EMBARGOED UNTIL: 11.30AM THURSDAY 12 JULY 2018

THE FORWARD VIEW – GLOBAL

JULY 2018

National Australia Bank

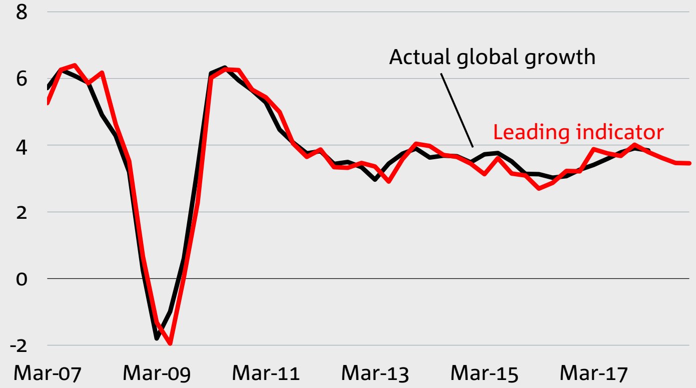
Summary – trade risks to the fore

- The imposition on 6 July of a 25% tariff by the US on around $34b of imports from China, immediately followed by matching retaliatory measures from China, highlights the rising trade war risk. While measures implemented to date are too small to knock the global economy off track, the concern is that we are at the start of a cycle where retaliation leads to further retaliation and other countries start raising their tariffs to protect their industries from the fall-out. Even ahead of any further escalation of trade barriers, a risk is that financial market reaction or a decline in business confidence could hit activity, although it is not evident in indicators yet.
- Trade concerns have been one factor weighing on financial markets, as have political developments in Europe and pressures on some EM countries and associated EME capital outflows, which have seen a number of EM central banks raise rates.
- That said, the global economy remains in reasonable shape right now despite some pressures on Emerging Market economies. Advanced economy growth looks like it picked up in Q2 and business survey readings are still at solid levels. In contrast, growth in China and some other EME countries looks to have slowed.
- Overall, assuming current trade disputes do not get out of control, global growth is set to remain above its long-run average for now, but we think annual growth will peak at 3.8% in 2018, consistent with our leading indicator of global growth which is pointing to a moderation in growth in coming quarters. Our forecasts for the out years have not fundamentally changed.

Global Growth Forecasts (% change)

	2017	2018	2019	2020
US	2.3	2.8	2.3	1.7
Euro-zone	2.6	2.1	2.0	1.8
Japan	1.7	0.9	1.0	0.7
UK	1.8	1.5	1.7	1.6
Canada	3.0	2.0	1.8	1.5
China	6.9	6.5	6.3	6.0
India	6.7	6.8	7.2	6.9
Latin America	1.3	1.6	2.4	2.6
Other East Asia	4.4	4.3	3.9	3.8
Australia	2.2	2.9	2.9	2.6
NZ	2.8	2.9	2.9	2.7
Global	3.8	3.8	3.7	3.5

Actual global growth and leading indicator (% yoy)



CONTENTS

Charts of the month 2

Financial and commodity markets 3

Advanced economies 4

Emerging market economies 5

Global forecasts and policies 6

CONTACT

Alan Oster, Group Chief Economist
+61 3 8634 2927

Gerard Burg, Senior Economist – International, +61 (0)477 723 768

Tony Kelly, Senior Economist
+61 (3)9208 5049

AUTHORS

Tony Kelly & Gerard Burg

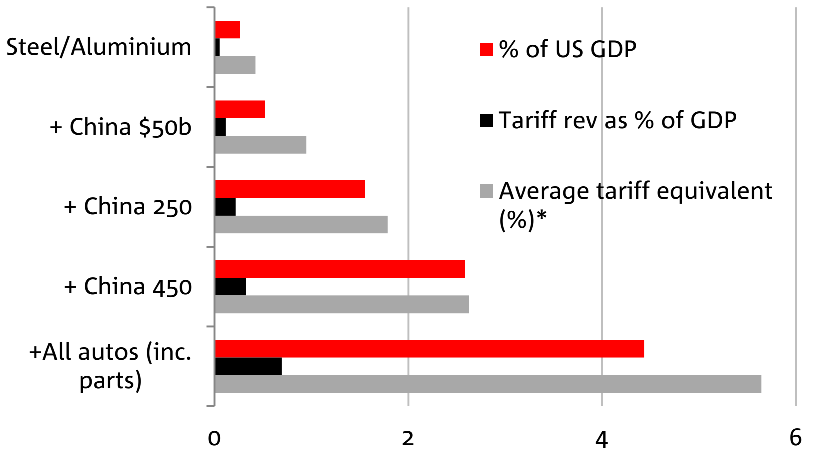
TRADE RISKS RISING

Concern is that a tit-for-tat retaliatory cycle escalates out of control

Implemented & threatened US tariffs are leading to retaliatory measures, including from China

