

# THE FORWARD VIEW – GLOBAL

AUGUST 2017



## *Global growth heading back toward trend after soft first quarter*

- After a disappointing first quarter, the pace of global upturn picked up in the June quarter as preliminary GDP results for China, the US and the Euro-zone – which collectively account for 45% of the world economy – showed faster growth. A combination of favourable financial conditions, still-stimulatory monetary policy and no head-winds from budget austerity have underpinned the ongoing moderate growth in the big advanced economies. Conditions in the emerging economies have been more mixed with solid growth in China and India whereas Russia and Brazil have experienced tough economic times.
- We expect global growth to rise from 3.2% in 2016 to 3.4% this year and an around-trend 3.5% in 2018. China and India remain the stand-out global performers, accounting for around half of global growth between them, with a promising looking upturn in the Euro-zone and growth of around 2% in the US driving much of the rest of global expansion.
- This month’s chart page stands back from the flow of monthly data to look at longer run trends and projections in population and productivity around the world, two of the key drivers of longer-term economic performance. Population ageing poses particular challenges for China, the US, Japan and the Euro-zone with the working age share of the population set to fall sharply through the next 20 years. Workforce participation rates are already trending down in many parts of the world and these adverse demographic and workforce trends mean that getting good outcomes on productivity is increasingly important in maintaining economic growth over the longer term. In Africa and India, by contrast, growing young populations will deliver a demographic boost to growth as the share of the working age population rises.

	IMF weights	2012	2013	2014	2015	2016	2017	2018	2019
US	15.8	2.2	1.7	2.6	2.9	1.5	2.0	2.3	2.0
Euro-zone	12.0	-0.9	-0.2	1.3	1.9	1.7	2.1	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	6.7	6.5	6.3
Emerging East Asia	8.0	4.7	4.3	4.1	3.6	3.9	4.0	4.0	3.9
NZ	0.2	2.5	2.2	3.4	2.5	3.1	2.5	3.0	2.6
Total	100.0	3.5	3.4	3.5	3.3	3.2	3.4	3.5	3.4

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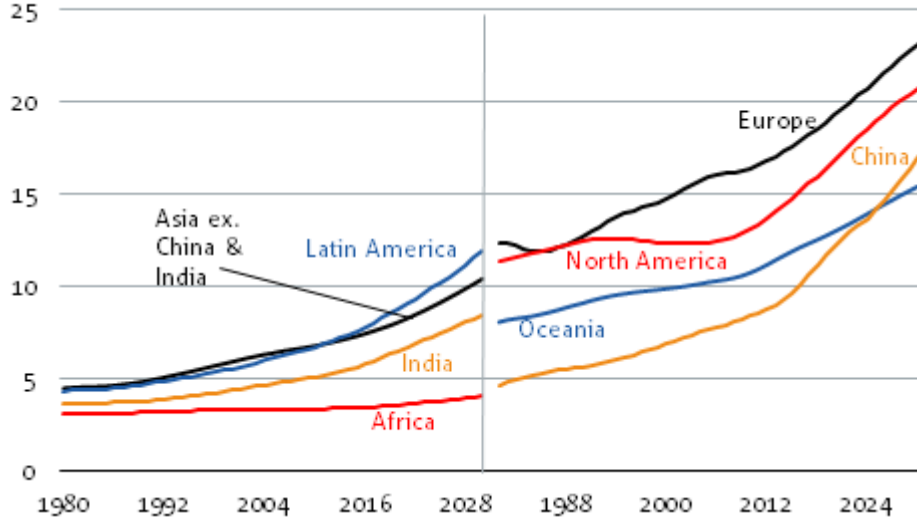
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# POTENTIAL GROWTH

## Population ageing & productivity pressure global growth

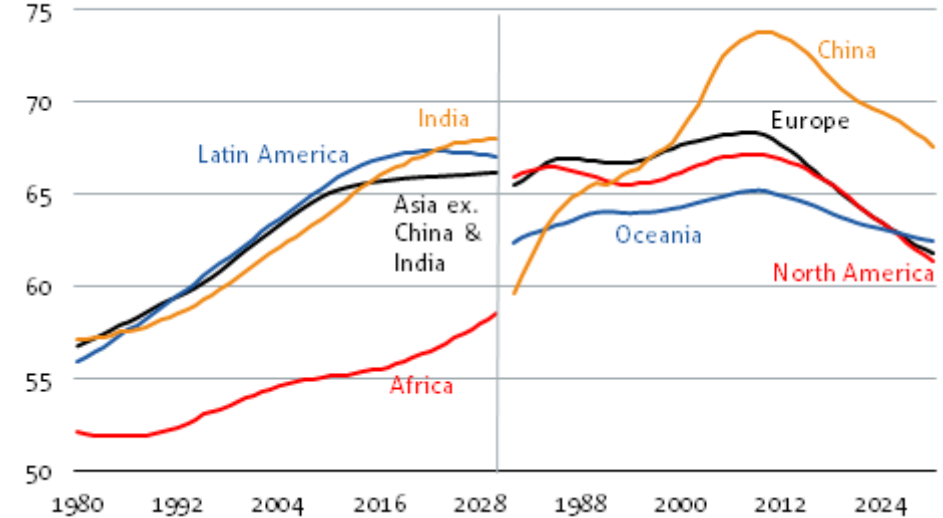
### POPULATION AGEING GATHERS PACE

Older age share (% of total population)



