EMBARGOED UNTIL: 11.30AM THURSDAY 10 FEBRUARY 2022

THE FORWARD VIEW – GLOBAL

FEBRUARY 2022

National Australia Bank

Latest COVID-19 wave has led to a soft start to 2022

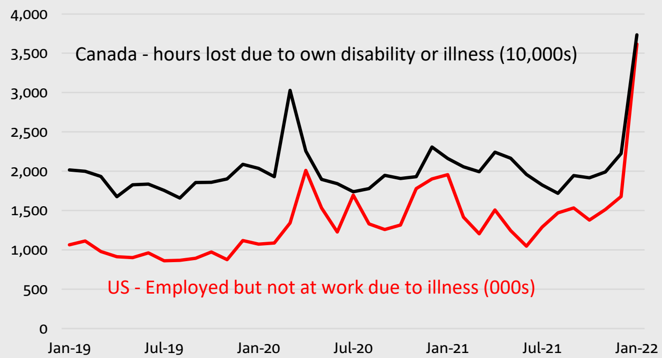
- The Omicron variant of COVID-19 has spread rapidly – with case numbers in a broad range of countries vastly exceeding previous peaks. Although death rates are typically below those of previous waves, the sheer number of cases is straining many healthcare systems and disrupting economic activity – as infected workers are forced to isolate.
- Market expectations around monetary policy have shifted, with policy rates set to rise more rapidly than previously anticipated. This has seen equity markets weaken and bond yields rise. Inflationary pressures have persisted, due to a range of factors – including various COVID-19 outbreaks, a shift in spending from services to goods, prolonged supply shortages of labour, raw materials and key inputs and disruptions to global shipping.
- Growth prospects for early 2022 appear relatively weak for both advanced economies and emerging markets, largely related to the current COVID-19 wave. Despite restrictions on activity generally being less onerous than in earlier waves, high frequency data indicates there has been an impact on activity. Business surveys point to services being particularly impacted. Receding case numbers in coming months should allow for a bump in growth from Q2.
- COVID-19 remains the primary risk to the global outlook, including the potential for further waves. There is considerable uncertainty how long the disruptions to global supply chains will persist. Political tensions have also escalated in a number of regions, most notably border tensions between Ukraine and Russia.
- Overall, our forecast for global growth in 2022 is softer – down to 4.2% (from 4.4% previously). This was driven by a weaker outlook for China, along with downward revisions for the United States, Japan and United Kingdom, while our forecast for India is somewhat stronger. Our forecast for 2023 is unchanged at 3.6%.

Global Growth Forecasts
(% change)

	2019	2020	2021	2022	2023
US	2.3	-3.4	5.7	3.4	2.2
Euro-zone	1.6	-6.5	5.2	4.0	2.5
Japan	-0.2	-4.5	1.7	2.7	1.8
UK	1.7	-9.4	7.3	4.2	2.1
Canada	1.9	-5.2	4.6	3.4	3.2
China	6.0	2.3	8.1	5.1	5.5
India	4.8	-7.0	8.2	7.5	6.0
Latin America	0.1	-6.9	6.3	1.9	1.7
Other East Asia	3.5	-2.9	3.9	4.3	4.8
Australia	2.0	-2.2	4.5	3.6	2.9
NZ	2.8	-1.9	5.3	4.9	1.5
Global	**2.8**	**-3.3**	**5.8**	**4.2**	**3.6**

Omicron – no widespread lockdowns but disrupting economies as many stay home due to illness (or quarantine)

