EMBARGOED UNTIL: 11.30AM THURSDAY 16 JULY 2020

THE FORWARD VIEW – GLOBAL

JULY 2020

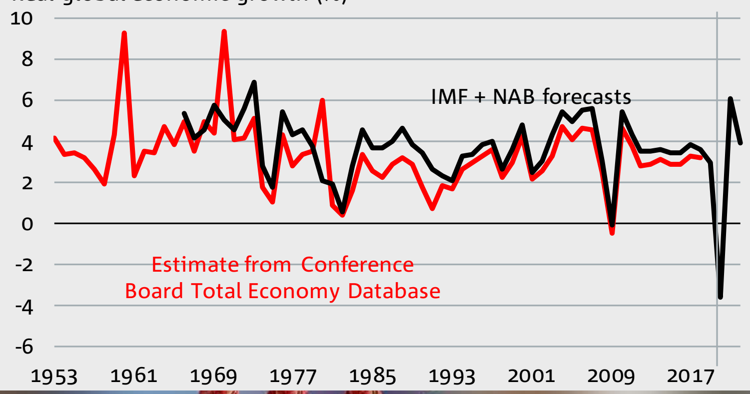
Global recovery continues but virus outbreaks a major risk

- The recovery in the global economy that started in May continued through June. Activity indicators for May and June improved as did business survey readings. Nevertheless, we still expect to see the biggest contraction in annual growth since at least the early 1950s and most likely since the Great Depression.
- The broadly improving trends for the global economy have generally resulted in stronger conditions in global financial markets, although financial conditions still remain tighter than pre-COVID-19.
- We expect that the trough in global economic activity will be in Q2, with a substantial rebound likely in Q3 barring a significant re-introduction of COVID countermeasures. In annual terms, the global economy is forecast to contract by 3.6% in 2020 (previously -3.7%), before increasing by 6.0% (was 6.2%) in 2021. in 2022 we expect the recovery to continue, with growth of 3.9%, modestly above its (pre-COVID) average of recent decades.
- A key risk to this outlook is renewed outbreaks of COVID-19 (as is occurring in the US) or uncontained outbreaks (e.g. Latin America, India) and re-imposition of restrictions (or delays in their removal). A reimposition of at least some restrictions has already occurred in some countries, such as in parts of the US, India and China, although as yet there has not been a repeat of the (essentially) nationwide shutdowns seen earlier. That said, the situation is fluid and this could change, and so virus developments remain a key risk.
- This will weigh on business and consumer confidence, and is one reason we expect that a full recovery from the global recession will take time for many countries. The fallout from the virus for travel, increased online shopping and work from home also points to large scale structural change. Moreover, other global risks remain in place – particularly around trade – which may cause firms may re-evaluate their supply chains, adding to the disruption to economies.

Global Growth Forecasts (% change)

	2018	2019	2020	2021	2022
US	2.9	2.3	-5.9	4.2	2.9
Euro-zone	1.9	1.2	-7.4	5.7	2.4
Japan	0.3	0.7	-6.2	3.0	1.4
UK	1.3	1.4	-8.2	6.5	2.4
Canada	2.0	1.7	-7.5	4.9	3.1
China	6.8	6.1	1.0	9.8	5.8
India	6.8	4.9	-1.5	8.0	6.0
Latin America	1.1	0.1	-7.4	3.1	3.5
Other East Asia	4.2	3.4	-1.3	5.8	4.3
Australia	2.8	1.8	-1.8	1.6	2.8
NZ	3.2	2.3	-7.8	3.0	4.2
Global	**3.6**	**3.0**	**-3.6**	**6.0**	**3.9**

