



THE FORWARD VIEW – GLOBAL

FEBRUARY 2020

Coronavirus to deliver a shock to global growth

- The Coronavirus outbreak that emerged in January – centred on China, the world’s largest economy – is likely to lead a major shift down in global growth, at least in Q1. The result in Q1 is expected to be the weakest rate of growth (in year-on-year terms) since the Global Financial Crisis, and the Chinese economy is expected to show no quarter-on-quarter growth (compared with an increase of 1.5% qoq in Q4).
- Reflecting the impact of Coronavirus counter-measures on economic activity, we have revised down our forecasts for global growth in 2020, particularly in China and the rest of East Asia. For the full year, we forecast growth of 3.0% (3.2% previously) – the same rate of increase as 2019, and well below the long term trend (3.5%). This outlook is predicated on a relatively short (single quarter) disruption in activity due to the Coronavirus, followed by a recovery in Q2; a ‘best-case’ scenario. For 2021, we expect a recovery in global growth, although this is heavily dependent on no further shocks (including no renewal of the US-China trade war).
- However, it is highly uncertain how long the virus will continue to spread and the containment measures remain in place. Should it prove to be a prolonged period, this would add significant additional downside risk to our forecasts.
- The Coronavirus struck when the global economy, while still fragile, was in slightly better shape with underlying momentum stronger than for much of 2019. Business surveys suggest that, prior to the virus emerging, global activity had started to turn the corner in late 2019 and into January 2020. Importantly, these improved indicators also applied to India which had been seriously underperforming. Moreover, there has been some alleviation in trade policy headwinds with the US-China Phase One trade deal and USMCA ratification almost complete.

Global Growth Forecasts (% change)

	2018	2019	2020	2021
US	2.9	2.3	1.8	1.9
Euro-zone	1.9	1.2	1.0	1.4
Japan	0.3	1.1	0.4	1.0
UK	1.3	1.4	1.0	1.4
Canada	1.9	1.6	1.4	1.7
China	6.6	6.1	5.5	5.8
India	7.4	5.1	6.2	7.1
Latin America	1.1	0.3	1.3	2.1
Other East Asia	4.1	3.4	3.3	3.7
Australia	2.7	1.8	1.5	2.6
NZ	3.2	2.2	1.7	2.3
Global	3.6	3.0	3.0	3.5

NAB global leading indicator

Actual global growth and leading indicator (% yoy)



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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 (0)477 746 237

