



THE FORWARD VIEW – GLOBAL

OCTOBER 2017

Summary

- Global economic upturn 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, little need for aggressive central bank moves on policy.
- Market volatility and economic policy uncertainty both fade as probability of severe “tail risk” events marked lower.
- As ever, there still are uncertainties – North Korea, Spanish politics, US economic policy, Italian elections etc.

| | IMF weights | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|--------------------|-------------|------|------|------|------|------|------|------|------|
| US | 15.5 | 2.2 | 1.7 | 2.6 | 2.9 | 1.5 | 2.1 | 2.3 | 2.0 |
| Euro-zone | 11.7 | -0.8 | -0.2 | 1.4 | 1.9 | 1.8 | 2.2 | 2.0 | 1.6 |
| Japan | 4.4 | 1.5 | 2.0 | 0.2 | 1.1 | 1.0 | 1.5 | 1.0 | 0.7 |
| China | 17.7 | 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 | 3.0 | 2.5 | 2.9 | 2.7 |
| Total | 100.0 | 3.7 | 3.4 | 3.5 | 3.3 | 3.2 | 3.4 | 3.6 | 3.4 |



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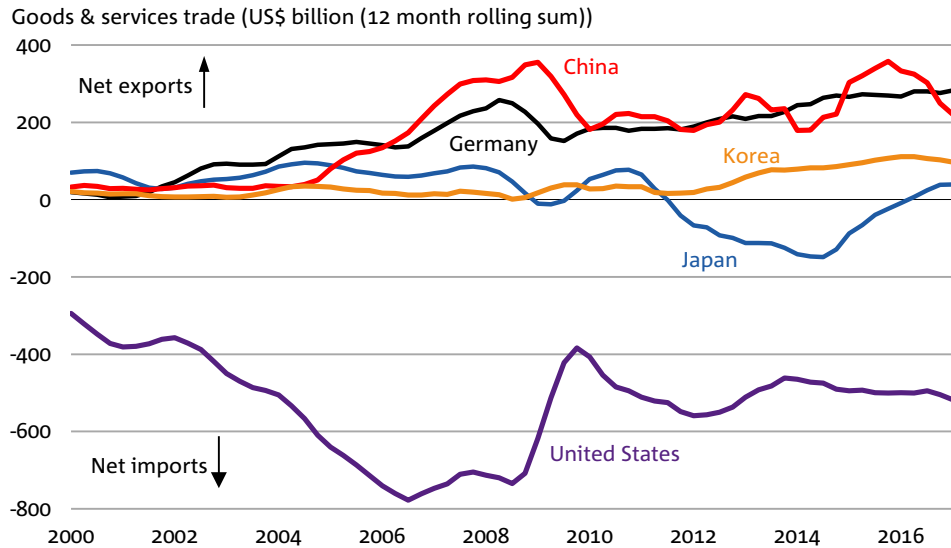
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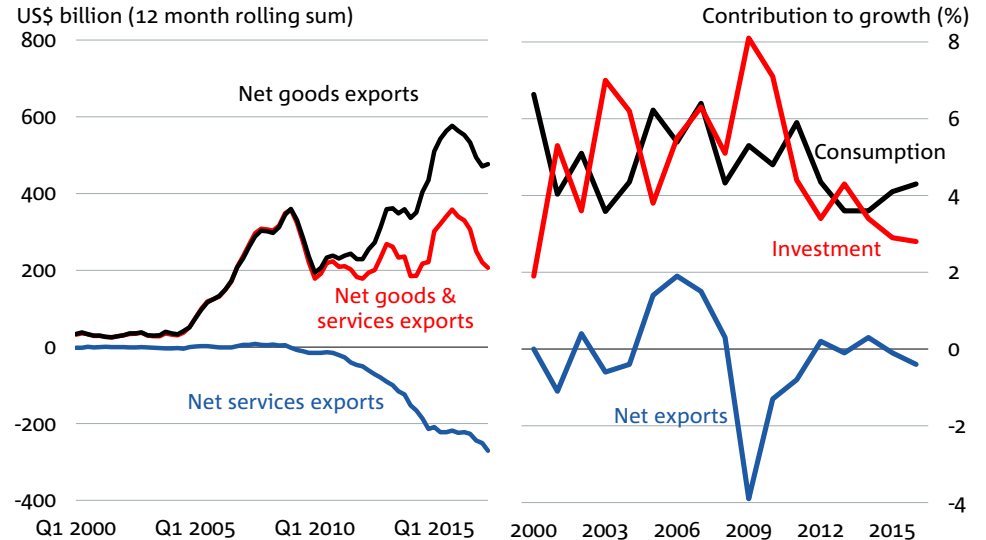
GLOBAL TRADE IMBALANCES

