EMBARGOED UNTIL: 11.30AM THURSDAY 15 NOVEMBER 2018

THE FORWARD VIEW – GLOBAL

NOVEMBER 2018

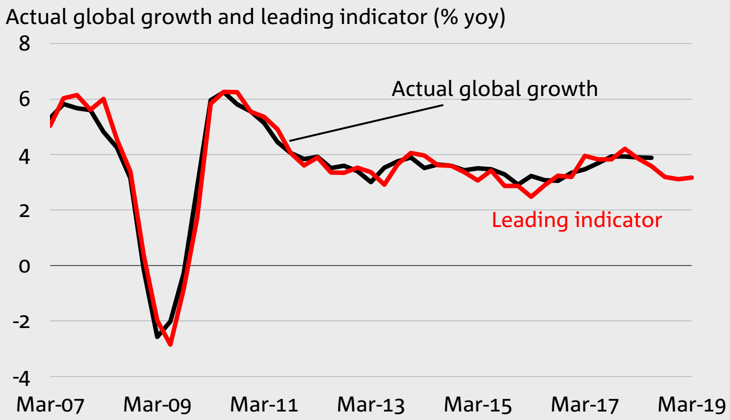
National Australia Bank

Summary – global growth is above average but slowing

- While global growth remains above average, available GDP data for Q3 point to a slowdown in the second half of the year. Business surveys also indicate a slowdown is underway, particularly in manufacturing, but there are tentative signs that overall activity may be stabilising. This is consistent with the message from our leading indicator.
- With growth slowing and increasingly divergent, central banks (on average) lifting policy interest rates, trade disputes and other events creating an uncertain back drop, financial market volatility has lifted. In October, there were large falls in equity markets, including in the US. Commodity prices also declined in the month, but this was largely driven by an easing in crude oil supply concerns, which is a welcome development if sustained.
- The divergence in the growth rates between the major advanced economies (AEs) that emerged in the first half of 2018 has carried over into Q3. The US economy posted another strong result, while Euro-zone growth slowed noticeably and Japan's economy went backwards, although some temporary factors appear to be partly responsible. Economic growth in the major emerging markets (EMs) likely slowed in Q3 – driven by weaker growth in China and a probable slowing in India's growth. After deteriorating for much of this year, EM financial markets have recently shown some signs of stabilising, but are likely to keep coming under pressure from US monetary policy tightening.
- We expect above average global growth in 2018 at 3.7%, slowing to 3.6% in 2019 and 3.5% in 2020 (the long-term historical average). This expected slowdown is driven by advanced economies as US fiscal stimulus fades, monetary policy tightens and supply constraints bite. The US-China trade dispute is a headwind to growth, as well as a risk if there is further escalation.

Global Growth Forecasts (% change)

	2017	2018	2019	2020
US	2.2	2.9	2.3	1.6
Euro-zone	2.5	1.9	1.7	1.6
Japan	1.7	0.9	1.2	0.9
UK	1.7	1.3	1.7	1.5
Canada	3.0	2.1	2.0	1.6
China	6.9	6.6	6.3	6.0
India	6.7	7.3	7.1	7.2
Latin America	1.3	1.2	1.8	2.4
Other East Asia	4.4	4.3	3.9	3.8
Australia	2.2	2.9	2.8	2.5
NZ	2.8	2.9	2.8	2.6
Global	**3.7**	**3.7**	**3.6**	**3.5**



