EMBARGOED UNTIL: 11.30AM THURSDAY 13 AUGUST 2020

THE FORWARD VIEW – GLOBAL

AUGUST 2020

National Australia Bank

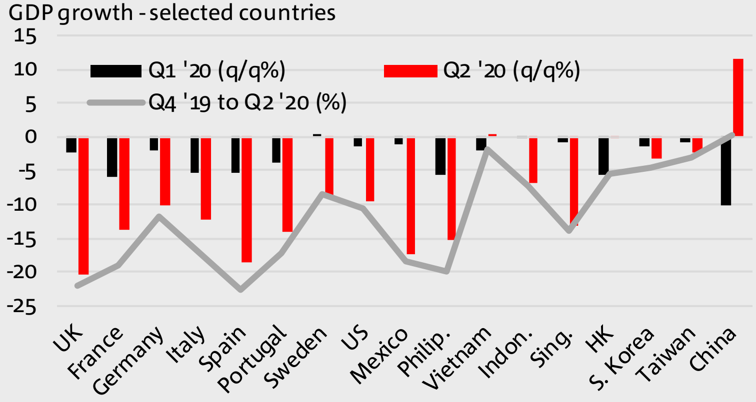
Global recovery continues but it is uneven and still a long way back to 'normal'

- The global economy continues to recover from the impact of COVID-19, and the associated societal and government response. However, there is still a long way back with progress uneven globally. Of particular concern, high frequency indicators for the US and India have stalled on the back of a resurgence of the virus, although in this regard the worst may be over for the US.
- The global recovery is being reflected in financial markets. Equity markets continue to recover, market volatility and spreads have eased and commodity prices have turned up. In contrast bond yields remain low reflecting the likely longer term fall out for economies and monetary policy.
- Incoming Q2 GDP data confirm a massive hit to advanced economies (AEs) from the response to COVID-19, including stringent containment measures. GDP fell by 9.5% q/q in the US, 20% in the UK and by 12.1% q/q in the Euro-zone; this was on top of smaller Q1 declines. The trough in activity across the AEs was centred on April and the subsequent recovery sets the stage for strong growth in Q3, although some countries have imposed some regional restrictions which are also acting as a brake on the recovery. A full recovery will take a long time.
- Trends are mixed across the Emerging Market economies. China's economy, the first to be impacted by COVID-19, recovered more strongly than expected in Q2, albeit unevenly, and GDP is now above its Q4 2019 level. In contrast, India's recovery appears to have stalled and COVID-19 continues to spread rapidly in Latin America.
- Our global forecast is marginally weaker this month at -3.8% for 2020 and +5.9% for 2021. How the virus spreads, and how countries respond (including maintaining appropriate fiscal support), is likely to remain a key driver of economies and so it remains a key risk for our projections.

Global Growth Forecasts (% change)

	2018	2019	2020	2021	2022
US	3.0	2.2	-5.1	3.7	2.8
Euro-zone	1.9	1.3	-7.0	5.9	2.3
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	-7.0	4.8	2.9
China	6.8	6.1	1.5	9.5	5.8
India	6.8	4.9	-4.0	8.0	6.0
Latin America	1.1	0.1	-8.4	3.9	3.6
Other East Asia	4.2	3.4	-3.2	5.3	5.1
Australia	2.8	1.8	-3.8	0.8	2.9
NZ	3.2	2.3	-7.8	3.0	4.2
Global	**3.6**	**3.0**	**-3.8**	**5.9**	**3.9**

