EMBARGOED UNTIL: 11.30AM THURSDAY 16 MAY 2019

THE FORWARD VIEW – GLOBAL

MAY 2019

National Australia Bank

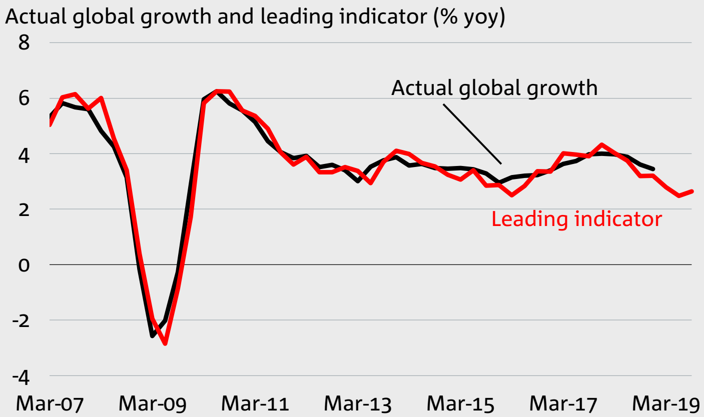
Summary –trade worries overshadow tentative signs of activity stabilising

- Financial markets had been recovering strongly from the turbulence of late last year, aided by a dovish turn in the direction of monetary policy, but have given up some their gains following the latest round of US-China tariff increases.
- There have been some signs of activity stabilising – Q1 GDP in some major economies was either stronger or unchanged, and the global composite PMI has basically moved sideways this year.
- While a fading impact from last year's fiscal stimulus is one factor likely to contribute to a slowing in US growth over the rest of the year, fiscal policy in other advanced economies and emerging economies has turned more supportive. Combined with still low policy interest rate settings by many central banks, this should help support growth.
- However, our leading indicator of global activity continues to point to a slowdown in growth. Given this, and the flare up in the US-China trade dispute last week, we have lowered our forecasts for global growth in 2019 to 3.3% (3.4%). We then expect growth to slowly return to its long-term trend, rising to 3.4% in 2020 (revised from 3.5%) and 3.5% in 2021. This projected return to trend reflects expected supportive policy settings, a fading impact from trade measures announced to-date, and a recovery from country/region specific shocks that have been weighing on growth (notably within the Eurozone and Latin America). Trade remains one of the key risks to the outlook; it is possible that the US and China will reach some accommodation in coming weeks, but equally the dispute could worsen. Moreover, trade disputes could emerge with other US trading partners, suggesting trade related uncertainty will be an enduring feature for a while to come.

Global Growth Forecasts (% change)

	2018	2019	2020	2021
US	2.9	2.5	1.8	1.8
Euro-zone	1.8	1.2	1.4	1.5
Japan	0.8	0.2	0.5	1.0
UK	1.4	1.5	1.5	1.6
Canada	1.8	1.2	1.7	1.8
China	6.6	6.3	6.0	5.8
India	7.1	7.1	7.2	7.1
Latin America	1.0	1.4	2.3	2.5
Other East Asia	4.2	3.8	3.8	3.9
Australia	2.8	2.0	2.2	2.3
NZ	2.8	2.4	2.6	2.5
Global	**3.6**	**3.3**	**3.4**	**3.5**

NAB global leading indicator



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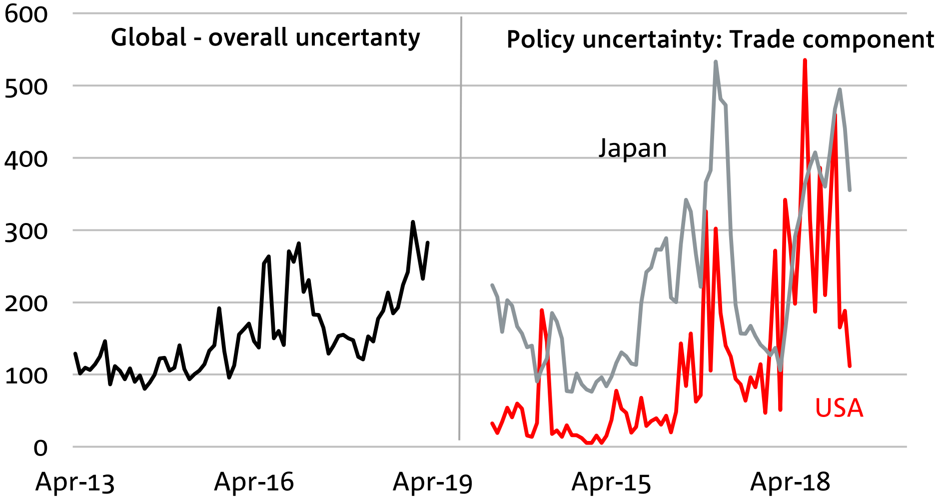
TRADE HEADWINDS BACK IN THE HEADLINES

