EMBARGOED UNTIL: 11.30AM THURSDAY 11 JULY 2019

THE FORWARD VIEW – GLOBAL

JULY 2019

National Australia Bank

Global growth remains under pressure even with US-China trade dispute pause

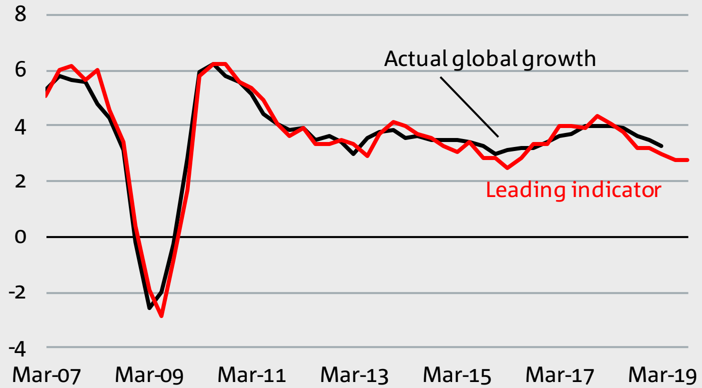
- After modest improvement in Q1, partial indicators in major advanced economies (AEs) point to a renewed easing in growth in Q2. Growth is expected to slow further in the second half of 2019 driven largely by the US economy. The latest business surveys also point to emerging market (EM) economic growth continuing to come under pressure.
- Following on from the tariff-induced uncertainty in May, financial markets have generally trended higher from early June. With global growth slowing, the policy outlook has turned more dovish and a reduction in central bank policy rates is likely both across AEs – led by the Fed – but also EM economies, where there has already been some policy easing so far this year.
- After having marked down our global growth forecasts over the last two months due to trade policy developments, the resumption of talks between the US and China is a welcome development. However, with the eventual outcome unclear, uncertainty remains elevated and it is likely to be a drag on investment. Moreover, possible future US trade action is not limited to China – the US may introduce auto tariffs or target 'currency manipulators' at some point. Other risks to the outlook include geopolitical issues (e.g. Brexit or oil supply disruptions) and US fiscal policy.
- We have left our forecasts unchanged this month, and expect global growth of 3.2% in 2019 and 3.3% in 2020. These rates of growth are below par, but not in recession territory, as the shift in global policy settings is expected to limit the growth slowdown currently underway.

Global Growth Forecasts (% change)

	2018	2019	2020	2021
US	2.9	2.4	1.7	1.7
Euro-zone	1.9	1.2	1.3	1.4
Japan	0.8	0.7	0.4	0.9
UK	1.4	1.3	1.3	1.5
Canada	1.8	1.3	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	2.9	2.4	2.6	2.5
Global	**3.6**	**3.2**	**3.3**	**3.5**

NAB global leading indicator

Actual global growth and leading indicator (% yoy)



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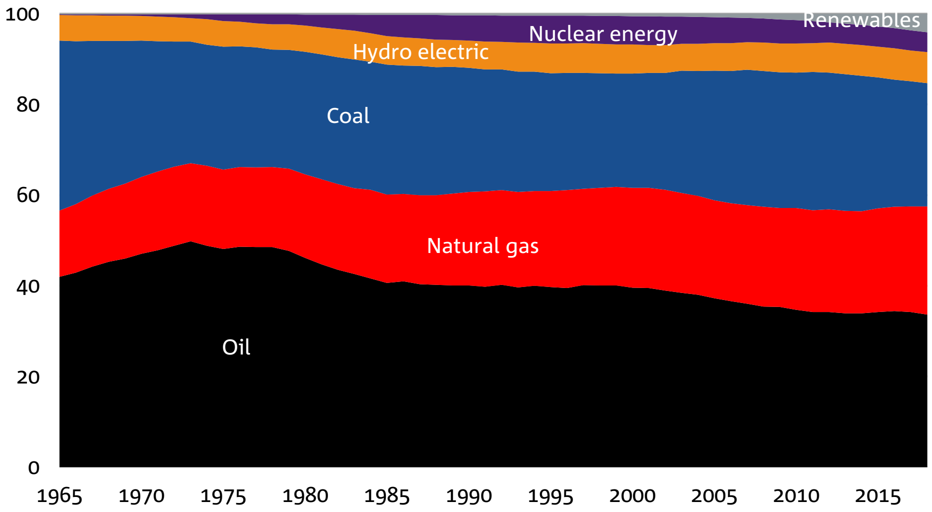
US-IRAN DIPLOMATIC TENSIONS RISK CLOSING OFF A KEY SUPPLY CHANNEL

A large share of global oil and natural gas supply travels through the Strait of Hormuz – where shipping is threatened by growing US-Iran tensions. A supply side shock to oil markets could further hit a weakening global economy.

