EMBARGOED UNTIL: 11.30AM THURSDAY 15 MARCH 2018

THE FORWARD VIEW – GLOBAL

MARCH 2018

National Australia Bank

Summary –sabre rattling ahead of a potential trade war?

- The global economic environment remains the most encouraging it has been for many years, as growth has broadened out across the advanced world, and some key emerging market economies have recovered from deep recessions.
- Financial market volatility has eased since the US equity market correction in late January but there are still a range of geo-political and market events that could emerge to again increase the level of uncertainty.
- The risk of a trade war has intensified as President Trump has imposed tariffs on US steel and aluminium imports.

	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	2.7	2.3
Euro-zone	11.7	-0.8	-0.2	1.4	2.0	1.8	2.5	2.5	2.4
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	6.9	6.5	6.3
Emerging East Asia	8.0	4.7	4.2	4.1	3.7	3.9	4.4	4.3	4.0
NZ	0.2	2.6	2.2	3.6	3.5	4.0	2.9	2.8	3.0
Total	100.0	3.7	3.4	3.5	3.4	3.2	3.6	3.8	3.6

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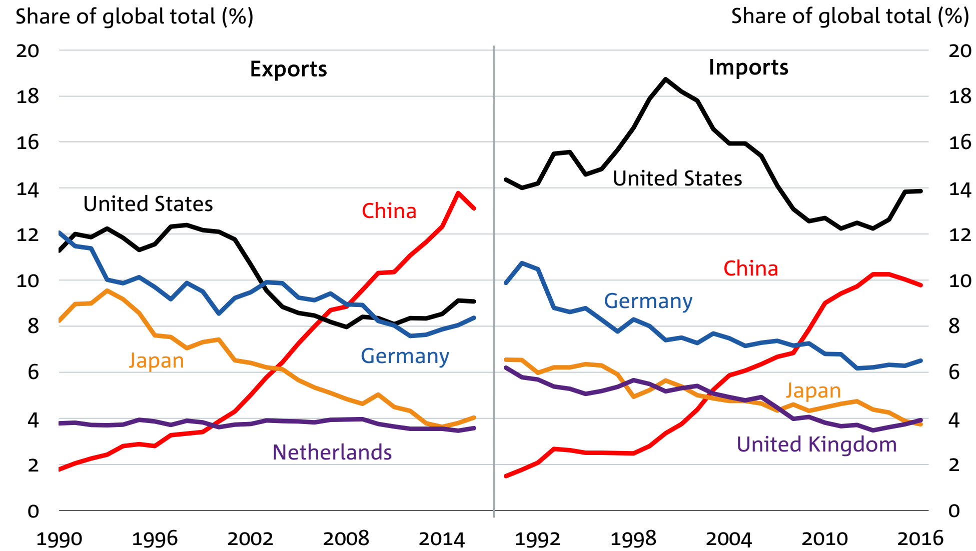
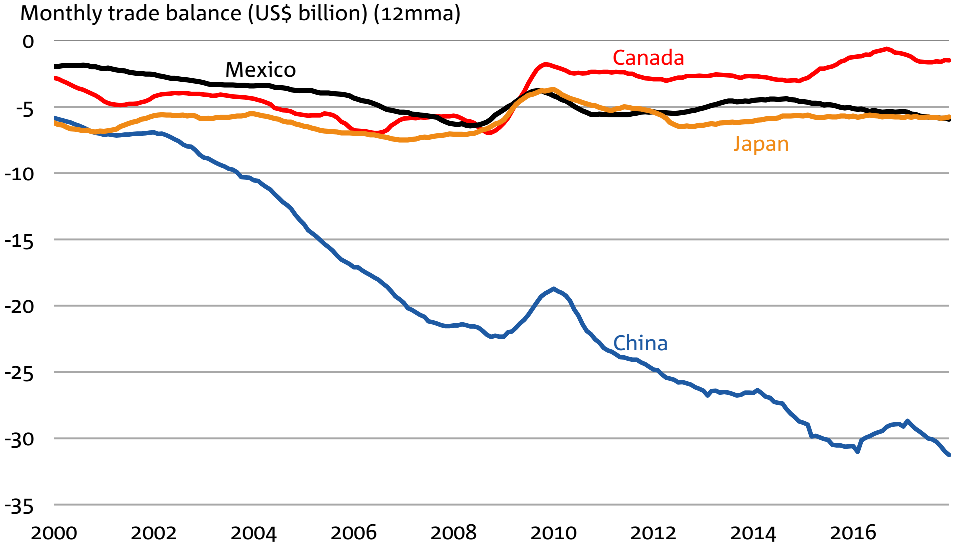
TRADE RISKS RE-EMERGE FOLLOWING TRUMP TARIFF PROPOSALS

