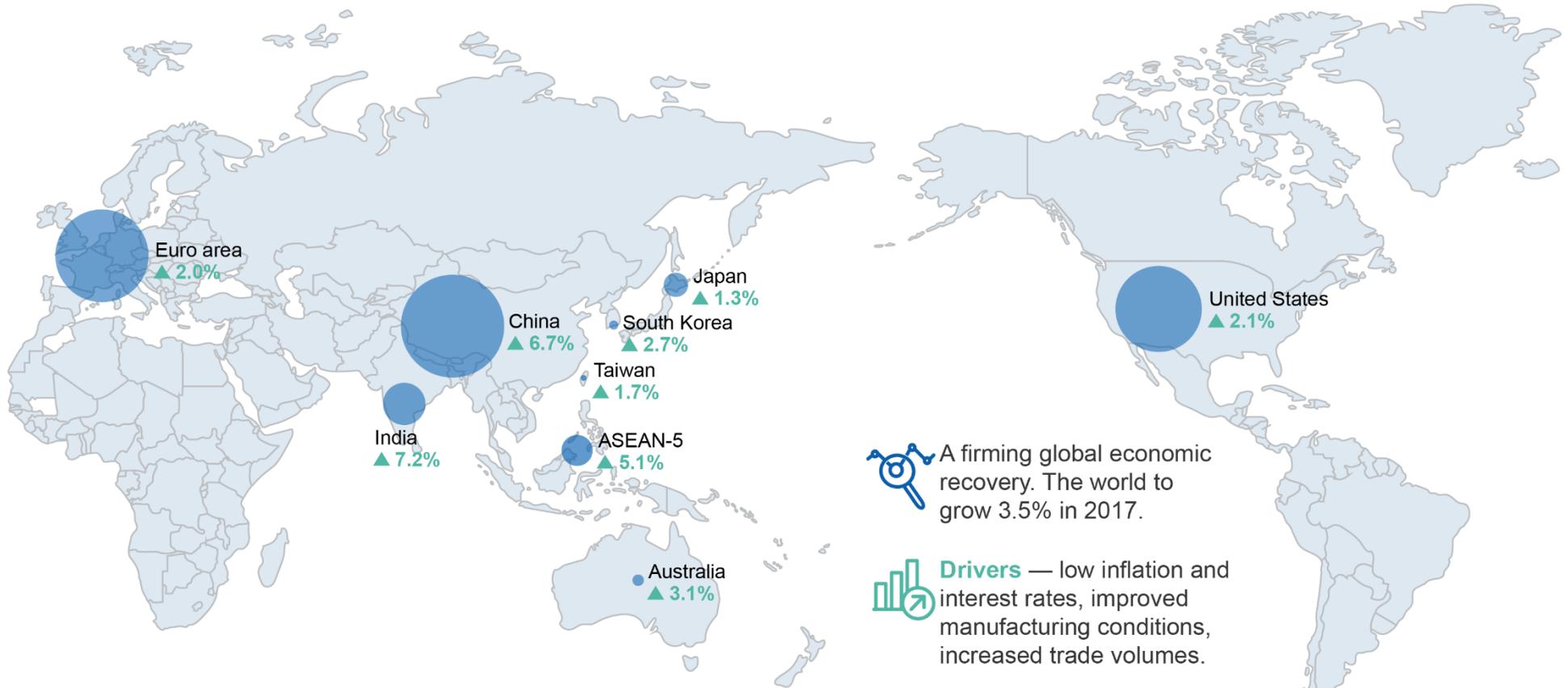


# Macroeconomic outlook

Resources and Energy Quarterly September 2017

- = 5% Share of global economy
- ▲ = Forecast GDP growth in 2017



 A firming global economic recovery. The world to grow 3.5% in 2017.

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

 **Risks** — geopolitical tensions over North Korea's missile program, rising debt levels in China.

## Summary

- The global economic recovery is firming, with world output forecast to grow by 3.5 per cent in 2017, 3.6 per cent in 2018, and 3.7 per cent in 2019 — supported by low inflation and interest rates.
- A sharp escalation of geopolitical tensions over North Korea's missile program could derail global economic growth projections.

