EMBARGOED UNTIL: 11.30AM THURSDAY 14 MARCH 2019

THE FORWARD VIEW – GLOBAL

MARCH 2019

National Australia Bank

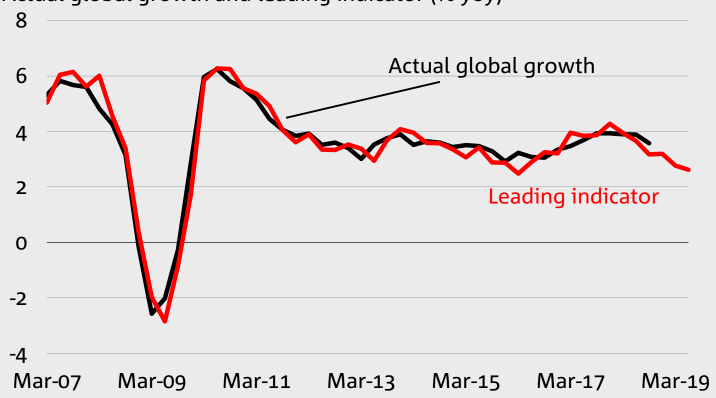
Summary – growth slowdown continues; risks still to the downside

- Financial markets have continued to recover, albeit still remaining below previous peaks, however this is on the back of more dovish monetary policy expectations, rather than underlying economic strength.
- Economic trends have generally softened – growth in major advanced and emerging market economies slowed in Q4, and more timely indicators (such as PMI surveys and our leading indicator) point to further slowing. This is particularly the case in manufacturing, which is more trade exposed than services.
- However this slowdown goes beyond global trade concerns, with weak domestic demand in a range of countries – particularly private consumption and business investment in non-US advanced economies. This broad based deterioration suggests that the any economic benefits derived from a cooling in US-China trade tensions should not be overstated.
- Given the recent negative trends, we have revised our growth forecasts lower for 2019 to a sub-trend 3.4%. A weaker profile for the Euro-zone, Japan and Latin America were the main contributors to this downward revision. Our leading indicator implies further weakness through to the middle of 2019, and suggests the risk to our forecasts is on the downside. That said, we expect growth to stabilise into 2020, in part due to the dovish turn in policy settings.

Global Growth Forecasts (% change)

	2017	2018	2019	2020
US	2.2	2.9	2.1	1.8
Euro-zone	2.5	1.8	1.2	1.6
Japan	1.9	0.8	0.5	0.7
UK	1.8	1.4	1.3	1.6
Canada	3.0	1.8	1.6	1.8
China	6.9	6.6	6.3	6.0
India	6.7	7.3	7.1	7.2
Latin America	1.3	1.1	1.6	2.4
Other East Asia	4.4	4.1	3.8	3.7
Australia	2.4	2.8	2.1	2.3
NZ	3.1	2.8	2.4	2.6
Global	**3.8**	**3.6**	**3.4**	**3.5**

