EMBARGOED UNTIL: 11.30AM THURSDAY 12 SEPTEMBER 2019

THE FORWARD VIEW – GLOBAL

SEPTEMBER 2019

National Australia Bank

Global growth slows further as trade disputes escalate… again

- The US-China dispute escalated further on 23 August as both countries announced further tariff increases. Compared to the early August trade escalation, market reaction has been more muted.
- Global economic growth slowed further in Q2 2019 to around 3.0% yoy, its lowest level since end-2015. This included a slowdown in major advanced economy (AE) GDP growth to 1.6% yoy in Q2 2019, down from the 2.5% pace of a year ago, and the lowest rate of growth since mid-2016. We expect this downward trend to continue through to early 2020 as the US-China trade dispute and other factors continue to weigh on growth.
- Growth in the five largest emerging markets (EM) economies also slowed. This included India, where growth fell to its lowest level since early 2013. US-China trade war spill-overs are intensifying with EM export volumes falling in June 2019, particularly in East Asia (excluding China).
- In the face of the global slowdown and subdued inflation, central banks are moving to support activity. For AE central banks this has mainly taken the form of signalling a change in the policy outlook but both the US Fed and the European Central Bank are expected to cut rates this month. In contrast, EM central banks have been more active in cutting policy rates.
- Global growth is forecast to average 3.1% in 2019, before edging up to 3.2% in 2020 (previously 3.3%) as the global economy stabilises. Our global leading indicator is also currently pointing to growth stabilising heading into 2020. A recovery to the long term trend (3.5%) is expected for 2021. Key to the upturn is the support from easier monetary policy and cyclical recoveries in Latin America and India, as well as no further escalation in trade disputes or current geo-political risks (such as a no deal Brexit) being realised.

Global Growth Forecasts (% change)

	2018	2019	2020	2021
US	2.9	2.2	1.6	1.8
Euro-zone	1.9	1.1	1.1	1.4
Japan	0.8	1.0	0.2	0.9
UK	1.4	1.2	1.2	1.5
Canada	1.9	1.6	1.6	1.7
China	6.6	6.3	6.0	5.8
India	6.8	5.7	6.8	7.1
Latin America	1.0	0.4	1.5	2.3
Other East Asia	4.1	3.5	3.7	3.8
Australia	2.7	1.7	2.2	2.5
NZ	2.9	2.1	2.4	2.0
Global	**3.6**	**3.1**	**3.2**	**3.5**

NAB global leading indicator

Actual global growth and leading indicator (% yoy)

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US-CHINA DISPUTE – MAINLY PLAYING OUT VIA TARIFFS, COULD IT WIDEN?

President's tweets raise prospect of bringing companies home…US investment in China not large (relative to economy) but adds to disruption and where would it end?

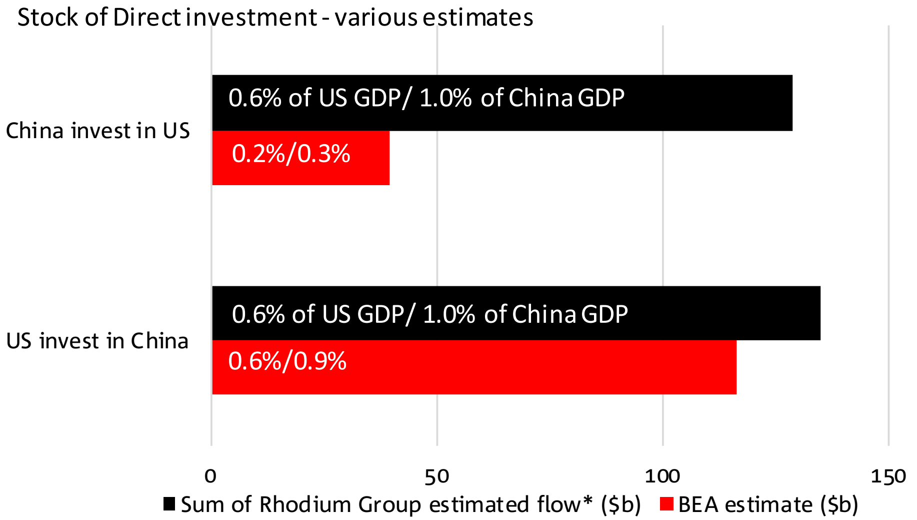
Implemented/threatened US tariffs & retaliation

> *"Our great American companies are hereby ordered to immediately start looking for an alternative to China, including bringing your companies HOME and making your products in the USA"*
>
> *President Trump, tweet, 23 August 2019*

Under the **International Economic Emergency Powers Act** the President can prohibit transactions (foreign exchange, credit transfers/payments), import or export of currency or securities, block/void/prohibit any acquisition, holding with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest.

