EMBARGOED UNTIL: 11.30AM THURSDAY 14 DECEMBER 2017

THE FORWARD VIEW – GLOBAL

DECEMBER 2017

National Australia Bank

Summary – Good news for Christmas

- Global economic backdrop is the best for five years as the upturn continues and recent GDP growth rises above trend.
- Signs of welcome broadening in the expansion to include more investment spending and key emerging economies.
- Market volatility and economic policy uncertainty both lower as probability of severe "tail risk" events is marked lower.
- Labour markets tightening around big advanced economies but still little sign of a pick-up in wage inflation.

	IMF weights	2012	2013	2014	2015	2016	2017	2018	2019
US	15.5	2.2	1.7	2.6	2.9	1.5	2.3	2.4	2.0
Euro-zone	11.7	-0.8	-0.2	1.4	2.0	1.8	2.4	2.2	1.9
Japan	4.4	1.5	2.0	0.3	1.4	0.9	1.8	1.4	0.9
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	4.2	4.1	3.7	3.9	4.3	4.1	3.9
NZ	0.2	2.5	2.2	3.4	2.5	3.0	2.5	2.9	2.9
Total	100.0	3.7	3.4	3.5	3.4	3.2	3.5	3.6	3.5

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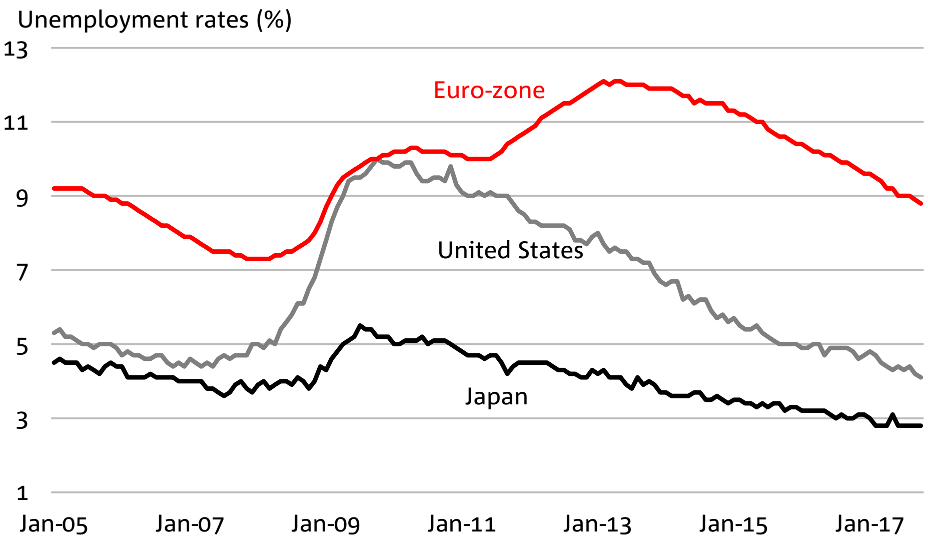
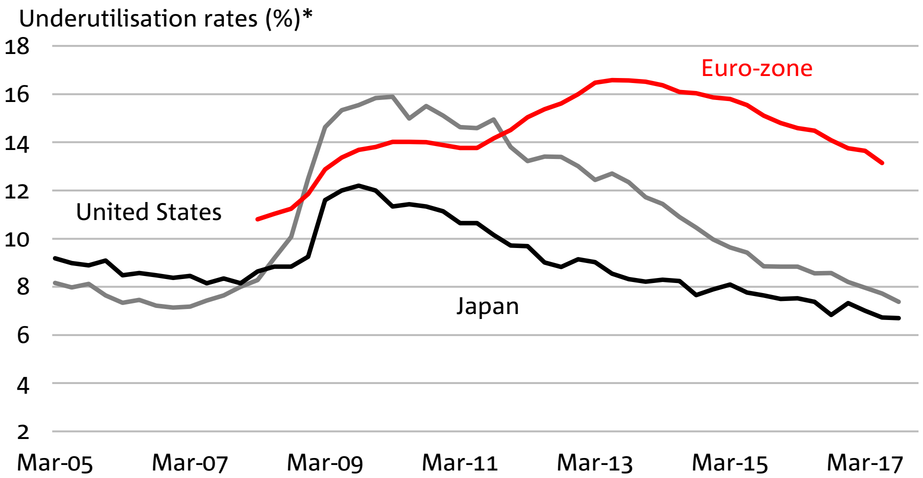
LABOUR MARKET IMPROVES ACROSS THE ADVANCED ECONOMIES

