EMBARGOED UNTIL: 11.30AM THURSDAY 11 JUNE 2020

# THE FORWARD VIEW – GLOBAL

## JUNE 2020

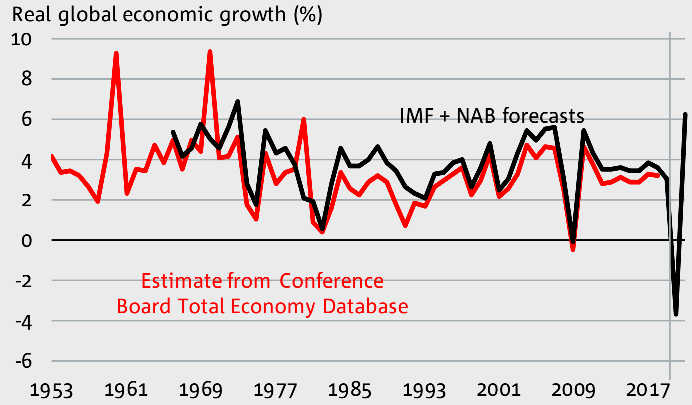
### Long climb back to 'normal' levels of global activity has started

- There was a massive plunge in activity across many countries in March/April, with the notable exception of China where the fall in activity was earlier (February). However, high frequency indicators point to an upturn in activity in May and into early June and business surveys have shown some improvement even if they still remain very weak. This has translated into an improvement in financial and commodity markets, although they have not fully recovered and there remains a degree of stress.
- The extent of the falls in activity that have been seen mean that extremely large falls in Q2 GDP for many advanced and emerging economies are likely, although with activity now strengthening, there may be a (partial) bounce back in Q3. We continue to expect that a full recovery will take a long time – including because of relatively weak consumption (due to high unemployment and caution due to COVID-19), permanent business failures caused by the recession, some long lasting structural changes which will take time to adjust to, and damaged balance sheets, including for governments.
- How governments manage the expiration of their COVID fiscal measures over time – some due to happen in coming months – looms as a key issue and a major source of uncertainty (together with the risk of a second wave of virus infections). In contrast, central bank policy is likely to remain highly supportive, if not eased further in countries with policy room, given the still weak level of activity and the likely deflationary impact of the recession.
- We expect the global economy to contract by 3.7% in 2020 (previously 3.8%), before increasing by 6.2% (previously 6.5%) in 2021. While there is a high degree of uncertainty over any forecast in the current environment the extent of the declines already seen to-date, combined with our expectation that a full recovery will take time, points to 2020 having the largest fall in annual growth since at least the 1950s, and most likely since the Great Depression.

**Global Growth Forecasts** (% change)

| | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|
| US | 2.9 | 2.3 | -6.8 | 5.3 |
| Euro-zone | 1.9 | 1.2 | -7.5 | 5.7 |
| Japan | 0.3 | 0.7 | -6.3 | 3.2 |
| UK | 1.3 | 1.4 | -8.4 | 6.4 |
| Canada | 2.0 | 1.7 | -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 | -6.8 | 3.3 |
| Other East Asia | 4.2 | 3.4 | -1.4 | 5.8 |
| Australia | 2.8 | 1.8 | -4.3 | 2.9 |
| NZ | 3.2 | 2.3 | -8.3 | 4.2 |
| **Global** | **3.6** | **3.0** | **-3.7** | **6.2** |

**2020 recession set to be the worst since at least the 1950s**

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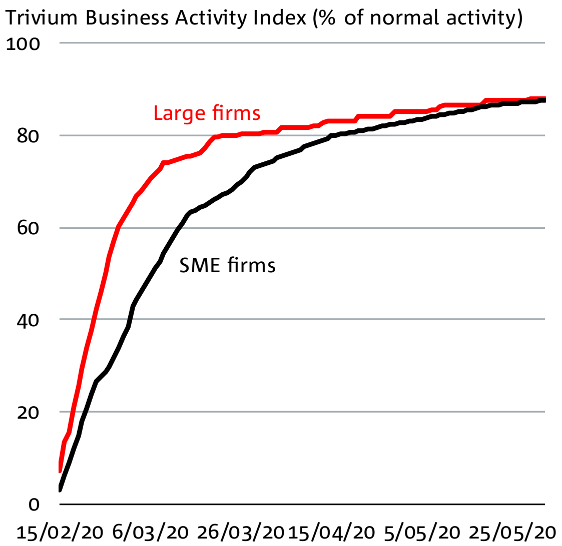
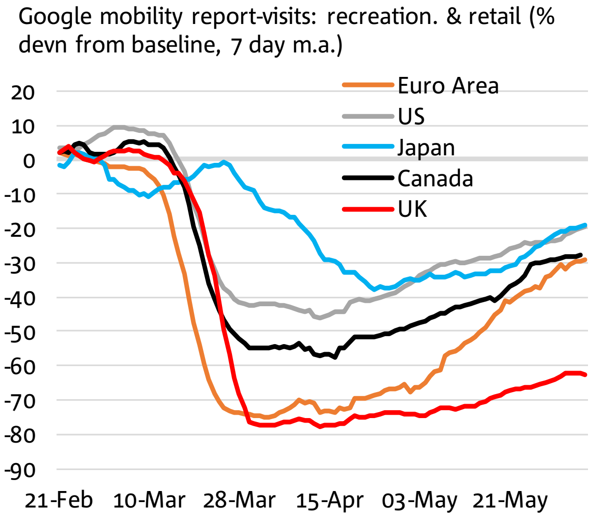
# RECOVERY UNDERWAY

