

THE FORWARD VIEW – GLOBAL

NOVEMBER 2017



Summary

- Global upturn continues, with growth next year set to just beat its long-term trend.
- 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.
- Big Pacific rim metro areas display similar housing affordability problems as their list of \$ million plus suburbs grows.

	IMF weights	2012	2013	2014	2015	2016	2017	2018	2019
US	15.5	2.2	1.7	2.6	2.9	1.5	2.2	2.3	2.0
Euro-zone	11.7	-0.8	-0.2	1.4	2.0	1.8	2.3	2.1	1.7
Japan	4.4	1.5	2.0	0.2	1.1	1.0	1.5	1.1	0.7
China	17.7	7.7	7.7	7.3	6.9	6.7	6.8	6.5	6.3
Emerging East Asia	8.0	4.7	4.3	4.2	3.7	3.9	4.2	4.1	3.9
NZ	0.2	2.5	2.2	3.4	2.5	3.0	2.5	2.8	2.8
Total	100.0	3.7	3.4	3.5	3.3	3.2	3.5	3.6	3.5



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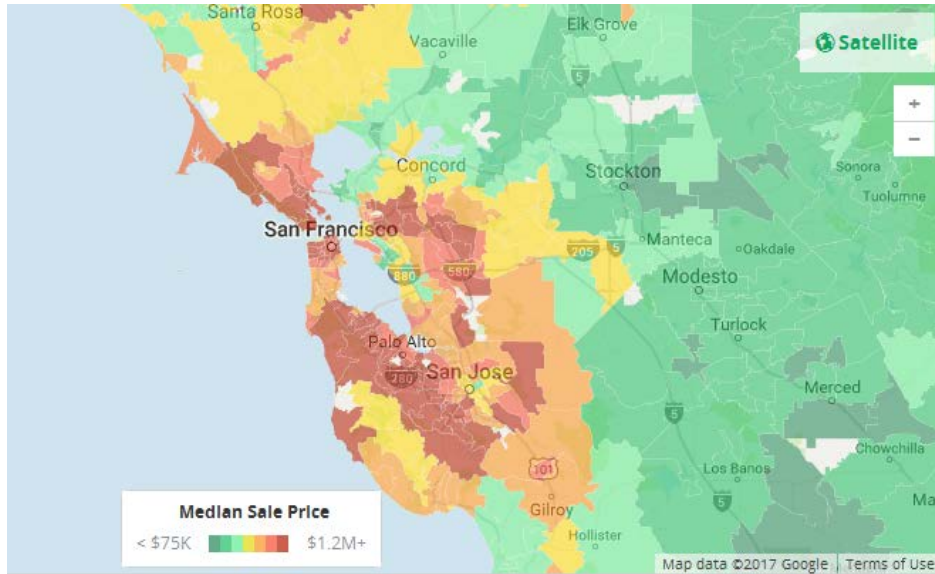
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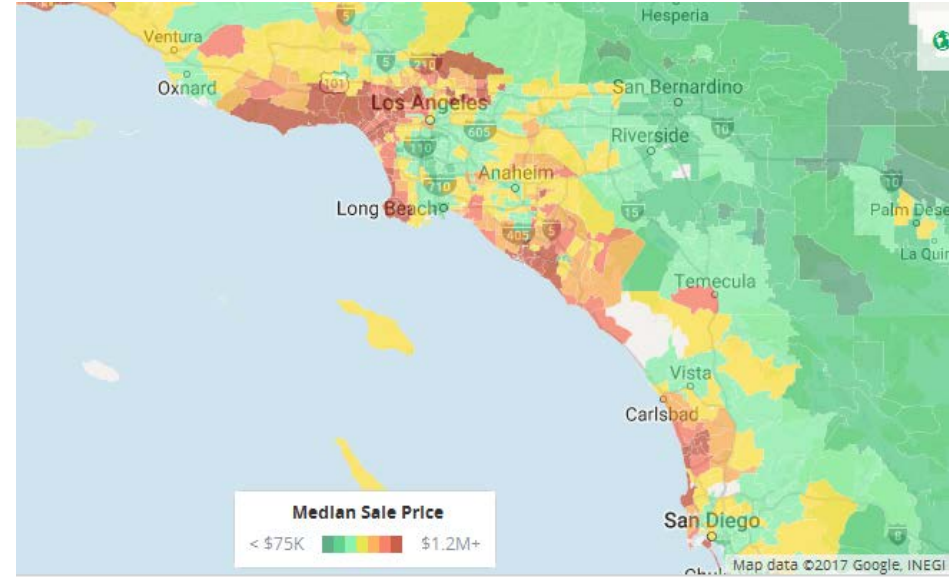
HOUSING AFFORDABILITY AN ISSUE ACROSS BIG PACIFIC RIM CITIES

