

THE FORWARD VIEW – GLOBAL

SEPTEMBER 2017



Summary

- Global growth lifts in mid-2017, heading back towards trend rate as pace of advanced economy output expansion picks up
- Inflation remains subdued and financial markets calm, little need for aggressive central bank moves on policy.
- Global economic upturn expected to continue, several “tail risks” to upturn fading but N. Korea the new worry.
- Uncertainty over US economic policy – how far will business taxes be cut? How aggressive will a Trump trade policy be?

	IMF weights	2012	2013	2014	2015	2016	2017	2018	2019
US	15.8	2.2	1.7	2.6	2.9	1.5	2.1	2.3	2.0
Euro-zone	12.0	-0.8	-0.2	1.4	1.9	1.8	2.2	2.0	1.6
Japan	4.2	1.5	2.0	0.2	1.1	1.0	1.5	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	4.2	4.1	3.7	3.9	4.1	4.1	3.9
NZ	0.2	2.5	2.2	3.4	2.5	3.1	2.5	3.0	2.6
Total	100.0	3.6	3.4	3.5	3.3	3.2	3.4	3.6	3.4

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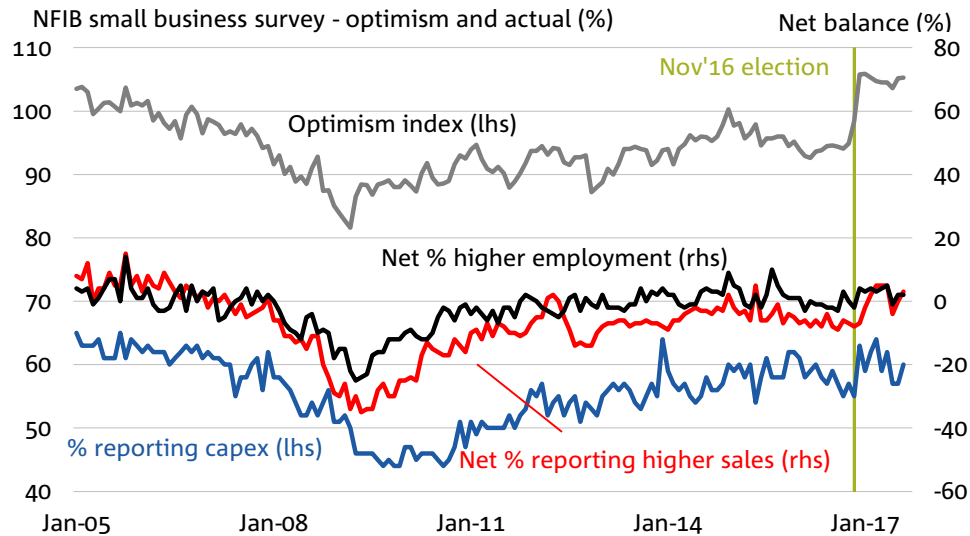
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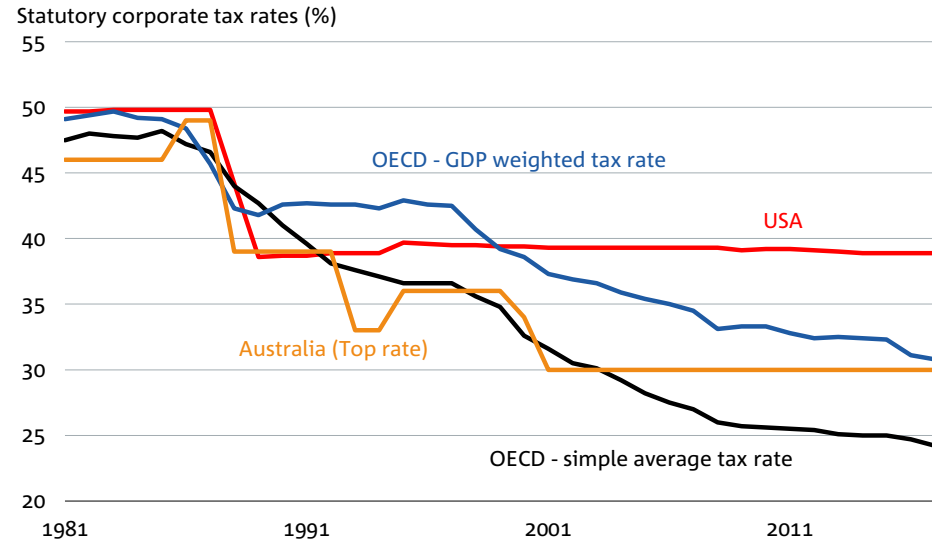
TRUMP'S ECONOMIC AGENDA – WHAT'S NEXT?