Many countries had exceptionally large falls in Q2 GDP



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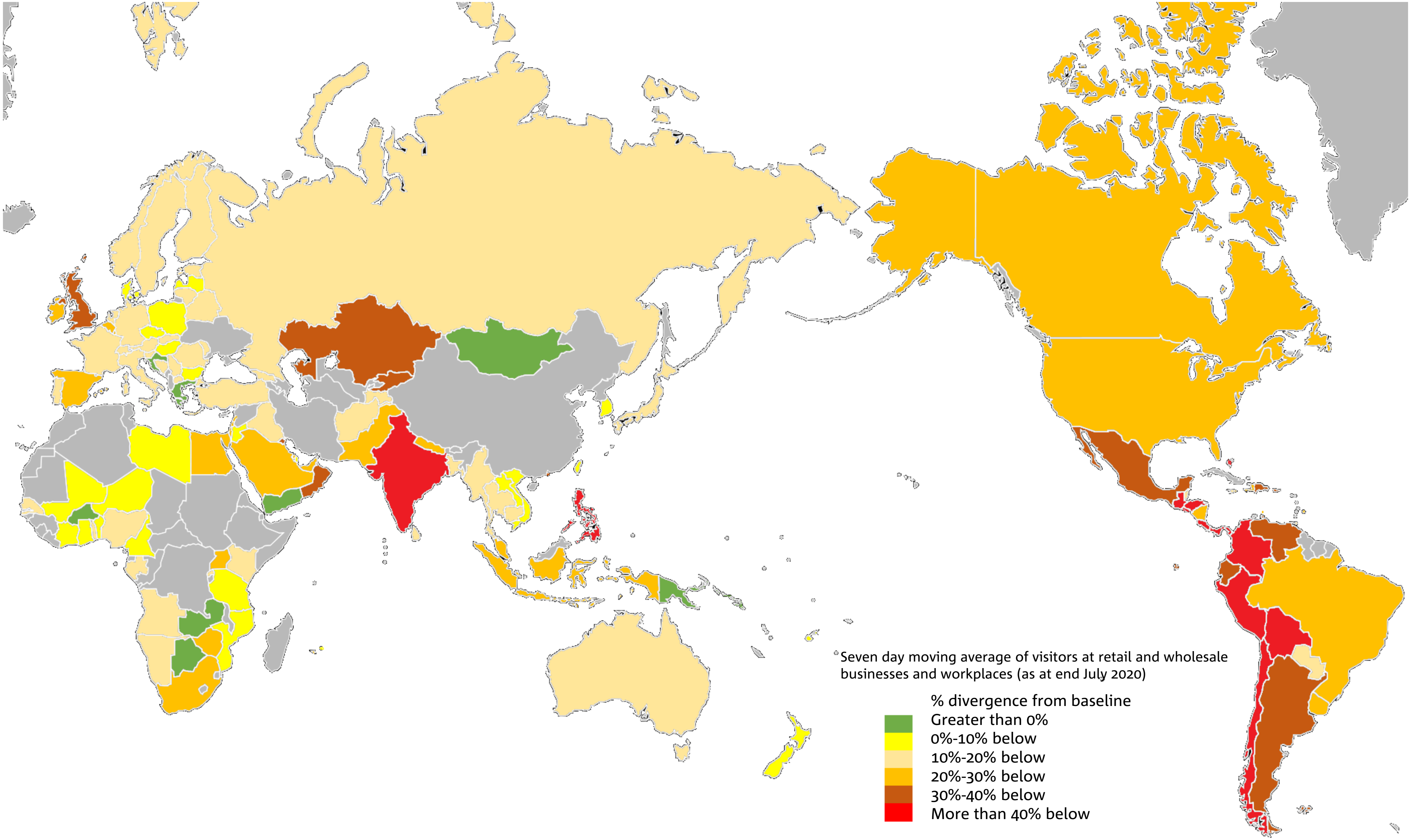
GOOGLE MOBILITY

While many regions are starting to recover, there is still a long way back to "normal"