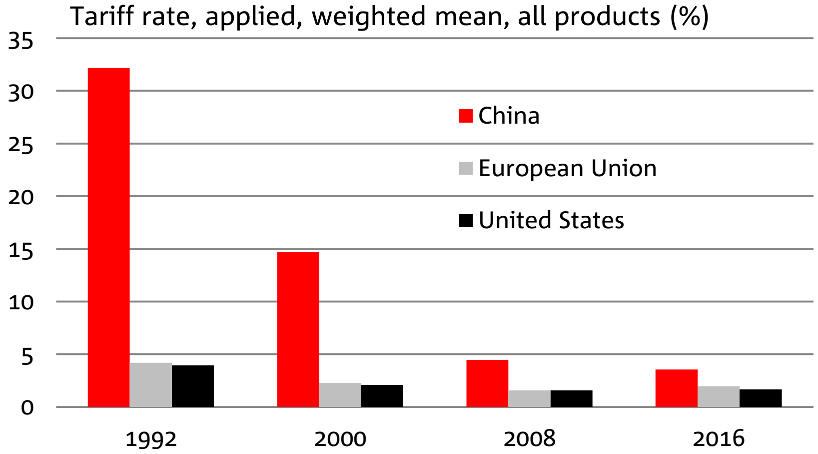
United States Measure	Status	Overseas Retaliation?
20-50% on washing machines/solar panels	In-place	
Steel (25%) & aluminium (10%)	In-place	Yes
25% on $50b China imports	$34b in-place $16b public hearings	Yes
10% on $200b China imports	Public consultation process has begun	Threatened
$200b China (rate unclear)	Threatened if China retaliates to $200b tariff	?
20-25% on autos (Europe or all, possibly includes parts)	US Section 232 investigation started 23 May - ongoing	Threatened

If all publically floated tariffs are put in place, average US tariff would rise by more than 5ppts



* ATE = (tariff * value of imports subject to tariff)/value of all US imports *

And while this would represent a major shift in tariffs…



Source: World Bank

…research indicates need a further escalation before there is a sizable shock on the global economy

