EMBARGOED UNTIL: 11.30AM THURSDAY 14 MAY 2020

THE FORWARD VIEW – GLOBAL

MAY 2020

National Australia Bank

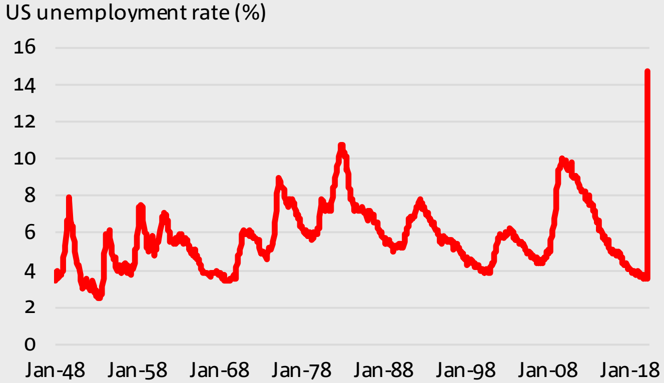
A massive contraction in global activity has occurred due to COVID-19

- We have revised down our forecasts for global GDP and now expect -3.8% in 2020 (was -2.8%) and +6.5% in 2021 (was 6.6%), reflecting some further escalation of containment measures (notably Japan) and only a gradual easing of restrictions in other economies, coupled with ongoing household and business caution.
- The forecast changes don't alter the overall picture – there has been a huge fall in activity across most of the world; in China it was centred in February but in many other economies it occurred over March/April. The fall in global GDP in 2020 is likely to be the biggest fall in since least since the 1950s, and most likely since the Great Depression.
- Global activity likely hit bottom in April; many countries have, or are in the process of, easing containment restrictions even if only gradually. While an easing in containment measures – if sustained – will likely lead to a bounce in activity, a full recovery from the downturn is likely to take an extended period of time for many. This is due to the damage to household/business balance sheets, as well as to government finances, the closures of many firms being permanent, and long-lasting structural changes to economies. Moreover, there are a range of risks that may slow or reverse any recovery, including that of further major outbreaks of COVID-19, financial market stress (with some EMs at risk of de-stabilising capital outflows), or a flare-up in geo-political tensions.
- The extent and speed of the decline in activity is highlighted by the US labour market. In February, the unemployment rate was at a 50 year low – two months later it is at its highest level since the series began (1948). Similarly, Canada's unemployment rate jumped to 13%. For other countries – such as Germany – government wage subsidy schemes have minimised the jump in measured unemployment, but this only hides the extent to which there are a lot of people who were meaningfully employed a few months ago doing relatively little (although by retaining a link to work such schemes may assist the recovery).

Global Growth Forecasts (% change)

	2018	2019	2020	2021
US	2.9	2.3	-7.4	6.8
Euro-zone	1.9	1.2	-8.4	6.3
Japan	0.3	0.8	-7.6	3.8
UK	1.3	1.4	-7.6	6.6
Canada	2.0	1.6	-7.5	4.9
China	6.8	6.1	1.0	9.8
India	6.8	5.3	-1.5	8.0
Latin America	1.1	0.2	-5.0	2.8
Other East Asia	4.2	3.4	-1.5	5.8
Australia	2.7	1.8	-4.3	4.2
NZ	3.2	2.3	-8.7	2.9
Global	**3.6**	**3.0**	**-3.8**	**6.5**

US unemployment – 2 months between 50 year low and record high (series began in 1948)



