EMBARGOED UNTIL: 11.30AM THURSDAY 15 SEPTEMBER 2022

THE FORWARD VIEW – GLOBAL

SEPTEMBER 2022

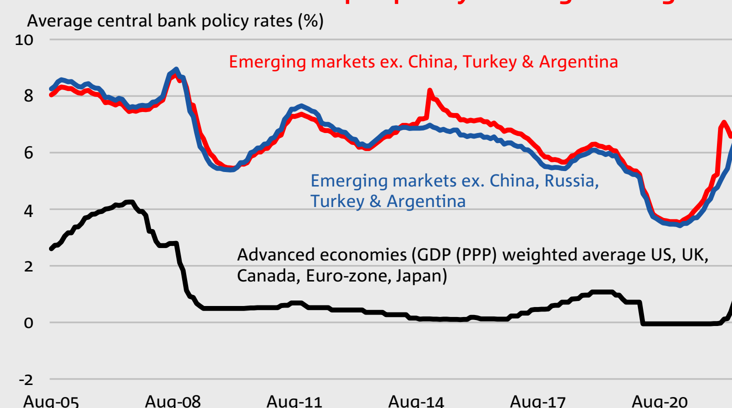
Economic outlook weakens as central banks continue to tighten

- Financial markets remained volatile into early September. Market expectations of central bank rate increases have generally moved higher in recent weeks – particularly for the ECB, which hiked rates by 75 basis points at its September meeting.
- Similarly, we still expect that the Fed will raise the Fed funds rate by 75bps at its meeting next week. However, we have revised higher our expectation for the peak fed funds rate for this cycle – we now expect a target range of 4.00-4.25% (3.50-3.75% previously) by early 2023. This change to the call means there is downside risk to our US growth forecast, which we will review in our next US Economic Update. This may have implications for when the Fed may start cutting rates if, as expected, inflation gradually falls back towards target and unemployment rises, but for now we retain our view that this won't occur until 2024.
- A range of indicators are pointing to potentially softer inflation in coming months. Producer prices – while still increasing at strong double digit rates – are now off their peak growth rates. Freight costs for container ships travelling from China to the United States and Europe have fallen significantly, while global food prices have fallen from peaks in April. Despite mixed trends in energy markets, oil prices are well below recent peaks.
- Overall, we see global economic growth slowing to 2.3% in 2023 – which excluding the extreme shocks of the global financial crisis and initial COVID-19 wave would be the weakest rate of growth since 1993. Given the rapid slowdown in activity, several advanced economies are at a heightened risk of recession in 2023 (should they not enter recession in late 2022). While we expect stronger growth in 2024 – 2.8% – this remains well below the long run average of 3.4% (from 1980 onwards).
- A broad range of risks continue to present uncertainty around our global forecasts. Should inflation persist as economic activity slows, central banks may lift rates to the point where a severe downturn becomes likely. The Russia-Ukraine conflict continues to drag onwards, while measures of supply chain pressures are easing, they remain historically strained and could face continued risks due to China's zero-COVID public health policies.

Global Growth Forecasts (% change)

	2020	2021	2022	2023	2024
US	-3.4	5.7	1.7	0.2	1.2
Euro-zone	-6.2	5.2	3.2	0.0	1.1
Japan	-4.6	1.7	1.5	1.3	0.9
UK	-9.3	7.4	3.5	0.1	0.6
Canada	-5.2	4.5	3.4	1.0	1.0
China	2.2	8.1	3.3	5.0	4.5
India	-6.6	8.3	7.3	4.4	5.6
Latin America	-7.0	6.2	2.6	0.5	1.3
Other East Asia	-2.8	4.3	4.5	3.3	3.7
Australia	-2.1	4.9	3.9	1.8	1.7
NZ	-2.1	5.6	2.1	0.4	1.5
Global	**-3.1**	**6.1**	**3.1**	**2.3**	**2.8**

