EMBARGOED UNTIL: 11.30AM THURSDAY 13 DECEMBER 2018

THE FORWARD VIEW – GLOBAL

DECEMBER 2018

National Australia Bank

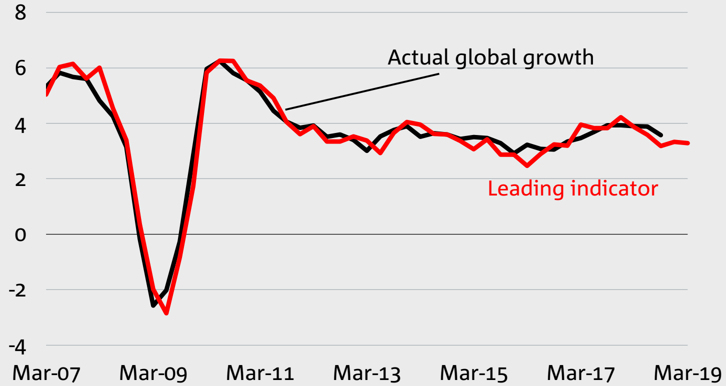
Summary – Slowing growth paired with greater uncertainty going forward

- Global growth slowed noticeably in Q3 – down to 3.6% yoy – following four quarters of fairly stable growth. Emerging markets were the main driver of this slowdown, led by India and East Asia (excluding China).
- Turbulence in financial markets has increased in recent times, reflecting concerns around the outlook for major economies, as well as risks related to the US-China trade dispute, Brexit and the Italian-European Commission budget dispute. Equity and commodity markets have exhibited considerable volatility and this, together with the slowdown in global growth, has contributed to doubts around the global monetary policy outlook.
- 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.
- 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 should largely occur 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.

Global Growth Forecasts (% change)

	2017	2018	2019	2020
US	2.2	2.9	2.3	1.6
Euro-zone	2.5	1.9	1.7	1.6
Japan	1.7	0.8	1.2	0.9
UK	1.7	1.3	1.6	1.5
Canada	3.0	2.1	2.0	1.6
China	6.9	6.6	6.3	6.0
India	6.7	7.4	7.1	7.2
Latin America	1.3	1.2	1.8	2.4
Other East Asia	4.4	4.2	3.8	3.7
Australia	2.4	2.9	2.4	2.3
NZ	2.8	2.8	2.8	2.6
Global	**3.7**	**3.7**	**3.6**	**3.5**

Actual global growth and leading indicator (% yoy)