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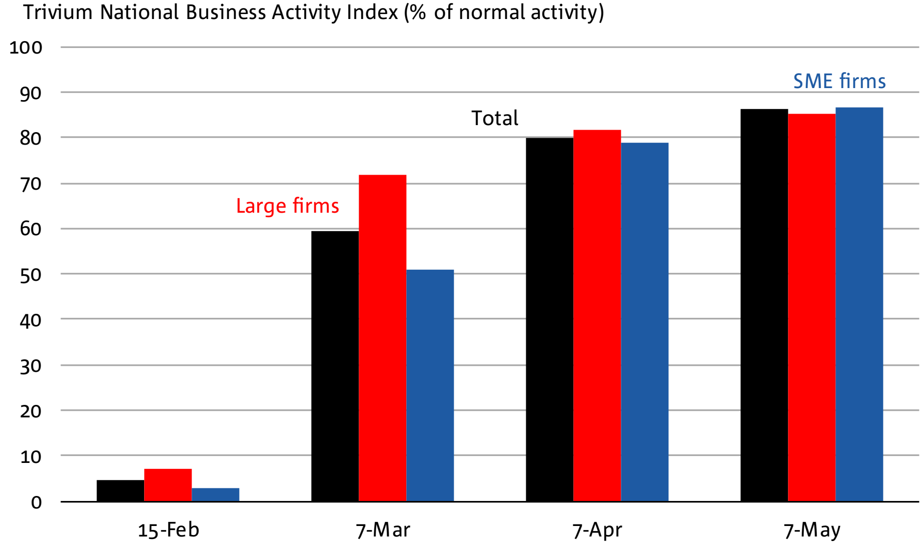
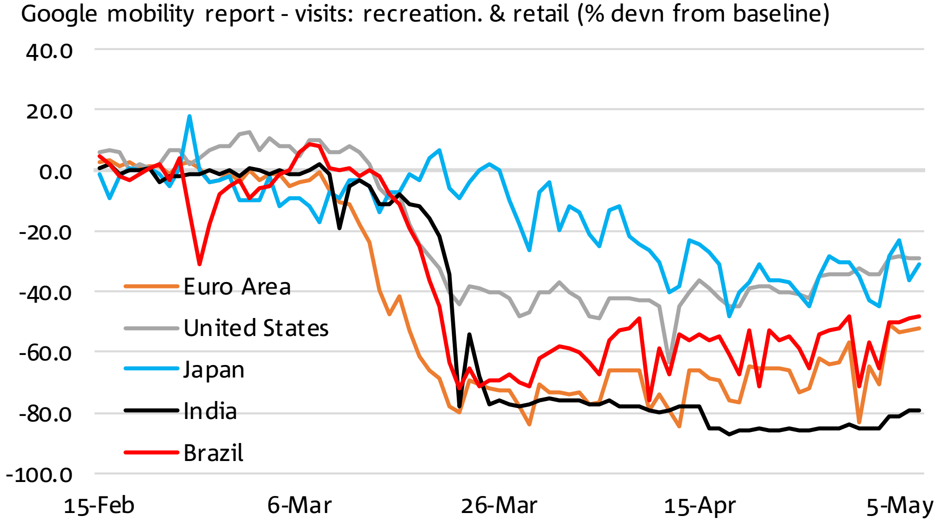
TROUGH APPEARS TO HAVE BEEN REACHED

Some high frequency indicators starting to show improvement…but a long way to go

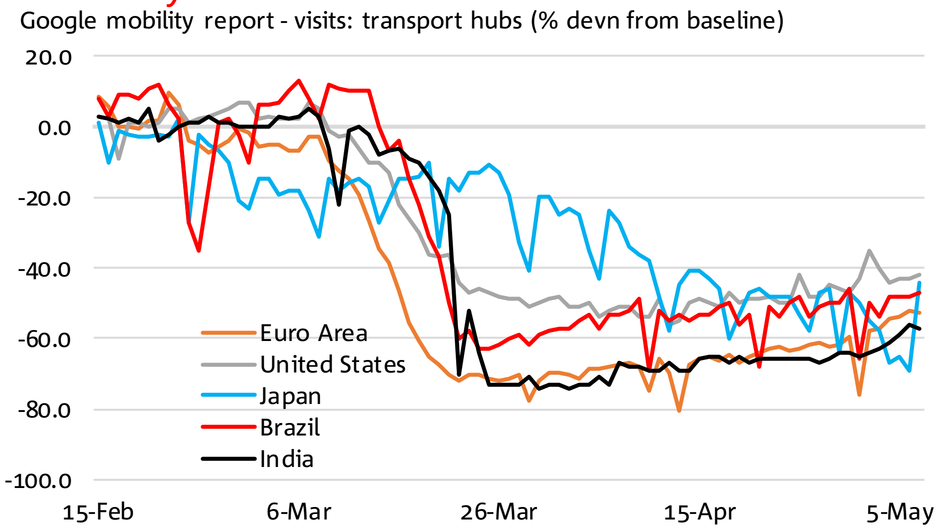
China first into recession and likely the first out – but risk of a plateau in the near term



