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National Australia Bank

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

Global growth slowed noticeably in 2018 Q3 following four quarters of fairly stable growth. Emerging markets were the main driver of this slowdown, led by India and East Asia (excluding China). Growth in the advanced economies is expected to converge somewhat in Q4, reflecting moderating growth in the US and an improvement in Japan and the Euro-zone. Short term prospects are less encouraging in emerging markets, given trade and industrial trends, particularly in countries such as Indonesia and Brazil. Recent financial market turbulence has also added to doubts around the global monetary policy outlook. Our forecasts for global economic growth are unchanged – increasing by 3.7% in 2018 before slowing to 3.6% in 2019 and 3.5% in 2020 (the long term trend rate of growth), but risks are on the downside. This slowdown should largely occur in the advanced economies, as US fiscal stimulus fades, monetary policy continues to tighten and supply side constraints become more binding.

- Global **financial markets** are firmly in 'risk-off' mode reflecting concerns over the growth outlook for the major economies, as well as ongoing uncertainty about the direction of the US-China trade dispute, Brexit and the Italian-European Commission budget dispute. The decision by the US to defer a scheduled increase in tariffs on Chinese imports by 90 days lifted markets only temporarily as doubts quickly resurfaced about the future of the relationship. Since the large falls in October, advanced economy equity markets have basically tracked sideways, albeit with a high degree of volatility. However, emerging market stock markets have climbed off their lows, and there has also been some appreciation in EM currency indices, providing a welcome sign of stabilisation.
- **Commodity prices** also declined through October and November, primarily due to falling oil prices following an easing of supply concerns. However, overall commodity prices have stabilised in recent weeks, near their lows for the year.
- Partly due to the turbulence in markets, as well as the global growth slowdown, doubts have arisen about the monetary policy outlook for the major **central banks**, leading to a marked reduction in long-term government bond yields. The overall outlook is still for policy tightening, but market expectations are now for this to occur to a much smaller degree. This is particularly true for the US where Fed speakers are indicating that in the future they are likely to be more sensitive to the ups and downs of the data. The prospect of a Fed pause has increased, although markets still expect the Fed to hike rates in December but not much beyond that. We still expect further hikes in 2019 as unemployment drifts lower and inflation gradually rises, although there is downside risk to our current projection of three rate increases in that year.
- The divergence between major **advanced economy** growth rates that developed through the first three quarters of 2018 is likely to narrow in Q4. US GDP growth, after a couple of very strong quarters, is set to moderate while we expect growth in the Euro-zone and Japan will rebound from its Q3 weakness, as some of the temporary factors weighing on growth unwind. That said, doubts persist about how much of the Euro-zone weakness is temporary as business surveys are pointing to an underlying slowdown. Overall, we expect the easing in advanced economy growth that occurred this year to continue into 2019. The impetus from US fiscal stimulus will fade, monetary policy is likely to tighten further, and with unemployment at low levels (particularly in the US and Japan), capacity constraints will also limit growth.
- Economic growth in **emerging markets** slowed considerably in Q3, with a broadly negative trend across most economies. Key emerging markets such as China and India both slowed – the former driven by tighter financial conditions, while growth in the latter fell to 7.1% yoy (from 8.2% yoy in Q2). While a slowdown in Indian growth was expected, as Q2 growth was inflated by base effects, the latest growth data was softer than expected. While industrial production has remained relatively stable in China and India, it has slowed notably in economies such as Indonesia and Brazil.
- **Global economic growth** slowed in the third quarter – down to 3.6% yoy – having remained fairly stable at around the 3.9% mark over the previous four quarters. The deceleration in emerging markets was the key driver – accounting for around three-quarters of the trend. Our forecasts for global economic growth are unchanged – increasing by 3.7% in 2018 before slowing to 3.6% in 2019 and 3.5% in 2020 (the long term trend rate of growth). This slowdown is largely expected in the advanced economies, as US fiscal stimulus fades, monetary policy continues to tighten and supply side constraints become more binding. That said, the weakness in growth in Q3 – while in line with our forecast for 2019 – highlights some downside risk to this outlook. International trade remains a key uncertainty.