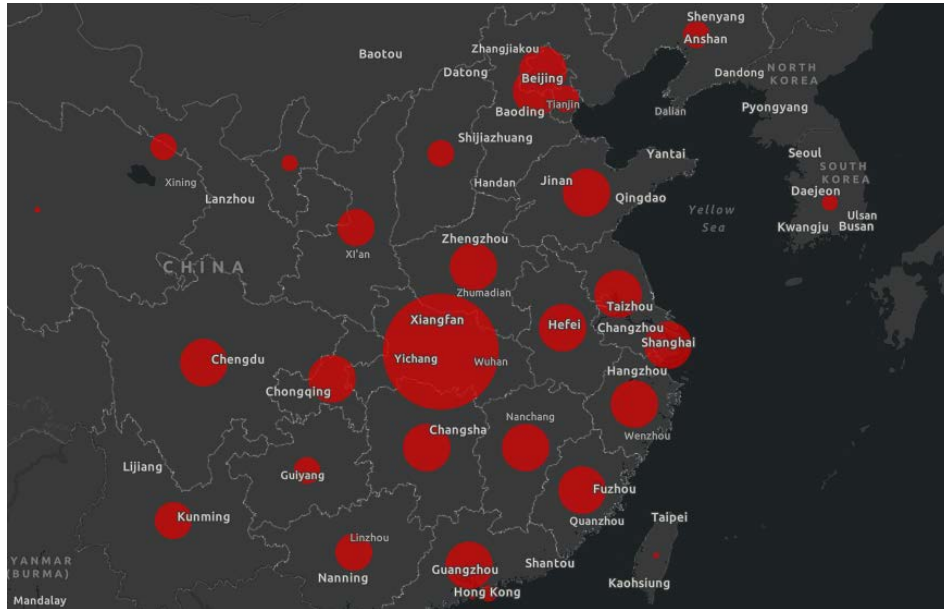
AUTHORS

Gerard Burg & Tony Kelly

CORONAVIRUS – IMPACT ON CHINA & ASIAN FORECASTS

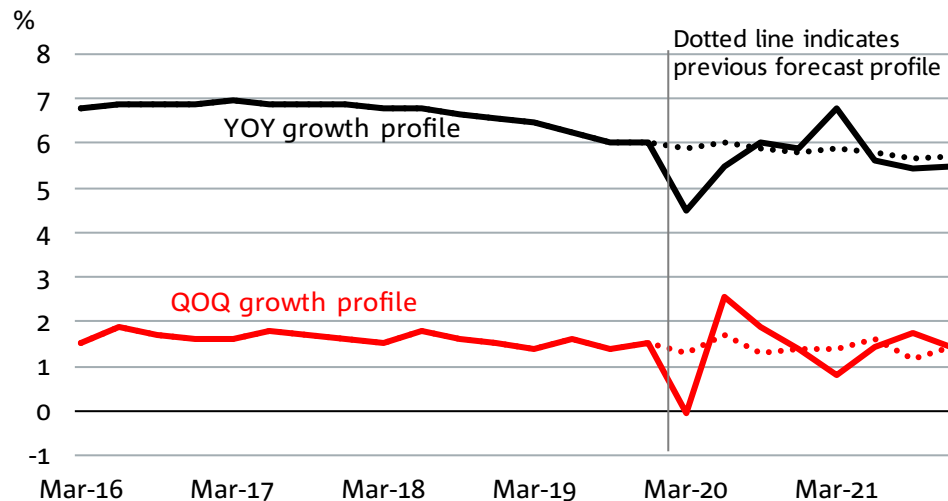
Virus outbreak to slow growth across Asia, with scale and duration uncertain

Coronavirus has spread across China, but centralised in Hubei



- For the past month, global attention has been focussed on the Covid-2019 or Coronavirus outbreak in China. The outbreak has been centred on the city of Wuhan in Hubei province in the country's centre. At the time of writing, Hubei accounts for almost three-quarters of confirmed cases, however as Wuhan is a major transport hub, the disease has spread across the country.
- The outbreak is likely to have a significant impact on both the Chinese and global economies in 2020. The vast majority of this impact is due to the reduction in activity (industrial production, transport and tourism, retail and other personal services) to lower the risk of transmission.
- It is too early to quantify the impact of the outbreak with any degree of confidence. Instead we assume a short term downturn and rebound in activity in subsequent quarters, similar to the profile exhibited with the SARS outbreak in 2003.
- As a result, our forecast assumes a sharp slowdown in Q1 – with no quarter-on-quarter Chinese growth (compared with an increase of 1.5% in Q4). This is equivalent to a 4.5% yoy increase for the quarter, the slowest rate of growth since 1990.
- The duration of the outbreak – and the timing of the likely rebound in activity when the outbreak passes – are inherently uncertain. Much will depend on whether economic activity is lost or merely deferred to later quarters. At this stage we assume a recovery in Q2, however there remains the risk of a larger and more prolonged downturn. China is forecast to grow by 5.5% in 2020 (down from 6.1% in 2019). At this stage, our forecast for 2021 is unchanged at 5.8% – a modest recovery from this year, but still in line with a longer term trend slowdown in growth.
- The Coronavirus is having flow on effects to neighbouring countries in East Asia – a region already impacted by spill over from the US-China trade war. Chinese factory closures could impact demand for commodities and semi-manufactured inputs from other economies, as well as industrial production in countries such as Taiwan, South Korea and Japan. For example, automaker Hyundai has shut factories in South Korea due to the unavailability of components.
- China is also a major source of tourists across much of South East Asian economies – with Vietnam and Thailand notable markets in this regard – and these countries will be impacted by reduced tourist arrivals in the near term.

Revision to Chinese growth profiles



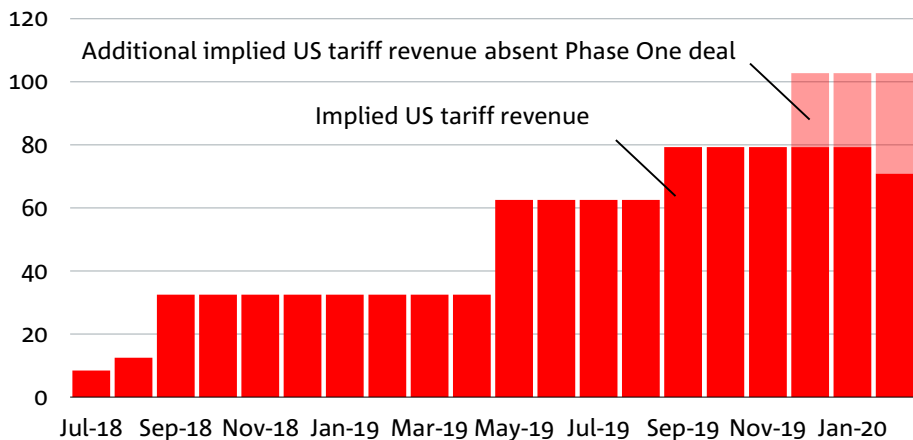
Source: CEIC, NAB Economics

US-CHINA PHASE ONE TRADE AGREEMENT

Deal a welcome respite but trade risks have not gone away - risk of trade diversion

Deal left most tariffs imposed during dispute in place

Value of Chinese exports X tariff rate (\$bn)*



Source: NAB Economics. * Based on estimated import values at the time tariffs announced. Assumes deal formally signed in January, with 15% tariff on \$110b reduced to 7.5% in Feb.