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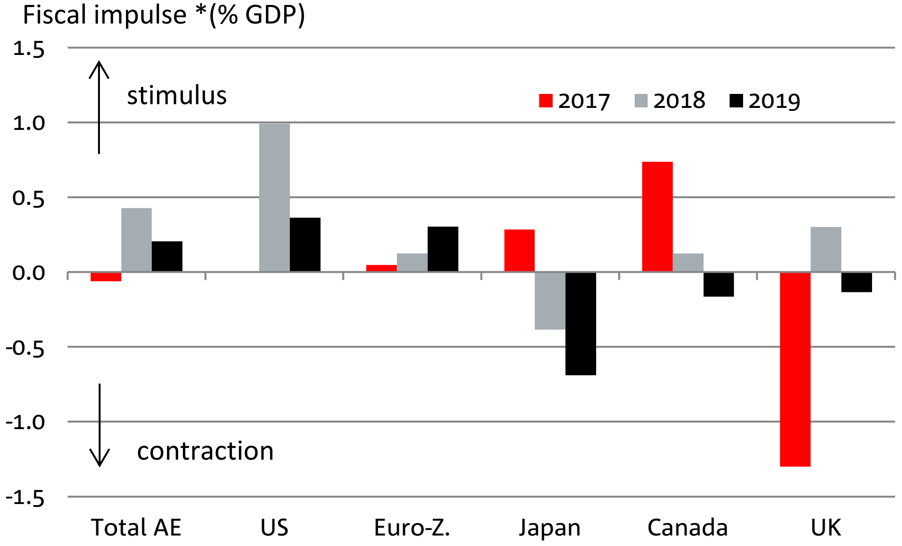
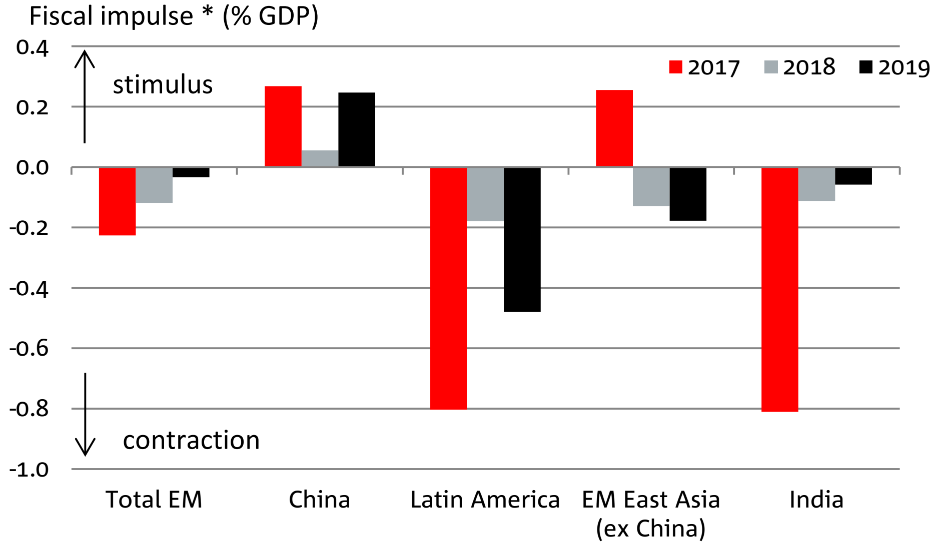
FISCAL POLICY SETTINGS

AE fiscal stimulus to fade & EM headwind continues outside of China

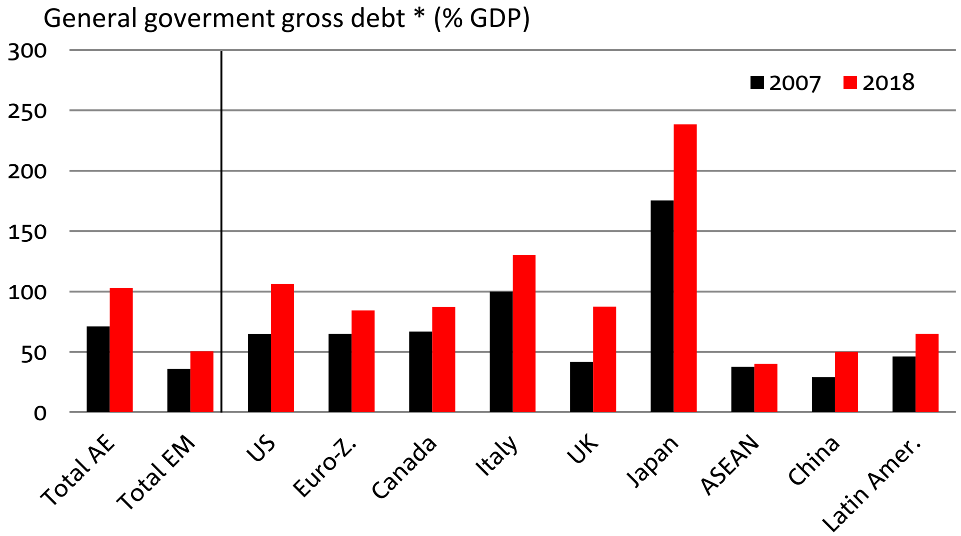
Adv. economy fiscal boost to slow in 2019 outside Euro-zone



