THE FORWARD VIEW – GLOBAL

DECEMBER 2022

National Australia Bank

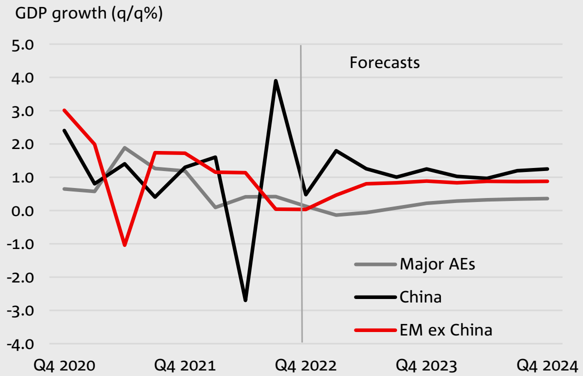
With inflation still high, policy rate hikes to slow growth in '23

- Global inflation data to October only point to a marginal easing in consumer price inflation, which remains high at 8.8% yoy. However, US CPI inflation again showed signs of easing in November, producer price inflation has been gradually falling since April and global commodity price indices have been trending lower since peaking in June.
- The major central banks continue to lift policy rates, highlighted by the US Federal Reserve lifting rates by 50bp this week with the European Central Bank and Bank of England expected to shortly follow suit, with further rate increases into 2023 expected. That said, government bond yields have recently moved lower and equity markets rallied. While this represents some easing in financial conditions, they have still tightened considerably over 2022 and there are signs bank lending standards are tightening.
- There were mixed results across the major AEs for Q3 GDP, including falls in the UK and Japan, but business surveys point to weakening conditions. UK GDP fell in Q3 and Euro-zone GDP is on the cusp of contracting in Q4, and we expect the US (in 2023), UK and Euro-zone to go into recession due to tight monetary policy and the energy supply shock.
- Business surveys suggest that overall conditions in emerging markets continued to deteriorate in November. This includes in the services sector where China was the key driver reflecting public health restrictions imposed in response to the latest COVID-19 wave. China's third major wave of COVID-19 has triggered various restrictions in many cities, which will negatively impact China's growth this quarter. However, it appears that China started to transition away from the strict zero-COVID health policies in early December. As a result, we have lowered our China GDP forecast for 2022 to 3.1% (3.4% previously), but expect higher growth in 2023 (5.2%, from 5.0% previously).
- Our global forecast is little changed this month, with a substantial slowing in growth anticipated in 2023 – down to 2.3% (previously 2.2%) – before a modest recovery to 2.8% in 2024. These rates of growth are well below the long-run average.

Global Growth Forecasts (% change)

	2020	2021	2022	2023	2024
US	-2.8	5.9	1.9	0.2	1.1
Euro-zone	-6.3	5.3	3.4	0.3	1.0
Japan	-4.7	1.7	1.5	1.4	0.8
UK	-11.0	7.5	4.4	-0.6	0.7
Canada	-5.1	5.0	3.6	0.9	1.0
China	2.2	8.1	3.1	5.2	4.5
India	-6.6	8.3	7.3	4.4	5.6
Latin America	-7.0	6.4	3.3	0.7	1.3
Other East Asia	-2.8	4.3	4.2	2.7	3.7
Australia	-1.8	5.2	3.5	1.2	0.8
NZ	-2.1	5.5	2.4	0.9	1.6
Global	**-3.0**	**6.0**	**3.3**	**2.3**	**2.8**

COVID-19 still weighing on China; AEs expected to slow further



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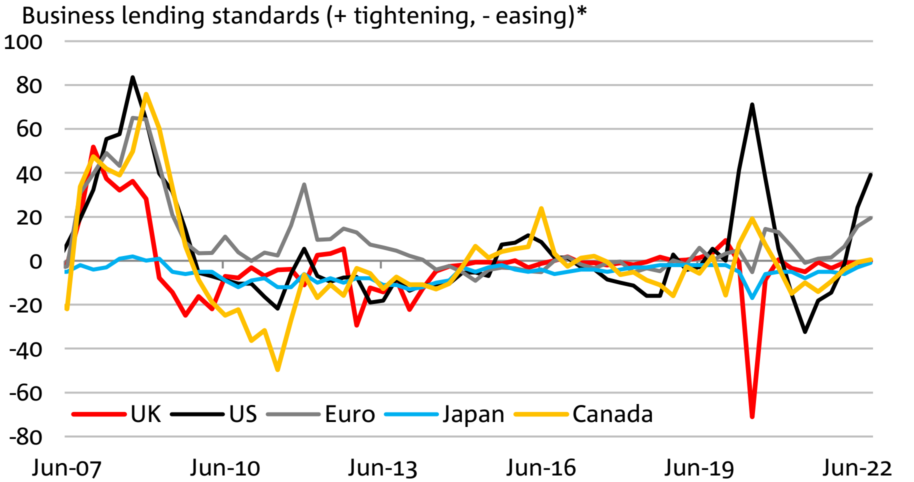
CHARTS OF THE MONTH