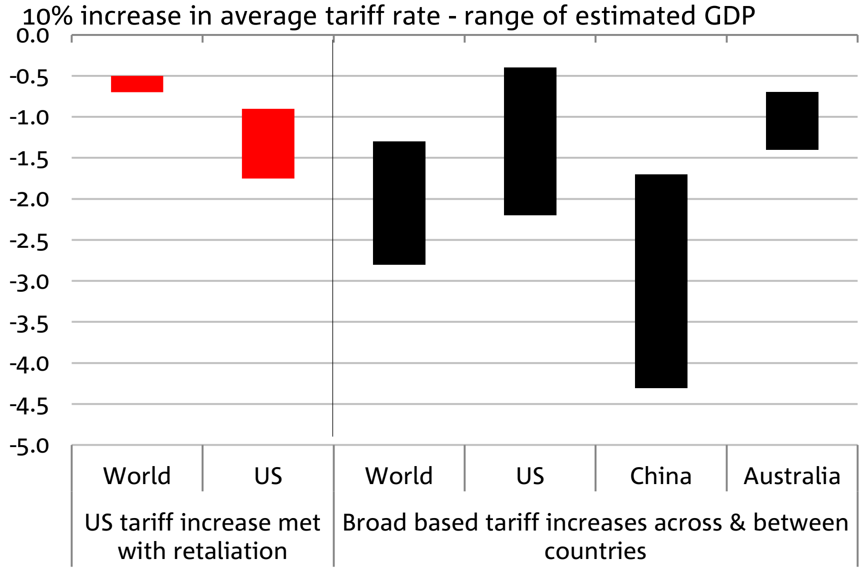


Chart shows estimates from various studies on the impact of tariff increases

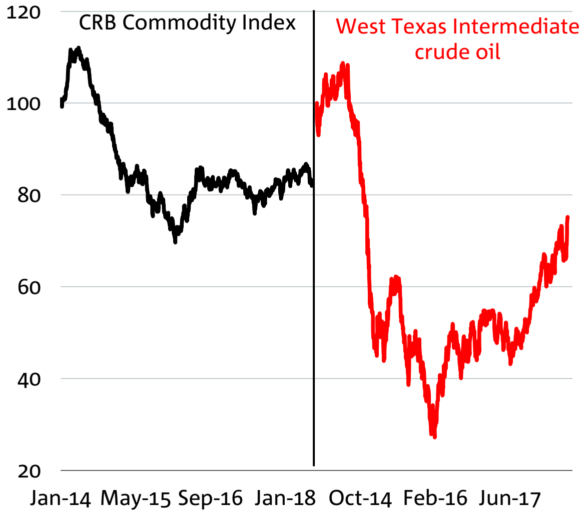
For further details see Trade Tensions on the Rise, July 2018

