

THE FORWARD VIEW – GLOBAL

JUNE 2018



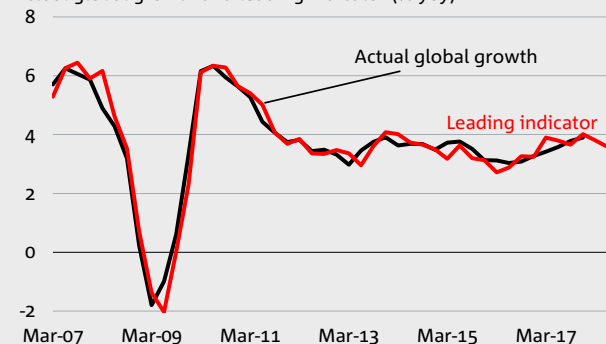
Summary – cracks starting to show in the upward global growth momentum

- Global growth was marginally softer in Q1, driven by a modest slowdown in the advanced economies. This was particularly evident in the Euro-zone and Japan leading to a divergence in growth after having previously exhibited a synchronised growth uptrend across most of 2016 and 2017.
- Global trade has also weakened with increased global trade tensions – especially around the US.
- Growth in the big emerging markets was slightly stronger (led by a rebound in India), but again trends diverged between economies. Various emerging market central banks are facing the challenge of managing capital outflows.
- It appears that the current global upswing has peaked (or is near that point). Certainly our leading indicator points to slower growth for the remainder of 2018. That said, despite signs many short and long term interest rates have started to increase, or will do so over the forecast period, our forecasts still imply above trend growth in both 2018 and 2019 before easing back to the long-term average of 3.5% in 2020.
- The US Fed raised rates again at its June meeting. We now expect the Fed to increase the fed funds rate two times in the second half of 2018 (previously one), with a further three rates hikes in 2019, resulting in a peak for this cycle of 3.25% (previously 3.0%).

Global Growth Forecasts (% change)

	2017	2018	2019	2020
US	2.3	2.7	2.3	1.7
Euro-zone	2.6	2.1	2.0	1.8
Japan	1.7	0.9	1.0	0.7
China	6.9	6.5	6.3	6.0
Other East Asia	4.4	4.2	3.9	3.7
NZ	2.9	2.9	3.0	2.4
Total	3.8	3.8	3.7	3.5

Actual global growth and leading indicator (% yoy)



CONTENTS

Charts of the month	2
Financial and commodity markets	3
Global economic trends	4
Advanced economies	5
Emerging market economies	6
Global forecasts and policies	7

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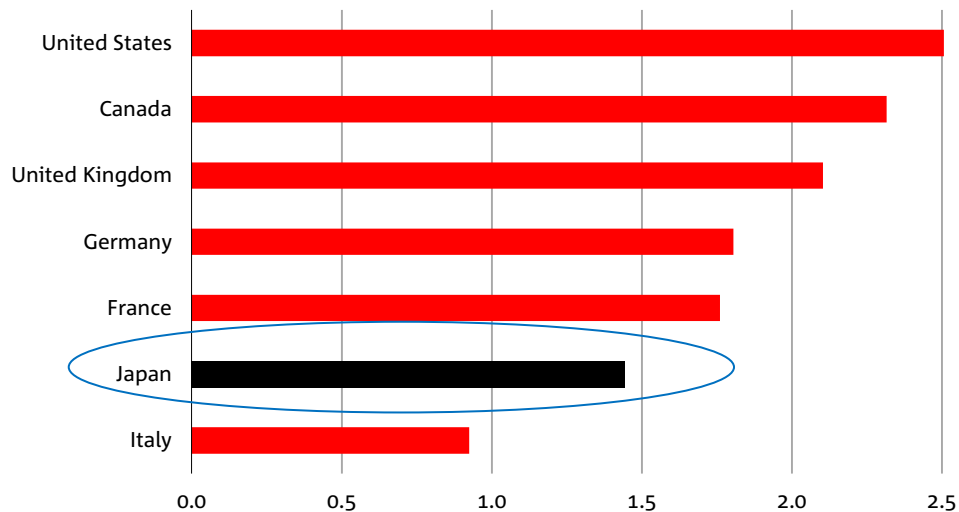
Gerard Burg