Trade disputes one factor behind slow global down last year…US-China dispute suggests more to come

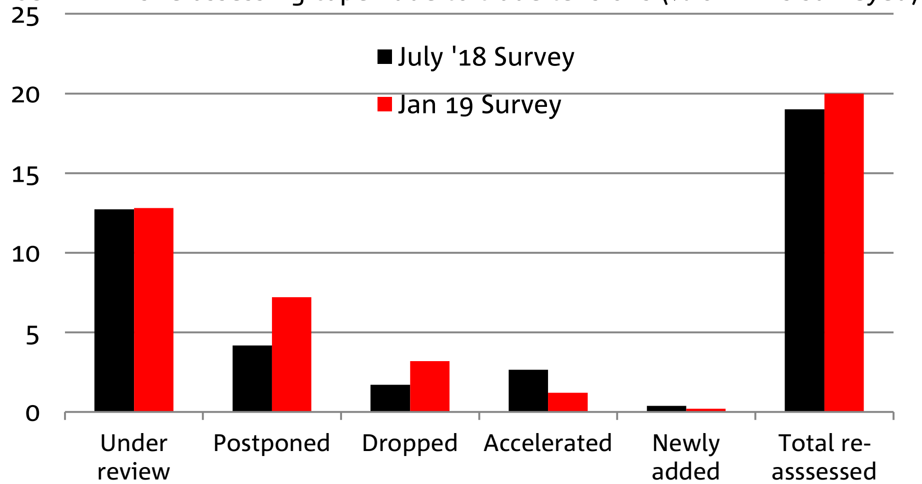
Policy uncertainty for businesses at a high level – US trade disputes one factor behind this

Economic policy uncertainy index



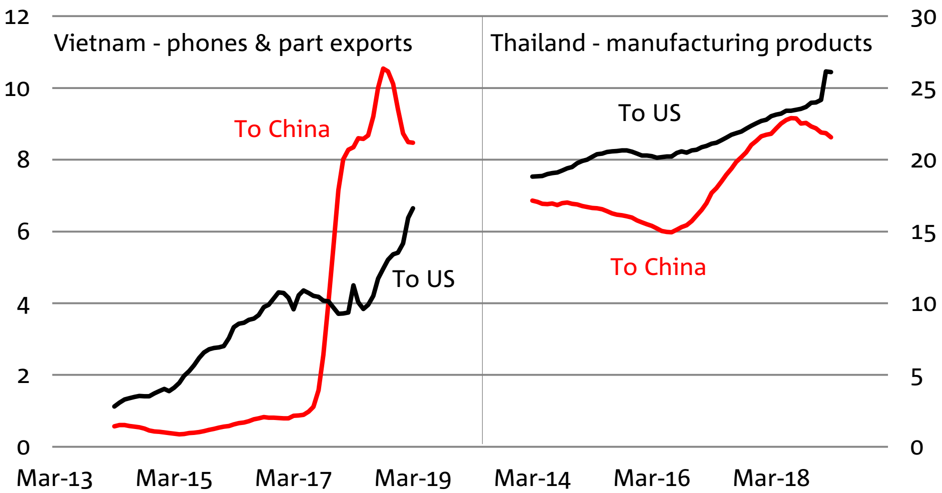
Atlanta Fed estimates trade dispute reduced US capex by 1.2% in 2018…could be more in 2019 given worsening in US-China trade dispute

USA - Firms re-assessing capex due to trade tensions (% of firms surveyed)



Signs Asia supply chains have adjusted…unclear how permanent

Vietnam and Thailand exports to US and China, by selected category ($US b)



