October 2017

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

***Global**: The global economic upturn is still under way, but there are a few signs that the pace of expansion is no longer accelerating. Inflation remains subdued and financial markets calm, meaning there is little need for aggressive central bank moves on policy. Market volatility and economic policy uncertainty are both fading as the probability of severe "tail risk" events are markedly lower. However, there still are uncertainties – North Korea, Spanish politics, US economic policy, Italian elections etc.*

- Reflecting improvements in the global economy, major advanced economy (AE) stock markets have been trending up. Movement towards possible tax cuts in the US – including corporate tax cuts – may have given some additional impetus. Despite continuing geo-political risks, such as North Korea/US tensions and recent unrest in the Catalonia region in Spain, market risk measures such as the VIX and credit spreads remain subdued.
- Around mid-year there was a general shift in advanced economy central bank rhetoric away from further easing to questioning when to tighten, which has lifted long-term bond yields. The US Fed has been raising rates for a while and announced a process of unwinding its large balance sheet last month. The Bank of Canada has raised interest rates twice this year. The ECB is expected to announce a slowdown in the pace of asset purchases at its meeting this month, and the Bank of England is signalling that a rate rise may not be far away. The Bank of Japan is the main exception as, despite its politically unpopular monetary easing measures, inflation remains well below target and so policy looks likely to be on hold for an extended time. Markets are pricing in only very gradual rate rises from most CB's, which would still see rates remain low by historical standards.
- After slowing through 2015 and the first half of last year, the pace of global growth started picking up from mid-2016. Consequently, world economic growth looks to be headed back to the 3½% trend rate seen since 1980 for the first time since mid-2015. Faster industrial growth in the big advanced economies accounts for much of the global industrial upturn, a trend reflected in broader measures of economic activity like GDP. Advanced economy growth picked up from 1¼% yoy in the first half of 2016 to over 2% yoy by mid-2017 and the business surveys are pointing to solid growth continuing into the second half of the year.
- The US and Euro-zone have driven most of this upturn in advanced economy expansion, with the US being one of the stronger performers through the post-GFC recovery while the Euro-currency block fared much worse, weighed down by peripheral country debt crises. As the Euro-zone is the third biggest global economic unit, after China and the US, better growth numbers in Europe will have a clear impact on the bottom line for global GDP. The most up to date information on monthly industrial output and business sentiment confirm that the economic upturn in the big advanced economies has continued into H2. Industrial sector business surveys reached very high levels in the US, UK and Euro-zone through to September, pointing to continued expansion. The Japanese survey results were, as usual, less positive, nevertheless the year-on-year volume growth of industrial output has been robust through the months of July and August. Importantly, US, UK and Euro-zone service sector business surveys continue to pick up, although there is some divergence between the big economies with the UK service sector continuing to grow but looking less robust, the Japanese one looking still quite flat while the US and Euro-zone stand out now as the best performers.
- Trends in emerging market economics remain mixed – with signs of slowing activity in India and China countered by recoveries in Brazil and Russia (as these economies emerge from deep recessions). Emerging economies received a boost from trade activity from late 2016 to early 2017, however export volumes have plateaued since this time, while growth in export values has stalled. This might suggest limited upside to economic growth in the short term – having seen a modest improvement in the five largest emerging markets in early 2017. While China's economic growth was relatively strong and stable across the first half, recent indicators point to a softening. This was particularly the case for fixed asset investment, which contracted in real terms in August – the weakest result since late 1995. That said, indicators of China's services sector – such as retail sales and air travel – remain robust. Softer industrial trends could result in weaker growth in H2 2017, in line with our forecasts.
- 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. There are a few signs that the rate of growth could be peaking in the advanced economies but it is too early to be certain. Emerging market economies account for most global output expansion and their growth could now start to improve, helping explain the lift in global growth to a slightly above trend 3.6% in 2018 from 2017's 3.4%. 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, but new risks have loomed into view – especially the geo-political situation involving North Korea and the political unrest in Spain where the Catalonian government is pushing for independence.
- 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*: The forecast outlook is essentially unchanged, following revisions to our expectations for the labour market and the RBA cash rate last month. We are pencilling in two 25bp rate hikes from mid-2018, with employment now expected to be strong enough to give the RBA enough confidence in its forecasts for an eventual lift in wages growth and inflation by that point. That said, we remain more cautious about the economic outlook than the central bank, mindful of the potential hurdles to growth such as impending peaks in dwelling construction and LNG exports, and a struggling household sector amidst low wages growth, higher energy prices and elevated underemployment and household debt.**