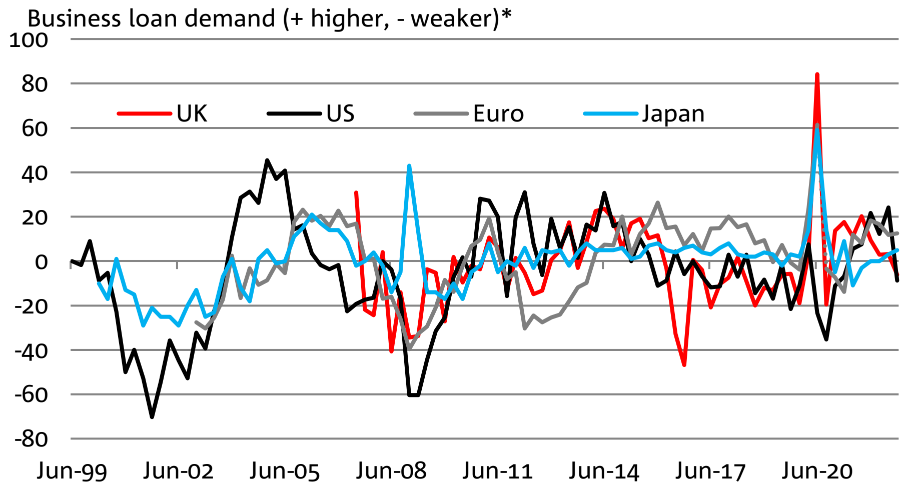
While central bank policy rates get the attention, there are signs that obtaining credit is starting to get harder and loan spreads have risen, pointing to a greater increase in borrowing costs than govt. bond yields alone suggest

Lending standards tightening in US and Euro-zone



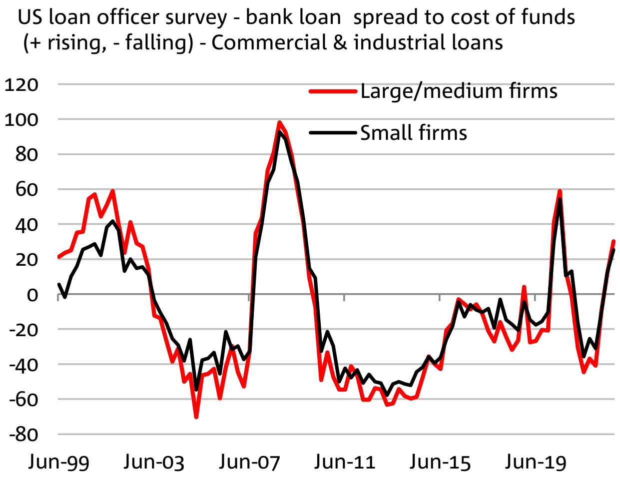
* Overall firm measure where available otherwise large firm, C&I loans. For UK 'availability' indicator used.

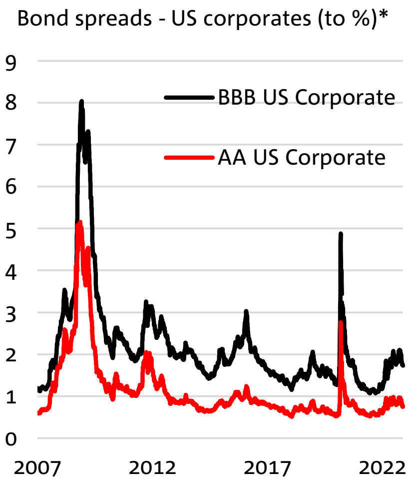
Business demand for loans has held up but now weakening in US, and has been easing in the UK