Price medians top \$1 million in large parts of North American Pacific metros

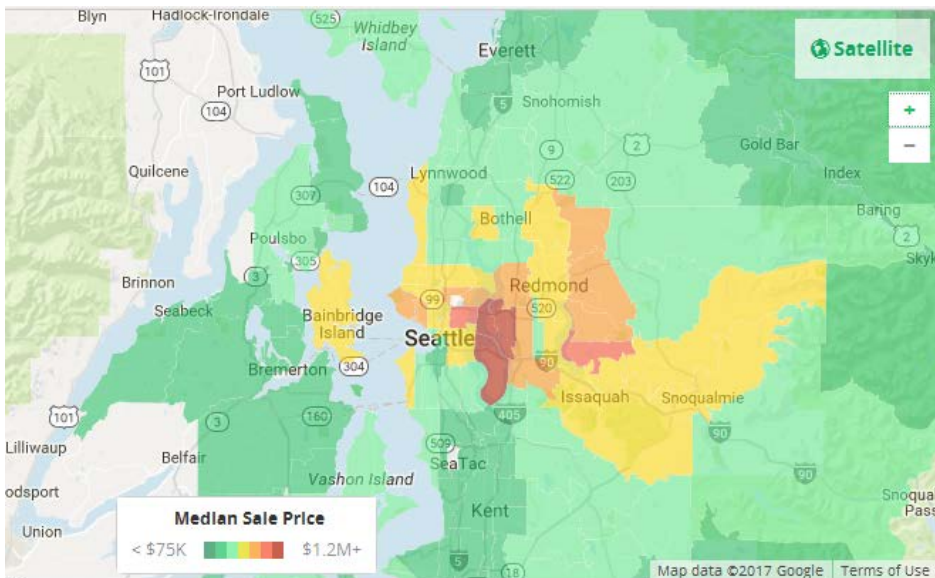
SAN FRANCISCO



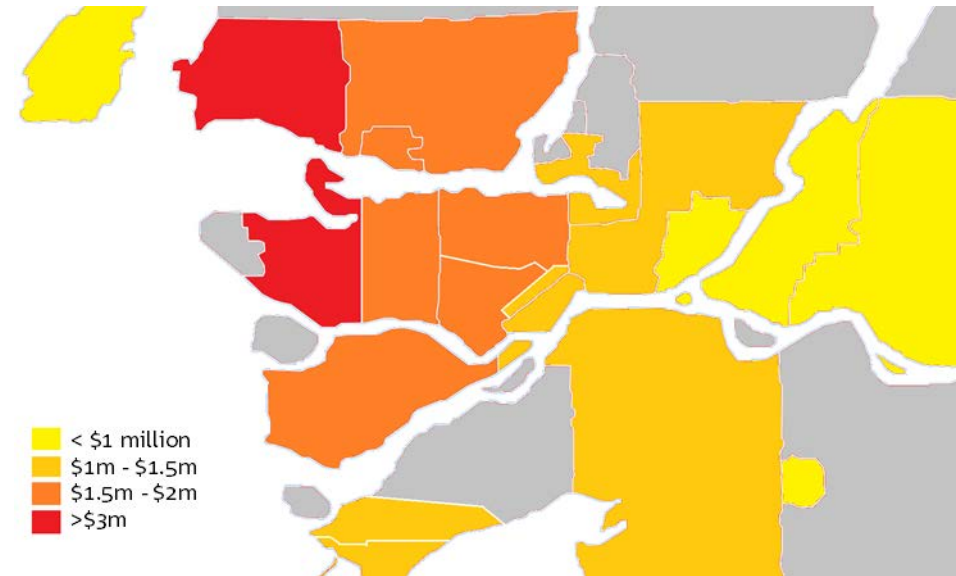
LOS ANGELES



SEATTLE



VANCOUVER

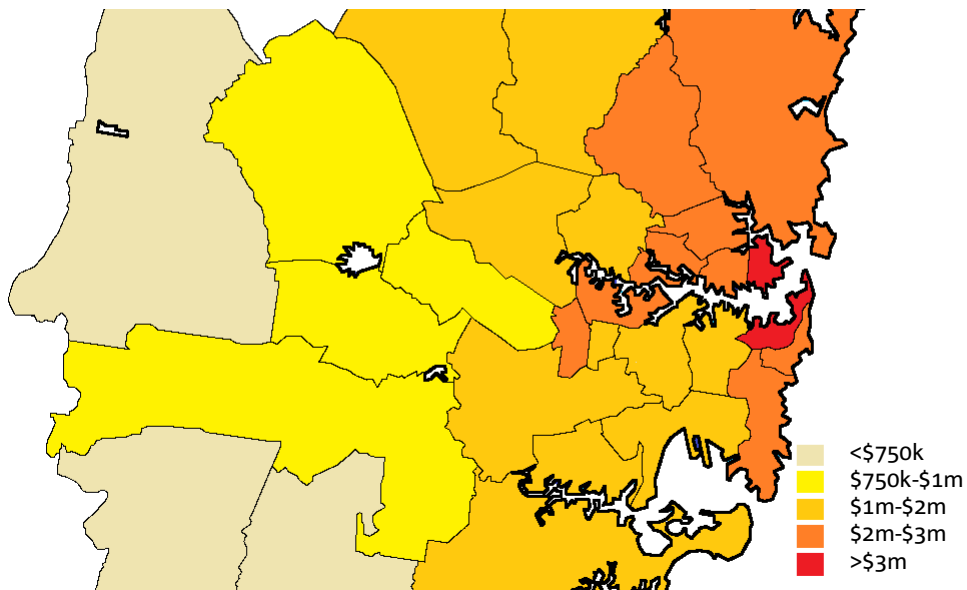


Sources: www.trulia.com, Real Estate Board of Greater Vancouver, www.zolo.ca, NAB Economics