NAB global leading indicator



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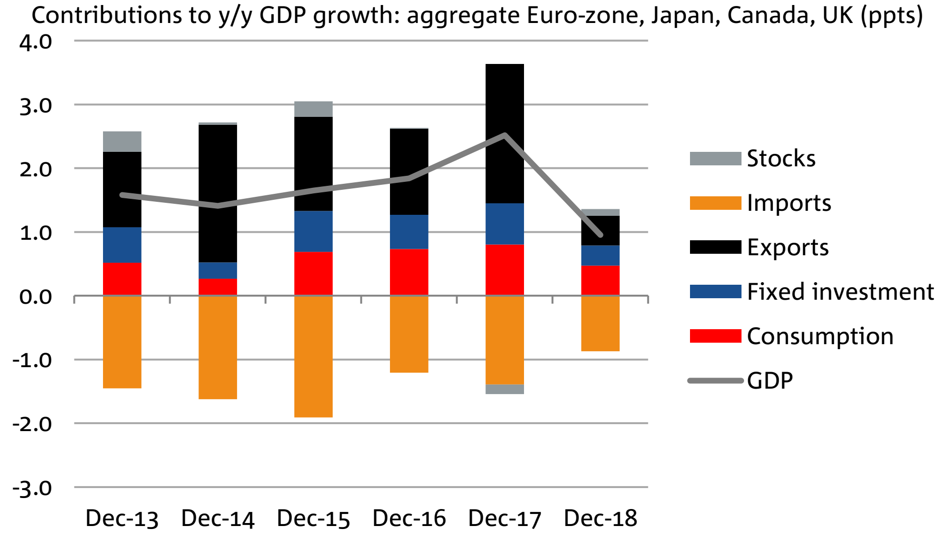
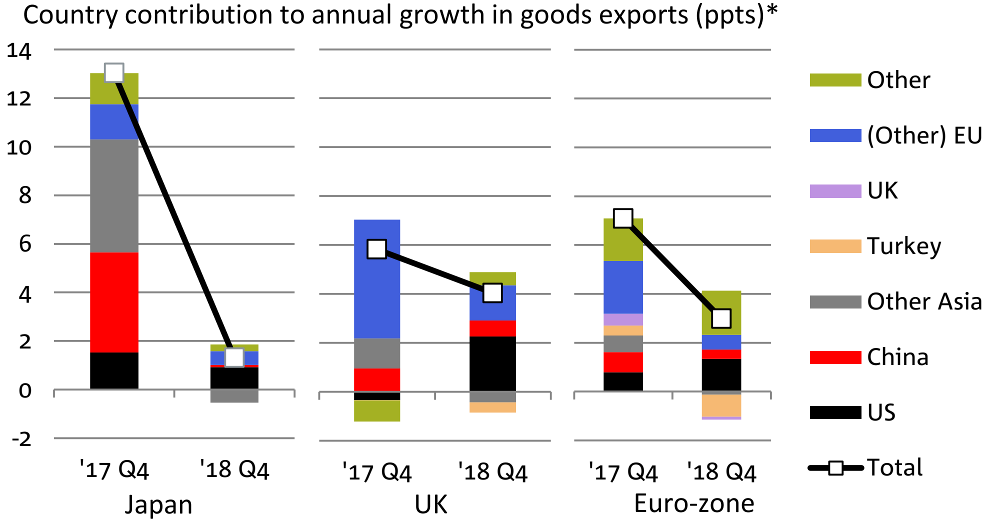
A CLOSER LOOK AT THE ADVANCED ECONOMY (EX US) 2018 SLOWDOWN

Fall in domestic demand & trade; mfg hard hit but labour markets holding up

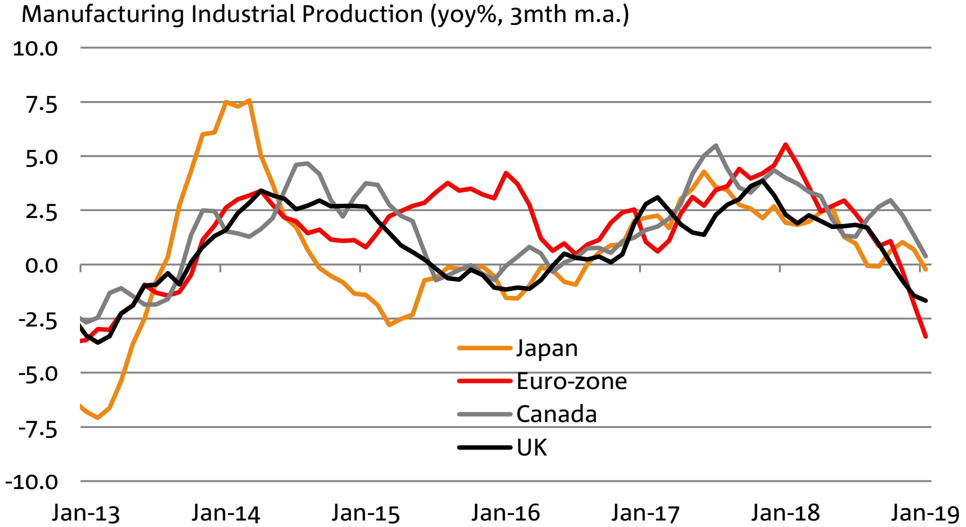
Domestic demand eased in 2018 but export decline stark



