EMBARGOED UNTIL: 11.30AM THURSDAY 16 AUGUST 2018

THE FORWARD VIEW – GLOBAL

AUGUST 2018

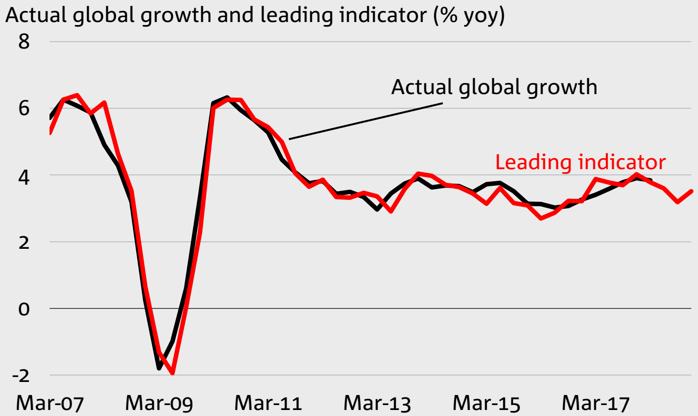
National Australia Bank

Summary – growth remains above trend, but risks a concern

- As expected, after hitting a soft patch in Q1, major advanced economy growth rebounded in Q2, with the exception of the Euro-zone. Business survey readings have also come off recent peaks but are still at solid levels. Fiscal policy (mainly in the US) as well as still stimulative monetary policy continues to underpin growth.
- A tightening in advanced economy monetary policy settings is underway. However, it is only gradual, particularly given the advanced stage of the economic cycle, highlighted by low (and falling) unemployment rates.
- Industrial indicators in emerging market (EM) economies are mixed and risk concerns are elevated as some EM financial markets have come under strong pressure, most notably Turkey recently, with some contagion to other EMs.
- Trade policy continues to be a major risk facing the global economy. Threatened US/China trade measures would represent a notable headwind to growth if put in place. Our forecasts assume that this does not occur, although without a high degree of confidence.
- Global growth appears to have remained above average through the first half of 2018, but with our leading pointing to a moderation in coming quarters, we think that this will represent the peak for this cycle. As a result we expect global growth to reach 3.8% in 2018 and then to ease over 2019 (3.7%) and 2020 (3.5%).

Global Growth Forecasts (% change)

	2017	2018	2019	2020
US	2.2	2.8	2.4	1.7
Euro-zone	2.5	2.0	1.8	1.7
Japan	1.7	0.9	1.1	0.9
UK	1.7	1.3	1.5	1.5
Canada	3.0	2.0	1.8	1.5
China	6.9	6.6	6.3	6.0
India	6.7	7.1	7.2	7.2
Latin America	1.3	1.6	2.4	2.6
Other East Asia	4.4	4.2	3.8	3.8
Australia	2.2	2.9	2.8	2.5
NZ	2.8	2.7	2.8	2.7
Global	3.7	3.8	3.7	3.5



CONTENTS

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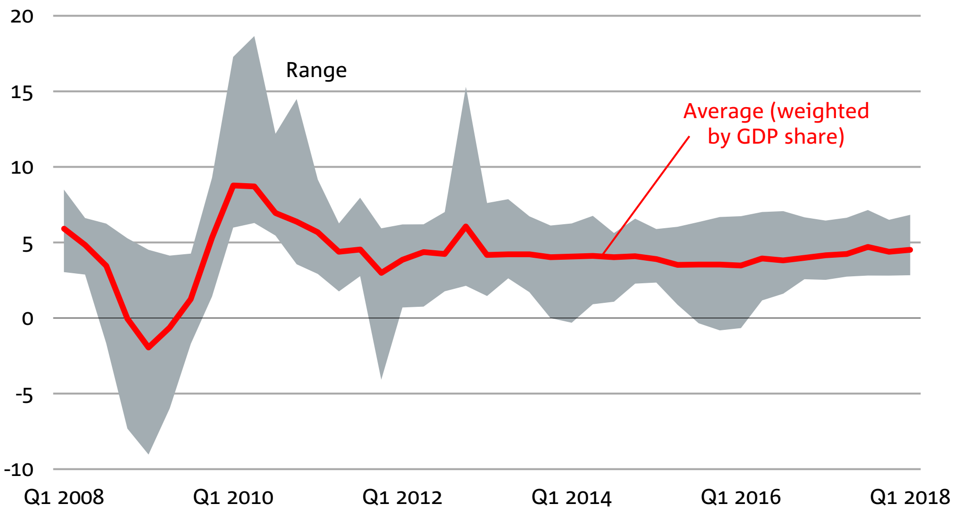
EAST ASIAN ECONOMIES

