EMBARGOED UNTIL: 11.30AM THURSDAY 16 JUNE 2022

THE FORWARD VIEW – GLOBAL

JUNE 2022

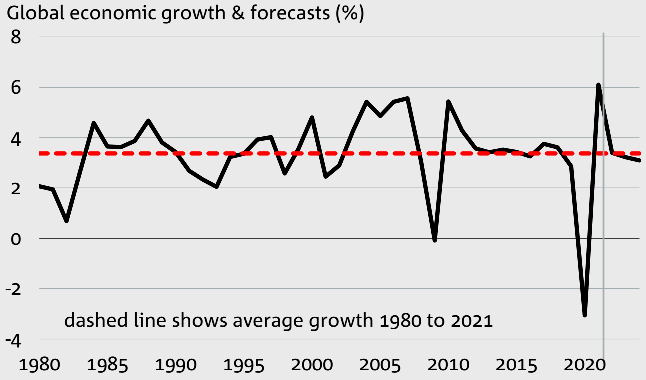
Global growth prospects continue to weaken

- Global inflation remains high and is showing no signs yet of easing. This is placing pressure on household finances which, in conjunction with central bank interest rate rises, is likely to slow growth.
- A focus of many advanced economy central banks has been to return rates to 'neutral'. However, with persistent supply side issues – which monetary policy cannot address – continuing to put pressure on prices, and adding to the risk that inflation expectations may de-anchor, there is a real possibility that central banks move rates well above neutral (and above what we are currently projecting). This risk is highlighted by the Fed's overnight increase in rates by 75bp and the Fed member projections for the fed funds rate which were well above what we had been expecting by the end of the year; we will review our expectations for the Fed (and the implications of Fed policy for growth) in coming days.
- The risk is that the speed and degree of policy tightening may prove too much for economies to handle, particularly given the commodity price shock currently in play. As a result, while not our current baseline forecast, recession risk for several of the major advanced economies, including the US, is uncomfortably high. Monetary policy acts with a lag so the risk is concentrated in 2023. Moreover, advanced economy growth is currently being supported by a normalisation of activity following the end of the COVID-19 wave earlier in the year and the high level of savings accumulated by households since the start of the pandemic. China is also starting to see a recovery in activity as restrictions in Shanghai and Beijing have been eased, although there are concerns at the time of writing that some restrictions may be re-imposed following another increase in COVID-19 case numbers, highlighting the uncertainty around China's economic outlook, given the continuation of zero-COVID health policies.
- While we still see global growth of 3.4% in 2022, we have lowered our 2023 global forecast to 3.2% (from 3.4%). This reflects lower forecasts for the United States, Euro-zone and Japan in particular. 2024 growth is expected to be only 3.1%, below the long run average of 3.4%.

Global Growth Forecasts
(% change)

	2020	2021	2022	2023	2024
US	-3.4	5.7	2.6	1.7	1.3
Euro-zone	-6.5	5.3	3.1	1.5	1.5
Japan	-4.5	1.7	1.3	1.6	1.0
UK	-9.3	7.4	3.7	0.9	1.4
Canada	-5.2	4.5	3.7	2.4	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	2.0	1.4	1.7
Other East Asia	-2.8	4.3	4.4	4.6	4.3
Australia	-2.1	4.8	3.8	2.0	2.0
NZ	-1.9	5.6	3.2	1.4	1.7
Global	**-3.1**	**6.0**	**3.4**	**3.2**	**3.1**