Jobless rate falling and people moving back into the labour market

UNEMPLOYMENT BELOW OR HEADING TOWARDS 2007 LEVELS

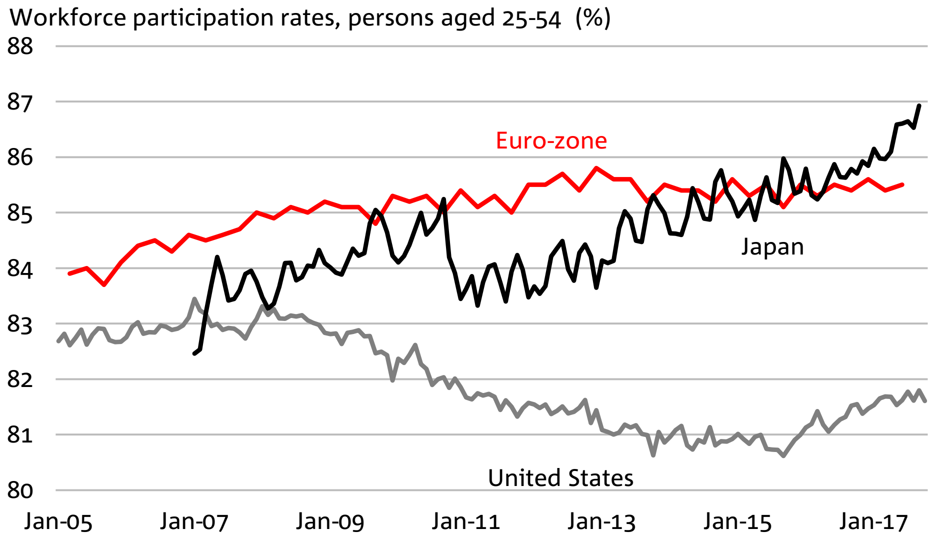


WIDER MEASURES OF LABOUR UNDER-UTILISATION TREND DOWN TOO

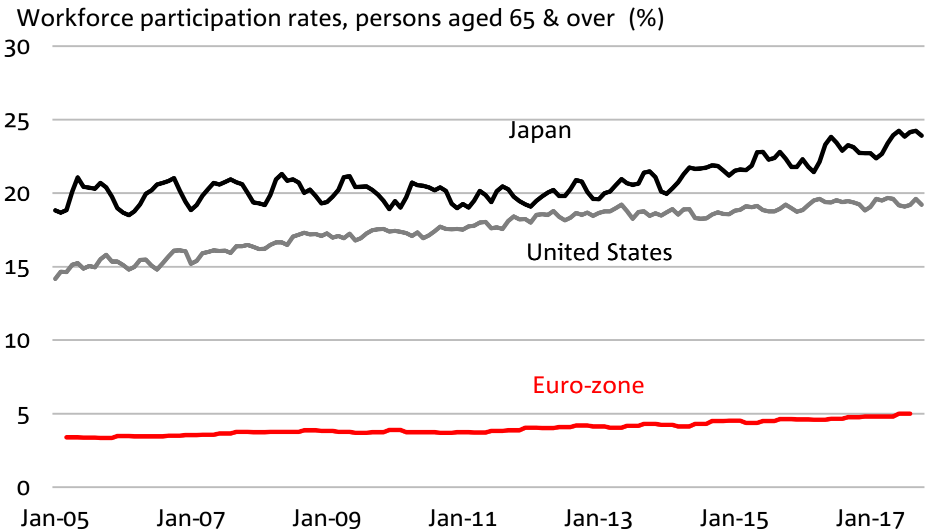


Unemployment plus underemployment were latter is US: Part-time (PT(for economic reasons; Japan, employed wishing more work time; Euro: PT, wishing to work full-time

WORKFORCE PARTICIPATION TRENDING HIGHER, EVEN IN THE US



MORE PEOPLE OVER 65 STAYING IN THE WORKFORCE



Sources: ThomsonReuters, Econdata DX (CEIC), Japan Statistics Bureau, US Bureau of Labor Statistics, Eurostats, OECD, NAB Economics

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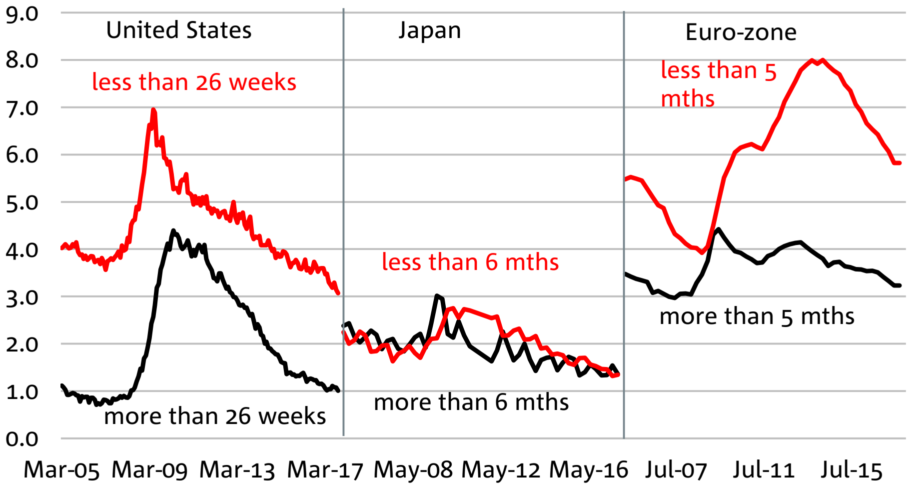
BEHIND THE AVERAGES, JOB OUTCOMES STILL VARY A LOT

Wages growth still modest despite tighter job markets

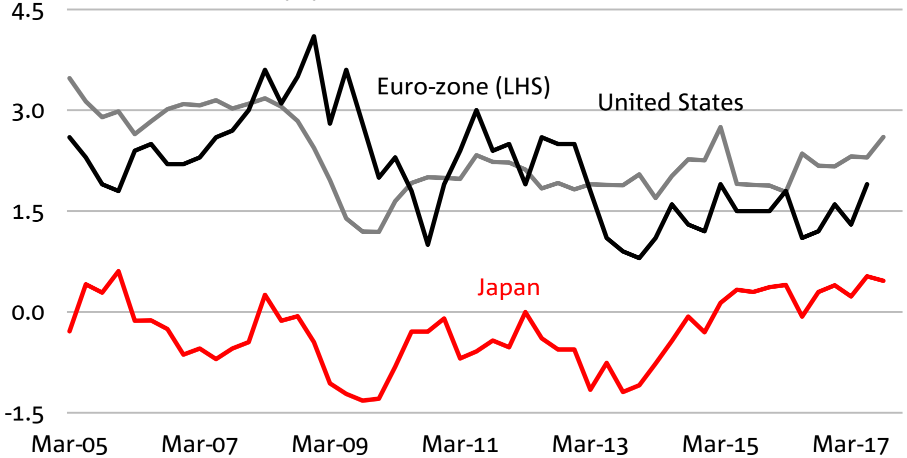
BIG POOL OF LONG-TERM JOBLESS IS SHRINKING