Economic growth has accelerated, but region is vulnerable to trade concerns

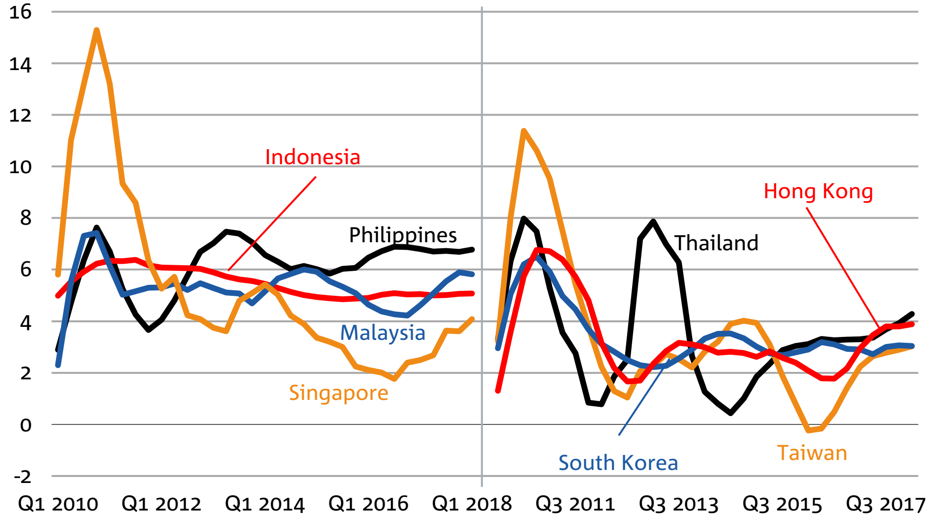
Growth up from 3.5% in Q1 ‘16 to 4.5% in Q1 ’18…

East Asian 8 economic growth (% yoy)



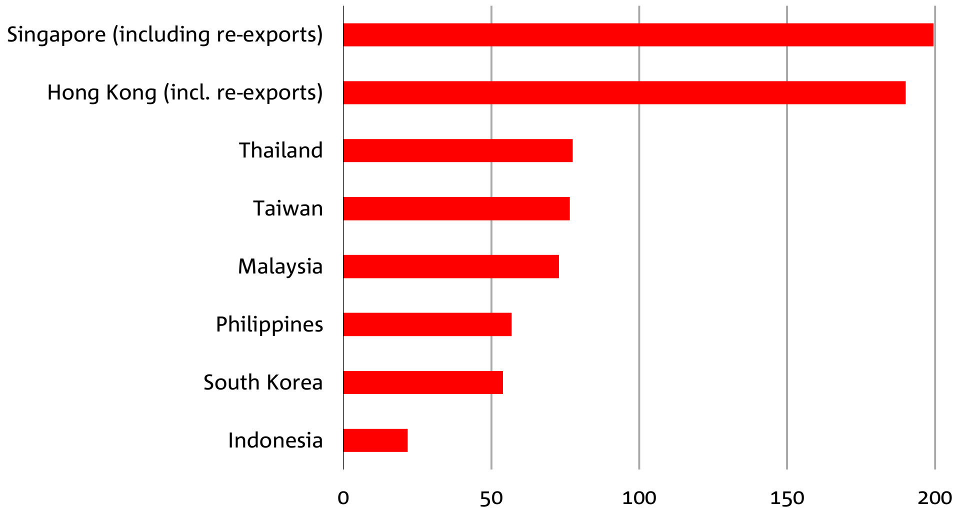
…driven by a broad upturn across the region

Economic growth (% yoy - 12mma)