CONTENTS

CONTACT

Alan Oster, Group Chief Economist
+61 3 8634 2927

Gerard Burg, Senior Economist – International, +61 (0)477 723 768

Tony Kelly, Senior Economist
+61 (3)9208 5049

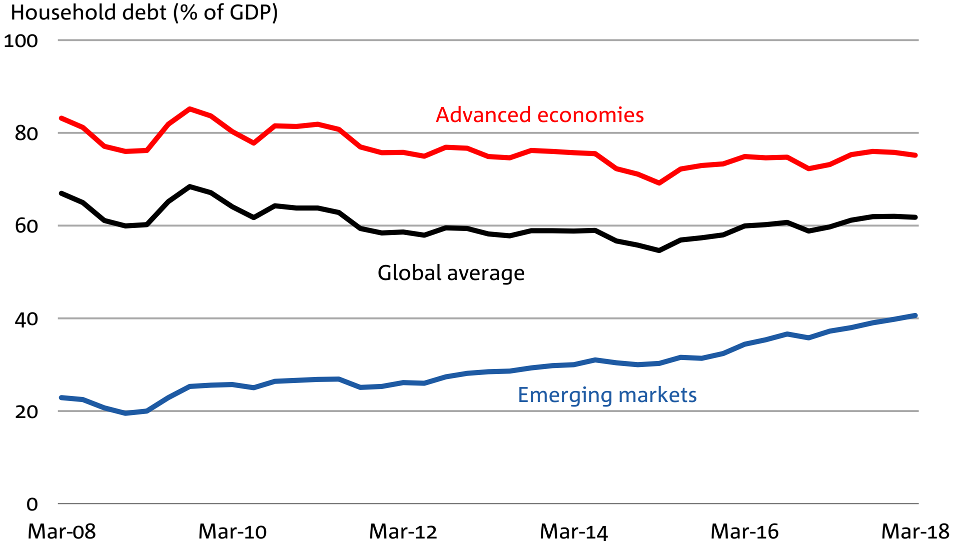
AUTHORS

Tony Kelly & Gerard Burg

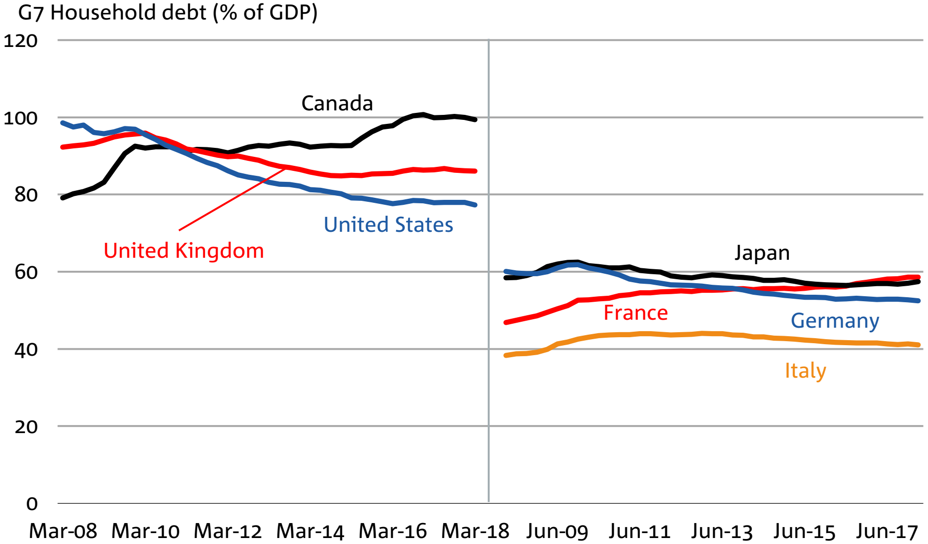
HOUSEHOLD DEBT

Globally balance sheet repair appears over with debt trending higher

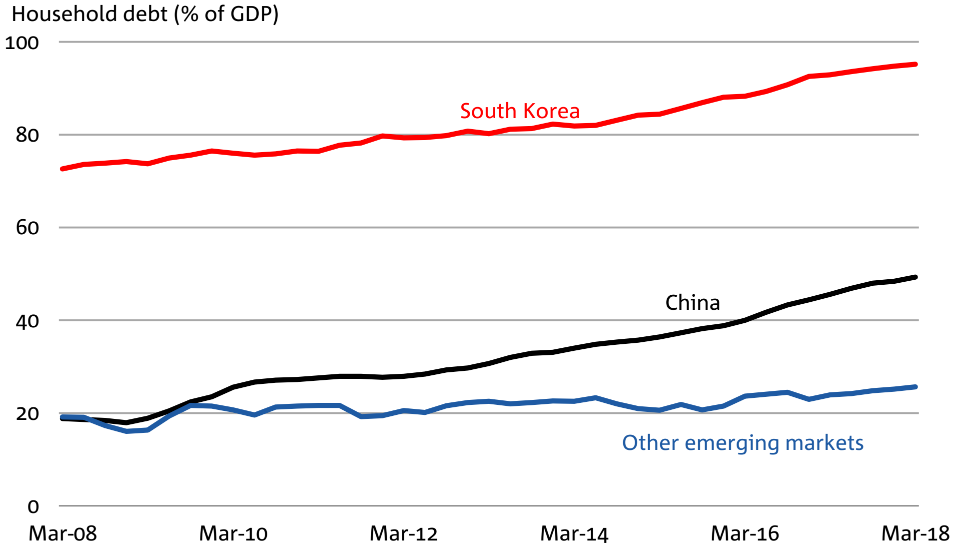
AE debt trending modestly higher since early 2015 (up 5% of GDP), while EM debt has climbed



