EMBARGOED UNTIL: 11.30AM THURSDAY 15 AUGUST 2019

THE FORWARD VIEW – GLOBAL

AUGUST 2019

National Australia Bank

US-China trade dispute escalates...again

- The latest escalation in the US-China trade war – with the US imposing a 10% tariff on most remaining China imports – has reverberated through financial markets. The decision follows closely on the heels of tariffs announced in May, the full impacts of which are still working their way through.
- The policy response will also be important. We now expect the Fed to make two more 25bp cuts to the fed funds rate this year, with the first in September. China is also likely to use policy measures to offset tariff impacts, including allowing further depreciation of its currency. Other central banks have eased policy this year and this trend is expected to continue.
- The pick up in Advanced Economy (AE) growth in Q1 was not sustained in Q2. We expect AE growth to slow further in H2 2019 before stabilising in 2020 as policy supports kick in and due to a fading impact from Japan's Q4 VAT increase. Trade exposed Emerging Markets are particularly struggling at present, with exports from East Asia falling significantly, while soft July economic data for China highlight the downside risks.
- We have lowered our forecast for global growth in 2019 to 3.1% (from 3.2%) with a key factor being the weakness in the Indian economy. We have left our forecasts for 2020 (3.3%) and 2021 (3.5%) unchanged, with the expected improvement in growth due to policy easing stabilising AE growth, as well as a recovery in economies affected by more domestic factors (India and Latin America). Trade policy is a key risk – both in terms of the impact of what has been announced (as estimates vary - see p2) but also how the US-China trade dispute (and other trade issues) develop. Our forecasts assume no increases in tariffs beyond what has already been announced (nor any winding back) with the uncertainty about what happens from here dragging on business investment. Political risks are also evident in several countries and Brexit uncertainty remains high.

Global Growth Forecasts (% change)

	2018	2019	2020	2021
US	2.9	2.2	1.7	1.8
Euro-zone	1.9	1.1	1.2	1.4
Japan	0.8	1.2	0.3	0.9
UK	1.4	1.2	1.2	1.5
Canada	1.9	1.4	1.5	1.7
China	6.6	6.3	6.0	5.8
India	6.8	6.3	7.0	7.1
Latin America	1.0	0.6	1.7	2.4
Other East Asia	4.1	3.5	3.7	3.8
Australia	2.8	1.6	2.2	2.3
NZ	2.9	2.4	2.6	2.5
Global	**3.6**	**3.1**	**3.3**	**3.5**

NAB global leading indicator

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TRADE HEADWINDS RISE AS US IMPOSES FURTHER TARIFFS ON CHINA IMPORTS

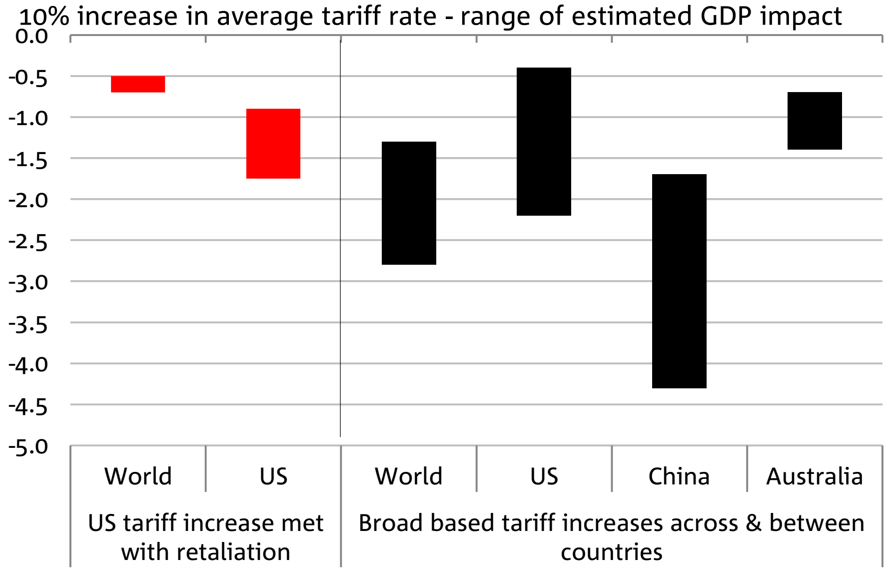
Estimates of tariff impacts vary widely – but building as tariffs ramp-up