ADVANCED ECONOMY GROWTH HEAVILY IMPACTED BY DEMOGRAPHIC CHANGES

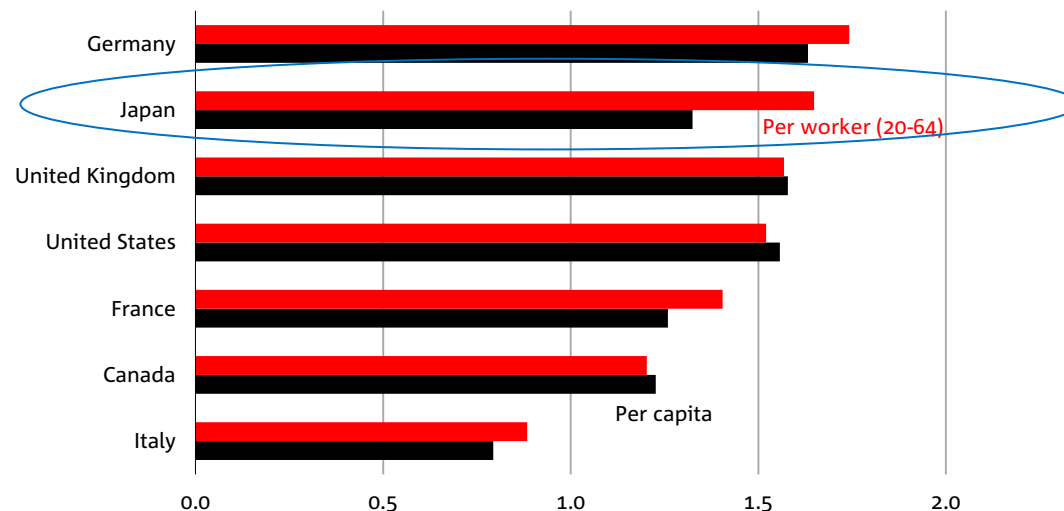
Population growth a key factor behind differing growth prospects

JAPAN HAS LAGGED MOST OTHER BIG ADVANCED ECONOMIES OVER THE PAST THREE DECADES, BUT HAS BEEN STRONG ON A PER WORKER BASIS

Long run annual average growth (1987 to 2017) (%)

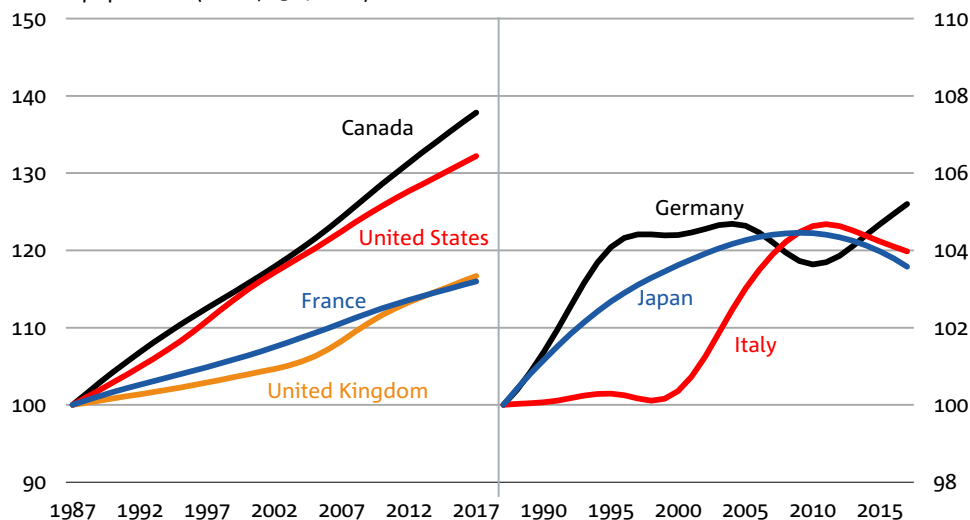


Long run annual average growth per capita and per worker (1987 to 2017) (%)

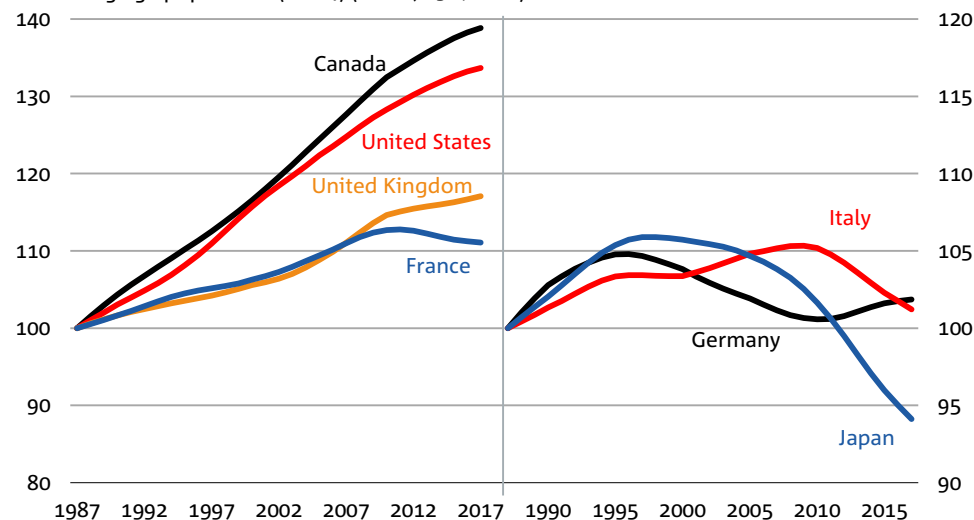


STRONG POPULATION GROWTH IN NORTH AMERICA VERSUS CENTRAL EUROPE AND JAPAN (WHERE WORKFORCE IS SHRINKING FAST)

Total population (Index, 1987=100)



