EMBARGOED UNTIL: 11.30AM THURSDAY 14 NOVEMBER 2019

THE FORWARD VIEW – GLOBAL

NOVEMBER 2019

National Australia Bank

Near term growth prospects still weak, but potential trade deal offers some upside

- Hopes of a US-China 'Phase One' trade agreement have lifted financial markets. While it is unclear if existing tariffs will be rolled back, should a deal be agreed it would suggest a lower risk of an extreme tail event and may lift business confidence. Less clear is whether the drag on business investment from the unclear nature of future trading relationships will change. Our forecasts are based on announced trade policy but the hopes of a deal suggests more upside risk than have been evident for a while.
- At the same time expectations of further major Advanced Economy (AE) monetary policy easing have been dialled back, although the recent easing that has been put in place is likely to remain for an extend period.
- Major AE growth appeared broadly steady in Q3 but we expect further slowing going forward. The most recent business surveys are consistent with subdued growth in the Eurozone, further slowing in the US and a turn for the worse in Japan (in part due to the increase in its Value Added Tax). We don't expect major AE growth (on a yoy basis) to stabilise until mid-2020.
- Our forecasts for global economic growth are unchanged this month, however there has been some shift in the underlying forecasts for key regions. Our upward revision to US economic growth for 2019 and 2020 was offset by our downward revision to Chinese and East Asian growth. This means that we expect the global economy to expand by a sub-trend 3.1% and 3.2% in 2019 and 2020 respectively, before returning to the long term trend of 3.5% in 2021. Recoveries in Indian and Latin American growth are the key contributors to the 2021 upturn, but there is considerable uncertainty around the growth prospects for these economies.

Global Growth Forecasts (% change)

	2018	2019	2020	2021
US	2.9	2.3	1.7	1.8
Euro-zone	1.9	1.2	1.0	1.4
Japan	0.8	1.0	0.2	0.9
UK	1.4	1.3	1.0	1.5
Canada	1.9	1.6	1.6	1.7
China	6.6	6.1	5.9	5.8
India	6.8	5.7	6.8	7.1
Latin America	1.0	0.3	1.3	2.1
Other East Asia	4.1	3.4	3.5	3.7
Australia	2.7	1.6	2.1	2.5
NZ	2.8	2.2	2.2	2.0
Global	**3.6**	**3.1**	**3.2**	**3.5**

NAB global leading indicator

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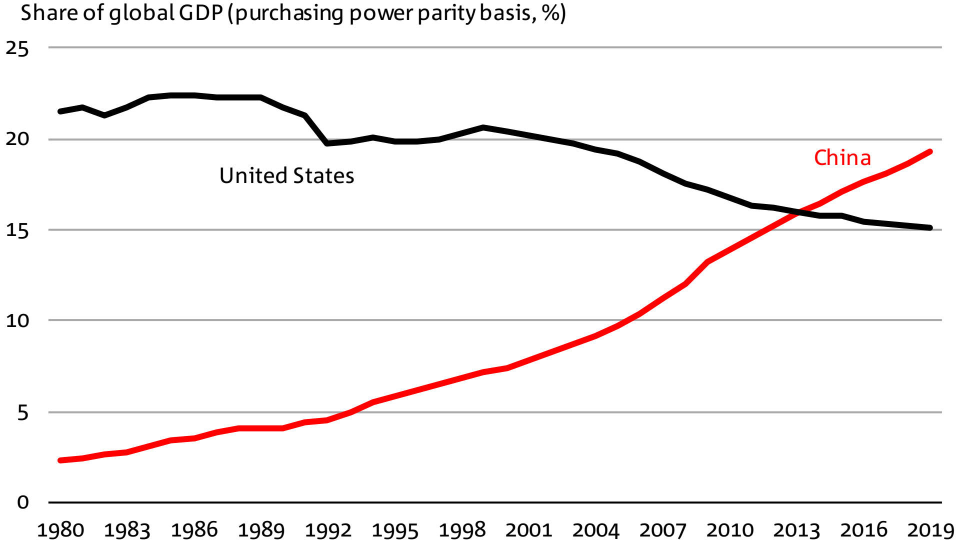
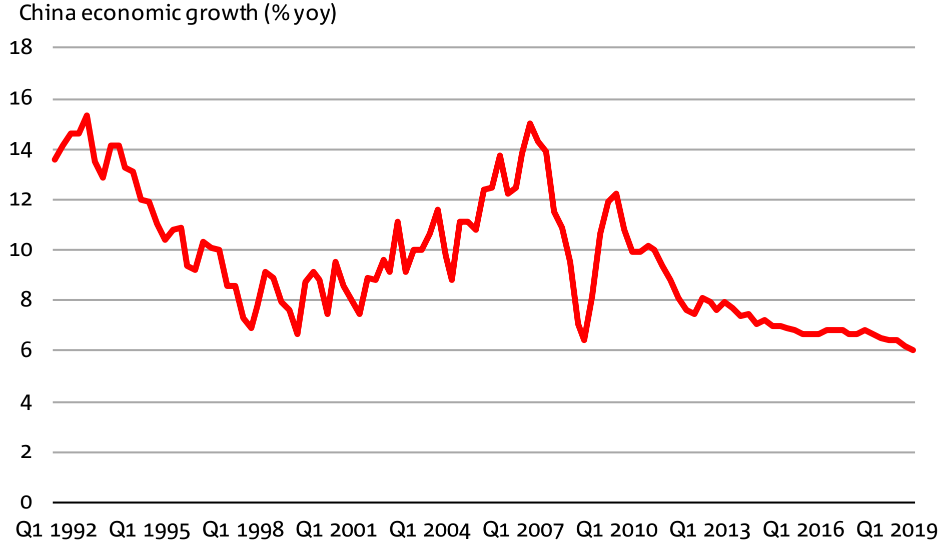
CHINA'S ECONOMIC GROWTH IS SLOWING

