EMBARGOED UNTIL: 11.30AM THURSDAY 12 MARCH 2020

THE FORWARD VIEW – GLOBAL

MARCH 2020

National Australia Bank

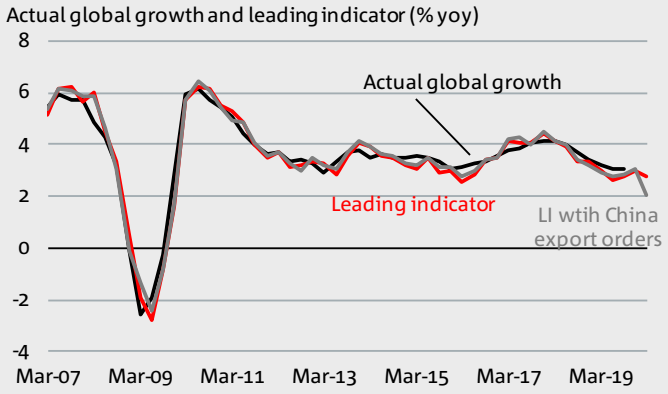
World growth to be hit hard in H1 2020 – at least – due to Coronavirus

- We have significantly lowered our global growth forecasts, mainly due to the slower than expected recovery in activity in China and the increasing spread of the Coronavirus to other countries, along with growing containment measures. We now expect global growth to be only 2.4% in 2020, revised down from 3.0% last month (and 3.2% pre-virus).
- Financial markets have gone into a tailspin with large falls in equities, bond yields and commodity prices. Central banks have, or are likely to, ease policy including through rate cuts, asset purchases and other measures to assure liquidity and credit availability. We now expect the US Fed to cut its policy rate by a further 75bp this month (and 25 bps in April).
- Growth is only likely to show recovery when panic around the spread of the Coronavirus starts to ease and containment measures (by government or self-imposed by households/businesses) start to recede. For now we are assuming that this will occur during Q2 but there is a high degree of uncertainty and it will vary by country (this is already occurring in China to some extent but for other countries further containment measures are likely to be announced). The economic impact of existing containment measures is also highly uncertain but is potentially significant. We now expect a large fall in China GDP in Q1, recessions in the Euro-zone and Japan and much lower growth elsewhere in H1, with risks skewed to the downside.
- Fiscal policy is also starting to step up – with several countries already announcing support packages. So far these measures have mainly been targeted at addressing the direct impacts of the virus (health funding, keeping affected households/businesses afloat), however they may well broaden, as flagged by the US's consideration of a payroll tax cut. While monetary/fiscal policy cannot address the underlying problem, it can reduce the risk (but not remove it) of an even deeper downturn (e.g. triggered by corporate failures, job lay-offs or capital flight from vulnerable EM countries).

Global Growth Forecasts (% change)

	2018	2019	2020	2021
US	2.9	2.3	1.5	2.1
Euro-zone	1.9	1.2	-0.1	1.8
Japan	0.3	0.8	-0.7	1.2
UK	1.3	1.4	0.7	1.6
Canada	2.0	1.6	0.9	1.8
China	6.6	6.1	4.8	6.1
India	6.8	5.3	5.5	6.3
Latin America	1.1	0.1	1.0	2.2
Other East Asia	4.2	3.4	2.9	4.0
Australia	2.7	1.8	1.2	2.8
NZ	3.2	2.2	0.9	2.7
Global	**3.6**	**3.0**	**2.4**	**3.6**