Waiting to see if tax and trade can make up for failure on health reform

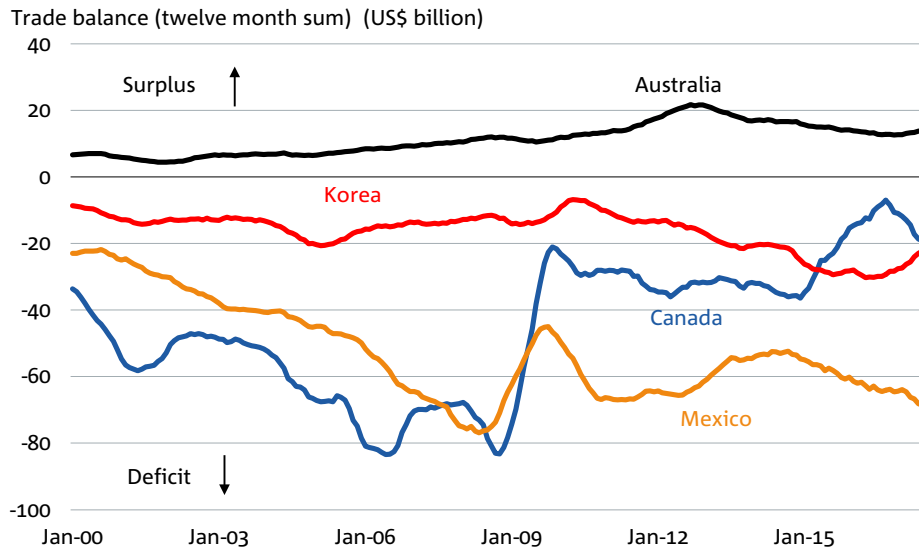
TRUMP WIN BOOSTS US BUSINESS OPTIMISM



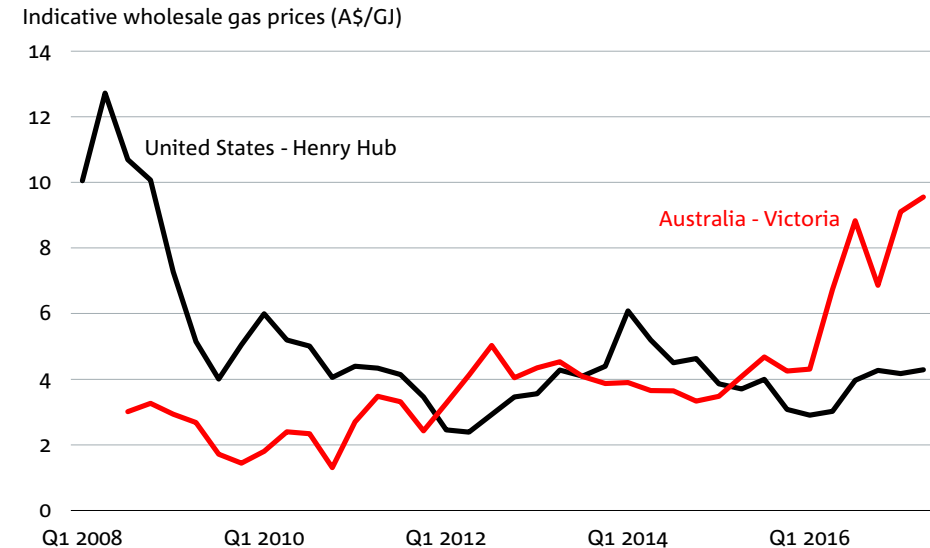
US CORPORATE TAX RATES HIGH BY GLOBAL STANDARDS



AUSTRALIA/US TRADE DEAL SHOULD LOOK GOOD TO TRUMP



GROWTH IN SHALE GAS SECTOR ADVANTAGES US INDUSTRY BUYERS



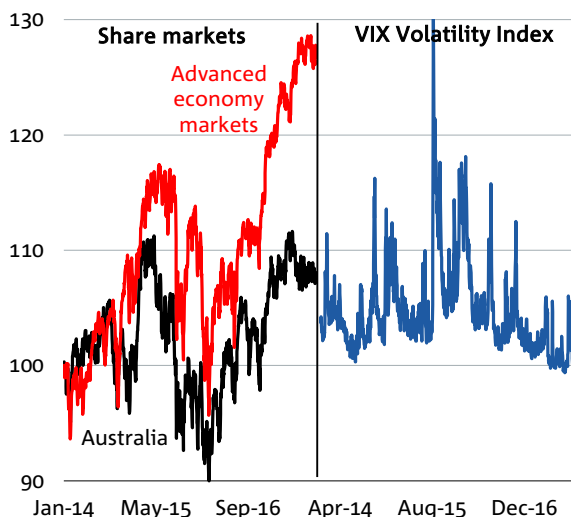
Sources: OECD, Datastream, AEMO, NAB Economics