Central banks continue rapid policy rate tightening



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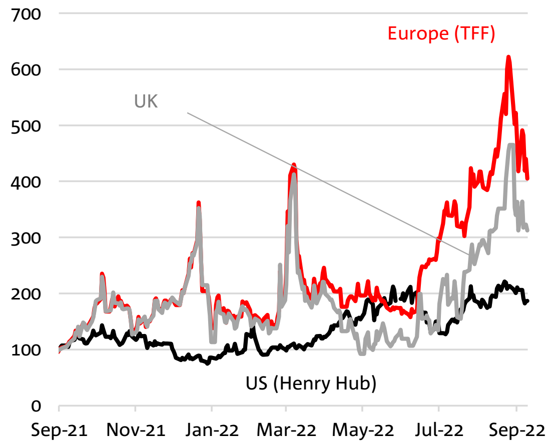
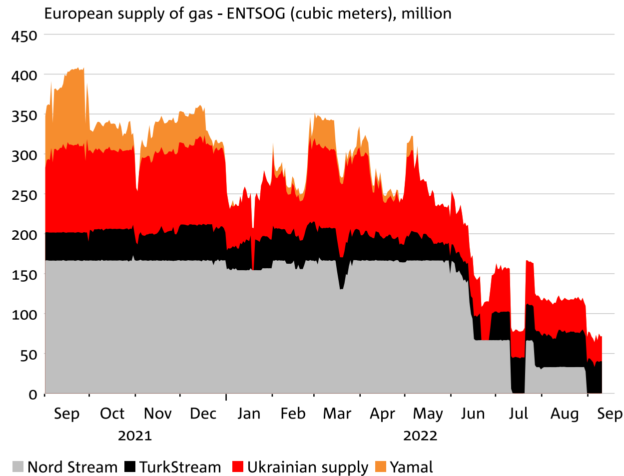
CHARTS OF THE MONTH

Lift in energy prices – particularly for natural gas – due to Russia supply disruptions is weighing heavily on Europe; governments now rushing to provide relief and limit impact on households and businesses

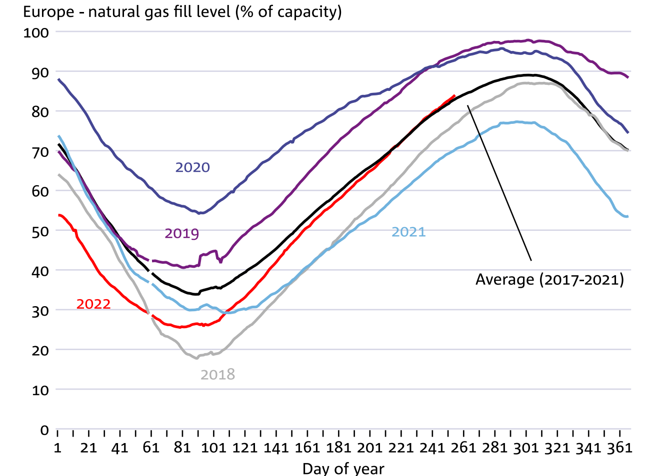
Gas prices very high and volatile - shock largest in Europe



Reflects Russia gas supply disruptions & possible policy response (e.g.'price caps')

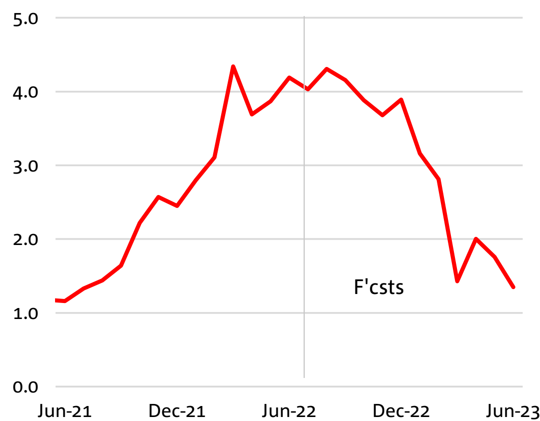


High prices/restrictions see gas storage hit 80% target – easing winter rationing concerns