China's growth has fallen to multi-decade lows, as its industrial sector suffers from the impact of the trade war with the United States. Manufacturers will hope that reported progress on a partial trade deal is not a false dawn.

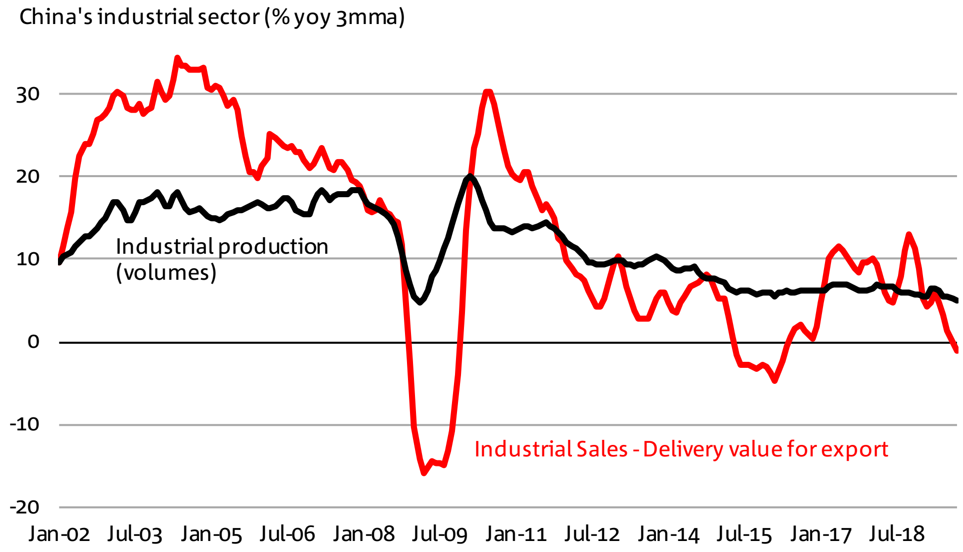
China became the world's largest economy (on a PPP basis) in 2014



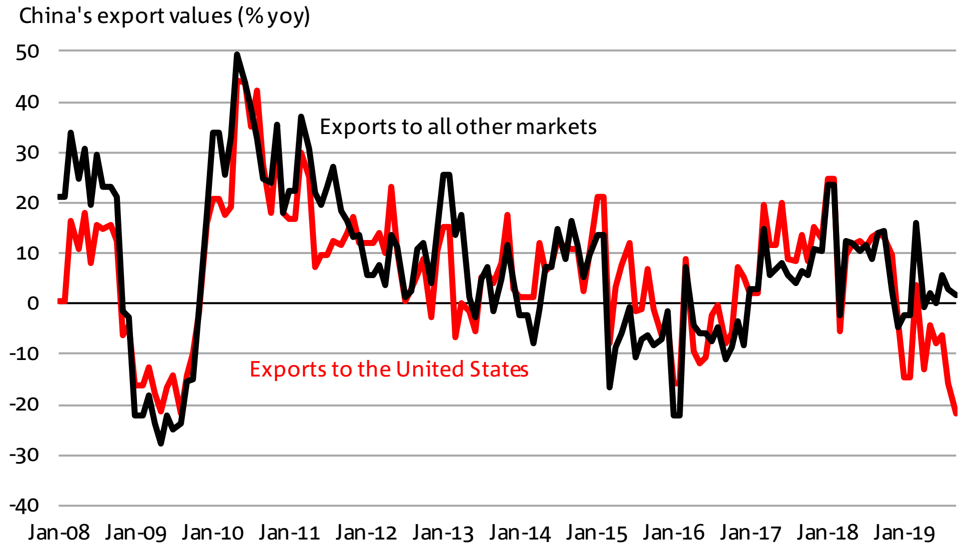
China's economic growth has continued to slow – down to 6% in Q3 2019, the slowest rate of growth since 1990