US tariffs on steel and aluminium not a big problem for China

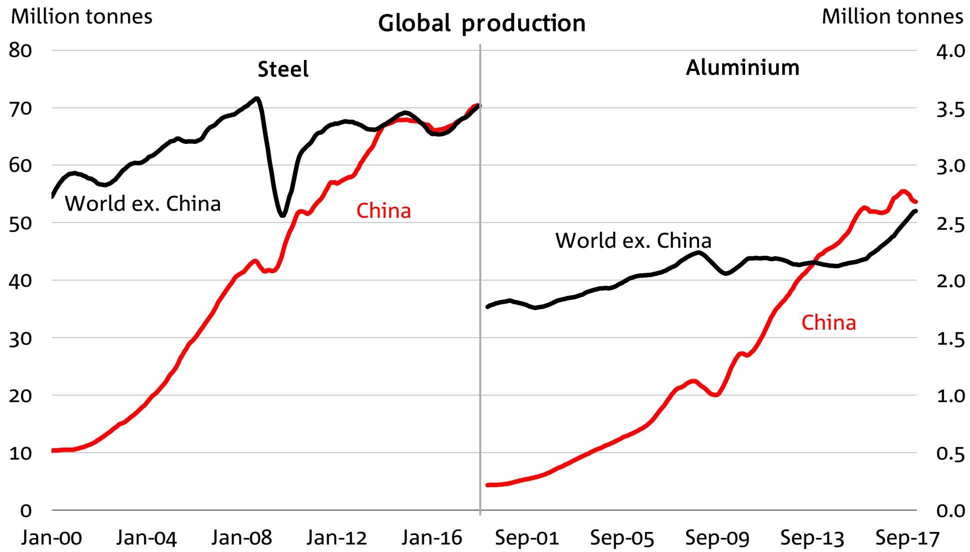
CHINA'S SHARE OF GLOBAL TRADE SURGED SINCE THE 1990S

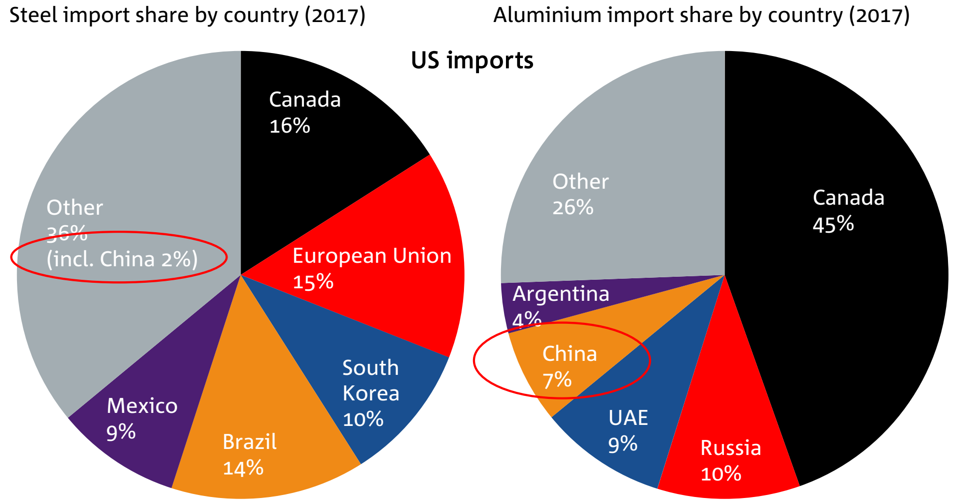


CHINA'S SURPLUS WITH US RAISES TRADE TENSIONS



CHINA THE DOMINANT PLAYER IN GLOBAL STEEL AND ALUMINIUM (WITH MASSIVE OVERCAPACITY), BUT LITTLE EXPOSURE TO US MARKET





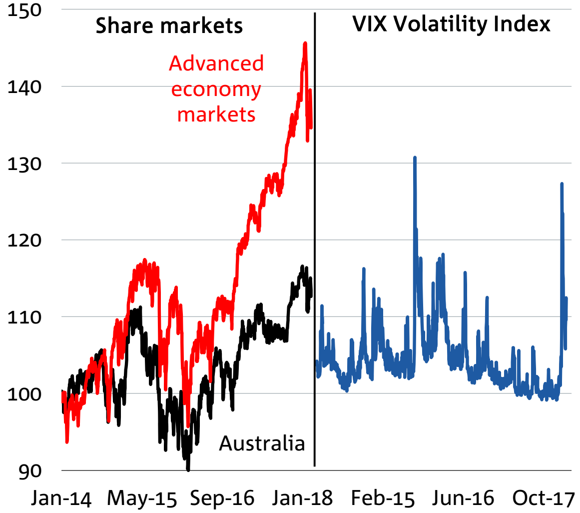
Sources: World Trade Organization, Datastream, World Steel Association, International Aluminium Institute, US Census Bureau, USGS, NAB Economics