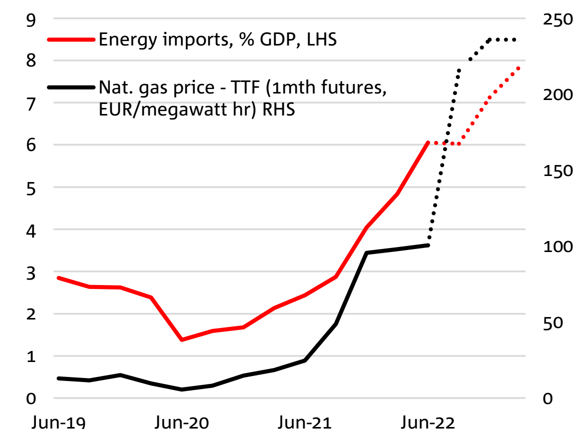


Some relief coming from recent easing in oil prices

Even if prices stabilise at August level energy price impact on Euro-zone CPI will persist till end year*



Cost of energy imports up significantly - big income hit for euro-zone*

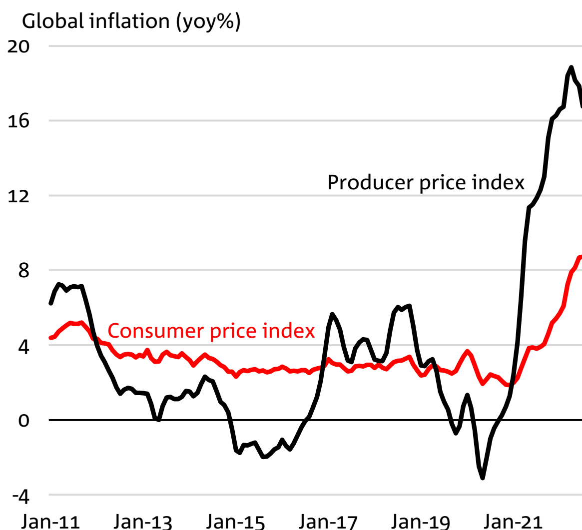


Sources: European Network of Transmission System Operators for Gas, Macrobond, Refinitiv, NAB Economics. *Assumes oil prices (in Euro terms) and natural gas prices equal August 2022 month average level (natural gas - €235/megawatt hr, brent oil – €96/barrel)