Weakness is evident in China's industrial sector, with export sales values plunging (likely due to discounting)



Impact of the US-China trade war is becoming clearer, with exports to the US plunging



Sources: IMF, Refinitiv, CEIC, NAB estimates

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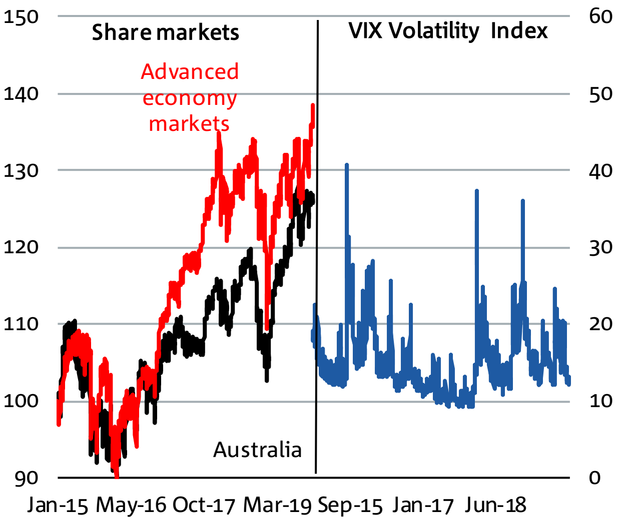
FINANCIAL AND COMMODITY MARKETS

Markets rally on trade hopes while expectations of monetary policy easing are scaled back

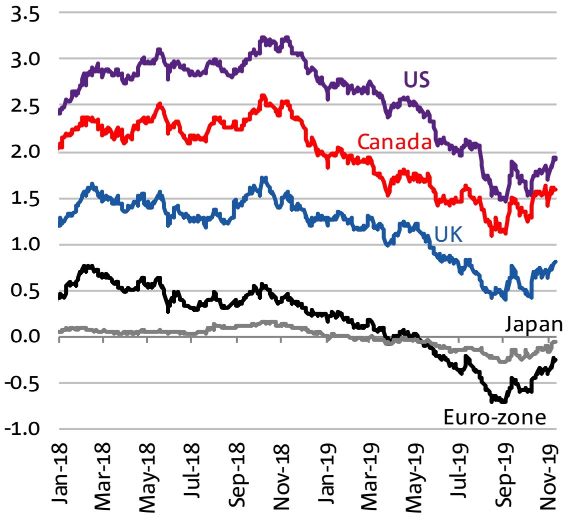
Shares rise on trade optimism as volatility eases

Share markets and volatility indices



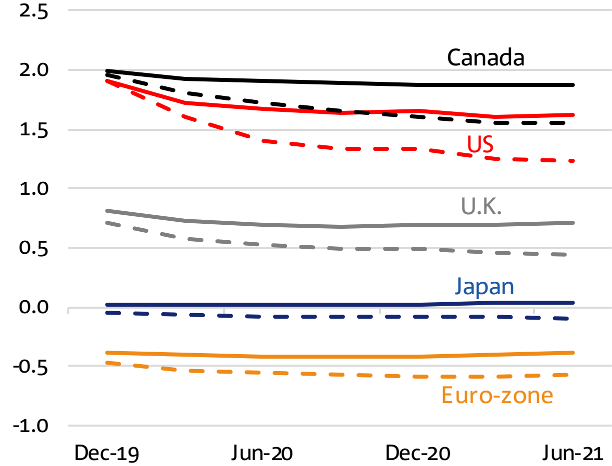
Bond yields up too, but still well below end-2018 levels

10yr government bond yields (%)