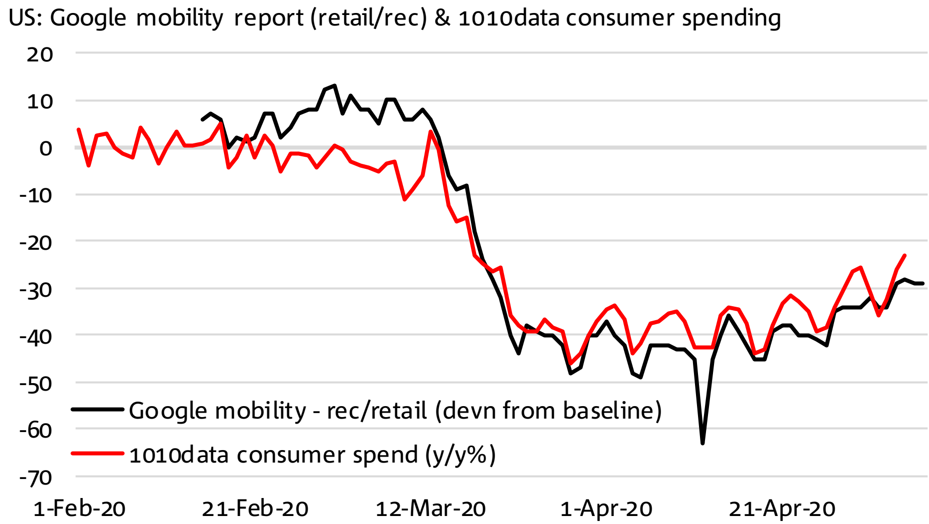
Large falls in retail/recreational trips…has bottomed out with gradual improvement in some countries



Mass transport avoided…again some improvement underway



Other high frequency data also signalling worst has past



Sources: Trivium, Google (https://www.google.com/covid19/mobility/), 1010data/exabel (https://1010data.exabel.com/covid-19/)

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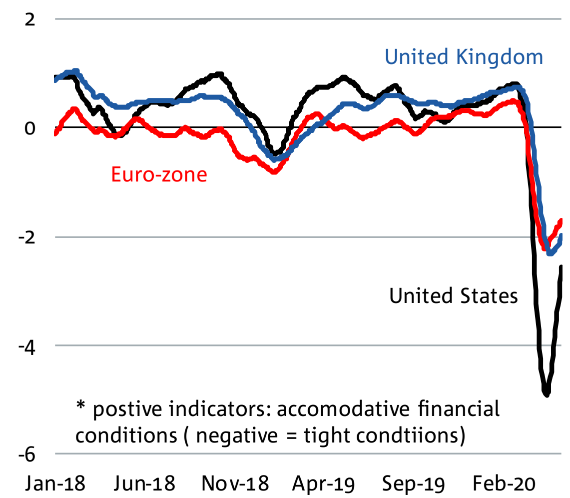
FINANCIAL AND COMMODITY MARKETS

Conditions weaker due to countermeasures, with EMs hit harder

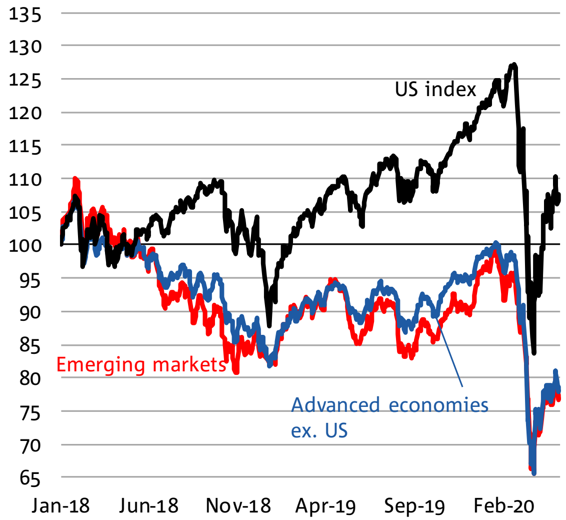
Countermeasures have impacted financial conditions

Finanical conditions indices (rolling monthly average)*



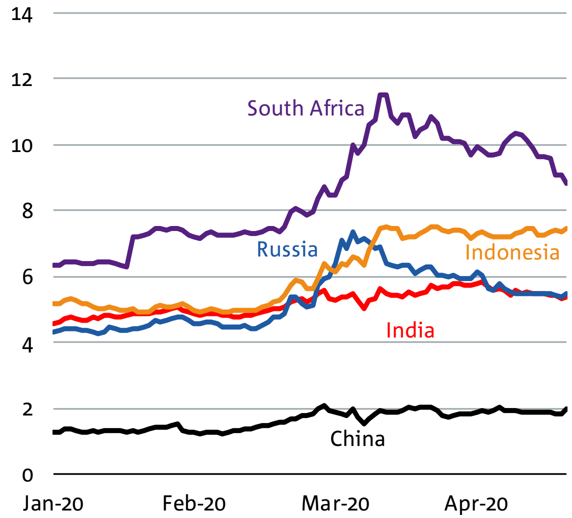
Equities have improved since mid-March, but well off recent peaks