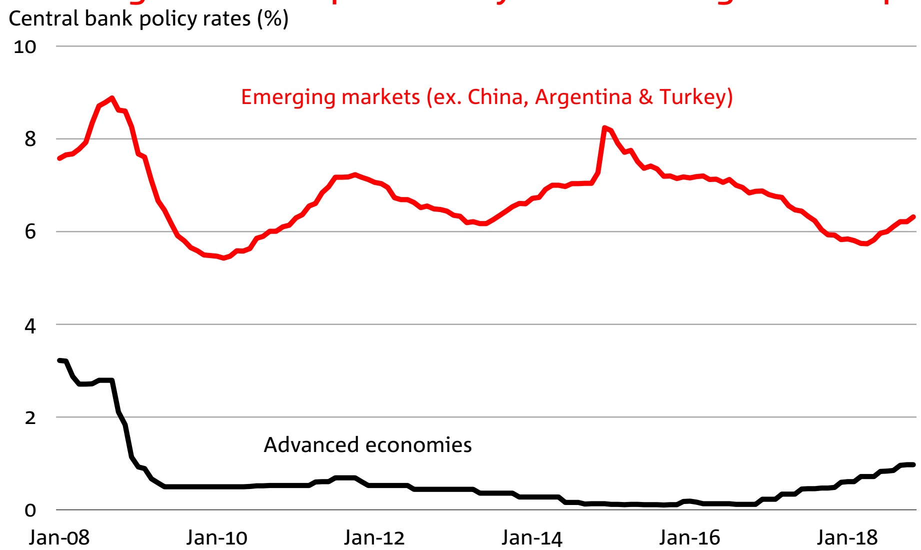
Trends mixed among big AEs, with US & UK debt below pre-GFC levels, Canada much higher



Little growth in EM household debt outside China & South Korea (may reflect limited access to finance)



Interest rates are starting to rise, increasing debt servicing costs and potentially constraining consumption



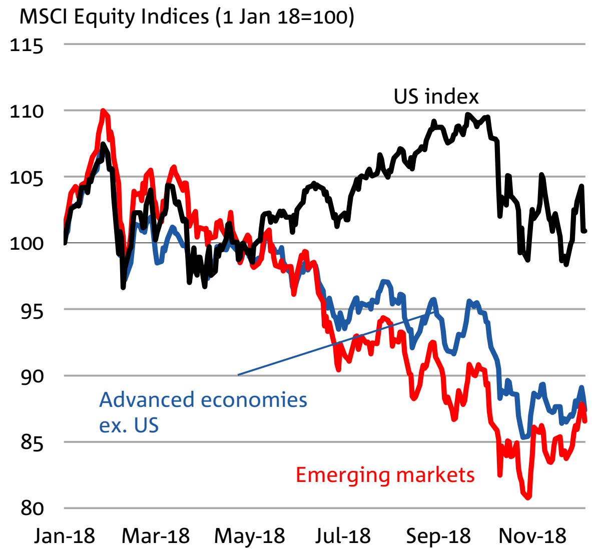
Sources: Bank for International Settlements, NAB Economics