NAB global leading indicator



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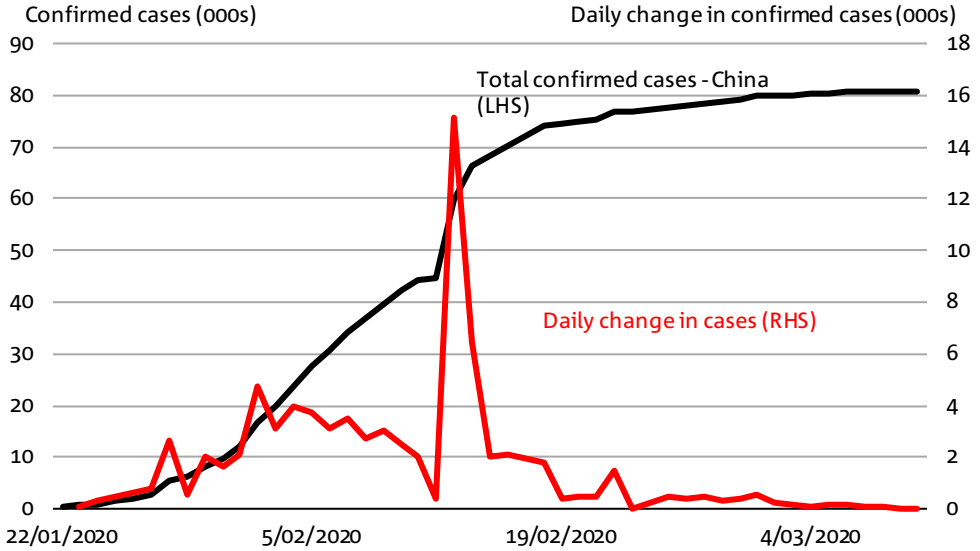
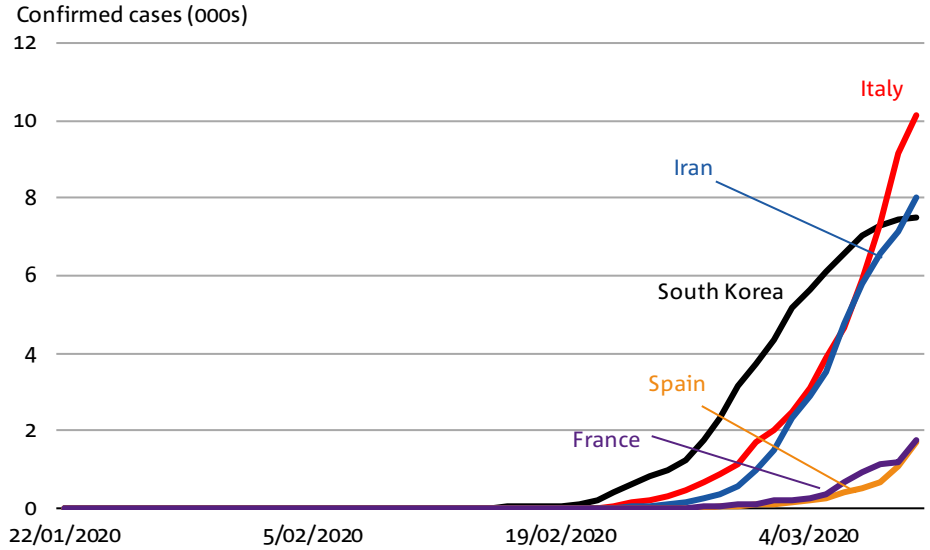
CORONAVIRUS SPREAD BEYOND CHINA

Global containment efforts placing downward pressure on growth as governments scramble to respond

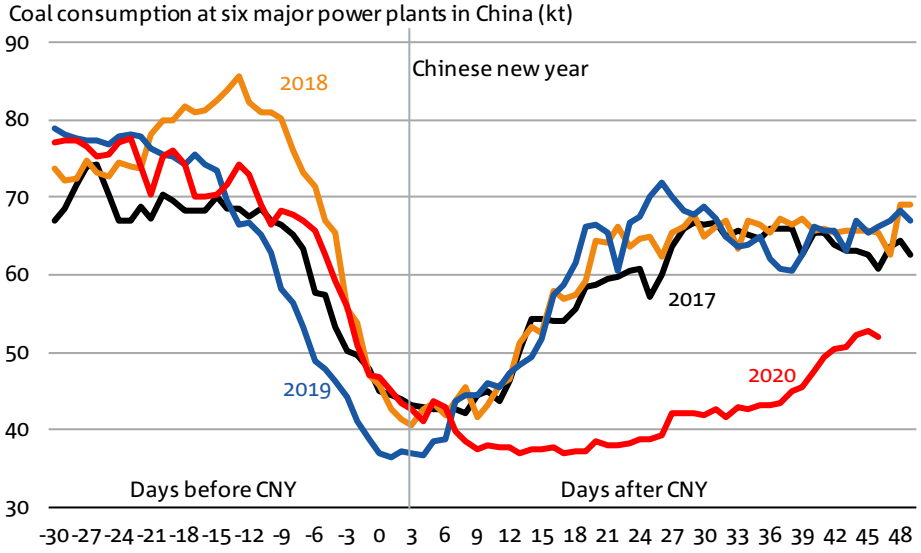
China accounts for the bulk of confirmed cases, however containment has brought spread under control...