National Australia Bank

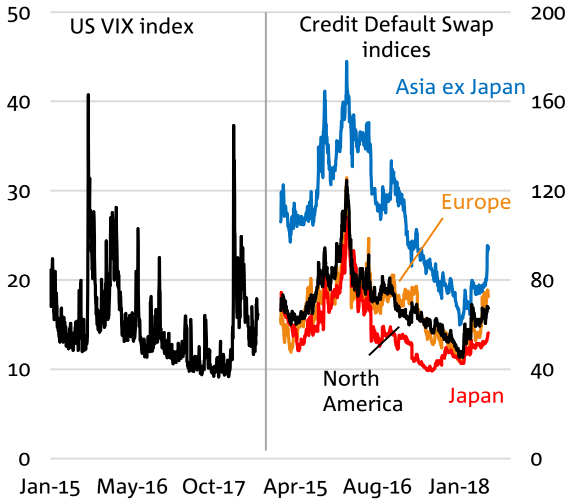
FINANCIAL AND COMMODITY MARKETS

Volatility and the US dollar are up, as EM economies come under pressure

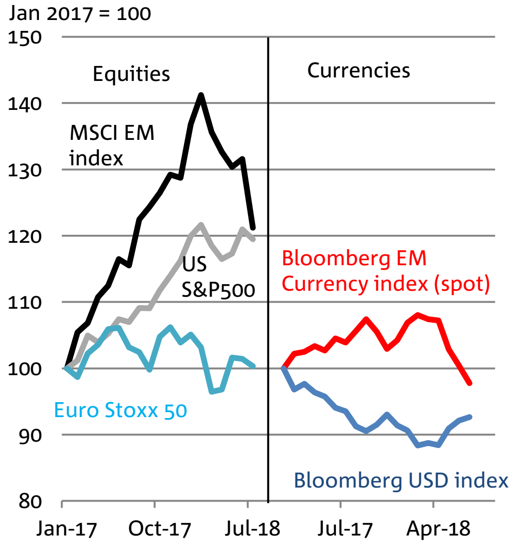
COMMODITY PRICES HAVE COME OFF



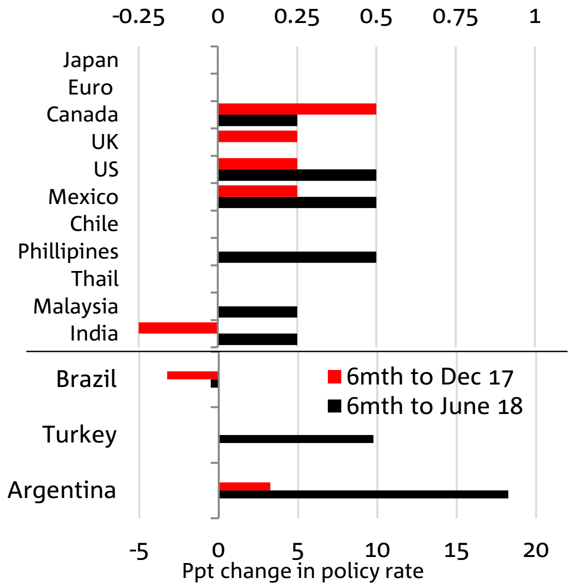
VOLATILITY/RISK UP



EMERGING MARKETS STRESSED



SHIFT TOWARDS EME RATE HIKES



 Sources: Datastream, Bloomberg, NAB Economics

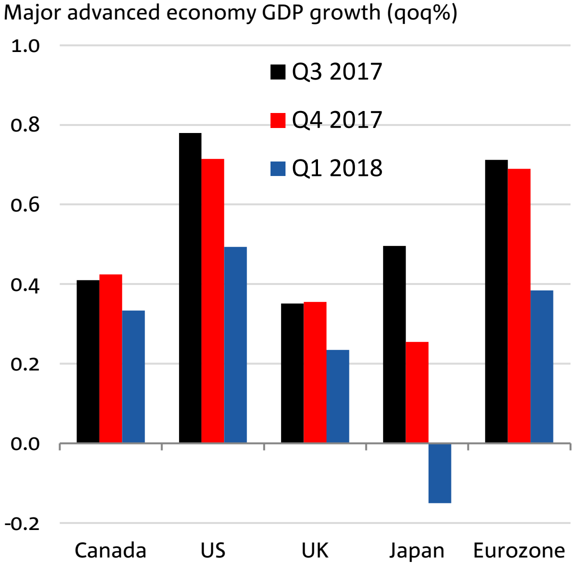
- While oil prices are at their highest level since late 2014 there has been some easing in overall commodity prices recently. The aggregate Thomson Reuters/CoreCommodity CRB Index has declined 5% since the end of May.
- The easing in commodity prices is another factor contributing to volatility in financial markets. The increase in Euro political uncertainty post the Italian elections, rising trade tensions between the US and some of its major trading partners, changing perceptions about central bank actions (particularly the US) and softer economic data to start the year have all contributed to a rise in volatility and risk measures. However, while indicators such as the VIX (a measure of equity market volatility) and CDS pricing have increased, they rose from very low levels by historical standards and are still not particularly high.
- These factors, as well as stronger US economic data in Q2 2018, have contributed to a rise in the US dollar since early April. This has added to pressure on some emerging market (EM) economies, leading to capital outflows, falls in equity prices and currency depreciation. In response, a number of EM central banks have lifted their policy rates this year, in a significant change from what was seen in the second half of 2017. A major exception is China; while its currency has also depreciated and its equity markets have declined, the authorities have recently moved to ease some of the policy tightening that had been put in place to bring credit growth under control.
- For the major central banks, policy is generally moving towards becoming tighter, with the exception of the Bank of Japan which appears to be on hold. The US Federal Reserve remains on track to deliver further rate rises, the Bank of Canada raised rates overnight and markets view a rate hike by the Bank of England later this year as likely.
- The ECB at its June meeting decided to start tapering its QE program after September with the result that there will be no net asset purchases from the start of 2019. While the ECB surprised markets in a dovish direction by indicating at the same time that key interest rates will remain on hold at least through to Summer 2019 the direction of policy (tighter) remains in place even if the timing has pushed out somewhat.