US-China trade dispute not the only possible trade risk

Trade issue	What has happened	What next?
US – China trade dispute	US 25% tariff on $50b of China imports over July/Aug. 2018 (equivalent China measures), and 10% tariff on $200b of imports in Sept. 2018 (China placed tariffs of 5-10% tariffs on $60b of US imports) which increased to 25% on 10 May (China lifted tariffs up to 25% on $60b of US imports, effective 1 June '19).	US has started the process to extend 25% tariffs to 'essentially all' other imports from China. US & China still talking to each other.
NAFTA re-negotiation/USMCA	US/Canada/Mexico have agreed to a revised NAFTA – now called USMCA. Still requires approval by each countries legislatures.	Canada/Mexico pushing for US steel/aluminium tariffs to be lifted before ratification & unclear if US Congress will support USMCA. If not ratified does US President walk out of NAFTA?
US-Euro trade negotiations & US auto tariffs	EU/US negotiating an agreement for zero tariffs on non-auto industrial goods but progress has been limited. US President has raised possibility of tariffs on autos including from Europe (but which could also affect Japan and South Korea).	Reports suggest little EU-US progress has been made. President Trump has until 18 May to agree/disagree with the findings of a Section 232 report on autos but has wide discretion about what to do thereafter; press reports point to to a six month delay.
US-Japan	The US and Japan started trade negotiations in April 2019.	There has been little reporting on how the talks are going.

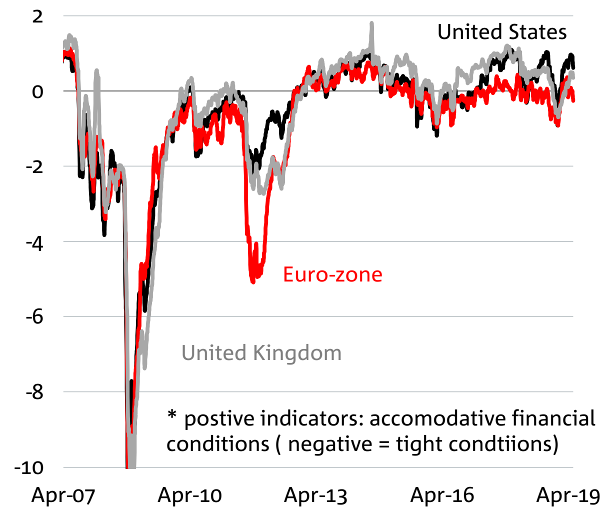
Sources: Refinitiv, Econdata DX (CEIC), "Measuring Economic Policy Uncertainty" by Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com, NAB Economics.

FINANCIAL AND COMMODITY MARKETS

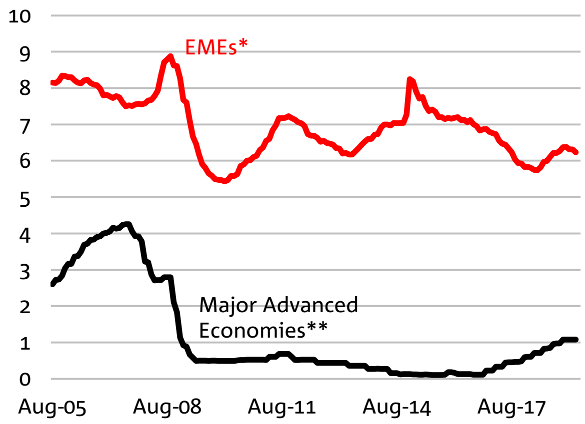
Financial conditions have improved over 2019 before US-China tariffs

RATE TIGHTENING CYCLE OVER FOR NOW…HELPING BROADER CONDITIONS

Finanical conditions indices (rolling weekly average)*



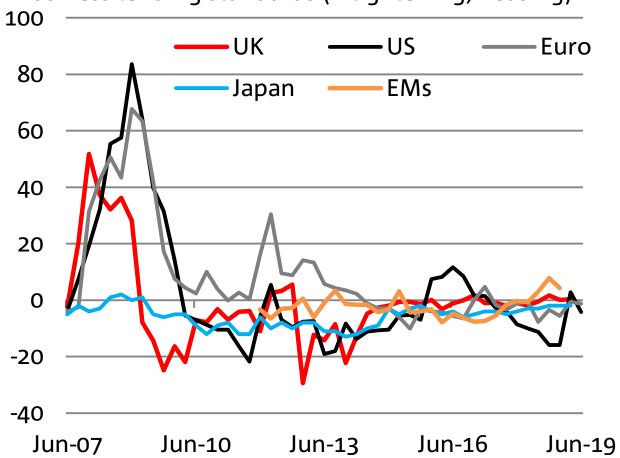
EM and AE : central bank policy rates (%)



* 19 Country weighted average; does not include China, Argentina or Turkey. **Weighted average of US, UK, Canada, Euro-zone, Japan . GDP (PPP) weights used.