National Australia Bank

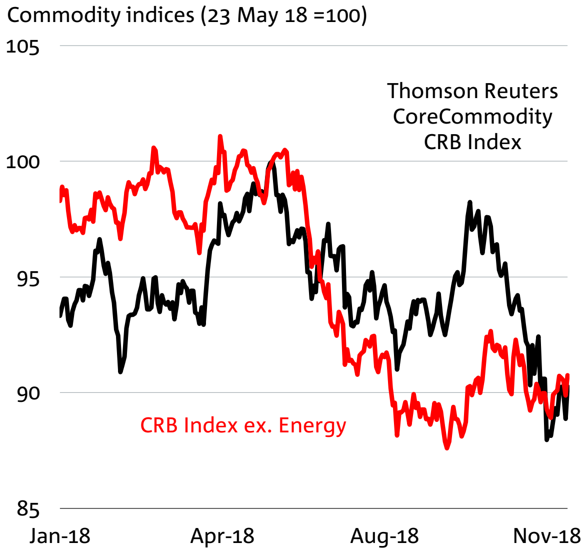
FINANCIAL AND COMMODITY MARKETS

Financial markets in risk-off mode – central bank rate expectations down

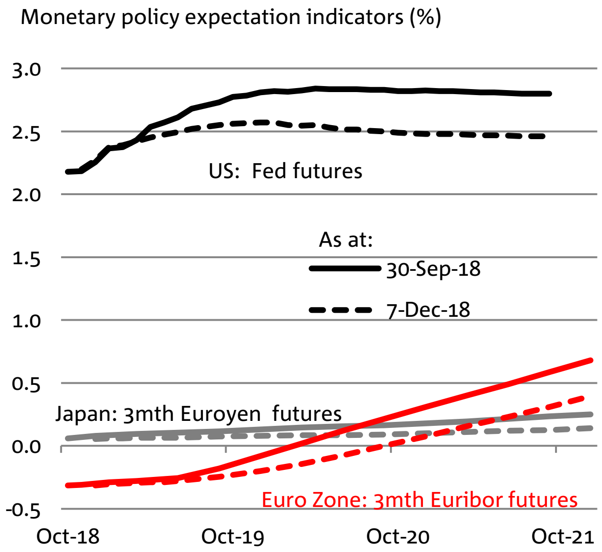
SHARP FALLS IN EQUITIES

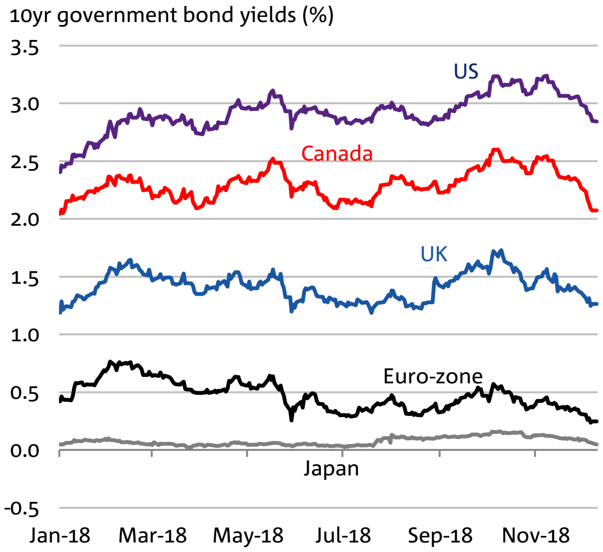


OIL LEADS COMMODITIES LOWER



CONCERNS OVER OUTLOOK SEES RATE EXPECTATIONS & YIELDS FALL





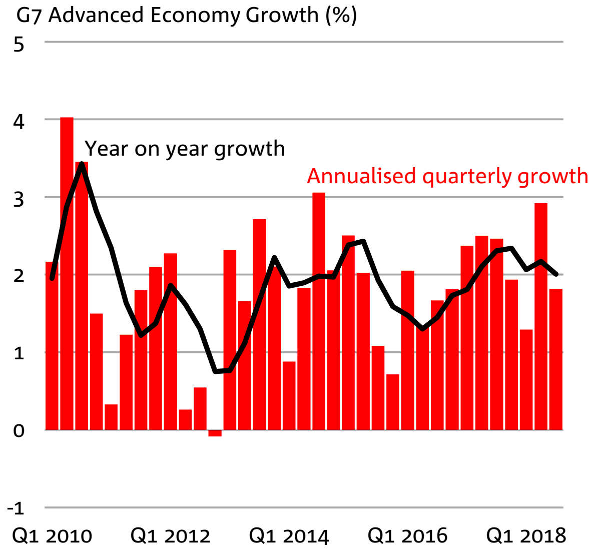
- Global financial markets remain firmly in 'risk-off' mode reflecting a variety of factors including concerns over the growth outlook for the major economies, as well as ongoing uncertainty about the direction of the US-China trade dispute, Brexit and the Italian-European Commission budget dispute. The decision by the US to defer a scheduled increase (on 1 January) in tariffs on Chinese imports by 90 days – pending talks between the two parties – lifted markets only temporary 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 after a difficult six months.
- 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 a tightening of policy settings, but market expectations are now for this to occur to a much smaller degree.
- This is particularly true for the US where the fed funds rate is now just below the range of Fed views of its neutral level. Fed speakers are indicating that, given the uncertainty about what the neutral rate is, they are likely to be more sensitive to the ups and downs of the data flows. Recent soft inflation readings and the turbulence in financial markets have raised the prospect of a Fed pause, although markets still expect the Fed to hike rates in December – as do we – but not much beyond that. We still expect further rate rises in 2019 based on our forecast for further falls in unemployment and a gradual lift in inflation, but the risk has shifted to fewer hikes.
- Expectations over Japanese and Euro-zone rates have also moved lower, as growth has slowed and with inflation still muted. However, as neither the Bank of Japan or the ECB were likely to make any major change to their policy settings in the near term, how these economies evolve over the next 12 months remains key.

