EMBARGOED UNTIL: 11.30AM THURSDAY 14 JULY 2022

THE FORWARD VIEW – GLOBAL

JULY 2022

National Australia Bank

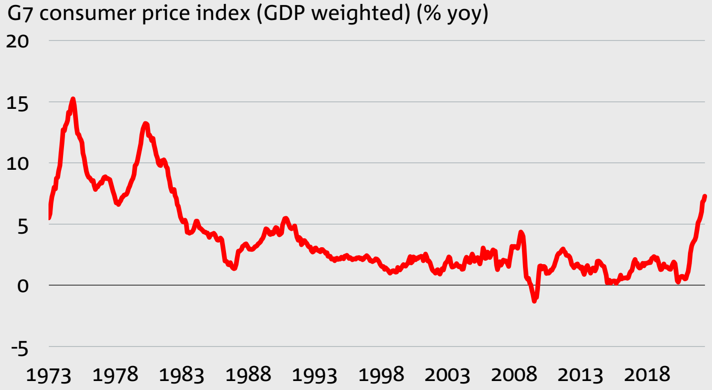
Tightening monetary policy puts the brakes on growth prospects

- Major central banks continue to tighten monetary policy in response to inflation rates that are running at decade highs, thereby straining household finances (which have also suffered from wealth effects due to asset repricing in equity and other financial markets).
- There is a risk that the supply side constraints that have contributed to inflationary pressures could persist for some time. The duration and severity of the Russia-Ukraine conflict remains uncertain – negatively impacting energy and agricultural markets – with the latter having the potential for prolonged impacts in low-income economies. Similarly, China is persisting with its public health response to COVID-19 – as highlighted by the recent lockdown in Xi'an – which presents ongoing risks to supply chains.
- As a result, global growth will be under considerable pressure over the next year, with the risk of recession in one or more advanced economies elevated. Our forecasts are consistent with mild recessions in the US, UK and the Euro-zone. Euro-zone recession risks are tied to Russian natural gas supply ahead of their winter; indeed, a major cutback of supply would raise the prospect of a severe recession (with spill overs to global energy markets and economic activity).
- COVID-19 continues to present substantial uncertainty to the global outlook. According to recent reports, the BA.5 subvariant of the Omicron variant (responsible for the lockdown in Xi'an) is more transmissible and faster spreading than earlier subvariants, increasing the risk of COVID-19 related disruptions, ranging from quarantine-related labour shortages through to large scale lockdowns in different regions (the latter primarily a concern in China).
- Overall, we see the global economy expanding by 3.2% in 2022 (previously 3.4%) and 2.9% in 2023 (was 3.2%). In 2024, we see a modest pickup, back up to 3.0%, however global growth is set to remain below the long run average of 3.4%.

Global Growth Forecasts (% change)

	2020	2021	2022	2023	2024
US	-3.4	5.7	1.9	1.0	1.2
Euro-zone	-6.5	5.3	2.9	0.8	1.4
Japan	-4.5	1.7	1.4	1.5	0.9
UK	-9.3	7.4	3.1	0.1	1.3
Canada	-5.2	4.5	3.7	1.7	1.4
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	2.2	0.7	1.2
Other East Asia	-2.8	4.3	4.4	3.8	3.8
Australia	-2.1	4.8	3.5	1.8	1.8
NZ	-2.1	5.6	2.8	1.3	1.7
Global	**-3.1**	**6.1**	**3.2**	**2.9**	**3.0**

