EMBARGOED UNTIL: 11.30AM THURSDAY 13 JUNE 2019

THE FORWARD VIEW – GLOBAL

JUNE 2019

National Australia Bank

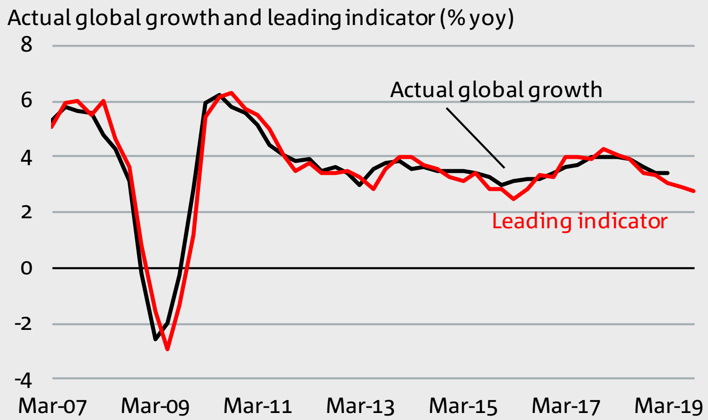
Summary – trade policy turbulence continues to unsettle the global economy

- In our view the global outlook has deteriorated. Financial markets hit a pothole in May following an escalation of the US-China trade dispute and the short-lived US threat to raise tariffs on imports from Mexico, although more dovish expectations around central bank policy have helped support share markets.
- NAB has revised down its forecast for the US Fed funds rate; we now expect it will be 50bps lower by the end of 2019 (previously we had expected no change) although the risk is that there will be more cuts rather than fewer.
- The latest data confirm that major AE growth strengthened in Q1. However, this is unlikely to be sustained and we expect growth to ease over the rest of the year. This is mainly due to a fading impact from last year's US fiscal stimulus, the impact of trade tensions, ongoing Brexit uncertainty and the planned increase in Japan's Value Added Tax later in the year.
- Emerging market (EM) economies are more trade exposed than the AEs and therefore the increase in trade tensions between the United States and China are a negative. This is particularly so for Asian EMs; while several economies in this region have increased exports to the US these have typically not been enough to offset lower exports to China and elsewhere.
- We have again lowered our global growth forecasts – to 3.2% in 2019 (from 3.3%) and to 3.3% in 2020 (from 3.4%) – due to an expectation that last month's trade policy events will negatively affect business sentiment and investment for an extended period of time. The forecast revision is also consistent with the message coming from our leading indicator of global activity. There is of course the clear risk that the US will implement additional trade barriers (e.g. extending tariffs to all China imports), although the situation is fluid and, as the US-Mexico agreement showed, it is possible trade worries could ease.

Global Growth Forecasts (% change)

	2018	2019	2020	2021
US	2.9	2.4	1.7	1.7
Euro-zone	1.8	1.2	1.3	1.4
Japan	0.8	0.7	0.4	0.9
UK	1.4	1.5	1.4	1.5
Canada	1.8	1.2	1.6	1.7
China	6.6	6.3	6.0	5.8
India	7.1	6.7	7.2	7.1
Latin America	1.0	0.8	1.8	2.4
Other East Asia	4.1	3.6	3.7	3.8
Australia	2.8	1.7	2.3	2.3
NZ	2.8	2.4	2.6	2.5
Global	**3.6**	**3.2**	**3.3**	**3.5**