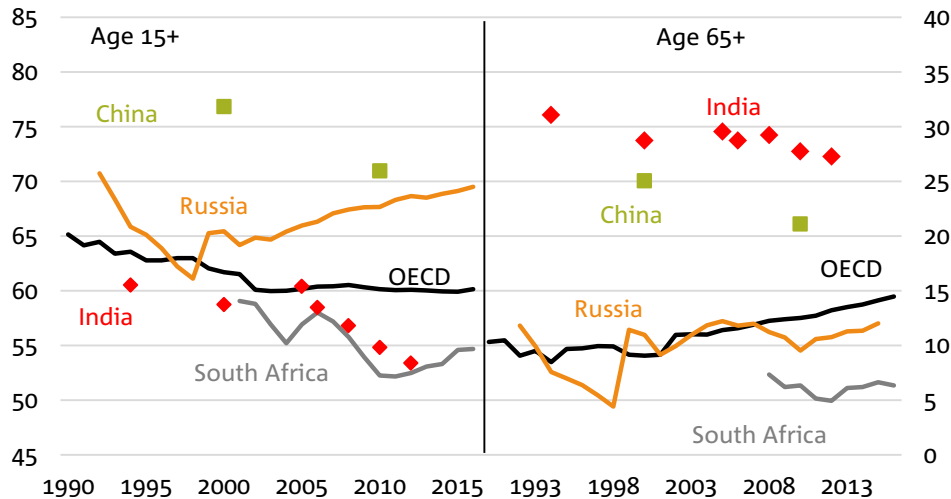
### WORKING AGE SHARE OF POPULATION FALLING

Working age share (% of total population)



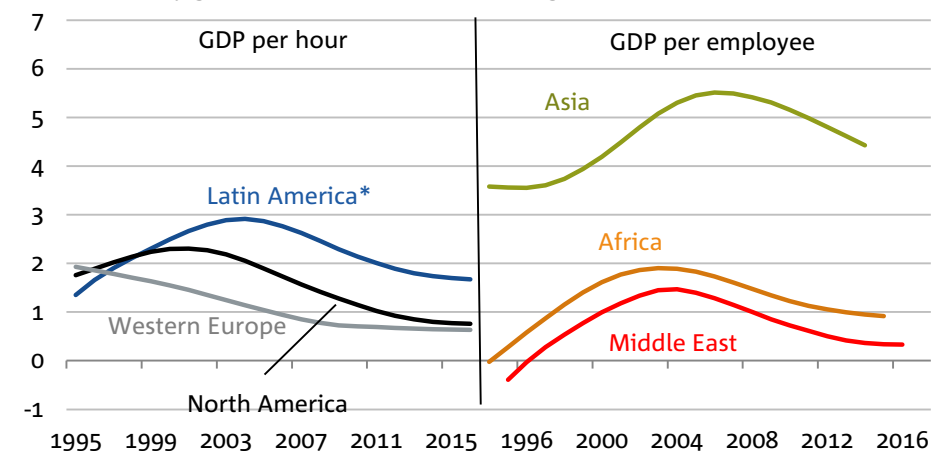
### FALLING WORKFORCE PARTICIPATION EVEN AS 65+ WORK MORE

Labour force participation rate (%)



### PRODUCTIVITY A POSSIBLE OFFSET – BUT GROWTH HAS SLOWED

Productivity growth trend (HP filter) (% change)