Implemented/threatened US tariffs & retaliation

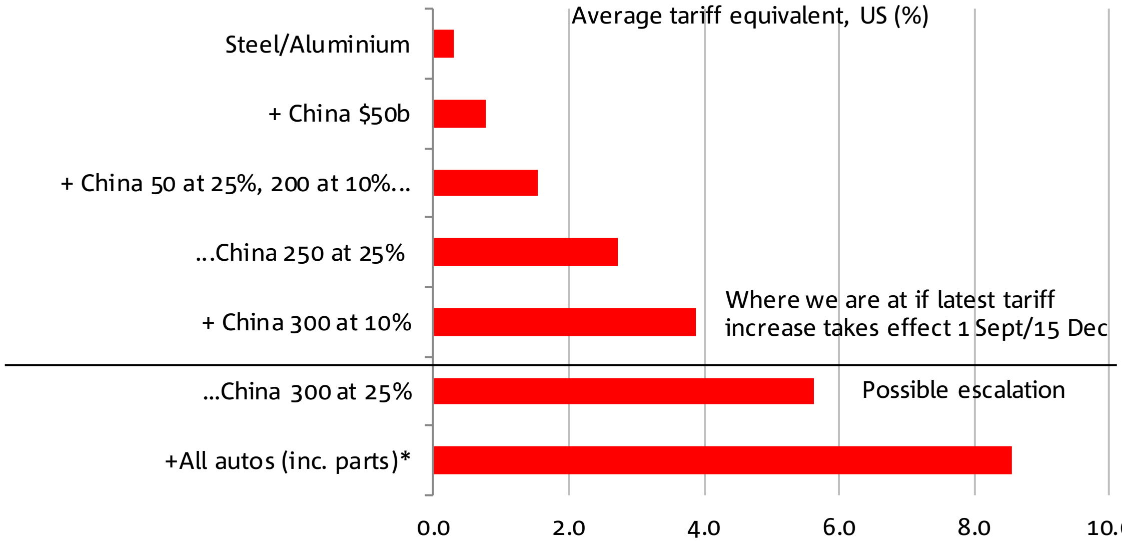
US Measure*	Overseas Retaliation?
20-50% on washing machines/solar panels – Jan '18	Tariffs placed by China on US sorghum imports seen as a retaliatory measure
Steel (25%) & aluminium (10%) – March 2018 - Approx $50b of imports - Value has declined with subsequent exemptions	Yes, including tariffs by China on aluminium, waste and scrap, and various agricultural products, and EU tariffs on approx. $3b of imports from US
$50b China imports – 25% tariff - $34b July '18 - $16b August '18	China: 25% tariffs on $50b of US imports
Further $200b China imports - 10% tariff from Sept. 2018 - 25% tariff from May 2019	China: on $60b of US imports - Tariffs of 5-10% - Raised to 5-25%
Up to a further $300b China imports - 10% tariff in two stages — 1 Sept. 2019/15 Dec 2019	US agricultural imports halted
Reports indicate tariffs of up to 25% on autos being considered US President deferred a decision on a US Section 232 report until November 2019 pending negotiations with (auto) trading partners	

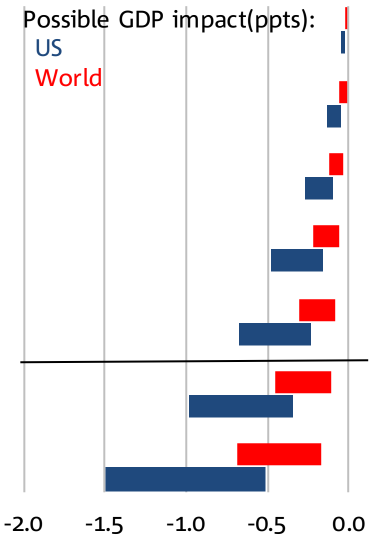
* Level of imports affected based on estimates at the time

Estimated impacts of 10% tariff increase from prior research*



If all publically floated tariffs on China are put in place, average US tariff would rise by around 6 ppts





* ATE = (tariff * value of imports)/value of all US imports * Excluding autos from Canada/Mexico as per USMCA side agreements the ATE would be 7%.

*Chart shows estimates from various studies on the impact of tariff increases. For further details see Trade Tensions on the Rise, July 2018

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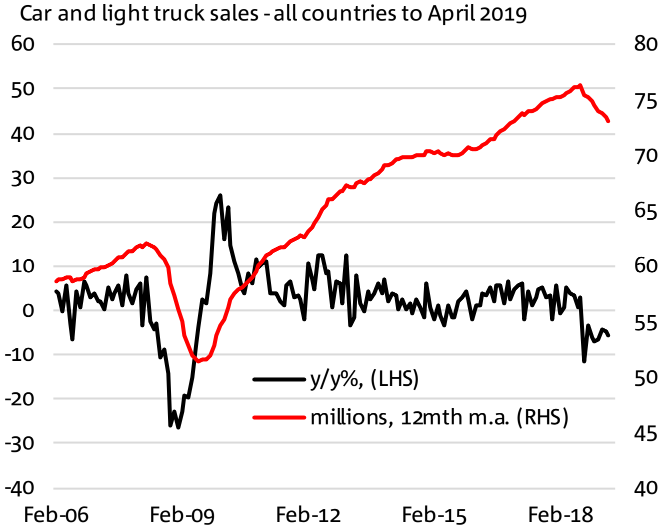
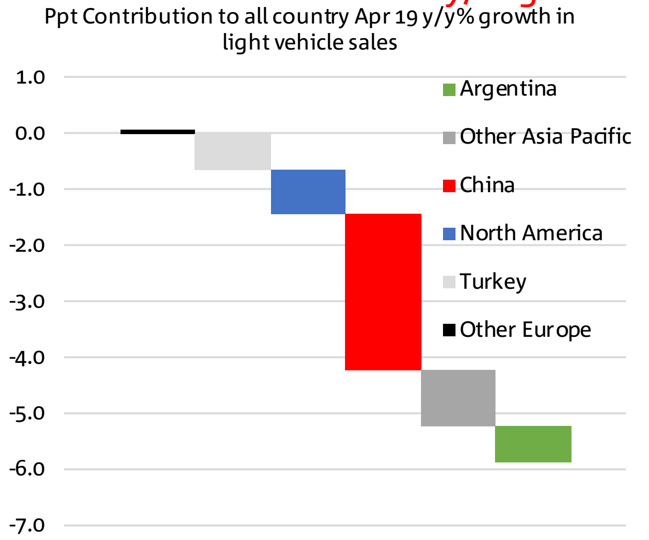
VEHICLES SALES AND PRODUCTION

Decline in sales – broad based but reflects recession (Argentina, Turkey), credit /economic slowdown/other factors (India, China), stage of the cycle (advanced economies). Changing emission standards, new vehicle types, changing preferences (millennials) also possible factors.