Global growth set to be disappointing



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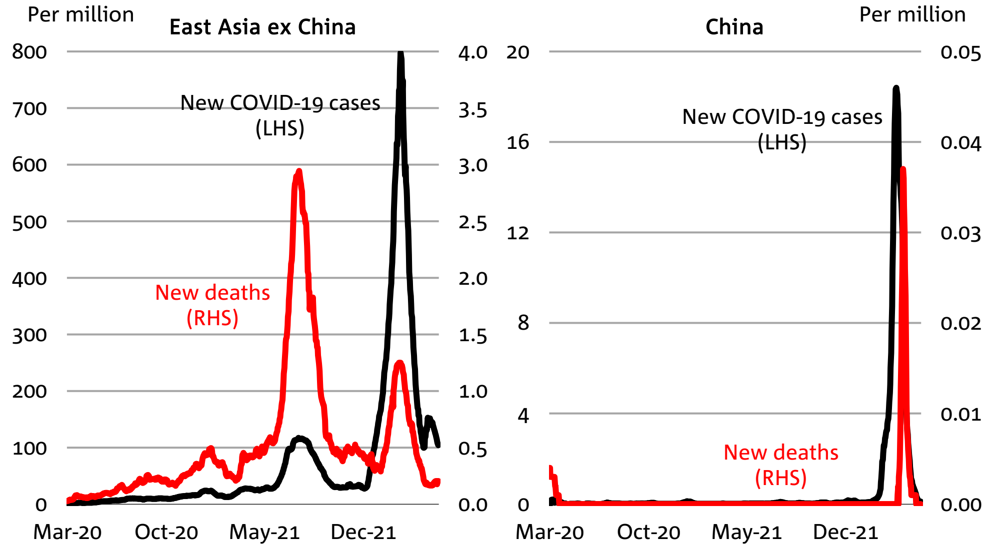
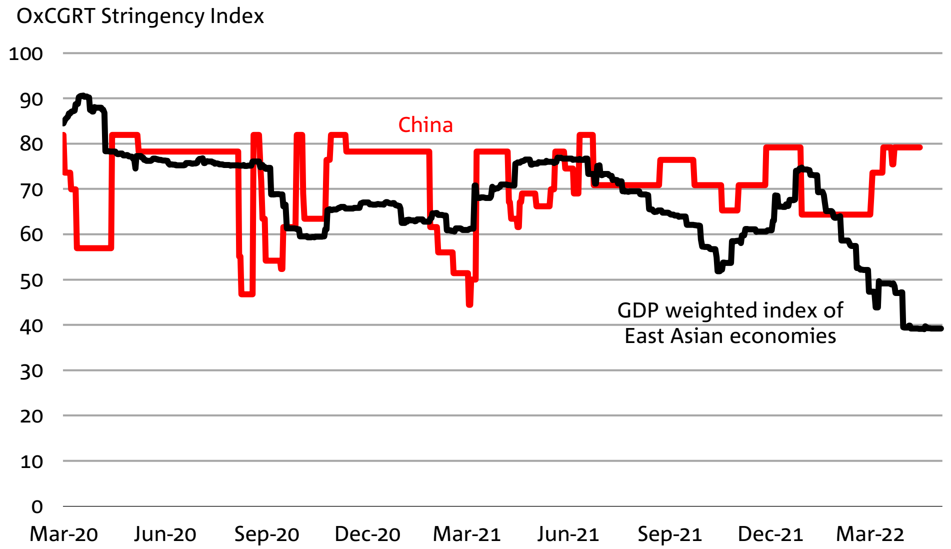
CHARTS OF THE MONTH

Stark contrast between strict public health policies in China and greater openness in other East Asia. China's policies are set to persist, risking further disruptions to its economic activity and global supply chains

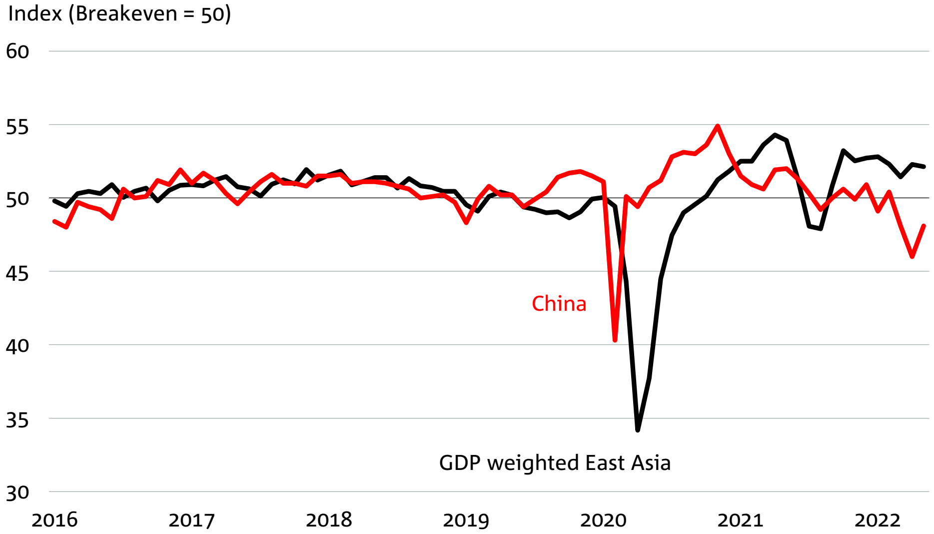
China's recent COVID-19 wave was relatively modest when compared with the rest of East Asia…