Inflation in major advanced economies remains high



CONTENTS

CONTACT

Alan Oster, Group Chief Economist
+61 (0)414 444 652

Gerard Burg, Senior Economist – International, +61 (0)477 723 768

Tony Kelly, Senior Economist
+61 (0)477 746 237

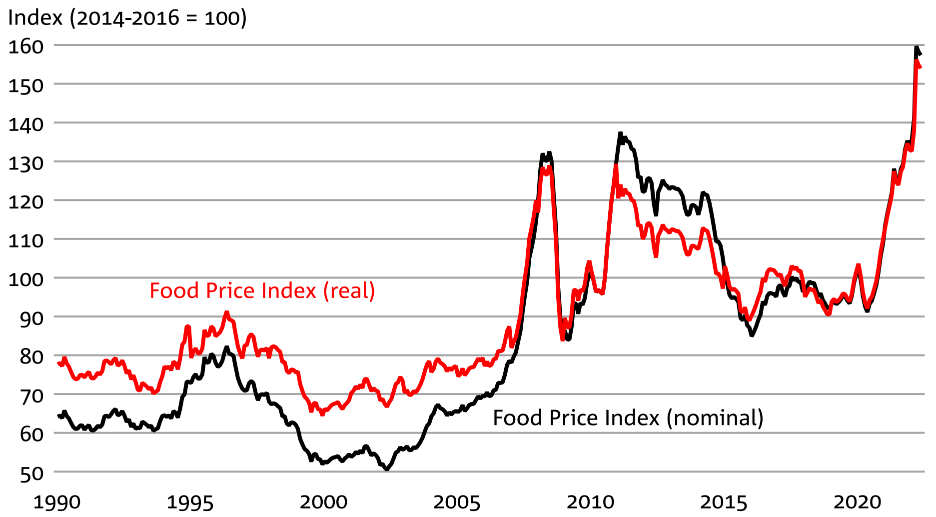
AUTHORS

Gerard Burg & Tony Kelly

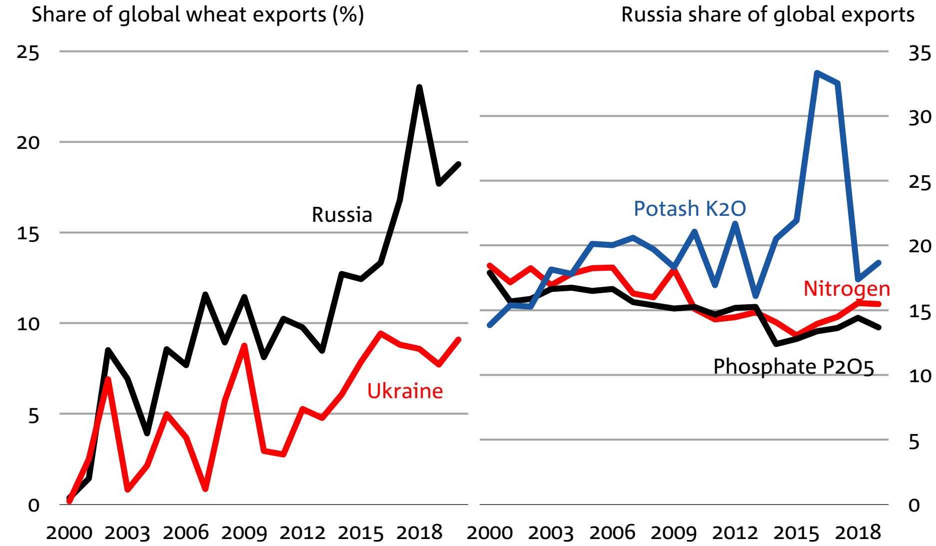
CHARTS OF THE MONTH

Food prices were already high ahead of the Russia-Ukraine conflict, which will limit global supply of grains and fertiliser. Resulting shortages and soaring prices will impact lower income countries most heavily

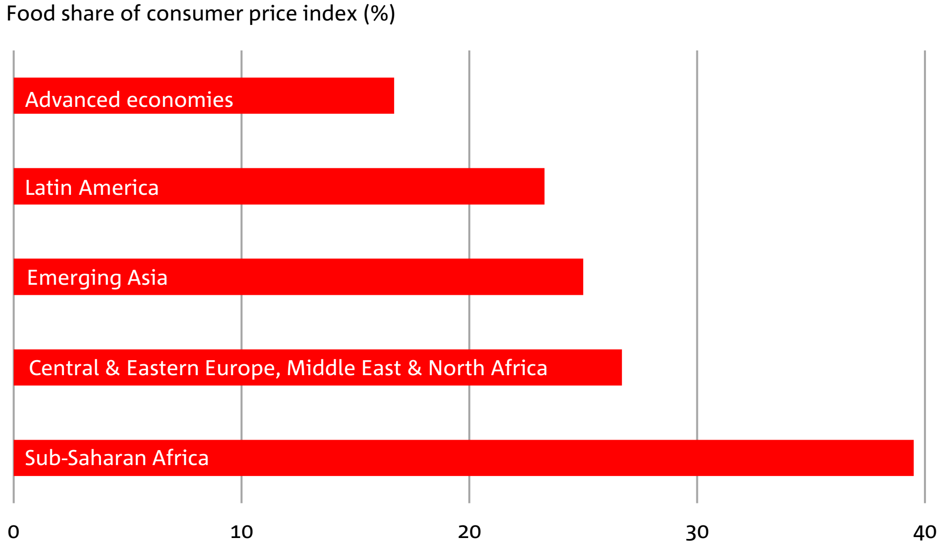
Food prices have soared since the start of the pandemic, with a spike following Russia's invasion of Ukraine