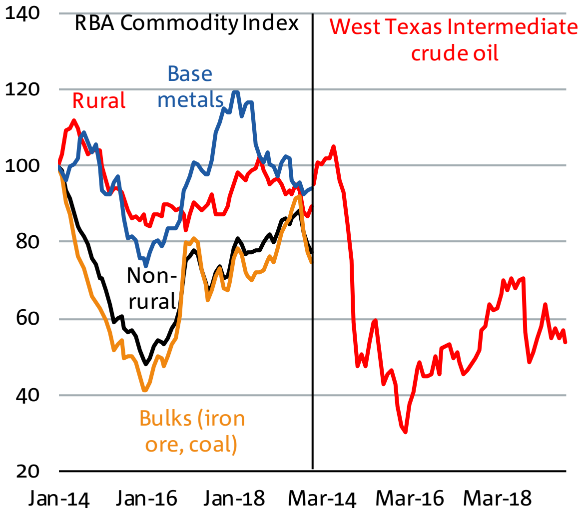
Policy easing expectations wound back – but hikes not in sight

3 month interest rate futures (%): as at 7 Nov '19 (solid line) and 7 Oct '19 (dashed line)



Commodity prices have been under pressure

Commodity price indices (Jan 2014 = 100)



- Elevated hopes of a US-China 'Phase One' trade agreement in the near future have helped to lift financial markets over the last month. Share markets have risen, as have bond yields, and market volatility has fallen back. The improved sentiment has been accompanied by a lowering of expectations for future major central bank policy easing.
- Our index of major advanced economy share markets has moved to a new high, driven by increases across the major share markets. Market volatility – as measured by the US VIX index – has also eased back to a modest level.
- Government bond yields have also increased, rising to their highest level in several months or more in early November, although they remain well down on their end-2018 highs. Highlighting the turnaround, the US government yield curve (3mth-10yr), helped along by a fed rate cut, is no longer inverted and French government 10 year debt no longer has a negative yield.
- Similarly, market expectations of future policy easing by the major central banks has shifted. That said, while rate cut expectations may have dampened, no one is expecting rate hikes in the foreseeable future. In other words, policy easing that has occurred (or may still occur) will be locked in for a while.
- At its end October meeting the US Federal Reserve cut rates, bringing the total reduction in the federal funds target range to 75bps since July. The Fed is signalling policy is likely to be on hold for now (in line with our expectation). However, while there is a possibility that the Fed may cut again if growth moderates further, the bar for the recent cuts to be reversed appears much higher. Similarly, both the ECB and Bank of Japan expect their policy rates to remain at 'present or lower levels'.
- Monetary policy has also been eased in emerging market economies (EMs) and this continued into October. This included further rate cuts by the central banks of South Korea, India and Russia. By historical standards, this EM easing cycle remains modest. Moreover, there is a risk that the likely pause in Fed easing may limit the capacity of some EMs to ease further.
- Commodity prices have declined in recent months. The RBA USD index of non-rural commodity prices fell 12% between July and October, driven by large falls in bulk commodity prices. Easing supply constraints (mainly in iron ore) and weaker Chinese demand is expected to see further price falls.

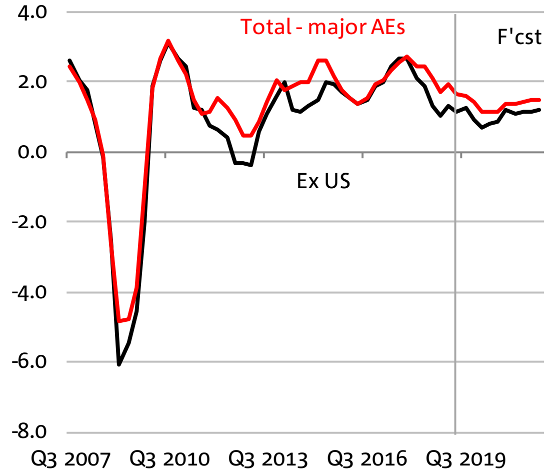
 Sources: Refinitiv, RBA, Bloomberg, NAB Economics