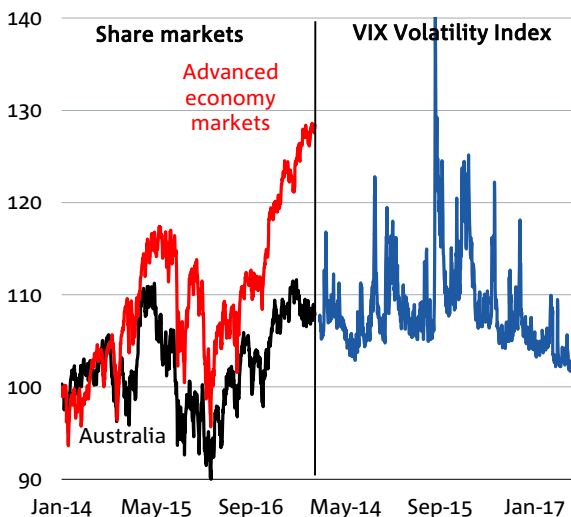
\* Brazil, Argentina, Mexico

# FINANCIAL AND COMMODITY MARKETS

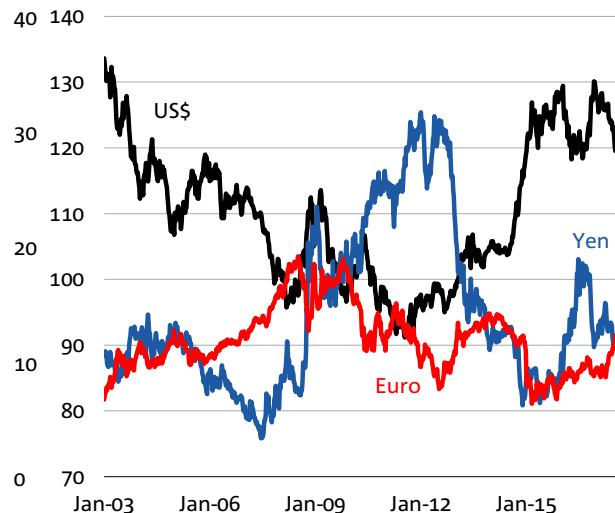
Share markets on the up, yields hold onto recent gains, US\$ weakens

## SHARE MARKETS UP, VOLATILITY LOW USD DOWN, EURO UP

Share markets and volatility indices

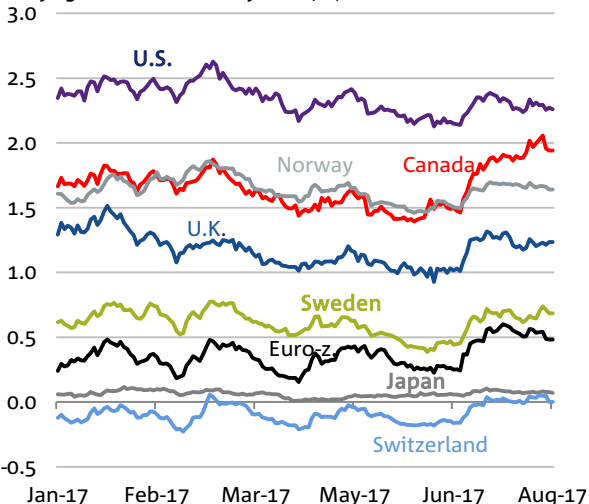


Trade weighted exchange rate indices (1 Jan 2010 = 100)



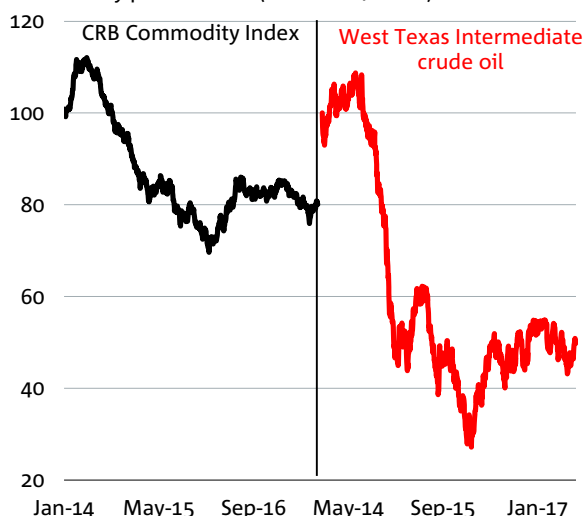
## YIELDS HOLD ONTO RECENT GAINS

10yr government bond yields (%)



## COMMODITY PRICES HAVE STABILISED

Commodity price indices (1 Jan 2014 = 100)