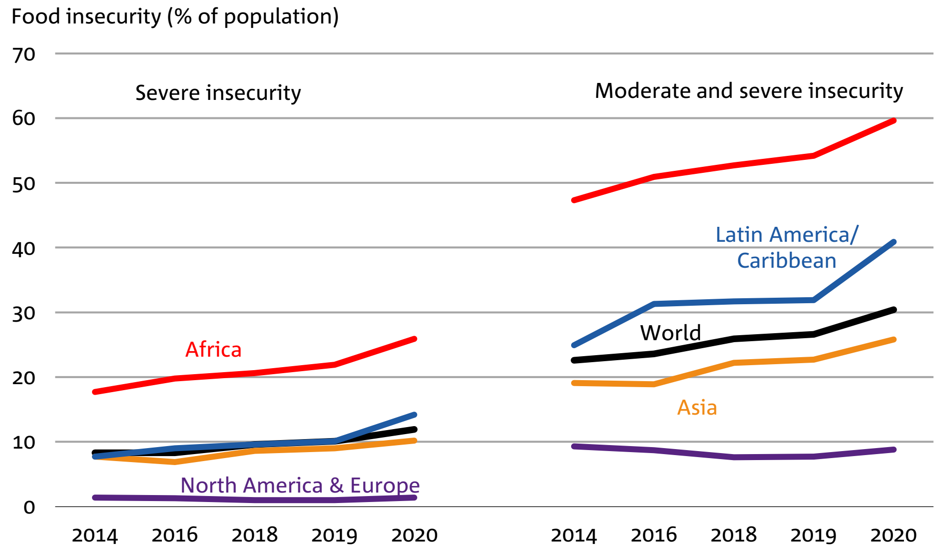


In addition to energy, the region is a critical supplier of grains and fertilisers to global markets



Lower income countries spend a larger proportion of income on food and have lower food security. Food insecurity has risen in recent years. Shortages and higher prices in these regions increase socio-political risks





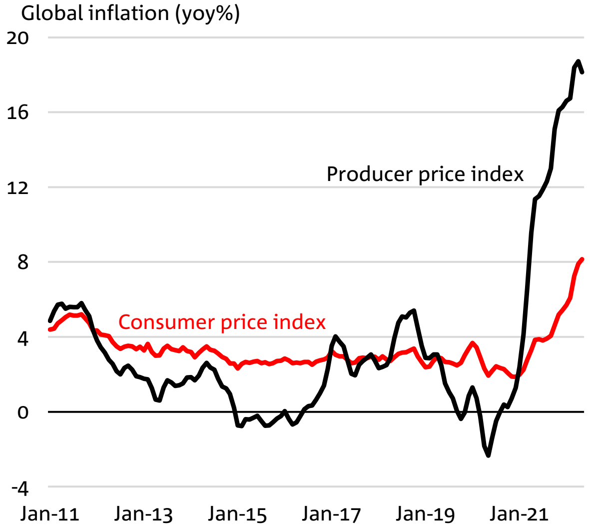
Sources: UN FAO, IMF, NAB Economics

National Australia Bank

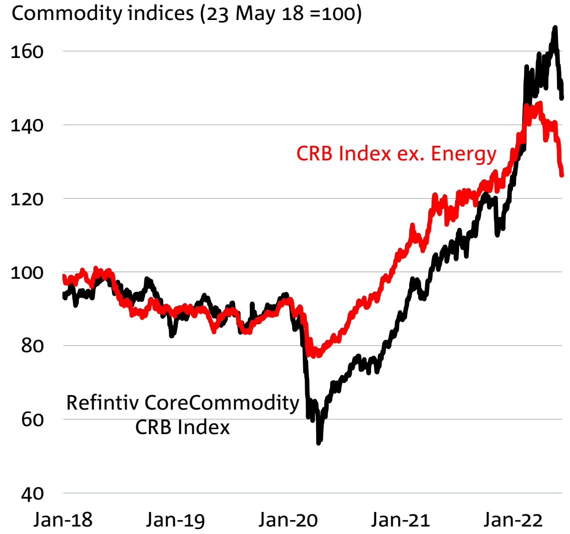
FINANCIAL AND COMMODITY MARKETS

Financial conditions continue to tighten as central banks rapidly increase policy rates

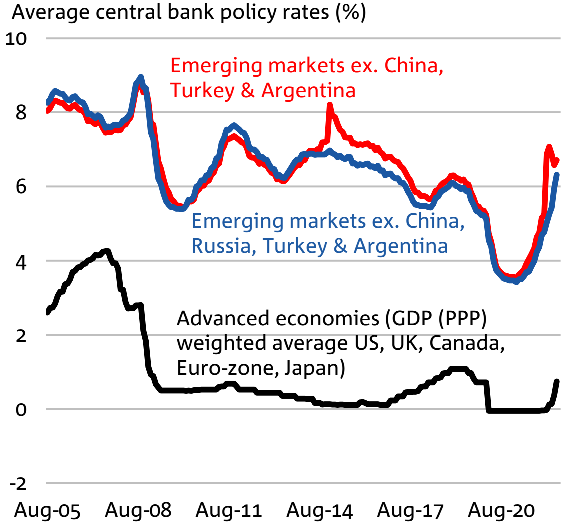
Inflationary pressures persisting, led by producer prices