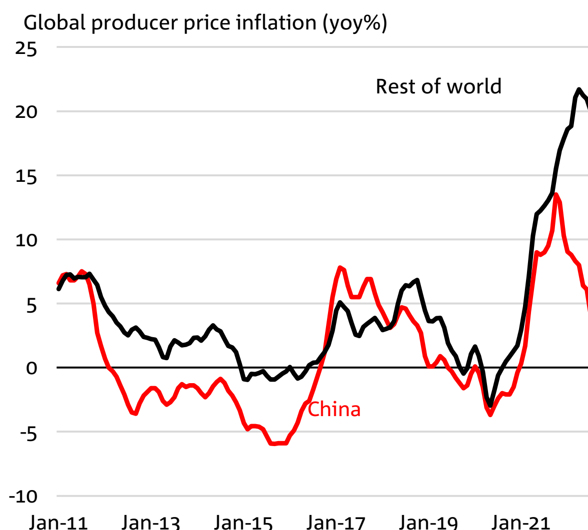
FINANCIAL AND COMMODITY MARKETS

Volatility continues as markets adjust monetary policy expectations

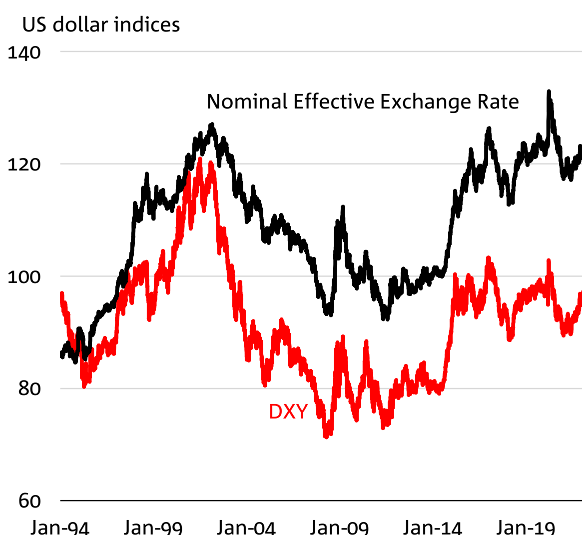
Inflationary pressures have persisted



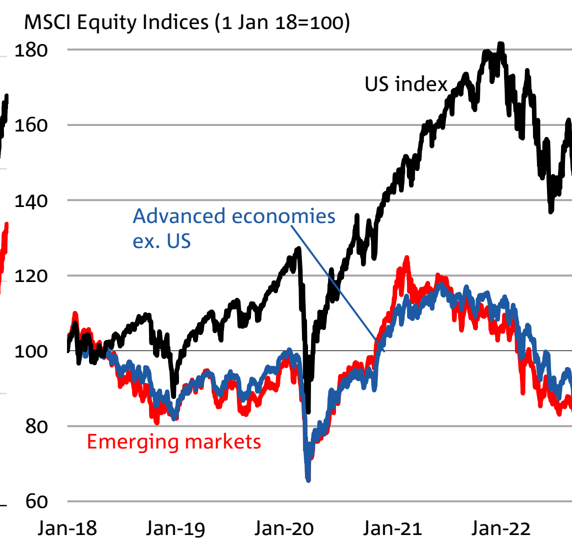
China is a major driver of the easing in producer prices



US dollar strength poses challenges for EMs



Equity markets retreated as policy rate expectations trended higher



Sources: Refinitiv, NAB Economics

- Volatility in financial markets continued into early September, as markets adjust monetary policy expectations against the competing factors of persistent inflation and weaker economic conditions. Market expectations of central bank rate rises have generally moved higher in recent weeks. The ECB hiked rates by 75 basis points at its September meeting. We also expect the US Fed will hike rates by 75bp next week and have revised higher our peak fed funds rate expectation (see p1).
- Consumer price data is widely available to July. Our estimate of global inflation was unchanged at 8.7% yoy, with a modest price acceleration in emerging markets offset by a slight easing in advanced economies.
- A range of indicators are pointing to potentially softer inflation in coming months. Producer prices – while still increasing at strong double digit rates – are now off their peak growth rates. It is worth noting that China explains a sizeable share of this easing, with the country's industrial sector ramping up exports (into slowing global markets) due to weakness in domestic demand. In addition, freight costs for container ships travelling from China to the United States and Europe have fallen significantly (albeit this may reflect deteriorating demand as well as easing constraints), while global food prices have fallen from peaks in April. Trends in energy markets are mixed however, with oil prices well below recent peaks, but natural gas prices (particularly in Europe) soared in August, although they too have fallen back in recent weeks.
- While the combination of weaker demand (particularly in advanced economies) following rapid policy rate hikes along with improving supply should place downward pressure on prices, there remain some significant risks. This includes the impact of energy shortages in Europe due to the shutoff of Russia gas flows to Germany, the ongoing Russia-Ukraine conflict and China's continued zero-COVID policies and tensions with Taiwan, which could once again disrupt global supply chains.
- The tightening monetary policy in advanced economies – particularly the United States – is having an impact on financial conditions in emerging markets. The US dollar has strengthened – the DXY index is at its highest levels in over 20 years and the Nominal Effective Exchange Rate was at record highs in early September. This increases the import costs and debt burdens for EMs with dollar denominated exposures.
- The continued deterioration in economic conditions and the prospect of further tightening of monetary policy to address inflationary pressures has seen global equity markets trend lower since mid-August (with volatility likely to continue), while government bond yields have trended higher over the same period.

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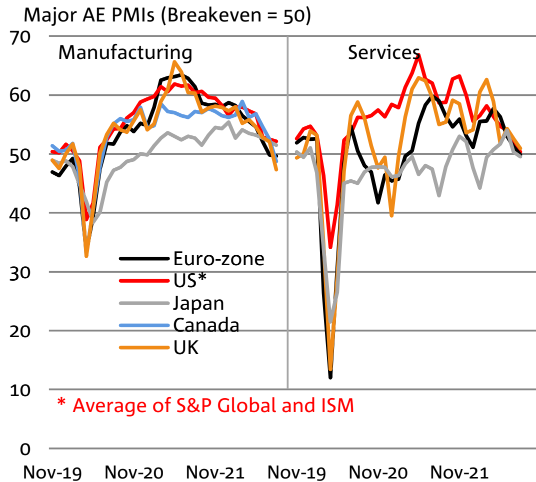
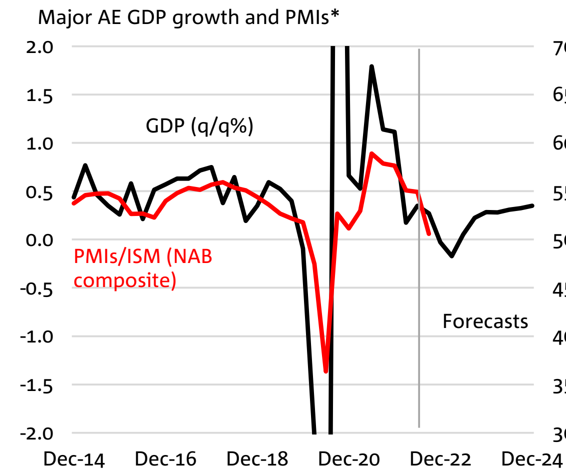
ADVANCED ECONOMIES