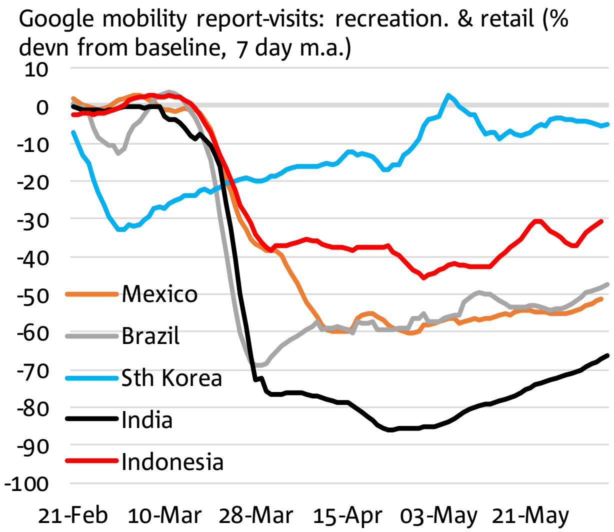
*High frequency data show improvement through May...China showing full return to 'normal' will be hard*

## China quick recovery to start but has slowed & still below pre-COVID level



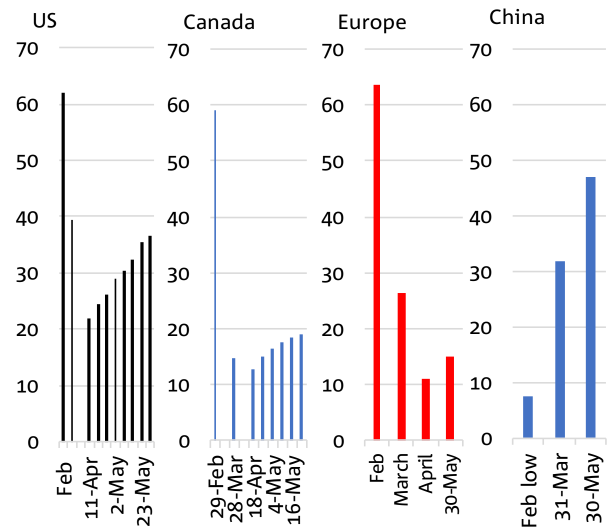

## Google mobility reports indicate recovery underway in AEs; EMs mixed - Sth Korea and some other Asian economies less affected, but Latin America struggling