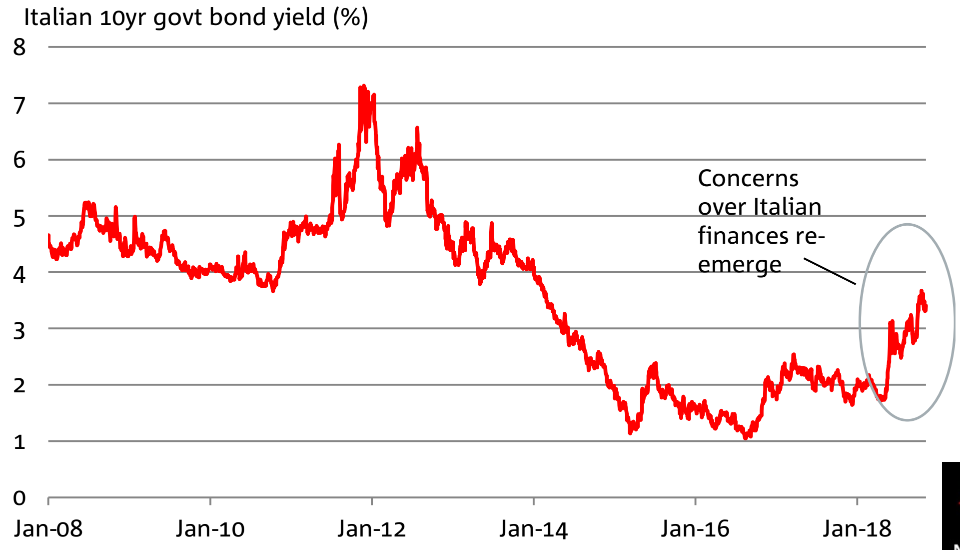
EM – China stimulus, but for other EMs fiscal headwinds



Govt. debt higher post GFC – possible loss of fiscal flexibility in a future shock



Fiscal policy effectiveness in Italy uncertain as looser policy causes a tightening in financial conditions



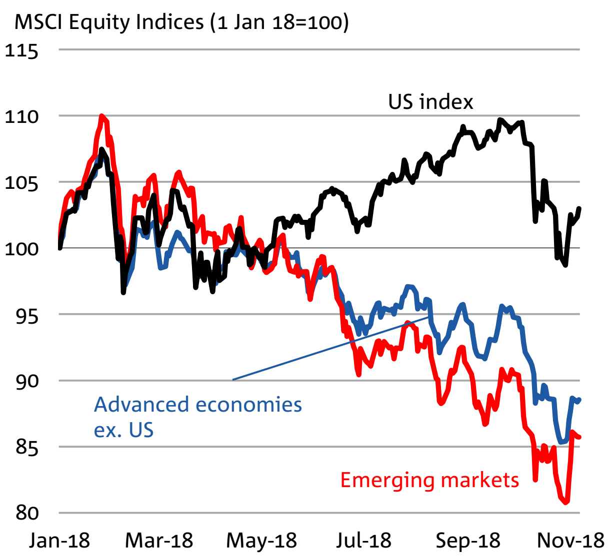
* Fiscal impulse =-(change in cyclically adjusted primary balance)

 Sources: IMF (Fiscal Monitor and World Economic Outlook database), Datastream, Ministero Dell'Economia e Delle Finanze (Italy), NAB calculations