For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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***Australia**: We have delayed the expected timing of our first expected hike by the RBA to H2 2020. For some time we have noted our expectation of the first rise occurring in mid-2019 was highly data dependent. Growth has generally been as expected, though wages growth and the build-up in inflationary pressure has not. The RBA also appears very patient and will wait for hard evidence of inflation returning to the target band on a sustainable basis. In addition, we have lowered our forecast for house prices; though still see the correction occurring in an orderly fashion. With further falls in house prices now factored in, we have incorporated a larger fall in dwelling investment and some additional spill-overs into weaker consumption. Consequently our GDP and inflation forecasts have been lowered a little – we see GDP growth of 2.9% in 2018 before slowing to 2.4% in 2019 and 2.3% in 2020. It is important to note however, that we still see a robust rate of economic growth, with activity supported by strong growth in government spending, exports and growth in non-mining business investment. Our monthly business survey confirms that business conditions remain well above average, despite having eased through 2018. Further, mapping survey responses to employment growth suggests ongoing growth of over 20k per month, which would still be enough to see the unemployment rate decline further (we expect unemployment to decline to 4.7% or so over the next year). As a result, we expect wage growth to lift gradually and for inflationary pressure to continue to build.*

- **National Accounts** data for Q3 confirmed that growth slowed in quarterly terms, though this likely includes some payback from stronger than expected outcomes in H1 2018. Over the year, GDP rose by 2.8% - still a relatively healthy rate. Government spending and net exports supported growth, while consumption growth was weak. Dwelling investment continued to grow, though this was a result of a sharp increase in alterations & additions, with new construction falling in Q3. Mining investment continued to fall in Q3 while non-mining business investment rose by less than expected. Going forward we expect the government sector and exports to continue to support growth (until the last of the large LNG projects reaches full production capacity). We expect business investment to also support growth, with spill-overs from the large public sector infrastructure pipeline flowing over to the private sector. We also expect the effect of the unwinding mining investment boom to wane, and see some upside from new projects as well as a higher level of sustaining capex. Indeed, the NAB Monthly Business Survey confirms mining now sees the highest confidence and conditions.
- The cooling in the **housing market** is evident across a range of indicators. Dwelling prices in Sydney and Melbourne continue to lead the declines, falling by a further 1.4 and 1.0% respectively in November. Peak-to-trough Sydney has now declined by 9.5% and Melbourne 5.8%. Hobart continues to grow relatively strongly, while Adelaide and Brisbane have recorded flatter outcomes over the year. We now forecast a larger peak-to-trough decline in prices of 15% for Melbourne and Sydney. We see the orderly correction continuing, and that even after these declines, prices will remain well up on 4 years ago. The cooling in the housing market is becoming more evident in other indicators with building approvals having trended down recently and credit growth slowing. It is likely that we will see a fall in dwelling investment but this is from a high level. Still strong population growth, low interest rates and low unemployment will provide some support.
- **Labour market** conditions remain strong. Ongoing above average employment growth has seen the unemployment rate step down from around 5.5% to 5.0%. Forward looking indicators of labour demand point to ongoing growth in employment. The NAB Monthly Business survey continues to point to employment growth of 20k+ per month, which would be enough to see the unemployment rate decline further, albeit at a slower rate than in recent months. Indeed, we forecast unemployment to decline further, reaching around 4.6% by end 2019, before edging slightly higher as growth slows. Wage growth should pick up slightly from its current low levels rising gradually towards 2.5% in 2019.
- The **trade surplus** narrowed in October, with a rebound in imports offsetting some of the ongoing growth in exports. The rebound in imports comes after a slowing in Q3 (which saw a boost to net exports), and was driven by an increase in capital goods imports. On the exports from, growth continues to be supported by a rise in non-rural exports (coal and LNG in the month). Going forward we expect LNG to provide further support as the last of the major LNG projects reaches capacity before levelling off for a period.
- Prices for **iron ore** moved back into the $60-70 range in November after a sharp correction on closure of steel mills in china ahead of the winter shutdown. **Coal prices** have generally held at high levels. **Oil prices** have continued to ease in the month. The NAB Rural Commodities Index fell 2.0% in November, reversing a 2.0% gain in October. Grains were generally lower (albeit from a very high peak), as were wool and lamb. Dairy export prices also trended lower (down 5.5%).
- The AUD/USD looks to end the year around 7.5% lower, but has largely range traded between 72-74c over recent months. Uncertainty over US-China trade relations and other EM stresses have driven much of this volatility. Our **USD/AUD** model continues to suggest a fundamental value estimate around US74c though we expect the pair to trade nearer to the US71c mark in the near term, before driving up over 2019.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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