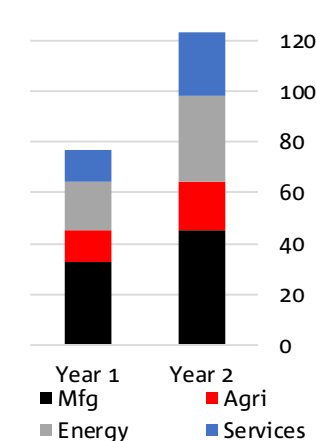
China to substantially increase imports from US...risk China reduces imports from other countries

US exports to China (\$b) - Phase One deal



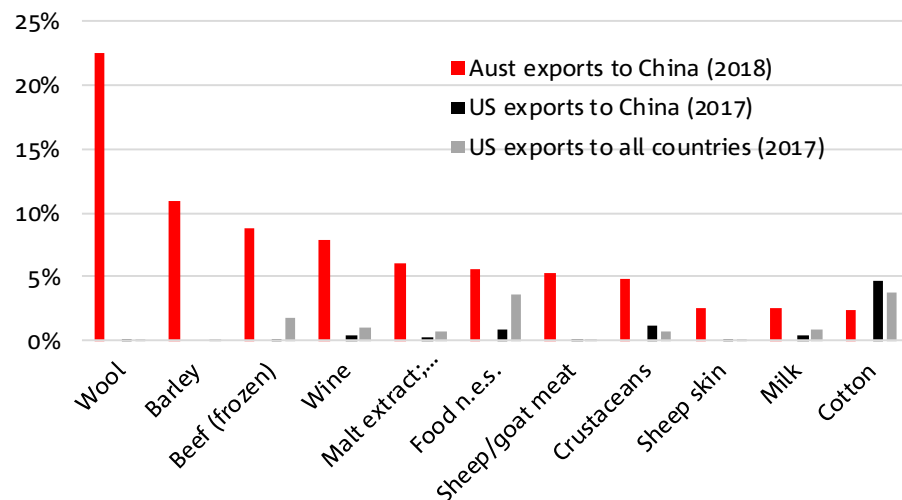
* Based on data for first three quarters of 2019.
**2017 level plus \$76.7b in '20 & \$123.3b in '21

Extra exports by category (\$b above 2017 level)

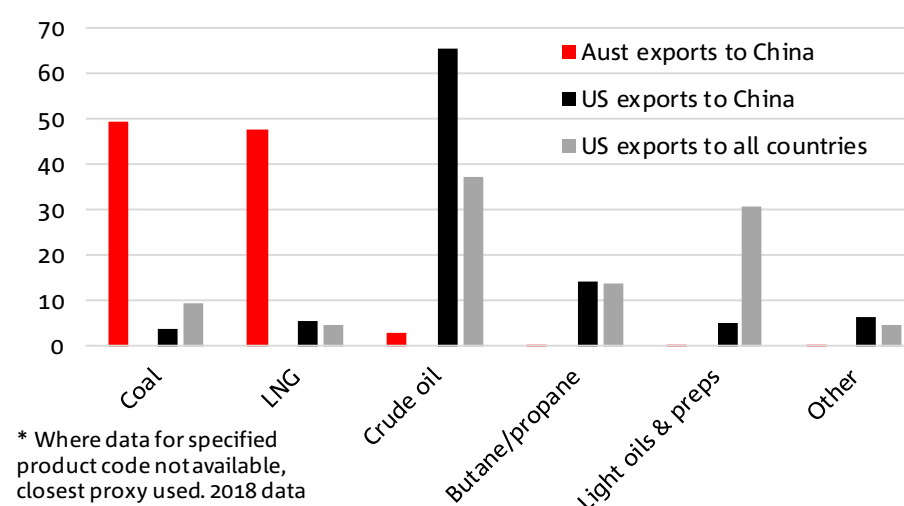


Energy & agri most obvious Australian exports at risk from trade diverting to the US – but there is little overlap (for now) between major Aust. & US export segments

Export shares (% of total exports of agri codes specified in Phase One Deal)



Export shares (% of total exports of energy codes specified in Phase 1 Deal*)

