EMBARGOED UNTIL: 11.30AM THURSDAY 14 FEBRUARY 2019

THE FORWARD VIEW – GLOBAL

FEBRUARY 2019

National Australia Bank

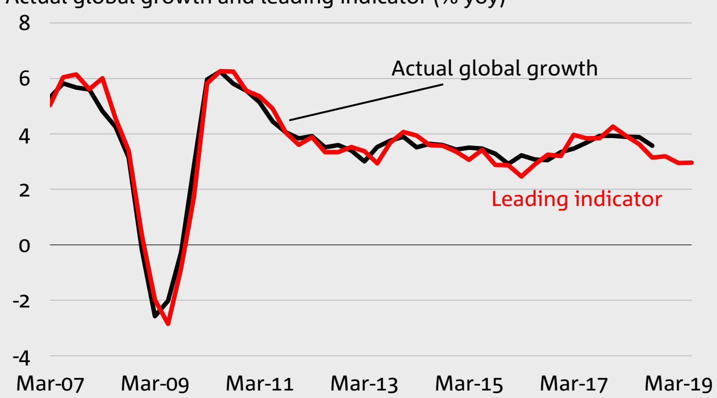
Summary – global slowdown continues into early 2019

- Economic growth continued slowing into Q4 last year – with China and the Euro-zone leading the way lower, while growth in the United States is expected to have come off its 2018 highs.
- Early indicators – such as global PMI survey measures – point to a further softening in the global economy into early 2019. Weaker manufacturing surveys suggest that global industrial production – which had been slowing for several months to the latest reading in November – is likely to ease further. However indicators for the larger service sector are holding up better, particularly in EM economies.
- Given the softer economic conditions, expectations around major central bank monetary policy have become more dovish – with comments from the US Fed that they will be more "patient" going forward. This has helped reverse some of the deterioration in financial conditions that occurred in late 2018.
- Our forecasts for global growth have been revised lower in 2019 – down to the long term trend rate of 3.5% (from 3.6% previously). Slower growth in the US, the Euro-zone and China are the key drivers of this trend. We expect growth to stabilise at this level in 2020, partly as a result of a dovish shift in policy.
- There are upside and downside risks to these forecasts, with greater downside in the short term if the slowdown in Euro-zone growth or the negative effects from Brexit/trade uncertainty end up greater than expected. However, the longer the weakness in growth persists, the greater the incentives for a resolution to these disputes, which would be supportive of growth further down the track.

Global Growth Forecasts (% change)

	2017	2018	2019	2020
US	2.2	2.9	2.1	1.8
Euro-zone	2.5	1.9	1.4	1.6
Japan	1.9	0.8	0.9	0.6
UK	1.8	1.4	1.3	1.6
Canada	3.0	2.1	2.0	1.8
China	6.9	6.6	6.3	6.0
India	6.7	7.4	7.1	7.2
Latin America	1.3	1.2	1.8	2.4
Other East Asia	4.4	4.2	3.8	3.7
Australia	2.4	2.9	2.4	2.2
NZ	3.1	2.8	2.6	2.6
Global	**3.8**	**3.7**	**3.5**	**3.5**

NAB global leading indicator



CONTENTS

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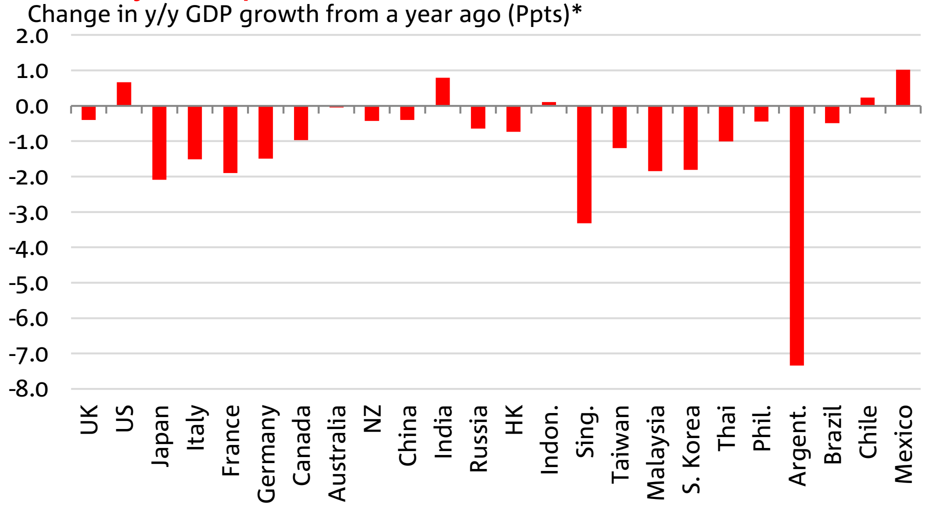
TRACKING THE SLOWDOWN & REACTION