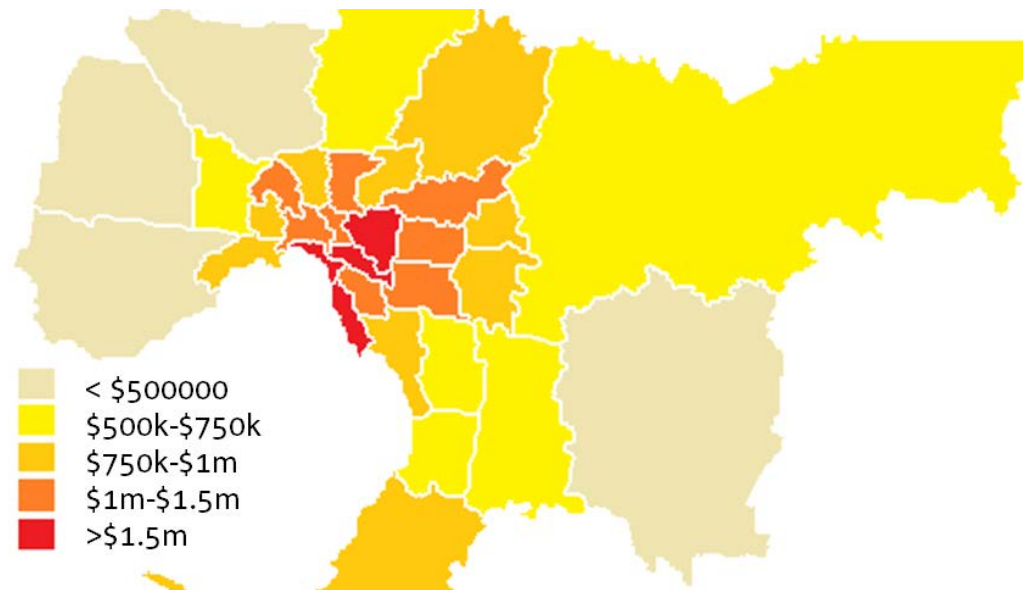
PACIFIC RIM HOUSING PRICES

\$1 Million median price districts spreading in W Pacific metros too

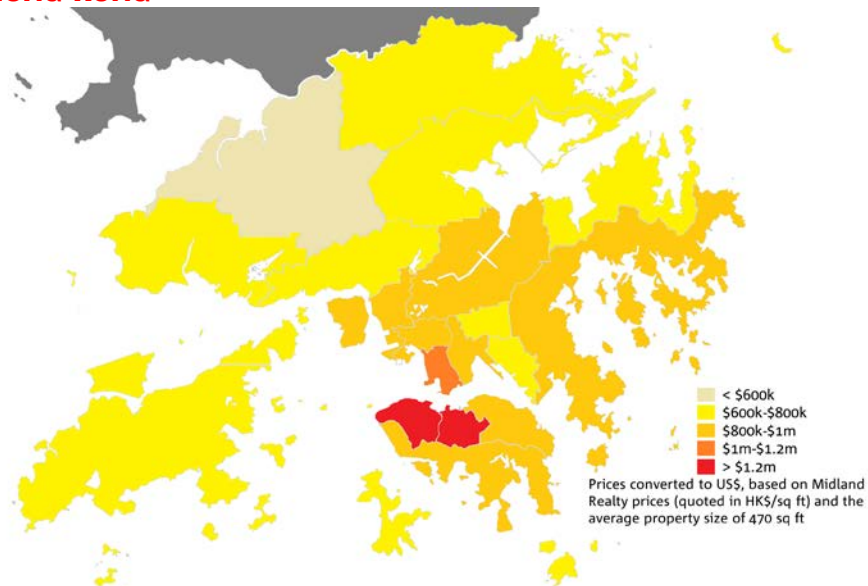
SYDNEY



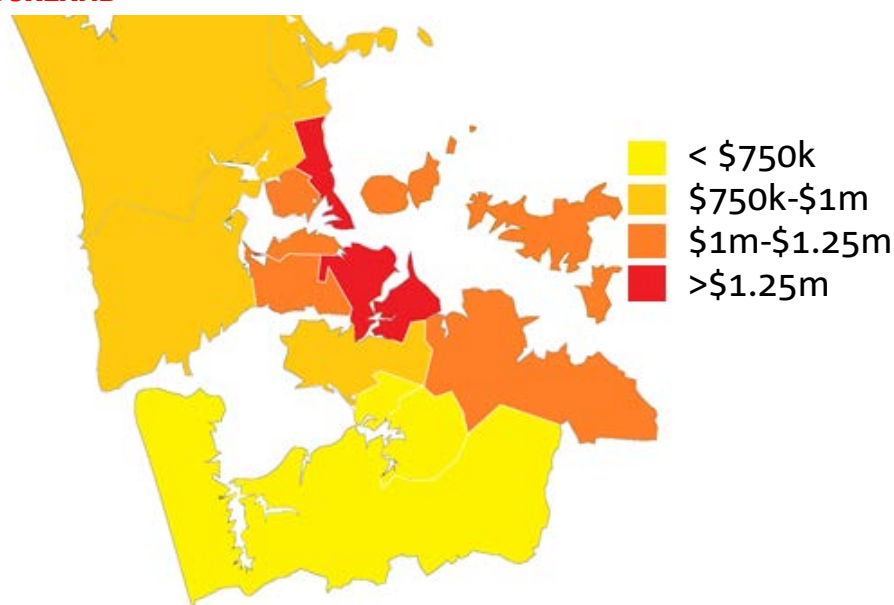
MELBOURNE



HONG KONG



AUCKLAND



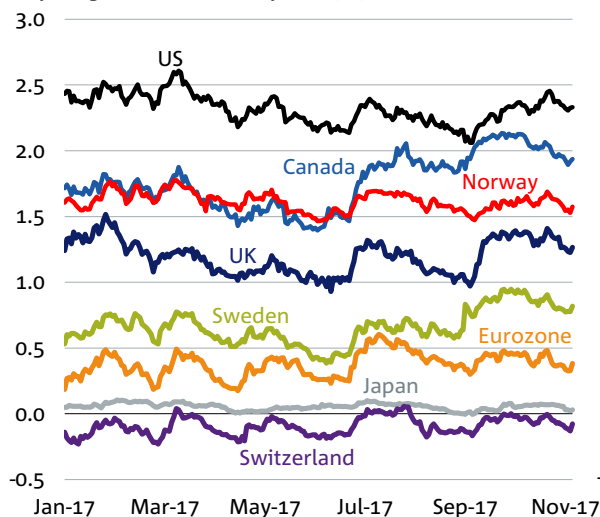
Sources: NSW Government, REIV, Midland Realty, QV, NAB Economics

