EMBARGOED UNTIL: 11.30AM THURSDAY 12 MAY 2022

THE FORWARD VIEW – GLOBAL

MAY 2022

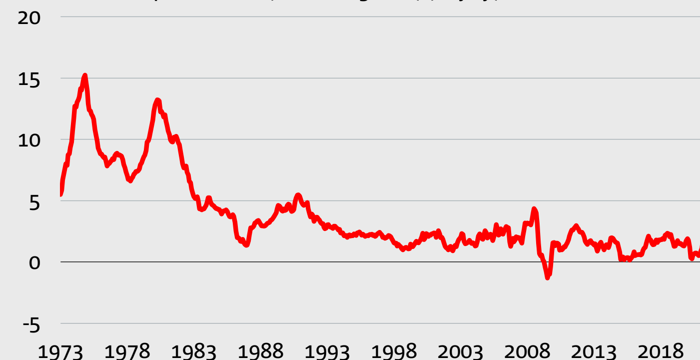
Growth set to slow to below its long-run average

- Inflationary pressures have persisted – with advanced economy consumer prices rising at their fastest pace since late 1982. While a range of central banks have started to raise policy rates, tighter monetary policy will only temper the demand side of the inflation equation, with various supply side pressures continuing. China's zero-COVID response to recent outbreaks has seen vessel queues grow in March and April. A lack of spare capacity in global container shipping means that this could disrupt the movement of goods for months to come. Similarly, the Russia-Ukraine conflict continues with no end in sight, which (having already hit energy markets) could impact global grain and fertiliser supplies, driving up already high food prices in coming months.
- Global PMI surveys point to a large divergence between advanced economies (where readings have remained strong) and emerging markets (where the weakness reflects China's large weight in the measure). In part this divergence reflects the differing stages of the pandemic in these regions, with most advanced economies having a high degree of effective vaccination against COVID-19, meaning they can withstand large scale outbreaks without a major impact on health systems or activity. Many emerging markets have either lower vaccination rates or less effective vaccines, increasing the risk of disruptions to activity in these countries – as exhibited by the lockdowns currently in place in China.
- We now expect the global economy to grow by around 3.4% in 2022 and 2023 (down from 3.7% and 3.5% respectively previously). The key drivers of the weaker outlook in 2022 are the lower growth rates for China and the United States. For 2024, we see growth slowing to 3.1% – well below the long run average of 3.5% – reflecting the lagged impacts of monetary tightening and of the large increase in energy prices.

Global Growth Forecasts
(% change)

	2020	2021	2022	2023	2024
US	-3.4	5.7	2.7	2.0	1.4
Euro-zone	-6.5	5.4	2.8	2.0	1.6
Japan	-4.5	1.7	1.5	1.9	1.0
UK	-9.4	7.5	3.9	1.1	1.5
Canada	-5.2	4.6	4.3	2.3	1.5
China	2.2	8.1	4.2	5.6	4.9
India	-6.5	8.1	7.0	5.7	5.8
Latin America	-7.0	6.2	1.6	1.5	1.7
Other East Asia	-2.9	4.3	4.4	4.6	4.3
Australia	-2.2	4.7	3.8	2.6	2.2
NZ	-1.9	5.6	3.2	2.2	2.6
Global	**-3.1**	**6.0**	**3.4**	**3.4**	**3.1**

Advanced economy consumer price growth at its highest in nearly three decades



CONTENTS

Special focus: US and Europe recession risks rising 2

Financial and commodity markets 4

Advanced economies 5

Emerging market economies 6

Global forecasts and policies 7

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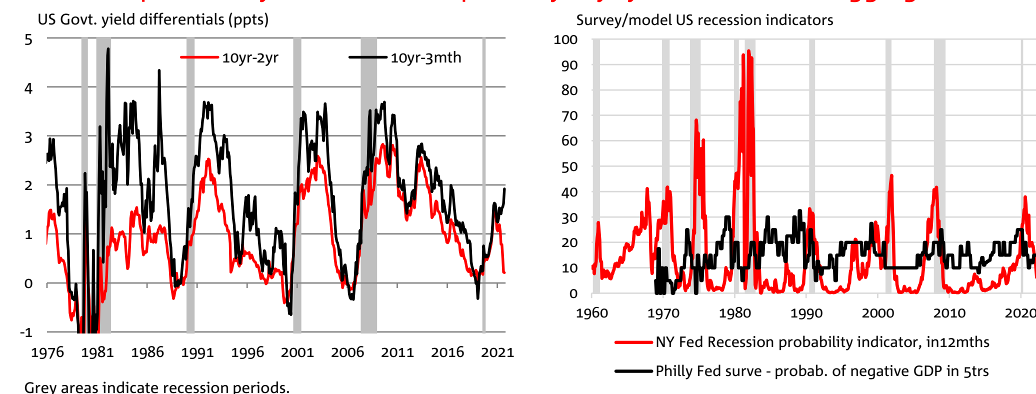
SPECIAL FOCUS: US AND EUROPE RECESSION RISKS RISING