Indicators of work lost due to illness



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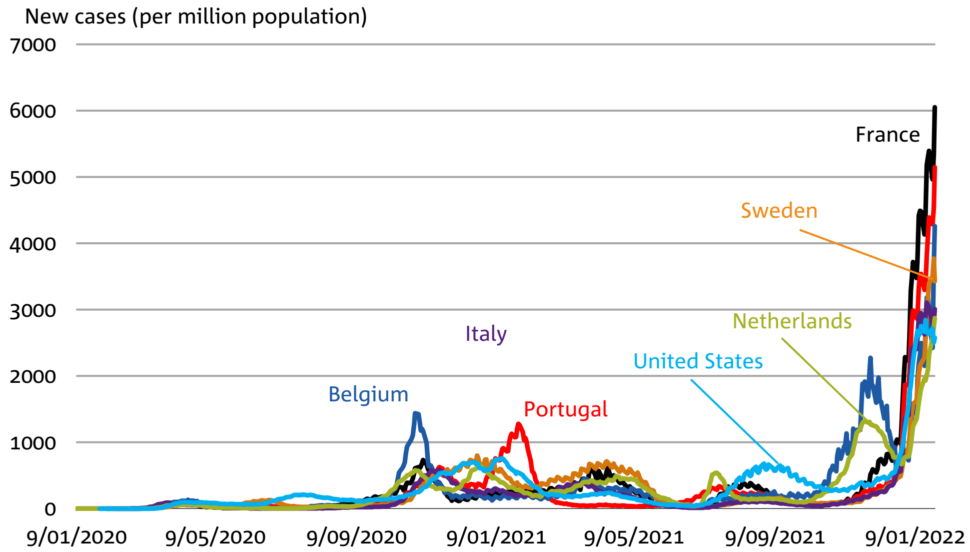
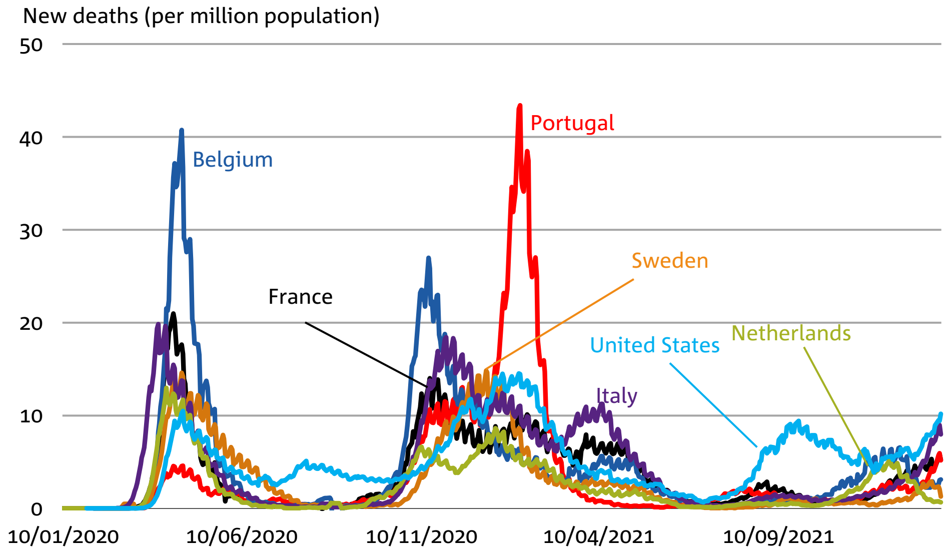
CHARTS OF THE MONTH

New COVID-19 cases have surged – particularly in parts of Europe and North America. Vaccinations have reduced the rate of death (although hospitals have come under increased pressure) – highlighting the risks around less vaccinated emerging markets

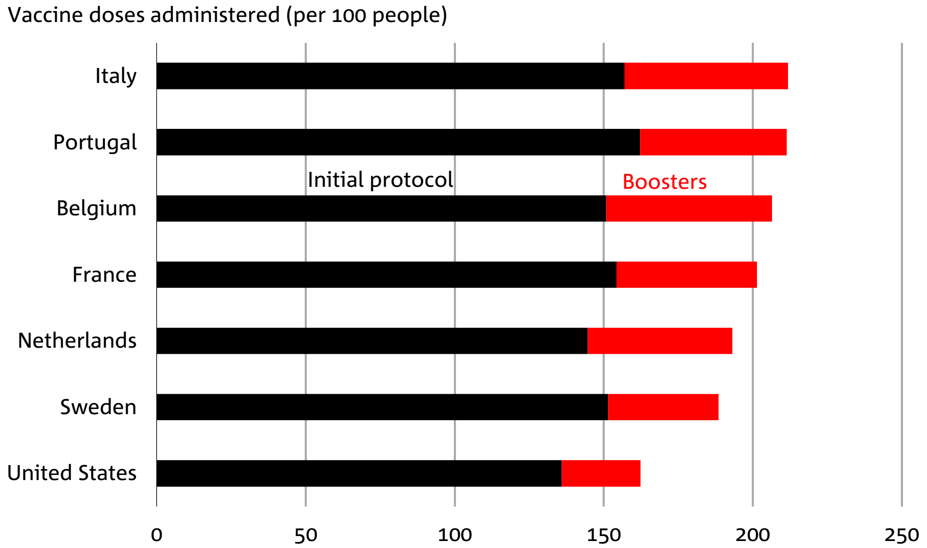
Omicron variant has led to surging case numbers (far in excess of previous peaks)…