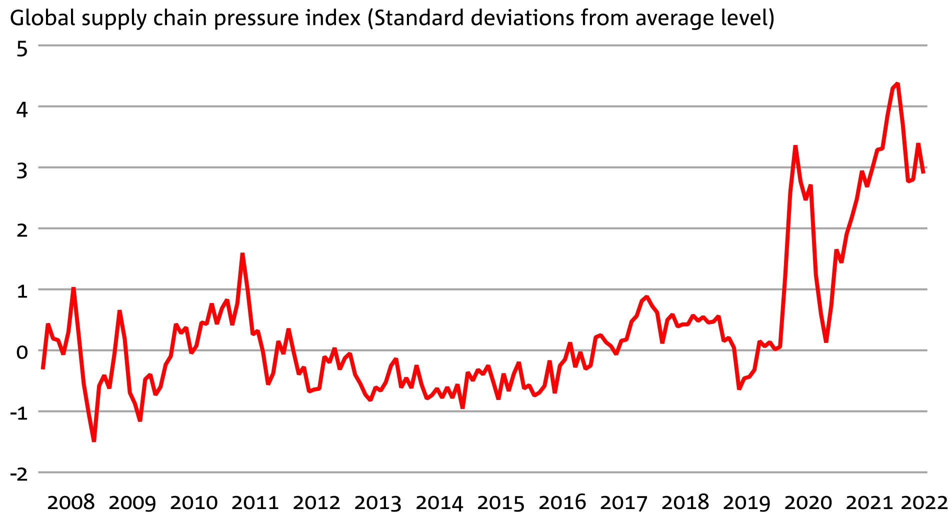
…however China's policy responses remain much stricter, while other Asia's approach is more akin to advanced economies



China's stricter approach looks set to continue, which will continue to impact its manufacturing conditions…



…and further disrupt already impacted global supply chains



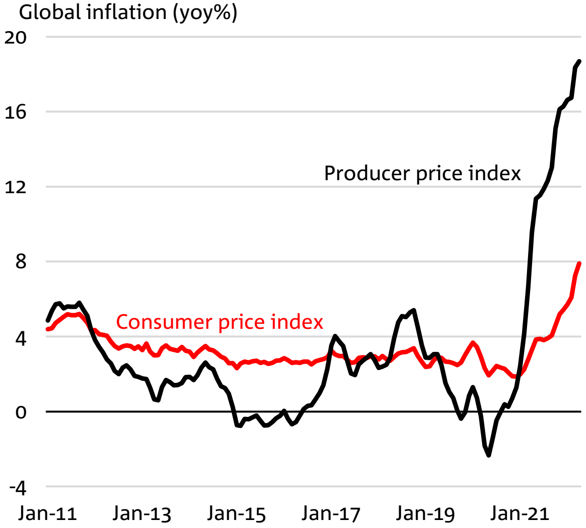
 Sources: Our World in Data, Oxford Coronavirus Government Response Tracker, IHS Markit, Federal Reserve Bank of New York, NAB Economics

National Australia Bank

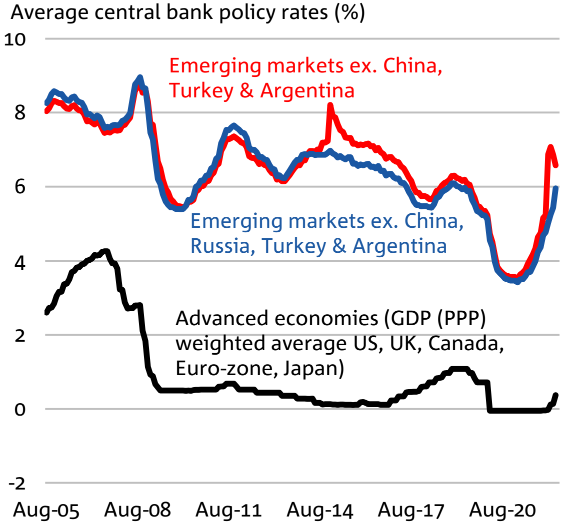
FINANCIAL AND COMMODITY MARKETS

Central banks respond to persistent inflation, risking recession and EM capital outflows