NAB global leading indicator



CONTENTS

CONTACT

Alan Oster, Group Chief Economist
+61 3 8634 2927

Gerard Burg, Senior Economist – International, +61 (0)477 723 768

Tony Kelly, Senior Economist
+61 (3)9208 5049

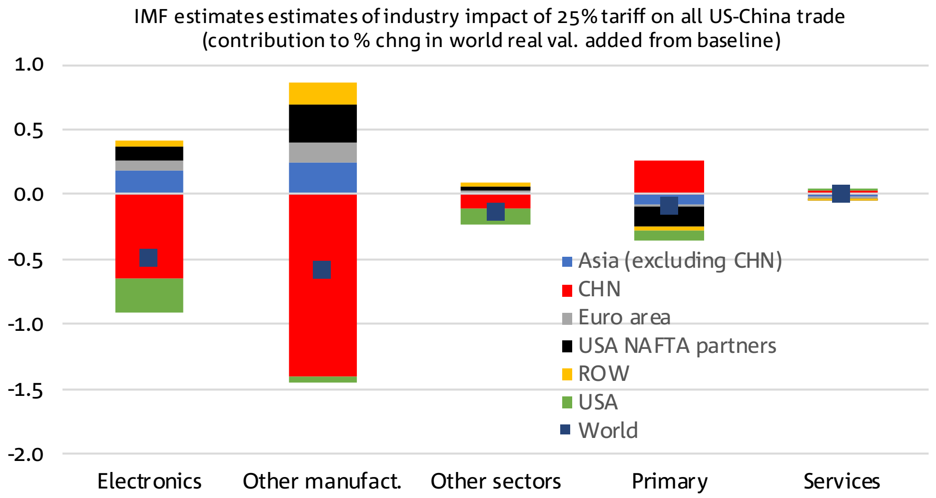
AUTHORS

Tony Kelly & Gerard Burg

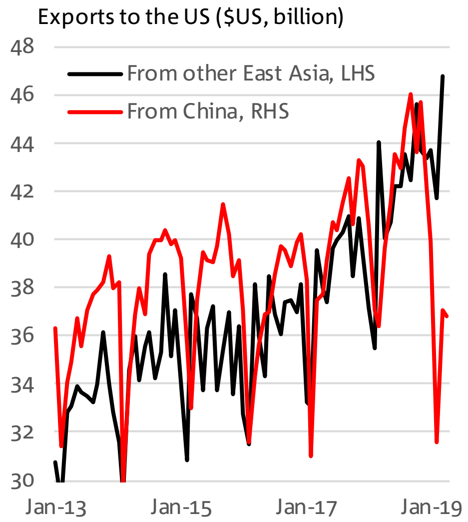
US CHINA TARIFFS AND THE ASIA REGION

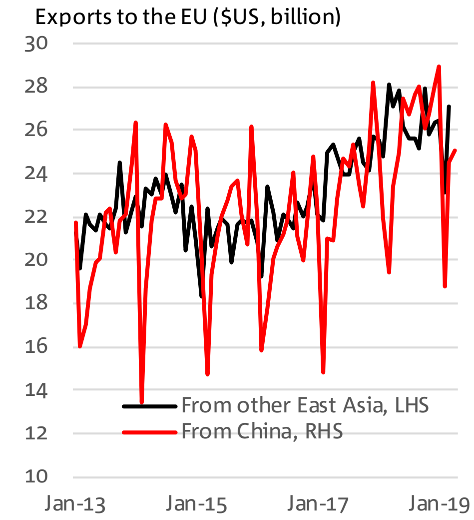
US tariffs on China may lead to some production shifting to other parts of Asia, but this may take time. For now the bigger issue is negative flow through to regional trade. Confidence effects & tighter financial conditions from trade disputes also need to be considered.

In theory US tariffs on China can have positive spill overs to other Asia economies, as China mfg. moves location

