EMBARGOED UNTIL: 11.30AM THURSDAY 11 AUGUST 2022

THE FORWARD VIEW – GLOBAL

AUGUST 2022

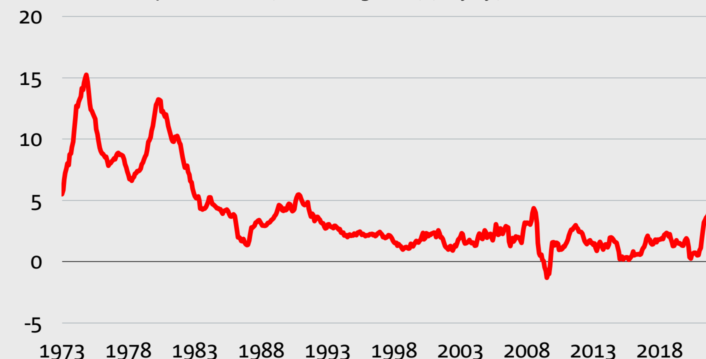
Weaker growth prospects, persistent inflation & geopolitical risk

- Tighter financial conditions are impacting activity in advanced economies, with spill-overs to emerging markets (via financial market, currency and trade channels). Financial markets have been volatile in recent times, reflecting shifting market expectations around central bank policy rates given competing forces of persistent inflation and slowing economic growth.
- It remains too early to suggest that inflationary pressures have subsided – with data available to June showing global consumer prices continuing to accelerate, up by 8.7% yoy (from 8.2% yoy in May) – although recent oil price falls (if sustained) will provide some downwards pressure. Among the largest advanced economies, consumer prices in June rose by the fastest pace since mid-1982. Global producer price growth has slowed marginally from peaks in April but remains close to 18% yoy. This suggests ongoing risks that central banks to continue to lift rates above market expectations.
- We now forecast the global economy to expand by 3.0% in 2022 (down from 3.2% previously) before slowing to 2.5% in 2023. Several advanced economies are at heightened risk of recession either later this year or next year. This rate of growth is well below the long run average (3.4% from 1980 onwards) and, outside of the extreme shocks of the global financial crisis and COVID-19 lockdowns, represents the weakest rates of growth since 2001.
- There remain a range of factors that present uncertainty around our forecasts. The Russia-Ukraine conflict has persisted for almost six months – considerably longer than initially anticipated – and continues to threaten supplies of energy, grains and other agricultural products. COVID-19 continues to spread, with the ongoing potential of mutations into variants with greater transmissibility and ability to reinfect – presenting risk to global supply chains. Tensions between the United States and China could intensify, following House Leader Nancy Pelosi's visit to Taiwan. In response, China has stepped up military exercises near Taiwan, potentially disrupting trade in the region. Finally, with inflation persisting at high levels, while growth is slowing, there is a risk of policy mistakes by central banks that could drive global growth lower.

Global Growth Forecasts (% change)

	2020	2021	2022	2023	2024
US	-3.4	5.7	1.6	0.2	1.2
Euro-zone	-6.5	5.3	3.0	0.4	1.4
Japan	-4.5	1.7	1.1	1.3	0.9
UK	-9.3	7.4	3.4	-0.4	1.2
Canada	-5.2	4.5	3.7	1.0	1.0
China	2.2	8.1	3.5	5.4	4.7
India	-6.6	8.3	7.0	5.1	5.6
Latin America	-7.0	6.2	2.2	0.6	1.2
Other East Asia	-2.8	4.3	4.2	3.6	3.7
Australia	-2.1	4.8	3.6	1.7	1.7
NZ	-2.1	5.6	2.8	1.3	1.7
Global	**-3.1**	**6.1**	**3.0**	**2.5**	**2.9**

Too early to suggest inflation has peaked



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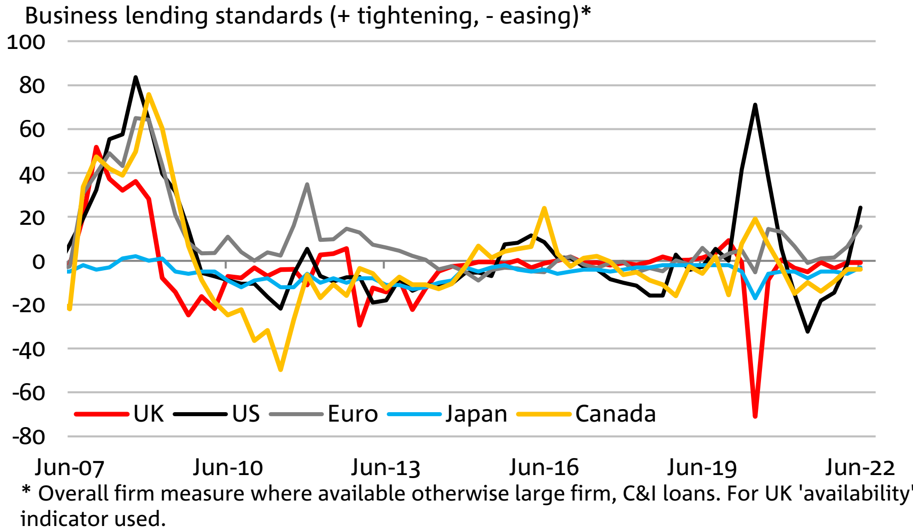
CHARTS OF THE MONTH

