

The Bigger Picture – A Global & Australian Economic Perspective

Global: Global economy forecasts unchanged as more evidence emerges that global growth emerged in Q3 and has continued into Q4 2009. But a good deal of recent growth is heavily influenced by policy. Risks remain that markets might be disappointed by growth trajectory. But “W” shaped recession not likely.

- Globally we have maintained our 2009 GDP forecasts of a touch under 1½% in 2009 (1.3%) and a touch above 3% in 2010 (3.1%). Early indicators are for a return to trend growth in 2011 (3¾%)
- Over the past month, growth numbers have surprised on the upside in China and Asia, have been largely as expected in the US, but have disappointed in the UK.
- More generally global measures of industrial production have continued to improve and the PMI surveys of manufacturing activity have accelerated in October – having finally reached the breakeven mark (index of 50) in August / September. That said surveys generally report much stronger expectations than current levels of activity.
- More recently commodity markets and freight markets which had moved earlier to price in strong recoveries have treaded water – with freight rates declining somewhat, in the face of new capacity.
- Also while confidence remains high there is little sign yet that business is moving to increase 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. Also capacity utilisation remains very low – both for capital and labour. Unemployment in the US is now 10.2% and 9% in Europe. Measures of idle capacity across US, Canada, Europe and Japan remain around 35%.
- It very much remains the case that China and Asia are the key drivers of the upward momentum. Chinese growth increased by around 2½% very much driven by the impact of the fiscal stimulus. Credit growth also remains very high – albeit there has been some tightening in credit availability. Industrial production and business sentiment has improved but export growth remains depressed. Overall, we now expect China’s domestically driven growth to be around 8¼% in 2009 and 9% in 2010. That strong momentum continues to flow over into Asia – with non Japan Asia expected to increase by around 3.3% in 2010.
- Japanese industrial production has increased for 7 months and growth has returned - but the “levels” remain appalling. The Tanken still remains at -33 (up from the record lows of -58 earlier this year) and unemployment is around 5¼%. Growth of around 2% is expected next year as consumer moderate increase spending, business investment stops falling and Japan benefits from rising trade. That said, the level of GDP by end 2010 will only be around that achieved in 2005.
- USA activity forecasts remain unchanged at -2.8% in 2009 and a touch over 2% in 2010. The Q3 results were heavily influenced by government initiatives – notably the cash for clunkers scheme and the first home owners’ tax credit scheme. Overall these initiatives accounted for around half the reported growth (or around 0.4%). Thus we expect little real growth in Q4. That said better equity and housing markets should help foster on going recovery in 2010.
- We remain unconvinced with European growth prospects. Growth in Q3 is likely to be very modest and in some cases (notably the UK) is still going backwards. The weak USD and GBP is fundamentally eroding competitiveness and bank balance sheets remain very weak. Overall we still see growth of less than 1% in 2010 in both the UK and Europe.
- 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 as business increases capacity utilisation in the face of on going demand growth. GDP forecasts revised up as Survey signals stronger growth in H2 2009. Job shedding phase ending and unemployment peak lowered to 6½ %. Rate forecasts unchanged – 4 ¼ % by March 2010 and an end point of 5½%.

