EMBARGOED UNTIL: 11.30AM THURSDAY 14 APRIL 2022

THE FORWARD VIEW – GLOBAL

APRIL 2022

National Australia Bank

COVID and conflict continue to cloud near term outlook

- The global economic outlook remains clouded by various factors, including China's policy response to fresh COVID-19 outbreaks (which has led to lockdowns in a range of major population centres), the Russia-Ukraine conflict (and its flow on effects on the supplies of various commodities, including energy) and the ongoing disruptions to supply chains (which could worsen if lockdowns in China persist).
- Financial and commodity markets were highly volatile in the first half of March, however markets appeared to have greater certainty in the second half, coinciding with policy rate rises by both the US Federal Reserve and Bank of England. This saw major advanced economy 10 year government bond yields rise above their pre-pandemic rates.
- Global business surveys suggest that economic activity held up comparatively strongly in March – however these measures are weighted more heavily towards advanced economies, where services have generally recovered from the impact of the Omicron wave earlier in the year. In contrast, Russia and China led the EM services measure lower.
- Our forecasts are unchanged this month – we expect that the global economy will grow by 3.7% in 2022 and then slow to a trend-like 3.5% in 2023. That said, we note the near term downside risk to our China forecast as a result of current (and any future) lockdowns. In addition, tail risks (such as a recession in a major advanced economy) down the track have risen given the combination of an energy price shock as well as monetary and fiscal policy tightening.

Global Growth Forecasts

(% change)

	2019	2020	2021	2022	2023
US	2.3	-3.4	5.7	3.2	2.1
Euro-zone	1.6	-6.5	5.2	3.1	2.4
Japan	-0.2	-4.5	1.7	1.9	1.9
UK	1.7	-9.4	7.5	3.8	1.2
Canada	1.9	-5.2	4.6	3.7	2.7
China	6.0	2.3	8.1	5.0	5.5
India	4.8	-7.0	8.2	7.2	6.1
Latin America	0.1	-6.9	6.2	1.5	1.6
Other East Asia	3.5	-2.9	4.3	4.6	4.6
Australia	2.0	-2.2	4.7	4.0	2.5
NZ	2.8	-1.9	5.6	3.2	2.2
Global	**2.8**	**-3.2**	**5.9**	**3.7**	**3.5**

China's Omicron outbreak far exceeds earlier waves, including the initial cases

CONTENTS

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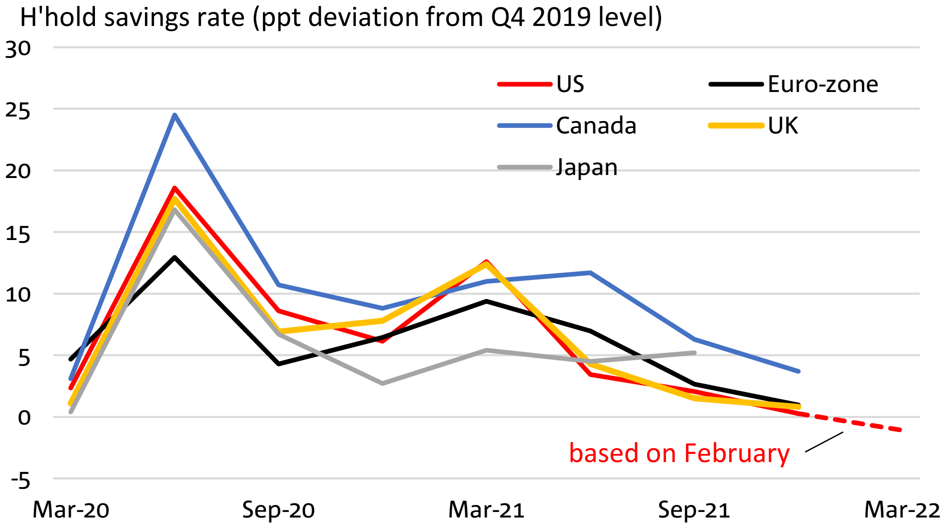
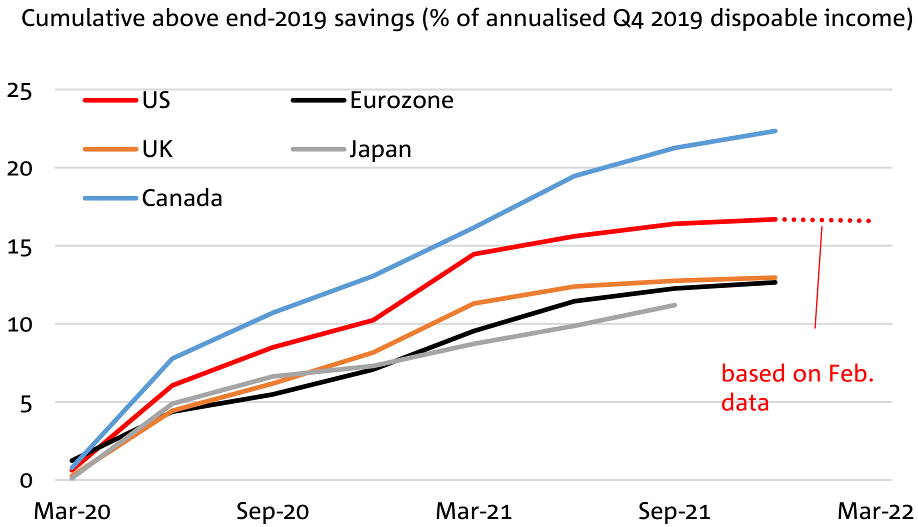
CHARTS OF THE MONTH