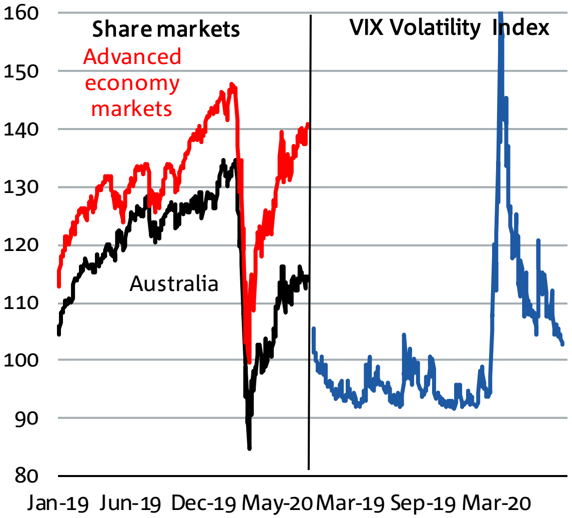
 Sources: Google, Our World in Data, NAB Economics

FINANCIAL AND COMMODITY MARKETS

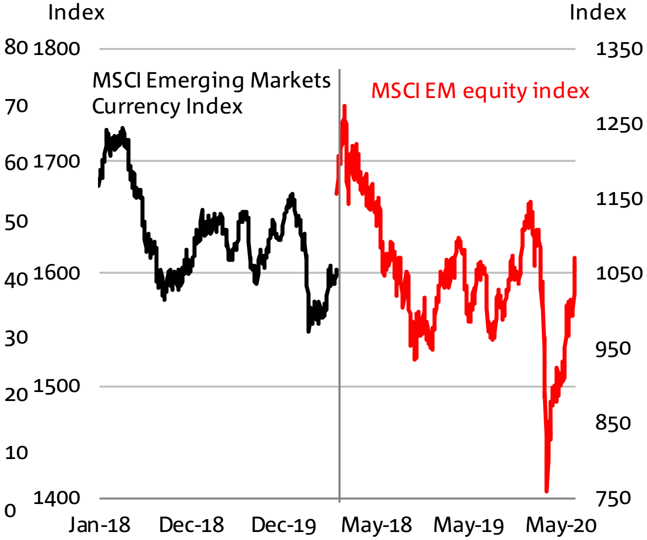
Markets continue to recover, but still not back to pre-COVID-19 levels

AE financial markets continue to recover

Share markets and volatility indices

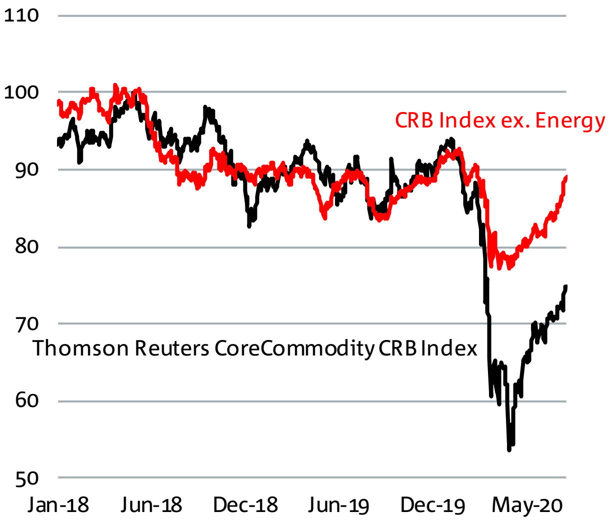


EMs also seeing better financial conditions



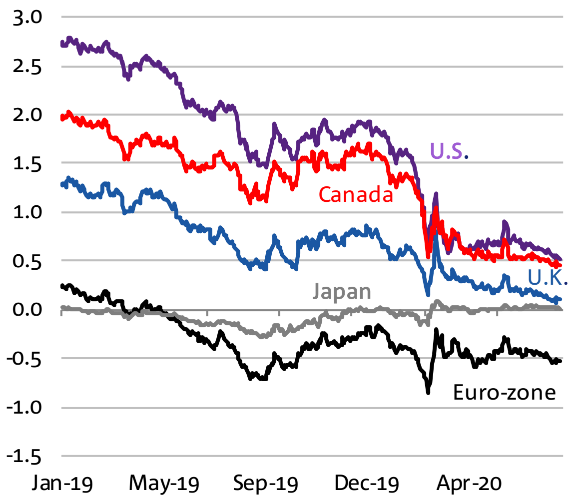
Commodity prices also moving up

Commodity indices (23 May 18 =100)



