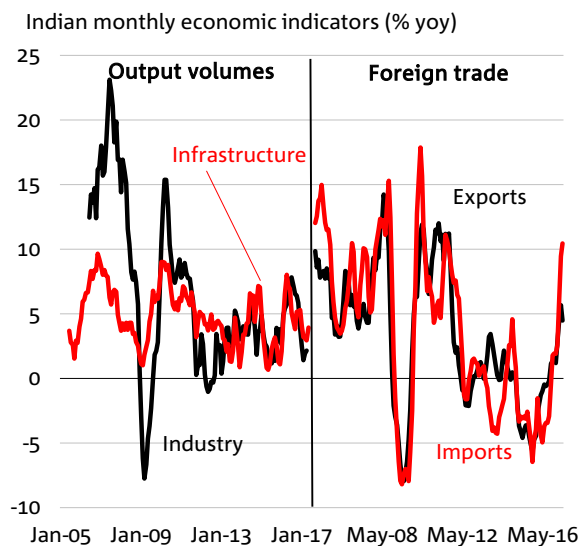


Economic growth in the emerging markets stagnated through the last year, largely reflecting the absence of additional growth momentum in the biggest economies. China is the biggest economy in the world, India ranks third, Russia sixth, Indonesia seventh and Brazil eighth. Together they account for around half of total output in the emerging economies and one third of the global economy.

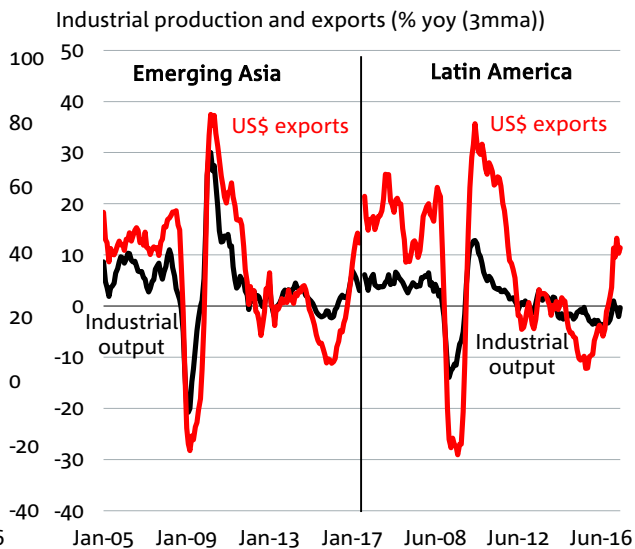
- Economic performance varies between the big emerging markets. China, India and Indonesia generally show rapid rates of economic expansion whereas Brazil and Russia were hit by deep and prolonged recessions. Both of these economies are starting to climb out of these recessions with Brazil's GDP rising 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.

- The latest monthly data on industrial output and trade does not show growth accelerating in the emerging market economies. The quarterly rate of industrial growth halved from 1.4% in December quarter 2016 to 0.7% in March quarter 2017 and the growth rate fell again to 0.5% in the 3-months ended April 2017. When it comes to exports, quarterly growth momentum was better maintained at 2¾% in late 2016 and early 2017 but it then softened to only 1% in the 3-months ended April after a particularly poor outcome in April month. The profile of imports is much the same with the quarterly pace of growth slowing slightly from 3.6% in December 2016 to 3.3% in March 2017 before a weak April monthly result cut the 3-month growth rate to only 1% in the 3-months ended April.