With stronger balance sheets and accumulated savings during the pandemic, advanced economy households are in in good position to absorb rising prices; on the business side corporate profits have recovered

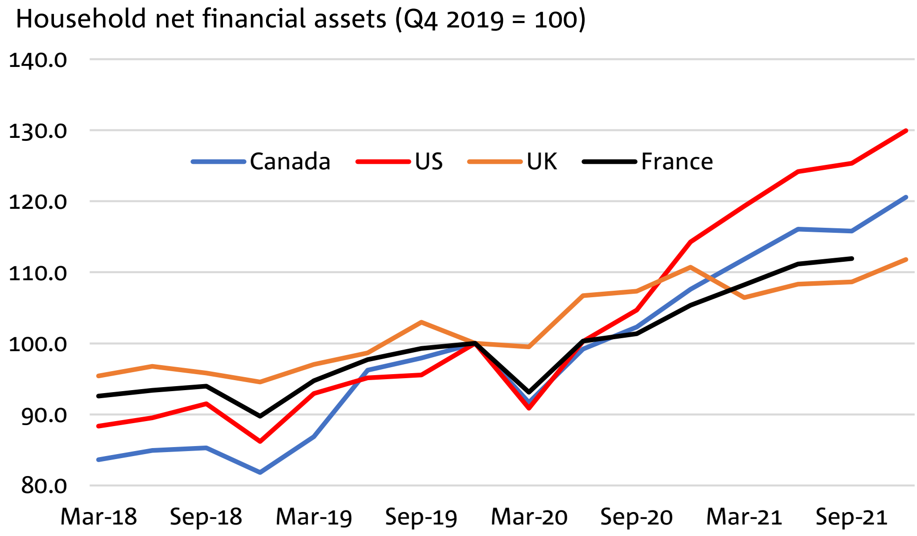
Household savings rate jumped during pandemic (on income levels supported by fiscal transfers)



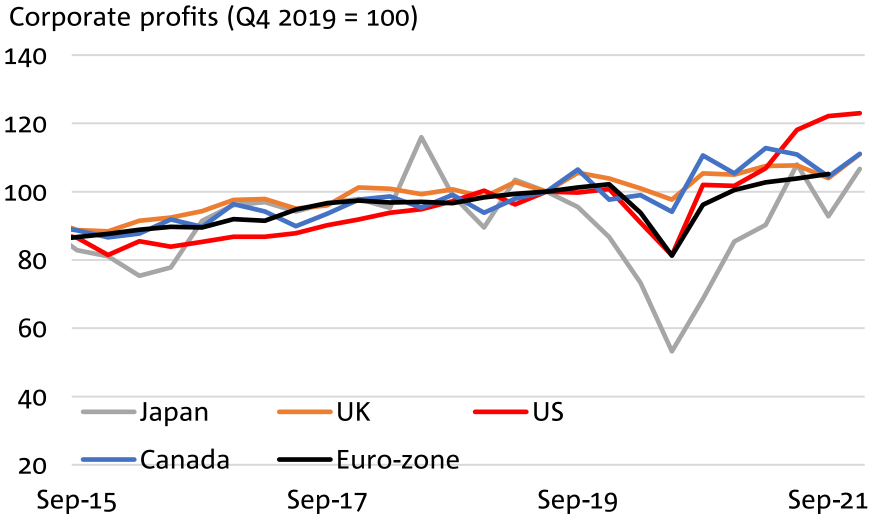
The accumulated savings in excess of their pre-pandemic level are substantial; US only just starting to dip into them