BANK LENDING STANDARDS

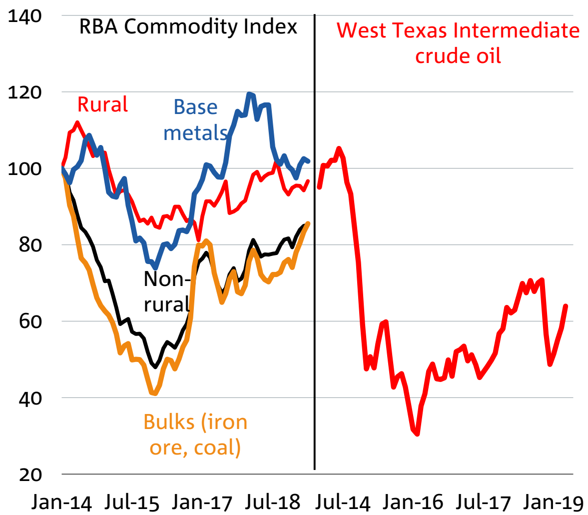
Business lending standards (+ tightening, - easing)*



* Overall firm measure where available otherwise large firms, C&I loans. For UK 'availability' indicator used.

COMMODITY PRICES STABLE OR UP

Commodity price indices (Jan 2014 = 100)



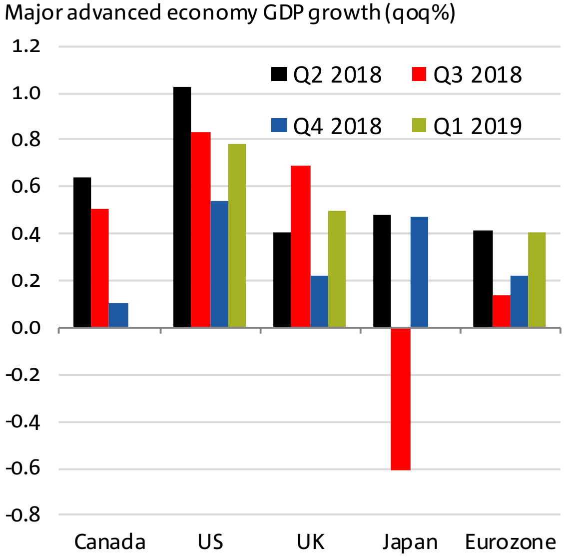
- Financial markets had been recovering strongly from the turbulence of late last year, with advanced economy equity indices (on average) regaining much of their lost ground, before the flare up in US-China trade tensions. Credit spreads have also narrowed and as a result measures of overall financial conditions have improved.
- This improvement in conditions has been helped along by a change in stance in many central banks. It is not so much about what they have done – policy rates are largely unchanged. Rather, expectations of future rate rises have been dialled back. The Fed has removed its tightening bias and is now indicating it will be 'patient' (we expect no move in rates up or down this year or next), while the European Central Bank and the Bank of Japan have pushed out their forward guidance on when rates may rise. Moreover, the EM tightening cycle, which was modest in terms of duration and degree, is over and there has been some net easing in EMs (principally driven by India). The Bank of England is an exception as it is projecting rate rises, but even here, with Brexit uncertainty still high, imminent action appears unlikely.
- Markets are generally even more dovish than the central bank guidance (for example, pricing in a Fed rate cut this year). This has contributed to a fall in long-term bond yields, which remain well below their peaks of last year.
- A concern associated with last year's equity market falls, rising credit spreads and uncertainty around the global outlook, was that it would lead to a material tightening in bank lending standards. However, while there was a modest shift in the US (since partially reversed), overall there appears to have been little shift in bank credit standards.
- The improvements in financial markets seen over much of 2019 have come under some pressure from the US move last Friday to raise tariffs on around US$200b of Chinese imports and China's subsequent retaliation. Equity markets have reacted negatively and measures of market volatility have moved higher.
- Commodity prices in recent months have either been moving sideways or moving higher (particularly oil, but this is also the case for bulk commodities). Base metal prices – which tend to the most sensitive to the global outlook – have stabilised in recent months, having fallen from recent peaks in mid-2018.