Duration of unemployment (% of labour force)



WAGE GROWTH STILL NOT ACCELERATING MUCH

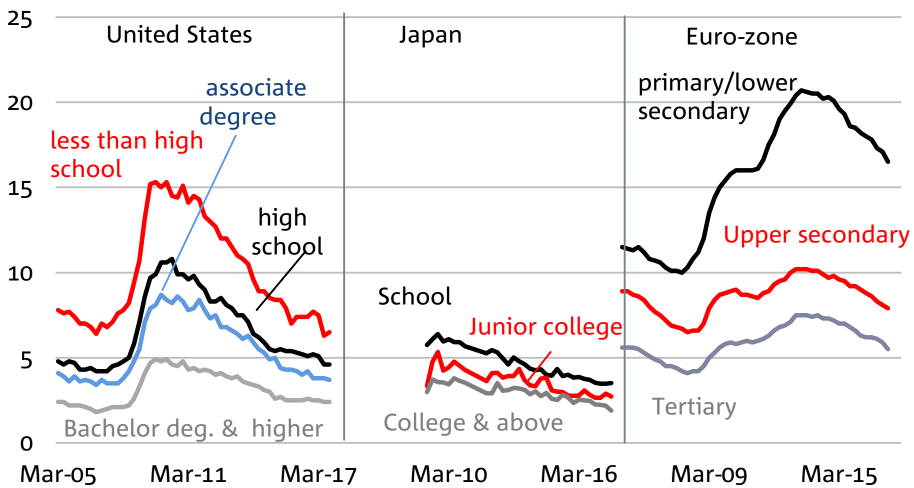
Labour cost measures* (yoy%)



* US: private sector employment cost index; Euro: Business Economy labour cost index; Scheduled payments per employee

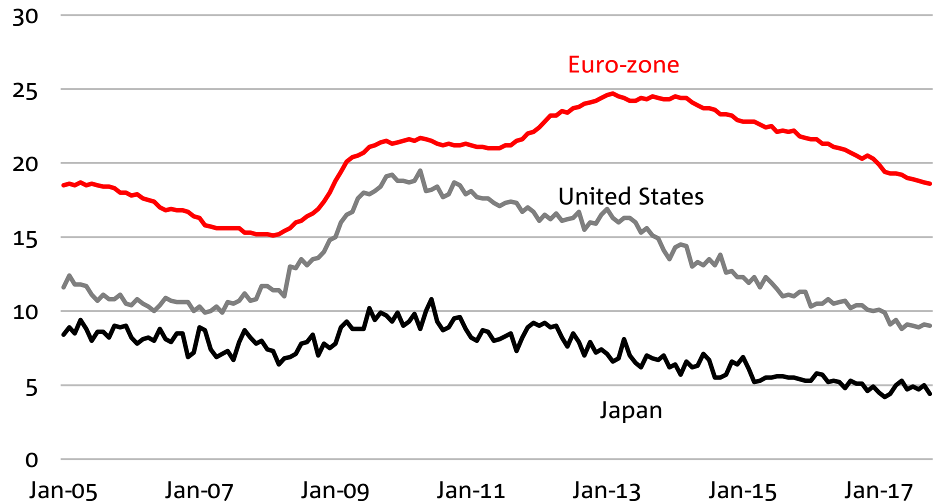
IT PAYS TO HAVE A DEGREE – LESS RISK OF UNEMPLOYMENT

Unemployment by level of education (%)



YOUTH JOBLESS RATE STILL ABOVE AVERAGE BUT ITS TRENDING DOWN

Youth (under 25) unemployment rates (%)



Sources: ThomsonReuters, Econdata DX (CEIC), Japan Statistics Bureau, US Bureau of Labor Statistics, Eurostats, OECD, NAB Economics

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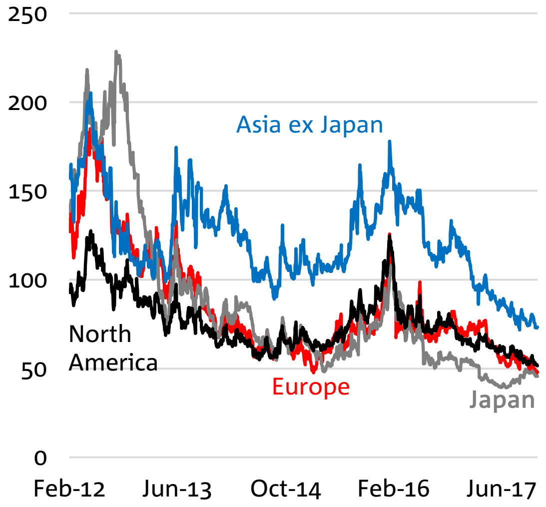
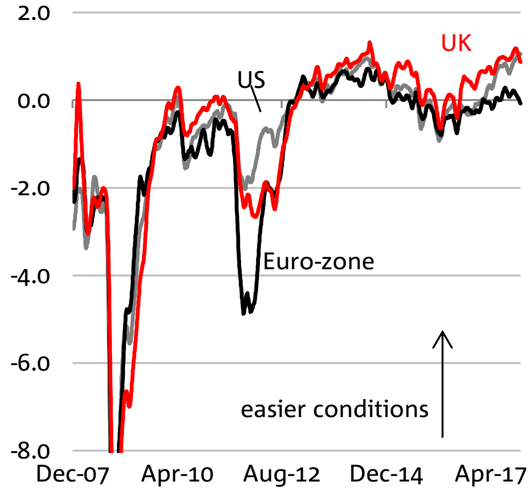
FINANCIAL AND COMMODITY MARKETS