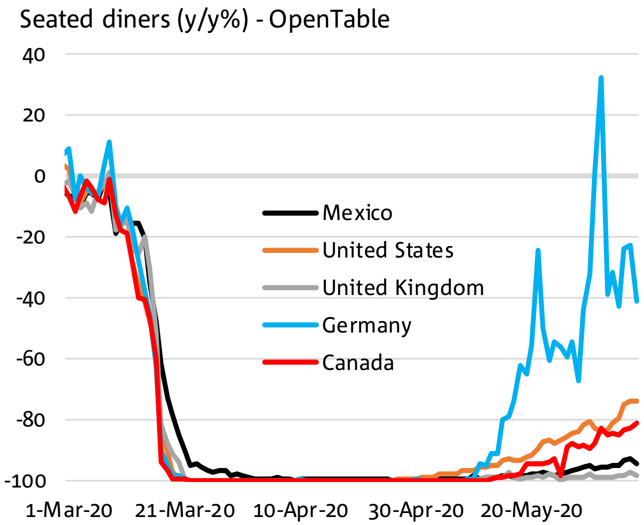

## Hotel occupancy up...long way to go

Occupancy rate (%) for open hotels - STR

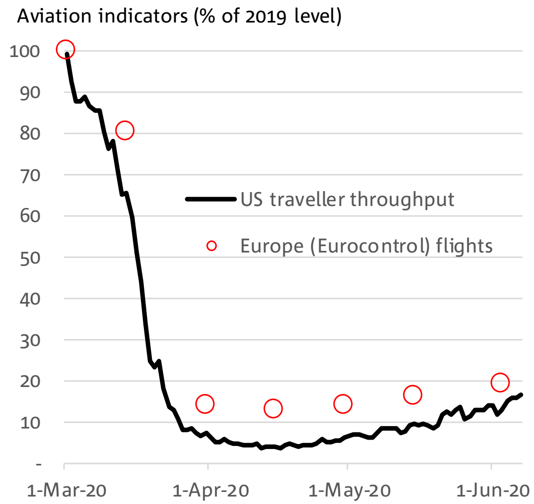



## Generally only a very slow recovery for restaurants

Seated diners (y/y%) - OpenTable




## Aviation in US/Europe struggling with minimal recovery




 Sources: Trivium, Google (https://www.google.com/covid19/mobility/), STR, OpenTable, TSA, Eurocontrol

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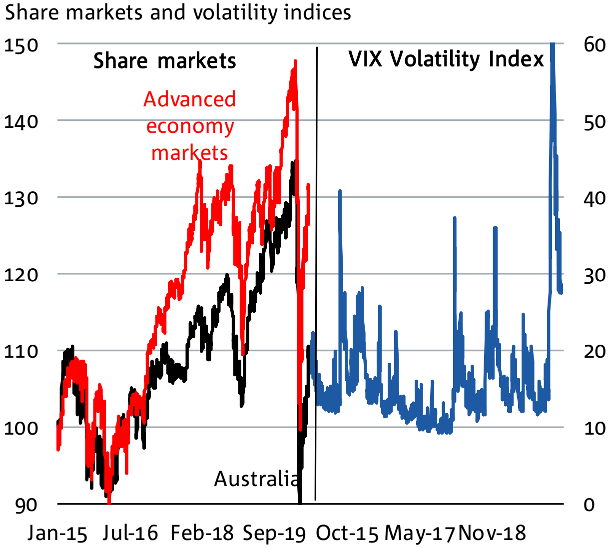
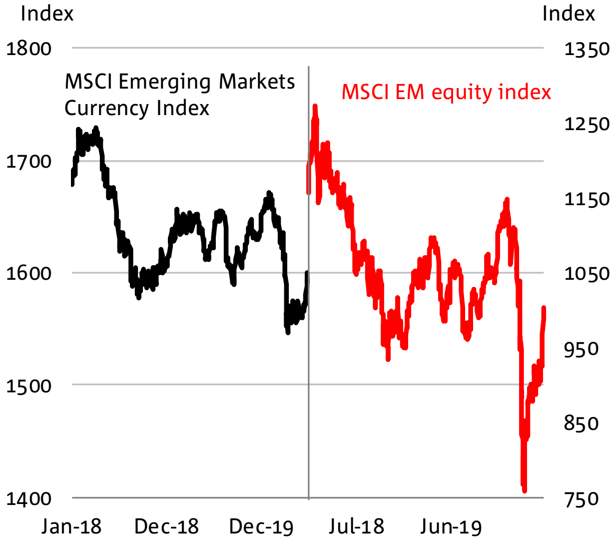
# FINANCIAL AND COMMODITY MARKETS

## *Signs of a global recovery is underpinning gains in financial markets*

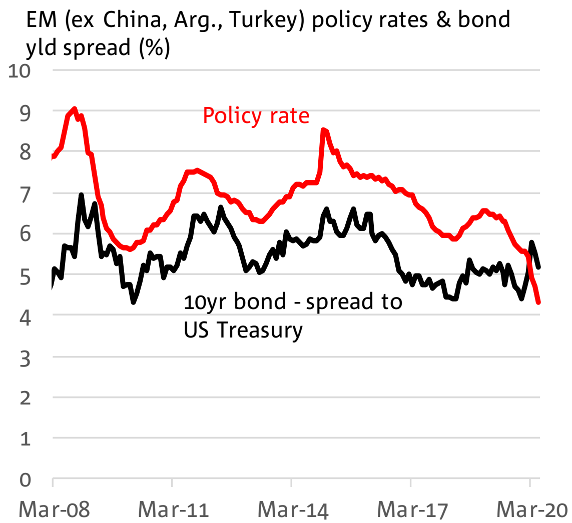
### Share markets continue to recover, volatility starting to ease