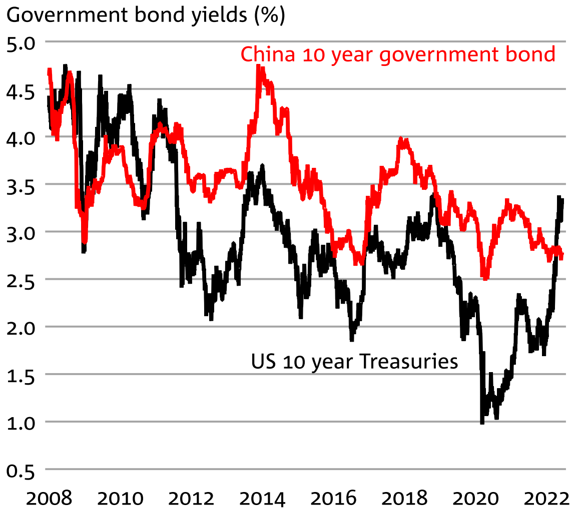
Inflationary pressures persist, with producer prices soaring



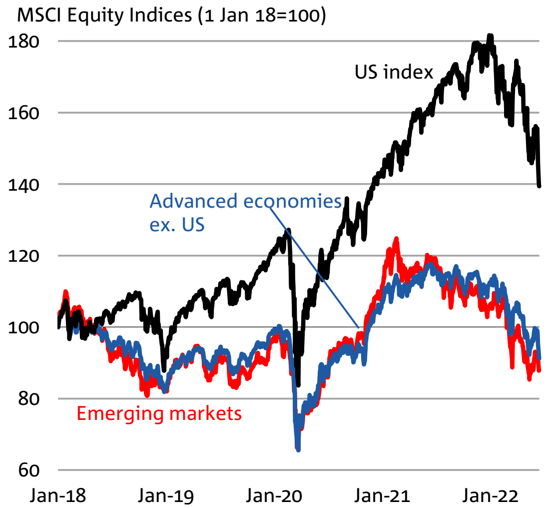
Major central banks are lifting rates, with EMs leading the way



Yields on US government bonds now exceed China



Equity indices have trended lower since CB tightening started



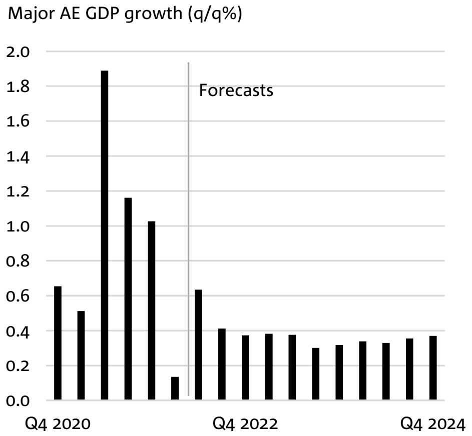
- Global inflation continued to accelerate in the early months of 2022, with supply side pressures continuing to impact prices. This is clearly evident in producer prices, which rose by almost 19% yoy in April. Manufacturers worldwide continue to face rising commodity prices, shortages of various key inputs and labour (to differing degrees in different locations), the impact of the Russia-Ukraine conflict and China's COVID-19 policies and disruptions to global transport and logistics. Several of these factors are likely to persist across the remainder of the year, with global food prices in particular likely to climb due to shortages of fertiliser, while China's zero-COVID approach could result in further lockdowns.
- These inflationary pressures flow through into consumer prices – which increased by almost 8% yoy in April. CPI inflation in the G7 economies is at its highest level since late 1982.
- In response to the surge in inflation, central banks are continuing to lift interest rates. Emerging market central banks rates are now above their pre-pandemic levels. The major advanced economy central banks were slower to move but there is now a rapid adjustment underway. Between March and June, the policy rate was increased 150bp by the Fed and 125bp by Bank of Canada while the Bank of England has raised rates by 90bps since late 2021. The ECB has announced it will lift rates by 25bp in July. The rapid shift to tighter policy is expected to continue; markets are pricing in further rate increases of between 175-215bps over the rest of the year for these banks. Of the major AEs, only the Bank of Japan is expected to remain on hold.
- Rapidly tightening monetary policy brings with it considerable risk. These measures are unable to address the supply side drivers of the current inflation pressure, but are likely to reduce demand, which could send various economies into recession.
- AE rate increases could result in capital flows from emerging markets to advanced economies, as yields on AE bonds have trended higher. Since early April, the yield on 10 year US Treasuries has exceeded the 10 year Chinese government bond. IIF capital flow data showed portfolio outflows from EMs in March and April of just over US$11 billion (following generally large inflows between April 2020 and February 2022). Further outflows could destabilise EM financial markets.
- Global equity markets have also trended lower as AE monetary policy has started to tighten. The MSCI AE indices have moved to new cyclical lows in June (at the time of writing) and, along with the EM index, are well below their 2022 peaks.