Financial conditions remain supportive of growth

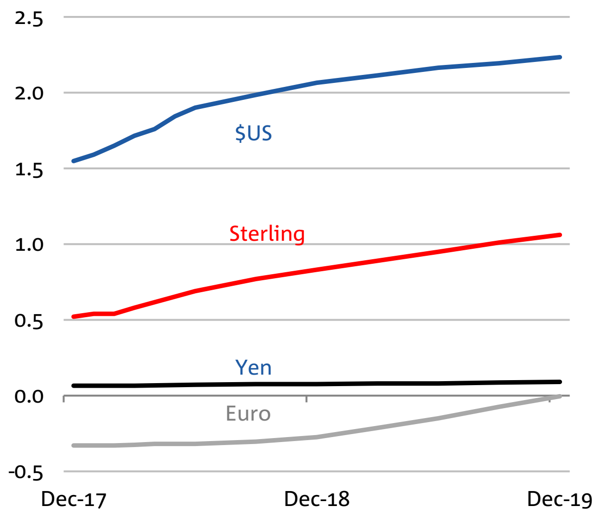
MARKETS CALM ABOUT RISKS



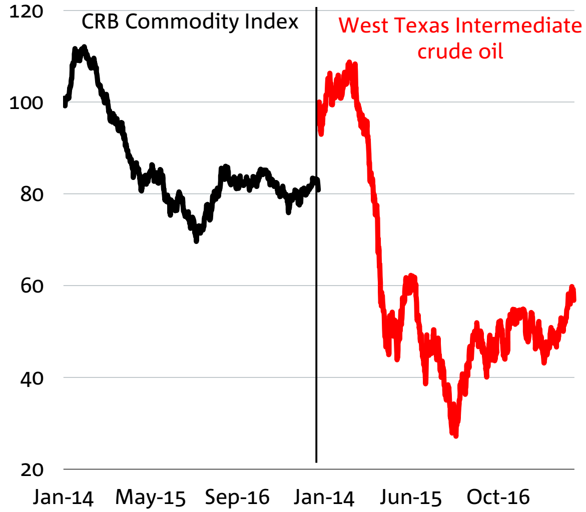
FINANCIAL CONDITIONS BENIGN



US FED STILL LEADING THE WAY



OIL PRICES MOVING UP



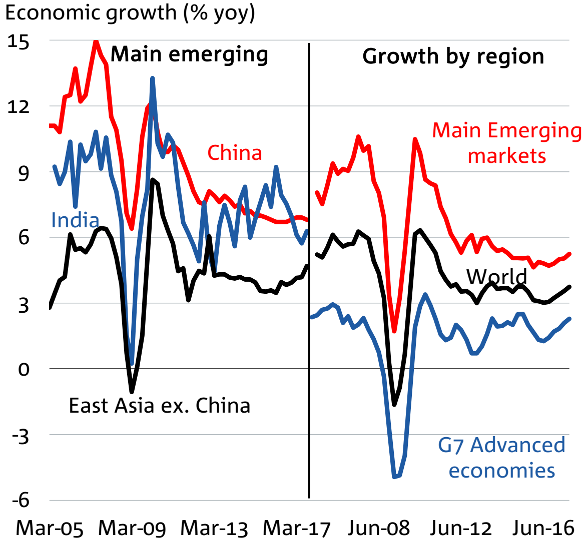
- Markets remain calm, with indicators of market stress and volatility such as credit spreads and the VIX index all remaining low. As a result, while several major central banks have raised rates this year – the US Fed, the Bank of England and the Bank of Canada - broader measures of financial conditions have either remained benign or eased further. The current combination of solid, above trend economic growth, falling unemployment and easy financial conditions would normally signal central bank rate hikes. However, with inflation generally below target in the advanced economies action is likely to be gradual.
- While there has been a shift in advanced economy central bank rhetoric away from further easing measures to when to tighten policy, there are still large differences between major central banks.
- Over 2018 the US Fed should continue to lead the way. The Fed raised rates three times in 2017 and started to unwind its large balance sheet. We expect another three rate hikes next year as well, conditional on a pick-up in inflation. Market pricing is more cautious for 2018, but even so it still has the Fed tightening policy more rapidly than any other major central bank. The Bank of England (BoE) is only signalling future 'gradual' and 'limited' rate rises.
- By contrast, other central banks are still in the midst of QE programmes which represent monetary easing. That said, the ECB has scaled back the size of its monthly asset purchases, and the programme will probably end next year. Markets are also debating when it might start to raise rates although this is not likely to happen until the end of 2018 at the earliest. The Bank of Japan continues to target a near zero 10 year government bond yield, and is undertaking asset purchases (although at a slower pace than before) with no change in policy in sight.
- While the major global stock markets have been trending up consistent with the improvement in the global economy and still very accommodative monetary policy settings, it has been a different story for commodity markets. After staging a mini-recovery in the first half of 2016, the CRB commodity price index has basically tracked sideways since. However, helped along by OPEC cuts and geopolitical risks in Iraq, oil prices have recently moved higher.