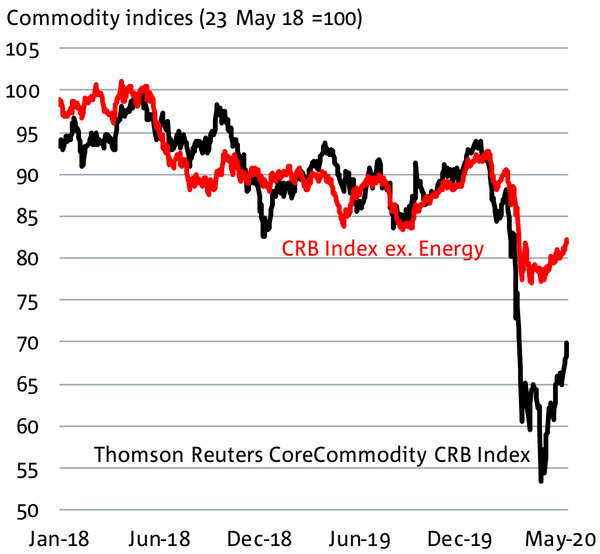

### Recovery also underway in EM markets




### EM central banks easing policy; EM spreads narrowing




### Commodity markets also showing gains…energy still well down



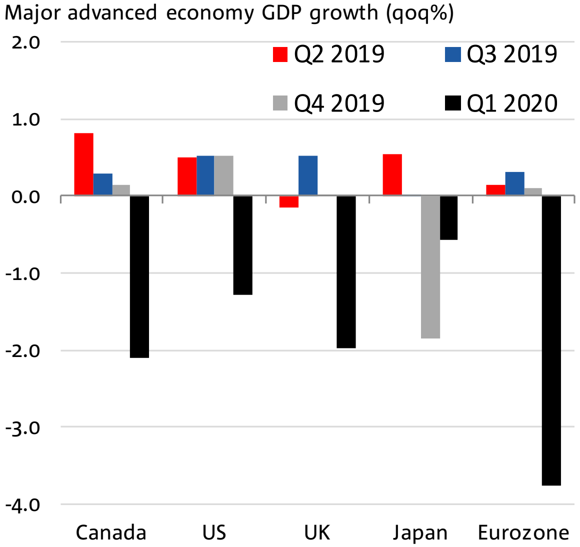

- With incoming activity data showing improvement, financial and commodity markets have continued to recover from the impact of the COVID-19 pandemic and the associated economic impact of containment measures. However, markets have not fully recovered and there remains a degree of stress.
- This can be seen in equity markets which fell sharply between mid-February and mid-March, but trended higher from April to early June. As a result, our composite indicator of AE stock market indices, has gone from being over 30% below its February peak to 'only' around 10% lower by early June. Stock market volatility has also declined substantially (as indicated by the US VIX) but remains elevated. Similarly, credit spreads have narrowed across a range of markets but are generally higher than pre-COVID-19.
- This is also the case in emerging market (EM) economies. Equity markets have partially recovered, as have currencies, as the large capital flows seen in March have stabilised (although they remain an issue for some countries, such as Brazil). A concern has been that stress on EM financial markets would force their central banks to tighten policy, counter to the need to support activity in the face of the large COVID-19-related shocks. In the event, EM central banks have been able to reduce their policy rates, and the recent narrowing of the EM bond spread to US Treasuries suggest that they have room to move further. That is not to say risks around EM markets have disappeared, as the fiscal and economic impacts of the global recession will mean the financial (and government fiscal) position of many will have weakened, leaving them more exposed.
- In contrast advanced economy (AE) central banks had limited room to ease policy rates (with the US Fed the main exception, although it too has now reached what it considers the lower bound for the fed funds rate). AE central banks have been active primarily through actions aimed to support financial market functioning and credit flow to businesses and households. Over the last month, the ECB has expanded its pandemic asset purchase programme, the BoJ introduced a funding programme to support SME lending, while the Fed launched its Main Street Lending facility.
- Commodity prices have largely mirrored developments in financial markets, and are still well down on their pre-COVID-19 levels, particularly in energy markets. However, there has been a partial recovery (although for some commodities, such as oil, this partly reflects supply cuts).