FINANCIAL AND COMMODITY MARKETS

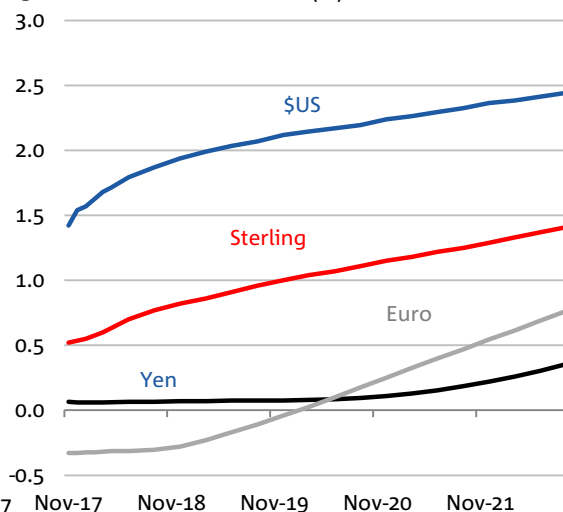
Central bank policy shifting but only slowly

YIELDS DOWN FROM RECENT PEAKS GRADUAL RATE RISES EXPECTED

10 year government bond yields (%)

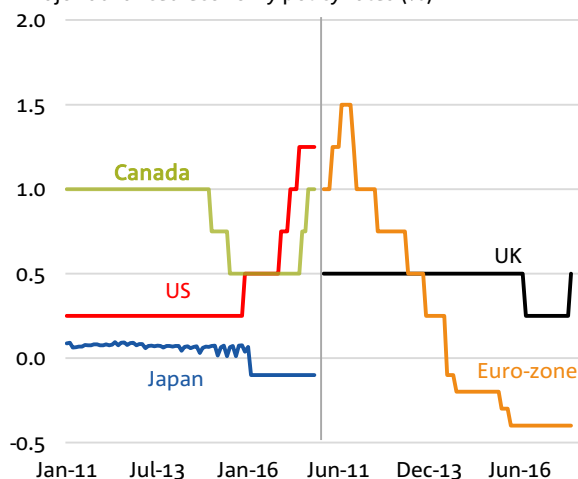


3 month interest rate futures (%)



BOE LIFTED RATES IN NOVEMBER

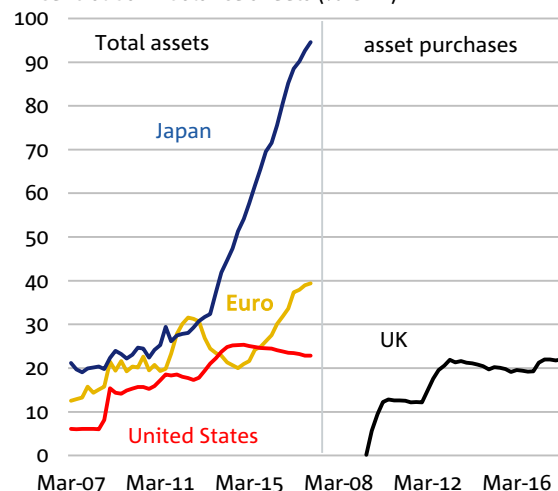
Major advanced economy policy rates (%)*



*Deposit rate used when negative

C.B. BALANCE SHEETS STILL LARGE

Central bank balance sheets (% GDP)



- Reflecting the ongoing growth in the global economy, as well as still loose monetary policy settings, major advanced economy stock markets continue to move higher. Moreover, despite geo-political risks flaring up from time-to-time – for example, North Korea/US and Catalonia separatist tensions in Spain – markets have not been particularly volatile. Overall commodity prices continue to broadly track sideways, although oil prices have been rising since the middle of the year.

- There has recently been some easing in long-term bond yields. That said they still generally remain above their mid-year level, prior to the shift in advanced economy central bank rhetoric away from further easing to when to tighten. However, any moves on interest rates will be gradual, and some central banks are still engaged in large scale asset purchases, although in these cases the pace has slowed down. Even with the Fed starting to reduce its balance sheet, major central bank balance sheets will continue to be very large for years to come.

- In November, the Bank of England (BoE) became the third major central bank to lift rates this year, following earlier moves by the US Fed and the Bank of Canada. The BoE's circumstances are different to other central banks – while growth has slowed following the Brexit vote, inflation is well above target and the unemployment rate is low. At this stage all the BoE has done is unwind its emergency post Brexit rate cut, and it is only signalling future 'gradual' and 'limited' rate rises.

- The European Central Bank (ECB) recently announced changes to its asset purchase program. Its net asset purchases are currently €60 billion a month but, starting in January 2018 and through to at least September 2018, the monthly pace will slow to €30 billion. Moreover, the ECB is saying that rates won't start to rise until well past the end of asset purchases. So the ECB is still easing, just more slowly, but the end of asset purchases is in sight.

- Similarly, the Bank of Japan also continues to purchase large amounts of assets, but at a slower pace. The reduced scale of asset purchases followed the policy switch in late 2016 to target a 10 year government bond yield of around zero per cent.

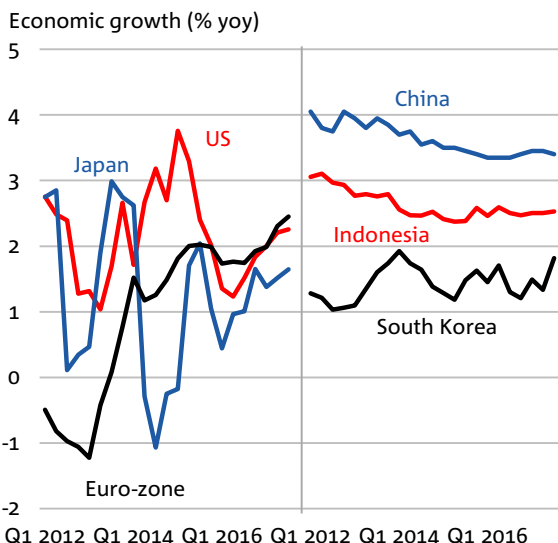
- In contrast, from October 2017 the Fed started unwinding the stock of assets accumulated under its previous asset purchase programmes, although only at a slow pace to start with.