FINANCIAL AND COMMODITY MARKETS

Volatility returns to trend, as central banks (led by the Fed) look to tighten

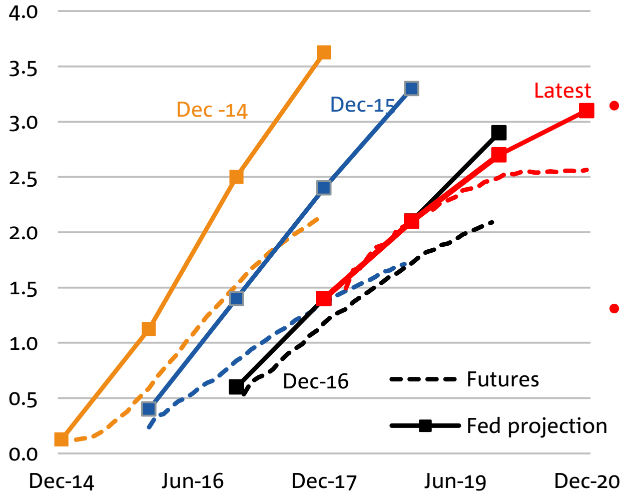
HIGHER VOLATILITY FROM FEB

Share markets and volatility indices

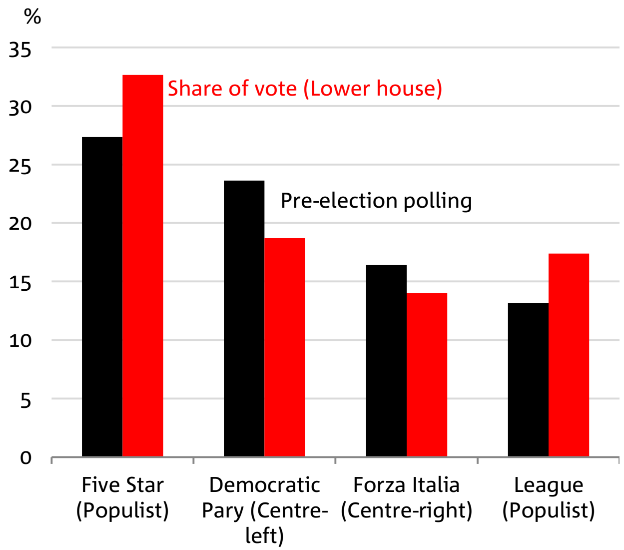


MARKETS IN LINE WITH FED OUTLOOK

Fed 'Dots' and Fed futures curve at selected dates (%)

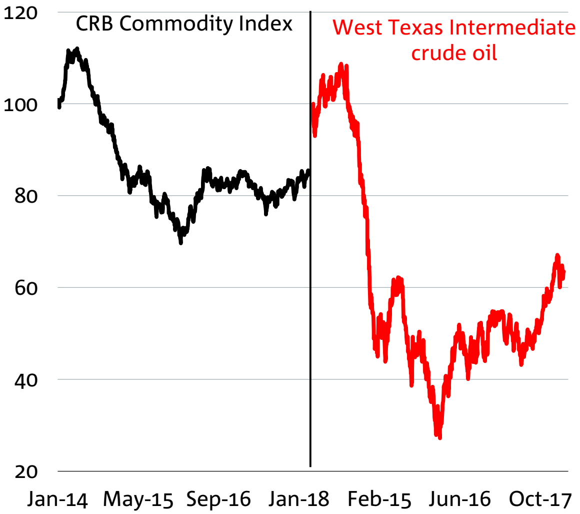


ITALIAN ELECTION RESULTS



OIL & METALS DRIVE COMMODITIES UP

Commodity price indices (1 Jan 2014 = 100)