Household balance sheets also improved in recent years



Corporate profits have at least recovered



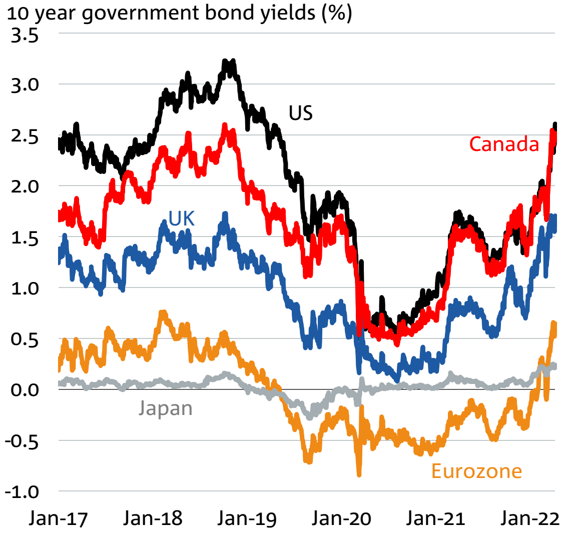
 Sources: Stats Canada, Japan Cabinet Office, Refinitiv, UK ONS, NAB

National Australia Bank

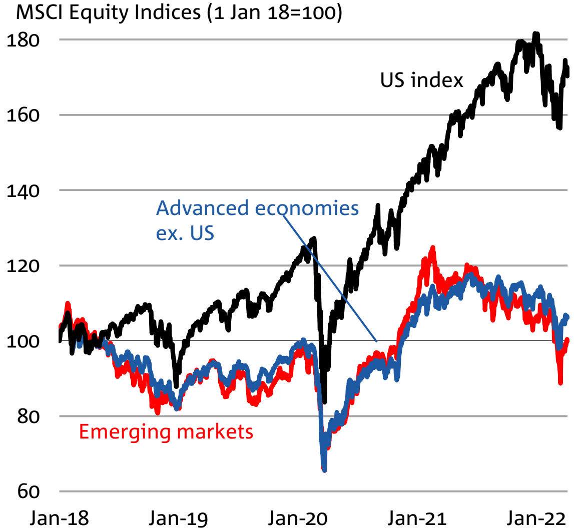
FINANCIAL AND COMMODITY MARKETS

Expectations of tighter monetary policy shook off Russia-Ukraine uncertainty in March

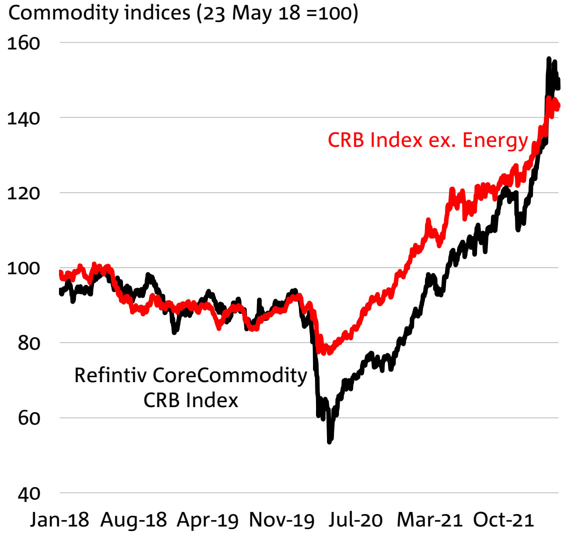
Bond yields rise above pre-pandemic rates