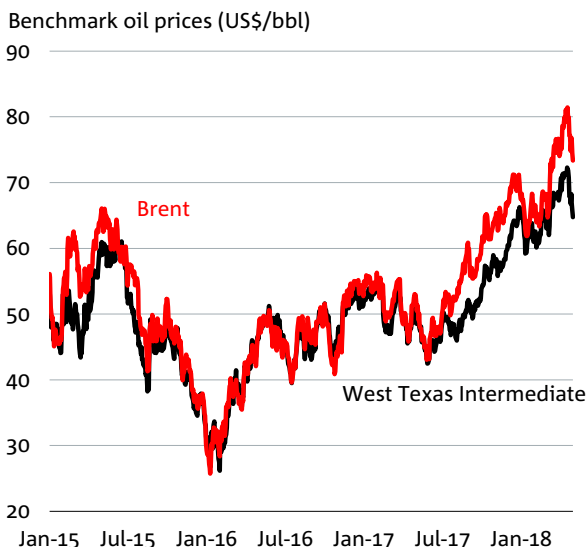
Working age population (20-64) (Index, 1987=100)



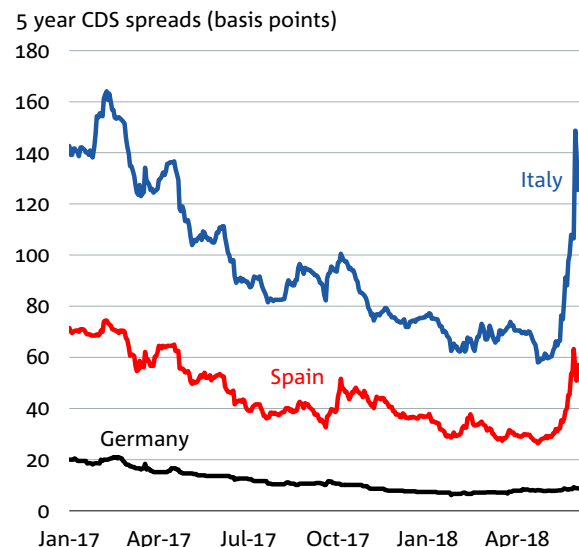
FINANCIAL AND COMMODITY MARKETS

Oil prices and European uncertainty contributing to volatility

OIL PRICES TRENDING HIGHER

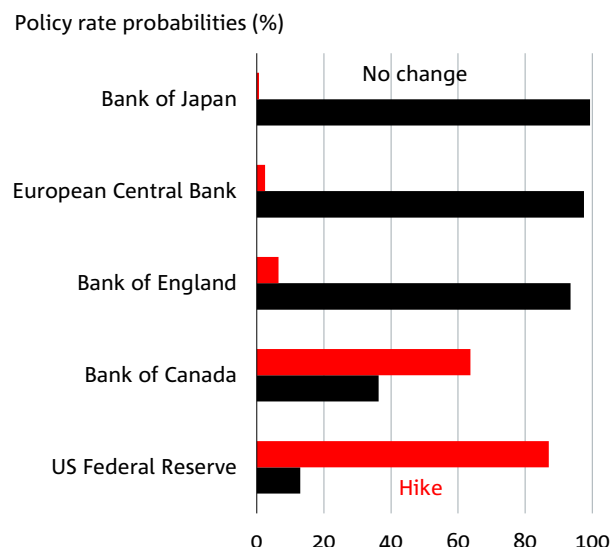
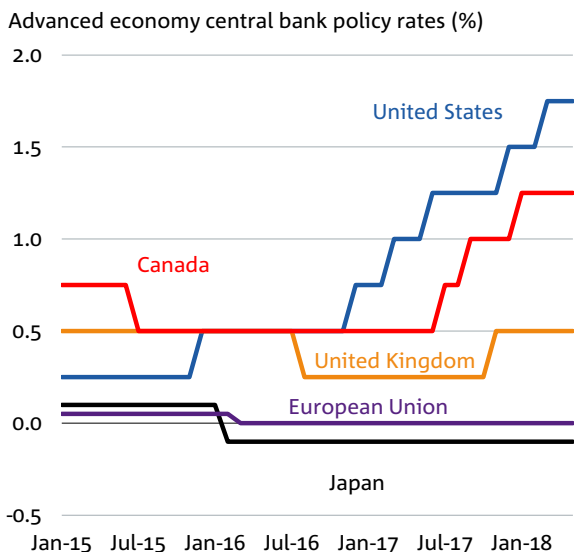


RISK SPIKES AROUND ITALY & SPAIN



- Global commodity prices have tracked higher – led by a surge in oil prices between early April and mid-May. Supply side factors have been at the heart of this increase – following an agreement between OPEC and Russia to restrict output and collapsing supply from Venezuela, along with concerns around Iranian output following the US withdrawal from the nuclear deal. Higher prices should entice US shale producers back into the market – suggesting there is limited upside to prices in coming months, with benchmark Brent prices peaking at around US\$80 a barrel in mid May, before pulling back to the mid \$70s in June.
- Increases in other commodity prices have been more modest. While the aggregate Thomson Reuters/CoreCommodity CRB Index rose by almost 14% yoy in May, the increase for non-energy commodities was just 3.5% yoy – largely reflecting growth in base metal prices.
- Political uncertainty in Italy and Spain has seen a spike in CDS spreads – highlighting investor concerns. Italy briefly appeared destined for fresh elections, although ultimately the populist coalition of the Five Star Movement and League was able to form a government. In Spain, a corruption scandal led to a non-confidence vote against the ruling conservative Popular Party, with a new minority Socialist government installed.

