EMBARGOED UNTIL: 11.30AM THURSDAY 16 APRIL 2020

THE FORWARD VIEW – GLOBAL

APRIL 2020

National Australia Bank

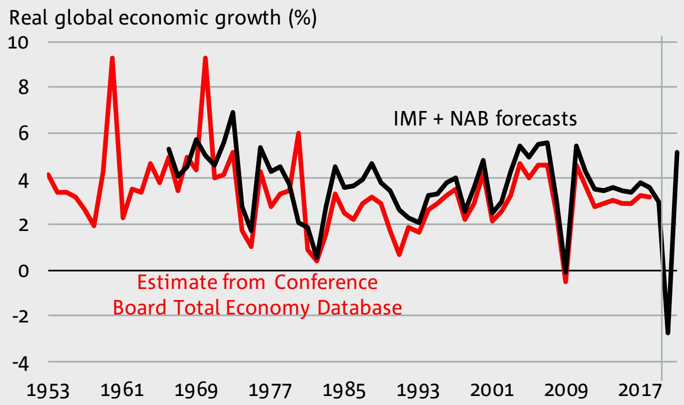
Global economy in its worst post-WW2 recession, recovery timing uncertain

- The global economy is clearly in a deep recession due to the rapid and widespread escalation in Covid-19 containment measures from mid-March. The cause of this global recession is very different to past episodes, with government policy – in the form of containment measures – forcing a decline in economic activity in order to reduce the Covid-19 death toll. While the cause may be very different, some of the longer-term consequences will be similar – many businesses that have been forced to shutdown will not re-open. And the extra debt that households and businesses are being forced to take-on to address a severe cashflow squeeze will have to be worked off over time, constraining future consumption and investment. As a result, activity is unlikely to return to its pre-virus trajectory for a while to come.
- The main purpose of the massive policy response from Governments and central banks is to keep as many businesses and households as possible solvent and liquid until containment measures are eased. Policy does appear to have helped to alleviate the significant tightening in financial conditions that occurred, but conditions remain tight, particularly for lower rated entities – however capital outflows present a financial market risk for emerging markets.
- The timing and strength of the recovery will be crucially dependent on when, and to what extent, containment measures are eased. China was the first country to implement severe restrictions and has already eased restrictions. While some other countries are now flagging an easing, others are still debating whether to escalate measures further – so it is not clear that we are yet at peak containment. Even an official easing in containment measures may have limited impact if households, still fearful of the virus, stay at home and avoid previous activities such as dining out.
- There is a high degree of uncertainty around any forecast right now. The magnitude of the falls in activity mean that the impact on quarterly growth of extending containment measures by a few weeks can be substantial. Any easing of measures risks second and third waves of virus spread and the reimposition of containment measures to address them.

Global Growth Forecasts (% change)

	2018	2019	2020	2021
US	2.9	2.3	-6.6	6.7
Euro-zone	1.9	1.2	-6.5	6.0
Japan	0.3	0.8	-5.0	3.9
UK	1.3	1.4	-6.1	6.2
Canada	2.0	1.6	-4.9	4.9
China	6.6	6.1	0.0	10.9
India	6.8	5.3	2.0	7.6
Latin America	1.1	0.2	-3.7	4.2
Other East Asia	4.2	3.4	0.1	4.0
Australia	2.7	1.8	-4.3	3.5
NZ	3.2	2.2	-6.5	1.9
Global	**3.6**	**3.0**	**-2.8**	**6.6**