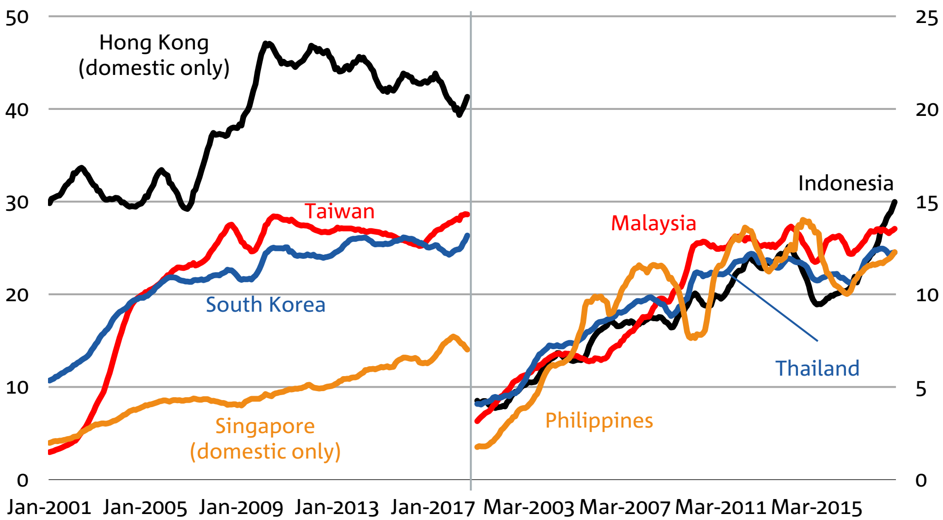


East Asia is highly trade exposed, and could be impacted by current tensions, given growing trade links with China

Exports of goods & services (% of GDP in 2017)



Exports to China (% share of total)



Sources: Datastream, NAB Economics

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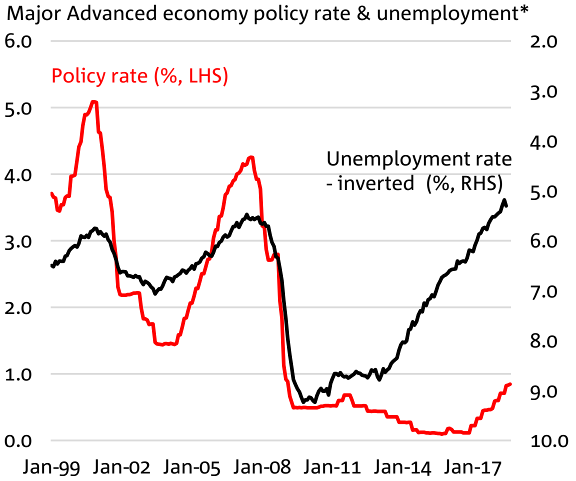
FINANCIAL AND COMMODITY MARKETS

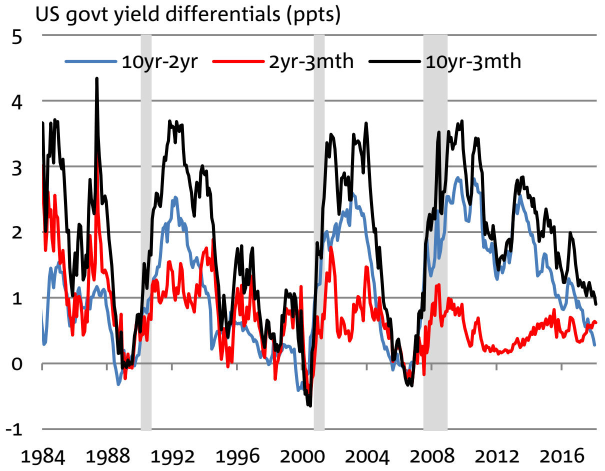
Gradual AE monetary policy tightening, but financial conditions not yet 'tight'

GRADUAL IS THE KEY



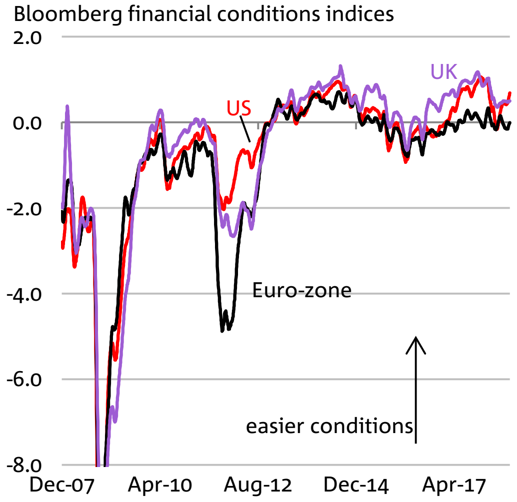
*PPP GDP weighted for US, UK, Canada, Japan, Euro-zone