 Sources: Datastream, NAB Economics

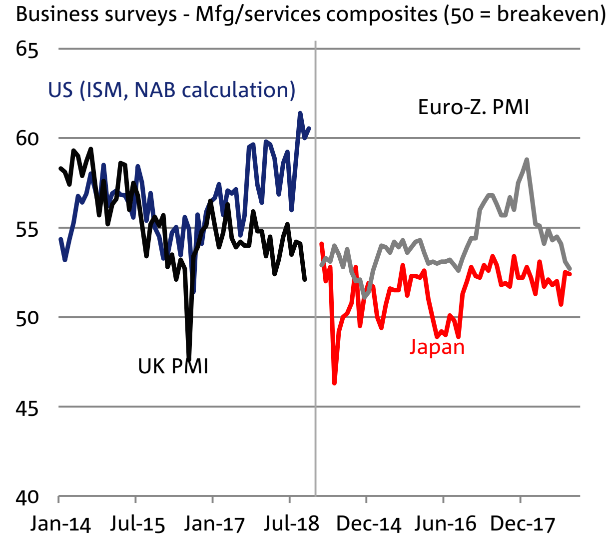
ADVANCED ECONOMIES

Divergence between major AEs to narrow in Q4; but overall growth is slowing

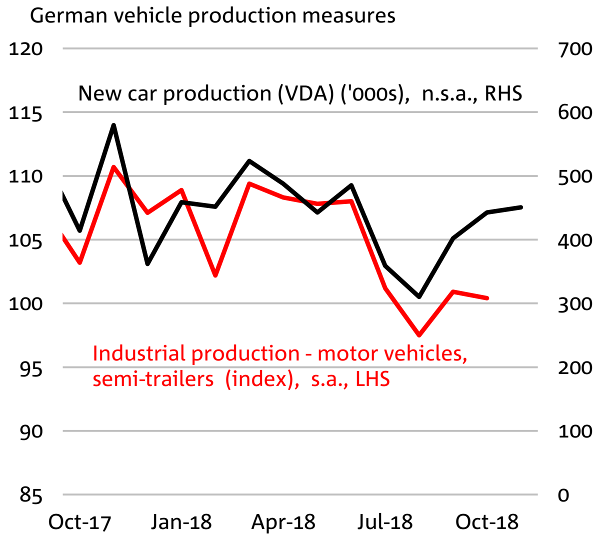
MAJOR AE GROWTH SLOWING



US STILL STRONG, EURO/UK CONCERNS

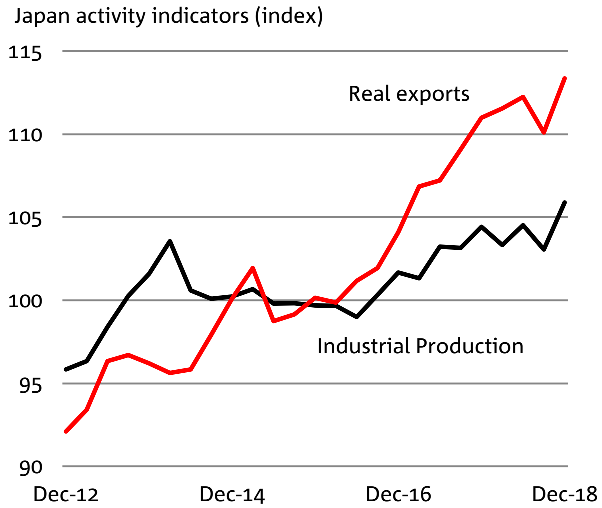


GERMAN WEAKNESS – TEMPORARY?