FINANCIAL AND COMMODITY MARKETS

Uncertainty about US policy outlook & geopolitical risks affecting markets

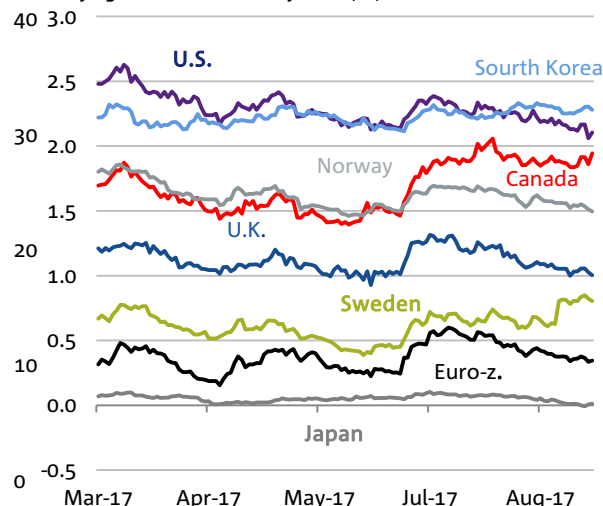
STOCK MARKETS TAKE A PAUSE

Share markets and volatility indices



JUNE YIELD SPIKE PARTIALLY UNWOUND*

10yr government bond yields (%)

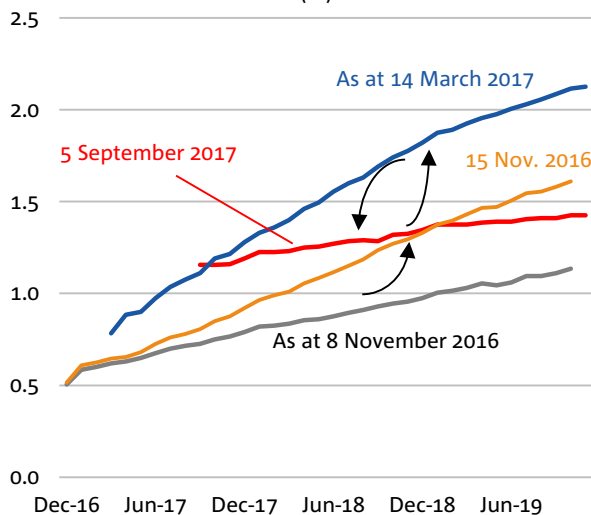


After rising strongly since the latter part of 2016, advanced economy stock markets have recently given up some of their gains. This is despite the resumption of strong growth across many advanced economies in the June quarter. In part this reflects concerns over the US political environment and geo-political risks, particularly relating to North Korea.

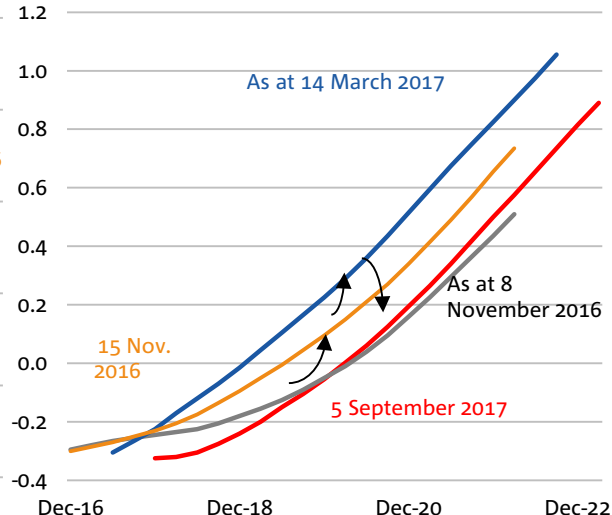
- This is not to say that financial markets are panicking. For example, the VIX volatility index has spiked on occasion but quickly settled, and South Korean 10 year government bond yields only rose modestly following missile tests by North Korea.
- Commodity prices, after falling through the first half of 2017, have broadly stabilised in recent months, supported by an improving demand outlook and USD weakness.
- The USD weakness appears to reflect improved global economic conditions (particularly in the Euro-zone) and a move from the Trump 'trade' to 'discount', as doubts about what changes the new administration can deliver have grown.
- These doubts can also be seen in interest rate markets. Expectations of Federal Reserve rate hikes rose following the US election in November last year, reaching a peak in mid-March. Since then expectations of future rate hikes have been unwound, despite the Fed actually delivering three rate hikes. 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.
- US financial conditions often affect other countries and recent times are no exception. The futures curve for Euro-zone interest rates moved higher following the US election but has now returned to where it was. However, the unchanged slope of the curve signals higher rates are expected in the future, reflecting the recovery in the Eurozone economy 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.