 Sources: Refinitiv, NAB Economics

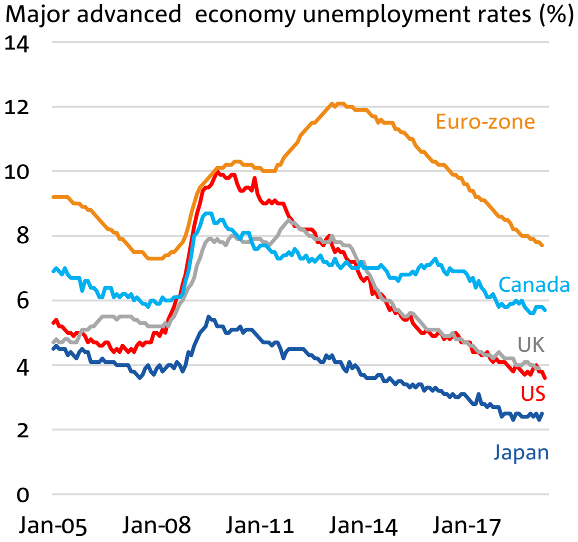
ADVANCED ECONOMIES

Some signs of stabilisation outside of the US, but not out of the woods yet

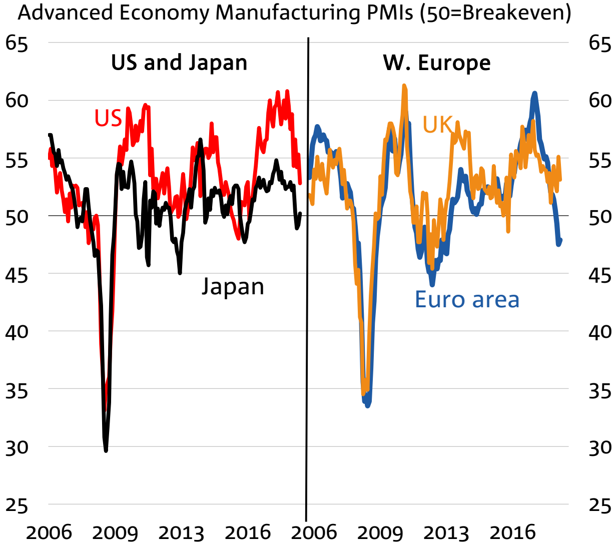
GDP GROWTH – BETTER SIGNS IN Q1



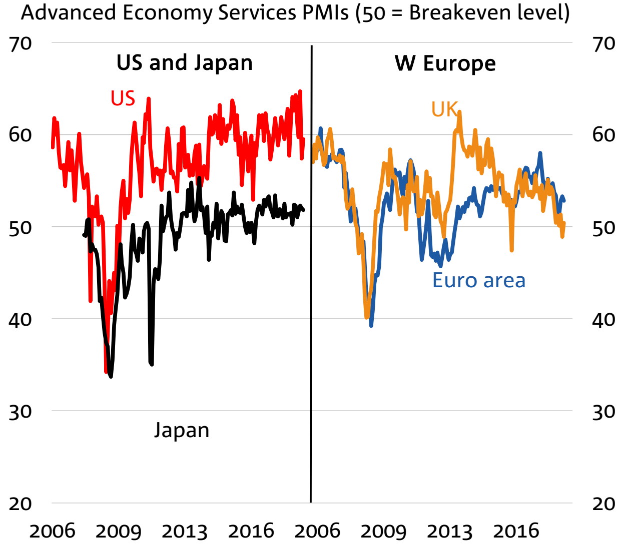
LABOUR MARKETS HAVE HELD UP



NON-US MFG MAY BE STABILISING



SERVICES SECTOR GENERALLY BETTER



- There were signs of an improvement in major advanced economy (AE) growth early in 2019. Estimates for Q1 GDP are now available for the US, Euro-zone and the UK, and there was a pick-up in quarterly growth in all three cases. While Q1 expectations for Japan do not have a similar upturn (indeed Japan could well go backwards), this should translate into around 2% yoy growth in Q1 for the major AEs, up from 1.9% yoy in Q4 2018.
- However, we expect the lift in the annual growth rate will be temporary. The US performance in Q1 was boosted by some transitory factors which will unwind. More fundamentally, a fading fiscal policy boost, the (lagged) effect of past monetary policy tightening, as well as supply constraints, should lead to lower growth over 2019 than seen last year. While still at reasonable levels, US business surveys have eased this year, consistent with this outlook.
- The improvement in the Euro-zone's and UK growth rate in Q1 has not been matched by the business surveys, which point to a resumption of more sluggish growth in Q2. The April Euro-zone manufacturing PMI rose slightly, for only the second time in sixteen months, but it is too early to be sure the worst is over.
- The Euro-zone has also been impacted by Brexit and how this will play out is it still highly uncertain. This uncertainty will continue to be a drag on the Euro-zone and UK economies. However, in the Eurozone, some headwinds from some local factors (German industry disruptions, French political unrest) should fade, monetary policy remains supportive and fiscal policy should boost activity this year. However, fiscal policy is moving in the opposite direction for Japan, with an increase in its VAT scheduled for Q4 2019.
- The intensification of the US-China trade dispute will be an additional headwind to AE growth. The latest US tariff measures are equivalent to around 0.15% of US GDP; this is a small fiscal shock, but is likely to have additional impact on business investment due to uncertainty and confidence impacts, particularly given previous expectations of an imminent agreement.
- Despite the growth slowdown in AEs (outside of the US) over 2018, labour markets have continued to hold up well. Countries with already low unemployment rates – the US, UK and Japan – have either moved sideways or seen further small falls in unemployment. The unemployment rate in the Euro-zone remains the highest of the major AEs, but even it has continued to fall.