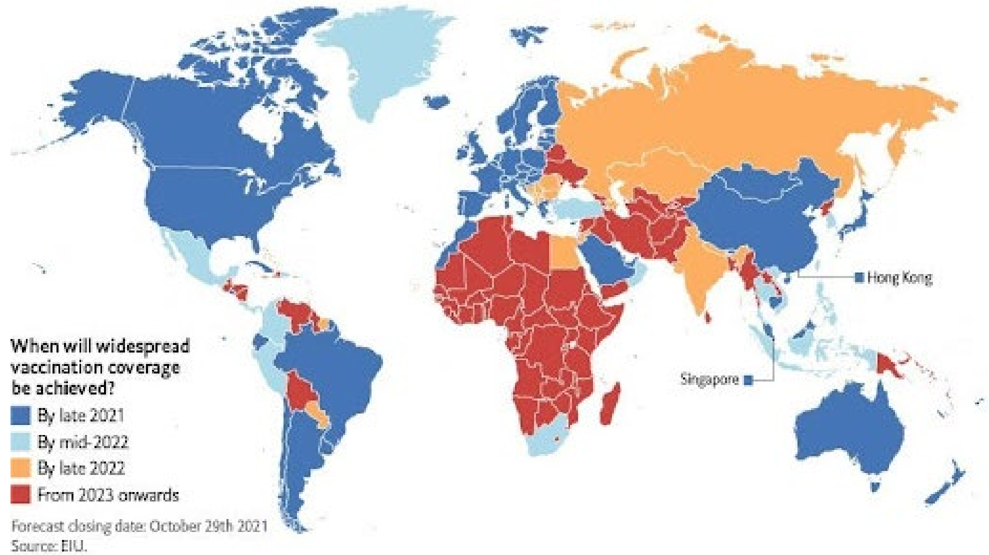
Death rates have increased when compared with late 2021, however they are below peaks of earlier virus waves



Boosters have been shown to be particularly important to combat Omicron…



…highlighting risks to less vaccinated emerging markets, and potential for further supply chain disruptions in 2022



Sources: Refinitiv, Our World in Data, Economist Intelligence Unit, NAB Economics

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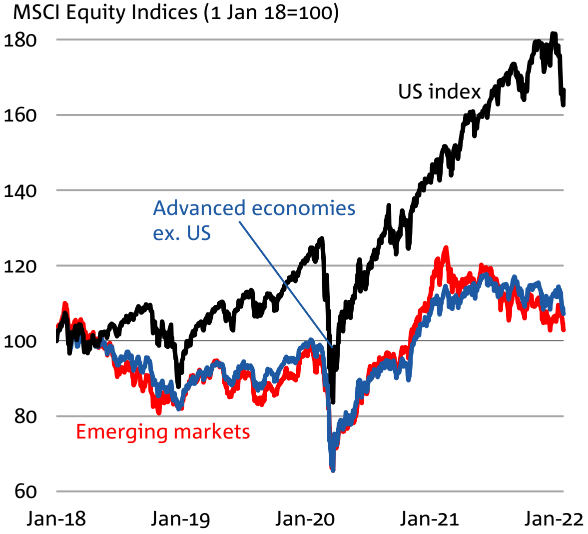
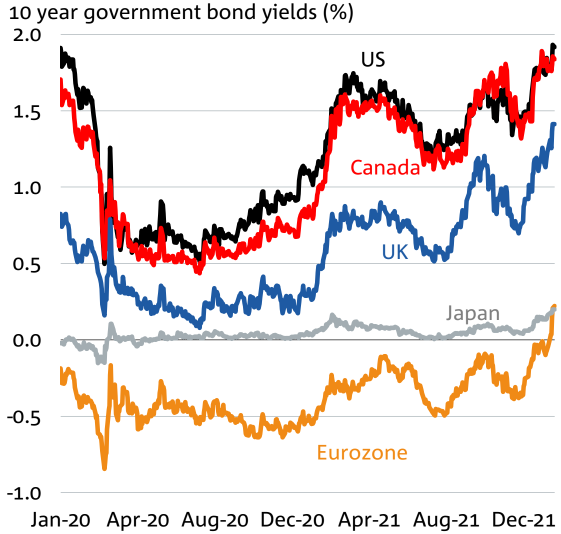
FINANCIAL AND COMMODITY MARKETS