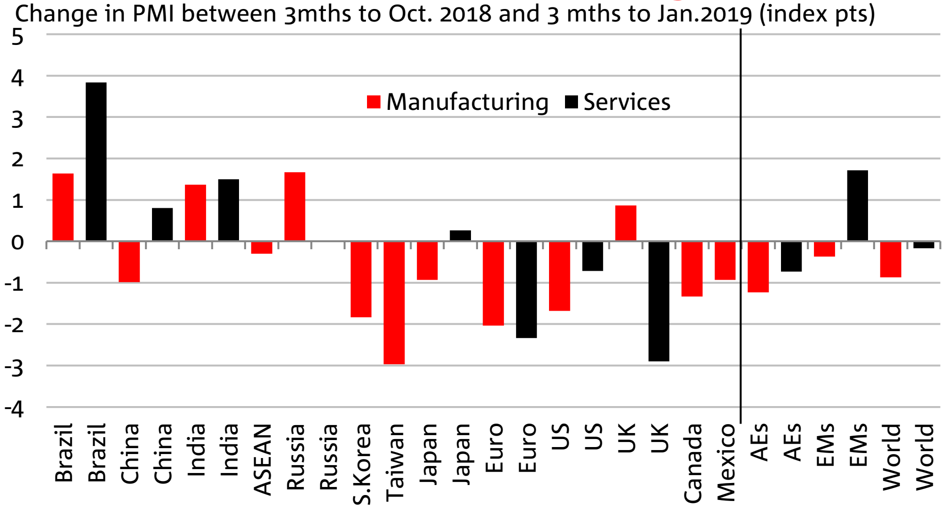
Slowdown continued into early 2019 in AEs, EMs better & policy adjusting