POLICY RATES HAVE DIVERGED, WITH THIS TREND SET TO CONTINUE

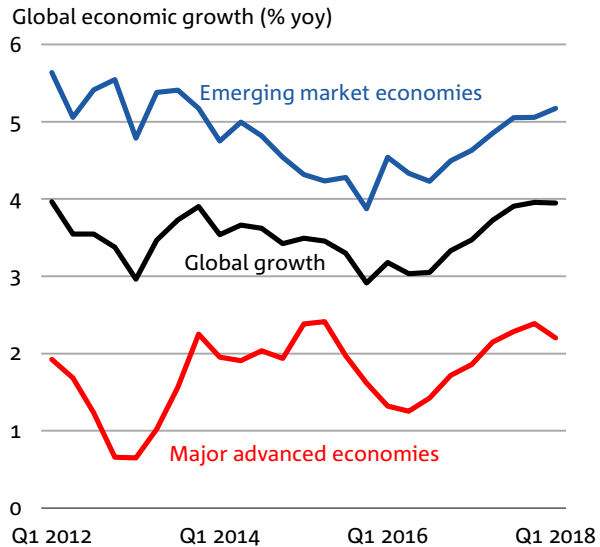


- As anticipated by markets, the US Federal Reserve raised the fed funds rates again overnight at its June meeting. With the US economy looking to be on solid ground, inflation close to target, and no impediment to continuing a quarterly tightening pace, we now expect two further fed fund rate increases in the second half of 2018 (previously one). We expect this to be followed by three increases in 2019, before the Fed pauses at a peak of 3.25% for this cycle (previously 3.0%) as the economy begins to slow due to tighter monetary policy and with the boost from fiscal stimulus well in the past.
- The Bank of Canada is also expected to lift rates at its next meeting in July (64% probability). Softer data has reduced the likelihood of another increase from the Bank of England, while the European Central Bank and Bank of Japan are likely to be slower to raise rates – given that they have considerable policy stimulus to unwind prior to any hikes.