ADVANCED ECONOMIES

Major AE growth expected to slow further

Slowdown in AE growth set to continue

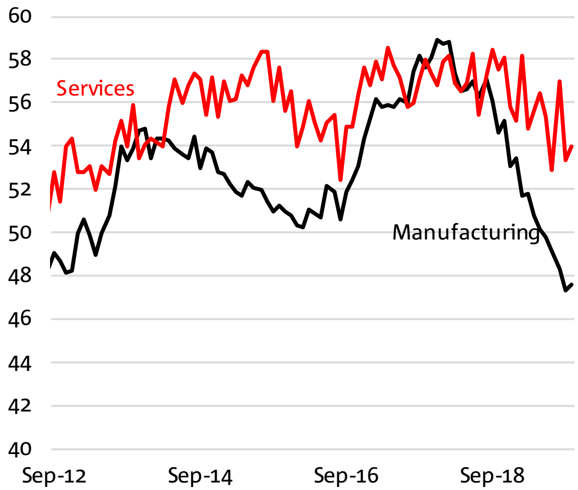
GDP growth - major AEs (yoy%)*



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

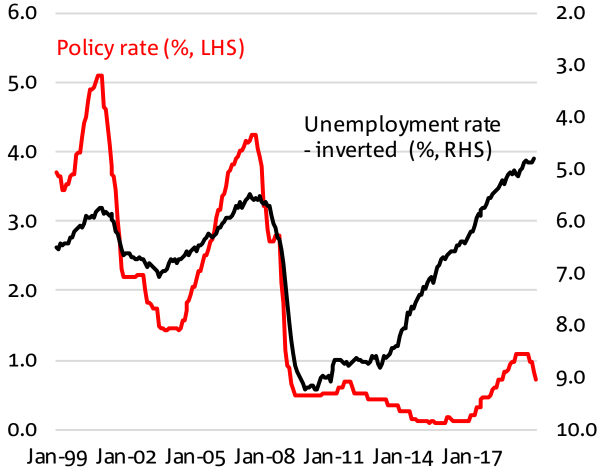
AE business surveys stabilised in October but still subdued overall

Major advanced economy PMIs (50=Breakeven)



Mon. policy easing modest, as is impact on labour mkts of slowdown

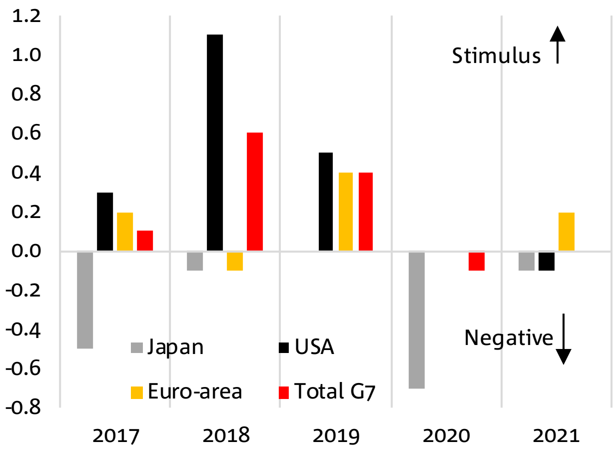
Major Advanced economy policy rate & unemployment*



*PPP GDP weighted for US, UK, Canada, Japan, Euro-zone

Fiscal stimulus of 2018/19 turning into a small headwind in 2020

Fiscal stimulus (% of GDP)*



* Negative of ppt change in IMF estimate of cyclically adjusted general government primary balance

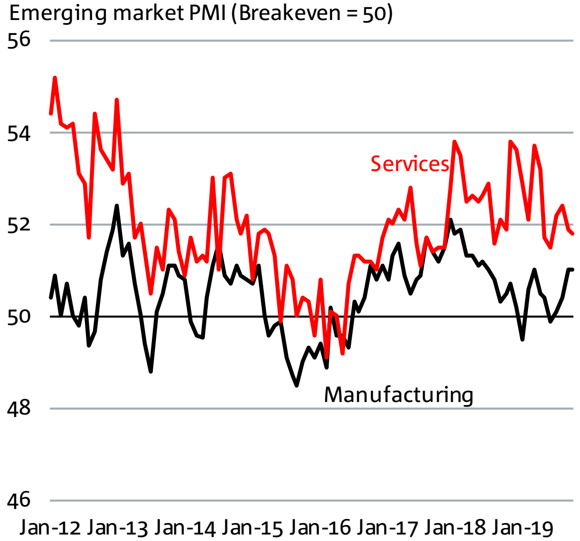
- Growth in the major advanced economies (AEs) appears to have been broadly steady in Q3. While initial estimates of GDP growth for Q3 have only been released for the US, Euro-zone and UK, together they make up over 80% of our major AE GDP growth aggregate. Given our Q3 forecasts for Canada and Japan, we expect Q3 major AE growth of 1.6% yoy, similar to the previous quarter.
- However, we don't expect that this represents the end to the slowdown that has been evident since late 2017. While the most recent business surveys show tentative signs of stabilising they are still consistent with subdued growth in the Eurozone, further slowing in the US and a turn for the worse in Japan.
- We don't expect major AE growth (on a yoy basis) to stabilise until mid-2020. This reflects modest support from monetary policy easing, ongoing – but potentially weaker – headwinds from trade and other geopolitical risks – and a small contractionary turn in AE fiscal policy.
- Events in coming months may alleviate the impact of the US-China and Brexit uncertainty. Tariffs scheduled to start on 15 October were suspended and there are hopes of a partial US-China trade deal, although whether it would involve rolling back existing tariffs is unclear. While this could boost confidence, unless any deal establishes a clear path forward, the uncertainty about future trading arrangements constraining business investment may persist. Similarly, the UK and EU agreement on the terms of the UK's withdrawal from the EU suggests a lower chance of a damaging 'no-deal' Brexit, but with an election underway the final outcome is unclear.
- Support for growth is coming from monetary policy easing; for the major AEs this has largely been limited to the US and, to a lesser extent the Euro-zone. However, yields have fallen across the board, supporting financial conditions. By past standards, the overall easing in policy has been modest due to a combination of limited policy room (ECB, Bank of Japan) and the fact that, while risks have been high, major AE labour markets have held up.
- On current settings, major AE fiscal policy is taking a contractionary turn. US fiscal policy is turning from a stimulatory stance to one that is more neutral, as is that of the Euro-Zone. More significantly, an increase in October in Japan's Value Added Tax represents a significant fiscal contraction and is likely to lead to negative Q4 GDP growth. That said, Japan's Prime Minister has announced a stimulus package – there are no details on the size but, if material, it would provide some upside to our forecast.