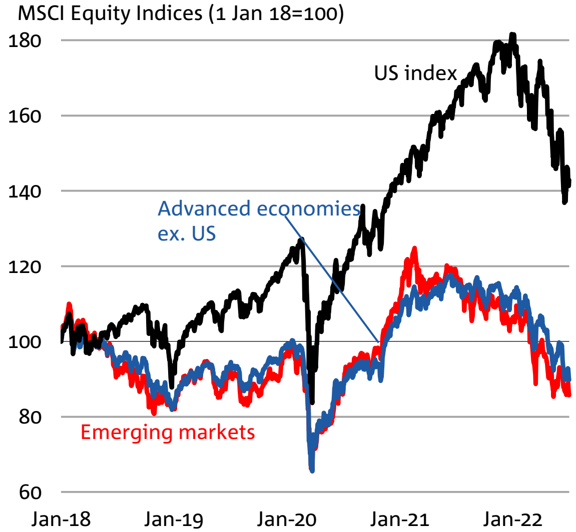
Commodity prices still high but off recent peaks



Central banks are lifting rates faster than previously anticipated



Global equity markets have retreated



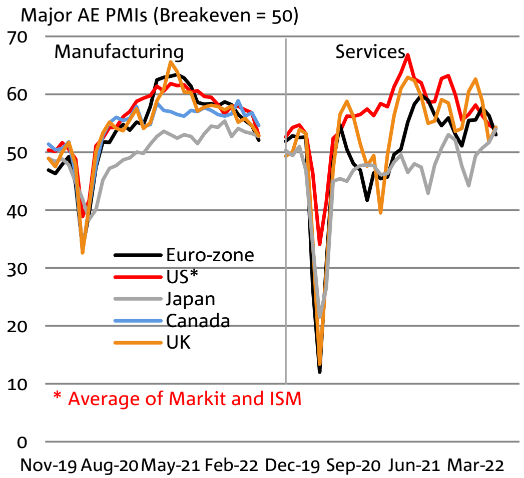
Sources: Refinitiv, Macrobond, NAB Economics

- Inflationary pressures have been a critical issue in 2022, leading to a global tightening in monetary policy that will slow economic growth, with the risk of recession in a number of countries in 2023. Global inflationary data is available to May and shows that these pressures have persisted. Large scale fiscal transfers during the pandemic and supply side constraints have been major factors. The latter reflects the shortages of labour and various key inputs, the impact of China's COVID-19 policies and the Russia-Ukraine conflict as well as various disruptions to the global transport and logistics sector.
- Global producer prices rose by just over 18% yoy in May, marginally weaker than in April, albeit remaining at levels that are high by historical standards. In part this easing reflects a weaker trend in China's producer price growth – down from double digit increases in late 2021 to 6.4% yoy in May, albeit some of this slowing may reflect weakness in China's domestic demand.
- It is too early to suggest that supply side inflation is slowing as a number of these factors could persist. The Russia-Ukraine conflict has the potential to further disrupt energy markets and food supplies (via lower grain and fertiliser exports), while China's zero-COVID approach is set to continue and could further disrupt supply of goods globally. That said, global commodity prices – as represented by the Refinitiv CoreCommodity CRB index – peaked in early June and have subsequently declined – in part reflecting concerns around slowing in the global economy. This could add downward pressure to producer prices if this trend persists.
- Soaring producer prices have flowed through into consumer prices as well – increasing by just over 8% yoy in May. Among the largest advanced economies, consumer prices rose by their fastest pace since mid-1982.
- A broad range of central banks started to tighten monetary policy from late 2021 – initially led by emerging markets. Advanced economy central banks were slower to respond, but generally have adjusted rapidly (albeit excluding the European Central Bank and Bank of Japan) – particularly in the case of the US Federal Reserve.
- The rapid change in monetary policy expectations resulted in a substantial repricing of financial assets, with equity and bond prices well below late 2021 highs. At the time of writing, the MSCI US index was just below its level at start of 2021, while the indices for other advanced economies and emerging markets are well below this mark (down over 15% and 20% respectively).