Growing imbalances fuel trade protection sentiment, particularly in the US

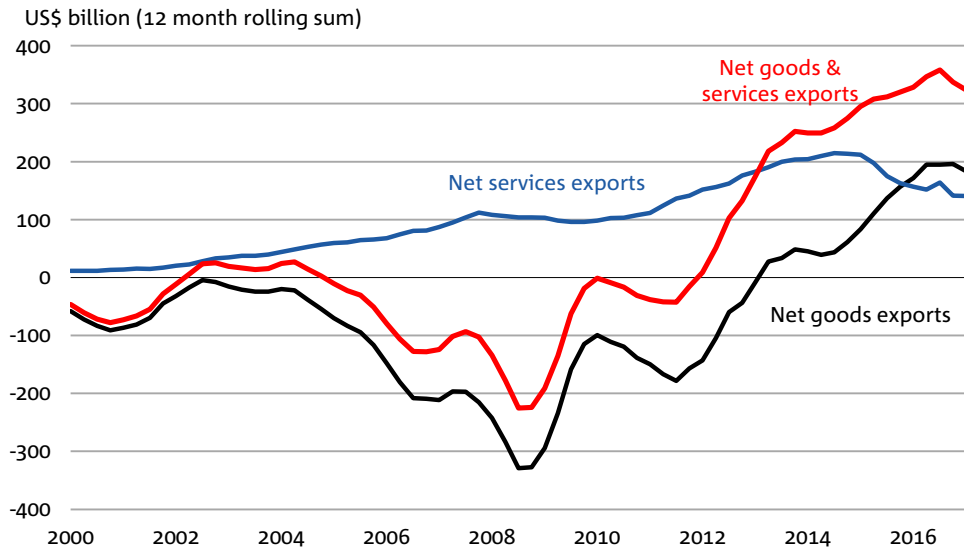
WIDENING TRADE IMBALANCES RAISE US IRE AND IMF CONCERN



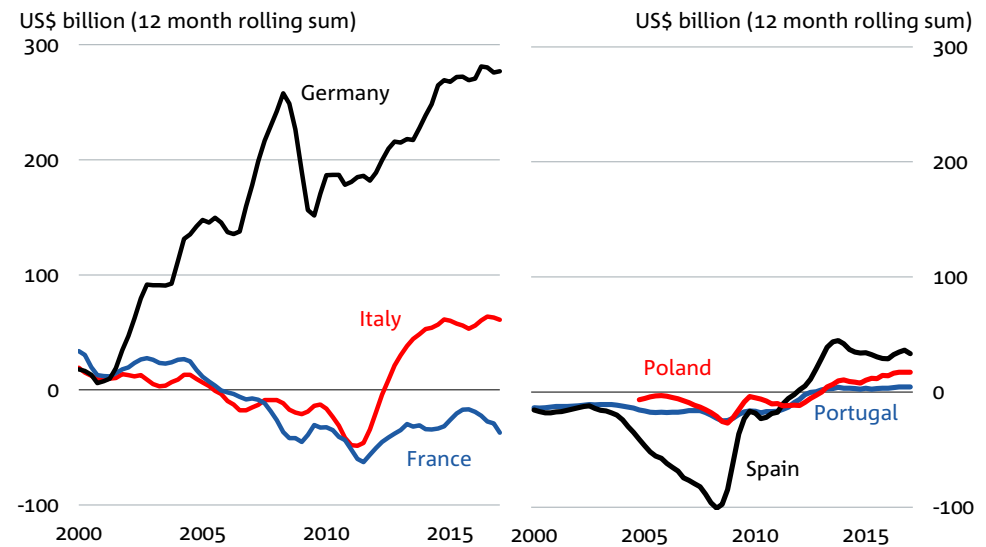
CHINA'S GROWTH SHIFTS TO DOMESTIC SPENDING, NOT EXPORTS



EUROPE'S SWITCH FROM PRE-GFC DEFICIT TO SURPLUS...