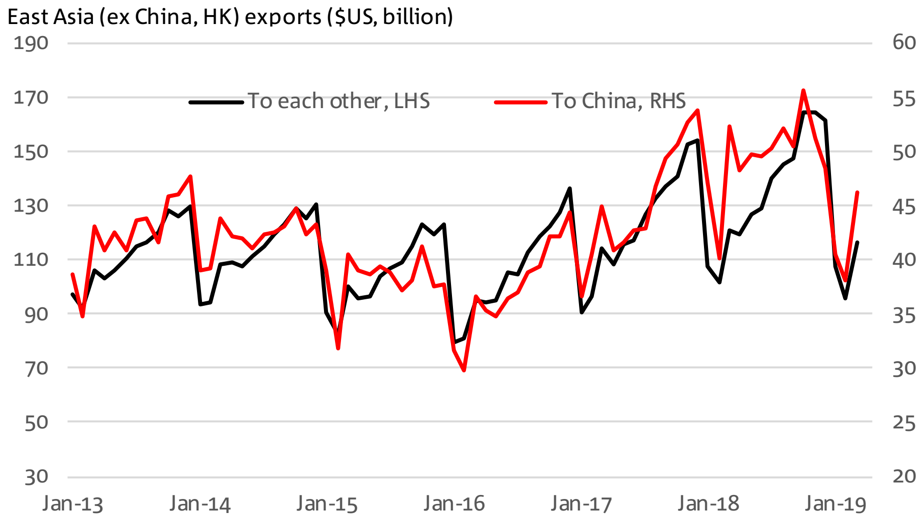


Some signs of this in trade with the US, but not yet evident from EU trade

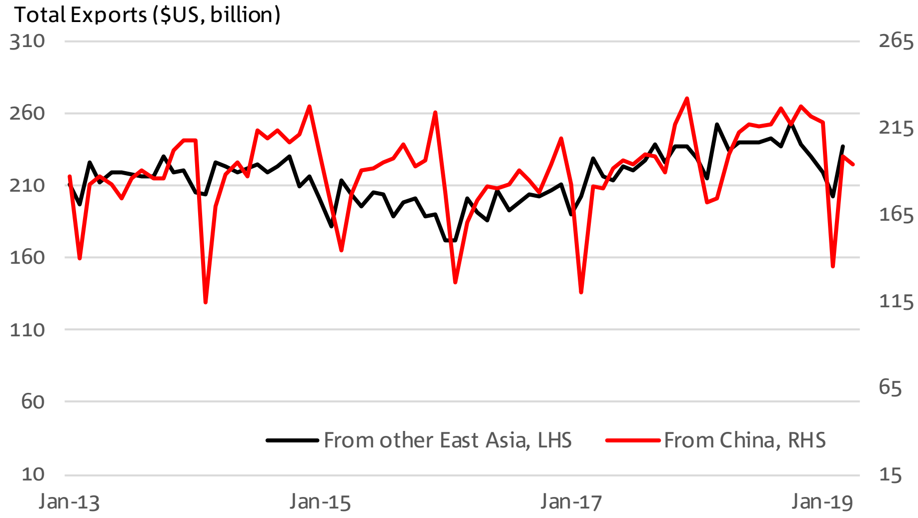




With highly integrated regional supply chains, lower China exports to US are impacting intra-regional trade



The net result is a decline in exports



Sources: Refinitiv, IMF (April 2019 World Economic Outlook), NAB Economics. East Asia (ex China, HK) includes Indonesia, Japan, Malaysia, Philippines, Singapore, Korea, Thailand, Vietnam.

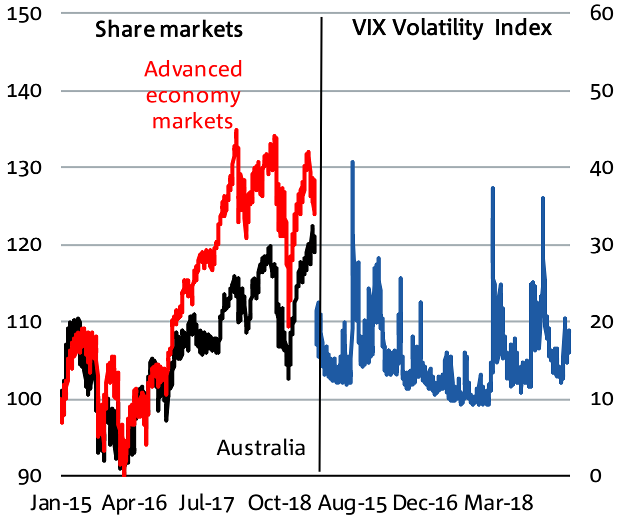
National Australia Bank

FINANCIAL AND COMMODITY MARKETS

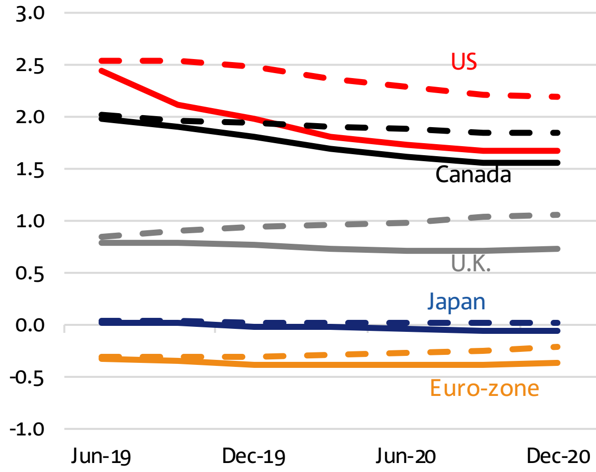
Hit from trade concerns on markets limited by hopes Fed will come to the rescue

TRADE CONCERNS: EQUITIES AND INTEREST RATES MOVE LOWER

Share markets and volatility indices

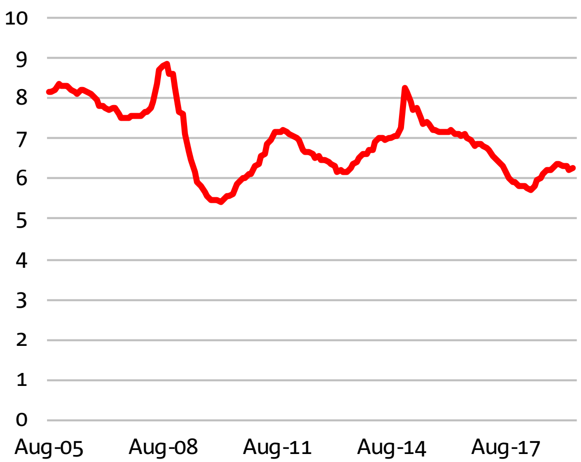


3 month interest rate futures (%): As at 1 May '19 (dashed line) and 6 June '19 (solid line)