 Sources: Refinitiv, Markit, Bloomberg, ISM, NAB Economics

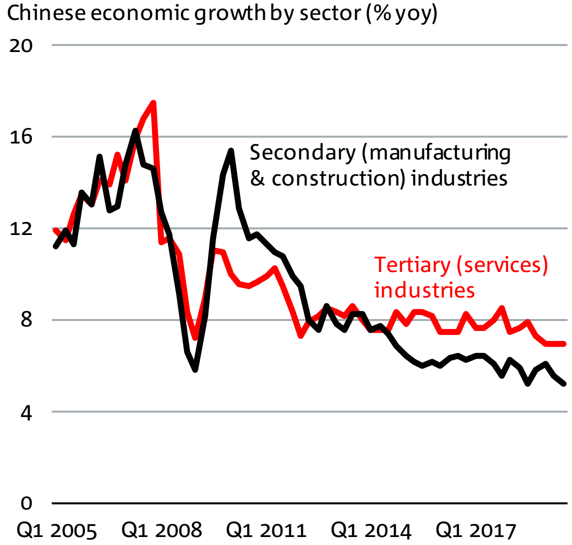
EMERGING MARKET ECONOMIES

Possible US-China trade deal would be a positive for trade impacted EM economies

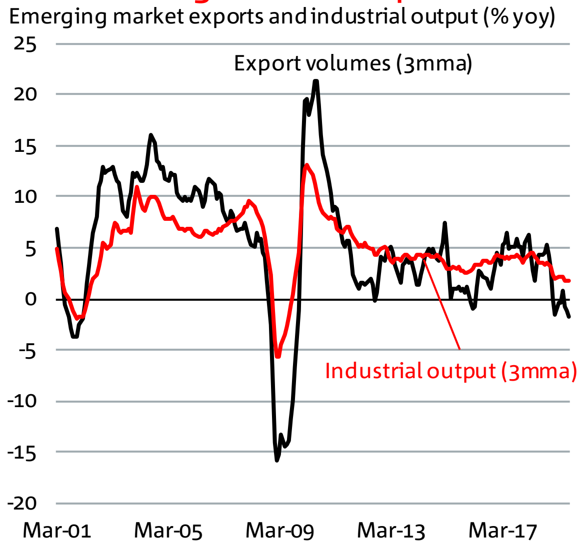
PMI surveys have stabilised recently, largely due to China...



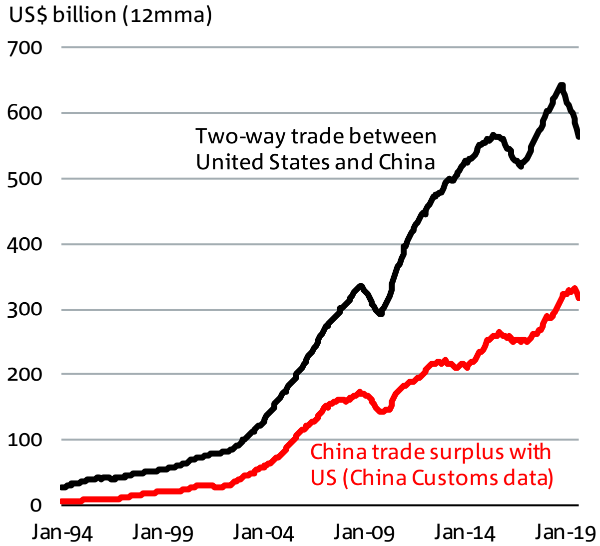
...despite manufacturing driving the slowdown in China's growth