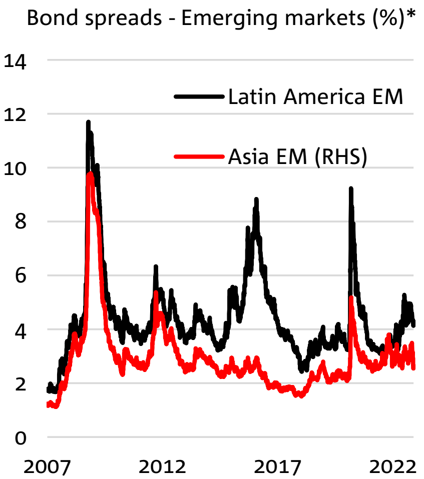


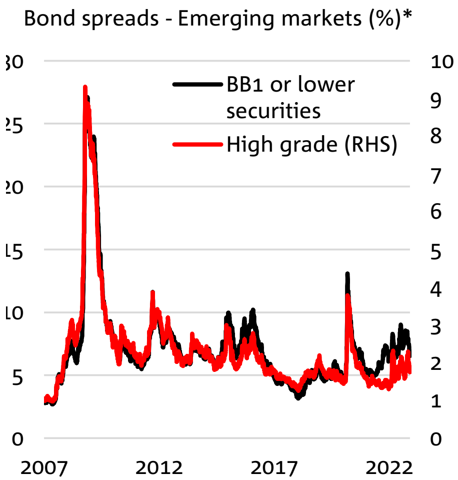
* Overall firm measure where available otherwise large firms, C&I loans.

US banks have lifted loan spreads as have bond markets (particularly for lower credits with some variation by region)









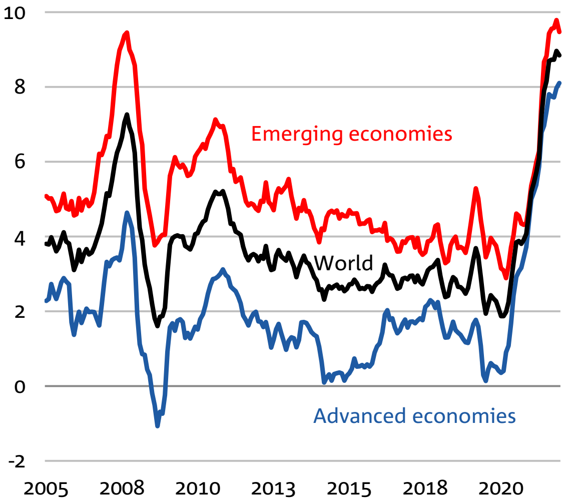
 Sources: Refinitiv, Bank of Canada, St Louis Federal Reserve (FRED), NAB Economics. * Spread to US Treasuries.

FINANCIAL AND COMMODITY MARKETS

Central banks slowing rate increases but inflation has yet to be tamed

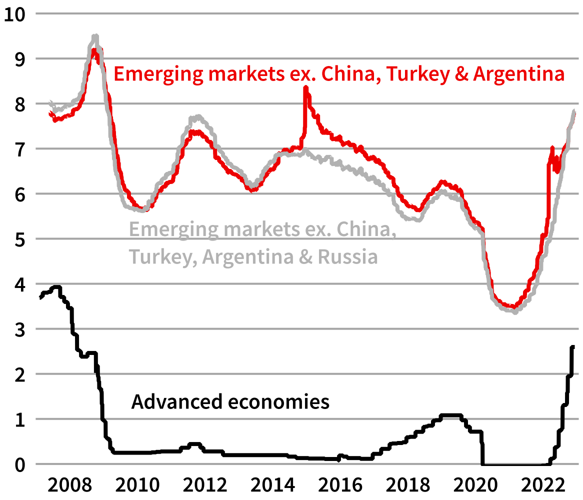
Inflation eased from cyclical highs in September

Consumer price inflation (% yoy)



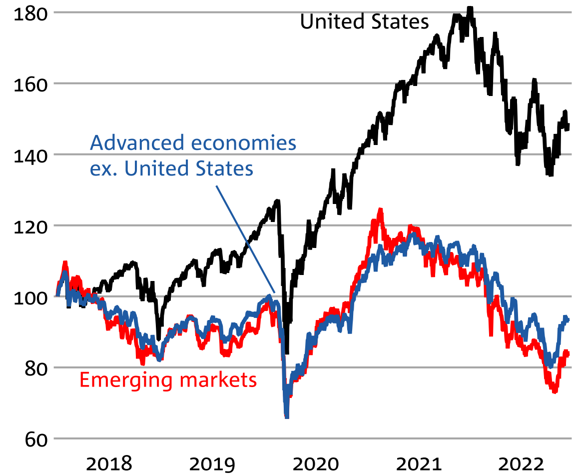
Central banks have continued to lift policy rates