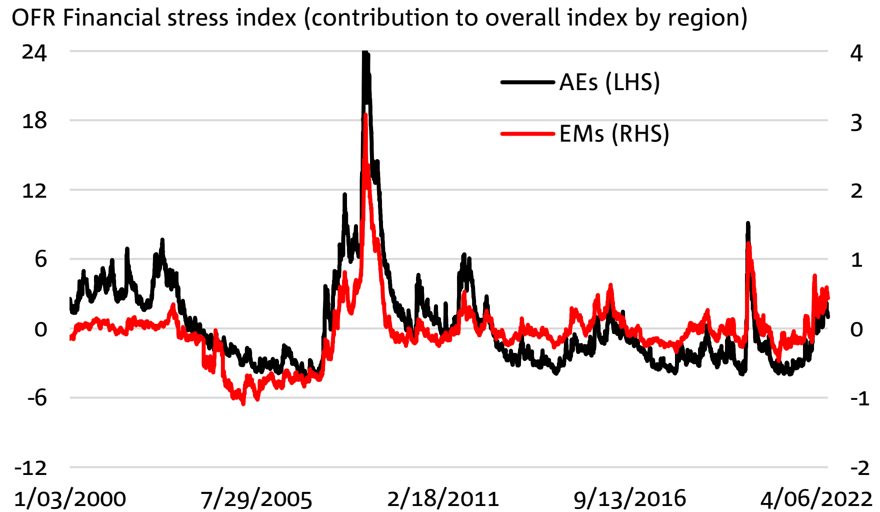
Tightening financial conditions not just a central bank rate hiking story – spreads, stress and lending standards rising – but not at critical levels

US and Euro-zone banks starting to tighten lending standards; not yet an issue in other major AEs

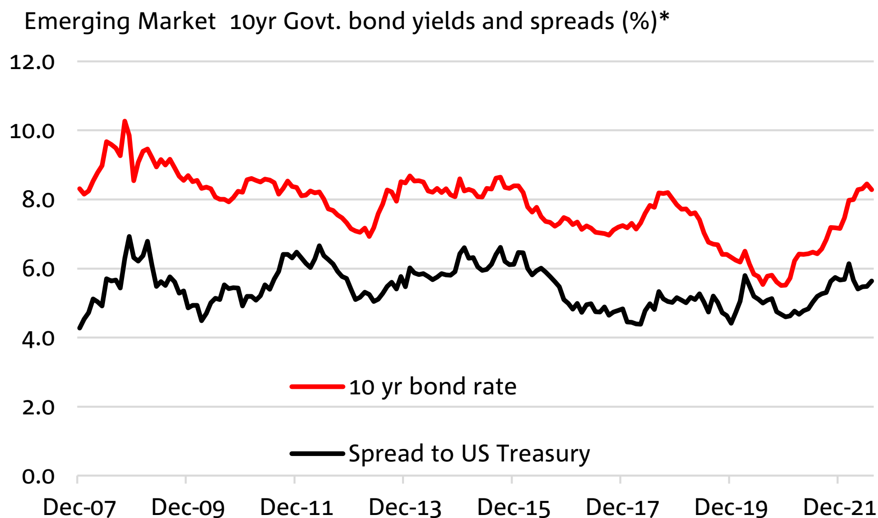


* Overall firm measure where available otherwise large firm, C&I loans. For UK 'availability' indicator used.