YIELD CURVE WARNING OVERSTATED



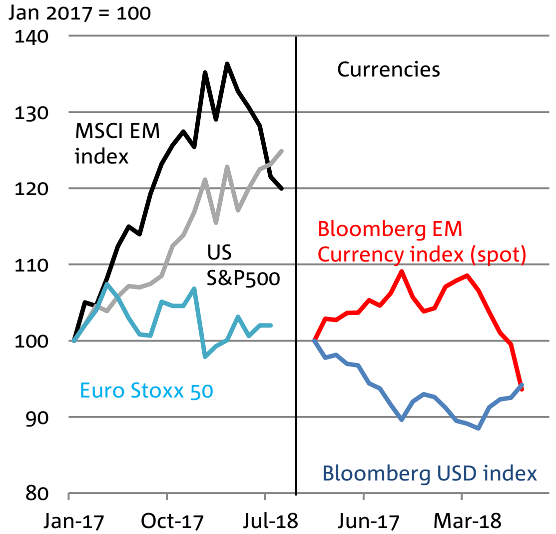
Yields based on Govt. rates. Greay areas indicate recession periods.

FINANCIAL CONDITIONS NOT TIGHT



* 30 day moving average

EMERG. MKTS STILL UNDER PRESSURE



- A gradual tightening in advanced economy monetary policy settings is underway. This month the Bank of England (BoE) raised its Bank Rate; this followed last month's hike by the Bank of Canada and the Fed's rate hike in June. However, the key word is 'gradual' – Fed and BoE rate tightening in particular is happening at a slow pace by past standards, and in the case of the ECB any tightening is still in the future. The Bank of Japan recently tweaked its policy with the result that 10 yr yields will be allowed to move a bit higher, but a major change in policy settings any time soon is unlikely.
- Policy tightening to-date looks particularly modest given the stage of the economic cycle – advanced economy unemployment is at decade lows. Of course, one reason for the muted response of policy is that inflation has been soft and below target.
- Monetary tightening is most advanced in the United States. This is not surprising as unemployment is low and inflation now essentially back on target; as a result more rate hikes are expected. Concerns have been raised about the flattening in the 10yr-2yr yield curve; this reflects the fact that historically an inverted yield curve has been followed by a recession within 6-24 months. However, it does not automatically follow that increases in the fed funds rate will invert the yield curve. Moreover, while in the past a similar signal has come from a yield curve calculated using different maturities, this is not the case this time around – particularly at the shorter-end where it has been broadly flat.
- Moreover, prior US recessions have also been preceded by more aggressive monetary tightening than is currently occurring. More generally, broader measures than just the policy rate indicate that financial conditions – in the US and other advanced economies – are not tight right now.
- In contrast, emerging market (EM) economies have been coming under pressure – reflected in falling currencies and stock prices – following the rise in the US dollar from early April, as well as due to local factors. While a few countries – such as Argentina and Turkey – have been hit particularly hard, there has been some broader contagion to EM economies, leading some EM central banks to raise rates.
- Overall commodity prices – as measured by the Thomson Reuters/Core Commodity CRB Index – after falling by around 8% between end May and mid-June, briefly stabilised before coming under further pressure as EM concerns re-emerged.

 Sources: Datastream, Bloomberg, NBER, NAB Economics

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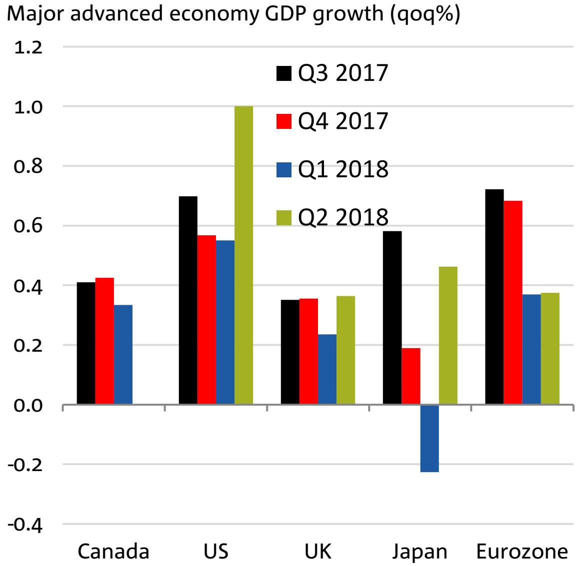
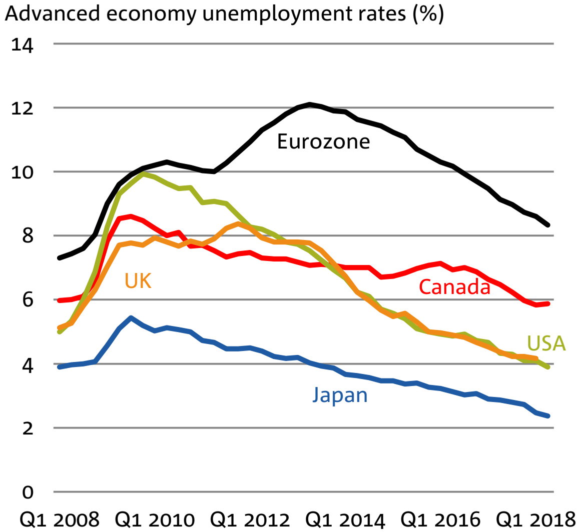
ADVANCED ECONOMIES