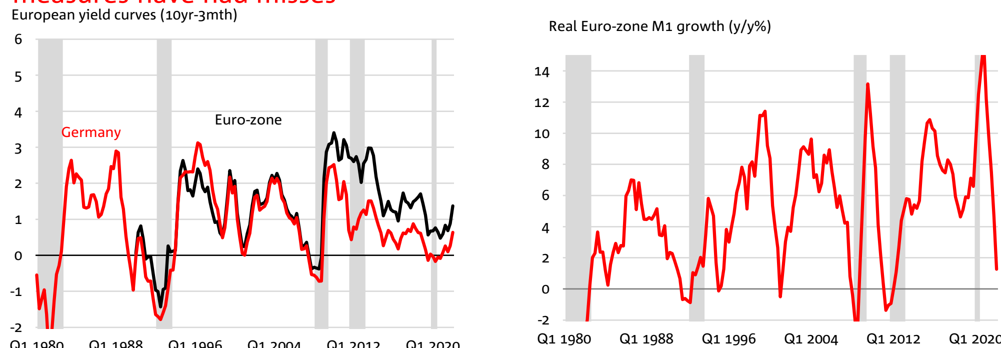
Recession indicators suggest a near term recession is unlikely, particularly given fading COVID drags

- Concerns around the risk of a recession in either the US or Europe are currently elevated. This reflects the combination of:
  - The Ukraine/Russia war, which has added to already high inflation
  - The rapid shift to much tighter (prospective) central bank policy
  - China's zero-COVID approach and the resulting impact on its economy and the implications for already stretched global supply chains.
- Moreover, the US 10yr-2yr yield curve, seen as a recession leading indicator, is close to inverting. However, other yield curve measures have steepened. The New York Fed's recession indicator (based on the 10yr-3mth curve) does not see a high risk of a recession in next 12 months. Nor did economists in the Philadelphia Fed's (February) survey.
- Similarly, the Euro-zone yield curve has steepened. That said, the yield curve does not have as strong a historical track record of forewarning of recessions in the Euro-zone as it does in the US. Another indicator of recession risk that is used is real M1 growth and it too is not at recessionary levels. However, it also has had past misses (false negatives and false positives) and 'QE' (central bank asset purchases) is likely distorting the information content of this measure (and the yield curve).
- US GDP declined in Q1 2022 (by 0.4% q/q). However, domestic final demand growth strengthened, with consumption solid and business investment strong. Moreover, business surveys point to an economy still growing; 428k non-farm jobs were added in April and weekly jobless claims data show no sign of a downturn in the economy. Euro-zone Q1 GDP was also soft, at 0.2% q/q (similar to Q4).
- A common factor affecting end 2021/early 2022 was a COVID wave which led to some restrictions (Europe) or disrupted the labour market. For example, in January, over 2% of US employees were absent from work due to illness. However, the number of people affected has since fallen significantly. Google Mobility data in the Euro-zone and the US has also improved. This should lead to a rebound in activity and we expect to see stronger growth in Q2, although we have tempered our forecasts in part due to the expected impact of higher energy prices and spill overs from lockdowns in China.
- Our US mini-model points to US growth falling to low levels in H2 2023 (see chart next page). While we run several variants of the model – including variables such as oil and asset prices, the yield curve (or real rates), lending standards and the US dollar – they all show a similar story.

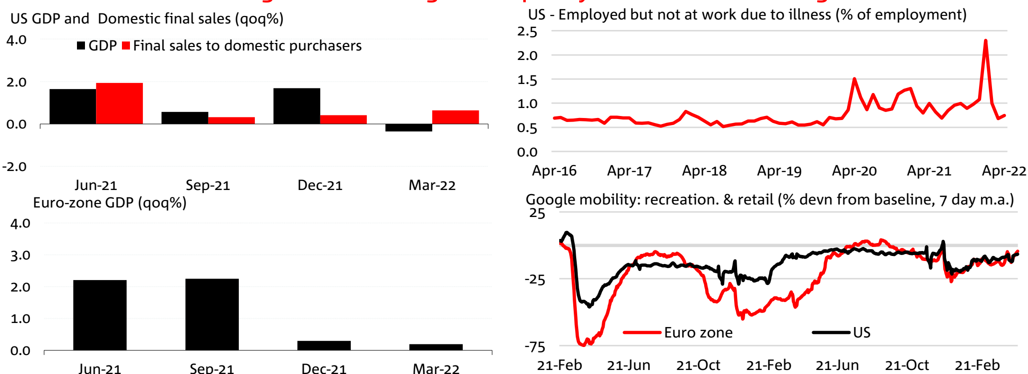
Recession probability indicators – expect 10yr-2yr yield curve not flagging 2022 recession risk



Euro-zone yield curve rising; real M1 falling but still positive; historically both measures have had misses



Soft Euro-zone & negative US Q1 growth partly due to COVID drags which are unwinding