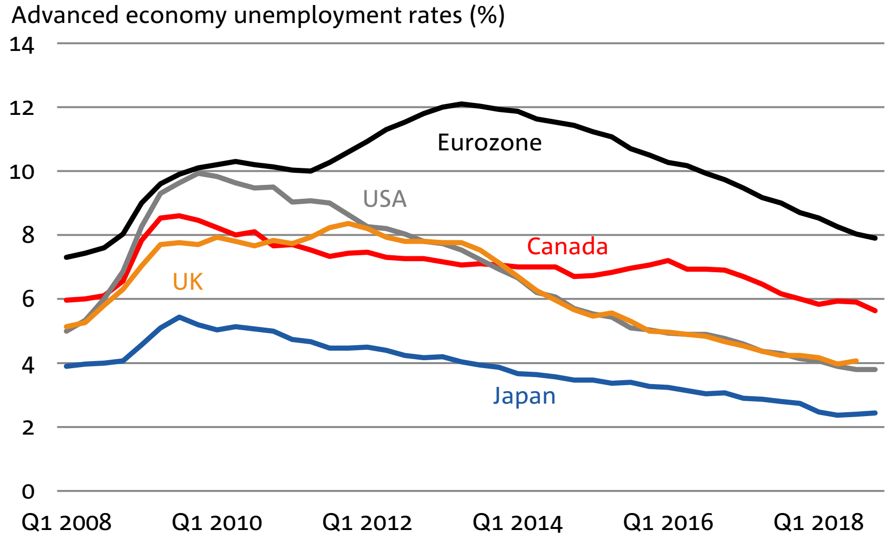
Decline in exports broad based but, outside of Japan, China not the key (direct) driver & US has been a support



Downturn stark in highly traded manufacturing



AE Manufacturing not labour intensive…helps explain why labour mkts holding up…but employment typically lags growth



Sources: Refinitiv, Office of National Statistics (UK), Eurostats, NAB Economics. * Current price data; 'Other Asia' for the UK comprised of Japan, South Korea, Singapore, Hong Kong & Taiwan.

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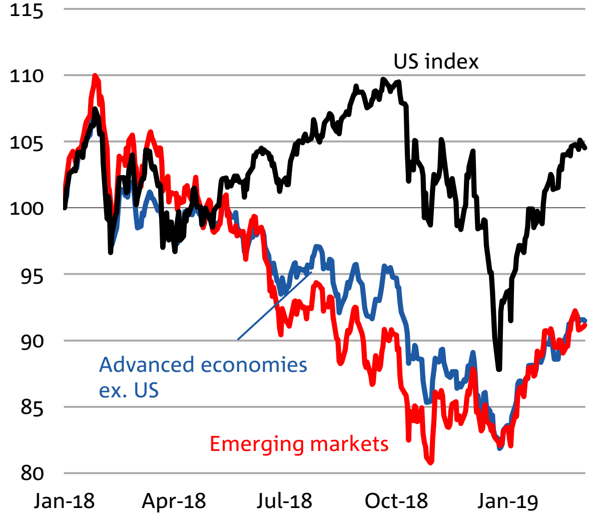
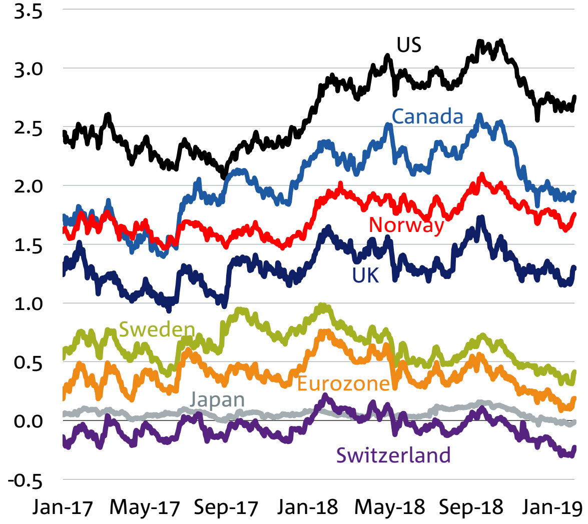
FINANCIAL AND COMMODITY MARKETS

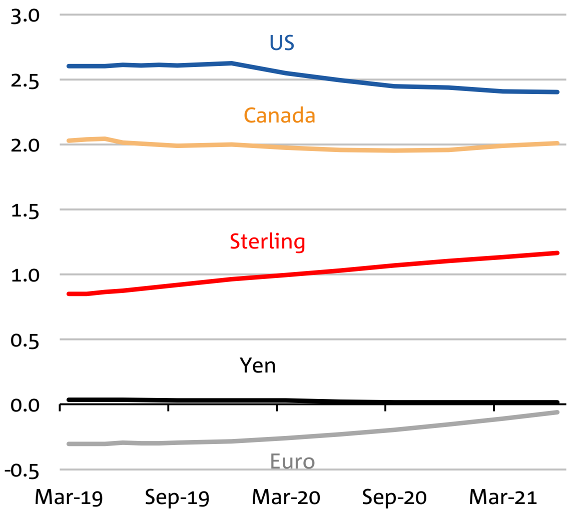
Financial markets continue to recover, supported by dovish policy expectations

