March 2019

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

Economic trends globally have generally softened – growth in major advanced and emerging market economies slowed in Q4, and more timely indicators point to further slowing early in 2019. The slowdown in growth goes beyond trade issues, with weak domestic demand in a range of countries. This broad based deterioration suggests that the any economic benefits derived from a cooling in US-China trade tensions should not be overstated. Financial markets have continued to recover, partly on the back of more dovish monetary policy expectations. Given the recent negative trends, we have revised our growth forecasts lower for 2019 to a sub-trend 3.4%. Our leading indicator implies further weakness through to the middle of 2019, and suggests the risk to our forecasts is on the downside. That said we expect growth to stabilise into 2020 - in part due to the dovish turn in policy settings.

- The recovery in **financial markets** that started in January continued into February. This was reflected in rising stock market indices as well as a narrowing in risk spreads and a decline in volatility measures. By early March, the US S&P 500 had recovered around three-quarters of the 20% fall seen from its September 2018 peak to December trough. The VIX measure of equity volatility has also declined substantially and is at a moderate level. There has also been a recovery in other advanced economy stock markets and Emerging Market (EM) equities. Similarly, US corporate bond yield spreads have narrowed, as have credit default spreads for investment grade corporates across North America, Asia and Europe as well as emerging markets.
- However, long-term bond yields remain noticeably lower across a wide range of countries, consistent with lower growth expectations and changed expectations for **major central bank monetary policy**. Markets are pricing in little or no chance of a rate hike by the major central banks this year, outside of the Bank of England (BoE). The tightening cycle for EM economies also appears to be over. The Fed is indicating that it will be patient and we don't expect any rate hikes this year. The ECB also shifted its stance, providing a new funding package for banks and delaying the time when rate hikes might be considered (now early2020). The Bank of Japan is in a difficult situation as it is not sure policy loosening would make things better given the possible impact of lower rates on the health of financial institutions. While forecast growth for the UK looks modest at best, the BoE expects inflation to eventually move slightly above target, requiring 'gradual' and 'limited' tightening. However, any action before a Brexit deal passes parliament is unlikely.
- **Major advanced economy** (AE) economic growth slowed to 1.9% yoy in Q4 2018, the weakest performance since early 2017. Excluding the US, major AE growth was only 0.9% yoy, the slowest it has been since mid-2013. We expect US and other AE growth to converge over 2019, with overall growth not reaching its trough until the end of the year. US growth is expected to slow from last year's rapid pace due to a fading fiscal policy boost and the effect of past monetary policy tightening. For the other major AEs we expect overall growth to remain weak in Q1 2019 before improving around the middle of the year, but then to weaken again (temporarily) at year end due to an increase in Japan's VAT. The underlying stabilisation of AE (ex US) growth that this outlook represents is based on some temporary headwinds that have weighed on growth fading, policy to be more stimulatory in the Euro-zone (including fiscal stimulus) and an improvement in trade sentiment. The latter assumes that the US-China will make a deal of some sort in the near term
- As **Emerging market economies** are generally more trade exposed than advanced economies, the current weakness in global trade is a more significant concern. EM trade volumes slowed considerably in the latter part of 2018, particularly in East Asia. Growth in India, the world's third largest economy, slowed in Q4 to 6.6% yoy, although business surveys have been improving, suggesting that growth will hold up reasonably well. China's National People's Congress confirmed an expected lower growth target for the country in 2019 – of 6%-6.5% – in line with our slowing forecast for the country. While trade has been a major focus, domestic trends – most notably weaker credit growth due to deleveraging – have had a bigger impact on growth.
- **Globally**, business manufacturing survey measures have continued to deteriorate through to February. However, the easing (from their early 2018 peak) in the global services PMI has been less significant and services typically account for a larger share of economies. While some form of trade agreement between the US and China is looking increasingly likely, it is unlikely to completely resolve all the issues, and the slowdown in global growth is not just a trade story. We have revised our growth forecasts lower for 2019 to a sub-trend 3.4%, although we still expect growth to stabilise in 2020 reflecting more stimulatory policy settings. However, our leading indicator of global growth implies further weakness through to the middle of 2019, and suggests the risk to our forecasts is on the downside.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

Authors: Alan Oster (Chief Economist) Tony Kelly (Senior Economist) and Gareth Spence (Senior Economist)