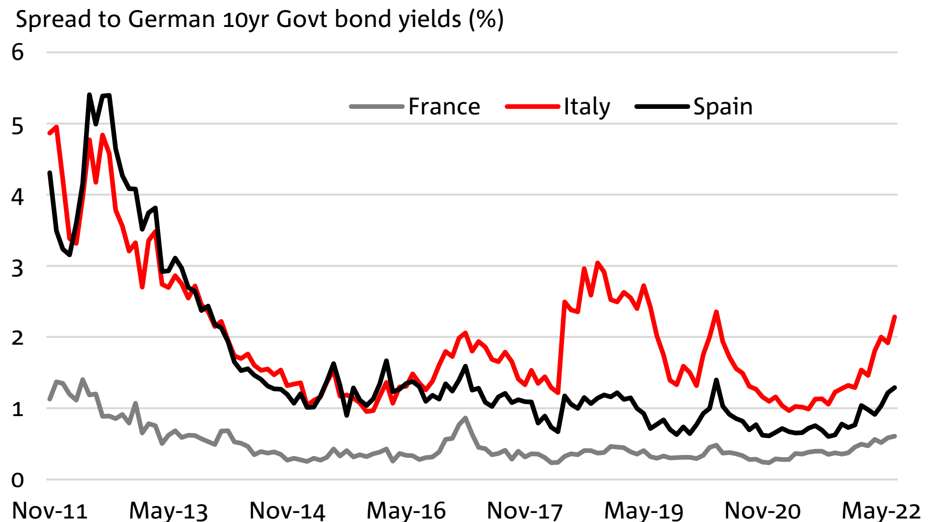
Overall financial stress measures have picked up – both in AEs and EMs



EM spreads (to US 10yr Tsy) increasing – still moderate overall but rise concentrated in Sth America/East. Europe



Increase in spreads within Euro-zone – not helped by Italian political instability



 Sources: Refinitiv, OFR, Bank of Canada, NAB Economics. * Sample includes 16 EM countries (does not include China, Turkey or Argentina)

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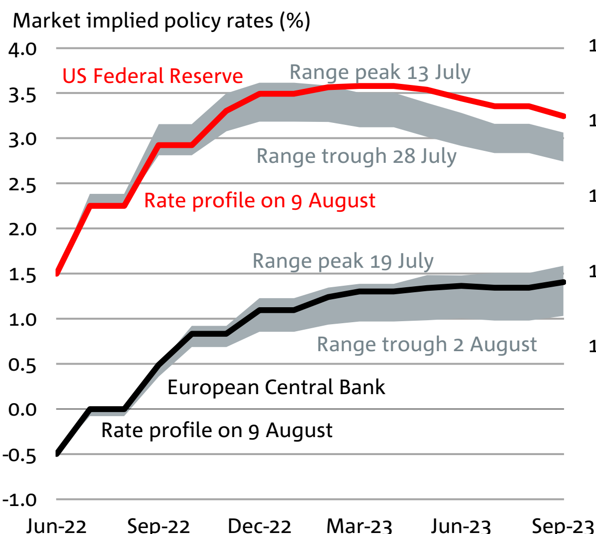
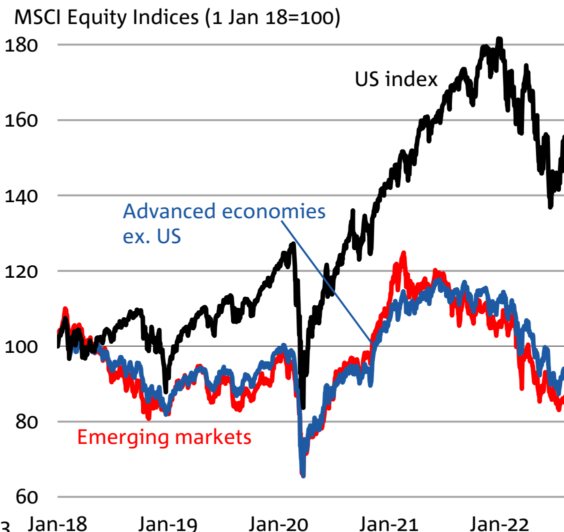
FINANCIAL AND COMMODITY MARKETS

Volatile conditions as market expectations shift around economic growth and monetary policy