2020 shaping up to be worst year for growth since WW2



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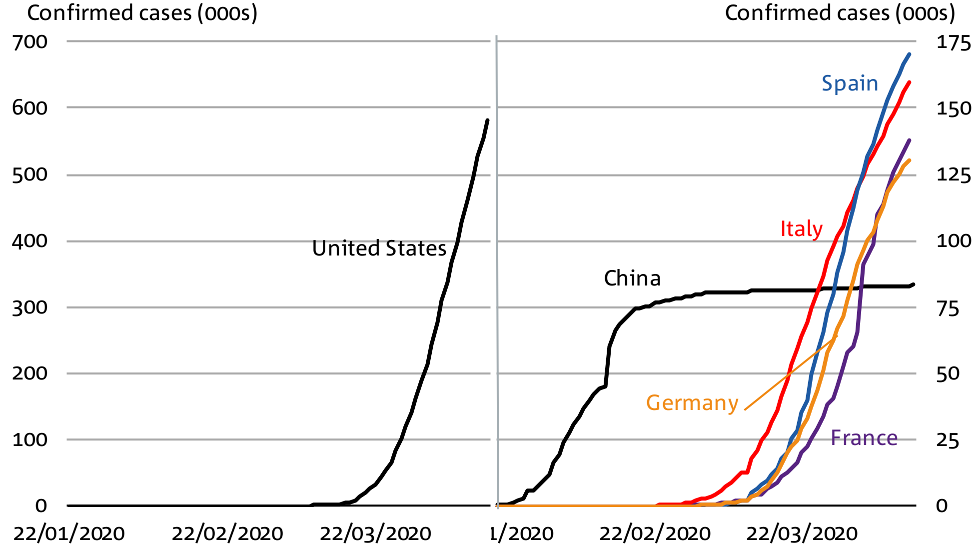
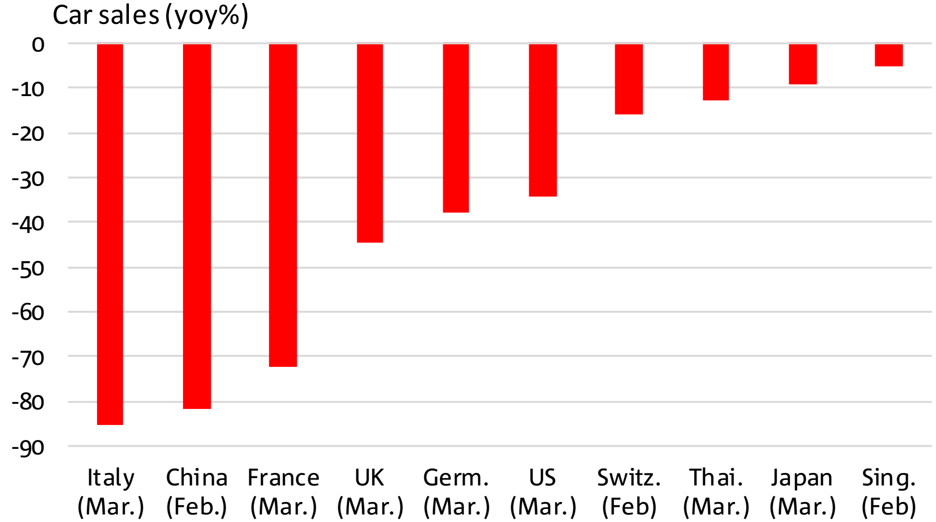
COVID-19 AND ITS IMPACT IN FOUR CHARTS

Global spread has seen an abrupt fall in activity, sharp rise in unemployment & large policy response

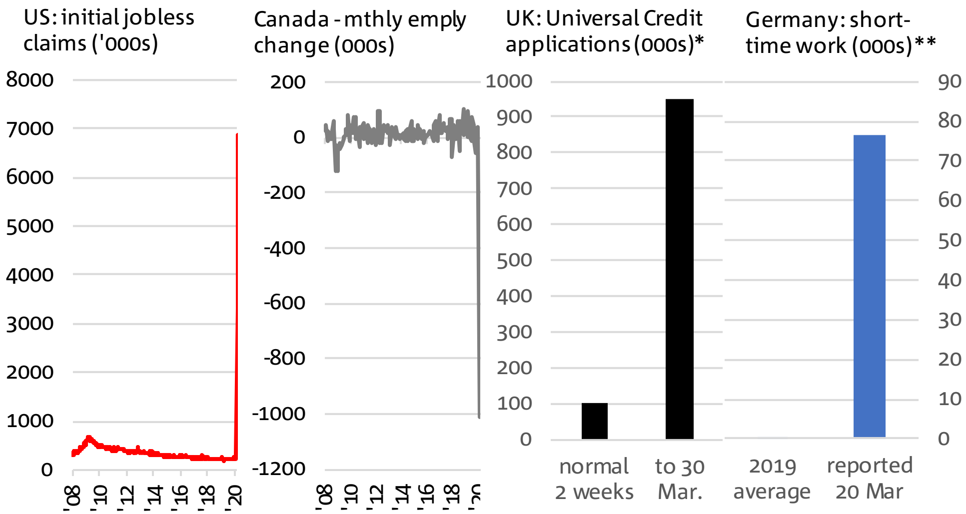
Covid-19 spread far beyond China, surging through March