Sources: Datastream, Bloomberg, ECB, Federal Reserve, NAB Economics

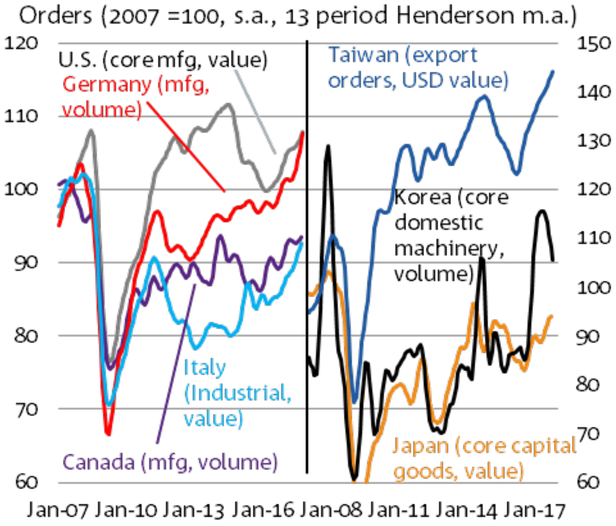
GLOBAL ECONOMIC TRENDS

A good year for the world economy as growth rises above trend

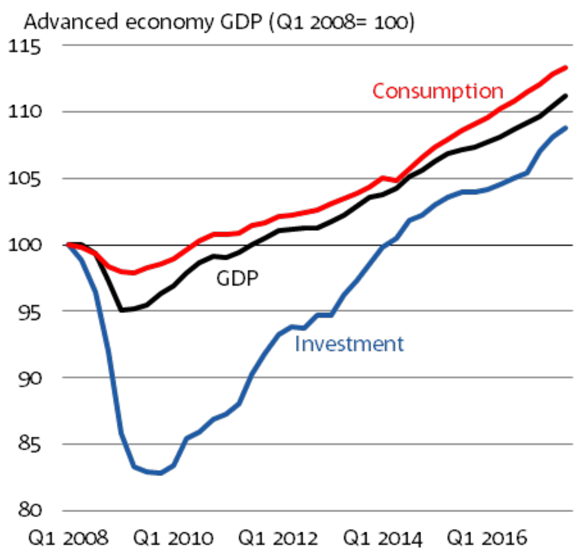
ABOVE TREND GROWTH ARRIVES



ORDERS POINT TO MORE STRENGTH



INVESTMENT GROWS FASTER



EMERGING GROWTH STAYS UP

- The world economic upturn continues to gather momentum. Global output growth has accelerated from around 3% yoy in mid-2016 to 3¼% yoy last December quarter, 3½% yoy in the first half of 2017 and 3¾% yoy in September. Consequently, global growth is now running above its 3½% long-term trend for the first time since mid-2005.

- Behind the volatility in the monthly data on industrial output, world trade and new orders is a solid performance. Inflows of new orders are generally a good leading indicator of output and these have been rising solidly across a range of advanced and emerging market economies. Global industrial production continues to grow solidly with growth running around 3¾% yoy in the latter half of the year, its strongest run since early 2014. World trade has also been picking up in 2017, after a long flat period through 2015 and 2016 with a sizeable lift in the pace of growth in the third quarter.

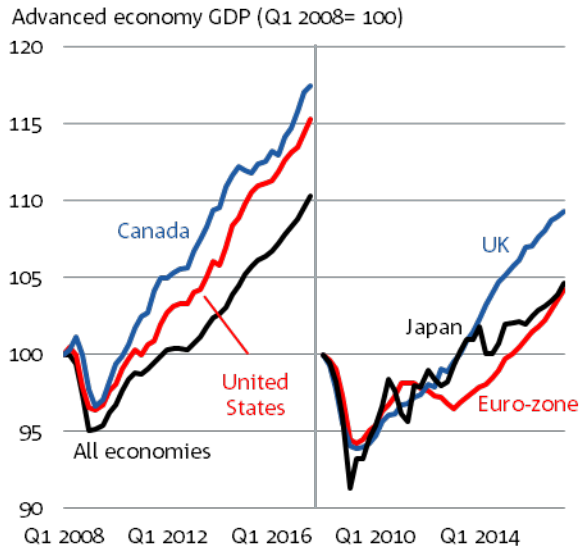
- One of the best aspects of the global economy through this year has been the way the upturn has become more securely established – broadening out geographically to include formerly soft economies and deepening with an acceleration in the pace of growth in fixed investment in the big advanced economies. As the upturn in demand gradually erodes surplus capacity across the G7 advanced economies, it is increasingly important that investment grows solidly to facilitate a long and sustainable period of economic growth – and that is now starting to happen with a ramping up in capital spending through the last year.

- While advanced economy growth has accelerated from 1¼% yoy in mid-2016 to 2¼% yoy in September 2017, it is the emerging market economies that provide the bulk of increased global output. That should continue as growth is lifting in a group of big emerging market economies (Russia, Brazil and India) whose output performance has been sub-par for much of 2017. As collectively they account for 13% of global output, movement out of recession in Brazil and Russia combined with an end to the hit to Indian growth from de-monetisation and the new GST will offset slower Chinese growth. As a result, the emerging economies should keep growing by over 5% yoy.