MARKET NOT EXPECTING FED TO DO MUCH MORE BUT SEES EURO RATE RISES

Fed funds rate futures curve (%)



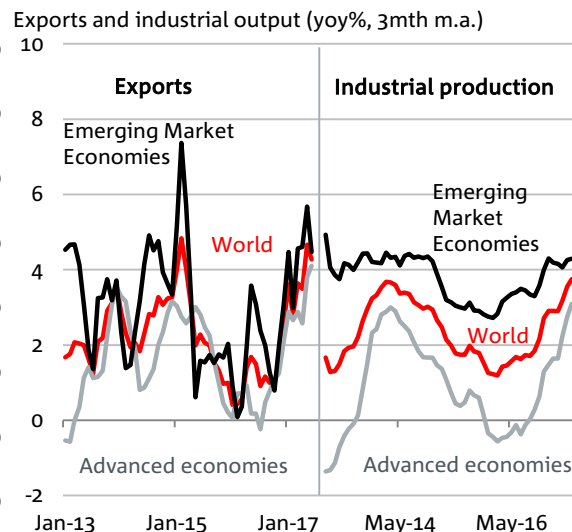
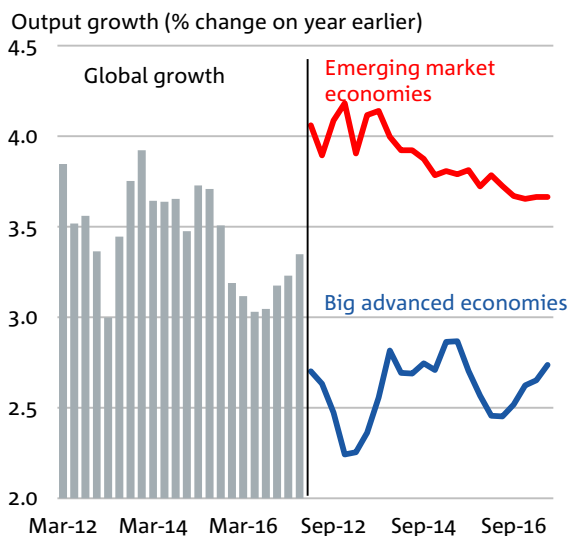
3mth Euro Euribor futures curve (%)



GLOBAL ECONOMIC TRENDS

Global growth rising toward trend pace as advanced economies lift

ADVANCED ECONOMY UPTURN LIFTS GLOBAL GDP, TRADE & INDUSTRY

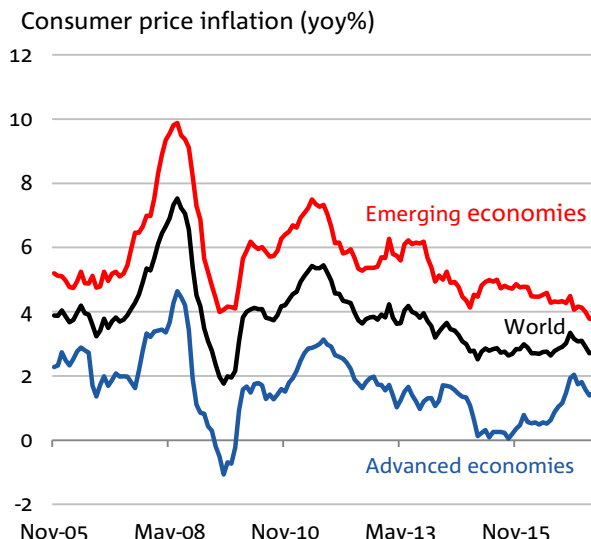


- After slowing through 2015 and the first half of last year, the pace of global growth started picking up from mid-2016. Growth bottomed out at 3% yoy in the June and September quarters of last year but it picked up to 3.2% in late 2016 and early 2017 before accelerating again to 3.3% in June quarter 2017. Consequently, world economic growth is now heading back to the 3½% trend rate seen since 1980 for the first time since mid-2015.