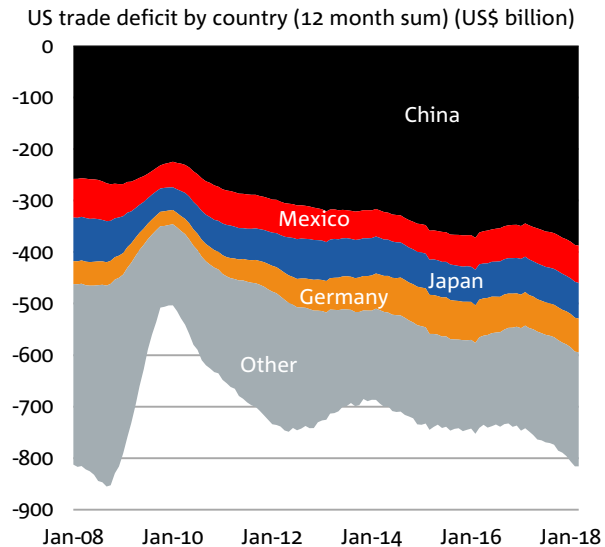
GLOBAL ECONOMIC TRENDS

Trade environment remains uncertain as the US imposes tariffs

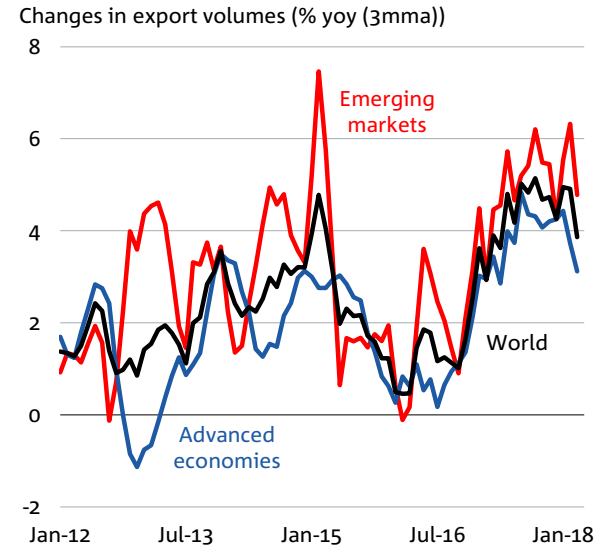
MIXED GROWTH TRENDS IN Q1



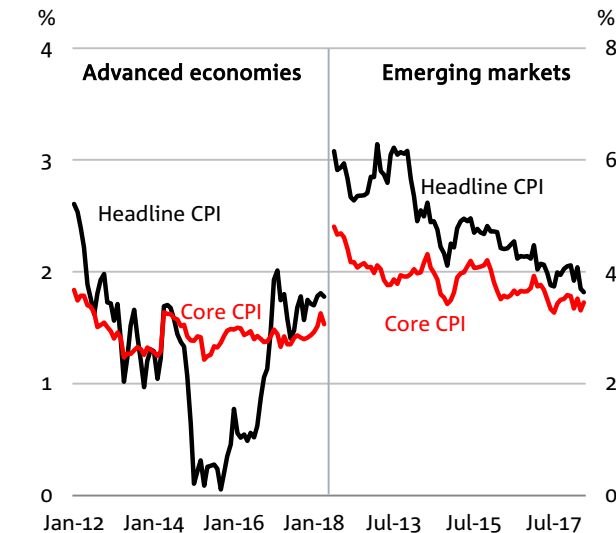
US DEFICIT DRIVES TRADE TENSIONS



TRADE VOLUME GROWTH SLOWED



INFLATION STILL LARGELY SUBDUED

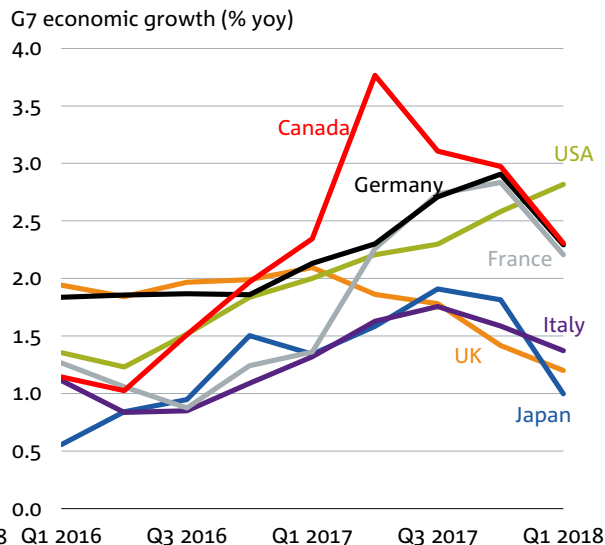
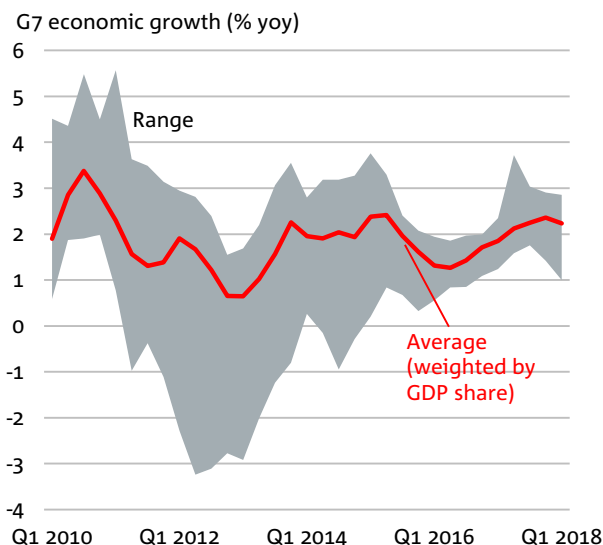


- Our estimate of global economic growth was marginally softer in the first quarter of 2018 – at around 3.9% yoy (compared with 4.0% in Q4 2017). Weaker growth in advanced economies had a larger impact than the modest improvement in emerging market growth.
- That said, global growth remains above its long term trend – having averaged around 3.5% since the start of the 1970s. This stronger performance reflects above potential growth in the major advanced economies, a trend that will eventually come under pressure as constraints begin to bite.
- Trends in international trade were less encouraging in March, with a marked slowdown in the growth of export volumes. On a three month moving average basis (due to the volatility of this data), the CPB measure of global trade volumes increased by 3.9% yoy (compared with recent trends near 5%). A major contributor to this trend was a slowdown in exports from emerging Asian economies.
- The global trade environment remains uncertain – particularly the relationship between the United States and China – with trade tensions ebbing and flowing since early March. Trade talks between the two countries during May appeared to have averted a trade war (with US Treasury Secretary Steven Mnuchin describing the trade war as “on hold”) in mid-May, before the White House announced at the end of May that it would impose its proposed tariffs on Chinese imports (with products to be identified on June 15).
- Similarly, the United States imposed its 25% tariff on steel imports and 10% tariff on aluminium on 1 June. As outlined in our [March issue](#), this measure will have a larger impact on Canada and the European Union, rather than China (which is not a major exporter of these goods to the US).
- Inflation is yet to significantly accelerate in advanced economies – despite tightening labour markets and less idle production capacity in most markets. Core inflation has remained near 1.5% (although it is around the 2% mark in the United States).