- Evidence from the October Business survey is that higher confidence levels has now spilled over into accelerating growth in demand – with a sharp jump in actual business conditions in October.
- Forward orders remain above long run averages and imply on going growth in demand of around 4% (on an annualised basis) over the past 6 months. The kick in activity reflects strong growth in trading, profits and employment. On the latter, it appears that the job shedding (and reduced hours) may be coming to an end.
- Critically, the Survey suggests that business are no longer meeting demand by running down inventories and importing (which was very much evident in Q3). We are now seeing signs of increased capacity utilisation (the survey measure jumping 2 percentage points to 82.1% in October) and a process of rebuilding inventories. That is the recovery process is broadening out.
- By industry it appears that the drivers of growth continue to evolve – with the initial phase of consumer related growth (June Quarter), moving to manufacturing and construction (September quarter) to transport, manufacturing, finance and personal & recreational services at present
- That has seen Nab increase its GDP expectations by around ¾ per cent in the second half of 2009 (flat previously). We still expect growth during 2010 of nearly 3% which would translate into year average growth of 2½% in 2010 (effectively both the year average 2009 and 2010 forecasts have been raised by ½%). These forecasts are very similar to last weeks RBA 2009 projection and a touch lower than their 2010 numbers (RBA 3.2% during 2010 Nab 3.0%). But are stronger than the Government's Mid Term Economic Update projections (Govt 1.5% for fiscal 2009/10 Nab 1.8%).
- With the job shedding phase nearing an end, we now see a peak in the unemployment rate at 6½% (6.7% previously) – and it could well be that the peak is even lower.
- The one area that is still not recovering is business investment plans. Broadly they remain at levels indicative of little net growth in investment over the next 18-24 months. Similarly, business demand for credit continues to weaken (with 45% of respondents to the Survey not wanting credit). As with global trends corporates appear to have used capital raisings to repair balance sheets and reduce debt. SME's, while more prepared to take on debt, remain cautious.
- Higher growth has seen a moderate upward revision to our core inflation forecasts – with increases of 2% now expected in the year to December 2010 (1.8% previously). This still relatively low outcome reflects the combination of a lagged output gap, the strong AUD and signs that retail inflation has fallen sharply in recent months.
- 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 - in the face of higher real interest rates and rising unemployment.
- We have not fundamentally 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 a bringing forward of the rate tightening cycle.
- On rates, we have not changed our forecasts. We still expect the RBA to increase the cash rate (by 25 points) in each of it next meeting till March 2010 – 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. The currency forecasts also have not changed, with the AUD expected to move to around 97c USD by late 2009 before moving to a touch above parity (USD 1.03) in 2010 and into the mid 90c range in 2011.

Alan Oster

Chief Economist

11 November 2009

03 8634 2927 (Mobile 0414444652)

Macroeconomic, Industry & Markets Research

Australia

Alan Oster Group Chief Economist + (61 3) 8634 2927
Jacqui Brand Personal Assistant + (61 3) 8634 2181

Vacant Head of Australian Economics & Commodities + (61 3) 8634 2832
John Sharma Economist – Australia + (61 3) 8634 4514
Ben Westmore Economist – Australia & Commodities + (61 3) 8634 8602

Dean Pearson Head of Industry Analysis + (61 3) 8634 2331
Gerard Burg Economist – Industry Analysis + (61 3) 8634 2788
Daniel Farley Economist – Property + (61 3) 8634 2168
Brien McDonald Economist – Industry Analysis & Risk Metrics + (61 3) 8634 3837
Frank Drum Economist – Agribusiness + (61 3) 8634 2041

Michael Lee Senior Economist – Modelling and Econometric Support + (61 3) 8634 8562

Tom Taylor Head of International Economics + (61 3) 8634 1883
Robert De Iure Economist – Country Risk + (61 3) 8634 4611
John O'Connor Economist – International + (61 3) 8634 8076
Mark Rodrigues Economist – International + (61 3) 8634 1823

Global Markets Research - Wholesale Banking

Peter Jolly Head of Markets Research + (61 2) 9237 1406
Robert Henderson Chief Economist Markets - Australia + (61 2) 9237 1836
Spiros Papadopoulos Senior Economist – Markets + (61 3) 8641 0978
David de Garis Senior Economist – Markets + (61 2) 9237 1180

New Zealand

Tony Alexander Chief Economist – BNZ + (64 4) 474 6744
Stephen Toplis Head of Market Economics - BNZ + (64 4) 474 6905
Craig Ebert Market Economist - BNZ + (64 4) 474 6799
Mark Walton Market Economist – BNZ + (64 4) 474 6799

London

Tom Vosa Head of Market Economics - Europe + (44 20) 7710 1573
David Tinsley Market Economist – Europe + (44 20) 7710 2910