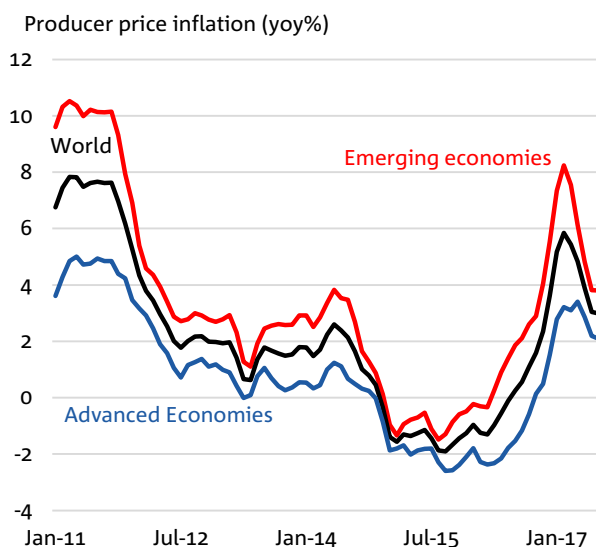
- This upturn in global growth has been driven by faster economic expansion in the big advanced economies where growth has picked up from around 1¼% yoy in the first half of 2016 to over 2% yoy in June 2017. Emerging market economy growth, by contrast, has flat-lined at just under 5% yoy since late 2015, held down by a combination of the fairly steady rate of Chinese economic expansion, recessions in Russia and Brazil and the disruptive impact of big changes in economic policy on Indian GDP.

- Cyclical changes in the pace of global growth tend to be seen most clearly in the pattern of world trade and industrial output – they tend to show the earliest and biggest swings in activity, exceeding the fluctuations in the service industries that generally form the bulk of GDP. Global industrial growth picked up from 0.6% qoq in March quarter 2017 to 1.2% qoq in June with rising momentum in both the advanced and emerging market economies. Comparisons of both industrial output and world trade with year-earlier levels shows the upturn most clearly. Industrial growth in the advanced economies has accelerated from practically nothing in mid-2016 to around 3% yoy a year later. Comparable growth measures for world trade show growth now running around 4% yoy.

WORLD CPI INFLATION EASES



AS DOES PRODUCER PRICE INFLATION



- While global growth has picked up, 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. Recessions lowered previously high inflation in Brazil and Russia, progress has been made in lowering India's high inflation and Chinese CPI inflation is only 1½% yoy.

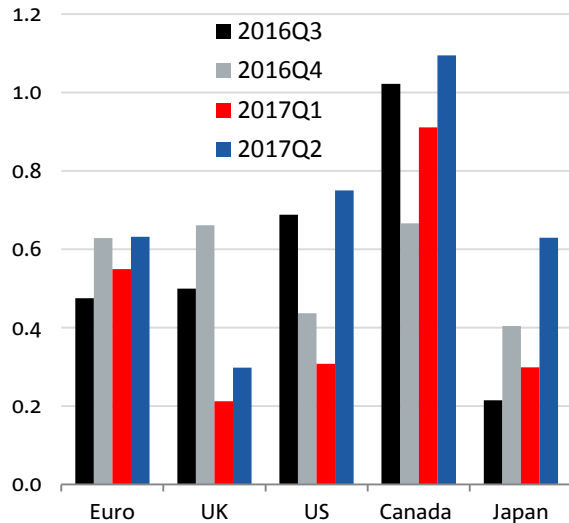
Sources: Datastream, Markit, ISM, Bloomberg, dXdata, NAB Economics

ADVANCED ECONOMIES

Broad based upturn in growth through mid 2017

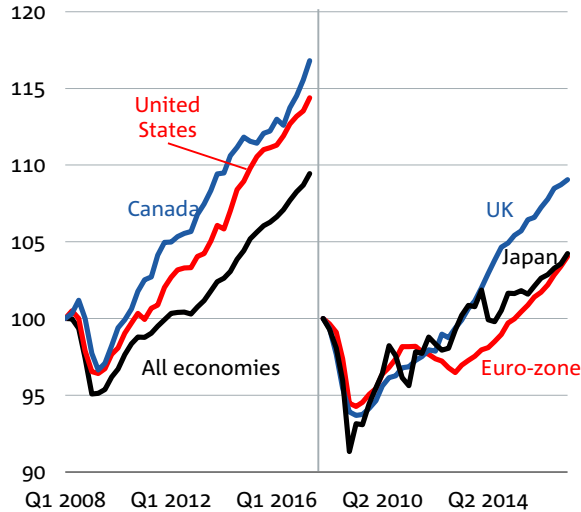
ROBUST Q2 GDP OUTCOMES

Major advanced economy GDP growth (qoq%)