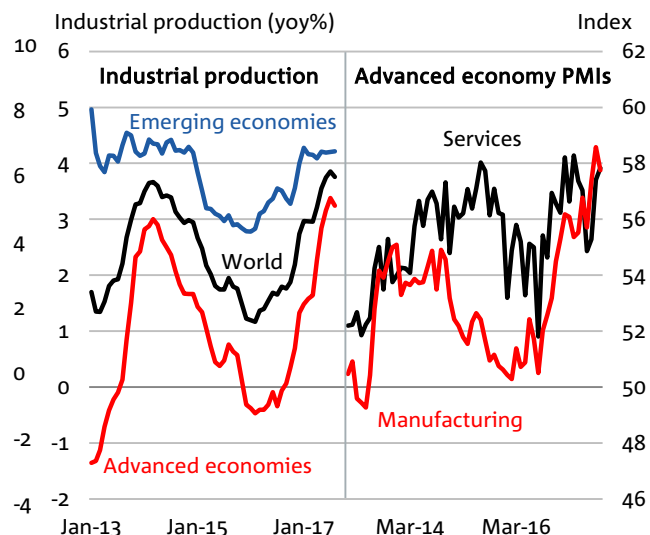
GLOBAL ECONOMIC TRENDS

Advanced economies to drive lift to above trend global growth

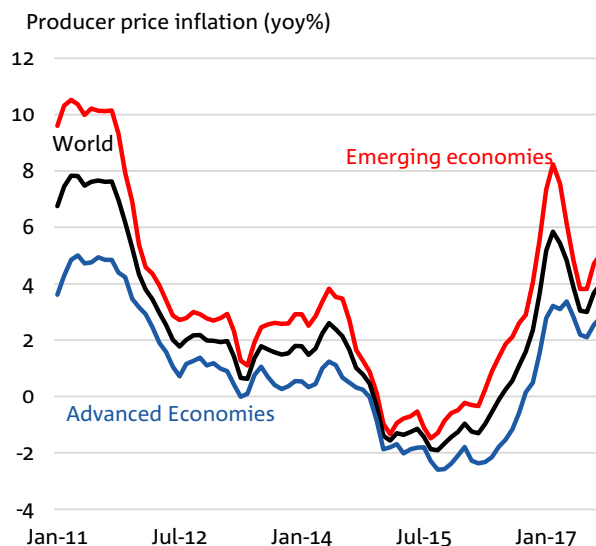
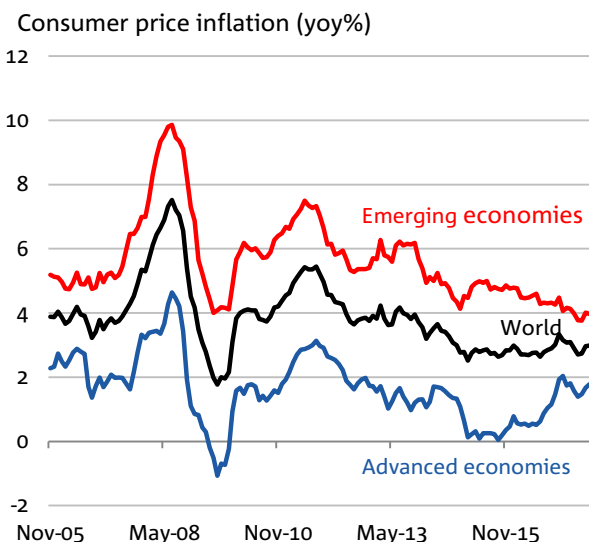
GROWTH CONTINUES INTO H2



INDUSTRIAL GROWTH TAKES OFF



ADVANCED ECONOMY INFLATION HIGHER PRODUCER PRICE INFLATION LIFTS

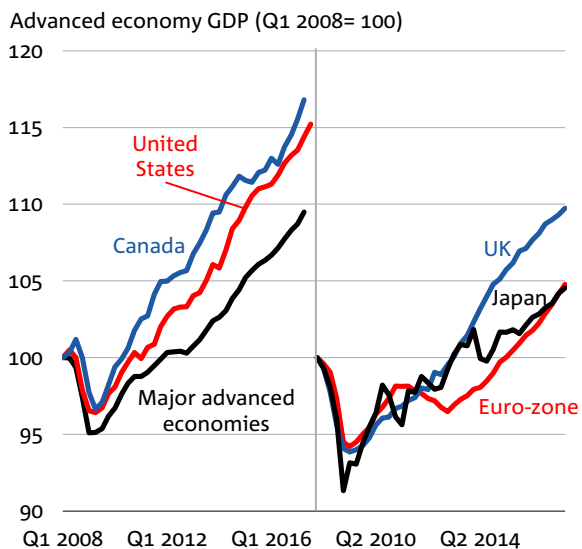


- A broad-based economic upturn continues across the global economy driven mainly by the advanced economies. Third quarter output data is now available for big economies that account for over half of global GDP. Growth in the US and Euro-zone, the second and third largest economic blocks, was running around 2½% yoy in the September quarter. The pace of expansion in the big emerging market economies continues to be robust with growth in China (the world's biggest economy) of 6.8% yoy and in Indonesia (the seventh biggest economy) of 5% yoy. As the impact of demonetisation and the introduction of a GST gradually fades in India, growth should lift in the world's fourth largest economic block.
- Timely data on industrial output and surveys of business sentiment show the industrial sector in the advanced economies has experienced a particularly marked improvement in conditions. Growth in industrial output picked up to around 3% yoy by August and preliminary data for September shows still strong growth. Similarly, readouts from the monthly purchasing manager surveys, available to October, are consistent with solid expansion in manufacturing and are far more buoyant than last year. Advanced economy business surveys show sentiment in the industrial sector matching that of the normally more buoyant service sector.
- Inflation has remained moderate through this acceleration in global growth. Headline consumer price inflation in the advanced economies has risen from practically zero in 2015 to much nearer the 2% inflation target adopted by several key central banks. Much of that increase reflects higher prices for energy and food, and excluding those volatile commodity items "core" CPI inflation has been stuck in a 1¼% to 1½% range since early 2013. In contrast, headline inflation in the emerging market economies has been trending down through the last 7 years to reach around 4% yoy in August 2017. Again, higher commodity prices have lifted the headline rate with core inflation running around 3½% yoy.
- A commodity-market related surge in producer price inflation was evident across both advanced and emerging market economies. Price pressures have risen lately but remain below that seen at the start of the year.