 Sources: Refinitiv, NAB Economics

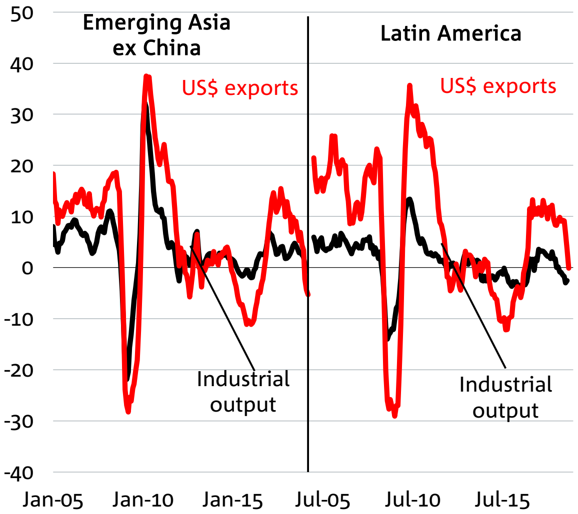
National Australia Bank

EMERGING MARKET ECONOMIES

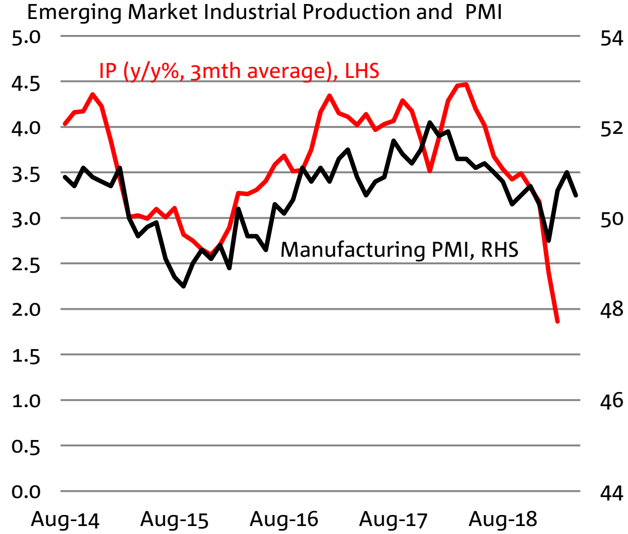
Signs that trade/IP bottoming out…but at risk from US-China tariffs

EM TRADE FALLING, IP SLOWING

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

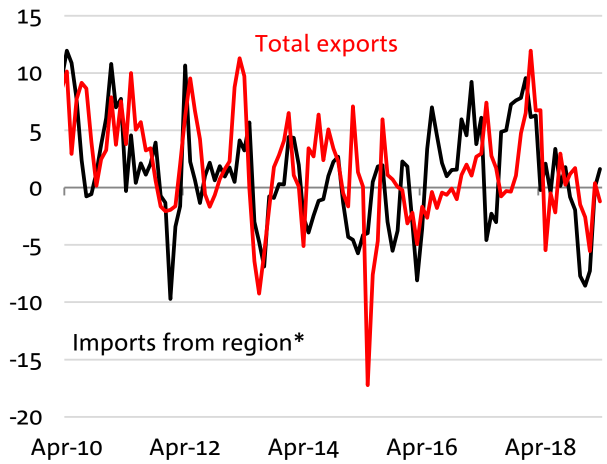


SURVEYS POINT TO IP REBOUND



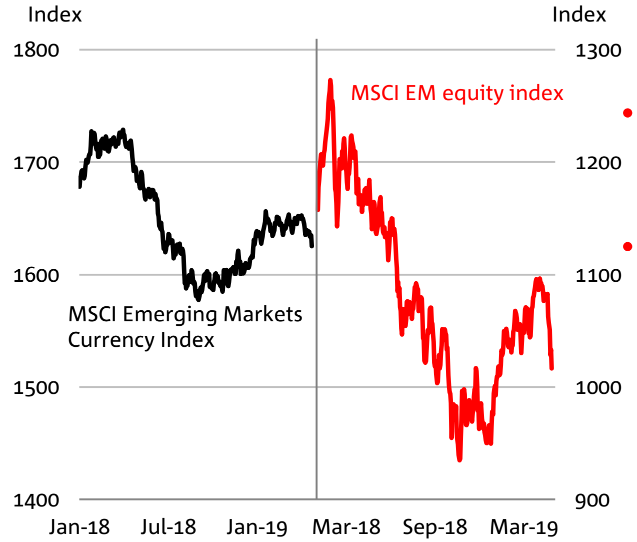
CHINA IMPORTS FROM REGION UP

China exports and imports (USD, 3mth/3mth, s.a.)