G7 LAGGARD ECONOMIES PICKING UP

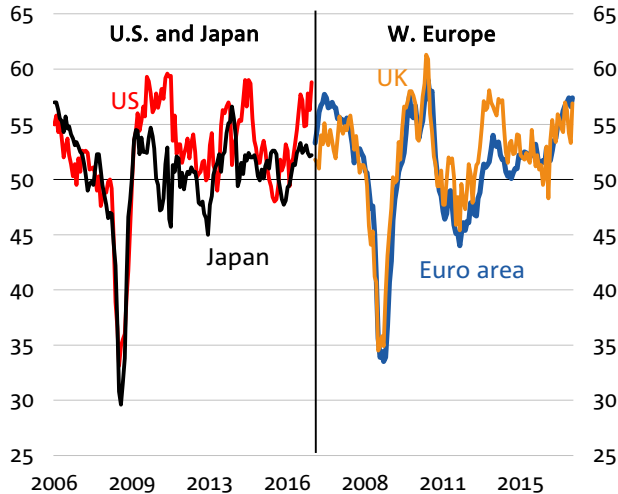
Advanced economy GDP (Q1 2008= 100)



- After several periods of sluggish growth, the pace of expansion in the big advanced economies lifted quite markedly in the June quarter. Second quarter growth averaged 0.7% qoq across the G7, well above the 0.4% growth in the March quarter and the 0.5% quarterly expansion averaged over the year to March. Comparing G7 GDP with its year-earlier level, 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 with US GDP growing by 0.8% in the quarter while the Canadian economy grew by over 1%. Japan, which has experienced quite a weak recovery from the 2008/9 financial crisis and global recession, also grew strongly, with quarterly growth in June of 0.6%.
- The Euro-zone has been another under-performer in terms of output growth through the last decade but here too conditions have been improving. Euro-zone GDP grew by 0.6% in the second quarter, up from March's 0.5% with Germany the strongest big Euro-zone economy and Italy the weakest. 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.

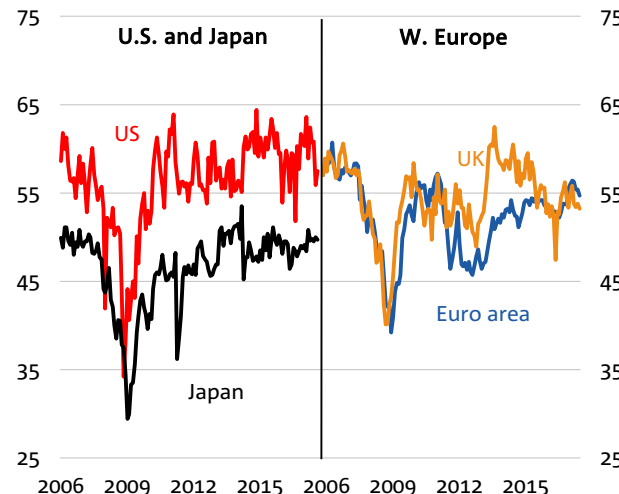
SURVEYS SHOW INDUSTRIAL GROWTH

Advanced Economy Manufacturing PMIs (50=Breakeven)



MIXED PICTURE FOR SERVICES

Advanced Economy Services PMIs (50 = Breakeven level)



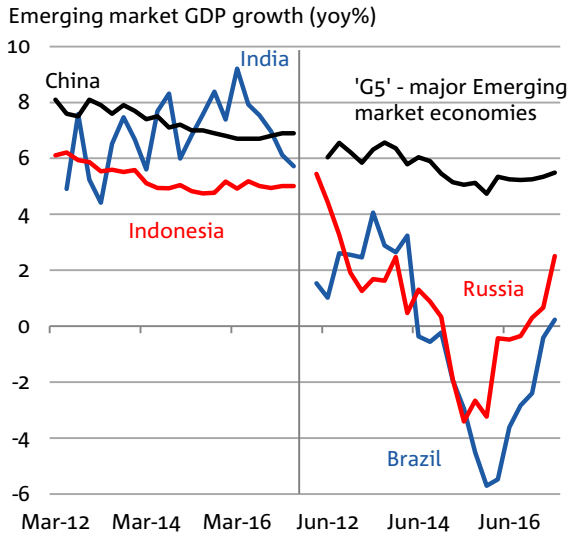
- Partial data on industrial output and trade along with the monthly business surveys provide the most timely measures of the pulse of economic growth in the advanced economies. Industrial output grew by 1.3% in the June quarter across the advanced economies, three times the 0.4% rate seen in the prior quarter. The trade data confirms the lift in momentum – with advanced economy export growth lifting from 0.7% to 1.8% between the first and second quarters of the year and comparable data for imports shows a similar lift in quarterly growth from 0.7% to 1.1%.
- 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.