Crude oil and natural gas still critically important energy sources (albeit share has declined since the 1970s)

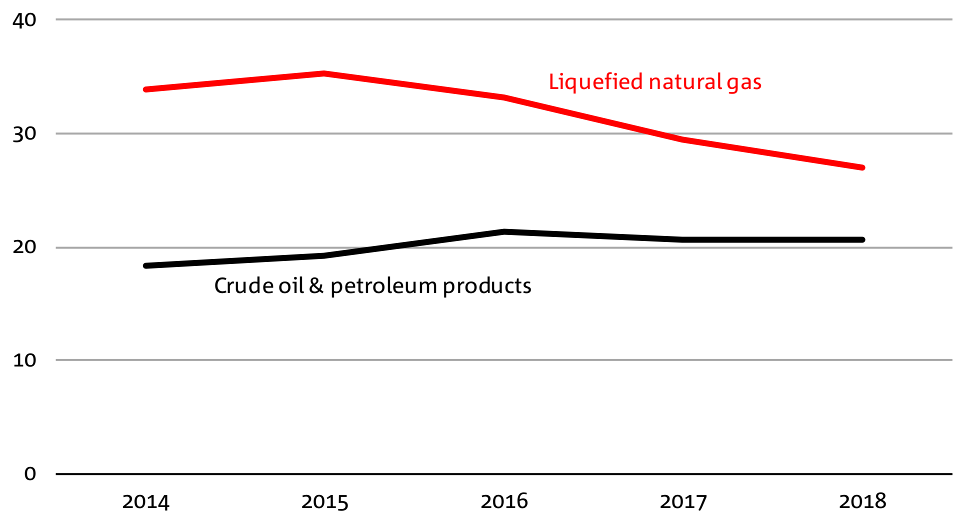
Global primary energy consumption by fuel (% of total)



The Strait of Hormuz is a key choke point for global oil and natural gas supply, with limited capacity to bypass

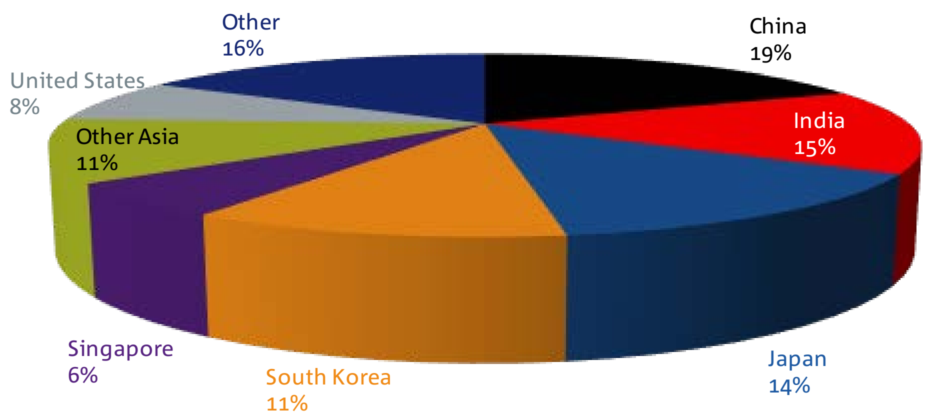
One-fifth of oil and one-quarter of LNG flows through the Strait

Energy flows through Strait of Hormuz (% of global consumption)



Around three-quarters of these flows are consumed in Asia, though disruptions would impact global markets

Oil flows through Strait of Hormuz by destination (% of total)