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



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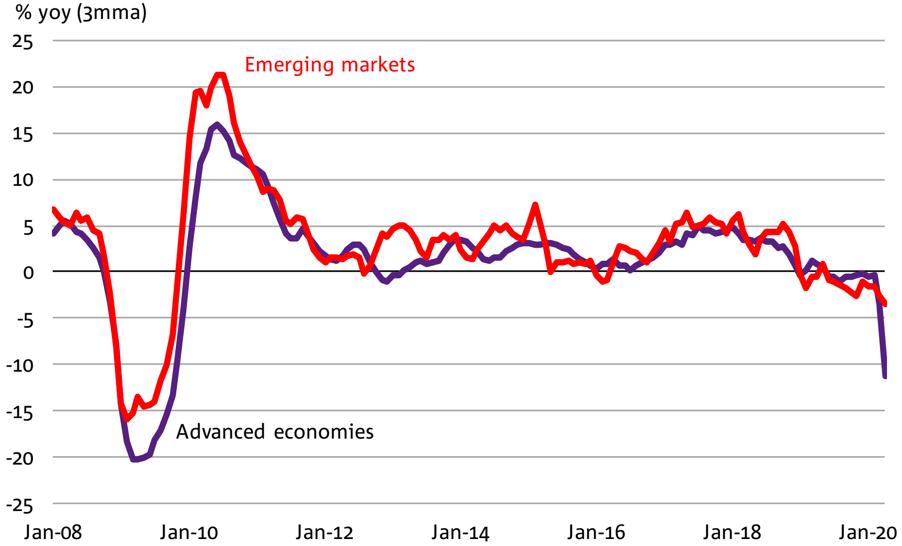
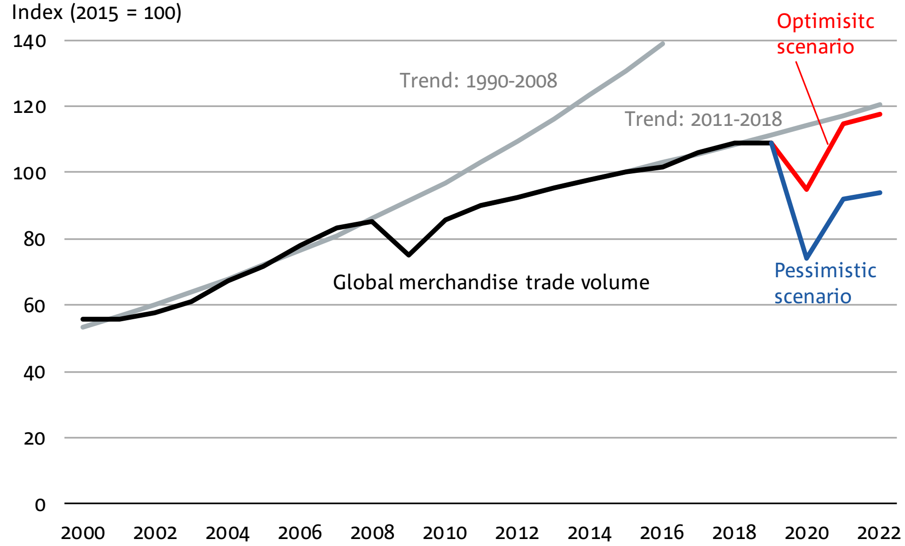
COVID-19 WILL IMPACT GLOBAL TRADE ACTIVITY IN 2020

Downturn in trade already evident, but the full scale remains uncertain

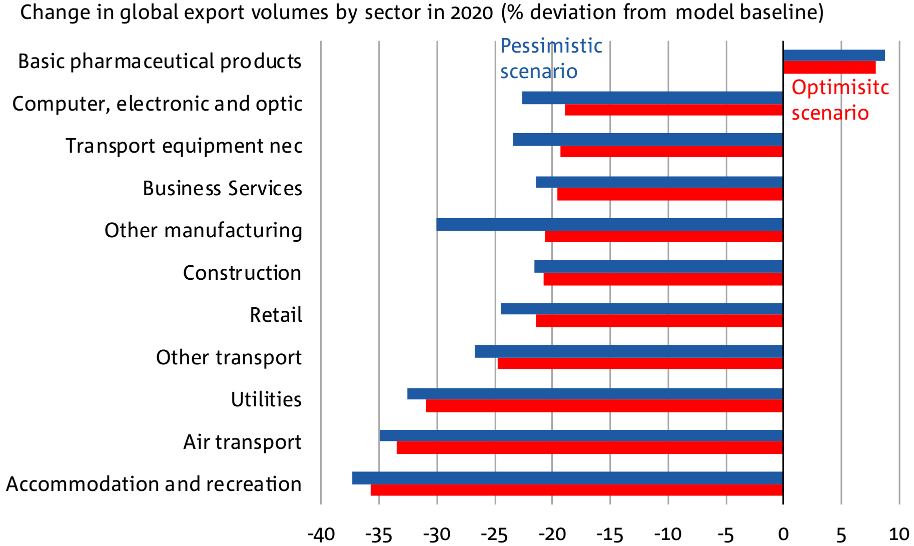
Data to April 2020 show sharp slowdown in AE exports, but longer running declines in EMs