- Financial market volatility has eased since the US equity market correction in late January but a range of geo-political and market events could trigger another bout of uncertainty. The closely watched VIX index spiked in early February as the sell-off in US markets gathered pace and has subsequently settled close to 20 points – roughly the long term trend level – following a long period of unusually low volatility.
- Recent market concern focused on the announcement in early March of a 25% tariff on US steel imports and 10% on aluminium imports, followed by the resignation of President Trump's pro-trade economic advisor Gary Cohn. Trump's campaign was highly protectionist and the proposed tariffs have raised fears around a potential trade war (which would have significant negative economic effects).
- US monetary policy could also tighten more rapidly than previously thought – with markets anticipating a more hawkish approach from the US Federal Reserve, following the appointment of Jay Powell as Chair. In testimony to the House Financial Services Committee, Mr Powell indicated that the Fed is less likely to be tempered by market volatility – calling into question the so-called Fed Put that slowed earlier rate rises.
- Federal Reserve projections – the so-called dot plot – point to three rate increases in 2018. For the first time in a number of years, financial markets are in line with this view – markets have generally anticipated fewer hikes than the dots, and have typically been closer to the mark.
- Central banks are gradually attempting to remove long-running emergency rates and policy measures, and return to more normal levels. The European Central Bank maintained policy rates at 0% in March, but removed a commitment to buy bonds if the current expansion slows – a tentative step towards normality.
- In Europe, the Italian general election in early March has resulted in a hung parliament – with sizeable gains for populist parties, while the centre-left and centre-right parties underperformed. While lacking a clear pathway, some Italian populists have favoured exiting the common currency. Elsewhere, EU negotiators rejected post-Brexit trade proposals from the UK – highlighting the ongoing challenges in their longer term relationship.
- Commodity prices indices have trended modestly higher since mid-2017, as global economic growth has strengthened. In particular, crude oil and metals prices have moved higher (in line with stronger global industrial trends).

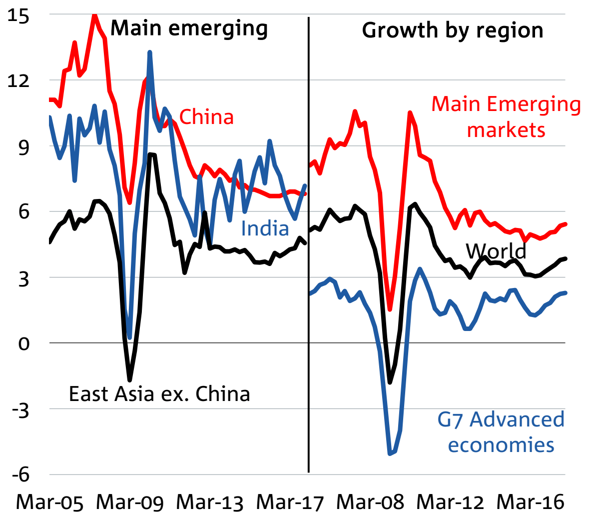
Sources: Datastream, Bloomberg, ECB, Federal Reserve, Italian Ministry of the Interior, NAB Economics

GLOBAL ECONOMIC TRENDS

Above trend growth continued in Q4, but trade tensions are an ill omen

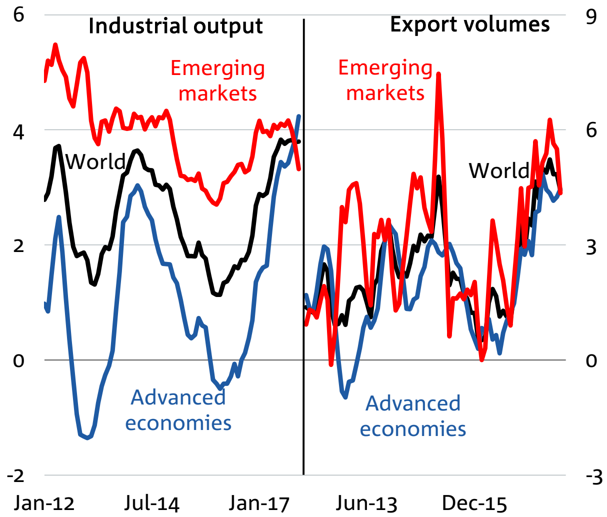
GLOBAL UPTURN CONTINUES

Economic growth (% yoy)



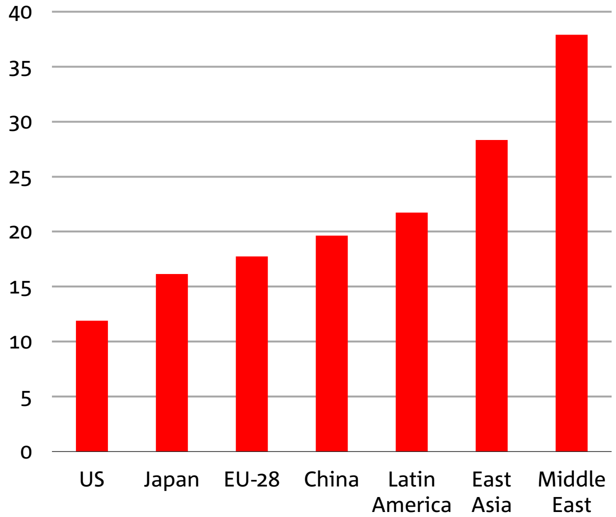
TRADE VOLUME GROWTH SLOWING

Global changes in trade and output (% yoy (3mma))