Growth rebounds from soft Q1; business surveys have eased but still solid

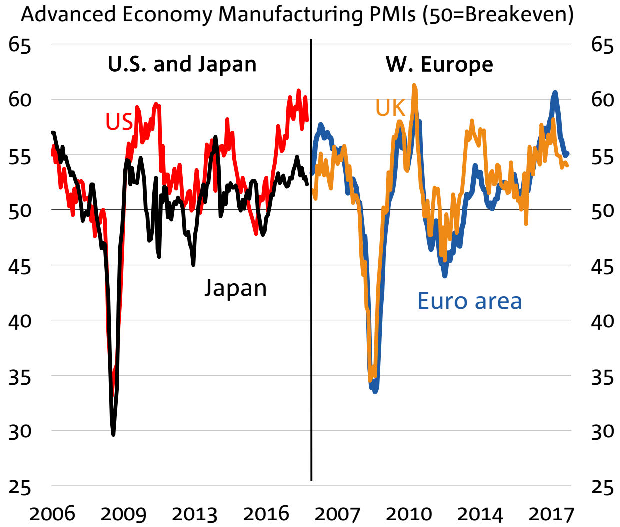
Q2 GROWTH REBOUND



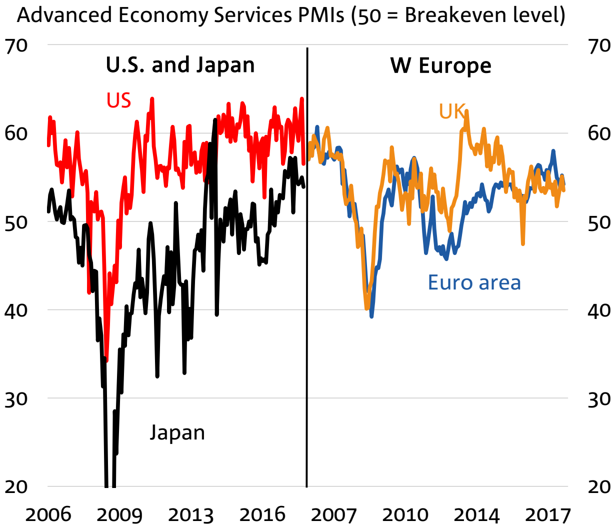
UNEMPLOYMENT LOW & FALLING



MFG SURVEYS STABILISING...