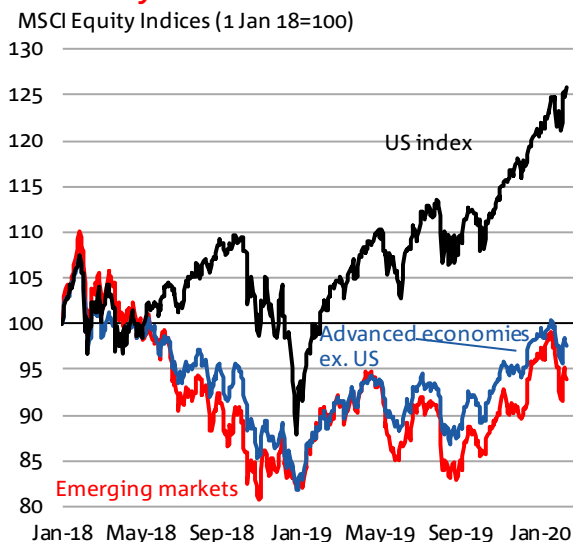


* Where data for specified product code not available, closest proxy used. 2018 data

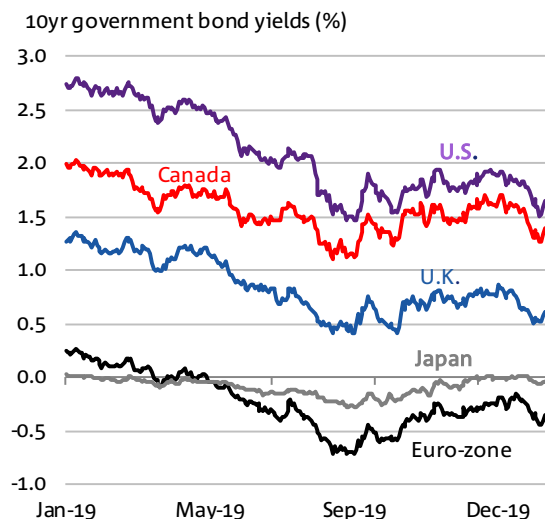
FINANCIAL AND COMMODITY MARKETS

Coronavirus fears driving markets – after initial falls, some stabilisation

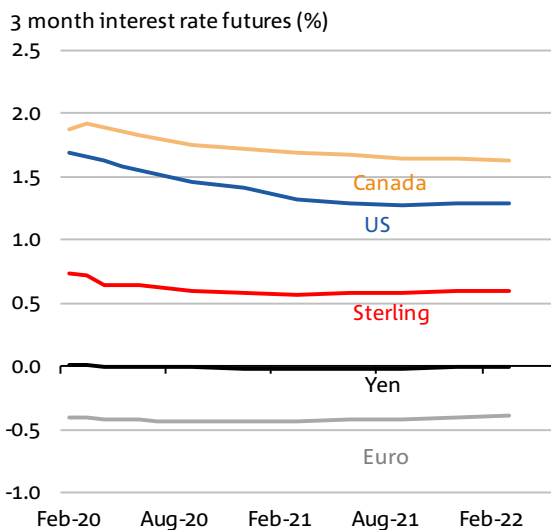
Virus fears hit stocks, but partial recovery