Sources: Datastream, NAB Economics

JAPAN – REBOUND FROM Q3 UNDERWAY



Q4 2018 based on October data

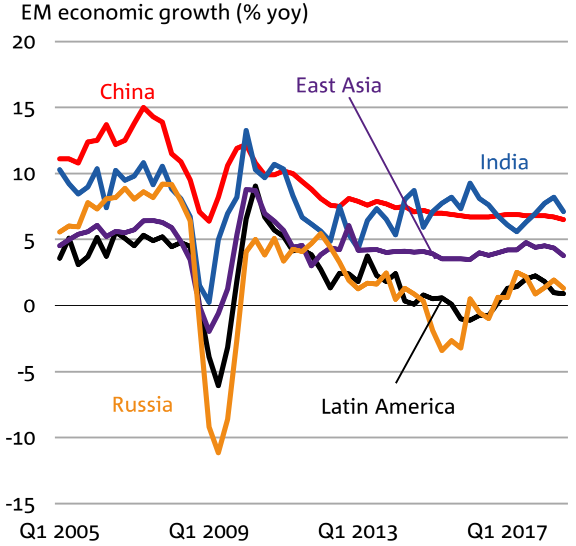
- The divergence between major advanced economy growth rates that developed through the first three quarters of 2018 is likely to narrow in Q4. US GDP growth, after a couple of very strong quarters, is set to moderate. At the same time, we expect growth in the Euro-zone and Japan will rebound from its 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.
- We have been expecting US GDP growth to slow to around 2¼% (annualised) in Q4 after running at almost 4% in the previous two quarters. Partial data for Q4 is consistent with this outlook. We expect growth to further ease through 2019 due to the impact of monetary policy tightening and as the tailwind from this year's fiscal stimulus fades. That said, business surveys continue to point to an economy in good shape, and growth is likely to remain above its 'potential' for a while, putting further pressure on an already low unemployment rate.
- Euro-zone GDP grew by only 0.2% qoq in Q3, its weakest annual growth rate since late 2014. German production has been affected by delays caused by a new vehicle emissions standards regime; German IP declined in October, so while a rebound is still expected, it may take longer than previously thought. However, business surveys suggest an underlying softening in growth is under way. This may reflect worsening conditions in Italy, the result of a budget dispute with the EC, as well as global trade and Brexit uncertainty. This points to a further slowdown in growth in 2019, although activity should be supported by still loose monetary policy and a modest fiscal policy tailwind. The recent falls in oil prices will also provide some short-term relief.
- While there are no clear signs yet of a noticeable rebound in Euro-zone growth in Q4, the near term outlook is more positive for Japan, where typhoons and a major earthquake contributed to a large decline in GDP in Q3. However, October data for trade and industrial production signal a rebound is underway in Q4.
- Overall, we expect the easing in advanced economy growth that occurred this year to continue into next year. 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.