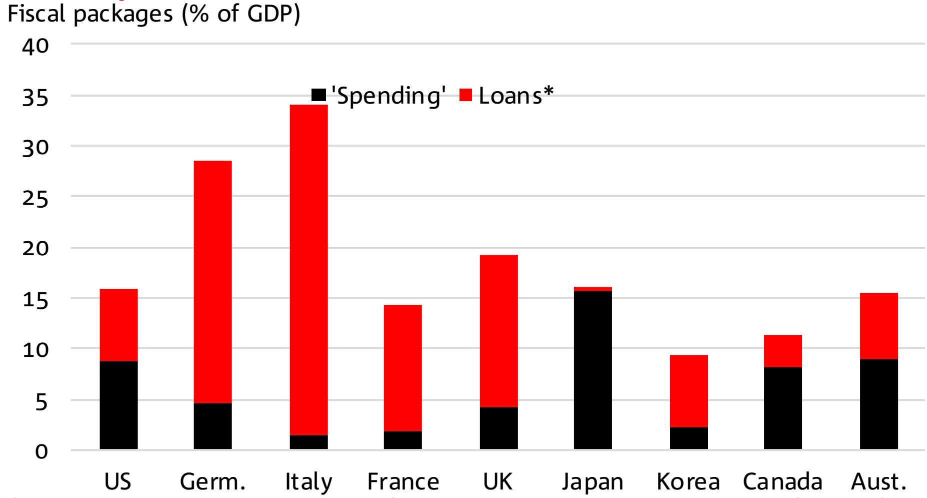
Large falls in activity...East Asia (ex China) holding up better



Massive, immediate, labour market impacts



Large policy response incl. significant fiscal support - more on the way



* Includes loan guarantees, equity stakes. If split not available all package cost included in 'spending'. Does not include central bank asset purchases in capital markets.

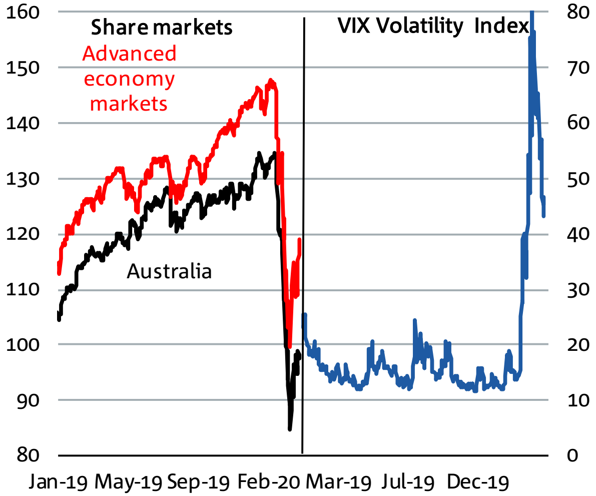
Sources: John Hopkins University ,Refinitiv, Financial Times, Federal Employment Agency (Germany), Federal Reserve, NAB Economics. * Over a two week period; Universal Credit includes people on low incomes. ** Number of company applications for the short-time work program for the week

FINANCIAL AND COMMODITY MARKETS

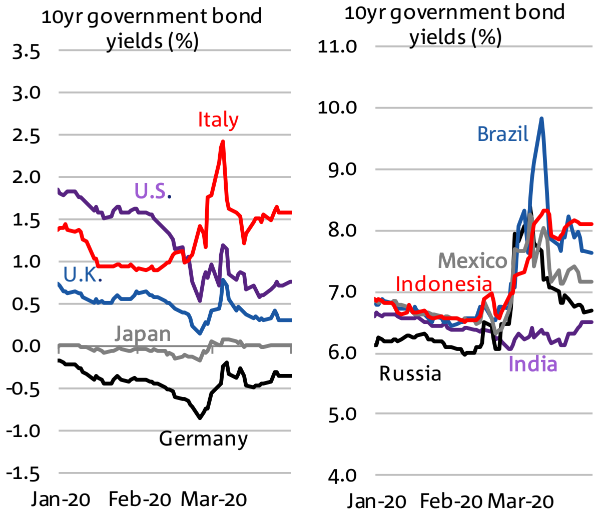
Severe financial mkt disruption – central bank action has reduced some of the stress