...as signs emerge that China is slowly getting back to business (if still a long way to go)



Rapid growth in confirmed Coronavirus cases outside China pose substantial risks to economic activity



Policy response ramping up, including fiscal policy – largely a targeted response but could broaden out

Examples of fiscal response include:

- China: local government investment plans have been increased, temporary waivers of social security contributions, delay in tax payments, support measures for auto sector
- US: $8b package (< 0.1% of GDP) directed at medical preparedness but administration considering other measures including a payroll tax cut
- South Korea: 11.7 trillion Won (0.6% of GDP) including health/ quarantine funding, support for businesses/exporters, child care,
- Germany: work subsidy, higher govt investment, liquidity support, tax holidays (<0.1% of GDP)
- Italy: tax credits for affected companies, tax cuts, health funding (3.6b Euro or 0.2% of GDP) with reports of an additional 10b to 16b Euro package soon
- Hong Kong: tax reductions, rates waivers, social security allowances, cash disbursements to residents (equal to over 4% of GDP)
- UK Budget: scrapping business rates, deferring tax payments, health system funding, easier access to sick pay, infrastructure spending (1.6% of GDP)

 Sources: John Hopkins University, CarbonBrief, Capital Economics, NAB Economics

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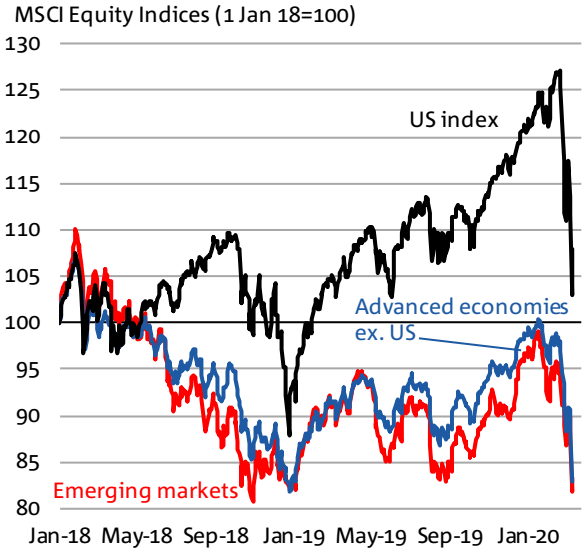
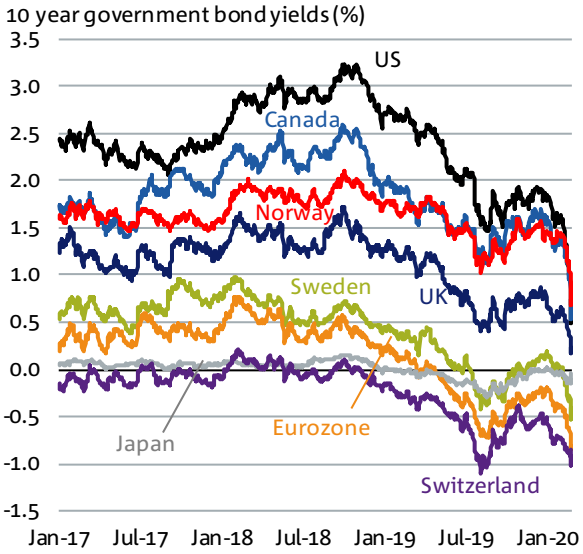
FINANCIAL AND COMMODITY MARKETS

Coronavirus spread sent global markets into a tailspin

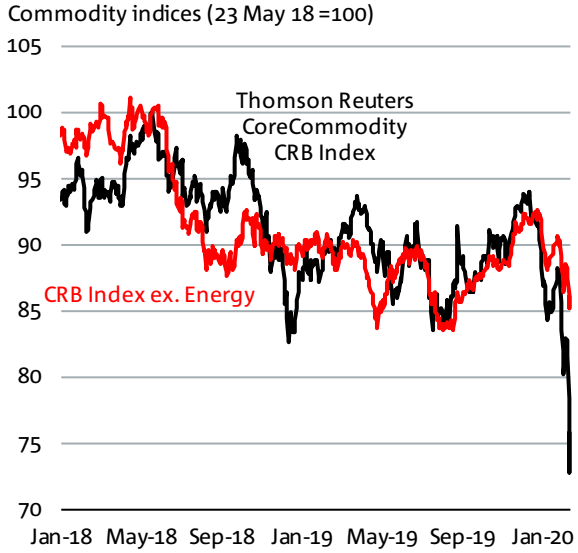
Equities sharply lower on wider Coronavirus outbreak…