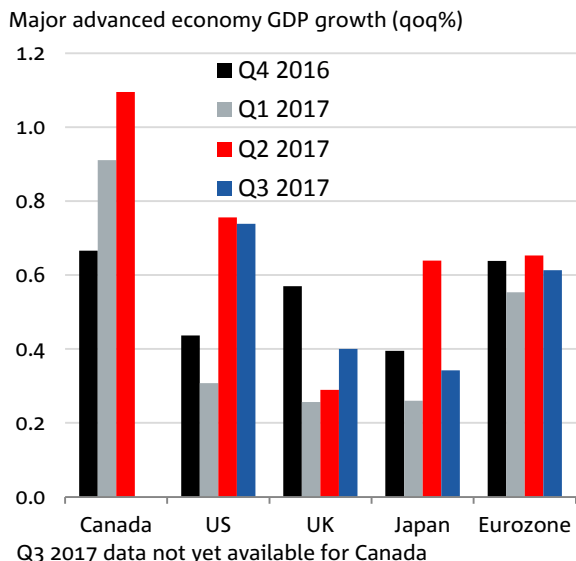
ADVANCED ECONOMIES

Solid upturn in output continues

VARIATION BETWEEN ECONOMIES

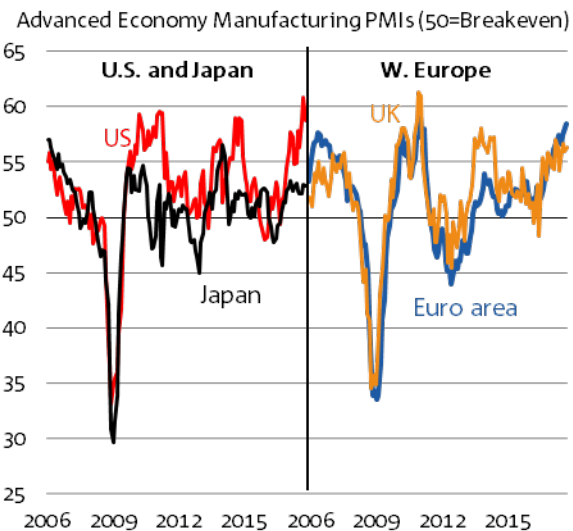


SOLID OUTCOMES CONTINUE INTO H2

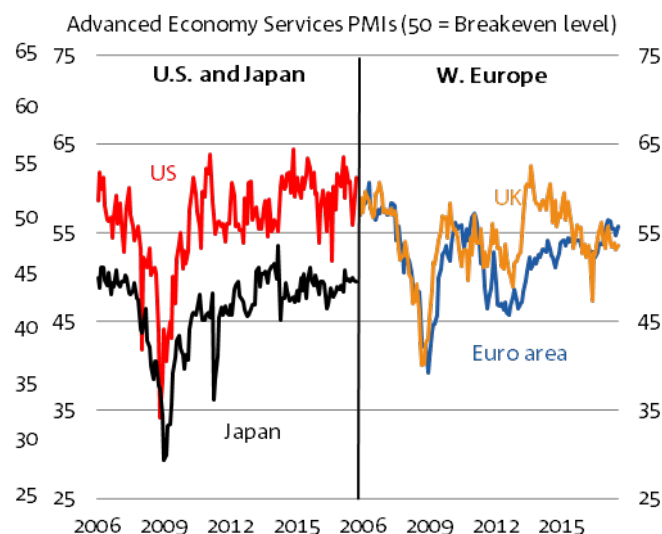


- Solid growth has continued in the big advanced economies. By mid-2017 the pace of expansion was running above its long-run potential in the two biggest economic blocks – the US and Euro-zone, which in combination account for two-thirds of advanced economy output. US economic growth was running at an annualised pace of almost 3% in the June and September quarters of 2017 while Euro-zone expansion was around 2½% annualised. Japanese growth slowed to 0.3% qoq in the September quarter, but this followed a very strong outcome in the previous three months, and growth is well above potential. The UK has out-performed the gloomy economic predictions made after last year's Brexit poll with annualised GDP growth increasing from 1.2% to 1.6% between the second and third quarters.
- The outcome of this above trend growth is falling rates of unemployment, with the Euro-zone jobless rate down from its 12% peak in the currency block's debt crisis to under 9% and the number of unemployed people has fallen by almost 1½ million over the year to September 2017. There remains great diversity within the Euro-zone economies, however, with still high jobless rates in Greece (21%), Spain (16.7%) and Italy (11.1%) while the German unemployment rate is down to 3.6% and the Netherlands is 4.7%.

INDUSTRY SECTOR CONFIDENCE HIGH



STRONG SERVICE SECTOR GROWTH



- The US labour market is also tightening as economic growth outstrips its long-run potential. The jobless rate fell to 4.1% in October, down from last October's 4.8% rate and far short of the 10% jobless peak rate of late 2009. The number of jobless people has fallen by over 1 million since the start of the year and in certain parts of the job market the pool of jobless candidates is drying up (the jobless rate for age 25+ graduates has fallen to 2%).
- The latest data confirms that the upturn in the big advanced economies is continuing. The latest set of monthly business surveys (for October month) show manufacturing conditions improving strongly in the big advanced economies while service sector growth continues at a solid pace. Industrial output continues to grow strongly with the annualised increase running at around 3% in the 3 months to August. Preliminary industrial output data for September shows the trend lift across Japan and the Euro-zone continuing alongside more subdued growth in the US (affected by hurricanes).