Share plunge with only a partial recovery

Share markets and volatility indices

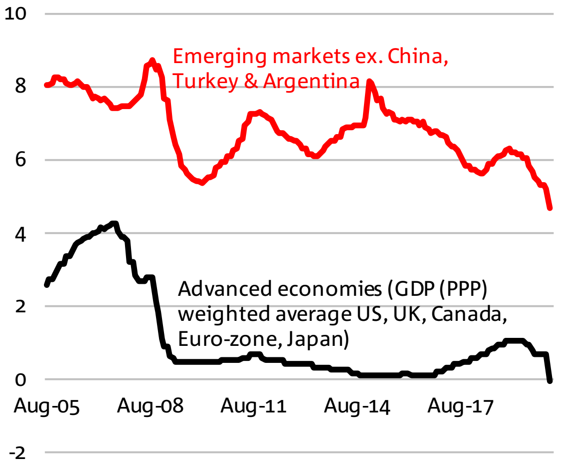


Mkt stress evident in bond yields – central bank action has helped



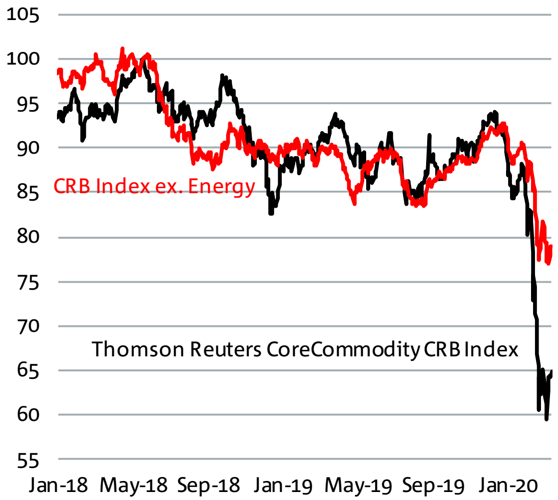
Central banks cutting rates & supporting lending/mkt liquidity

Average central bank policy rates (%)



Large falls in commodity prices, particularly oil

Commodity indices (23 May 18 =100)



- The rapid global ramping up of Covid-19 containment measures, and the scale and speed of the resulting damage to economies, has severely stressed financial markets. While stress remains in certain markets – particularly those with low credit quality – it is off its peaks, helped by government and central bank policy measures.
- Share markets have seen very large falls. Our composite measure of major advanced economy share markets at one stage was over 30% off its February peak. Market volatility, as measured by the US VIX also rose to levels last seen in the GFC. While equity markets have partially recovered in recent weeks they remain well down.
- Market dislocation was also evident in government bond markets. In March yields rose, reflecting elevated stress on financial markets as well as the need to absorb substantially higher government bond issuance as fiscal action ramped up. This stress was evident even in the highly liquid (and safe haven) US government bond market and more pronounced for weaker sovereigns, including EMs. Outside of government funding markets, spreads also rose, including for highly rated corporates. Investment funds have also come under pressure from a large volume of redemptions.
- Central banks have responded by cutting rates and moving to support financial markets to ensure market functioning and on-going credit provision. The Fed has launched a multitude of programs to address problems across various markets, including in the USD market, and is supporting lending to businesses (with Treasury backing). The ECB, BoJ and BoE have also initiated asset purchase programmes and funding support for banks. As a result spreads have narrowed although particularly for low credit quality corporates and EMs they remain elevated. Regulatory requirements on banks have also been eased to ensure the flow of credit and early signs indicate that this is indeed happening (e.g. outstanding US commercial & industrial loans have increased by 21% over a four week period).
- A consequence of market stress, including capital outflows and currency depreciation (see p5), can be to limit the ability of EM central banks to ease policy (or to force tighter policy). However, so far, this has not been the case. Seventeen of the 21 EMs we track have lowered their policy rate over the last two months.
- Not surprisingly, in an environment of collapsing activity, commodity prices have fallen. This has particularly been the case for oil prices due to a breakdown on OPEC+ production limits, although there has been a recent deal to curb output.

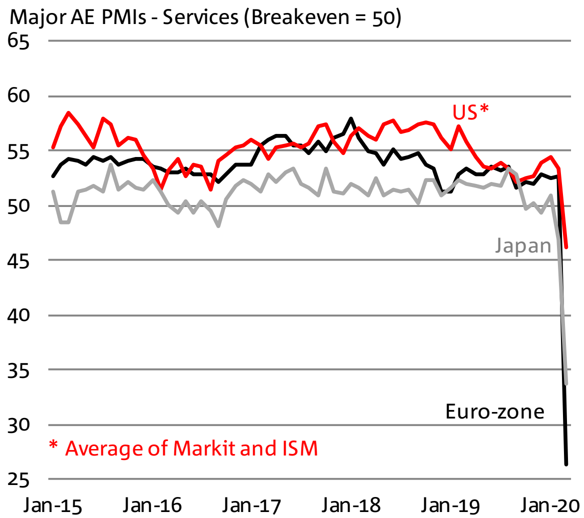
 Sources: Refinitiv, NAB Economics (As at 11/3/2020 AEDT)