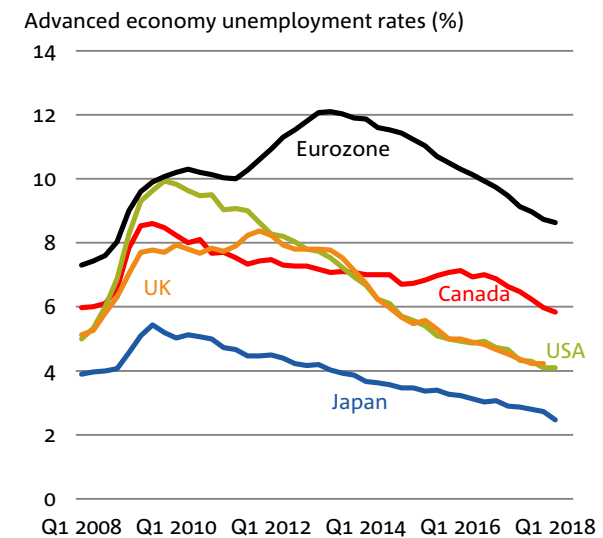
ADVANCED ECONOMIES

Synchronised growth breaking away in Q1, with only the US accelerating

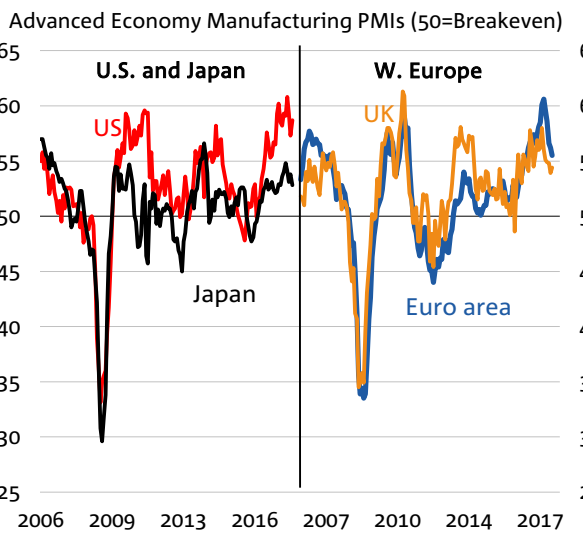
GROWTH TRENDS START TO DIVERGE, WITH UK, JAPAN & ITALY WEAKER



LABOUR MARKETS TIGHTENING



SURVEYS STRONG BUT OFF PEAKS



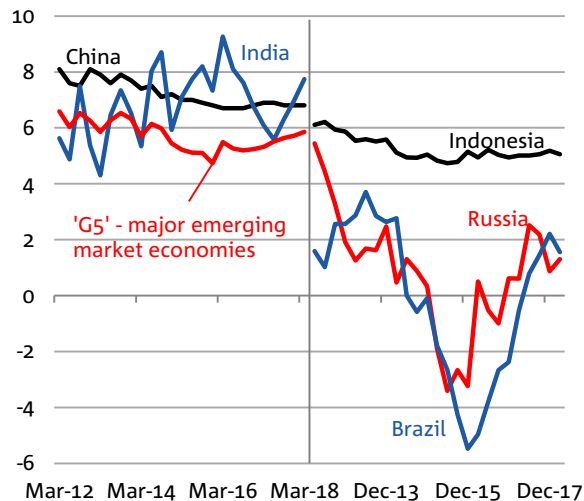
- Economic growth in the big advanced economies was slightly weaker in early 2018 – increasing by 2.2% yoy in Q1, compared with 2.4% in Q4 2017. Although this slowdown was modest, it points to a divergence in conditions across countries, which over recent years have displayed relatively synchronised growth.
- Growth in Japan, the United Kingdom and Italy has slowed in recent quarters (to between 1% yoy and 1.5% yoy in Q1). A range of short term factors have been identified as drivers – including adverse weather conditions and political uncertainty – making it unclear if the softer growth in this quarter was an outlier or if it marks the start of a slowing trend.
- Brexit negotiations between the UK and European Union remain challenging, with EU negotiators describing the UK position as “a fantasy”. BoE Governor Carney has warned of the risks of a disruptive Brexit, which could feature either higher inflation or weaker growth, depending on the Bank’s monetary policy response.
- In contrast, growth in the United States has accelerated to almost 3% yoy in Q1. Early indicators of growth point to strong conditions in the second quarter, highlighting some upside potential to advanced economy growth in the short term. That said, as the impact of the fiscal stimulus from the large package of tax cuts at the start of this year fade, we expect growth to slow back towards potential as capacity constraints start to bite and monetary policy tightens.
- Labour markets in advanced economies have broadly tightened since 2012, with estimates of the average rate of unemployment across major advanced economies at their lowest levels since the late 1970s. That said, rates remain comparatively high in economies such as Italy and France.
- Business surveys continue to point to robust conditions in advanced economies – with both manufacturing and services PMIs in solidly positive territory. That said, these measures are generally weaker than peaks at the start of the year. Similarly forward looking indicators in major business surveys have weakened in recent months – pointing to potentially weaker economic growth in coming months.