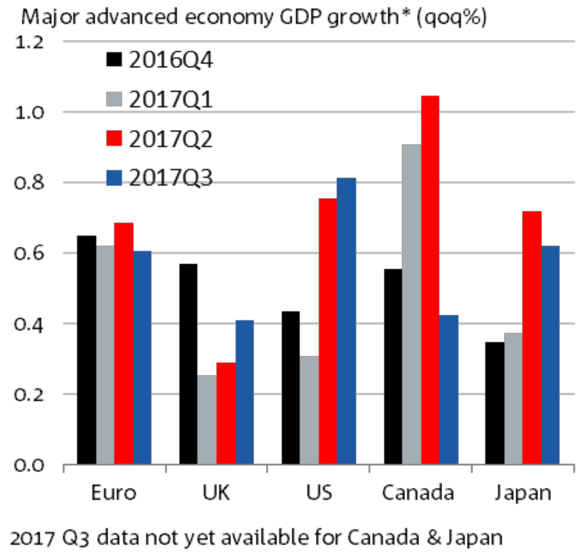
ADVANCED ECONOMIES

Solid growth spreads to include previously soft economies

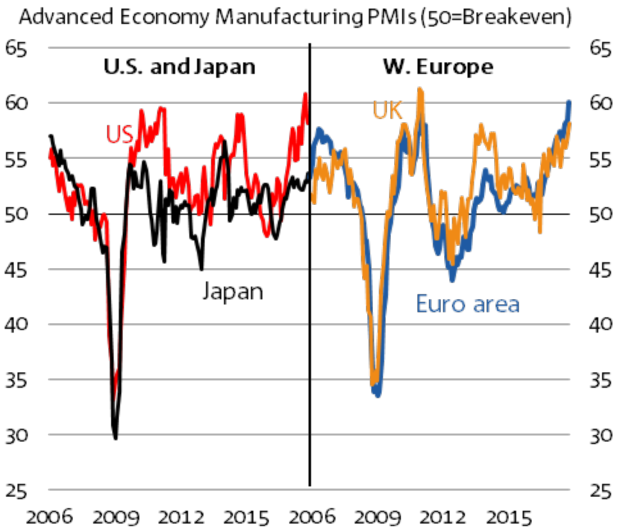
GROWTH RAMPS UP ACROSS G7



SOLID GROWTH IN MOST AREAS

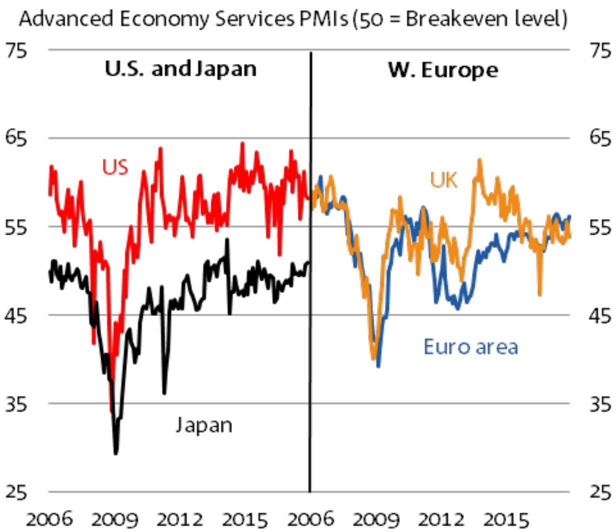


INDUSTRY SURVEYS VERY OPTIMISTIC



Sources: Datastream, Markit, ISM, NAB Economics

SERVICE PROVIDERS OPTIMISTIC TOO



- The upturn in the advanced economies is broadening out. The US and Canadian economies have been the standout growth performers through the recovery from the GFC. The UK growth record has fallen well short of what was seen in earlier recoveries but it has, at least, been far better than that experienced in the two worst-performing areas - Japan and the Euro-zone, which in combination represent a sizeable 16% of the world economy.

- 2017 has seen the pace of expansion finally pick-up in those two slower growing economies. Euro-zone growth has ramped up to an annualised rate of around 2½% in the year ended September quarter 2017, well above the 1¾% annualised pace averaged over the previous year. There is, however, still great divergence within the Euro-zone with Germany recording a strong economic upturn while the Italian economy is smaller than it was in early 2008! The Japanese economy has also seen a marked lift through 2017 with second and third quarter growth averaging almost 2¾% at an annualised pace.

- Recent output expansion in both the Euro-zone and Japan outstrips estimates of the growth in their long-run productive potential, an outcome only made possible by eroding margins of spare capacity. The Bank of Japan thinks that country's potential annual growth is currently between ½% and 1% and most other estimates are under 1%. The jobless rate has fallen under 3%, there is declining under-employment, little idle capacity in manufacturing and "output gap" estimates show that the economy has few spare resources left. This highlights the importance of getting a solid upturn in investment to lift the economy's productive potential and sustain future growth.

- Estimates of the pace of growth that the Eurozone can sustain over a long period have been revised lower since the global financial crisis. It is now thought that the Eurozone, the third biggest economic block in the world (after China and the US) can only grow over the long haul at an annual average rate of around 1% but that does not mean that the region's current 2.6% yoy economic upturn has to suddenly stop. The Euro-zone unemployment rate is still a high 8.8% and there is plenty of under-employment and idle capacity in parts of the currency block. Higher investment is, however, still important in securing a lasting upturn in the pace of output expansion.