National Australia Bank

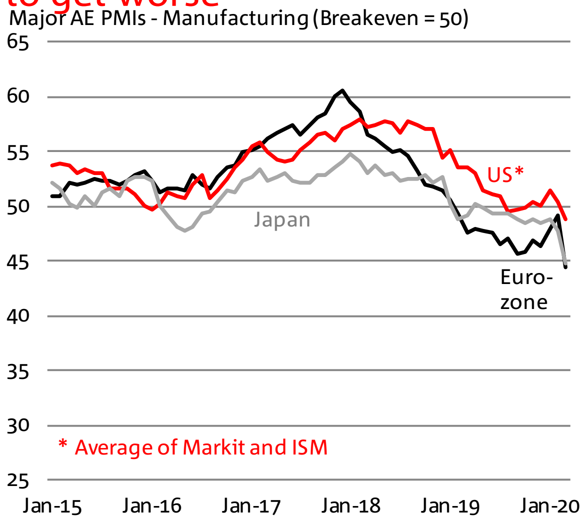
ADVANCED ECONOMIES

Large falls in activity in AEs and a major deterioration in labour markets

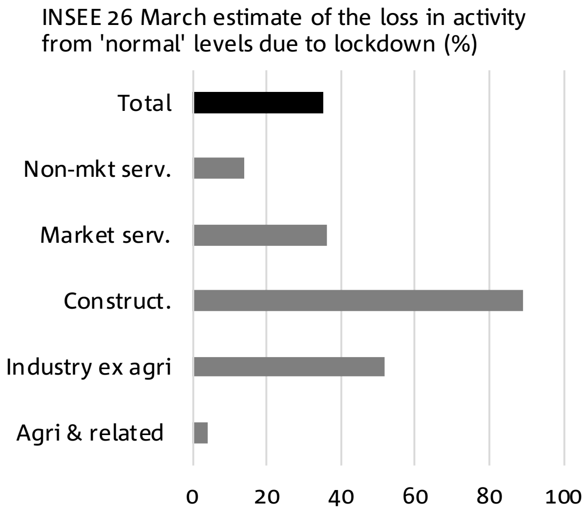
Record falls in service sector PMIs



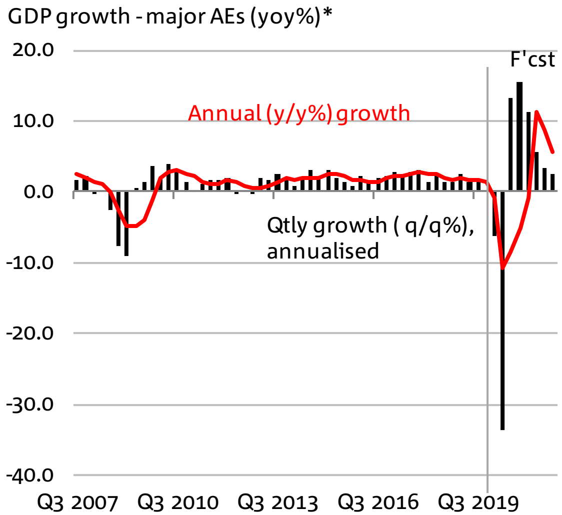
Manufacturing down – and likely to get worse