 Sources: Refinitiv, Macrobond, NAB Economics

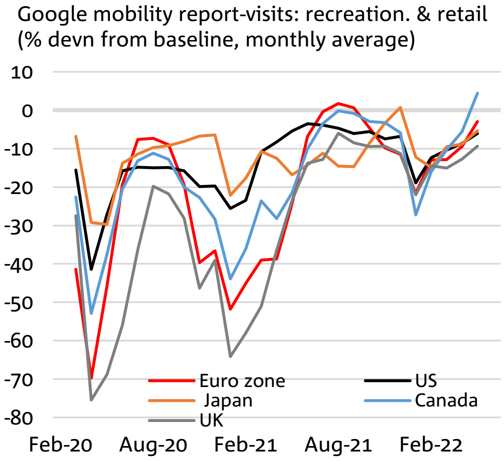
ADVANCED ECONOMIES

AE GDP growth expected to rebound in Q2 before slowing through to H2 2023

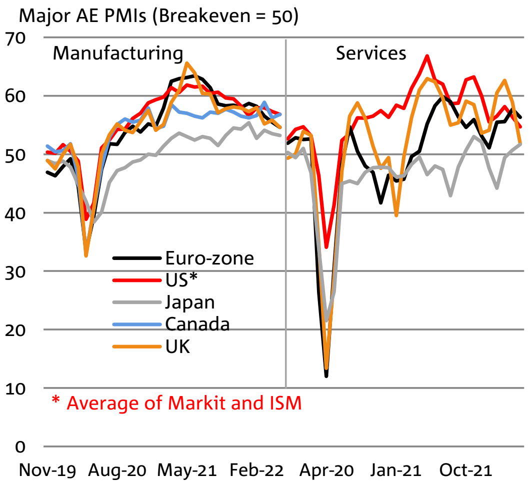
Major AE GDP growth to bounce back in Q2 before slowing



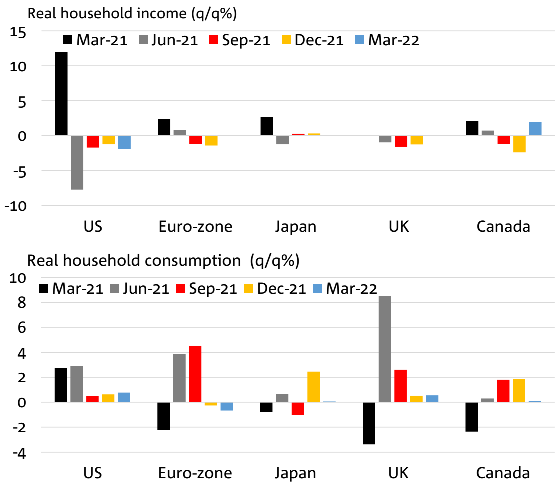
Q2 to be boosted by recovery from Q1 COVID impact



Business surveys resilient



Consumption has held up in face of real income falls…so far



Sources: Refinitiv, NAB Economics.