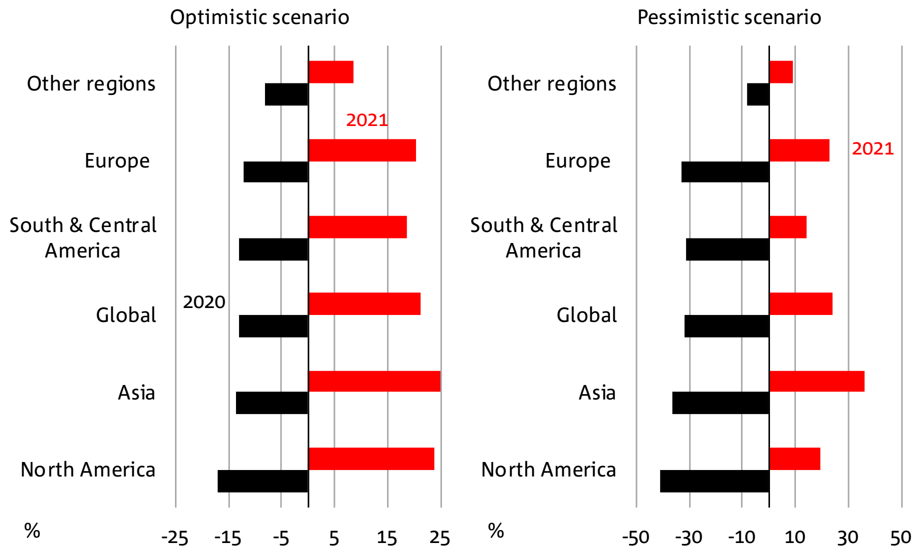
WTO forecasts steep decline in global trade volumes in 2020. Question is how fast is the recovery?



Transport and accommodation services among the hardest hit sectors



North America & Asia record the largest downturn in exports in 2020, with Asia seeing the largest recovery



Sources: CPB, World Trade Organization, NAB Economics

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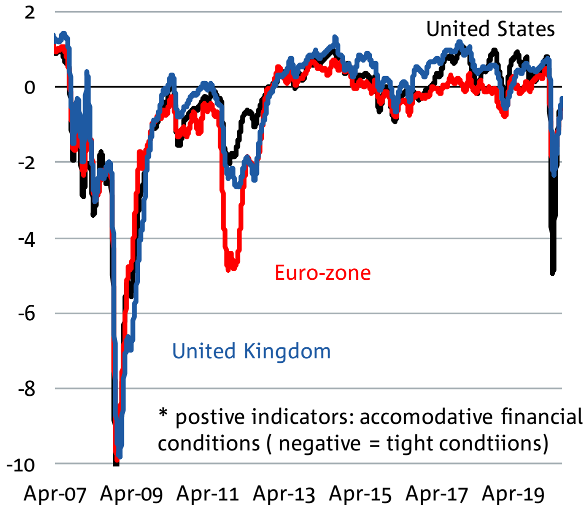
FINANCIAL AND COMMODITY MARKETS

Broadly improving trends in line with global recovery, but signs of stress persist

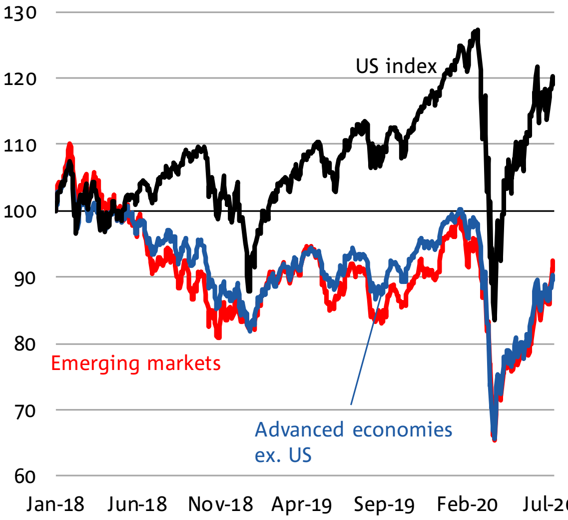
Improvement in financial conditions, but still negative

Finanical conditions indices (rolling monthly average)*



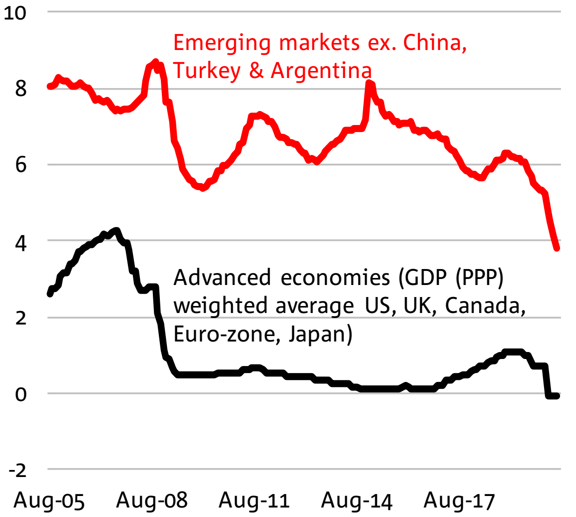
Equity markets have surged from deep troughs in late March