EM trade activity going backwards, constraining industrial production



Trade between US & China has contracted; trade surplus still wide



Sources: Refinitiv, Markit, CEIC, NAB Economics

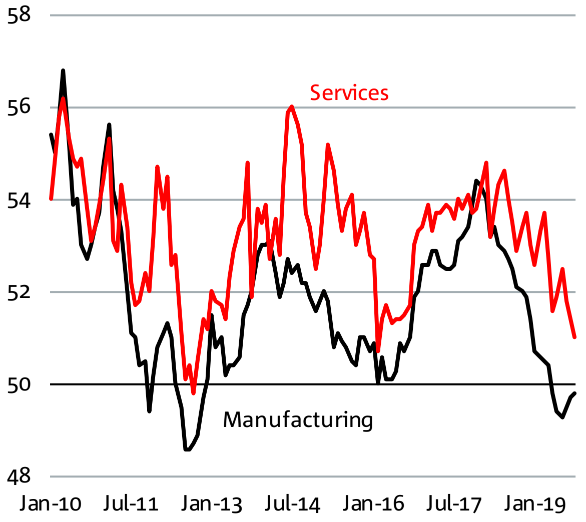
- Global business surveys provide the most up-to-date indicators of economic conditions. Emerging market PMI surveys have been relatively stable in recent months – with the manufacturing measure unchanged in October at 51.0 points, while the services reading was slightly softer at 51.8 points (from 51.9 points previously).
- A key contributor to the strength in the EM manufacturing reading has been China – where the private sector Caixin Markit PMI survey has strengthened in recent months (contrary to the drop in exports and slowing economic growth, as well as the official PMI survey produced by the National Bureau of Statistics). In contrast, manufacturing PMIs for India, Brazil and Indonesia deteriorated.
- China's economy grew by 6.0% yoy in Q3 2019 – the weakest rate of growth since 1990. The slowdown in growth was driven by China's secondary sector – manufacturing and construction – with conditions in the former significantly weaker as a result of the US-China trade war. Given the larger than expected slowdown in growth in Q3, we have revised our forecasts lower – to 6.1% in 2019 and 5.9% in 2020 (previously 6.25% and 6.0% respectively),
- Economic growth in emerging markets is far more trade dependent than advanced economies – with the region impacted both directly and indirectly from the US-China trade war and slowing global economic conditions. On a three month moving average basis, emerging market export volumes fell by 1.7% yoy in August, with East Asia excluding China the key driver of this trend. It is worth noting that US and Chinese tariffs increased in September, meaning data are unlikely to improve in coming months.
- Reports suggest that the US and China are close to agreeing to a partial trade deal – which may stabilise the relationship between the two countries. That said, there remains significant uncertainty around tariff measures going forward – with China seeking a roll back of some existing measures, while further tariffs are (at the time of writing) scheduled for implementation in mid-December.
- Weakness in global trade, combined with income effects in many emerging markets, has negatively impacted EM industrial production – which grew by 1.7% yoy (3mma) in August, compared with growth around 4% between early 2017 and mid-2018. Latin America and East Asia (excluding China) were the main contributors to this slowdown.

GLOBAL FORECASTS, POLICIES AND RISKS

Progress on trade/Brexit could present some upside to our near term sub-trend outlook

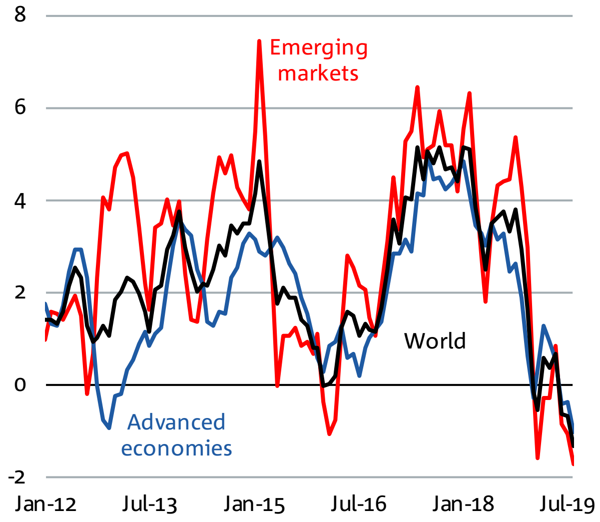
PMI surveys point to global slowdown since early-to-mid '18

JP Morgan Global PMI (Breakeven = 50)



