

The Bigger Picture – A Global & Australian Economic Perspective

Global: *Global growth has strengthened and we have revised up our forecasts to 4%. That growth momentum continues to be driven from China, Non Japan Asia and developing economies. Growth prospects have also strengthened in the USA. Europe & UK continue to struggle.*

- The latest business surveys suggest that the pace of global recovery has started to accelerate. Industrial output is now up 9% y/y to February while world exports have accelerated to almost 15% y/y to January. We have raised our global growth forecasts up, to around 4% in both 2010 (previously 3½%) and 2011.
- These revisions are concentrated in East Asia, where the strong upturn in China is spilling over into a rapid rebound in industrial activity across the entire region. Chinese industrial output was up by almost 20% y/y in late 2009 but that slowed to 12¾% y/y in early 2010 (although the numbers can be affected by holiday timing). Indian industrial output was up by 20% y/y in late 2009 and early 2010, reflecting fiscal stimulus boosting domestic spending. We have revised up our 2010 Chinese and Indian growth forecasts to 9.5% and 7.5% respectively.
- The strongest upturn has come in the smaller and more open trade-dependant emerging economies of the region. Their industrial output was up by almost one-third at the end of 2009 and into early 2010. In part, this exceptional result reflects the scale of the previous downturn they had experienced - there was scope for a rebound, once demand returned, and a combination of the upturn in the Chinese economy and local economic stimulus measures provided the necessary demand. Overall, we now expect Non Japan Asia (ex China) to grow by around 5½ % in 2010 following a fall of -4.3% in 2009. We also expect growth in these economies of around 5% in 2011.
- The Japanese economy has fared better than expected but much of this reflects the growth in exports to the fast recovering emerging economies across East Asia. Japanese domestic demand is still not strong and deflation has returned. Overall Japanese growth could be around 2¼% in 2010. The strength of the recovery in global trade (and commodity prices) has also seen strong rebounds in Latin American economies where growth is now likely to be around 3½% in 2010.
- In the US, however, there are signs that policy measures are at least beginning to bear fruit. Certainly ISM surveys point to a strengthening in demand. Also, fundamental models suggest that after a period of very low real rates, improving equity markets, stabilizing housing markets, low currency and improving credit conditions, should boost growth in 2010. Accordingly, we have increased our US forecasts to 3.3% (previously 2.5%) in 2010 and 3% in 2011. That said, US unemployment will remain high for a long time and the forecast growth in 2010 does little more than reverse the fall in activity in 2009. In the medium term, commercial property also looms as a further significant problem.
- European prospects on the other hand remain bleak – with growth still expected to be less than 1% in 2010. While we do not expect the sovereign risk concerns in Europe to be allowed to develop, the need to at least put fiscal balances onto a medium term sustainable path will mean the growth prospects will remain very depressed for a long time. Global credit de-leveraging also is likely to continue for some time. To a large extent these factors together with the need to reverse the current stance of monetary policy will also impact on medium term prospects across all large developed economies.
- Overall, the forecasts imply the persistence of sizeable output gaps alongside high unemployment in many big developed economies. The emerging market economies look set to play a far more prominent role in the composition of global growth through the next few years with particularly sizeable contributions from China and India.

Australia: Economic growth momentum accelerating after slower start to 2010. With faster growth in our major trading partners and a large income effect from rising commodity prices, growth forecasts increased to 3½% in 2010 and 4¼% in 2011. Unemployment lowered to 4½% by end 2010. Interest rates to be hiked more aggressively (5¼% by end 2010 and 6% by late 2011).

- The key result from our March Business Survey was an implied sharp acceleration in activity after a slower start to 2010. Particularly strong readings were reported in the labour market (the strongest readings since November 2007) and forward orders – broadly consistent with domestic demand growing at an annualised rate of around 4½% in Q1 2010 but accelerating through the quarter.
- Business confidence remains at very high levels and capacity utilisation jumped 1.4% to 82.1%.
- The combination of an accelerating near term growth momentum, faster growth in our major trading partners (now expected to be around 4¾% in 2010 vis a vis -0.4% in 2009), and much stronger income effects from commodity prices (following expected iron ore and coal quarterly contract price increases of around 115% and 55% respectively) underpins the increases in our GDP forecasts.
- We now expect GDP to increase by 3½% in 2010 (3% previously) and 4¼% in 2011 (previously 4%). The strength of these forecasts is best reflected in the domestic demand forecasts, which have been raised to 5½% in 2010 and 5¼% in 2011.
- Undoubtedly, the key driver of our upward forecast growth numbers is the additional income generated by the now sharply higher terms of trade forecasts – up 18% over 2010. That, in turn, flows over into additional investment, profits and consumption. An additional stimulus – albeit temporary - is the actual construction of the Gorgon LPG project. The strength of income growth together with even further reductions in unemployment means that house prices (in an environment of continuing undersupply) rise further – up around 10% both this year and next.
- Asset price wealth will add to additional income to underpin private consumption growth of around 3¾% through the course of 2010 and into 2011. With business becoming more confident and investment intentions strengthening, we have increased our business investment forecasts to around 15% growth in both 2010 and 2011. That will also add to the demand for business credit. It is also an environment where bad debts should be much reduced.
- The strength of these demand and GDP forecasts clearly mean further strengthening of the labour market. We now expect growth of employment to strengthen to around 3¼% per annum over the forecast period. That means even allowing for high labour force participation that the unemployment rate drops to around 4½% by end 2010 and around 4% by end 2011.
- Clearly the forecast environment will require a tight policy stance to prevent both wage and price pressures. We have increased our inflation forecasts. We now expect core inflation to be around 2½% by end 2010 and a touch higher (2¾%) by end 2011. While inflation remains well controlled at present, there are already signs, in the business survey, of accelerating wages pressures - albeit from low levels – and especially so in mining.
- Given these forecasts we now see the RBA as needing to be in a more aggressive mode. Thus we expect cash rates to be 5¼% by end 2010 – which would, in an environment of higher bank spreads, be a touch on the tight side of neutral. Tentatively we have pencilled in rate rises in May, August, September and December. For 2011 we expect rates to rise to 6% which would be the best part of ¾% above neutral and is somewhat more aggressive than current market expectations.

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