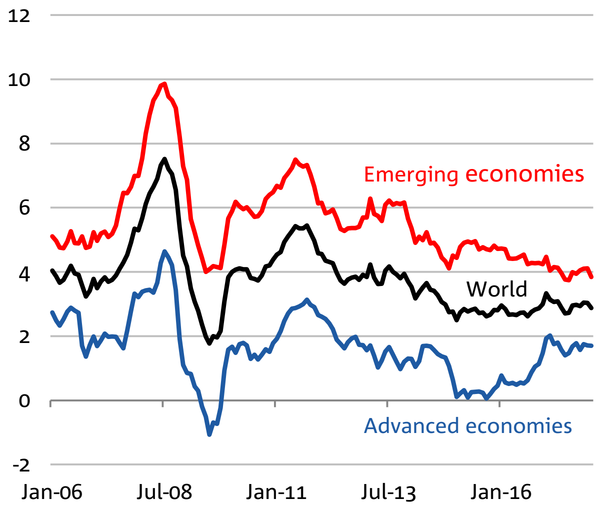
EMES MORE TRADE EXPOSED

Exports of goods & services in 2016 (% of GDP)



INFLATION SLOWLY EDGING UP

Consumer price inflation (yoy%)



- Above trend global economic growth has continued, with the sustained, synchronised upturn in advanced economies (which account for just under a third of global output) supported by continued expansion in the big emerging markets (where trends have been somewhat more divergent).
- Business survey readings in advanced economies remain strong – with manufacturing readings in February just off the seven year highs recorded at the end of 2017, while forward looking indicators suggest that businesses expect positive conditions are set to continue.
- That said, there are some near term trends that are somewhat less encouraging – with growth in emerging market industrial production and global trade volumes both slowing since recent cycle peaks in September 2017 – with the latter down from around 5¼% yoy at the peak to 4.5% yoy in December.
- The increased potential for a trade war emanating from recent US tariffs imposed on steel and aluminium presents an increased risk to global growth. The European Union has already threatened retaliatory tariffs which could escalate the level of trade tensions, while US action against China (proposed during the 2016 Presidential election campaign but so far not implemented) could soon occur. It is emerging markets – rather than big advanced economies – that have the most to lose from renewed protectionism, given that trade drives a greater share of their growth.
- Inflation has gradually trended higher – but it has been heading towards the bottom end of target ranges for most advanced economies, rather than higher levels that would prompt rapid central bank responses. That said, the potential for more rapid increases in US policy rates could influence a range of global financial markets.

Sources: Datastream, CPB, World Bank, Eurostat, NAB Economics

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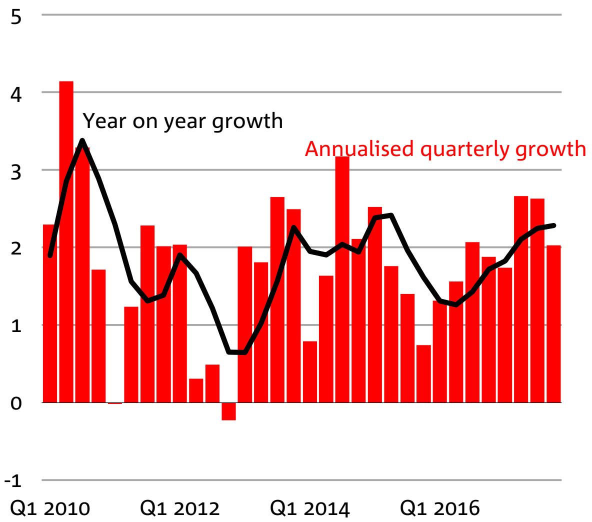
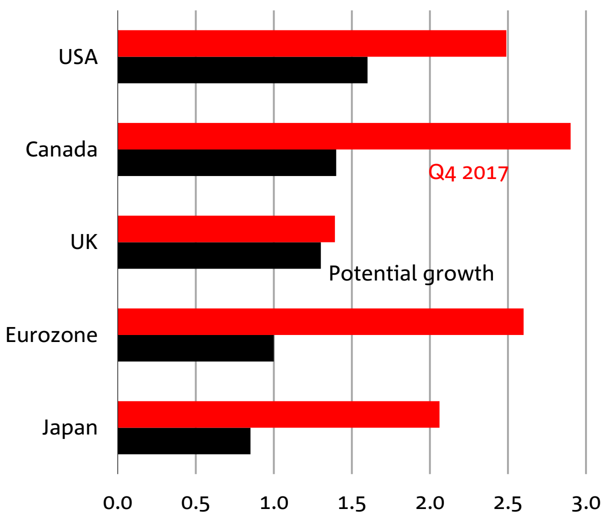
ADVANCED ECONOMIES