In contrast, declines in bond yields remain entrenched

10yr government bond yields (%)



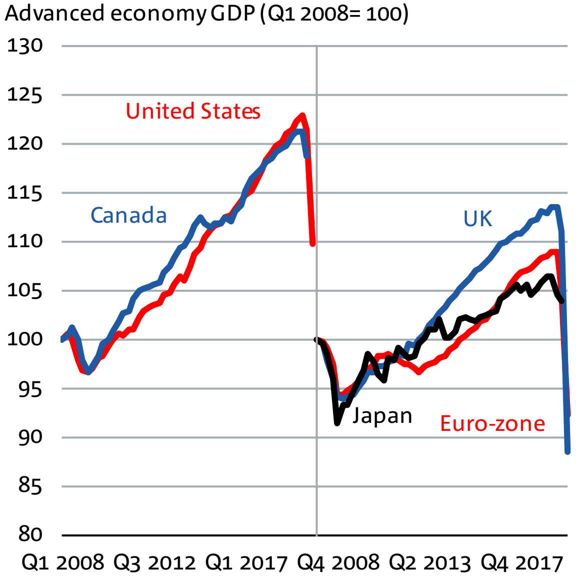
- The ongoing recovery in the global economy since its nadir around April is being reflected in financial markets. Equity markets continue to recover, market volatility and spreads have eased and commodity prices have turned up. In contrast, bond yields remain low.
- Our composite measure of advanced economy equity markets in early August was around 5% below its February peak, a substantial improvement on the 30% fall experienced in March. However, the pace of recovery has moderated in recent months, perhaps in part due the resurgence of the virus in parts of the world. Despite this, market volatility (while still high) has also continued to edge down. It is a similar story with credit spreads which have narrowed further.
- The improvement in markets has been supported by the measures put in place by central banks and Governments to support market functioning and the continued flow of credit. This has included bank funding programs, asset purchases and loan guarantees. That said, surveys of bank lending standards in the US and Eurozone point to a tightening of standards in the banking sector.
- The scope for further monetary easing by the major advanced economy central banks is limited – either because rates are at what is considered to be their lower bound (e.g. the Fed) or due to a reticence to make rates more negative (ECB, BoJ) in an environment where fiscal policy is the more powerful tool. However, the Fed is moving towards flexible average inflation targeting and is likely to complement this with outcome based forward guidance (e.g. a promise to keep rates low until inflation is back at its target level).
- The improvement has also been experienced by Emerging Market economies (EMs), with equity markets rising and currencies stabilising. The non-China EMs capital outflows seen earlier in the downturn have also stopped. However, the substantial damage done to many EM economies and government finances means destabilising capital flight is likely to remain a risk for some time.
- Similarly, commodity prices have increased over the last month, although energy prices remain well below pre-virus levels.
- In contrast, the fall in 10 year government bond yields, particularly for those countries with policy room pre-virus, has not reversed. This reflects expectations that activity, inflation and policy rates will remain subdued for a long time (relative to pre-virus expectations). In contrast, yields have not moved significantly either in the Euro-zone or, in particular, Japan where the BoJ targets the 10 year rate.

 Sources: Bloomberg, Refinitiv, NAB Economics

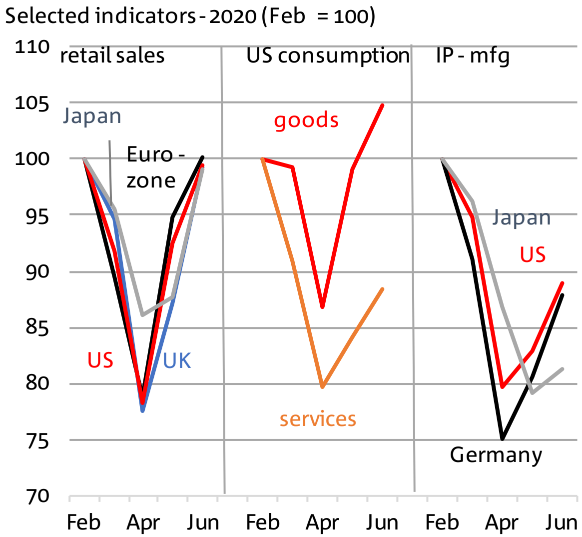
ADVANCED ECONOMIES

Massive fall in Q2 GDP - recovery underway but is being held back by virus resurgence