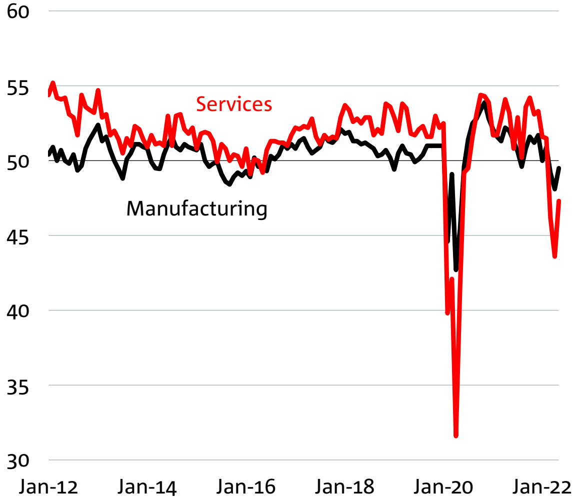
- Major advanced economies (AE) GDP growth slowed to a crawl in Q1 2022 (0.1% q/q), although results were mixed. GDP declined in the US and Japan, while in contrast growth was solid in the Euro-zone (0.6% q/q), the UK and Canada (0.8% q/q). However, the Euro-zone result was flattered by Irish GDP (up 11%) which can be very volatile. Ex Ireland, Euro-zone growth was soft at 0.2% (down from 0.5% in Q4).
- A factor behind the weak result was the COVID-19 wave that peaked during the quarter. This affected activity either from a re-introduction of some restrictions, caution about using in-person services, or absences from work due to quarantine/illness. Since the wave peaked, mobility data has moved higher and the business PMI survey readings remain solid, consistent with stronger growth in Q2. However, overall the AE business surveys are trending down, pointing to a fading tailwind from re-opening, and the emergence of several headwinds.
- Supply issues remain a constraint on growth. While business survey indicators for supplier deliveries and order backlogs have shown some improvement, they remain elevated. As supply issues are resolved, this should boost growth (and also take pressure off prices). However, in the near term, the continuing fall-out from the Ukraine-Russia conflict and China lockdowns means there is a risk that supply issues worsen for a while before getting better.
- Tighter financial conditions, as central banks move to lift rates, and the impact of high inflation on household budgets are further headwinds. Price pressures are likely to persist for a while yet. Core AE CPI inflation is yet to show signs of slowing, and energy & food prices continue to come under renewed pressure. Delays in the pass through of wholesale costs to retail electricity prices means that the full impact of the prior cost increases are yet to be fully felt and oil prices have risen in recent weeks.
- The high level of savings accumulated through the pandemic by AE households will help absorb some of these pressures. Illustrating this, the US and UK has seen real (after inflation) household income decline in the last 3-4 quarters but real consumption rise (although this will partly reflect to ongoing normalisation from COVID-19). For how long this dynamic can be sustained is unclear. While the financial buffer built up by households is substantial (particularly in the US and Canada), with consumer confidence low, equity prices falling, war and talk of recession, households may wish to horde savings rather than eat into them.

EMERGING MARKET ECONOMIES

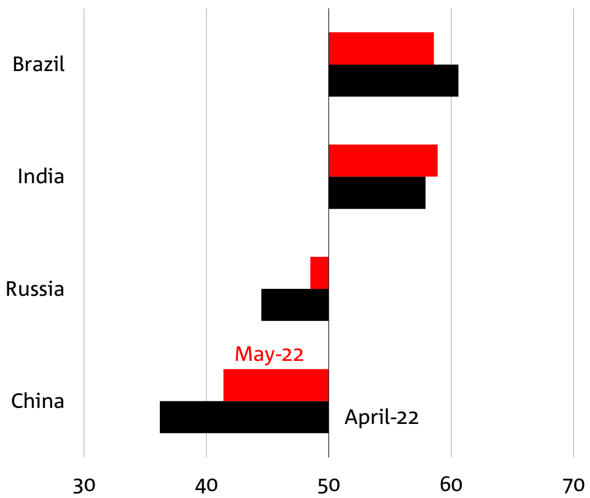
China's lockdowns drove EM weakness and the recovery (so far) appears cautious

PMI readings remained negative in May, but there was a wide margin between China's weakness and strength in Brazil and India

Emerging market PMI (Breakeven = 50)

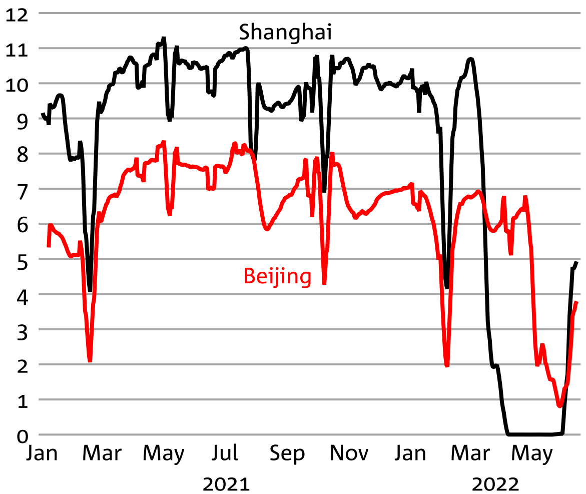


Major EM services PMIs (Breakeven = 50)



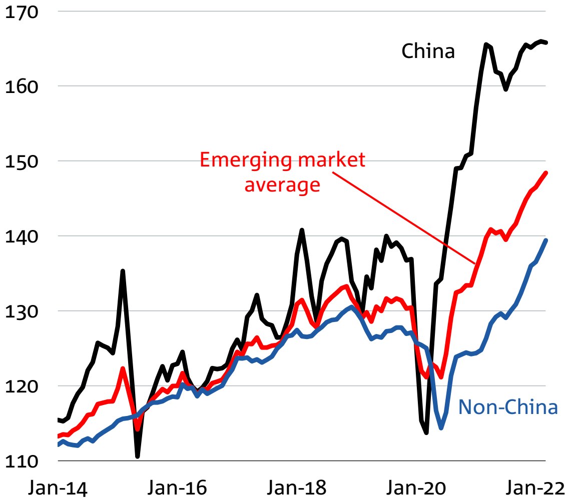
Subway data point to cautious reopening in China