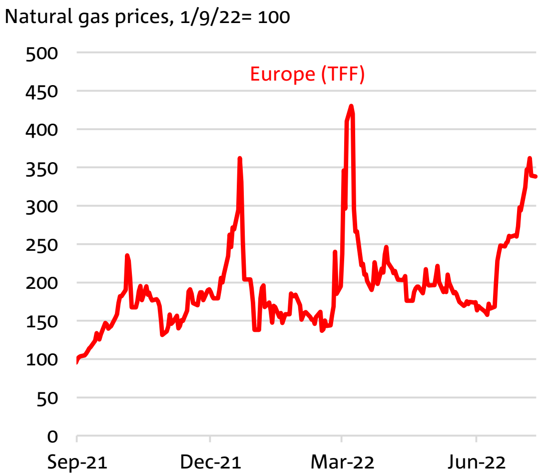
ADVANCED ECONOMIES

AE GDP growth faltering – US, UK and Euro-zone likely to go into mild recession (or close to it)

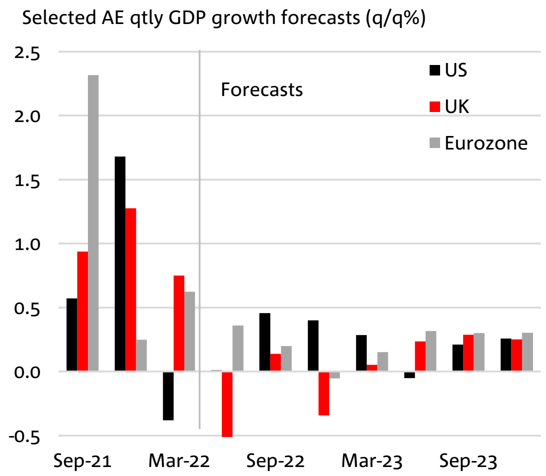
Surveys still in growth territory but easing



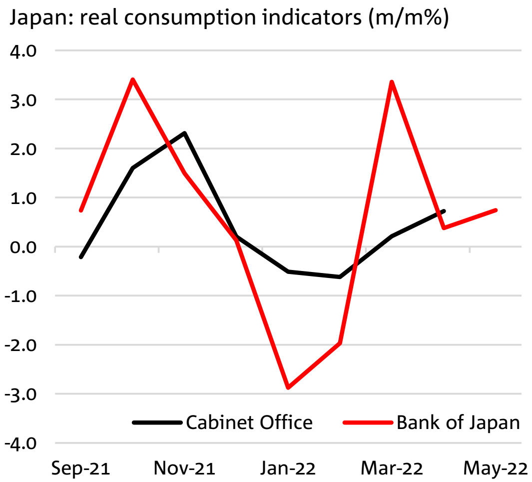
Renewed energy concerns for Europe



US, Euro-zone & UK all facing one or more qtrs. of negative growth



Japan – post Omicron wave rebound underway



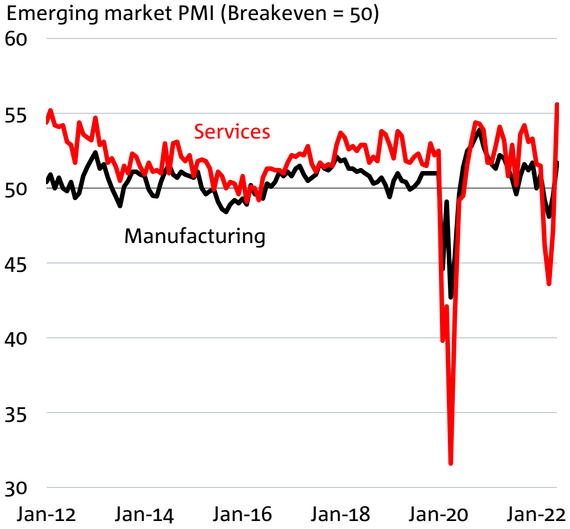
Sources: Refinitiv, NAB Economics.

