EMBARGOED UNTIL: 11.30AM THURSDAY 14 OCTOBER 2021

THE FORWARD VIEW – GLOBAL

OCTOBER 2021

National Australia Bank

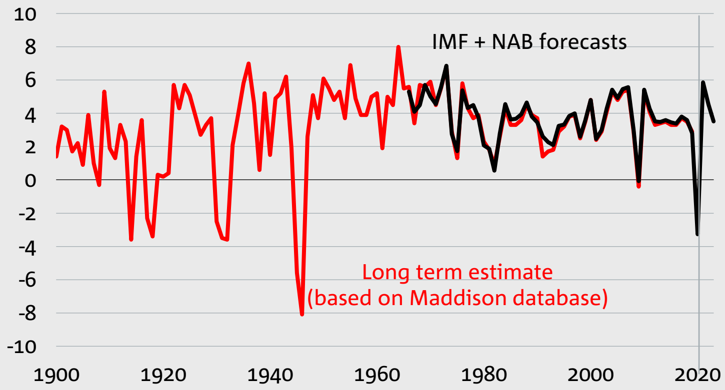
Energy woes add to persistent supply bottlenecks in slowing global recovery

- We have revised our global economic forecasts lower this month – to 5.9% for 2021 (down from 6.0% previously) – largely driven by a weaker outlook for the United States (along with some downgrades in the EU, Japan and Canada). Our outlook for 2022 is also slightly weaker – at 4.5% (from 4.6% previously). We continue to anticipate global growth slowing to its long term average of 3.5% in 2023.
- We expect quarterly growth in Q3 to be similar to that of Q2, helped by India where activity has recovered as COVID-19 countermeasures have eased.
- The downward revisions to the outlook are in part driven the by persistence of supply bottlenecks in the global economy. This headwind may get even stronger given recent energy shortages and spikes in energy prices, which have led to production cuts, including in China. Higher energy prices will also weigh on consumers spending power. At this stage it is unclear how long these shortages will persist.
- These disruptions, along with shortages of key inputs and rising commodity prices, have contributed to inflationary pressures, with both global producer prices and consumer price inflation currently elevated.
- Global equity markets trended lower from the second week of September, due to the likely default of the Chinese property giant Evergrande, and broader concerns around China's property market. This has also contributed to a large fall in iron ore prices.

Global Growth Forecasts
(% change)

	2019	2020	2021	2022	2023
US	2.3	-3.4	5.7	3.9	2.1
Euro-zone	1.5	-6.5	5.1	4.2	2.0
Japan	0.0	-4.7	2.5	3.1	1.0
UK	1.4	-9.8	7.1	5.6	2.4
Canada	1.9	-5.3	5.2	3.8	2.5
China	6.0	2.3	8.7	5.9	5.7
India	4.8	-7.0	8.0	6.8	5.6
Latin America	0.1	-6.7	6.0	2.4	1.7
Other East Asia	3.5	-2.9	4.3	4.7	4.8
Australia	1.9	-2.4	3.3	2.9	2.3
NZ	2.4	-2.9	4.5	3.5	1.5
Global	**2.8**	**-3.3**	**5.9**	**4.5**	**3.5**