Slowdown in growth last year was broad based – US and India key exceptions

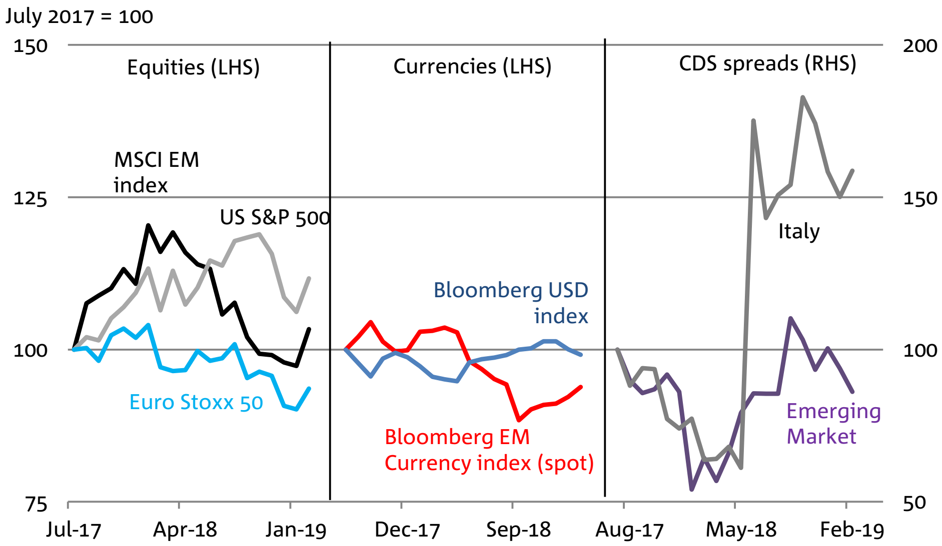


* Based on most recent data available for each country

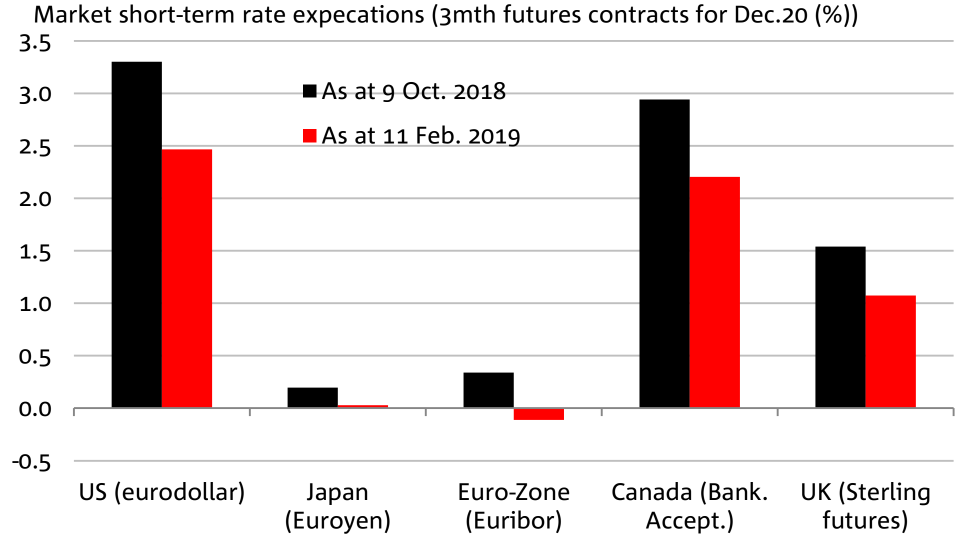
Business surveys suggest slowdown continuing '19 in more adv. economies but EMs ex China doing better



Signs that the deterioration in financial conditions has stabilised



Market expectations of future interest rates shifts down as monetary policy expected to adjust to support growth



 Sources: Bloomberg, Refinitiv, NAB Economics. PMI data from Markit except China and US which use an average of Markit and NBS (China), ISM (US) indices

FINANCIAL AND COMMODITY MARKETS

Markets stabilising as the Fed becomes 'patient'

FED TURNS 'PATIENT'

From: *"some further gradual increases in the target range for the federal funds rate..."*

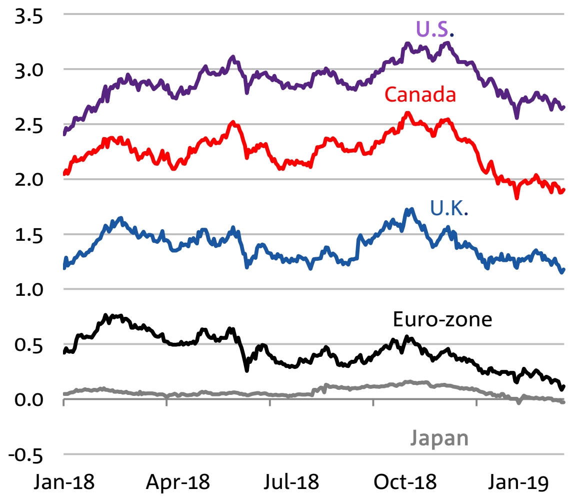
(December '18 FOMC meeting statement)

To: *"the Committee will be **patient** as it determines what future adjustments to the target range for the federal funds rate may be appropriate..."*

(January '19 FOMC meeting statement, emphasis added)

BOND YIELDS DOWN

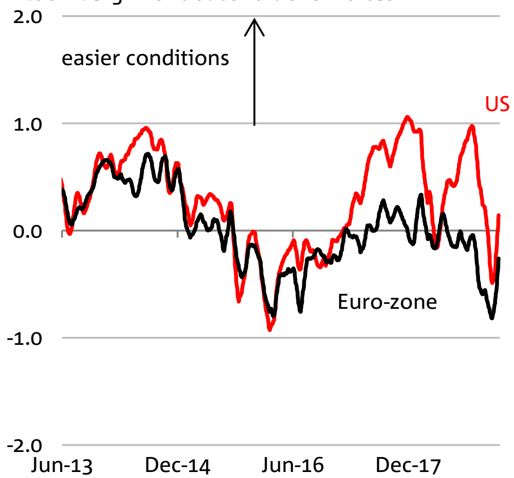
10yr government bond yields (%)