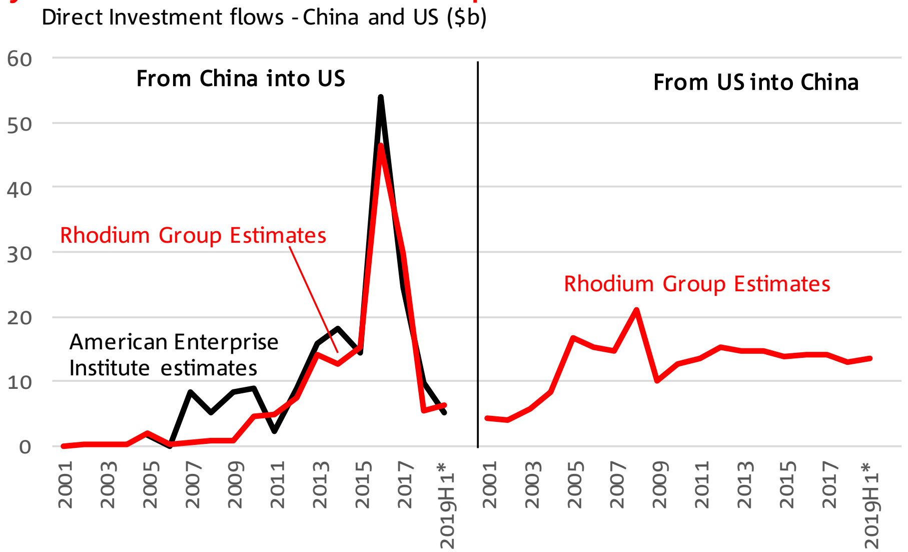
Bottom line: The President can't 'order' US companies home but could make life difficult. In any event, if pursued, it could broaden trade dispute to include disrupting financial flows and business investments, further dragging down global growth.

US-China direct investment not large relative to their economies

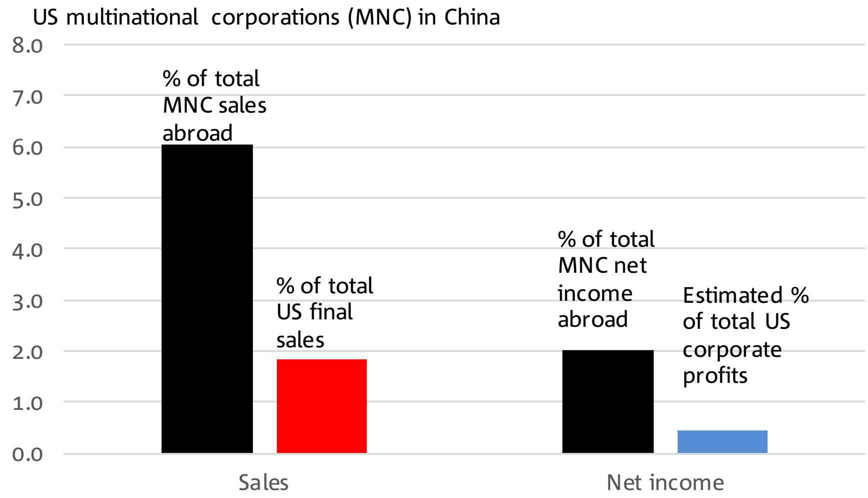


* 2005 to 2018; controlling interest FDI

Investment flows into US from China slowed last year – trade concerns or capital flow restrictions?