 Sources: Bloomberg, Refinitiv, NAB Economics

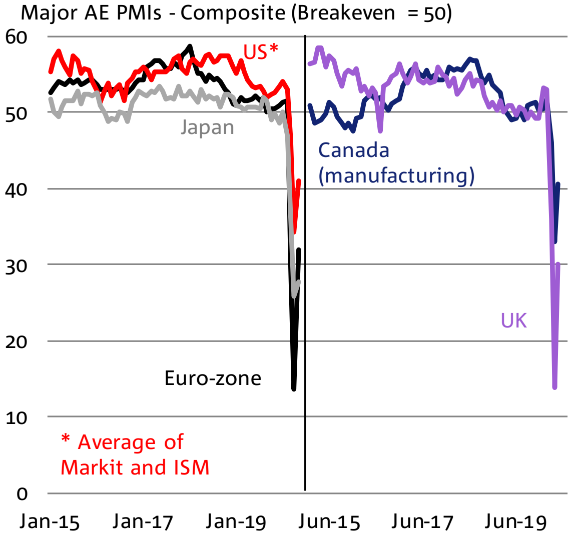
# ADVANCED ECONOMIES

*March/April collapse but recovery underway…a full recovery to take an extended time*

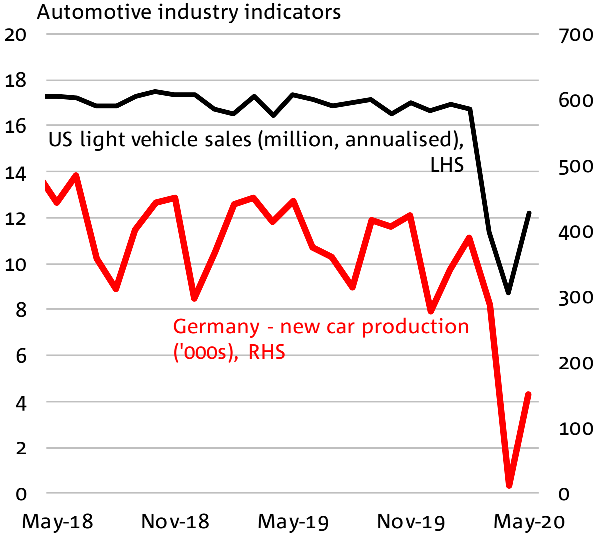
## Q1 GDP - large falls everywhere



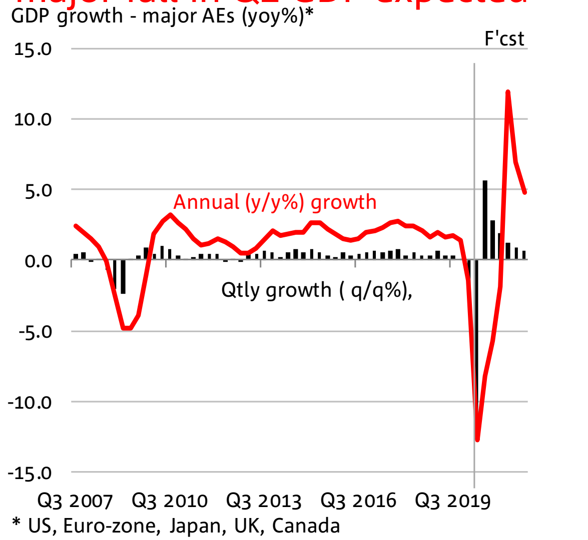

## Business survey collapse in April, but some improvement in May




## March April plunge, May rebound




## While recovery already underway major fall in Q2 GDP expected




Sources: Refinitiv, NAB Economics

- The introduction of significant restrictions on activity to bring COVID-19 under control produced a large fall in activity across the major advanced economies (AEs) in March and April. All the major AEs saw significant falls in Q1 GDP and even larger falls are expected for Q2. However, as restrictions have eased activity has started to recover, but while there may be an initial bounce a full recovery is likely to take an extended time. This is because of continued social distancing, the balance sheet damage done to many businesses/individuals, permanent business closures and long lasting structural impacts.
- Between February and April, retail sales declined by 21% in the Euro-zone, 23% in the US, 14% in Japan and 22% in the UK. A range of high frequency indicators point to activity recovering in May (see page 2) and May auto sales in the US, and auto production in Germany, rose sharply. Moreover, the number of jobs in the US increased 2.5m in May. However, most indicators remain substantially below their pre-virus levels (the number of US jobs is still down around 20m), so the average level of activity across Q2 will likely be substantially below that in Q1.
- This can be seen in estimates by INSEE of the fall in French GDP. In late March and through April it was down around 35% from 'normal', but by late May was 'only' down 21% (compared to a 5.3% q/q fall in Q1).
- While the incoming data continue to point to a substantial fall in activity in Q2, we have revised up our estimates for some countries either due to better than expected data (US, Germany, Japan), or, in the case of Japan, an earlier than expected end to the national state of emergency. However, we have revised down our forecast for the UK due to signs of an only slow improvement in the level of activity.
- Over the last month Japan and Germany have announced further substantial fiscal packages, and the EU is aiming to set up a Recovery Fund. How governments manage fiscal policy, balancing the need (and appropriate time) for further stimulus against the need to get budgets under control will be important in the period ahead. It won't be an easy balancing act; for example, over the two months to April US household income increased a massive 11% due to government payments (despite massive job losses) but this extra income was saved (the savings rate increased from 8% to 33%). How quickly these savings are run-down in coming months will depend on many factors, including how quickly the labour market recovers, thereby filling the gap as government support measures end.