EM CENTRAL BANKS STARTING TO EASE

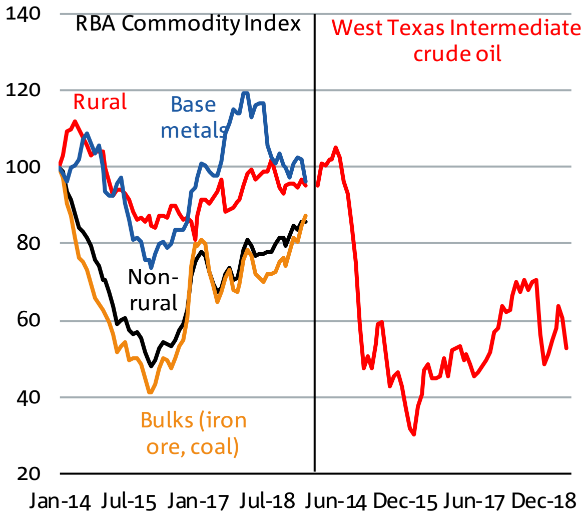
EM average policy rate* (%)



* GDP weighted average of 19 EM countries central bank policy rate (does not China, Argentina, Turkey)

COMMODITY PRICES MIXED

Commodity price indices (Jan 2014 = 100)



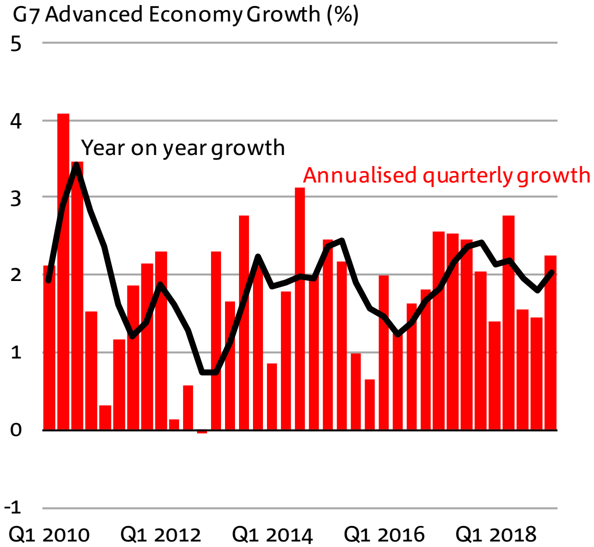
- The recovery in financial markets that had been occurring over 2019 hit a sizable pothole in May following the breakdown in US-China trade talks – and subsequent tariff increases and a ratcheting up of rhetoric by the two parties – and then the US announcement in late May threatening tariffs on imports from Mexico.
- This led to a fall in our index of major advanced economy share markets by as much as 6%. Market volatility – as measured by the VIX – also rose, and there was some widening of credit spreads. More dovish expectations around central bank policy helped support share markets and, together with a last minute decision not to proceed with the tariffs on imports from Mexico, there has been some recovery more recently.
- The change in market expectations of central bank policy has been most evident for the US, but interest rates futures suggest rate expectations have been marked down for all the major central banks. Apart from the US, this is particularly so for the central banks with more policy room to move (Canada and the UK). Various Fed speakers have made it clear that the Fed is ready to respond if needed to 'sustain the expansion'; we now expect two 25bp Fed fund rate cuts in the second half of this year. This will most likely be in September and December, but risk is that they will occur sooner rather than later, and that there will be more than two cuts.
- With rates at very low levels (including negative deposit rates) the bar to any monetary policy easing by the ECB and the BoJ is high. However, at its June meeting the ECB pushed out its forward guidance, and is now indicating that rates will not be lifted from their present levels at least through the first half of 2020 (previously end 2019).
- The fall in EM stock markets following the renewed trade tensions was even greater than for the AEs. EM currencies also came under renewed pressure, including a depreciation of the Chinese Yuan against the USD (from around 6.7 to over 6.9). A rise in the USD (EM depreciation) is a risk in the current environment as it could trigger capital outflows, thereby constraining the policy flexibility of some EM central banks. However, at this stage, on a net basis EM central banks have recently been easing policy, adding to the shift in AE central bank policy.
- Commodity prices have not escaped the fallout from negative sentiment around the global outlook, with oil and base metals prices falling since late May. In contrast, bulk commodity prices have risen, but this is in part a reflection of supply constraints (mainly for iron ore).