Weighted average central bank rates (%)



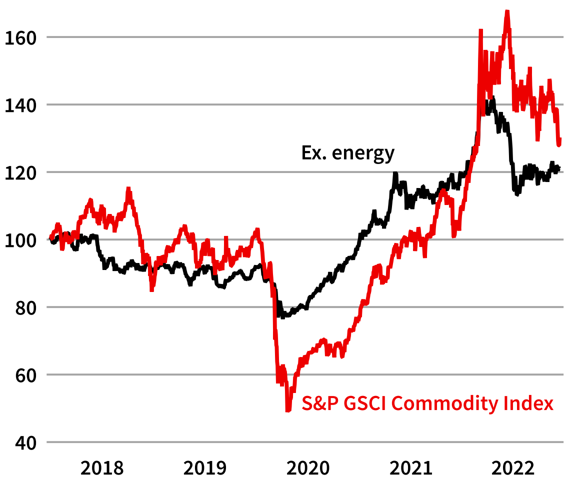
Equity prices rallied across November but well off peaks

MSCI Equity Indices (1 Jan 18=100)



Falling energy prices drive commodities lower

Commodity indices (1 January 2018 = 100)



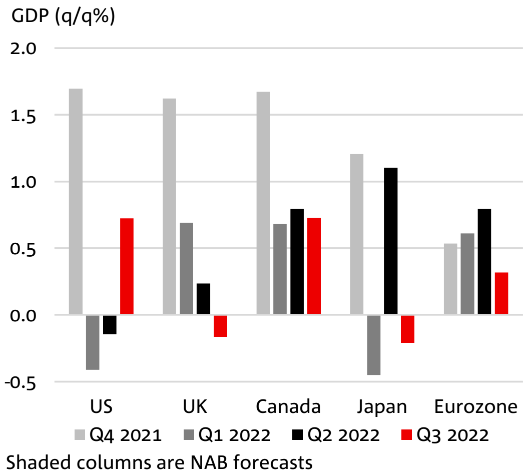
- Global inflation data are available to October and point to a marginal easing in consumer price growth – down to 8.8% yoy (from a cyclical peak of 9.0% yoy in September). Growth was marginally stronger among advanced economies – in part reflecting energy costs in Europe – and slightly weaker in emerging markets – suggesting that it remains too early to have confidence that inflationary pressures have peaked, although US core inflation stepped down over October/November.
- Inflation has proved more persistent than central banks had earlier anticipated, meaning that they have continued to lift policy rates in response. That said, the rate of increases is starting to slow – following four consecutive 75 basis point hikes up to November, the US Federal Reserve lifted rates by 50 basis points in December. We expect two further 25 basis point increases by the Fed in early 2023 before it pauses at a target range of 4.75-5.00%, but the December Fed member projections point to a possibly slightly higher peak of 5.00-5.25%. Similarly, we expect the Bank of England and the European Central Bank to hike by 50 basis this week (down from 75bp last time).
- Global producer price growth has gradually slowed since peaking in April (at 18.9% yoy), but remains at high rates – increasing by 13.0% yoy in October. Key to this slowing trend has been China – where producer prices fell by 1.3% in October, with non-China producer prices increasing by 16.8% yoy. This may reflect discounting by Chinese producers in response to weakness in both domestic and export markets.
- Volatility in global financial markets has persisted – albeit bond market volatility (as measured by the MOVE index) has come off peaks recorded in mid-October. Equity markets rallied from mid-to-late October to late November, albeit the MSCI indices remain well below levels recorded in the early months of 2022. Similarly, bond yields have generally trended lower from mid-October – when a range of 10 year government bonds for advanced economies were at their highest rates since 2007.
- Global commodity price indices have been trending lower since peaking in June. In early December, the aggregate S&P GSCI dropped to its lowest level since February, albeit this largely reflected the impact of falling energy prices, with non-energy prices broadly trending sideways since August. In contrast, crude oil (WTI) fell from over US$120 a barrel in early June to almost US$70 a barrel at the time of writing. This largely reflects the impact of weaker global demand – including the risk of recessions in advanced economies in 2023 – despite efforts by OPEC+ to place a floor under prices. That said, oil demand in China could strengthen as zero-COVID policies are unwound.