EMERGING MARKET ECONOMIES (EMES)

Growth still solid, but risks are starting to emerge and could spread

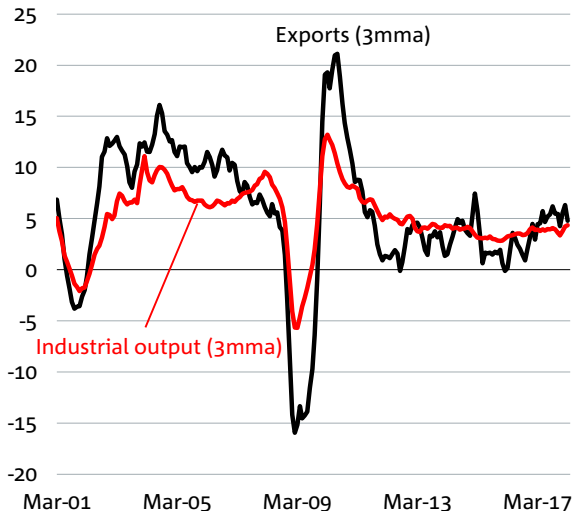
GROWTH EDGES UP IN EARLY 2018

Emerging market GDP growth (yoy%)



SOFTER GROWTH IN TRADE

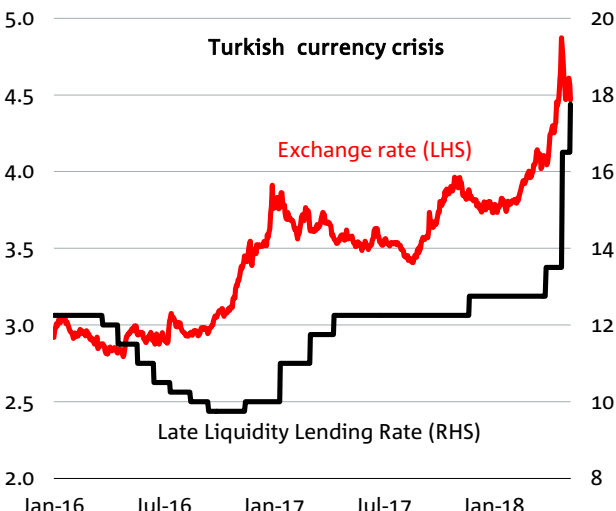
Emerging market exports and industrial output (% yoy)



- Economic growth in the big emerging market economies edged higher in Q1 2018 – to almost 6% yoy (from 5¾% in Q4 2017) – but the underlying trends were mixed. The improving trend was driven by the continued rebound of growth in India (the world’s third largest economy) – which grew by 7¾% yoy in Q1.
- In contrast, China and Indonesia (respectively the largest and seventh largest economies) saw growth remain relatively stable. The trends for Brazil and Russia were less encouraging – Brazil’s growth slowed to 1.6% yoy and although Russian growth picked up to 1.3% yoy (from 0.9% in Q4 2017) it remains well off the strong rates across the middle of 2017.
- Industrial production and export data provide more timely indicators of economic conditions. Although growth in industrial production has trended higher in recent months – increasing by 4.4% yoy (on a three month moving average basis) in March (compared with recent lows of 3.3% in December), this increase reflects base effects, with output plateauing since the start of the year.

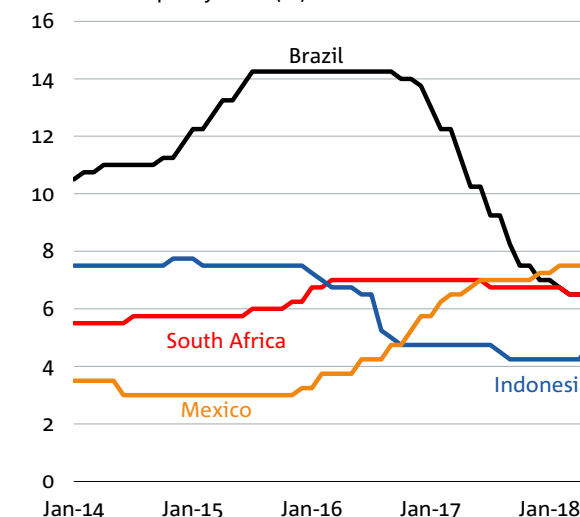
TURKEY’S CURRENCY UNDER STRAIN

Exchange rate (Lira to USD) Policy rate (%)



CENTRAL BANKS UNDER PRESSURE

Central bank policy rates (%)



- While emerging market export volumes have remained comparatively strong (relative to the post-GFC period), growth appears to have slowed in March. The risks associated with retaliatory trade actions in response to US trade policy fall more heavily on emerging markets (given the higher export share of GDP).
- Smaller capital dependent emerging markets are facing some significant challenges – with Turkey in the midst of an inflation and currency crisis (triggering a series of emergency rate rises and monetary policy reform from its central bank) ahead of an upcoming Presidential election. Between the start of the year and late May, the Turkish lira depreciated almost 30%, before stabilising more recently.
- Several central banks have responded to the pressure of capital outflows (driven by an increasing focus on risk in these economies along with higher rates in the United States) with Indonesia and Argentina (which has received an IMF bailout) lifting rates. Higher rates have the potential to derail the modest recoveries in economies such as Brazil and South Africa.