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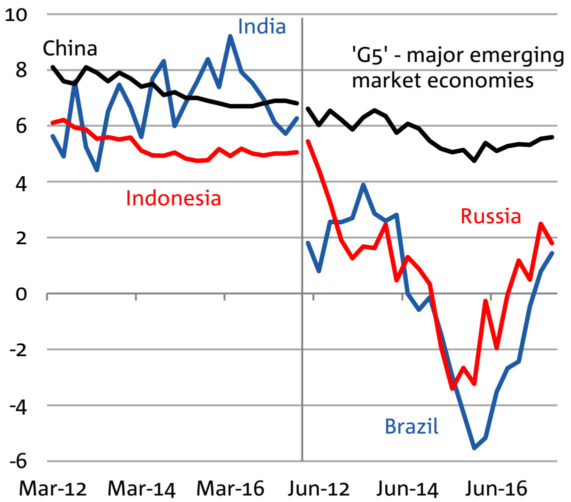
EMERGING MARKET ECONOMIES (EMES)

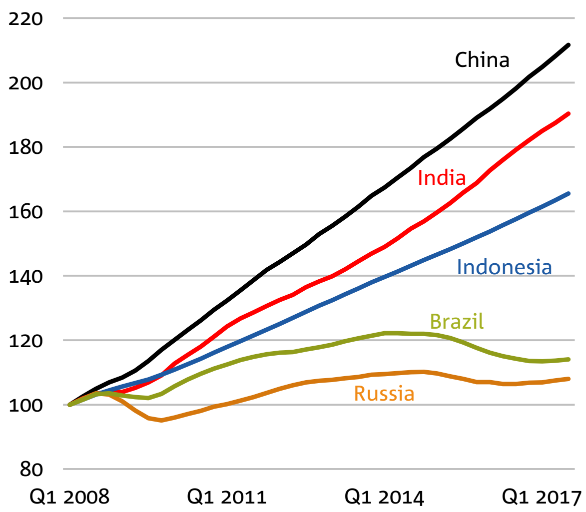
Recovery in 3 key economies to support EME growth as China set to slow

BRAZIL & RUSSIA RECOVERING BUT CONTINUE TO LAG OTHER MAJOR EMES

Emerging market GDP growth (yoy%)

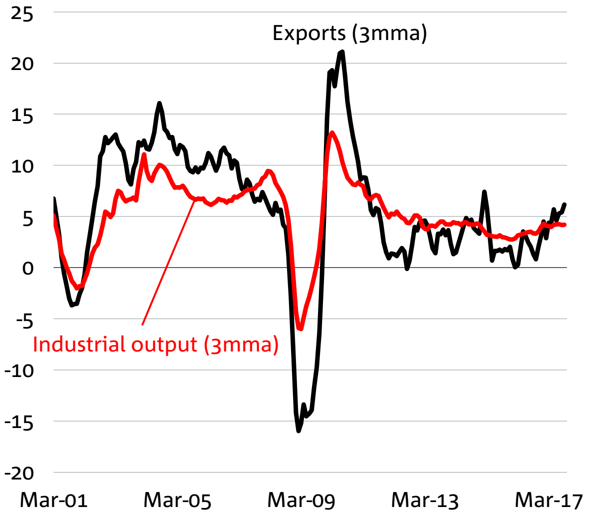


Emerging market GDP index (12mma) (Q1 2008 = 100)



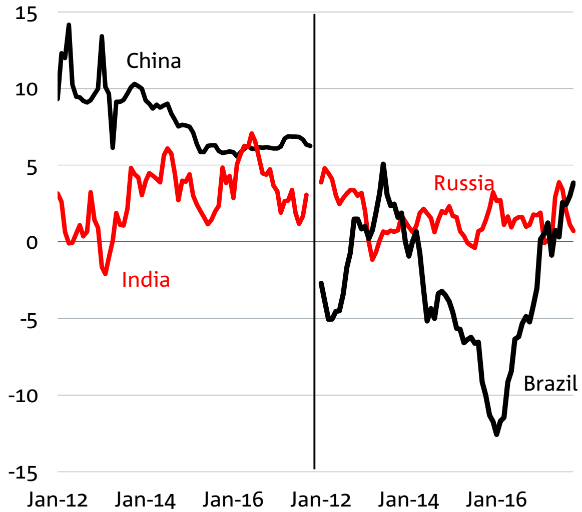
STABLE INDUSTRIAL GROWTH MASKS

Emerging market exports and industrial output (% yoy)



DIVERGENT TRENDS IN ECONOMIES

Industrial production (% yoy (3mma))



Sources: Datastream, CEIC, NAB Economics

- Economic growth in the biggest 5 emerging market economies increased from around 5¼% yoy in March quarter to 5½% in June and rose again slightly in September - the fastest rate of growth for this group for three years. Most of the improvement since the cyclical low in late 2015 has been driven by Russia and Brazil – as their economies have recovered from deep recessions. In contrast, Indian growth has been disrupted by shifts in domestic economic policy while China and Indonesia have tracked sideways.

- Brazil's economic recovery has largely been driven by domestic consumption – in part reflecting a recent decline in unemployment (from 13.7% in March 2017 to 12.2% in October) – however it is worth noting that both Brazil and Russia's overall economies are still smaller than at their previous peaks in 2014. Getting faster growth in Brazil faces challenges, given the sizable increase in public debt since 2014 and proposed austerity measures from the government.