 Sources: Refinitiv, Macrobond, NAB Economics

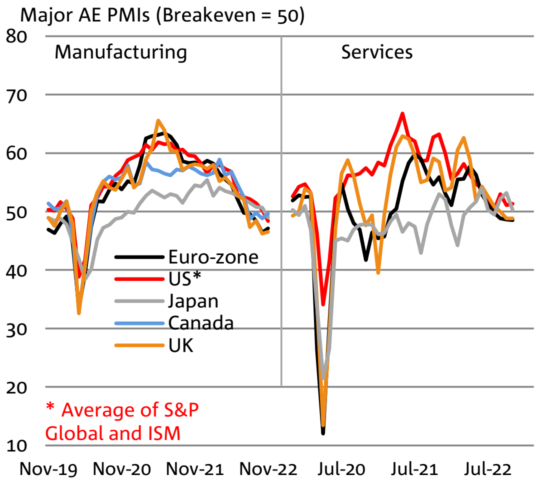
ADVANCED ECONOMIES

Mixed Q3 GDP growth for major AEs – real test lies ahead

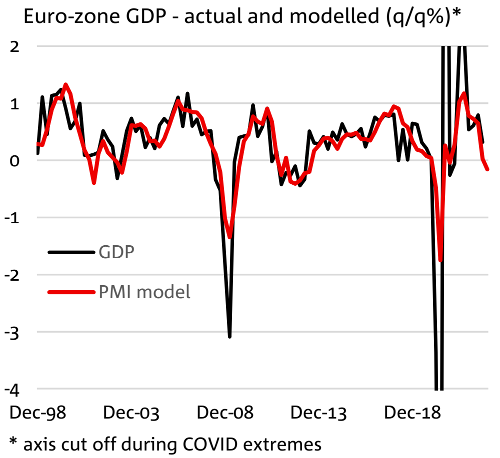
Eurozone, UK, Japn weaker in Q3, US bounced back



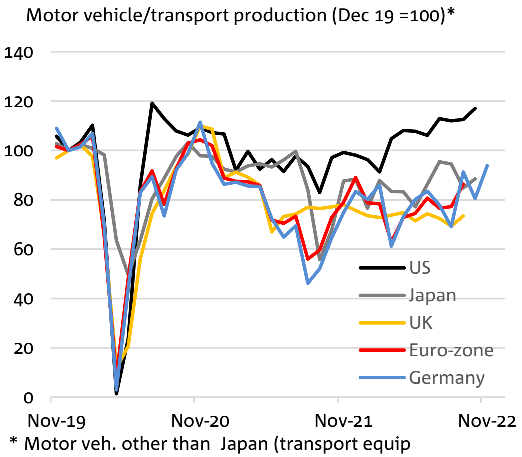
Mfg surveys still trending down services more mixed but also low