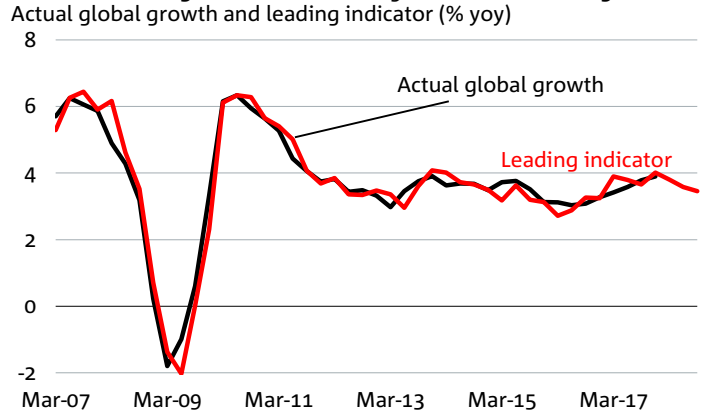
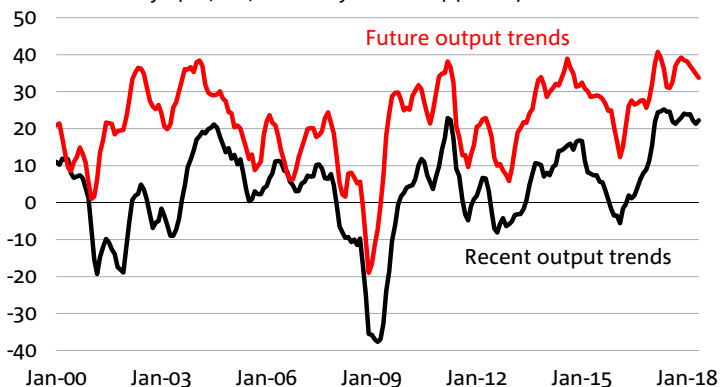
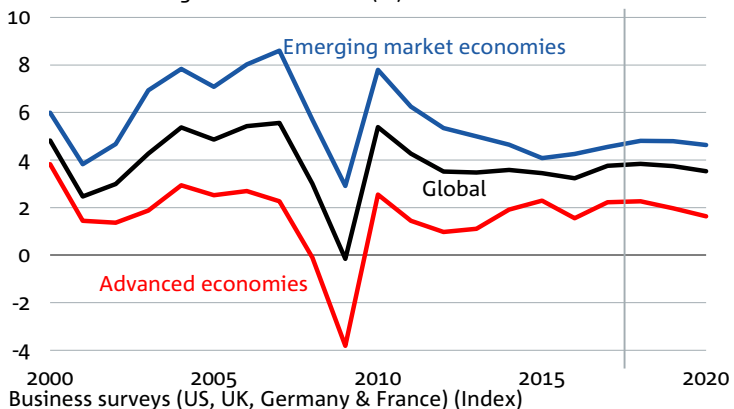
Sources: Datastream, Bloomberg, CEIC, NAB Economics

GLOBAL FORECASTS, POLICIES AND RISKS

Global growth rate may have peaked, but still above trend for now

GROWTH TO SLOW AWAY FROM PEAKS

Global economic growth & forecasts (%)



- It appears that the current global economic cycle has either peaked or is near this point – with a modest dip recorded in Q1 2018. Our leading indicator also suggests that growth is set to slow across the remainder of the year. However, while the cycle may have peaked, we expect global growth to remain above trend this year and the next (at around 3.75%), before moving back to its long term trend (3.5%) in 2020.
- This move back towards trend is likely to be most evident in the big advanced economies. Low rates of unemployment and diminishing idle capacity will begin to constrain growth and increase inflationary pressures, leading central banks to tighten their policy settings. Forward looking measures in advanced economy business surveys appear to be softening.
- The uncertain global environment presents a number of risks – particularly the negative impacts of escalating trade tensions and out-of-cycle fiscal stimulus in the United States. Various emerging market central banks are facing the challenge of capital outflows – highlighting one side of the risks associated with the removal of monetary stimulus and normalising policy rates. Inflated asset prices and high debt levels in advanced economies also contribute to the risk as interest rates begin to increase.

GLOBAL GROWTH FORECASTS (% change)

	2013	2014	2015	2016	2017	2018	2019	2020
US	1.7	2.6	2.9	1.5	2.3	2.7	2.3	1.7
Euro-zone	-0.2	1.3	2.1	1.8	2.6	2.1	2.0	1.8
Japan	2.0	0.4	1.4	0.9	1.7	0.9	1.0	0.7
UK	2.1	3.1	2.3	1.9	1.8	1.5	1.7	1.5
Canada	2.5	2.9	1.0	1.4	3.0	2.0	1.8	1.5
China	7.8	7.3	6.9	6.7	6.9	6.5	6.3	6.0
India	6.4	7.4	8.2	7.1	6.7	6.8	7.2	6.9
Latin America	2.9	1.3	0.3	-0.6	1.3	2.6	2.8	2.7
Other East Asia	4.2	4.1	3.6	3.8	4.4	4.2	3.9	3.7
NZ	2.2	3.6	3.5	4.0	2.9	2.9	3.0	2.4
Total	3.5	3.6	3.5	3.2	3.8	3.8	3.7	3.5

Sources: Datastream, Bloomberg, NAB Economics

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