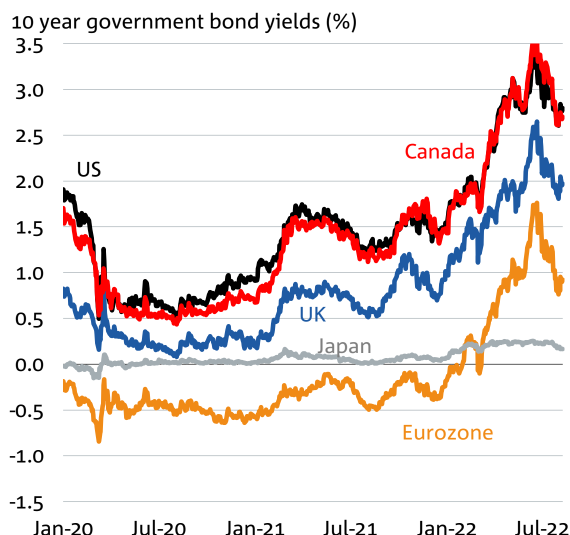
Volatility in market rate expectations



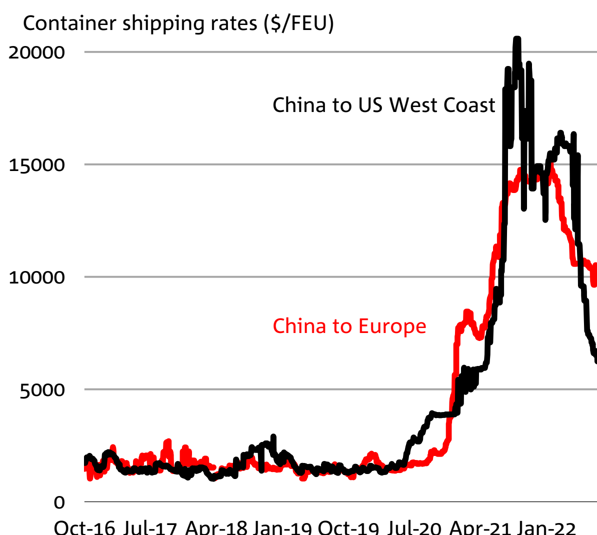
US equities rallied on softer rate expectations



...while bond yields retreated, but have edged higher recently



Falling shipping costs point to reduced supply-demand imbalance



- Financial markets have been relatively volatile in recent months, as they have adjusted monetary policy expectations in the face of the competing forces of rising inflation and deteriorating economic conditions in a broad range of countries. From mid-to-late July, it appeared that the latter factor came to the forefront of thinking, with market implied policy rates for major advanced economies (such as those of the US Federal Reserve and European Central Bank) edging lower, as fears of recessions in advanced economies intensified.
- This shift to a lower profile for policy rate expectations was evident in a range of financial markets. Equity markets saw a modest recovery in the second half of July, led by the advanced economies (particularly the United States). It is worth noting that most of the increases in the US equities were concentrated among the largest technology stocks. Gains in emerging markets have been much more muted – in part reflecting the recent trend of capital outflows from these economies.
- The combination of weaker growth prospects and the shift in policy rate expectations contributed to a retreat in government bond yields across July from recent peaks in June. However, in recent days yields have moved slightly higher once again – as hawkish commentary from Federal Reserve board members and a strong US jobs report saw policy rate expectations shift higher once again.
- It remains too early to suggest that inflationary pressures have subsided – with data available to June showing global consumer prices continued to accelerate, up by 8.7% yoy (from 8.2% yoy in May) – although if the recent fall in oil prices is sustained this will provide some relief (highlighted by 0% m/m growth in the US CPI in July). Among the largest advanced economies, consumer prices in June rose by the fastest pace since mid-1982. Global producer price growth slowed marginally from peaks in April but remains close to 18% yoy. This suggests ongoing risks that central banks continue to lift rates above market expectations.
- There are signs that some of the supply side inflationary pressures may be easing. Container shipping costs from China to major advanced economies have fallen significantly in recent months, while commodity prices (though still high in recent history) are well off the recent cycle peaks of June 2022. It is worth noting that these factors may also reflect easing demand as economic activity in advanced economies slows. That said, China's zero-COVID public health policies and renewed tensions regarding Taiwan along with the Russia-Ukraine conflict continue to present risk of disruptions to global supply chains in the near term.

Sources: Refinitiv, NAB Economics

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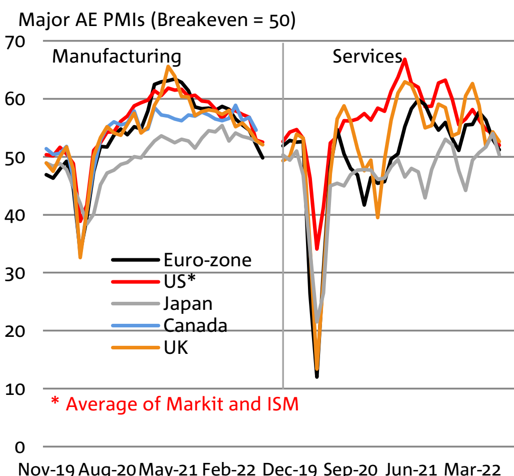
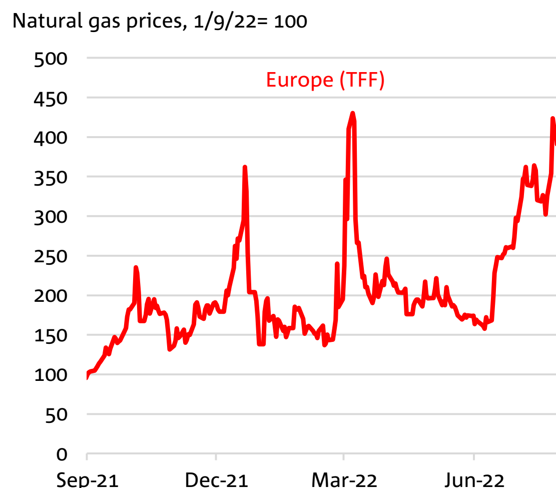
ADVANCED ECONOMIES