Sales in China a small part of US activity abroad and relative to its overall economy but would hurt



Sources: Bureau of Economic Analysis (BEA), Rhodium Group, American Enterprise Institute, NAB estimates

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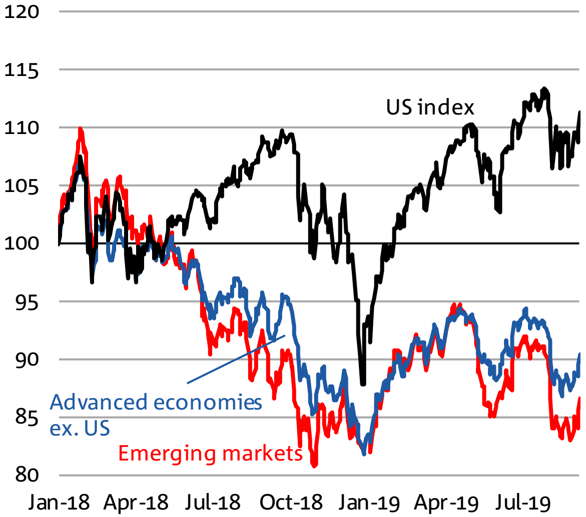
FINANCIAL AND COMMODITY MARKETS

Markets take latest US-China escalation in their stride

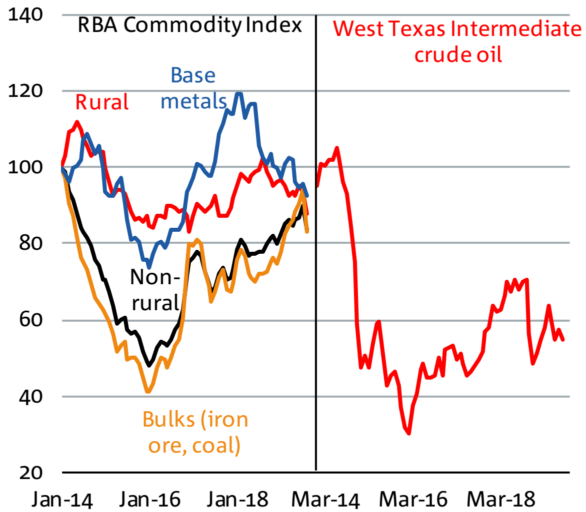
Markets less affected by latest trade escalation

MSCI Equity Indices (1 Jan 18=100)



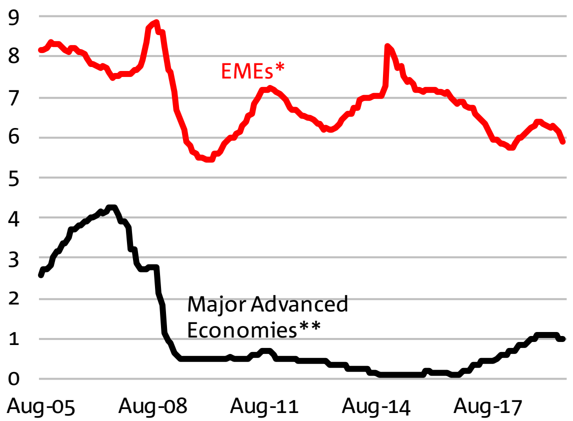
Bulk prices have held up in a broader downturn

Commodity price indices (Jan 2014 = 100)



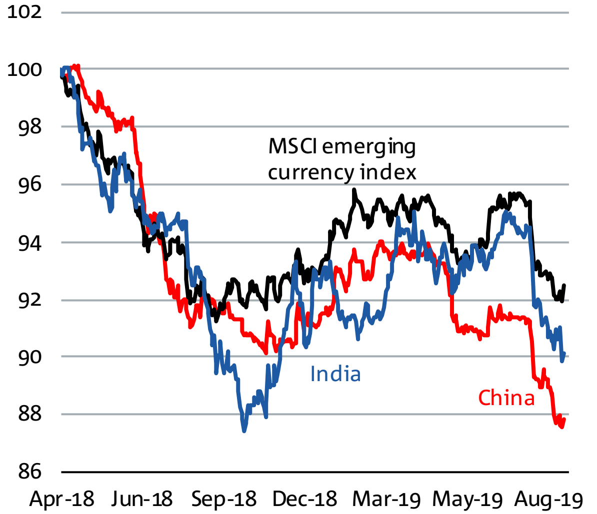
Central banks: AE talk, EM action despite currency pressures

EM ex China and AE : central bank policy rates (%)



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

Emerging market currency indices (to US$) (3 April 18 = 100)