RECOVERY IN STOCK MKTS CONTINUES BUT BOND YIELDS STAY DOWN

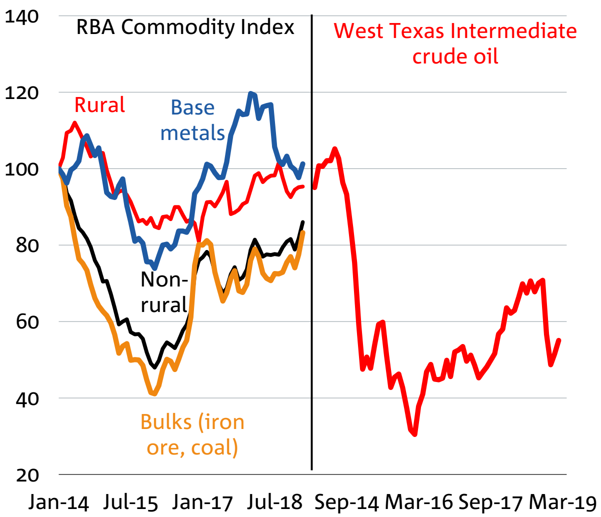




LITTLE MOVE IN RATES EXPECTED



COMMODITY PRICES MIXED



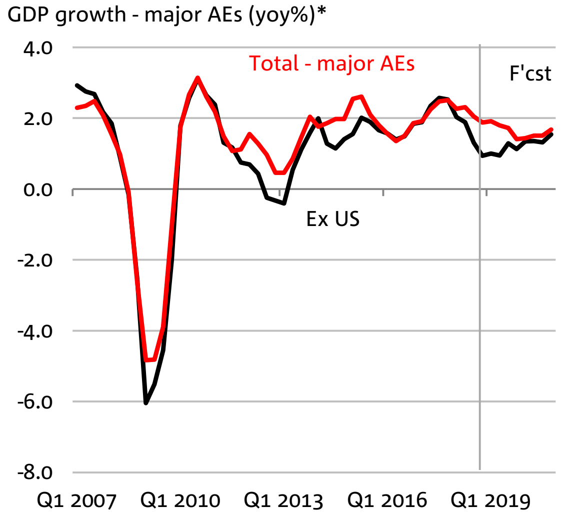
- The recovery in financial markets that started in January continued into February. This was reflected in rising stock market indices as well as a narrowing in risk spreads and a decline in volatility measures. This is not to say that all is back to where it was before late last year's ructions – not only have equities and spreads not yet fully recovered, but the improvement is on the back of a shift down in expectations of central bank monetary policy action.
- By early March, the US S&P 500 had recovered around three-quarters of the 20% fall seen from its September 2018 peak to December trough. The VIX measure of equity volatility has also declined substantially and is at a moderate level. There has also been a recovery in other advanced economy stock markets and Emerging Market (EM) equities. Similarly, US corporate bond yield spreads have narrowed, as have credit default spreads for investment grade corporates across North America, Asia and Europe as well as emerging markets.
- However, long-term bond yields remain noticeably lower across a wide range of countries. This is consistent with lower growth expectations and changed expectations for major central bank monetary policy. Markets are pricing in little or no chance of a rate hike by the major central banks this year, outside of the Bank of England (BoE). The tightening cycle for EM economies also appears to be over.
- The Fed is indicating that it will be patient and we don't expect any rate hikes this year. We think one is probable in 2020 if, as expected, unemployment stays low and inflation gradually rises. The ECB also shifted its stance, providing a new funding package for banks and delaying the time when rate hikes might be considered (from 'the summer of 2019' to end 2019). The Bank of Japan is in a more difficult situation as it is not sure policy loosening would make things better given the possible impact of lower rates on the health of financial institutions. While forecast growth for the UK looks modest at best, Brexit has lowered the UK's growth potential and the BoE expects inflation to eventually move slightly above target, requiring 'gradual' and 'limited' tightening. However, any action before a Brexit deal passes parliament is unlikely.
- Recent trends in commodity prices have been mixed. The slowdown in the global economy weighed on oil prices and base metals, although they have stabilised recently. In contrast, supply side issues lifted bulk commodity prices and the RBA's USD measure in February was at its highest level since 2014.