- The impact of the slowdown evident in the global economy, as well as ongoing uncertainty around the US-China trade relationship and Brexit, continues to reverberate around financial markets. That said, there has been some recent improvement in conditions, which may in part be due to expectations of major central bank monetary policy turning more dovish; an expectation recently corroborated by the US Fed.
- After large falls in October, equity markets moved down again sharply in December, with our composite measure of advanced economy stock markets declining almost 10% over the month. Stocks recovered somewhat over January, although at the end of the month they were still around 8% below their end-September 2018 level. The stress in financial markets late last year was not limited to equities; credit spreads and measures of financial market volatility also rose. Commodity markets have generally been less impacted apart from oil prices which also fell in late 2018, although partly due to supply factors.
- As a result, overall measures of financial conditions deteriorated in late 2018/early 2019, although they have stabilised recently and have partially recovered. This is likely to be in part due to a lowering in expectations of central bank tightening (see chart on previous page), which has contributed to a large decline in government bond yields.
- Notably, the Fed, which as recently as its December meeting was still flagging gradual rate rises, removed its bias towards raising rates at its January meeting, instead indicating that it would be patient. We don't expect any rate hikes this year (although we think one is likely in 2020), and markets have gone even further with pricing suggesting the next move is most likely a cut. This will be a relief to Emerging Market economies, which came under pressure earlier in 2018, in part due to the pressure on capital flows from rising US rates. More recently EM financial conditions have held up well with currencies, on average, rising as have equities, while credit spreads have narrowed.
- The European Central Bank has been more cautious in adjusting its policy stance, still indicating that rates will remain on hold 'at least through summer of 2019'. However, the ECB now acknowledges that risks have moved to the downside. The Bank of Japan is also unlikely to change policy settings any time soon, as it continues to be torn between the need to loosen policy if it is to achieve its inflation objective and concerns over the impact on financial system stability of doing so.

MARKETS HAVE STABILISED

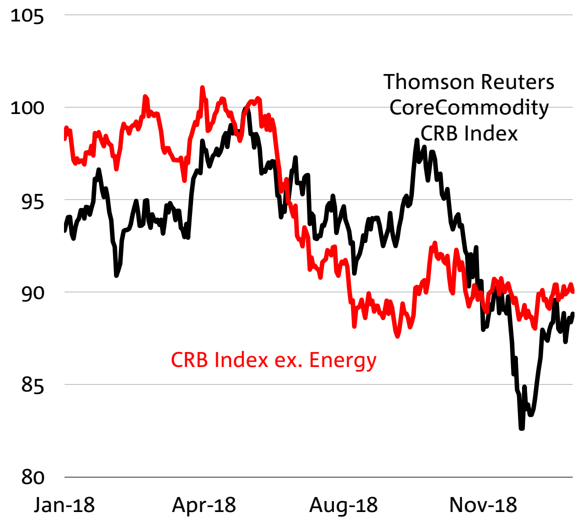
Bloomberg financial conditions indices



* 30 day moving average

COMMODITY PRICES GOING SIDEWAYS

Commodity indices (23 May 18 =100)