* Jpn, HK, Sing. Thai., Viet., S. Kor., Taiwan, Malay., Indonesia

MARKETS DOWN ON TRADE DISPUTE



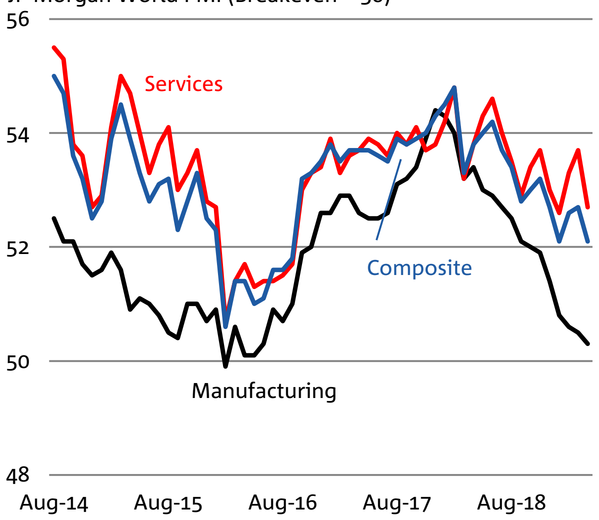
- Emerging market (EM) economies have been hit hard by the slowdown in global growth as it has been centred around trade sensitive manufacturing. While EM exports have been falling, and industrial production (IP) slowing, there were some signs that the worse may be over. However, the intensification of the US-China trade dispute that occurred last week risks re-starting a downward cycle in trade and the manufacturing sector.
- EM trade volumes have slowed sharply since late 2018 – from growth of 5.6% yoy (three month average) in October 2018 to -2.6% yoy by February. The recent sharp downward turn could in part reflect a bring forward of trade activity ahead of last September's round of US/China tariff increases, but the slowdown in global growth is a more persistent underlying factor.
- There has been a related downturn in EM IP growth at the same time, from of around 4% yoy (3 mth average) in mid-2018 to 1.9% in February. However, the EM manufacturing PMI has moved higher in recent months, consistent with some pick-up in IP growth. China data for GDP (data to Q1 2019) and IP (data to April) also point to growth stabilising (even with the March spike in IP being short lived).
- Another indication that activity might have been stabilising comes from Asian region trade flows. With China importing many intermediate goods from South East and East Asia before assembling into finished goods for export, imports from its Asian neighbours often lead China export growth, and growth in these imports has resumed.
- Similarly, EM financial indicators had been showing improvement, highlighted by a stable EM currency index and improvement in equities. However, the flare-up in the US-China trade dispute has lead to a notable fall in equities, as well as some pressure on currencies.
- If the increase in US and China tariffs remain in place, a key issue to watch will be how China's authorities respond to offset the negative impact on the economy. To-date China's growth, while slowing, has been broadly in-line with our expectation pre the start of the US-China dispute (and broader global slowdown). This partly reflects the use of policy measures (such as credit provision and fiscal policy) to keep the economy in-line with growth targets. Accordingly we have left our China forecasts unchanged for now, but will review once China's domestic policy response to the recent US tariff increase becomes clearer.