## Global outlook

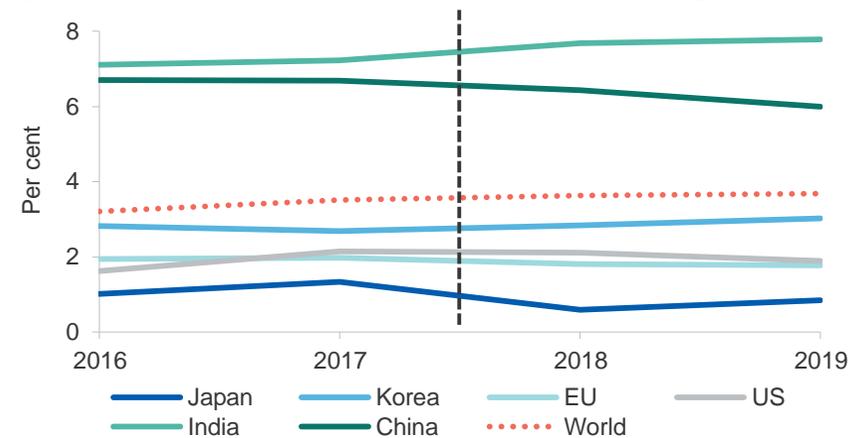
The global economic recovery has continued to build, evidenced by improved June quarter 2017 gross domestic product (GDP) figures from several major countries/regions. China recorded year-on-year GDP growth of 6.9 per cent, up from the growth rate in the March quarter 2017. In the United States, the economy grew by 2.1 per cent annualised in the June quarter. The European Union and Japan also recorded a year-on-year growth of 2.3 and 2.1 per cent, respectively.

The sustained recovery in global economic has been driven by rising business confidence and assisted by ongoing loose monetary conditions as inflation stays low. The world Purchasing Manager's Index (PMI) — an indicator of the economic health of the global manufacturing sector — hit a six-year high in August, at 53.1. This points to ongoing firm growth in the manufacturing sector in the short term, thus to rising global metal consumption.

The International Monetary Fund (IMF) did not change its global growth projections in its July 2017 economic update; the impact of upward revisions in GDP growth projections for China, the EU and Japan are expected to be offset by the downward revision in GDP growth projected for the US. Global economic growth is forecast to rise steadily further over the forecast period, reaching 3.7 per cent by 2019, up from 3.1 per cent in 2016.

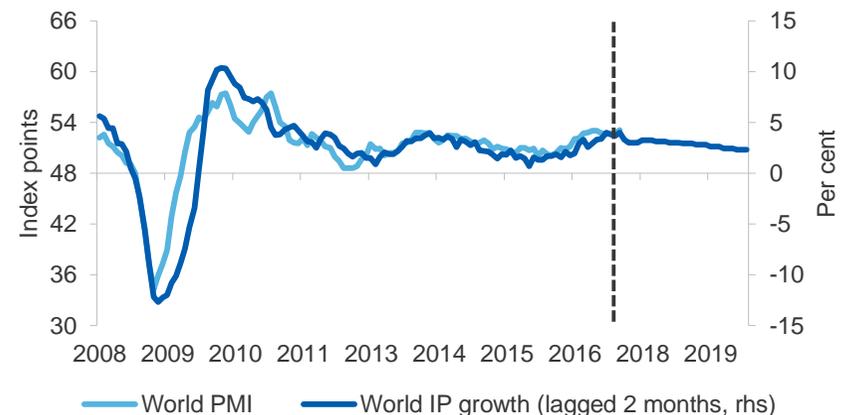
In China, fiscal support is expected to continue ahead of the 19th National Congress of the Communist Party of China in mid-October. In Japan and the EU, stronger economic activity in the first half of 2017 have been the catalyst for an upward revision to growth estimates. However, the IMF is less sanguine about the prospect of stimulatory US fiscal policy; reform appears to be much more difficult than expected, notwithstanding a Republican-controlled Congress.

Figure 2.1: Global and major economies real GDP, YoY growth



Source: International Monetary Fund (2017)

Figure 2.2: Industrial production vs World PMI, YoY growth



Source: Netherland CPB (2017); World Trade Monitor April; Markit (2017); JP Morgan Global Manufacturing PMI

Inflation in the Advanced economies remains low, and below or within the target range of 2–3 per cent set by most of the major central banks. This is allowing the central banks plenty of scope to withdraw their stimulatory monetary policy in a gradual fashion. World industrial production is forecast to grow at an annual average rate of slightly less than 3 per cent over the outlook period, supporting global GDP growth.

Any outbreak of hostilities on the Korean peninsula could have severe impacts on the global economy and Australian resource exports. China, Japan and South Korea are the main markets for Australia’s resource commodity exports. In 2016–17, China, Japan and South Korea accounted for 51 per cent (or \$61 billion), 7.1 per cent (or \$8.4 billion), and 5.8 per cent (or \$6.8 billion) of resource commodity exports, respectively.