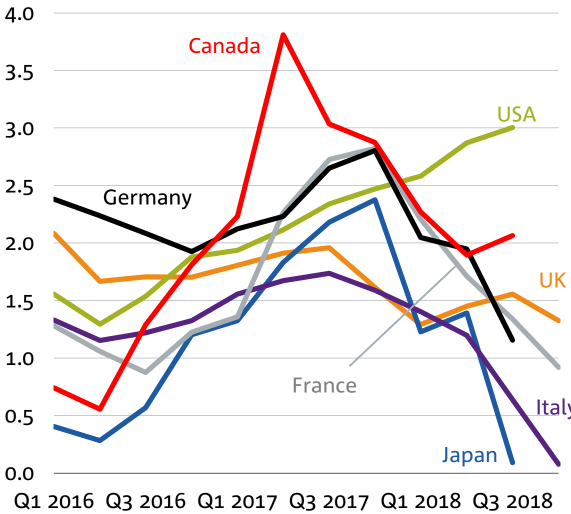
 Sources: Refinitiv, NAB Economics

ADVANCED ECONOMIES

US to join in AE slowdown in 2019

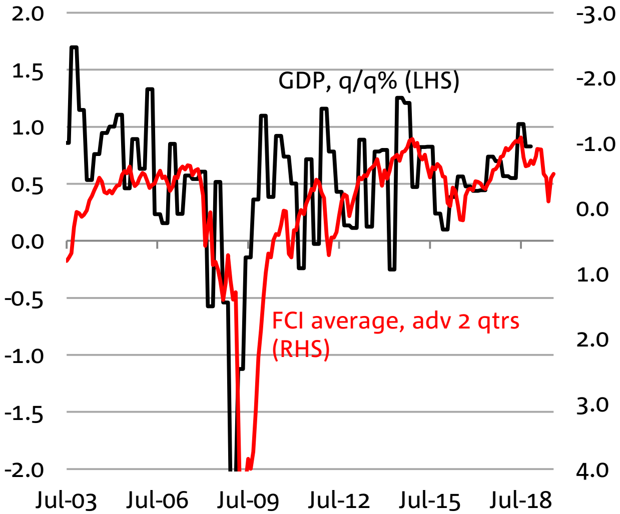
APART FROM US, AE GROWTH SLOWED

G7 economic growth (% yoy)



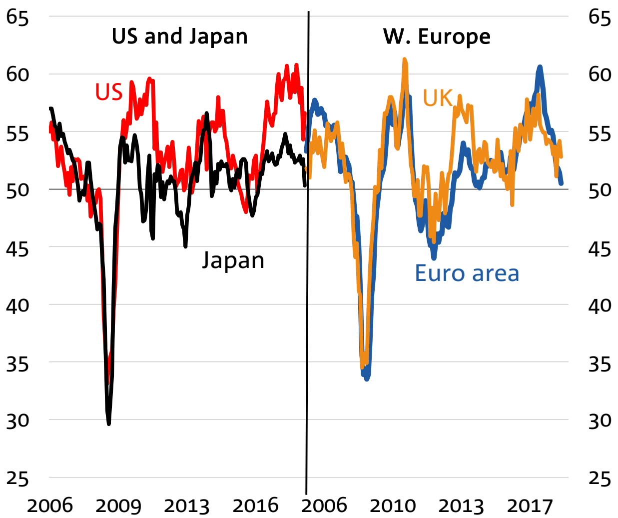
US LIKELY TO SLOW IN 2019

US Financial conditions indices & GDP growth



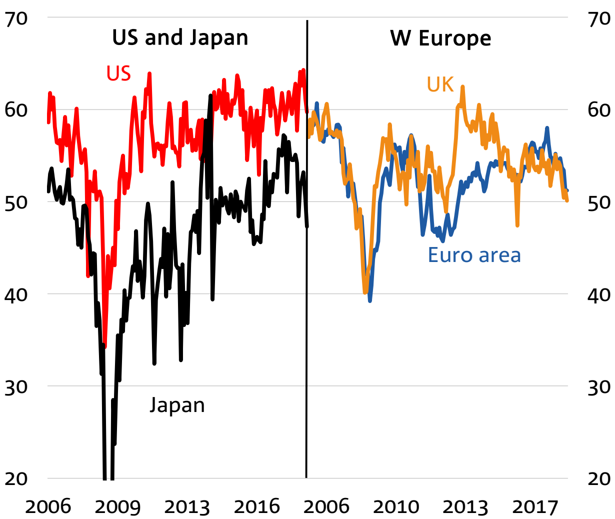
MFG WEAKNESS CONTINUING...

Advanced Economy Manufacturing PMIs (50=Breakeven)



...AND HAS SPREAD TO SERVICES

Advanced Economy Services PMIs (50 = Breakeven level)