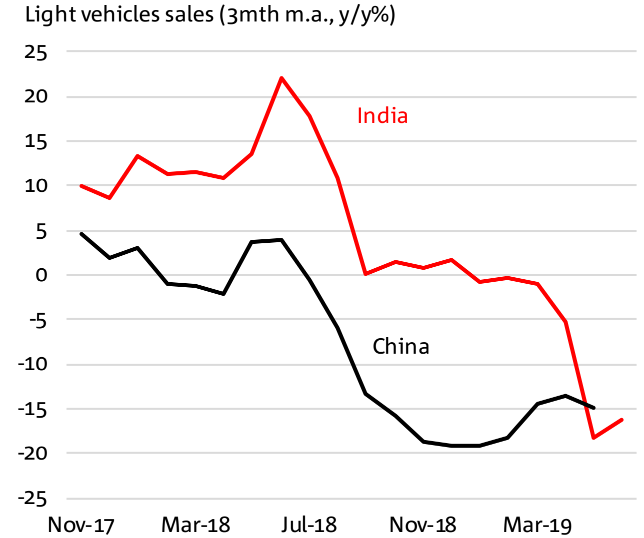
Big slump in vehicle sales – concentrated in light veh. segment



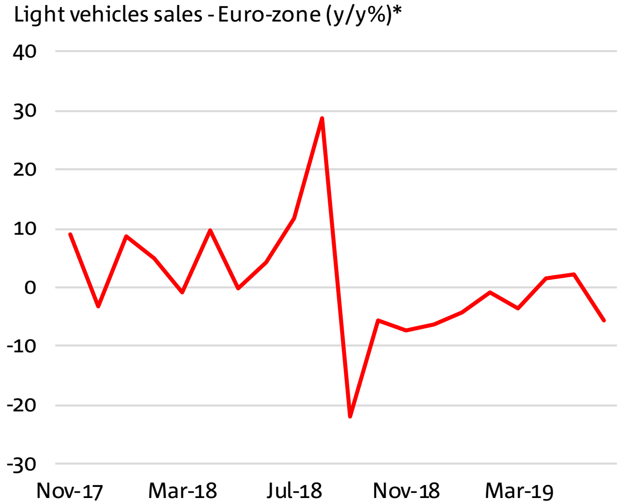
Broad based – but outsized contributions from Turkey/Argentina