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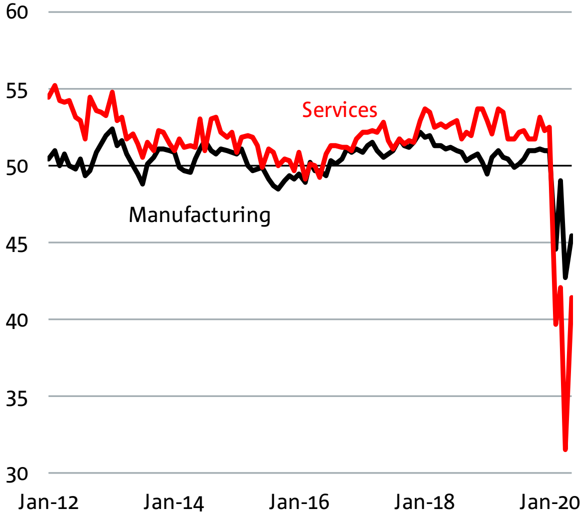
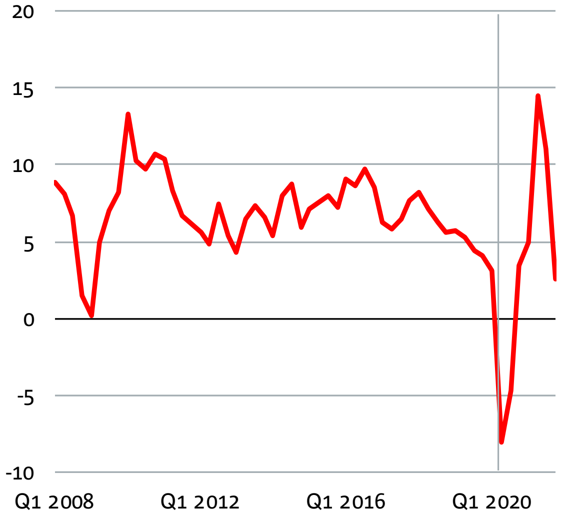
# EMERGING MARKET ECONOMIES

## *EMs remained constrained by domestic COVID countermeasures and weak global demand*

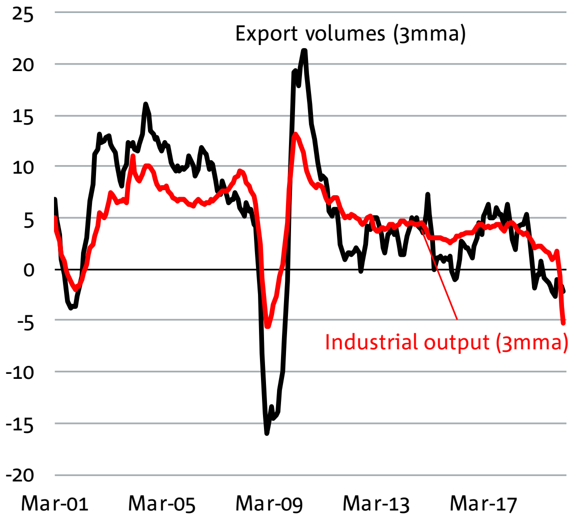
### PMI surveys highlight the weakness in EMs in May