- Indian economic growth strengthened in Q3 – increasing by 6.3% yoy (compared with 5.7% in the June quarter) – following five quarters of slowing. We anticipate stronger growth in 2018, at 7.1% (compared with 6.4% this year), as the negative impacts of taxation changes and the demonetisation program wash out of the system.

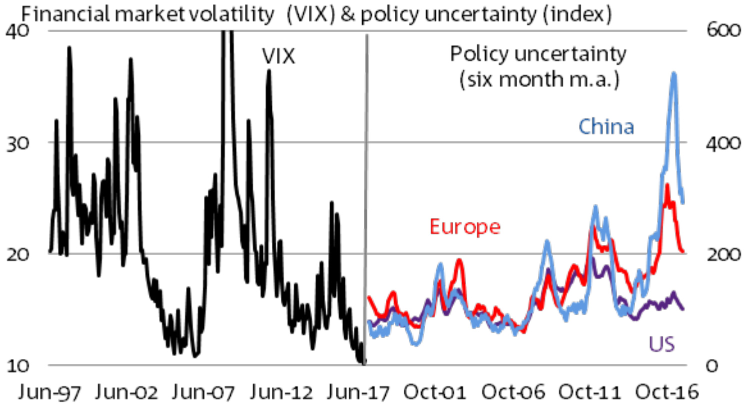
- Broad measures of industrial production and export volumes across the wider emerging market economies show divergent trends. Growth in industrial production accelerated in late 2016 – from around 3.5% yoy mid year to around 4¼% yoy in January 2017 – but has largely remained stable across 2017. Trends are mixed across the major economies – with Brazilian output recovering strongly, counter to weaker trends in India and volatility in Russia.

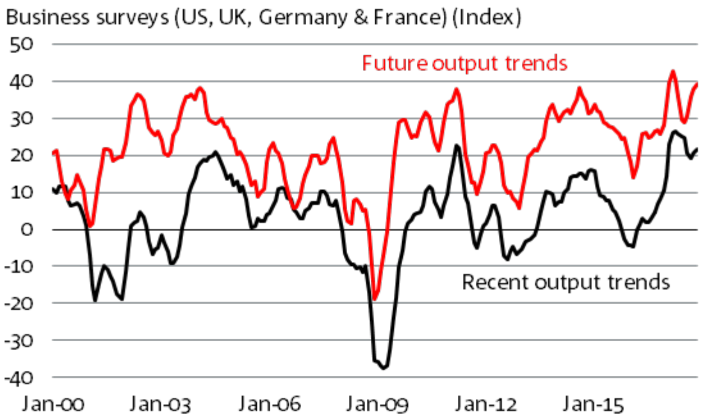
- Growth in export volumes accelerated across 2017 with the most notable upturn occurring in the third quarter (as volumes had been quite stable through the first half of the year). A recent increase in imports for both advanced and emerging market economies offers opportunities for trade dependent economies across East Asia and Latin America with solid growth in industrial output in key export-driven economies in the former region.

GLOBAL FORECASTS, POLICIES AND RISKS

Global upturn broadens-out to cover more countries and stronger investment

STABLE ENVIRONMENT AND BUOYANT BUSINESS





- This is the best global backdrop for Australia we have seen for years. Economic growth has ramped up to an above trend level, business confidence is high and measures of financial market volatility, risk spreads and policy uncertainty (a proxy for the political risk that weighed so heavily on markets last year) are well down from earlier highs. We expect the global upturn to continue with above trend growth continuing into 2018 and the risks look skewed toward getting better rather than worse growth outcomes.
- While this growth phase has been under way for years now, economic expansions do not just die of old age – they need a trigger to stop them. In the past a common trigger ending economic upturns has been central bank rate rises designed to curb rising inflation - but that is not an issue this time with central banks trying to engineer higher rather than lower inflation. Similarly, there does not seem much appetite for budget austerity around the world, removing another trigger. Commodity markets look amply supplied, limiting the chances of commodity shock like the 1970s OPEC ones and global regulators have stepped up their oversight of financial systems, reducing the chances of another 2007/8 style financial crisis.
- As always, there are risks – political problems from Euro-zone elections (it is Italy's turn next year), increased risk taken on by investors seeking returns in a low yield world, the chance that central banks (especially the Fed) could be too quick to cut off their support for economic growth by lifting rates or winding back asset purchases too aggressively and the backdrop of high debt that households, corporates and governments carry in different parts of the world. While all these risks exist, they are so much discussed by markets and economic agents that there is a good chance we can avoid taking steps that would trigger problems – allowing the global upturn to roll on through the next few years.

GLOBAL GROWTH FORECASTS (% change)

	2012	2013	2014	2015	2016	2017	2018	2019
US	2.2	1.7	2.6	2.9	1.5	2.3	2.4	2.0
Euro-zone	-0.8	-0.2	1.4	2.0	1.8	2.4	2.2	1.9
Japan	1.5	2.0	0.3	1.4	0.9	1.8	1.4	0.9
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	3.0	2.1	1.8
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	6.4	7.1	7.3
Latin America	2.7	2.5	0.9	0.1	-0.9	1.1	2.5	2.9
Emerging East Asia	4.7	4.2	4.1	3.7	3.9	4.3	4.1	3.9
NZ	2.5	2.2	3.4	2.5	3.0	2.5	2.9	2.9
Total	3.7	3.4	3.5	3.4	3.2	3.5	3.6	3.5

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

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