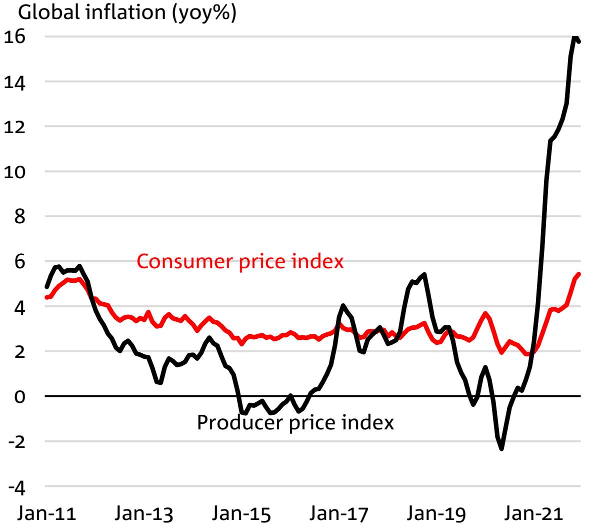
Persistent inflationary pressures have shifted expectations around global monetary tightening

Shifting monetary policy and inflation expectations has seen equities soften and bond yields increasing across January

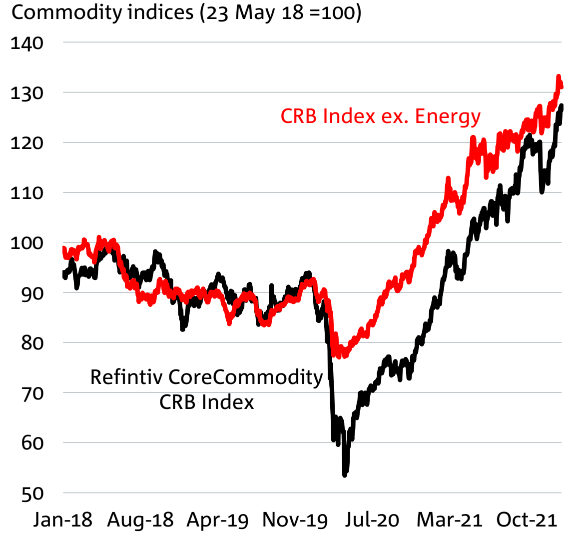




Producer price surge continued, while CPI pushed higher



Commodity prices at highest levels since late 2014



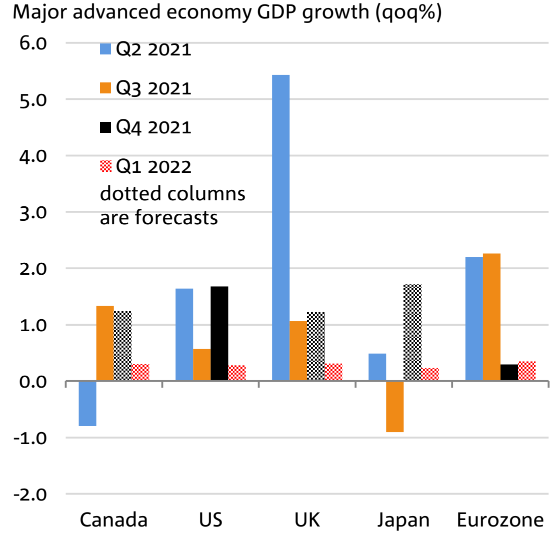
Sources: Refinitiv, NAB Economics

- Financial markets responded in January to growing expectations of monetary tightening related to persistent inflationary pressures. We expect the US Federal Reserve to lift rates four times over 2022 (each by 25bps), starting in March, although there is a risk that they will do more (market pricing has five hikes). The Fed is also expected to start quantitative tightening (reducing the size of its balance sheet) this year; we now expect this to kick-off in Q3 (previously Q4). In addition, financial markets have faced a number of risk factors – including the rapid spread of the Omicron variant of COVID-19, along with geopolitical tensions between Russia and Ukraine (which threatens energy supplies to Europe).
- Global equity markets generally trended lower across January, led by the United States. Compared with the start of the month, the US MSCI equity index was down around 10% in late January – with the big tech stocks suffering double digit declines. Similarly, other advanced economy equities fell by almost 5% and emerging markets by over 3%.
- In contrast, the shift in monetary policy and inflation expectations has contributed to an increase in a broad range of government bond yields since mid-December. While 10 year US Treasuries have reached their pre-pandemic levels in early February, many others (such as the 10 year bonds for the UK, Eurozone and Canada) have moved above them.
- Inflationary pressures have persisted. A range of factors have contributed to this trend – including various COVID-19 outbreaks, a shift in spending from services to goods, prolonged supply shortages of labour, raw materials and key inputs and disruptions to global shipping. This has been most evident in producer prices – which rose by around 15.8% yoy in December (marginally below the November peak).
- Following a brief dip in early December, commodity prices have continued to trend higher, contributing to the producer price pressure. In early February, the Refinitiv CoreCommodity CRB Index rose to its highest level since late 2014. Energy commodities have increased comparatively strongly since the dip. Oil prices continued to rise after OPEC+ resisted calls to rapidly increase oil output, reaffirming plans in early February to modestly expand production starting in March. Similarly thermal and coking coal prices have risen strongly.
- Consumer prices have increased more modestly than producer prices, however pressure from the latter saw global consumer prices rise by around 5.4% yoy in December, the strongest rate of increase since October 2008. Among the advanced economies, these have been the largest increases since the mid-1990s.