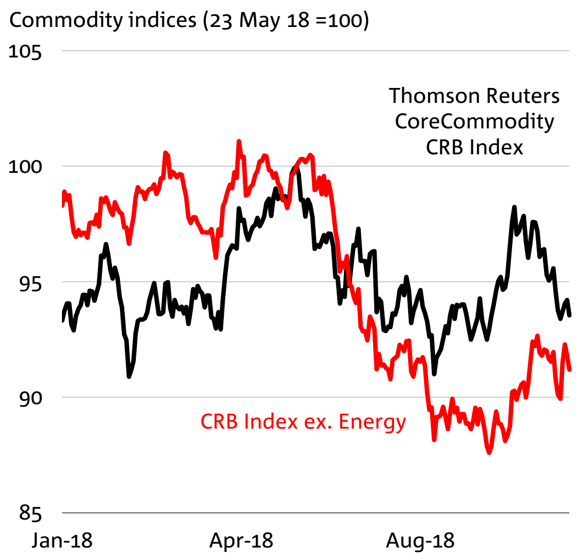
FINANCIAL AND COMMODITY MARKETS

Equities & commodities have retreated; policy rates continue to head higher

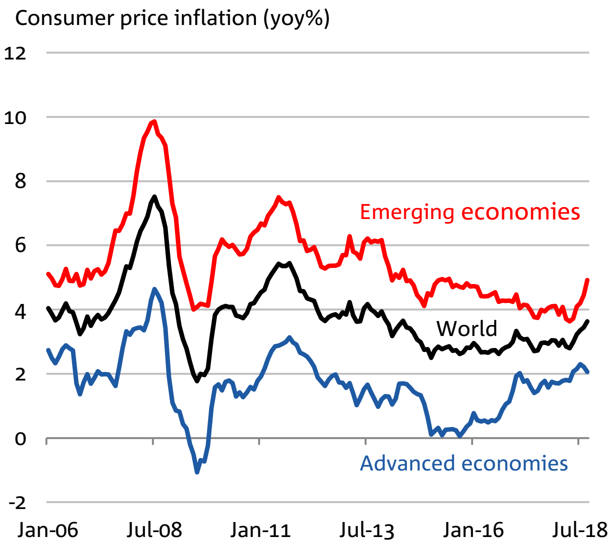
SHARP FALLS IN EQUITIES



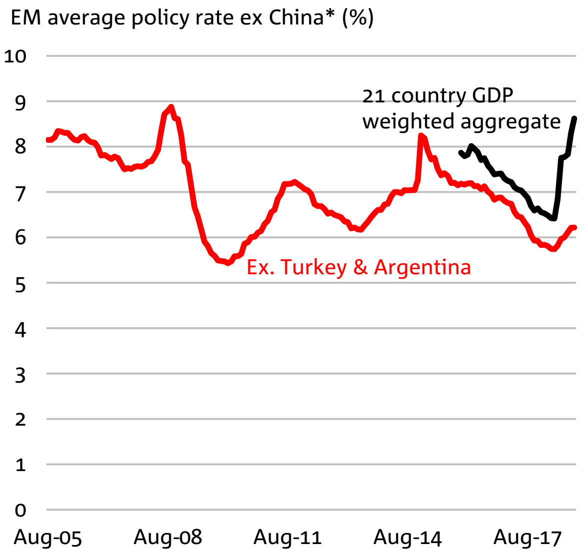
OIL LEADS COMMODITIES LOWER



EM INFLATION INCREASING



EM POLICY RATES MOVING UP



- Global equity markets fell considerably across much of October – continuing a downward trend that has been evident for some time in both emerging markets and advanced economies excluding the United States. However, US markets also corrected in October – almost erasing the gains recorded in 2018 – with disappointing profit outcomes and outlooks, particularly in tech, contributing.
- Volatility increased over this period as well – with the VIX volatility index rising back above 20% in October (compared with a trend near 14% over the previous year). Considerable policy uncertainty persists – including EU approval of Italy's budget, the rise of populism in Brazil uncertain implications of the US mid-term election results, along with the uncertainty around US-China trade tensions.
- Commodity prices have also fallen from peaks in early October – with the aggregate Thomson Reuters/Core Commodity CRB Index down over 4.5% at the time of writing. This was largely driven by falling oil prices, as exemptions to US sanctions on Iran have eased supply concerns.
- While much of the focus regarding supply side constraints has fallen on advanced economies, inflationary pressures have risen more recently in emerging market economies. In part this reflects the decline in emerging market currencies since April (down around 7% at the time of writing) – leading to higher import prices. This is particularly evident in countries such as Turkey.
- The constraints in advanced economies are driving many central banks to tighten monetary policy. As widely expected, the Bank of Canada hiked rates at its October meeting, while the US Federal Reserve is tipped to raise rates in December. The European Central Bank and Bank of Japan remain unlikely to hike in the short term – albeit the ECB is set to end asset purchases this quarter.
- The upward trend for advanced economy policy rates provides a "pull" factor – attracting capital flows as yields increase, with capital currently exiting emerging markets. This is creating pressure on EM central banks to increase rates – which have increased sharply since the start of the year. Our 21 country aggregate measure of EM policy rates has risen by 2ppts since April, however this reflects large scale increases in crisis ridden Turkey and Argentina. Excluding these economies, policy rates have increased more modestly – by around ½ ppt over the same period.