French statisticians (rough) estimate of activity loss is huge



Large fall in AE GDP expected



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

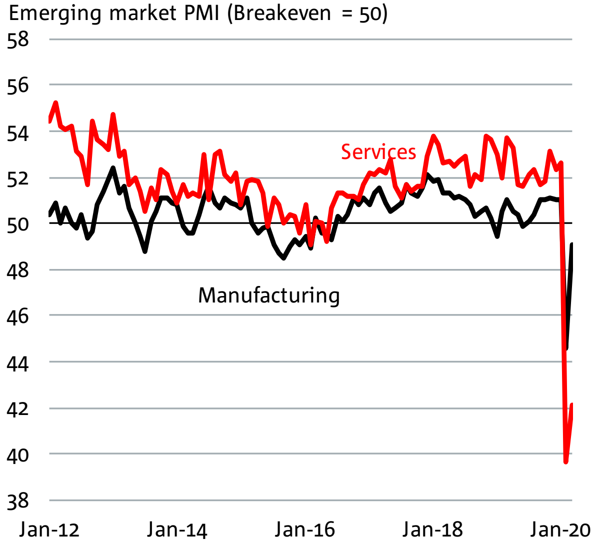
- Major advanced economies (AEs) have seen a rapid and severe reduction in activity due to Covid-19 containment measures. We expect double digit declines in some major advanced economies in Q2. The scale of the collapse in activity is already evident in labour market readings which have deteriorated with unprecedented speed.
- Some business surveys in March recorded exceptionally large falls, particularly the services sector, where many of the initial containment measures (travel bans, closure of restaurants) fell. Some countries have now also initiated factory closures and in other countries, even where they are not mandated, closures are occurring either due to a lack of demand for finished product or safety concerns. No sector will be spared – even health providers are under pressure as non-Covid-19 treatments decline.
- The scale and breadth of the fall in activity have been highlighted by estimates prepared by INSEE, the French statistical office. The INSEE estimates are, unusually, based on a mix of quantitative and qualitative information, and point to a fall in activity of around 35% from the French lockdown.
- There will be differences between (and within) countries depending on the scale and timing of the containment measures put in place. In Q2 we expect GDP in the US, UK and Euro-zone to fall by around 10% q/q. The French INSEE estimates suggest that, if containment measures remain in place through Q2, the falls in activity will be much larger than this. For Japan we are expecting a more modest (but still large fall) as its containment measures are not as restrictive and its close ties to China, which is starting to recover, and other East Asia – which is doing relatively well – will help. That said, last week a large part of Japan was placed on a state of emergency, although compliance with the recommended measures is voluntary.
- We tentatively have some recovery in major AE GDP in Q3 but this will be entirely dependent on when, and to what extent, containment measures are eased. Some European countries have started to ease restrictions while others have recently extended them. We do not expect activity to return to its pre-virus level until well into 2021.
- With many businesses shutting up shop or facing a collapse in demand, the impact on labour markets has been immediate. This has been highlighted by the 16.7m initial jobless claims in the US over a three week period (about 10% of the labour force) but other countries has also seen a rapid deterioration (see p2).

Sources: Refinitiv, INSEE, NAB Economics

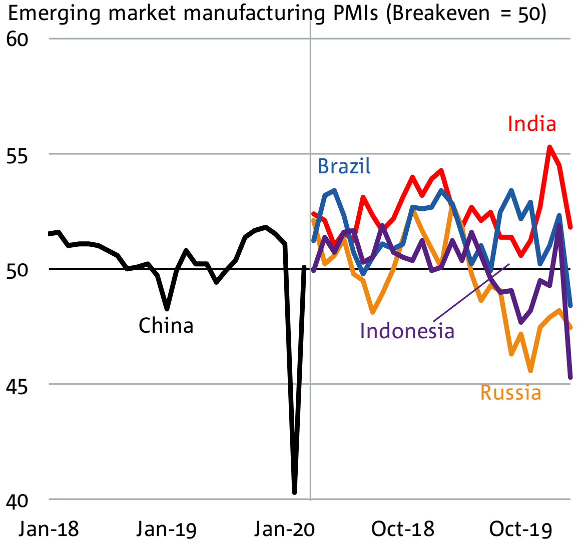
EMERGING MARKET ECONOMIES

Covid-19 containment measures are slowing EMs sharply, with capital flight a risk

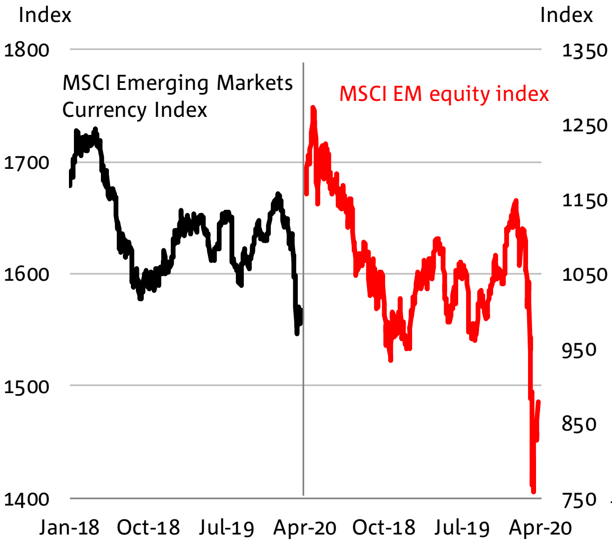
EM PMI measures remained negative in March…