Business surveys trending down – expect AE economic downturn towards end of year/into 2023

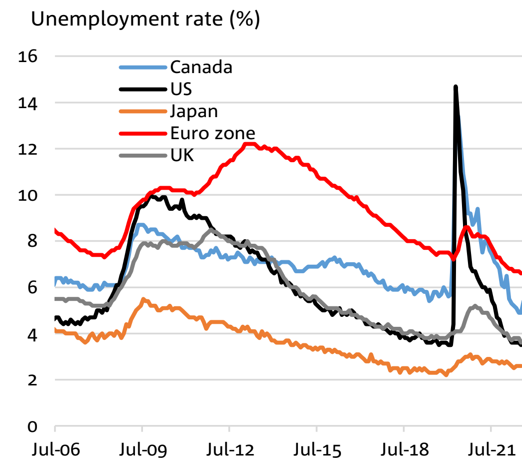
Surveys continue to ease – with some now below breakeven



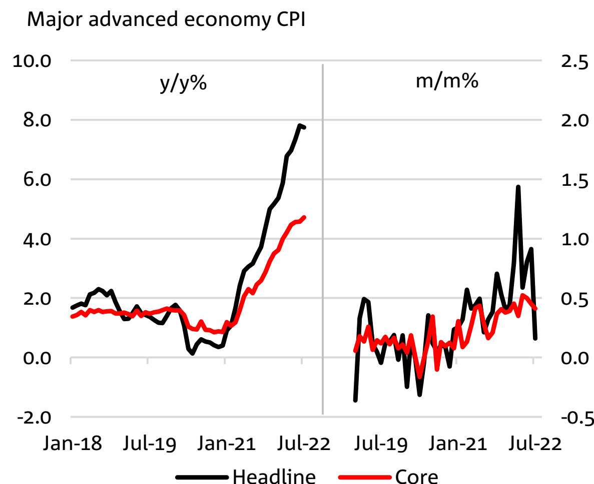
Surveys not reliable qtr-to-qtr but do track GDP over time



Unemployment rates low & but signs they have troughed



Some inflation relief on oil price fall but y/y rate and core still high



Sources: Refinitiv, NAB Economics

- After recording the weakest quarterly growth since the 2020 COVID recession in Q1 (0.2% q/q) major advanced economy (AE) growth moved higher in Q2 (0.4% q/q). The improvement mainly reflected a smaller fall in US GDP and stronger growth in Japan, offsetting a fall in UK GDP.
- We expect slightly lower, but broader based, AE growth in Q3, US GDP growth is expected to turn positive and we expect the same for the UK (but it is line-ball). Early 'hard' data for the quarter have been reasonable - in July, there were increases in consumption in the US, retail sales in the Euro-zone and UK, and industrial production in the US and Japan (but fell in the UK and, most likely, in the Euro-zone). Growth in Japan is likely to be held back by a COVID wave, but the impact on consumption so far has been smaller than in previous waves, and we don't expect GDP to decline.
- However, we remain pessimistic about the outlook beyond this. This in part reflects the impact of monetary policy tightening outside of Japan – both the lagged impact of past rate rises and of rate rises to come. Despite a poor growth outlook, high inflation and tight labour markets mean that the major AE central banks will lift rates further. We have noted previously that we expect the US to enter recession in 2023 as a result of Fed policy tightening and other global headwinds.
- Another substantial headwind is the commodity price shock arising from Russia's invasion of Ukraine. Increases in gas prices are producing a large negative income shock for Europe (see p2). Some European governments have moved to stabilise stressed elements of the energy industry. At the same time there are proposals to levy energy windfall taxes and also to change pricing arrangements – getting this all to work without further disrupting the energy sector will be challenging. Budget relief is also being provided; e.g. the German and UK governments have flagged fiscal packages – around 2% of GDP (but funded by a windfall tax) for German and around 6% of GDP for the UK government (probably largely debt financed). These unfolding developments have the potential to materially change the outlook; this month we revised up our UK forecast for 2023 reflecting the size of the stimulus but, noting that it doesn't resolve the underlying supply issues, marked down the 2024 forecast.
- Business surveys are also pointing to growing downside pressure. Business surveys continued to ease into August; the S&P Global PMIs declined for all the major AEs outside the US ISM. In many cases readings are below the breakeven level (50) although past experience suggests they would need to fall further to signal a recession. Surveys aren't reliable indicators of quarterly GDP growth but over time the two move together.