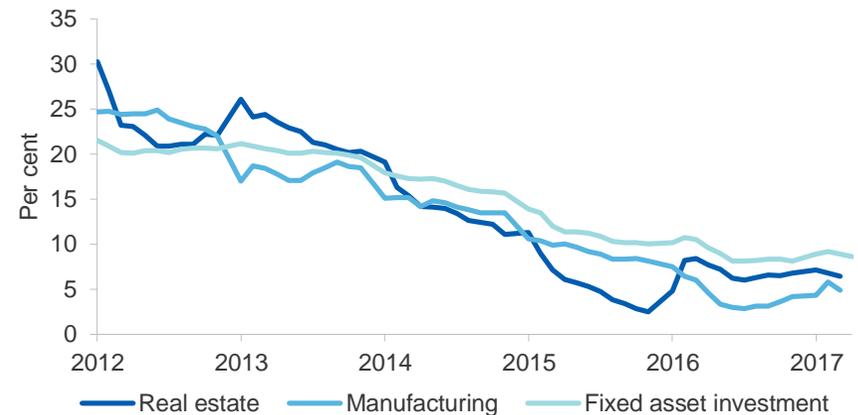
Rising debt levels in China and the uncertainty of fiscal policy in the US, pose additional risks to the global outlook. In China, total debt continues to rise (now at more than 250 per cent of GDP). Any sharp rise in bank bad debts could harm the country’s medium term economic growth. In the US, there are uncertainties over the Trump administration’s fiscal policies and the passage of proposed reforms. Any significant US fiscal stimulus would potentially add to demand and possibly inflation, putting pressure on the US Federal Reserve to raise official interest rates.

## China

Chinese GDP growth was better than expected in the June quarter 2017 at 1.7 per cent (6.9 per cent annualised rate). This was up from 1.3 per cent in the March quarter, driven by the continued strong performance in the residential construction activity. Over this period, property new starts and sales increased at an average monthly year-on-year growth of 16 and 13 per cent, respectively.

China’s industrial production increased by 6.4 per cent year-on-year in July 2017, driven by increased output of electricity, gas and water (up 9.8 per cent year-on-year). Manufacturing production rose by 6.7 per cent year-on-year in August, a slower pace than in previous months. Mining output fell by 1.3 per cent year-on-year, reflecting the impacts of the government’s shutdown of loss-making operations.

**Figure 2.3: Breakdown of Chinese investment, YoY growth**



Source: National Bureau of Statistics, China (2017)

**Figure 2.4: Chinese monthly residential activity, YoY growth**



Source: National Bureau of Statistics, China (2017)

There are a few factors behind the modest pick up in growth in recent months, including the change of the Chinese central government’s ‘one child’ policy to two children that provides incentive to families to upgrade their homes; the shift in demand from big cities to smaller cities, due to purchase restrictions in the large cities; government subsidies to people who would like to relocate from a shanty (small and badly built property) to a better dwelling; and expectations of further gains in property prices. The sustained recovery of the real estate sector from the multi-year low at the end of 2015 has been a strong catalyst for the rise in steel production. This, in turn, has supported Australia’s iron ore exports to China.

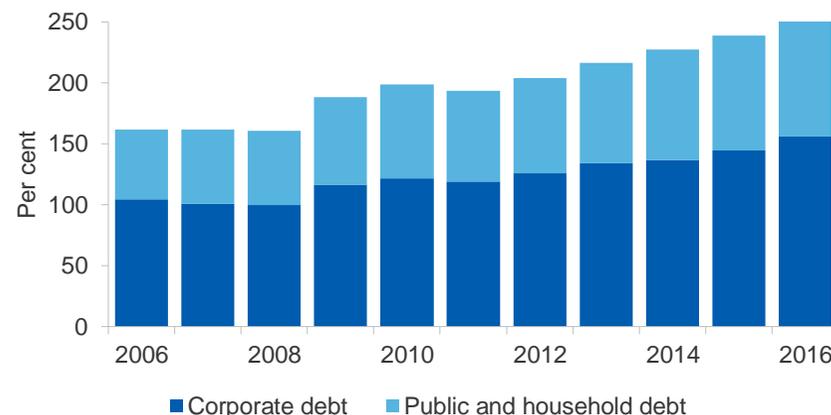
The transition from export and investment-led growth towards consumption-led growth economy in China has led to the outperformance of fixed asset investment (FAI) — investment in machinery, land, buildings, vehicles, and technology — over real estate and manufacturing investment. Despite falling from the high in 2012, FAI is still likely to grow at a monthly average of 8 per cent year-on-year growth in 2017.