China sales declining for a while…now India as well

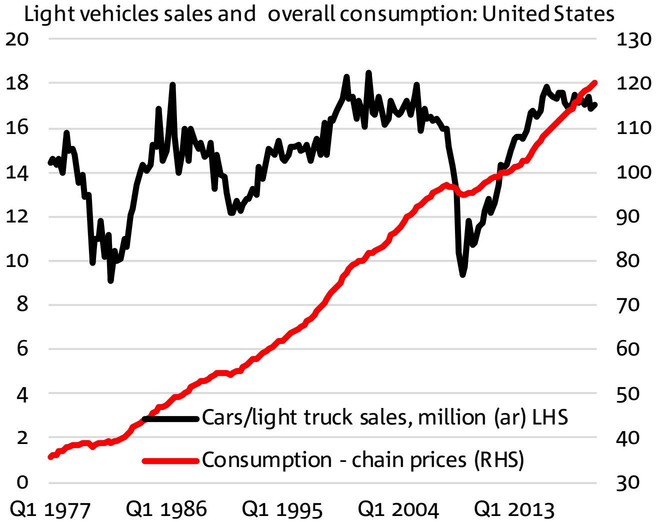


Euro-zone – new emissions standards disruption & growth downshift

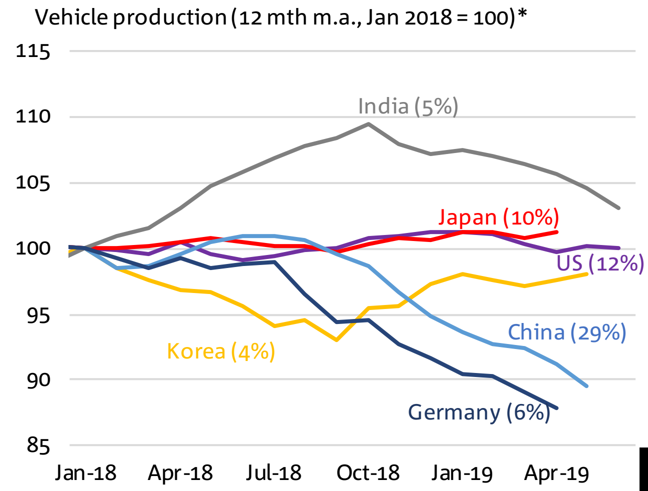


* Based on data for 15 of 19 euro-zone countries

In advanced economies people only want so many cars



Impact on global production concentrated in China, India, Germany



* Share of 2018 world vehicle production in brackets

 Sources: Refinitiv (Wards Intelligence, US BEA), NAB Economics

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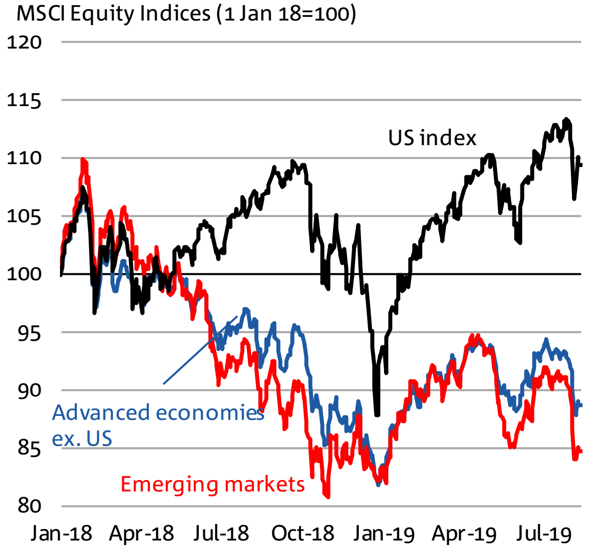
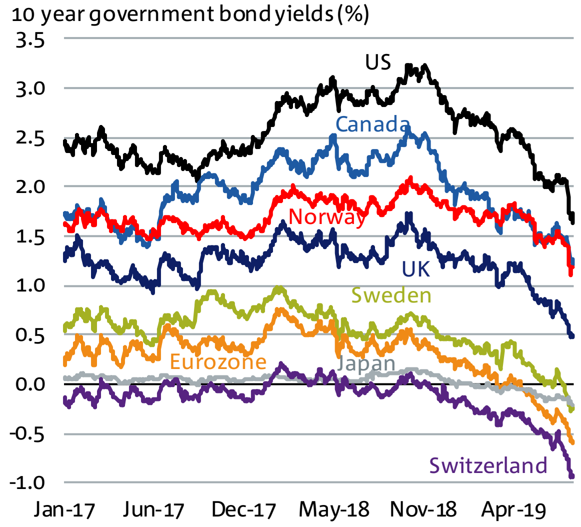
FINANCIAL AND COMMODITY MARKETS

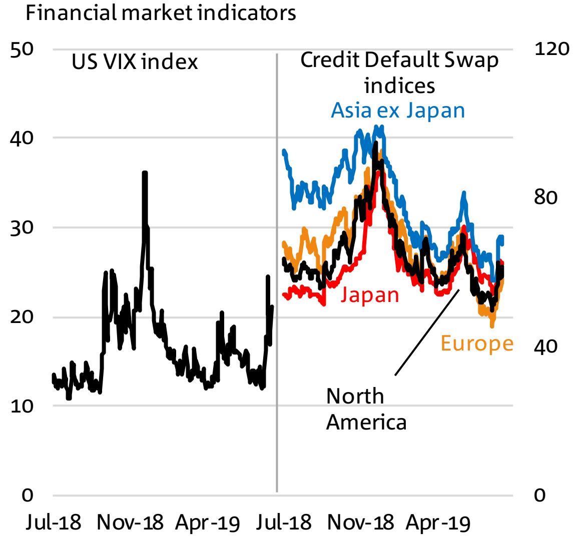
Financial markets react to trade dispute escalation – central banks to ease policy further