...LED BY SURGING GERMAN TRADE FLOWS



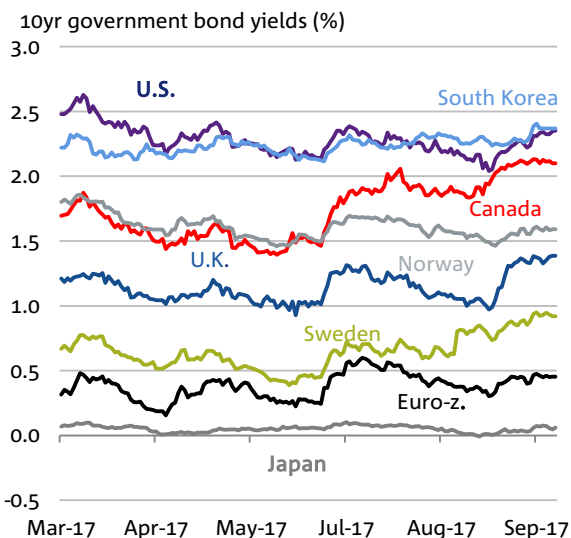
Sources: OECD, Datastream, CEIC, NAB Economics



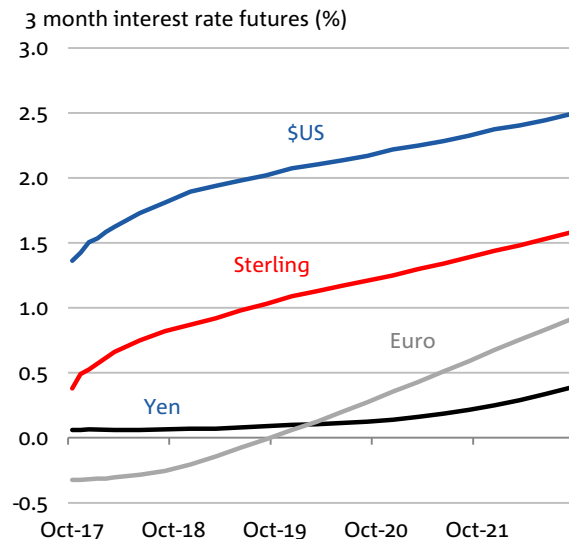
FINANCIAL AND COMMODITY MARKETS

AE unemployment at low levels signals rate are on the way up... slowly

BOND YIELDS UP SINCE MID-YEAR

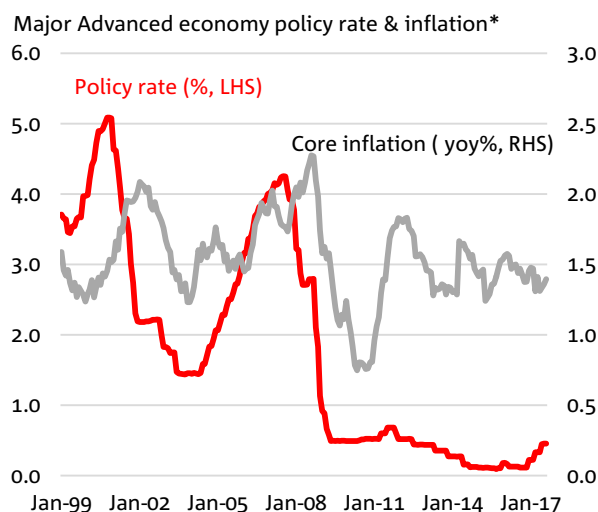
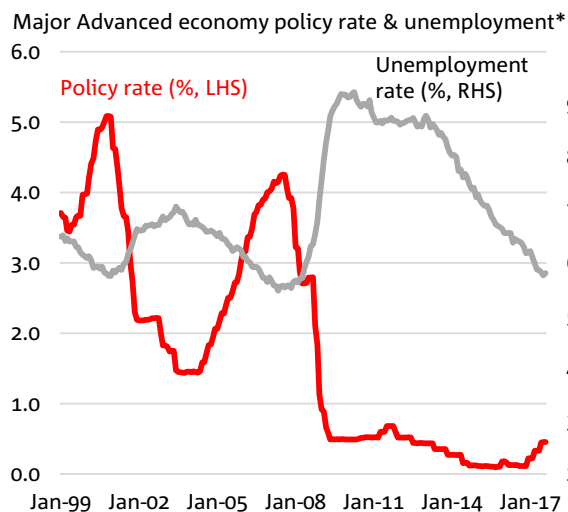


GRADUAL RATE RISES EXPECTED...