China’s Monetary Conditions Index points to lower activity readings as 2017 comes to an end. Money supply (M2) growth has been slowing for nine months.

Growing concerns over debt levels in China represent the main risk to this medium-term outlook. As of 2016, the ratio of debt to GDP was 258 per cent — with corporate debt (at 156 per cent of GDP), and public and household debt (at 102 per cent of GDP). To address the rising debt issue, the People’s Bank of China has vowed to take ‘prudent and neutral’ measures. Large injections of support will be avoided, and more efforts will be made to deleverage the economy. Chinese GDP growth is expected to fall modestly in the short-term, from 6.7 per cent in 2017 down to 6 per cent in 2019.

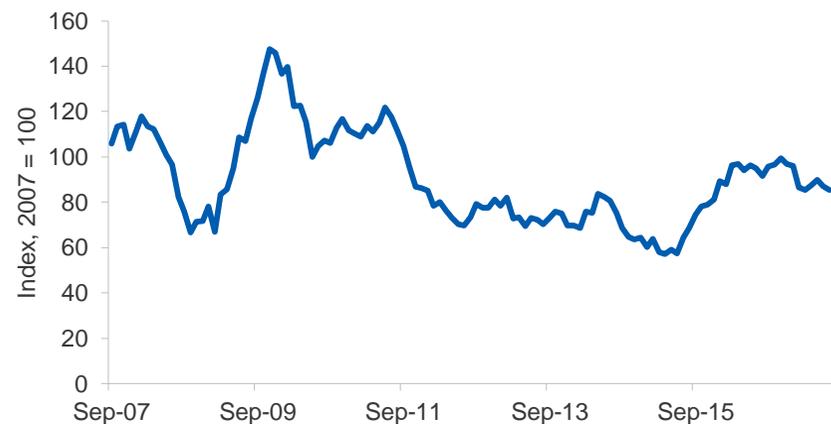
Government measures to curb a further rise in debt are likely to have a direct impact on economic growth. This strategy, in turn, will affect commodity exporters like Australia, due to reduced demand for commodities. In the July 2017 economic update, the IMF advised commodity exporting countries to ‘adjust to lower revenues’.

**Figure 2.5: China’s total debt**



Source: International Monetary Fund (2017)

**Figure 2.6: China — Monthly monetary conditions index**



Source: National Bureau of Statistics of China (2017)

## United States

US GDP rose by 2.1 per cent (annualised) in the June quarter, driven by strong consumption growth, and rising exports. The Institute of Supply Management (ISM) index of factory activity hit a 13-year high in September, pointing to strong commodity demand. 'Initial Jobless' claims recently reached multi-decade lows, which suggest further falls in unemployment may be in prospect over the coming few months. Such a decline would be helpful for consumer sentiment and spending.

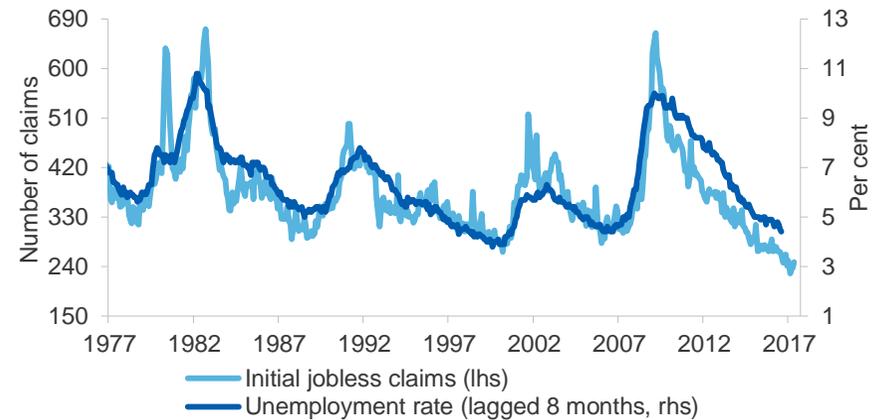
A succession of severe hurricanes have battered the southern United States in the past month. Hurricane Harvey wrought very significant damage around the city of Houston during the last week of August, disrupting the US economy. Houston is one of the United States' largest cities; the area in and around Houston is home to large energy, chemical and shipping industries and accounts for 3 per cent of the nation's GDP. The economic damage from Hurricanes Harvey and Irma has initially been estimated at US\$150 billion, and significant effects on US GDP growth may be seen in the September quarter national accounts. August industrial output fell by 0.9 per cent in the month to be 1.5 per cent higher year-on-year. It was the first decline in industrial output since January 2017, and Hurricane Harvey is estimated to have reduced total output by 0.75 of a percentage point.