National Australia Bank

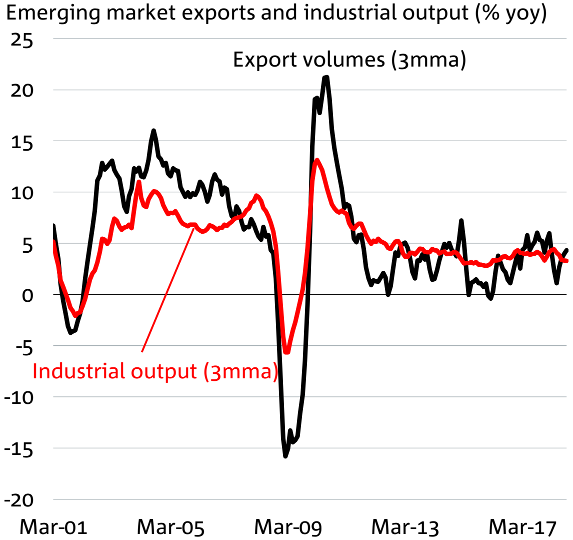
EMERGING MARKET ECONOMIES

Broad slowing in EM growth in Q3; trade tensions and capital flows a concern

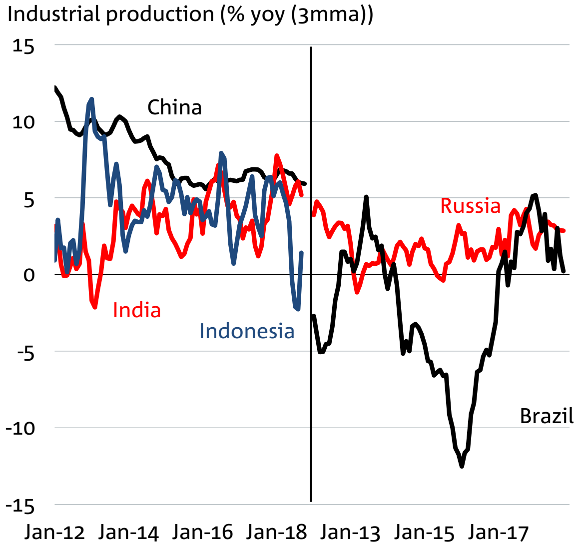
BROAD BASED SLOWING IN Q3



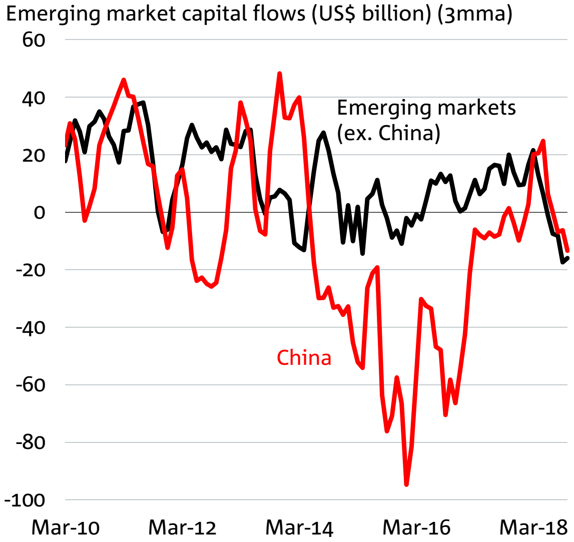
TENSIONS YET TO SLOW TRADE



IP SLOWING IN INDONESIA & BRAZIL



CAPITAL FLOWING OUT OF EMS



- Economic growth in emerging markets slowed considerably in Q3, with a broadly negative trend across most economies. Our aggregate measure saw growth dip just below 4.7% yoy in the quarter, compared with 5.1% yoy in Q2.
- 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, given that Q2 growth was inflated due GST related weakness in Q2 2017, the latest growth data was softer than expected. There was also a notable slowing in East Asian markets – which may partially reflect the impact of the US-China trade dispute on this highly trade dependent region.
- Trade tensions between the US and China have eased a little, following the meeting between Presidents Trump and Xi, with a 90 day “ceasefire”, delaying the proposed increase in tariffs on 1 January to allow for further talks. That said, given the complexity and wide scope of the dispute, we doubt that they can be resolved in this window, and therefore the risk of escalation remains.
- Despite the trade tensions, export volumes strengthened up to September (the latest data available) – increasing by 4.4% yoy (3mma), compared with 4.0% in August. That said, it is worth noting that the second round of US tariffs commenced on 24 September, meaning that the impact of this measure is unlikely to be evident.
- In contrast, industrial production in emerging markets has generally slowed – increasing by around 3.3% yoy (3mma) in September, compared with a trend near 4.0% between mid-2016 and mid-2018. While output growth has remained relatively stable in larger markets such as China and India, it has slowed notably in economies such as Indonesia and Brazil. The emerging market manufacturing PMI has trended lower since its recent cyclical peak in December 2017.
- Capital flows present a risk to emerging market growth prospects – with outflows threatening financial stability in a range of countries. On a three month moving average basis, around US$29 billion flowed out of emerging markets in October.
- Despite these outflows, emerging market equities have improved a little in recent times – up just over 7% from levels in late October. That said, equities remain over 20% below the peak levels recorded in late January. Similarly, the MSCI emerging market currency index has strengthened by 2.3% since September 2018.

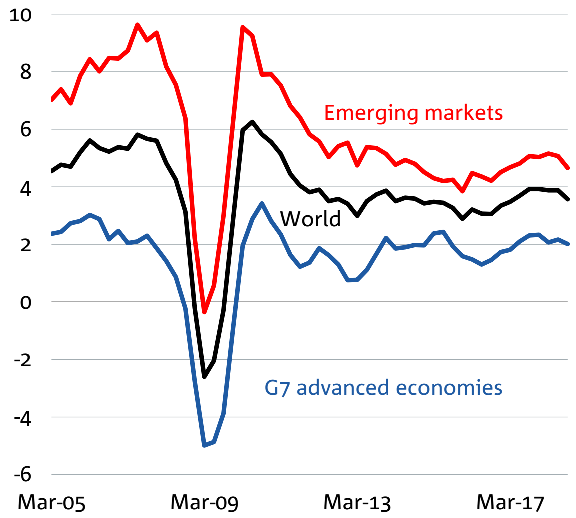
Sources: Datastream, CPB, IIF, NAB Economics

GLOBAL FORECASTS, POLICIES AND RISKS

Global growth weaker in Q3, growth set to slow in coming years

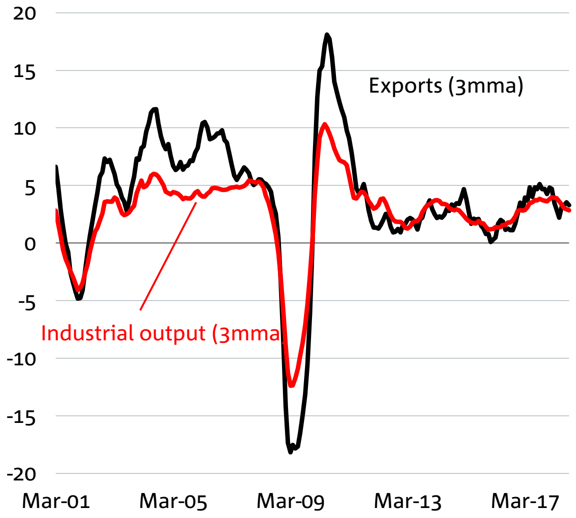
WEAKER GROWTH IN Q3

Economic growth (% yoy)