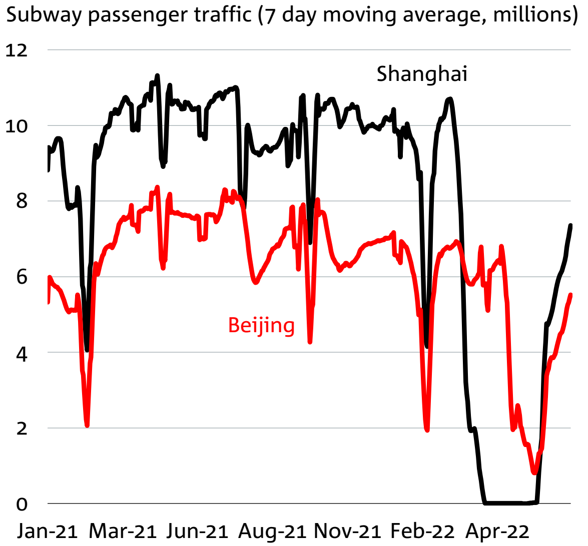
- We have made major downward revisions to our forecasts for economic growth in the US, Euro-zone and the UK. We see one or more negative quarters of growth in each of these economies over the next year.
- In last month's Global Forward View we noted our forecasts were subject to a review of our expectations for the Federal funds rate (following the Fed's June meeting). We subsequently lifted our expectations of the speed, and magnitude, of increases in the fed funds rate and lowered our growth forecasts for the US. This included an expectation that the US was likely to go into recession in 2023.
- Since then US partial data for Q2 GDP have disappointed, including downward revisions to prior months, meaning that we now expect flat GDP growth in Q2 but note tracking estimates based on data to date point to a another GDP decline in Q2. Even if Q2 GDP contracts, we would discount the notion that the US was in recession in H1 2022. Real GDI (which conceptually should equal GDP) grew in Q1, business surveys have signalled growth throughout and employment has grown strongly in H1.
- The US (measured on a common currency basis) is the largest economy in the world. Through various trade, financial market (such as equities) and confidence channels, a downturn in the US can have large spill-over impacts on other economies.
- The Euro-zone and UK are also heavily exposed to the fall-out from the Ukraine/Russia conflict. The war shows no sign of ending soon, leading to renewed concerns recently over natural gas supply to Europe and whether countries such as Germany can build up adequate stores ahead of winter (if not rationing could be introduced). This has been reflected in a spike in European natural gas benchmark prices. In the short-term, the removal of COVID related restrictions should support Euro-zone growth in Q2 and Q3 but as this effect wanes we expect growth to slow and have a small contraction in Q4 factored in reflecting at least some energy disruptions in winter. For the UK we expect negative GDP in Q2, but partly due to one-off factors (such as the Queen's Jubilee), so see a partial recovery in Q3 before growth contracts again at the end of the year.
- Japan is also benefiting from the ending of the COVID related quasi state of emergency. Consumption indicators have grown strongly since March. While industrial production has fallen this should rebound with the pickup underway in China activity. Japan is hurt by the global commodity price shock but, unlike the other AEs the Bank of Japan is not tightening policy. The resulting large fall in its exchange rate will help underpin external competitiveness and we see Japan's growth as slowing but remaining positive.

EMERGING MARKET ECONOMIES

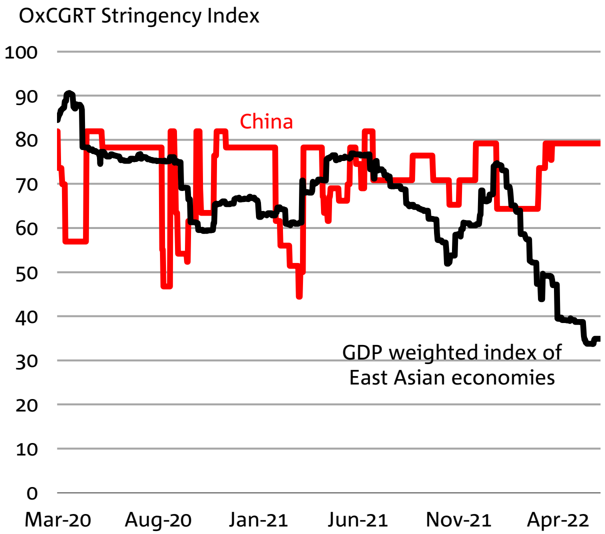
Survey data show a China rebound in June, however COVID risk persists

EM PMIs rebounded in June on China's reopening, however high frequency transport data point to incomplete recovery