MSCI Equity Indices (1 Jan 18=100)



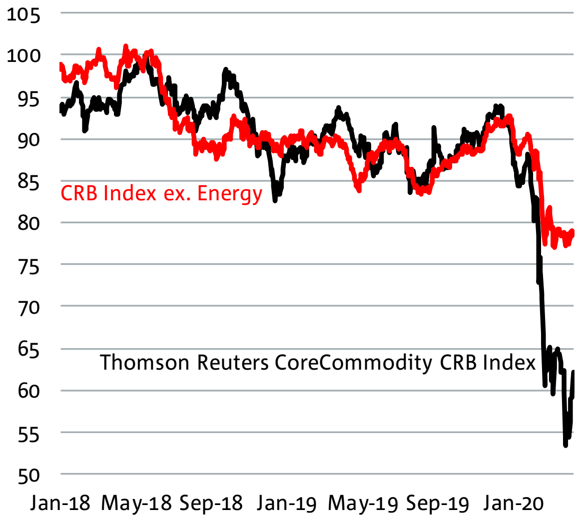
Widening spreads between EM and US government bonds

Emerging market bond spreads (to US) (%)



Oil led commodity prices lower through to mid-April

Commodity indices (23 May 18 =100)



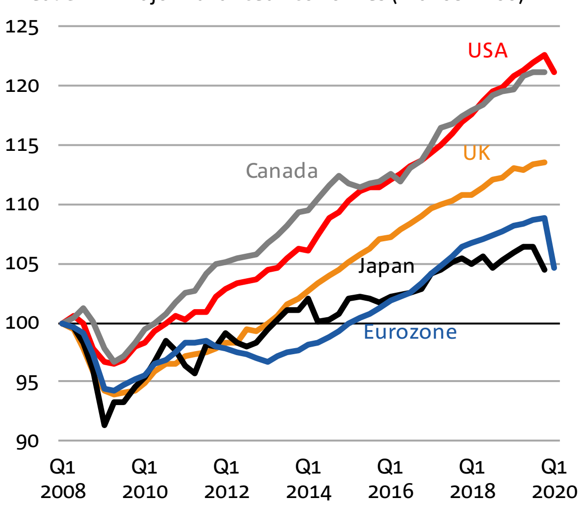
- Financial markets remain under considerable stress, given the dislocation caused by a wide range of countermeasures to COVID-19 imposed globally. That said, conditions differ considerably between individual markets and regions.
- Bloomberg financial conditions indices deteriorated in major advanced regions between mid-March and mid-April, with the US measure falling to its weakest level since the Global Financial Crisis. In contrast, European measures were their weakest since the 2011-12 European debt crisis. Despite policy efforts, conditions remain tight.
- Equity markets fell sharply between mid-February and mid-March, but trended higher across April – despite the worsening economic climate. In part, this reflected market perceptions that markets were over-sold in the downturn, as well as funds flowing into equities from other asset markets. US equities rose more strongly than other markets – likely due to perceptions of the US being a safe haven.
- That said, equity markets remain well below the levels recorded in February – prior to broad COVID-19 lockdowns – and volatility in these markets has been elevated (if somewhat lower in April).
- Government bond yields have generally trended lower in recent months – as expectations around economic growth, inflation and interest rates have eased as COVID-19 countermeasures have been introduced in a wider range of countries. Since the start of the year, spreads between 10 year US treasuries and major emerging market bonds have widened, which likely indicates a flight to safety.
- At the time of writing, Argentina's government is on the brink of default, having failed to agree to a debt restructuring with bond holders. Should it occur, it would be the country's ninth sovereign default. Spreads on sovereign credit default swaps – essentially the cost of insurance against defaults – have risen since the start of the year. While the spread for China has retreated since peaks in March, economies such as Argentina, Brazil and Indonesia have seen spreads increase more recently.
- Commodity prices have fallen sharply since early March, as the widening COVID-19 countermeasures have constrained demand, while supplies have generally remained ample. In particular, oil prices have plunged, with OPEC+ production cuts insufficient to counter the perilous decline in demand as transport activity has been curtailed. US oil prices briefly turned negative in April, on fears that storage capacity was almost exhausted.