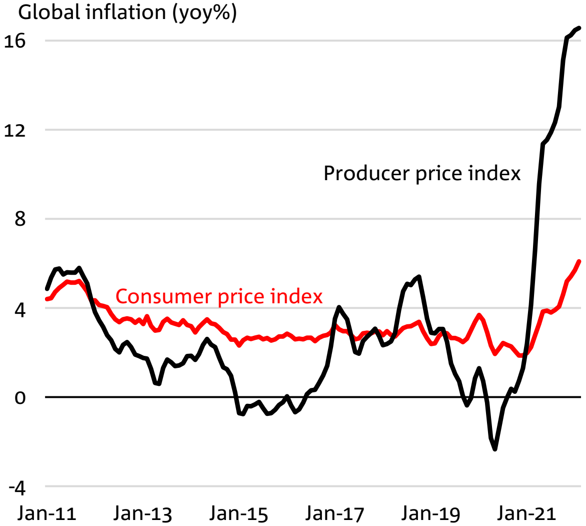
Equity markets remained volatile in March



Commodity prices trended sideways from early March



Advanced economy consumer prices near four decade highs



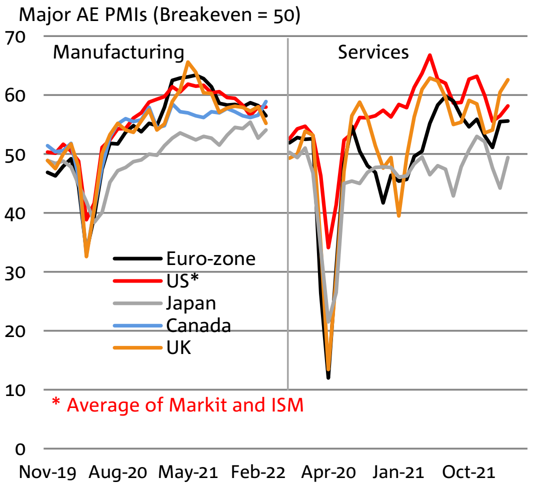
- Financial markets remained negatively impacted by the Russia-Ukraine conflict in the first half of March, before generally starting to recover. This coincided with both the US Federal Reserve and Bank of England increasing policy rates.
- Government bond yields – which generally declined following the start of the Russia-Ukraine conflict – rose from the second half of the month, as expectations of further monetary policy tightening across 2022 strengthened. Yields for most major advanced economy government bonds now exceed pre-pandemic rates.
- Equity markets remained volatile in March, with MSCI indices generally declining across the first half of the month, before subsequently recovering (albeit to differing degrees) in the second half of March and early April. US markets staged the strongest recovery – returning to levels recorded in early February – with this increase driven by the largest technology stocks (with other non-tech stocks generally trending lower from mid-March onwards).
- Commodity prices have also been volatile in recent weeks, reflecting both supply and demand concerns (the latter related to China's COVID-19 outbreaks), but have broadly tracked sideways since early March. Oil prices briefly exceeded US$120 a barrel in the early part of March and have subsequently swung above and below US$100 a barrel. Estimates of Russian seaborne oil exports suggest that they fell in March, albeit not as severely as markets may have feared. That said, allegations of war crimes in Ukraine may harden the resolve of various countries to strengthen sanctions against the Russian state and its firms, which could further restrict commodity supplies.
- Commodity prices are just one of several inflationary pressures that have persisted. There continue to be shortages of raw materials, key inputs (such as semi-conductors) and labour to varying degrees in different markets, while COVID-19 continues to cause disruptions – most notably in China – which could trigger additional supply chain issues.
- These issues are particularly reflected in global producer prices, which rose by over 16% yoy in February. Consumer prices also continue to climb – up by just over 6% yoy. Long run historical estimates of global consumer prices are difficult to produce, however for the seven largest advanced economies, consumer prices rose by their strongest rate since late 1982 (at the tail end of the period of stagflation related to the second oil shock and loose monetary policy).