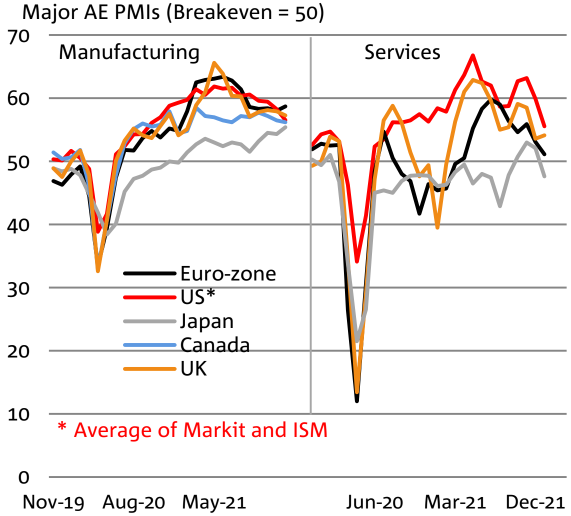
ADVANCED ECONOMIES

Latest COVID wave likely to supress AE growth early in 2022; labour markets very tight

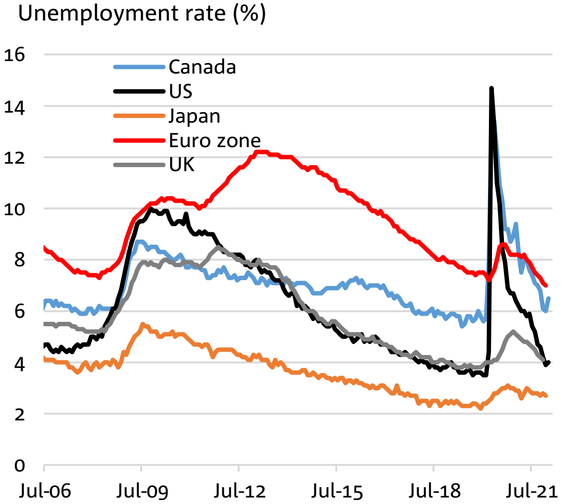
COVID wave hit Euro-Area growth in Q4; major AEs in Q1



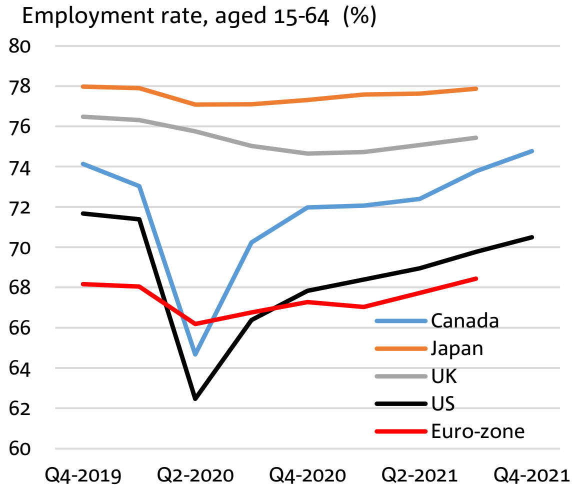
COVID again weighing on service sector; manufacturing holding up