Euro-zone - business surveys point to an economy on the cusp of contraction



Supply issues remain – Japan & Europe auto recovery incomplete



Sources: Refinitiv, Macrobond, NAB Economics

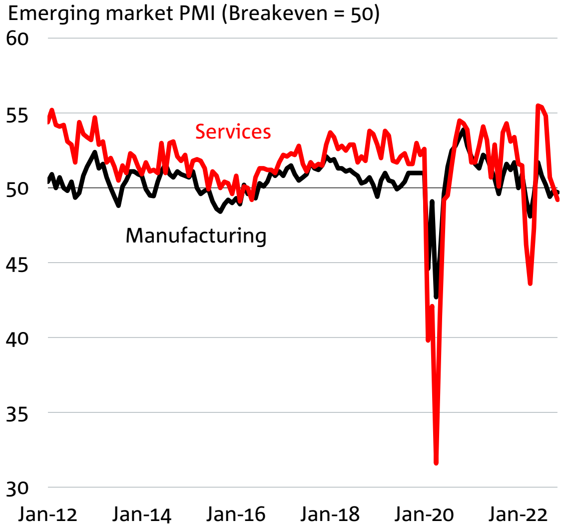
- There were mixed results across the major AEs for Q3 GDP. Since last month, US and Euro-zone Q3 GDP have been revised up slightly but the story remains the same – the US rebounded while Euro-zone growth slowed. Growth remained solid in Canada (although monthly GDP and Stats Canada advice points to a loss of momentum at end Q3/early Q4) but growth fell in both the UK (but by less than expected) and Japan.
- The fall in Japan was a surprise. Although domestic demand grew, a net trade detraction lead to the GDP fall. While we expect growth to remain solid due to the unwinding of COVID restrictions and still loose monetary policy, Japan does face several headwinds. The global lift in energy prices was a negative income shock and Yen depreciation adds to the rise in prices and squeeze on real income. Supply chain issues persist, with auto production struggling to recover. While Yen depreciation improves traded sector competitiveness, the global economy is slowing and restrictions on international arrivals until October meant the tourism sector could not benefit from the lower currency. We expect growth to bounce back in Q4, with early consumption indicators for the quarter strong, but the outlook is more uncertain than the absence of monetary tightening might suggest.
- Manufacturing sector business surveys continue to trend down. Services sector PMIs have been a bit more mixed, with Japan and the US holding up better, but for Europe they are signalling contraction. The services/ manufacturing divide reflects the slowdown in global demand, inventories having been rebuilt, and the normalisation in consumer spending towards services that is underway. There also remain supply issues – as with Japan, the Euro-zone auto production has yet to fully recover but as these issues are resolved it should provide a boost to growth.
- While business surveys can provide a indication of how an economy is faring, they are not always a reliable guide to quarterly GDP growth. The link between the two is closest in the Euro-zone, and a simple model indicates that the PMIs are consistent with slightly negative growth in Q4, although it has underpredicted GDP growth in recent quarters.
- We expect the US, UK and Euro-zone to go into recession due to tighter monetary policy and the energy supply shock. UK GDP fell in Q3 and Euro-zone GDP is on the cusp of contracting in Q4. For the US it is a 2023 story. We expect a relatively modest downturn (particularly US/Eurozone) but how far central banks need to take policy rates is the major risk – given that core inflation is still high and labour markets remain very tight, although recent US inflation data has shown signs of slowing. Upside risks come from the pull back in oil prices and still high levels of 'excess savings' built up by households in the pandemic.

National Australia Bank

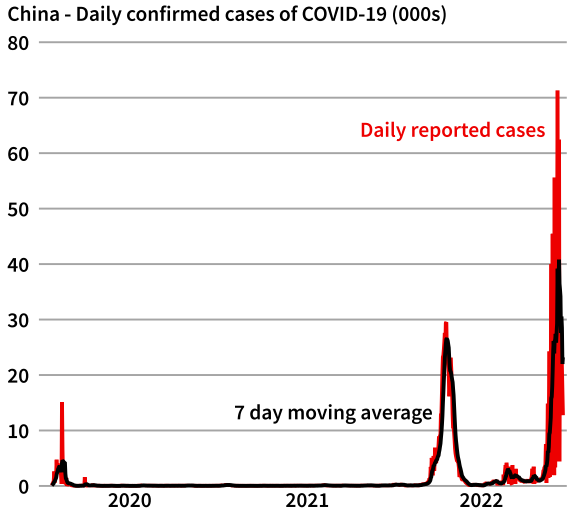
EMERGING MARKET ECONOMIES

COVID-19 wave impacting near term activity; slowing trade a constraint going forward

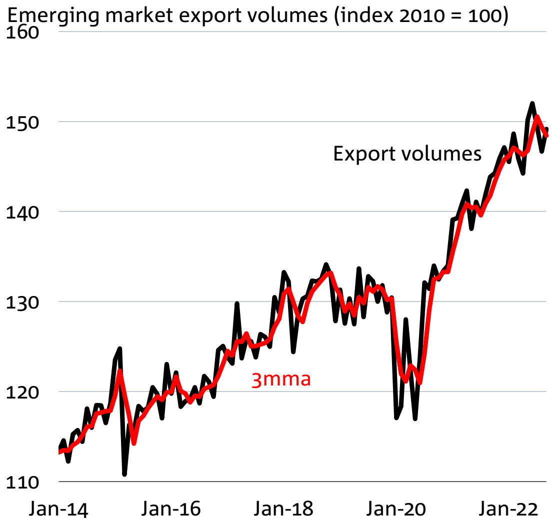
Weaker services drove aggregate EM PMI lower in November...



