December 2019

THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

While major Advanced Economy growth was little changed in Q3, we expect US growth to ease somewhat further and Japan's economy is set to contract in Q4, although the yoy growth rate is likely to bottom out by mid-2020. Growth in Emerging Market economies eased slightly in Q3 driven by a slowdown in China and India, although we expect EM growth to pick up from here. Our world GDP growth indicator for Q3 is at 3.0% yoy, basically the same as in Q2, our global leading indicator suggests that growth may have bottomed out and the global manufacturing PMI has started to turn around. These indicators are consistent with our forecasts for global growth (on a yoy basis) to remain around current levels before strengthening from mid-2020. We are expecting global growth of 3.0% in 2019 (revised down from 3.1%), 3.2% in 2020 and 3.5% in 2021. Trade policy remains a risk to the outlook although at the time of writing press reports indicate that a "Phase One" US-China trade deal is imminent.

- **Trade policy** uncertainty has been a factor weighing on global growth. At the time of writing, press reports indicate that a US-China deal – which would include a delay of the 15 December tariffs and roll-back some existing ones – has been agreed in-principle but still awaits the US President's approval (not a small caveat). While, if the deal goes ahead, it would be a boost to sentiment and reduce downside risks to the outlook, significant areas of disagreement between the US and China will likely remain. Moreover, earlier this month the US announced it would remove steel and aluminium tariffs exemptions for Brazil and Argentina and threatened tariff increases on some French and EU imports; a reminder that trade tensions are not limited to US-China and that trade policy uncertainty is likely to remain elevated.
- Prior to today's reports of an imminent US-China trade agreement, the **equity market** response to these trade developments had been muted – with the US S&P 500 dipping by around 2% from all-time highs in late November, along with a modest uptick in the VIX volatility index, before largely recovering. **Bond markets** appeared to lose momentum in November – following a rise in yields from the lows seen in Q3 2019 a range of major advanced economies have seen bond yields fall somewhat since mid-November, as **monetary policy** expectations point to further easing (compared with a flatter outlook at the start of the month).
- **Non-rural commodity prices** have fallen in recent months – with the RBA US dollar index down round 13% from its recent cycle peak in July. This decline was led by bulk commodities (primarily iron ore), as supply disruptions have begun to unwind and demand is likely to weaken in coming months as some Chinese mills close for the winter.
- Major **Advanced Economy** (AE) growth was little changed in Q3, although we expect US growth to ease somewhat further and, in particular, Japan's economy is set to contract in Q4 following the VAT increase in October. However, the easing in US monetary policy since mid-year and a turn towards fiscal stimulus (in the UK and Japan) should help stabilise growth in 2020. Business surveys have also recently showed signs of stabilising and AE labour markets have held up well.
- Brexit related uncertainty has also been an issue for the UK and, to some extent, the Euro-zone. The **UK election** was held yesterday with the result unknown at the time of writing. If a Conservative government is re-elected (the expected result of most opinion polls) this will lead to the formal withdrawal of the UK from the EU but it does not mean that the uncertainty around the UK's relationship with the EU has been resolved (which will be determined by negotiations post-withdrawal with a deadline of end 2020).
- Overall growth among the largest **emerging market** (EM) economies slowed in Q3, led by weaker conditions in China and India (respectively the largest and third largest economies in the world). Growth for the five largest EMs slowed to 4.9% yoy. While only slightly lower than in Q2, this was the weakest rate of growth since Q2 2009, when these economies started to recover from the Global Financial Crisis. Emerging market PMIs have strengthened in recent months – driven by a strong increase in service sector readings. In contrast, after showing some recovery, EM manufacturing surveys have been stable for the past three months.
- Data available to September indicate world trade and industrial production have been tracking sideways recently, while the timelier global manufacturing PMI measure suggest that this levelling out might be turning into a recovery. Moreover, global GDP growth for Q3 is tracking at 3.0% y/y, the same as in Q2, and our leading indicator also suggests that global growth may have bottomed out. While we have lowered our forecasts for **global growth** in 2020 to 3.0% (from 3.1%), due to the weak Q3 GDP outcome for India, we still expect growth to stabilise and then start to recover in 2020. This reflects the easing in monetary policy in the US and across many EMs, as well an expected recovery in India and Latin America. We are projecting global growth of 3.2% in 2020 and 3.5% in 2021.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

Alan Oster (Group Chief Economist), Ph: +(61 3) 8634 2927 or M: 0414 444 652
Alt: Antony Kelly (Senior Economist); Gareth Spence (Senior Economist)