Labour markets are tight…



…though scars are still evident; US employment still well down



- Major advanced economy (AE) growth appears to have been robust in Q4 2021, at a similar rate to Q3. As expected, Euro-zone growth slowed appreciably in Q4 but this was offset by much stronger growth in the US and, we expect, Japan as it exited emergency settings. Similarly, monthly GDP data to November point to further robust growth in the UK and Canada.
- However, Q1 2022 growth is likely to be much weaker as all the major AEs are experiencing a COVID wave. While restrictions on activity have generally been less onerous than in earlier waves (outside of parts of Europe, while parts of Japan are now back in a 'quasi state of emergency'), high frequency data indicates there has been an impact on activity. Business surveys indicate that, as before, the services sector is the most impacted.
- The sheer number of cases is disrupting economies due to the number of people required to isolate along with individuals reducing social interaction due to health concerns. That said, survey measures suggest supply chain pressures have either stabilised or improved a little. This suggests that supply bottlenecks are gradually being addressed – US Q4 GDP growth was in large part driven by re-stocking while major AE auto production has lifted – which could provide a lift to growth.
- However, supply headwinds are likely to remain a factor for a while. Transmission of the virus has the potential to further disrupt global production and transportation networks, particularly in countries with a strict approach to managing COVID (such as China). Moreover, labour markets in the major AEs are very tight, with unemployment rates low by historical standards, signalling that finding staff is an increasing constraint on growth. That said, particularly in the US and the UK, employment is still well below pre-pandemic levels as many people have left the labour force, although workforce participation is showing some gradual improvement.
- Outside of Japan the latest COVID wave is already receding across the major AEs. This should see a recovery in growth in coming months and a bump in Q2 GDP.
- Overall for the major AEs we have lowered our forecasts, with lower growth in 2022 only partially offset by higher 2023 growth. This reflects a delay to the recovery from the current COVID wave (a drag on 2022 but boost for 2023) as well as the impact of high inflation on household budgets, the rapid tightening of labour markets and the bring forward of monetary tightening.

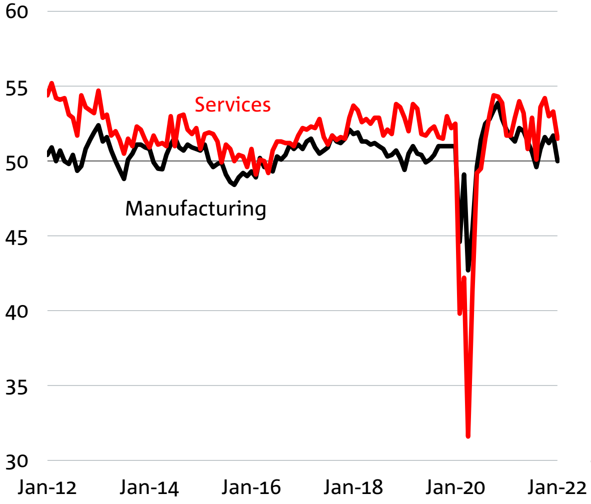
Sources: Refinitiv, OECD, NAB Economics.

EMERGING MARKET ECONOMIES

Surveys point to weak growth momentum heading into 2022

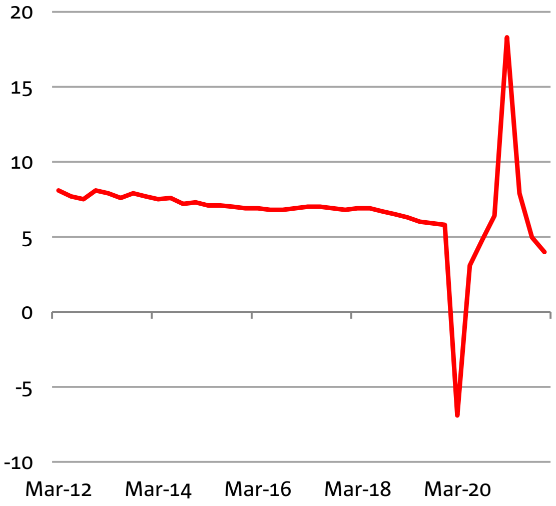
Softer conditions in EM mfg and services in January

Emerging market PMI (Breakeven = 50)



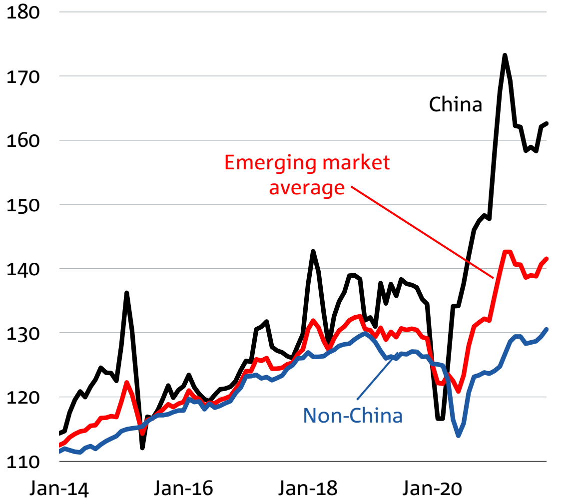
China's Q4 growth was weak when compared to pre-pandemic rates

China economic growth (% yoy)