MSCI Equity Indices (1 Jan 18=100)



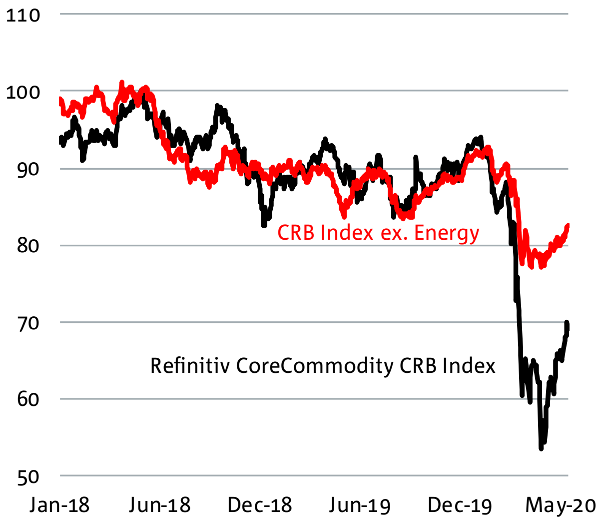
EM central banks have cut rates, despite concerns about outflows

Average central bank policy rates (%)



Commodity prices trending higher but still relatively weak

Commodity indices (23 May 18 =100)



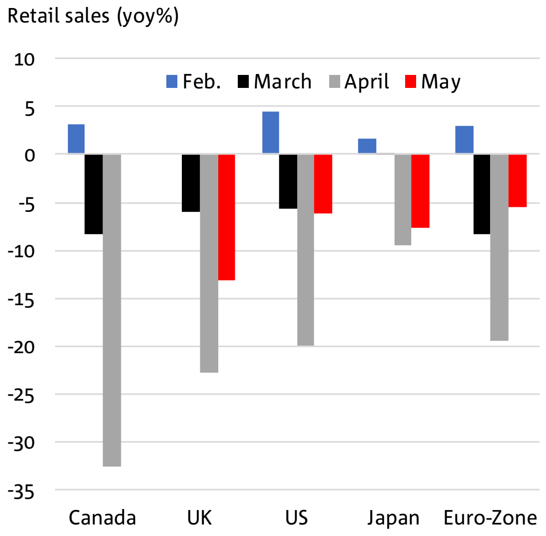
Sources: Bloomberg, Refinitiv, NAB Economics

- The broadly improving trends for the global economy – albeit recovering from incredibly weak levels – have generally resulted in stronger conditions in global financial markets. Financial condition indices for major advanced economies deteriorated sharply between mid-March and mid-April, but have subsequently improved – though not yet back to pre-COVID-19 levels.
- It is worth noting that these indices remain marginally in negative territory – despite central banks having little conventional policy room for easing. This suggests that there remains some degree of stress in financial markets that is yet to be resolved.
- This recovery is relatively broad based from a geographic perspective – with equity market indices in the United States and Emerging Markets showing increases in excess of 40% from the late March troughs (at the time of writing), while the increase in other advanced economy indices was slightly below this rate. However, these indices remain below their pre-COVID-19 levels.
- Volatility – as measured by the US VIX index – has also declined from peaks in March, that briefly exceeded those recorded during the Global Financial Crisis. However, volatility at the time of writing remains well above the typical pre-COVID-19 levels.
- Risks in financial markets persist – particularly among emerging markets, where the unchecked spread of COVID-19 in some countries presents downside to the expected Q3 recovery (see page 5). These markets are more vulnerable to capital outflows (albeit funds flowed into emerging markets in June).
- Concerns around outflows have not constrained emerging market central banks from easing monetary policy. Our weighted average of EM policy rates (which excludes China, Turkey and Argentina) has fallen by around 150 basis points since January. Cuts to rates in India, Brazil and Russia were the main contributors to this decline.
- Commodity prices have trended higher from a trough in April, however the CRB Index remains well below pre-COVID-19 levels. In particular, energy prices have been weaker – reflecting the impact of sharply weaker demand for oil, as COVID-19 has disrupted global transportation. While OPEC+ has agreed to production cuts, these measures have only restored prices to the low US$40 range – a low level by recent historical standards. The recovery in non-energy commodity prices has been muted, despite improving global manufacturing indicators.