- 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 markets 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. Commodity prices, after falling through the first half of 2017, have broadly tracked sideways.
- 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 slow down 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.

...AS RATES VERY LOW DESPITE UNEMPLOYMENT CLOSE TO PRE-GFC LEVEL



*PPP GDP weighted for US, UK, Canada, Japan, Euro-zone

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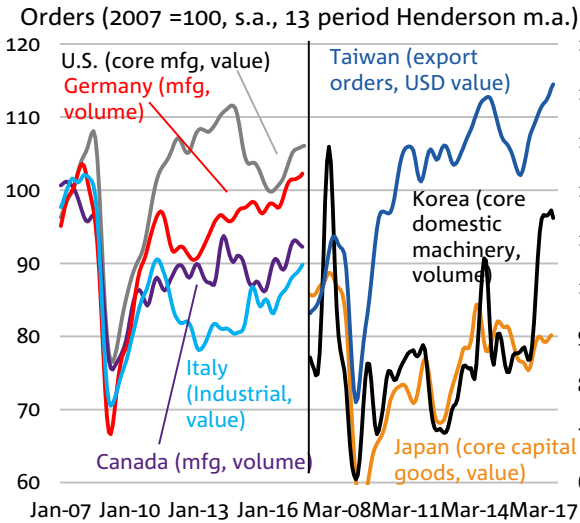
Sources: Datastream, Bloomberg, NAB Economics

- It may appear surprising that central banks are looking to tighten in an environment where inflation generally remains below target (with the exception of the UK). However, aggregate core inflation in major economies is not exceptionally low – it is near the bottom of the typical range since the late 1990s. Moreover, monetary policy is also set with a view as to how the real economy is performing and the aggregate unemployment rate is essentially back to its pre-GFC level. Some central bankers see the lower unemployment rate as signalling inflationary pressures down the track.
- Against this backdrop, central banks see less need for exceptionally low policy rate settings. In the case of the ECB and the UK (which cut rates after the Brexit vote) the change in outlook is also about removing some of the 'emergency' monetary stimulus that has been put in place rather than signalling an ongoing series of rate increases. Consistent with this, and still subdued inflation, markets are pricing in only very gradual rate rises which would still see rates remain low by historical standards.

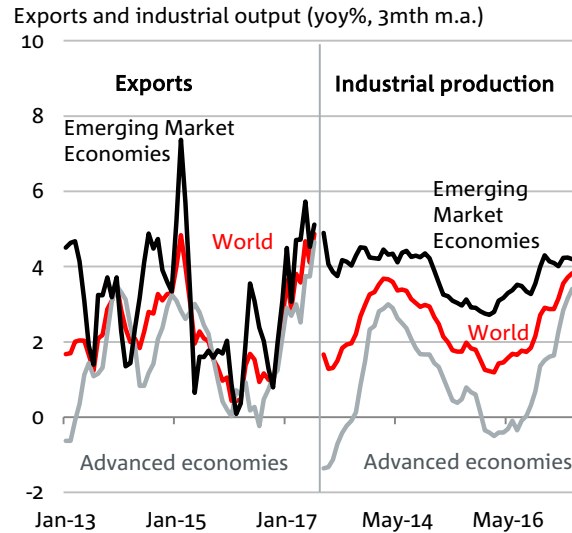
GLOBAL ECONOMIC TRENDS

Global growth rising toward trend pace as advanced economies lift

ORDERS LIFT IN KEY ECONOMIES



TRADE/INDUSTRY UPTURN ROLLS ON

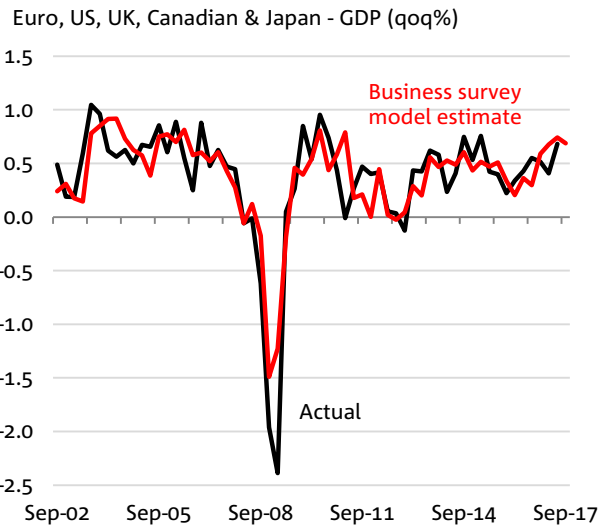


- After slowing through 2015 and the first half of last year, the pace of global growth started picking up from mid-2016. Growth bottomed out at 3% yoy in the June and September quarters of last year but it picked up to 3.2% in late 2016 and early 2017 before accelerating again to 3.3% in June quarter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