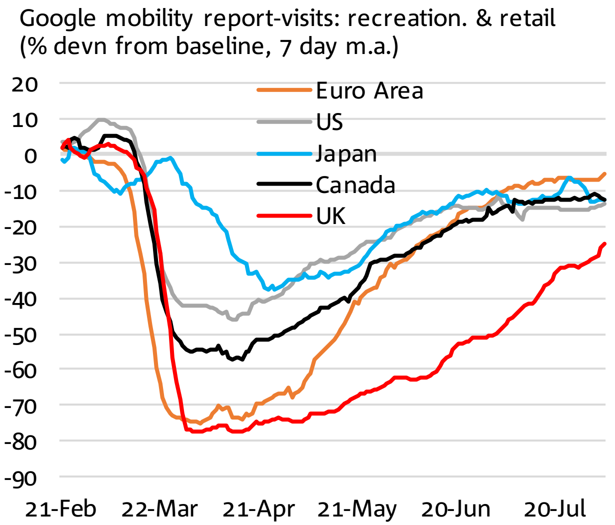
Q2 Crash in US & Europe... other AEs will be similar



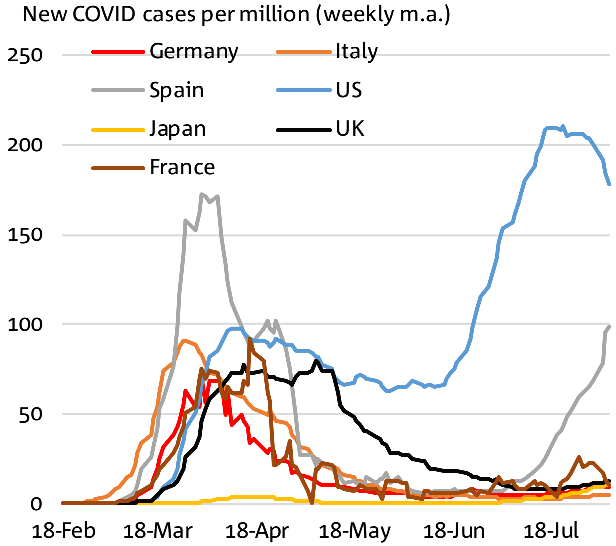
Q2 plunge reflects March/April declines...recovery since May