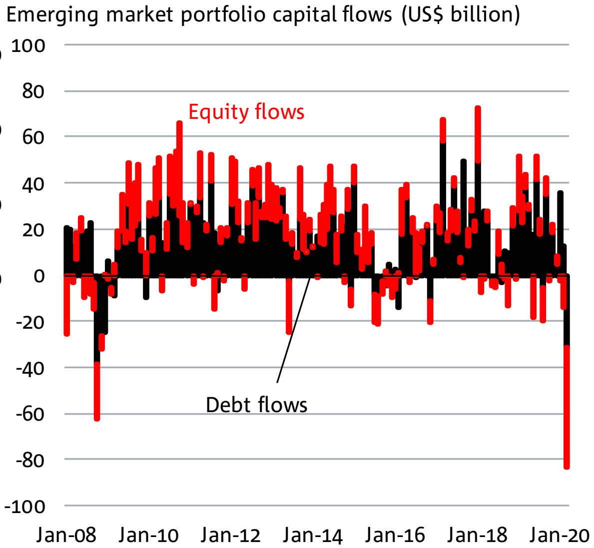
…with differing stages in the Covid-19 containment cycle



Covid-19 spread hit EM equities and currencies



Capital outflows intensifying in March, a threat to recovery



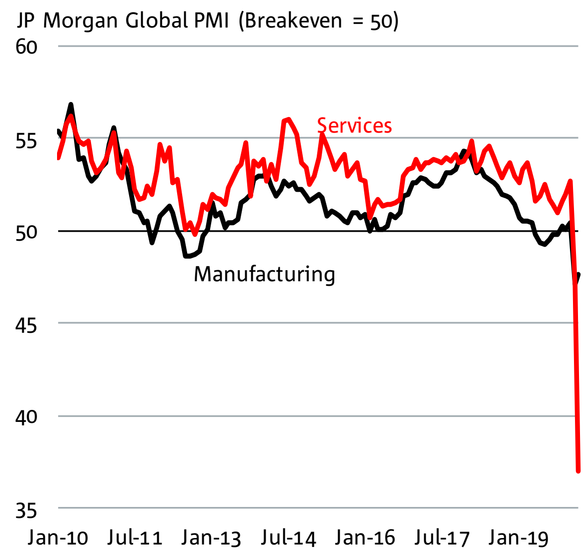
- Escalating containment measures across a wide range of countries (with the exception of China, where containment is gradually being rolled back) slowed economic activity across emerging market (EM) economies in March. PMI surveys provide some of the most timely cross country comparisons of economic activity.
- At the aggregate level, the EM manufacturing PMI was less negative in March at 49.1 points (from 44.6 points in February). These measures are compared with the previous month, suggesting that overall March was still weaker than February. Services measures have been even weaker than manufacturing – due in part to the closer physical contact in a range of services. In March, the aggregate EM services PMI was 42.1 (compared with 39.7 points previously).
- The aggregate results mask some divergent trends across different economies – which largely reflect the different stages in Covid-19 responses. As China was the first economy to implement severe restrictions on resident movement and economic activity, it experienced the earliest downturn and is starting the earliest recovery. Stronger results for China – particularly in manufacturing – drove the less negative results in March, while most other countries deteriorated, having commenced the containment cycle later – particularly India, which introduced a 21 day shutdown in late March.
- The growing spread of Covid-19 in March and early April led to a sharp downturn in EM equities and currencies across much of the period. The MSCI equity index fell around 25% by late March, before a subsequent modest recovery.
- Estimates by the International Institute of Finance (IIF) suggest that emerging market economies suffered dramatic capital outflows in March – with a record outflow from EM equity markets (totalling around US$52.4 billion) and the largest outflow from debt since October 2008 (at around US$31.0 billion). Asia accounted for the largest share of the outflows, however all regions recorded declines.
- These outflows threaten to tighten financial conditions in EM economies, counter to efforts of monetary authorities attempting to ease policy to support their economies during the current containment driven downturn and position them for subsequent recovery. The IIF note that sub-Saharan African economies are particularly exposed – due to a sharp run up in debt in recent years. Some economies may consider implementing capital controls to stem the flow.