 Sources: Refinitiv, NAB Economics

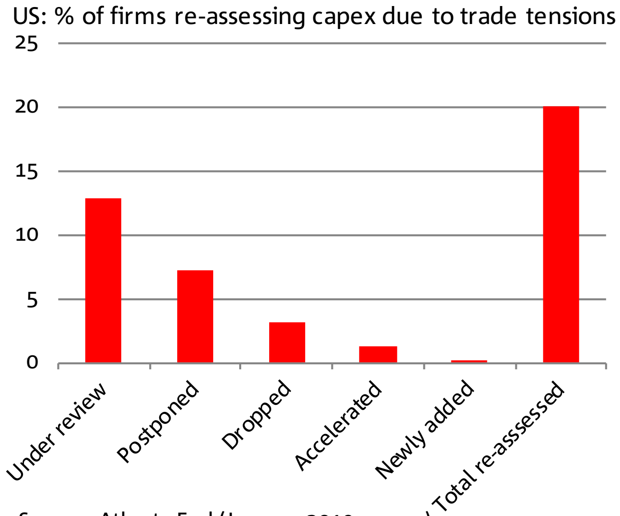
ADVANCED ECONOMIES

Upturn in Q1 likely to be short-lived due to trade and other headwinds

Q1 PICK UP IN AE GROWTH

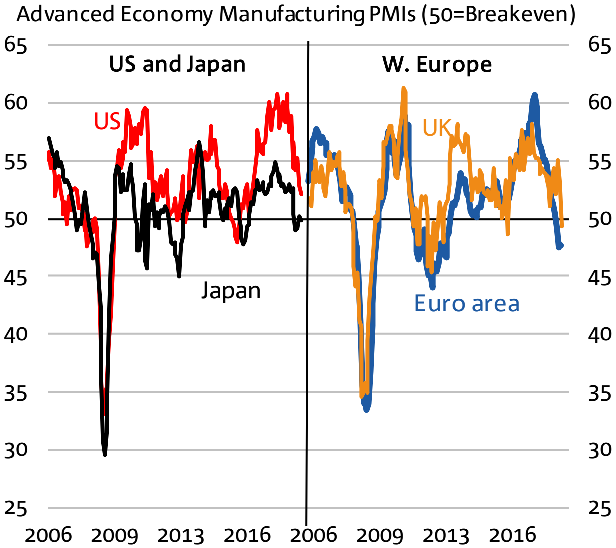


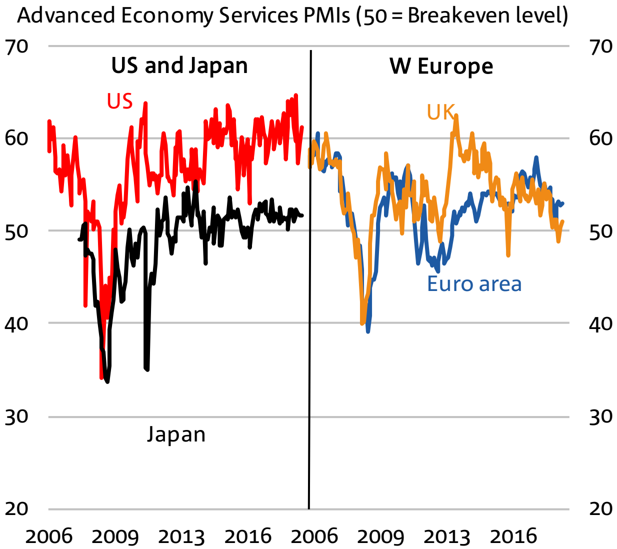
TRADE DISPUTES A NEGATIVE



Source: Atlanta Fed (January 2019 survey)

BUSINESS SURVEYS: US EASING; EURO-ZONE/JAPAN STABLE AT LOW LEVELS





- Growth in the major advanced economies (AE) strengthened in Q1, although this appears unlikely to be sustained and we expect growth to ease over the rest of the year. Quarterly GDP growth accelerated in Q1 in the US, Japan, the Euro-zone and the United Kingdom. Canada was the exception with growth essentially unchanged at a weak level. As a result, compared to a year ago, major AE growth increased to 2.1% from 1.9% y/y in the previous quarter.
- However, with an escalation of trade disputes in May, ongoing Brexit uncertainty, and the planned increase in Japan's Value Added Tax later in the year, we expect growth to resume slowing over the rest of 2019. This will primarily be driven by the US, with the other major AEs expected to broadly track sideways at a subdued rate of growth.
- The expected US growth slowdown reflects a fading impact from last year's fiscal stimulus and past monetary policy tightening. Last month we marked down our US forecast to reflect the impact of increased US tariffs on China (and China's retaliatory moves). We have done so again this month given escalating trade tensions. The US-China dispute is expanding to company specific measures/threats and while the threatened tariffs on Mexican imports has been 'suspended' for now following a last minute deal between the two countries, the hit to business sentiment is likely to persist. As a result, we expect trade uncertainty will remain elevated at a high level for a sustained period to come. The Fed is expected to respond through rate cuts, but the benefits will take a while to fully come through.
- The impact of trade uncertainty will not be quarantined to the US, but will be a drag on global business sentiment and investment. In the case of Europe, this is reinforced by the ongoing Brexit drama. In Italy, a budget dispute with the EU last year triggered a recession and political risks have recently re-surfaced around fiscal plans – and their consistency with EU requirements – and possible new financing measures seen by some as a backdoor way of introducing a domestic currency. That said, broader Euro-zone fiscal policy has turned stimulatory this year which should provide some support.
- The latest business surveys are broadly consistent with this outlook. US indicators are still reasonable but are easing and while there has been some stabilisation in Japan and the Euro-zone, their surveys remain at low levels. This is particularly so for the manufacturing sector which is heavily exposed to trade and business investment weakness.