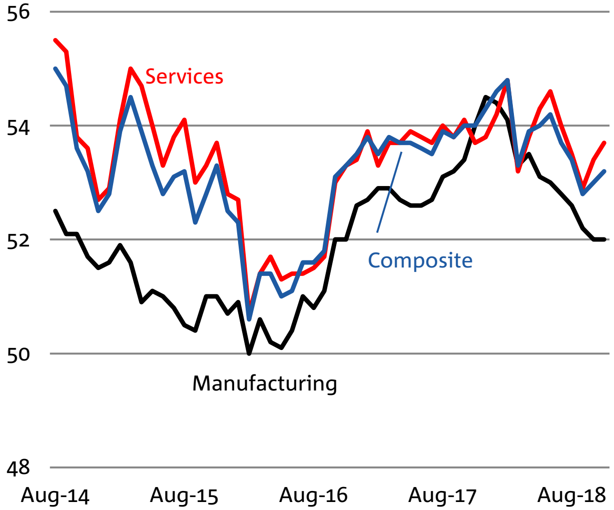
SOFTER TRADE & OUTPUT TRENDS

Global exports and industrial output (% yoy)



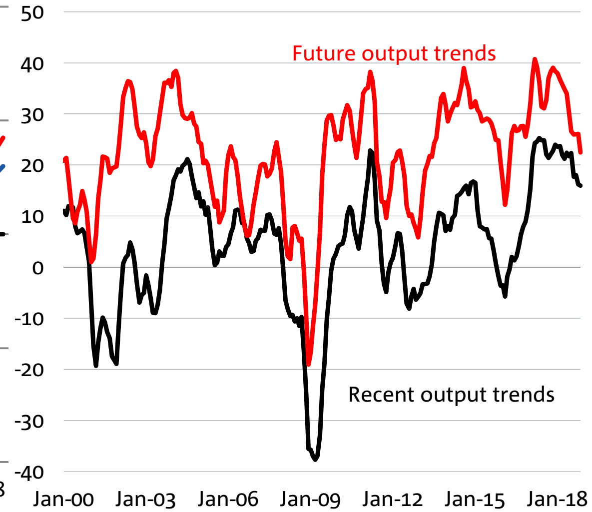
MFG TRENDS WEAKER SINCE LATE '17

JP Morgan World PMI



BUSINESS EXPECTATIONS OFF PEAKS

Business surveys (US, UK, Germany & France) (Index, 3mma)



- 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. In a sense the scale of the slowdown is overstated – given the exaggerated strength of Indian growth in Q2 due to base effects.
- 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. While the 90 day "ceasefire" between the US and China represents an easing in tensions between the two countries, it is far from any resolution. There remains a considerable risk of a further worsening in coming months, particularly given China's record trade surplus with the US in the twelve months to November.
- Overall, growth in global trade appears to be slowing – with the CPB measure expanding by just 3.3% yoy (3mma) in September – a little stronger than the weakness evident mid year, but well below the rates recorded between Q1 2017 and Q1 2018. Much of this trend has been in advanced economies – where there has been a slowing trend evident since the early months of 2018.
- Growth in industrial production has also trended lower – in line with weaker conditions reported in global PMI surveys. Business surveys in major advanced economies remain comparatively strong, but have fallen from peak levels from late 2017 and early 2018. These trends are also echoed in our leading indicator (see front page) – which points to weaker but stabilising global economic growth in coming quarters.
- There are also other sources of uncertainty. There remains the prospect of strengthening in both Japan and the Euro-zone in the short term, providing some upside risk. Similarly, supply-led declines in oil prices (if sustained) are a positive for the global economy. In contrast, financial market volatility and uncertainty around monetary policy could impact business confidence and investment decisions across a range of countries.

 Sources: Datastream, CPB, Markit, NAB Economics

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

John Sharma
Economist
+(61 3) 8634 4514

Australian Economics and Commodities

Gareth Spence
Senior Economist – Australia
+(61 4) 36 606 175

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics

Tony Kelly
Senior Economist
+(61 3) 9208 5049

Gerard Burg
Senior Economist – International
+(61 3) 8634 2788

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

National Australia Bank