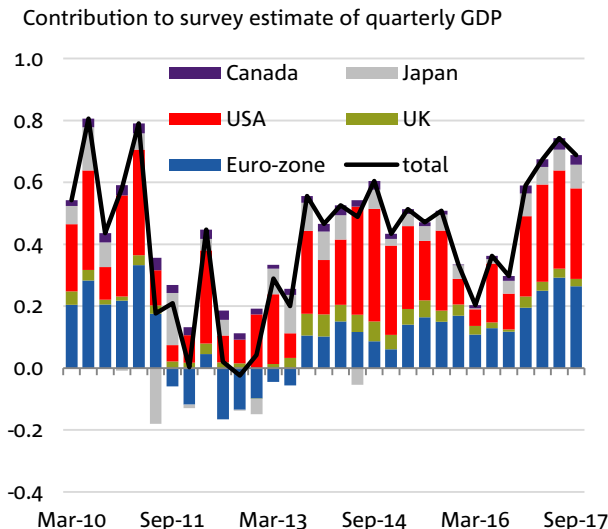
- The most up to date monthly information on industrial output, orders and world trade shows growth continuing into the second half of the year. New industrial orders have kept growing across key economies like Germany, the US, Italy, South Korea and Taiwan. While recent orders growth has been less impressive for Japanese investment goods and Canadian manufacturing, the overall global trend looks to be one of solid growth.

- Trend growth in global industrial production lifted from less than 2% yoy in late 2016 to around 3¼% yoy through June and July. There are a few signs that upward momentum in growth was fading around mid-year with the pace of industrial growth in the CPB global data no longer ramping up at the rate seen earlier in the year. Although the rate of growth remains solid, August data for industrial output in a wide range of economies shows that growth is not accelerating in the way it was through the early months of the year.

SURVEYS POINT TO MORE GROWTH



GROWTH FOCUSED ON US AND EURO



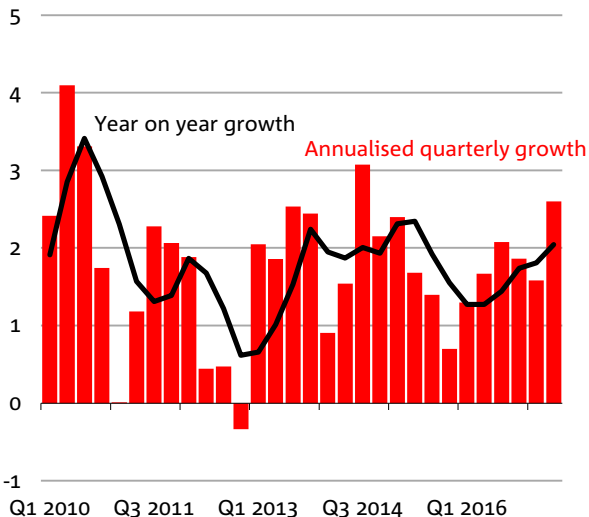
- Faster industrial growth in the big advanced economies accounts for much of this global industrial upturn, a trend reflected in broader measures of economic activity like GDP. Advanced economy growth picked up from 1¼% yoy in the first half of 2016 to over 2% yoy by mid-2017 and the business surveys 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.

ADVANCED ECONOMIES

Upturn keeps going but at varying speeds

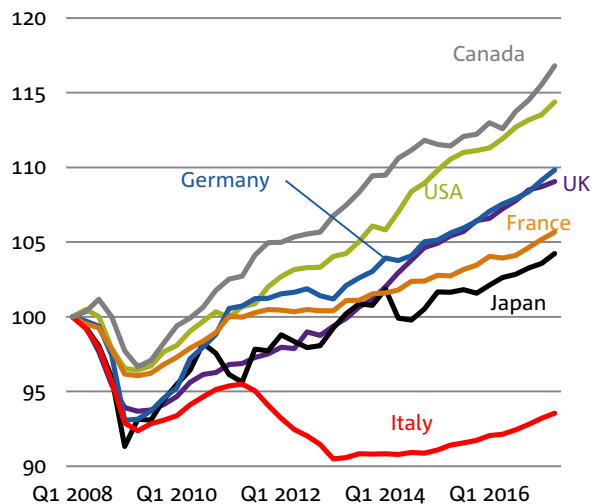
ADVANCED ECONOMY GROWTH LIFTS

G7 Advanced Economy Growth (%)