Sources: Refinitiv, NAB Economics

ADVANCED ECONOMIES

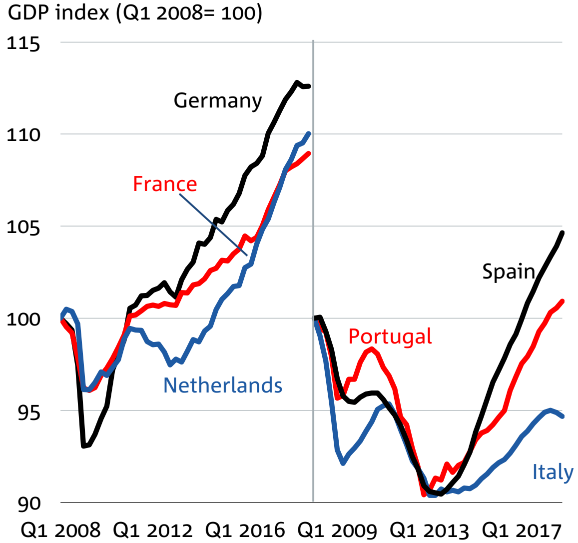
US and other AE growth to converge over 2019 – overall trough likely end year

US & OTHER AE GROWTH TO CONVERGE

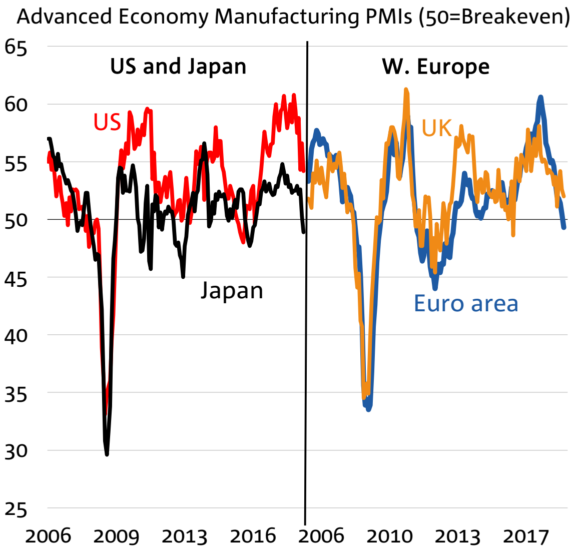


* US, Euro-zone, Japan, UK, Canada

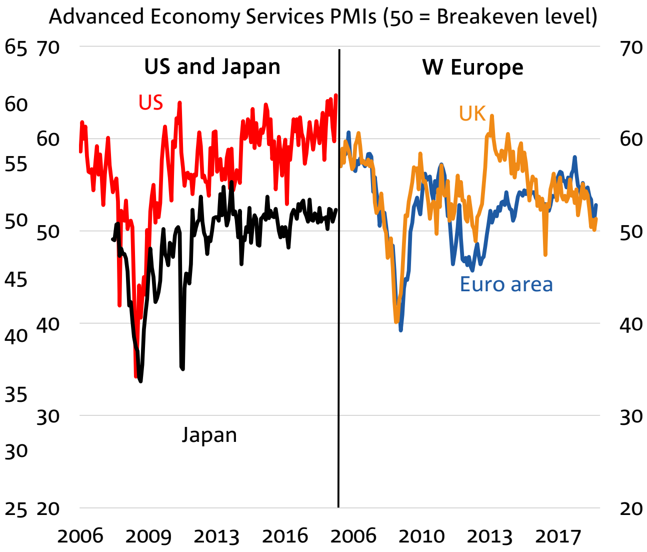
MIXED TRENDS WITHIN EURO-ZONE



MFG STILL FALLING



SERVICES STABILISED IN FEB



- Major advanced economy (AE) economic growth slowed to 1.9% yoy in Q4 2018, the weakest performance since early 2017. This was despite robust growth in the US. Excluding the US, major AE growth was only 0.9% yoy, the slowest it has been since mid-2013.
- We expect US and other AE growth to converge over 2019, with overall growth (on a yoy basis) not reaching its trough until the end of the year. US growth is expected to slow from last year's rapid pace due to a fading fiscal policy boost and the (lagged) effect of past monetary policy tightening. While early indicators such as retail sales are consistent with slower growth in Q1, US business surveys remain solid, financial conditions have improved this year, so at least for the US there is some upside risk to the forecast.
- For the other major AEs we expect overall growth to remain weak in Q1 2019 before improving around the middle of the year, but to then weaken again (temporarily) at year end assuming the scheduled increase in Japan's VAT is implemented.
- The underlying stabilisation of AE (ex US) growth that this outlook represents is based on the view that some temporary headwinds that weighed on growth will fade. This is particularly so for Europe where the divergent experience across Euro-zone countries highlights the importance of some idiosyncratic factors which should ease – particularly relating to German industry and French political unrest – while others may be more persistent (Italian politics). Moreover, policy will be more stimulatory in the Euro-zone (including some fiscal stimulus) and some improvement in trade sentiment is likely. The latter is based on the assumption that the US-China will make a deal of some sort in the near term, although it is possible that the US President may decide on some auto tariff measures which, depending on their scope, could negate any benefits from this. We are also assuming a Brexit deal is eventually passed through the UK parliament but this remains highly uncertain.
- The incoming data remain very mixed making it difficult to assess the underlying trajectory and highlighting the wide risks. A case in point being January's increase in German factory sales but a decline in industrial production at the same time. January data for Japan was very weak signalling the risk of a fall in GDP growth in Q1. Business surveys for Japan show that the manufacturing sector has been hard hit by the global downturn in manufacturing and trade, although the services sector is doing better.