Even after downward forecast revisions, still expect strong 2021 and 2022 growth



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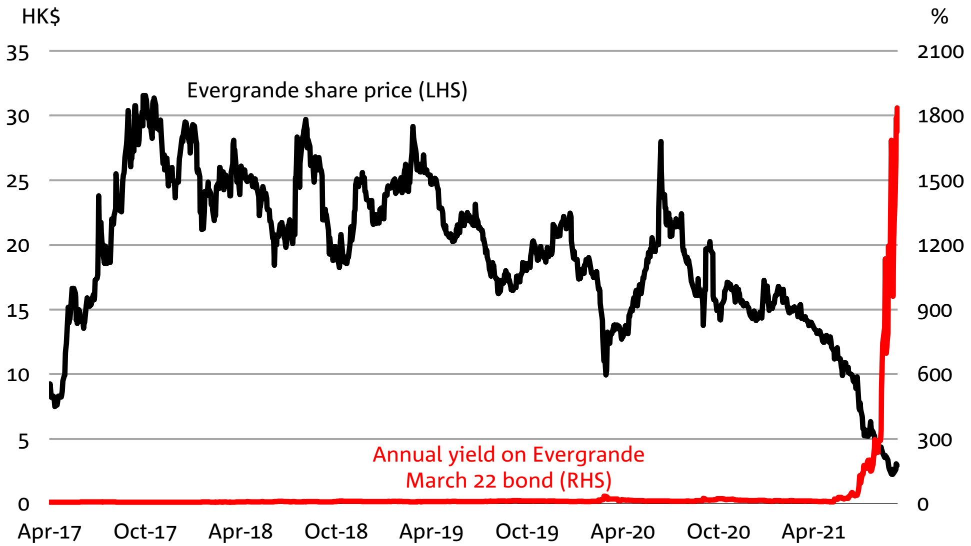
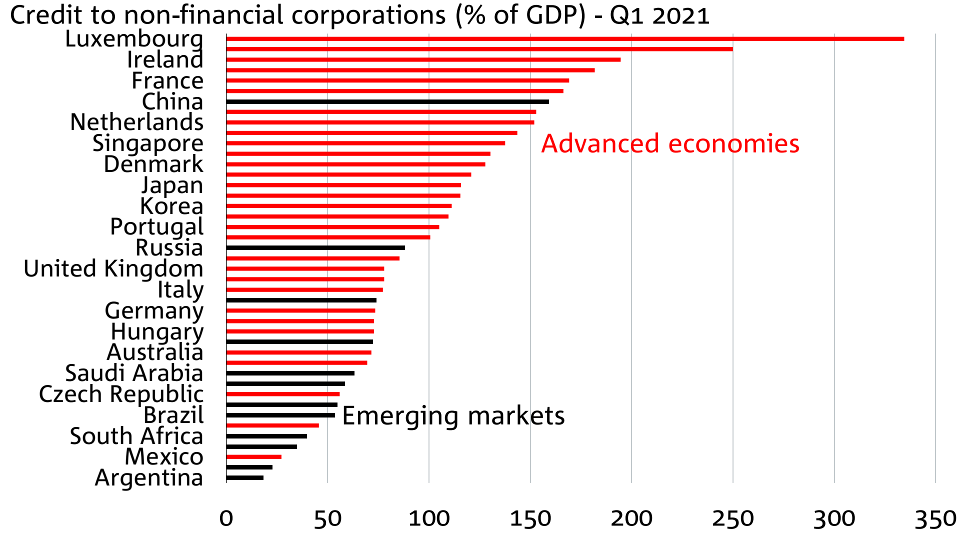
CHARTS OF THE MONTH

China's economy has been hit by twin crises in September – with the likely default of property giant Evergrande highlighting China's massive corporate debt, while fuel shortages and regulatory requirements have impacted electricity supplies

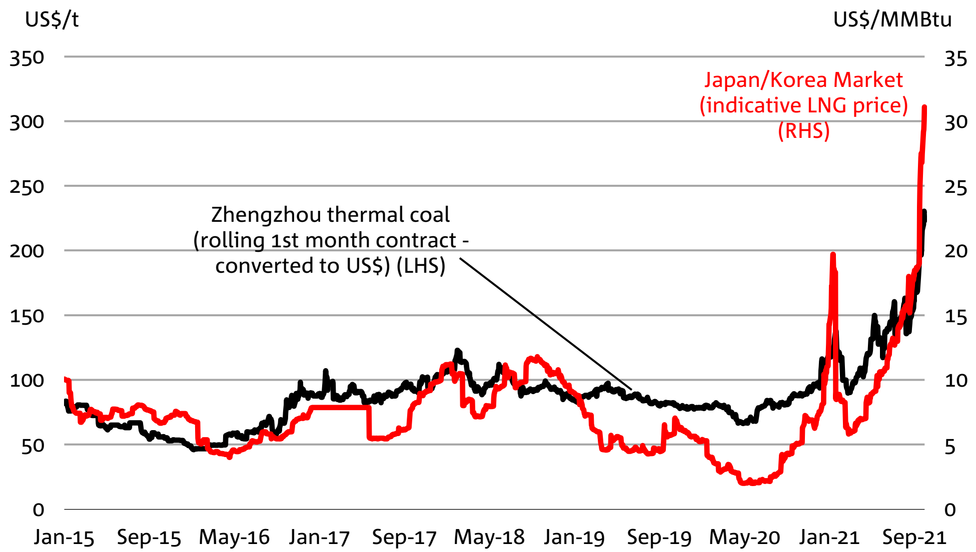
Highly indebted Evergrande has missed bond coupon payments, causing its share and bond prices to plunge