Weak US data and growing European energy problems further dim the major AE outlook

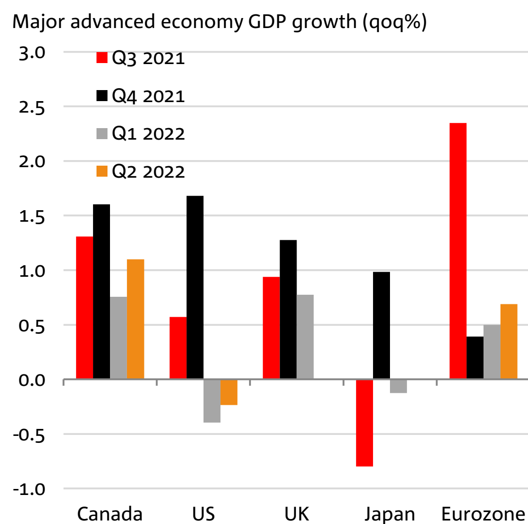
Surveys – downwards trend continues into July



European gas supply concerns growing

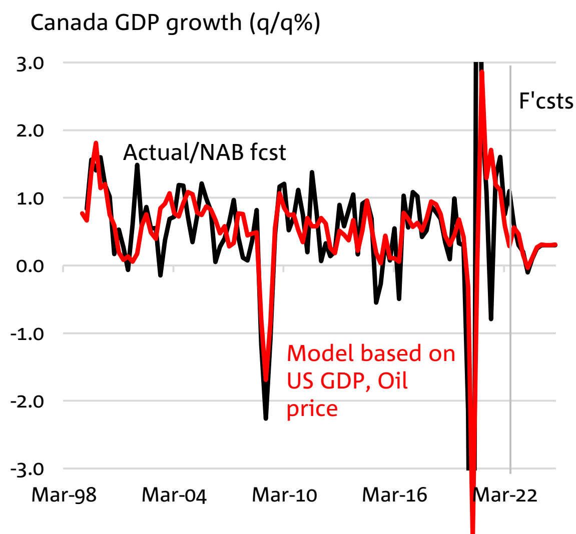


US has 2nd qtr of negative growth; but Euro-zone & Canada hold up



Sources: Refinitiv, NAB Economics.

A US recession will drag Canada down with it



- We have again marked down our AE growth forecasts. This mainly reflects disappointing US data and a worsening European energy outlook. A deterioration in the US and Europe will also spill-over to other countries. This includes Canada which is highly exposed to the US.
- US GDP declined by 0.2% q/q in Q2, disappointing our expectation of zero growth and follows a 0.4% fall in Q1. Unlike Q1, the weakness was broad based across the expenditure components. While two quarters of negative growth is a typical recession marker, the indicators used by NBER's recession dating committee do not point to a recession through to May although there may be enough weakness in June if it was to be sustained into Q3 for a declaration to be made. We continue to expect the US will go into a recession (one with rising unemployment), most likely in 2023 but acknowledge the possibility that it may occur sooner.
- In contrast, while we had expected a boost from the removal of COVID-19 restrictions, Euro-zone Q2 GDP of 0.7% q/q surprised to the upside. While the ECB has only just started to lift rates, energy supply issues are expected to weigh heavily on the economy over the winter. Recent Russia supply cuts increase the prospect of material energy shortages during the winter. This has not only led to another spike in prices but increases the prospects of rationing. While we are factoring in a relatively modest recession for the Euro-zone, the severity will depend heavily on what happens next – for example, a complete halt to Russian energy exports to the EU could easily see a severe recession in the Euro-zone. Higher energy costs are also negatively impacting the UK where we also expect to see a recession.
- We have marked down our forecasts for Canada this month. While Stats Canada have flagged strong Q2 GDP growth (1.1% q/q) based on advance information, monthly GDP data point to a clear slow down in growth since February. Moreover, the performance of the Canadian economy has historically been closely tied to the US, not surprisingly given its close links. Last year 75% of Canada's goods exports (and over 50% of service exports) were to the US. As in the US, inflation is very high and monetary policy has tightened rapidly – the Bank of Canada has raised rates by 225 bp this year (as has the US Fed) and markets are pricing in further hikes.
- Japan has been experiencing (in terms of reported cases) its largest COVID wave by some margin. While the Government is not planning to re-introduce restrictions, it will still likely curb activity. Unlike the other AEs, the Bank of Japan is not tightening policy but the economy will still be impacted by weaker global growth and, as an energy importer, by any further global energy market disruptions.