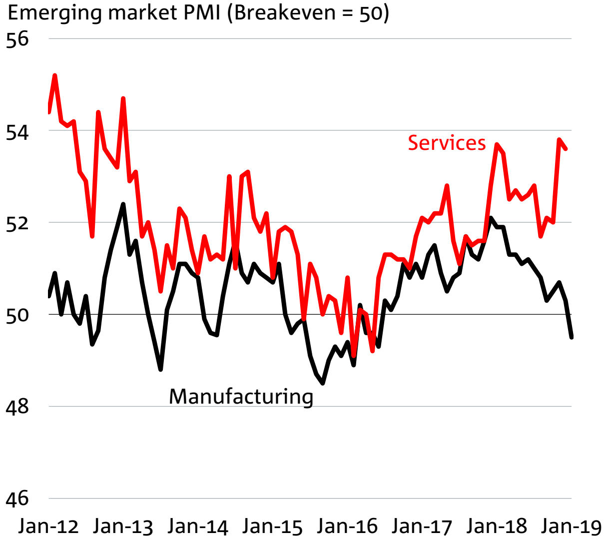
- There was a broad based slowdown in economic growth across the major advanced economies last year, with the US being the major exception as growth accelerated, fuelled by fiscal expansion.
- Over 2019 we expect US growth to slow, although Japan (at least until the VAT increase towards end 2019) and the Euro-Zone growth should stabilise. Monetary policy is already starting to adjust to the slowdown, which will help stabilise growth. Risks remain, including continuing uncertainty around US trading relationships although if the US-China were to reach (even a limited) agreement on trade this could boost confidence.
- Available indicators for the US, including business surveys, still point to an economy growing at a solid rate in the final quarter of last year, although off its 2018 highs. A fading fiscal policy boost and the deterioration in financial conditions in late 2018 (notwithstanding a partial recovery) points to a slowdown in growth through to the middle of 2019, before stabilising later in the year.
- Euro-zone GDP grew by only 0.2% qoq in Q4 resulting in annual growth of 1.3% yoy, the weakest outcome since 2013, in part due to the Italian economy falling into recession. A combination of factors appear responsible – some industry specific factors in Germany, the Italy/EU budget dispute, as well the negative effects on trade and business confidence of the US China-trade dispute and Brexit (which is also weighing on UK growth). As some of the more temporary factors fade, growth is expected to recover somewhat – particularly given still easy monetary policy settings and an expected fiscal boost. However, December's Italian-EU budget truce has failed to materially reverse the deterioration in Italian financial conditions and further falls in business surveys highlight the risk that falling sentiment becomes self-reinforcing.
- Natural disasters weighed on Japanese GDP in Q3, and indicators suggest a rebound in Q4 is likely. However, we have lowered our expectations for Japanese growth in 2019 and 2020. This reflects two factors. Firstly, the impact on Japan's trade flows from the slowdown in global growth – likely a factor in the recent deterioration in Japan's PMIs. Secondly, we are now incorporating the planned October 2019 VAT increase in our forecast; while it has been delayed twice before, it appears likely to go ahead this time around.

 Sources: Refinitiv, NAB Economics. FCI is an average of Goldman Sachs & Bloomberg FCIs, Chicago Fed NFCI, Kansas & St Louis Fed Stress indices (a higher number indicates easier conditions).

EMERGING MARKET ECONOMIES

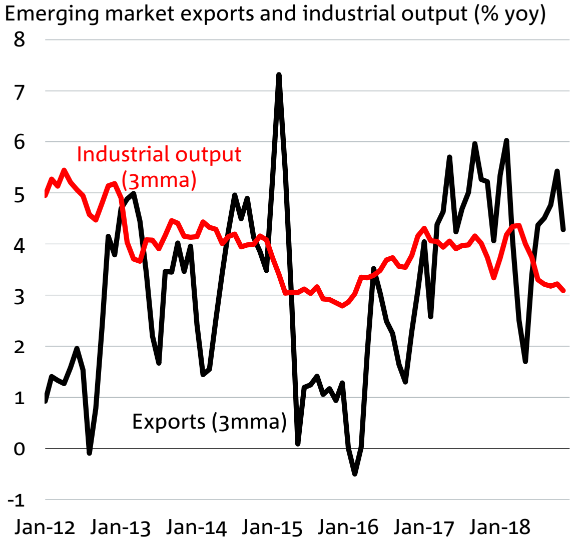
China trending lower as EM manufacturing slows