Equities down on trade developments… as were bond yields

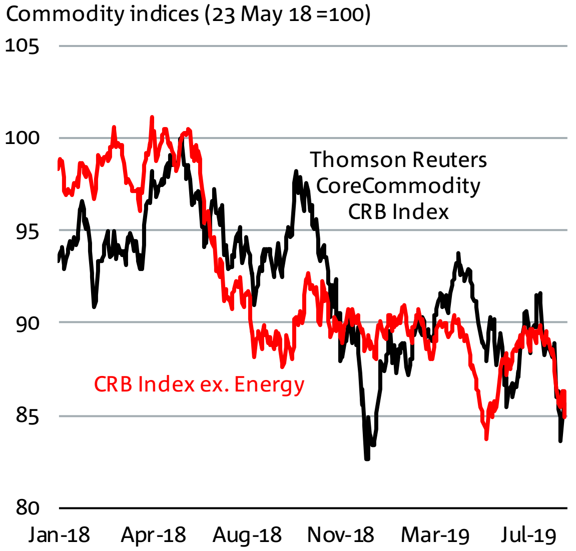




Market volatility moved higher, as did credit spreads



Commodity prices also move down, giving up recent gains



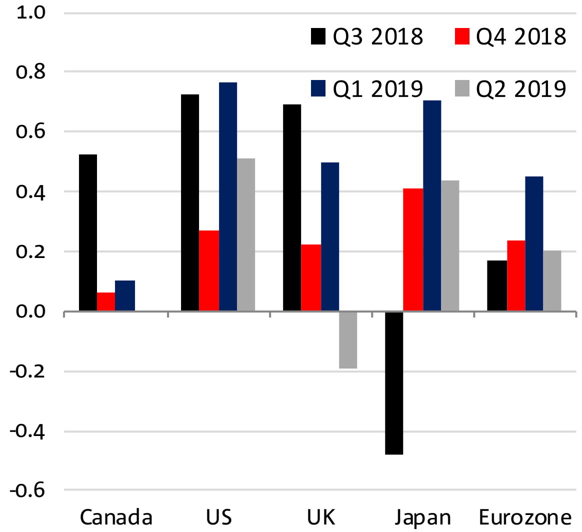
- The US decision on 1 August to further escalate the trade war with China reverberated through financial markets. The announcement was for a 10% tariff on remaining China imports starting 1 September, but on 13 August it announced that the new tariff would be delayed for a range of products until 15 December. Stock markets and bond yields declined sharply following the 1 August decision, commodity prices fell and credit spreads increased somewhat. Markets have also come under pressure from political developments in Argentina, ongoing protests in Hong Kong and weak Chinese and German economic data.
- In the days following the announcement of further tariffs on imports from China, US equities moved to around 5% below their end July level, with similar sized declines across other stock markets. US equity prices are still around their year ago level but other advanced economies and EM equity markets are lower. Financial market volatility – as measured by the US VIX index – also increased albeit not to a particularly worrying level (judged by history). The same is true for credit spreads which widened but are not noticeably elevated.
- The downward pressure on the global growth outlook that comes from the latest trade escalation, and the resulting expectation that the dovish turn in central bank monetary policy evident this year will intensify, saw bond yields decline even further.
- The US Federal Reserve cut the fed funds rate by 25bp at its July meeting. We had been expecting the Fed to cut rates by a further 25bp in September before going on hold, but with trade headwinds intensifying, and given on-going Fed concerns over below target inflation, we now also expect another 25bp rate cut by end 2019.
- In contrast, the ECB left policy unchanged at its last meeting, but it is now indicating that not only will rates not be increased through to H1 2020 but that they might be lowered, suggesting that it will ease policy at its next meeting. It also indicated that it is investigating options for new asset purchases (QE). Similarly, the Bank of Japan is signalling that the possibility of it easing policy has increased.
- A range of EM central banks have also eased policy in recent months. This includes the Bank of India, which cut its policy rate by 110bp so far this year to 110bp). In China, we expect the authorities to set policy to limit fall-out from the US-China trade dispute, including allowing controlled appreciation in the USD/CNY.
- Commodity prices have also moved down sharply since the end of July, with particularly large falls in oil and iron ore prices.

 Sources: Refinitiv, RBA, NAB Economics

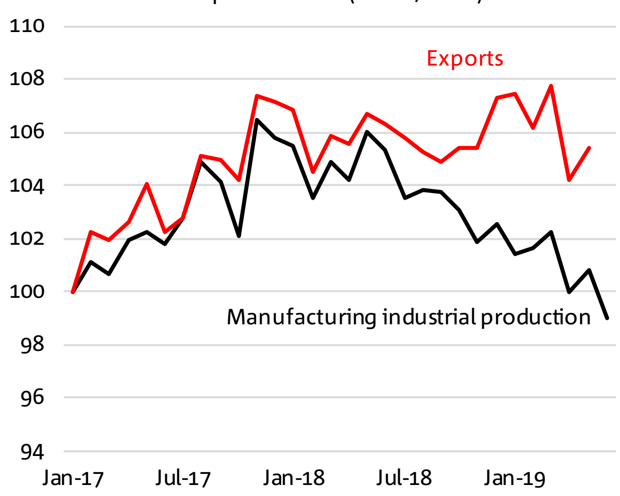
ADVANCED ECONOMIES

Advanced economies to remain under pressure through rest of 2019

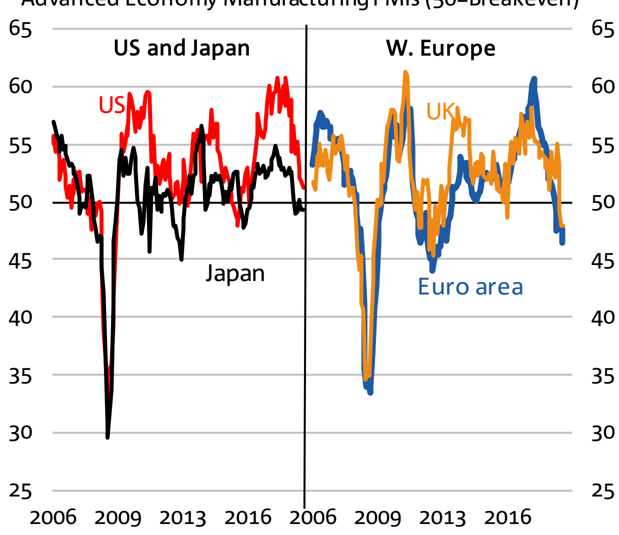
Slowdown resumes in Q2

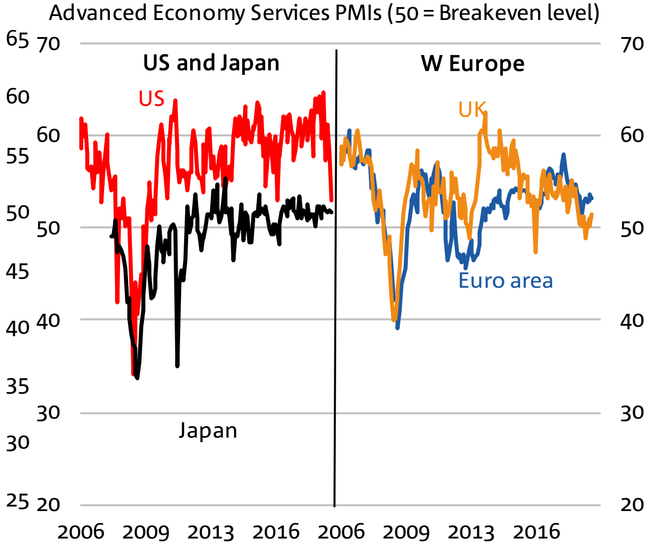


Germany's problems not just trade



Business surveys – US turning down, Euro mfg sector down again in July but services holding up





