THE FORWARD VIEW – GLOBAL

SEPTEMBER 2018

National Australia Bank

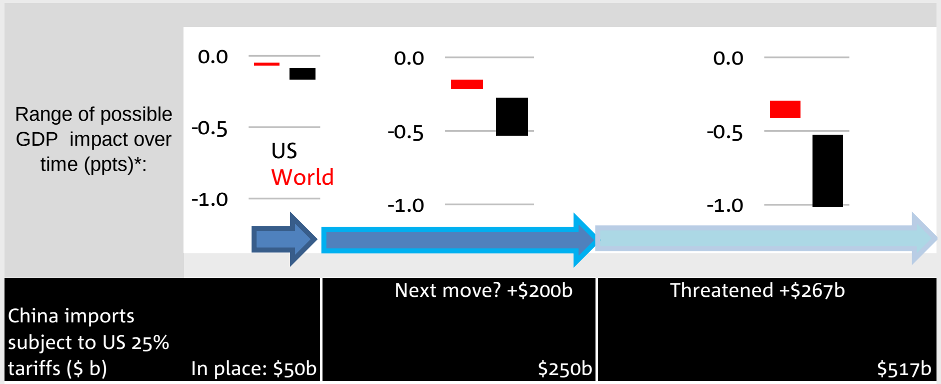
Summary – growth at a multi year high but set to slow as risks build

- Our tracking indicator of the major advanced and emerging market economies points to global economic growth reaching its highest rate since September 2011 (at around 4.0% yoy) in Q2 2018. That said, we maintain our view that global growth is near the peak of the current cycle and our global leading indicator also points to weaker growth in the second half of 2018.
- Moreover, underneath this solid headline reading, growth has become less synchronised. Among the major advanced economies, annual growth rates have slipped outside of the US. Similarly, EM growth was largely held up by an acceleration in India. This divergence is likely to be exacerbated in the second half of the year due to a major deterioration in financial conditions in certain EM economies, such as Argentina and Turkey.
- Contagion across the range of EM economies is so far limited but remains a concern against a backdrop of ongoing trade tensions.
- Reinforcing the growth slowdown is the gradual tightening in monetary policy underway across both Advanced and EM economies (although it is not yet 'tight'), the fading over time of this year's US fiscal stimulus and growing supply constraints. Overall, we expect global growth to peak this year at 3.8%, before easing over 2019 and 2020.
- Our forecasts are based on implemented tariff measures. The US is widely expected to announce new tariff measures on Chinese imports – but the scope and timing remains unclear. As illustrated below, threatened US tariff measures on Chinese imports (and retaliatory Chinese action) represent a substantial downside risk to growth although a range of factors, including the fiscal and monetary policy response, would shape the overall impact.

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	1.1	1.2	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	7.3	7.2	7.2
Latin America	1.3	1.5	1.9	2.5
Other East Asia	4.4	4.2	3.8	3.8
Australia	2.2	2.9	2.8	2.5
NZ	2.8	2.6	2.9	2.7
Global	3.7	3.8	3.7	3.5

Trade risks – potential for a substantial headwind to growth



* Also includes impact from steel/aluminium tariffs & assumes China retaliation

Note: for background on the estimates in this chart refer to Trade Tensions on the Rise – July 2018