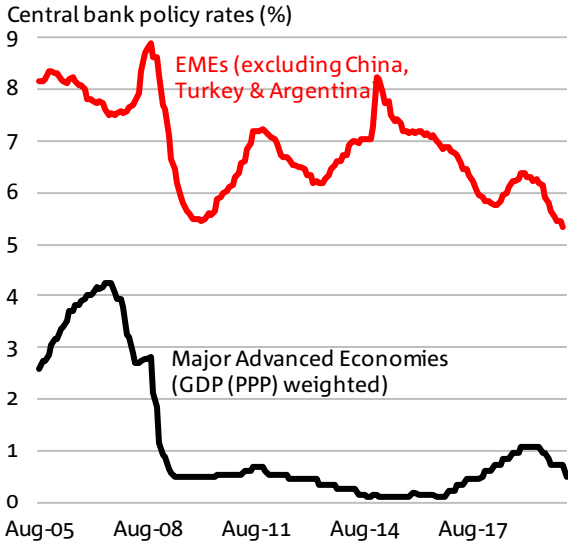
…with bond yields falling over the same period



Commodity prices fell on lower Chinese & global demand prospects



Central banks easing monetary policy



- The growing spread of the Coronavirus spooked financial markets in late February – particularly as the number of cases in Northern Italy and South Korea increased rapidly. Global equity markets have fallen sharply – with US markets down around 19% peak to trough (at the time of writing), from an all time high on 19 February. There were more modest declines for other advanced economies (around 15.4% over the same period) and emerging markets (14.4%) – with these markets already below earlier peaks in January.
- Bond yields have fallen across most major markets – again starting in the latter part of February – as the spread of the Coronavirus lowered expectations around global economic growth and inflation. Yields on ten year US treasuries fell to an all time low.
- Commodity prices have also fallen – on expectations that slower global economic growth would further weaken demand for raw materials. The recent cycle peak for the CRB index was in early January, with prices falling sharply following the initial Coronavirus outbreak in China – reflecting China's key role in global commodity demand. Prices retreated further in late February, following the outbreak in Italy and South Korea, with energy markets most significantly hit (with a further drop in March as OPEC+ failed to agree to production cuts).
- Central banks are easing policy. In early March, the US Federal Reserve cut the fed funds rate by 50 basis points outside of its regular meeting schedule and we expect a further 75 basis point cut this month (and 25 bps more in April). The Bank of Japan and European Central Bank have less conventional policy room but are likely to make a small (10 basis points) reduction in their deposit rates and increase asset purchases. Other targeted measures (aimed at ensuring market liquidity and continuing credit flow) are likely in a range of countries.
- Emerging market central banks have been cutting more significantly since early 2019. Indonesia, Mexico and Brazil were among the EM central banks to ease policy in February. The People's Bank of China has also edged its policy rate lower – with a modest 10 basis point cut in mid-to-late February.
- That said, there are concerns around the efficacy of monetary easing – given that the Coronavirus has largely been a supply side shock outside China. However, these measures should provide some support in the near term, while consumer and business confidence (potentially supported by lower interest rates) will be critical to the recovery phase of this downturn.

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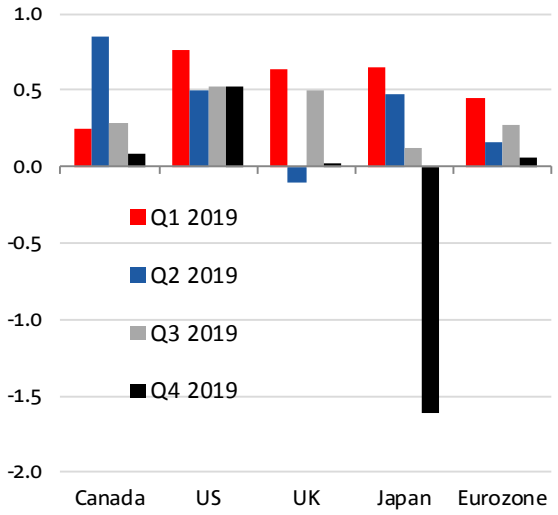
 Sources: Refinitiv, NAB Economics (As at 11/3/2020 AEDT)