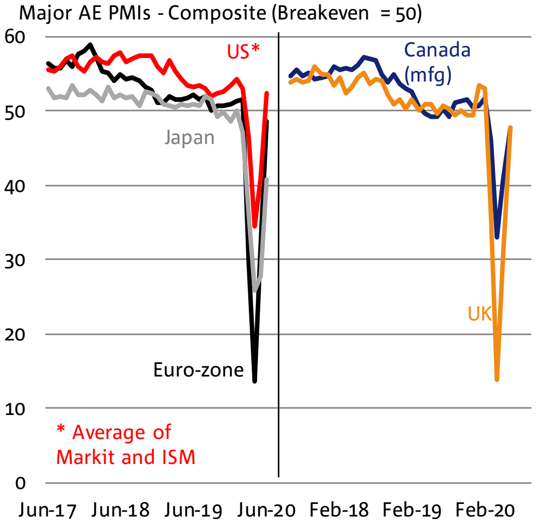
ADVANCED ECONOMIES

Recovery continued through June; still a long way to go and virus outbreak in US a concern

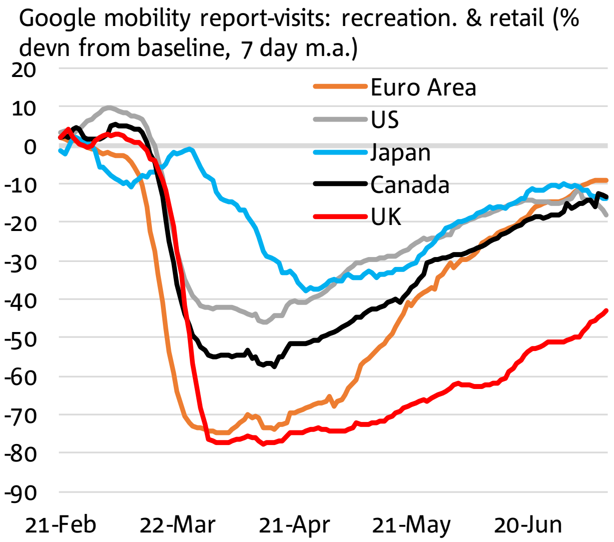
Activity data bounces back in May



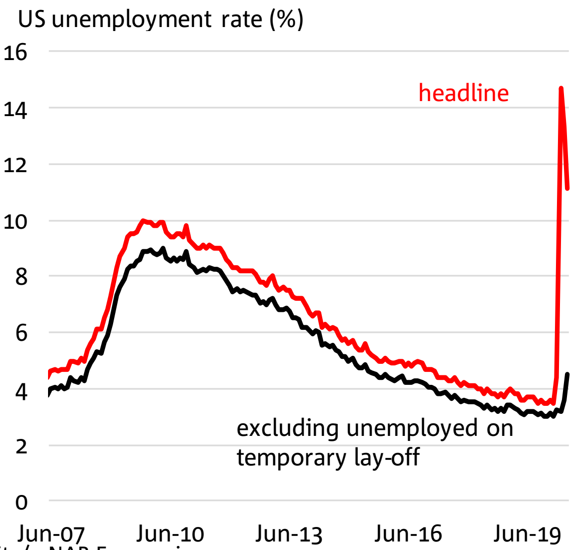
Business surveys indicate further gains in June...



...as do high frequency data, but US starting to weaken again



Recovery underway but long-term damage will remain



- After the massive declines in activity in many advanced economies over March and April, incoming data point to a strong rebound over May and June. However, the average level of activity in Q2 is still well below that seen in Q1, so our expectation of very large GDP falls in the quarter remains in place. Moreover, we continue to expect that a full recovery will take an extended period of time, and the speed of recovery will be uneven particularly if there are further outbreaks of the virus as in the US currently.
- Between February and April, retail sales declined by around 20 to 30% in the major AEs but there was a substantial bounce back in May. Notably, in Germany retail sales moved above their pre-COVID level, perhaps pointing to an element of pent-up demand, but for most sales are still well down. In Japan the fall was smaller, and the bounce back more muted, perhaps reflecting the latter timing of restrictions and their largely voluntary nature.
- High frequency data – such as Google mobility reports – also confirms improvement through June. More recently, some (but not all) high frequency data for the US have either flattened out or fallen slightly. As some restrictions have been re-imposed and re-opening plans delayed – this is not a surprise, but there is considerable uncertainty around what will happen next. As incoming US data has been better than expected we recently lifted our forecast for Q2 but, reflecting the increased virus spread, lowered the forecast for subsequent quarters. How the virus spreads – and any re-emergence – and the policy response remains a key risk. Japan has also seen an upturn in cases recently but it has yet to lead to a shift in COVID-19 policy measures.
- The size of the swings in economic activity are illustrated by monthly GDP estimates where available. In France, GDP was estimated to be 16% below its typical level in March; this rose to -32% in April but by June had recovered to 'only' -12%. Similarly, between February and April Canadian and UK GDP fell by 18 and 25% respectively.
- While there has been a rapid rebound in activity, it still remains well below its pre-COVID-19 levels and a full recovery is likely to take a long time. This reflects the likelihood of further outbreaks of the virus delaying or winding back, 're-opening', household and business caution, damaged balance sheets, tighter financial conditions, permanent business closures and long lasting structural impacts. Supporting this theme, while the US unemployment rate has fallen over the last two months (to a still very high level), the rate for those not in the temporary lay-off category has risen.