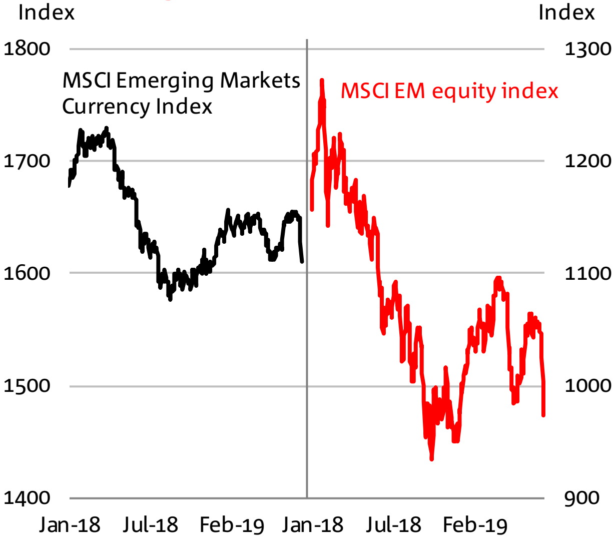
- Q2 GDP estimates are now available for major AEs, other than Canada, and indicate that the pick up in growth in Q1 was not sustained. We expect AE growth to slow further in H2 2019 before stabilising in 2020 partly due to monetary policy support kicking in and as the impact from Japan's VAT increase fades.
- US growth has long been expected to ease, as growth last year was boosted by a substantial fiscal stimulus while the Fed tightened policy over 2018. The US-China trade war – and the broader global slowdown – is also taking its toll particularly on business investment. The latest business surveys point to an economy further slowing into H2 2019 and the surveys are yet to reflect any impacts from the latest US-China trade escalation. However, Fed policy has changed direction, culminating in a rate cut in July, and we expect further easing in the months ahead which will provide support to the economy.
- The Euro-zone remains a source of concern. While growth in Q2 was 0.2% q/q (only a little below the average of the previous three quarters), the manufacturing PMI declined further in July and is well below its breakeven level. The PMI reading for Germany is even weaker. Germany's industrial production (IP) has trended down since end-2017, while Euro-zone IP has broadly tracked sideways, reflecting industry specific factors including a troubled auto sector (see p3). The Euro-zone services sector PMI has held up better, as has the labour market, so a continuation of modest growth looks likely, but the region remains exposed to the US-China trade escalation and Brexit uncertainty.
- Brexit is an even bigger drag for the UK economy, where growth declined q/q in Q2. This was partly due to pay back for solid growth in Q1 and due to a bring forward of annual auto factory shutdowns. How Brexit is ultimately resolved remains unclear but for now it remains a drag on the economy.
- Q2 growth in Japan was notably higher than expected at 0.4% q/q. The October increase in the Value Added Tax will weigh on activity (even if the rush to avoid it provides a boost to activity in Q3) as will the latest US-China trade escalation. As a result, we expect much weaker year average growth in 2020.
- Trade remains a big risk to the outlook. Even assuming no further escalation a major uncertainty is the impact on business sentiment and how this flows through to investment and hiring decisions. Political developments within Italy also remain a concern – Italian credit spreads have widened recently with a split in the governing coalition.