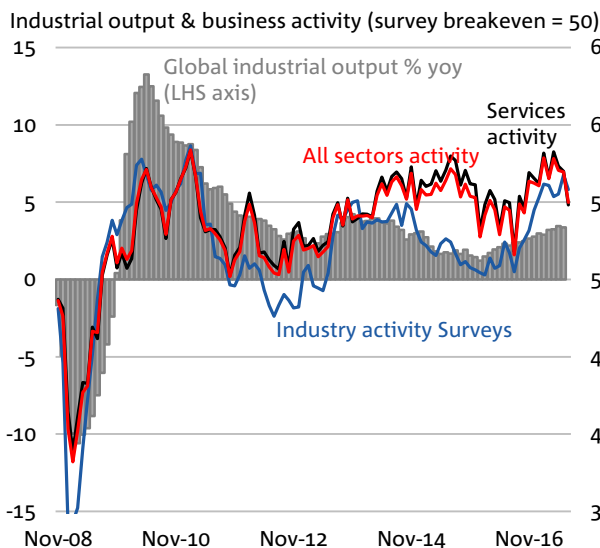


- Reflecting the improvement in the global economy, major equity markets have moved higher this year. At the same time, measures of financial market volatility have moved to very low levels, probably in part reflecting some risks receding such as Euro political risk. Credit spreads have also been falling, contributing to an underlying easing in financial conditions. Commodity prices which had been in decline since early this year have stabilised recently, supported by an improving demand outlook and USD weakness.
- Rising asset prices, easing financial conditions and a sounder global outlook were noted by advanced economy central banks. While the US Federal Reserve has been tightening policy for a while (with more expected) the Bank of Canada recently raised its policy rate for the first time since 2010. Other central banks signalled an end to their easing bias, contributing to a rise in long-term government bond yields.
- Sometimes it is a case of being careful what you wish for. The strength of the Euro-zone economic recovery and the prospect of a tapering of the ECB's QE asset purchase program have contributed to a rise in the Euro. Along with bond yields rising, this represents a tightening in financial conditions which will weigh on still below target inflation. In July, the ECB deferred discussions on the future of its QE program, trying to get the tightening in financial conditions under control, although we still think that it is likely to announce a future tapering of QE at its next meeting. The Bank of England also remained on hold in its August meeting, but continues to point to 'gradual' and 'limited' policy tightening down the track.
- US specific factors has also contributed to the strength of the Euro. Difficulties in getting major legislation through Congress and other political factors appear to be one driver, but a recent slowdown in inflation has also seen financial markets mark down their expectations of future Fed rate rises. The Fed, for now, disagrees and is sticking to its line that if the economy evolves as expected, further gradual rate hikes will be needed. This will depend crucially on coming inflation readings. What is clearer is that balance sheet 'normalisation' – the unwinding of the Fed's balance sheet – is set to start soon, most likely in September.
- The Bank of Japan (BoJ) is expected to persist with its very loose monetary policy for an extended time, but appears to have little appetite for further easing measures. This is despite, at its July meeting, once again pushing out the year that it expects to meet its inflation target (from fiscal year 2018 to 2019).

