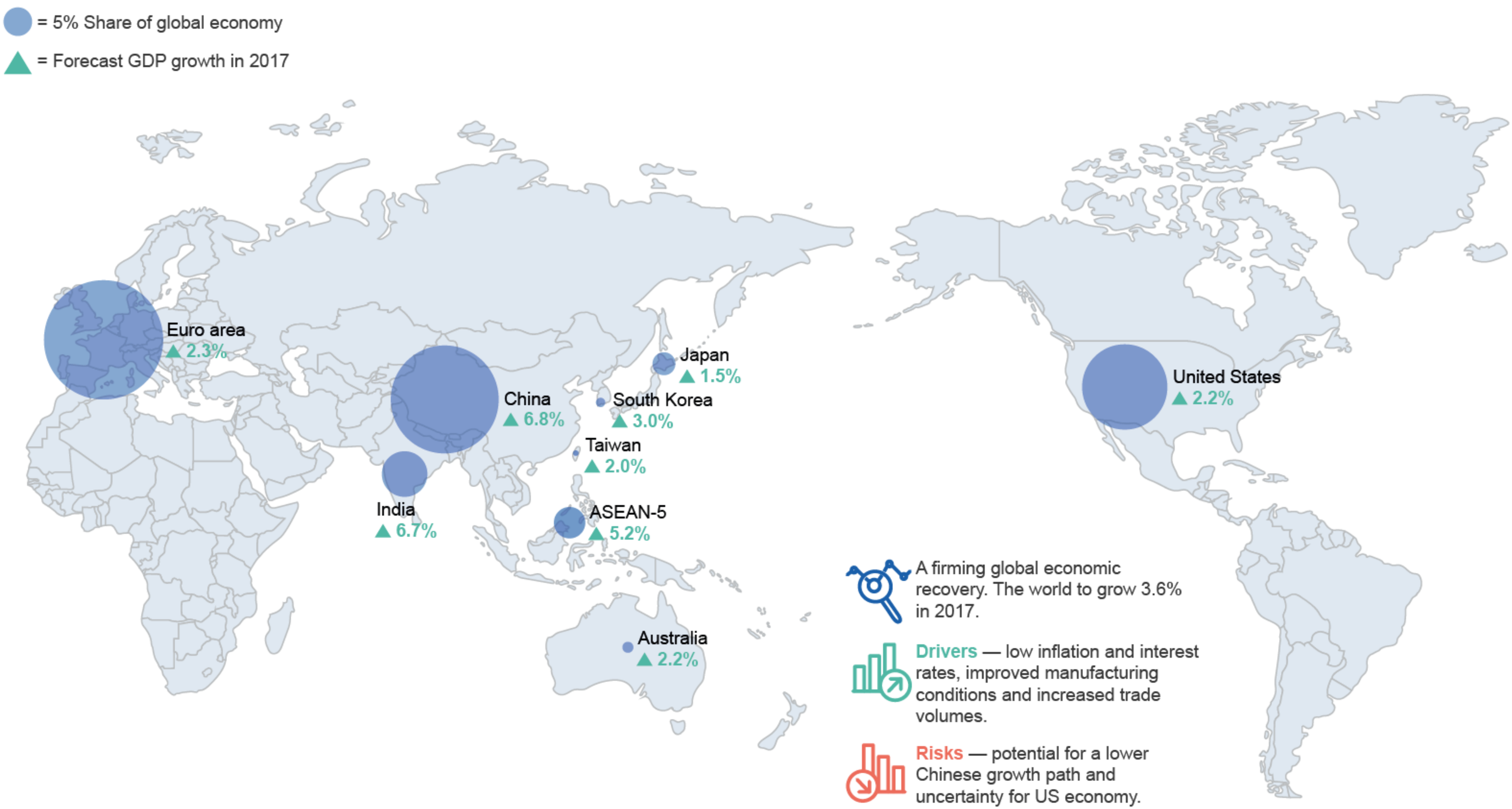
Macroeconomic outlook

Resources and Energy Quarterly December 2017



A firming global economic recovery. The world to grow 3.6% in 2017.

Drivers — low inflation and interest rates, improved manufacturing conditions and increased trade volumes.

Risks — potential for a lower Chinese growth path and uncertainty for US economy.

2.1 Summary

- The global upswing in economic activity is strengthening, with global growth forecast to rise to 3.6 per cent in 2017 and 3.7 per cent in 2018 and 2019.
- The potential for a lower Chinese growth path and uncertainty around the US economy represent risks to the outlook.

2.2 Global economic outlook

World industrial production — an important indicator of resource and energy commodity demand — continued to grow at a robust pace in the September quarter. Industrial production grew by 3.5 per cent — the fastest rate of growth since 2011.