National Australia Bank

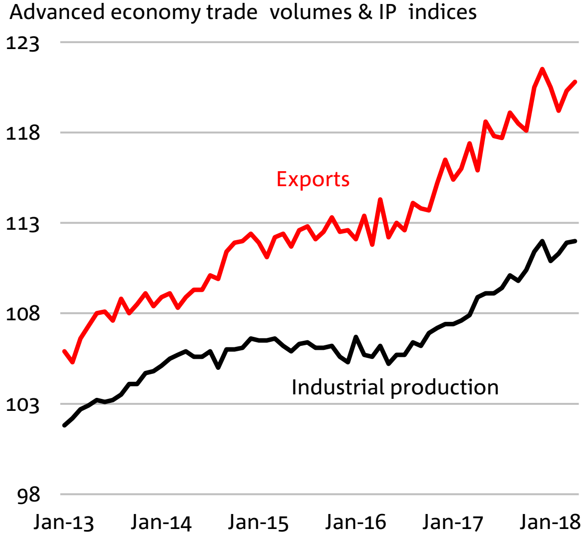
ADVANCED ECONOMIES

A rebound from soft Q1 looks likely; looking ahead business surveys still solid

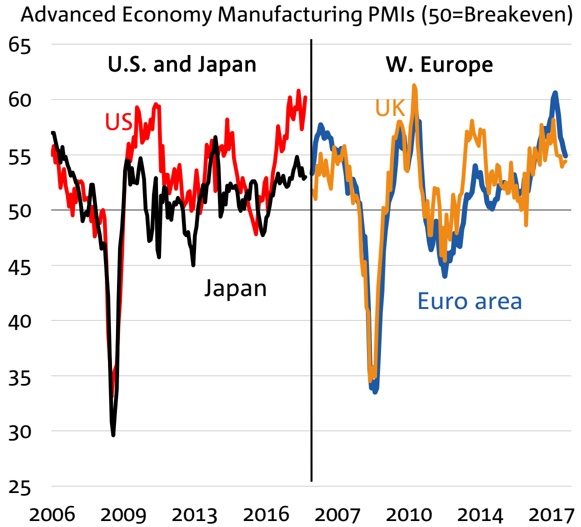
GROWTH SLOWED IN Q1



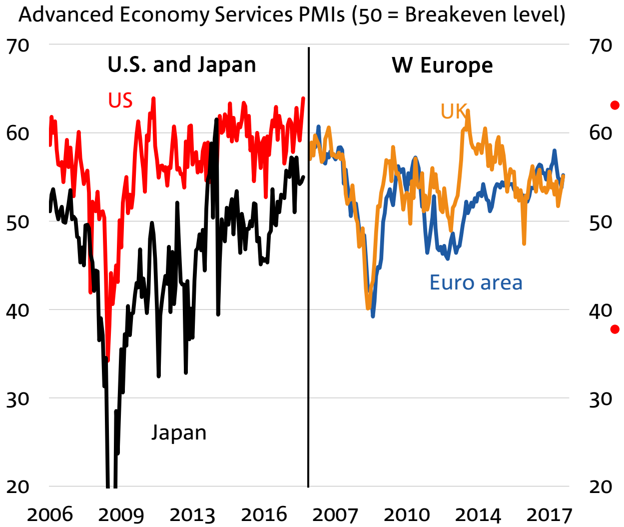
EXPORTS, IP – TENTATIVE SIGNS OF LIFE



MANUFACTURING SURVEYS MIXED



SERVICES HOLDING UP BETTER



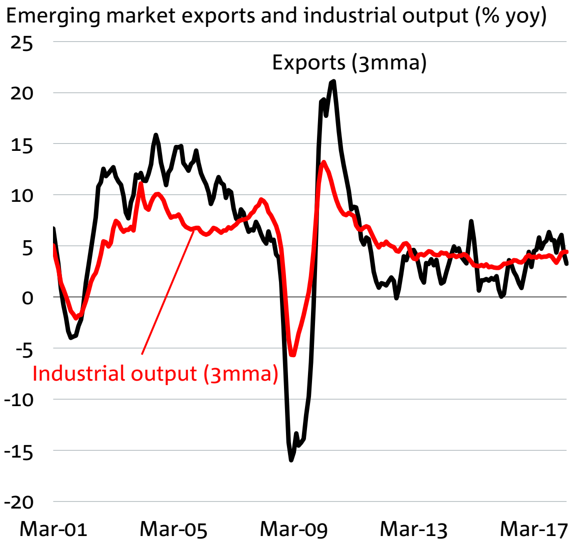
Sources: Datastream, NAB Economics

- While economic growth in the major advanced economies clearly slowed in Q1 2018, partial indicators point to stronger growth in Q2. Moreover, business surveys are consistent with solid growth going forward, even if below the highs of last year. Monetary policy across the advanced economies remains a factor supporting growth, notwithstanding some gradual tightening. The major downside risk is from trade tensions and the possibility that businesses might defer investment activity until the uncertainty clears up.
- Measures of exports and industrial production are still soft on a three-monthly basis but have recently showed tentative signs of improvement. These indicators are focussed on the goods sector, while business surveys suggest the more important services sector is tracking more strongly. Manufacturing surveys are still trending down in some countries (Euro-zone, Japan) but service sector readings are generally higher and have stabilised.
- The Q2 improvement is is most evident in the US where GDP nowcasts currently estimate growth of close to 4% qoq (annualised), almost double that seen in Q1. With a large fiscal stimulus at the start of the year, solid growth this year for the US is no surprise. However, as the impact of the stimulus fades over time, gradual monetary policy tightening continues and with capacity constraints likely to increasingly bite, growth is expected to slow over coming years.
- Japan should rebound from its first negative quarter of growth over two years – available data so far in Q2 for industrial production, consumption and trade are all showing improvement on Q1. Similarly, the UK slowed to a crawl in Q1, partially due to poor weather, but new monthly GDP data show activity grew more quickly in May alone than in the whole of Q1.
- The short-term outlook for the Euro-zone is a bit more mixed. Industrial production weakened in April although May German IP was up strongly. Retail sales are not showing much momentum although growth is tracking higher than in Q1. While GDP growth may strengthen into Q2, the strength seen last year look unlikely to be repeated any time soon. Measures of consumer and business confidence, while still solid, have come off their highs, and with the unemployment rate continuing to fall, capacity constraints are becoming an issue.