Sources: Refinitiv, NAB Economics

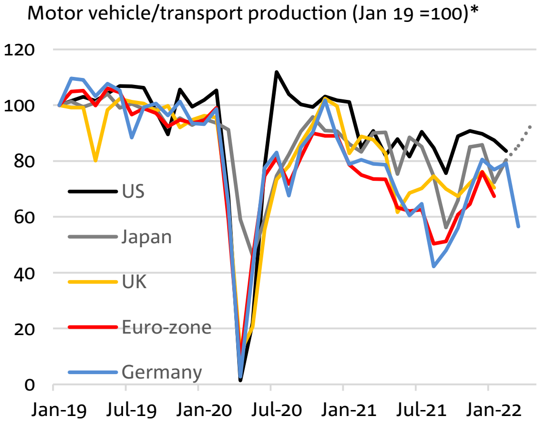
ADVANCED ECONOMIES

Activity rebounding from early '22 COVID wave but risks elevated

Services rebound as COVID cases remain below early '22 peaks

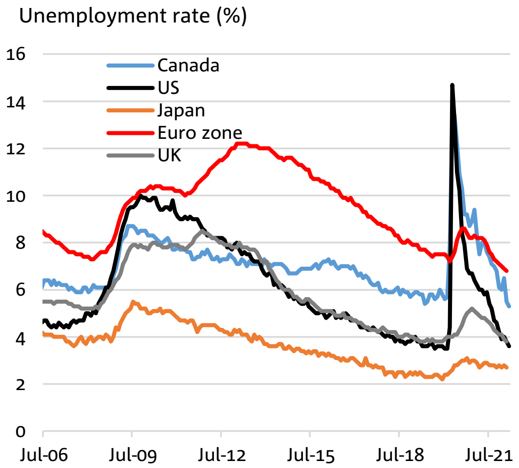


Major AE auto production recovery has stalled

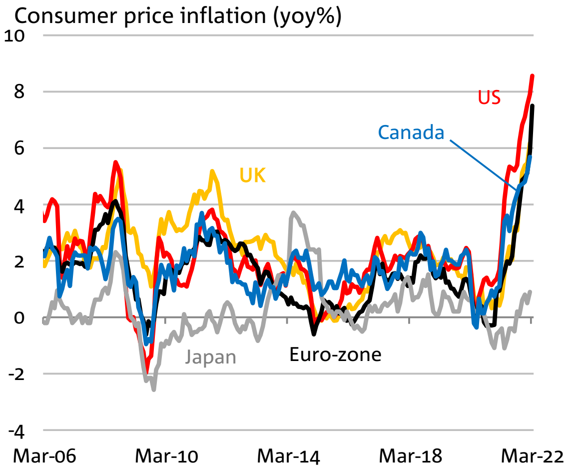


* Motor veh. other than Japan (transport equip.). Japan Mar/Apr data are producer expectations

Supply issues not just in goods; labour markets are tight



High inflation will hit household budgets



- March business surveys were consistent with solid growth in the major advanced economies (AEs). Of note, there has been a recent recovery in service sector readings which had previously come under pressure because of the COVID-19 wave earlier in the year. COVID-19 risk has not gone away; in the EU and UK, there was a pick-up in COVID-19 cases in March but it already appears to have ended without case numbers reaching earlier peaks or restrictions being re-imposed.
- In part owing to the pressure on in-person service activity, as well as business disruptions due to isolation requirements, we had been expecting broad based weakness in Q1 GDP growth across the major AEs. However, with strong monthly GDP estimates for the UK (for January) and Canada (preliminary estimate for Feb), we now look for solid growth in Q1 for both these countries.
- While activity should be seeing a boost from easing pandemic effects, supply disruptions remain a headwind. The recovery in major AE auto production that started last year has stalled – this may partly reflect COVID disruptions (e.g. workers isolating) but the Ukraine/Russia conflict has also impacted supply chains (including in the auto sector) and contributed to a decline in German auto production in March. Lockdowns in China may also add to supply issues. However, as supply bottlenecks are addressed, and inventories re-built, this should boost growth and take pressure off prices. Supply constraints are also evident in labour markets with unemployment rates at low levels.
- The Russia/Ukraine conflict is adding to already high inflation due to the associated rise in energy prices. The resulting impact on household incomes is likely to constrain consumer activity. Against this, continuing strong employment growth in some countries – such as the US – will work the other way. Moreover, across all the major AEs, households accumulated savings well in excess of pre-pandemic levels over 2020 and 2021 which will help absorb price increases (see page 2).
- Major AE central banks have also tightened policy or expectations of when they might tighten have been brought forward. In either case, this is flowing through to interest rates and tighter financial conditions.
- While the continued unwinding of pandemic impacts and resolution of supply chain bottlenecks over time should support growth, from around the second half of 2022 we expect to see a slowdown in major AE growth. The strong cross-currents in-play right now means that uncertainty around the outlook is higher than normal and the risk of tail events (such as recessions, particularly in 2023/2024) is elevated.