Inflation remains low: consumer prices rose by 1.9 per cent year-on-year in August, the highest inflation rate in three months. Despite staying below the target range of 2–3 per cent, inflation is expected to pick up over the next few months, fuelled by stronger demand pressures.

The US dollar has depreciated significantly in recent months, as persistently low inflation has reduced the prospect of a succession of quick interest rate hikes by the US Federal Reserve. It is expected that the US Fed will raise the Federal Funds rate once more before the end of the year, after a rate hike in June. Several rate hikes then seem likely in 2018. The US Fed will begin to gradually reduce its balance sheet from October 2017.

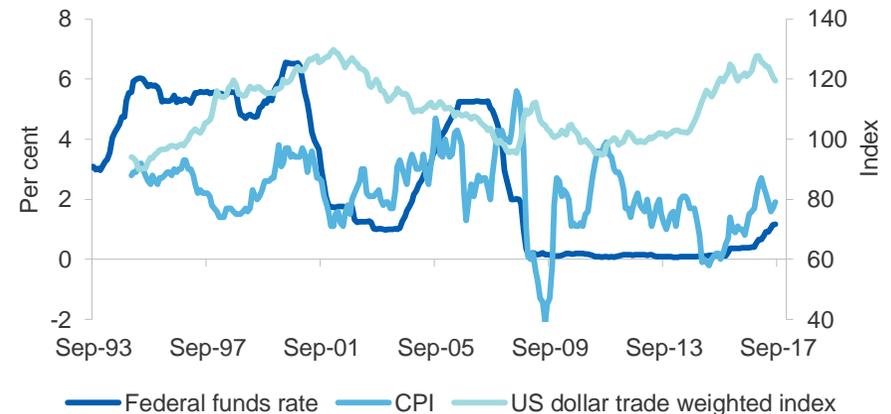
The IMF has lowered its economic growth projection for the US as a result of concerns over fiscal policy. US economic growth is expected to remain at around 2.1 per cent over 2017 and 2018, before edging down to 1.9 per cent in 2019.

**Figure 2.7: US unemployment rate vs Initial jobless claims**



Source: US Bureau of Labour Statistics (2017) Unemployment rate; US Department of Labour (2017) Initial jobless claims

**Figure 2.8: US Federal funds rate, CPI and US dollar**



Source: US Federal Reserve (2017) Federal funds rate; US Bureau of Labour Statistics (2017) US CPI Urban Consumers;

## Japan

Japan's economy, the fourth largest in the world, grew by 1.4 per cent (annualised) in the June quarter 2017, driven by rising domestic business activity and stronger exports. Japanese Machine Tool Orders—a leading indicator for capital spending—increased by 10 per cent year-on-year in July. Higher investment is likely to support employment growth in the next few quarters.

The most recent Bank of Japan (BoJ) statement (released following the July BoJ Board meeting) forecast continued expansion in the Japanese economy in the short to medium-term, supported by Government fiscal stimulus. Inflation is likely to rise to around 2 per cent during the outlook period, as Japanese firms pass on the cost of rising wages. The BoJ is expected to continue with quantitative easing measures, to keep prices from falling and to encourage investment.

Despite a recent strengthening, Japan retains the slowest GDP growth among the advanced economies, and a military confrontation in its region—while unlikely—would push Japan into recession.