 Sources: Bloomberg, Refinitiv, NAB Economics

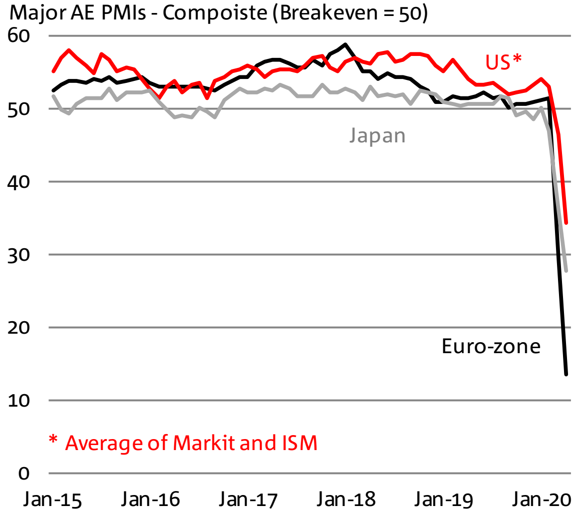
ADVANCED ECONOMIES

A gradual easing in containment measures won't stop huge falls in Q2 GDP

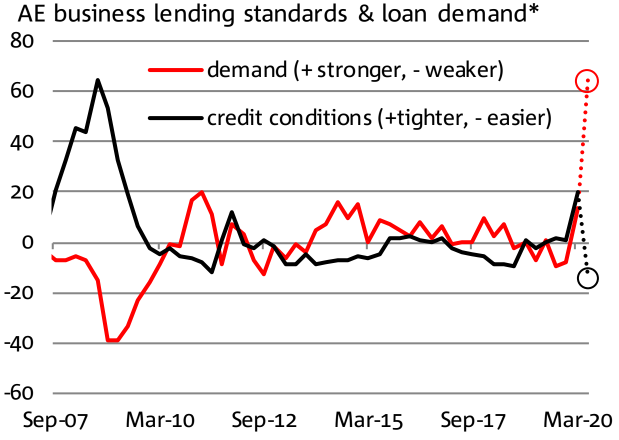
US & Euro-zone GDP down in Q1; others to follow



Business survey collapse in April

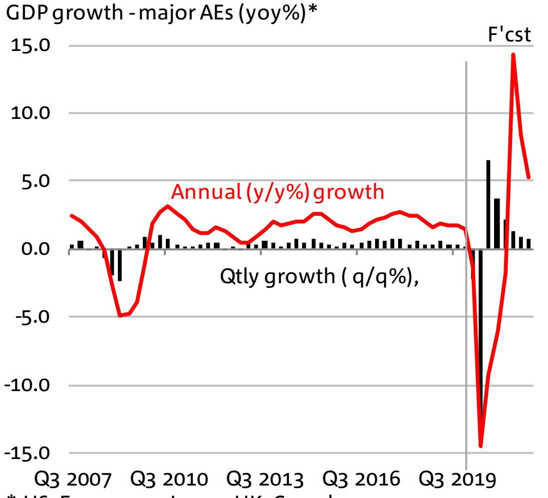


Credit still flowing…and businesses drawing it down unlike GFC



* Overall firm measure where available otherwise large firms, C&I loans. US, UK, Japan, Euro-zone. 2020 Q2 a projection (average of UK, Euro-zone). GDP PPP weights.