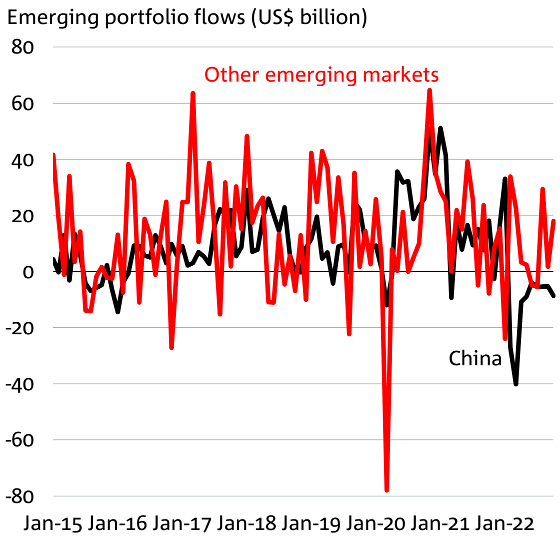
...with China's third COVID-19 wave impacting demand



EM export volumes trending lower on weaker AE demand



Capital has flowed from China since February 2022



- Business surveys suggest that overall conditions in emerging markets continued to deteriorate in November. The EM composite PMI fell further into negative territory – down to 49.0 points (from 49.8 points in October). This downturn was largely driven by the services sector, although trends differed considerably between individual countries.
- The EM services PMI fell to 49.2 points in November (from a neutral 50.0 points previously). China was the key driver of this downturn, reflecting the public health restrictions imposed in response to the latest COVID-19 wave. This was partially offset by stronger readings in India and Russia (albeit Russia's measure remains in negative territory).
- China's third major wave of COVID-19 has continued through early December – with new case numbers far exceeding previous waves. This triggered various restrictions in different locations – with Nomura estimating that 512 million people in 68 Chinese cities were impacted by COVID measures in late November. That said, it appears that China started to transition away from the strict zero-COVID health policies in early December (see page 6).
- The EM manufacturing PMI edged lower – down to 49.7 points (from 49.8 points in October). The largest change in November was in Brazil, where output slowed sharply, with respondents to the PMI survey noting public policy uncertainty and deteriorating export demand.
- Economic growth in emerging markets is typically more trade dependent than is the case in advanced economies. Global trade data are available up to September, and although there was an uptick in EM export volumes in September, the level remains below the peak recorded in June. More recent Chinese data – available up to November – point to a sharp slowing from the world's largest exporter, in part due to deteriorating demand from advanced economies. This presents risks for China's growth, given the weakness of domestic demand – particularly household consumption – since the start of the pandemic.
- Emerging market capital flows have been volatile in recent months, with sizeable outflows from EMs across much of the year. In particular, capital has been flowing from China since February 2022, where the People's Bank of China has maintained its policy rates at low levels (when compared with the rapid tightening in most advanced economies). This risks destabilising both China's currency and its domestic financial market.

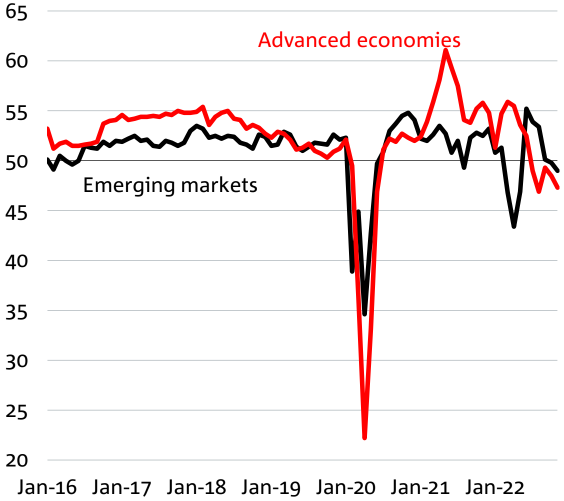
 Sources: S&P Global, Macrobond, CPB, Refinitiv, NAB Economics

GLOBAL FORECASTS, POLICIES AND RISKS

Global focus on China as it starts to transition away from zero-COVID

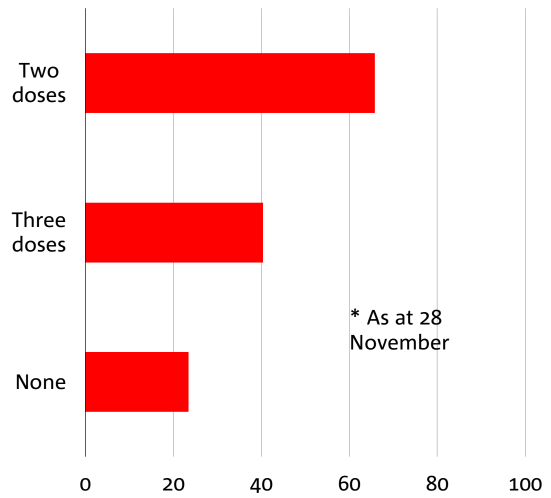
Advanced economies led the downward trend in PMIs