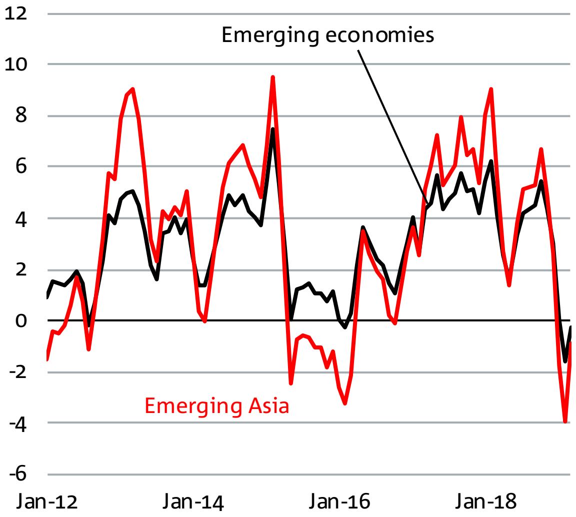
Sources: Refinitiv, Atlanta Federal Reserve, NAB Economics

EMERGING MARKET ECONOMIES

Expanding trade measures a negative for EM economies

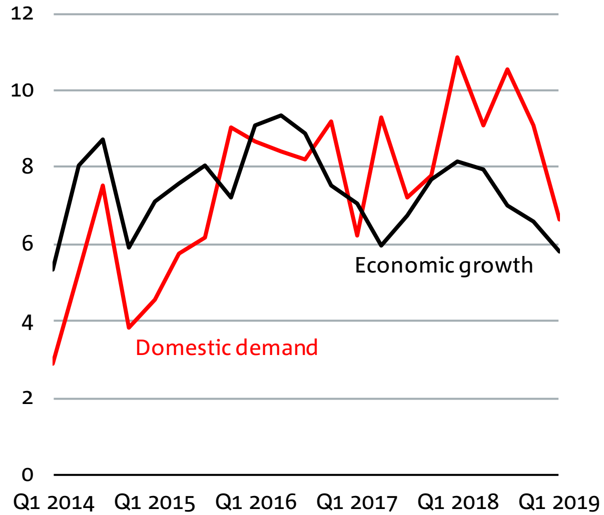
EXPORT VOLUMES HAVE PLUNGED

Emerging market export volumes (% yoy 3mma)



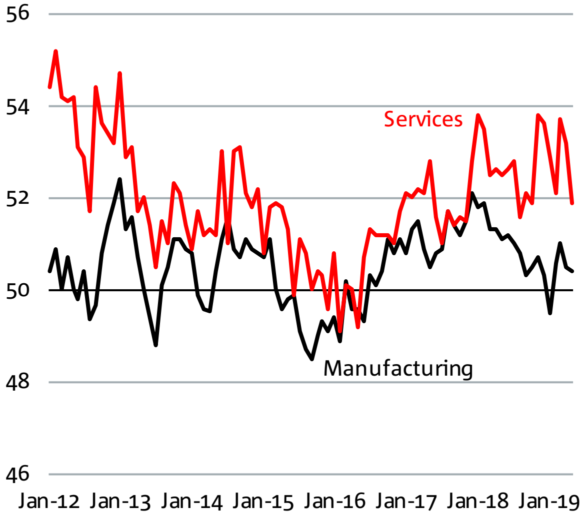
INDIA'S GROWTH HAS SLOWED

Indian economic growth (% yoy)

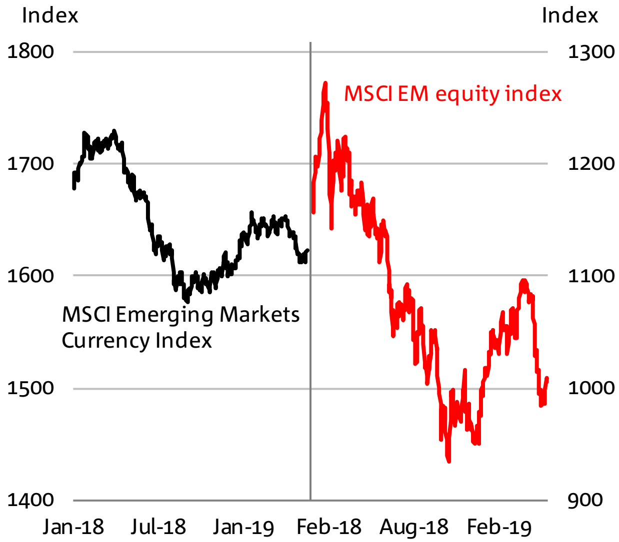


MIXED TRENDS IN PMI SURVEYS

Emerging market PMI (Breakeven = 50)