Q2 shock – but expect partial recovery in Q3



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

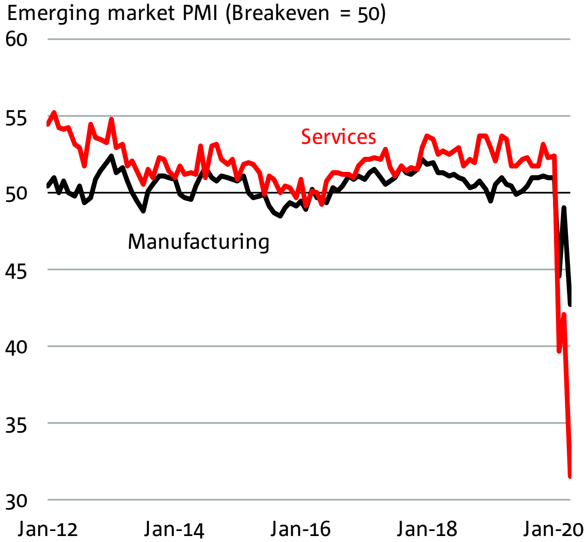
- US, Eurozone and UK GDP fell in Q1, and we expect similar results for the other major advanced economies (AEs). Q2 will be worse by a considerable order of magnitude. While available indicators point to the trough having been reached in April and now starting to recover, it will be a long-time before activity is fully recovered.
- US Q1 GDP fell by 1.2% qoq in Q1, its largest fall since the end of 2008. The Euro-zone declined 3.8% qoq, including a 4.7% qoq fall in Italy and a 5.8% qoq drop in France. In the UK GDP declined 2% q/q.
- There was a further large fall in business survey readings in April. To illustrate the extent of fall in activity, the French statistics agency estimates that activity was 35% below normal on 23 April. With containment restrictions being eased only gradually (and at different times within countries or regions), the average level of activity for Q2 is likely to be well below that of Q1.
- In Japan, the early April state of emergency instituted for some prefectures was extended nationwide in mid-April and was recently extended through the whole of May. While following the restrictions are voluntary it appears to have affected activity through April, although it may have bottomed out in the 2nd half of month (see p2).
- Governments and central banks have implemented a wide range of policies to support their economies. This is evident in the marginal increase in Euro-zone unemployment in March with short-time work and other schemes are being extensively used (but also reflects people leaving the workforce and not being counted as unemployed). Germany's unemployment rate increase by 0.7% in April, but a record 10m workers are on short-time work. The US has also put in payroll support but its unemployment rate jumped to a staggering 14.7% in April, while the unemployment rate reached 13% in Canada.
- Credit facilitation has also been an important part of the policy support. While lending standards – as indicated by qtly surveys – have tightened somewhat (driven by the US where the survey was conducted at a time of greatest financial market dislocation), credit is flowing and businesses are using this to meet their cashflow needs
- While we expect a bounce in Q3 as restrictions are eased, the level of activity will remain well below where it was at the start of the year. Indeed, under our forecasts the level of AE GDP at the end of 2021 is still below its end 2019 level. Moreover, there is the risk of further outbreaks of the virus as economies re-open, and the possibility of restrictions being reimposed.

Sources: Refinitiv, Bank of Japan, ECB, NAB Economics

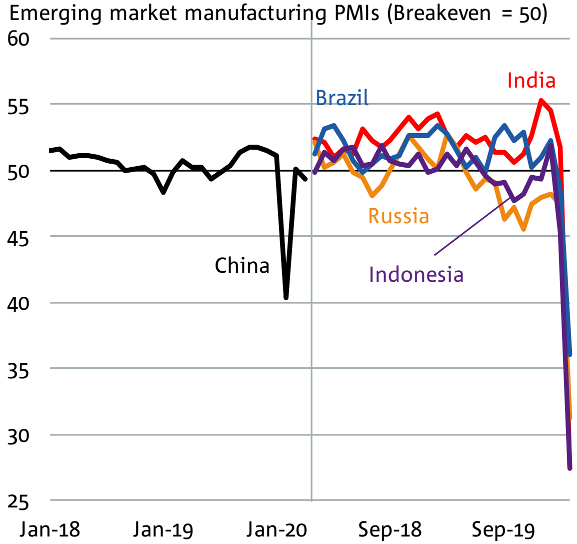
EMERGING MARKET ECONOMIES

China's recovery showing signs of a plateau while other EMs are suffering

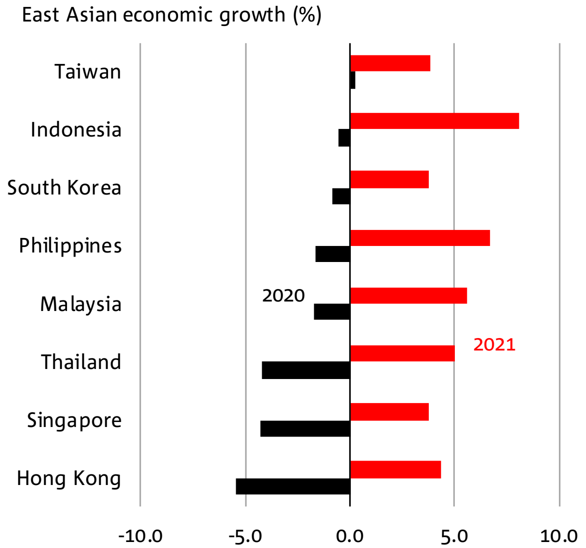
PMIs show continued weakness in EMs – particularly in services