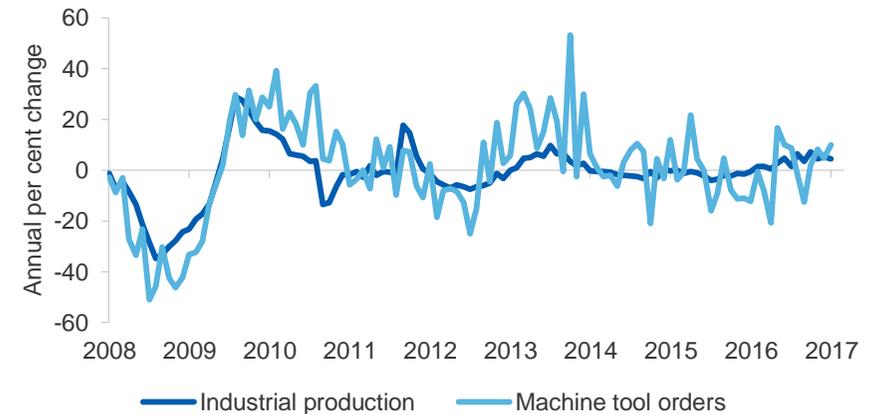
Growth is forecast to be 0.6 per cent in 2018 and 0.8 per cent in 2019. A scheduled doubling in the consumption tax—to 10 per cent effective in October 2019—could boost 2019 growth artificially by bringing forward consumption from 2020.

## South Korea

South Korea's real GDP growth rate decelerated to 2.7 per cent (annualised) in the June quarter, as a result of political instability, lower exports and falling vehicle production and sales.

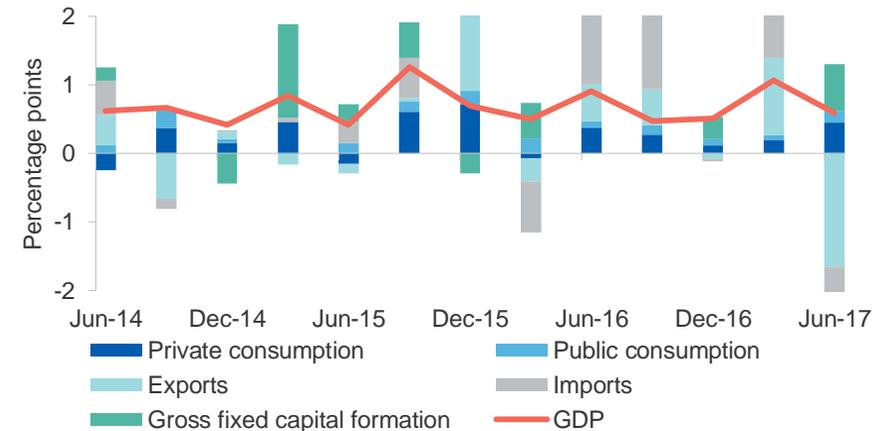
The recent decline in Korea's vehicle production is attributed to sluggish vehicle exports, high labour costs, and tense labour relations, which are driving Korean automakers to look to relocate their manufacturing facilities to other countries, such as China. Globally, Korean carmakers are facing stiff competition from China and the US, where their sedan models have lost market share to sport utility vehicles. In addition, the backlash over the deployment of a US missile defence system outside Seoul has reduced the sale of Korean cars in the Chinese market by over 50 per cent. The same driver has been blamed for lower tourist arrivals from China and other lost exports.

**Figure 2.9: Japanese Industrial Production vs machine tool orders**



Source: Ministry of Economy, Trade and Industry, Japan (2017) Indices of Industrial Production; Japan Machine Tool Builder's Association (2017) monthly Machine Tool Orders

**Figure 2.10: Korea — Contribution to YoY GDP growth**



Source: Bank of Korea (2017)

Geopolitical risks could also create significant uncertainty in South Korea in the short to medium term. The economy is forecast to grow by 2.8 per cent in 2018, and by 3 per cent in 2019, propelled by recovering private consumption and improved exports and investment. Increased demand for semiconductors and telecommunication products will boost exports. Exports of automobiles and ships are on a more lacklustre trajectory, however, and boosting household income remains an urgent issue for the Moon Jae-In administration.

## India

India's GDP growth slowed to an annualised rate of 7.2 per cent in the June quarter, as the economy lost some momentum due to the roll-out of the goods and services tax (GST); the fallout of the demonetisation of high-value currency notes may have also had some residual impacts. The GST also appears to have weighed on growth in manufacturing output, which slowed to 1.2 per cent in the June quarter from 5.3 per cent in the March quarter. Mining activity declined by 0.7 per cent in the June quarter.