MIXED PICTURE FOR GROWTH

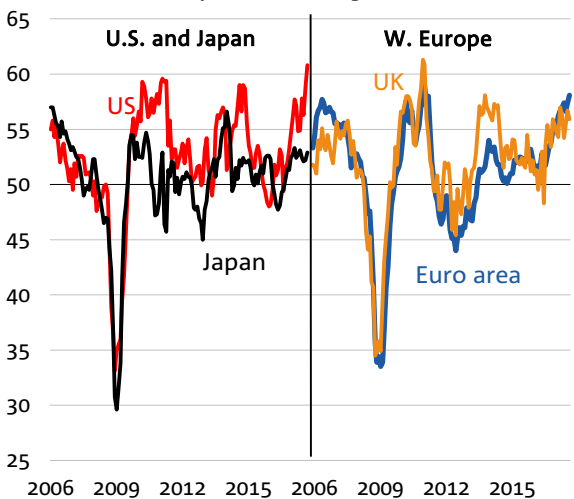
Real GDP - Major Advanced Economies (Mar 08 = 100)



- After a period 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 0.5% quarterly average 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.
- This lift in advanced economy growth follows a period of great diversity in performance. The best G7 economic performers have been Canada and the United States while Italy has clearly been the worst with its mid-2017 output still well below its early 2008 level, marking almost a decade of lost economic growth which has brought mass youth unemployment. The UK was one of the better G7 performers through the early years of the recovery from the GFC but Germany is now outpacing it. Japan was another under-performer after its 2014 GST hike hit the economy harder than expected but output there has begun to look better.

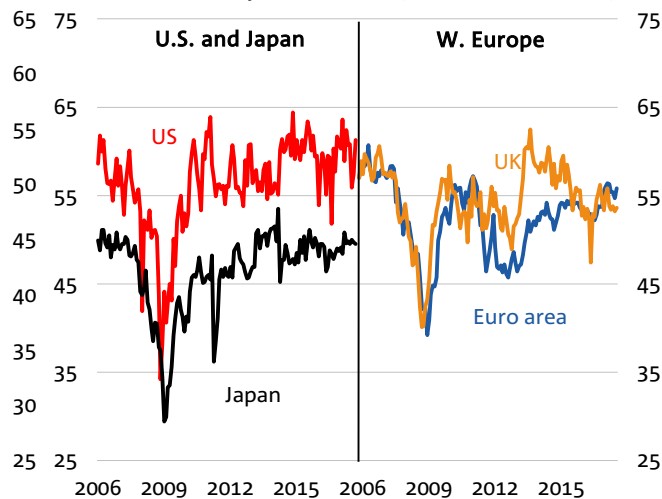
INDUSTRIAL SURVEYS BUOYANT

Advanced Economy Manufacturing PMIs (50=Breakeven)



SERVICES SURVEYS POSITIVE TOO

Advanced Economy Services PMIs (50 = Breakeven level)



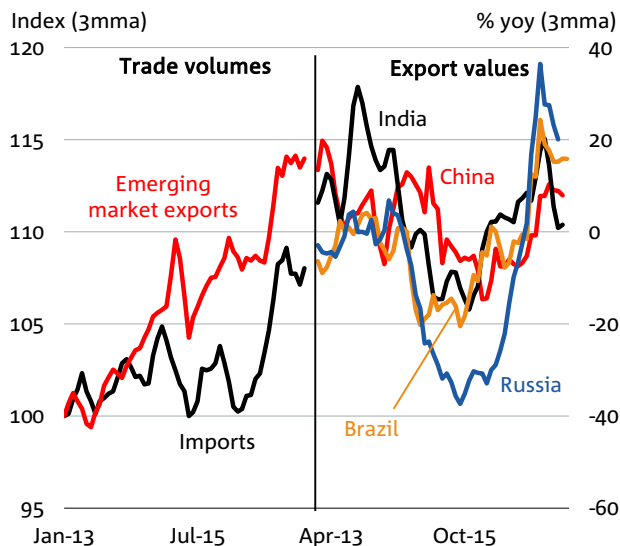
- The most up to date information on monthly industrial output and business sentiment confirm that the economic upturn in the big advanced economies has continued into the second half of the year. Industrial sector business surveys reached very high levels in the US, UK and Euro-zone through to September, 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.
- While the industrial surveys show the timing and extent of the cyclical upswing in the manufacturing sector across the advanced economies, it is services that provide the bulk of output and employment. Consequently, the continued expansion shown in the US, UK and Euro-zone service sector business surveys is of greater importance in picking national trends in economy-wide output. However, 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.