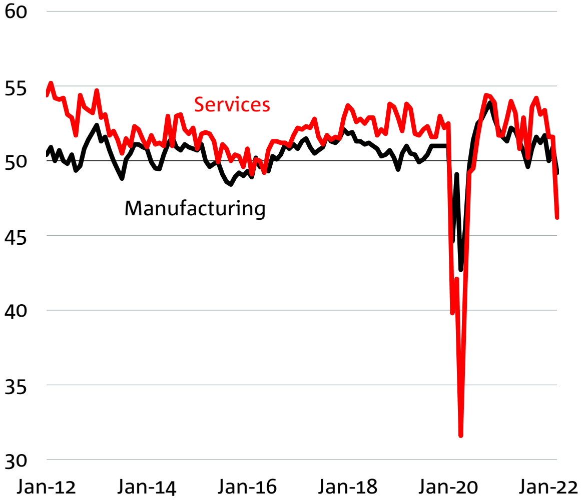
Sources: Refinitiv, NAB Economics.

EMERGING MARKET ECONOMIES

Mixed conditions in EMs – with China and Russia negatively impacted in March

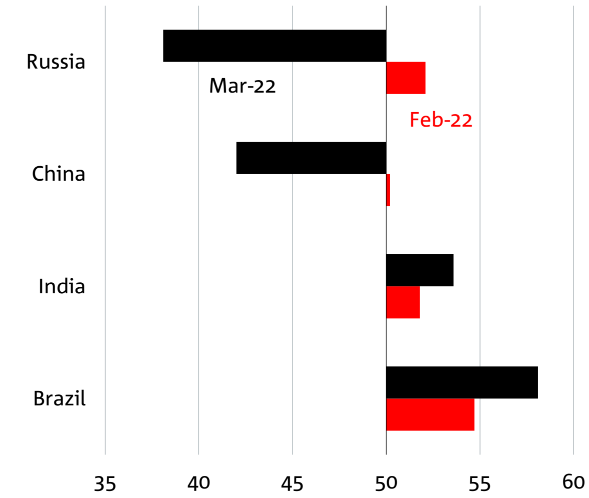
EM services PMI plunged on impact of COVID and conflict

Emerging market PMI (Breakeven = 50)



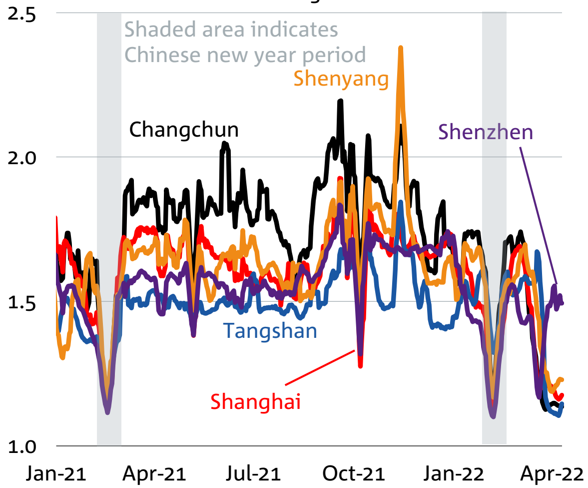
Russia and China's services sectors hard hit in March

EM services PMI (Breakeven = 50)



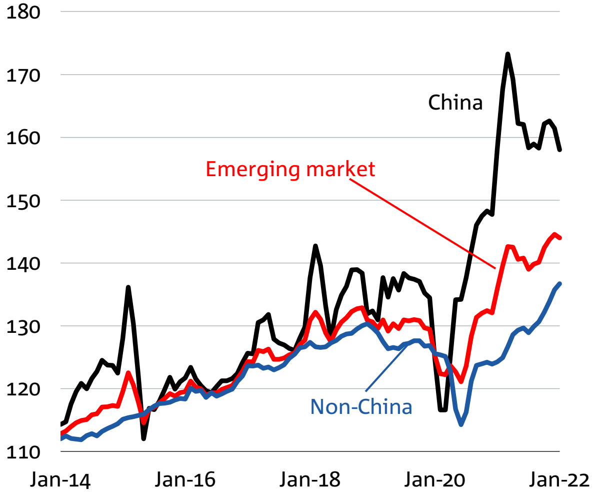
China road congestion data highlights impact of lockdowns