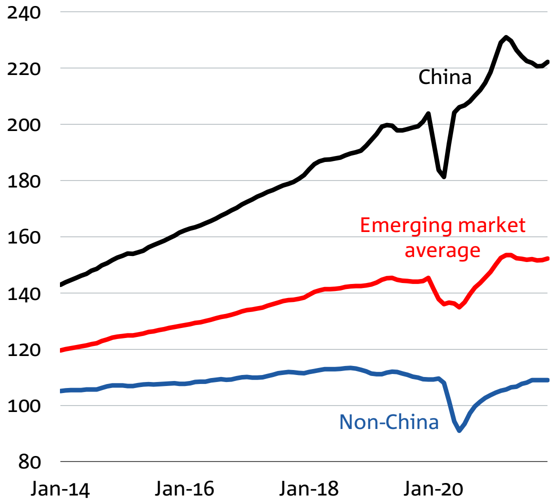


China's manufacturers have been the beneficiaries of increased global goods demand, with other EM output still below 2019 levels

Emerging market export volumes (index 2010=100) (3mma)



EM industrial production (index 2010=100) (3mma)



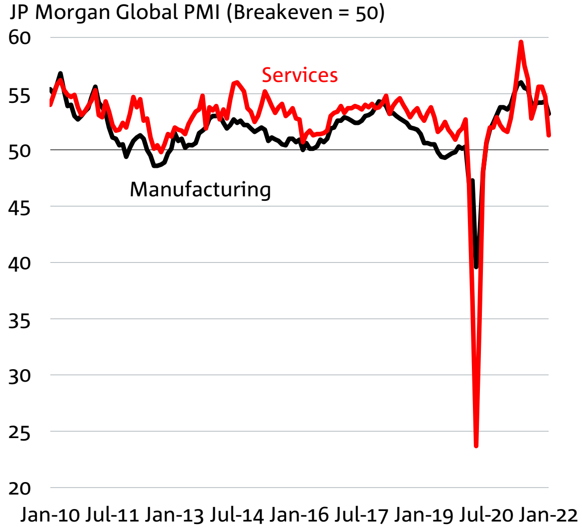
Sources: Refinitiv, IHS Markit, CPB, NAB Economics

- At an aggregate level, emerging market purchasing manager indices softened in January, down to 50.8 points (from 53.2 points previously). The results for both manufacturing and services PMIs were weaker.
- The EM manufacturing PMI slowed to 50.0 points in January, from 51.2 points in December. China was the key driver of this weaker trend, with its measure turning negative in January, along with weaker readings in India and Brazil. Disruptions due to fresh waves of COVID-19 were a common theme across these countries.
- Similarly, the EM services PMI slowed to 51.5 points (from 53.3 points in December). China and India drove the softer trend for services, with COVID-19 disruptions also a major factor, leading to slower growth in business activity and new orders in both countries.
- China's economic growth slowed to 4.0% yoy in Q4 (from 4.9% yoy in Q3), reflecting weaker growth in construction-linked industrial production and retail sales – with the latter contracting in real terms in December. Compared with pre-pandemic rates of growth, this increase was historically low, and it appears that weak momentum has continued into early 2022. Travel and tourism spending data for Chinese new year was marginally weaker than 2021 levels and well below that of 2019.
- Growth in emerging markets is more export dependent than for advanced economies. Export volumes trended higher in the latter months of 2021 – likely reflecting increased demand ahead of Christmas – however volumes remained below the peaks recorded in the first four months of the year. Given that the pandemic-induced consumption switch from services to goods is not expected to persist, export growth opportunities are likely to be limited going forward.
- China has been the main beneficiary of stronger goods demand – with exports rising more rapidly than other EMs from pandemic related troughs. A similar trend is evident in industrial production – with output in emerging markets excluding China still below its pre-pandemic level – in stark contrast to the increases in China's output.
- Tightening monetary policy in advanced economies poses risks for EMs. Some EM central banks have already raised rates – largely to address inflation concerns – while others may be forced to do so to prevent capital flight. Increasing rates too rapidly could risk the ongoing economic recoveries from the pandemic.

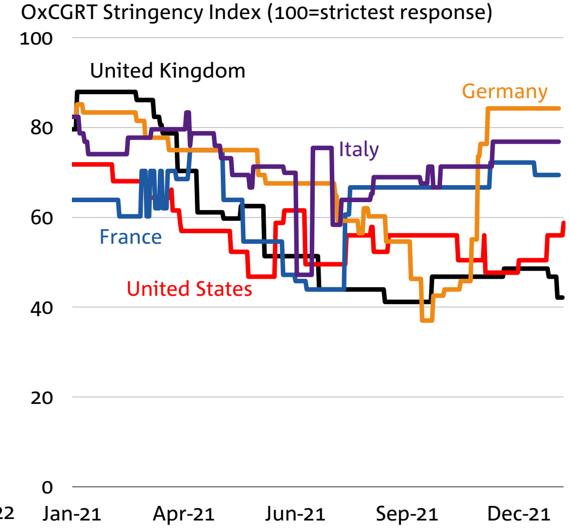
GLOBAL FORECASTS, POLICIES AND RISKS

2022 likely to face various disruptions, as pandemic and supply chain issues persist