Sources: Datastream, Markit, ISM, NAB Economics

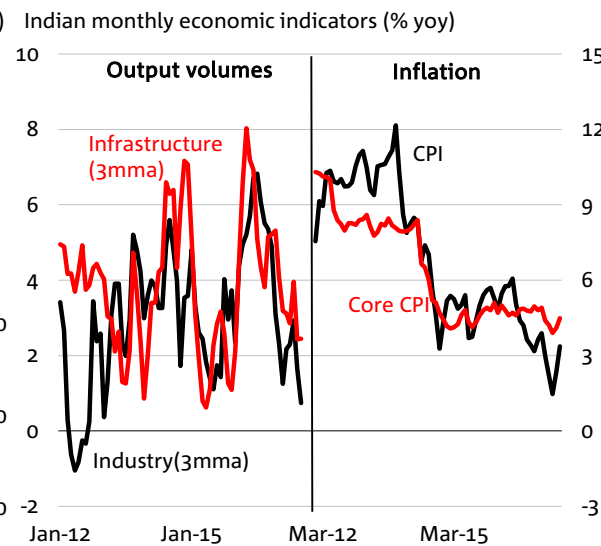
EMERGING MARKET ECONOMIES

Trends still mixed – weaker China & India countered by Brazil and Russia

VOLUMES PLATEAU, VALUES DOWN



WEAKER INDIAN INDUSTRIAL TRENDS

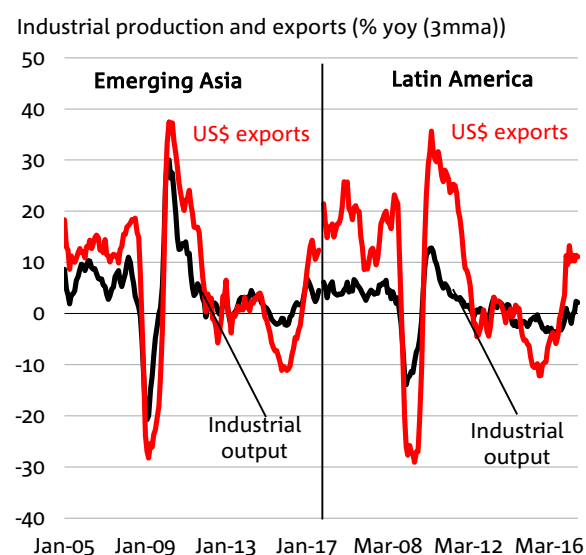


- Trends in emerging market economies remain mixed – with signs of slowing activity in India and China countered by recoveries in Brazil and Russia (as these economies emerge from deep recessions). Emerging economies received a boost from trade activity from late 2016 to early 2017, however export volumes 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.
- Following strong rates of growth across 2016, the pace of expansion in India's industrial and infrastructure output slowed considerably in 2017 – with industrial output contracting year-on-year in June with a modest recovery in July. The economy is also adjusting to the introduction of the GST in July, with PMI surveys slumping in July but returning to positive territory for both manufacturing and services in September. The Reserve Bank of India lowered its economic growth and raised its inflation forecasts recently, highlighting supply side challenges for the economy ([see here for more details](#)).