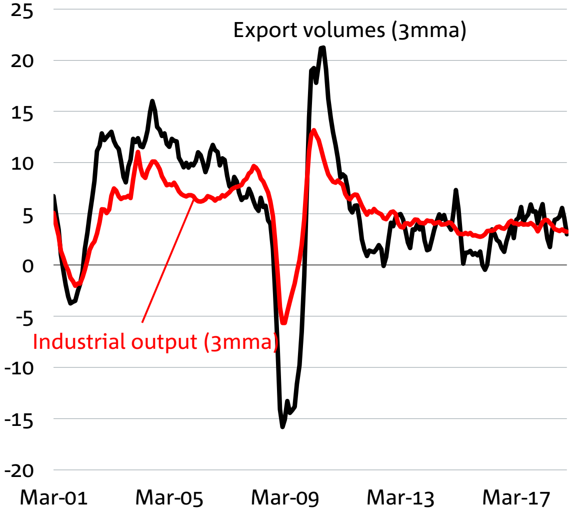
 Sources: Refinitiv, NAB Economics

EMERGING MARKET ECONOMIES

Weaker global trade environment is generally negative for EMs

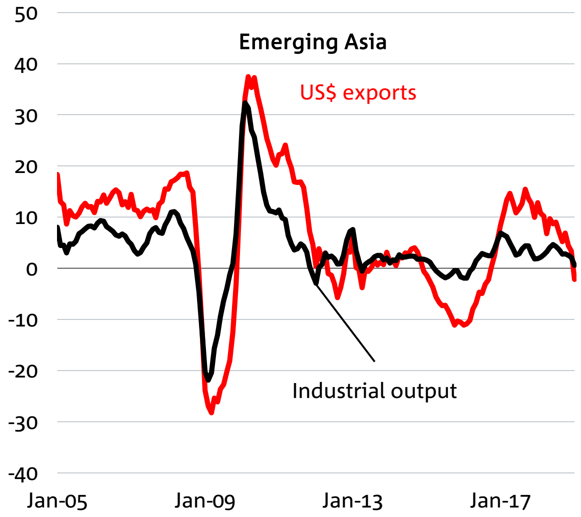
EM TRADE VOLUMES SLOWING

Emerging market exports and industrial output (% yoy)



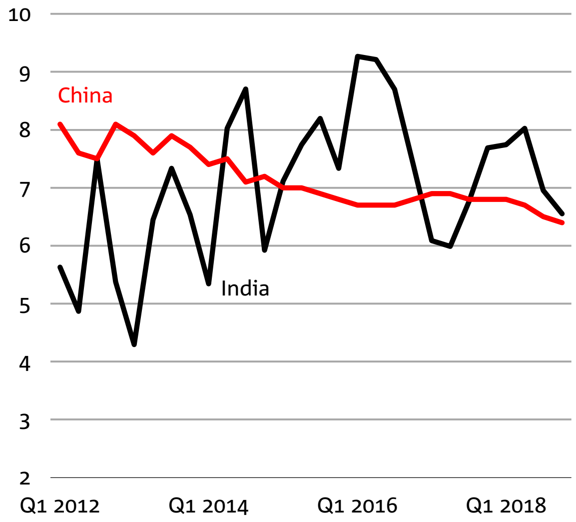
PLUNGE IN US$ EAST ASIA TRADE

Industrial production and exports (% yoy (3mma))

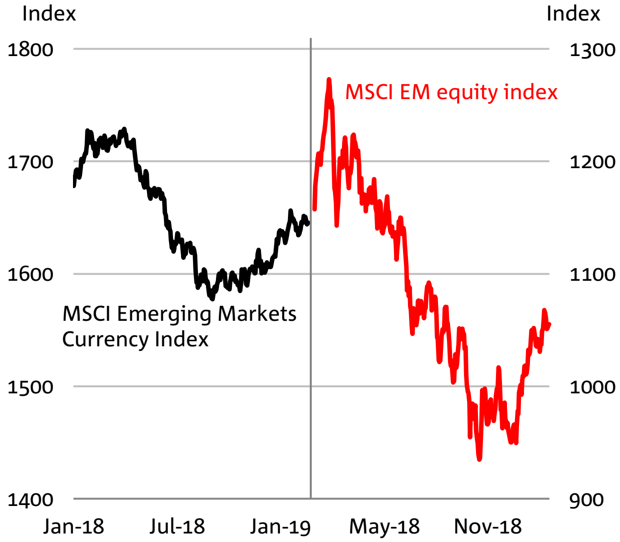


SLOWER INDIA & CHINA GROWTH

Economic growth (% yoy)