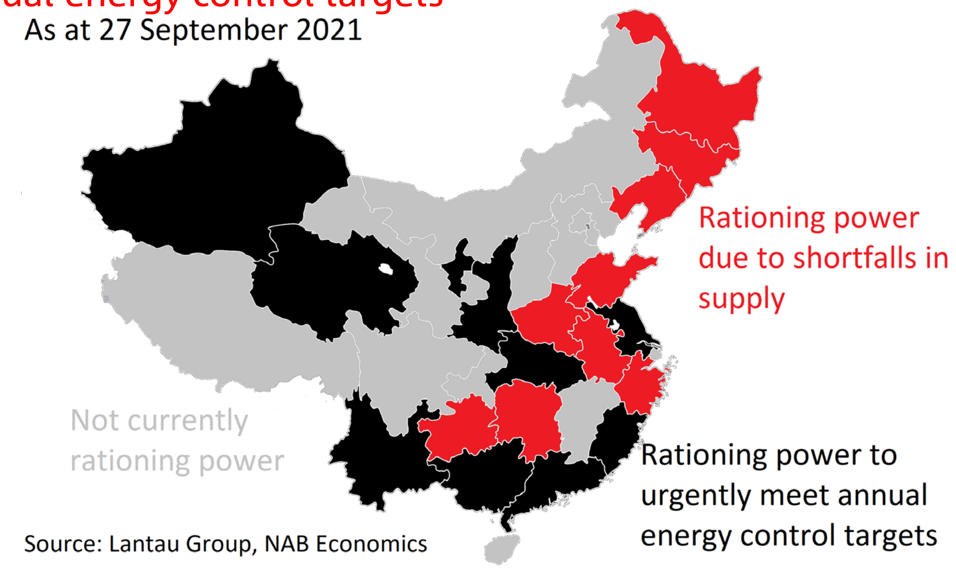


Debt in China's corporate sector far exceeds its emerging market peers, along with many advanced economies



Soaring costs for fossil fuels have limited electricity generation, with some generators unprofitable due to regulated prices, while some provinces have to ration power to meet their annual energy control targets





Source: Lantau Group, NAB Economics

 Sources: Bloomberg, BIS, Lantau Group, NAB Economics

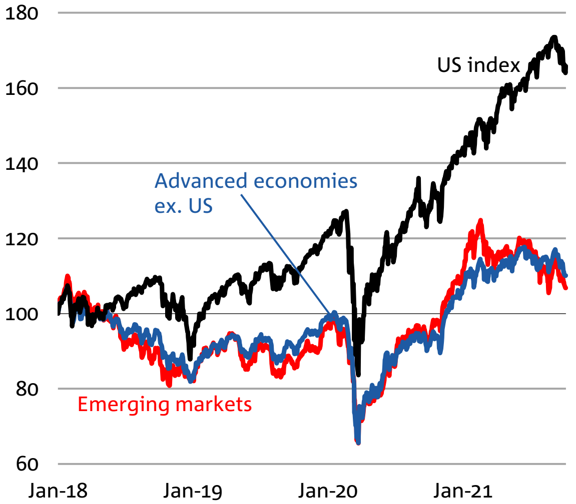
National Australia Bank

FINANCIAL AND COMMODITY MARKETS

China default fears spooked equity markets; inflationary pressures persisting

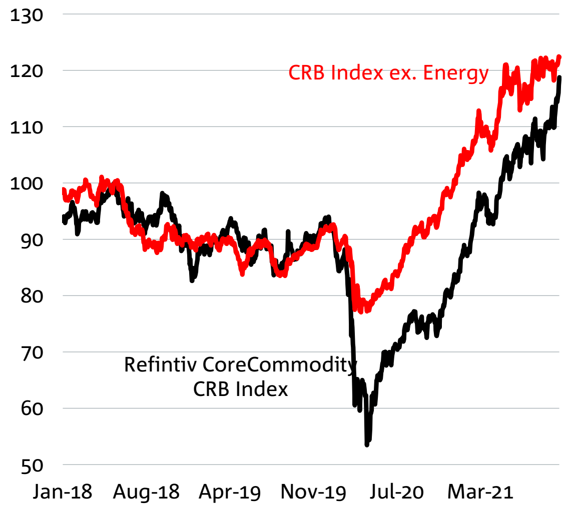
Global equity markets lower on China Evergrande fears