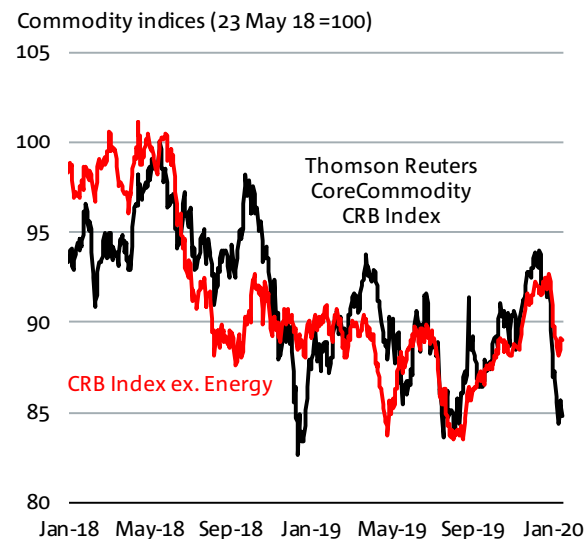
Virus fears also see a fall in yields



Major AE central banks – expected to be on hold or cut rates



Commodity prices down sharply as China is a major market

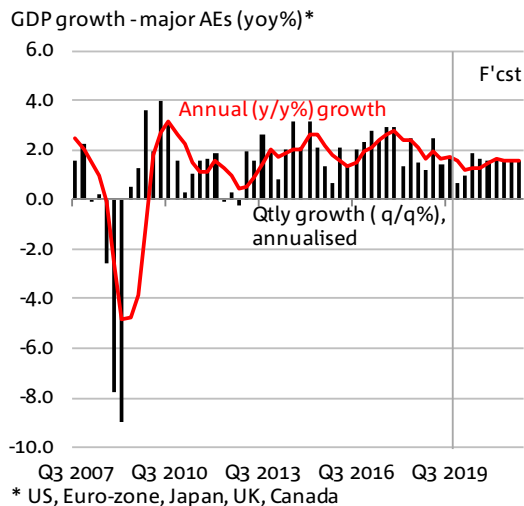


- The coronavirus outbreak, and the impact of the containment efforts, jolted financial markets, more than outweighing any gains from a lessening of trade headwinds following the signing of the US-China Phase One deal and passage of the USMCA trade agreement through the US Congress. However, since early February markets have either stabilised or recovered to some degree. This is important as a deterioration in global financial conditions is one way the virus can (indirectly) affect the global economy.
- Global stock markets recorded large falls, but by varying degrees. The US S&P 500 fell as much as 3% from its mid-January peak and there were greater falls in other markets. Notably the Shanghai stock market fell by over 10%, and the overall MSCI EM index was down around 7.5% at one stage. Since early February US stocks have recovered their losses but in other markets there has been only a partial recovery. The VIX stock market volatility indicator also rose but not to a particularly alarming level before moderating.
- Bond yields also declined, reflecting the diminished prospects for growth along with the resulting prospect that central banks may have to move to support their economies.
- Major AE central banks are likely to 'look through' the virus impact initially; but if virus containment efforts are prolonged, the resulting economic damage (and risk of a downward spiral) would likely prompt a re-think, at least for the AEs with more policy room. Market pricing incorporates rate cuts in the US, Canada and, to a lesser extent the UK, but does not see a major shift in ECB or Bank of Japan settings. While our central projection for Fed policy has been for the Fed to remain on hold, even before the Coronavirus outbreak, risks were skewed towards further easing – due to persistent below target inflation and the likely move to average inflation targeting following completion of the Fed's monetary policy review (expected mid-year).
- In contrast, EM central bank policy continues to be eased – already in February China, Brazil, Russia, Thailand and the Philippines have eased monetary policy settings.
- Commodity prices fell sharply as the immediate demand outlook soured because of the expected impact of the Coronavirus on global activity. The Thomson Reuters Core Commodity CRB index declined by as much as 8% from its mid-January level, while the fall in the energy component was even larger.

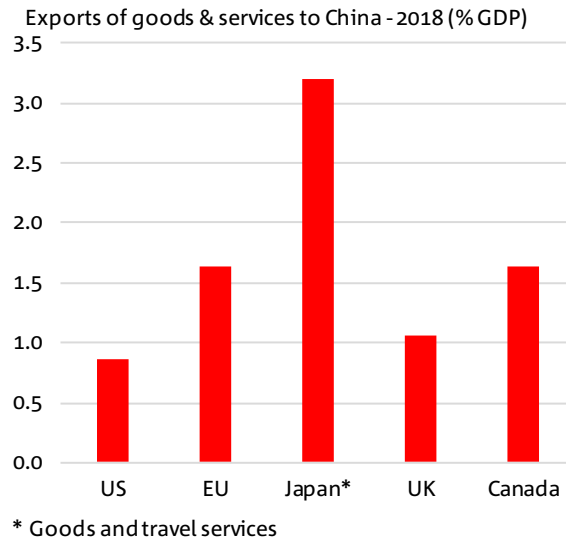
ADVANCED ECONOMIES

Sluggish end to 2019 likely to continue into early 2020; Coronavirus a risk

Nearing the trough of major AE growth...Coronavirus a risk

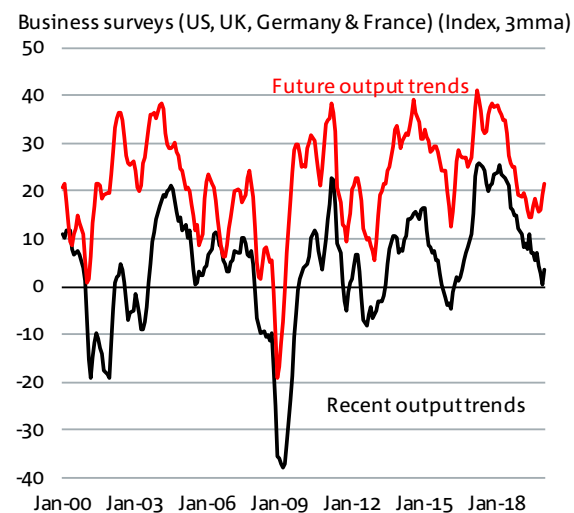
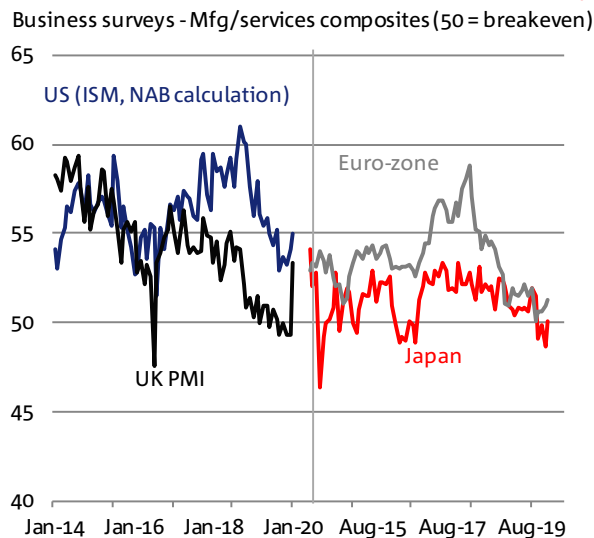