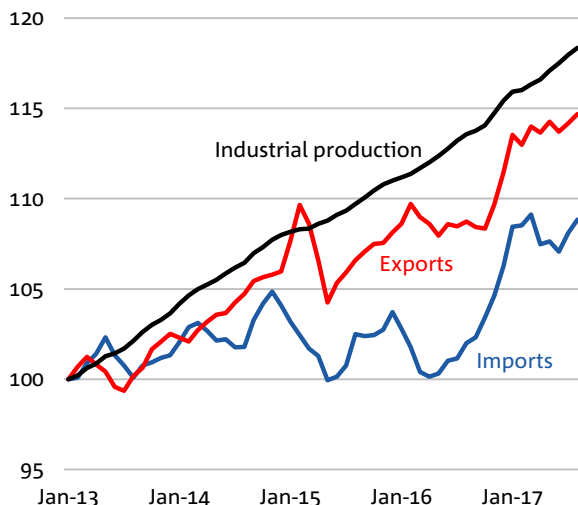
Sources: Datastream, Markit, ISM, NAB Economics

EMERGING MARKET ECONOMIES (EMES)

Steady growth masks mixed trends in different markets

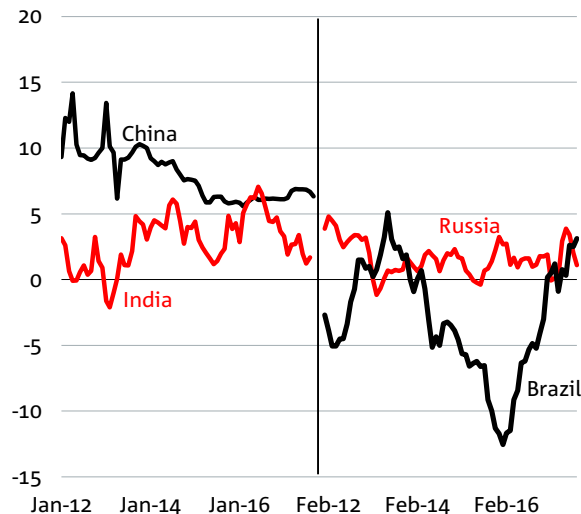
STEADY GROWTH IN EMES

Emerging market trade volumes & IP (Jan 2013 = 100)



MIXED TRENDS BY COUNTRY

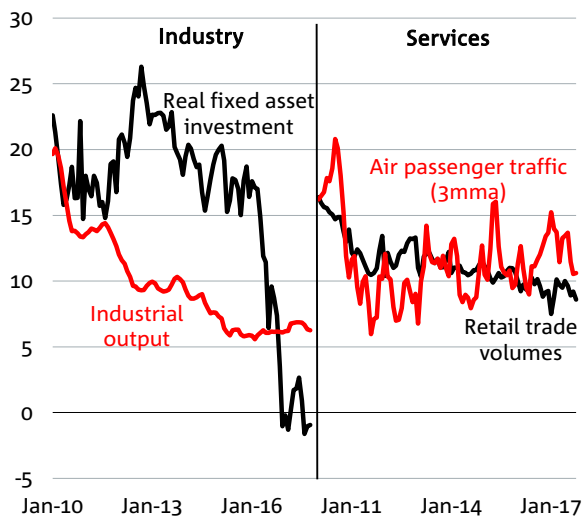
Industrial production (% yoy (3mma))



- Industrial production and export volumes provide a timely indication of economic activity in emerging market economies. According to the CPB measure, there has been little acceleration in the growth of industrial production in recent months – with year-on-year growth remaining around 4.2% (on a three month moving average basis) – around the same rates seen since the start of the year. While export volumes are relatively strong year-on-year (up 5.5% in August), they have been stagnant in recent months – with the bulk of the increase having occurred between October and December last year.
- This flat growth profile masks mixed industrial production trends in major emerging markets. The main improvement has been in Brazil – as the economy has recovered from a deep recession – with production increasing by 3.1% yoy (3mma) in September (the strongest rate of growth since mid-2013). In contrast, there has been a noticeable slowdown in industrial growth in India and South Africa since the middle of 2016, while Indonesian growth has stabilised around 5%. In China – the world’s largest economy – industrial production growth has trended around 6¼% yoy since early 2015.

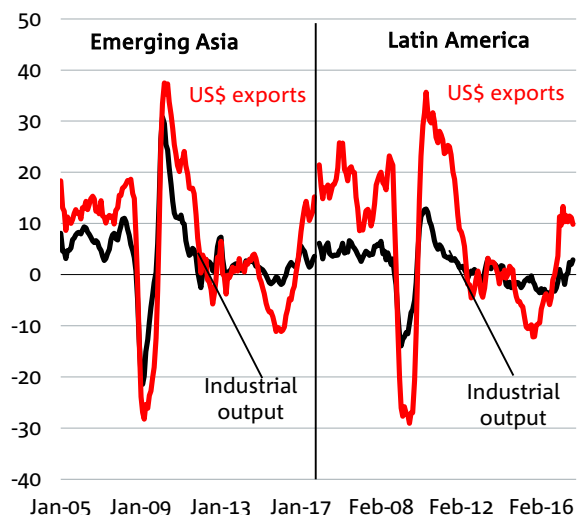
CHINA'S ECONOMIC INDICATORS

Chinese monthly economic indicators (% yoy)



MODEST PICKUP IN OUTPUT

Industrial production and exports (% yoy (3mma))