Sources: Datastream, Markit, ISM, NAB Economics

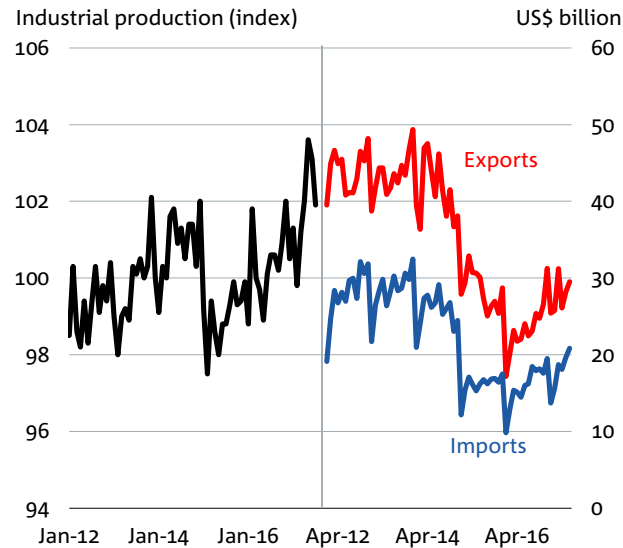
EMERGING MARKET ECONOMIES

Mixed picture – India weaker, Russia & Brazil coming out of recession

RECOVERY LIFTS EMERGING GDP



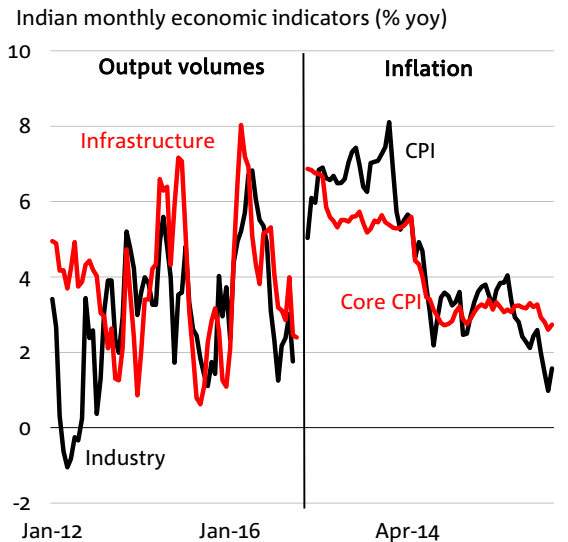
RUSSIAN OUTPUT & TRADE IMPROVING



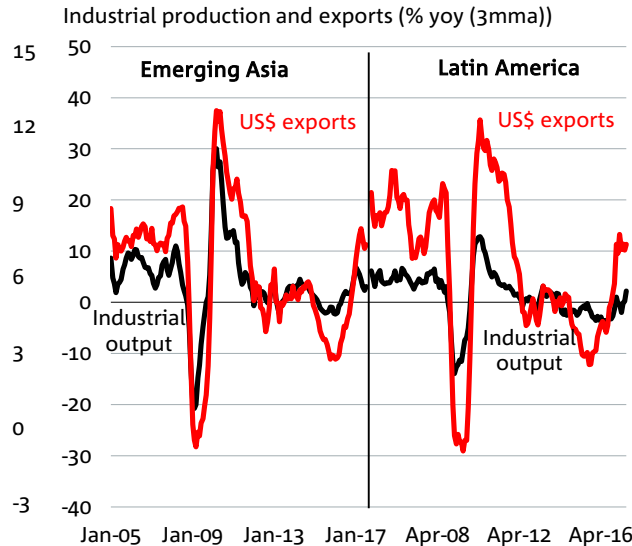
Economic growth in major emerging market economies trended higher in the second quarter – back up to 5.5% yoy (compared with 5.4% between Q1 2016 and Q1 2017). That said, there have been markedly different conditions across the individual economies.

- Russia – the world’s sixth largest economy – has been a major contributor to faster growth. Russian growth rose to 2.5% yoy in Q2, up from 0.7% in Q1 2017 and 0.3% in Q4 2016. Improving industrial production and export trends have helped to bring the economy out of a deep recession. Similarly, growth has turned positive in Brazil – at 0.2% yoy – from -0.4% in Q1.
- In contrast, India’s economic growth has slowed considerably in recent quarters – down to 5.7% yoy in Q2 (having fallen from a peak of 9.2% yoy in Q1 2016). Slowing industrial growth has been a major driver – with output rising by just 2.0% yoy in the first half of the year. While India’s government has attributed the slowdown to one-off factors, weak inflation may indicate soft underlying demand.