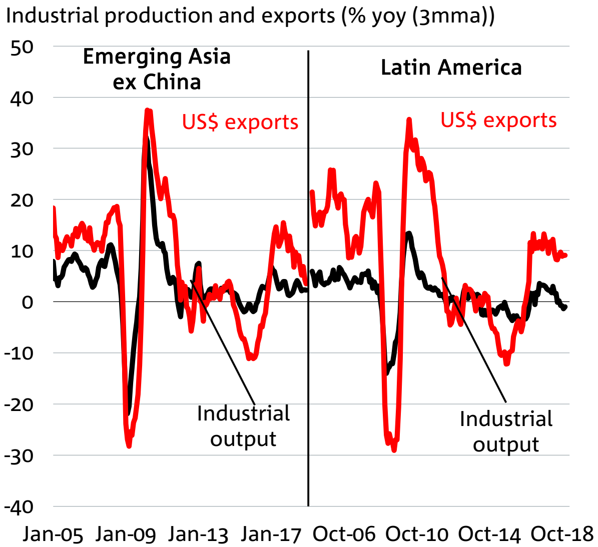
MIXED TRENDS IN EM PMI SURVEYS



CHINA GROWTH AT 28 YEAR LOW

IP SLOWING, TRADE IMPACT STILL TO COME; ALREADY EVIDENT IN ASIA





- PMI surveys provide the most timely snapshot of conditions in emerging market economies. These surveys currently highlight some highly divergent trends between the more trade-exposed manufacturing space and the more domestic-oriented services sector.
- Emerging market manufacturing has deteriorated since its peak at the end of 2017, turning negative in January 2019 for the first time since mid 2016. The US-China trade dispute has contributed to weaker manufacturing survey results in China, but more general weakness in trade activity has impacted conditions in both Indonesia and South Africa.
- In contrast, services PMIs have remained relatively strong – near its highest readings since early 2013. Again, China is a major driver, while improving trends in Brazil have provided support.
- Other timely indicators of emerging market trends have improved in recent months. Sovereign credit default swaps – effectively the cost of insurance against government default – have retreated almost 50 basis points since late December. Similarly, there has been a recovery in EM equities, with the MSCI index up around 12% from the trough in late October (albeit still far below the peaks of January 2018) and currencies have been trending higher. This suggests that fears in financial markets may have eased, in part supported by more dovish expectations around advanced economy monetary policy.
- China's economy slowed in Q4 2018 to 6.4% yoy, its equal weakest rate since 1990. This was largely related to the deleveraging program that limited new credit issuance during the year. So far, stimulus has been limited when compared with earlier episodes, and further slowing is anticipated this year.
- EM trade data is yet to show a clear impact from the US-China trade tensions, however this data is only available to November – the first month that Chinese trade data showed any slowing. US importers appeared to bring purchases forward to avoid the impact of rising tariffs, meaning that Chinese trade data in November and December was particularly weak. Growth in emerging market industrial production (on a three month moving average basis) peaked in March and has been slowing ever since.
- Outside of China, US dollar denominated trade in East Asia has seen slowing growth since early 2018. This region provides substantial quantities of raw materials and components for Chinese manufacturing, which then supplies to global markets. Weakness in global trade is a negative for the region.

 Sources: Refinitiv, CPB, IIF, NAB Economics

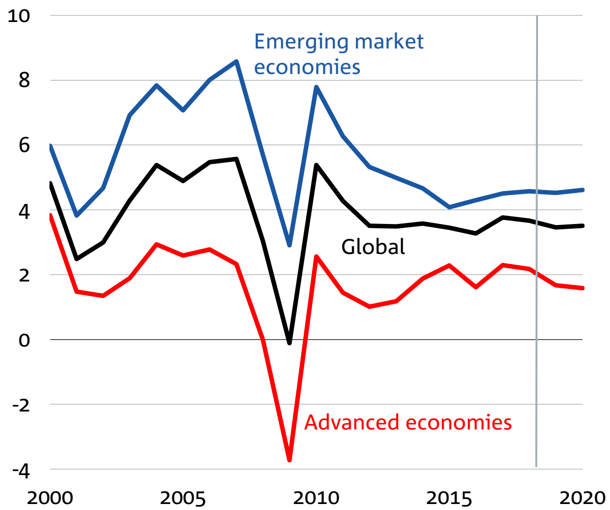
National Australia Bank

GLOBAL FORECASTS, POLICIES AND RISKS

Slower Q4 growth trend looks likely to continue in Q1

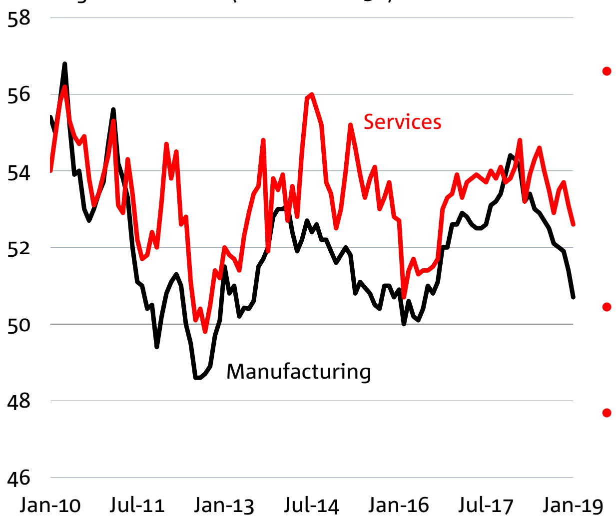
AE DRIVING SOFTER GROWTH IN '19

Global economic growth & forecasts (%)