Of the major AEs, Japan most exposed to a China downturn



- Overall major advanced economy (AE) growth was likely very subdued in Q4 2019, and another sluggish quarter of growth is expected in Q1 2020. Business surveys, which stabilised towards the end of 2019, strengthened in January and point to an underlying improvement in AE economies. However, the fall-out from Coronavirus containment efforts, and other one-off factors, is likely to delay a substantive improvement in AE growth until mid-2020.
- Q4 GDP data are available for the US, Euro-zone and UK. US growth was slightly higher than expected and the economy continues to grow at a solid, above trend rate. That said, Q1 growth is likely to be held back by the halt in Boeing 737 MAX aircraft production. In contrast, Euro-zone growth was weaker than expected, and at 0.1% q/q was the weakest growth since early 2013. Similarly, the UK economy stagnated in Q4. For Japan, negative GDP growth is expected in Q4 due to the impact of the October VAT increase.
- Japan is also the most exposed of the major AEs to the fall-out from the Coronavirus. This is not only because its direct trade exposure to China is higher, but through its linkages to the rest of the Asia region, which will also see growth come under pressure (see page 2). At this stage, we have made smaller changes to the forecasts for other AEs because of the Coronavirus (marking down Q1 somewhat with some subsequent rebound). Trade exposures are relatively small (and the net trade impact even smaller as imports will also moderate) but clearly it represents a downside risk. Apart from a reduction in external demand, factory closures in China and elsewhere could become a significant issue if maintained for any length of time – as existing inventories of parts are depleted, production may be curbed or halted in affected businesses. Anecdotal reports suggest that this will be a near-term problem for some firms.
- Towards the end of last year business survey readings for the major AEs showed signs of stabilising. This improvement continued into January – notably the Japan composite PMI moved back above breakeven for the first time since the VAT was increased and there was a large bounce in the UK following the December election (and associated clearer path for Brexit). The Euro-zone also recorded its strongest reading since August. While some fall back is likely in coming months due to Coronavirus related disruptions, the surveys indicate that AE growth was starting to turn as trade risks receded.

Surveys stabilised late 2019 & improved into early 2020 with future expectations also up...but too early to see any Coronavirus impacts

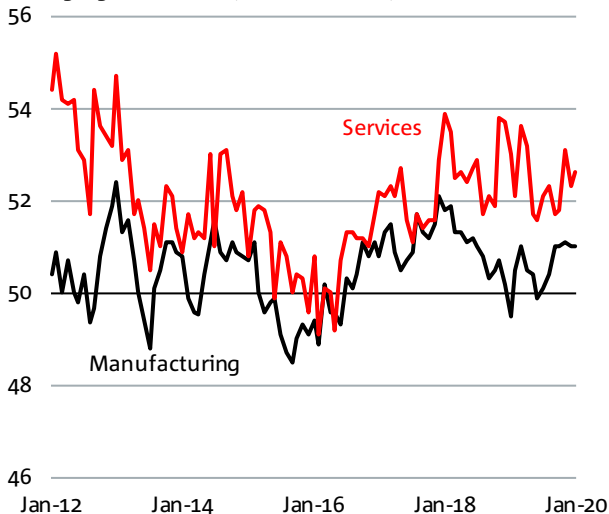


EMERGING MARKET ECONOMIES

EMs stabilised prior to virus outbreak, but a major downturn is likely in the short term

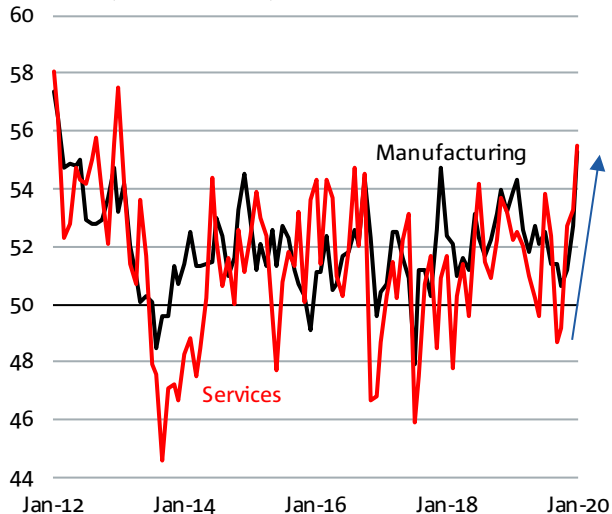
EM PMI surveys point to pre-virus stabilisation...