ADVANCED ECONOMIES

Coronavirus fall-out means major AE economies likely to go backwards in H1

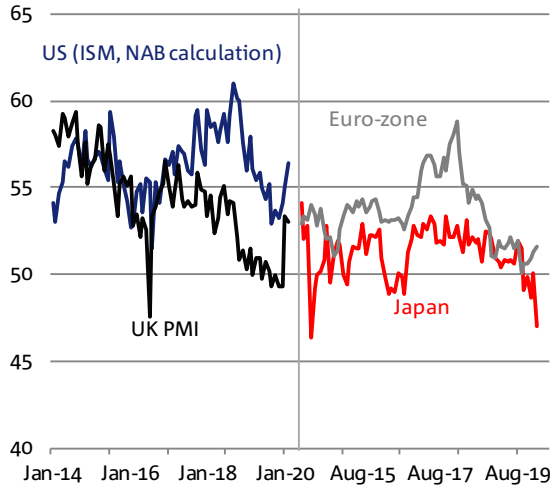
Q4 GDP generally weak outside US with Japan crunched by VAT

Major advanced economy GDP growth (qoq%)



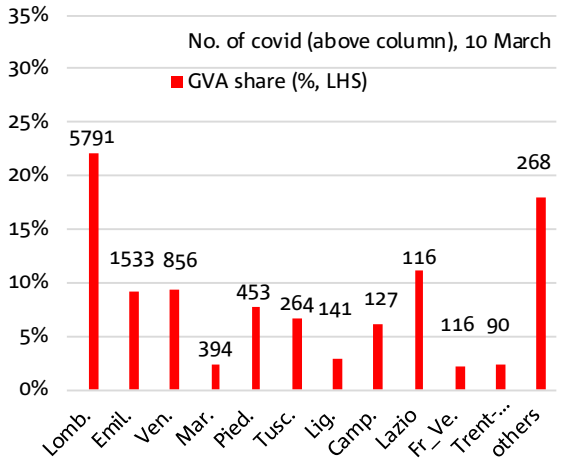
Surveys better early in Q1 but virus impact evident in Japan

Business surveys - Mfg/services composites (50 = breakeven)



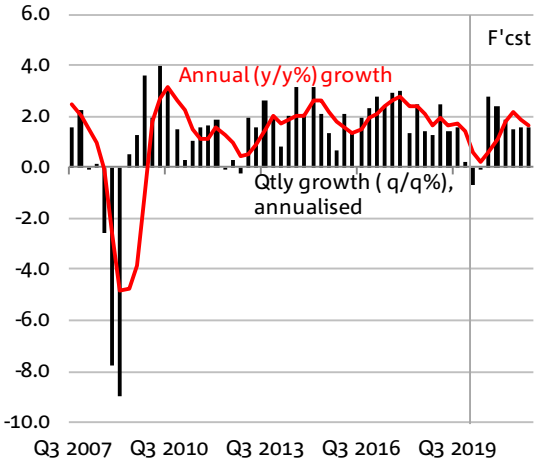
Virus spread to AEs...Italy hard hit in its most productive regions