Subway passenger traffic (7 day moving average, millions)



Growth in trade activity has largely excluded China in early 2022

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



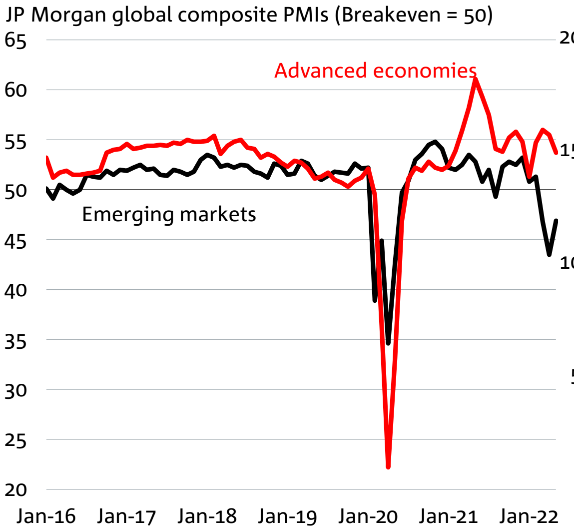
- Emerging market PMIs remained in negative territory in May – reflecting the ongoing impact of China's COVID-19 public health response in various locations – albeit it was less negative than in April. The EM manufacturing PMI rose to 49.5 points in May (from 48.1 points previously), while the EM services PMI rose to 47.3 points (from 43.6 points in April).
- There remains a considerable disparity between PMI readings for China and other major emerging markets – particularly for services. While the China services reading improved in May – up to 41.4 points from 36.2 points in April – this remains the third weakest reading on record. In contrast, the equivalent services measures in both India and Brazil remain strong, while Russia's was less negative.
- China's PMI readings are likely to strengthen considerably in June. From the start of the month, Shanghai began to reopen from its long running COVID-19 lockdown, while other restrictions in Beijing have also been eased. While consumers may remain somewhat cautious – as demonstrated by the modest recovery in high frequency data such as subway passenger traffic – activity is nevertheless likely to increase in coming months.
- As noted on page 2, there remains a stark contrast between China's public health response to COVID-19 outbreaks and that of other East Asian economies – with the latter moving more towards advanced economy settings. Despite international criticism, various Chinese officials – including President Xi – have publicly endorsed the country's zero-COVID policies, with reports suggesting recent investments in permanent testing and quarantine facilities point to these policies persisting through 2023. It appears that authorities remain concerned that more open policy would result in a rapid increase in COVID-19 cases that would quickly overwhelm the healthcare system.
- Emerging market economic growth is typically more trade dependent than advanced economies. Global trade data are available up to March and shows that while emerging market export volumes trended higher in recent months, volumes from China have remained broadly stable since August 2021, with the acceleration coming from other markets – most notably non-China Asia and Africa & Middle East. More recent monthly Chinese data point to falling volumes, in part reflecting the impact of COVID-19 measures on trade activity.

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

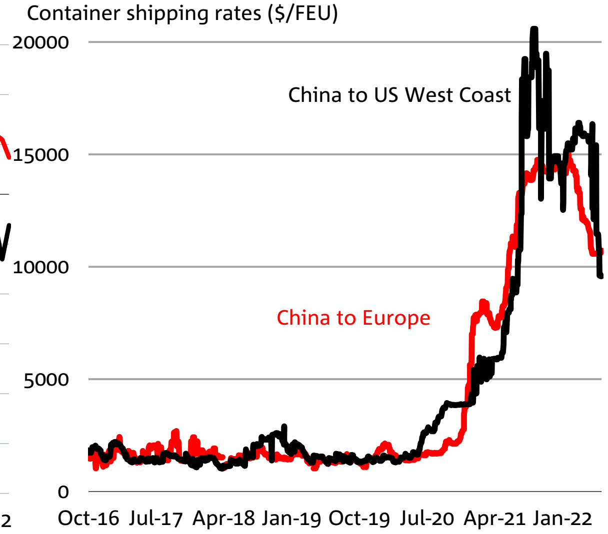
GLOBAL FORECASTS, POLICIES AND RISKS

Global growth prospects are weaker in coming years, with considerable risks persisting