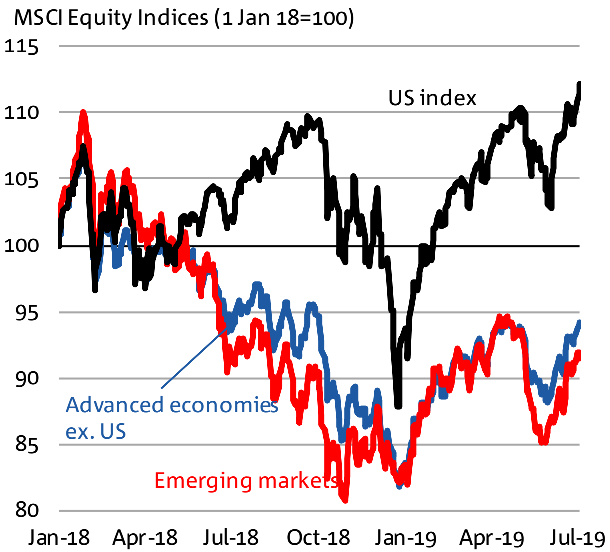
Sources: BP Statistical Review of World Energy 2019, US Energy Information Administration, NAB Economics

National Australia Bank

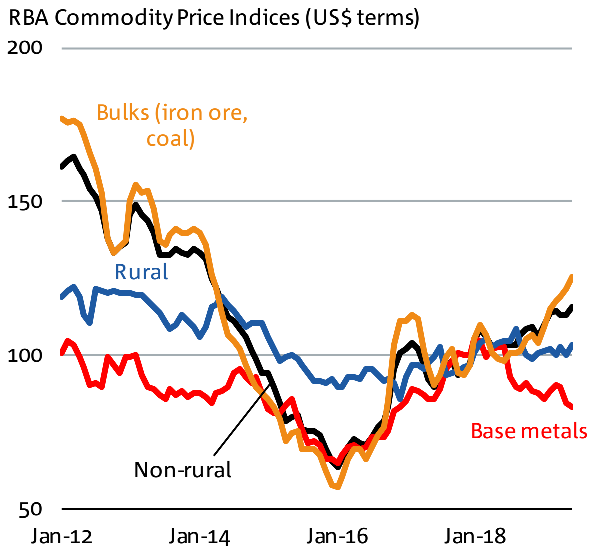
FINANCIAL AND COMMODITY MARKETS

Financial conditions improving on eroding fears (for now) and easing policy

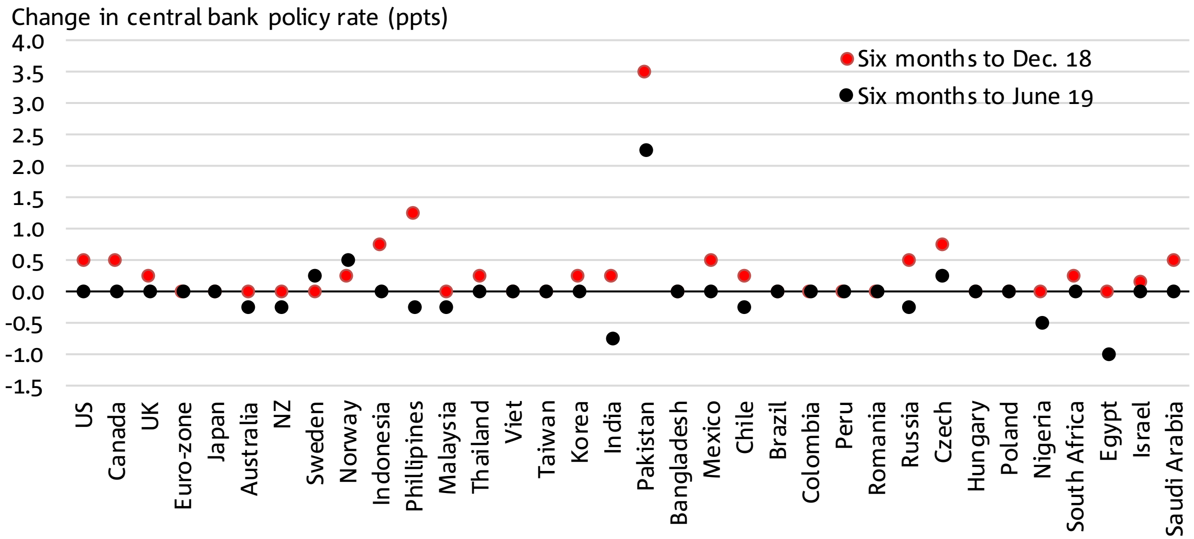
Equities higher across June



Commodity markets mixed



Monetary policy has turned more dovish – with more cuts likely



- Following on from the tariff-induced uncertainty in May, financial markets have generally trended higher from early June. US equity markets rose by around 7.2% during the month, with other advanced economy markets rising by 5.2% and emerging markets by 4.6%.
- While these increases have brought the US MSCI index to record highs in early July, other advanced economies and emerging market equities remain below the recent cycle peak (in January 2018) and the all time high prior to the GFC.
- Financial market volatility – as measured by the US VIX index – declined across the month, as fears around US tariffs on Mexico eroded and the prospect of further negotiations between the US and China following the G-20 meeting increased.
- Weaker economic growth and the deterioration in manufacturing conditions in recent quarters have impacted global commodity markets – however conditions are mixed across different sectors. Base metals have continued to soften – largely reflecting the deteriorating conditions in China's manufacturing sector – while iron ore prices have continued to climb as a result of supply constraints in both Brazil and Australia.
- Markets continue to expect easing monetary policy going forward, in an effort to address the weakening economic environment and still subdued inflation. The US Federal Reserve has the greatest capacity as its policy rate is higher than the other major AE central banks. We anticipate two 25bp cuts to the Fed Funds Rate – in July and September. In contrast, the European Central Bank has limited ammunition, given rates remain at emergency low levels. That said, we expect a further cut to ECB deposit rates, with the potential for a resumption in asset purchases should additional support be required.
- Similarly, emerging market monetary policy is easing, led by three 25 bps cuts in Indian policy rates. Indian financial conditions have worsened due to the collapse of a major shadow bank, which has constrained lending.
- China may seek to ease monetary policy to counter the negative impacts of the US-China trade tensions. That said, the PBoC governor has reiterated the importance of addressing systematic risk – highlighting the competing short and medium term goals of the country's authorities.