Sources: Refinitiv, CPB, NAB Economics

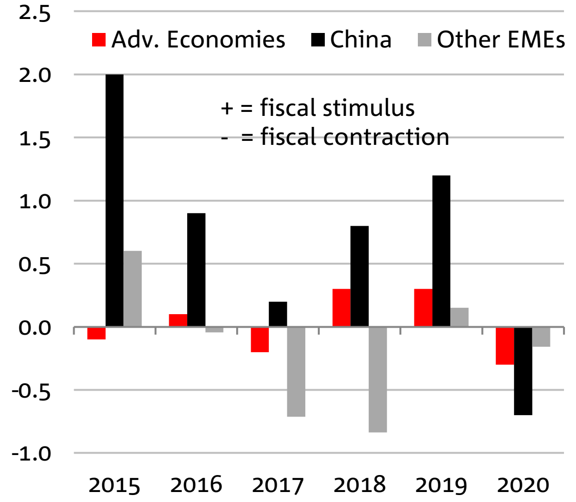
GLOBAL FORECASTS, POLICIES AND RISKS

Tentative signs of non-US activity stabilising…but trade headwind picks up

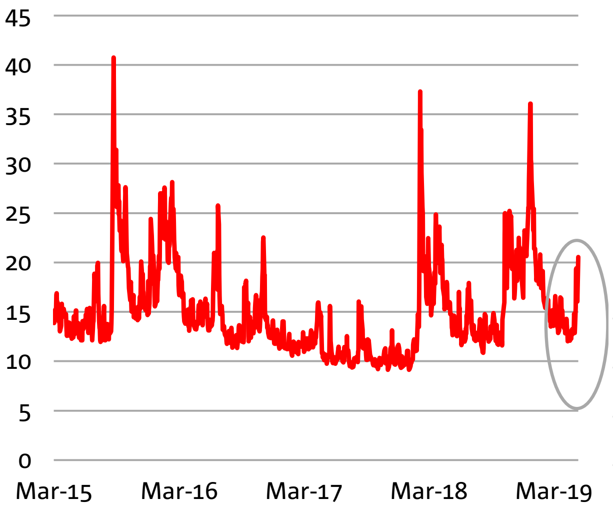
PMI COMPOSITE STABILISING?



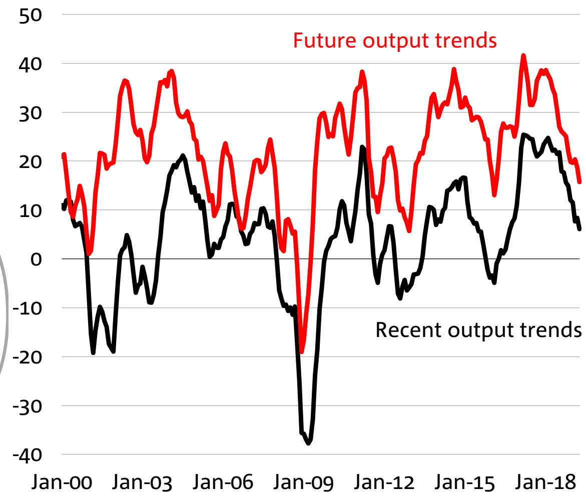
FISCAL POLICY SUPPORTING GROWTH



TARIFFS: MODEST IMPACT ON MKTS



BUSINESS EXPECTATIONS DOWN



- While the latest data – only available to February – continue to show further slowing in industrial production and a plunge in trade (now declining on a yoy basis), other indicators point to a possible stabilisation in the global economy. In Q1, GDP for some of the world's major economies either strengthened (US/Euro-zone/UK) or was stable (China). While the composite global PMI fell in April, it was still around the level seen in January. The manufacturing PMI did fall again but there was some (small) improvement in the Euro-zone and Japan, where the readings had been decidedly weak, and China is still up from where it was earlier in the year.
- That said, we expect US growth to slow back to around its trend rate. This will put downward pressure on global growth, even as some other regions (such as the Euro-zone) stabilise.
- The lower US growth expectation partly reflects a fading impact from last year's US fiscal policy boost. However, the IMF estimates fiscal policy in AEs overall will provide the same boost this year as it did last year. There has been a big swing in China's fiscal policy settings as it moved to limit the slowdown in growth and for other EM fiscal policy has also turned stimulatory the year. At the same time, monetary policy settings in most AEs remain very supportive of growth (except in US where monetary policy is near neutral).
- However, AE policy capacity, outside of the US, to react to any shocks to activity is limited. In this context, last week's intensification of the US-China trade dispute, is particularly concerning. So far financial market reaction has been relatively restrained (although equities are down modestly and volatility has increased), perhaps because the US and China are still talking to each and the increase in tariffs does not apply to goods already in transit (so the impact is still a couple of weeks away). However, with enforcement mechanisms apparently one of the sticking points, even if some sort of deal is reached, tensions could easily flare up again. Moreover, the US-China dispute is not the only trade policy risk (see p2).
- The lift in US tariffs on China imports represents an additional headwind to growth, which we have incorporated into our forecasts. Our leading indicator of global activity has also been highlighting downside risks to our forecasts for a while, although it does show growth stabilising later in the year, and business expectations continue to ease. As a result, we have lowered our forecasts for global growth in 2019 to 3.3% (3.4%), and in 2020 to 3.4% (from 3.5%). We are still projecting 3.5% growth in 2021.

Sources: Refinitiv, CPB, Markit, NAB Economics

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