- Outcomes in the September NAB Monthly Business Survey were generally upbeat. Business conditions remain rock steady at levels close to their multi-year highs, but business confidence rose only modestly after a big fall last month. Encouragingly, capacity utilisation rates rebounded a little and are still elevated, while the Survey's indicator of capital expenditure improved.
- 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 September NAB survey employment conditions eased in August, but remained well above long run average – consistent with an annual job creation rate of around 240k (around 20k 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. Despite the recent improvements in the labour market, wages growth remains weak.
- High frequency indicators of **consumer spending** continue to be weak. The official ABS measure of retail sales contracted by 0.6% mom in August, as foreshadowed by NAB's new Cashless Retail Sales Index released two weeks earlier. Weakness was broad-based across store types and across states, consistent with NAB's data. Also worrying is renewed weakness in business conditions for the retail sector, which has retreated back into negative territory. Part of the catalyst for the fall in sales may reflect a shift towards online spending, with NAB's Online Retail Index strong in August, although this cannot fully explain the magnitude of the decline. Rather, there are a number of potential headwinds, including a backdrop of low household income growth - strength in employment notwithstanding - as well as high underemployment and household debt and higher energy prices. These factors are all expected to limit any upswing in consumer spending through the forecast horizon – although there was a small improvement in spending for non-essentials evident in NAB's Household Spending Behaviours data, despite an increase in spending on utilities.
- Consistently good outcomes in the NAB Survey point to a relatively strong **business sector**. However, these have not passed through to investment quite as expected, signalling ongoing risk aversion and a preference towards balance sheet repair – the recent closures of auto manufacturing plants and higher utility prices may be negatively impacting investment and business confidence (in some areas) as well. There are, however, some encouraging signs, with the value of non-residential building approvals still showing a positive trend despite falling in August; 10.5% higher y/y, while commercial vehicles sales are also seeing reasonable growth according to industry data. Leads on the longer-term outlook have been better lately too, with the ABS Private Capex survey pointing to stronger non-mining investment in FY18 – more consistent with solid capex expectations in the NAB Quarterly Business Survey. There is also a large pipeline of infrastructure projects that is expected to keep **public investment** elevated, although the growth rate may have peaked. Official data show business credit growth holding up at acceptable levels as well, although at 4.5% y/y in August that is still soft by historical standards.
- Sydney's housing market is finally showing signs of cooling, as evidenced by lower price growth and auction clearance rates. Melbourne's house prices growth remains rapid however, while there is strong performance in Hobart, Canberra and to a lesser extent, Adelaide. Despite some softer trends, housing finance approvals (owner-occupier) appear to be picking up again, and while the value of investor finance approvals has fallen this year, it appears to have stabilised. On the supply side, residential building approvals rose modestly in August, and the trend has been showing positive growth recently (with a surprise improvement coming from Queensland). While building approvals have held up a little better than expected, they are still well down over the year (-15½%) and we still expect the downward trend to resume at some point given some of the challenges facing the market.
- The **trade** surplus improved slightly in August to be around $990 million, with services trade continued to improve. Iron ore exports recovered in August following rail maintenance in July, and coal and LNG exports lower. The NAB non-rural commodity price index is expected to recover somewhat in Q3, largely driven by the small gain in iron ore prices in July, which have since fallen back. Base metal prices also strengthened during the quarter and are expected to show some further strength in Q4, however, that will be more than offset by the normalisation in iron ore prices, which is expected to drive the commodity price index lower from Q4.
- The AUD has depreciated by ~2 cents over the past month vis-à-vis the USD to 0.78 at the time of writing. While this has partly reflected USD strength, the AUD has underperformed relative to the size of the USD move, and has also fallen against every other major currency with the exception of the Japanese yen. This has largely reflected weakness in industrial metals and bulk commodity prices. We expect to see further progress towards our AUD/USD year-end target of 0.75 in coming weeks - assuming no quick reversal of the downward move in commodity prices, no major set-back to the December Fed hike odds, and/or tax reform optimism in the US.
- 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.