Early Q3 indicators generally higher but progress levelling off



Virus – and society's response – remains a key driver of economies



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

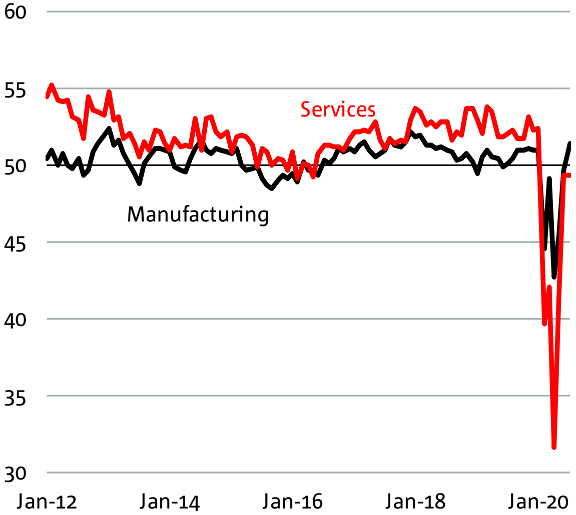
- Incoming Q2 GDP data confirm a massive hit to advanced economies from the response to COVID-19, including stringent containment measures. The declines in activity mainly occurred over March and April, with activity picking up since then. The spread of the virus continues to be a major factor with renewed surges leading to some restrictions being re-imposed or 're-opening' delayed. This will particularly weigh on the service sector and we continue to expect that a full recovery will take an extended period of time.
- In the US, GDP fell by 9.5% q/q, the UK fell an extraordinary 20% and the Euro-zone declined 12.1% q/q; this was on top of smaller Q1 declines. Within the Euro-zone, Germany's economy went backwards by 10% in Q2 while in Spain the fall in activity was 18%. Large falls in GDP are also expected for Canada and Japan.
- The peak-to-trough declines in activity were much worse - activity indicators collapsed over March and April, but generally recovered over the rest of the quarter. Retail sales for the major AEs were close to their pre-COVID-19 levels by June. Retail sales indicators are focussed on goods purchases, while COVID-19 has had a bigger impact on services, particularly around travel, accommodation and hospitality and even health. US data shows goods consumption in June above February levels but the services sector has a long way to go before it fully recovers.
- The shift up in activity over May and June sets the stage for strong growth in Q3. High frequency data and business surveys, particularly for Europe, point to further gains over July. In the US, where a resurgence of the virus has seen a re-introduction of some restrictions in some states, high frequency indicators has been tracking sideways. This is also the case for Japan which has also seen a pick-up in COVID-19 cases and some regional measures to reduce spread. Similarly in Europe progress has slowed; perhaps also due to some regional restrictions (e.g. in UK and Spain) to combat rising virus numbers.
- How the virus spreads, and how countries respond to any future uplift in cases, is likely to remain a key driver of economies. Even absent further spikes in COVID-19, a full recovery is likely to take an extended time. This is because many business closures will be permanent, the uncertainty around COVID-19 will engender business and household caution (particularly for major investments), damaged balance sheets, tighter financial conditions and the time needed to adjust to structural changes accelerated by the virus (e.g. on-line retail, work from home).

EMERGING MARKET ECONOMIES

Manufacturing leading EM recovery, but very mixed by country and COVID risk persisting

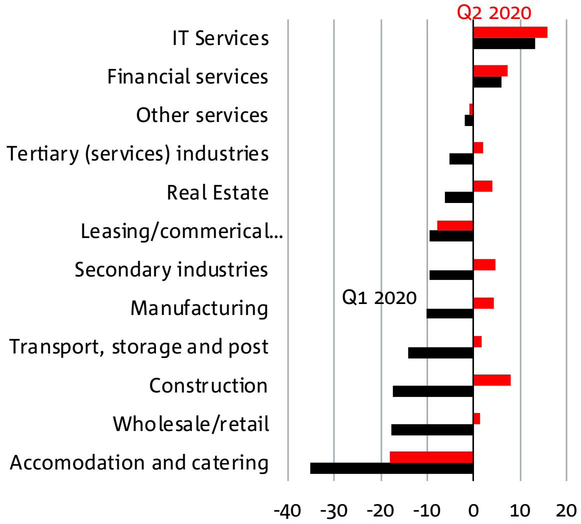
PMI measures show a recovery led by manufacturing

Emerging market PMI (Breakeven = 50)



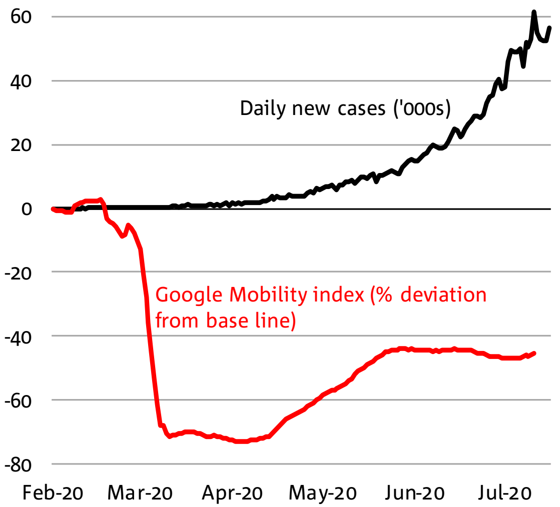
China's growth in Q2 was uneven, led by IT and financial services