Selected China road traffic congestion indices



Asia (ex China) and E Europe drove export volume growth

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



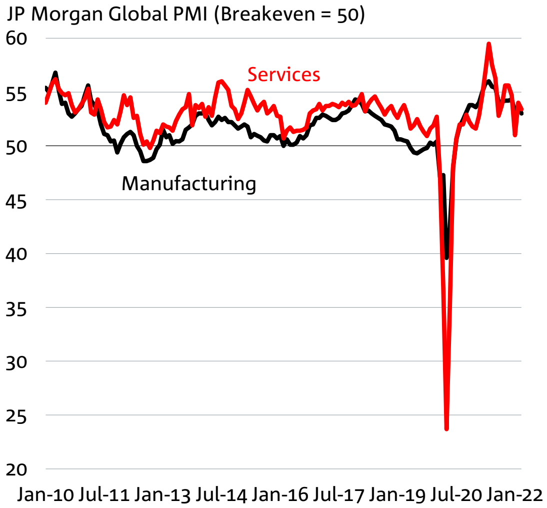
- Emerging market PMIs deteriorated in March – reflecting the impact of COVID-19 in China and weaker activity in Russia (following the sanctions imposed following Russia's invasion of Ukraine). The EM services PMI plunged to 46.2 points (from 51.5 points previously) – despite strong improvements in the readings for Brazil and India. In contrast, there was a more modestly negative trend in the EM manufacturing PMI – down to 49.2 points (from 50.9 points in February).
- Chinese authorities implemented lockdowns in a range of cities in March and early April – including the economically important centres of Shanghai and Shenzhen – as new COVID-19 case numbers have risen to record highs. This was reflected in both official and private sector PMI measures for China turning negative in March – with a particularly sharp decline in the Caixin Markit services PMI. It is worth noting that the lockdown in Shanghai commenced after these surveys were completed. China's policy response to COVID-19 outbreaks is in stark contrast to those now in place in advanced economies – in part reflecting the lower efficacy of China's domestically produced vaccines.
- Factory closures and port congestion related to COVID-19 lockdowns in China have the potential to exacerbate existing supply chain disruptions – particularly if lockdowns are prolonged (the indefinite extension of Shanghai's lockdown was announced in early April). Reports suggest that vessel queues at China's two largest ports have lengthened considerably over the past month – with no spare capacity in global container shipping to compensate for any delays.
- Global trade data are only available up to January, meaning that neither the impact of the Russia-Ukraine conflict or China's COVID-19 disruptions is yet evident. Emerging market export volumes climbed at the end of 2021 – in line with typical demand patterns around Christmas – however volumes were only modestly above previous peaks recorded in early 2021.
- That said, there has been some diverging trends in export volumes by region. Exports from China have fallen considerably from its early 2021 peaks (albeit volumes remain considerably higher than pre-COVID-19 levels), while the pick up in EM volumes since May 2021 has been driven by non-China Asia and, to a lesser extent, Eastern Europe. Export volumes from the latter are likely to fall as a consequence of the Russia-Ukraine conflict.