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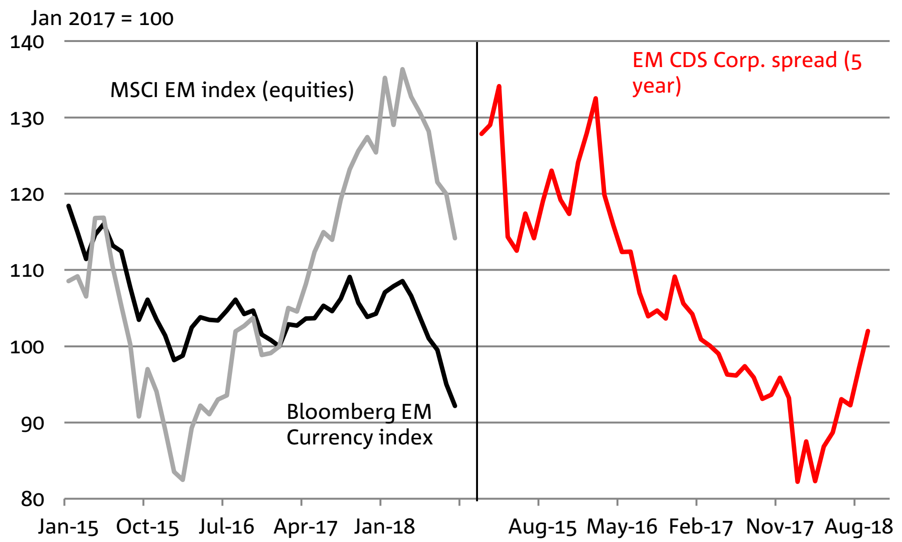
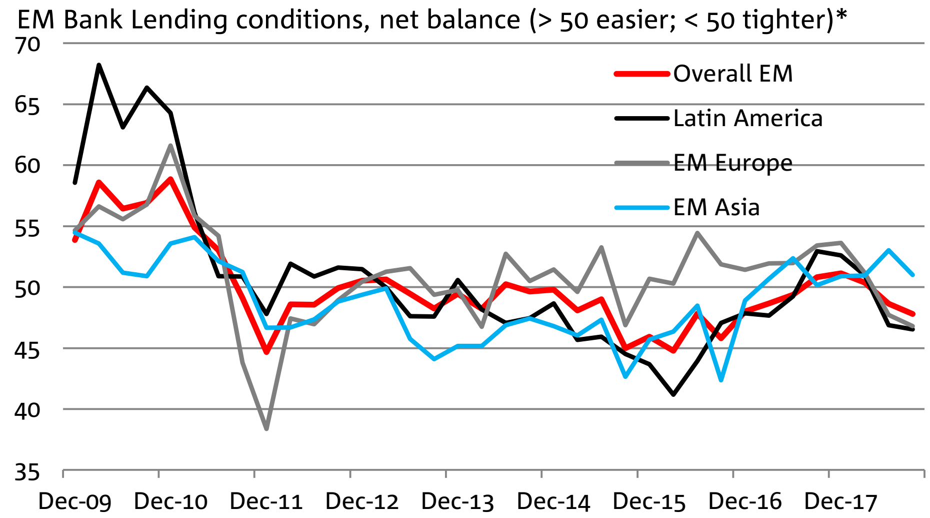
EMERGING MARKETS UNDER STRESS

EMs under stress – while largely centred on some markets, some broader spillovers