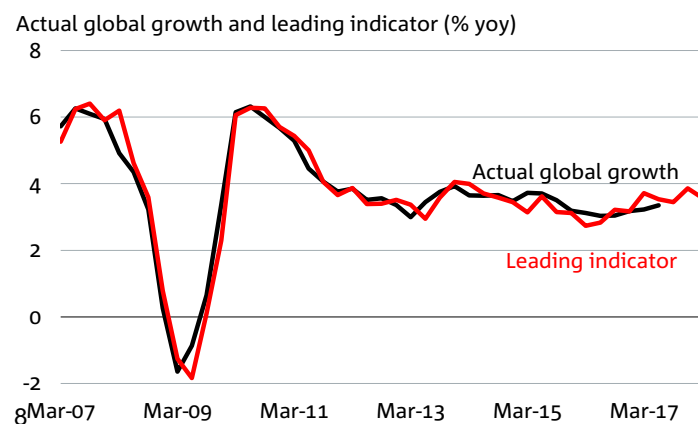
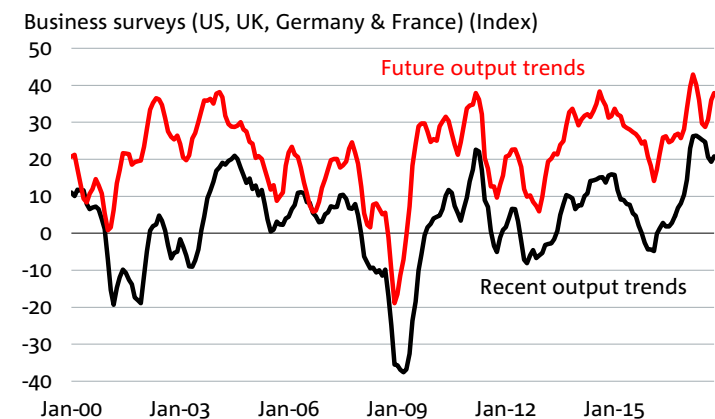
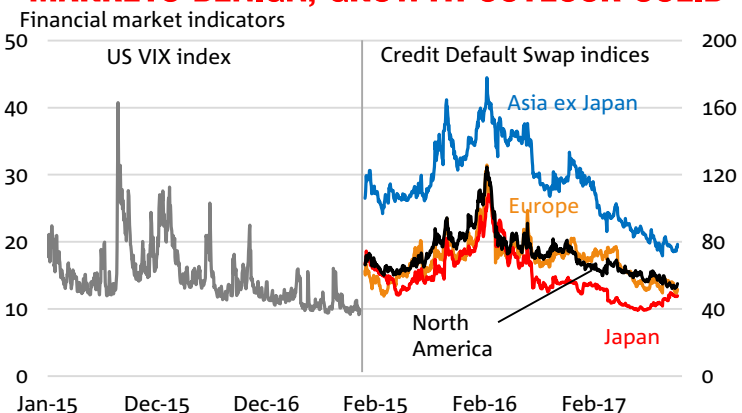


- China’s economic growth slowed marginally in Q3 – at 6.8% yoy (compared with 6.9% across the first half of the year). Industrial activity is likely to slow in Q4 – with Chinese authorities ordering the shutdown of a sizeable share of steel production capacity to address pollution concerns during the northern winter.
- China’s latest indicators point to a modest slowing trend following the recent leadership change, which could flow through into weaker demand for imports from other emerging markets.
- Industrial production in East Asia has picked up in recent months particularly in the more export orientated economies with a heavy reliance on the electronics sector. While Brazil’s recovery has driven Latin American output higher. East Asia and Latin America are highly trade exposed with large commodity sectors and some of the strength in export values appears to be commodity price related. These regions will hope that demand from advanced economies offsets any slowdown in import demand from China.

GLOBAL FORECASTS, POLICIES AND RISKS

Global upturn stays on track with growth set to beat its long-run trend

MARKETS BENIGN, GROWTH OUTLOOK SOLID



- The global economic upturn remains on track with global growth expected to return to its 3½% long run trend this year before accelerating to modestly above trend in 2017, which should be the best year for the global economy since 2012. Measures of financial market volatility are very low by historical standards while bond yields, credit spreads and default swap pricing are also low. Very low interest rates have led to investors taking on more risk as they search for higher yields, a strategy that could clearly run foul of the expected upward trend in central bank policy interest rates.
- Central banks in the big advanced economies should be well aware of risks currently embedded in markets and will not want their long-engineered reflation of demand to stall. Hence the tightening in monetary policy should be gradual and modest with interest rates ending up well below their pre-GFC peaks. Governments do not appear inclined to embark on rounds of budget consolidation either, despite high debt burdens, with the emphasis in fiscal policy on lowering rather than lifting taxes.
- With the global economic upswing looking set to continue and the authorities reluctant to take measures that could short-circuit this long awaited upturn, much of the focus of risks is now on geopolitical trends and events and what they might mean for economic policy. The outcome of last year's Brexit referendum and President Trump's vote-winning economic platform highlighted the importance of ensuring that the benefits of market-oriented growth models are spread through the population to avert sudden U-turns in policies. This year's election outcomes in big Euro-zone economies have not led to similar changes but the Italian general election due in early 2017 stands as another test for markets.

GLOBAL GROWTH FORECASTS (% change)

	2012	2013	2014	2015	2016	2017	2018	2019
US	2.2	1.7	2.6	2.9	1.5	2.2	2.3	2.0
Euro-zone	-0.8	-0.2	1.4	2.0	1.8	2.3	2.1	1.7
Japan	1.5	2.0	0.2	1.1	1.0	1.5	1.1	0.7
UK	1.5	2.1	3.1	2.3	1.8	1.5	1.5	1.5
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	6.8	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	4.3	4.2	3.7	3.9	4.2	4.1	3.9
NZ	2.5	2.2	3.4	2.5	3.0	2.5	2.8	2.8
Total	3.7	3.4	3.5	3.3	3.2	3.5	3.6	3.5

Sources: Datastream, Bloomberg, NAB Economics

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