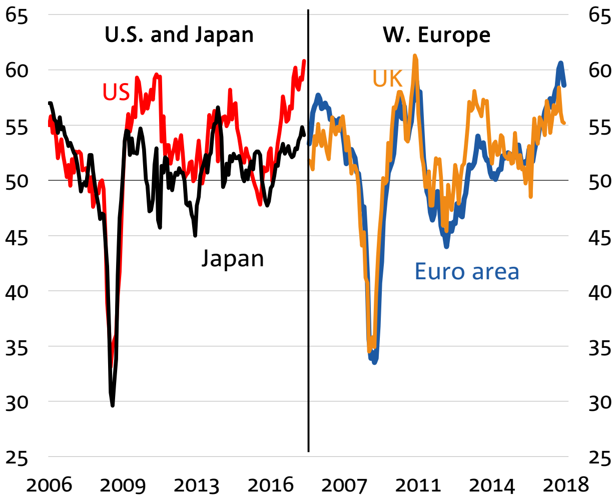
Strong performance has continued, but constraints will start to bite

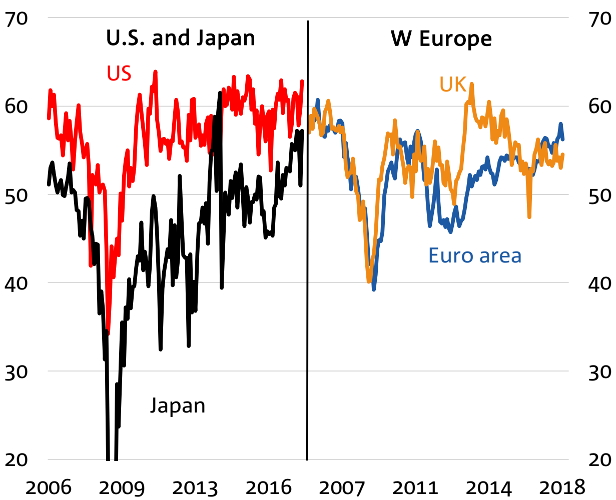
GROWTH TRENDING HIGHER… BUT RUNNING ABOVE POTENTIAL





STRENGTH IN US SURVEYS PUSH MFG AND SERVICES NEAR RECORDS





- From recent lows in mid-2016 (near 1¼%), growth in the big advanced economies accelerated – moving up to 2.3% yoy in Q4 2017. Particularly encouraging has been the synchronised nature of this upturn, with many previously weaker regions – such as Japan and the Eurozone – recording stronger growth in recent times. The strongest performers in Q4 were Germany and Canada – with growth close to 3% yoy – followed by France and the United States (both around 2.5%).
- The main exception has been the UK, where uncertainty around the post-Brexit environment is impacting the economy (particularly private consumption). Growth slowed to 1.4% yoy in Q4 2017, having trended around the 2% mark from the second half of 2015 until early 2017.
- It is worth noting that growth in many of these economies is running ahead of their potential – possible only in the short term as they erode the excess labour and production capacity that was built up in the post-GFC period.
- Labour markets are tightening in the big advanced economies – with weighted unemployment across the G7 at its lowest levels on record (stretching back to the late 1970s). That said, there are some marked differences within the group – with rates still high in both Italy and France (at around 11% and 9% respectively).
- As a result, sustaining growth in the longer term will require significant investment in capital (which has generally been weak in the post-GFC period) and a substantial boost to labour participation and productivity – with productivity growth generally underwhelming in recent years.
- Business surveys in major advanced economies continue to highlight ongoing strength. Our aggregate of manufacturing PMIs was just below record levels in February (stretching back to the early 2000s), while the services reading was the highest since January 2004.

