September 2017

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

***Global**: Global growth has lifted in mid-2017, heading back towards its trend rate as the pace of advanced economy output expansion picks up. Inflation has remained subdued and financial markets calm, meaning there is little need for aggressive central bank moves on policy. The global economic upturn is expected to continue, while several of the "tail risks" to growth appear to be fading – although North Korea has become the new worry. There is still uncertainty around US economic policy, including how far business taxes will be cut, and how aggressive will a Trump trade policy be?*

- After rising strongly since the latter part of 2016, advanced economy stock markets have recently given up some of their gains. This is despite the resumption of strong growth across many advanced economies in the June quarter. In part this reflects concerns over the US political environment and geo-political risks, particularly relating to North Korea – although the VIX volatility index has remained relatively muted.
- Expectations of future rate hikes by the US Fed have been unwound since the election. This is more than just a Trump effect as inflation has also slowed noticeably in the US. As a result, while the Fed is likely to start winding back its balance sheet at its September meeting, a further rate hike this year will depend on inflation strengthening. In the Eurozone, higher rates are expected given the economic recovery and expectations of ECB tapering its QE program next year. The ECB is indicating that it will likely make a decision about its QE program in October. Some analysts had expected the details might be announced sooner, but the rise in the Euro has made the ECB cautious. This, as well as the uncertainty around the direction of US monetary policy, has contributed to the unwinding of the June spike in long-term bond rates for some countries. However, this is not the case for all countries – for example, Canadian yields have held onto the June increase, supported by another Bank of Canada monetary tightening this month.
- Global growth bottomed out at 3% yoy around mid last year but has picked up to 3.3% in June quarter 2017. Consequently, world economic growth is now heading back to the 3½% trend rate seen since 1980 for the first time since mid-2015. This upturn in global growth has been driven by faster expansion in the big advanced economies, while emerging market economy growth has largely flat-lined. Global industrial growth also picked up in the March quarter, with rising momentum in both the advanced and emerging market economies. While global growth has improved, price pressures remain muted. There was a commodity-driven run-up in producer prices but that has faded and it did not feed into much of a lift in global consumer price inflation. If anything, CPI inflation seems to be slowing, falling short of the 2% inflation targets adopted by many advanced economy central banks.
- After several periods of sluggish growth, the pace of expansion in the big advanced economies lifted quite markedly in the June quarter. Annualised G7 GDP growth has surpassed 2% yoy for the first time since the first half of 2015. The second quarter pick-up in advanced economy growth has been broad-based. North America saw quite solid economic outcomes through mid-2017. Japan, which has experienced quite a weak recovery from the 2008/9 financial crisis, also grew strongly, while conditions in the Euro-zone have been improving. The UK was the weakest G7 economy in terms of growth for the second consecutive quarter and Brexit concerns appear likely to weigh on business sentiment and investment over the next year. In terms of the more timely data, the business surveys confirm that expansion has continued through to August with manufacturing showing especially solid results across the US and Europe. Service sector trends are more mixed – the UK is looking softer but Japan and the Euro-zone had picked up but have eased more recently.
- Economic growth in major emerging market economies trended higher in the second quarter, although there have been markedly different conditions across the individual economies. Russia – the world's sixth largest economy – has been a major contributor to faster growth, while growth has turned positive in Brazil. In contrast, India's economic growth has slowed considerably in recent quarters. China's growth has been stable in the first half of the year – ahead of October's 19th National Congress, where significant leadership change could influence future economic reforms.
- The lift in advanced economy growth has helped drive global growth toward trend and both the business surveys and our leading indicator point to continued expansion. Meanwhile, growth has been stagnant in the emerging market economy, but that is expected to improve, helping explain the anticipated lift in global growth to a slightly above trend 3.6% in 2018 from 2017's 3.4%. The nature of the risks that threaten to de-rail this quite rosy global outlook has changed. Many of the most severe tail risks have faded in the last few years, although new risks have loomed into view – especially the geo-political situation involving North Korea.
- 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*: Stronger employment, GDP and investment data have seen us revise our forecasts lower for unemployment, and slightly increase our forecasts for GDP growth and inflation. While we remain cautious about aspects of the economic outlook, we now believe the labour market will strengthen enough to allow the RBA to remove some of the emergency stimulus currently in place. We are pencilling in rate rises of 25bps in August and November of 2018 and a further two 25bp hikes in 2019, although the precise path will be data dependent. A cash rate of 2½% by end-19 is still well below the RBA's estimates of neutral (~3.5% nominal), suggesting monetary policy will remain supportive of the economy.