Sources: Markit, Refinitiv, IIF, NAB Economics

GLOBAL FORECASTS, POLICIES AND RISKS

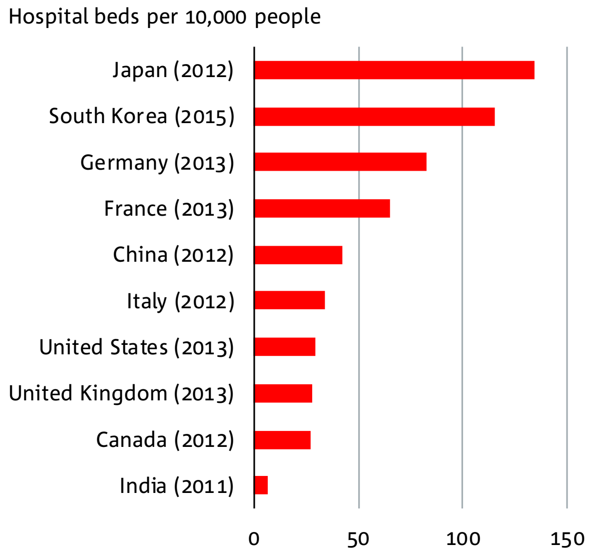
Wider Covid-19 spread and containment to trigger largest global slowdown in multiple decades

Services sector at the heart of the downturn in March

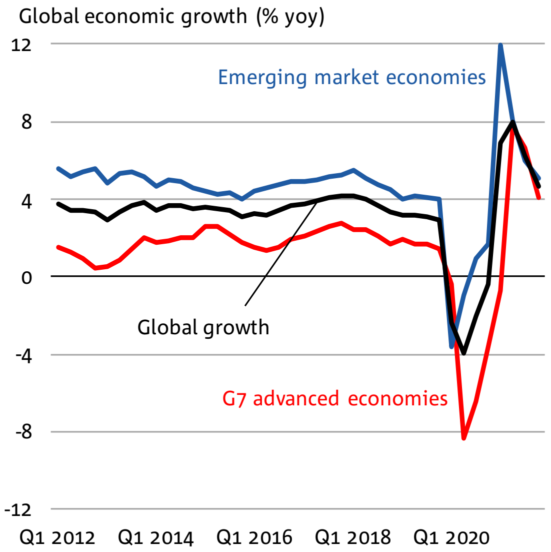


Scale of China's slowdown in Jan-Feb exceeded expectations

Limited healthcare capacity a major issue for India



Steep downturn in H1 2020; strong recovery in 2021



Sources: Markit, CEIC, World Bank, IMF, NAB Economics

- Global PMI surveys highlight the widespread negative impact of Covid-19 countermeasures have had on economic activity. The composite index fell to 39.4 points in March (from 46.1 points in February). This result was weakest result since February 2009. On average, survey results were more negative in advanced economies than emerging markets in March (reflecting the reduction of containment measures in China), with services more impacted than manufacturing.
- There remains considerable uncertainty around the economic outlook – as a wider range of countries have imposed stronger containment measures (including restricting business activity and resident movement to varying degrees) as Covid-19 cases continue to grow. The duration and depth of downturn is highly unclear, however the near term outlook has deteriorated significantly since our March Forward View.
- In part this reflects the scale of the downturn in industrial activity and retail sales in China across January and February – far in excess of our earlier expectations. We expect China's economy to contract by 12% yoy in Q1 and record no growth for the full year.
- We have also revised down our forecast for India (the world's third largest economy), given the Covid-19 outbreak and shutdown implemented. There are significant concerns around India's capacity to address the virus, given the population density of major cities and underdeveloped healthcare system. This may necessitate a longer than planned shutdown to reduce the spread.
- We now forecast the global economy to contract by 2.8% in 2020 – with advanced economies declining more than emerging markets. The impact is expected to spread across the first half – with the China-led downturn in emerging markets more significant in Q1, while the advanced economy downturn is larger in Q2.
- This annual decline is the largest since at least the early 1950s and likely the Great Depression (although data limitations make this difficult to confirm) – see chart on page 1.
- Global growth is expected to rebound significantly in 2021 as normal activity resumes – up by 6.6%. Apart from the timing and extent of the easing in containment measures, a key issue is how much lasting impact there is from the downturn this year. Prolonged unemployment, permanent business closures and lower consumer confidence (or greater caution) are a source of downside risk. Similarly, an increased debt burden – used to support businesses and households through the current downturn – could constrain demand going forward.

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