Sources: Datastream, NAB Economics

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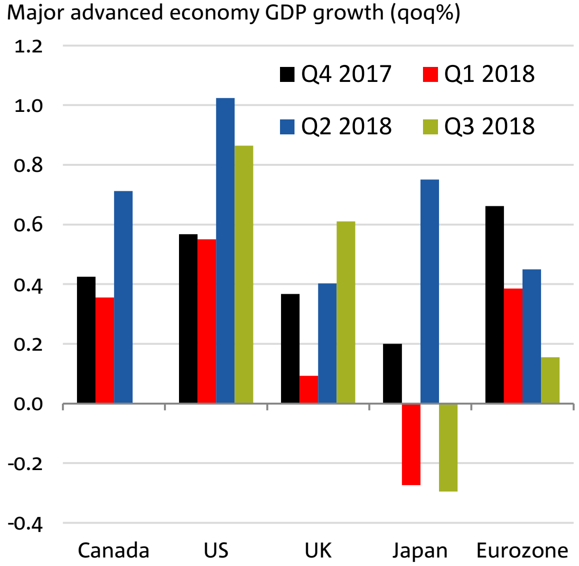
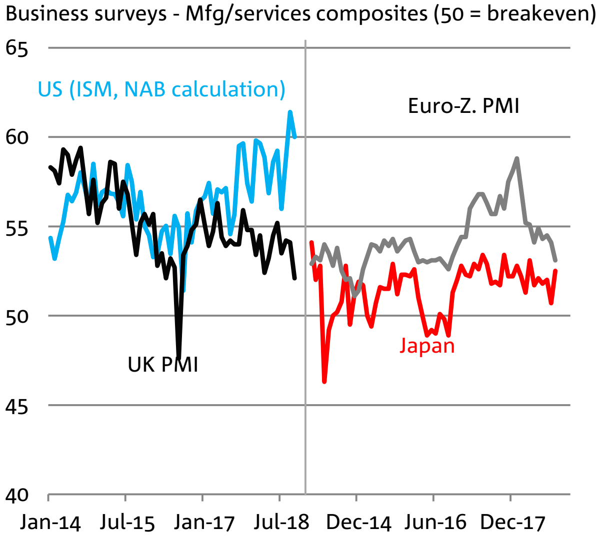
ADVANCED ECONOMIES