Regional GVA shares & no. of Covid-2019 cases



H1 growth under severe pressure with downside risk

GDP growth - major AEs (yoy%)*



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

- Signs of an upturn in activity in the major advanced economies (AEs) following a poor Q4 are certain to be overwhelmed by the increasing fall out from the Coronavirus. We now expect a decline in the major AE economies in the first half of the year, including recessions in Japan and the Euro-zone. Risks around this view are skewed to the downside given the increasing spread of the virus, fear-driven reaction and growing containment measures by authorities.
- Q4 GDP outcomes for the major AEs indicate growth was very weak outside of the US. For the Euro-zone, this was a continuation of a slowdown that has been evident for a while, reflecting factors such as the US-China trade war. For Japan the bigger issue in Q4 was the hit from a typhoon and the increase in the VAT. With trade tensions easing, AE business survey indicators towards the end of 2019 and into early 2020 pointed to a strengthening in activity. This also remained the case in February, with the exception of Japan (the most exposed major AE to the widespread factory closures in China and the hit to tourism, where PMIs tumbled).
- The increasing spread of the Coronavirus globally is likely to lead to a major weakening in economic activity at the end of Q1 and into Q2 at the least. This reflects the likelihood of growing supply disruptions, the impact of containment measures and community reaction (staying at home).
- Italy has also seen a major outbreak – centred around some of its more economically important regions in the North. Case numbers are growing in the rest of Italy and Europe, as well as in the US. Authorities are responding with a variety of measures. In particular, in Italy, quarantine restrictions have now been imposed on the entire country (although travel for work appears permitted). The economic impact of such extraordinary measures is hard to quantify but is likely to be significant and produce a major contraction in the Italian economy. The risk is that such measures spread to the rest of Europe and to North America.
- As a result we have included in our forecasts for Q1 and Q2 a significant hit to consumption and activity more generally. This includes negative growth in Japan and the Euro-zone in H1 and little to no growth in the other major AEs. Clearly there is an unusually high degree of uncertainty around any point estimate in current circumstances.

Sources: Refinitiv, Eurostats, www.thelocal.it, NAB Economics

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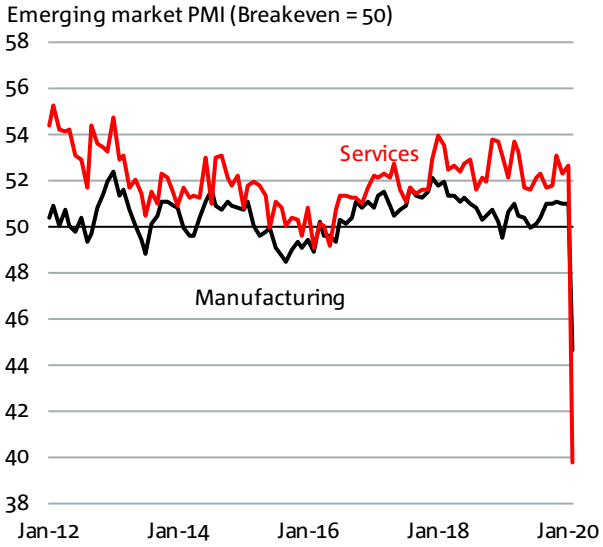
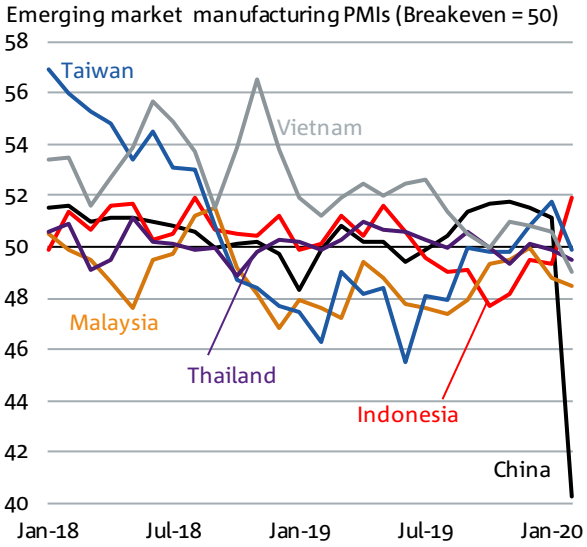
EMERGING MARKET ECONOMIES

Virus driven supply chain disruptions a major issue for emerging markets

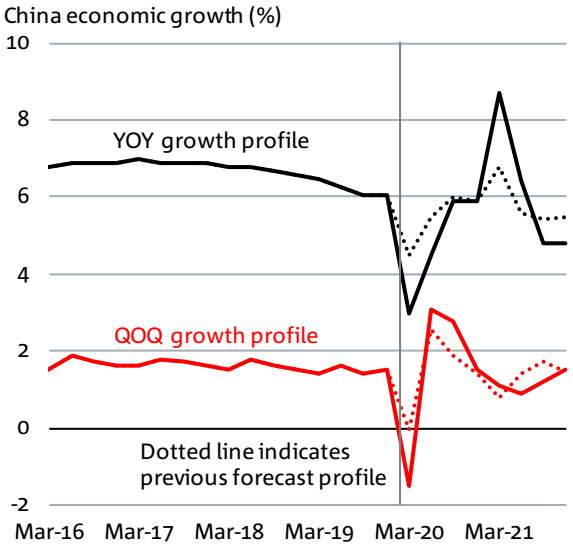
PMI surveys show a plunge in EM manufacturing and services...