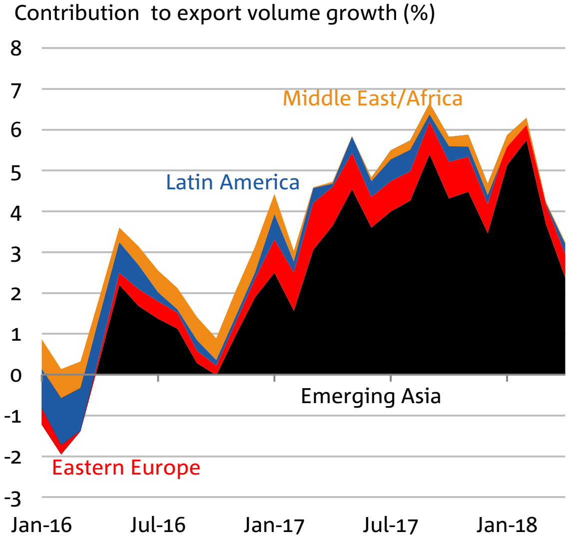
EMERGING MARKET ECONOMIES (EMES)

Trade tensions & USD strength trigger emerging market risk aversion

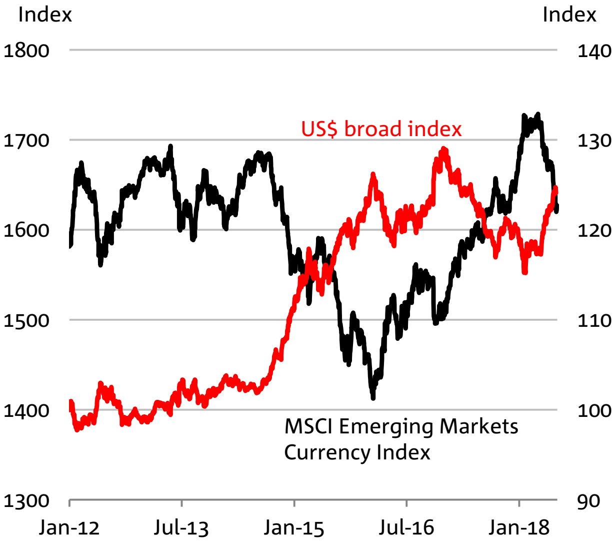
EXPORT VOLUMES SLOWING



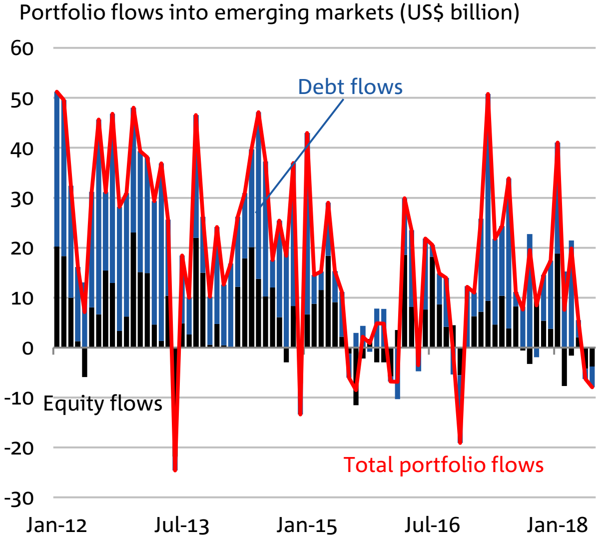
ASIA LEADS THE EXPORT SLOWING



EME CURRENCIES UNDER PRESSURE...