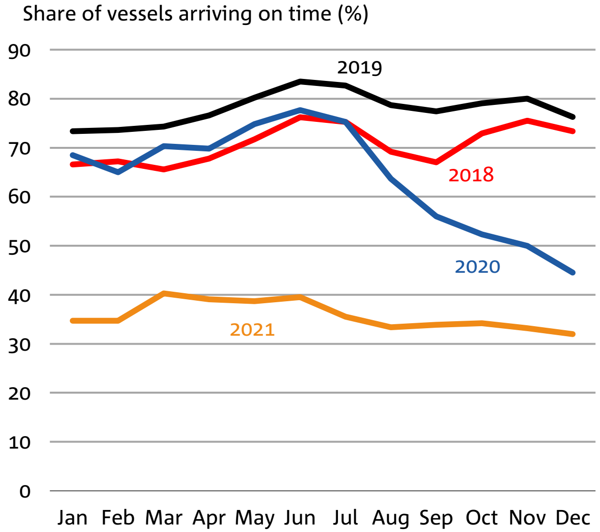
Weaker services sector in AEs drags down global PMI

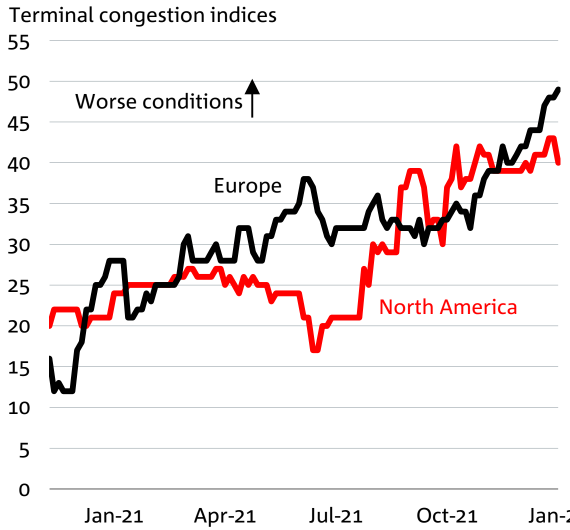


Stringency index points to fresh COVID-19 measures



Shipping and port congestion indicators point to widespread constraints in supply chains that continue to persist





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

- The JP Morgan global composite PMI provides one of the timeliest measures of global economic activity. This aggregate measure softened in January – down to 51.4 points (from 54.3 points previously), with this trend driven by a deceleration in the services sector – which, while remaining in positive territory, fell to an 18 month low. The services reading was weaker among advanced economies than emerging markets.
- In part, this softer outcome may reflect tighter COVID-19 countermeasures in a range of advanced economies – particularly in Europe (with the UK being a notable exception) – along with greater caution from consumers. This appears consistent with the larger downturn in the consumer services sub-category of the global services PMI than either business or financial services.
- The primary risk to the global outlook remains COVID-19. The Omicron variant has spread incredibly rapidly – with this wave far exceeding previous peaks in terms of identified cases. While a smaller proportion of infections are requiring hospitalisation, the sheer number of cases is straining healthcare systems in a wide range of countries, with the potential for further economic disruption. In addition, there is growing evidence to suggest that China's domestically manufactured vaccines have lower efficacy against Omicron than mRNA vaccines – posing additional risks for China and countries that have received exports of its vaccines.
- Other risks remain – including the persistent disruptions to global supply chains (ranging from shortages of labour and inputs, through global distribution to final consumer markets) that are yet to fully unwind. Political tensions have also escalated in a number of regions, most notably border tensions between Ukraine and Russia.
- There is considerable uncertainty around the outlook for China – the world's largest economy (on a PPP basis). Comparatively weaker vaccine protection against the Omicron strain means that hard lockdowns in response to Chinese COVID-19 outbreaks remain likely – with flow on effects for global supply chains. Reflecting the weak momentum in key parts of China's economy entering 2022 (particularly in the property sector), along with lower growth potential from exports, we have cut our forecast for the full year to 5.1% (previously 5.8%).
- The weaker outlook for China is a major driver of a softer forecast for global economic growth in 2022 – down to 4.2% (from 4.4% previously). In addition, we have lowered our expectations for growth in the United States, Japan and United Kingdom, while our forecast for India is somewhat stronger.

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