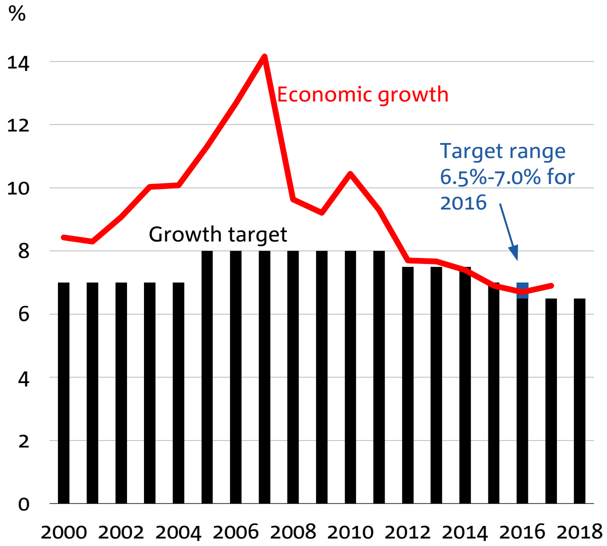
Sources: Datastream, CBO, Bank of Canada, Bank of Japan, Norges Bank, Bank of England, Markit, ISM, NAB Economics

EMERGING MARKET ECONOMIES (EMES)

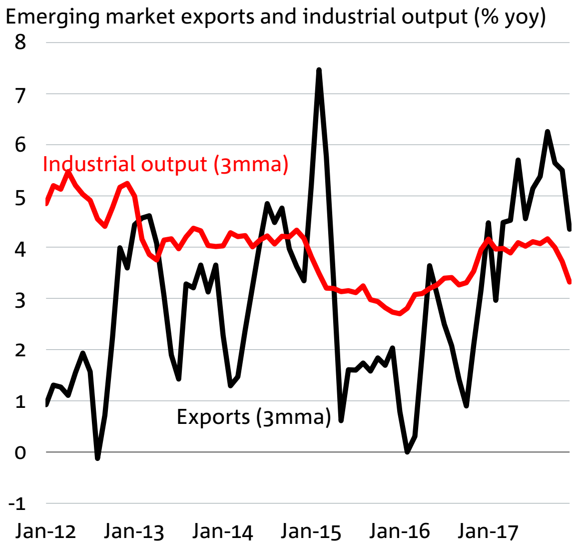
Big markets have improved, but recent industrial trends are softer

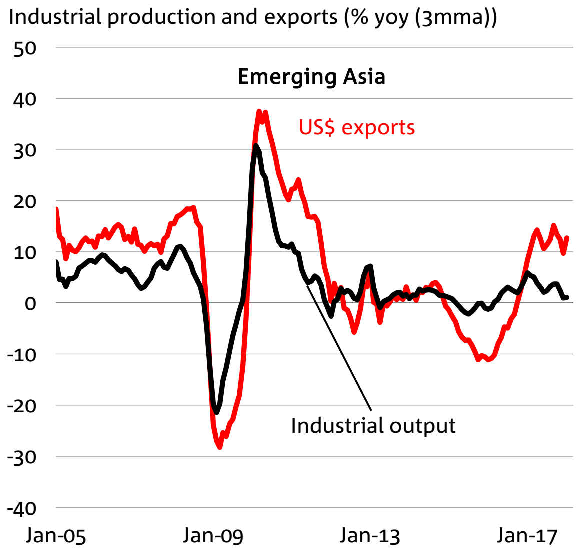
MIXED TRENDS IN MAJOR EMES

CHINA'S GROWTH CLOSER TO TARGET



RECENT INDUSTRIAL TRENDS SOFTER... ...PARTICULARLY IN ASIA





Sources: Datastream, Bloomberg, CEIC, NAB Economics

- Overall trends for the big emerging market economies have improved in recent quarters – with economic growth pushing up to 5¾% in Q4 2017, up a full percentage point from the recent lows at the end of 2015.
- That said, trends have differed considerably. Indian growth picked up in Q4 – up to 7.2% yoy – with the negative impacts of tax changes and demonetisation washing out of the system. Similarly, Brazil's economic recovery has continued – with growth pushing up to 2.2% – as it pulls out from a deep recession. In contrast, Russian growth appears to have slowed in Q4, albeit only preliminary estimates were available at the time of writing.
- China's period of economic stability has continued – with growth remaining at 6.8% yoy in Q4. Economic targets unveiled at the National People's Congress in early March point to more of the same – with growth target unchanged at 6.5% and growth in money supply and credit "around the same as last year". The only significant shift is a smaller fiscal deficit target, at 2.6% of GDP (from 3.0% last year), which may point to softer (near target) growth in 2018.
- While economic growth in the big markets has strengthened, recent industrial data across the wider emerging market economies appears a little softer. The CPB measure shows a marked slowing towards the end of 2017 – from around 4.0% yoy (on a three month moving average basis) across the first ten months of the year, to 3¼% yoy by December.
- Similarly, growth in export volumes has also slowed – to around 4.5% yoy (3mma) in December – having accelerated across much of 2017 to a peak of 6¼% yoy in September. This slowdown in volumes was almost entirely driven by trends in emerging Asian markets.
- It appears that the softer industrial trends are primarily in the smaller emerging Asian economies – with robust conditions in both China and India continuing. The decline in our measure of output growth since September was led by South Korea, Singapore and Malaysia.