PRICES LIFT BUT VOLUMES SOFT



EXPORTS LIFT SIGNIFICANTLY



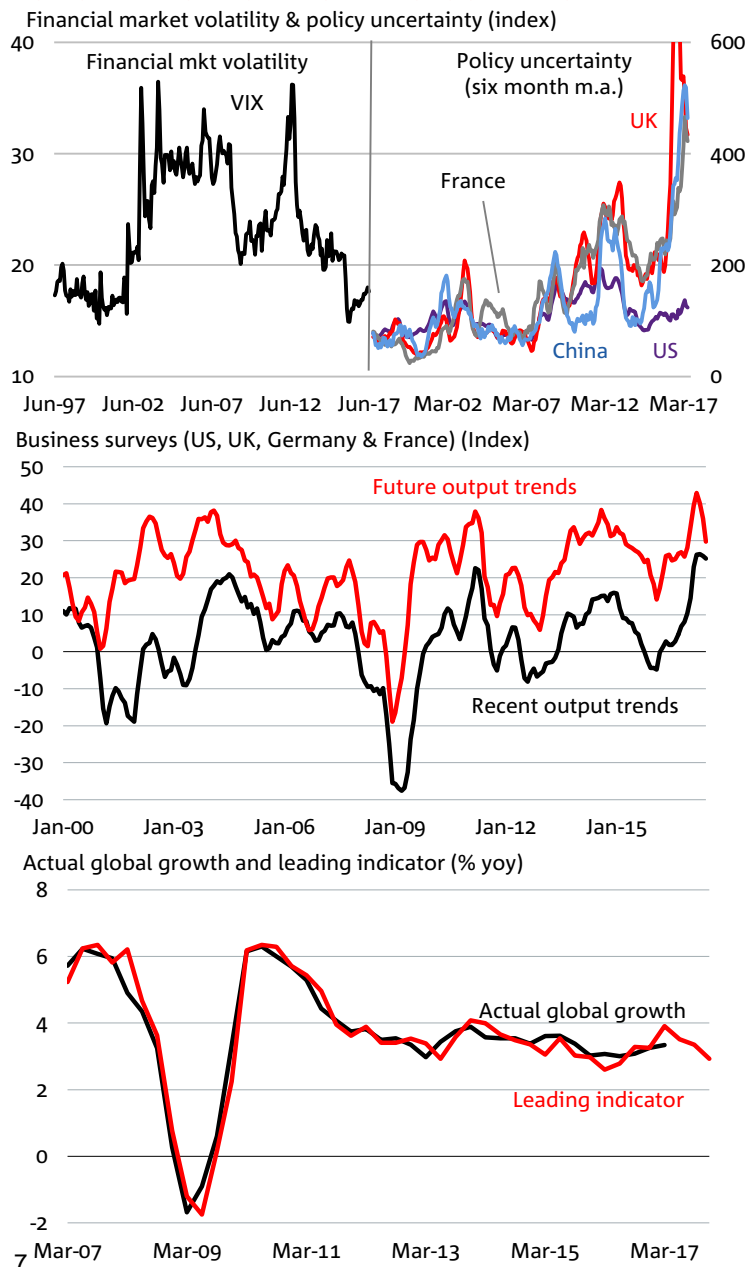
- East Asia has some of the most open trade-driven economies in the world, normally useful markers of whether the pulse of global economic growth is quickening. The trends here are not particularly encouraging with industrial output growth actually slipping from around 6% yoy at the start of the year to around 3% yoy by May. Export receipts in US\$ remain solid but much of this reflects higher prices for the commodities that are prominent in the output mix of places like Indonesia, Thailand and Malaysia – it does not reflect a surge in export volumes. This is all consistent with a levelling out in the growth of world trade rather than further acceleration.

Sources: Datastream, CEIC, NAB Economics

GLOBAL FORECASTS, POLICIES AND RISKS

Geo-political risks fail to dent the upturn

GROWTH UPTURN SET TO CONTINUE



- While the global economic upturn is continuing, early 2017 has not yet seen it reach the speed needed to hit the annual growth targets of big international agencies like the IMF (who predict 3½% growth for this year). Expectations for future output in the latest business surveys of big advanced economies remain consistent with moderate growth – but they have softened a little. Our leading indicator of global economic activity shows growth trending down rather than up through the latter half of the year, driven by two especially volatile components of the measure – the drop in industrial metals prices and a subsiding in air freight volume growth to more normal levels. Their volatility means it is too early to move away from our forecast that the global economic upturn continues, with growth lifting from 2016’s 3.1% to a predicted 3.3% this year and another rise to a trend-pace of 3.5% in 2018.
- Global growth has proved resilient despite the numerous scares – repeated concerns over the future of the Euro-zone, UK Brexit, worries that President Trump’s trade policy could lead to trade frictions with China, the early 2016 share market losses linked to uncertainty over Chinese economic policy, the now fading risk of global inflation and so on. This highlights the extent to which years of economic policy aimed at delivering a boost to activity in the big advanced economies have delivered results alongside the strong growth dynamics in places like China and India. As always, risks remain but the low level of the VIX “index of uncertainty” points to quiescent markets not pricing in much financial volatility at a time when the focus has shifted to geo-political risks associated with elections in big advanced economies and security in East Asia.

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	1.0	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	-1.1	0.9	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; “Measuring Economic Policy Uncertainty”, Baker S., Bloom N., Davis S.J., at www.PolicyUncertainty.com

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