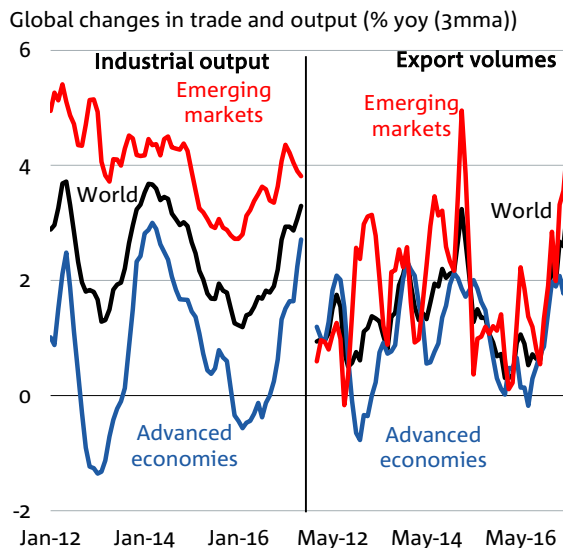
# GLOBAL ECONOMIC TRENDS

## Strength of upturn varies between regions and sectors

### SURVEYS SHOW UPTURN CONTINUES

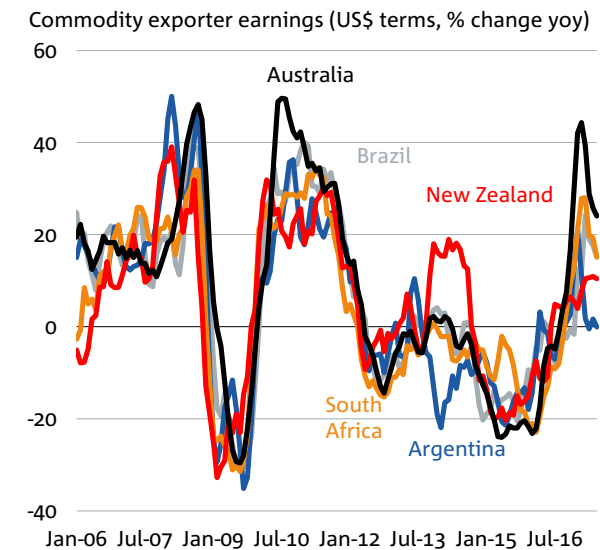


### ADVANCED ECONOMIES PICK UP

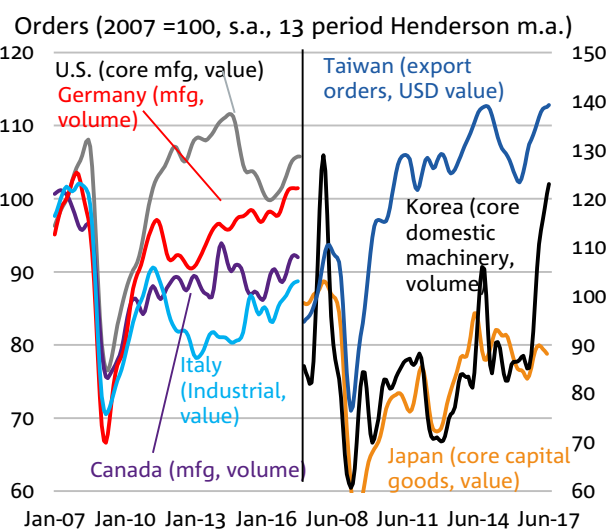


- After picking up through 2016, global growth levelled off at around 3¼% yoy through late 2016 and early 2017 – better than the 3% seen through late 2015 and early 2016 but below the long-term pace of 3½% and a disappointment for those who hoped to see the acceleration in the rate of global expansion continue unabated.
- The most timely partial measures of economic activity – which focus on industrial output and international trade – point to moderate ongoing growth. The pace of economic expansion has, if anything, picked up slightly through this year. Global industrial output was running at an annualised rate of around 2½% in the first quarter of the year but annualised growth appears to have picked up to around 2¾% in first two months of the second quarter. This faster growth momentum in the global industrial sector is more evident in the year on year changes where growth has risen from just over 1½% yoy in mid-2016 to over 3½% yoy by mid-2017. Measures of manufacturing orders provide timely hard data that tracks business cycles and order inflows remain buoyant across several key economies.

### COMMODITY PRICE STIMULUS FADES



### ORDERS DATA MIXED BUT POSITIVE



- More timely measures of industrial output for a collection of big economies show growth stayed around 3.6% yoy through June with especially solid growth in East Asia (including China). Monthly business survey results across the big advanced economies are available to July and these are consistent with growth persisting through the middle months of the year but at a slightly slower pace. Combining the measures of manufacturing and service sector activity to produce a whole-economy measure of output suggests that growth in the big advanced economies has been softening. This reflects lower readings in the services sector that accounts for the bulk of these economies. Manufacturing sector surveys have held up much better than services but the pace of growth in services, while slower than it was, is still faster than manufacturing.
- Business cycles across large parts of the global economy are heavily influenced by commodity prices as swings in global markets help drive growth in their national incomes and move their currencies. The impact of the 2016 upturn in commodity markets is evident in the export values of big Southern Hemisphere commodity producers but several are now seeing slower \$US export growth.

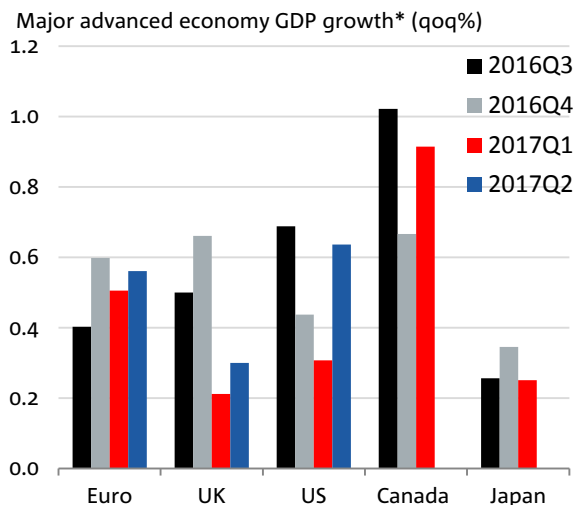
Sources: Datastream, Markit, ISM, Bloomberg, dXdata, NAB Economics



# ADVANCED ECONOMIES

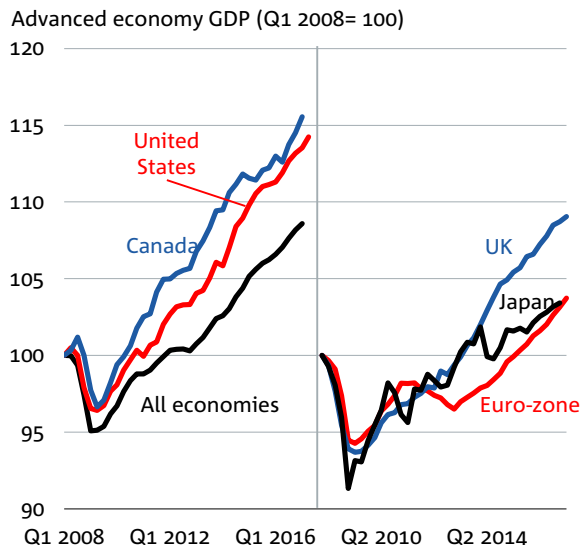
## June quarter GDP growth lifted after disappointing start to year