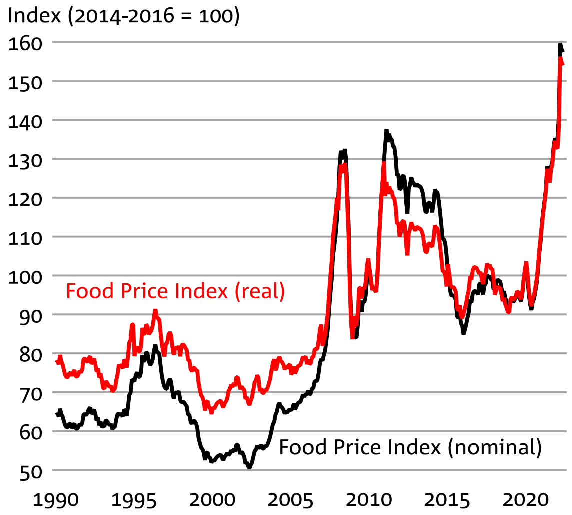
PMIs highlight the divergence between EMs and AEs



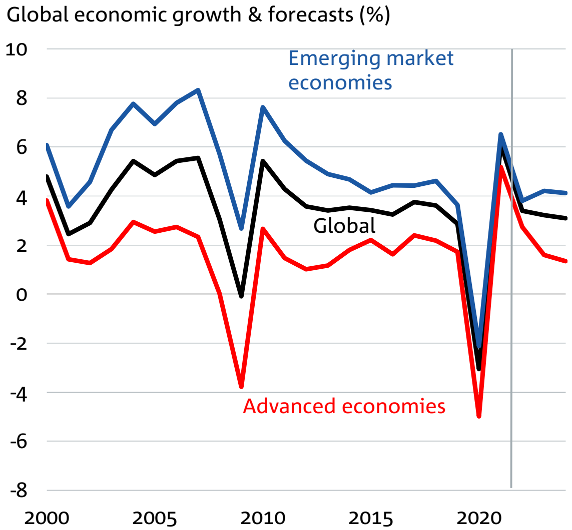
Container freight rates have eased but remain high



Already high, food prices could rise further in coming months



Global growth set to ease across the next two years



Sources: IHS Markit, Eikon, FAO, Macrobond, Refinitiv, NAB Economics

- Global business surveys continue to highlight the diverging conditions between individual economies. At a high level, the JP Morgan global composite PMI was marginally stronger in May, at 51.5 points (up 0.3pts) – reflecting a better outcome for emerging markets that more than offset a slight softening in advanced economy readings. That said, there remains a wide margin between the negative level in the emerging markets PMI – which largely reflected the impact of various COVID-19 responses on China's activity – and the relatively strong outcomes among AEs.
- COVID-19 remains a major risk to our global outlook, primarily through the risk of further lockdowns in China, although additional waves that negatively impact other regions cannot be ruled out. This will remain the case until widespread, effective vaccination has been achieved globally.
- Even in the absence of further lockdowns in China, the recent measures imposed constrained activity at several ports, including Shanghai – the world's largest port by throughput – meaning that container shipping could be a point of disruption in global supply chains. Measures of disruption in this sector – such as the Global Supply Chain Pressure index (see page 2) and container freight rates had been easing in recent months.
- Following revisions to a range of forecasts, we have revised our global economic forecasts, with the most significant changes coming in 2023 and reflects lower forecasts for the United States, Euro-zone and Japan. For the US this in part reflects a greater than expected tightening in financial conditions, while lower US growth will also spill over to other countries. Overall, we see the global economy growing by around 3.4% in 2022 (largely unchanged from last month) and 3.2% in 2023 (down from 3.4% previously). In 2024, we see global growth slowing a little further – down to 3.1% – reflecting in part the lagged impacts of monetary tightening and higher energy prices. Forecast global growth for 2023 and 2024 is below the long run average of 3.4% (since 1980).
- Beyond COVID-19, there remain a range of risks to our outlook. The duration and economic impact of the Russia-Ukraine conflict is uncertain. The related global impact on food supplies due to reduced exports of grains and fertiliser from the region could drive prices higher and risks political turmoil in lower income countries. The FAO's Food Price Index rose to a record high (in nominal terms) in March, and has only eased marginally since. The risk of a policy mistake is high given expected policy tightening by the major central banks cannot resolve supply side constraints, and policy could turn even more aggressive if inflation does not start to abate soon.

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