Emerging market indices under pressure

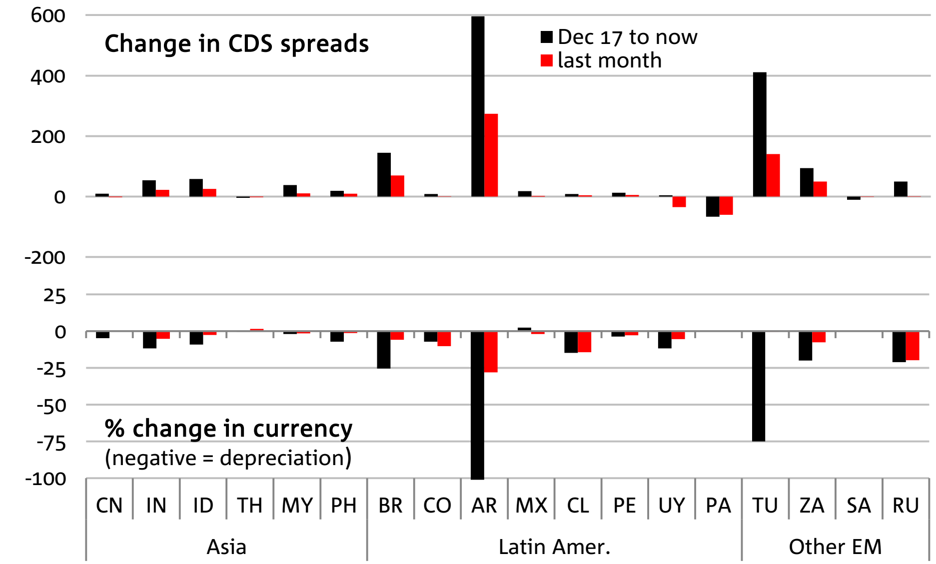


Bank lending conditions turn down…EM Asia holding up

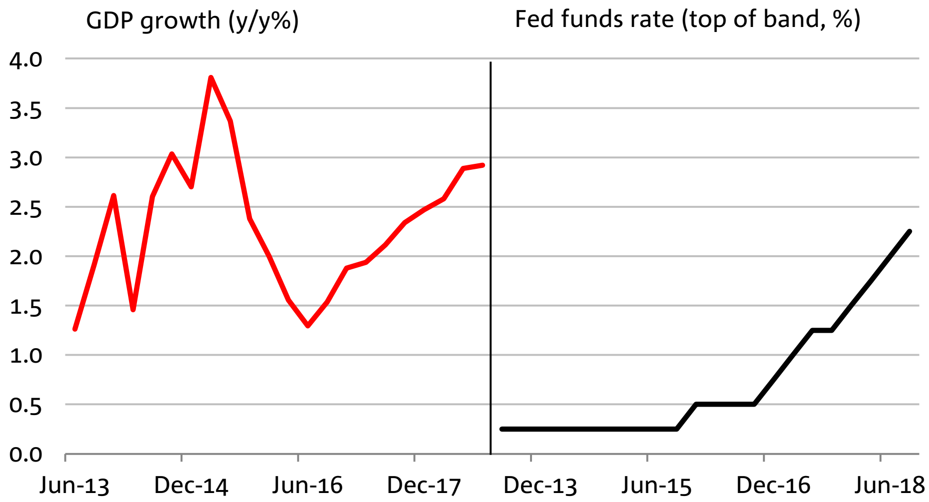


* 2018 Q3 is an expectation

Impact mainly on certain EMs – but direction same for most



US strength & rate rises draws capital flows away from EMs



Sources: Datastream, Bloomberg, NAB Economics. Note - CH: China, IN: India; ID: Indonesia; TH: Thailand; MY: Malaysia; PH: Philippines; BR: Brazil; CO: Colombia; AR: Argentina; MX: Mexico; CL: Chile; PE: Peru; UY: Uruguay; PA: Panama; TU: Turkey; ZA: South Africa; SA: Saudi Arabia; RU: Russia

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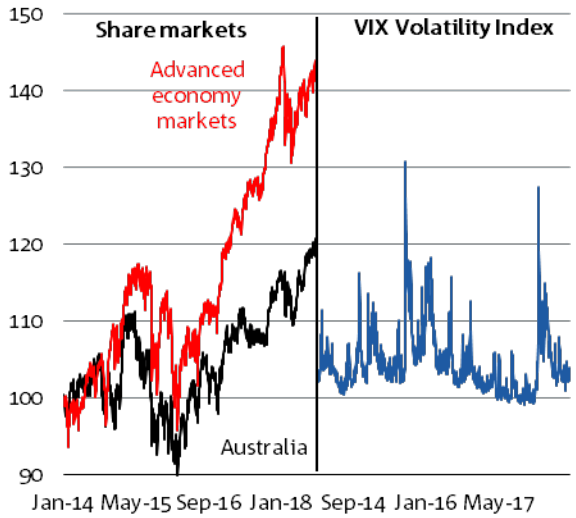
FINANCIAL AND COMMODITY MARKETS

AE markets relatively calm in face of EM stress…global policy tightening underway