Sources: Refinitiv, NY Federal Reserve, Philadelphia Federal Reserve, Macrobond, NAB Economics

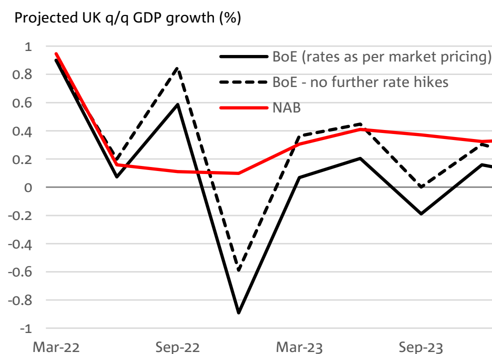
National Australia Bank

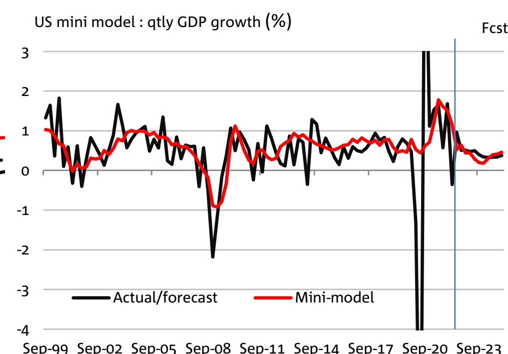
SPECIAL FOCUS: US AND EUROPE RECESSION RISKS RISING

From late 2022 and into 2023 recession risk uncomfortably high; little capacity to absorb a worsening of existing shocks

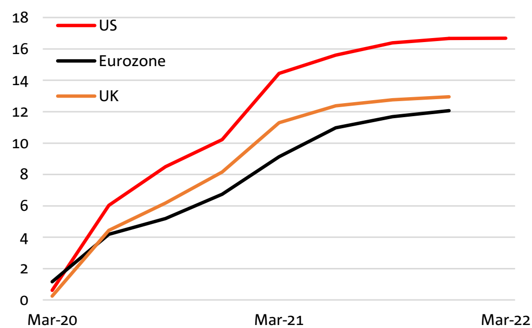
- The risk of a recession is particularly high in the UK. The Bank of England is projecting a large fall in GDP in Q4 2022, driven by a crunch in real incomes from rising energy costs. With only a weak recovery expected subsequently, projected 2023 growth is a small negative. The BoE's modelling is based on market pricing of rates; an alternative assumption of no further rate hikes sees growth of around 0.8% in 2023 and a far more modest rise in unemployment.
- A factor reducing recession risk are strong private sector balance sheets. Households built up savings over the pandemic which they can draw on to support spending. The BoE's projections have real household income falling more than 7% over 2022 but how this translates to activity is uncertain. US consumption has risen in each of the last four quarters despite a fall in real household income in each quarter.
- While we are not currently forecasting recession in the US, Euro-zone or UK (although we are not far off for the latter), it is clear that the risk of a recession has risen. With growth expected to slow to low or modest levels there is little room for error; e.g. how much recent declines in consumer confidence will affect activity is uncertain (see p5). An escalation of current shocks could see a recession become probable rather than possible.
- One possible trigger would be a worsening of the economic fall-out from the Ukraine/Russia war, such as through an end to natural gas (and oil) imports from Russia. Modelling by the Bundesbank of a similar scenario found that it would detract 5% from German GDP in 2022 due to higher energy prices, energy rationing and increased uncertainty. This would also impact other countries through reduced trade and higher energy costs.
- This would also feed into another possible trigger – namely more rapid (and to a higher level) central bank rate hikes – as it would lift headline inflation. This could add to AE central bank concerns of inflation expectations becoming unanchored and trigger even stronger policy action. For the US, our expectation for rates to peak at 2.50-2.75% is partly dependent on a clear deceleration in core inflation through this year. However, supply disruptions from China lockdowns, or changed wage/inflation dynamics, may mean that core inflation does not ease.
- The combination of events adds to the concerns. Each additional shock becomes harder to absorb and the resulting loss of confidence and market volatility can cause greater risk aversion. That said, the impact of monetary tightening come through with a lag, while the China lockdowns are occurring right now. If these were to become less frequent towards end-22/start-2023, then this could provide some global economic impetus.

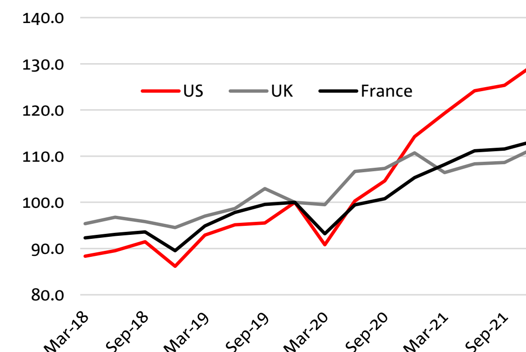
BoE flagging a possible UK recession; our mini-model points to weak US growth H2 2023