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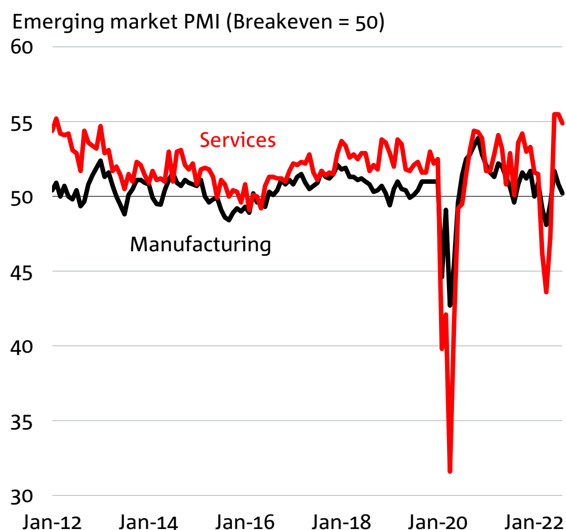
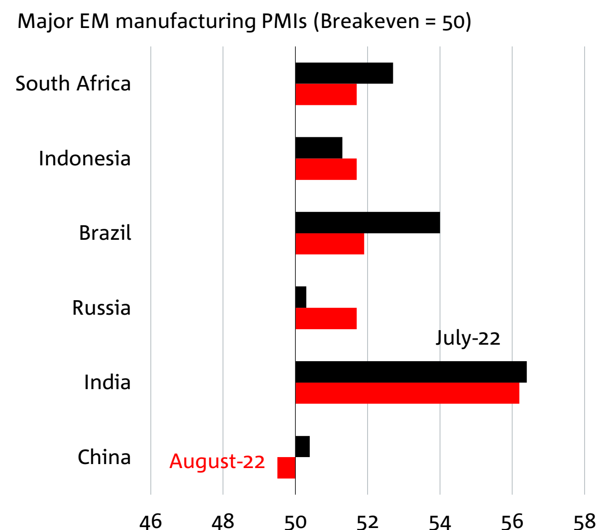
EMERGING MARKET ECONOMIES

EMs face growing challenges from weaker growth/higher policy rate advanced economies

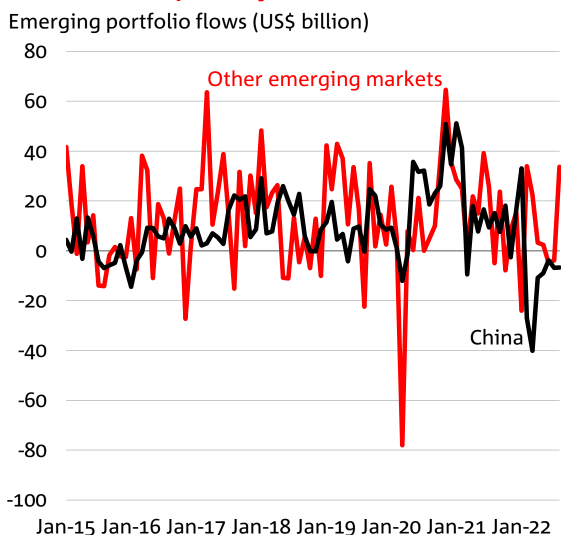
Diverging trends between manufacturing and services