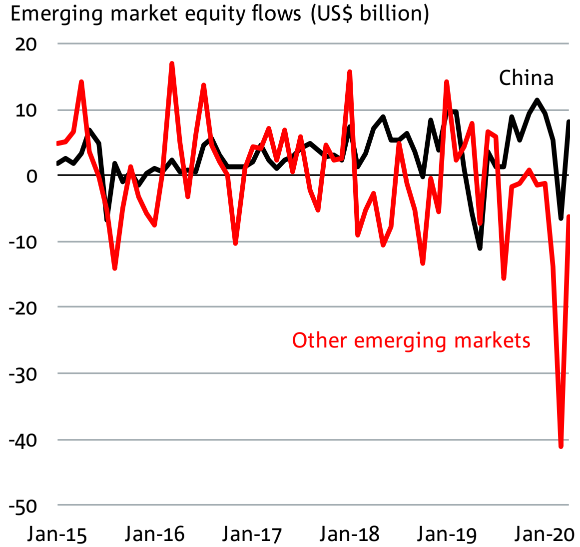
Manufacturing PMIs plunged in India and Indonesia



East Asia hit hard – particularly trade and tourist economies



Capital flow risk remains – equity outflows ex. China in April



Sources: Markit, Refinitiv, IIF, NAB Economics

- Conditions in emerging market economies have deteriorated, as COVID-19 countermeasures have impacted domestic output and demand, while the global economic downturn has restricted export demand from advanced markets.
- This is evident in the sharp downturn in emerging market PMI surveys. At an aggregate level, the Emerging Market Manufacturing PMI fell to 42.9 points – indicating a month-on-month decline in activity. This measure has been in negative territory since February, however the weaker outcome in April likely reflects increased number of countries that have implemented measures to prevent the spread of COVID-19. The EM services PMI was even weaker in April – at just 31.5 points, with India (see below) and Russia particularly negative.
- Preliminary indicators of Chinese conditions in April suggest that consumers remain cautious (compared with hopes of a boost as pent up demand was met). Analysis of UnionPay credit card data showed spending slowing in the first two weeks of April, when compared with levels in late March. This may suggest a plateauing in China's growth – leading to more of a U-shaped recovery, as opposed to the more rapid V-shaped recovery initially hoped for.
- Growing political tensions between China and a range of countries present a risk to the global economy when the widespread recovery phase commences. In early May, President Trump flagged the possibility of re-introducing tariffs that had been rolled back under the Phase One trade deal.
- Conditions in other key emerging market economies deteriorated rapidly in April. Manufacturing PMIs for India and Indonesia fell particularly sharply, with both below 30 points, while India's services PMI fell to just 5.4 points – highlighting the severity of its lockdown on economic activity.
- India has announced an extension of its COVID-19 countermeasures until mid-May, however it has eased restrictions in areas considered lower in risk. Major metropolitan areas (the core of the economy) are considered higher in risk and will remain constrained.
- Emerging market economies remain vulnerable to capital outflows. In April, there was a modest net inflow, however this followed a record outflow in March. The positive equity market inflows were concentrated in China, with a net outflow from non-China markets.

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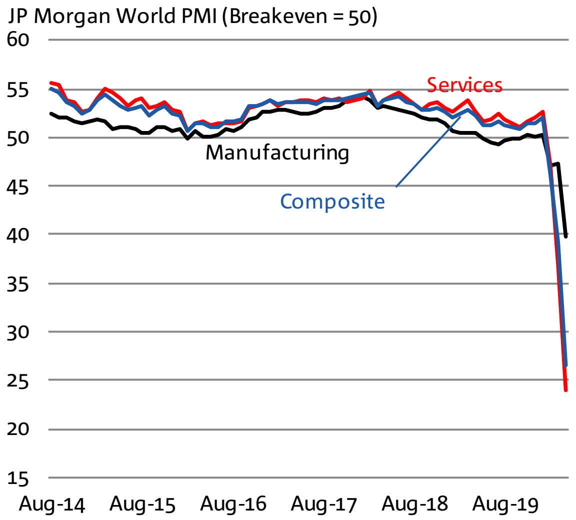
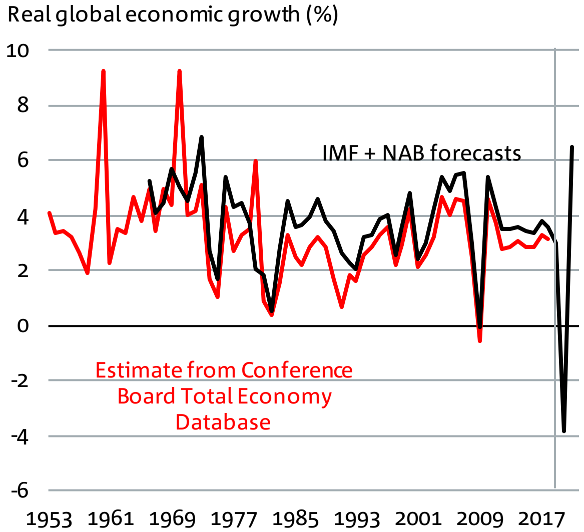
GLOBAL FORECASTS, POLICIES AND RISKS