### EARLY SIGNS OF Q2 GROWTH REBOUND



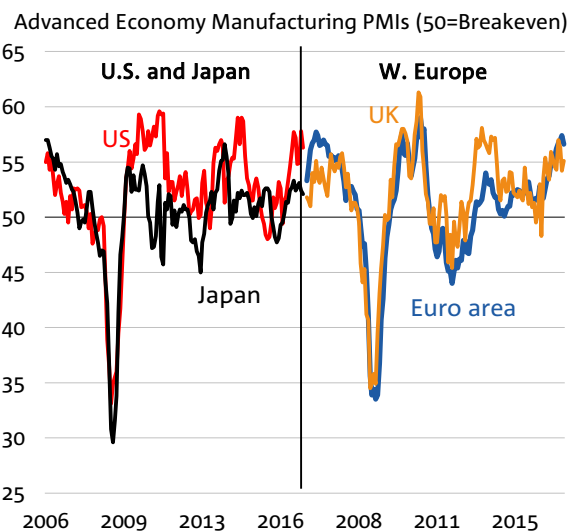
2017 Q2 data not yet available for Canada & Japan

### DIVERSITY IN PERFORMANCE

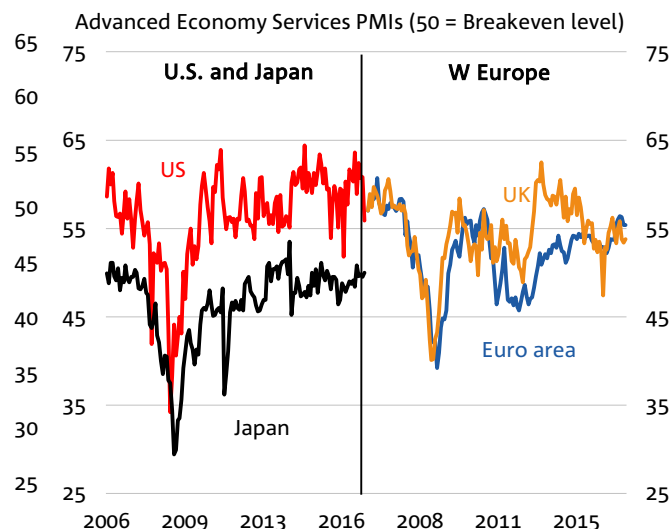


- While growth in the big advanced economies through late 2016 and early 2017 disappointed those who expected a smooth ramping-up in the pace of economic expansion, available indicators point to a re-acceleration in growth in the June quarter. Quarterly GDP growth in both the Euro-zone and UK strengthened modestly while there was a strong re-bounce US economic growth. If expectations for Canadian and Japanese June quarter growth are realised, the year-on-year change in output, which had stabilised around the 1.8 to 1.9% mark in early 2017, is likely to move higher to around 2.0% 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 the most recent data for 2017 pointing to output that was 16% and 14% respectively above early 2008 levels.
- Japan and the Euro-zone have had the worst 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. The Euro-zone took even longer, only exceeding its early 2008 GDP level at the end of 2015. Since March 2008, output has only risen by a disappointing 3% in Japan (to the March quarter 2017) and 4% in the Euro-zone (to the June quarter 2017).

### INDUSTRIAL UPTURN PERSISTS



### SOLID SERVICES SECTOR, BUT US DIPS



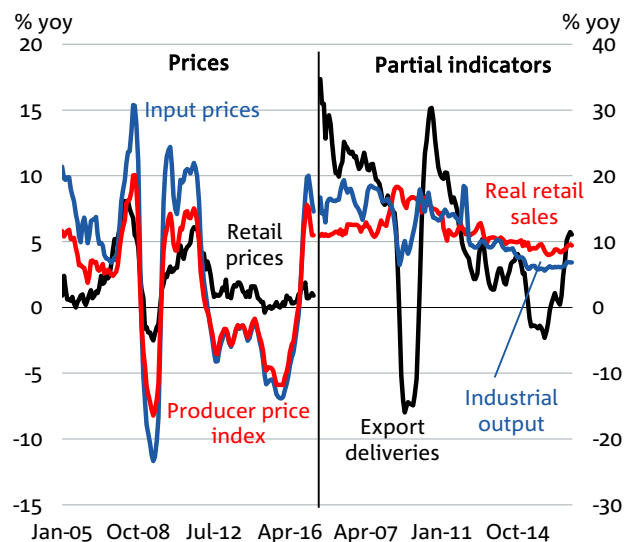
- The UK lies in the middle of these two groups with output rising by almost 9% between early 2008 to mid 2017.
- Monthly business surveys provide the most timely measure of economic activity and they generally show the expansion continuing at a moderate pace across the big advanced economies. Consistent 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, the services surveys have tended to show the highest sustained readings. However, there was a large fall in the US non-manufacturing ISM in the last month (although it remains well in positive territory), which provides a cautionary note to the outlook. At the same time the Euro-zone services indicator continues to track at a high level.