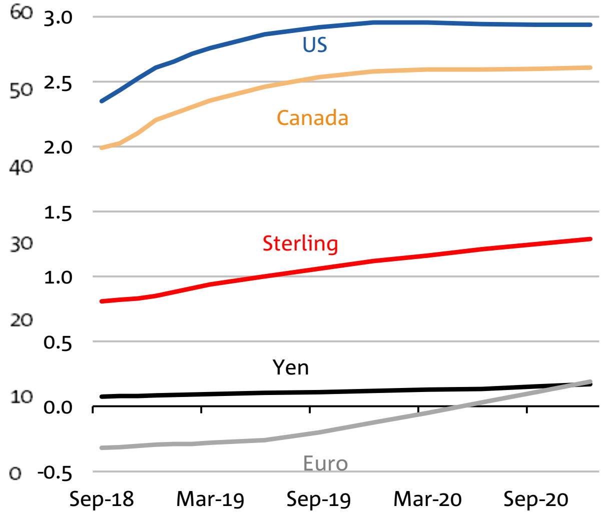
AE MKTS RELATIVELY CALM

Share markets and volatility indices



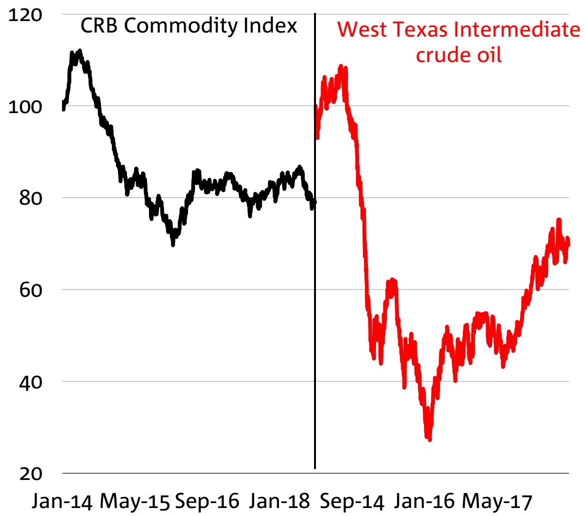
AE POLICY TIGHTENING…GRADUALLY

3 month interest rate futures (%)



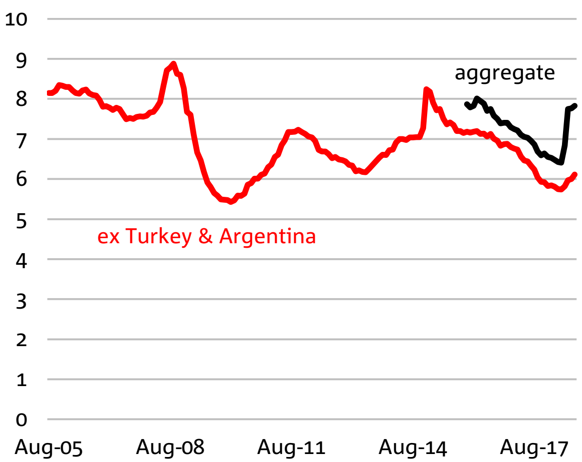
COMMODITY PRICES EASING

Commodity price indices (1 Jan 2014 = 100)



EM RATE HIKES GENERALLY MODEST

EM average policy rate ex China * (%)



* GDP weighted average of 19 EM countries central bank policy rate

- The acute financial market stress evident in some emerging markets (see previous page) has not yet led to significant spill overs to the major advanced financial markets, although safe haven flows have contributed to the recent easing in long-term yields and currency movements. Our advanced economy equity index has been on an upwards trend since March; in recent months the gains have been driven by the US S&P index as doubts over the trajectory of other major economies have emerged. While there has been some increases in spreads and measures of volatility, they generally have not been particularly large (outside of Italy where there are policy concerns).
- There have also been some downward moves in commodity prices. The Thomson Reuters/Core Commodity CRB Index has fallen in recent months. While this might in part reflect US dollar strength, the larger falls have been in base metals such as copper, which can be more sensitive to the economic outlook and risk sentiment.
- With advanced economy growth above trend and unemployment rates moving close to, or below, estimates of their long-term sustainable level, the major advanced economy central banks are looking to tighten policy. However, this is happening only gradually as inflation pressures are muted, although core inflation in the US is now at the Fed's 2% long-term target.
- As a result, policy tightening is most advanced in the US, although this year both the Bank of Canada and the Bank of England have lifted rates. Markets are expecting further increases, although only limited in the UK as Brexit uncertainty weighs on the outlook. While the European Central Bank will wind back and end its asset purchases over Q4 2018, as it is facing stubbornly low inflation rates are set to remain on hold through the 2019 summer. The Bank of Japan continues to fall short of its inflation target, meaning that major changes in its policy (in either direction) appear unlikely any time soon.
- US Federal Reserve rate increases often puts pressure on EM central banks to also lift rates, as they seek to avoid pressure on the currency and outward capital flows, and this is again the case. However, outside of Turkey & Argentina (where structural problems and other domestic factors have put their markets under extreme pressure) the increase in EM rates so far this year is relatively modest. Nevertheless, it does represent a tightening in policy which may be expected to weigh somewhat on growth.