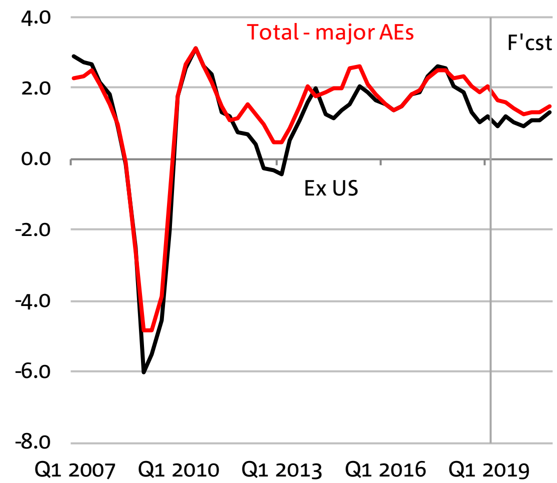
 Sources: Refinitiv, RBA, NAB Economics

ADVANCED ECONOMIES

Advanced economy slowdown to continue over the rest of 2019

AE growth to slow further

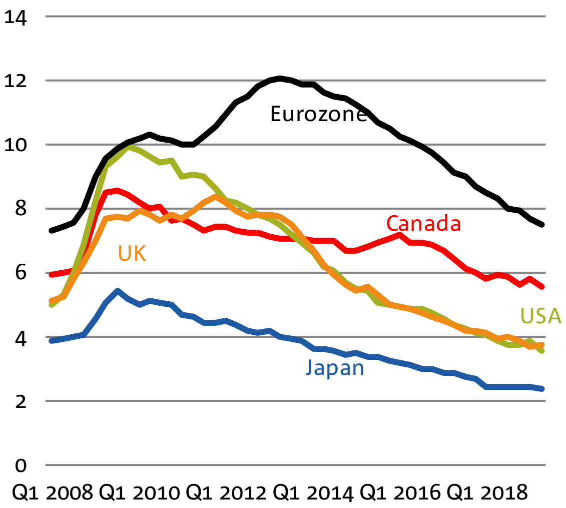
GDP growth - major AEs (yoy%)*



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

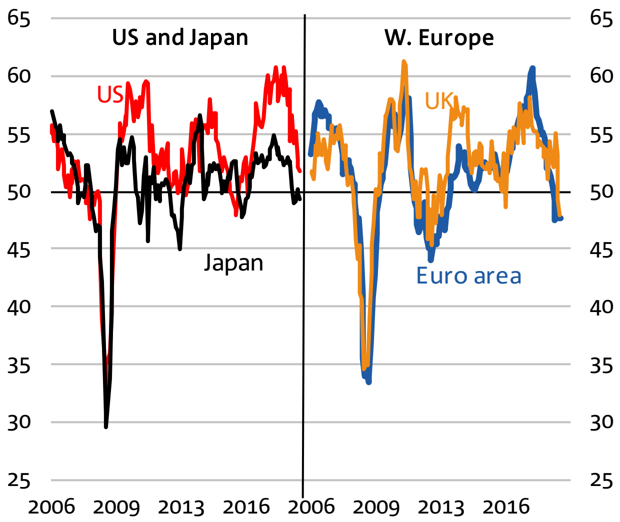
Labour markets holding up

Advanced economy unemployment rates (%)

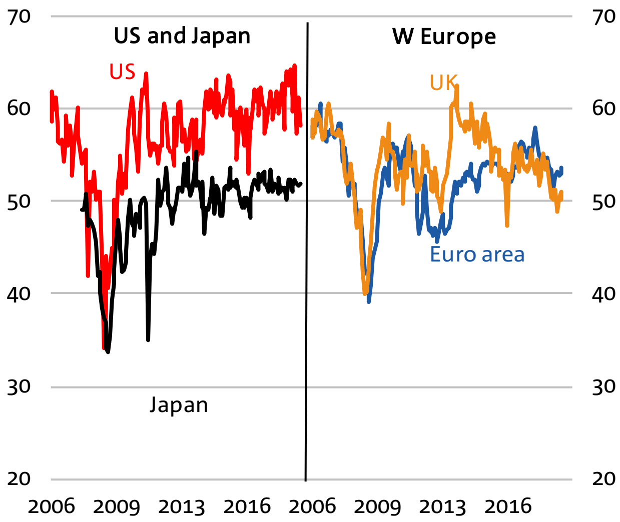


Business surveys – mfg weaker, services better, overall subdued

Advanced Economy Manufacturing PMIs (50=Breakeven)



Advanced Economy Services PMIs (50 = Breakeven level)



- After modest improvement in Q1, partial indicators in major advanced economies (AEs) point to renewed easing in growth in Q2. Growth is expected to slow further in the second half of 2019 as the robust growth seen in the US economy seen over the last year unwinds.
- US growth will be affected by a fading impact from the 2018 fiscal stimulus, lagged impacts from the tightening in financial conditions last year and trade uncertainty which is depressing business sentiment and investment. Tracking estimates for Q2 GDP point to growth being well down on what has been seen over the last year. However, Fed policy easing will support the economy and while business surveys have also moved down, especially in manufacturing, overall they are still at a level consistent with ongoing growth in the economy.
- The expected slowdown in US growth will be enough to drag total major AE growth down as growth for the other major AEs is, in aggregate, expected to broadly track sideways at a modest level.
- The UK is not only facing the difficulty of a global slowdown and trade policy uncertainty, but also heightened Brexit and political uncertainty (including an increased risk of a no-deal Brexit). With monthly GDP data for April and May below their Q1 level, and falls in some business surveys, these forces appear to be catching up with the UK.
- The Euro-zone is not as exposed to Brexit as the UK, but regional supply chains mean it is a still a problem. Coupled with broader trade headwinds from the global slowdown, auto industry problems in Germany and only modest levels of policy support from the monetary and fiscal authorities, growth is likely to be muted. Japan's growth rate has picked up recently, but business surveys suggest that underlying momentum is not strong – not surprisingly as the fall out from trade disputes is most pronounced in the Asian region. A scheduled increase in Japan's value added tax in October will also weigh on the economy.
- Despite the slowdown in AE economies, labour markets have held up surprisingly well, although the pace at which unemployment rates are declining has generally slowed. However, the unemployment rate in the Euro-zone has continued to decline at a steady rate.
- Trade remains a big risk to the outlook. Our forecasts assume no further escalation (or improvement) but it is easy to see how this might change. This includes the emergence of other trade disputes, with the US President still deciding whether to act on auto tariff increases as well as on his claims that the ECB is a 'currency manipulator'.