Sources: Datastream, Markit, ISM, NAB Economics

# EMERGING MARKET ECONOMIES

## China and India driving most of the growth

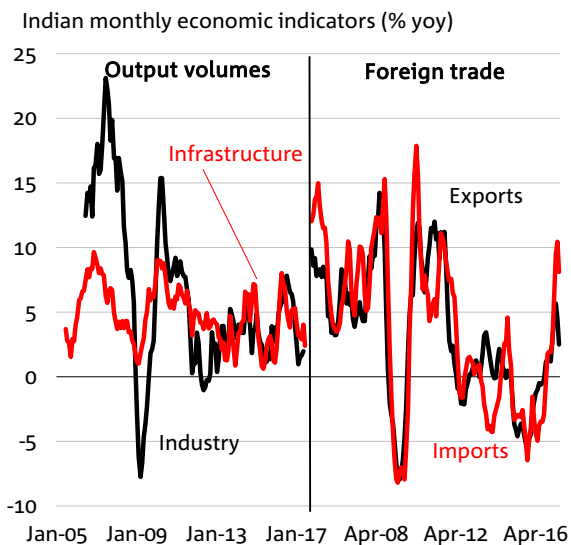
### VARIATION BETWEEN BIG ECONOMIES CHINESE ACTIVITY & PRICES GROWING



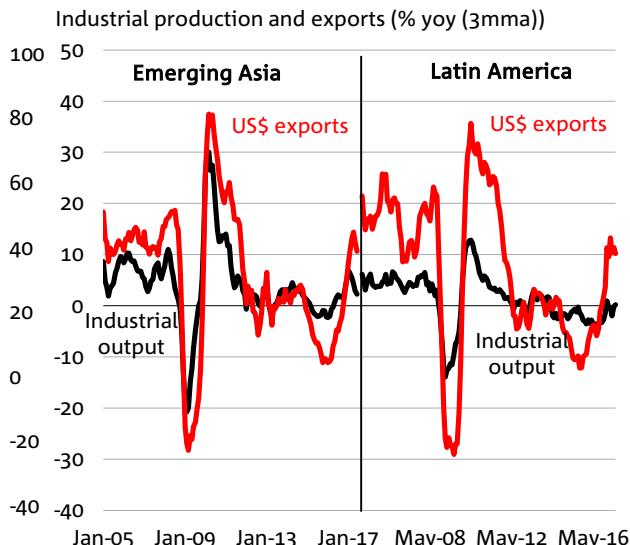
Only a few emerging market economies have released their second quarter growth rates and these show expansion continuing at a solid rate. Chinese growth lifted from 6.8% yoy in the December quarter of 2016 to 6.9% in March quarter 2017 and it stayed at that rate in June quarter. However, quarterly growth rates show a lift in growth momentum from 1.3% in March to 1.7% in June.

- Indonesian economic growth stayed around 5% yoy in the June quarter, around the pace seen through the last few years but faster growth would help create more jobs for the rapidly growing population. As China and Indonesia are the biggest and 7<sup>th</sup> biggest global economies, their early numbers point to robust growth continuing across much of the emerging economy area.
- Industrial output growth in emerging markets broadly stabilised in the second quarter after a slowdown through end-2016 and early 2017. Quarterly growth slowed sharply from 1.5% in December 2016 to 0.6% in March 2017 and it was running at around the March quarter rate in the 3 months to May. The growth performance of emerging economy export volumes differs from that of industrial output. Quarterly export volume growth was a solid 2.6% and 2.8% in December 2016 and March 2017 respectively – without the slowdown seen in industrial output. While the monthly trade data are volatile, there does seem to be an export slowdown in the second quarter with volume growth running at 1.6% in the 3 months to May.

### SOME SOFTENING IN INDIAN DATA



### EXPORT LIFT NOW EASING

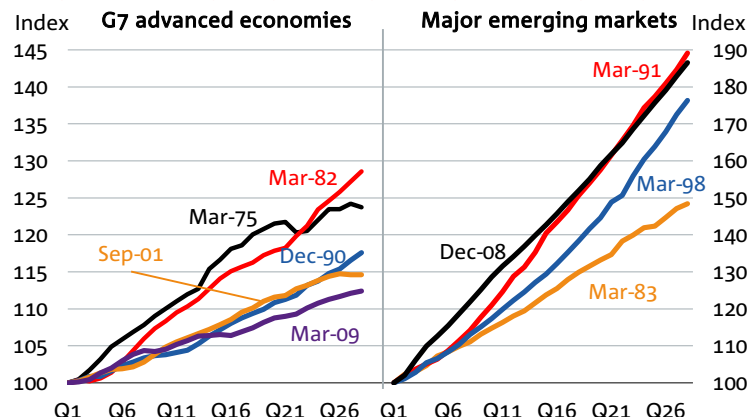


- China and India are the key drivers of emerging economy growth, accounting for almost half of the block's output and over two-thirds of its growth. Emerging East Asia is a particularly trade-driven region and there has been a softening in growth there recently. Industrial output growth in the region – excluding China – has slowed from around 6% yoy at the start of 2017 to around 2% yoy by June and the growth in US\$ export earnings appears to have peaked. Industrial growth remains subdued in Latin America, weighed down by Brazil's economic and political woes. Growth in the region's US\$ export earnings also appears to have peaked, probably reflecting the course of commodity prices.