Sources: Refinitiv, https://www.google.com/covid19/mobility/ , NAB Economics

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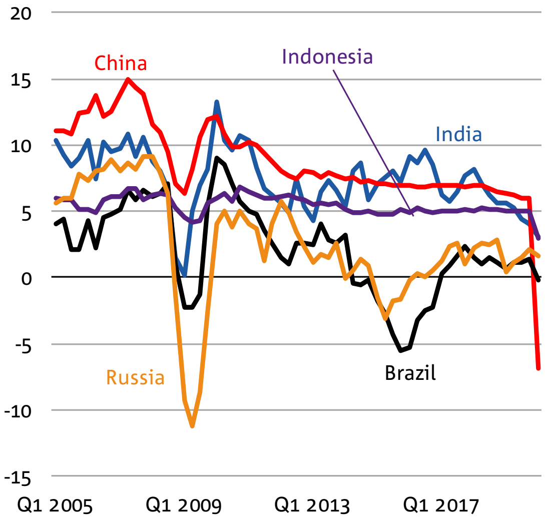
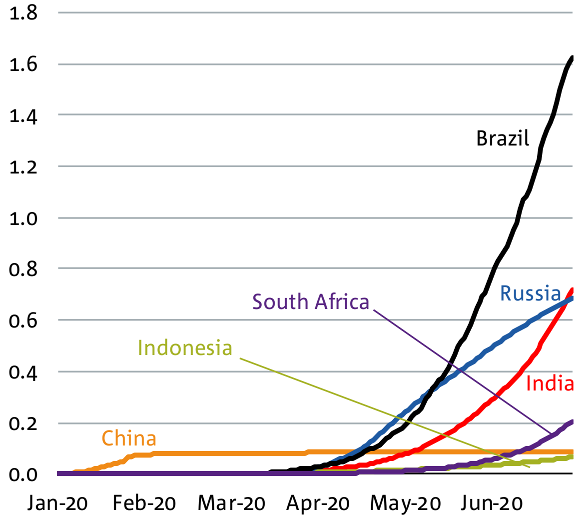
EMERGING MARKET ECONOMIES

PMIs point to recovery from multi-decade lows, but COVID risk remains

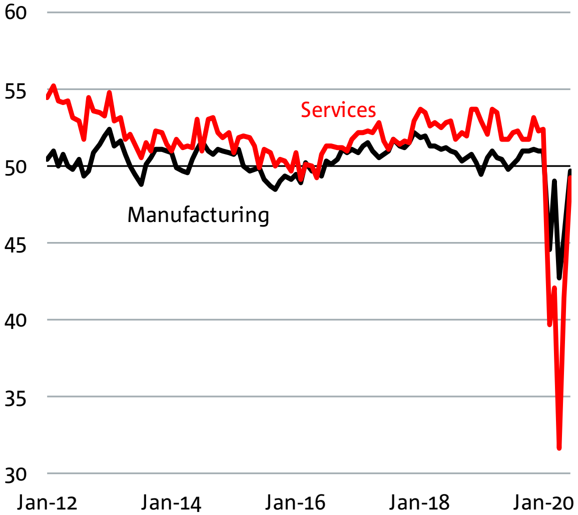
Q1 downturn driven by China; others to follow in Q2