 Sources: Refinitiv, NAB Economics

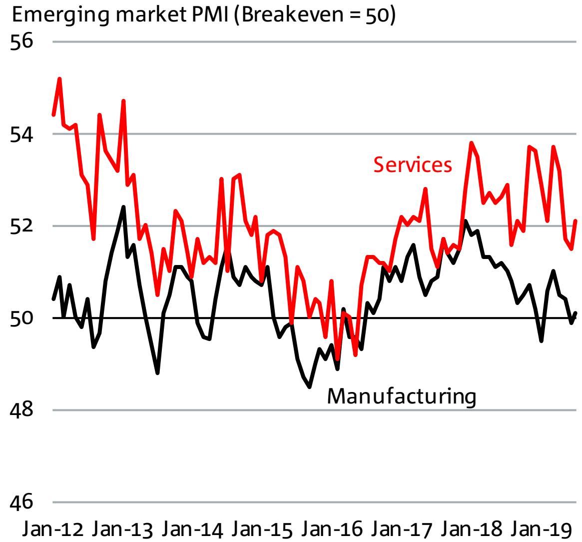
EMERGING MARKET ECONOMIES

Further deterioration in global trading environment a negative for EMs

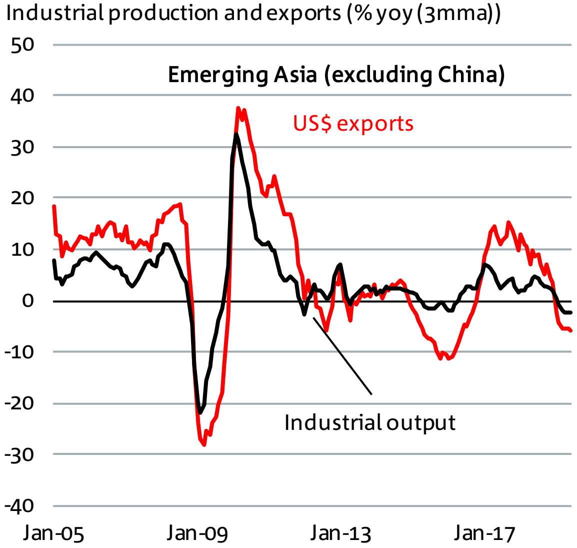
EM currencies & equities plunged following tariff escalation



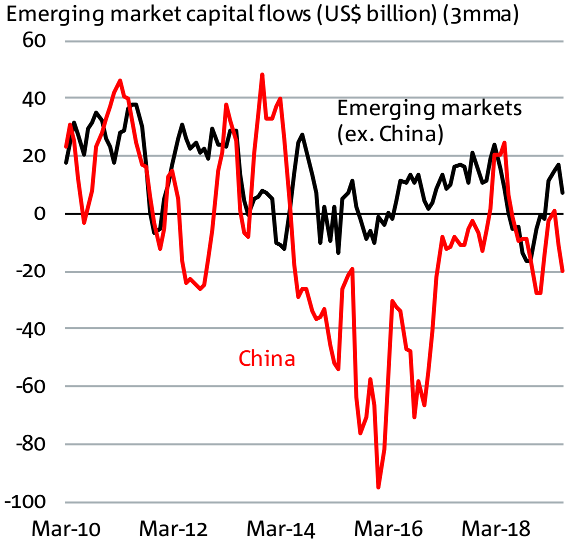
Manufacturing PMIs have trended lower



Exports from EM Asia (ex China) have fallen sharply



EM fears could drive further capital outflows



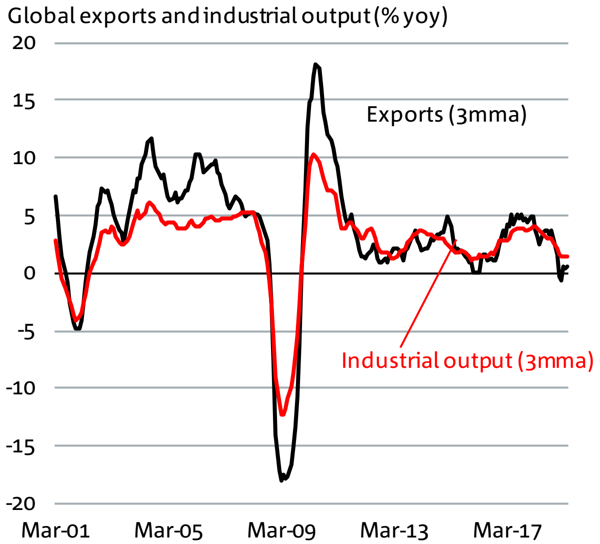
Sources: Refinitiv, CPB, NAB Economics

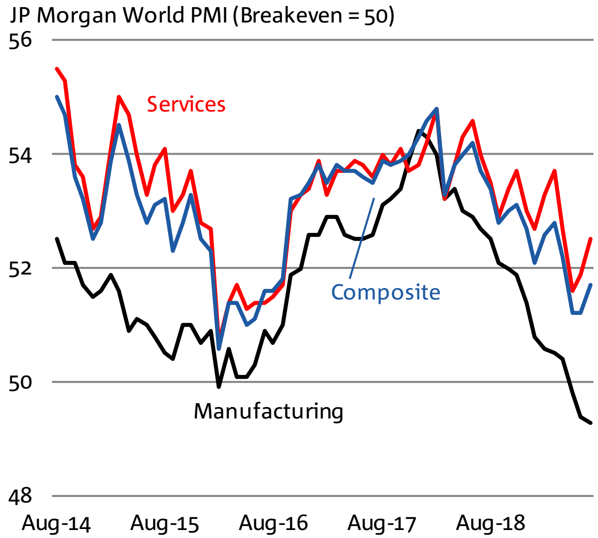
- Uncertainty around the global trade environment persists – with the latest increase in US tariffs on Chinese exports (along with reported retaliation from China) a broadly negative outcome for emerging market (EM) economies.
- The latest trade measures were announced after the release of most of the latest economic indicators for EM economies, meaning that the impact of the change is difficult to gauge. That said, high frequency measures, such as the MSCI EM currency and equity indices plunged following the announcement – with both the Chinese and Indian currencies sharply lower.
- Industrial production, fixed asset investment and retail sales growth in China was soft in July, following a surprise pickup in June. A trend across these two months points to a continued gradual slowdown, even before the next phase of US tariffs. For now, our growth forecasts remain unchanged on the assumption of a domestic policy response, but the growing trade headwinds highlight downside risk.
- The escalation in US tariffs is particularly negative for EM manufacturers. PMI surveys are available up to July, showing EM manufacturing at essentially neutral levels, having deteriorated from robust conditions in late 2017-early 2018. In contrast, EM services have held up comparatively well (albeit weaker than recent peaks).
- The impact of trade tensions between the United States and China extends beyond these economies – particularly to emerging East Asian economies. There has been evidence of trade diversion, with exports from these economies to the US increasing. However, this has not been enough to offset falling exports to China, meaning that total exports have fallen. In June, US dollar denominated exports fell by 6.0% yoy (on a three month moving average basis).
- In line with this trend, industrial production in East Asia has tracked lower, as both export and domestic demand has softened. Output fell by 2.2% yoy (3mma) in June. Elsewhere, industrial production has also slowed in India and contracted in Brazil.
- Negative economic trends in emerging markets could be reinforced by capital flows – as investors seek safe havens. In aggregate, the IIF's capital flow measure shows flows out of the broad region have been driven by outflows from China. Fears of further slowing and heightened risk in EMs could result in outflows – placing additional pressure on financial markets in these countries.