...OVERALL BUSINESS SURVEYS SOLID



Sources: Datastream, NAB Economics

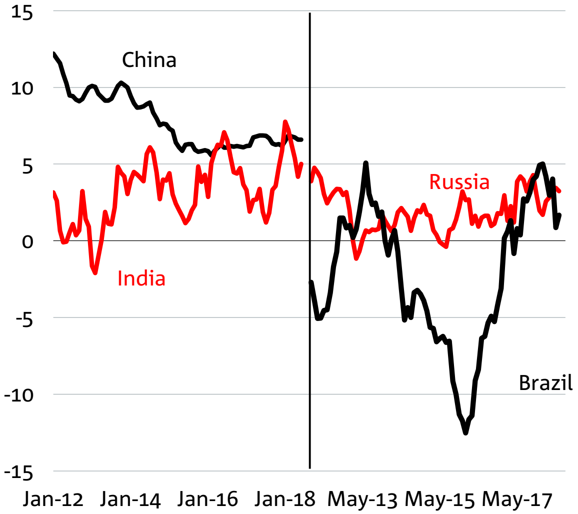
- After hitting a soft patch in Q1, major advanced economy growth has rebounded in Q2. This was most evident for the US, but was also true for Japan and the UK. Canada is also widely expected to show stronger growth in Q2.
- Monetary policy across the advanced economies remains a factor supporting growth, notwithstanding some gradual tightening to-date. Fiscal policy has also turned supportive, particularly in the US. Supply constraints are likely to become an increasing constraint on growth, as highlighted by the already low unemployment rates in many advanced economies. The major downside risk is from trade tensions and the possibility that businesses faced with an uncertain environment might defer investment.
- Growth in advanced economy goods exports and industrial production remains soft on a three-monthly basis, but has shown some improvement in recent months. Similarly, while off recent peaks, manufacturing business survey indicators have generally stabilised. In contrast, there were declines in non-manufacturing business surveys in July – particularly in the US – although given the month-to-month noise it is too early to draw any definite conclusions. Moreover, the current levels of the PMI surveys, are still consistent with solid rates of growth.
- The Q2 improvement in GDP growth was most pronounced in the US, with growth of just over 4% qoq (annualised). Growth is being supported by this year's large fiscal stimulus (tax cuts and increases in government spending). Exports also surged in Q2 – perhaps reflecting a bring forward of activity ahead of Chinese tariffs. As the fiscal stimulus fades, monetary policy tightens gradually and capacity constraints kick-in, growth is expected to slow over coming years.
- The exception to the story of an advanced economy rebound in Q2 was the Euro-zone, with the rate of growth similar across both Q1 and Q2 and well down on the second half of last year. While measures of consumer and business confidence have come off their highs, they are still at robust levels. Traditionally, the PMI surveys have closely tracked Euro GDP growth, but recently have pointed to higher GDP growth than has actually been the case. As a result our forecasts only allow for a modest growth rebound in the second half of 2018.

EMERGING MARKET ECONOMIES (EMES)

Slowing trade volumes and currency concerns point to some EM risk

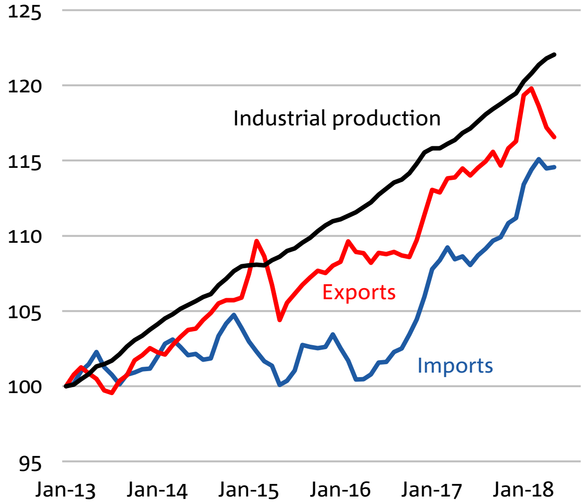
MIXED INDUSTRIAL TRENDS

Industrial production (% yoy (3mma))



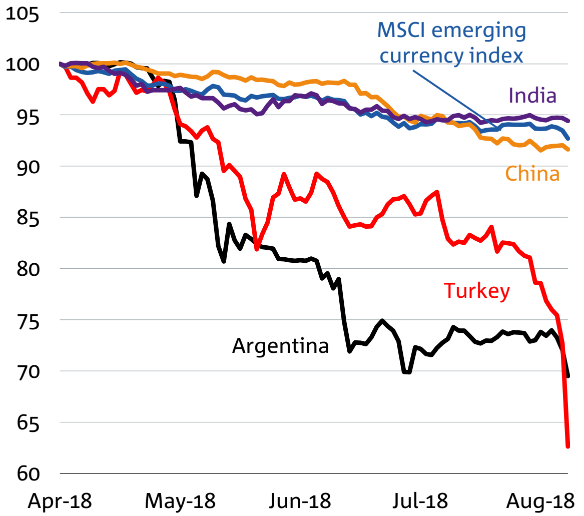
EXPORT VOLUMES SLOWING

Emerging market trade volumes & IP (Jan 2013 = 100)



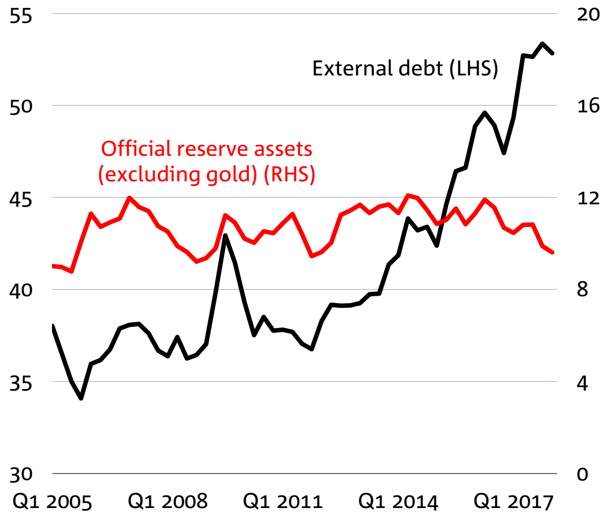
EME CURRENCIES WEAKER

Emerging market currency indices (to US$) (3 April 18 = 100)