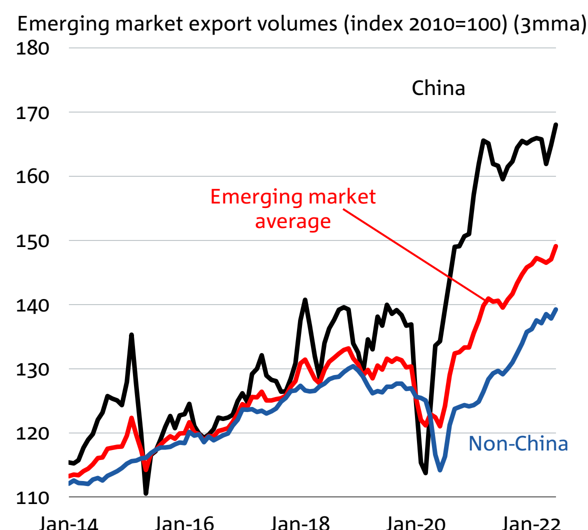
China and Brazil drive EM mfg PMI lower in August



Capital continues to flow from China on policy imbalance



Exports have supported China's growth but trade likely to slow



- Emerging market business surveys have continued to show diverging conditions between manufacturing and services sectors. The EM composite PMI edged lower in August – to 53.4 points (from 54.0 points previously).
- The EM manufacturing PMI continued to soften in August, down to a near neutral 50.2 points (from 50.8 points in July). The key driver of this trend was China, where the manufacturing PMI fell into negative territory, reflecting the impact of weaker demand, a fresh wave of COVID-19 infections and a heatwave impacting power supplies in parts of the country during the month. A weaker reading for Brazil's manufacturing PMI also contributed to the softness in the aggregate EM measure.
- In contrast, the EM services PMI remained comparatively strong – at 54.9 points (from 55.5 points in both June and July). Weaker readings for services in Russia and China were largely offset by a stronger outcome in India.
- China's zero-COVID public health policies remain a near term risk. According to the National Health Commission, there were 68 cities in either partial or full lockdown (albeit the severity of these measures varies considerably) in early September, with Shenzhen (a global electronics manufacturing centre) and Chengdu the most notable. Chinese authorities have repeatedly backed this public health approach, meaning that the risk of supply chain disruptions remains in the near term.
- After five straight months of capital outflows from emerging markets, data from the Institute of International Finance showed a sizeable inflow of capital in August. This was primarily driven by investments in non-Chinese equity markets, with China continuing to record capital flight – in part reflecting the imbalance in monetary policy, with a marginal cuts in policy rates in China in August (counter to rapid rate increases in advanced economies).
- Global trade data are available to June and continue to point to continued strong growth in export volumes from China and other East Asian economies. China's industrial sector has been increasingly export focussed as domestic demand has remained soft. We expect trade growth will weaken in coming months and into 2023, as slowing growth in advanced economies hits demand for imported goods.

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

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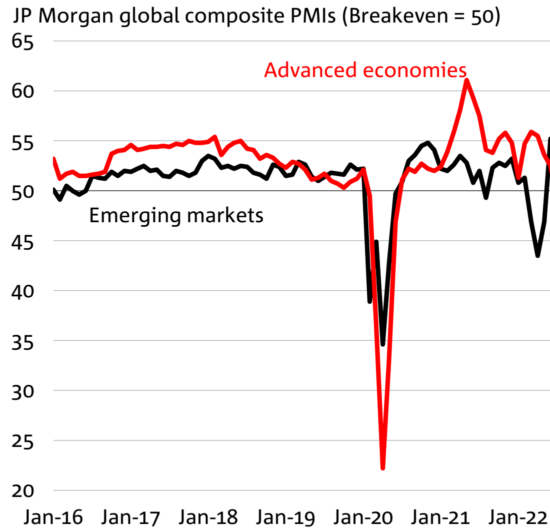
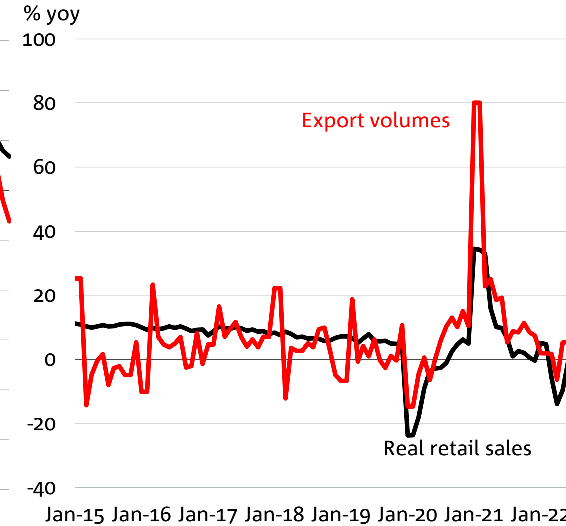
GLOBAL FORECASTS, POLICIES AND RISKS