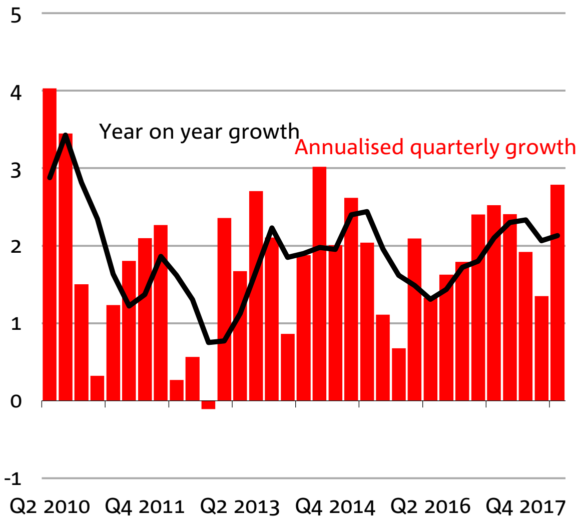
Sources: Datastream, Bloomberg, NBER, NAB Economics

ADVANCED ECONOMIES

Advanced economy growth looking solid…still expect some slowdown from here

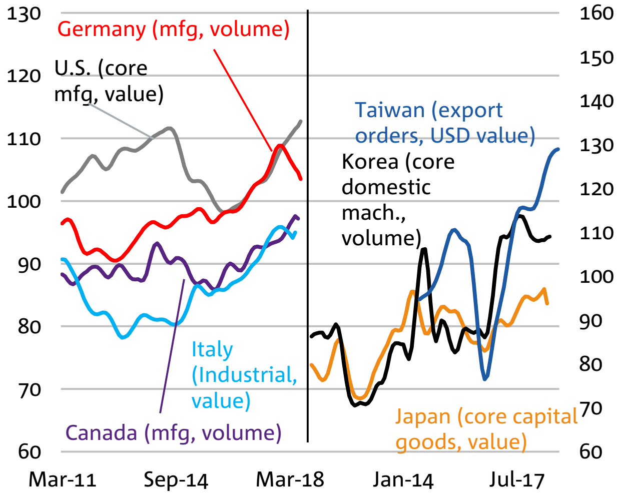
Q2 GROWTH REBOUND IN G7

G7 Advanced Economy Growth (%)



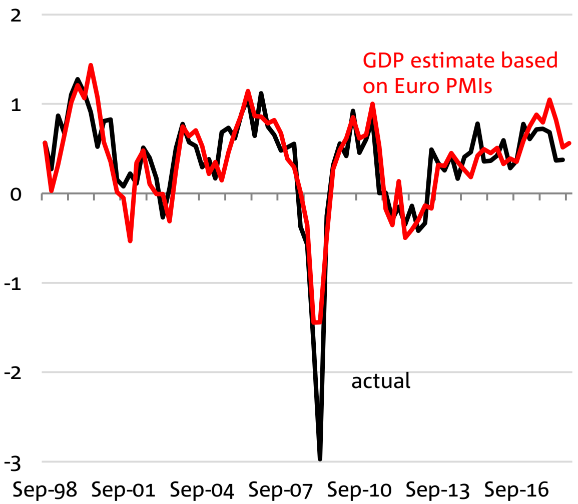
ORDERS POSITIVE …EXCEPT GERMANY

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



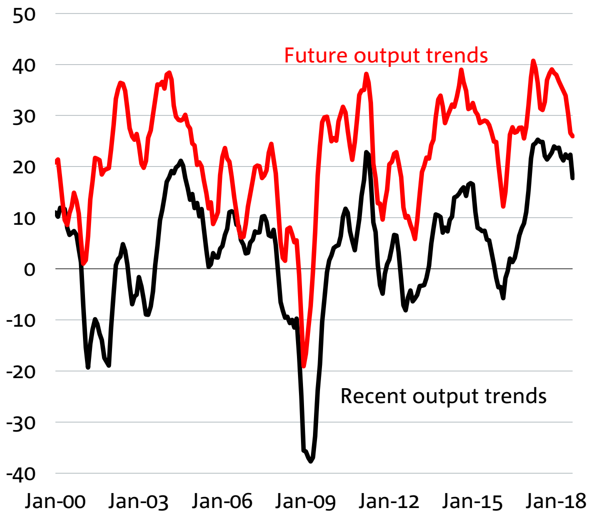
EURO SURVEYS POINT TO BETTER H2

Euro-zone GDP: business survey estimates (qoq%)



GROWTH STILL SOLID BUT OFF PEAK

Business surveys (US, UK, Germany & France) (Index, 3mma)