- The US-China dispute escalated further on 23 August as both countries announced further tariff increases. Market reaction has been relatively subdued. Since early-to-mid August markets have broadly tracked sideways, and recently have turned up a little. In contrast, the tariff increases announced at the start of August led to sharp declines in stock markets and bond yields.
- Equities have recorded some gains since early September, in part due to the news that the US and China will hold further talks in October and a reduced chance of a no-deal Brexit next month. This has been broad based, with AE ex US markets as well as EM equities more than holding their ground over the last month. However, market volatility – as measured by the US VIX index – remains somewhat elevated.
- AE Bond yields also generally stabilised from mid-August before rising over the last week or so, but remain at very low levels. Yields are under pressure from the weak global outlook and geo-political risks that raise the risk of very poor outcomes, and the resulting expectation that central banks will continue to loosen policy.
- While there has been much talk of monetary policy easing, among the major advanced economy central banks, only the US Fed has cut rates so far this year. However, both the Fed (by 25bps) and the European Central Bank (up to 20bps) are expected to cut rates at their September meetings. The ECB may also start up its QE program again. How much more they will do beyond this is unclear, but we expect the US Fed to further reduce the fed funds rate (by 25bps) in Q4.
- In contrast, EM central banks have been much more on the front foot. Of the 21 EM (ex China) central banks we track, twelve have cut rates this year. Only two have increased rates, including Argentina which has been forced to tighten due to stress in its financial markets.
- While not measurable through a single policy rate, China's monetary stance has also eased. This has been achieved, in part, by allowing its currency to depreciate against the US dollar, and most recently by a cut in banks required reserve ratio. Other EM currencies have also declined, including India following poor economic data.
- In recent months prices most sensitive to the global outlook – base metals – have started falling again. The (equally weighted) Thomson Reuters Core Commodity price index is now around its low for recent years. Fortunately for Australia, bulk commodity prices have risen this year, even with recent falls; as a result the RBA's non-rural commodity price index has held up reasonably well.

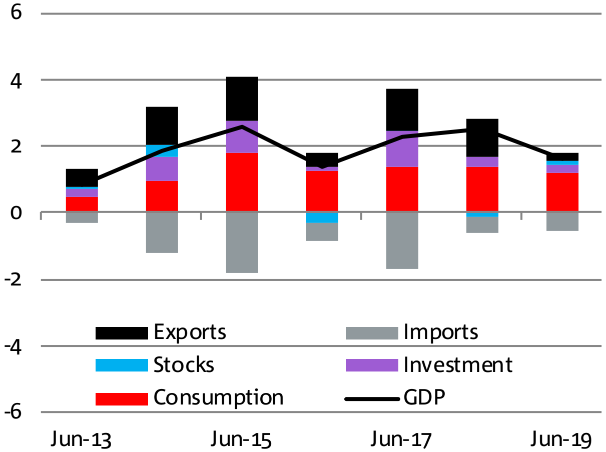
 Sources: Refinitiv, RBA, NAB Economics

ADVANCED ECONOMIES

Advanced economy slowdown driven by lower investment and exports

AE growth slowdown reflects pull back in investment and exports

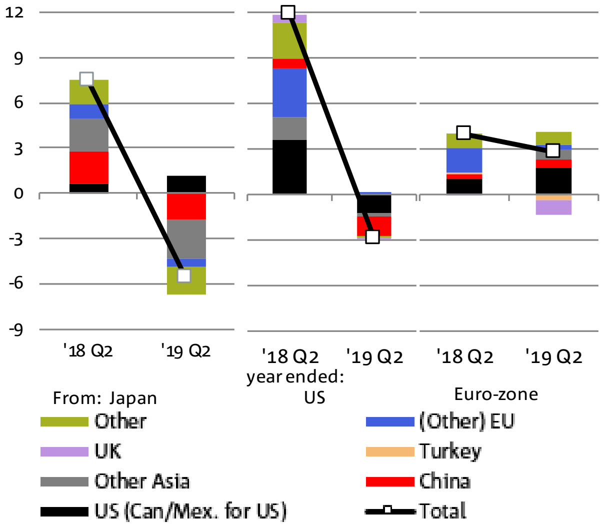
Ppts contribution tto Major AE GDP growth y/y%*



* US, Euro-Z., UK, Can.,Jpn. Note - simple addition of trade flows (i.e. intra-major AE trade not netted out)