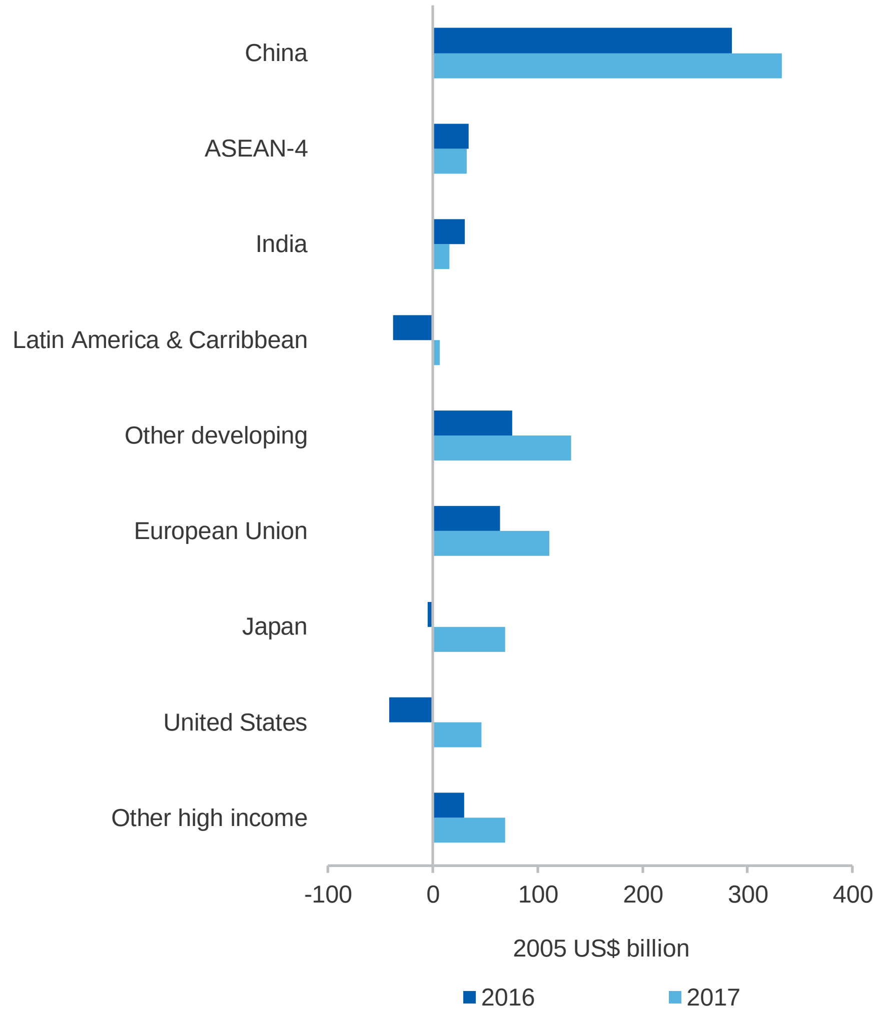
As demonstrated in Figure 2.1, China remains the key driver of world industrial production, accounting for around 40 per cent of growth in the year to September 2017. Growth in industrial production has also picked up markedly in high income countries, particularly Japan and the United States (which both fell in 2016), as well as the European Union.

However, growth in global automobile sales appear to have slowed so far in 2017, growing by only 2.9 per cent in the calendar year to September, compared with the 6.9 per cent growth recorded in 2016. In particular, vehicle sales have declined in the United States (down 1.8 per cent) and South Korea (down 0.7 per cent). Vehicle sales in China — the world's largest consumer of vehicles — grew by 4.8 per cent. Automobile manufacturing is an important source of demand for steel and aluminium.

More broadly, the global economic upswing appears to be strengthening, with global GDP growth forecast to gather speed in the next two years. The pickup in global growth is expected to be broadly based, accelerating in advanced and emerging market economies.

Following a slowdown in 2016, world merchandise trade in 2017 is estimated to have grown at the fastest rate in six years, mostly thanks to Europe's recovery. However, the potential for protectionist policies pose a risk to the medium term outlook for trade.

Figure 2.1: Annual growth in world industrial production



Notes: European Union excludes Greece and Malta, for which recent data was not available; ASEAN-4 includes Indonesia, Thailand, Malaysia and the Philippines

Source: World Bank Global Economic Monitor (2017)

Figure 2.2: World merchandise trade growth (year-on-year) and global trade leading indicator

Notes: The global trade leading indicator is a diffusion index: positive readings indicate expanding global trade, while a negative reading indicates contracting global trade.