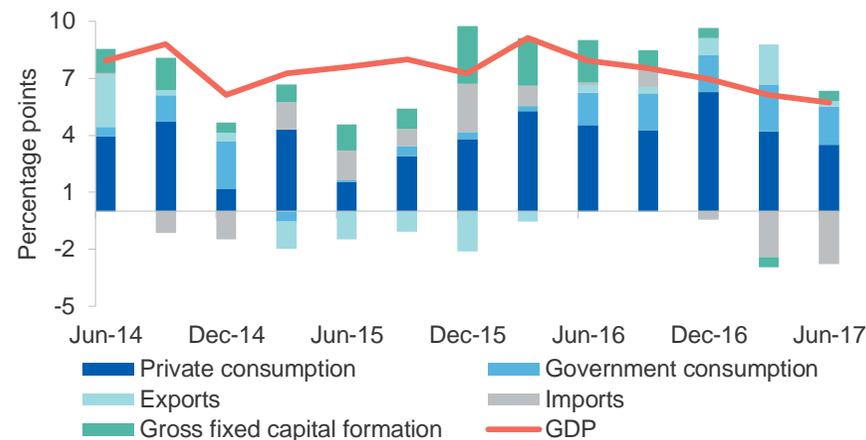
A recovery in growth is expected as 2017 comes to an end, supported by remonetisation and improved financial conditions. The Reserve Bank of India lowered its key lending rate by 0.25 per cent in early August, a move which is likely to boost consumption and economic activity into 2018. India's economy is forecast to grow at an annual rate of 7.8 per cent in 2018 and 2019, supported by rising consumption. The GST likely drew forward consumption from the second half of 2017 and early 2018. Further analysis on the Indian economy and its implications for exporters of Australian resource commodities can be found in the India Special Topic in this publication.

## Europe

Eurozone GDP grew by 0.6 per cent in the June quarter 2017 and by 2.1 per cent through the year: this was the highest rate of GDP growth recorded since the start of the debt crisis in the second quarter of 2011.

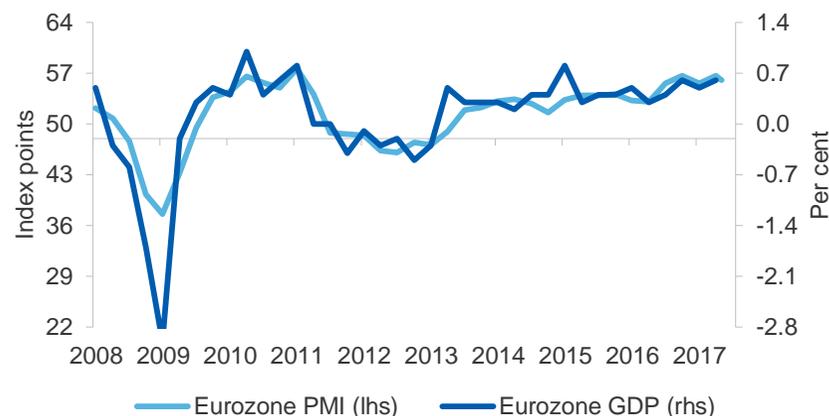
Recent election results in France and the Netherlands have eased financial market fears of a significant political shift to the right, and have generated positive economic momentum in the Eurozone. The Eurozone's Composite PMI remained high in September, pointing to ongoing relatively strong growth in the short term.

**Figure 2.12: India — Contribution to YoY GDP growth**



Source: India Central Statistical Organisation (2017)

**Figure 2.13: Eurozone PMI vs Real GDP, QoQ growth**



Source: Eurostat (2017) Euro Area Gross Domestic Product; Markit (2017) Eurozone Composite PMI

Factories in France are hiring at their best pace since 2000, and in Spain, at a rate not seen since the start of monetary union in 1998. The Spanish economy recorded a 0.9 per cent year-on-year rise in GDP in the June quarter 2017 (annualised rate of 3.1 per cent). It was the strongest expansion in nearly two years, and was mainly due to higher consumer spending.

Germany, the Eurozone's largest economy, recorded a 0.6 per cent rise in GDP in the June quarter 2017. German GDP has been supported by strong labour force conditions; the unemployment rate is now at its lowest level since Reunification. However, Germany continues to be heavily reliant on external demand, and could be negatively impacted by a slowdown in other major economies.

The Eurozone economy is forecast to grow at an annual rate of 1.8 per cent in 2018 and 2019, driven by stronger consumption and ongoing loose monetary policy. At its September meeting, the European Central Bank (ECB) Board reaffirmed its loose monetary policy stance by retaining rates at record lows, even keeping the door open to increasing bond purchases if needed. The ECB is expected to make a number of decisions on tapering its massive stimulus program in October 2017.

In the United Kingdom (UK), consumer spending fell for the third month in a row in July to be just 0.8 per cent higher year-on-year. This suggests the impact of Brexit vote is starting to ripple through households, leaving the UK vulnerable to a consumption-led slowdown. In addition, Brexit-related uncertainties are causing UK businesses to delay decisions about building new capacity. A deferral of investment is likely to lower industrial production activity, which may have consequences for short and medium term economic growth.