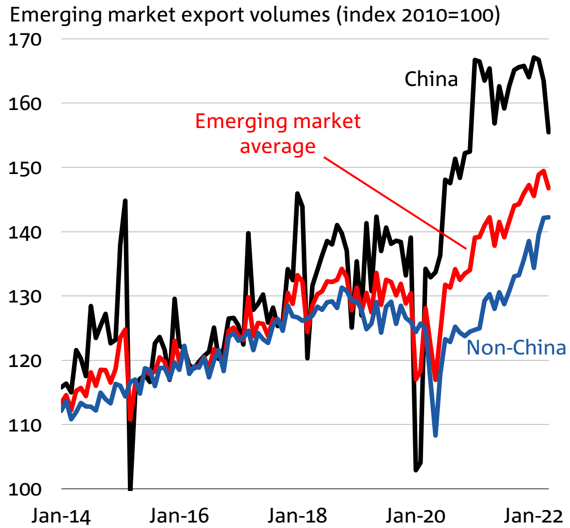




China's public health policies at odds with the rest of East Asia



China's export volumes sharply lower in April



- There was a sizeable rebound in emerging market PMIs in June – largely reflecting improved readings from China. The EM services PMI was the big mover – surging to 55.6 points (compared with 47.3 points in May). The increase in the EM manufacturing PMI was more modest – pushing up to 51.7 points in June (from 49.5 points previously).
- As expected, China's PMI readings were considerably stronger in June – particularly in services – as COVID-19 restrictions were eased in both Shanghai and Beijing. The Caixin Markit services PMI rose from 41.4 points in May to 54.5 points in June, highlighting that this broad sector is particularly impacted by constraints on movement and face-to-face interactions.
- Other major EMs recorded comparatively more modest improvements in services PMIs as well – with Brazil and India already at high levels, while Russia strengthened from negative readings between March and May to positive levels in June.
- Although China's PMI data point to a strong rebound, high frequency data – such as daily subway passenger traffic – suggests that there is still some way to go before there is a full recovery. Anecdotal reports suggest that local authorities in various localities are remaining extremely cautious, such as continuing mass testing regimes that could discourage economic activity.
- We have previously noted that we expect China's public health response to COVID-19 to continue – reflecting both the endorsement of these measures by President Xi and other senior officials as well as recent investment in testing and quarantine facilities. At the time of writing, authorities in Xi'an, the capital of Shaanxi province, were commencing a lockdown following a fresh COVID-19 outbreak. China's public health stringency remains in stark contrast to the more open approach – similar to most advanced economies – across the rest of East Asia.
- The initial impact of China's recent lockdowns has started to appear in global trade data – which are currently available up to April. China's export volumes fell by almost 5% month-on-month, as Shanghai (home to the world's largest container port) suffered disruptions to transport and logistics. The weaker economic growth outlook for advanced economies is a negative for major emerging market exporters in the near term.

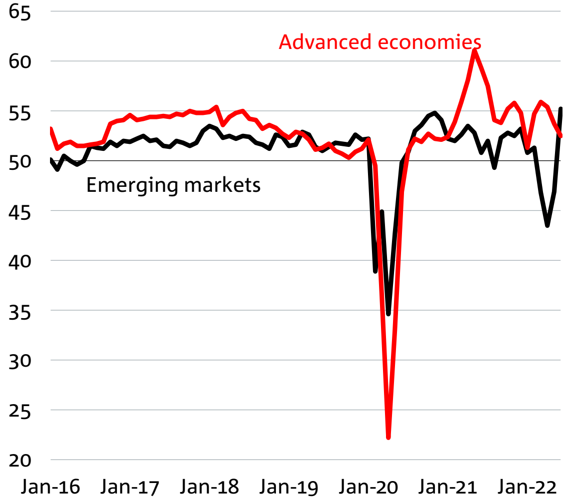
Sources: IHS Markit, Macrobond, CPB, Our World in Data, NAB Economics

GLOBAL FORECASTS, POLICIES AND RISKS

Despite upturn in global surveys, outlook is weaker with substantial risks persisting

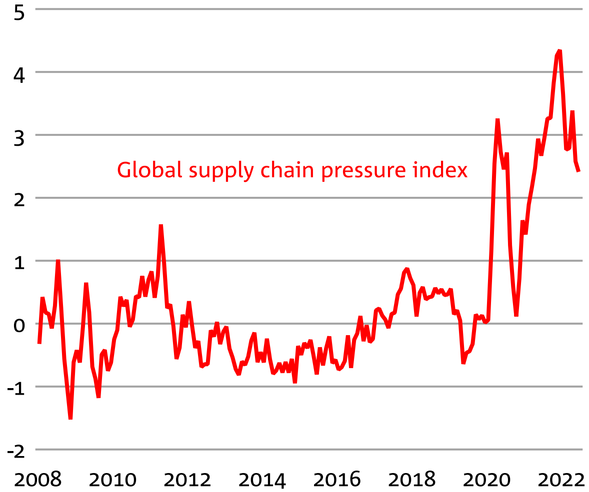
China's reopening drove the improvement in global PMIs

JP Morgan global composite PMIs (Breakeven = 50)



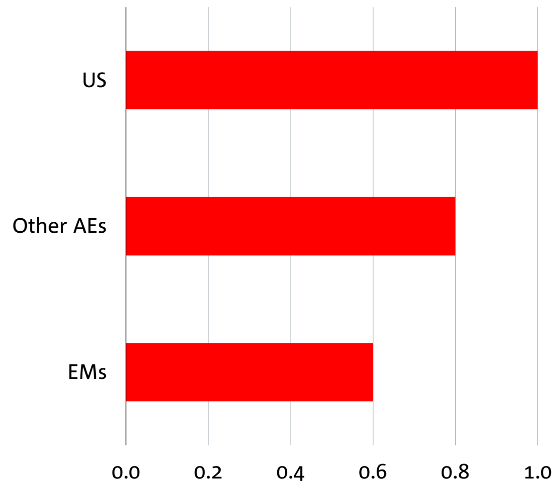
Supply chains remain strained and new COVID strain remains a threat