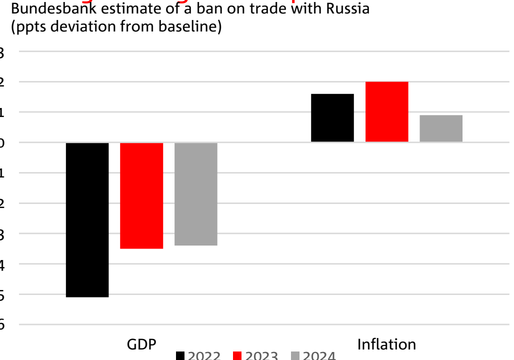


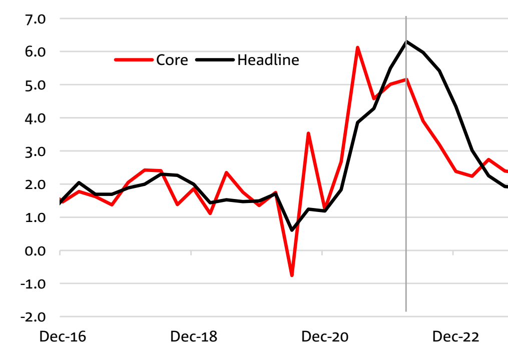
One positive - private sector balance sheets in good shape





Possible triggers - EU ban on Russia natural gas or US inflation stays high triggering more Fed tightening than expected



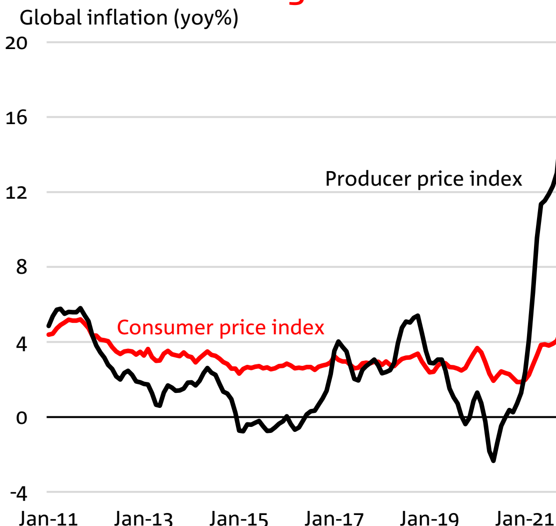


 Sources: Refinitiv, Bank of England, Bundesbank, NAB Economics

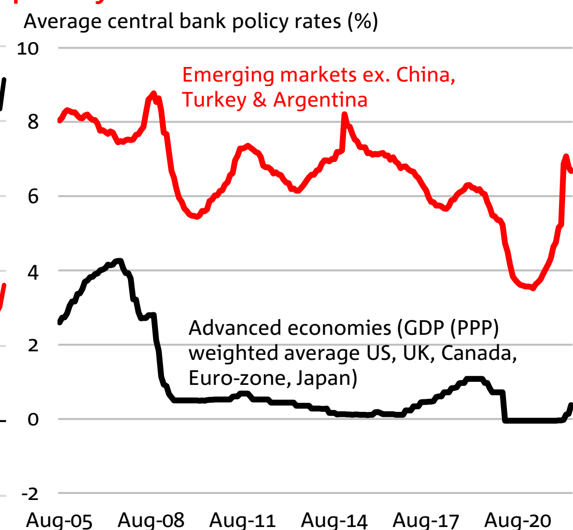
FINANCIAL AND COMMODITY MARKETS

Central banks to dampen demand side, but supply side drivers of inflation remain

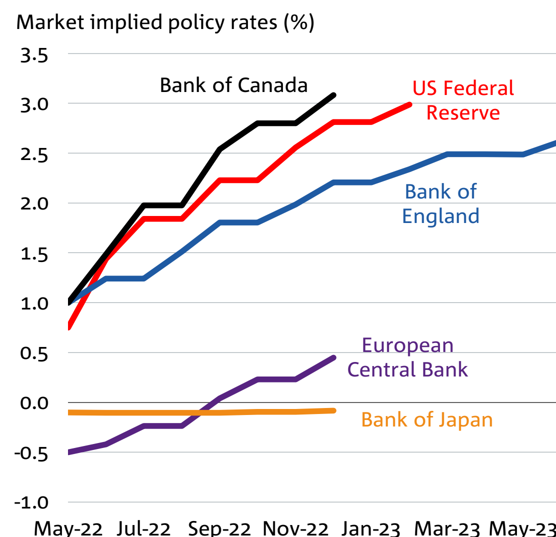
Consumer price growth near three decade highs