MSCI Equity Indices (1 Jan 18=100)



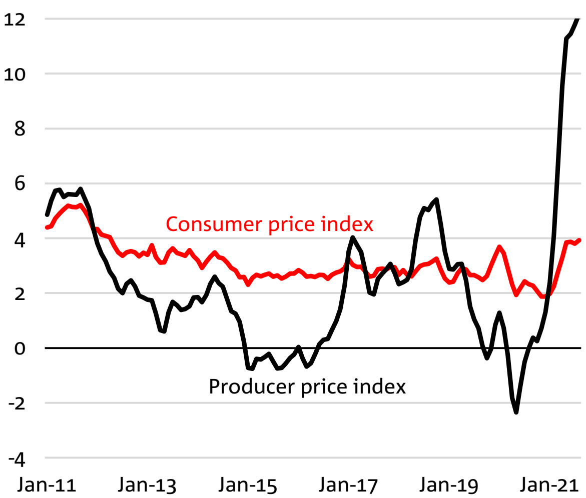
Energy driving commodity indices higher, non-energy flat

Commodity indices (23 May 18 =100)



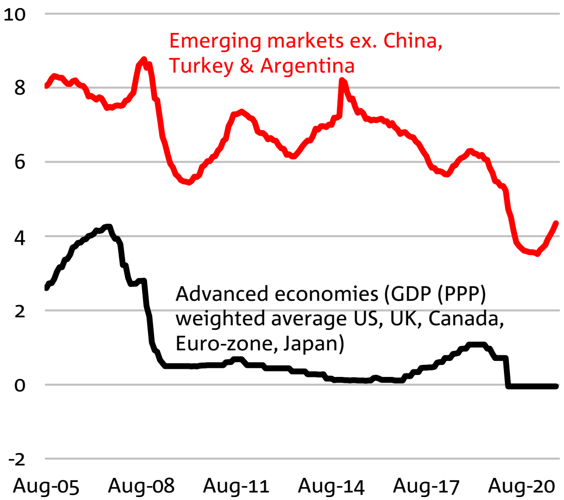
Supply chain pressures contribute to surging producer prices

Global inflation (yoy%)



EM central banks lifting rates, but still below pre-COVID levels

Average central bank policy rates (%)



Sources: Bloomberg, Refinitiv, NAB Economics

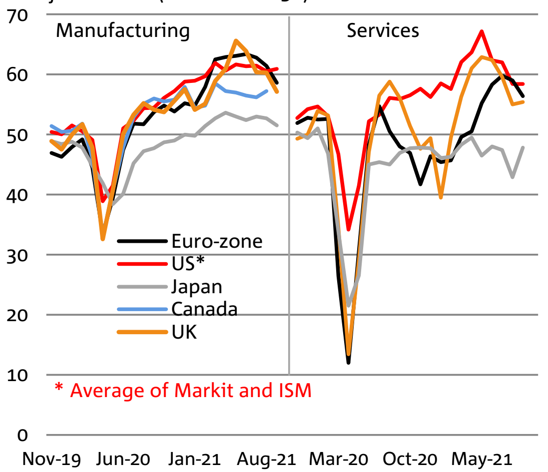
- Global equity markets trended lower from the second week of September, as fears related to the likely default of the highly indebted Chinese property giant Evergrande spooked markets (one of the few companies identified by the People's Bank of China that could cause systematic risk for the country's financial sector).
- Fears largely centred on concerns that the collapse of Evergrande could produce a similar outcome to the failure of Lehman Brothers in 2008 – triggering further defaults, insolvency in banks and causing markets to seize-up. The PBoC has addressed these concerns by pumping liquidity into interbank markets, but a lack of clarity from Chinese authorities around the future of Evergrande has added to concerns.
- Beyond financial sector risks, there are concerns that Evergrande's default could have a negative impact on the broader property sector – leading to weaker demand for a broad range of commodities – particularly metals. Excluding energy, the Refinitiv CoreCommodity CRB Index has tracked broadly sideways since late July, while spot prices for iron ore have retreated considerably over the same period.
- In contrast, energy prices have risen considerably – with spot prices for crude oil, thermal coal and liquefied natural gas trending higher. This has contributed to electricity shortages in China that have reportedly impacted manufacturing output in September, and some European manufacturers have reportedly curbed production. At this stage it is unclear how long these shortages will persist. That said, this has the potential to further interrupt already disrupted supply chains.
- These disruptions, along with shortages of key inputs and rising commodity prices, have contributed to inflationary pressures. This has been most evident in global producer prices – which rose by an estimated 12.2% yoy in August – which has also flowed through into high consumer price growth – estimated at 3.9% yoy in August, albeit the growth rate has been relatively stable over the past three months.
- In recent months, a range of emerging market central banks have lifted their policy rates, led by Brazil, Russia and Mexico, although our aggregate measure remains well below pre-COVID-19 levels. We expect the US Fed to start tapering in November, but it will be a while before it hikes rates. That said, market expectations of the timing of rate hikes for some major advanced economy central banks have been brought forward (with markets pricing a rate hike by the Bank of England this year).