Sources: Datastream, NAB Economics

- The latest data confirm that major advanced economy growth rebounded strongly in Q2 after a soft patch in Q1. This was led by the US, but Japan, the UK and Canada all experienced stronger growth, with only Euro-zone missing out with growth unchanged from Q1. However, outside of the US, the annual growth rate has declined in these economies. Although we expect growth to remain solid, it appears unlikely to return to 2017 highs .
- Data on new orders continues to show reasonable strength across advanced economies, although Germany is a notable exception. More broadly, Euro-zone indicators remain mixed, leading to uncertainty around the growth trajectory. German industrial production declined in July (although France has seen improvement recently), retail sales growth was weak early in Q3 and, while still at high levels, business and consumer sentiment has eased a little. The Euro-zone business survey PMIs do a good job at tracking the region's GDP growth and, while they have also come off their peak, they point to growth holding up in the second half of the year. Accordingly, with monetary policy still very loose, we continue to expect above trend growth in the Euro-zone, but below the pace seen in 2017.
- There is also some downside risk in Japan in Q3 given a series of extreme weather events, including flooding, typhoons and a major earthquake. However, any impact would be reversed in subsequent quarters and it does not change the underlying picture of above trend growth. In contrast, partial data for the US remains strong and is pointing to another robust quarter of growth.
- Overall, across the advanced economies, monetary policy is still relatively loose and so supportive of above trend growth, while fiscal policy has also turned more supportive, particularly in the US. While growth should remain above trend, the pace is likely to ease, as suggested by business survey future output indicators. Monetary policy will become less stimulative over time, and this year's US fiscal stimulus impact will fade. Unemployment rates continue to trend down – and are at very low levels in the US, UK and Japan – suggesting that supply will be an increasing constraint.
- A major downside risk remains trade tensions. A general loss of confidence, supply chain disruptions or the possibility that businesses might defer investment until future trading arrangements become clearer, could all weigh on activity.

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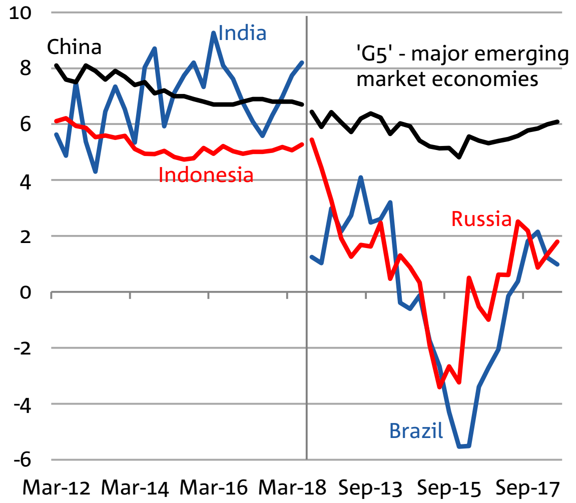
EMERGING MARKET ECONOMIES (EMES)

India drives stronger EM growth, but fear could stymie the outlook

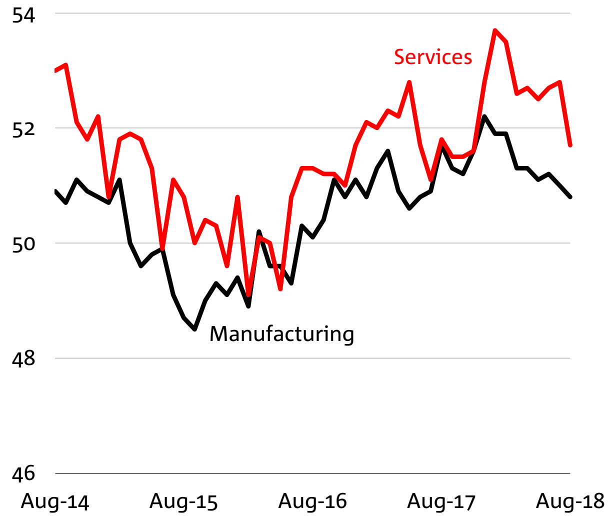
MAJOR EM GROWTH STRONGER...