Emerging market PMI (Breakeven = 50)



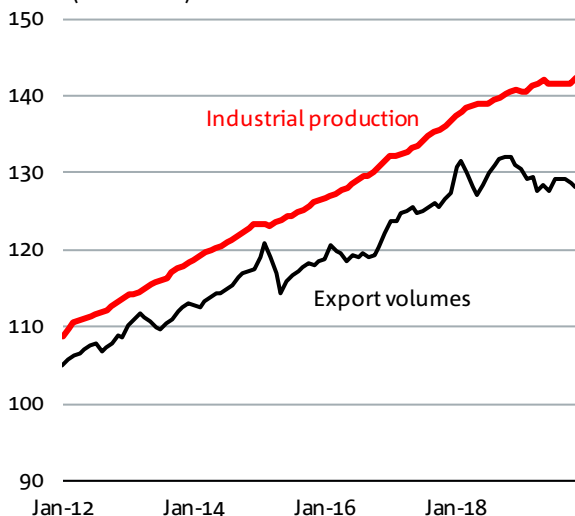
...with India the standout performer last month

India PMI (Breakeven = 50)



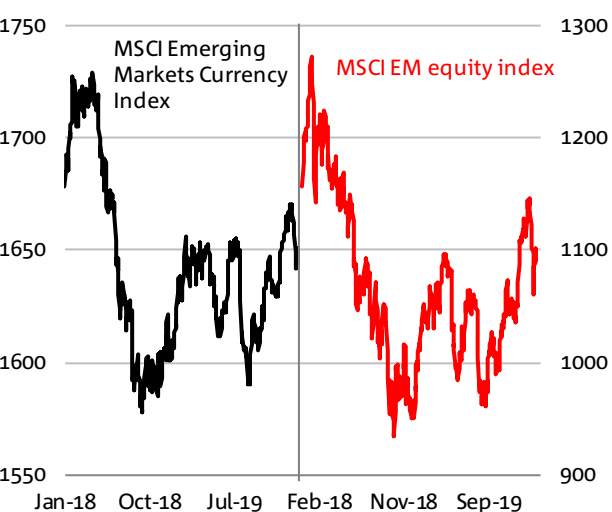
EM trade and industrial production largely flat since mid-2019

Index (2010 = 100)



EM currencies and equities weaker following virus outbreak

Index

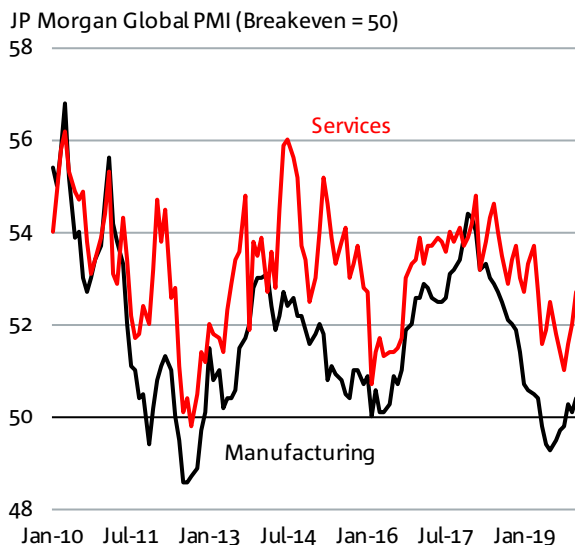


- Economic conditions in emerging markets appeared to stabilise in the latter months of 2019, as trade tensions between the United States and China eased as a result of the Phase One trade deal. That said, the Coronavirus outbreak in China is likely to have a negative impact on emerging markets – primarily in China and East Asia, with spill over via trade and travel links with other regions. At this stage, the scale and duration of the downturn is uncertain; our updated forecasts this month assume a recovery commencing in Q2.
- PMI surveys provide some of the most up-to-date indicators of activity – however the most recent surveys were completed prior to the introduction of quarantine measures that escalated Coronavirus fears. January surveys largely confirm the theme of stabilisation prior to the outbreak – with manufacturing remaining at levels seen since September 2019, while services were near the middle of the range recorded since early 2018.
- A key driver of the relative strength in the January PMI readings was India – with the services PMI at a seven year high, while the manufacturing reading was its highest in almost eight years. The surveys point to stronger domestic demand – particularly for services – and better employment indicators, in line with improved unofficial unemployment data. India’s Finance Ministry has also confirmed that it will loosen fiscal policy in FY 2020/21, which will provide additional support for the economy. A recovery in Indian economic growth in 2020 is critical to underpinning stable global growth this year.
- The US-China trade war resulted in reduced trade activity between the two countries, with spill over effects East Asian trade. In November 2019, export volumes from emerging markets fell by around 3.0% yoy (on a three month moving average basis). That said, it is worth noting that export volumes slowed considerably between late 2018 and mid-2019, but subsequently stabilised. However, trade activity is likely to decline in the short term as a result of the Coronavirus.
- Markets have reacted negatively to the Coronavirus outbreak – with both the MSCI EM currency index and equity index declining sharply from mid-January (albeit at the time of writing, EM equity markets have partially recovered from early February lows).

