

The Bigger Picture – A Global & Australian Economic Perspective

Global: *Global economy forecasts unchanged as global growth emerges in Q3. But a good deal of recent growth is heavily influenced by policy and signs are for weaker growth in Q4. “W” shaped recession not likely.*

- For the second month in a row we have maintained our global forecasts of a drop of just under 1½% in 2009 (-1.3%) and growth of a touch above 3% in 2010 (3.1%). We also expect a return to trend growth in 2011 (3¾%). Nor has there been much change in the country forecasts
- Over the past month, PMI manufacturing surveys have remained above the 50 breakeven mark but have edged down a touch from last month (our global index was 52.5 in November compared with 53.8 in October). That reflects a slight slowing in manufacturing growth as some of the Government “specials” pass and the restocking phase passes its peak.
- There has also been some scaling back in near term growth expectations based on broader surveys (an index based on surveys in the US, UK, Germany and Japan slowed from +33 in August to +22 in November). That said, global industrial production continues to improve and is now only down 6.6% on this time last year (albeit the pace of improvement has also slowed a touch).
- It very much remains the case that China, India and Non Japan Asia are the key drivers of the upward momentum. Chinese industrial production growth accelerated to 16.1% in the year to October while annual growth has also clearly re-emerged in Taiwan (8.0%) Korea (4.4%) and Singapore (3.6%). Indian GDP was up 3.6% in Q3 and industrial production is now up 9% over the year. Against that the G3 economies (and large European economies) while improving, are still reporting double digit percentage falls in industrial production vis a vis this time last year.
- Revisions to USA and European Q3 GDP estimates have been relatively minor and we have not changed our 2010 forecasts of 2.1% and 0.7% respectively. Similarly we still see Chinese growth of 9% in 2010. Following the latest accounts we see Japanese growth of only 1.9% in 2010 - following a fall of 5.5% in 2009. Elsewhere in Asia, driven by the strength of China and improving trade volumes, we expect growth in non Japan Asia to increase by 3.3% in 2010.
- On a more encouraging note unemployment in the USA and Japan both unexpectedly improved in the latest estimates by around ¼ point (to 10.0% in the USA and 5.1% in Japan). There has also been a further move up in commodity prices – which have maintained their current momentum – albeit freight rates remain somewhat soft in the face of new capacity.
- While confidence remains high there is little sign yet that business is increasing investment. Indeed demand for business credit has continued to decline globally. In part that reflects corporates using capital markets to repay debt and SMEs either de-leveraging or remaining extremely cautious.
- We remain unconvinced with European growth prospects. Growth in Europe was confirmed at 0.4% in Q3, consistent with an overall fall in activity in 2009 of around 4%. The UK is still in recession. The weak USD (and the GBP) continues to erode European competitiveness while bank balance sheets remain very weak. European industrial production and business surveys continue to improve but unemployment is still very high and capacity utilisation very low. Overall we still see growth of less than 1% in 2010 in both the UK and Europe.
- Overall we see central banks in both Europe and the USA as likely to start increasing rates towards the end of 2010.
- While we do not expect a “W” recession in 2010, growth of only 3% is very subdued for a recovery phase. Key drivers limiting the recovery in 2010 remain: increased unemployment (not likely to peak until late 2010), reduced private sector demand for debt, and the need to increase interest rates (to start in 2010 – outside of Australia) and fiscal policy (2011).

Australia: Australian recovery broadens further. GDP forecasts revised up as Survey signals stronger growth in late 2009. Job shedding phase ending and unemployment peak lowered to 6.2 %. Rate forecasts unchanged – 4¼ % by March 2010 and an end point of 5½%.

- The November Business survey again points to further rises in business confidence (the highest level since mid 2002) and fundamental strength in demand. With forward orders back to levels last seen in mid 2007 the Survey would be consistent with growth in demand of around 4¾% (at an annualised rate) in the second half of 2009.
- As well as strong business outcomes in November, the Survey shows capacity utilisation trending up while business is no longer de-stocking. Critically, business appears to have finished the labour shedding and the Survey points to increased hours worked in Q4 – for the first time since late 2007.
- By industry, recent surveys have pointed to a rolling change in the sectors driving growth. The process was initially driven by retail/wholesaling but more recently broadened to manufacturing and construction (reflecting government programs). In November the industry story was much more mixed. Most sectors, indeed, reported significant falls in outcomes (mining manufacturing and services). However, this was largely offset by renewed strength in retail and wholesale (with significant forward orders in the retail sector pointing to a relatively strong Xmas).
- The one area that is still not recovering is business investment plans. Broadly, they remain at levels suggesting little growth in investment over the next 12-18 months. Corporates have used capital raisings to repair balance sheets and reduce debt. SME's remain cautious.
- With the strong Survey results and partial data, we now expect GDP growth of nearly 1% in Q3 (to be published next week). We now expect Q4 GDP to grow by around ½% - meaning that our 2009 GDP forecasts have been increased by ¼ point to 1¼%. With growth still expected to be near trend (3%) in the 12 months to December, the year average growth rate for 2010 has also been revised up by ¼% to 2¾%.
- With the job shedding and reduced hours phase having passed, we have lowered our expected unemployment peak to 6.2% (previously 6½%) – with employment growth of around 2% during 2010 (following around ¼% in 2009).
- While wage and price pressures remain low over the past year the Survey suggests that wage pressures have increased in each of the last 5 months. Also, retail prices in the Survey increased quite strongly in November as retailers re-built margins. Against that, purchase costs were flat (AUD impact). Overall we have not changed our core inflation forecasts - with core inflation expected to increase by 2% in the year to December 2010. This still relatively low outcome reflects the combination of a lagged output gap and the strong AUD.
- On the AUD we have marginally shaved our AUD/USD forecast to 95c for end 2009 (from 97c) but expect to see the AUD rise to around 1.03 USD in 2010 before moving back to the mid 90c in 2011.
- One feature of the forecasts is that the combination of under supply, the FHOB and low interest rates have moved house prices higher. In the near term we expect house prices to continue to increase (around 5% during 2009) before falling moderately (-5%) in 2010 – due to higher real interest rates.
- We have not changed our credit forecasts. Business credit continues to under-perform relative to expectations. Housing credit is being maintained by first home owners and to a lesser extent lower rates but will be tempered by the rate tightening cycle.
- On rates, we have not changed our forecasts. We still see the RBA increasing the cash rate by 25 points in both February and March - bringing the rate to 4¼%. We then expect the RBA to pause for around 6 months before delivering progressive 50 point rises until rates are back to neutral (around 5½%) by 2011. Risks, in the near term, are that a stronger economic recovery could see an even stronger RBA response – albeit the private banks rate decisions have partially offset that concern.

Alan Oster
Chief Economist
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