	Foreign Exchange	Fixed Interest/Derivatives
Sydney	+800 9295 1100	+ (61 2) 9295 1166
Melbourne	+800 842 3301	+ (61 3) 9277 3321
Wellington	+800 64 642 222	+800 64 644 464
London	+800 747 4615	+ (44 20) 7796 4761
New York	+1 800 125 602	+1877 377 5480
Singapore	+ (65) 338 0019	+ (65) 338 1789

DISCLAIMER: "While care has been taken in preparing this material, National Australia Bank Limited (ABN 12 004 044 937) does not warrant or represent that the information, recommendations, opinions or conclusions contained in this document ("Information") are accurate, reliable, complete or current. The Information has been prepared for dissemination to professional investors for information purposes only and any statements as to past performance do not represent future performance. The Information does not purport to contain all matters relevant to any particular investment or financial instrument and all statements as to future matters are not guaranteed to be accurate. In all cases, anyone proposing to rely on or use the Information should independently verify and check the accuracy, completeness, reliability and suitability of the Information and should obtain independent and specific advice from appropriate professionals or experts.

To the extent permissible by law, the National shall not be liable for any errors, omissions, defects or misrepresentations in the Information or for any loss or damage suffered by persons who use or rely on such Information (including by reasons of negligence, negligent misstatement or otherwise). If any law prohibits the exclusion of such liability, the National limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable. The National, its affiliates and employees may hold a position or act as a price maker in the financial instruments of any issuer discussed within this document or act as an underwriter, placement agent, adviser or lender to such issuer."

UK Disclaimer: So far as the law and the FSA Rules allow, National Australia Bank Limited ("the Bank") disclaims any warranty or representation as to the accuracy or reliability of the information and statements in this document. The Bank will not be liable (whether in negligence or otherwise) for any loss or damage suffered from relying on this document. This document does not purport to contain all relevant information. Recipients should not rely on its contents but should make their own assessment and seek professional advice relevant to their circumstances. The Bank may have proprietary positions in the products described in this document. This document is for information purposes only, is not intended as an offer or solicitation nor is it the intention of the Bank to create legal relations on the basis of the information contained in it. No part of this document may be reproduced without the prior permission of the Bank. This document is intended for Investment Professionals (as such term is defined in The Financial Services and Markets Act 2000 (Financial Promotion) Order 2001) and should not be passed to any other person who would be defined as a private customer by the rules of the Financial Services Authority ("FSA") in the UK or to any person who may not have experience of such matters. Issued by National Australia Bank Limited A.C.N. 004 044 937, 88 Wood Street, London EC2V 7QQ. Registered in England BR1924. Head Office: 500 Bourke Street, Melbourne, Victoria. Incorporated with limited liability in the state of Victoria, Australia. Regulated by the FSA in the UK.

U.S. DISCLAIMER: This information has been prepared by National Australia Bank or one of its affiliates or subsidiaries (collectively, "NAB"). If it is distributed in the United States, such distribution is by National Australia Capital Markets, LLC (NACM) which accepts responsibility for its contents. Any U.S. person receiving this information wishes further information or desires to effect transactions in the securities described herein should call or write to NACM, 200 Park Avenue, New York, NY 10166 (or call (877) 377-5480). The information contained herein has been obtained from, and any opinions herein are based upon sources believed to be reliable and no guarantees, representations or warranties are made as to its accuracy, completeness or suitability for any purpose. Any opinions or estimates expressed in this information is our current opinion as of the date of this report and is subject to change without notice. The principals of NACM or NAB and/or its affiliates may have a long or short position or may transact in the securities referred to herein or hold or transact derivative instruments, including options, warrants or rights with securities, or may act as a market maker in the securities discussed herein and may sell such securities to or buy from customers on a principal basis. This material is not intended as an offer or solicitation for the purchase or sale of the securities described herein or for any other action. It is intended for the information of clients only and is not for publication in the press or elsewhere.