JP Morgan global composite PMIs (Breakeven = 50)



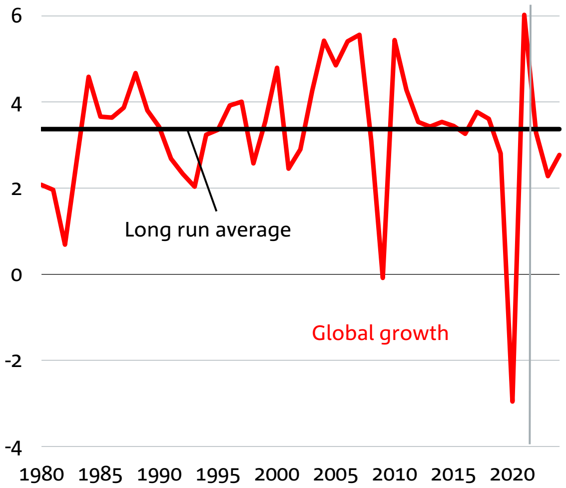
Vaccination rate among elderly population a constraint in China

China vaccination rate (% of over 80s population)*



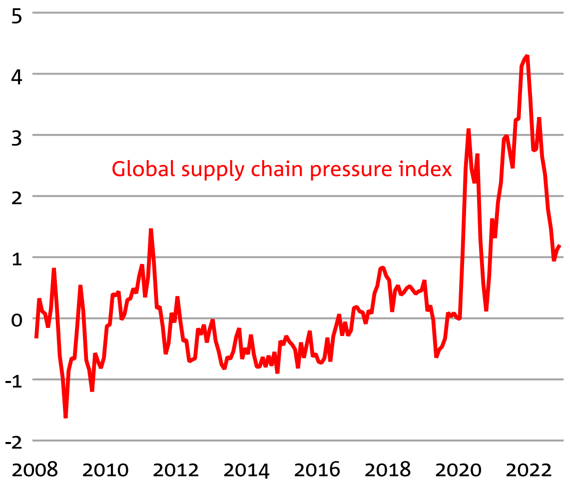
Global growth set to slow well below long run average

Global economic growth & forecasts (%)



Supply chain pressures have softened by not disappeared

Standard deviations from average level



- Global business surveys continue to point towards slowing economic activity in November. The JP Morgan global composite PMI fell to 48.0 points – down from 49.0 points in October – driven by softer conditions in the services sectors, although manufacturing again declined. In part, this reflects the impacts of tightening financial conditions on demand.
- China's COVID-19 public health policies are evolving rapidly, in the light of mass protests across the country that have been unseen for decades. Policy changes include relaxing quarantine measures, scaling back mass testing and eliminating proof of negative tests to enter public spaces. A key risk regarding this policy pivot is the low rate of vaccination among China's elderly population. Just over 40% of over 80s have had at least three doses of domestically produced vaccines. Although zero-COVID policies have constrained China's economy in recent times, the relaxation of these policies will not necessarily result in an immediate bounce, with a disruptive period likely as infections increase, the health system comes under stress and residents may choose to self-isolate.
- The latest COVID-19 wave is set to negatively impact China's growth this quarter. As a result, we have lowered our forecast for 2022 to 3.1% (from 3.4% previously), with stronger base effects leading to a small upgrade to 2023 – to 5.2% (from 5.0% previously). The easing of public health policies could provide a boost (once China is through a volatile transition period) however the downturn in the property sector continues to present risk.
- Our global forecast is essentially unchanged this month, with a substantial slowing in growth anticipated in 2023 – down to 2.3% (previously 2.2%) – before a modest recovery to 2.8% in 2024. It is worth noting that these rates of growth are well below the long run average of 3.4% (recorded between 1980 and 2021). Excluding the extreme shocks associated with the Global Financial Crisis and the initial wave of COVID-19, the downturn anticipated in 2023 is forecast to be the largest since 1993.
- The global outlook remains clouded by a range of risk factors. The Russia-Ukraine conflict has continued – contributing to supply disruptions for energy, grains and fertilisers – with a resolution still appearing some time away. The persistence of inflationary pressures, and the lag in inflation data, means that there remains a risk that central banks could excessively tighten monetary policy – driving advanced economies into deeper recessions than necessary to curb inflation. Beyond these immediate concerns, geo-political tensions could increase – particularly following US policy measures that will limit China's access to leading edge semiconductors.

Sources: S&P Global, China National Health Commission, Macrobond, Refinitiv, IMF, NAB Economics

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