ADVANCED ECONOMIES

Growth still benefiting from re-opening but being tested by ongoing supply bottlenecks & energy shortages

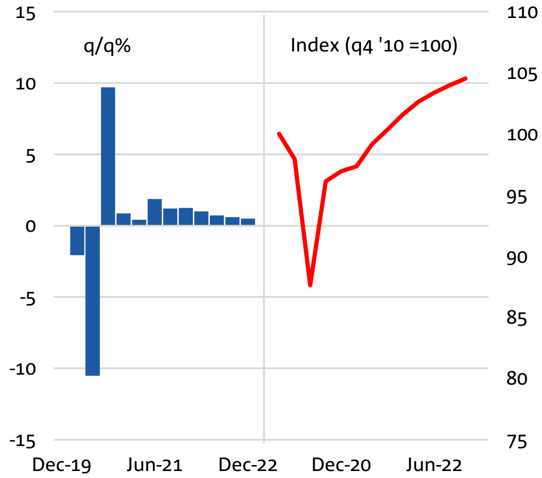
Business survey have slipped but still solid

Major AE PMIs (Breakeven = 50)



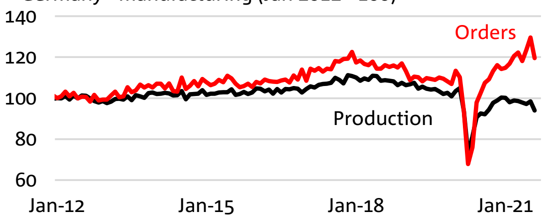
Longer term the bounce back in investment is a positive

Major AE GDP

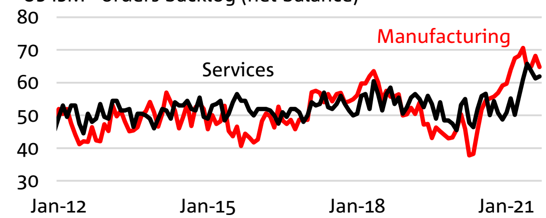


Supply bottlenecks remain a headwind

Germany - manufacturing (Jan 2012 =100)

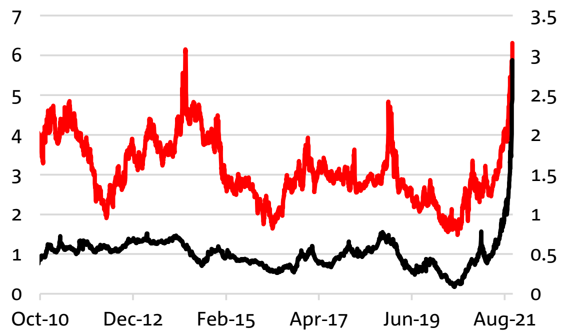


US ISM - orders backlog (net balance)