US still strong, but other AE growth weaker, partly due to temporary factors

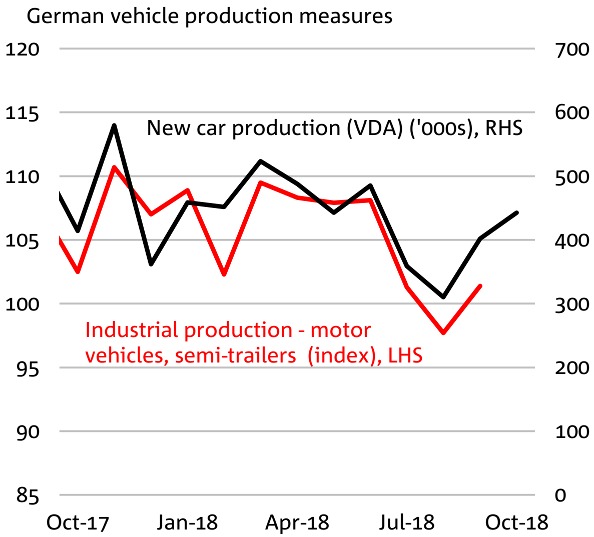
EURO-ZONE & JAPAN STUMBLE IN Q3



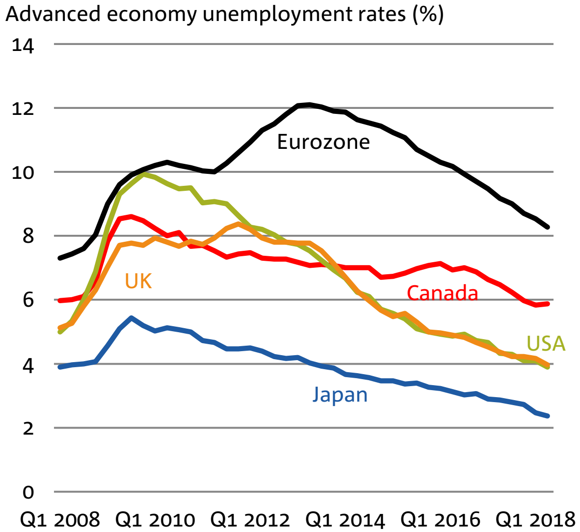
DIVERGENCE ALSO SEEN IN SURVEYS



GERMAN AUTO DISRUPTION



LABOUR MARKETS TIGHTENING



Sources: Datastream, NAB Economics

- The divergence in the growth rates between the major advanced economies that emerged in the first half of 2018 has carried over into Q3. The US economy posted another strong result and, while there was some improvement in the UK, Euro-zone growth slowed noticeably and Japan's economy went backwards. Some temporary factors contributed to the weakness in Japan and the Euro-zone, although surveys also suggest that conditions have softened.
- The United States economy continues to be boosted by a large fiscal stimulus, with GDP growth again robust in Q3. As a result, annual GDP growth was 3.0% yoy, its fastest pace in over three years.
- Euro-zone GDP grew by only 0.2% qoq in Q3, resulting in the weakest annual growth rate since late 2014. This included a fall in German GDP, at least in part due to auto production delays resulting from a new emissions standards regime; however, this is already starting to reverse. Italy was another source of weakness in Q3, and this is potentially more enduring as the tightening in financial conditions caused by the Italian government's budget dispute with the European Commission continues. We think Euro-zone growth has clearly shifted down from its 2017 level but expect it to remain above trend for now – monetary policy is still supportive, and fiscal policy will also provide a modest tailwind in 2019.
- Temporary factors, in the form of typhoons and a major earthquake, appear to be the main drivers of the fall in Japanese GDP in Q3. This makes it difficult to assess the underlying state of the economy but while business surveys show some softening they are still at reasonable levels.
- While we expect advanced economy growth to stay above trend for now, we think it is likely to slow over time. The US fiscal stimulus is set to fade, monetary policy is gradually being tightened and, with low unemployment rates across many countries, supply constraints will increasingly bite.
- A risk to the outlook for advanced economies is the impact of current trade tensions between the US and China. Advanced economy data – available to August – show that export growth has come off but only modestly. However, this is before the recent escalation of the US-China tariff dispute in September. Moreover, the uncertainty and confidence effects of the dispute can also lead to a reduction in business investment.

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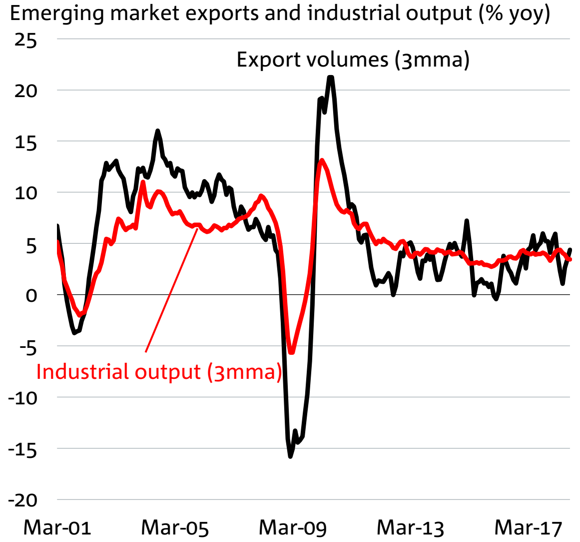
EMERGING MARKET ECONOMIES

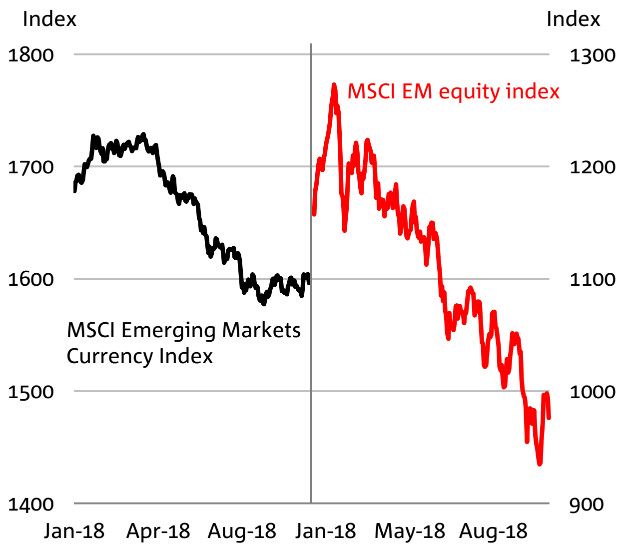
China (and likely India) to drive down EM growth in Q3