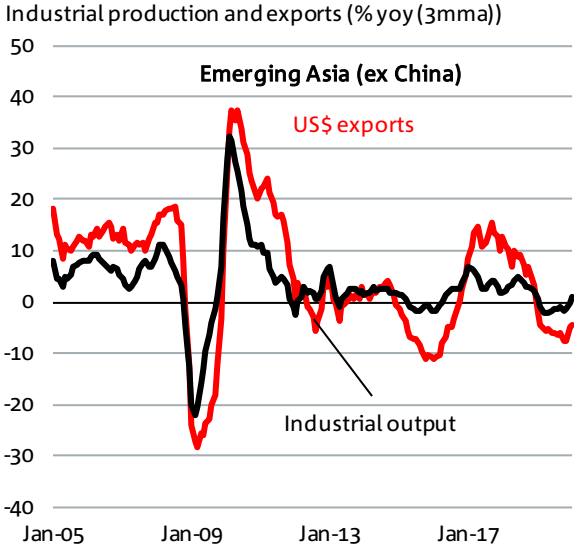
...led by China. Data show limited Covid-19 impact elsewhere



China downturn likely larger than our previous forecasts



Industrial trends, particularly trade, negative prior to Covid-19



- So far there is limited data that provides a clear picture of the Coronavirus impact on emerging market economies. PMI surveys – which are among the most timely indicators of economic activity – showed a sharp drop off in February, with the EM manufacturing measure falling to 44.6 points (the weakest outcome since the global financial crisis), while the services measure fell to 39.8 points (an all time low).
- However, this trend was driven largely by China – where PMI readings for manufacturing and services were at all time lows (reflecting the impact of Coronavirus containment measures on economic activity).
- Our previous Forward View in February outlined a modest "best case" downward revision to China's economic growth in 2020. PMI readings for February were steeply negative, and the apparent recovery towards normal activity has been slow – as indicated by daily data such as coal consumption at major power plants (as shown on page 2). As a result, we have further reduced our forecasts – assuming a 1.5% qoq contraction in economic growth in Q1 (compared with a previous expectation of no change).
- Weaker economic activity (particularly manufacturing) in China has flow on effects for its neighbours in East Asia. Manufacturing PMIs for Taiwan and Vietnam were noticeably weaker in February – with the impact of slowing Chinese activity cited as a key driver. However, these surveys were completed prior to the rapid increase in Coronavirus cases outside China (particularly South Korea) which will further impact regional supply chains. As a result, we would expect further deterioration in these measures in March.
- China sits in the middle of global supply chains – with close linkages across East Asia. Global trade activity was already weak prior to the outbreak of the Coronavirus, reflecting the impact of the earlier US-China trade war, with emerging market export volumes falling by 1.2% yoy (on a three month moving average basis) in December.
- In US dollar terms, exports in emerging Asia (excluding China) fell by 4.4% yoy (3mma) in January. Demand prospects remain negative in the short term – dependent on the widespread resumption of industrial production in China and other regional centres, as well as a post-virus recovery in consumer confidence in advanced economies.

Sources: Markit, Refinitiv, NAB Economics

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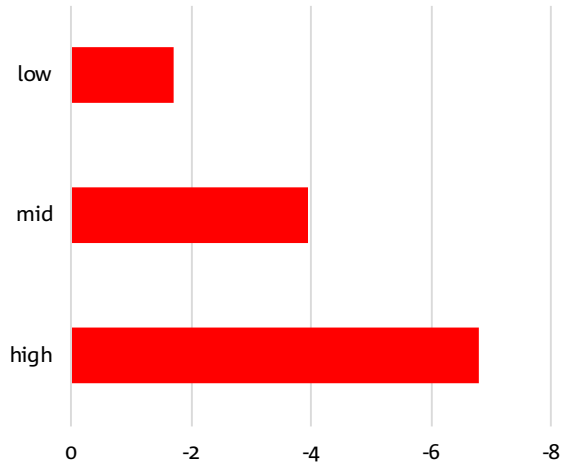
GLOBAL FORECASTS, POLICIES AND RISKS

Virus spread, panic & containment efforts to lead to a big shock to global growth in H1

Virus economic impact in part from containment efforts...what next?