FINANCIAL MKT TRENDS IMPROVING



Sources: Refinitiv, CPB, IIF, NAB Economics

- Emerging market economies are generally more trade exposed than advanced economies, meaning that the current weakness in global trade presents some significant concerns for these countries. EM trade volumes slowed considerably in the latter part of 2018 – with volumes increasing by 3.0% yoy (on a three month moving average basis) in December, down from 4.6% in November and 5.6% in October.
- The trade relationship between the United States and China has improved in recent weeks – with the indefinite delay of US tariff rate increases. The potential for easing in trade tensions between the two countries is a positive for EM trade generally, particularly at a time when European import demand appears to be slowing.
- The weaker global trade trend is particularly evident in East Asia, where exports have slowed dramatically in US dollar terms. Exports in January fell by 2.2% yoy (3mma) – compared with double digit growth in the early months of 2018. Sizeable falls were recorded in South Korea (particularly for semi-conductors), Singapore and Thailand.
- Growth in India, the world's third largest economy, slowed in Q4 to 6.6% yoy. There remain a number of challenges for India's economy in 2019, including an increase in unemployment (estimated at 7.2% in February in a private sector survey by CMIE), volatility in the exchange rate and political uncertainty given upcoming elections. Our growth forecasts (7.1% in '19; 7.2% in '20) are generally below consensus. That said, business surveys have been improving, suggesting that growth will hold up reasonably well.
- China's National People's Congress in early March confirmed an expected lower growth target for the country in 2019 – of 6%-6.5% – in line with our slowing forecast for the country. While trade has been a major focus, domestic trends – most notably weaker credit growth due to deleveraging – have had a bigger impact on growth.
- More timely indicators present a mixed picture for conditions across key emerging markets. The composite EM PMI was unchanged in February – with an improvement in manufacturing measures offset by slowing in services. Similarly, capital flows data showed inflows into non-China EMs, while China continues to experience outflows (on a three month moving basis). More positively, equity markets and the broad EM currency index have improved since the start of the year – suggesting greater confidence around the prospects in these markets.

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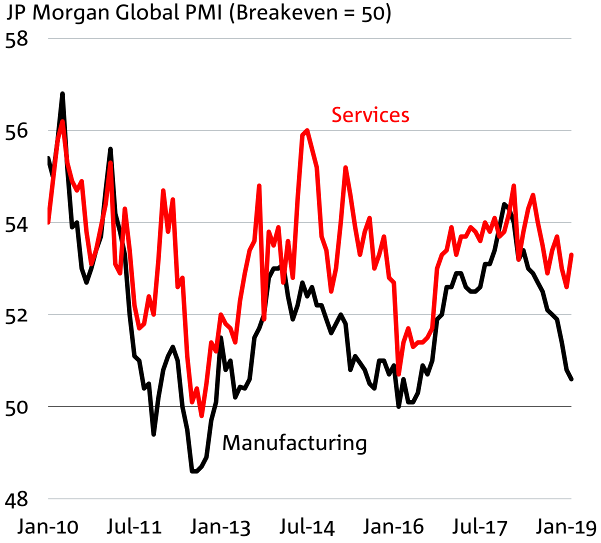
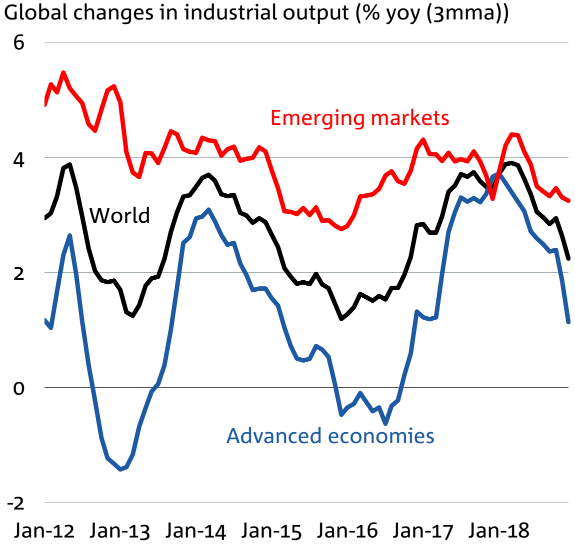
GLOBAL FORECASTS, POLICIES AND RISKS