CHINA'S GROWTH SLOWED IN Q3

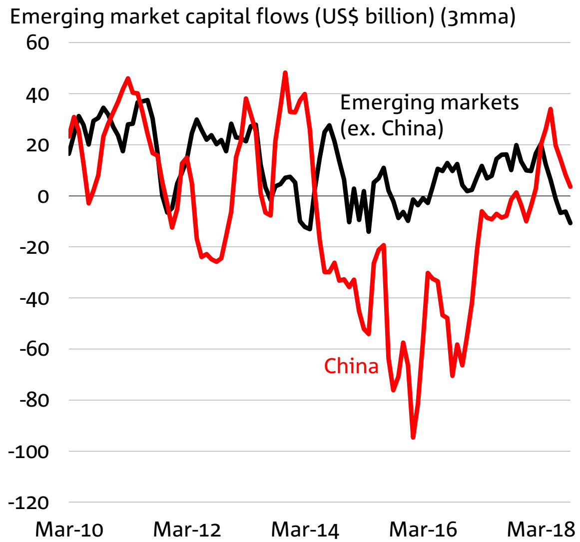
TRADE VOLUMES A LITTLE STRONGER



CURRENCIES STABLE; EQUITIES DOWN



CAPITAL OUTFLOWS FROM EMES



- Economic growth in the major emerging markets likely slowed in Q3 – driven by weaker growth in China and a probable slowing in India's growth (which will be released at the end of the month).
- China's economic growth slowed to 6.5% yoy in the third quarter of 2018 – the slowest rate of increase since Q1 2009 (the trough of the Global Financial Crisis). While trade tensions with the United States have been high profile, we argue that the deleveraging program – most evident across the first half of the year – was the major driver of this trend. That said, trade could have a growing impact over coming quarters as the full effects emerge.
- Global trade data (as reported by the CPB) is currently available to August – prior to the second round of US-China tariffs, meaning that we are yet to see any clear impact from these measures. Emerging market export volumes have accelerated more recently – up by 4.4% yoy (on a three month moving average basis) in August, compared with recent lows of 1.1% yoy (3mma) in May. This increased growth rate may reflect purchases being brought forward ahead of the tariffs.
- Industrial output growth in this region appears to be slowing – increasing by 3.5% yoy (3mma) in August – however the overall level of the IP index has barely increased since the start of the year. The emerging market manufacturing PMI has trended lower over this period as well.
- Trends in EM financial market indicators have been somewhat mixed recently. The MSCI emerging markets equity index fell considerably between late January and late October – down almost 27% peak-to-trough – however there has been a slight pick up more recently. In contrast, the MSCI EM currency index has stabilised since August, having fallen considerably from all-time peaks in April 2018.
- Spreads on credit default swaps – the cost of insurance against default – have also shown some improvement. Spreads dipped below 200 basis points in early November, down from the recent peak in August of almost 250 basis points. That said, they remain well above the rates at the start of 2018.
- Despite this easing, capital outflows from emerging markets pose some growing risk for the broad region – with the potential to destabilise financial conditions. Excluding China, around US$10.7 billion flowed out of emerging markets in September (on a three month moving average basis), the largest outflow since April 2015.

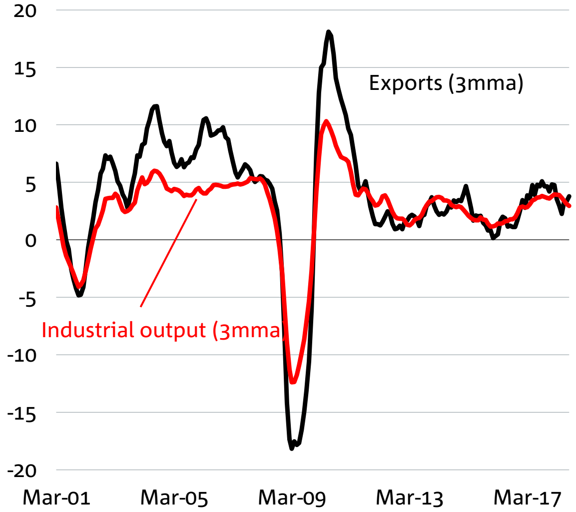
Sources: Datastream, CPB, IIF, NAB Economics

GLOBAL FORECASTS, POLICIES AND RISKS

Global growth still above average but expected to slow over the next two years

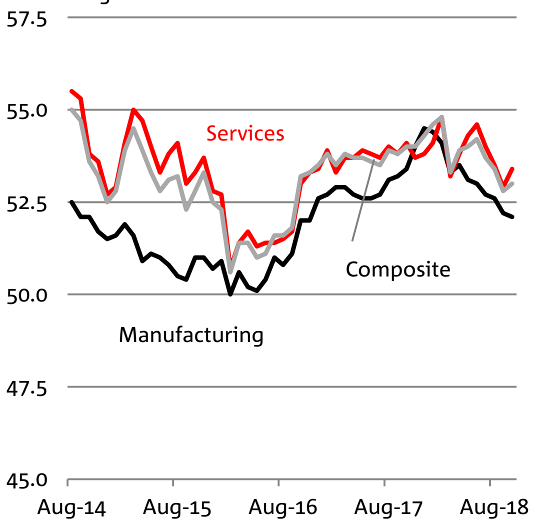
TRADE STABILISES, IP STILL EASING

Global exports and industrial output (% yoy)