Energy shortages has to led to surging prices

Natural gas prices



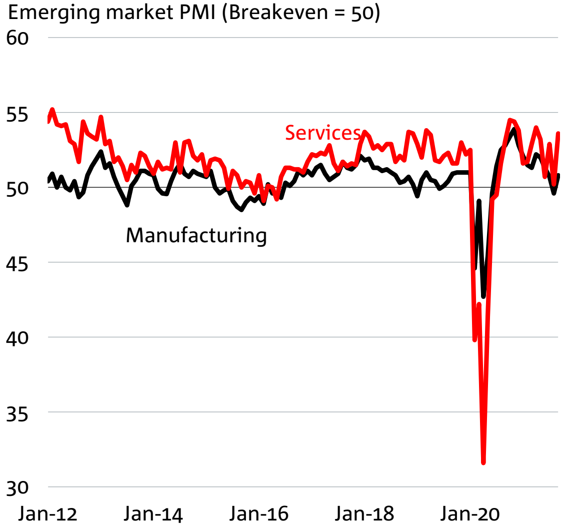
- GDP growth in the major advanced economies (AEs) was very strong in the June quarter and well up on the prior two quarters' pace. We expect there to be slower but still robust growth, in aggregate, in each of the two final quarters of 2021. This is consistent with business survey indicators which have come off their peaks but generally remain at solid levels. However, a range of countervailing factors means there is considerable uncertainty around the near term outlook.
- The strongest growth in Q2 was in the UK and the Euro-zone due to the relaxation of COVID-19 restrictions. As re-opening occurred over time, and was not complete until early Q3, Q3 growth is set to be strong in Europe even with the mixed monthly data evident so far in the quarter. US growth has also clearly slowed from its very rapid, fiscal stimulus induced, H1 pace, but is expected to remain solid and may get a bounce as its most recent COVID-19 wave continues to ease. Adding to this Canada, which saw a decline in Q2 GDP due to lockdowns early in the quarter, should see a boost as restrictions have been eased. Japan will lag as its state of emergency did not end till late September; while this means another soft result is likely in Q3, it should see a Q4 bounce particularly with COVID-19 case numbers falling.
- Several factors might derail this apparent rosy outlook. Supply issues (shortages of parts such as semi-conductors, transportation delays and difficulties finding staff) have been evident for a while. This can be seen in business survey indicators such as delivery times, order backlogs, and production/order gaps. While it is expected that these bottlenecks will be addressed over time – leading to a boost in production – there is little sign yet of any material improvement. Indeed German IP declined 4.6% m/m in August, including a 17.5% fall in motor vehicle production. Japan also saw a large fall in manufacturing production in August (although the US and France saw increases).
- Adding to the problems are energy shortages (natural gas and, in the UK, petrol), particularly in Europe, which has led to a spike in prices. Reports indicate some energy intensive manufacturers have already reduced production. Moreover, to the extent higher market prices feed through into retail prices, it will also reduce household spending power, particularly if prices were to remain high for an extended time.
- The forecasts assume that the continued roll-out of vaccines will mean there is no significant return to the use of lockdowns to curb the spread of COVID-19. However, there remain concerns around the possibility of another winter wave in North America and Europe, and how hospitals might cope, which may test this assumption.

Sources: Refinitiv, US Energy Information Agency, NAB Economics

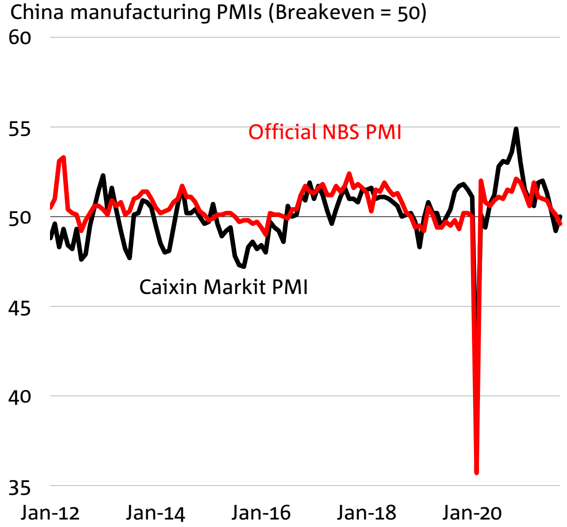
EMERGING MARKET ECONOMIES

Slowing trade volumes could impact EM growth, while US-China tensions could re-emerge