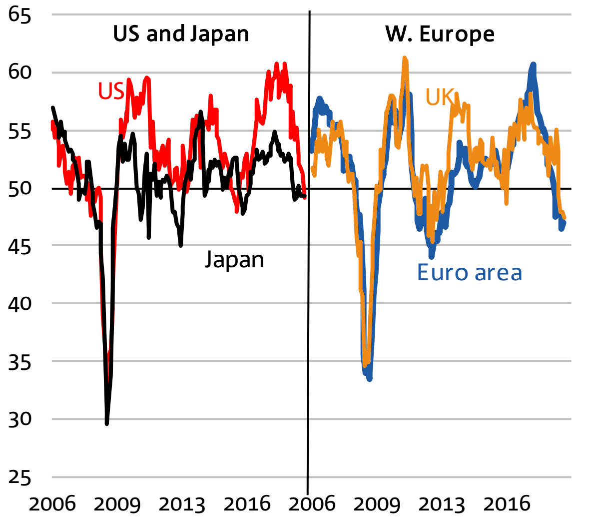
US-China – part of trade slowdown story but not the only factor

Country contribution to y/y% growth in goods export values (ppts)*



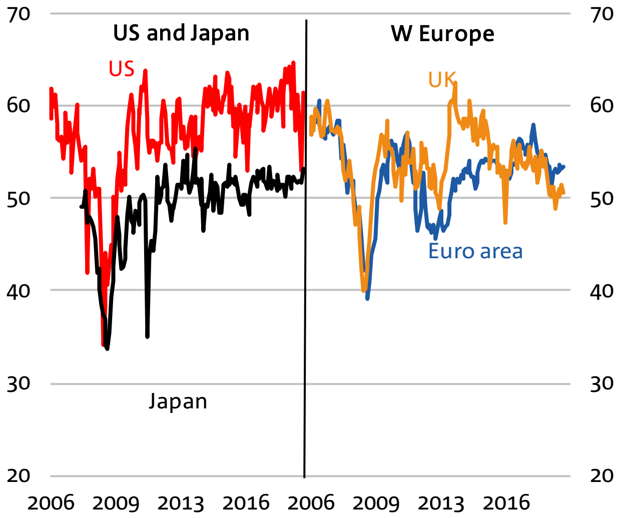
Business surveys – US manuf. stalls – like the other major AEs

Advanced Economy Manufacturing PMIs (50=Breakeven)



Services sector doing better but has also eased

Advanced Economy Services PMIs (50 = Breakeven level)



- Major AE GDP growth slowed to 1.6% yoy in Q2 2019, down from the 2.5% pace of a year ago, and the slowest rate of growth since mid-2016. We expect this downward trend to continue through to early 2020 as the US-China trade dispute and other factors continue to weigh on growth. The impact of last year's fiscal stimulus in the US is largely in the past. Japan's economy will also be impacted by a tax induced fiscal tightening in Q4.
- Monetary policy easing should help to stabilise growth, although with policy capacity limited in the Euro-zone and Japan, and doubts about its effectiveness, the expected recovery in growth through 2020 and 2021 is relatively modest. This also assumes that there is no further escalation in trade disputes beyond what has been announced.
- A simple aggregation of the expenditure components of GDP for the major AEs indicates that the slowdown in growth over the last two years has been driven by lower fixed investment (likely driven by lower business investment), with the pull back in consumption more modest. Trade growth – both exports and imports – has been scaled back; for exports this has mainly occurred over the last year.
- Data on the value of goods exports by destination helps shed some light on what is driving the weakness in exports. Lower exports to China have been a factor for the US and Japan and the impact of the US-China dispute is also reflected in falling exports to other Asian economies. The US has also seen a broader weakening in trade reflecting dollar strength and slower trading partner growth. In contrast, for the Euro-zone, the US-China dispute does not appear to be a major factor, with declines in exports to the UK (Brexit) and Turkey (recession), as well as weaker exports to other EU countries, the main drivers.
- The latest business surveys continue to point to weak growth outcomes. Manufacturing has been particularly hard hit as it is highly exposed to trade and investment flows. US manufacturing survey readings have continued to fall and are now below 'break-even'. While still weak, manufacturing in Japan and the Euro-zone have shown signs of stabilising recently but with further rounds of US tariffs to come this may not last. Business surveys continue to show that the services sector is holding up a little better. In the case of Japan, it may reflect a bringing-forward of activity ahead of October's Value Added Tax increase – which could be followed by a slump.