FIN MARKETS WEAKER POST TARIFFS



- Emerging market economies are far more trade exposed than advanced economies. Therefore the increase in trade tensions between the US and China (along with the possible expansion in US trade measures to other countries) are a negative for EMs.
- Ahead of the latest measures, emerging market trade volumes have been weak – decreasing 0.3% yoy (on a three month average basis) in March, compared with growth of over 3.0% in December last year. In particular, emerging economies in Asia have been weak – with volumes declining by 0.7% yoy in March. While several economies in this region have increased exports to the United States (trade diversion due to the tariffs on China's exports), these have typically not been enough to offset lower exports to China and elsewhere.
- The unexpected announcement of US tariffs on Mexican goods, despite being subsequently 'suspended', adds to the uncertainty about future trading arrangements. Indeed, Mexico was expected to be one country that would benefit from trade diversion away from China to alternative producers. While the tariff threat has receded for now it could easily re-surface if Mexico is seen by the US as not following through on the details of the agreement. More generally, there is a likely to be an ongoing negative impact on business sentiment, which could lead to delayed or cancelled investment.
- India's economic growth slowed considerably in Q1 2019 – increasing by 5.8% yoy (compared with 6.6% in Q4 2018). Domestic demand has slowed considerably over the past few quarters – with investment growth slowing sharply in Q1. Reflecting the weaker than expected growth, we've revised down our forecast for India's growth – to 6.7% in 2019; achieving this relies on recent cuts in interest rates, and a post-election recovery in sentiment, stabilising growth.
- More recent trends in PMI surveys are more mixed. While manufacturing PMIs appear to have stabilised (at least ahead of latest trade measures), service sector indicators have softened (albeit this indicator has been highly volatile in recent months).
- Financial markets have deteriorated in the wake of the worsening trade environment. The MSCI emerging market equity index fell by just over 10% peak to trough, with only a modest upturn in early June. Similarly, the EM currency index has trended lower since early May, led by a depreciation in the Chinese Yuan. Deteriorating sentiment around emerging markets could trigger capital outflows from these economies.