Emerging market GDP growth (yoy%)



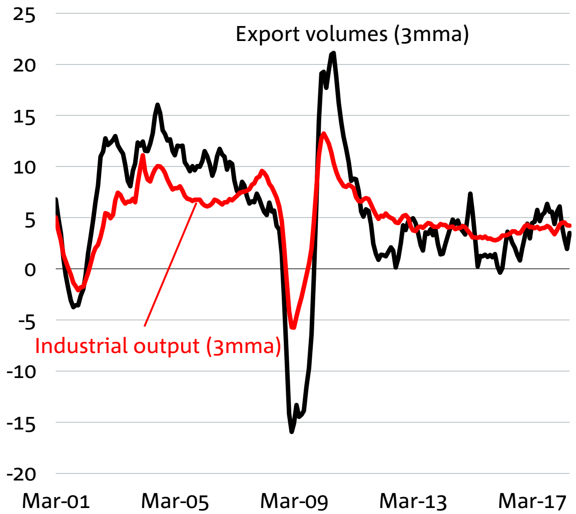
...BUT PMIS ARE SOFTENING

Emerging market PMI (Breakeven = 50)



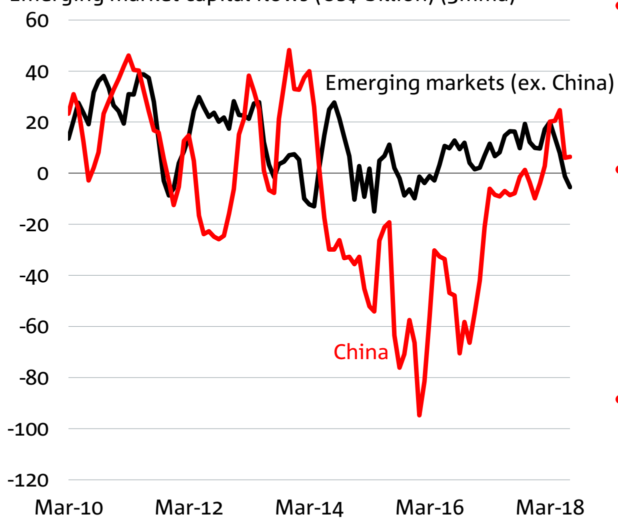
TRADE GROWTH WEAKER THAN 2017

Emerging market exports and industrial output (% yoy)



CAPITAL OUTFLOWS AS FEARS BUILD

Emerging market capital flows (US$ billion) (3mma)



- Despite the growing uncertainty around international trade, economic growth in the big emerging markets edged higher in Q2 2018 – to 6.1% yoy (from 6.0% in Q1). Growth has accelerated since the end of 2015 (when it dipped below 5%), however trends have remained mixed across the group.
- The main contributor to the upturn was India, where growth accelerated to 8.2% yoy (from 7.7% in Q1). That said, part of this strength reflects base effects, with tax changes in mid-2017 hitting India's economy at the time. In contrast, both Chinese and Brazilian growth eased.
- Emerging markets may struggle to maintain this growth momentum moving forward, once the negative impacts of US trade measures become evident. The first set of tariffs against Chinese imports came into effect in early July – with additional measures likely to be introduced in coming months – with spillover effects on other emerging market economies (particularly in East Asia).
- Trade data from after the tariff imposition is not yet available. CPB emerging market export volumes accelerated in June – up 3.5% yoy (on a three month moving average basis), compared with 1.9% in May. However, this was still well below the trend recorded between Q1 2017 and Q1 2018 (5.0% yoy) and may reflect purchases being brought forward to avoid US/China tariff measures.
- More timely indicators, such as PMI surveys, suggest that conditions in emerging markets are softening. Measures for both manufacturing and services peaked at the start of 2018 and have weakened since – the latter being somewhat surprising, as services are typically less trade exposed.
- Risks around emerging markets are building – with a number of countries facing currency crises (most notably Argentina and Turkey) – with the aggregate MSCI emerging market currency index down almost 9% since its early April peak. EM equity markets have also fallen – down around 20% from a late January peak. Similarly, there are signs of capital flows out of emerging markets (particularly outside China), which could destabilise financial conditions.
- While these emerging market fears are currently isolated to a few economies, contagion can quickly spread. A number of central banks have been forced to raise policy rates, which could constrain growth.