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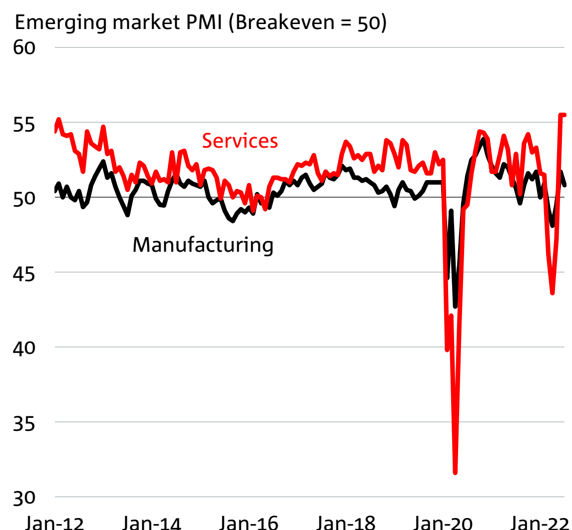
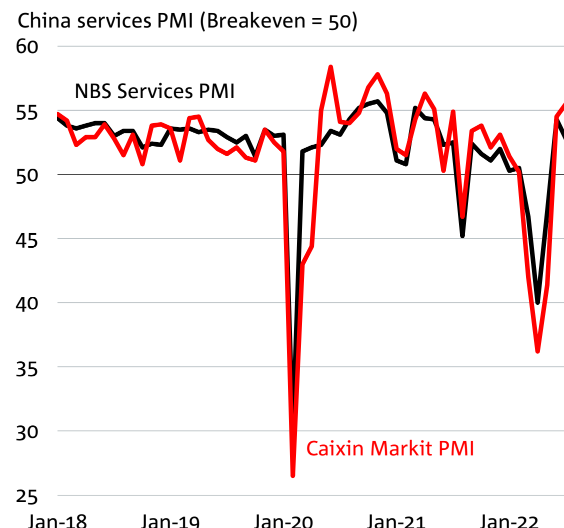
EMERGING MARKET ECONOMIES

Tighter AE monetary policy will pressure in EMs through financial, currency and trade channels

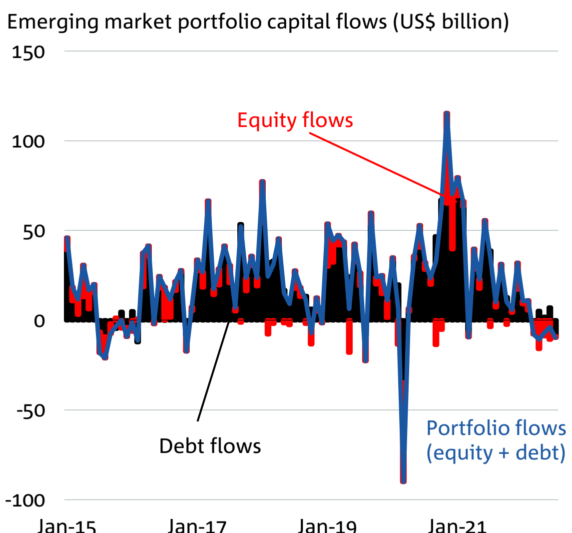
Diverging trends between EM services and manufacturing



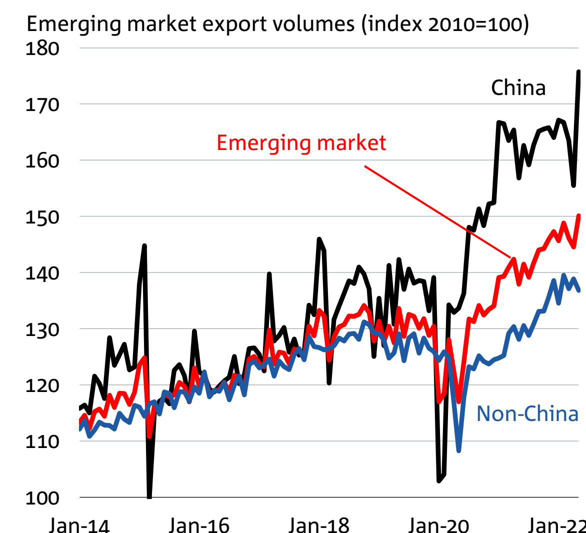
Conflicting readings in surveys of China's services sector