TURKEY HIGHLY EXPOSED

Turkish risk indicators (% of GDP)



- Trends in emerging market economies remain mixed – with risk concerns elevated by the growing trade tensions between the United States and China (which could have spill-over effects into other emerging markets) and currency crises in a number of countries.
- Industrial indicators are mixed across the major emerging markets – with output growth in China remaining relatively stable, while growth in India and Brazil has slowed since the early part of the year.
- China's economic growth was marginally softer in Q2, down to 6.7% yoy (following three straight quarters of growth at 6.8%). This robust result was despite a deleveraging program aimed at addressing the country's debt. The pace of deleveraging may slow in H2, to support growth in response to US tariffs.
- US tariffs on Chinese imports (and China's retaliatory measures) came into effect in early July, however it is too early to see any impact in the data. Chinese trade data for July showed an increase in dollar denominated imports from the US – up 11% yoy, in line with recent trends – albeit this was smaller that the overall increase in Chinese imports (up 28% yoy). Similarly, exports to the United States rose by 11% yoy, marginally slower than overall export growth of 12%.
- Trade trends for emerging markets softened ahead of the tariff imposition. CPB data up to May showed a slowing rate of growth for export volumes – at just 1.8% yoy (on a three month moving average basis) – with volumes declining since a peak in February.
- Risk focus in recent weeks has increasingly turned towards Turkey. Although relatively small (at around 1.7% of global GDP), a financial crisis in the country could spill-over into Europe via the banking sector (particularly Spanish, Italian, Dutch and French institutions), and there has already been some pressure on Italian bond yields.
- Turkey's currency has been falling sharply in recent months (down over 40% since the start of the year), a particular problem given the size of the country's external debt (around 53% of GDP) – which is largely foreign currency denominated – and limited foreign reserves (less than 10% of GDP). Almost 62% of the country's debt is in US dollars, with a further 35% in Euros.

 Sources: Datastream, CPB, NAB Economics

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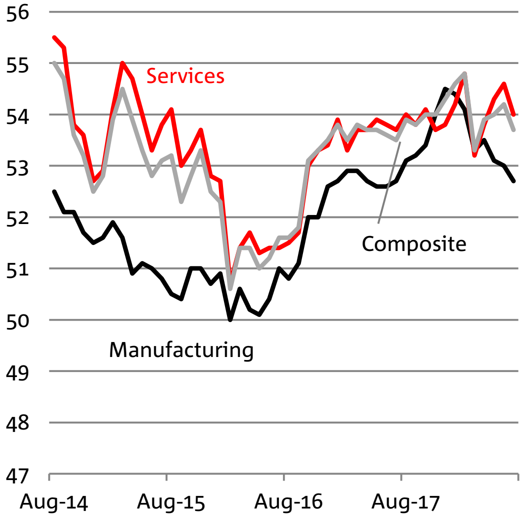
GLOBAL FORECASTS, POLICIES AND RISKS