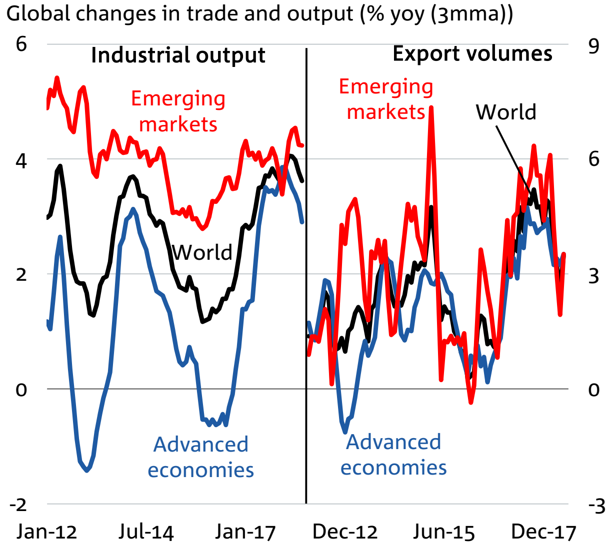
Sources: Datastream, CPB, IIF, NAB Economics

GLOBAL FORECASTS, POLICIES AND RISKS

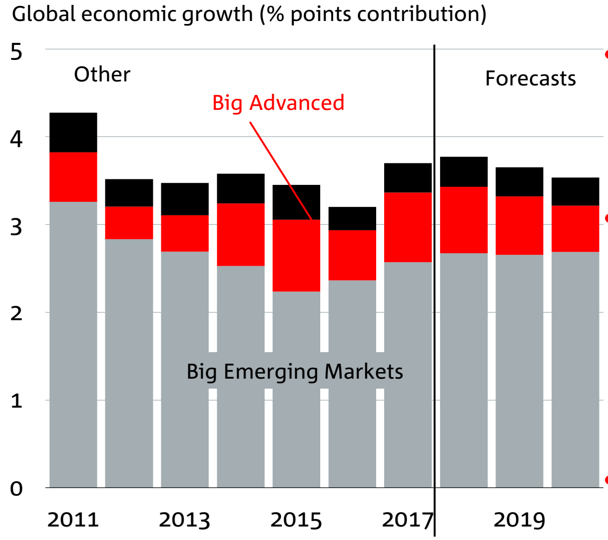
Global growth at a six year high, but set to slow (with risks rising)

GLOBAL GROWTH HAS ACCELERATED, BUT FORWARD INDICATORS WEAKER

TRADE & OUTPUT TRENDS SOFTER



ADVANCED GROWTH TO SLOW



- The uptick in growth in emerging markets, combined with the modest turn-around in advanced economies, has driven global economic growth to its highest rate since September 2011 (at around 4.0% yoy).
- That said, we maintain our view that global growth is near the peak of the current cycle – as the signs of stresses in a number of emerging markets grow and constraints in advanced economies start to bite (leading to higher policy rates). Our global economic leading indicator is pointing to weaker growth across the second half of 2018.
- Industrial production is another warning sign for slower growth. The CPB measure of global IP has slowed markedly in recent months – from around 4.0% yoy (on a three month moving average basis) at the start of 2018, to almost 3.5% yoy mid-year. This is consistent with a notable slowdown in global manufacturing PMIs.
- Trade tensions remain a major risk for the global economy; in particular, the future of NAFTA and the prospect of escalating US/China tariffs. Although the US has reached agreement with Mexico on changes to NAFTA and is currently in discussions with Canada, there is no certainty agreement will be reached. Meanwhile, the US is expected to announce tariffs on up to $200b of imports from China, though the extent and timing of action is uncertain. If China retaliates (as it has indicated it will do), President Trump has threatened further tariffs that would essentially encompass all of China's exports to the US.
- If all of these tariffs on Chinese imports were to implemented, past studies suggest a negative hit to GDP growth, over time, of around 0.5-1.0 ppts for the US and 0.3-0.4 ppts for global growth. The final impact will depend on the affect on confidence, financial market reaction as well as the fiscal/monetary policy response.
- Global economic growth is set to slow in coming years – largely driven by slowing trends in advanced economies, as US fiscal stimulus fades and monetary policy gradually tightens in the face of intensifying capacity constraints. In contrast, emerging market growth is expected to remain relatively stable – with India and non-China East Asia remaining strong, while a modest slowing in China is offset by a recovery in Latin America. Trade tensions and growing risks around the emerging markets point to some downside to these forecasts.
- Overall, we expect global growth to ease in coming years – from 3.8% in 2018 to 3.7% in 2019 and 3.5% (the long term trend rate) in 2020.

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 Sources: Datastream, NAB Economics

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