...WITH CAPITAL FLOWING AWAY



Sources: Datastream, CPB, Bloomberg, IIF, NAB Economics

- Emerging market economies are far more exposed to global trade policy and risk sentiment than advanced economies, and there are a number of signs of stress in some of these countries.
- Data for industrial production and export volumes provides some of the timeliest indicators of underlying conditions in these markets. Overall industrial production has strengthened in recent months – increasing by 4.4% yoy in April (on a three month moving average basis) – compared with a recent cyclical low of 3.3% in December. That said, output appears to have plateaued somewhat since January this year.
- Growth in export volumes has slowed considerably in recent months – back towards the post-GFC trend levels. In April, exports rose by 3.2% yoy (3mma) (compared with an average of around 5¼% over the previous twelve months). The key driver of this slowdown has been East Asia – the region that will be most impacted both directly and indirectly by US tariffs against China. More generally, recent data point to some slowing in China, in line with our expectations.
- A range of factors are pointing towards stress in some emerging markets. The MSCI Emerging Markets Currency Index has plunged since it reached an all time high in April – down almost 6% in early July. Over this period, the Argentinian Peso has fallen almost 40%, the Turkish Lira over 15% and the Chinese Yuan around 5.6%.
- Some observers have suggested that the People's Bank of China is allowing the currency to depreciate to (at least partially) offset the negative impacts of the US tariffs – an action unlikely to be popular in Washington. That said, there are significant risks attached to such a strategy – with the potential for capital flight to resume, at a time that financial market liquidity is relatively tight due to deleveraging.
- More broadly, capital flight has been underway across the emerging markets – according to data produced by the Institute of International Finance. Around US$211 billion flowed into emerging markets in the twelve months to April 2018. However, there are now outflows of over US$14 billion across May and June – as risk aversion sent capital towards safe haven assets.

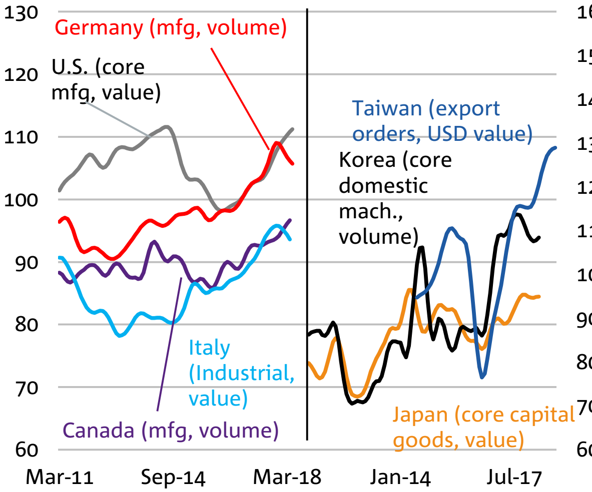
National Australia Bank

GLOBAL FORECASTS, POLICIES AND RISKS

Global growth rate may have peaked, but still above trend for now

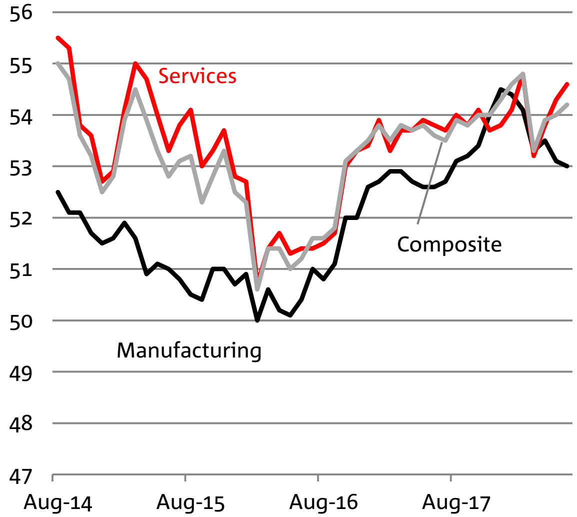
ORDERS STILL ELEVATED

Orders (2007 =100, s.a., 13 period Henderson m.a.)