Global growth remains above trend but expected to ease

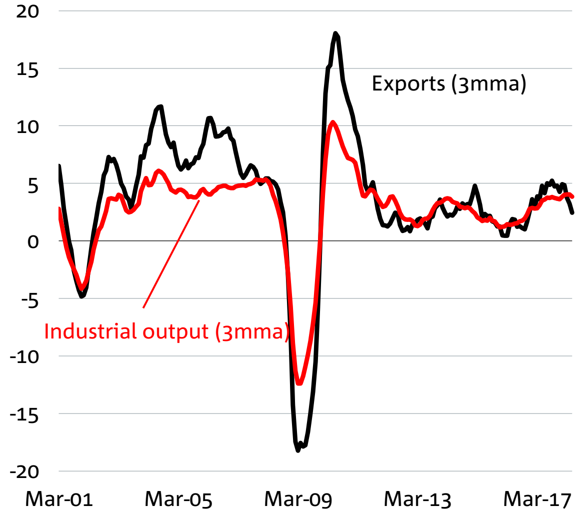
BUSINESS SURVEYS STILL SOLID

JP Morgan World PMI

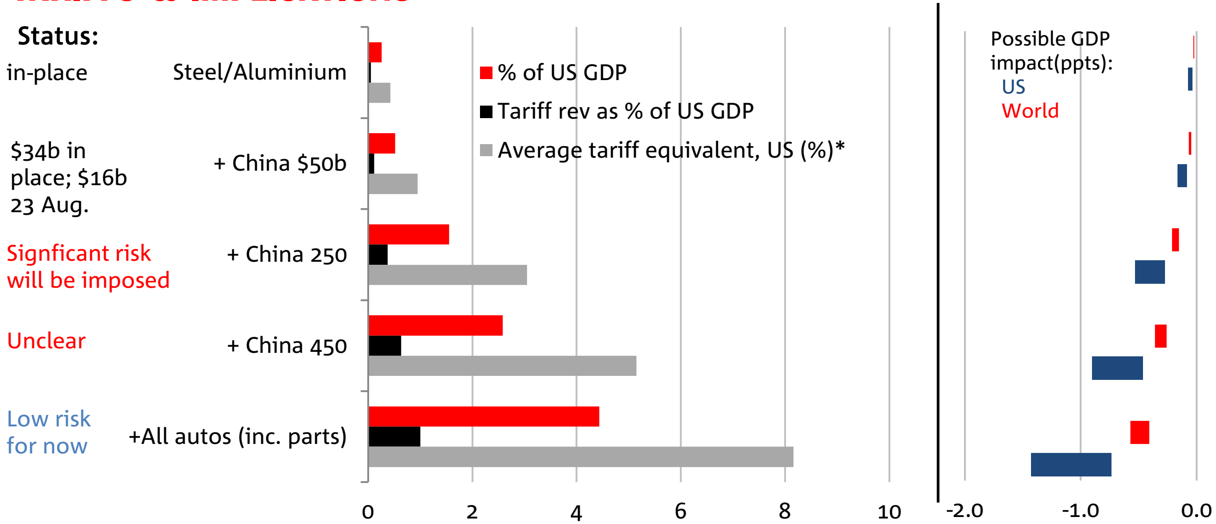


GLOBAL IP/TRADE – MIXED SIGNALS

Global exports and industrial output (% yoy)



TARIFFS & IMPLICATIONS



* ATE = (tariff * value of imports)/value of all US imports * Assumes 25% tariffs on China imports. China amounts refer to cumulative level of imports subject to US tariffs.

- While the recent partial indicators for EM economies have been somewhat mixed, the rebound in major advanced economy growth in Q2 2018 suggests that overall the global economy continued to grow at an above trend rate through to mid-2018.
- Global industrial production growth (y/y basis) has been trending up since mid-2015, although the growth rate has stabilised in recent months. A possible warning sign is the downturn in global trade volume growth in recent months. Business surveys also point to global manufacturing conditions having eased. This is also true of the more important services sector, but to a lesser degree, and the services PMI remains at a robust level.
- We continue to think that the current global economic cycle will peak this year. Our leading indicator (see Chart on front page) suggests that growth is set to slow across the remainder of this year.
- A slowing in global economic growth in coming years will be most evident in advanced economies, due to gradual monetary policy tightening, US fiscal stimulus fading and capacity constraints. The ongoing transition of China's economy, and associated trend growth slowdown, will also be a factor although still robust growth in India will provide an offset. Overall, we expect global growth of 3.8% this year, but for growth to ease to 3.7% in 2019 and 3.5% in 2020.
- Trade actions remain a major risk for the global economy. There was some recent good news with US/EU talks resulting in potential US tariffs on Euro auto imports being put on hold. However, 25% tariffs on a further $16b of China exports to the US will be imposed on 23 August, and the mooted tariff on a further $200b of imports was increased from 10% to 25%. China has indicated it will retaliate which could trigger US tariffs on another $200b of imports from China.
- If all the threatened US/China tariffs were to go ahead it would increase the average US tariff rate by around 5ppts. Studies have indicated a tariff increase of this magnitude would lower US GDP by 0.5-0.9ppts and world GDP by 0.2-0.4ppts. While this might be spread out over a few years it would represent a strong headwind to US and global growth (particularly in East Asia – see page 2).
- While trade remains the key risk, recent developments in Turkey are a reminder that navigating gradual monetary policy normalisation in advanced economies, given structural and policy weaknesses in some EM countries, is not going to be all smooth sailing.

 Sources: Datastream, Bloomberg, NAB Economics

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