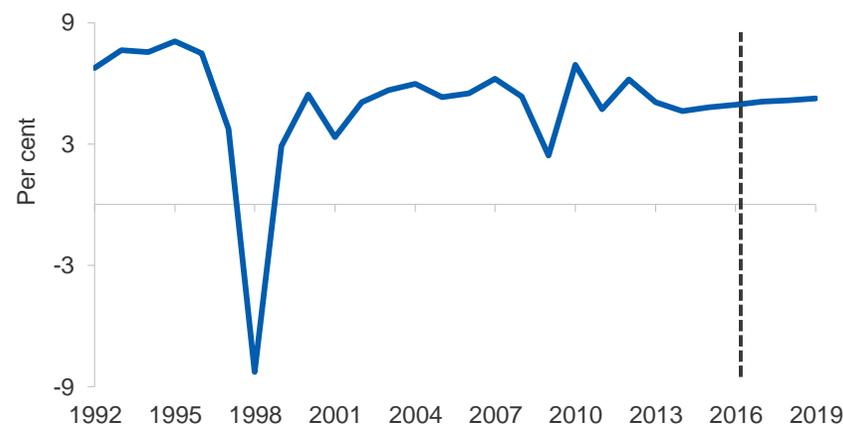
Italy's GDP advanced by 0.4 per cent in the June quarter 2017, driven by firm consumer spending, a rebound in fixed investment and inventory accumulation. The economy expanded by 1.5 per cent through the year, the strongest pace of expansion since the second quarter of 2011. On the back of sustained economic growth in the first half of 2017, the government of Prime Minister Paolo Gentiloni is expected to raise its forecast for 2017 GDP growth to around 1.4 per cent.

## ASEAN-5

The ASEAN-5 group of nations — Indonesia, Malaysia, the Philippines, Thailand and Vietnam — is home to 559 million people, with a combined GDP of \$US 2.1 trillion (as at 2016). ASEAN-5 is a significant export market for Australia's thermal coal, crude oil and refinery feedstocks, LNG, iron ore, aluminium, copper, and gold. ASEAN's commitment to spend more on infrastructure is vital in order to boost economic and social development through the improvement of basic necessities. According to the Asian Development Bank (ADB), ASEAN will need to spend US\$950 billion on infrastructure projects by 2020. It is a major opportunity for Australia's resources and energy exports

ASEAN-5 recorded 5.4 per cent year-on-year growth in GDP in the June quarter 2017, lower than China's growth rate, but higher than the global growth rate of 3.2 per cent year-on-year. Over this period, the Indonesian economy grew by 5 per cent year-on-year, Malaysia by 5.8 per cent, the Philippines by 6.5 per cent, Thailand by 3.7 per cent, and Vietnam by 6.2 per cent. Growth in the ASEAN-5 is forecast to remain robust over the rest of 2017, and over 5 per cent in 2018 and 2019.

Figure 2.15: ASEAN-5 — Real GDP, YoY growth



Source: International Monetary Fund (2017)

**Table 2.1 Key world macro-economic assumptions**

Per cent	2016	2017a	2018a	2019a
Economic growth b				
Advanced economies	1.7	2.0	1.9	1.9
United States	1.6	2.1	2.1	1.9
Japan	1.0	1.3	0.6	0.8
European Union 28	2.0	2.0	1.8	1.8
Germany	1.8	1.8	1.6	1.4
France	1.2	1.5	1.7	1.7
United Kingdom	1.8	1.7	1.5	1.6
South Korea	2.8	2.7	2.8	3.0
New Zealand	4.0	3.1	2.9	2.6
Emerging economies	4.3	4.6	4.8	4.9
Emerging Asia	6.4	6.5	6.5	6.3
ASEAN-5 d	4.9	5.1	5.2	5.3
China e	6.7	6.7	6.4	6.0
Chinese Taipei	1.4	1.7	1.9	2.0
India	7.1	7.2	7.7	7.8
Latin America	-1.0	1.0	1.9	2.5
Middle East	3.8	2.3	3.2	3.2
World c	3.2	3.5	3.6	3.7
Inflation rate b				
United States	1.3	2.0	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; IMF (2017) Article IV Consultation with the United States of America - Concluding Statement of the IMF Mission; Department of Industry, Innovation and Science