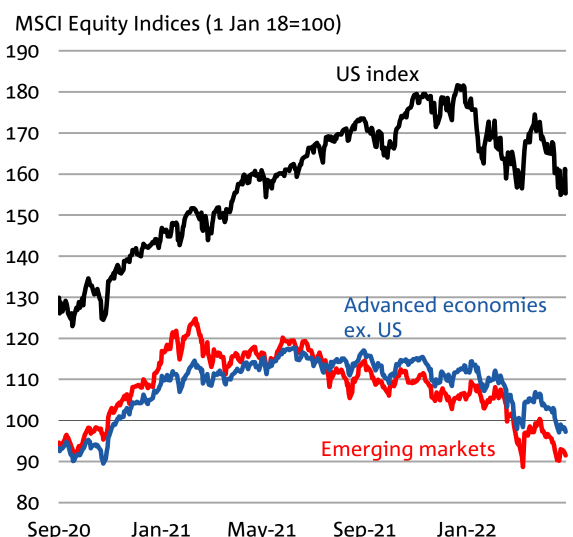
Central banks have started to lift policy rates



Policy rate expectations point to further rate rises



Equity markets have trended lower since the start of the year



- Widespread global inflation data is available to March and shows that inflationary pressures have persisted in recent months. This remains most evident in producer prices, which rose by over 18% yoy in March – in a large part reflecting a broad range of supply side constraints. These include the fallout from the Russia-Ukraine conflict, commodity price increases, shortages of key inputs (notably semi-conductors, where shortages could persist until 2024) and labour (in different sectors and locations) and disruptions to global transport and logistics.
- Soaring producer prices have flowed through into consumer prices, which rose by around 7.2% yoy in March. Among the largest advanced economies, prices in March rose at their fastest rates since late 1982 (with Germany's inflation rate at its highest since 1974).
- Across much of 2021, major central banks generally argued that inflationary pressures were transitory, but this view has shifted more recently – particularly given concerns that inflation expectations are moving higher. Emerging market central banks led the increase – with our measure of EM policy rates now well above pre-pandemic levels – while advanced economy banks have started to raise rates more recently. Since the start of 2022, the US Federal Reserve (Fed), the Bank of England and the Bank of Canada have increased rates by 75 basis points. The European Central Bank looks likely to end net asset purchases in June with its first rate hike to come in July.
- The Fed has signalled its intention to raise rates 'expeditiously' back to 'neutral' (if not higher). We expect a fed funds target range of 2.25-2.50% by year end but the risk is that they go higher and more quickly.
- While tighter monetary policy may temper the demand side of the inflation equation, various supply side pressures look likely to persist. China's zero-COVID response to recent outbreaks has seen vessel queues grow in March and April. A lack of spare capacity in global container shipping means that this could disrupt the movement of goods for months to come. Similarly, the Russia-Ukraine conflict continues with no end in sight, which could impact global grain and fertiliser supplies, driving up already high food prices in coming months. The European Union is currently debating a ban of Russian oil, which could impact energy markets.
- Tighter monetary policy – and expectations of further rate rises to come – have contributed to weaker trends in equity markets. The MSCI US index peaked at the start of January and has trended lower since (despite a brief rally across the second half of March).

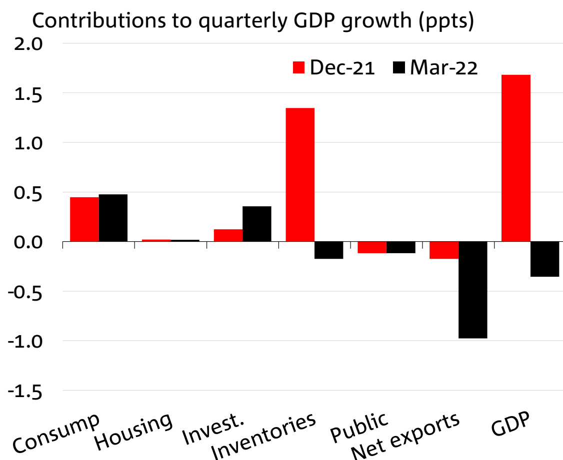
Sources: Refinitiv, NAB Economics

National Australia Bank

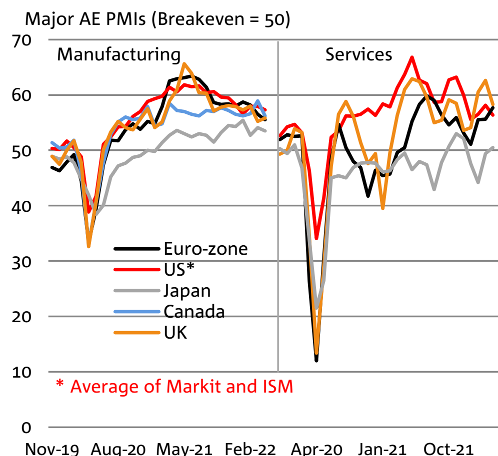
ADVANCED ECONOMIES

AE Q1 GDP growth looking weak; rebound in Q2 expected but risk to outlook growing