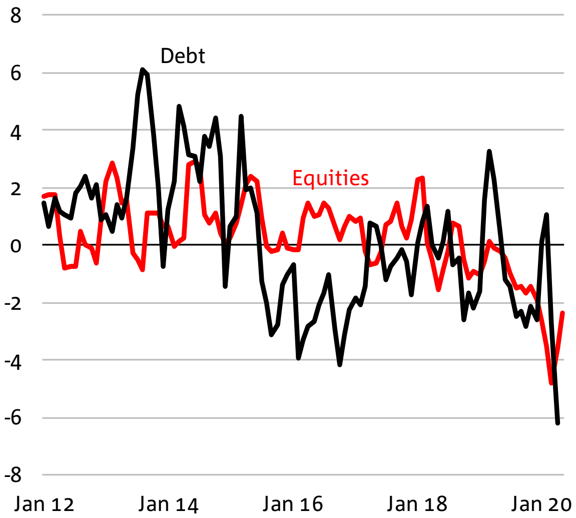

### India's growth slowed in Q1, but downturn is still to come




### Trade activity has deteriorated and will likely fall further




### Capital outflows a growing risk for Brazil




- Widespread countermeasures to the spread of COVID-19 have had a significant negative impact on emerging market economies, constricting domestic demand while exporters face a deeply depressed global trade environment.
- PMI surveys provide some of the most timely cross country comparisons of economic conditions. The aggregate Emerging Market Manufacturing PMI edged up to a still negative 45.4 points in May (from 42.9 points previously). This implies that manufacturing conditions remained very weak, particularly outside China.
- Services PMIs have been weaker – highlighting that interpersonal interaction is more frequently required in areas such as personal services than in capital intensive heavy industry. The aggregate EM Services PMI pushed up to a less negative 41.4 points (from 31.5 points in April).
- Economic growth in India – the world's third largest economy on a PPP basis – slowed in Q1 2020, down to 3.1% yoy. This was above our expectations (at 2.0% yoy) however the statistics agency noted challenges in collecting and compiling data due to COVID-19 restrictions – meaning that this result could be revised lower. These restrictions were implemented in late March, meaning that Q2 will likely show a sharp contraction. We continue to forecast a full year fall in India's GDP of around 1.5%.
- Emerging markets are more trade dependent than advanced economies, and the sharp decline in activity in major advanced economies therefore represents a substantial headwind. EM export volumes fell by 2.2% yoy (on a three month moving average basis) in March, however there will likely be further larger falls across Q2 as countermeasures became more widespread.
- Capital outflows have become a growing issue for Brazil – with investors alarmed by the handling of the COVID-19 outbreak and policy response of authorities. Outflows threaten the financial stability of Brazil and Latin America as a whole, following Argentina's technical default in late May. More generally, capital flows for Emerging Markets could remain volatile in the near term – as investors weigh the higher returns available in EM debt and equity markets against the perceived risks to these investments.

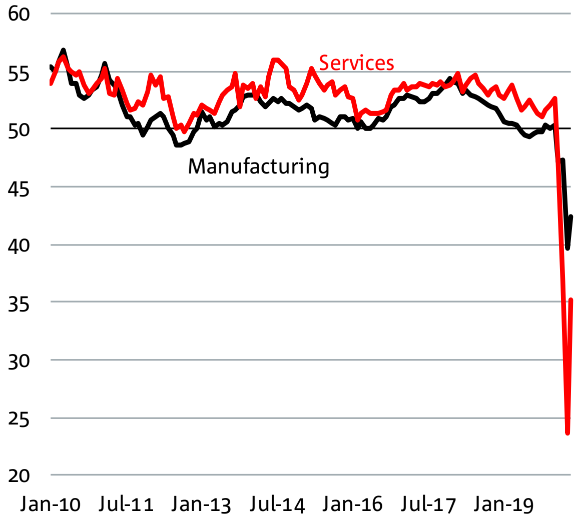
 Sources: Markit, Refinitiv, IIF, NAB Economics

# GLOBAL FORECASTS, POLICIES AND RISKS

## *Global economy to recover from Q2 trough, but a wide range of risks persist*

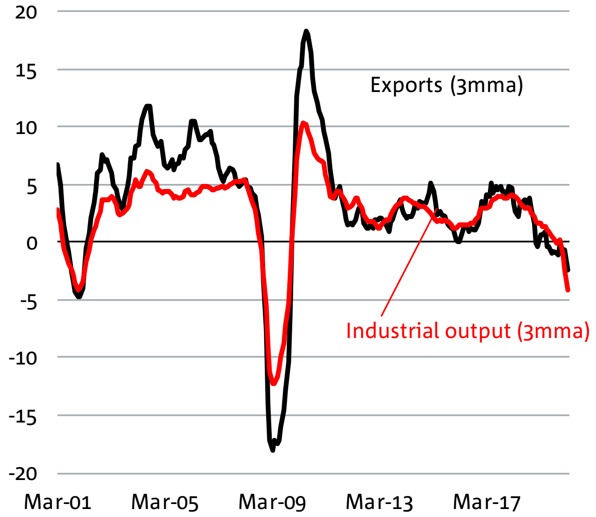
### Global PMIs show conditions remained negative in May