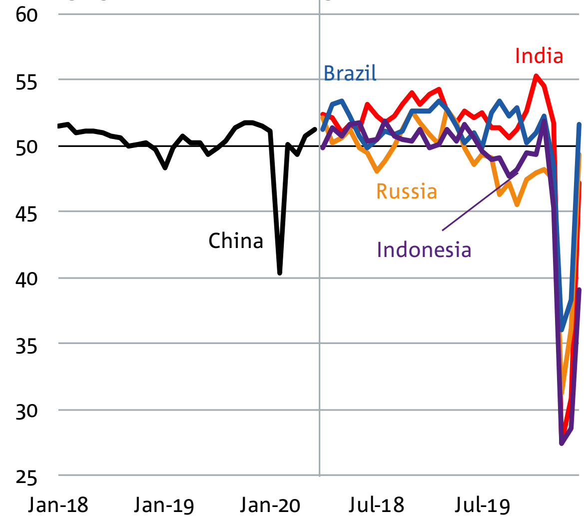
Unchecked spread of COVID-19 a threat to Q3 economic recovery



Sharp rebound in EM services PMI in June



India and Russia drove rebound in EM manufacturing



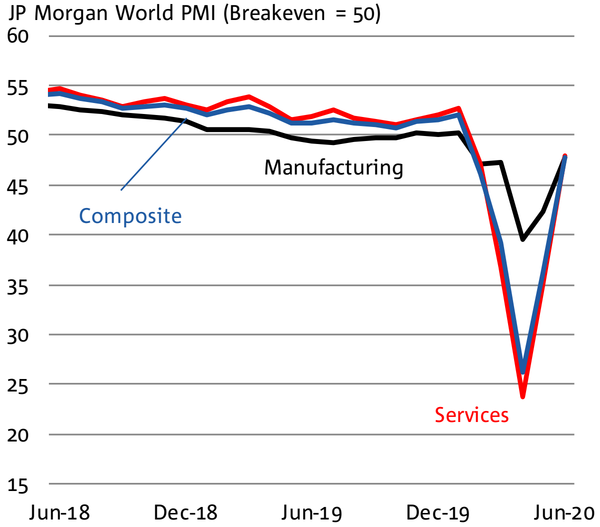
- Economic growth in emerging markets declined rapidly in Q1 2020 – falling by an estimated 2.2% yoy – the weakest rate of growth since at least early 1995 (when our quarterly measure commenced). The sharp downturn in China – due to its COVID-19 countermeasures – was the primary driver.
- While China likely recorded a partial recovery in Q2, the downturn in other major EMs during this period is likely to result in a larger slowdown in the quarter. We expect the broad recovery in EMs to commence in Q3, however there remains considerable uncertainty, particularly given the unchecked spread of COVID-19 in a number of these economies. For example, various cities in India are reintroducing lockdowns due to the surge in cases.
- PMI surveys for EM economies were considerably improved in June – consistent with our recovery expectations. The aggregate EM manufacturing PMI rose to an effectively neutral 49.6 points (from 45.4 points in May). While the measure for China was marginally improved, the rapid turn around in India and (to a lesser extent) Russia were key drivers.
- The recovery in the aggregate EM services PMI was considerably stronger – up to 49.2 points (from 41.4 points previously). India and China were the main contributors, with the China services PMI particularly strong at 58.2 points in June.
- That said, the weakness in global trade is likely to remain a constraint on the emerging market recovery in the near term – with economic growth in the region more highly dependent on trade than advanced economies. Export volumes for emerging markets contracted by 3.4% yoy (on a three month moving average) in April, with a deeper contraction likely in May.
- There remains uncertainty around the direction and volume of global capital flows – which poses risks for the financial stability of a range of emerging market economies. Recent months have seen some large outflows, particularly for non-China Asia and Latin America, however there was a reversal in June, with the Institute of International Finance reporting almost US$33 billion of inflows during the month.
- Volatile risk sentiment is likely to remain in the near term, as investors weigh higher returns in EM financial markets against the perceived risks to these investments.