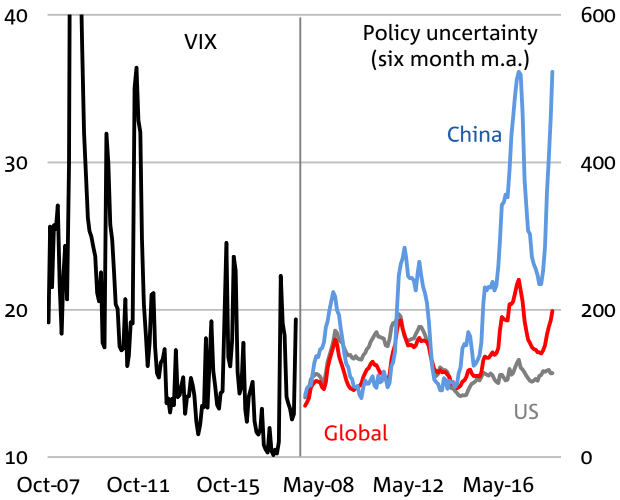
SOME SIGNS OF STABILISATION

JP Morgan World PMI



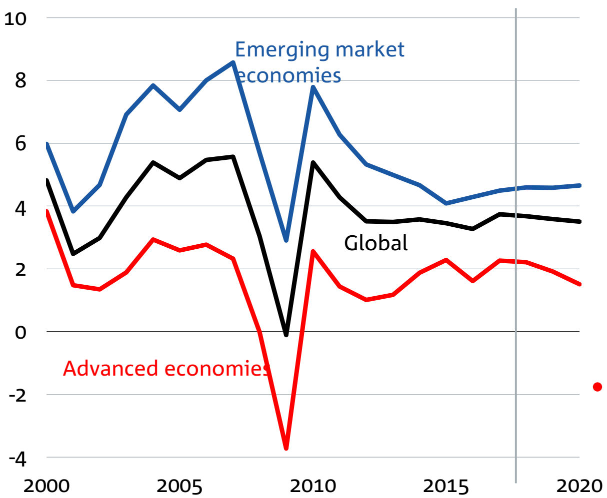
MARKET & POLICY UNCERTAINTY UP

Financial market volatility (VIX) & policy uncertainty (index)



MODEST SLOWDOWN – AE DRIVEN

Global economic growth & forecasts (%)



- While global economic (GDP) growth has been steady over the four quarters to June 2018 – at around 3.9% yoy – available GDP data for Q3 point to a slowdown in the second half of the year, and an increasing divergence between the performance of different regions and countries. Monthly world trade and industrial production data (to August) also point to a slowdown, with growth rates off recent peaks. The trade data have improved a little in recent months, but this may be due to attempts to get ahead of US-China tariff increases.
- International trade is dominated by goods rather than services and business surveys also point to a slowdown in world manufacturing. However, while the surveys also suggest there has been a slowdown in the much larger services sector, it has been more modest and is showing signs of stabilising. This is also the message from our global leading indicator (front page) – it is pointing to growth slowing before stabilising around end 2018/early 2019.
- There are a number of risks to the outlook. On the upside, the passing of what look like temporary constraints on Euro-zone and Japan growth may be followed by a stronger than expected bounce-back and current US strength may persist for longer than expected. The recent fall in oil prices due to an easing in supply concerns is also a welcome development if sustained.
- On the downside, while the signs of dialogue between the US and Chinese presidents are welcome, tariffs are set to ramp up further on 1 January 2019 unless there is any agreement to change course. As a result the risk of a deterioration in business sentiment leading to a large negative impact remains. Moreover, while we left our China forecast unchanged following the recent tariff measures, this was on the basis that other policy measures would offset the impact; whether this is the case remains to be seen, and uncertainty with China's economic policy is at high levels. Financial market volatility has also lifted from last year's lows which can affect growth if it leads to tighter financial conditions. As central banks tighten policy, another risk is that they go too far; especially the Fed as its policy actions can affect financial conditions in other countries, particularly EMs.
- We expect to see above trend global growth of 3.7% in 2018, but slowing to 3.6% in 2019 and 3.5% in 2020 (the long-term historical average). The slowdown is expected to be driven by AEs as the boost from this year's US fiscal stimulus fades, monetary policy gradually tightens and supply constraints bite. The US-China trade dispute also represents a headwind to growth.

Sources: Datastream, "Measuring Economic Policy Uncertainty" by Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com , NAB Economics

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