Source: CPB Netherlands Bureau for Economic Policy Analysis; Morgan Stanley

2.3 China

Economic growth in China in 2017 was surprisingly robust — GDP growth is estimated to have accelerated from 6.7 per cent in 2016 to 6.8 per cent in 2017. This reflects economic stimulus, strengthening external demand and a payoff from domestic reforms. China's trade with the rest of the world is picking up, with recent growth at rates not seen since 2011. Exports in the year to October were up 7.5 per cent while imports rose by 17 per cent over the same period.

Between 2014 and 2016, the Chinese authorities reduced lending rates, eased real-estate macro-prudential policies and increased general government net borrowing. These policies contributed to a boom in construction and supported the demand for construction raw materials, many of which originate in Australia. However, since late 2016 the authorities have been gradually tightening financial conditions. As a result, construction investment is now declining and construction activity is beginning to slow.

At the 2017 Communist Party Congress, President Xi Jinping appeared to signal less focus on the pace of the expansion, and higher attention to tasks such as curbing pollution, taming financial risks and closing the income gap. A lower Chinese growth path would have a major impact on global commodity demand.

Figure 2.3: Indicators of Chinese construction activity, year-on-year change

Notes: Construction fixed asset investment is cumulative calendar year to date.

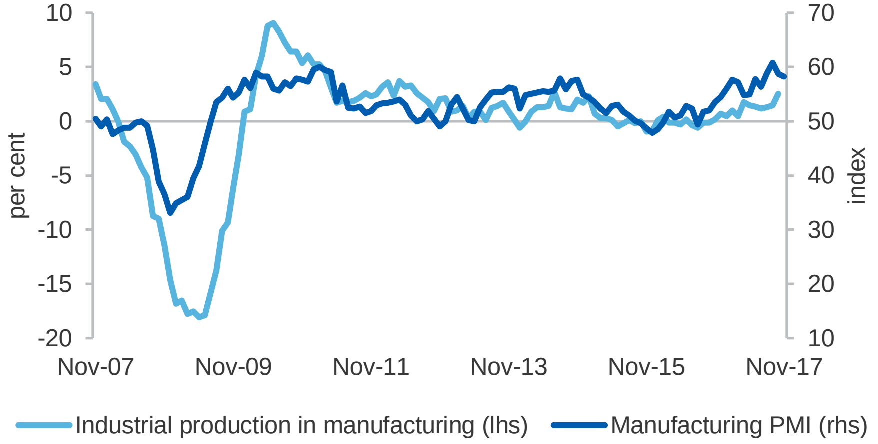
Source: National Bureau of Statistics China

2.4 United States

The US manufacturing industry continued to expand in November — with the manufacturing PMI dipping slightly further from a thirteen-year high reached in September. The dip in the index — through to levels which still point to an expansion in manufacturing activity — was attributed to post-hurricane supply-chain difficulties, and is expected to impact activity for the next three months. The US manufacturing PMI — which tends to lead industrial production in manufacturing — points to a pickup in economic activity in the manufacturing sector in the coming months.

Activity in the US construction sector also appears to be improving. Construction starts — according to the Dodge Construction Index — have grown by 10 per cent in the calendar year to October 2017. This is well above the 2.8 per cent growth recorded in 2016.

Figure 2.4: Indicators of activity in the US manufacturing sector



Notes: The manufacturing PMI is a diffusion index, where a reading above 50 indicates expansion in the industry, and a reading below 50 indicates contraction

Source: US Federal Reserve; Institute for Supply Management

There appears to be a lot of optimism around the US economy at present, with economic activity expected to pick up in the short term. US GDP growth is forecast to increase from 1.5 per cent in 2016 to 2.2 per cent in 2017 and 2.3 per cent in 2018. This optimism is also reflected in financial markets' expectations for company profits, with the US S&P 500 hitting a new record high in November.

However, US economic growth may decelerate beyond 2018. The spread between two year and ten year Treasury bond yields is the lowest it has been since the global financial crisis. This narrowing of the spread suggests that bond markets are pricing in a period of very low inflation and low economic growth.

The US Federal Reserve is continuing to gradually wind down the measures taken to mitigate the effects of the financial crisis. Should this occur more rapidly than anticipated, higher US interest rates may lead to a sizable tightening of global financial conditions. Countries with external imbalances or which are heavily reliant on external funding, particularly those in emerging Asia, may be vulnerable to higher US interest rates. Higher US interest rates may force these countries to increase their own domestic interest rates to avoid capital outflows. Higher interest rates would also dampen domestic investment and consumer demand, while raising public sector borrowing costs.

The US Government has just passed a tax reform bill, which went into effect on 1 January 2018. The full implications for economic growth and government debt are still unclear.

2.5 Other major markets

Industrial activity has also gathered pace in the major markets of the European Union, Japan and South Korea.