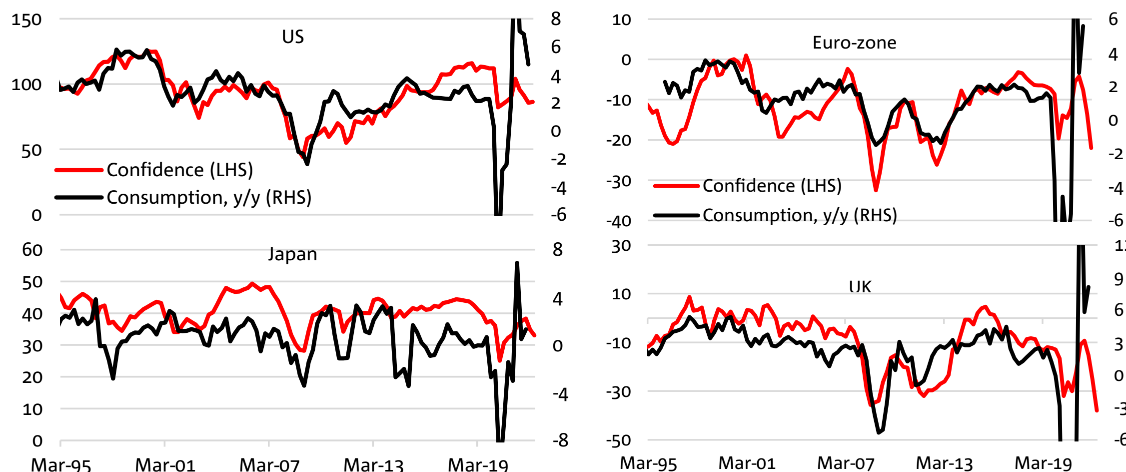
Fall in US Q1 GDP not as bad as it seems



Business surveys still solid



Consumer confidence has fallen across the major AEs; not always a tight relation to consumption particularly in the COVID period*



Sources: Refinitiv, NAB Economics. *US average of Michigan Uni. and Conference Board measures, Euro-zone - European Commission survey; UK – GFK survey, Japan – Cabinet Office survey

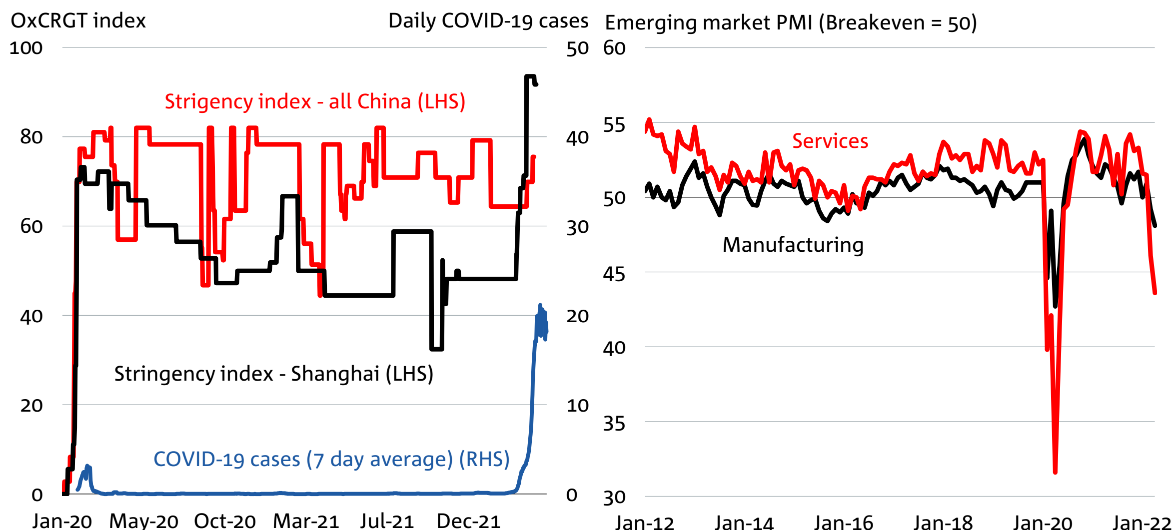
- We had been expecting soft-to-weak Q1 GDP growth in the Euro-zone, US and Japan. In the event, US Q1 GDP was weaker than expected, falling 0.4% q/q. However, the decline was driven by inventories and net exports while consumption growth was solid and business investment strong. As a result, we don't see the Q1 fall itself as major concern although it highlights the ongoing supply issues. At the same time Euro-zone growth was soft, at 0.2% q/q.
- Both the US and Euro-zone economies were affected by a COVID-19 wave in Q1, and its reversal should boost growth in Q2. Similarly, we continue to expect negative Q1 GDP growth in Japan but with a rebound in Q2. In contrast, monthly GDP data for the UK and Canada point to robust Q1 GDP growth.
- Beyond Q1 the outlook is challenging. The spike in commodity prices following the Ukraine/Russia conflict is adding to already high inflation and crunching household income. At the same time, a more rapid tightening of monetary policy is now expected. This month we also significantly marked down our China forecast due to ongoing lockdowns. This will impact the major AEs both through reduced export demand and by adding to supply chain disruptions. However, there is an impetus coming from the ongoing return to pre-pandemic 'normal' and savings accumulated by households during the pandemic provide a buffer against a real income shock.
- Apart from the direct effects of some of these factors, activity can also be impacted though other channels, such as lower consumer confidence. Lower confidence can lead to increased risk aversion and reduced demand. Historically, the link between consumer confidence measures and consumption is mixed – it has broken down in the US post the GFC and was always weak in Japan. The correlation (pre-COVID) was stronger for the Euro-zone and the UK – two economies which have seen the largest recent falls. However, even here the link was not always tight and nor did confidence always lead activity. COVID-19 has further scrambled the link. Moreover, in the Euro-zone, business sentiment (from the same survey) has held up much better, clouding interpretation of the fall in consumer confidence.
- As a result of these factors, as well as recent data, we have lowered our expectations for 2022/2023 growth in the US, Euro-zone and Japan (and continue to expect a significant slowdown in the UK). The uncertain impact of the various headwinds, as well as the possibility that they will worsen, means the risk of a major AE recession in coming years has risen (see pp 2-3).