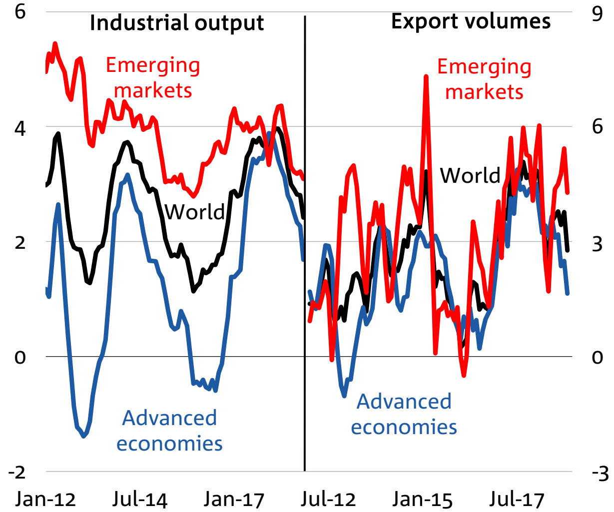
SURVEYS POINT TO A SOFTER Q1

JP Morgan Global PMI (Breakeven = 50)



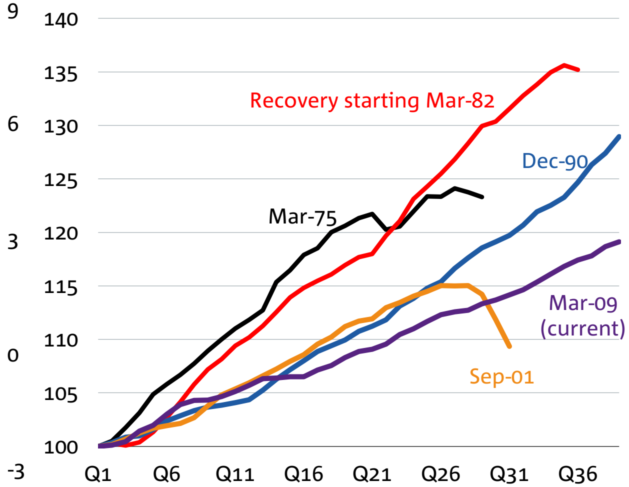
IP AND TRADE BOTH SLOWING

Global changes in trade and output (% yoy (3mma))



GROWTH CYCLE SLOW BUT PERSISTENT

Advanced economy recoveries (index of GDP)



Q1 is the first quarter of recovery, matching chart labels

- The data available for Q4 economic growth has generally been weaker – with slowing growth in China and the Euro-zone, along with expectations of slower but still solid growth in the United States – suggesting a continuation of the modest slowing trend that has been evident across the year.
- Early indicators – such as global PMI survey measures – point to a softer start to 2019, with manufacturing surveys weaker across both advanced and emerging markets and services while advanced economies led the softer services results. Weaker manufacturing surveys suggest that global industrial production – which had been slowing for several months to the latest reading in November – is likely to ease further.
- This slowing trend is also echoed in our leading indicator (see front page), which points to a further weakening in economic growth across the first half of 2019 (albeit starting to stabilise).
- Our forecasts for global growth have been revised lower in 2019 – down to the long term trend rate of 3.5% – but remain unchanged for 2020, also at 3.5%. Expected slower growth in both the United States and the Euro-zone are the key drivers of this trend, along with China.
- The prospects for international trade remain a key uncertainty to the outlook. Despite US comments about progress in US-China negotiations, the deadline of 1 March is rapidly approaching – when the second round of US tariffs will increase to 25% in the absence of an agreement.
- That said, trade concerns are much wider than the US-China relationship. Growth in global export volumes has slowed in recent months – increasing by just 2.8% yoy (on a three month moving average basis) in November (compared with rates near 5% in both January and February). Weaker economic growth in both the United States and Europe is a negative for trade dependent regions such as East Asia and Latin America.
- There remains a degree of uncertainty around our forecasts. On the upside, the impact of the US fiscal stimulus may be more persistent than expected, while lower oil prices a positive for energy importing nations. In contrast, the upturn in financial market volatility, and the continuing uncertain trade environment could further impact confidence and investment, which authorities may struggle to lean against given limited policy flexibility.

 Sources: Refinitiv, CPB, Markit, NAB Economics

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