Tighter monetary policy rapidly slowing global growth, while risks persist

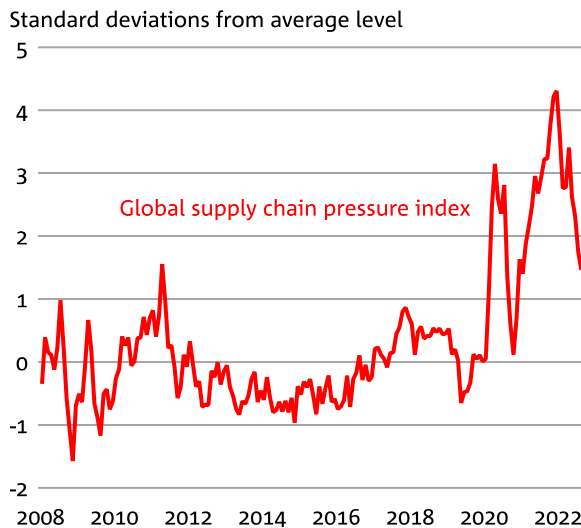
Advanced economies leading global surveys lower



China's manufacturers have been export dependent since COVID-19



Supply chain measures improving but still somewhat constrained



Weak global growth prospects in the next two years

- Weaker conditions in advanced economies drove aggregate global PMI measures lower in August. The JP Morgan global composite PMI dipped to 49.3 points (from 50.8 points in July) – a rapid deterioration into negative territory (having been at a strongly positive 53.5 points in June). The rapid tightening in financial conditions (both from monetary policy and lending standards) and energy security pressures in Europe have negatively impacted these measures.
- We have made further revisions to our global forecasts this month – with a slight upward revision to growth this year to 3.1% (from 3.0% previously). This reflected somewhat stronger growth in Latin America, East Asia, India and the Euro-zone (among other changes), with the bulk of these changes reflecting stronger than previously expected growth or upward revisions to official data for the first half of 2022.
- In contrast, our outlook for 2023 and 2024 is weaker this month, with a weaker growth profile for China the key driver. China's zero-COVID public health measures and property downturn are continuing to negatively impact domestic demand, while the country's industrial sector has been ramping up exports – a source of growth that is unlikely to continue as demand in advanced economies continues to slow. We expect China to grow by 3.3% in 2022 (down from 3.5% previously) and 5.0% in 2023.
- Overall, we see global economic growth slowing to 2.3% in 2023 – which excluding the extreme shocks of the global financial crisis and initial COVID-19 wave would be the weakest rate of growth since 1993. Given the rapid slowdown in activity, several advanced economies are at a heightened risk of recession in 2023 (should they not enter recession in late 2022). While we expect stronger growth in 2024 – 2.8% – this remains well below the long run average of 3.4% (from 1980 onwards).
- A broad range of risks continue to present uncertainty around our global forecasts. Should inflation persist as economic activity slows, central banks may lift rates to the point where a severe downturn becomes likely. The Russia-Ukraine conflict continues to drag onwards – with the immediate threat of restricted natural gas flows to Europe along with ongoing concerns around supplies of grains and fertilisers. While measures of supply chain pressures are easing, they remain historically strained and could face continued risks due to China's zero-COVID public health policies. Tensions between the United States and China could re-emerge as China's trade surplus with the US trends higher or if diplomatic tensions regarding Taiwan were to intensify.

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

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