Extended run of capital flight from EMs is adding pressure



Trade volumes rebounded in May but unlikely to last



- Emerging market business surveys highlighted diverging conditions in July. Overall, the EM composite PMI was marginally weaker – down to 54.0 points, from 55.2 points previously – but trends differed between aggregate measures of manufacturing and services.
- The manufacturing PMI eased somewhat in July, down to 50.8 points from 51.7 points in June. China was the primary driver of this trend, with China's manufacturing PMI barely above neutral levels (from stronger readings in June). This suggests that gains from reopening were minimal – inline with reports that COVID-19 restrictions across April and May had limited impact on the country's factories. In contrast, the manufacturing PMI for India was considerably stronger.
- Counter to the weaker manufacturing reading, the EM services PMI remained strong – unchanged at 55.5 points. A surprise strengthening in China's services PMI was the main driver – with this reading coming after a decline in the official NBS survey, albeit the changes in both measures were modest. The comparative strength of services PMIs (when compared with manufacturing) reflects the larger negative impact on this sector from China's earlier COVID-19 measures.
- The rapid tightening in advanced economy monetary policy is impacting financial conditions in emerging markets. Data from the Institute of International Finance suggest that there have been portfolio (equities and debt) outflows from EMs totalling over US$39 billion between March and July 2022. This was the longest run of monthly outflows since the start of 2005 (when the data commenced). Capital flight from EMs has seen borrowing costs rise and currencies depreciate – with considerable pressure on smaller economies – with Sri Lanka, Pakistan and Bangladesh seeking IMF support in recent months.
- Growth in emerging markets is typically more trade dependent than is the case for advanced economies. Global trade data are available to May 2022 and show a sizeable rebound in China's export volumes in that month – in part reflecting some catchup following the large negative COVID related impact in April. China's official trade value data (available to July) saw an even stronger increase – rising to its second highest level on record, as COVID restrictions eased further.
- This rebound in trade activity is unlikely to continue. The sharply weaker economic growth forecast for advanced economies will see weaker demand for imported goods in 2023, which will be a negative trend for EM manufacturers.

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

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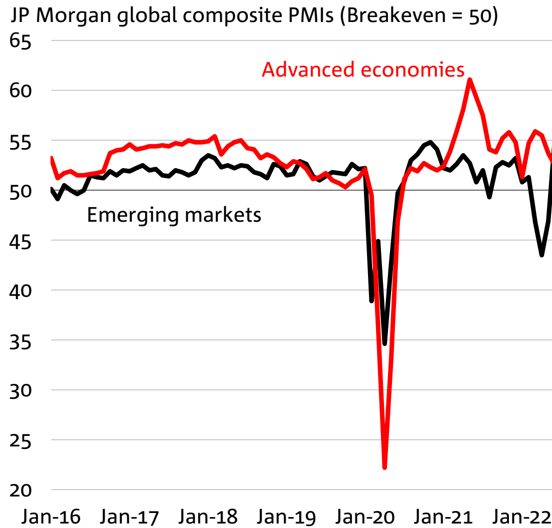
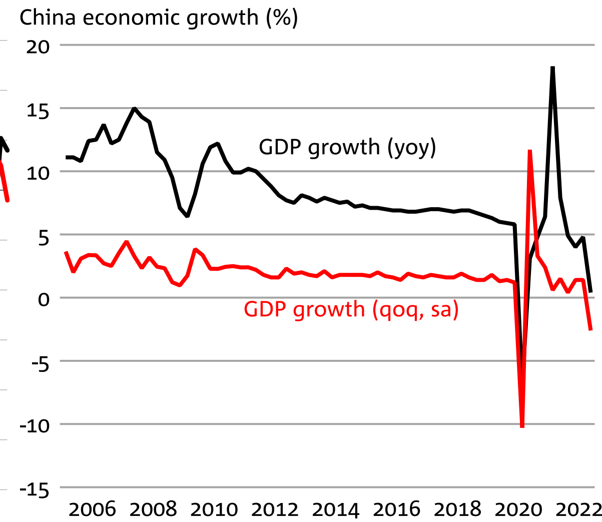
GLOBAL FORECASTS, POLICIES AND RISKS