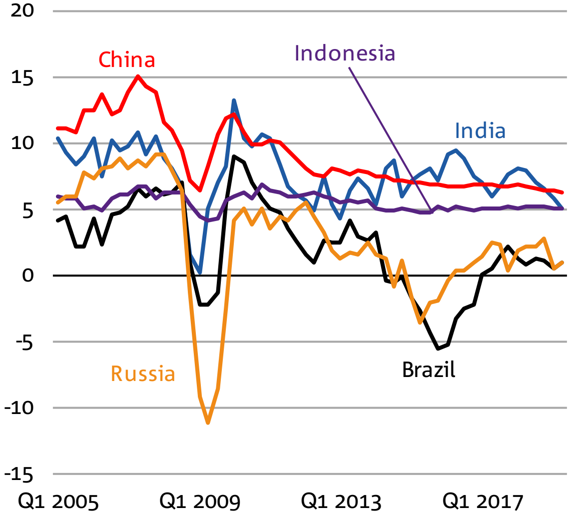
Sources: Refinitiv, NAB Economics. * Other Asia includes Korea, Taiwan, Hong Kong, Singapore (and Japan for US/Euro exports)

EMERGING MARKET ECONOMIES

India drives the growth slowdown, as EM trade indicators continue to worsen

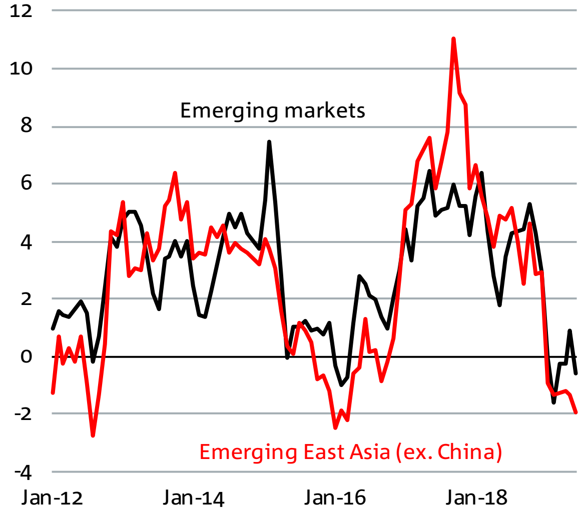
India (and China) led major EM growth lower

Major EM economic growth (% yoy)



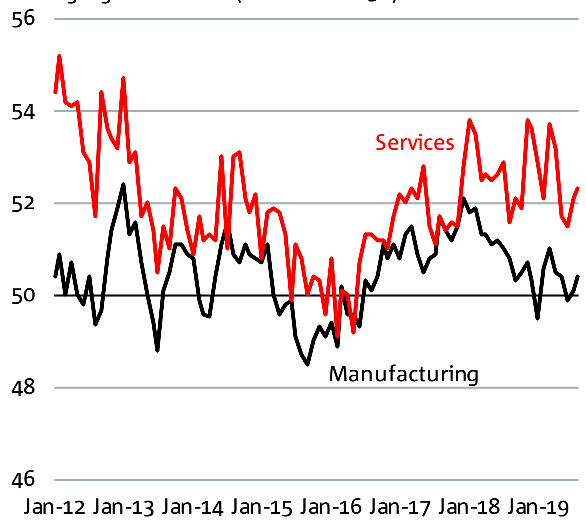
EM export volumes contracted more rapidly in East Asia

Emerging market export volumes (% yoy 3mma)



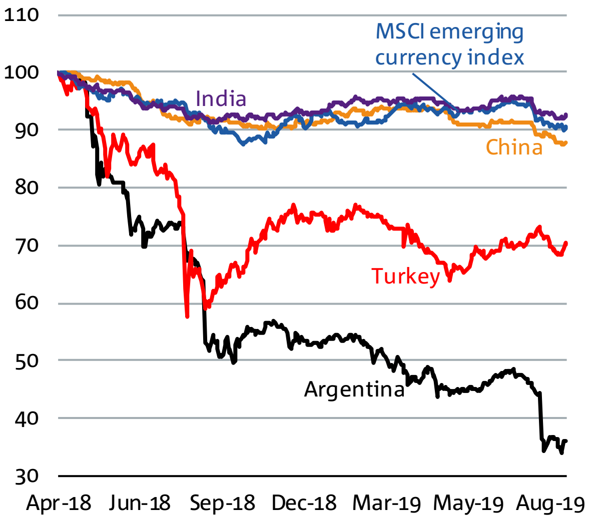
PMI results stronger in August but well below recent cycle peaks

Emerging market PMI (Breakeven = 50)



EM currencies generally weaker since early August

Emerging market currency indices (to US$) (3 April 18 = 100)