 Sources: Markit, Refinitiv, John Hopkins University, NAB Economics

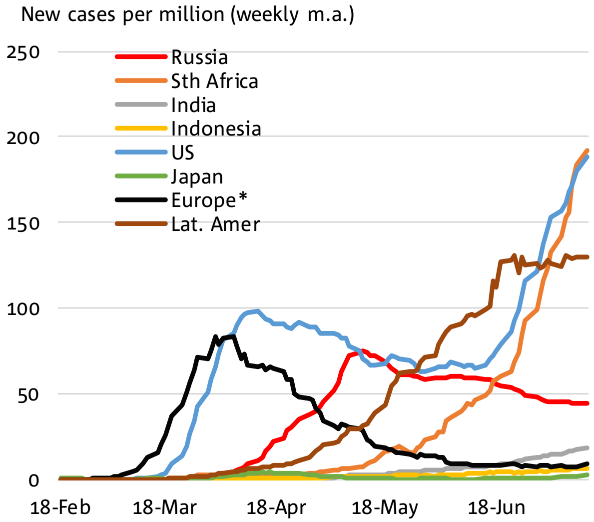
GLOBAL FORECASTS, POLICIES AND RISKS

Global recovery continues into June, but virus still spreading in many regions

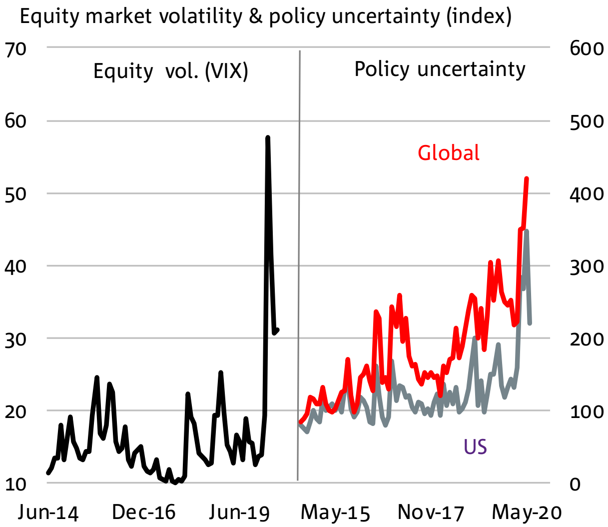
Broad based upturn in business surveys in June



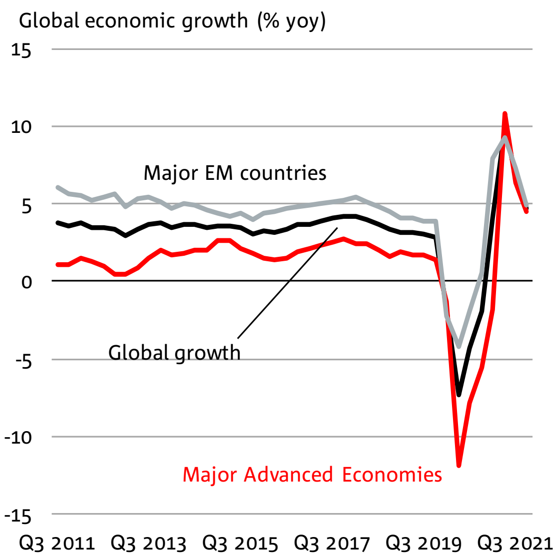
COVID still a risk – still high or rising in some regions



Markets still volatile and policy uncertainty very high



Expect the trough to be in Q2



- The global economy is continuing to recover from the extremely deep downturn caused by measures to reduce the spread of COVID-19. While we have modestly revised up our forecast for 2020, we still expect to see the biggest contraction in annual growth since at least the early 1950s and most likely since the Great Depression.
- The JP Morgan Global PMI improved further in June, reaching 47.7 points for the composite (manufacturing plus services) measure. The gains occurred both in manufacturing and services, although were more pronounced for the later which was more affected by the COVID-19 countermeasures put in place earlier in the year. The improvement was broad based; of the 41 country PMIs we have data for, 39 improved in June (based on composite measure where available).
- As a result we expect that Q2 will be the trough in global economic activity. While a wide range of countries have eased their restrictions, the pace of the recovery remains uncertain. It could easily be interrupted by renewed outbreaks of COVID-19 and re-imposition of restrictions (or delays in their removal). At this stage there appears to be a high bar to a return to the (essentially) nationwide shutdowns seen earlier – some countries are easing restrictions even as cases remain high (e.g. in Latin America), other have re-imposed (some) restrictions at the local/state level (e.g. India, US, China) while the French PM has ruled out another total lockdown if cases were to spike. That said, the situation is fluid and this could change, and so virus developments remain a key risk.
- Another related uncertainty is how governments manage the unwinding of the large fiscal programs put in place. Not surprisingly measures of policy uncertainty are extremely high and financial markets continue to exhibit considerable volatility.
- These factors will weigh on business and consumer confidence, and is one reason we expect that a full recovery from the global recession will take time for many countries. The fallout from the virus for travel, increased online shopping and work from home also points to large scale structural change. Moreover, other global risks remain in place – particularly around trade – which may cause firms may re-evaluate their supply chains, adding to the disruption.
- We expect the global economy to contract by 3.6% in 2020 (previously -3.7%), before increasing by 6.0% (was 6.2%) in 2021. In 2022 we expect the recovery to continue, with growth of 3.9%, modestly above its (pre-COVID) average of recent decades.

 Sources: Refinitiv, 'Measuring Economic Policy Uncertainty' by Scott R. Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com, NAB Economics. * Europe represented by Germany, France, Italy, Spain, UK.

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