

## The Bigger Picture – A Global & Australian Economic Perspective

September 2010

***Global: Although the momentum of global growth is slowing we still see Growth of around 4¾% this year slowing to nearer 4% over 2011/12. That is no “double dip” recession. The outlook for Europe, while still weak, has improved and there are encouraging signs in the US, but Japan remains sluggish. Global growth continues to be driven by the emerging market economies. Chinese growth has eased modestly but we still expect double-digit growth this year while India and Brazil have been very strong.***

- Evidence is accumulating that the pace of global economic growth is slowing. While there is no evidence of the much discussed double dip, the CPB’s measure of world export volumes point to a reduction in the trend momentum of growth.
- The global industrial output numbers and the purchasing manager index (which gives a forward looking assessment of near term trends in the big developed economies) confirm that the pace of expansion is slowing. The rate of 3-month average growth of global industrial output has slipped from 12¼% (year on year) in May to 10½% yoy in July and the monthly figure is 10% yoy.
- There are still very marked variations in the pace of economic expansion across the different parts of the world. The big emerging market economies are still driving an unusually large amount of this recovery (relative to previous upturns). There has been a substantial recovery in industrial activity in the big industrial economies but activity remains below its pre-recession levels. Industrial output in the US is still around 10% below its mid-2007 level and the corresponding figures for Japan and the Eurozone are 12% and 10% respectively.
- **Overall we now expect global growth of 4.7% in 2010 moderating to around 4¼% and 4% in 2011 and 2012 respectively.** Turning to the individual economies, the revised second quarter US national accounts show growth running at an annualized rate of 1.6%. While this is well down on the first quarter figure of 3.7%, the pattern of growth was quite encouraging. Private sector final demand does seem to be increasing, so it is not a case that the recovery is entirely due to transitory changes in the stock cycle and fading public sector stimulus. We expect growth to average around 3% through the next couple of years.
- In the case of Japan, real GDP barely expanded in the second quarter with household consumption especially weak. Exports have been the main driver of recent business cycles in Japan and this remains the case with a bounce-back of around 30% yoy in volumes from the previous recession hit levels. As consumption looks set to remain soft, we expect Japanese growth to stay around 2½% through the next couple of years and deflation to continue, extending the long period of flat nominal GDP.
- The solid 1% growth reported in the preliminary Eurozone national accounts for June quarter owed much to the strength of exports, particularly from Germany. Final demand remains weak in the periphery economies but there are promising signs that the German recovery could be broadening out and we have increased our 2010 growth forecast to 1¾%, up ¼% from the previous estimate.
- The emerging market economies have shown a much stronger performance through the last few years. Industrial output in China and India kept growing through the downturn and, while the Asian tiger economies experienced a severe downturn their bounce-back has been very strong. As a result, output is well above pre-crisis levels in all these regions.
- Turning to the individual emerging market economies, the latest crop of partial indicators from China showed a modest easing in the pace of growth. Nevertheless, the economy is still expanding very quickly and there is no sign of any slowing in the rate of growth of exports. Given the Government’s priority on sustaining rapid growth to maintain job creation, we expect growth to stay solid - at 10½% this year and 9% in 2011.
- Finally, Brazil is another big emerging market economy where rapid growth is contributing significantly to the solid global growth number for 2010. While we expect growth to slow from the exceptionally rapid rate of the peak of 8¾% yoy seen in the June quarter, the outlook is still one of solid growth.

***Australia: A multi-speed economy is re-emerging as commodity exports enter a new boom while many domestic sectors (notably retail and construction) struggle. While Q2 growth was strong, NAB surveys (forward orders, capacity and business conditions) point to near-term softness. Nevertheless, rising commodity prices, new resource projects and booming capex plans imply annual growth will push through 4% during 2011. We expect rates to rise again in early 2011, but if inflation risks escalate we may see a November move.***

- Our Australian growth forecast for 2010 have been revised up a little to 3¼% (from 3%) following the strong Q2 GDP outcome. Although business confidence rebounded in August, conditions remained unchanged. The re-emergence of a multi-speed economy is evident as the NAB survey showed transport, recreation and mining doing strongly while retail and construction struggled. The survey is consistent with domestic demand running at an annual rate of around 3% in Q3, well down from rates reported in Q2, while exports moved out of negative territory for the first time since October 2008.
- Non-rent consumer spending growth was boosted to 1.8% in Q2 by large increases in many of the 'non-retail' categories such as recreation & culture, health, vehicle purchases (reflecting a large increase in SUV sales), transport services and insurance & other financial services. Retail turnover continued growing into July, but was mostly focused in cafes, restaurants and take-away food. Household goods, clothing and department stores continue to perform poorly. The NAB survey suggests that prices and margins in retailing (which excludes cafes, etc from the survey definition) remain under extreme pressure. Higher interest rates and the absence of last year's government subsidies may be playing their part in the retail story.
- Housing price growth has eased in recent months under higher interest rates. The burgeoning housing shortage and high levels of job security are likely to keep house prices growing at an annual rate of around 7% in 2011, although we expect relatively flat prices in H2 2010.
- The construction environment is changing as the fiscal stimulus begins to fade and new minerals engineering projects start up. The total value of building approvals has declined to levels not greatly above those recorded during the GFC. Non-residential approvals have declined substantially as the education building program is wound back. However, there has been a substantial increase in the pipeline of engineering construction work, much of which reflects the commencement of the Gorgon LNG project and capex intentions have increased sharply, especially in the mining sector.
- The terms of trade rose 12.5% in Q2 following renegotiated iron ore and coal prices that drove the NAB non-rural commodity price index up by 42%. The export sector added about \$10 billion to the economy in Q2 and there is more to come. Coal exports rose by more than half in Q2 (with both prices and volumes up) and higher prices drive metal ore exports up by more than 40%. Modest rises are expected in bulk commodity contract prices in 2011 and metals and oil prices are likely to rise as concerns about global growth abate.
- There was also a strong rise in the NAB rural commodity price index (up 5% in August) driven by supply constraints in the northern hemisphere. Given these constraints, exports of Australian grains and dairy are likely to pick up in coming months. Improving demand in non-Japan Asia and the Middle East should support meat and livestock exports over the coming year.
- We expect GDP growth of 3¼% in 2010 (3% previously), 3¾% in 2011 (unchanged) and 4½% in 2012. In financial years, growth is predicted to be 3¼% in 2010/11 and 4¼% in 2011/12. Our expectations for are touch higher than the RBA in 2012 but otherwise similar, while we are more bullish than the Treasury July PEFO.
- Uncertainty about global growth and a moderate outlook for domestic demand should keep the RBA on hold for a while. The tightening cycle is expected to begin in February 2011, with 25 points per quarter lifting the cash rate to 5½% by late 2011. However, the momentum in the export sector and its potential impact on domestic income could initiative a November move: much will depend on the Q3 CPI outcome to be released at the end of October.

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