***Australia**: The Q4 National accounts have confirmed that economic growth slowed significantly in H2 2018. The figures showed substantial weakness in the private sector, led by a fall in dwelling investment and only modest growth in consumption. In addition, business investment saw a lift in the non-mining sector, though this was partially offset by ongoing declines in the mining sector. Supporting growth was strong spending in the public sector. While we have updated our forecasts, integrating the Q4 national accounts, we have not significantly changed our view on economic growth over the next two years. We expect GDP to grow by 2.5% over the year to December 2019 before slowing to 2.2% in December 2020. While the labour market has so far remained resilient to the slowing in growth over H2 2018, it likely lags economic activity, and with an outlook for slower growth, we expect little improvement on unemployment from here, in fact we now forecast for the unemployment rate to drift up slightly over the next two years. With inflation currently low, and financial stability risks having abated, we think a forward looking central bank will cut the cash rate from here, to bolster the economy and see better outcomes in the labour market and potentially see inflation return to the centre of the target band sooner. While the timing of a renewed easing cycle is data dependent – any near term cut would be driven by deterioration in the labour market – we think the bank will move to ease rates in July and again in November.*

- We now expect t**wo cuts of 25 bps to the cash rate in July and November**. There is some risk this could occur sooner, should the labour market materially deteriorate in coming months. Absent an immediate deterioration in the labour market, we think the Bank will act to provide further support to the economy with the growth outlook weaker than 6 months ago, inflation at a low starting point and financial stability risks having abated. In the end, we think the decision will be driven by less progress in the labour market than previously expected as the lagged effects of weakening in growth begin to emerge. A policy of "least regret" would see a forward looking central bank cut rates, to support growth and see better outcomes in the labour market with a faster return of inflation to the target band.
- The Q4 national accounts suggest a relatively good outcome for **business investment** in the back end of 2018 with non-mining investment rising by 5.5% q/q. The mining sector continues to contract with investment declining by 2.2% q/q. Both business conditions and confidence declined in February, and are now both below average. Other forward indicators such as forward orders and capacity utilisation have also declined to below average levels, suggesting little improvement from here. Overall, the survey is signalling a significant loss of momentum in the business sector, and suggests this has continued into the first quarter of 2019.
- **Consumption** recorded a second weak quarter of growth. Spending on goods appears to have slowed significantly, and while spending on services has held up, it too has slowed. Official retail sales suggest only weak growth in January, with nominal volumes rising by 0.1% following the decline in December. We expect the weakness in household consumption to continue with ongoing weak wage/income growth expected to persist in addition to already high debt levels and weaker consumer confidence. For now we do not expect large "wealth effect" impacts from the fall in house prices, with the story around the consumer dominated by income. That said, ongoing falls in house prices do present a risk of further weakness in consumption.
- The pace of decline in **house prices** appears to have eased slightly over the past two months, though both Sydney and Melbourne declined a further 1.0% in February. Credit growth has slowed further and loan approvals have continued to weaken. The cooling in the housing market has started to translate into activity indicators. With building approvals now having trended down for some time, dwelling investment in the national accounts declined relatively sharply – falling by 3.4% driven by a decline in both new building and alterations & additions. This result was in line with our view of a decline of around 18% over the next two years. We also expect house prices to decline a little further, with both Sydney and Melbourne ending down around 15% from peak-to-trough.
- **Labour market** conditions remain healthy with a further lift of employment of 39k in January and an unchanged – but relatively low – unemployment rate of 5.0%. With the labour market a lagging indicator of growth, it is possible that employment growth will slow from here. To date, however, conditions have shown resilience to slowing growth. Close monitoring of forward indicators over coming months will be warranted to assess whether developments on the activity side begin to translate into the labour market. For now, these indicators generally point to healthy growth but have eased slightly.
- The **trade surplus** widened to near record levels in January (largely a result of a surge in volatile gold exports) but also increases in metal ores, coal and LNG. This comes after net exports subtracted 0.2ppts from growth in the December quarter, but is in line with our view that growth will be supported by LNG exports as production reaches capacity.
- Our outlook for **commodity prices** is broadly unchanged; we expect a peak in Q1 2019 before prices begin to ease modestly. Iron ore prices have come off over the past month, but remain high, while coal prices have increased. Oil prices have been somewhat stronger recently, with Brent trading in the in the mid-US$60s range since mid-February, while WTI is in the low-mid US$50s range.
- The **AUD/USD** has traded around the US71c mark over the past month. We expect the Aussie to end the year around US75c before drifting up further to US79c over 2020.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

Group Economics

Alan Oster
Group Chief Economist
+(61 3) 8634 2927

Jacqui Brand
Executive 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
+(61 0) 436 606 175

Phin Ziebell
Economist – Australia
+(61 0) 475 940 662

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
+(61 3) 9208 2929

International Economics

Tony Kelly
Senior Economist
+(61 3) 9208 5049

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

Global Markets Research

Ivan Colhoun
Global Head of Research
+(61 2) 9237 1836