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

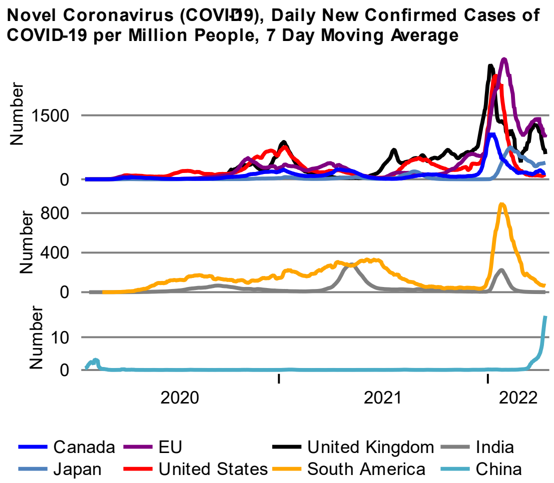
GLOBAL FORECASTS, POLICIES AND RISKS

Growth holding up in face of Ukraine/Russia war but recession risk has risen

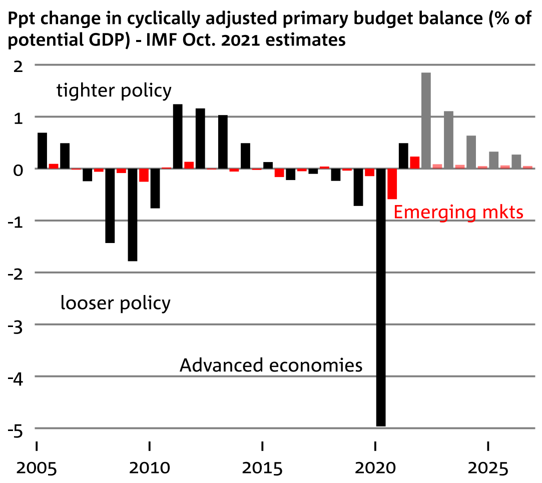
Global PMIs still solid despite China falls due to COVID-19



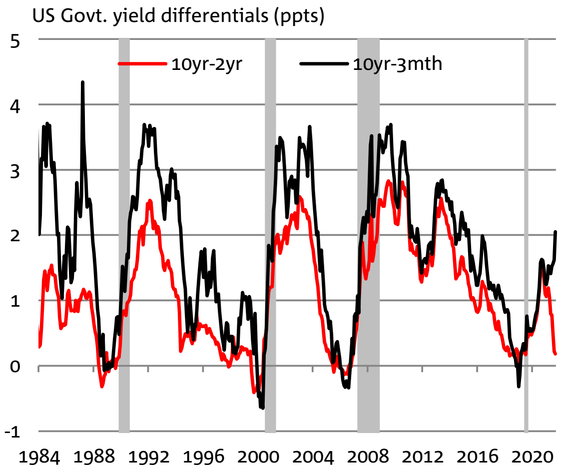
COVID-19 has not gone away; impact on China a risk



Its not just monetary policy tightening – fiscal policy too



Yield curve as a recession indicator...but which yield curve?



Grey areas indicate recession periods.

- Business surveys suggest that global activity held-up in March despite Russia's invasion of Ukraine and the spike in commodity prices. The JP Morgan global composite PMI declined to 52.7 (from 53.5), with falls in both the manufacturing and services PMIs. The largest falls were in Russia (sanctions) and China due to COVID-19 lockdowns in parts of the country.
- The impact of lockdowns in China are a reminder that COVID-19 remains a risk to the economic outlook, particularly in emerging markets where vaccine protection is generally weaker. We have left our China growth forecast unchanged but there is clear near-term downside risk.
- COVID-19 impacts can spill-over globally through lower demand or by disrupting supply chains. While survey measures point to ongoing supply chain bottlenecks, so far they do not indicate any worsening as a result of the China lockdowns and Russia/Ukraine conflict. While supply-chain bottlenecks remain an issue, as they ease this will provide a boost to growth.
- Risks around the outlook are rising. Central banks are set to tighten policy at a much faster pace than previously expected. While the focus for many is to return rates to a more 'neutral' level, the speed of the adjustment may prove disruptive and, with the 'neutral' level of rates unknown, the risk of a policy mistake is high. Moreover, if inflation does not ease as expected, policy rates may need to move above neutral. At the same time, the global economy is trying to digest a major commodity price shock; our forecasts assume that energy prices will start to slowly ease in H2 2022 but clearly there is major uncertainty around the duration of, and fallout from, the Ukraine/Russia conflict.
- Adding to the risks, fiscal policy is also tightening globally. That said, to a large extent this reflects the withdrawal of COVID-19 support which is being filled by greater private sector activity. Moreover, much of the fiscal support during the pandemic was saved (see page 2) providing households with a substantial buffer.
- We expect the global economy to grow by 3.7% in 2022 and then slow to a trend like 3.5% in 2023. However, clearly tail risks (such as a recession in one or more of the major AEs) have risen. Such risks have gained attention with the US 10yr-2yr spread flattening out as historically US yield curve inversion is typically followed by recession. In contrast, other (arguably better) yield curve measures (such as the 10yr-3mth spread) do not point to any near term risk. That said, forward markets suggest these measures may too invert down the track, flagging growing recession risk particularly in 2023 and beyond.

 Sources: Refinitiv, Macrobond, NAB Economics

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