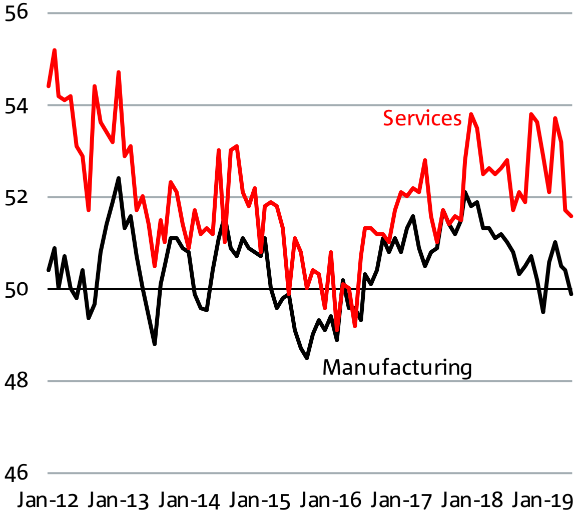
Sources: Refinitiv, Atlanta Federal Reserve, NAB Economics

EMERGING MARKET ECONOMIES

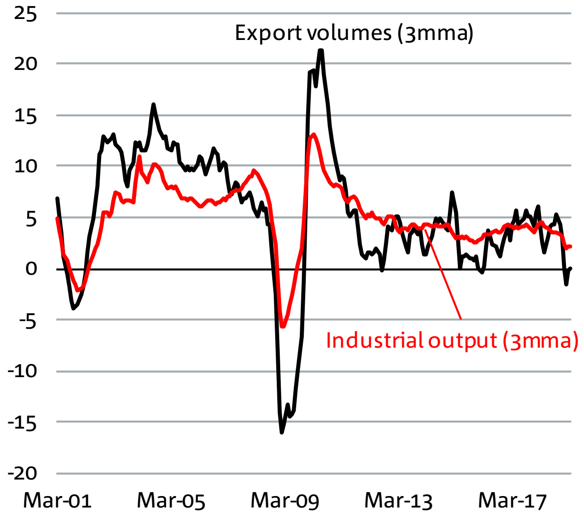
EM economies remain under pressure, policy responding to limit downturn

Further weakening in EM PMIs, which suggests IP & trade will come under renewed pressure

Emerging market PMI (Breakeven = 50)

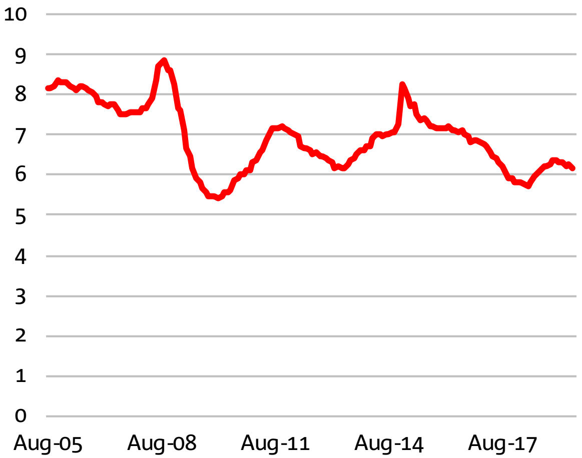


Emerging market exports and industrial output (% yoy)



Monetary policy is responding

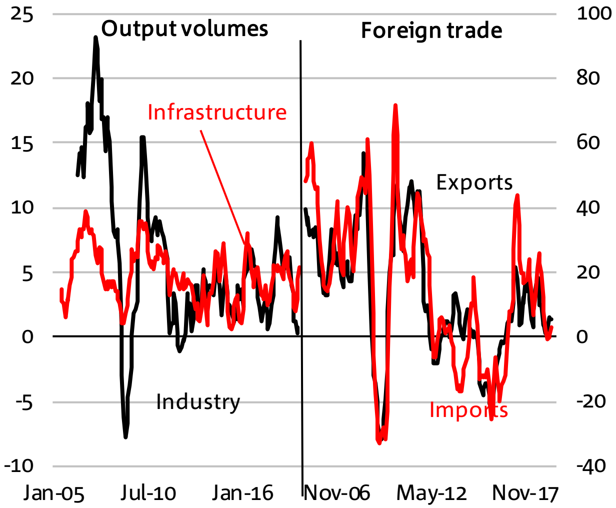
EM average policy rate* (%)



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

Indian economy facing headwinds

Indian monthly economic indicators (% yoy)