EMERGING MARKET ECONOMIES

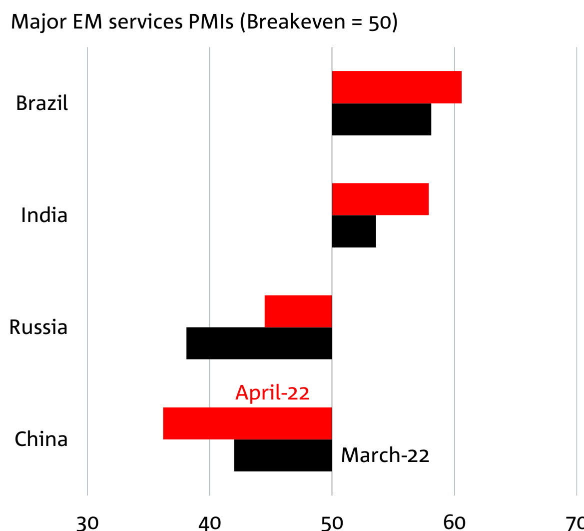
China's Omicron wave has hit economic activity and will further disrupt global supply chains

China maintains its COVID policy response to Omicron wave

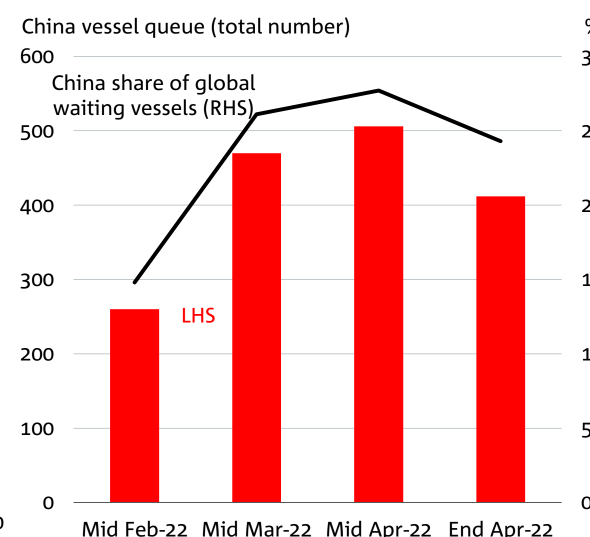
EM PMI measures highlight the impact of China's lockdowns



Stark differences in trends, with China driving the downturn



Vessel queue off China's ports likely to impact supply chains



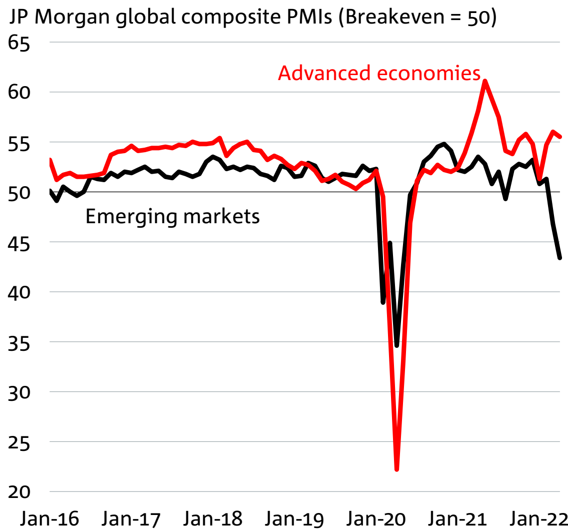
- China's Omicron COVID-19 wave continues to impact domestic economic activity and is likely to further disrupt global supply chains. Despite China's reported case numbers being relatively modest (when compared with international trends), they remain near their highest levels at any point of the pandemic, and authorities continue to respond to these outbreaks with economically damaging lockdowns.
- At the time of writing, Shanghai was starting its fifth week of a harsh lockdown, while rising case numbers in Beijing have raised fears that the city could follow suit. A large number of smaller urban centres also remain impacted to varying degrees.
- There appears to be little appetite for a broad public health policy change among Chinese authorities. While vaccination rates are generally high in China, a large proportion of elderly residents have not received either a booster (third shot) or a second shot. In addition, domestic vaccines are believed to have a much lower efficacy against the Omicron variant, meaning that adopting a more open policy towards COVID-19 outbreaks – such as those in most advanced economies – would likely result in the healthcare system becoming quickly overwhelmed.
- Emerging market PMIs highlight the impact of China's COVID-19 response. The EM Services PMI fell to 43.6 points (from 46.1 points in March) – with China's measure plunging to 36.2 points, the second weakest reading on record (after the initial COVID-19 lockdowns of February 2020). In contrast, services measures improved in other major EMs, particularly India and Russia.
- The EM manufacturing index fell much more modestly in April, down to 48.1 points (from 49.2 points in March and positive territory in February). Once again, China was the key driver of the decline, somewhat offset by an improvement in the Russian measure.
- The various COVID-19 disruptions in China have impacted factory output, freight movements and port facilities. According to maritime data firm Windward, around one-fifth of the world's container shipping capacity were queued outside ports in mid-April – with over 27% of these vessels waiting off China's ports. While a late April assessment suggests a slight easing in China's vessel queue, it remains considerably higher than earlier in 2022. The lack of spare capacity in global container shipping means that China's COVID-19 response is likely to further disrupt supply chains in coming months.