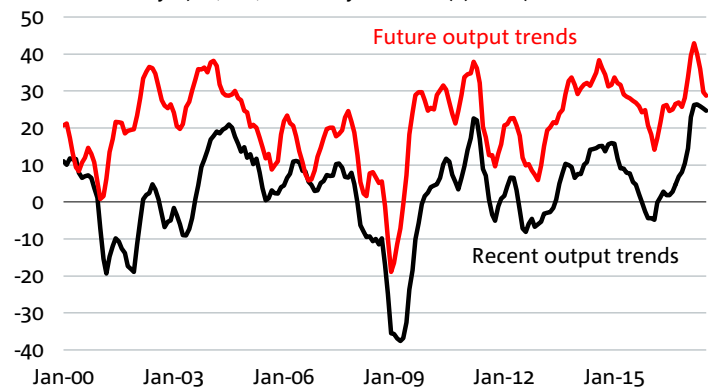
# GLOBAL FORECASTS, POLICIES AND RISKS

## Geo-political risks fail to dent the upturn

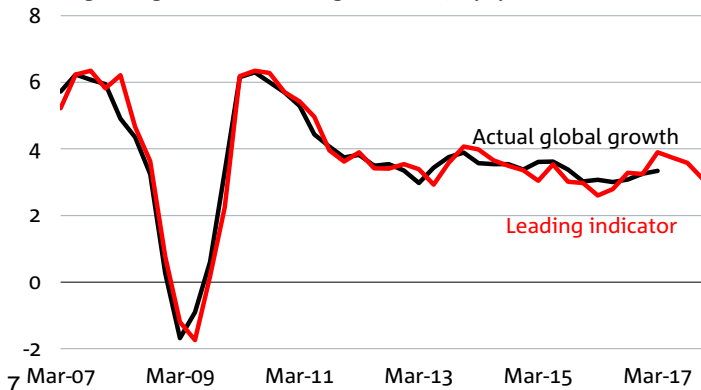
### MODERATE UPTURN BUT BIG DIVERGENCE



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



Actual global growth and leading indicator (% yoy)



- While the current global upturn has been moderate in pace, there was an unusually sharp divergence in output performance between the advanced and emerging economies. We have tracked the advanced economies to compare how their output recovered after successive recessions and found that the current growth phase has been particularly weak. Output recoveries from the troughs of the mid-1970s, early 1980s, early 1990s and early 2000s were all stronger than the post-GFC recessionary trough. The weak recoveries in Japan and the Euro-zone explain much of this disappointing advanced economy record. The Emerging Market Economies, on the other hand, have experienced one of their strongest recovery phases since the GFC, showing a better output record than in the early 1980s and late 1990s – led by China.
- Recent trends show some rebalancing in the distribution of growth with the big advanced economies faring better through mid-2017 while emerging economy growth seems to have stayed fairly flat. Overall, we expect global growth to rise from 2016's 3.2% to 3.4% this year and 3.5% in 2018 – taking the pace of global expansion back to around its trend pace. Forward looking measures in the business surveys remain consistent with solid rates of growth in the advanced economies but our leading indicator of global growth dips in the final quarter of 2017 as air freight volume growth and industrial metals prices are expected to fall to more historically normal levels. The reduction in risk overhanging the upturn is more important than the minor (upward) changes in growth forecasts we have adopted in the last 6 months. Market concerns over such high-impact “tail risks” to global growth as a Euro-zone collapse or Chinese hard landing have faded through the last 6 months, contributing to the low levels of the VIX index of volatility.

### GLOBAL GROWTH FORECASTS (% change)

	2012	2013	2014	2015	2016	2017	2018	2019
US	2.2	1.7	2.6	2.9	1.5	2.0	2.3	2.0
Euro-zone	-0.9	-0.2	1.3	1.9	1.7	2.1	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	1.4	1.6
Canada	1.7	2.5	2.6	0.9	1.5	2.2	2.0	2.0
China	7.7	7.7	7.3	6.9	6.7	6.7	6.5	6.3
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	4.0	4.0	3.9
NZ	2.5	2.2	3.4	2.5	3.1	2.5	3.0	2.6
Total	3.5	3.4	3.5	3.3	3.2	3.4	3.5	3.4

Sources: Datastream, The Conference Board, IMF, NAB Economics

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