Wide range of indicators point to further slowing in economic growth

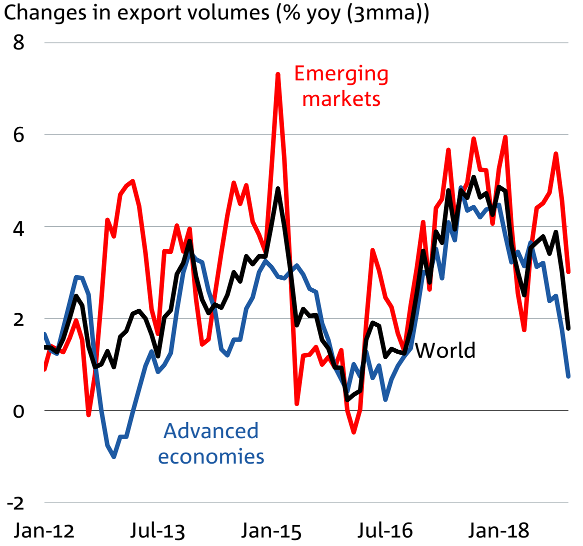
PMI SURVEYS TRENDING DOWN



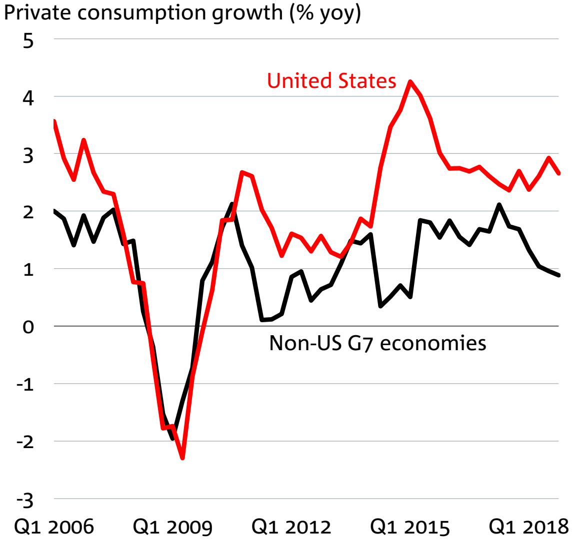
AE MFG SLOWING RAPIDLY



SHARP DOWNTURN IN GLOBAL TRADE



WEAKER NON-US CONSUMPTION



- The early readings for economic conditions in Q1 2019 have generally been weaker than previously expected – suggesting that the anticipated downturn in the global economy may be occurring faster, and to a greater extent, than was forecast.
- Much of this slowdown has been evident in the manufacturing space – where growth in output was stalling in December last year and PMI survey measures have continued to deteriorate through to February. It is worth noting that the easing in the global services PMI has been less significant since its peak in early months of 2018 (and services typically account for a larger share of economies – particular in the advanced region).
- Weakness in global trade is one part of this story – growth in global export volumes has plunged in recent months, down to 1.8% yoy (3mma) in December, compared with almost 4% in October – but so too is domestic demand. Advanced economy exports have slowed more dramatically than emerging markets. This goes beyond the US-China trade dispute, with private consumption and business investment in advanced economies outside the United States slowing considerably across 2018. The main drivers of this downturn have been Germany, Canada and Japan, impacting demand for local and imported manufactured goods.
- This broad based deterioration may undercut any economic benefits derived from a cooling in US-China trade tensions. Some form of agreement between the two countries looks increasingly likely, however it is unlikely to completely resolve all the issues.
- Reflecting these negative trends, we have revised our growth forecasts lower for 2019 to a sub-trend 3.4%. A weaker profile for the Euro-zone, Japan and Latin America were the main contributors to this downward revision, along with Canada and Russia (to a lesser extent).
- The greater than expected slowdown is also seen in our leading indicator (see front page), which implies further weakness through to the middle of 2019, and suggests the risk to our forecasts is on the downside.
- A wide range of factors present uncertainty to our forecasts. The extent of stimulus in China (in response to slowing growth in late 2018) remains far from clear, while ongoing uncertainty around US trade policy, the Brexit negotiations, further financial market and energy price volatility and shifting expectations regarding monetary policy could impact investment decisions.

Sources: Refinitiv, CPB, Markit, NAB Economics

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