- Economic growth in the five largest emerging markets slowed further in Q2, down to 5.0% yoy, compared with 5.3% yoy in Q1 2019 and the recent cycle peak of 6.1% yoy in Q1 2018. This was the weakest rate of growth since Q4 2015, when both Brazil and Russia were in the midst of deep recessions.
- India's economic growth continued to slow in the second quarter – down to 5.0% yoy (compared with a relatively weak 5.8% in Q1). This was the slowest rate of growth since March 2013, with weakness in both private consumption and investment persisting from the previous quarter. It is unclear how committed the Government is to its fiscal deficit target, as meeting the target would curtail spending in coming quarters, further impacting growth.
- Emerging market growth is typically more trade dependent than that of advanced economies, and the uncertainty around the global trade environment has been broadly negative. The trade war between the United States and China has continued to intensify (with a new phase of tariffs implemented on 1 September), with a range of spill-over effects across the EM Asia region.
- According to the CPB World Trade Monitor, emerging market export volumes fell by 0.6% yoy (on a three month moving average basis) in June 2019. The impact was larger in East Asia (excluding China), where volumes fell by 1.9% yoy.
- PMI surveys provide a more up to date measure of conditions (than GDP or trade volumes) in emerging markets. Given the worsening trade environment, it was somewhat surprising to see the EM manufacturing PMI strengthen in August – up to 50.4 points (from 50.1 points in July). A sizeable improvement in China (also at 50.4 points in August) was the key driver of this trend, however this reading was ahead of the latest imposition of tariffs (and may reflect the bringing forward of activity). In contrast, EM services have held up comparatively well (albeit weaker than recent peaks of early 2019).
- Since early August, there has been a significant decline in EM currency indices – with the Chinese Yuan breaking the 7 to 1 US dollar ratio and a fresh plunge in the Argentinian Peso. The latter reflects the country's slide into a fresh crisis, with the government implementing capital controls, demanding firms repatriate foreign earnings and proposing a reprofiling of its foreign debt.

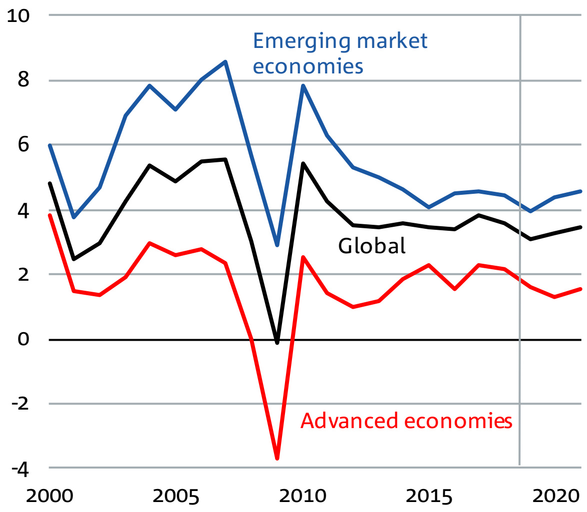
 Sources: Refinitiv, CPB, NAB Economics

GLOBAL FORECASTS, POLICIES AND RISKS

Global growth continues to slow; easing monetary policy key to a return to trend by 2021

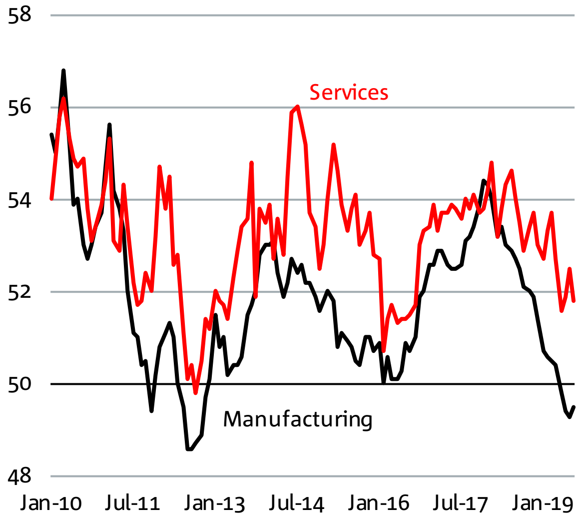
Global growth slowing in '19; expected recovery led by EMs

Global economic growth & forecasts (%)