Pandemic modelling illustrates downside risks (McKibbin et al)

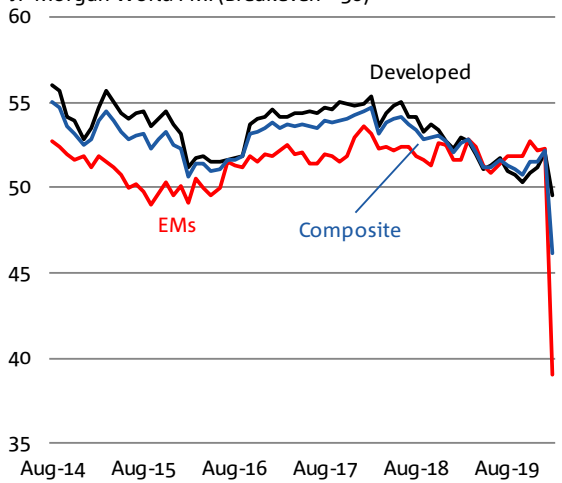
Estimates of pandemic impacts on global GDP (ppts)*



* Low, mid, high indicate the severity of the pandemic

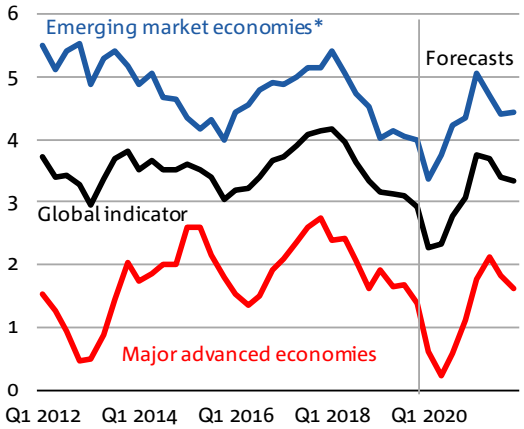
Covid-19 shock evident in surveys... mainly China driven at this point

JP Morgan World PMI (Breakeven = 50)



Sharp downturn in global growth in H1 is expected

Global economic growth (% yoy)



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

- Due to the slower than expected recovery in China and the increasing spread of the Coronavirus to other countries, we have significantly lowered our global growth forecasts. We now expect global growth to be only 2.4% in 2020 (from 3.0% last month and 3.2% pre-virus).
- Risks and uncertainties around the forecasts are high. Central to the forecast is an expectation that containment efforts will be somewhat successful, leading to an initial economic slowdown being followed by stabilisation and then recovery. Whether this is the case, and how quickly any rebound commences, is highly uncertain. China has seen a slowdown in the rate of new cases and its economy is showing signs of some recovery (albeit very slow). Other countries are at an earlier stage so it is too soon to tell.
- Countries experiencing a rapid increase in the number of infections are putting in a range of containment measures, while other countries are pondering what to do next. A large part of the economic impact comes from the containment measures themselves. Consumer and business behaviour (not going out to cinemas, cutting back on travel) is another factor. What new containment measures will be implemented, and how consumers/businesses react, is hard to predict. It is possible that if containment fails, governments may change tack adding further uncertainty to the outlook.
- Modelling of pandemics suggests that this could be just the start, and that the economic fall-out could be even more severe than we are projecting. Financial markets do not just work off a central forecast, but encapsulate the range of possible outcomes. Increased testing will likely mean that the number of new cases reported will climb steeply, at least for a while, even if there is underlying improvement in the situation. The resulting turbulence in markets adds to fears further increasing the risks of households and businesses shutting up shop.
- The longer the virus impacts economies, the greater the risk of second round impacts – company failures (e.g. in the US with corporates highly geared), layoffs (or unpaid leave) leading to financial stress, and capital flight from vulnerable EMs – triggering a deeper and longer downturn.
- Policy – both fiscal (initially targeted at improving health outcomes, or supporting affected businesses/households but may well broaden – e.g. the US is considering payroll tax cuts) and monetary policy – is being deployed. It may not be able to resolve the underlying cause, but it can mitigate the economic impact and reduce the risk of a deeper downturn.

Sources: Markit, Refinitiv, The Japan Times, Financial Times, Bloomberg, The Australian, NAB Economics. Pandemic impact chart based on country/region estimates in McKibbin, Fernando (2020) of a temporary (non-recurring) virus pandemic of different severity aggregated using IMF GDP PPP weights.

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