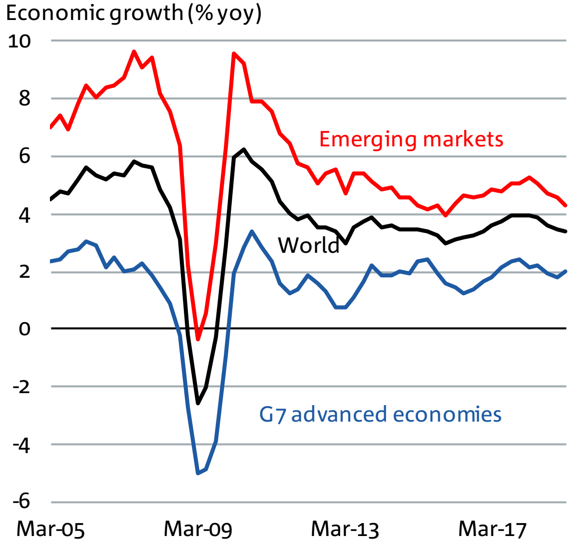
- Emerging market (EM) growth continues to come under pressure. While the pause in the US-China trade dispute is a welcome development, trade uncertainty remains high and the impact of the announced increases in US-China tariffs is yet to be fully felt. Policy is responding – not only in China where authorities will seek to limit any trade fall-out – but also in other EMs as a range of central banks have recently cut their policy rate. Reassuringly there has been some improvement in financial conditions this year and net capital flows (ex China) have generally been positive as well.
- Business surveys, the most timely measure of conditions, indicate that EM manufacturing has continued to weaken – falling back below the breakeven 50 point mark in June. Among the largest EMs, China, Russia and South Africa recorded sub-50 point (negative) readings, while conditions in Brazil improved. Manufacturing is highly trade exposed and, in contrast, the EM services PMI has generally held up better although in June it eased to its softest reading since late 2017.
- The latest data on EM industrial production (IP) and exports for April showed tentative signs of stabilisation. Annual IP growth, which had steadily slowed since H1 2018, was unchanged while exports were at the same level as a year ago, following negative readings in previous months. However, this predates the latest round of US-China tariffs (announced in May) which is likely to place renewed pressure on IP and trade.
- In China, May data showed some further signs of weakness, with IP and fixed asset investment growth slowing. We expect policy makers will act to broadly offset the impact of the US-China trade dispute on the economy. This policy response is a key reason for maintaining our growth forecasts at 6.25% this year and 6% in 2020.
- The direction of the Indian economy remains a concern. India's economic growth slowed considerably in Q1 2019. While IP and trade flows in April/May have at least stabilised, growth rates remained generally weak. Moreover, the June PMIs disappointed hopes of a post-election bounce, with the composite PMI falling to its lowest level in over a year, suggesting there is downside risks to our (already below consensus) forecasts for Indian GDP. One issue has been a tightening in credit conditions due to problems in the non-bank financial sector. The Reserve Bank of India has responded by cutting rates by 75bp so far this year and the Government has also proposed measures to shore up the financial system.