- **Real GDP** figures for Q2 showed a pick-up in growth to a quarterly rate of 0.8% (and 1.8% yoy). While this partly represented a bounce-back from weather disruptions in Q1, non-mining and government investment were encouraging. The main area of weakness in the figures was in wages growth, as well as dwelling construction. This is despite particular strength in the labour market so far this year.
- The August NAB Monthly Business Survey showed some mixed results, but is still encouraging overall. Business conditions rose to their highest level since early 2008, but confidence appeared to hit a roadblock – dropping to just below its long-run average. Capacity utilisation rates were lower, but still elevated, while the Survey's indicator of capital expenditure partially rebounded – but is still down from its peak.
- The latest ABS **employment** report showed another 54k jobs were created in August (seasonally adjusted), the 11th month of consecutive increases. The participation rate continued to rise to 65.3%, the highest level since Sept 2012. Given the strong gain in employment, the unemployment rate steadied at 5.6% despite the increase in participation. The improvement was broad-based across the states, although NT has been weakening recently. The official data seems to be catching up with leading indicators including the NAB Business Survey, which have been pointing to improvements in the labour market for some time. The latest August NAB survey showed a significant increase in the employment conditions index, to +11 points from +7 points, which points to an annual job creation rate of around 270k (around 22k per month), sufficient to see the unemployment rate push lower. Other leading indicators including the ABS job vacancies data and SEEK job ads have also been pointing to further tightening in the labour market. Full time employment growth has picked up speed, however underemployment remains prevalent and will continue to keep a lid on wages growth.
- **Household spending** was solid in Q2 at 0.7% qoq, although somewhat softer than expected due to a large drop in spending on electricity, gas & other fuel. Nominal retail sales were flat in July after rising 0.2% in June. This suggests that the strength in April and May was somewhat temporary. NAB's Cashless Retail Index, also implied a slowdown in June and July, although is rising at a stronger rate than the official measure of retail sales in yearly terms (7.3% yoy). Conditions for retailers remain very challenging, with the NAB Business Survey for August showing another negative read, reflecting weakness in trading conditions (sales) and profitability (as margins are squeezed). Higher energy prices will weigh on discretionary spending in Q3, while the increase in the minimum wage should assist lower paid workers to some extent (despite the loss of penalty rates for some). Further out, we expect moderate growth in household consumption amidst soft household income and wages growth (despite further gains in employment), and cautiousness amidst high household debt levels.
- Underlying private **business investment** rose by 1.1% in the quarter – the third consecutive quarter of growth (up 1.5% over the year; the first annual rise since March 2013). The ABS suggested that mining may have been a drag on investment in Q2, but the overall trend still indicates a lesser impact from the mining investment "cliff". Meanwhile, NAB estimates suggest that non-mining investment held up in the quarter. More timely indicators such as the NAB Business Survey and non-residential building approvals have been encouraging. Consistent with that, leads on the longer-term outlook for business investment showed more positive signs lately, with the ABS Private Capex survey pointing to stronger non-mining investment in FY18 (chart) – more consistent with solid 12-month ahead expectations in the NAB Quarterly Business Survey.
- Government spending was much stronger in Q2, in large part driven by a surge in **public investment**, which is consistent with a ramp-up if infrastructure programs). A large pipeline of infrastructure projects is expected to keep public investment elevated, although the growth rate may have peaked.
- The newly released hedonic property price index from Corelogic suggests that momentum in the **housing** market has slowed from its previous peak, although the extent varies across markets – momentum in Melbourne appears to have held up better than most. Auction clearance rates also point to softer conditions in the market, and again the trend is more apparent in Sydney than in Melbourne – although both are showing lower clearance rates than at the same time in recent years. Dwelling investment was broadly flat in Q2, and is 2.5% lower over the year. While that partly reflects weather disruptions in recent quarters, it raises the possibility that dwelling construction has already peaked – pointing to a more elongated cycle as dwelling construction holds steady at a high level for some time. This presents some downside risk to our expectation for dwelling construction activity, although new approvals have actually held up a little better than many expected.
- Net **exports** rebounded from a weather affected Q1, and together with the ramp-up in LNG exports, added 0.3 ppts to GDP growth in Q2. The trade surplus then narrowed slightly in July, but exports are expected to rise strongly again for the rest of the quarter, led by stronger resource volumes. We expect a positive contribution to GDP growth from net exports in Q3, before slowing down to more neutral levels as LNG exports flatten off.
- The **AUD** has been resilient of late, but our expectation of softening in the terms of trade and further rate hikes by the US Fed (one later this year and 3 next year in line with the Fed's dots) should see re-appreciation of the USD and some softening in the AUD. However there are currently upside risks to our AUD forecasts, with market pricing more cautious on the Fed, raising the possibility of a weaker USD.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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 Fixed Income Research
+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
Senior Markets Strategist
+64 4 924 7652

Joelene Simoes
Publications & Web Administrator
+64 4 474 9771

UK/Europe

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.