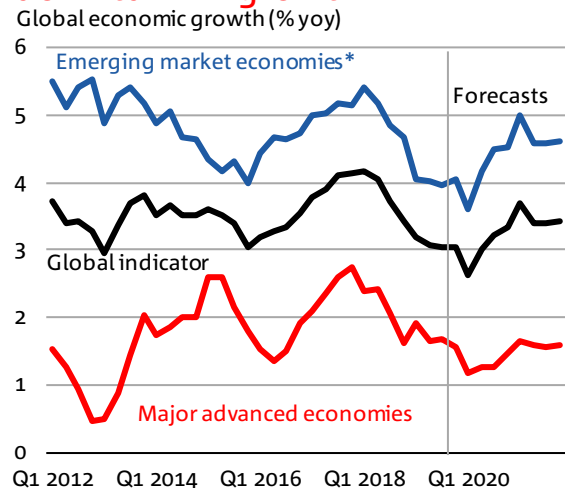
GLOBAL FORECASTS, POLICIES AND RISKS

Coronavirus containment to drive down growth in Q1, particularly in EMs

Global PMI trends encouraging prior to virus outbreak



Outlook assumes short term downturn in growth

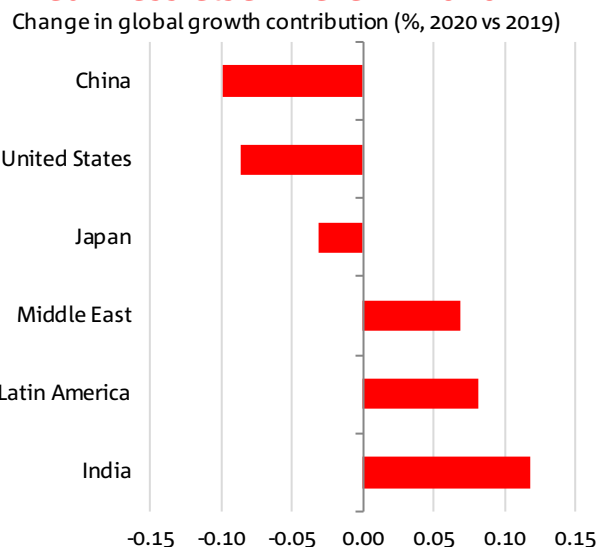


* Based on China, India, major Latin America & East Asia countries, Russia

Trade war hit global trade and industry; virus will hit it again



India the key economy to offset weakness elsewhere in 2020



- Compared with the trade war related weakness in global PMI measures in mid 2018, there was a notable improvement in these surveys in early 2020. Although survey measures of trade have not yet improved – with the Phase One deal between the US and China only signed in mid-January (see page 2), and large scale tariffs remaining in place – new order measures were much improved, along with employment and business sentiment. It is likely that the Coronavirus will have a significantly negative impact on PMI readings starting in February.
- Efforts to contain the Coronavirus will likely restrict global trade and manufacturing activity in the short term, along with personal services in affected regions, and tourism & travel services worldwide (particularly in markets when Chinese tourists comprise the largest share of visitors). According to data from the CPB, global exports contracted by 1.5% yoy (on a three month moving average basis) in November 2019, while industrial output was unchanged (compared with average growth above 3% yoy in 2018).
- Reflecting the impact of Coronavirus counter-measures on economic activity – primarily in China and, to a lesser extent, in East Asia, we have revised down our forecasts for global growth in 2020. For the full year, we forecast growth of 3.0% – the same rate of increase as 2019, and below the long term trend (3.5%).
- This outlook is predicated on a relatively short (single quarter) disruption in activity due to the Coronavirus, followed by a recovery in Q2. The result in Q1 is expected to be the weakest rate of growth (in year-on-year terms) since the Global Financial Crisis. Should the impact of the virus be prolonged, this would add additional downside risk to our forecasts.
- Even before the Coronavirus, most major economies and regions were expected to record weaker growth in 2020 – most notably the US, Japan and China. The unchanged rate of global growth from 2019 to 2020 is dependent on a recovery in India (the world's third largest economy), Latin America and the Middle East.
- India's economy is forecast to grow by 6.2% in 2020 – up from an expected ten year low of 5.1% in 2019. The Reserve Bank of India cut its policy rate by 135 basis points in 2019, which should provide support for an investment-led recovery in growth – albeit below the country's trend rate of growth for the past decade.

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

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