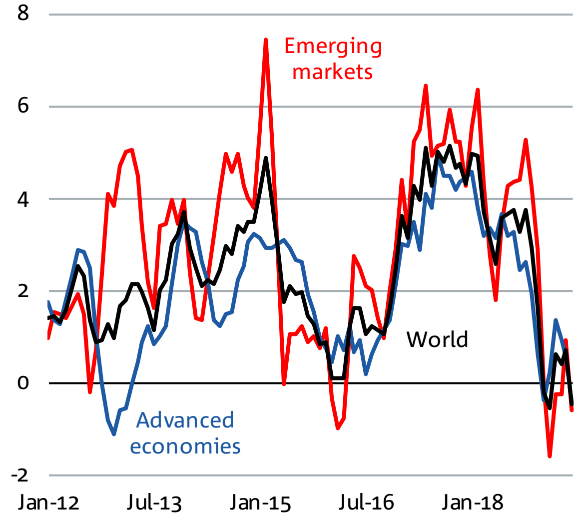
Global growth slowing in '19; recovery to trend led by EMs

JP Morgan Global PMI (Breakeven = 50)



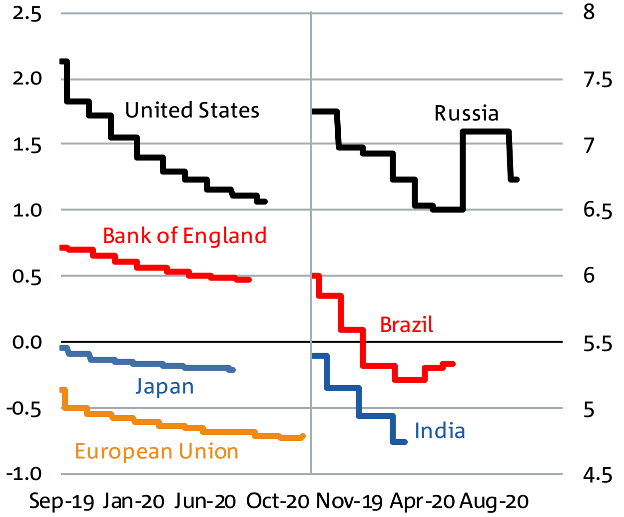
Global trade volumes contracted in June

Changes in export volumes (% yoy (3mma))



Monetary policy expected to ease, providing support for future growth

Market implied central bank policy rates (%)



- Global economic growth continued to slow in Q2 2019, down to an estimated 3.0% yoy (compared with 3.1% yoy in Q1). Weaker growth in the major advanced economies was the main contributor – led by a slower increase in the United States.
- PMI measures provide a more up-to-date indication of economic conditions, with global measures available to August. The global manufacturing PMI has remained negative since May 2019, albeit it was marginally less negative in August (49.5 points compared with 49.3 points in July). In contrast, services PMIs – which comprise the bulk of economic activity, particularly in advanced economies – have held up comparatively well. That said, they have trended lower from peaks in 2018, down to 51.8 points in August.
- The deteriorating trends for manufacturing largely reflects the worsening global trade environment and declines in business investment. On a three month moving average basis, global export volumes contracted by 0.5% yoy in June – close to the weakest outcome (-0.6% yoy in February 2019) since the GFC. This was prior to the most recent rounds of US-China tariffs, which could slow trade further. Our forecasts assume no further tariff measures (beyond what has already been announced), however as recent history has shown, such a scenario should not be ruled out, meaning that trade tensions present a downside risk to our outlook.
- We have lowered our forecast for Indian growth, given the weaker than expected outcome in Q2. Easing monetary policy is expected to support a modest recovery in the short term (led by investment), however downside risks (particularly around consumption) persist.
- Central banks around the world are responding to the weaker economic environment with generally more dovish monetary policy – either lowering policy rates or providing softer forward guidance. In markets with already extremely low rates – such as Japan and the European Union – further unconventional policy is being considered.
- A weaker outlook for India is the main change to our global forecasts, along with smaller revisions for other regions – reflecting in-coming data and the most recent tariffs. Global growth is forecast to average 3.1% in 2018, before edging up to 3.2% in 2020 (previously 3.3%). A recovery to the long term trend (3.5%) is expected for 2021. Key to the upturn is the support from easier monetary policy and cyclical recoveries in Latin America and India. The latter is far from assured, as recent turbulence in Argentina has demonstrated, with risks generally weighted to the downside.

Sources: Refinitiv, CPB, Markit, NAB Economics

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