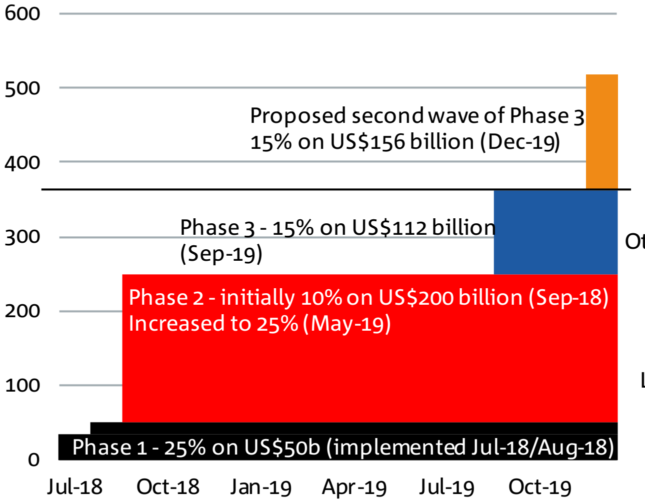
Global trade activity has continued to contract

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



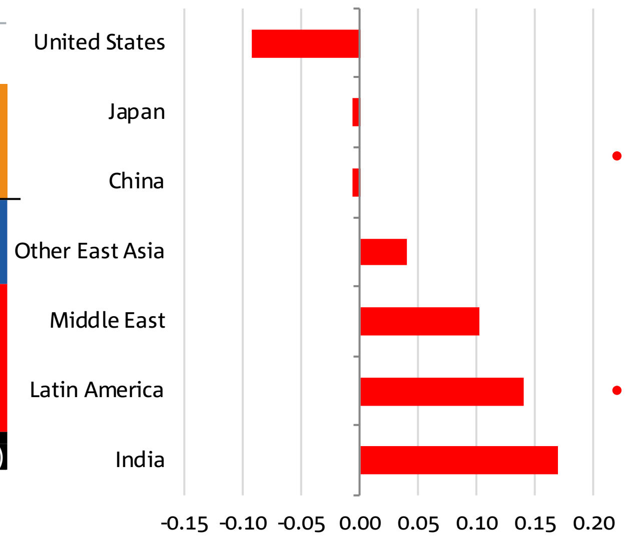
Current and scheduled US tariffs on Chinese exports

Value of Chinese exports to the US (US$ billion)



India and Latin America the key drivers of expected recovery in '21

Change in global growth contribution (%, 2021 vs 2019)



- Global PMI measures highlight the deterioration in economic conditions since early-to-mid 2018. The manufacturing measure remains in negative territory – albeit it edged closer to the breakeven level in October – largely driven by the surprising upturn in the Caixin Markit manufacturing PMI for China. Services PMIs have continued to weaken, reflecting the slowdown in global growth.
- Uncertainty has been a major constraint to business investment in recent quarters, reflecting the impact of factors such as the US-China trade war and the ongoing Brexit stalemate. Progress appears to have been made on both of these issues – albeit the 'Phase One' deal is yet to be signed for the former and the latter is subject to parliamentary approval post December's general election. While it is too early to suggest a full resolution of these constraints, markets appear much more optimistic than they have in the past year, with more upside risk to our forecasts than was previously the case.
- That said, there remains considerable uncertainty around the US-China trade relationship going forward. Chinese negotiators are seeking a roll back of some of the existing tariffs in place, but it is unclear if President Trump would accept such a concession. Given the ebb and flow of US-China trade tensions, another deterioration cannot be ruled out – as the US President said this week "If we don't make a deal, we're going to substantially raise those tariffs."
- Trade activity has continued to weaken – reflecting the direct impact of the US-China trade war, the spill-over effects on other economies (particularly in East Asia) as well as other factors impacting Europe. Global export volumes contracted by 1.3% yoy (on a three month moving average basis) in August – led by emerging markets.
- Our forecasts for global growth are unchanged this month, however there has been some shift in the underlying forecasts for key regions. Our upward revision to US economic growth – to 2.3% (from 2.2%) in 2019 and 1.7% (from 1.6%) in 2020 offset our downward revision to China's growth – to 6.1% (from 6.25%) in 2019 and 5.9% (from 6.0%) in 2020. Our outlook for East Asia was also trimmed, reflecting weaker conditions across the region – largely driven by trade.
- This means that we expect the global economy to expand by a sub-trend 3.1% and 3.2% in 2019 and 2020 respectively, before returning to the long term trend of 3.5% in 2021. Recoveries in Indian and Latin American growth are the key contributors to the pickup in growth, although there remains some uncertainty around the growth prospects for these economies.

Sources: Refinitiv, Markit, PIIE, NAB Economics

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