China's growth by sector (% yoy)



India's recovery appears to have stalled as COVID cases rise

Indian COVID-19 trends



Trade data shows volumes fell through to May

Emerging market exports and industrial output (% yoy)

- Business surveys provide some of the most timely indicators of conditions in Emerging Markets. Aggregate data for July shows that EMs have returned to positive territory, with the composite measure at 50.8 points. This was driven by a pickup in manufacturing, with services remaining unchanged at a slightly negative 49.3 points.
- That said, trends remain mixed across major EM economies. The recovery in EM manufacturing was led by China, Indonesia and Brazil – with the latter's strength (rising to 58.2 points in July from 51.6 points previously) somewhat surprising given the rapid spread of COVID-19 in recent months.
- China's economy recovered in Q2, growing by a stronger than expected 3.1% yoy and exceeding the levels recorded in Q4 2019 on a seasonally adjusted basis. As a result we have revised our forecast for China up in 2020 (to 1.5%, from 1.0% previously). However, this was an uneven recovery, with strong growth in IT and financial services but relative weakness in consumer sectors.
- Q2 data available to date for East Asia showed much weaker than anticipated conditions across the region – particularly the Philippines and Indonesia – where COVID-19 cases have surged recently.
- In contrast, manufacturing PMIs in India and Russia deteriorated in July. India's attempts to recover from the impact of COVID-19 countermeasures appear to have stalled – with Google Mobility data (tracking visits to retail and workplace locations) showing that movements have plateaued since mid June, limiting the strength of the anticipated recovery in Q3.
- Global trade remains relatively weak – in part reflecting constrained demand in advanced economies due to elevated unemployment. Trade data lags some other high frequency indicators, with the CPB measure of trade volumes showing EM exports contracted by 6.0% yoy (on a three month moving average) in May. It may take some time for AE consumers to rebuild sufficient confidence to underpin EM export growth.
- Emerging markets also face the risk of capital outflows that could impact the financial stability of some economies. Recent months have seen modest inflows, however these followed large outflows in March. In particular, Latin American economies appear vulnerable, given concerns related to Argentinian debt along with the significant spread of COVID-19 across the region.

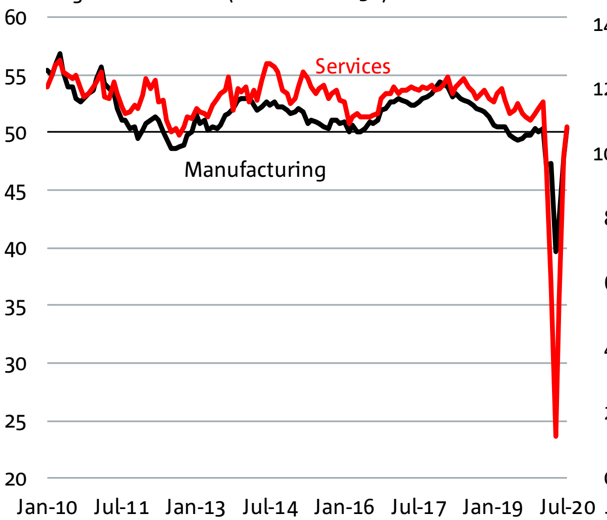
Sources: Markit, Refinitiv, Google, John Hopkins University, NAB Economics

GLOBAL FORECASTS, POLICIES AND RISKS

Recovery is underway, but there are many risks beyond just virus outbreaks along the road