 Sources: Refinitiv, CPB, NAB Economics

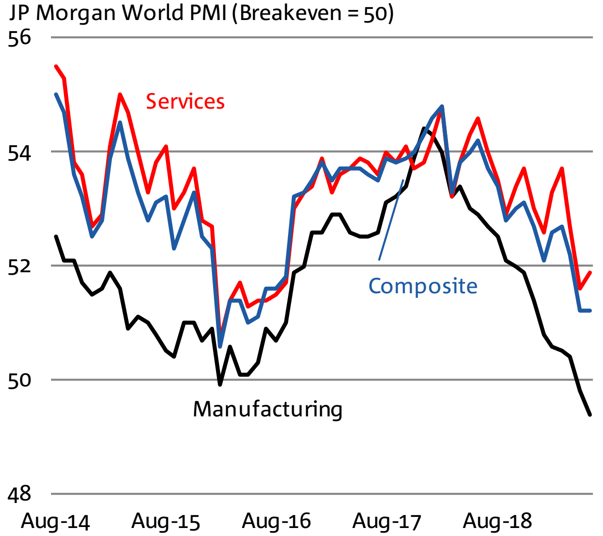
GLOBAL FORECASTS, POLICIES AND RISKS

Indicators point to continued sub-par growth; risks slanted to the downside

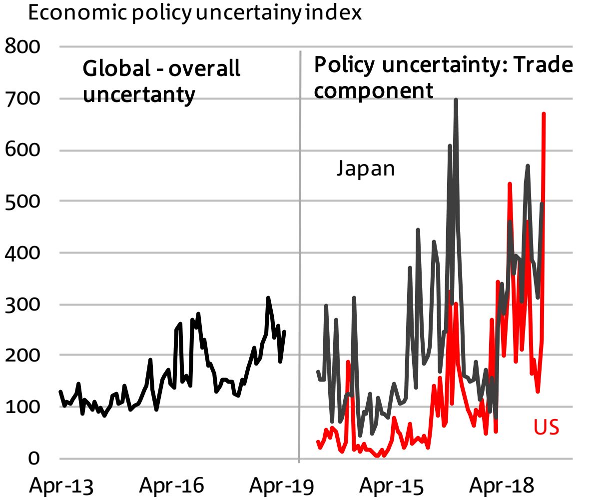
Global growth easing into 2019



Surveys suggest Q2 down further

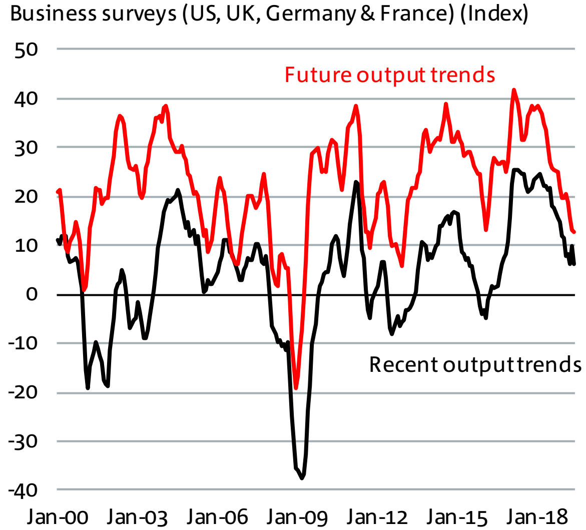


Trade remains a headwind



* Data through to May 2019, for other series to June 2019

Outlook weak but not terrible



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

- The slowdown in global economic growth over 2018 continued into the first half of 2019. Global GDP growth eased to 3.3% yoy in Q1 2019, well down from the 4.0% rate at the start of 2018. World IP and trade data for April 2019 also point to subdued growth. IP growth eased further to 1.3% yoy (its slowest rate since early 2016). While trade growth returned to positive territory over March/April at 0.4% yoy it is still very weak and will come under renewed pressure following the recent increases in US-China tariffs.
- The impact of renewed trade tensions in recent months can be seen in business surveys. The world manufacturing PMI in has fallen below the breakeven level (50). The services PMI has also declined but it remains in positive territory. Further weakening is also the message from our global leading indicator (see page 1), although it indicates that growth might stabilise in Q3.
- The easing in growth since early 2018 reflects a number of factors. These include past policy tightening - led by the US Fed and China deleveraging – trade disputes, Brexit (affecting not just the UK but also the rest of Europe) and some country specific factors.
- Some of these factors are still at play. While the US and China recently agreed to resume of talks there is no timeline for resolving their trade dispute. As a result trade policy uncertainty is likely to remain elevated, dampening business sentiment and investment.
- However, monetary policy is increasingly becoming supportive of growth (see page 3). As a result, despite the slowdown in growth financial conditions are generally supportive which should help stabilise activity. After having marked down our global growth forecasts over the last two months due to trade dispute escalation, we have left our forecasts unchanged this month at 3.2% in 2019 and 3.3% in 2020. These rates of growth are below par, but not in recession territory, consistent with the message from business survey outlook indicators.
- Trade policy remains a key risk to the outlook. The forecasts assume no further escalation in trade disputes (or improvement). The US-China talks could drag on, breakdown or resolve the dispute – suggesting risks are two sided. However, possible US trade action is not limited to China – the US may introduce auto tariffs or target 'currency manipulators' at some point. Trade is not the only risk, with geopolitical (e.g. Brexit or oil supply disruptions – see p2), and US fiscal policy (where action is required to avoid fiscal cuts later this year) other notable risks.

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