Japan's industrial production grew by 4.8 per cent in the calendar year to September 2017 — the fastest expansion since 2010. Favourable business conditions in Japan have been supported by ongoing easy monetary policy and a $US45 billion fiscal stimulus program which was launched in the second half of 2016. However, beyond 2017, economic and industrial production growth is forecast to slow significantly, as the fiscal support of recent years fades.

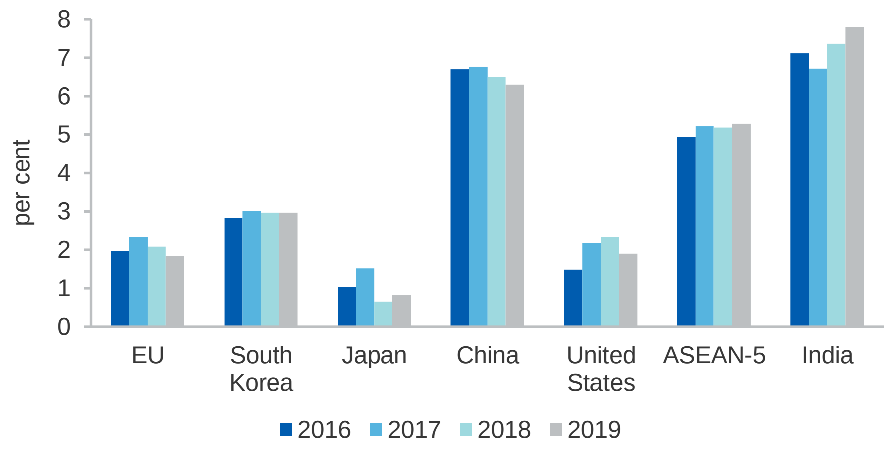
Economic activity in the Euro area in 2017 was supported by easy monetary conditions and an acceleration in exports amid a broader pickup in global trade. The Euro area's Composite PMI currently points to firm GDP growth over the coming few months. The Euro area's GDP growth is expected to moderate slightly in the next two years, held back by weak productivity and an aging population. Monetary policy is not expected to lend as much support as in the past few years.

Economic growth in the ASEAN-5 economies is also likely to have picked up in 2017, supported by improved external demand from China and Europe. Resilient domestic demand and a healthy global backdrop are expected to support solid (over 5 per cent) economic growth in the ASEAN region over the next two years. However, upcoming elections in Malaysia, Thailand and Indonesia could present short term hurdles.

Similarly, South Korea's economic growth likely picked up in 2017, supported by the recovery in global trade. The pick-up in exports and rising business and consumer confidence should continue to support economic growth in South Korea in the short term, with growth likely to be 3 per cent in 2018 and 2019.

India's economic growth is estimated to have slowed to 6.7 per cent in 2017 — reflecting disruptions associated with the currency exchange initiative (introduced in November 2016) as well as transition costs associated with the launch of the national Goods and Services Tax in July 2017. India's economic growth is expected to pick up in the next two years, but will likely depend on the impact of fiscal consolidation, removal of infrastructure bottlenecks, and the pace of revival of private investment and the banking sector.

Figure 2.5: Outlook for Gross Domestic Product by key markets



Source: IMF World Economic Outlook October 2017

Table 2.3: Key world macroeconomic assumptions

Per cent	2016	2017 a	2018 a	2019 a
Economic growth b				
Advanced economies	1.7	2.2	2.0	1.8
United States	1.5	2.2	2.3	1.9
Japan	1.0	1.5	0.7	0.8
European Union 28	2.0	2.3	2.1	1.8
Germany	1.9	2.1	1.8	1.5
France	1.2	1.6	1.8	1.9
United Kingdom	1.8	1.7	1.5	1.6
South Korea	2.8	3.0	3.0	3.0
New Zealand	3.6	3.5	3.0	2.5
Emerging economies	4.3	4.6	4.9	5.0
Emerging Asia	6.4	6.5	6.5	6.5
ASEAN-5 d	4.9	5.2	5.2	5.3
China e	6.7	6.8	6.5	6.3
Chinese Taipei	1.5	2.0	1.9	2.0
India	7.1	6.7	7.4	7.8
Latin America	-0.9	1.2	1.9	2.4
Middle East	5.1	2.2	3.2	3.2
World c	3.2	3.6	3.7	3.7
Inflation rate b				
United States	1.3	2.1	2.1	2.2

Notes: **a** Assumption; **b** Change from previous period; **c** Weighted using purchasing power parity (PPP) valuation of country gross domestic product by IMF; **d** Indonesia, Malaysia, the Philippines, Thailand and Vietnam; **e** Excludes Hong Kong

Source: IMF (2017) World Economic Outlook; Department of Industry, Innovation and Science