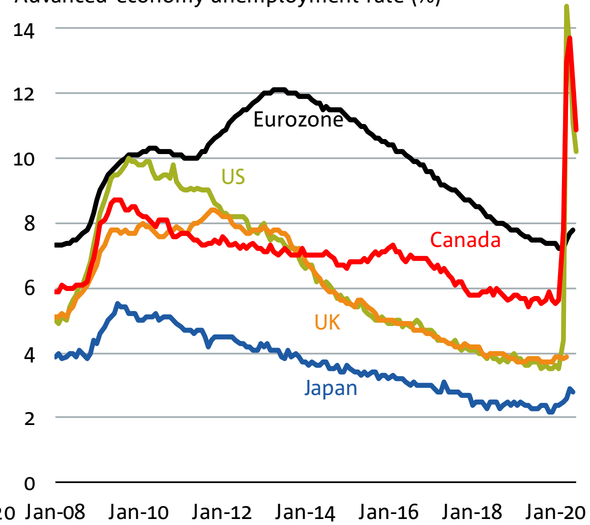
Global PMI measures turned positive in July

JP Morgan Global PMI (Breakeven = 50)



Labour markets present a risk around fiscal unwind

Advanced economy unemployment rate (%)

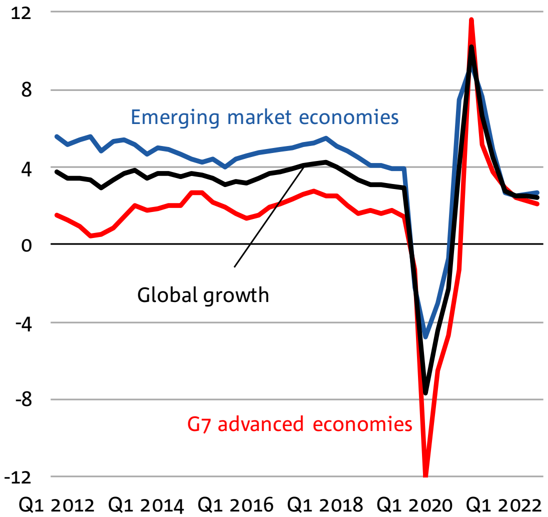


Phase One trade deal yet to boost US exports to China

US$ billions (12 month rolling sum)

Recovery spread over 2021 and 2022, with above trend growth

Global economic growth (% yoy)



- The JP Morgan Global PMI continues to show signs of recovery – with measures of manufacturing and services activity both returning to positive territory in July, the strongest outcome since January. This is consistent with our view that Q2 will mark the trough in the global downturn, however there will be some divergence in the road to recovery, with the composite PMIs for a number of major economies (including Japan, India and Brazil) remaining negative.
- While the global economy is likely to grow strongly in-Q3, the impact of steep declines in the first half of the year will see the largest contraction in annual economic growth since the early 1950s, and most likely since the Great Depression.
- Risks of fresh outbreaks of COVID-19 remain a significant concern. Although there appears a low probability of the large scale, country wide lockdowns seen during the first wave of outbreaks, localised hard countermeasures – such as those currently imposed in Melbourne and others recently imposed in parts of China, India and the United States – remain a risk, and could disrupt a smooth path to recovery.
- The duration of global emergency fiscal programs implemented presents another uncertainty. Unemployment is elevated in a range of countries, such as the US and Canada, while in others (such as the Eurozone) government wage subsidy programs have been more successful in keeping workers employed. If these programs, and other policy supports, are unwound too rapidly, it risks stalling the recovery in advanced economies.
- Trade tensions between the United States and China could reignite, with the Trump Administration banning US corporates from transactions related to WeChat – a messaging app that has become a major payments platform in China. While somewhat distorted by COVID-19 countermeasures, the Phase One trade deal signed in January is yet to result in an increase in Chinese purchases of US goods.
- In addition, the US Presidential election in November presents uncertainty around US economic policy – both on a domestic and international front.
- Our forecasts are marginally weaker this month, with a contraction in the global economy of around 3.8% now expected in 2020. Upgrades to forecasts for some advanced economies were more than offset by a weaker outlook for India, East Asia and Latin America. We continue to expect the recovery to be spread over 2021 and 2022, with above trend growth in both years.

Sources: Refinitiv, Markit, US Census Bureau, NAB Economics

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