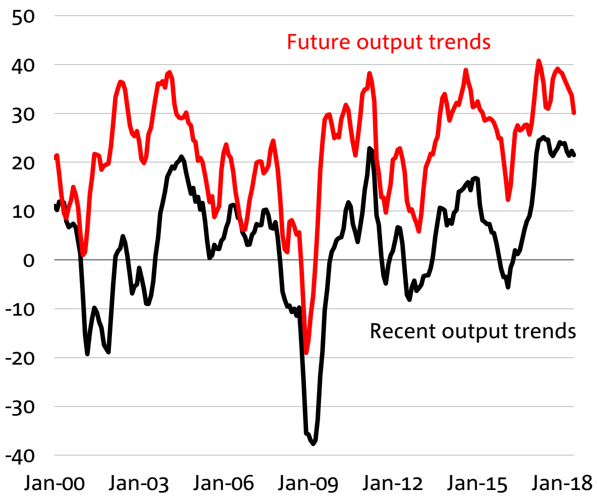
SERVICES HOLDING UP

JP Morgan World PMI



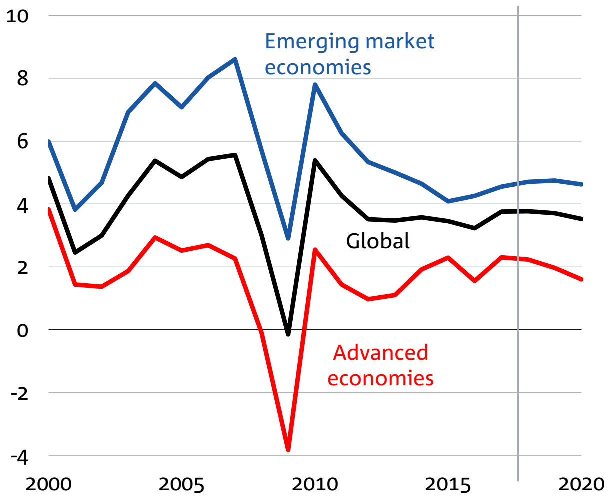
EXPECTATIONS SOLID BUT OFF HIGHS

Business surveys (US, UK, Germany & France) (Index)



ADVANCED ECONOMIES SET TO SLOW

Global economic growth & forecasts (%)



Sources: Datastream, Bloomberg, NAB Economics

- Negativity around the global trade outlook – and the potential implications for economic growth – needs to be weighed against the relative strength of recent economic performance. Growth in Q1 2018 was marginally lower than the peak in Q4 2017, however this was the strongest increase in over six years. Growth in Q1 was close to 4% yoy, which remains above the long term trend (3.5% since the early 1970s).
- There remain a number of positive indicators that suggest that relatively solid economic growth is likely to continue in the near term. These include forward order measures in major economies – which remain elevated – and robust PMI measures for services sector (which accounts for the largest share of economic activity in major economies).
- That said, it is likely that the current global economic cycle has either peaked or is near its peak (should growth in Q2 surprise on the upside, led by an upturn in the United States). Our leading indicator suggests that growth is set to slow across the remainder of this year. Similarly, forward looking measures in advanced economy business surveys have started to soften, but remain historically strong.
- Slowing in economic growth in coming years will be most evident in advanced economies – where monetary policy is becoming tighter and which are hitting capacity constraints in labour markets and idle production capacity is diminishing. This is the key driver of our weaker outlook for the global economy – easing to 3.7% growth in 2019 and 3.5% in 2020 (from 3.8% this year).
- However there are also a range of risks – most notably the potential for escalating trade restrictions across a range of economies. Global monetary policy decisions will remain challenging – with emerging markets facing capital outflows and currency depreciations, while many advanced economies face risks associated with inflated asset prices and high debt levels. Political uncertainty also remains a risk factor – including the poor progress made in Brexit negotiations between the United Kingdom and European Union.

National Australia Bank

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

Australian Economics and Commodities
Gareth Spence
Senior Economist – Australia
+(61 4) 36 606 175

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Behavioural & Industry Economics
Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics
Tony Kelly
Senior Economist
+(61 3) 9208 5049

Gerard Burg
Senior Economist – International
+(61 3) 8634 2788

John Sharma
Economist – International
+(61 3) 8634 4514

Global Markets Research
Peter Jolly
Global Head of Research
+61 2 9237 1406

Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

Important Notice

This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances.
NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it. Please click here to view our disclaimer and terms of use.