EM services PMI surged in Sep, as China's COVID restrictions eased



Differing composition may explain divergent China mfg PMI trends



Export volumes have trended lower since April

China falling short of targets under trade deal with US

- Purchasing manager indices provide some of the most timely indicators of underlying economic conditions in emerging markets. Aggregate measures of both manufacturing and services were stronger in September (although it is worth noting that the manufacturing reading in September was weaker than those recorded earlier in 2021).
- The EM manufacturing PMI moved back into expansionary territory at 50.8 points (compared with a negative 49.6 points in August). Key contributors to this upturn were Indonesia, China and Russia – however in the case of China, this apparent strength raises questions around the timing (given the country's power shortages in late September) as well as the industrial composition of the survey. China's official manufacturing PMI (produced by the National Bureau of Statistics) turned negative, with this survey thought to contain a larger share of traditional heavy industry (such as steel, cement and chemicals), where conditions are likely less favourable.
- The strengthening in the EM services PMI – up to 51.3 points in September (from 49.5 points previously) – was primarily driven by China. This likely reflected a reduction in restrictions following the COVID-19 outbreak that commenced in July.
- Emerging markets are generally more dependent on international trade than advanced economies. Recent months have seen continued strong growth in EM export volumes (albeit considerably weaker than earlier in the year) – up by 6.9% yoy – however base effects have contributed to the strength of growth in 2021.
- That said, recent trade trends have been somewhat weaker – with volumes peaking in April 2021 before subsequently drifting lower. At this stage it is not entirely clear if this slowing is related to supply chain disruptions, soaring prices or weaker demand (or some combination of these factors).
- Trade tensions between China and the United States have the potential to reignite in coming months. China's trade surplus with the US has expanded rapidly since April 2020, with the 12 month moving average surplus rising to a record high of US$368 billion in August 2021. US Trade Representative Katherine Tai has completed a review of China's trade policy and met with Vice Premier Liu He in October to discuss China's failure to meet its commitments under the "Phase 1" trade deal.

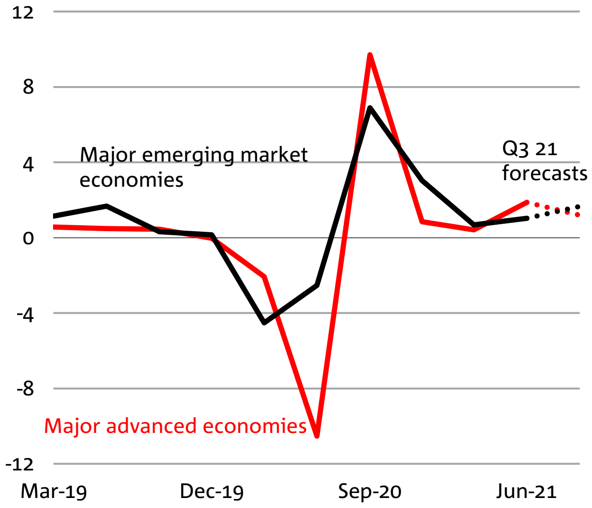
 Sources: Refinitiv, IHS Markit, CPB, PIIE, NAB Economics

GLOBAL FORECASTS, POLICIES AND RISKS

Global growth now forecast below 6% in 2021; COVID remains the key risk

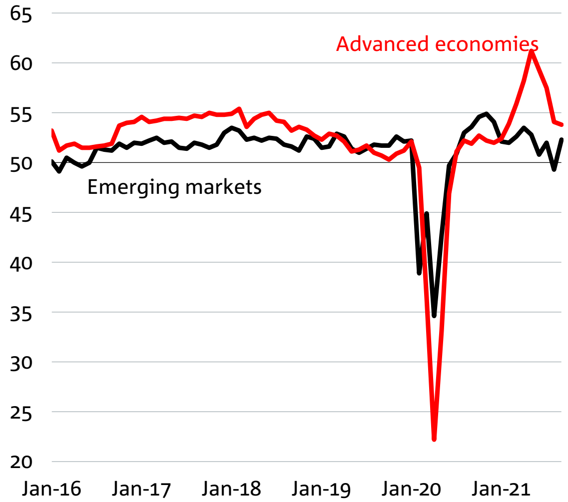
Marginal strengthening in forecast Q3 growth driven by India…

Global economic growth (% yoy)