Australia**: **Following the release of the Q3 national accounts we have maintained the shape of our forecasts, expecting weakness in the household sector to persist and only modest business investment growth. This is expected to be offset by further near-term growth in exports and continued strong public-sector spending. Overall, we expect growth of around 1¾% this year and continued below-trend growth of 2.0% and 2.4% in 2020 and 2021. These weak growth outcomes will see employment growth slow to around 1% and the unemployment rate rise to around 5.5%. With this level of spare capacity, it is likely that wage growth will also remain modest – continuing to drive low rates of household income growth. We also expect inflationary pressure to remain weak, not reaching the bottom of the RBA's target band until end 2021 with both domestic and global inflation remaining weak. Hence, rates are likely to remain low for an extended period and will likely need to move lower in the near-term to provide further stimulus. We see a further two 25bp rate cuts in 2020 – the first occurring in February alongside a reassessment by the RBA of its forecasts and the second in June. We also see the risk of a move to unconventional policy should the economy turn out weaker than our current set of forecasts – that is, the unemployment rate rises further above the 5.5% mark.

- The **RBA left the cash rate unchanged at 0.75% in December** but maintained its easing bias, stating the bank is "prepared to ease further to support sustainable growth in the economy, full-employment and achieve the inflation target over time". We have included an additional 25bp cut to the cash rate in our rate track. We now expect cuts in both February and June 2020 - taking the cash rate to 0.25%. At this point, we see an increased risk of a move to 'unconventional' policy in H2 2020 should the labour market deteriorate more significantly than we forecast, with low inflation posing little constraint to further easing. Previously, we had pencilled in only a further 25bp cut to the cash rate and hoped to see a material support from fiscal policy, which now looks unlikely in the required timeframe.
- The **unemployment rate** edged up to 5.3% in October – but broadly it continues to hover around ¼ ppt above its trough in February 2019. Alongside a further tick-down in the participation rate, employment fell by 19k in the month, its largest fall since August 2016. Overall, year-ended growth in employment remains above that of the working-age population but has slowed from over 2.5% to around 2.0% in recent months. This slowing follows a softening in indicators of labour demand such as job ads and vacancies. Going forward, we expect employment growth to slow further (falling to just 1% y/y) with private sector growth remaining weak. At this pace, we think the unemployment rate will edge higher and that wages growth with remain muted as spare capacity in the labour market grows.
- **Consumption growth** slowed to 1.2% y/y in Q3 – its weakest pace since the GFC. In the quarter the 0.1% outcome was driven by a rise in health, recreation & culture and spending on financial services. This was offset by weakness in other, more discretionary items. This pattern has been broadly reflected over the year, with discretionary spending growth all but stalling and growth in spending on essentials also slowing significantly. This is in line with a constrained household forced to spend only on those items it requires. Households appear to have saved the bulk of tax refunds. Retail sales numbers for the first month of Q4 were again weak, recording no growth in the month – suggesting that volumes in Q4 will again weight on consumption growth.
- **Business investment** recorded another soft outcome in Q3 with a small rise in the non-mining sector offset by a fall in mining investment. By asset, machinery & equipment and engineering investment saw a decline, while non-residential building construction rose in the quarter. The NAB Monthly Business survey continues to suggest weak activity outcomes in the sector with conditions stabilising at below average levels in the first two months of Q4. Forward looking indicators also unwound their recent improvement with business confidence falling back to 0 index points, capacity utilisation declining back to average and forward orders declining to a below average (and negative) position. The weakness in the business survey presents a risk that business investment remains weak going forward.
- **House prices** in Sydney and Melbourne have risen strongly since reaching a trough in May. The activity side of market remains soft with construction pulling back and approvals for new dwellings continuing to trend down. The Q3 national accounts showed a further fall in dwelling investment of 1.7% in the quarter (new dwellings were down 2.5%) taking the decline over the year to 9.7%. We expect a similar decline over 2020 before construction stabilises in 2021.
- **Net exports** contributed 0.2% to GDP growth in Q3, for an annual contribution to growth of over 1.0%. These increases have been driven by the ramp up of LNG production as the last of the mega-projects inters production. Data for the first month of Q4 suggest some pull-back in exports with iron ore softening. We expect further grown in exports over the near-term before they level out as LNG production reaches capacity.
- **Commodity prices** were generally flat over the month. Iron ore saw declines early in the month for a rise back above $90 per tonne in the second half of November. Both thermal and coking coal prices were stable in the month. Our forecasts for commodity prices are largely unchanged.
- The **exchange rate** recently - post the increased confidence of a US-China trade deal and less action priced for the Fed - is trading around US68.5c, with the TWI around 59.5. We have not changed our currency forecast of 0.69c by end 2019 and around 0.70c by end 2020 and 0.74c by end 2021.

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