JP Morgan Global PMI (Breakeven = 50)



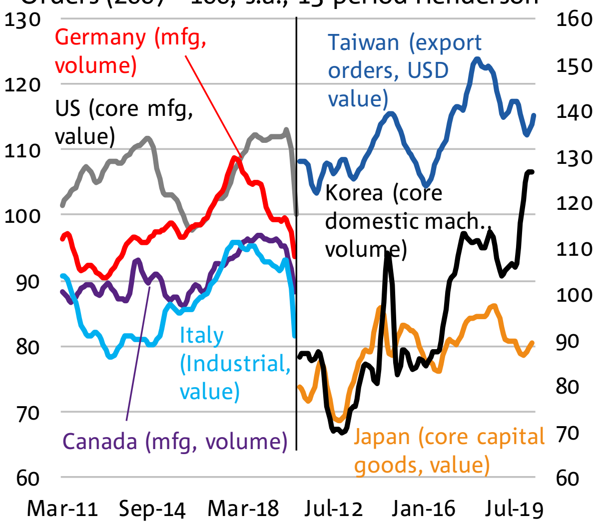

### Global trade has slowed sharply; supply chains may change

Global exports and industrial output (% yoy)



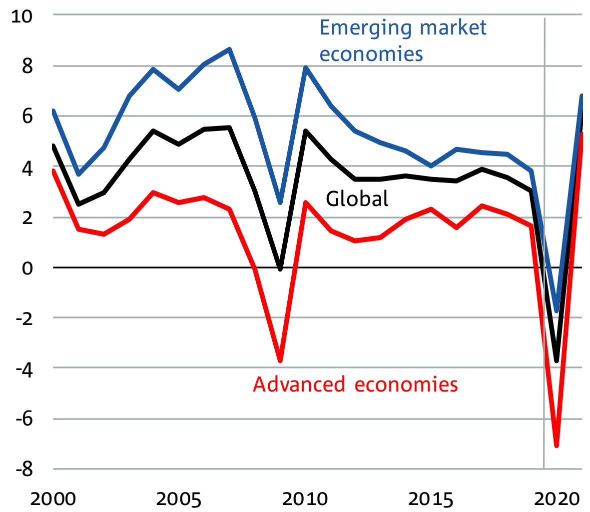

### New order data stronger in Asia than Europe and North America

Orders (2007 =100, s.a., 13 period Henderson




### The sharp downturn in the global economy in 2020

Global economic growth & forecasts (%)




Sources: Markit, Refinitiv, CPB, IMF, NAB Economics

- The global economy is in the midst of a deep downturn, the result of countermeasures to COVID-19 disrupting normal activity. Long term time series data suggests that 2020 will record the biggest contraction since at least the early 1950s and most likely since the Great Depression.
- Global PMI surveys provide some of the most timely readings of economic conditions. The JP Morgan Global PMI was less negative in May – at 36.3 points for the composite (manufacturing plus services) measure, from 26.2 points in April, however this still points to a broad deterioration in conditions during the month. Service sectors appear more heavily impacted, particularly consumer services.
- Available data shows that global trade volumes have contracted since mid-2019, however this downturn accelerated in March, falling by 3.8% yoy . As a broader range of economies extended COVID-19 lockdowns in April, upcoming data will likely remain weak for some time.
- A long term consequence of COVID-19 could be changes to global supply chains. The initial outbreak in China and its subsequent spread highlighted vulnerabilities and fragility in existing supply chains. Multinational firms may re-evaluate manufacturing and sourcing decisions, potentially to the detriment of Chinese manufacturers. It is too early to determine if this would mean increased onshore activity in advanced economies or a transfer from China to its near neighbours. To this end, it is interesting to note that while new industrial orders in North America and Europe have plunged, they have remained comparatively strong in Japan, Korea and Taiwan.
- Although we continue to expect Q2 to be the trough in global economic activity, given that a wide range of countries have started to ease their restrictions, the shape of the recovery remains uncertain. While there may be an initial bounce in activity in the second half of 2020, a range of factors could result in a slower recovery, including relatively weak consumption (due to high unemployment and caution due to COVID-19), business failures and constrained government balance sheets, with the latter likely to take several years to work through.
- The global economy is forecast to contract by 3.7% in 2020, before increasing by 6.2% in 2021. That said, there remain a broad range of risks to this forecast – including the potential for a second wave of COVID-19 infections that could result in additional counter measures, ongoing supply chain constraints and the risk of heightening US-China trade tensions. On the upside, it is possible the initial bounce in activity as restrictions are eased with be greater than we are factoring in.

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