Standard deviations from average level



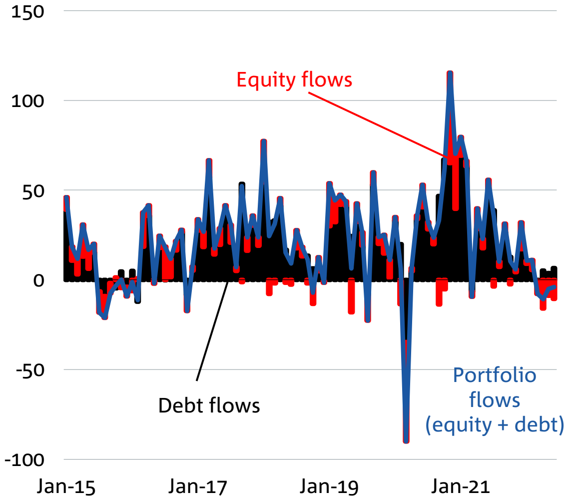
Slowing growth in US will spill-over into other economies

Spill-overs from 1% change in US economic growth (World Bank 2017 estimates)



Capital flows from EMs following AE central bank hikes

Emerging market portfolio capital flows (US$ billion)



- Global business surveys were stronger in June, with the JP Morgan composite PMI moving up to 53.5 points (from 51.3 points in May). However, there were marked differences between advanced economies, where trends have softened since March (as financial conditions have tightened) and emerging markets – where the rebound was driven by reopening in China (following recent COVID-19 lockdowns).
- COVID-19 continues to present substantial uncertainty to the global outlook. According to recent reports, the BA.5 subvariant of the Omicron variant (responsible for the lockdown in Xi'an) is more transmissible and faster spreading than the earlier BA.2.2 subvariant (which drove the recently relaxed measures in Shanghai and Beijing) and anti-bodies from earlier strains may offer little protection – increasing the risk of COVID-19 related supply disruptions, ranging from quarantine-related labour shortages through to large scale lockdowns in different regions (the latter primarily a concern in China).
- We have made significant downward revisions to the outlook for a range of advanced economies – reflecting in part the impact of tighter than previously expected monetary policy and high prices on domestic demand – which will have spill-over effects for emerging markets. Our forecast for China is unchanged; Q2 national accounts data will be released shortly after the release of this report, and risk is likely weighted to the downside, which would further impact growth in East Asia.
- Overall, we see the global economy expanding by 3.2% in 2022 (previously 3.4%) and 2.9% in 2023 (was 3.2%). In 2024, we see a modest pickup, back up to 3.0%, however global growth is forecast to remain below the long run average of 3.4% (from 1980 onwards).
- The conflict between Russia and Ukraine continues to provide uncertainty around our forecasts. It continues to disrupt energy and agricultural markets – with likely lower fertiliser exports from Russia reducing the capacity of other agricultural producers to offset lost grain exports from both Russia and Ukraine. Further constraints on natural gas flows from Russia to Europe could negatively impact European growth; potentially far more severely than our forecasts allow for. A complete cut off of gas supplies would likely lead to a major recession.
- There remains a risk that central banks will tighten policy more than we expect which would further heighten recession risk next year. This would also increase the likelihood of capital flight from emerging markets, which could destabilise financial markets in some of these economies.

Sources: IHS Markit, Macrobond, World Bank, IIF, NAB Economics

Group Economics

Alan Oster
Group Chief Economist
+(61 0) 414 444 652

Jacqui Brand
Personal Assistant
+(61 0) 477 716 540

Dean Pearson
Head of Behavioural & Industry Economics
+(61 0) 457 517 342

Australian Economics and Commodities

Gareth Spence
Senior Economist – Australia
+(61 0) 436 606 175

Brody Viney
Senior Economist
+(61 0) 452 673 400

Phin Ziebell
Economist – Agribusiness
+(61 0) 475 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 0) 477 723 769

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 0) 455 052 520

Steven Wu
Economist – Behavioural & Industry Economics
+(61 0) 472 808 952

International Economics

Tony Kelly
Senior Economist
+61 (0) 477 746 237

Gerard Burg
Senior Economist – International
+(61 0) 477 723 768

Global Markets Research

Ivan Colhoun
Chief Economist
Corporate & Institutional Banking
+(61 2) 9293 7168

Skye Masters
Head of Markets Strategy
Markets, Corporate & Institutional Banking
+(61 2) 9295 1196