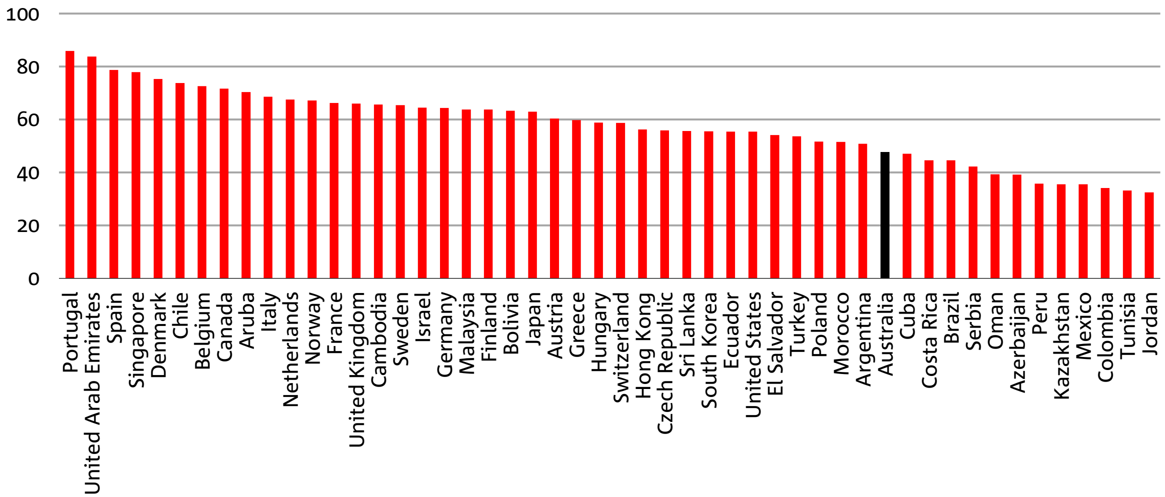
… while PMI surveys point to softening trends elsewhere

JP Morgan global composite PMIs (Breakeven = 50)



Uneven distribution of COVID-19 vaccinations poses some ongoing risk for the global economy

Fully vaccinated population (%) - countries with population



- Trends in global economic growth remain highly disparate – reflecting economies that are at different stages of their recoveries from COVID-19, particularly given fresh outbreaks of the virus in different regions and the differing degree of vaccination rates worldwide.
- Overall, we expect similar quarter-on-quarter global economic growth in Q3 to that of Q2. That said, this apparent stable growth rate is due to stronger growth in India (the world's third largest economy on a purchasing power parity basis), where activity recovered as COVID-19 countermeasures have eased, and China presents some downside risk. In contrast, most other major economies and regions are expected to slow.
- This slowing trend (outside of India) is consistent with softening trends in purchasing manager indices. The JP Morgan global composite PMI averaged 53.8 points in Q3, compared with 57.3 points in Q2. However, the global PMI was marginally stronger in September (at 53.0 points, compared with 52.5 points in August), with weaker readings in advanced economies more than offset by a rebound in China's service sector PMI (as conditions improved following China's most recent COVID-19 outbreak).
- COVID-19 remains the primary risk to our global economic outlook. Due to the typically lower rate of vaccination rates in emerging market economies, these countries are more exposed to the risk of further outbreaks (and associated downturns in economic activity). This has the potential to persist for the foreseeable future – with the Economist Intelligence Unit forecasting widespread vaccination will not occur in much of Africa and South East Asia until 2023.
- However, supply chain disruptions – particularly related to China – appear to be a growing risk, highlighted by the country's power shortages in September. These issues are increasingly being identified in global PMI surveys. Despite the potential for long term supply chain realignment away from the country, China remains central to global goods manufacturing and will continue to do so for some time.
- Our global economic forecasts have been revised marginally lower this month – to 5.9% for 2021 (down from 6.0% previously) – largely driven by a downward revision to our outlook for the United States (along with some downgrades in the Euro-zone, Japan and Canada). Our outlook for 2022 is also slightly weaker – at 4.5% (from 4.6% previously), with the US and UK the main contributors. We have not changed our forecast for China, despite the energy and property market issues, as we will review it following the Q3 GDP release next week.

Sources: Refinitiv, IHS Markit, Our World in Data, NAB Economics

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