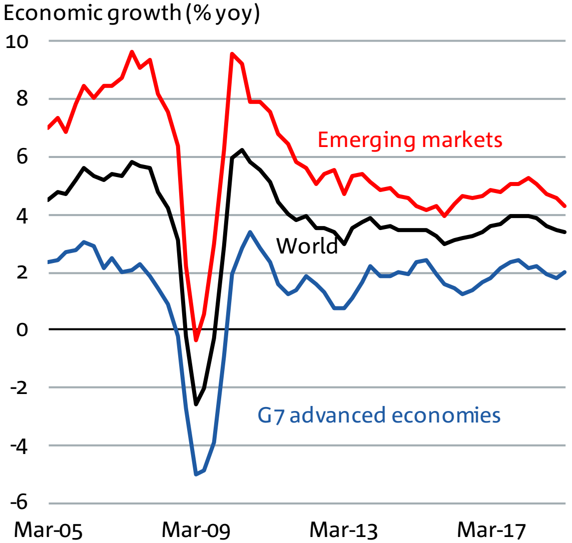
Sources: Refinitiv, CPB, NAB Economics

National Australia Bank

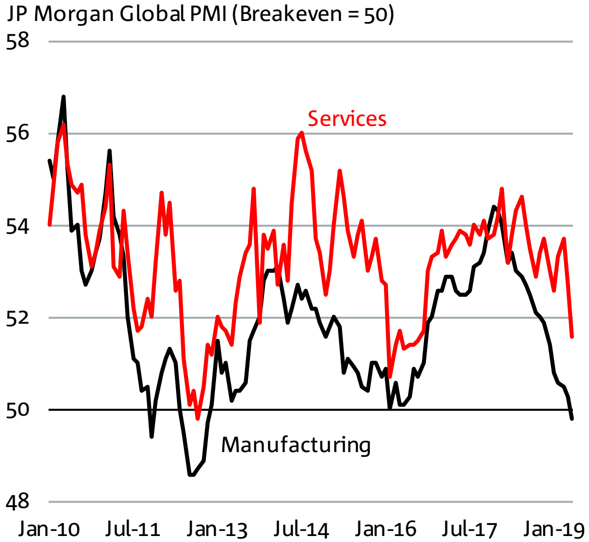
GLOBAL FORECASTS, POLICIES AND RISKS

EMs drove Q1 slowdown; limited AE monetary policy firepower going forward

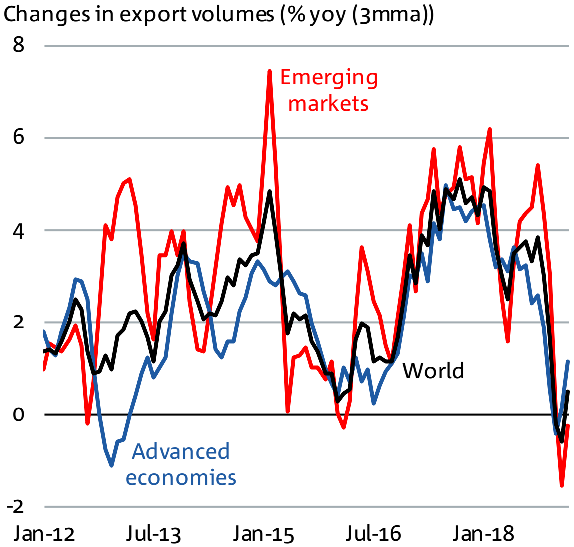
GLOBAL GROWTH DOWN IN Q1



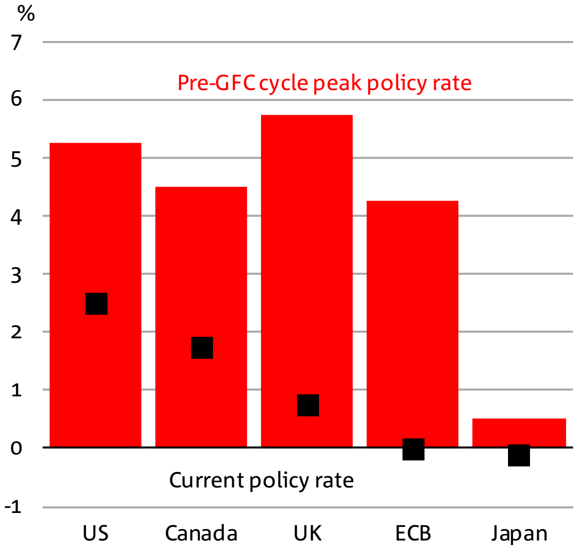
MANUFACTURING MUCH WEAKER



TRADE DOWNTURN



LIMITED CENTRAL BANK AMMUNITION



- Global economic trends were a little mixed in Q1 2019, with the major AEs strengthening, while emerging markets weakened – down to 4.3% yoy (from 4.6% in Q4). The larger scale of the decline in EMs means that our estimate of global GDP growth eased again to 3.4% yoy, down from the long term trend rate of 3.5% yoy in Q4 2018. The easing in global growth since early 2018 reflects a number of factors, including prior Fed rate hikes, China credit tightening, some country specific factors (Argentina, Turkey and Italy) as well as trade tensions.
- Global business survey measures suggest that the slowing trend is set to continue in Q2 – with manufacturing PMIs turning negative (albeit only modestly so) and services measures becoming less positive. In both cases, weaker trends in the advanced economies were the main drivers of these results. The downturn in manufacturing is linked to the deterioration in global trade volumes. While there was a modest upturn in March some of this reflected base effects and came well before the increase in US-China trade measures – meaning that a renewed downturn is likely.
- While emerging markets drove the slowdown in Q1, the weaker growth that we forecast this year is also driven by advanced economies, as fading stimulus slows US growth and the Euro-zone's struggles continue. Given the worsening global trade environment, we have revised our forecasts for global growth lower – to 3.2% in 2019 and 3.3% in 2020 (from a previous 3.3% and 3.4% respectively).
- Trade policy is the key risk to the outlook. Our forecasts assume that existing tariffs remain but don't include new US tariffs. However, we expect trade disputes to remain in the headlines, leading to elevated uncertainty about global trading arrangements – a drag on business investment. Clearly there is a high risk that new trade barriers will be put in place by the US, e.g. an extension of tariffs to all imports of Chinese goods or on autos. However, the situation is very fluid, as the threatened tariffs on Mexico, and subsequent withdrawal, showed. Just over a month ago expectations of a US-China deal were high, so it is also possible that other trade worries may calm.
- We expect looser monetary policy to limit the downside to growth – however the limited conventional capacity (given current low policy rates) and still sizeable global central bank balance sheets (following GFC asset purchases) means these bodies have minimal ammunition to fight a sustained economic downturn.

 Sources: Refinitiv, CPB, Markit, NAB Economics

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

John Sharma
Economist
+(61 3) 8634 4514

Australian Economics and Commodities

Gareth Spence
Senior Economist – Australia
+(61 4) 36 606 175

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics

Tony Kelly
Senior Economist
+(61 3) 9208 5049

Gerard Burg
Senior Economist – International
+(61 3) 8634 2788

Global Markets Research

Ivan Colhoun
Global Head of Research
+61 2 9237 1836