SERVICES STRONGER THAN INDUSTRY



OUTPUT EDGING UP IN L. AMERICA



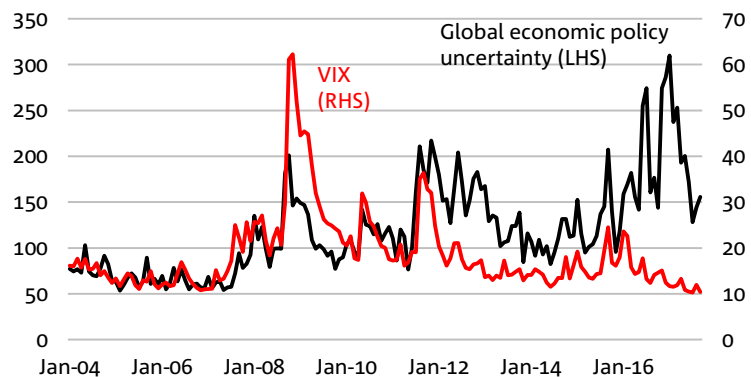
- While China's economic growth was relatively strong and stable across the first half, recent indicators point to a softening. This was particularly the case for fixed asset investment, which contracted in real terms in August – the weakest result since late 1995. That said, indicators of China's services 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.
- Industrial output for emerging markets has been growing near trend levels. According to the CPB measure, quarter-on-quarter output rose by 1.1% in Q2 (up from 0.7% in Q1) and this edged up to 1.2% in the three months to July – roughly the average growth rate since 2010. However export volumes have plateaued in recently (contracting 0.5% qoq in Q2 and increasing 0.2% in the three months to July).
- Slower export volumes are a negative for trade exposed East Asia and Latin America. Output growth in Asia softened across the middle of the year (following robust rates in early 2017), while recoveries in Brazil and Argentina have returned Latin American output to positive territory. Strength in export values appear to be commodity price related, and some momentum has been lost recently.

GLOBAL FORECASTS, POLICIES AND RISKS

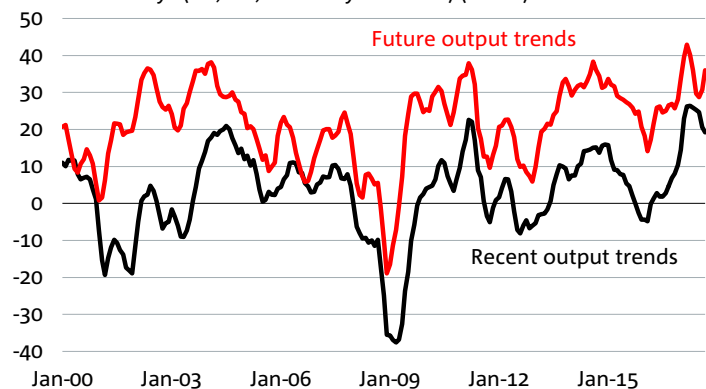
Global upturn keeps going as risk/uncertainty measures slide

UNCERTAINTY FADES AND GROWTH CONTINUES

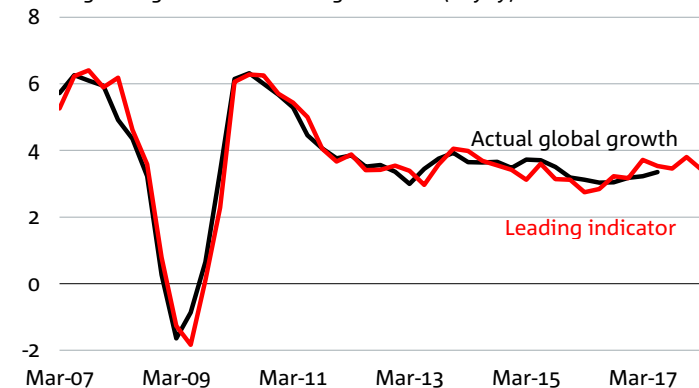
Economic policy uncertainty and financial volatility



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. 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 – 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. As these economies 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%.
- Measures of risk and uncertainty have faded as the upturn has kept going. Financial market volatility has been trending down since early 2016 and it is now lower than before the GFC. Uncertainty over economic policies spiked in the wake of the Brexit vote and the election of President Trump but policy uncertainty indices have fallen back in the wake of market-friendly outcomes in the French and German elections.
- 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, monetary policy has not been aggressively tightened, 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 and the political unrest in Spain where the Catalanian government is pushing for independence.

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 | 1.5 | 2.1 | 3.1 | 2.3 | 1.8 | 1.5 | 1.4 | 1.6 |
| Canada | 1.7 | 2.5 | 2.6 | 0.9 | 1.5 | 2.8 | 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 | 1.1 | 2.5 | 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 | 3.0 | 2.5 | 2.9 | 2.7 |
| Total | 3.7 | 3.4 | 3.5 | 3.3 | 3.2 | 3.4 | 3.6 | 3.4 |

Sources: Datastream, “Measuring Economic Policy Uncertainty” by Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com, NAB Economics

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