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

GLOBAL FORECASTS, POLICIES AND RISKS

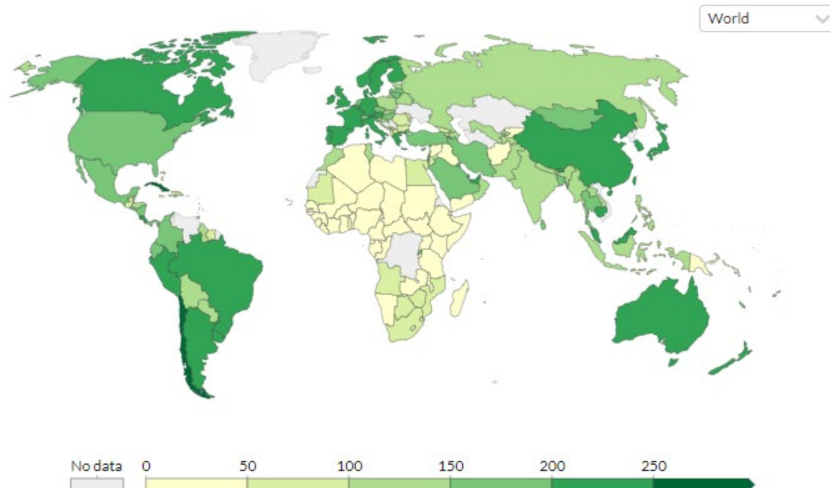
Diverging conditions between regions; sub-trend growth over our outlook period

Stark divergence between AEs and EMs in recent surveys



Widening gap between China's target and our forecast

Considerable divergence in vaccine access and vaccination rates globally, along with differing efficacy of vaccines



- The JP Morgan global composite PMI declined further in April – down to 51.0 points (from 52.7 points in March). Conditions are now highly divergent between advanced economies – where readings have remained strong – and emerging markets (which is weighted towards China).
- In part this divergence reflects the differing stages of the pandemic in these regions. Most advanced economies have a high degree of effective vaccination against COVID-19, meaning that even large scale outbreaks (such as Omicron) have been withstood without health systems becoming overwhelmed and the negative impact on economic activity minimised.
- In contrast, many emerging markets continue to lag in terms of vaccine access and rollout, while others have relied on less effective vaccines (such as those supplied by China). This increases the risk of disruptions to activity in these countries – as exhibited by the lockdowns currently in place in China.
- We have previously flagged downside risk to China's outlook, and reflecting the impact of the recent lockdowns on economic activity, we have cut our forecast for 2022 to 4.2% (previously 5.0%). Given that China's zero-COVID approach appears unlikely to change in the near term, and the risk of further outbreaks around the country, downside risk to this outlook remains. That said, recent reports suggest that Chinese authorities remain committed to their 2022 growth target of 5.5%.
- We now expect the global economy to grow by around 3.4% in 2022 and 2023 (down from 3.7% and 3.5% respectively previously). The key drivers of the weaker outlook in 2022 are the lower growth rates for China and the United States. For 2024, we see growth slowing to 3.1% – below the long run average of 3.5% – reflecting the lagged impacts of both monetary tightening and large increases in energy prices.
- A broad range of risks have emerged in recent times. There remains considerable uncertainty around the duration and economic impact of the Russia-Ukraine conflict (with global food prices likely to be affected in coming months). Major central banks have flagged more rapid than previously expected increases to policy rates – which could prove disruptive in a range of economies, in addition to the risks of a policy mistake. It is also possible that central banks may need to push rates above "neutral" levels if high inflation persists – a reasonably likely outcome given the range of supply side factors contributing to current inflationary pressures. With several shocks hitting the global economy at once, the risk of a recession in a major economy is rising.

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

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