INDIAN INDUSTRY WEAKER



PRICES DRIVING EXPORTS HIGHER



- China’s growth has been stable in the first half of the year at 6.9% yoy – ahead of October’s 19th National Congress, where significant leadership change could influence future economic reforms.
- Industrial output in emerging economies has gradually recovered from relatively weak growth in the first quarter. According to the CPB measure, quarter-on-quarter output rose by 1.1%, stronger than the 0.8% increase in Q1, but still lagging the 1.4% increase in Q4 2016. In contrast, there appears to be a slowing trend in export volumes. Emerging market export volumes fell by 0.5% qoq in Q2, down from a 2.3% increase in Q1 and 2.8% in Q4 2016.
- This slower trend appears evident in trade exposed East Asia and Latin America. While US dollar denominated exports have risen, much of this is connected to commodity price trends. Volumes are less robust – with a slowing trend evident in industrial output in Asia while Latin American output has only recently returned to modest growth.

GLOBAL FORECASTS, POLICIES AND RISKS

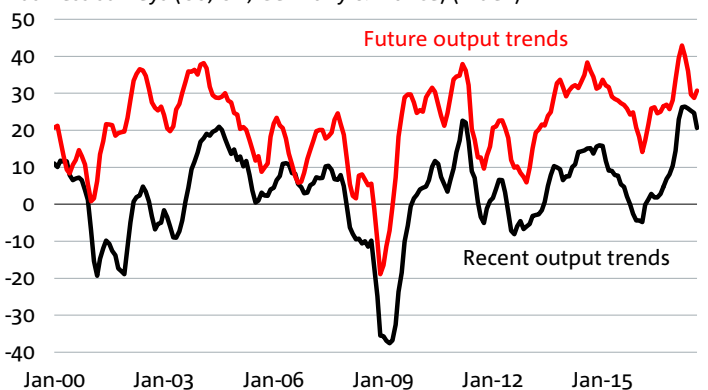
Growth picks up as markets stay calm in the face of geo-political risks

CREDIT MARKETS STILL RELAXED

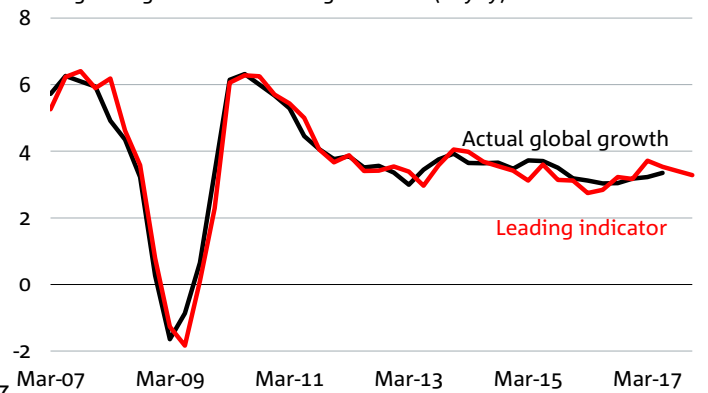
ITRAXX Credit Default Swap indices



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



Actual global growth and leading indicator (% yoy)



- 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. The emerging market economies generally drive most global output expansion but their growth has stagnated recently. This could start to improve now - China's economy has avoided the much discussed "hard landing", the impact of the policy changes that have held back Indian growth should pass and the Russian and Brazilian economies are now gradually recovering from deep recessions. As these economies ranked as 1st, 3rd, 6th and 8th biggest in the world and cumulatively represent one-third of the global economy, that helps explain the 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 – low probability high impact events that would really damage the global economy – have faded in the last few years. The Euro-zone has not collapsed, the world has not fallen into deflation, there has been no overly aggressive tightening of monetary policy by central banks, US-China trade tensions have risen but full-scale global trade wars have not broken out. In their place, new risks have loomed into view – especially the geo-political situation involving North Korea.
- So far, the markets have remained surprisingly relaxed about this heightened risk – the VIX index of financial market volatility has stayed low by historical standards, government bond yields have stayed low and actually resumed their downward trend so investors are still around at these low yields, and corporate credit market pricing is not showing any great lift in concern over default risks.

GLOBAL GROWTH FORECASTS (% change)

	2012	2013	2014	2015	2016	2017	2018	2019
US	2.2	1.7	2.6	2.9	1.5	2.1	2.3	2.0
Euro-zone	-0.8	-0.2	1.4	1.9	1.8	2.2	2.0	1.6
Japan	1.5	2.0	0.2	1.1	1.0	1.5	1.0	0.7
UK	1.3	1.9	3.1	2.2	1.8	1.5	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	7.3	6.1	7.0	7.5	7.9	6.8	7.4	7.6
Latin America	2.7	2.5	0.9	-0.2	-1.1	0.9	2.6	2.9
Emerging East Asia	4.7	4.2	4.1	3.7	3.9	4.1	4.1	3.9
NZ	2.5	2.2	3.4	2.5	3.1	2.5	3.0	2.6
Total	3.6	3.4	3.5	3.3	3.2	3.4	3.6	3.4

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

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