Clouded outlook with persistent inflation, slowing growth and ongoing geopolitical risks

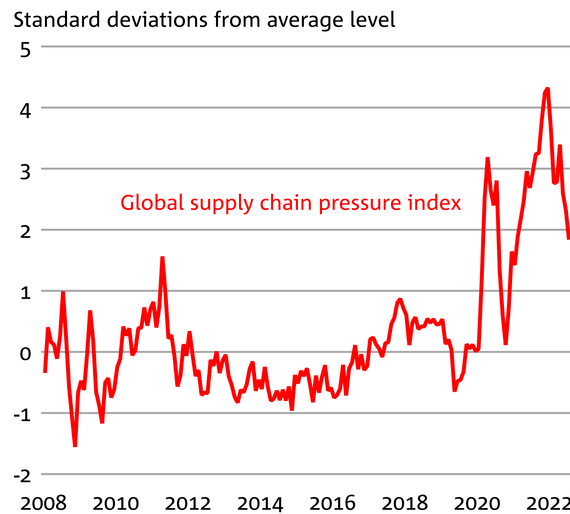
PMIs point to deteriorating conditions in AEs



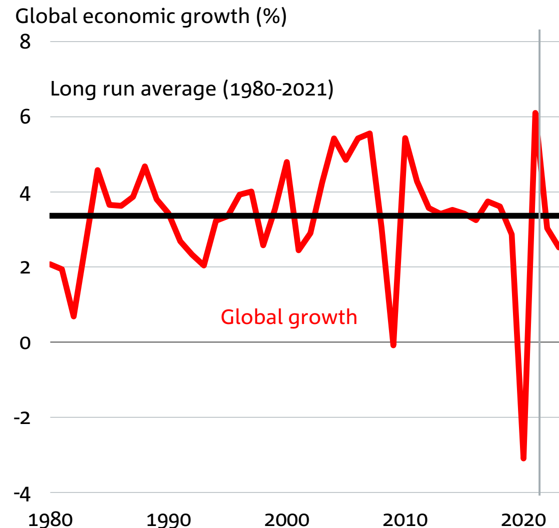
China's economy contracted rapidly in Q2



Supply chains appear to be improving but risks persist



Economic growth set to slow below long run average



Sources: IHS Markit, Macrobond, Federal Reserve Bank of New York, NAB Economics

- Global PMI measures softened in July, led by the deteriorating conditions in advanced economies – reflecting both the tighter financial conditions in recent months as well as concerns around energy security in Europe. The JP Morgan global composite PMI dropped to a modestly positive 50.8 points (from 53.5 points previously). The advanced economy composite PMI turned negative in July, having weakened since its recent peak in March, while the EM measure was marginally softer.
- Following our previous report in July, China's second quarter GDP was released, with activity contracting more rapidly than had been anticipated. China's economy declined by 2.6% qoq (seasonally adjusted), as public health measures in response to COVID-19 outbreaks in a range of regions (most notably Shanghai and Beijing) slowed growth. We have revised our forecast for China's growth in 2022 lower – to 3.5% (from 4.2% previously) – noting that this would require a rebound in the second half. The potential for further lockdowns highlights downside risk to this forecast.
- In addition to the revised outlook for China (the world's largest economy on a purchasing power parity basis), we have also lowered our forecasts for the United States, Japan, Canada and the Euro-zone, with the largest impacts coming in 2023. Weaker demand in these economies will also negatively impact growth in China, India and East Asia in 2023.
- We now forecast the global economy to expand by 3.0% in 2022 (down from 3.2% previously) before slowing to 2.5% in 2023. Several advanced economies are at heightened risk of recession next year (if not in late 2022). This rate of growth is well below the long run average (3.4% from 1980 onwards) and, outside of the extreme shocks of the global financial crisis and COVID-19 lockdowns, would be the weakest growth since 2001.
- There remain a range of factors that present uncertainty around our forecasts. The Russia-Ukraine conflict has persisted for almost six months – considerably longer than initially anticipated – and continues to threaten supplies of energy, grains and other agricultural products. COVID-19 continues to spread, with the ongoing potential of mutations into variants with greater transmissibility and ability to reinfect – presenting risk to global supply chains. Tensions between the United States and China could intensify, following House Leader Nancy Pelosi's visit to Taiwan. In response, China has stepped up military exercises near Taiwan, potentially disrupting trade in the region. Finally, with inflation persisting at high levels, while growth is slowing, there is a risk of policy mistakes by central banks that could drive global growth lower.

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