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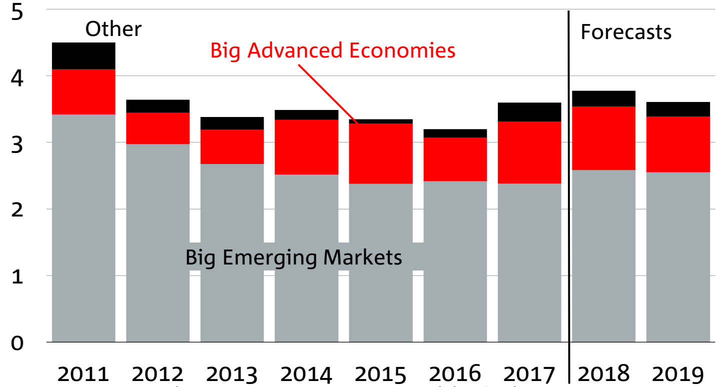
GLOBAL FORECASTS, POLICIES AND RISKS

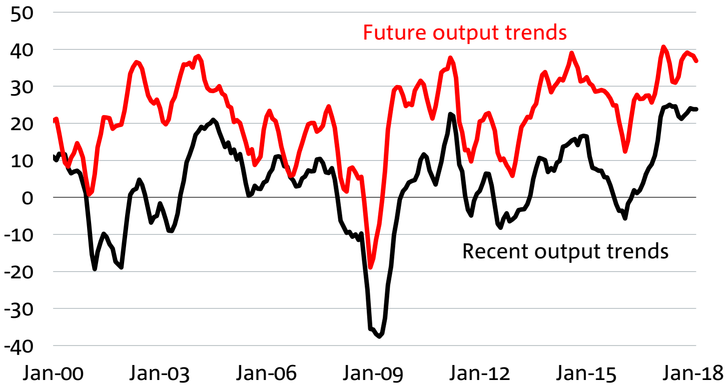
Growth heading back down to trend on advanced constraints, China softening

ABOVE TREND GROWTH UNTIL 2019

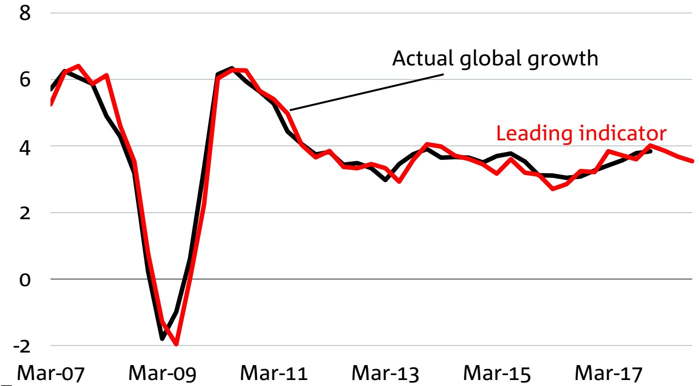
Global economic growth (% points contribution)



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



Actual global growth and leading indicator (% yoy)



- The global economic environment remains the most encouraging it has been for many years, as growth has broadened out across the advanced world, and some key emerging market economies have recovered from deep recessions. We expect that the current above trend growth can continue this year and next, on the proviso that advanced central banks remain relatively cautious in their moves to tighten policy and governments place a low priority on budget repair and debt management, along with key risks remaining in check.
- Beyond this point, supply constraints are likely to impact – with unemployment already historically low in major advanced economies and spare production capacity severely eroded – bringing advanced economy growth back towards potential and inflation tracking higher. Similarly, we anticipate further softening in China's growth profile – with this economy being the world's largest on a purchasing power parity basis.
- The prospect of an escalating trade war – between the United States, the European Union and/or China – has emerged as a heightened risk to our outlook. Despite bold statements from President Trump, a trade war would be negative for all economies involved.
- We expect that central banks will raise their rates cautiously in coming years – curbing the rate of economic growth in the short term but also reducing the risks of overheating. Bond yields and inflation should trend higher over this period, as supply constraints in advanced economies tighten.

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	2.7	2.3
Euro-zone	-0.8	-0.2	1.4	2.0	1.8	2.5	2.5	2.4
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	1.9	1.8	1.8	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	6.9	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	1.2	2.6	2.9
Emerging East Asia	4.7	4.2	4.1	3.7	3.9	4.4	4.3	4.0
NZ	2.6	2.2	3.6	3.5	4.0	2.9	2.8	3.0
Total	3.7	3.4	3.5	3.4	3.2	3.6	3.8	3.6

Sources: Datastream, Bloomberg , NAB Economics

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