Set for biggest fall in global GDP for many decades; full recovery to take time with many potential pitfalls

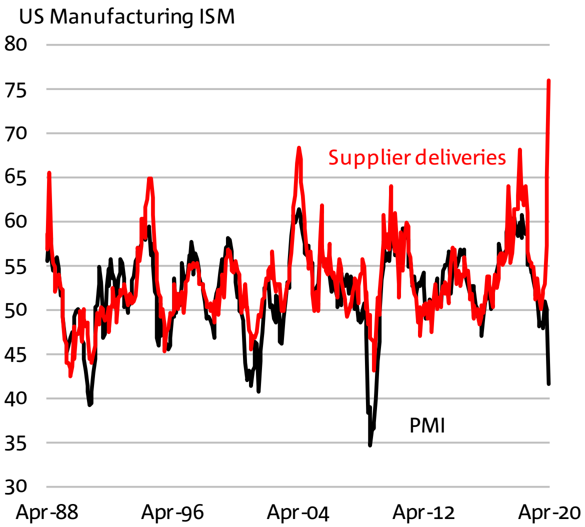
Fall in global activity accelerated in April



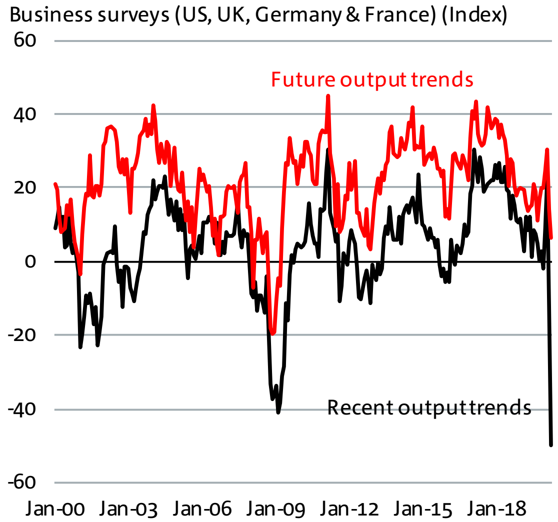
Global GDP set for largest fall since the ’50s, if not the great depression



Large supply disruptions evident and…longer-term issues to address



Expectations holding up better as likely already past the trough



- The impact of the COVID-19 countermeasures are likely to see the biggest fall in global GDP at least since the 1950s, and most likely since the Great Depression. We expect global GDP to fall by -3.8% in 2020. While growth is expected to rebound in 2021 by 6.5%, there are considerable risks around this outlook and the net result is well short of the historical average 7% growth over a two year period.
- Available Q1 GDP reports are pointing to broad based falls in activity. The JP Morgan World PMI plunged further in April, with services sectors remain the worst hit as they are most impacted by social distancing.
- The trough in activity is likely to be in Q2, as many countries have started to ease restrictions, although this will only be a gradual process. Societal behaviour is also likely to remain cautious as governments continue to recommend social distancing. Moreover, there is a risk of fresh outbreaks of the virus which may see some restrictions reimposed.
- While an easing in containment measures – if sustained – will likely lead to a bounce in activity, a full recovery from the downturn is likely to take an extended period of time for many countries. While this recession is unique, many of the problems it causes aren’t. Many businesses that were marginal at the time of downturn will likely close permanently. The damage to household and business balance sheets will likely hold back future activity.
- The significant deterioration in public finances across most countries will also need to be worked through. It is possible that EM capital outflows will end up de-stabilising some economies.
- Structural change within economies is also likely to be acute – for example, from a shift in international migration (changing future infrastructure needs), forced changes in work practices becoming permanent (increased work from home/less need for offices) as well as the possibility of less travel affecting tourism. It takes time to move resources from one sector to another.
- While businesses closures and consumers staying at home are major factors behind the downturn, there have been also widespread supply disruptions, as indicated by the rise in ‘supplier deliveries’ indicators in business surveys. While this will fade over time, supply chains – and their possible reorganisation and re-location – were already a major issue due to the US-China trade dispute. The risk of this dispute re-escalating has risen due to US-China tensions over COVID-19.

Sources: Refinitiv, World Bank, IMF, The Conference Board, NAB Economics

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