GLOBAL FORECASTS, POLICIES AND RISKS

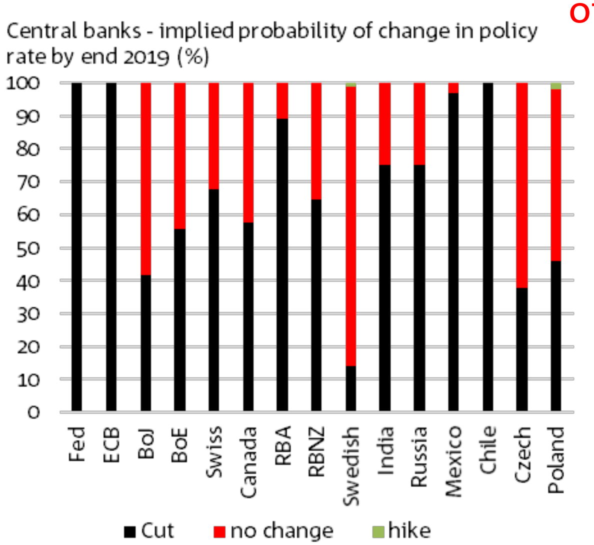
Latest tariff increases further pressure global growth; a lot hinges on an effective monetary policy response

While weak, PMIs, IP & trade stabilising ahead of recent tariffs

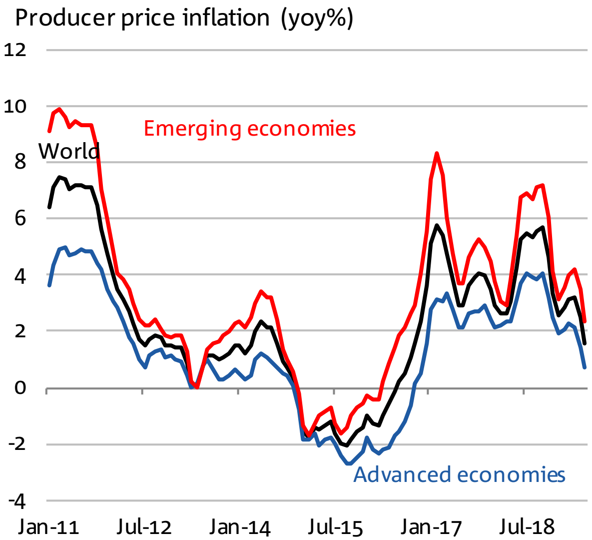




Central banks to the rescue?



Prod. price growth was waning ahead of recent commodity price declines



Sources: Refinitiv, CPB, Markit, NAB Economics

- Based on data released so far, it is likely that global economic growth continued to slow in Q2. Year-on-year GDP growth in both China and the United States (the world's largest and second largest economies respectively) slowed, as it did in the Euro-zone while Japan was broadly unchanged. Partial data for India remain weak and do not point to a substantial rebound in GDP growth in Q2.
- World IP and trade data are available through to May, and were growing at a weak 1.4% and 0.6% y/y% (3mth average) respectively. The global manufacturing PMI continued to fall through to July, including a large drop in June following the US and China tariff increases announced in May. However, the global services PMI has picked up in recent months. The IP, trade and survey data had been pointing to activity stabilising; but the US-China tariff and other trade measures announced in May and August suggest that these indicators will come under renewed pressure. Our leading indicator of global growth (p1) points to a further slowdown in global activity in Q3.
- We have lowered our forecast for global growth in 2019 to 3.1% reflecting a variety of factors including revisions to US data, continuing weakness in India as well as the growing trade headwinds (see p2 for a range of estimates on their impact). We expect growth to pick up modestly to a still below-trend 3.3% in 2020 and further recover in 2021 (3.5%).
- Our expectation that global growth will start to recover in 2020 is based on two main assumptions. Firstly, that central banks will deliver further monetary easing which provides meaningful support to growth. Secondly, that there will be a recovery in growth in India and Latin America (where domestic factors have also affected growth). While market pricing suggests a high likelihood that central banks will ease policy, the effectiveness is uncertain and, as the turbulence in Argentinian financial markets this week shows, a recovery in Latin America is not assured. A sustained downturn in commodity prices will also weigh on commodity exporters such as Brazil.
- Our forecasts are based on no change to already announced trade barriers. With the US also considering auto tariffs and voicing displeasure over 'currency manipulators' trade risks are slanted towards further escalation. Political risks are also evident including in Hong Kong, Argentina, Italy, a recent dispute between Japan and Korea (which is spilling over into trade) and Brexit uncertainty remains high.

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